THE CONSUMER CODE

News from WS+B's Consumer Products & Entertainment Services Group

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THE LATEST LEASE ACCOUNTING PROPOSAL COULD HAVE A SIGNIFICANT IMPACT ON RETAIL AND RESTAURANT BALANCE SHEET

The second version of lease accounting reform is out for public scrutiny and comment. If passed, the current lease accounting proposal will significantly overhaul the way companies report leased assets and liabilities – and their underlying processes and systems to capture needed data will have to ramp up accordingly. Many sophisticated companies are already planning for its significant changes; should you be preparing now?

CONSIDER: Lease accounting has been under review by the accounting rule makers since 2006 and passage of the current proposal is far from an accepted conclusion. Although the Financial Accounting Standards Board ("FASB") members agree that lease accounting needs improving, and all leases belong on a balance sheet, they disagree among themselves as to the details. They narrowly voted to release this iteration by a vote of 4 - 3. The public vetting process is extensive, and reflects users' divergent reactions. FASB has solicited feedback through public roundtables and comment letters. Many stakeholders are far from positively embracing even the broad strokes of the proposal. Some support the basic premise of all leases appearing on the balance sheet; others believe expanded disclosures will provide improved financial transparency. Leading industry organizations, such as the Equipment Leasing and Finance Association and the US Chamber of Commerce, are stridently expressing that the significantly higher compliance costs outweigh any benefits. Therefore, educated observers see considerable potential for further modifications, which in turn will push out its effective date further.

Does this mean lease accounting reform will eventually fade away? We believe not. Although the final details may be modified, new lease accounting rules are coming. Specifically, some version of expanded lease disclosures and recording all leases on lessees' and lessors' balance sheets are likely.

We believe that prudent leaders of small and mid-sized businesses should employ a watch-and-wait approach. Specifically, until the final form of lease accounting overhaul is agreed upon, we recommend the following:

- **Monitor** – Keep an eye on significant developments, especially the effective date of a final leasing standard. Identify reliable sources, such as WithumSmith+Brown, for timely accounting updates. A likely effective date will not be before 2015.
- **Survey** - Review and summarize your current lease involvements, noting property vs equipment leases, long vs short term, high vs low dollar, and fixed vs variable payments.

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- **Evaluate** - Assess whether your financial covenants and ratios, such as EBITDA, will change. Consider initiating discussions with your lender to reduce future surprises and waiver fees. Companies with a substantial amount of leasing – either from a few high dollar, long-term leases or a high volume of individually small leases -- should not forget financial alternatives to leasing, such as capital purchases.
- **Strategize** – If lease accounting reform is not something that either your company or you wants to implement or be involved with, consider whether your financial statement users will accept income tax or modified cash basis reporting. This can be a cost-effective option.

In summary, there have been two lease accounting proposals, and still, no unifying harmony of users that see value in its costly and complicated compliance. Stay tuned —could lease accounting version 3.0 be next?

At WS+B, we are experts in assessing the impact of compliance with accounting changes. We would be pleased to discuss with you how other current developments in accounting and financial reporting would affect your business.

For more information on the topic discussed, please contact your local WS+B advisor or:

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