COMPLIANCE WEEK
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Questions abound as companies adopt new lease accounting standard

The rise in questions on the new lease accounting standard suggest some companies are cracking the spine on that new rulebook, reports **Tammy Whitehouse**.

Even as companies are still getting their arms around new accounting rules for revenue recognition, the rise in questions on the new lease accounting standard suggest some are digging into that new rulebook as well.

The Financial Accounting Standards Board adopted new requirements for all public companies to bring leased assets and their related liabilities on to corporate balance sheets beginning in 2019. That's a year after public companies are required to begin following massive changes in how to recognize revenue in financial statements.

When it comes to adopting new accounting standards, most companies are devoting the majority of their time and energy to the new revenue standard, where the changes are bigger and the effective date is sooner, says James Barker, a senior consultation partner in the national office at Deloitte & Touche. "People are probably not as far along as they'd like to be," he says. "Resources are scarce, but we've had a lot of good traction with questions, and we expect that to pick up into next year."

Activity so far seems focused in the largest companies and those most affected by the new rules, experts say. "We're seeing it a lot where real estate leases are significant to operations," says Anastasia Economos, a partner at EY and the Americas accounting change leader for leases. "We see it in retail, in very large companies, and in global decentralized organizations where it often takes longer to implement these kinds of changes."

Dean Bell, a partner at KPMG, says he saw an increase in lease accounting activity moving into autumn as the firm began receiving more requests for proposals. "There's definitely an uptick," he says. "Companies are thinking of this standard in earnest now."

And if they're thinking about it, they're surely raising questions, a common pattern in the adoption of new accounting standards. Sure enough, FASB is hearing questions too, which prompted the staff to take the unusual step of providing some high-level, informal answers to the questions it is hearing most often.

Right out of the gate, the biggest questions seem to surround assuring everyone is on the same page in understanding exactly what constitutes a lease. That's important to assure a common understanding of exactly what assets and liabilities must be added to corporate balance sheets. "It's the rigor of calculating it and putting it on the balance sheet that's causing everyone to stop and think about things more carefully," says Economos.

Before the new accounting standard requiring even today's operating leases to be added to corporate balance sheets, there was little difference from an accounting perspective between the effect of an operating lease, a rental agreement, or some other kind of service agreement. They all represented expenses that were channeled through expenses and perhaps disclosed where appropriate in footnotes.

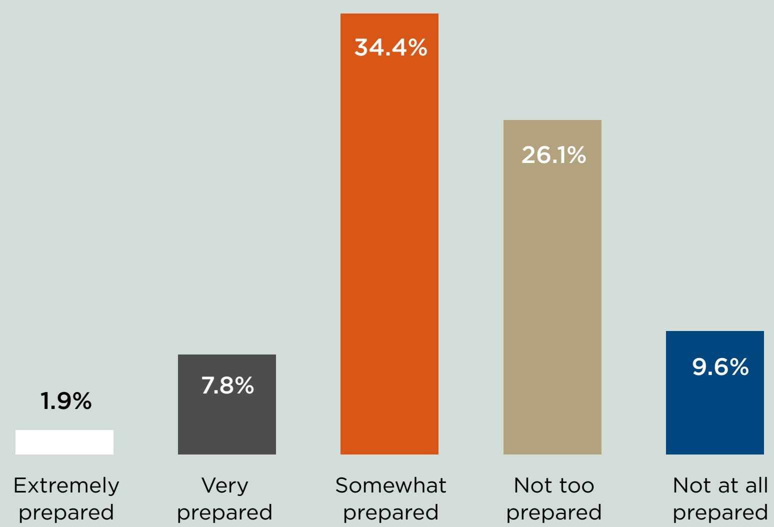
Now that leases need to be added to the balance sheet, the implications are more serious. "Under the new standard, if you haven't identified all of your leases you probably have a balance sheet error," says Barker. That's the kind of mistake that leads to discussions of restatement.

FASB says it didn't intend to make wholesale changes to the definition of a lease under the new standard. "If it was a lease under the current standard, it's still a lease," says Ryan Brady, senior manager at Grant Thornton. "That's probably still true." The issue many companies now face is whether they have leases embedded in service agreements that have not been identified as leases in the past.

In working with companies in the energy sector, Brady has already seen the question arise around pipeline sections called laterals, which connects producers to a well or a main pipeline. The lateral section is an asset, but is it leased or pro-

HOW PREPARED ARE YOU?

Deloitte asks respondents to its recent survey how prepared they are for the lease accounting standard.



Source: Deloitte & Touche

vided under a service arrangement? "If you go through the model, there are some views that they do meet the definition of a lease under the new standard, and there are some views that they don't," he says.

Barker says he's hearing similar questions over advertising on billboards vs. advertising added to the exterior wall of a building. Acquiring space on a billboard seems to fit in the definition of a lease, but what about acquiring space on an exterior wall that provides a much higher purpose as a component of a building than it does as a space for advertising? In such cases involving secondary uses, Barker says, that question arises regularly.

Complex, multinational organizations are starting to recognize the job they face in identifying all those kinds of arrangements to assure they are captured and reflected under the new standard, says Sean Torr, managing director in Deloitte's advisory practice. "How do you identify all those unique situations across the organization that aren't black and white and then put in a process and controls to be able to identify that on an ongoing basis?" he asks.

FASB staff says it is also hearing questions about the discount rate companies will need to use to calculate the numbers that will be factored into the balance sheet, although it doesn't say what kinds of questions it's hearing, nor does it provide any answers or feedback.

Companies will need to establish processes and controls under the new standard for setting the discount rate they'll use to calculate the present value of a stream of lease payments. Barker says he's hearing questions about whether companies will need to establish different discount rates for different leases as part of their transition to the new standard.

"The answer clearly is yes," he says. "The discount rate that might apply to a five-year arrangement might be different than the rate for a 20-year arrangement." Setting discount rates based on current economics might be more straightforward, but companies will have to do some research on historic leases that will be added to the balance sheet at adoption to assure the discount rates reflect the economics of the day when the lease was established.

Some are even pondering whether it might be possible to end up with a negative discount rate to reflect a loss arrangement, says Barker. "The answer is probably no, but it's too early to say," he says. ■