



## Lease accounting: What you need to know

September 15, 2020  
Webinar starts at noon CT



**Stephanie Roths**  
Manager  
Assurance services

Presented by  
**AGH**  
CPAs & ADVISORS



# Administration

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# Administration



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# Administration



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To ask questions during the presentation,  
use the questions box on the right side of your screen.





# Administration



Please provide your feedback  
at the end of today's presentation.



## **Stephanie Roths**

Manager  
Assurance Services

Specializes in financial institution, manufacturing and governmental audits

Experience with employee benefit plan auditing

Member of the AICPA and KSCPA



# Learning objectives

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Understand the requirements of the new standard

Learn how to apply the new standard to existing capital and operating leases

Learn how the new leasing standard will affect financial reporting for your organization



# ASC 842 overview

## Major changes:

- Balance sheet presentation for operating leases
  - Right of use asset
  - Lease liability
- “Finance lease” terminology
- Requirements for finance (capital) lease recognition
- Disclosure requirements

## Effective dates:

- Public Business Entities: Fiscal years beginning after December 15, 2018 (12/31/19 FYE)
- Private Companies: Fiscal years beginning after December 15, 2021 (12/31/22 FYE)

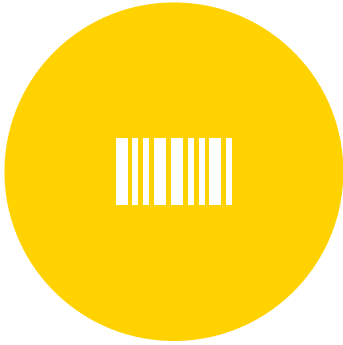
## Transition method:

- Modified retrospective approach
- Optional beginning RE adjustment
- Practical expedient for existing leases

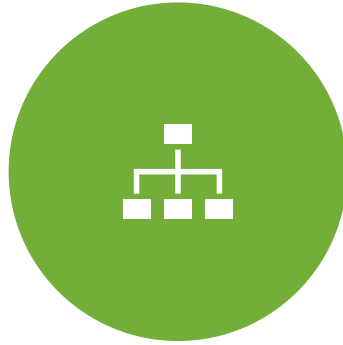
# **POLLING QUESTION #1**

Please answer for continuing education credit

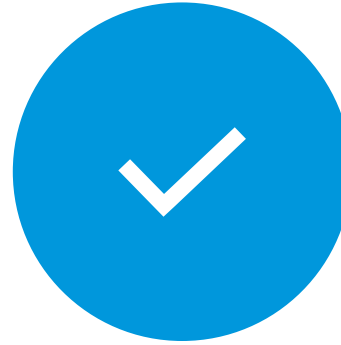
# Lease Recognition – Four Key Steps



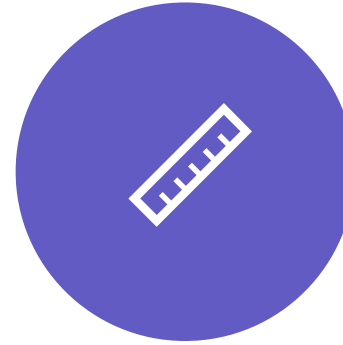
IDENTIFICATION



CLASSIFICATION

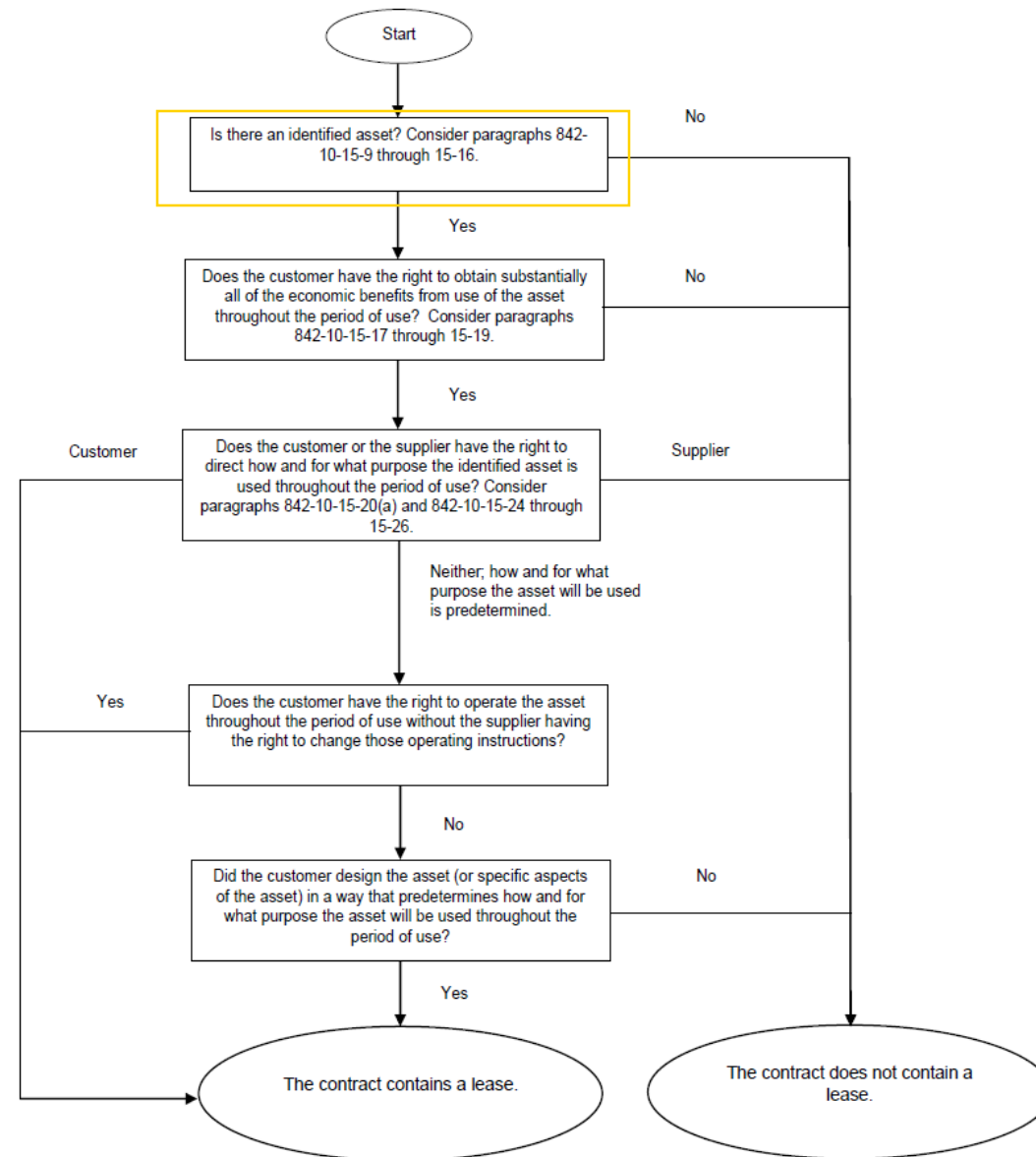
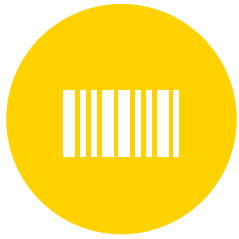


