CONSTRUCTION ISSUE SHEET

LEASES

ASC 842: BANKING AND SURETY CONSIDERATIONS

ASC 842's changes affect all financial statements, but the balance sheet is the most affected. For instance, construction companies may find their debt-to-equity ratio has increased or there has been a decrease in the return on assets.

The relevant issues, which center on how short- and long-term financing is reported on contractors' financial statements, affect how banks and sureties evaluate contractors' financials as they determine issues such as loan amounts.

The changes to operating leases, which often were reported in financial statement footnotes, now must be reported on the balance sheet. The affect loss of off-balance sheet financing can be illustrated by the following chart:

UNCHANGED BALANCE SHEET ENTRIES

ASSETS:

- Cash
- Accounts receivable
- Contract asset
- Prepaid expenses and other current assets
- Total current assets

LIABILITIES AND STOCKHOLDER'S EQUITY:

- Line of credit
- Accounts payable and accrued expenses
- Contract liability
- Stockholder's Equity

CHANGED BALANCE SHEET ENTRIES

ASSETS:

- Property and equipment
- Operating lease right of use (ROU) asset
- Financing lease ROU asset
- Capital lease ROU asset
- Total assets

LIABILITIES AND STOCKHOLDER'S EQUITY:

- Current portion of operating lease liability
- Current portion of financing lease liability
- Current portion of financing lease obligations
- Total liabilities
- Operating Lease Liability, less current portion
- Financing Lease Liability, less current portion
- Capital Lease Liability, less current portion
- Total Liabilities and Stockholder's Equity

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Consider how a company's debt-to-equity ratio would be affected: While construction industry data suggests a debt-to-equity ratio of under 3 is acceptable, the new calculation may increase the ratio to well over 3. As a result, the company's borrowing capacity may decrease.

The construction financial professionals' most powerful tool in guiding the contractor's banker and surety is by analyzing, understanding and adjusting to these changes.

Pay attention to the balance sheet changes required by ASC 842.

HAVE QUESTIONS?

Adams Brown, Strategic Allies and CPAs, provides a wide range of traditional and specialized CPA and consulting services to construction businesses, contractors and sub-contractors across the nation. The firm has a specialized, diverse team of experts immersed in the industry that holistically serves construction leadership teams. To learn more, contact Mark P. Barnett, Jr., CPA, CVA, CGMA, CCIFP, MBA, Construction Industry Leader, at MBarnett@AdamsBrownCPA.com or 870.520.6215.

16 STEPS TO TAKE IN PREPARATION OF ASC 842 ADOPTION

1. Gather all contracts in one place
2. Review all contracts for previously unknown leases (e.g., embedded, in substance leases)
3. Review general ledger for expense account activity
4. Review reoccurring vendor payments for service or supply contracts
5. Review complete and in process projects to ensure that future amortization of any embedded leases is considered
6. Review reoccurring vendor payments for service or supply contracts
7. Inventory identified leases according to significant lease terms (e.g., purchase, renewal or cancellation options, initial direct costs)
8. Document procedures used to identify leases
9. Determine policy elections and practical expedients
10. Assess whether existing systems, internal controls, and processes are adequate
11. Draft new lease accounting policy outlining how policy elections and practical expedients will affect financial statements
12. Determine whether lease accounting software is needed; if it is, review vendor options; finalize software selection
13. Upload lease details, including applicable historical transactions, into lease accounting software
14. Manually test to ensure accuracy of software
15. Prepare new disclosures
16. Review all processes and procedures with accountant/auditor to ensure compliance