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FINANCIAL REGULATION

New Rule to Shift Leases Onto Corporate Balance Sheets

In effect in 2019, accounting shift may make many firms look much more leveraged

Some large companies like AT&T Inc. may have to add tens of billions of dollars to their balance sheets to account for debt-like obligations they incur when they pay to lease real estate, airplanes, office equipment and other items. That's due to a new rule issued Thursday by the Financial Accounting Standards Board that takes effect for public U.S. companies in 2019. PHOTO: REUTERS

By Michael Rapoport

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Accounting rule makers made their overhaul of lease accounting official on Thursday, issuing a new rule that will require U.S. companies to add huge amounts of leases to their balance sheets and thus make many companies look much more leveraged.

Under the Financial Accounting Standards Board's new rule, companies will have to add to their books the debt-like obligations they incur when they pay to lease real estate, airplanes, office equipment and other items. Currently, companies are required to disclose their lease obligations only out of the spotlight, in the footnotes to their financial statements.

Some large companies like Walgreens Boots Alliance Inc. and AT&T Inc. may have to add tens of billions of dollars in leases to their balance sheets, and overall balance sheets could swell by as much as $2 trillion, according to some estimates.

The rule, which the FASB approved in principle in November, will take effect for public companies in 2019.

Many companies, like airlines who lease planes and retail chains who lease real estate for their stores, have large amounts of long-term lease obligations that are effectively the same as debt, but under current rules they aren't carried on the balance sheet and their impact isn't readily visible to the average investor who doesn't delve into the footnotes. The change is intended to make it easier for those investors to get a better, clearer picture of companies' true obligations.

"It puts things in a more transparent condition," said James Kroeker, the FASB's vice chairman.

> **(The new rule) adds light to one of the last remaining crevasses of off-balance-sheet accounting.**
>
> —James Kroeker of the Financial Accounting Standards Board

Regulators and other observers have long been concerned about rules that allow companies to keep some items off their balance sheets. Mr. Kroeker said the new lease rule "adds light to one of the last remaining crevasses of off-balance-sheet accounting."

The new rule calls for both assets and liabilities reflecting the value and costs of leases to be added to the balance sheet, so companies' book value isn't likely to change significantly. But companies' leverage will be much more evident, and some financial ratios like return on assets could be affected.

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Short-term leases, those lasting less than a year, will be exempt from the new rule. In addition, the accounting for those on the other end of lease transactions—the lessors, the owners of the property that's being leased—will remain largely unchanged from current rules.

The FASB's new rule culminates more than a decade of work. Lease-accounting rules haven't been significantly revamped in 40 years, and critics have contended that companies use the current rules to their advantage, structuring the terms of their leases to allow them to be kept off the balance sheet. In 2005, the Securities and Exchange Commission called on the FASB to overhaul its lease rules, and the board has been moving toward a revamp since then.

Non-U.S. companies will also soon face requirements similar to those the FASB issued Thursday. The International Accounting Standards Board, the FASB's global counterpart that sets accounting rules for most countries outside the U.S., issued its own lease-accounting overhaul in January, similar to the FASB's but differing in some respects.

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