ASC 842 Considerations & Best Practices

Outsourced Accounting & Audit Services

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Team Biographies

Donna Ekl

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Donna is a member of Forvis Mazars' Outsourced Accounting Services division. She has more than 25 years of experience in both nonprofit and for-profit organizations delivering **Unmatched Client Experiences**®.

She has extensive experience in leading financial planning and analysis, as well as shaping overall strategic business plans, long-range fiscal goals, and operation objectives. Her experience includes creating financial board packets and presentations, cash flow analysis, P&L projections, financial reporting, annual and monthly budget creation and reporting, grant writing, and compliance work.

Donna is a summa cum laude graduate of Robert Morris University Illinois, Chicago, with a B.S. degree in business management with a focus on accounting.

Dan Kats

Director

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Dan has more than 14 years of public accounting experience with not-for-profit, commercial and governmental entities, providing audit and consulting services such as financial statement audits and financial statement reviews. He has worked with a variety of entities, including universities, colleges, foundations, not-for-profit organizations, associations, construction and real estate entities, retail and professional services organizations, state agencies and municipalities.

He has helped plan and manage Uniform Guidance audits for various engagements, including student financial aid and other education department programs, social service programs and other grants for not-for-profit clients as well as agreed-upon procedures.

Dan is a 2007 graduate of the College of Business, University of Illinois at Urbana-Champaign, with a B.S. degree in accounting, and a 2008 graduate with an M.A.S. degree.

Upon Completion of This Webinar, the Participants Will Be Able to:

1. Identify a lease
2. Prepare an amortization schedule
3. Complete initial measurements of lease liability and Right-of-Use (ROU) Assets
4. Prepare monthly journal entries

ASC 842 – Lease Background

- Requires a lessee to recognize substantially all leases on its balance sheet as lease liabilities with a corresponding right-of-use (ROU) asset.
- Modifies the definition of a lease to focus on the ability of the lessee to **control** the **underlying asset** for a period of time.
- Effective date for nonpublic entities was fiscal years beginning after December 15, 2021

- **ASC 842 Impact:**
  - **Lessor** – no fundamental changes
  - **Lessee**:
    - ***Operating leases*** – significant changes (balance sheet recognition, discounted cash flows, modified definitions)
    - ***Finance leases*** (formerly known as capital) – no fundamental changes

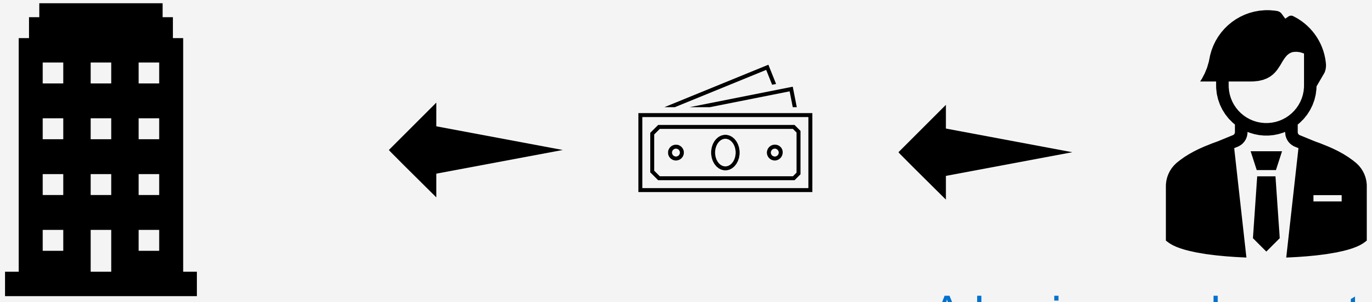
ASC 842 Considerations & Best Practices
Difference between a Lessor & Lessee

Define Lessor & Lessee

A **lessor** and a **lessee** are the parties involved in a lease agreement.

- Under ASC 842, a **lessor** is defined as an entity that enters into a contract to provide the right to use an underlying asset for a period of time in exchange for consideration
- Under ASC 842, a **lessee** is defined as an entity that obtains the right to control the use of an identified asset for a period of time in exchange for consideration. The lessee has the right to use the asset and its benefits, while being obligated to make payments for that right.