INITIAL  
MEASUREMENT

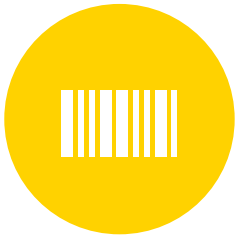


SUBSEQUENT  
MEASUREMENT

# Lease Identification

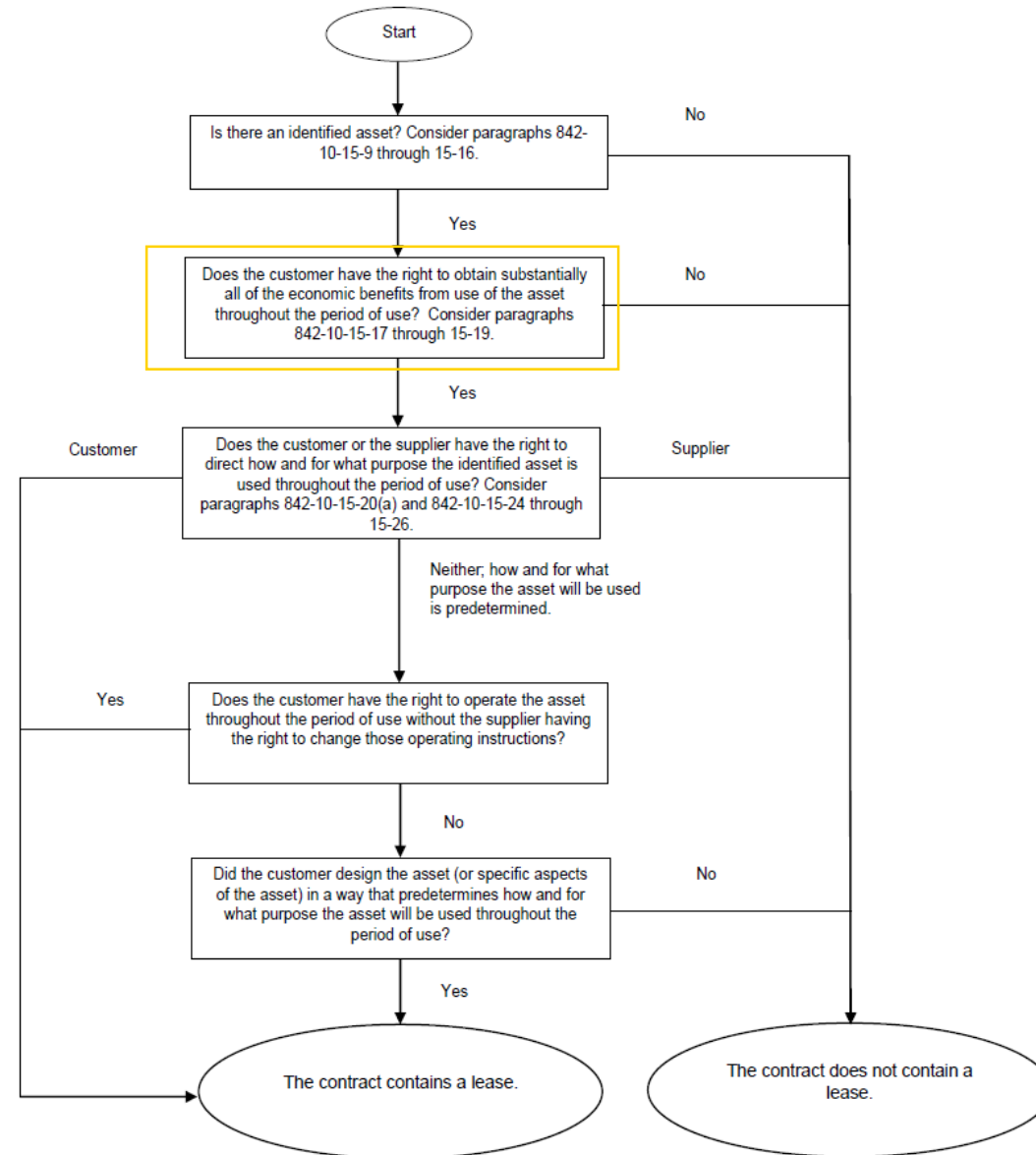
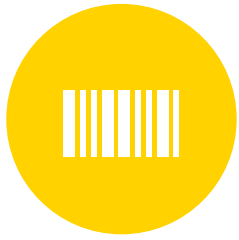


# Lease Identification – Identified Asset



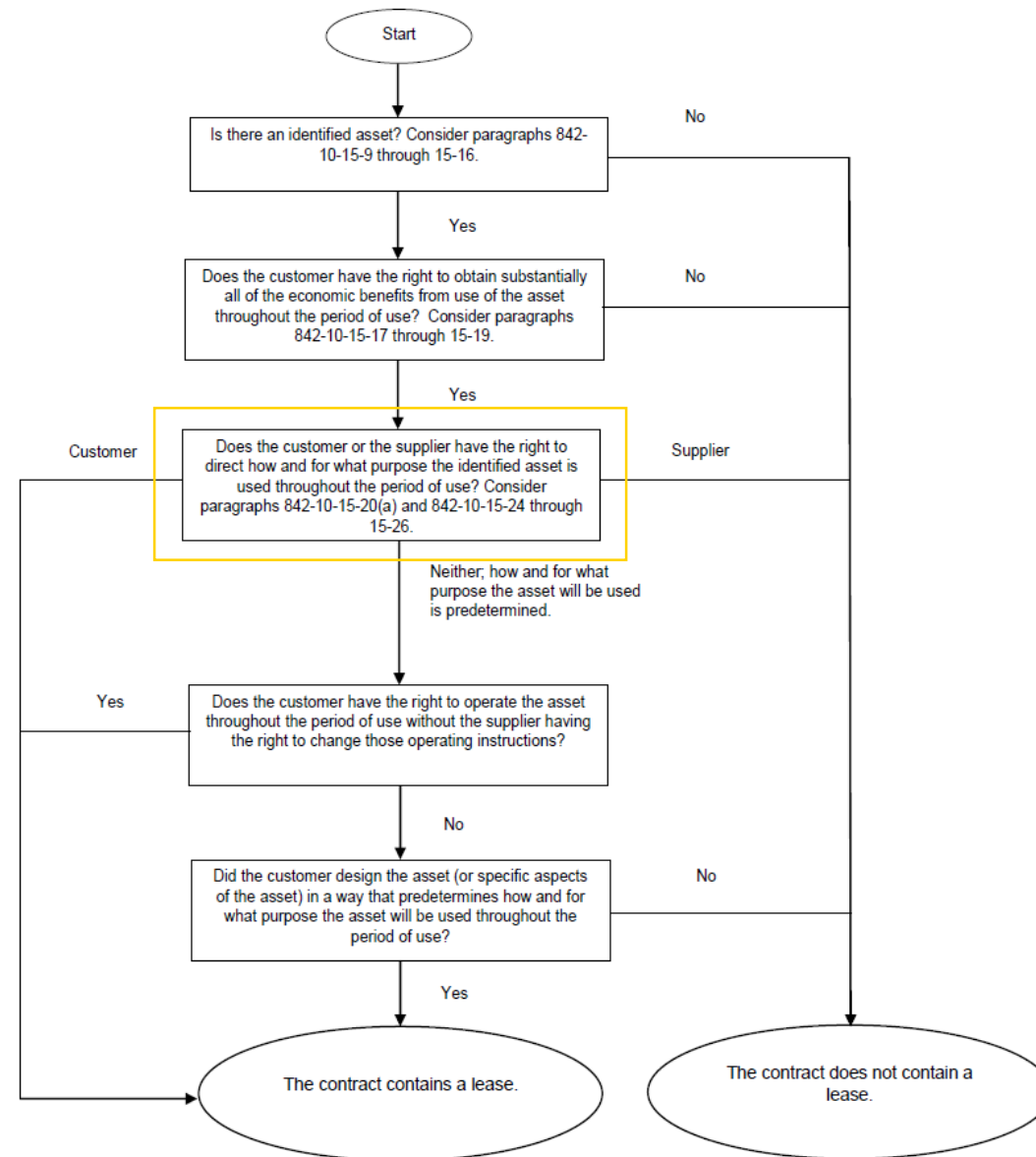
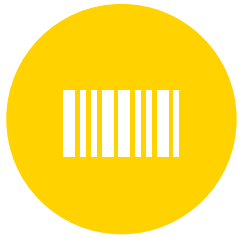
- Asset identification can be explicit or implicit
- Substantive substitution rights
  - Supplier has the practical ability to substitute alternative assets throughout the period of use
  - Supplier benefits economically from exercising substitution rights

