How to Mitigate the Effects of FASB Lease Accounting Changes on your Company

The effective date of January 2018 is fast approaching. With regard to leases for corporate real estate, finance executives and their teams can take the following steps to prepare and mitigate:

- Review each of your leases, starting with the largest obligations to clearly understand how they will be accounted for under the new rules. Focus particularly on those that may have "a significant economic incentive" to exercise a renewal option, which could effectively double the lease term.

  IE - Including a renewal option doubles the total balance sheet liability under the new standards. The impact on shareholder equity would increase sustainability, and net income will take an annual hit.

- Focus on reducing the spread between a lease's liability and the corresponding "right of use". The more these two items are misaligned, the more skewed the impact will be on the balance sheet and shareholder equity. Key issues include the rental rate and timing of rent increases, costs of services that have been embedded in the base rent, and the impact of free rent and other incentives. These all contribute to the spread between the asset and liability balances under the new rules. However, if structured correctly these items can also reduce the spread to achieve substantially better financial results.

- Consider renegotiating leases now, even if they are not immediately up for renewal. During the negotiations, ensure that any service charges for operating expenses, such as maintenance and taxes, are clearly delineated. It is often difficult to separate the expenses from rent during the negotiation process, so work closely with your tenant advisor to address areas of concern with an eye toward reducing the impact.

- Finally, leverage technology specifically designed to assess the impact of new rules.

CONCLUSION

By anticipating how new and existing leases will be classified and accounted for under the new standards, corporations will be in a much better position to develop a strategy that minimizes any negative impact the lease accounting rule changes would otherwise have on financial statements.

If you do not have a great system in place, call Mike for a free consultation

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