The New Lease Accounting Standard’s Impact on Lessors’ Customer Interaction

Note: This is the third article in a four-part series of articles featured in the QuickBrief e-newsletter designed to help ELFA members prepare for the new lease accounting rules. The new rules are scheduled to take effect for financial periods starting after Dec. 15, 2018, for public companies and after Dec. 15, 2019, for private companies. This article is excerpted from information on ELFA’s Lease Accounting webpage.

It’s important for lessors to understand how the lease accounting rules will impact your customers and your product offerings. The rules will not be as cumbersome as first thought, and there are actually some opportunities.

The lessor sales staff will require training and preparation to better meet their customers’ needs, and potentially differentiate themselves in the marketplace:

- They have to understand the new rules and the implications.
- They have to be prepared in order to address customers’ questions and objections.
- Their marketing plans have to be adjusted for product changes.
- Marketing materials have to be updated.

Customers should be made aware that both the FASB and IASB agreed to eliminate the need to estimate likely renewals and variable rents. Further, the FASB retained the GAAP two-lease model where operating leases would be capitalized but treated differently than finance leases.

Operating leases are accounted for virtually the same as under current GAAP for P&L cost purposes; that is, the cost pattern will remain as the straight line average rent. Additionally the FASB decided that the capitalized operating lease liability is not to be classified as debt—rather it will be an “other” operating liability. The resulting impact is minimal impact on debt covenants, and in fact, no impact on debt limit covenants.

These changes made by the FASB present the financial impact of operating leases more closely to the true economics of the transaction and also eliminate most of the negative aspects of the new rules. The amount capitalized will be less than the equipment cost and the cost is straight lined so **there will still be an accounting benefit to leasing over borrowing to buy**. The greater the residual assumed and the higher the tax benefits, the lower the capitalized amount. The issue for lessors is to ensure that their customers understand all of this.

Lessors should review their lease structures against the new rules to see which products work best and where changes should be made. Lessors should also look at the impact on asset types and markets so that they focus on the areas where the prospects are best given the details of the new rules. There are positive and negative nuances in the new rules that need to be understood.

Dealer/Vendor Partner Impact: Revenue Recognition

The new treatment of Operating leases remain neutral territory for many sellers. In reality, manufacturers, dealers and distributors will see no revenue recognition impact for Operating lease contracts. Generally speaking, manufacturers who sell through an independent dealer network will not have revenue recognition impact, as long as any "put" provided, or recourse or residual positions taken by the manufacturer, do not create an "economic incentive" for the buyer to exercise (i.e., the recourse cannot be more than 10% of the fair value of the asset sold). Dealers and manufacturers selling directly to equipment purchasers within the same group of consolidated companies (i.e., wholly owned captive finance companies) will not have up-front gross profit recognition if the captive's end user leases are Operating leases.

This article is excerpted from "Navigating the New Lease Accounting Standard" and "Changes in Lease Accounting: The Benefits of Equipment Lease Financing Remain," available at www.elfaonline.org/industry-topics/lease-accounting.

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.