Despite the lessee having possession of the asset, the lessor retains the legal ownership through the period of time under the agreement.



Office building owner is the **lessor**.

A business who rents a defined space from the building owner is the **lessee**.

ASC 842 Considerations & Best Practices
Important Terms

Definition of a lease

- A lease is a contract that conveys the **right to control** the use of an **identified asset** for a period of time in exchange for **consideration**.
  - Right to control
  - Identifiable asset
  - Consideration
- A lease that meets any of the conditions below is classified as a **Finance Lease**:
  - The lease transfers ownership of the underlying asset to the lessee by the end of the lease term.
  - The lease grants an option to purchase the underlying asset that the lessee is reasonably certain to exercise (below FMV cost).
  - The lease term is for most of the economic life of the underlying asset.
  - The present value of the sum of the lease payments equal or exceed substantially all the fair value of the underlying asset.
  - The underlying asset is of such a specialized nature that it is has no alternative use to the lessor at the end of the lease term.

Lease Commencement vs. Lease Inception

- Lease **inception**
  - The date of the lease agreement or commitment, if earlier
  - Determination of whether a contract is a lease
- Lease **commencement**
  - The date on which a lessor makes an underlying asset available for use by a lessee
  - The date the lessee gains control of the underlying asset
  - The date you determine the lease **classification** (operating vs. finance)
  - The date you **measure** the lease (calculating Lease Liability and ROU Assets)
  - The date you **recognize** the lease (recording of Lease Liability and ROU Assets)

ASC 842 Considerations & Best Practices
Lease Term

- The **lease term** is the **noncancelable period**, including free rent periods.
- Options for additional periods the lessee is **reasonably certain** to exercise.
- Periods covered by an option to extend the lease in which exercise of the option is controlled by the lessor (rare cases).
- The noncancelable period is the period for which the contract is enforceable.
  - When both lessee and the lessor can terminate the lease without significant penalty then the lease is NOT enforceable.
  - If only a lessor has the right to terminate a lease, the period covered by the option is included in the lease term.
  - If only a lessee can terminate a lease, a determination is needed whether the lessee is reasonably certain to exercise the option.

Reasonably Certain (NEW) is an option when economic incentives create a high likelihood that they will do so, more than 75%.

- Favorable prices
- Business interruption
- Significant leasehold improvements
- If you are not reasonably certain to exercise the option, then the option should not be included in the calculation.

A **short-term lease** is 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.

A lessee can elect to not record a short-term lease on the balance sheet and would instead recognize lease payments on a straight-line basis over the lease term in a manner like how operating leases are accounted for under ASC 840.

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Lease Payments

Fixed amounts

- Fixed amounts included in the lease agreement:
  - Listed monthly rent payments
  - Specified minimum amounts for:
    - Utilities
    - Property taxes
    - Common Area Maintenance
- Variable payments based on an index or rate calculated at the spot rate at lease commencement.

Variable amounts

- Variable lease payments that are based on the usage or performance of the underlying asset
  - Percentage or proportionate share of:
    - Utilities
    - Property taxes
  - Payments per use

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Discount Rate

- The higher the discount rate, the lower the lease liability
- **Implicit rate:**
  - Lessee should use the rate implicitly in the lease if the rate is readily determinable. However, this rate is usually not readily determinable.
- **Incremental borrowing rate:**
  - An amount equal to the lease payments
  - On a collateralized basis
  - Over a similar term

- **Risk-free rate** option
  - Not a public business entity
  - Use a risk-free discount rate for the lease from the U.S. Treasury
    - https://home.treasury.gov
      - Resource-center
      - Data-chart-center
      - Interest-rates
  - Preferred method, as information is readily available

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Another way to describe ASC 842

Lease Liability

Lease is just a fancy word for when someone lets you use something (like a toy or a bicycle) for a while. It's like borrowing, but with rules.

When you borrow the toy, you promise your friend that you'll take good care of it and give it back when the time is up. That promise is like a "lease liability." It's like saying, "I promise to return the toy on time."