# Lease Identification

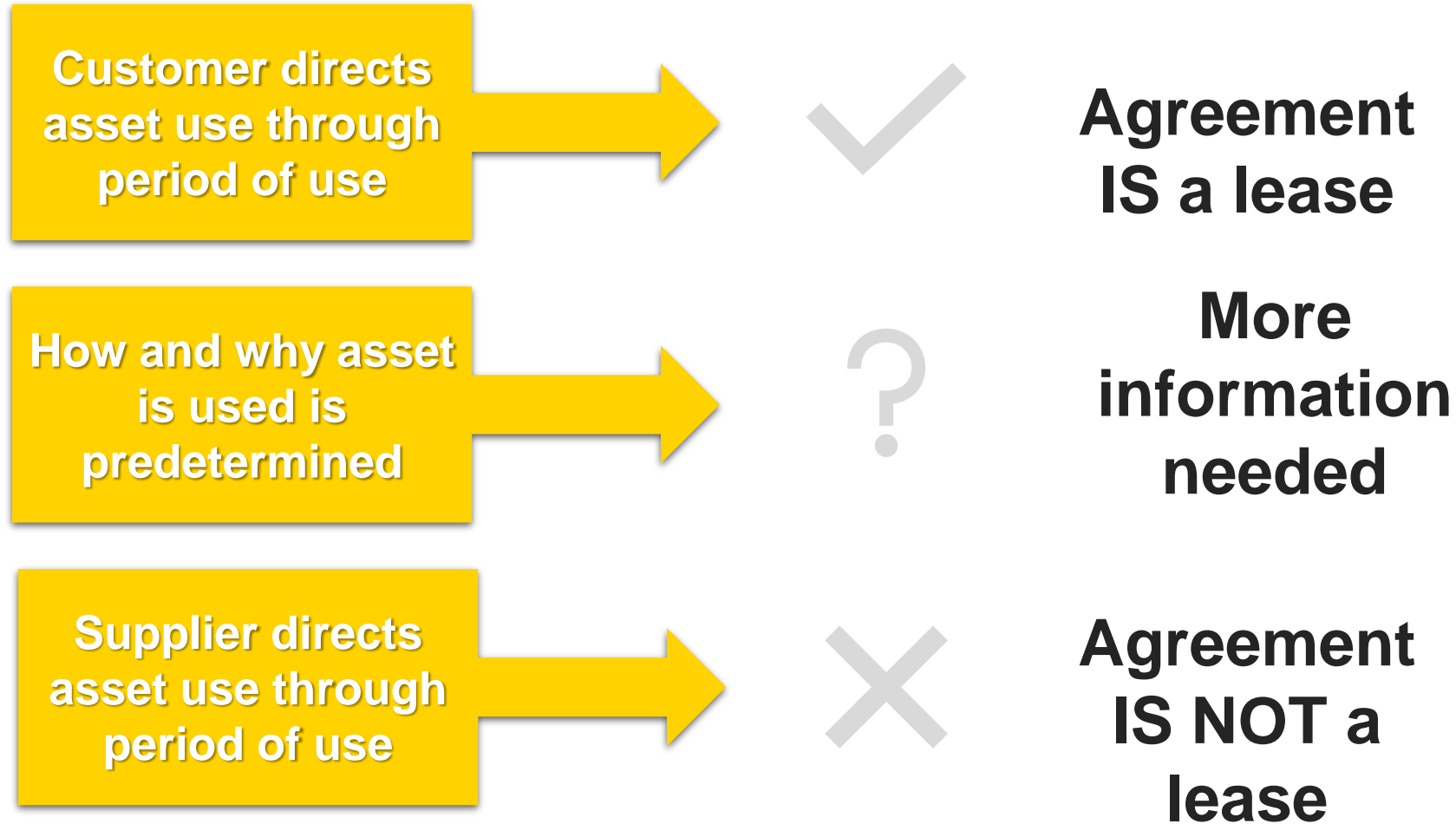
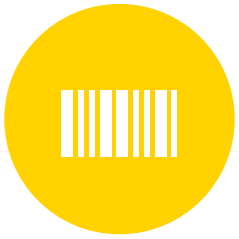




