

NEW RULES FOR REAL ESTATE LEASES

New Rules - Topic #2

2019 Update



Financial Analysis & Advisory

Multinationals - "A Different World"

The Financial Accounting Standard Board's (FASB) joint-lease project to revamp financial reporting for leases concluded with the issuance of Topic 842, which recognizes leases on the balance sheet.

Unfortunately, FASB was not able to achieve a comprehensive coverage with the International Accounting Standard Board's (IASB) new lease standard. While FASB's Topic 842 is similar to IASB's IFRS 16, it incorporates different rules for lease obligation measurement and reporting.

The difference between the two rules is significant for any organization whose parent and subsidiary(ies) issue financial statements under both FASB and IASB standards. It is the reporting requirements of the entity that determine which standards apply, not the location of the leased property. Organizations with these dual reporting requirements will face the extra burden of dual reporting for some or all of their lease agreements.

The illustrations below reflect how the new standards will differ for leases that are currently categorized as operating leases under FASB and IASB rules.



DAY ONE

CALCULATION OF THE OPENING BALANCES WILL BE THE SAME GLOBALLY (FASB & IASB)

CASH PAYMENT	
DAY 1 OF EACH PERIOD	
	NNN RENT
Year 1	\$800,000
Year 2	\$824,000
Year 3	\$848,720
Year 4	\$874,182
Year 5	\$900,407
Year 6	\$927,419
Year 7	\$955,242
Year 8	\$983,899
Year 9	\$1,013,416
Year 10	\$1,043,819
TOTAL	\$9,171,103
ROU ASSET/ LIABILITY	\$6,818,420

The ROU asset and the lease liability opening balances are calculated from the base NNN rent (i.e. rent without services or base year).

The implicit rate of the lease (if available) or the incremental borrowing rate of the organization is applied to calculate the present value of the lease payments.

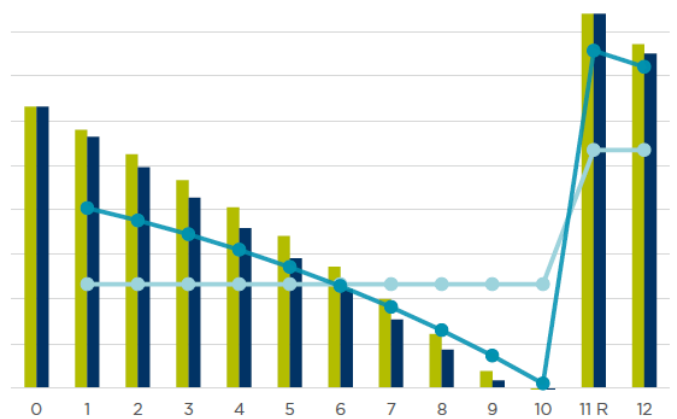
The present value of the cash flow is the opening asset and liability in this example.



DAY TWO

EXPENSE PATTERNS AND ASSET BALANCES DIVERGE

FASB | IASB COMPARISON
Ten Yr Lease with Renewal



The new rules for expensing leases differ by jurisdiction. Topic 842 applies a straight-line expense pattern consistent with operating lease treatment under the current ASC 840 (FAS 13). IFRS 16 IASB will follow an interest and amortization expense pattern for all leases, which front-loads expenses. This graph also depicts a renewal in year 11, which shows a dramatic impact on asset and expenses.

This divergence will impact transaction management, database administration and financial reporting systems for all multinationals with lease portfolios.

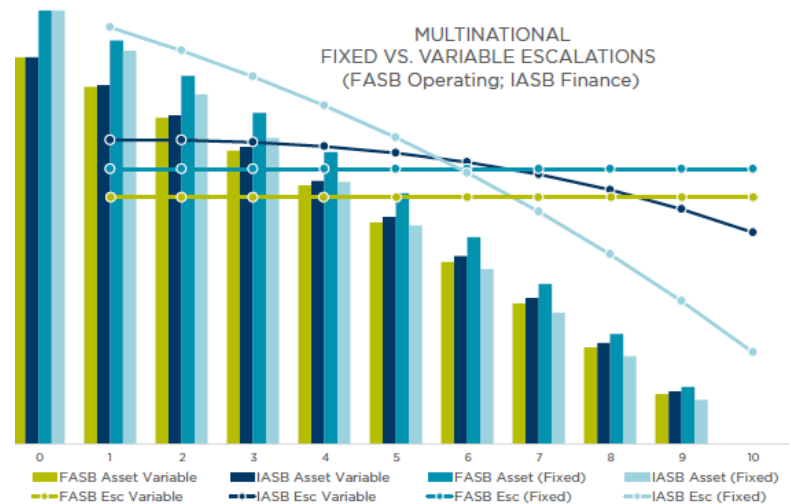
FASB (U.S. GAAP) versus IASB (All IFRS Based Countries)

CATEGORY	FASB	IASB
Expense Pattern	Straight Line (Former Operating Leases)	Interest / Amortization (All Leases)
Liability	Operating Liability (Unless Capital Lease)	Debt Liability
Small Lease	Leases ≤ 1 Year Exempt	Leases ≤ 1 Year or ≤ 5,000 USD
Variable Lease	No Re-Measurement of Obligation	Lease Re-Measurement Required
Re-Measurement Discount Rate	Only with Lease Change	At Event
Sale Leaseback	Profit Recognition at Sale	Profit Recognition Partial Deferral

Sample of Divergence:

VARIABLE VS FIXED RATE LEASE

This graph compares a lease which may be structured as a fixed or a variable rate lease negotiated for a multinational company. As you can see, there are a variety of potential reporting outcomes for the expense patterns and ROU asset balances carried for a similar lease obligation.



In Summary

The new lease standards for multinational companies will add complexity to lease portfolios and transactions.

1. Lease portfolios for some multinational companies may require databases and lease administration software that can accommodate both sets of rules
2. Budgeting for lease transactions may require both Topic 842 and IFRS 16 measurements for approval
3. Budgeting for jurisdictions with different annual expense patterns and reporting will be a challenge
4. ROU asset balances for individual leases will differ based on region reported
5. Lease administration must incorporate financial updates during lease term to re-measure variable lease payments, per IFRS 16.



Cushman & Wakefield's Financial Analysis & Advisory group will continue to prepare updates to assist our business partners with timely information related to commercial real estate.

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