

Does the new lease standard, ASC 842, result in an increased risk of bankruptcy for mall-based retail stores?

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ABSTRACT

This paper examines whether *ASU 2016-02, Leases (Topic 842)* results in an increased risk of bankruptcy for traditional, mall-based retail establishments. The new leasing standard requires that lessees gross-up their balance sheets by recognizing assets and liabilities for leases that were originally considered off-balance sheet and operational in nature. Our expectation is that the inclusion of off-balance sheet financing will increase the likelihood of bankruptcy because of increased financial risk. To test our assumption, we compare Altman Z-scores computed on actual, reported results to derived, pro forma results which were modified for the inclusion of the leasing standard for 40 merchants for the fiscal period 2009 - 2018. Our results confirm our expectations, suggesting that the lease standard magnifies bankruptcy risk. As such, by examining the impact of the new lease standard through the lens of bankruptcy, our results clarify the implication of moving off-balance sheet financing onto the balance sheet for retailers that are most susceptible to the “retail apocalypse.”

Keywords: ASU 2016-02, Leases, Topic 842, Bankruptcy, Altman Z, Retail