

## ASC 842: UNDERSTANDING RELATED PARTY LEASES

Under ASC 842, leases with related parties should be treated no differently than if they were leases with an unrelated party, except for a specific aspect of accounting for a sale-leaseback transaction. That seems straightforward, but some related-party transactions do not have legally enforceable terms and conditions because (1) they may not be formally documented and (2) the terms may not be at arms' length.

Nevertheless, this is a big change from the previous standard. Related party leases may be unenforceable since unwritten terms can create enforceable rights and obligations. For example, there may be underlying management or operating agreements that create enforceable rights and obligations.

Lessees and lessors should follow the ASC 842 requirements as well as the requirements of ASC 850, Related Party Disclosures. This means evaluating the nature of the relationships, the descriptions of the transactions and all information needed to understand how the transactions impact the financial statements. The disclosures required under ASC 850 provide information needed to understand the nature of the leasing arrangements even if they are not recognized and measured on the balance sheet under ASC 842.

Making the necessary assessments requires considerable judgment (e.g., whether the transaction truly is at arms' length) and subject matter expertise.



## HAVE QUESTIONS?

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# 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