Right-of-Use (ROU) Assets

Imagine you have a special sticker that says, "I can play with this toy!" That sticker represents your right to use the toy. In accounting, we call this sticker a "right-of-use asset." It's like saying, "Hey, this toy belongs to me for a little while!"

Balance Sheet

Imagine you have a special notebook where you write down all your important stuff. Well, companies have something similar called a "balance sheet." With ASC 842, companies must record both the right-of-use asset (the sticker saying they can use something) and the lease liability (the promise to give it back) in their balance sheet. It's like keeping track of borrowed toys!

ASC 842

Lessee Accounting under ASC 842

Initial Measurement

Lease liability

- Present value of unpaid, *i.e.*, future, lease payments:

Sum of all lease payments

x Discount rate

= **Lease Liability**

Right-of-Use (ROU) Assets

Lease liability

+ Initial direct costs

+ Lease prepayments

– Lease incentives received

= **ROU asset**

Straight-Line Lease Expense

Sum of all lease payments

– Lease incentive received

+ Initial direct costs

+ Prepaid rent

= <u>Remaining lease cost</u>

÷ Lease term

= **Lease expense**

Other:

- **Security deposit** – if returned at the end of the lease term, then no impact on Lease Liability and ROU Assets calculation. If being applied against future payments, will impact initial measurement of Lease Liability and ROU Assets
- **Prepaid rent** – If paid before the commencement date it would reduce Lease Liability but will be added back to ROU Assets

Operating Lease Example 1

5-year lease, same annual payments

Assumptions:

- **Lease Term** – 5 years
- **Payments** – $25,000 annually, paid at the end of each year
- **Discount Rate** – 3.93%
- **Utilities** – 10% of the bill
- **Security deposit** – $5,000 to be returned at the end of the lease

Lease Liability

Year 1	$25,000
Year 2	$25,000
Year 3	$25,000
Year 4	$25,000
Year 5	$25,000
Total	$125,000
PV at 3.93%	**$111,515**

ROU Assets

Lease liability:	$111,515
+ indirect cost:	-
+ lease prepayments:	-
- lease incentives:	-
= ROU Assets	**$111,515**

Rent Expense

Lease payments:	$125,000
÷ Lease term:	5 years
= Straight-line lease expense:	**$25,000**

Operating Lease Example 1 – Amortization Schedule and JE

5-year lease, same annual payments

Period	Date	Cash	Beginning Lease Liability	Liability Accretion	Payments	Ending Lease Liability	Beginning ROE Assets	ROU Asset Adjustment	Ending ROE Assets	Lease Expense
1	2024	$25,000.00	**(111,514.76)**	(4,382.53)	$25,000.00	(90,897.29)	**111,514.76**	(20,617.47)	90,897.29	25,000.00
2	2025	$25,000.00	(90,897.29)	(3,572.26)	$25,000.00	(69,469.55)	90,897.29	(21,427.74)	69,469.55	25,000.00
3	2026	$25,000.00	(69,469.55)	(2,730.15)	$25,000.00	(47,199.70)	69,469.55	(22,269.85)	47,199.70	25,000.00
4	2027	$25,000.00	(47,199.70)	(1,854.95)	$25,000.00	(24,054.65)	47,199.70	(23,145.05)	24,054.65	25,000.00
5	2028	$25,000.00	(24,054.65)	(945.35)	$25,000.00	-	24,054.65	(24,054.65)	-	25,000.00
5.00		**125,000.00**		**(13,485.24)**	**125,000.00**			**(111,514.76)**		**125,000.00**

Journal Entries

Journal entry 1 – to record ROU Assets and Lease Liability at commencement date:

ROU Assets: $111,515

Lease Liability: ($111,515)

Journal entry 2 – to record rent expense for the period:

Rent Expense: $25,000

ROU Assets: ($25,000)

Journal entry 3 – to record payment per lease agreement:

Cash: ($25,000)

Lease Liability: $25,000

Journal entry 4 – to record the impact of the present value discount:

