A restaurant case study of lease accounting impacts of proposed changes in lease accounting rules

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Abstract

Purpose

New lease accounting rules are proposed that will fundamentally change the way leases are accounted for and reported in financial statements. This paper seeks to provide information on the proposed new rules and to illustrate their impact on financial statements and financial ratios using a single restaurant company.

Design/methodology/approach

The case of a single restaurant company, CEC International, is used to illustrate the potential impact of the new rules. Additional examples are used to illustrate the impact on financial policies. Financial statements were adjusted and various financial ratios such as interest coverage, leverage and profitability ratios were computed before and after capitalization.

Findings

The results show that financial statements presented will change dramatically when lease assets and liabilities are added to the balance-sheet. The expense recognition pattern will change significantly and negatively impact performance measures such as interest coverage and capital ratios but improve cash flow measures such as EBIT and EBITDA.

Practical implications

All restaurant companies and managers must assess the costs and benefits of complying with the proposed new rules and start analyzing and evaluating their impact on existing debt agreements, executive compensation plans, and the lease versus buy decision.

Originality/value

This paper serves to inform restaurant managers about the potential implications of the new rules, so managers can prepare, plan and formulate strategies to mitigate their impact.

Keywords

Leasing | Financial ratios | Restaurant industry | Regulation | Accounting

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