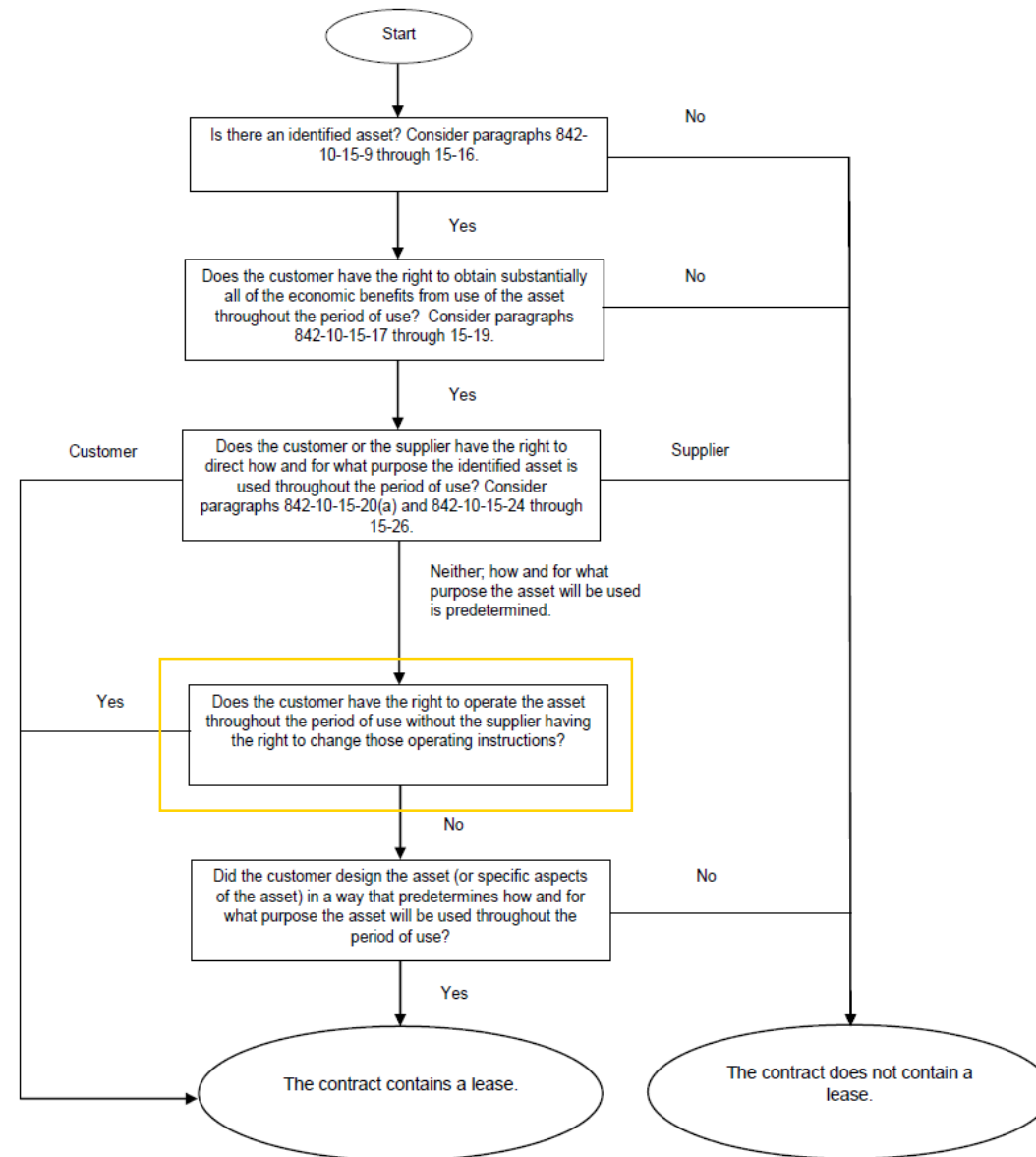
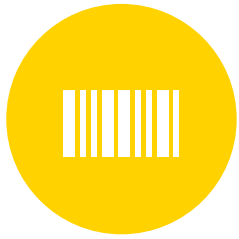
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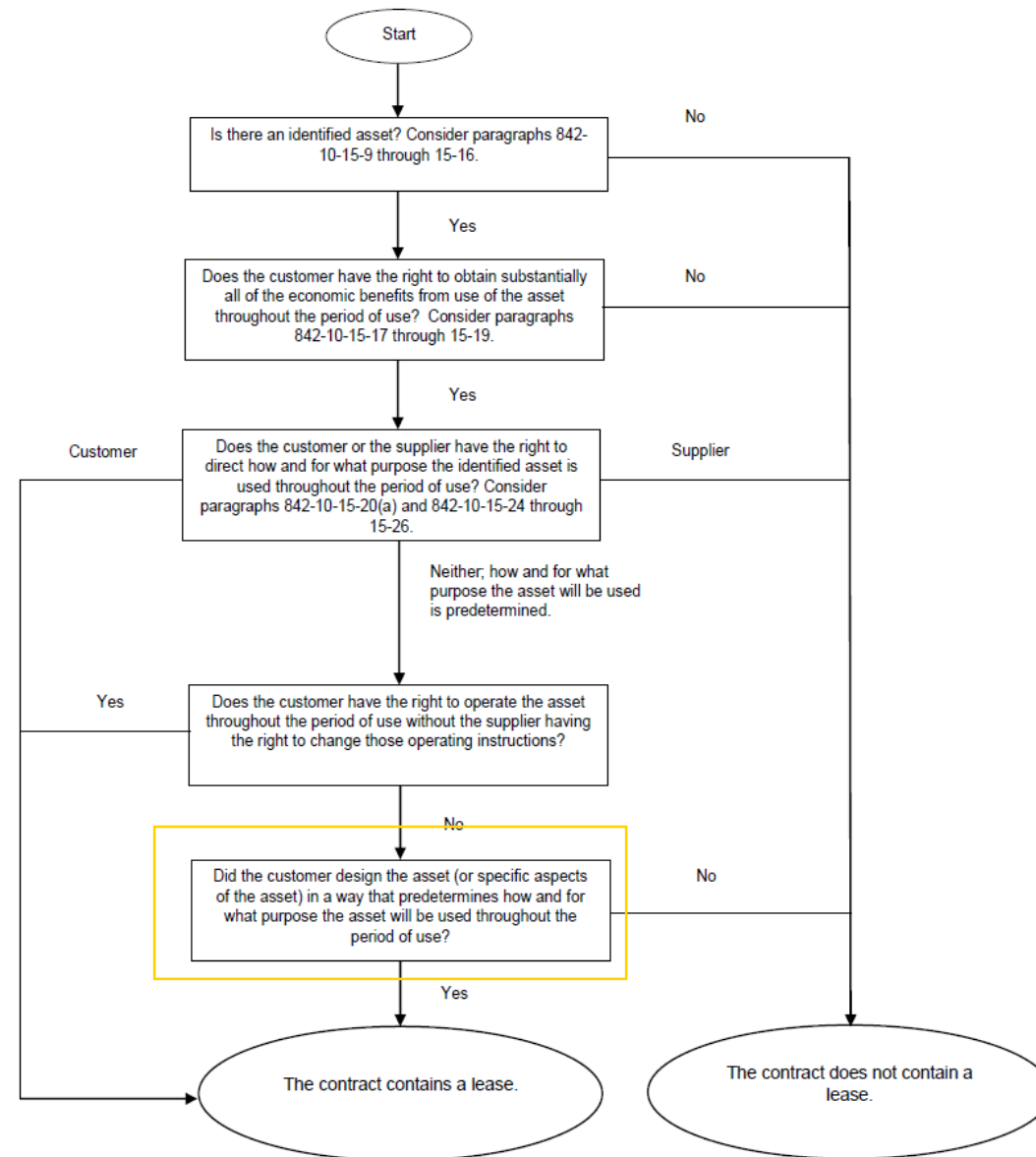
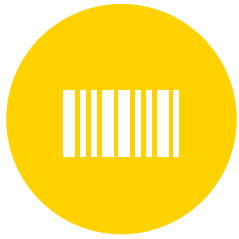
# Lease Identification – Direct Asset Use