ROU Assets: $4,383

Lease Liability: ($4,383)

Operating Lease Example 2

5-year lease, escalating terms

Assumptions:

- **Lease Term** – 5 years
- **Payments** – $25,000, escalating 10% each year, paid at the end of each year
- **Discount Rate** – 3.93%
- **Utilities** – 10% of the bill
- **Security deposit** – $5,000 to be returned at the end of the lease

Lease Liability

Year 1	$25,000
Year 2	$27,500
Year 3	$30,250
Year 4	$33,275
Year 5	$36,603
Total	$152,628
PV at 3.93%	**$135,167**

ROU Assets

Lease liability:	$135,167
+ indirect cost:	-
+ lease prepayments:	-
- lease incentives:	-
= ROU Assets	**$135,167**

Rent Expense

Lease payments:	$152,628
÷ Lease term:	5 years
= Straight-line lease expense:	**$30,526**

Operating Lease Example 2 – Amortization Schedule and JE

5-year lease, escalating terms

Period	Date	Cash	Beginning Lease Liability	Liability Accretion	Payments	Ending Lease Liability	Beginning ROE Assets	ROU Asset Adjustment	Ending ROE Assets	Lease Expense
1	2024	$25,000.00	**(135,167.08)**	(5,312.07)	$25,000.00	(115,479.14)	**135,167.08**	(25,213.43)	109,953.64	30,525.50
2	2025	$27,500.00	(115,479.14)	(4,538.33)	$27,500.00	(92,517.48)	109,953.64	(25,987.17)	83,966.48	30,525.50
3	2026	$30,250.00	(92,517.48)	(3,635.94)	$30,250.00	(65,903.41)	83,966.48	(26,889.56)	57,076.91	30,525.50
4	2027	$33,275.00	(65,903.41)	(2,590.00)	$33,275.00	(35,218.42)	57,076.91	(27,935.50)	29,141.42	30,525.50
5	2028	$36,602.50	(35,218.42)	(1,384.08)	$36,602.50	-	29,141.42	(29,141.42)	0.00	30,525.50
5.00		**152,627.50**		**(17,460.42)**	**152,627.50**			**(135,167.08)**		**152,627.50**

Journal Entries

Journal entry 1 – to record ROU Assets and Lease Liability at commencement date:

ROU Assets: $135,167

Lease Liability: ($135,167)

Journal entry 2 – to record rent expense for the period:

Rent Expense: $30,526

ROU Assets: ($30,526)

Journal entry 3 – to record payment per lease agreement:

Cash: ($25,000)

Lease Liability: $25,000

Journal entry 4 – to record the impact of the present value discount:

ROU Assets: $5,312

Lease Liability: ($5,312)

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Operating Lease Example 3

5-year lease, escalating terms and fixed utilities payments

Assumptions:

- **Lease Term** – 5 years
- **Payments** – $25,000, escalating 10% each year, paid at the end of each year
- **Discount Rate** – 3.93%
- **Utilities** – $1,000 annually
- **Security deposit** – $5,000 to be returned at the end of the lease

Lease Liability

Year 1	$26,000
Year 2	$28,500
Year 3	$31,250
Year 4	$34,275
Year 5	$37,603
Total	$157,628
PV at 3.93%	**$139,628**

ROU Assets

Lease liability:	$139,628
+ indirect cost:	-
+ lease prepayments:	-
- lease incentives:	-
= ROU Assets	**$139,628**

Rent Expense

Lease payments:	$157,628
÷ Lease term:	5 years
= Straight-line lease expense:	**$31,526**

