FAQ:
Answers to Some Frequently Asked Questions About Lease Accounting Changes for Lessees

- **What is the lease accounting standard?**
  The lease accounting standard is the rule that pertains to the financial accounting and reporting of lease contracts. The standard is developed by the U.S. Financial Accounting Standards Board (FASB), the organization responsible for setting accounting standards for nongovernmental entities in the United States.

- **Why was the standard changed?**
  The lease accounting rule was changed to provide decision-useful information to investors and other users of financial reports, and to respond to a Securities and Exchange Commission (SEC) directive to bring assets and liabilities on the balance sheet.

- **When will the new lease accounting rule take effect?**
  The new standard is scheduled to take effect for financial periods starting after December 15, 2018 for public companies and after December 15, 2019 for private companies. For companies with calendar year ends that means 2019 for public companies and 2020 for private companies.

- **What's changing? What's not?**
  Change: The biggest change is that the new standard will change how leases are accounted for on corporate balance sheets. Instead of appearing as a table of future payments in the footnotes, they will appear on the balance sheet, as an asset and liability but as a non-debt liability.
  No change or limited change: Many of the lease accounting changes are relatively neutral. The new rules have no impact on the income statement. There is a limited effect on debt covenants. The rules for classifying whether a new contract is a Capital (Finance) or an Operating lease are virtually the same as before under GAAP.

- **Does it make good financial sense to lease or finance equipment anymore?**
  Yes. There are many reasons to lease equipment, and the primary reasons will remain intact under the new rules, from maintaining cash flow, to preserving capital, to obtaining flexible financial solutions, to avoiding obsolescence. See the following and the table below of "Leasing Benefits: Before and Now."

- **Is the capitalized asset cost with Operating Leases really *lower* compared to a loan or cash purchase?**
  Yes. Although Operating Leases will add assets and liabilities to the balance sheet, the asset amounts (rental/right of use (ROU) amount) will be lower than the cost of an outright purchase.

By way of further explanation, an Operating Lease's capital asset cost is lower than a lease or cash purchase because the balance sheet presentation of an Operating Lease reflects only the present value of the rents due under the contract as the asset amount. As a result, it is still "partially" off-balance sheet. In addition, since the cost of an Operating Lease is reported as a straight line expense of the full lease payment each period, there is no front-end loaded P&L impact that comes from expensing depreciation and imputed interest costs as there is when you borrow to make an outright asset purchase. The net result is that leasing, compared to borrowing to buy, will show a better ROA, which can be the basis for bonus compensation, and ROA is a measure used by equity analysts.

- **Are the rules retroactive?**
  The new rules are implemented retroactively, so all Operating Leases (except for short-term leases) will need to be capitalized in the financials reported in the transition year. If comparative balance sheets and income statements are presented the Operating Leases must be capitalized in the earliest period presented.

- **Will my credit rating be changed by the additional liabilities?** Your credit rating *should not change* just because the FASB changes the rules for recording and capitalizing Operating Leases. Bank lenders and credit analysts already take into consideration the Operating Lease obligation included in your footnotes. They estimate the value of the implied asset and liability created by Operating Leases to adjust their measures and ratios used to make credit assessments. The proposed formula under the new rules is substantially the same as the method used by rating agencies today.

- **Will I have to recognize all leases on the balance sheet?**
  The answer varies depending on the lease conditions. If you are reporting under International Financial Reporting Standards (IFRS)/ U.S. generally accepted accounting principles (US GAAP), the answer is yes. However, if the contract duration is equal to or less than 12 months, the off-balance-sheet approach previously used for Operating Leases applies. If the contract qualifies as a service, the contract does not have to be recognized on the balance sheet. For IFRS companies, the lease does not have to be recognized if the value of the asset is low (with a benchmark less than $5,000), irrespective of term. (NOTE: This is not the case under US GAAP.)

- **What's the difference between US GAAP and IFRS with respect to lessee accounting?**
  Under both rules, all leases have to be recognized on the balance sheet. Under IFRS, there is a lease model (Finance) for lessees and the costs must be recognized in the P&L, similar to the way Capital Leases were previously booked, *i.e.*, imputed interest costs are a downward sloping curve (relatively higher at the beginning of the lease term) and asset amortization is level, thus creating a front-loaded expense pattern on the P&L. The liability is treated as debt.

  Under US GAAP there are still two kinds of leases: Finance Leases (comparable to current Capital Leases) and Operating Leases (comparable to current Operating Leases) and their costs are reported accordingly in the P&L, which is no change from previous practice. In other words, a Finance Lease reports front-loading of costs and a split in amortization and interest costs, while an Operating Lease shows only single level rental expenses in the P&L. The operating lease liability is a non-debt liability.

Leasing Benefits: Before and Now

Lessee (End-user) Benefits	**Before**	**Now**
Capital Needs	• Added source of capital • Fixed rate (vs. revolver)	• No change
Cash flow savings	• 100% financing, level payments • Lower payments resulting from tax benefits and residual investment by Lessor • Skip / seasonal payments • Financing for training and installation costs	• No change
Tax Benefits	• Trade potentially unusable MACRS benefits (AMT, NOL) for lower payments • Expensing of full payment on income tax returns	• No change
Flexibility	• Options to fit varying business needs at end of lease term • Add-ons / upgrades made easy	• No change
Asset Management	• Manage technology cycle/reduce obsolescence risk • Manage asset replacement cycles	• No change
Financial Reporting Benefits (Operating Leases)	• Off-balance sheet asset and obligation • Improves debt, ROA and ROE ratios	• Asset amount on balance sheet is less than cost • Liability on balance sheet, but as non-debt • On-book obligation lower than debt or cash due to residual investment • Will have little impact to debt ratios and financial measures
Convenience	• Streamlined financing process for many transactions • Often available at point of sale	• No change

More Information:
To learn more about this topic, visit the Equipment Leasing and Finance Association's Lease Accounting webpage at www.equipmentfinanceadvantage.org/newLAR.cfm.

Disclaimer: The information in this document is a summary only and does not constitute financial advice. Readers should obtain their own independent accounting advice that takes into account all relevant aspects of a particular lessor’s or lessee’s business and products.