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The New Lease Standard: What Does It Mean for Your Institution?

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After much anticipation, in November 2015, the FASB announced the tentative effective date of the accounting standard titled *Leases*, ASC Topic 842. The new standard is expected to be effective for public business entities for fiscal years beginning after Dec. 15, 2018, including interim periods within those years. The standard is expected to be effective for non-public business entities for fiscal years beginning after Dec. 15, 2019. Early adoption of the standard will be permitted.

Financial institutions will be significantly impacted by the leases standard, as not only do they enter into leases as part of their business (branches, operations and headquarters facilities), but many loan agreements with customers have covenants based on certain balance sheet ratios, which may be significantly affected by the proposed standard.

Since early adoption is permitted, it is likely that banks will be immediately affected by the new leasing standard, either through their own leasing activities or through their customers. Accordingly, bank management should begin to consider the following areas in planning for implementation of the standard:

- Monitor internal control systems – particularly for banks required to maintain internal control environments under FDICIA and Sarbanes-Oxley (SOX).
- Create an inventory of leases and their key terms.
- Determine initial classification

- Evaluate whether the balance sheet impact of leases would put the bank over a key asset size threshold (e.g., \$500 million, \$1 billion or \$10 billion), which would trigger additional regulatory requirements.
- Analyze impact on financial covenants with customers – particularly balance sheet covenants such as debt-to-equity ratios and debt service coverage (DSC) ratios.
- Train loan officers on the likely impact to their customers, including effect on existing debt covenants.
- Determine the impact on regulatory capital ratios due to grossing up of the balance sheet/change in risk weighted assets.

Financial institutions that consider these steps should be well prepared for the start date of the new leases standard.

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