

## FASB Sounds Retreat on New Accounting Standards for Leases

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Last year we reported in advisories directed to our health care ([see advisory](#)) and real estate ([see advisory](#)) readers that the Financial Accounting Standards Board (FASB) is considering new accounting rules for real estate and equipment leases, new rules that would dramatically change the way in which leases are reported in financial statements of public and private companies and nonprofit organizations. The proposed rules were published in an Exposure Draft (Topic 840-Leases) released by the FASB in August 2010.

It now appears that the FASB may be ready to reverse course, and perhaps even to adhere to its current rules, which draw a bright line between capital and operating leases. We believe that those who have been preparing for the new rules may want to hold tight until the FASB's direction becomes more certain.

In a nutshell, the new rules would discard the fundamental distinction in today's generally accepted accounting principles (GAAP) between an operating lease and a capital lease. The premise of the new rules is that all leases—no matter the duration or economic terms—should give rise to an asset, and a liability, on the balance sheet of both the lessor and the lessee. These new accounting standards would create real challenges for lessees, since a lessee is required to value the future liability created by a lease using a complex “expected outcome analysis.”

There would also be more complexity for lessors under these standards, since each lessor must choose between two alternative methods of financial recording for the lease—a choice that depends on whether the lessor will continue to have “significant exposure” to the rights and benefits of the leased asset during and after the expiration of the lease.

These, and other problems lurking in the Exposure Draft, were discussed in our earlier advisories. The FASB invited comments last year, and, not surprisingly, various industry groups (and, predominant among them, real estate and equipment leasing associations) filed extensive critical commentary about the Exposure Draft. When the comment period closed in December, 781 separate comments had been filed. Many submitters argued that financial statements would be less informative, and less reliable, if these proposed standards were adopted.

Earlier this week the FASB released a summary of a recent joint meeting it held with its sister European organization, the International Accounting Standards Board. (IASB had co-authored the Exposure Draft with the FASB.) This meeting was convened to further discuss the proposed standards and the comments received on the Exposure Draft.

The summary reveals that the FASB may be having a profound change of heart—or, at least, that it wants to move more slowly on any rewrite of the current lease accounting rules. The FASB and the IASB have decided to acknowledge that all leases are not necessarily the same, and the FASB directed its staff to consider the possibility of a new approach that would distinguish between two types of leases—a “finance lease” and an “other-than-finance lease.”

Sound familiar? This looks very much like a return to the current rules, which draw a fundamental distinction between a capital lease and an operating lease. In addition, the FASB and the IASB have now acknowledged that the proposed standards required too much forecasting of the results of inherently unknowable future events, which would have produced great differences in accounting treatment between similar leases. The FASB and the IASB decided to clarify several other points in the proposed Exposure Draft, and the FASB instructed staff to seek additional guidance from the affected industries.

While the FASB has stopped well short of abandoning the Exposure Draft, this recent release certainly signals that the process of modernizing the lease accounting standards will substantially slow down. That process is more likely to result in incremental changes to the existing GAAP rules, rather than a

wholesale and sweeping rewrite of the rules (as seen in the August 2010 Exposure Draft).

Clients should consider suspending their planning for life under the new lease accounting standards until it becomes more clear which direction the FASB will be taking on this important subject.

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