EQUIPMENT LEASING AND FINANCE ASSOCIATION

Change in Lease Accounting Rules
Fact Sheet
May 2013

What is the Leases project?

- As part of the global effort to establish uniform corporate financial accounting standards, the Financial Accounting Standards Board (FASB) and its sister organization, the International Accounting Standards Board (IASB), are working jointly to develop a new model for the recognition of assets and liabilities arising under lease contracts.

- A majority of U.S. companies across a wide spectrum of industries lease equipment and real estate as part of their day-to-day operations. Currently, operating leases are not reported on companies' balance sheets; they are typically included in the footnotes of companies' financial statements. The Boards' intent is to record these transactions on balance sheet (i.e., capitalize all leases with lease terms of more than one year on lessees' books).

- The current model, Statement of Financial Accounting Standards No. 13, *Accounting for Leases* (SFAS 13 in the U.S.; IAS 17 in Europe and other jurisdictions where IFRS is recognized), governs the accounting for commercial lease transactions related to plant, property and equipment. The proposed new standard will impact the balance sheets of all companies subject to U.S. GAAP who use leasing to acquire the use of assets or as part of their asset management strategy.

What is the timeline for the lease accounting project?

- The FASB and IASB have been working on the Leases project since 2006. They issued the first proposal, or "Exposure Draft," for a new lease accounting standard in August 2010. Approximately 800 comment letters were submitted in response to the Exposure Draft. As a result, the Boards re-deliberated and elected to apply many of the recommended changes and issue a new Exposure Draft.

- The FASB and IASB issued the second Exposure Draft on May 16, 2013, followed by a 120-day comment period. After the comment period, the Boards will again deliberate. Following re-deliberation, a new rule is expected to be issued sometime in 2014. Transition to the new rule would occur by 2016 or later.

What are the primary components of the proposal released May 16, 2013?

- The current risk-reward model, which distinguishes a capital lease from an operating lease, would be replaced with a so-called Right of Use approach. Under this model, the lessee would account for the lease contract's rights and obligations as assets and liabilities, using a method similar to capital lease accounting for virtually all equipment leases.

- Two types of leases would be recognized: some will be accounted for as financing arrangements, similar to a loan, and others treated like rentals. The distinction will depend on how much of the leased item is consumed during the term of the lease. Leases of buildings and property will be treated like rentals, while equipment leases (including aircraft assets) will be considered financing contracts.
- With this equipment vs. real estate classification split, the expense related to the former would be front-loaded, similar to interest in a mortgage financing, while the lease expense in the latter type of lease would be recognized as it is today with operating leases, on a straight-line basis.
- The ED eliminates leveraged lease accounting. Lessors will use either operating lease accounting for straight-line leases or a finance-lease-like method called the receivable and residual method for front-ended cost leases. As in lessee accounting, the method used will be determined by the amount of the leased item that will be used up during the term of the lease.

How will the proposed Exposure Draft impact businesses?

- Estimates are that U.S. public companies have more than $1.3 trillion in operating lease payments that will be brought on balance sheets, adding assets and liabilities.

- Many businesses do not object to having to record leases on their books. Rather, they object to *how* the proposal would require them to account for and report lease transactions, contending that aspects of the proposal are too complex, impose burdensome regulation on businesses and do not accurately reflect the economics of the lease transaction. If the proposed changes do not reflect an appropriate balancing of costs and benefits, they could result in an unwarranted increase in cost of capital to U.S. companies that utilize leasing.

How widespread is equipment leasing?

- Equipment is leased and financed for use in virtually every sector of industry, including business, retail and office equipment; agricultural equipment; IT equipment and software; aircraft; manufacturing and mining machinery; rail cars and rolling stock; vessels and containers; trucks and transportation equipment; construction and off-road equipment; and medical technology and equipment.

- Most businesses require equipment in order to operate and make a profit. Equipment leasing and financing help all types and sizes of commercial businesses in the United States to acquire the equipment they need to conduct their business operations. There are many benefits to leasing, and the primary reasons to lease equipment will remain intact despite the lease accounting proposal, from maintaining cash flow, to preserving capital, to obtaining flexible financial solutions, to avoiding obsolescence.