CONSTRUCTION ISSUE SHEET

LEASES

ASC 842: DISTINCTION BETWEEN FINANCING LEASES AND OPERATING LEASES

Finance Leases

Finance leases (sometimes called capital leases or sales leases) are leases in which the lessor has legal ownership of an identified asset, and the lessee has (1) operating control over an identified asset and (2) a share in the economic risks and rewards resulting from changes in the valuation of that asset.

Leases that meet any of the following criteria, are considered finance leases:

- Ownership of the underlying asset transfers to the lessee by the end of the lease term
- The lessee has the option of purchasing the asset by the end of the lease term
- The lease term is for at least 75% of the asset's economic life
- The present value of the lease payments plus the asset's residual value equal at least 90% of the asset's fair value
- The asset is specialized in nature for the lessee and for which the lessor has no alternative use

Operating Leases

Leases that do not meet any of the above criteria are considered operating leases. Operating leases are contracts that allow for the use of an identified asset but do not convey ownership rights of that asset. In addition:

- There is no option for the lessee to purchase the asset
- The lease term is not a major part of the asset's economic life
- The value of the lease payments does not equal or exceed the fair value of the underlying asset
- The asset remains useful to the lessor at the end of the lease term

FINANCE LEASE = Lessor has legal ownership of the asset

OPERATING LEASE = Lessor has no option to purchase the asset

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@Adams-BrownCPA.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