# Leases (ASC 842)


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## What should we do?

- Understand the changes to current GAAP.
- Understand the transition requirements and determine how your company will adopt the new standard.
- Find resources to help train your professional staff to ensure effective and efficient implementation.
- Educate users and other stakeholders about the changes they can expect in your company's financial statements.

# Lease Accounting

### Accounting Standards Update 2016-02 (ASU 2016-02)

Leasing is utilized by many entities as a way to gain access to assets, obtaining financing and/or reducing an entity's exposure to the full risks of asset ownership. Before the issuance of ASU 2016-02 lessees were required to classify leases as either capital or operating leases. With capital leases, lessees recognized assets and capital lease obligations and recognized expenses associated with capital leases by amortizing the leased asset and recognizing interest expense on the capital lease obligation. With operating leases, lessees would not recognize assets and lease obligations on their balance sheet, but would recognize the lease payments on a straight-line basis over the life of the lease.

Some criticized the previous lease guidance related to the accounting for operating leases in the financial statements of lessees, which was the main focus of the Financial Accounting Standards Board (FASB) in issuing the ASU. Fundamentally, lessor accounting for leases did not change, however some revisions were made to conform to align with the lessee guidance.

# Learning and Implementation Plan

### PREPARING YOUR COMPANY FOR THE CHANGE

**How Ready Are You for New Lease Accounting Standards?**

Public business entities (including not-for-profit entities that has issued, or is a conduit bond obligor for) are required to adopt the standard for fiscal years beginning after December 15, 2018, including interim periods within those fical years. That means an effective date of January 1, 2019 for public entities with a December 31 year end. Nonpublic entities have an additional year to adopt. All entities may elect to early –adopt.

In transition, lessees and lessors are required to recognize and measure leases at the beginning of the earliest period presented using a modified retrospective approach. This approach has a number of optional practical expedients that relate to the identification and classification of leases that commenced before the effective date, initial direct costs for leases that commenced before the effective date, and the ability to use hindsight in evaluating lessee options to extend or terminate a lease or purchase the underlying asset.

STEP 1

Assign company staff to form a task force to become experts and take the lead on understanding the new leases standard. Input may be needed from finance, accounting and legal.

STEP 2

Update lease inventories and decide on transition method. Inventory all leases for the company and decide on whether or not to elect optional practical expedients for applying the modified retrospective approach.

STEP 3

Review legal agreements and debt covenants. Changes to the balance sheet may affect contractual agreements or debt covenants. Companies should work with lenders through the normal course of business to amend

STEP 4

Discuss with stakeholders. Recognizing ROU assets and liabilities can have a significant effect on the balance sheet. Having early discussions with stakeholders may ease the transition



An entity that elects to apply the practical expedients will, in effect, continue to account for leases that commence before the effective date in accordance with previous GAAP unless the lease is modified, except leases that are required to recognize a right-to use (ROU) asset and a lease liability for all operating leases at each reporting minimum lease payments that were tracked and disclosed under previous GAAP.

There is also specific guidance for sale and leaseback transactions, build-to-suit leases, leveraged leases, and amounts previously recognized in accordance with business combinations guidance for leases.

Is your organization still determining how to start transitioning to the new lease accounting standards? The experienced CPAs at N&K can help you navigate the new accounting rules and other accounting issues that you may have.

## How can we help?

N&K's professionals can assist your organization on your implementation of ASU 2016-02. We can assist your organization with establishing your implementation plan, meeting with stakeholders, lenders, and other financial personnel to discuss the impact of ASU 2016-02. Our professional staff can provide training sessions for your accounting personnel and your organization's implementation task force regarding the lease transition considerations.

- Training sessions for key personnel and stakeholders
- Review potential financial statement impact of lease standards to ratios and other key indicators
- Assistance with transitional guidance options
- Review current lease agreements for proper accounting treatment

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