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How New Regs Impact Leasing, Revenue

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To lease or not to lease, that's the question these days. Add to that changes regarding calculating revenue.

Two accounting regulations changed recently, affecting leasing and revenue recognition. These aren't the hottest topics for headlines, but for businesses, the changes go right to the bottom line. And they are going to impact many industries, including food and beverage. Think of the changes as two sand traps. You can avoid problems, but if you're not careful, they can make life and business a lot tougher.

Let's start with revenue recognition rules, which require companies to analyze timing based on when revenue is realized in a financial statement. The new rules impact exactly how and when you record what you make. Sounds like a big deal? It is. This could impact costs such as vendor and customer rebates, slotting fees, promotions and discounts, which all enter significantly into a company's financial statements. Kraft Heinz recently understated the costs of goods it sold by $208 million, due to the way it booked rebates and costs related to suppliers. Getting revenue right isn't a detail, and you need to make sure you're calculating revenue under new rules.

The other new accounting regulation that came out has to do with leases. At least from the perspective of balance sheets, it's a big change. In the past, many leases were considered "off balance sheet," meaning they were expensed as you went along. The new regulation requires you to treat a lease as a right-to-use asset and a corresponding liability for the present value of all

future lease payments on the balance sheet. The main impact: Companies that lease will have a big, new liability on their books. This is going to leverage up a company's balance sheet for debt. This doesn't only apply to major leases, but to all leases from equipment to real estate.

Food and beverage and other retailers are going to (and already are starting to) be impacted. Most real estate leases escalate. Accounting GAAP requires you to straight line that lease over its full term. Companies that used to use off balance sheet financing through leasing had an advantage over companies that bought and paid for assets. To make an equal playing field, accounting regulators said if you lease or buy, you have to treat things the same way. Now that lease shows up on your books as debt. With taxes, you write off your lease as you pay it. The tax rules, which are different from the accounting rules, haven't changed.

Will the new leasing rules factor into decisions about whether to buy or lease? They could push more people to do a purchase, but it's hard to say whether the impact will take place. I think people would be more motivated to buy, because in the past leases would never show on your balance sheet, but that's only one factor among many. Fred's recently adopted the new standard to put leases on its balance sheet. It's in the process of closing 250 stores and laying off 155 workers. Did the new standards cause this? Let's just say, they probably didn't help.

While the accounting changes won't affect taxes, they could impact bank covenants. Many companies haven't prepared adequately for this. Bankers may have to rewrite the documents. All of these changes could turn into financial sand traps. With some planning, you can avoid the sand traps, even if they're out there. So yes, regulatory changes are sand traps on the green. But if you're up on your game, they're just part of the bigger picture. Knowing they're out there is the first step to avoid getting caught in them.

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