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8 THINGS TO KNOW ABOUT THE LEASE ACCOUNTING STANDARD CHANGES

8 Things to Know About the New Lease Accounting Standards

Whether reporting using GAAP or IFRS financials, the following are important for you to consider as you prepare for new lease standards:

1. **Balance Sheets will Swell for Many Corporations**
   Both IASB and FASB standards require that all leases longer than a year will be treated as right of use assets with corresponding obligations and depreciation treatment. This will be a significant change for many companies that use current lease rules to treat lease expense as a rental expense. Trillions of operating lease dollars are expected to come on US balance sheets as a result of this change.

2. **It is not too Soon to Start Gathering Your Lease Data**
   The FASB leasing standard will require a two-year lookback period of comparable financials, meaning that upon adoption companies must present their leasing activities for the past two years as if the standard were effective during that period. For this reason, it is very important to start collecting lease information in 2016 to make certain all required details are available for future reporting.

3. **New Testing Criteria will be Required in the Future for GAAP Lessees**
   For GAAP companies, all leases over a year must be tested. Leases where the lessee consumes a significant portion of the asset or retains most risks of ownership will be treated as Type A leases. Conversely, Type B lease treatment will be applied in cases where the lessor retains most ownership risk and takes most of the depreciation.

4. **Expensing Patterns will Change and may Impact Key Financials**
   GAAP Type A leases and all IFRS capital leases will have front-loaded expense recognition, which means lessees may experience higher total expenses earlier in lease terms. Front-loaded expense may cause profit and loss figures to decrease due to higher early-term expense.

5. **Financial Ratios for Borrowing will also be Affected**
   Ratios that exclude financing activities like EBITDA will increase due to interest components now being included for capital leases. With obligations now being recorded for most leases, debt to equity ratios will increase, causing companies to look more leveraged.

6. **Accounting Groups will Become Increasingly Responsible for Leases**
   In the future, all lease agreements must be routed through central accounting for lease classification tests and accounting treatment. Maintaining capital leases requires much more bookkeeping upon initiation and throughout the lease life. Additionally, accounting departments preparing for the standard will require expertise in leasing to ensure that all regulatory requirements are met and that all necessary steps are followed.

7. **Accounting System Changes will be Needed to Handle Capital Leases**
   With increased bookkeeping complexity, maintaining lease agreements in spreadsheets will become nearly impossible for companies with more than a handful of leases. Additionally, contracts systems will require modifications to ensure all agreements are checked for leases and that they are routed to accounting.

8. **Forecasting Financial Impact is Crucial**
   The balance sheet, income statement, and cash flow impacts of the leasing standards may have significant changes to financial metrics and future budgets. Having the ability to forecast these changes allows companies to alert investors and creditors of any potential negative impacts ahead of time, in addition to assisting financial planners to determine the optimal strategies going forward.

About PowerPlan

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