

Lease accounting

A board of directors must include a natural person

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To lease or to buy?

The Financial Accounting Standards Board and the International Accounting Standards Board recently issued a joint discussion paper that has significant implications for how companies account for leases.

The primary objective of the proposed rule is that all assets and liabilities arising from leased assets are recorded on the balance sheet, effectively eliminating off-balance sheet accounting for operating leases. This will result in significant increased liabilities on the typical corporate balance sheet which in turn could have a knock-on effect on key performance indicators such as asset turnover ratios, return on capital, and debt-to-equity ratios. This may further impact borrowing capacity or compliance with loan covenants.

The proposed rule could have a significant impact on the property sector.

With property having a balance sheet liability, companies will need to consider more carefully how to manage and reduce that liability. As a major cost for many businesses, property will become a much more strategic business issue; businesses may prefer to own rather than lease.

The proposed rule will also add to the pressure for shorter lease lengths. Companies will also need to consider whether they want more break clauses in property leases to create flexibility in their balance sheet.

It may also impact on the lending capacity of banks – which are significant lessees and lessors – if they have to report higher liabilities.

The comment period will end on 15 December 2010, with the final standard expected to be published in June 2011. The effective date of the new leasing standard is, however, still uncertain.

Board composition: only corporate directors no longer sufficient

As from 1 October 2010, all companies (including dormant companies) must have at least one natural director, i.e. a natural person rather than a company or other legal entity.

This requirement under section 155 Companies Act 2006 (the "Act") took effect from 1 October 2008 but transitional provisions applied to companies who did not have a natural person as a director but did have the requisite number of directors on 8 November 2006 (when the Act received royal assent). Such companies were granted a period of grace until 1 October 2010. Therefore, any company still relying on these transitional provisions must appoint at least one new director who is a natural person by the deadline of 1 October this year.

The Secretary of State may issue a defaulting company with a direction to comply, and failure to comply may result in fines of up to £5,000 for both the company and directors in default, with the possibility of additional daily default fines being issued.