# Lease Identification



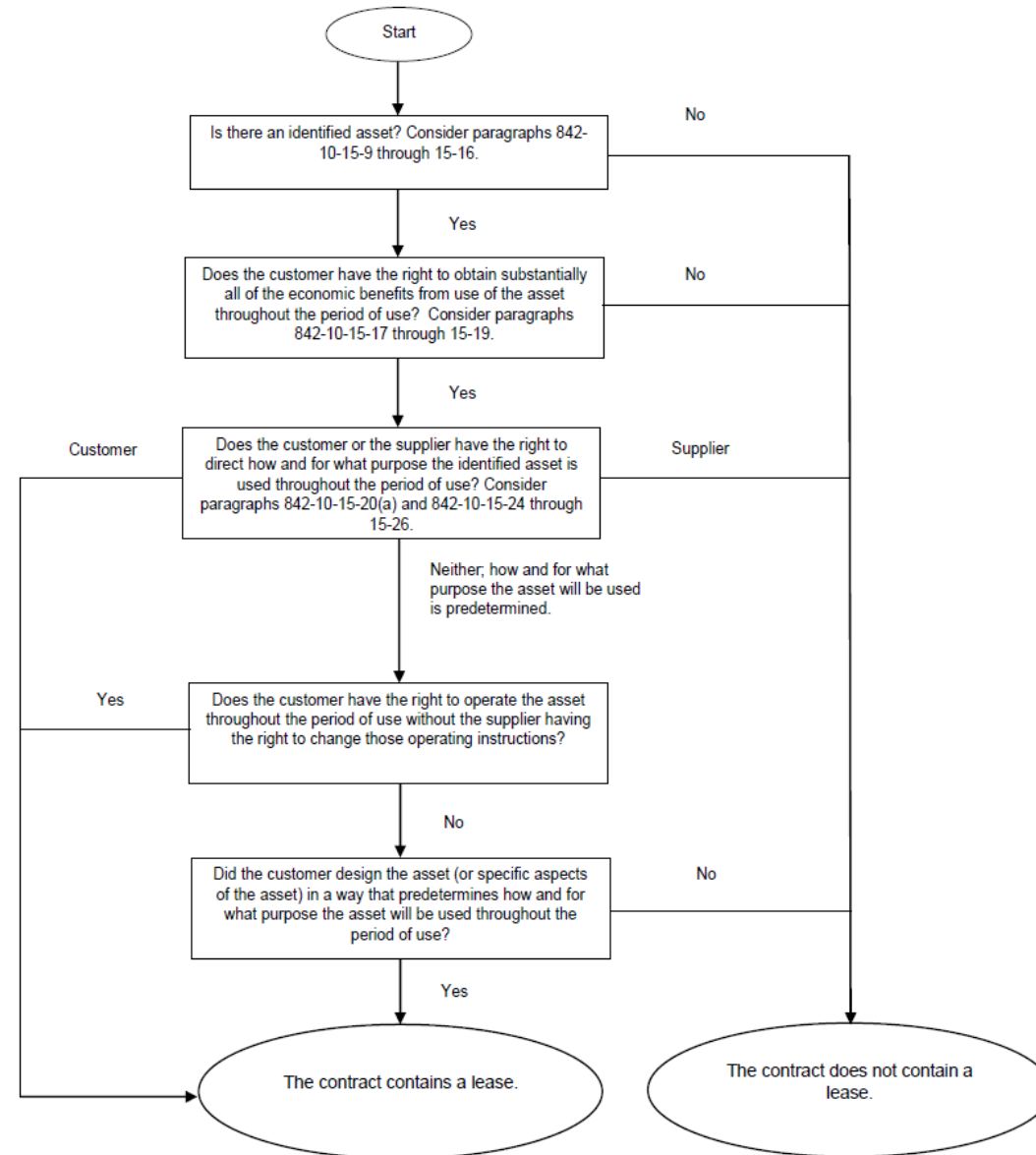
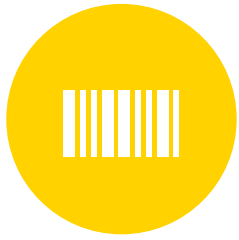
# Lease Identification



## POLLING QUESTION #2

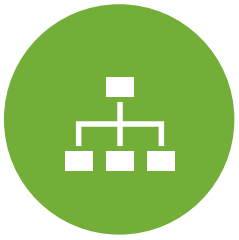
Please answer for continuing education credit

# Lease Identification





# Lease Classification



## Finance Lease

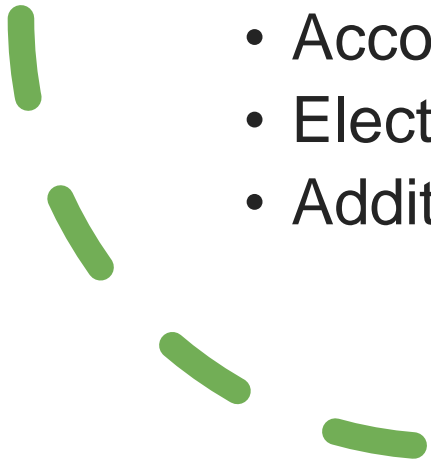
- Transfers ownership
- Purchase option that the lessee is reasonably certain to exercise
- Major part of economic life
- Substantially all fair value
- Specialized nature

## Operating Lease

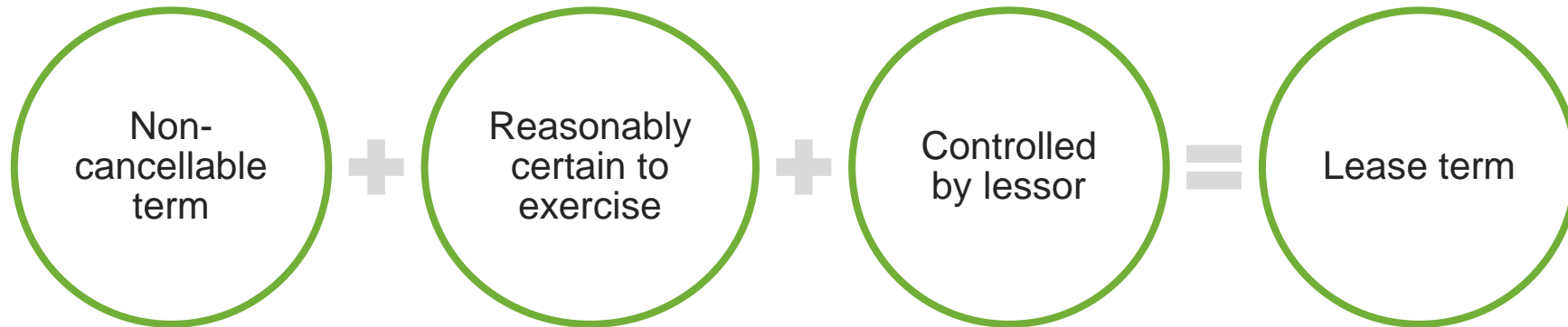
- Not a finance lease

# Lease vs. Nonlease Components

- Nonlease components
  - Maintenance services
  - Administrative tasks to initiate the lease
  - Reimbursement or payment of the lessor's costs
- Allocate consideration to lease and nonlease components
- Practical expedient
  - Accounting policy election NOT to separate
  - Election made by class of asset
  - Additional disclosures



# Initial Measurement – Lease Term



- Subsequent reassessment:
  - Lessee elects to exercise an option that they had previously determined they were not reasonably certain to exercise
  - Lessee elects to NOT exercise an option that they had previously determined they were reasonably certain to exercise

# Initial Measurement – Short Term Leases



- Short term lease – A lease that, at the commencement date, has a lease term of 12 months or less and does not include an option to purchase the underlying asset that the lessee is reasonably certain to exercise
- As an accounting policy, lessees may elect not to apply recognition requirements to short-term leases
- Accounting policy election is made by class of underlying asset to which the right of use relates

# Initial Measurement – Lease Liability



\* Only variable lease payments based on an index or rate are included here. Other variable payments are NOT included in the initial measurement of the lease liability.

