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Post-Enron Accounting Rule Requires Companies to Report Leases

By **PETER EAVIS** FEB. 25, 2016

The Enron accounting scandal happened nearly 15 years ago, but the announcement on Thursday of a new accounting rule shows that its impact is still being felt in corporate America.

The Financial Accounting Standards Board, the body that sets accounting rules, has issued a final rule that changes how companies account for most of their leases.

Though leases are similar to loans, companies have long been permitted to exclude most leases from their balance sheets. As a result, investors looking at a company's financial statements may have struggled to calculate its true financial obligations. The new rule requires that the most common type of lease be included on a company's balance sheet, potentially giving investors a more accurate picture of a company's health.

Regulators started to consider a change in lease accounting after the collapse in 2001 of Enron, whose executives made the company look stronger than it was by keeping some of its financial obligations "off-balance sheet."

"This adds light to one of the remaining crevices of off-balance-sheet accounting," James L. Kroeker, vice chairman of the Financial Accounting Standards Board, said about the new rule.

The board estimates that the rule could add more than $1 trillion of obligations to the liabilities section of the balance sheets of public companies traded in the United States. That compares with $26 trillion of total liabilities for those companies, according to the board.

The increase in liabilities was one of the reasons companies criticized the rule. Using certain measurements that aim to assess a company's creditworthiness, the new leasing rule might make a business look more indebted. Lenders might then be less willing to extend credit to it.

"This standard can have a severe impact on the ability of businesses to go out and get debt," said Tom Quaadman, at the U.S. Chamber of Commerce's Center for Capital Markets Competitiveness.

Still, the lease obligations added to the balance sheet will be offset by corresponding assets. As a result, the rule will not erode a company's net worth, an important measure of financial strength. Also, when the obligations turn up on the balance sheet, there may be few big surprises. Companies already make disclosures about their lease obligations in the notes of their financial statements.

Bringing all the leases onto the balance sheet is expected to have benefits for investors. The rule further standardizes how leases are presented in financial statements — and perhaps subjects them to deeper scrutiny by auditors. The rule could make it easier for investors to compare the strength of several companies in one sector.

"The new guidance responds to requests from investors and other financial statement users for a more faithful representation of an organization's leasing activities," Russell G. Golden, chairman of the accounting standards board, said in a statement.

Under the new rule, companies must bring their "operating leases" onto their balance sheets. Operating leases give a company the right to use an asset, like a retail location in a mall, over time. Companies owe far more through operating leases than they do through capital leases, which are already accounted for on companies' balance sheets. Capital leases typically allow companies to gain ownership of the asset at the end of the lease. Leases of less than 12 months will not have to be included on the balance sheet.

The new leasing rule will not affect earnings. The way lease payments are reflected in the income statement will not change.

Industry lobbyists have asserted that adopting the rule on leases will create new costs for companies. But they also said that the accounting standards board had listened to companies' concerns.

"F.A.S.B. has been very receptive to hearing what the problems are," Mr. Quaadman said, referring to the board.

For most public companies, the rule will take effect in 2019, but companies may adopt it earlier.

Since Enron's collapse, the accounting standards board has taken other steps to prevent companies from hiding the true extent of their financial obligations. The board has, for example, introduced rules that aim to prevent companies from using special off-balance-sheet entities to obscure how much they really owe.

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