Bloomberg BNA Accounting Policy & Practice Report®

Leasing

Not All Leases Created Equal Under New Accounting Rule

By Amanda Iacone

Printers and pop machines. They are staples of workplaces everywhere and are often leased. But they might not show up on corporate balance sheets under new lease accounting rules.

The change will require public companies to report both operating and finance leases on the balance sheet beginning in 2019. That means trillions of dollars' worth of office space, warehouses, rail cars, even planes and other equipment will show up on financial statements for the first time.

Companies, facing a mountain of leases scattered across the globe and a tight timeline, are triaging leases to focus on contracts with the most significant value for their business and industry.

Snapshot

- Companies weigh whether a contract is significant enough to make difference to investor
- Companies must report material capital, operating leases on balance sheets

The new lease accounting standard technically applies to all leases from real estate to office equipment. "In reality, however, there is some level of materiality that needs to be considered," said Denise Hinkle, vice president of client development for Scribcor Global Lease Administration in Oak Brook, Ill.

It's up to each company to determine what materiality—a financial shift that could alter investment decisions—means for their balance sheet. And items like vending machines, printers, copiers, even computers might not make the cut, Hinkle told Bloomberg Tax.

"The cost of maintaining capitalization schedules on a coffee pot far outweighs the benefit of reporting that on your financial reports," she said.

Applying the standard to small dollar leases like vending contracts would also add to the vast work load to locate the contracts, upload those documents into a computer system to pull out the relevant financial information, and then run the calculations to determine the value of the asset and liability.

Quick and Dirty

To limit the workload as much as possible, companies are weeding out immaterial contracts based on a "quick and dirty analysis" of the terms and what's being leased, said Dee Mirando-Gould, managing director of Moss Adams LLP's technical accounting consulting practice in Seattle.

Some of her clients have set aside those immaterial contracts to focus on leases representing a more significant value, and that could result in a material shift to the balance sheet, Mirando-Gould told Bloomberg Tax.

Any contracts not considered material likely won't go through the calculation to determine its value. And whether it's operating or a capital lease doesn't matter, she said.

"It's immaterial. So we don't have to apply the lease standard," she said.

Miranda-Gould said companies still should track those assets, store the documents, and record the expenses. They will need those details to prove to their auditors why that equipment or real estate shouldn't be reported on the balance sheet.

"The days of having a lease contract where you looked at it, figured out if it was a capital lease or an operating lease, and throw it in a file drawer and ignore it forever after that, are gone. You still have to think about it," she said.

Embedded Leases Surface

Another way companies are culling the number of documents they must evaluate is to eliminate contracts that aren't by nature a lease and don't contain leasing clauses within them.

Mathew Keshav Lewis, senior vice president of regulatory response solutions at Axiom Global Inc. based in New York,told Bloomberg Tax that before Axiom's clients begin pulling any data from contracts, they are sorting through the documents to eliminate duplicates and to pull out any obvious contracts that contain no hidden leasing components, known as embedded leases.

Embedded leases could form a significant part of third-party outsourcing agreements that essentially are a lease of people, technology, even telecommunication lines. Or a manufacturing service agreement could be written in a way that a company is essentially leasing the right to use a specific piece of equipment, Lewis said.

Axiom provides a contracting service that taps artificial intelligence to read the documents— which could be as long as several hundred pages—searching for key words or phrases that indicate the contract includes an embedded lease. Company staff would then review those flagged contracts and determine whether they should be included among the lease contracts or not, he said.

But even with the help of AI, the work could take several weeks to complete, Lewis said.

Both Mirando-Gould and Lewis said that identifying all relevant leases remains a major challenge for companies.

“I would expect you're going to see clients all the way up through January and February of next year ahead of annual reporting deadlines doing this work,” Lewis said.

To contact the reporter on this story: Amanda Iacone in Washington at aiacone@bloombergtax.com

To contact the editor responsible for this story: S. Ali Sartipzadeh at asartipzadeh@bloombergtax.com

---

ISSN 1558-6669