\*\* Only if reasonably certain

\*\*\* Based on lease term determined at lease inception

# Initial Measurement – Lease Liability



Lessee enters a 10-year lease of an asset with an option to extend for an additional 5 years. Lease payments are \$50,000 per year during the initial term and \$55,000 per year during the optional period, all payable at the beginning of each year. Lessee incurs initial direct costs of \$15,000. At the commencement date, lessee concludes that it is not reasonably certain to exercise the option to extend the lease. The rate implicit in the lease is not readily determinable. Lessee's incremental borrowing rate is 5.87%.



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# Initial Measurement – Discount Rate



- If readily determinable – rate implicit in the lease
- If not readily determinable – the entity's incremental borrowing rate
- Non PBE's – Risk-free discount rate for a comparable lease is allowed

# Initial Measurement – Lease Liability



B2					
=NPV(B1,B7:B15)					
	A	B	C	D	
1	Rate	5.87%			
2	NPV	\$ 342,017			
3					
4	Period	Payment			
5	0	50,000			
6	1				
7	2	50,000			
8	3	50,000			
9	4	50,000			
10	5	50,000			
11	6	50,000			
12	7	50,000			
13	8	50,000			
14	9	50,000			
15	10	50,000			
16					



# Initial Measurement – Right of Use Asset

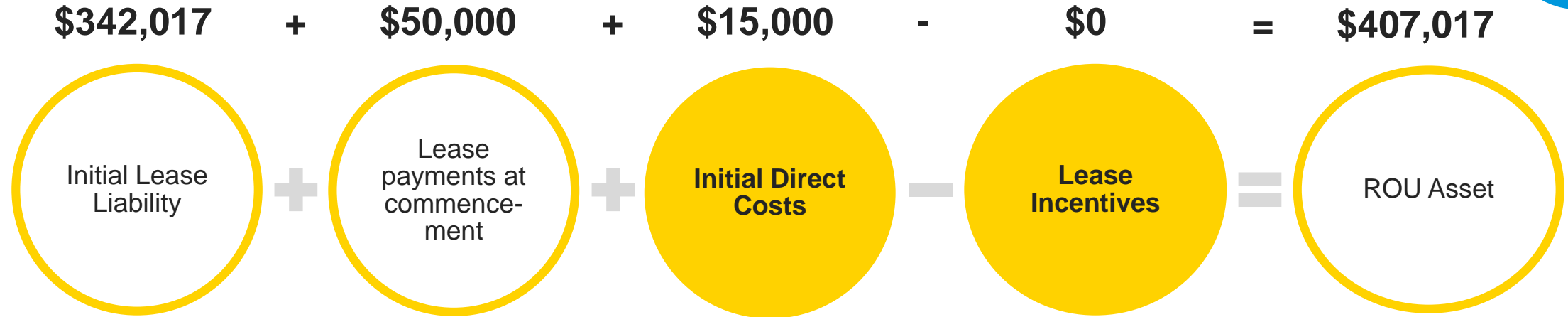


- Initial direct costs:
  - Incremental costs of a lease that would not have been incurred if the lease had not been obtained
  - Commissions
  - Incentives to existing lessee to terminate their lease
- Lease incentives:
  - Payments made to or on behalf of the lessee
  - Losses incurred by lessor to assume a lessee's pre-existing lease with a third party.

# POLLING QUESTION #3

Please answer for continuing education credit

# Initial Measurement – Right of Use Asset



Lessee enters a 10-year lease of an asset with an option to extend for an additional 5 years. Lease payments are \$50,000 per year during the initial term and \$55,000 per year during the optional period, all payable at the beginning of each year. **Lessee incurs initial direct costs of \$15,000.** At the commencement date, lessee concludes that it is not reasonably certain to exercise the option to extend the lease. The rate implicit in the lease is not readily determinable. Lessee's incremental borrowing rate is 5.87%.

# Initial Measurement



Date	Account	Debit	Credit
1/1/20X1	Right-of-use asset	407,017	
	Lease liability		342,017
	Cash (fixed payment)		50,000
	Cash (initial direct cost)		15,000
		407,017	407,017
To record right-of-use asset, the related lease liability, and cash transactions.			

# Subsequent Measurement



## Finance lease:

- Asset: Depreciated on straight line basis
- Liability: Increased for interest, reduced for payments
- Income statement: Amortization expense, interest expense

## Operating lease:

- Asset: Adjustment for lease liability +/- lease incentive and initial direct cost
- Liability: Increased for interest, reduced for payments
- Income statement: Lease expense

# Subsequent Measurement – Finance Leases



Period	Payment	Interest	Lease Liability	Amorti- zation	ROU Asset
0	50,000		342,017		407,017
1		20,076	362,093	40,702	366,315
2	50,000			40,702	
3	50,000			40,702	
4	50,000			40,702	
5	50,000			40,702	
6	50,000			40,702	
7	50,000			40,702	
8	50,000			40,702	
9	50,000			40,702	
10	50,000			40,702	

# Subsequent Measurement – Finance Leases



Date	Account	Debit	Credit
12/31/20X1	Amortization expense	40,702	
	Accumulated amortization		40,702
	Interest expense	20,076	
	Lease liability		20,076
		60,778	60,778
To record year 1 activity.			

# Subsequent Measurement – Finance Leases



Period	Payment	Interest	Lease Liability	Amorti- zation	ROU Asset
0	50,000		342,017		407,017
1		20,076	362,093	40,702	366,315
2	50,000	18,320	330,413	40,702	325,613
3	50,000			40,702	
4	50,000			40,702	
5	50,000			40,702	
6	50,000			40,702	
7	50,000			40,702	
8	50,000			40,702	
9	50,000			40,702	
10	50,000			40,702	



# Subsequent Measurement – Finance Leases



Date	Account	Debit	Credit
12/31/20X2	Amortization expense	40,702	
	Accumulated amortization		40,702
	Interest expense	18,320	
	Lease liability	31,680	
	Cash		50,000
		90,702	90,702
To record year 2 activity.			

