THE CAR AND TRUCK FLEET AND LEASING MANAGEMENT MAGAZINE

How Will New Lease Accounting Standards Affect Fleets?

March 01, 2017

New accounting standards for reporting lease transactions take effect after December 15, 2018 for public companies and December 2019 for private businesses. As a result, many organizations with fleets of vehicles are trying to figure out how these new rules will impact them moving forward. The Financial Accounting Standards Board (FASB) instituted the new rules in order to bring United States reporting practices in line with international standards and essentially provide more balance-sheet transparency by requiring companies to show how much money is committed to lease assets, which could include everything from vehicles to real estate.

The bottom line is that the "operational lease" ceases to exist in financial statement footnotes or anywhere else. Any lease with a term greater than 12 months will have to be reported on the balance sheet. The leased vehicles will be shown as "right-to-use" assets and lease payments as liabilities. It is a long time coming as the leasing standards have not been updated since first instituted 40 years ago, and the divergence between how United States companies report leased assets versus European accounting practices continues to complicate financial reporting for global organizations.

What does this mean for fleet managers?

Overall, the central issues are administrative. The new accounting requirements do not lessen the operating benefits of leasing which include reducing capital outlays and upfront costs, providing predictable cash flows, and reducing


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headaches caused by aging vehicles. The impact on fleet managers should be minimal, although it may be necessary for them to sit down with company accountants to figure out the lifecycles of the vehicles in use and the asset value assumptions based on that schedule, assuming an open-ended leasing structure typical of most U.S. companies. An interesting byproduct of the new rules may be that more managers consider the closed-end leasing options favored by European counterparts, although it may involve shopping around as not all North American fleet leasing companies offer them.

Asset valuations in open- versus closed-end leases

Because U.S. companies often prefer open-ended leasing with terms based on vehicle application and utilization, it can be more challenging to account for those assets. If you have vehicles rotating out on a regular basis, you will need to figure out how many will cycle based on utilization and then properly account for their asset values. This may be complicated when settling up after resale. If the vehicle sells for more than what was calculated in the agreement, then the client gets the difference. If it sells for less, the client has to reimburse the leasing company. Either way, those transactions will need to be figured into the reporting.

This may make closed-end leasing a more attractive option. With a closed-end lease, the term is set with monthly payments based on the estimated residual value of the asset at the end of the term. In essence, a fixed value is built in, so there is no guesswork in the reporting. Once the term is over, the vehicle is turned in and the leasing company assumes all the resale risk.


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An opportunity to synch with European operations

A significant benefit of the new leasing accounting standard, and one of the drivers for the change, is that organizations with a global footprint or that are owned by a European parent company will now be able to standardize their lease accounting, whether they both use the same type of leasing structure or not. The new FASB standards synch what had been two different financial reporting practices in which, most often, the North American organization considered leases an operating expense and the European side reported them as liabilities. Now, both will report leases based on the intent of the lease agreement – to use the equipment through its life expectancy, use it for a set period of time and turn it in for resale value, or use it for a set period with the leasing company assuming the resale risk.

The role of your fleet management company

Regardless of your lease structure, if you are using a fleet management company, that vendor should work with you to provide lifecycle valuations based on how vehicles are used and what the resale market should bear based on make and model year while also supporting the corporate accounting team with the transition to meet the new FASB requirements. And, with today's integrated telematics and fleet management systems, managers can get detailed reports with all the data they need to track these assets and ensure accurate reporting not only for proper accounting, but overall operating efficiency. These capabilities become more relevant as increased transparency may result in increased scrutiny, placing greater importance on the role of fleet managers and their outside partners as experts in controlling costs and optimizing fleet operations.

**This article is not meant to provide tax or accounting advice. Please check with a certified accounting professional for information regarding new lease categorization and reporting requirements.*