Operating Lease Example 3 – Amortization Schedule and JE

5-year lease, escalating terms and fixed utilities payments

Period	Date	Cash	Beginning Lease Liability	Liability Accretion	Payments	Ending Lease Liability	Beginning ROE Assets	ROU Asset Adjustment	Ending ROE Assets	Lease Expense
1	2024	$26,000.00	**(139,627.67)**	(5,487.37)	$26,000.00	(119,115.04)	**139,627.67**	(26,038.13)	113,589.54	31,525.50
2	2025	$28,500.00	(119,115.04)	(4,681.22)	$28,500.00	(95,296.26)	113,589.54	(26,844.28)	86,745.26	31,525.50
3	2026	$31,250.00	(95,296.26)	(3,745.14)	$31,250.00	(67,791.40)	86,745.26	(27,780.36)	58,964.90	31,525.50
4	2027	$34,275.00	(67,791.40)	(2,664.20)	$34,275.00	(36,180.60)	58,964.90	(28,861.30)	30,103.60	31,525.50
5	2028	$37,602.50	(36,180.60)	(1,421.90)	$37,602.50	(0.00)	30,103.60	(30,103.60)	0.00	31,525.50
5.00		**157,627.50**		**(17,999.83)**	**157,627.50**			**(139,627.67)**		**157,627.50**

Journal Entries

Journal entry 1 – to record ROU Assets and Lease Liability at commencement date:

ROU Assets: $139,628

Lease Liability: ($139,628)

Journal entry 2 – to record rent expense for the period:

Rent Expense: $31,526

ROU Assets: ($31,526)

Journal entry 3 – to record payment per lease agreement:

Cash: ($26,000)

Lease Liability: $26,000

Journal entry 4 – to record the impact of the present value discount:

ROU Assets: $5,487

Lease Liability: ($5,487)

Operating Lease Example 4

5-year lease, escalating terms, fixed utilities payments, and prepaid rent

Assumptions:

- **Lease Term** – 5 years
- **Payments** – $25,000, escalating 10% each year, paid at the end of each year
- **Discount Rate** – 3.93%
- **Utilities** – $1,000 annually
- **Security deposit** – $36,603 to cover the last year of the lease

Lease Liability

Year 1	$26,000
Year 2	$28,500
Year 3	$31,250
Year 4	$34,275
Year 5	$1,000
Total	$121,025
PV at 3.93%	**$109,442**

ROU Assets

Lease liability:	$109,442
+ indirect cost:	-
+ lease prepayments:	$36,603
- lease incentives:	-
= ROU Assets	**$146,045**

Rent Expense

Lease payments:	$121,025
+ lease prepayments:	$36,603
= Total payments:	$157,628
÷ Lease term:	5 years
= Straight-line lease expense:	**$31,526**

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Operating Lease Example 4 – Amortization Schedule and JE

5-year lease, escalating terms, fixed utilities payments, and prepaid rent

Period	Date	Cash	Beginning Lease Liability	Liability Accretion	Payments	Ending Lease Liability	Beginning ROE Assets	ROU Asset Adjustment	Ending ROE Assets	Lease Expense
1	2024	$26,000.00	**(109,441.63)**	(4,301.06)	$26,000.00	(87,742.69)	**146,044.63**	(27,224.54)	118,820.09	31,525.60
2	2025	$28,500.00	(87,742.69)	(3,448.29)	$28,500.00	(62,690.97)	118,820.09	(28,077.31)	90,742.77	31,525.60
3	2026	$31,250.00	(62,690.97)	(2,463.76)	$31,250.00	(33,904.73)	90,742.77	(29,061.84)	61,680.93	31,525.60
4	2027	$34,275.00	(33,904.73)	(1,332.46)	$34,275.00	(962.19)	61,680.93	(30,193.14)	31,487.79	31,525.60
5	2028	$1,000.00	(962.19)	(37.81)	$1,000.00	0.00	31,487.79	(31,487.79)	-	31,525.60
5.00		**121,025.00**		**(11,583.37)**	**121,025.00**			**(146,044.63)**		**157,628.00**

Journal Entries

Journal entry 1 – to record ROU Assets and Lease Liability at commencement date:

ROU Assets: $146,045

Security Deposit: ($36,603)

Lease Liability: ($109,442)

Journal entry 2 – to record rent expense for the period:

Rent Expense: $31,526

ROU Assets: ($31,526)

Journal entry 3 – to record payment per lease agreement:

Cash: ($26,000)

Lease Liability: $26,000

Journal entry 4 – to record the impact of the present value discount:

ROU Assets: $4,301

Lease Liability: ($4,301)

ASC 842
Lease Incentives

Lease Incentives Received at Lease Commencement

Lease incentives that have already been received by the lessee at lease commencement are not included in the calculation of the lease liability because they do not reduce any future lease obligation.