# Subsequent Measurement – Finance Leases



Period	Payment	Interest	Lease Liability	Amortization	ROU Asset
0	50,000		342,017		407,017
1		20,076	362,093	40,702	366,315
2	50,000	18,320	330,413	40,702	325,613
3	50,000	16,460	296,873	40,702	284,911
4	50,000	14,491	261,364	40,702	244,209
5	50,000	12,407	223,771	40,702	203,507
6	50,000	10,200	183,971	40,702	162,805
7	50,000	7,864	141,835	40,702	122,103
8	50,000	5,391	97,226	40,702	81,401
9	50,000	2,774	50,000	40,702	40,702
10	50,000	--	--	40,702	--

# Subsequent Measurement – Operating Leases



Period	Payment	Interest	Lease Liability
0	50,000		342,017
1		20,076	362,093
2	50,000		
3	50,000		
4	50,000		
5	50,000		
6	50,000		
7	50,000		
8	50,000		
9	50,000		
10	50,000		

## Total Lease Cost

Total lease payments

Initial direct costs

Periodic lease costs  
recognized in prior  
periods

# Subsequent Measurement – Operating Leases



Period	Payment	Interest	Lease Liability	Adjust. to Asset	ROU Asset
0	50,000		342,017		407,017
1		20,076	362,093	31,424	375,593
2	50,000				
3	50,000				
4	50,000				
5	50,000				
6	50,000				
7	50,000				
8	50,000				
9	50,000				
10	50,000				

# Subsequent Measurement – Operating Leases



Date	Account	Debit	Credit
12/31/20X1	Lease expense	51,500	
	ROU asset		31,424
	Lease liability		20,076
		51,500	51,500
To record year 1 activity.			

# Subsequent Measurement – Operating Leases



Period	Payment	Interest	Lease Liability	Adjust. to Asset	ROU Asset
0	50,000		342,017		407,017
1		20,076	362,093	31,424	375,593
2	50,000	18,320	330,413	33,180	342,413
3	50,000				
4	50,000				
5	50,000				
6	50,000				
7	50,000				
8	50,000				
9	50,000				
10	50,000				

# Subsequent Measurement – Operating Leases



Date	Account	Debit	Credit
12/31/20X2	Lease expense	51,500	
	Cash		50,000
	ROU asset		33,180
	Lease liability	31,680	
		83,180	83,180
To record year 2 activity.			

# Subsequent Measurement – Operating Leases



Period	Payment	Interest	Lease Liability	Amortization	ROU Asset
0	50,000		342,017		407,017
1		20,076	362,093	31,424	375,593
2	50,000	18,320	330,413	33,180	342,413
3	50,000	16,460	296,873	35,040	307,373
4	50,000	14,491	261,364	37,009	270,364
5	50,000	12,407	223,771	39,093	231,271
6	50,000	10,200	183,971	41,300	189,971
7	50,000	7,864	141,835	43,636	146,335
8	50,000	5,391	97,226	46,109	100,226
9	50,000	2,774	50,000	48,726	51,500
10	50,000	--	--	51,500	--



# Subsequent Measurement – Operating Leases



Right of Use Assets under operating leases are measured as the value of the lease liability adjusted for:

Prepaid or accrued lease payments

Unamortized lease incentives

Unamortized initial direct costs

Impairment

# Subsequent Measurement – Operating Leases



Period	Amortization	ROU Asset	Lease Liability	Prepaid Rent	Unamort. IDC	ROU Asset
0		407,017	342,017	50,000	15,000	407,017
1	31,424	375,593	362,093	--	13,500	375,593
2	33,180	342,413	330,413	--	12,000	342,413
3	35,040	307,373	296,873	--	10,500	307,373
4	37,009	270,364	261,364	--	9,000	270,364
5	39,093	231,271	223,771	--	7,500	231,271
6	41,300	189,971	183,971	--	6,000	189,971
7	43,636	146,335	141,835	--	4,500	146,335
8	46,109	100,226	97,226	--	3,000	100,226
9	48,726	51,500	50,000	--	1,500	51,500
10	51,500	--	--	--	--	--

# Balance Sheet Presentation

For both right  
of use assets  
and lease  
liabilities:



Presented separately in  
either FS or notes



Cannot combine assets OR  
liabilities under operating  
and finance leases



Current vs. non-current

# Income Statement Presentation

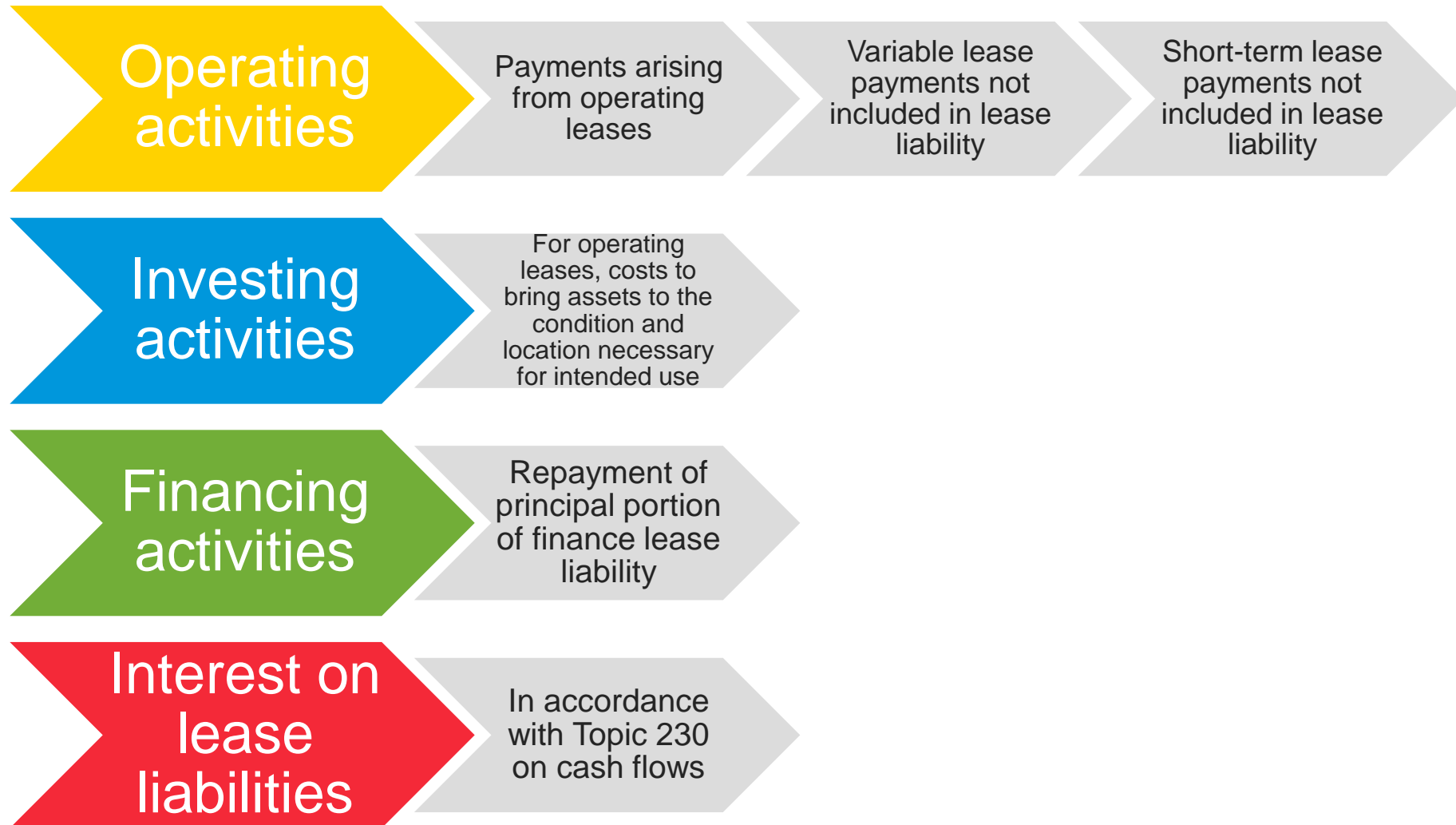
## Finance leases

- Interest expense and amortization expense
- Not required to be presented as separate line items
- Present consistently with other interest expense and amortization of similar assets

