

## Grubb & Ellis Corporate Finance

### Lease Accounting Changes Are Changing...

UPDATE: February 18, 2011

A joint meeting of the International Accounting Standards Board (IASB) and the Financial Accounting Standards board (FASB) was held Wednesday, February 16<sup>th</sup>, that produced a major reversal from the Lease Accounting Exposure Draft (ED) issued last August. One of the most controversial - and most commented upon - aspects of the ED was the provision that would capitalize net rent associated with renewals. The intent of language in the ED was to capture the “most likely term of occupancy” that would include assessment of both the base contract term and renewals.

While the Boards are still grappling with the exact terminology, it appears now that lease renewals will only be capitalized if there is a clear economic incentive to do so on the part of the lessee. For example, renewals at a bargain rate would still be capitalized. This may force a lessee to choose between a heavier balance sheet presentation and better lease economics.

Another onerous component of the ED was also scrapped on Tuesday – the regular reassessment of the likely outcome at each reporting date. Only significant changes in the lessee and/or its business will require reassessment of the lease.

On one hand, these changes to the ED should simplify both the initial implementation of the new standard as well as the ongoing compliance. However, it means that a rules-based methodology will remain, and could have a material impact on how some companies approach leasing. Companies that make decisions that are heavily influenced by GAAP will have a bias toward shorter lease terms in order to minimize the impact of the new standard as now defined. This is striking in that it works against FASB’s objectives of moving to a principles-based approach to reduce the opportunity to manipulate the impact of leases on the balance sheet.

CAUTION – FASB and IASB still have to agree on final wording and guidance, making this a work in progress. Stay tuned!

**For more information contact:**

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