CBRE
ENTERPRISE NOTES

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Please take the time to read this latest update regarding the upcoming changes to lease accounting. It is important that we continue to monitor these changes in order to provide our clients with insight around this important topic within our industry. – Ed and Whitley

Lease Accounting Update: Back to the Front Burner?

Highlights

- The revised Exposure Draft on lease accounting will be issued in May.
- Real estate leases will generally fall under the Single-Lease Expense Method, which results in a straight-line expense over the term of the lease (similar to current lease accounting).
- All leases must be capitalized, except for short-term leases (less than 12 months).
- The new standard will most likely be issued in 2014.
- The effective date will be no sooner than 2016.

Based on recent discussions with the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB), collectively the “Boards,” the long-awaited revised Exposure Draft on lease accounting is to be issued in May—more than two-and-a-half years after the original Exposure Draft was issued in August 2010.

All indications are that the Boards will put forth the dual methodology for lessees agreed upon this past summer, which was outlined in our November update. This dual approach will result in most real estate leases being treated in accordance with the Single-Lease Expense (SLE) Method, which recognizes the lease expense on a straight-line basis over the primary term of the lease. Although the actual accounting under the SLE Method is a bit more complicated, this expense recognition pattern is similar to current operating lease treatment. Equipment leases, on the other hand, will generally be accounted for using the Interest & Amortization (I&A) Method, which results in the undesirable front-loaded expense treatment. This approach will also apply to real estate leases that do not qualify for the SLE Method (i.e. leases considered more of a “financing”). No matter which approach is used, the proposal will still require that **all leases be capitalized** (except for leases of less than 12 months).

Noting the complexities introduced by these proposed accounting changes, there are many stakeholders who fail to see the benefits of changing from current lease accounting. This point of contention will now be compounded as it has become evident that the dual methodology places the real estate industry at odds with the equipment leasing industry who feels they are burdened with the least desirable of the two approaches (i.e. front-loaded expenses). Central to their argument is that either all leases should be treated in the same manner or no changes should be made to current lease accounting. While many in the real estate industry would be more than happy to retain current lease accounting, if a change is inevitable, the straight-line approach (SLE Method) is the most desirable for real estate leases.

Despite the continuing uncertainty on this issue, the real estate industry can be comforted knowing the unfavorable accounting treatment relating to option periods (which has changed so they are now only included in the capitalization calculation if a “significant economic incentive” exists to exercise the option) and percentage rent have generally been taken out of play.

However, it is still possible for additional changes to be introduced. Therefore, all real estate stakeholders are encouraged to submit comment letters during the 120-day comment period after the revised Exposure Draft is issued. This may be our final opportunity to express an opinion on the topic. While the final standard will most likely be issued in 2014, with an effective date of no sooner than 2016, it is important to emphasize that comparable periods presented in a company’s financial statements will need to be re-stated to reflect the changes to lease accounting. As a result, this topic will soon merit front-burner status once again!

The CBRE Global Task Force on Lease Accounting will continue to keep you apprised of developments on this topic and will provide you with a detailed update after the revised Exposure Draft is issued.

If you wish to share this information with your clients, please feel free to forward the attached file.

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