## Operating leases

- Lease expense
- Recognize as a component of continuing operations

# Cash Flow Statement Presentation



# Financial Statement Disclosures

Quantitative  
and  
qualitative  
information  
about:

- Leases
- Significant judgments
- Amounts recognized in financial statements related to leases

# Financial Statement Disclosures

- General description of leases
- Basis by which variable lease payments are determined
- Existence and terms/conditions of options to extend or terminate
- Narrative disclosure about options that are recognized as part of ROU asset and lease liability, and those that are not
- Existence and terms of residual value guarantees provided by lessee
- Restrictions or covenants imposed by leases
- Significant leases that haven't commenced yet, including involvement in construction or design

# Financial Statement Disclosures

		Year Ending December 31,	
		20X2	20X1
	Lease cost		
→	Finance lease cost:	\$XXX	\$XXX
	Amortization of right-of-use assets	XXX	XXX
	Interest on lease liabilities	XXX	XXX
→	Operating lease cost	XXX	XXX
→	Short-term lease cost	XXX	XXX
→	Variable lease cost	XXX	XXX
→	Sublease income	(XXX)	(XXX)
	Total lease cost	<u>\$XXX</u>	<u>\$XXX</u>
	Other information		
	(Gains) and losses on sale and leaseback transactions, net	\$(XXX)	\$XXX
	Cash paid for amounts included in the measurement of lease liabilities	XXX	XXX
	Operating cash flows from finance leases	XXX	XXX
	Operating cash flows from operating leases	XXX	XXX
	Financing cash flows from finance leases	XXX	XXX
	Right-of-use assets obtained in exchange for new finance lease liabilities	XXX	XXX
→	Right-of-use assets obtained in exchange for new operating lease liabilities	XXX	XXX
	Weighted-average remaining lease term—finance leases	XX years	XX years
	Weighted-average remaining lease term—operating leases	XX years	XX years
	Weighted-average discount rate—finance leases	XX%	XX%
	Weighted-average discount rate—operating	XX%	XX%



# Financial Statement Disclosures

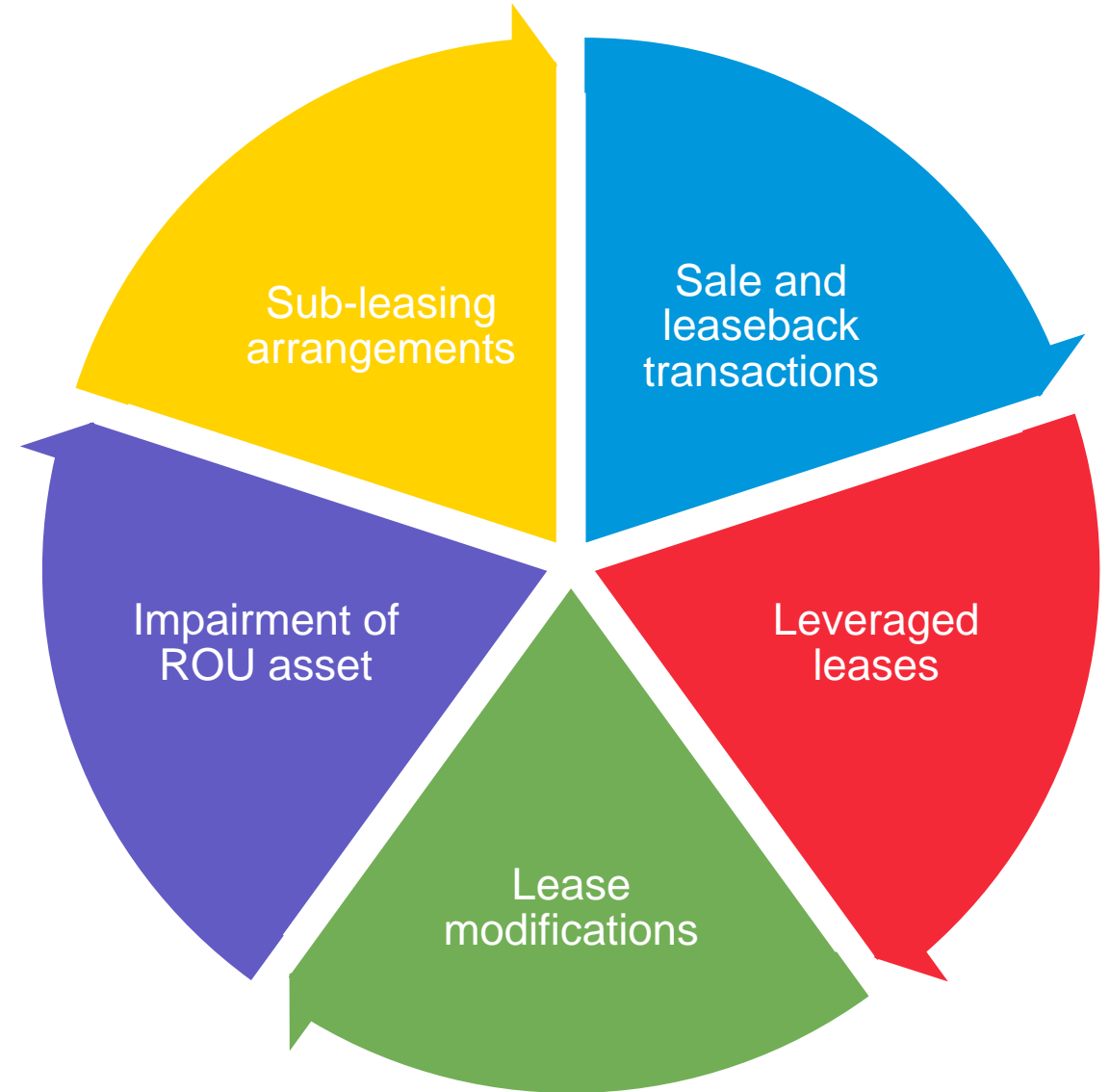
- Maturity analysis
  - Reconciliation to balance sheet
- Related party transactions
- Short-term leases
- Practical expedient (lease vs. non-lease components)

# **POLLING QUESTION #4**

Please answer for continuing education credit



# Other Considerations



# Thank you for attending



## Stephanie Roths

Manager, Assurance Services



[Stephanie.Roths@aghlc.com](mailto:Stephanie.Roths@aghlc.com)



316.291.4004



[linkedin.com/in/stephanieroths](https://www.linkedin.com/in/stephanieroths)

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