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Lease Accounting Made Easy

Using Technology to Manage Leases In House

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Marie Calabrese, CPA

- Accounting principal at Gross Mendelsohn
- Specializes in construction, architects and engineers
- Heads up the firm's lease standard team

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Caleb Christensen, Technical Accountant

- CPA Firm Partnerships Manager at Netgain
- Former auditor and accounting consultant
- Responsible for system training, and technical accounting consulting

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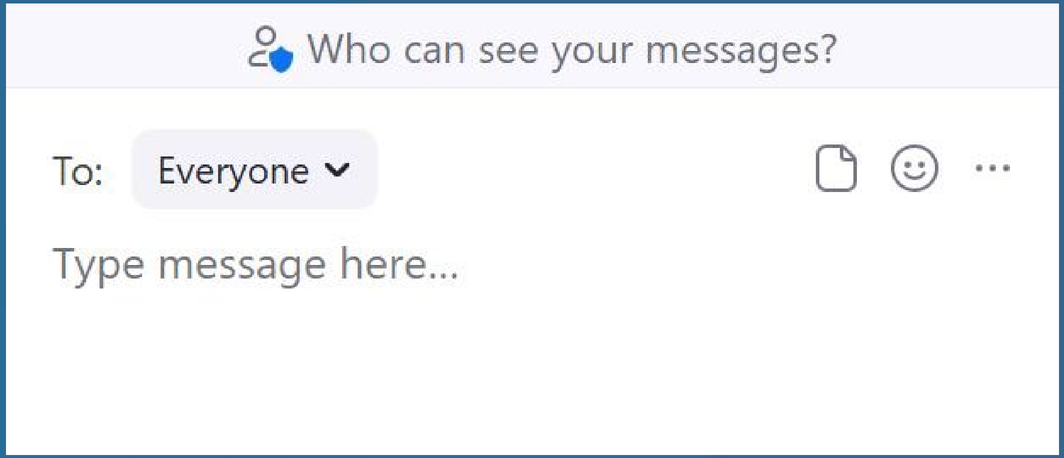
Quick Housekeeping

After the webinar, you will receive:

- Link to Gross Mendelsohn's new lease standard resource center
- Webinar recording
- Slides

Questions?
Use the Zoom chat box.

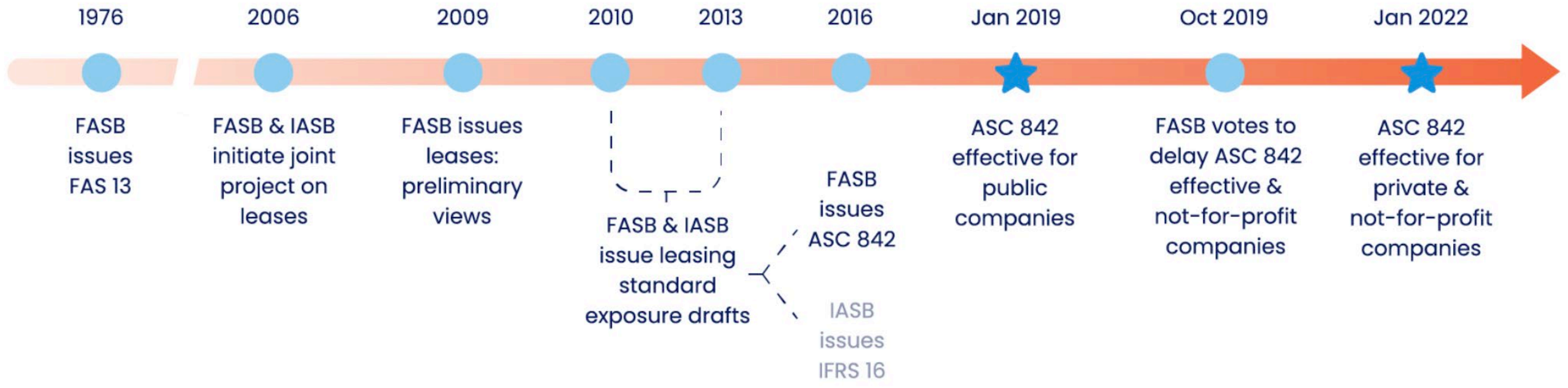


History & effective dates

FASB Privately-held entities: Reporting periods beginning after December 15, 2021