Consequently, lease incentives received are included as a reduction of the ROU asset for the ROU asset to reflect the net lease costs.

Lease Incentives Receivable at Lease Commencement

Lease incentives receivable by the lessee at lease commencement, but not yet received at lease commencement, are included in the calculation of the lease liability.

As these future cash payments from lessor to lessee are already included in the calculation of the lease liability, *i.e.*, netted against future lease obligations, they do not need to be included separately in the calculation of the ROU asset.

Lease incentives **not** “received or receivable” at lease commencement, but that are based on future events, *i.e.*, contingent lease incentives, are not specifically addressed in ASC 842.

Operating Lease Example 5

5-year lease, same annual payments and one year of free rent

Assumptions:

- **Lease Term** – 5 years
- **Payments** – $25,000, annually, paid at the end of each year, first year is free
- **Discount Rate** – 3.93%
- **Utilities** – 10% of the bill
- **Security deposit** – $5,000 to be returned at the end of the lease

Lease Liability

Year 1	-
Year 2	$25,000
Year 3	$25,000
Year 4	$25,000
Year 5	$25,000
Total	$100,000
PV at 3.93%	**$87,460**

ROU Assets

Lease liability:	$87,460
+ indirect cost:	-
+ lease prepayments:	-
- lease incentives:	-
= ROU Assets	**$87,460**

Rent Expense

Lease payments:	$100,000
÷ Lease term:	5 years
= Straight-line lease expense:	**$20,000**

Operating Lease Example 5 – Amortization Schedule and JE

5-year lease, same annual payments and one free year of rent

Period	Date	Cash		Beginning Lease Liability	Liability Accretion	Payments	Ending Lease Liability		Beginning ROE Assets	ROU Asset Adjustment	Ending ROE Assets		Lease Expense
1	2024	$0.00		**(87,460.10)**	(3,437.18)	$0.00	(90,897.29)		**87,460.10**	(16,562.82)	70,897.29		20,000.00
2	2025	$25,000.00		(90,897.29)	(3,572.26)	$25,000.00	(69,469.55)		70,897.29	(16,427.74)	54,469.55		20,000.00
3	2026	$25,000.00		(69,469.55)	(2,730.15)	$25,000.00	(47,199.70)		54,469.55	(17,269.85)	37,199.70		20,000.00
4	2027	$25,000.00		(47,199.70)	(1,854.95)	$25,000.00	(24,054.65)		37,199.70	(18,145.05)	19,054.65		20,000.00
5	2028	$25,000.00		(24,054.65)	(945.35)	$25,000.00	-		19,054.65	(19,054.65)	-		20,000.00
5.00		**100,000.00**			**(12,539.90)**	**100,000.00**				**(87,460.10)**			**100,000.00**

Journal Entries

Journal entry 1 – to record ROU Assets and Lease Liability at commencement date:

ROU Assets: $87,460

Lease Liability: ($87,460)

Journal entry 2 – to record rent expense for the period:

Rent Expense: $20,000

ROU Assets: ($20,000)

Journal entry 3 – to record payment per lease agreement:

Cash: $0

Lease Liability: $0

Journal entry 4 – to record the impact of the present value discount:

ROU Assets: $3,437

Lease Liability: ($3,437)

Operating Lease Example 6

5-year lease, escalating terms and lease incentive

Assumptions:

- **Lease Term** – 5 years
- **Payments** – $25,000, escalating 10% each year, paid at the end of each year
- **Discount Rate** – 3.93%
- **Utilities** – 10% of the bill
- **Security deposit** – $5,000 to be returned at the end of the lease
- **Lease Incentive:** – $15,000 tenant allowance

Lease Liability

Year 1	$25,000
Year 2	$27,500
Year 3	$30,250
Year 4	$33,275
Year 5	$36,603
Total	$152,628
PV at 3.93%	**$135,167**

