LaSalle Solutions
White Paper

Understanding the new FASB rules for lease accounting

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Leasing is one of the primary avenues for the acquisition of vital corporate assets such as computers, communication devices, material handling equipment and more. The Equipment Leasing and Finance Foundation estimated that over two-thirds of the value of all equipment and software purchased in 2015 was financed, up from only 55 percent in 2011. Leasing in particular surged over this time period and ultimately accounted for twice as much total financing as secured loans, the second most popular option.

While leasing offers unique advantages in terms of flexibility and cost management, it has also long been a major cause of opacity in financial reporting. Previously issued rules for lease accounting required lessees to classify leases as either capital (finance) or operating leases. In reality, this categorization system allowed reporting entities to keep many leases off their balance sheets, since relatively few were classified as capital. Historically, organizations have disguised their poor financial health with operating leases that did not have to be recognized. Investors could have been misled about a company's true lease obligations.

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Overview of the major changes in ASC 842

In response, the Financial Accounting Standards Board (FASB) formulated fresh guidance, in the form of ASC 842, released in 2016 and set to take effect in 2019. The new FASB rules make wide-reaching changes, but the key updates are as follows:

- **The capital/operating categorization is still in effect** and subject to the same classification tests. However, each capital lease asset must now be labeled as a Right of Use Asset (ROUA) and disclosed — along with its liabilities — separately from the ROUAs and liabilities of operating leases.
- **All leases lasting a year or longer must be recorded as ROUAs** in the assets section of balance sheets, along with their corresponding lease liabilities. Before, operating leases were identified as rent expenses in income statements and in footnotes to financial statements.
- **Debt to equity ratios should not change much under ASC 842.** Liabilities from operational leases will be reported outside of traditional debt, which is welcomed news to organizations that might otherwise struggle with investors. At the same time, any increases in leverage will still require careful attention and management.
- **ROUA liability calculations now factor in a broader set of payment types**, including interim lease payments and other rents. These numbers will be used to determine a ROUA's value and liabilities. Plus, lease renewals must be disclosed unless part of a month-to-month arrangement anticipated to last less than a year.

Together, the FASB rules could shift more than $1 trillion in leases onto the balance sheet. Given the scope of the changes and the complexity of the necessary transitions, it makes sense that many organizations feel like they have an uphill struggle in front of them. Extensive reporting and modern software for managing leases, maintenance contracts and other financial and technical assets will be necessary for compliance.

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The challenges in transitioning to the new FASB guidance

Disclosures

For publicly traded firms, the de facto transition period started years ago, even though the official deadlines are not until 2019 or 2020, depending on a firm's reporting calendar. An early start was necessary to comply with Security and Exchange Commission (SEC) rules mandating comparable statements from the old and new reporting periods.

The SEC wants to ensure that investors understand how each firm is altering its accounting practices. Multiple years of reports related to income statements and balance sheets must be compiled to give a clear picture of how and why the FASB changes are being applied.

To that end, organizations with leased assets have significant disclosure obligations both initially and on an ongoing basis. Any change in accounting principle must be disclosed upfront during the period it takes effect, accompanied by an explanation and a description of the method for implementing it. In describing its methodology, the reporting entity must offer details on any retrospective adjustments, alterations to income from continuing operations and cumulative effects on retained earnings.

Ongoing disclosures have to include additional details about leases, which may prove difficult for lessees because of the processes and tools they rely on for tracking leases.

Tracking

Spreadsheets have been mainstays of lease accounting for decades because of their familiarity, ease of use and low cost. However, they are not ideal for ASC 842 compliance:

- They are not naturally unified data sources, instead tending toward multi-sheet informational sprawl that requires extensive manual work to mitigate.
- They do not offer lease event notifications or asset tracking, which in addition to decreasing visibility can also result in penalties.
- They are not conducive to collaboration, revisions, advanced forecasting and other workflows that will be common when managing the FASB adjustment.
- The specific issues with spreadsheets are part of a larger problem with insufficient lease tracking technology.

A 2016 survey of accountants and finance directors, conducted by Deloitte Touche Tohmatsu, found that roughly half of the respondents thought the switchover to the updated rules would be somewhat or extremely difficult.

Almost one-third of the respondents thought their current software was insufficient for compliance, while 27.7 percent believed they needed technological upgrades to comply.

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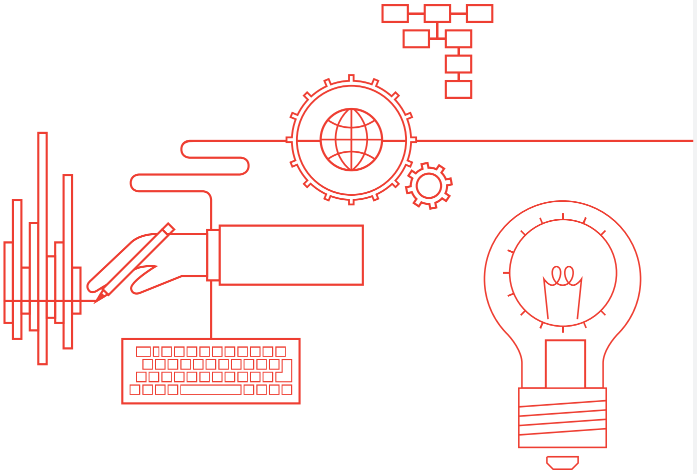
The lease accounting benefits of partnering with LaSalle Solutions

LaSalle Solutions' customized ***Easy***Lease equipment leasing programs offer a transparent approach to asset financing and acquisition across a variety of industries, including professional services, material handling and healthcare. Moreover, we provide a cloud-based platform, LAMP, that aggregates all lease management information in one place to simplify processes, improve planning and ease administrative burden.

LaSalle listens to each customer individually to understand what is needed in a leasing solution and how it should be structured. LAMP adds another dimension to lifecycle management by streamlining the retrieval of lease and asset information across multiple systems, eliminating the need for those problematic spreadsheets. This combination of service and technology greatly simplifies FASB lease accounting compliance while saving you time and money.

Fully complying with the updated FASB rules requires help from the right partners. LaSalle Solutions will give every customer the guidance to make a successful transition.



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For more information:

To learn more about LaSalle's Leasing Solutions, visit http://www.lasallesolutions.com/leasing or contact your local representative.

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