GASB 87: Reporting periods beginning after June 15, 2021

ASC 842 Timeline & effective date



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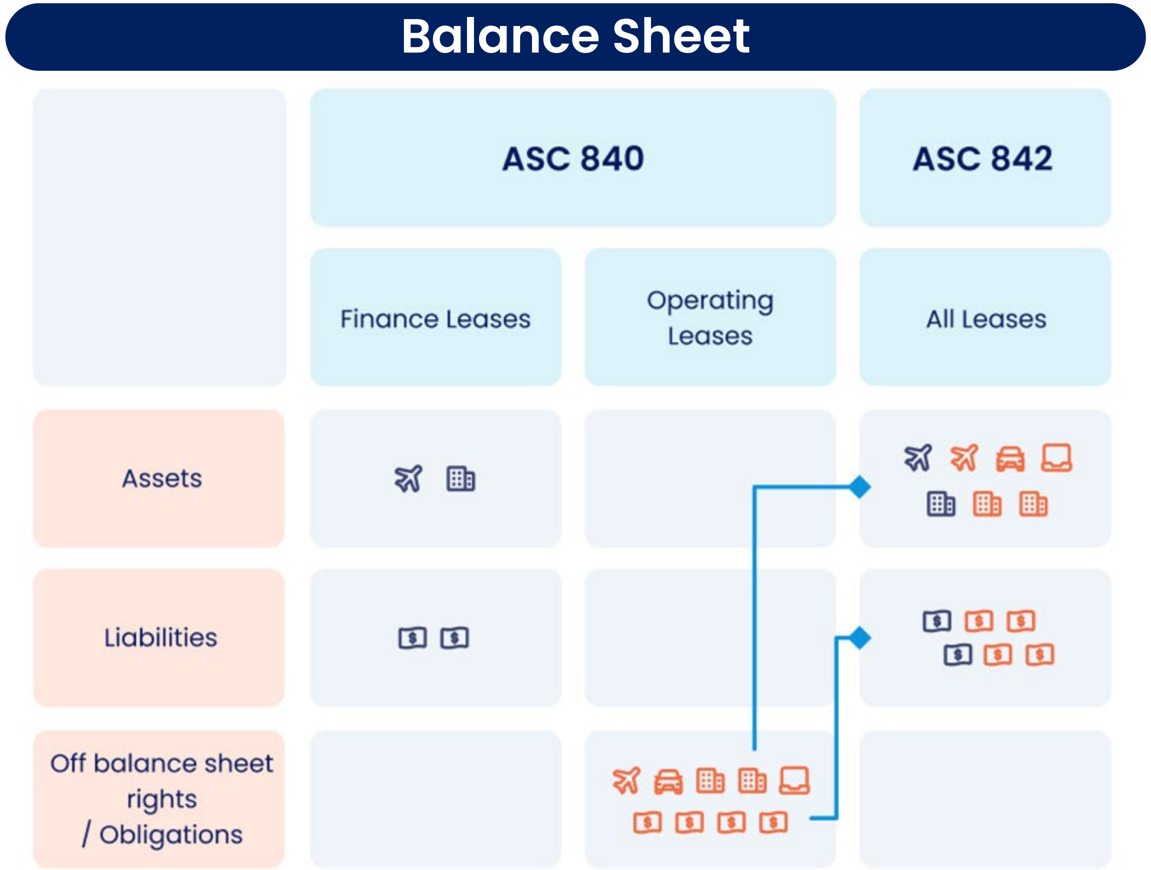
What changed?

Under ASC 840, only capital leases were captured on the balance sheet, while operating leases were off-balance sheet and reflected only in the P&L. Leases were classified based on strict guidelines, called “bright lines.” This classification system gave companies the ability to generate lease agreements so that they would qualify as an operating lease, when, in substance, they more closely resembled a capital lease, and therefore remained off the balance sheet.

Now, under ASC 842 virtually all leases must be reflected on the balance sheet. At the time the lease is commenced, a new “right of use” (ROU) asset account is introduced for all lease types, and a “lease liability” is recorded. The biggest impact of this change is on operating leases.

The P&L (no change): For the presentation of operating and finance leases on the income statement, the FASB elected to maintain a distinction between operating and finance leases. In the case of operating leases, an operating cost expense is recorded and included in EBITDA. For financing leases, depreciation and interest expenses are recorded below EBITDA.



More accounting is required

Under the old standard, a fixed-payment operating lease was simple, and monthly entries were all the same:

ASC 840

Lease Scenario

- 3 year fleet vehicle lease
- $500/Month
- $0 Down payment
- Operating lease

Initial & Monthly Entries			
	DEBIT:	Vehicle expense	$500
	CREDIT:	Accounts Payable	$500

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More accounting is required

Under the new standard, there's an initial journal entry and subsequent journal entries that change each month:

Initial Journal Entry: When the lease is commenced, a lease liability is recorded, which is equal to the present value of all future lease payments. A right of use asset is recorded for the same amount and adjusted for initial direct costs, prepayments, or incentives.

Subsequent Journal Entries: Accounting for operating leases is a new concept to understand. Lease expenses must still be recorded on a straight-line basis, and the liability is brought down using the effective interest method. The imbalance between decreasing interest accretion and a constant expense requires companies to "plug" their monthly draw-down of their ROU asset via accumulated amortization. The plug amount will typically increase over the lease term, as shown in the example.

ASC 842

Lease Scenario

- 3 year fleet vehicle lease
- $500/Month
- $0 Down payment
- Operating lease under ASC 842

Initial Entry	DEBIT:	Right of use asset	$16,683
	CREDIT:	Lease liability	$16,683
Month 1 Entry	DEBIT:	Lease vehicle expense	$500
	DEBIT:	Lease liability	$430
	CREDIT:	ROU accum. amort.	$430
	CREDIT:	Accounts Payable	$500
Month 2 Entry (changes each subsequent month)	DEBIT:	Lease vehicle expense	$500
	DEBIT:	Lease liability	$432
	CREDIT:	ROU accum. amort.	$432
	CREDIT:	Accounts Payable	$500

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Lease classifications

Operating: Lessee will recognize lease expense on a straight-line basis over the term of the lease. A right-of-use asset and a lease liability (both discounted by the relevant discount rate) will be established on the balance sheet at commencement and reduced throughout the life of the lease.

Financing: Lessee will recognize interest expense and amortization expense over the term of the lease. A right-of-use asset and a lease liability (both discounted by the relevant discount rate) will be established on the balance sheet at commencement and reduced throughout the life of the lease.

Short-Term: Lessee will recognize expense on a straight-line basis over the term of the lease (less than 12 months). No balance sheet impact.

Low Value: Lessee will recognize expense on a straight-line basis over the term of the lease. No balance sheet impact. Leases are immaterial individually and in aggregate.

Transition Methods

Effective:

- Apply the new standard from the transition date forward. Comparative periods in the financial statements are still presented under ASC 840. ***Highly recommended.***

Comparative:

- Apply the new standard for all comparative periods presented in the financial statements. This means that clients will have to retroactively account under ASC 842 rules.

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NetLease Demo

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