ROU Assets

Lease liability:	$135,167
+ indirect cost:	-
+ lease prepayments:	-
- lease incentives:	($15,000)
= ROU Assets	**$120,167**

Rent Expense

Lease payments:	$152,628
- lease incentives:	($15,000)
= Total payments:	$137,628
÷ Lease term:	5 years
= Straight-line lease expense:	**$27,526**

Operating Lease Example 6 - Amortization schedule and JE

5-year lease, escalating terms and lease incentive

Period	Date	Cash	Beginning Lease Liability	Liability Accretion	Payments	Ending Lease Liability	Beginning ROE Assets	ROU Asset Adjustment	Ending ROE Assets	Lease Expense
1	2024	$25,000.00	**(135,167.08)**	(5,312.07)	$25,000.00	(115,479.14)	**120,167.08**	(22,213.43)	97,953.64	27,525.50
2	2025	$27,500.00	(115,479.14)	(4,538.33)	$27,500.00	(92,517.48)	97,953.64	(22,987.17)	74,966.48	27,525.50
3	2026	$30,250.00	(92,517.48)	(3,635.94)	$30,250.00	(65,903.41)	74,966.48	(23,889.56)	51,076.91	27,525.50
4	2027	$33,275.00	(65,903.41)	(2,590.00)	$33,275.00	(35,218.42)	51,076.91	(24,935.50)	26,141.42	27,525.50
5	2028	$36,602.50	(35,218.42)	(1,384.08)	$36,602.50	-	26,141.42	(26,141.42)	0.00	27,525.50
5.00		**152,627.50**		**(17,460.42)**	**152,627.50**			**(120,167.08)**		**137,627.50**

Journal Entries

Journal entry 1 – to record the usage of tenant allowance to leasehold improvements:

Leasehold Improvements: $15,000

Cash: ($15,000)

Journal entry 2 – to record the reimbursement from the landlord:

Cash: $15,000

ROU Assets: ($15,000)

Journal entry 3 – to record ROU Assets and Lease Liability at commencement date:

ROU Assets: $135,167

Lease Liability: ($135,167)

Journal entry 4 – to record rent expense for the period:

Rent Expense: $27,526

ROU Assets: ($27,526)

Journal entry 5 – to record the first payment per lease agreement:

Cash: $25,000

Lease Liability: ($25,000)

Journal entry 6 – to record the impact of the present value discount:

ROU Assets: $5,312

Lease Liability: ($5,312)

ASC 842

Common Control Arrangements

Issue 1: Practical Expedient to Use Written Terms and Conditions

- Many related-party leases don't have legally enforceable terms
- Practical expedient allows related-party companies to use the written terms to determine:
  - Whether a lease exists and, if yes,
  - The classification and accounting for that lease

Issue 2: Accounting for Leasehold Improvements (LHI) in Common Control Lease

- Before ASC 842 – LHI are amortized over the shorter of the remaining lease term and the useful life of the improvements
- Under ASC 842 – LHI are amortized over the useful life of the improvements if lessee continues to control the asset
- Be aware to avoid the following pitfalls
  - Conclusion of no lease = no LHI
  - Conclusion of S/T lease no renewal = no LHI at lease end
  - Arrangement Cancellable by Either Party With Notice Period – Short-Term Lease Conclusion
    - No ROU asset or lease liability being recorded
    - LHI amortized over the useful life if the lease continues

ASC 842
Best Practices & Controls

With best practices, your financial statements will reflect the accuracy of the data recorded. To ensure leases are recorded properly, make sure your company follows these controls.

Transaction Controls

- Policies should be clear who is authorized to sign a lease
- Typically, the President, CEO, Executive Director, and/or CFO are designated and authorized lease signers

IT General Controls

- Make sure there is a central filing system for all leases with proper rights associated with the file

Activity Related Controls

- Signers have clear and concise direction of signed lease sharing
- Ensure notification to the correct people is in place, like administration, operational departments, and of course, the accounting department

Financial Reporting Controls

- The accounting department will assess, calculate amortization schedules, and record monthly journal entries.

Contact

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