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ENTERPRISE NOTES

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Revised Exposure Draft on Lease Accounting Issued: Here we go again!

Yesterday, the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB), collectively the "Boards," issued the long-awaited Revised Exposure Drafts for the "Leases" project. Just shy of three years after issuing the Original Exposure Draft in August 2010, the Revised Exposure Draft represents the culmination of the Boards' deliberations after reviewing nearly 800 comment letters and holding numerous joint working group meetings, public roundtables, workshops, webcasts, etc. (Note: While the FASB and IASB have each released their own version, they are generally the same with only minor differences).

As with the Original Exposure Draft, the Revised Exposure Draft provides a 120-day comment period (ending September 13, 2013) for stakeholders to voice their opinions, both pro and con. There is no doubt the Boards will have many more deliberations on this topic before arriving at a final standard, which could be issued in mid-2014 at the earliest. The Boards have not provided guidance on the potential effective date of the new standard; however, it is estimated to be no sooner than 2017. In addition, a look-back period will be required for any comparable periods presented in a company's financial statements.

CBRE's Global Task Force on Lease Accounting (Task Force) will be issuing a detailed white paper shortly that will provide an in-depth review of the key topics in the Revised Exposure Draft. The paper will also include a discussion of what companies can be doing now to facilitate implementation of the new standard, as well as strategies to be considered in advance of the new standard. In the interim, we provide for your review the following select highlights from the Revised Exposure Draft from the lessee and lessor perspectives:

Select Highlights

Lessee Perspective

- The Revised Exposure Draft requires real estate leases, including ground leases, be capitalized. The exception to this is short-term leases, which are defined as those with a maximum lease term, including renewal options, that does not exceed 12 months.
- Leases are to be classified as one of two types, each with its own expense recognition pattern:
    - **Type A Lease** – Includes most equipment leases and some real estate leases (i.e. real estate leases that would most likely be considered capital/finance leases under current accounting requirements). The expense recognition methodology associated with this lease type will result in the front-end loaded expense pattern as proposed in the Original Exposure Draft.
    - **Type B Lease –** In general, most real estate leases will be Type B leases (i.e. real estate leases that would generally be considered operating leases under current

accounting requirements). The expense recognition methodology associated with this lease type will result in a straight-line lease expense similar to current operating lease treatment.

- Unlike the Original Exposure Draft, option periods will not be capitalized unless there is a “significant economic incentive” to exercise the option.
- Percentage/turnover rent is no longer required in the determination of the Right-of-Use (RoU) asset. To deter possible abuse as a result of this guidance, lease payments that are in-substance fixed lease payments, but are structured as variable lease payments in form must be included in the capitalized RoU asset.
- Variable Lease Payments (VLPs), which includes CPI increases, will be included in the RoU asset. Although each CPI increase will trigger a reassessment of the RoU asset and the liability.
- Executory costs, most commonly operating expenses, are allowed to be segregated from the rent payment and excluded from the calculation of the RoU asset.
- Initial direct costs (i.e. legal fees, leasing commissions, etc.) must be added to the initial balance of the RoU asset.
- If a sale/leaseback meets the criteria for a sale and is at fair value with current market rates, the gain or loss associated with the sale is to be recognized immediately. This differs from current U.S. GAAP (Generally Accepted Accounting Principles), which requires a gain be amortized over the term of the lease.

Lessor Perspective

- The Boards have proposed an approach for lessor accounting similar to that of lessee accounting, which requires leases to be classified as either a Type A or Type B lease.
- The classification of the leases will be based upon whether or not the lessee acquires and consumes more than an insignificant portion of the leased asset. If yes, the lease will be classified as a Type A Lease. If no, the lease will be classified as a Type B lease.
- In general, the approach for Type A leases will require the lease receivable be capitalized and the underlying asset be de-recognized (i.e., removed from the balance sheet). The details of this approach are too complex for the scope of this document; however, they will be reviewed in detail in our white paper.
- Type B leases will follow today’s operating lease model. This means the lease receivable will not be capitalized and the underlying asset will remain on the lessor’s balance sheet. This approach will be used for most real estate leases.

If you have any questions, please reach out to any member of the Task Force listed below. You can review the Revised Exposure Drafts on the FASB website or the IASB website.

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