



The New Lease Accounting Standard

What You Need to Know

Webinar begins at 11:00 am



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Effective Date: Years **BEGINNING** after 12/15/21

Calendar year businesses and nonprofits will see changes to their financial statements for the year ended December 31, 2022

Fiscal year businesses and nonprofits will see changes to their financial statements in 2023

Who Will Be Impacted by the New Lease Standard?

Determining Whether a Lease Exists Under ASC 842

Initial Measurement of the Lease Liability

Initial Measurement of the ROU Asset

Sample Financial Statements

Operating Lease Example Calculations and Journal Entries

Example #1

- A lessee leases a piece of equipment
- The lease term is 5 years
- Lease payments are fixed at \$50,000 and are due annually at the beginning of each year
- Lessee incurs \$5,000 of initial direct costs and receives \$3,000 cash lease incentive from the lessor at the lease commencement date
- The lessee will use their 6% incremental borrowing rate as the discount rate to calculate the lease liability

Example #1 Cont.

- Initially, lease liability is \$223,255, which is the present value of the \$50,000 annual payments over 5 years, discounted at 6%
- The ROU asset is $\$225,255 = \$223,255$ lease liability less the \$3,000 cash incentive + the \$5,000 initial direct costs

Example #1 Cont.

Initial journal entry to record lease:

Debit ROU \$225,255

Credit lease liability <\$223,255>

Credit cash <\$2,000>

**(\$5,000 paid for direct costs less \$3,000 received for incentive)*

Example #2

- A lessee leases a piece of equipment
- The lease term is 3 years
- Lease payments are **\$100,000 for year 1, \$110,000 for year 2, \$125,000 for year 3** and are due annually at the end of each year
- The lessee will use their 5.51% incremental borrowing rate as the discount rate
- Initially lease liability is \$300,000—the present value of the annual payments over 3 years, discounted at 5.51%
- The ROU asset is \$300,000, which is the same as the lease liability since there were no incentives received, direct costs paid, etc.

Example #2 Cont.

Initial journal entry to record lease:

Debit ROU \$300,000
Credit lease liability <\$300,000>

The subsequent entries in Year 1 will be:

Debit lease expense \$111,667
Debit lease liability \$83,465

**(\$100,000 lease payment less \$16,535 interest component)*

Credit ROU <\$95,132>
Credit cash <\$100,000>

**(lease payment made in Year 1)*

Calculations—Example #2

- The total payments made over the 3-year period equal \$335,000
- For operating leases, a single lease expense is recognized on a straight-line basis over the lease term— $\$335,000/3 = \$111,667$
- The lessee should recognize \$111,667 in operating lease expense each year of the 3-year lease term

Calculations—Example #2 Cont.

	Year 1	Year 2	Year 3	Total	
Interest component	16,535	11,935	6,530	35,000	(\$300,00 lease liability x 5.51%)
Amortization expense	95,132	99,732	105,136	300,000	(difference between S/L lease expense and interest component)
Total lease expense	111,667	111,667	111,666	335,000	straight-line lease expense
Operating cash flows	100,000	110,000	125,000	335,000	

Calculations—Example #2 Cont.

	End of Year 1	End of Year 2	End of Year 3	
ROU asset	204,868	105,136	-	(ROU - amortization expense)
Lease liability	216,535	118,470	-	(lease liability balance - lease payment made + interest component)

More Journal Entries—Example #2

The subsequent entries in Year 2 will be:

Debit lease expense \$111,667

Debit lease liability \$98,065

**(\$110,000 lease payment less \$11,935 interest component)*

Credit ROU asset <\$99,732>

Credit cash <\$110,000>

**(lease payment made in Year 2)*

More Journal Entries – Example #2 Cont.

The subsequent entries in Year 3 (final year of lease) will be:

Debit lease expense \$111,666

Debit lease liability \$118,470

**(\$125,000 lease payment less \$6,530 interest component)*

Credit ROU asset <\$105,136>

Credit cash <\$125,000>

**(lease payment made in Year 3)*

Example #2 Cont.

If the lease in example 2 had been in existence for 1 year before the transition to ASC 842:

- The initial lease liability at the date of transition would be \$216,535 rather than \$300,000
- The liability would have been calculated based on the PV of the remaining future lease payments at the date of transition

Example #2 Cont.

Initial journal entry to record lease at the date of transition (1 year after commencement of lease):

Debit ROU \$216,535

Credit lease liability <\$216,535>

Transition Entries

Deferred rent balance and/or unamortized lease incentive liability balance through the right-of-use asset account should be removed at the time of transition if an entity has:

- A deferred rent asset
- Liability balance
- An unamortized lease incentive liability balance

Example #2—Finance Lease

If the lease in example 2 was a finance lease (*similar to legacy capital leases*), then the following calculations and journal entries would apply:

	Year 1	Year 2	Year 3	Total
Interest component	16,535	11,935	6,530	35,000
Amortization expense	100,000	100,000	100,000	300,000
Total lease expense	116,535	111,935	106,530	335,000
Operating cash flows	16,535	11,935	6,530	35,000
Financing cash flows	83,465	98,065	118,470	300,000
Total cash flows	100,000	110,000	125,000	335,000

Example #2—Finance Lease Cont.

	End of Year 1	End of Year 2	End of Year 3
ROU asset	200,000	100,000	-
Lease liability	216,535	118,470	-

Example #2—Finance Lease Cont.

Initial journal entry to record lease:

Debit ROU \$300,000

Credit lease liability <\$300,000>

The subsequent entries in Year 1 will be:

Debit interest expense \$16,535

Credit lease liability <\$16,535>

Debit amortization expense \$100,000

Credit ROU asset <\$100,000>

Debit lease liability \$100,000

Credit cash <\$100,000>

**(lease payment made in Year 1)*

Example #2—Finance Lease Cont.

The subsequent entries in Year 2 will be:

Debit interest expense	\$11,935	
Credit lease liability		<\$11,935>
Debit amortization expense	\$100,000	
Credit ROU asset		<\$100,000>
Debit lease liability	\$110,000	
Credit cash		<\$110,000>

**(lease payment made in Year 2)*

Example #2—Finance Lease Cont.

The subsequent entries in Year 3 will be:

Debit interest expense	\$6,530	
Credit lease liability		<\$6,530>
Debit amortization expense	\$100,000	
Credit ROU asset		<\$100,000>
Debit lease liability	\$125,000	
Credit cash		<\$125,000>

**(lease payment made in Year 3)*

Transition Methods

Modified Retrospective Method

Current-Period Adjustment Method

Practical Expedients

An entity may elect the following practical expedients when applied to leases that commenced before ASC 842's effective date:

- An entity need not reassess whether any expired or existing contracts are/or contain leases
- An entity need not reassess the lease classification for any expired or existing leases
- An entity need not reassess initial direct costs for any existing leases

Transition Disclosures

Disclosures

Lease costs

Other information

Weighted averages

Maturity analysis

Recording TI Allowances Under ASC 842

Related Party Leases