



ASC 842: WHAT TO LOOK FOR WHEN REVIEWING LEASES

According to ASC 842, a lease is defined as

“A contract, or part of a contract, that conveys the right to control the use of identified property, plant, or equipment (an identified asset) for a period of time in exchange for consideration.”

This may seem straightforward, but most leases contain clauses and subclauses that must be examined more closely under ASC 842. For example, to be an identified asset, the contract may not permit the substitution of one asset for another asset if the substitution benefits the supplier. (This rule may be especially relevant during this time of supply shortages.)

The following guidelines offer a list of contract elements that must be reviewed:

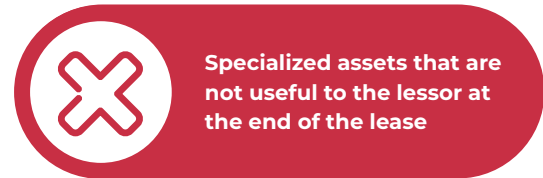
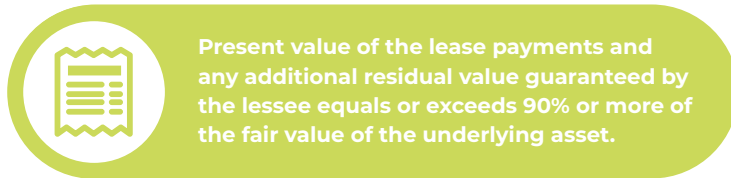
INVENTORY ALL CONTRACTS

List all contracts and review them for any information impacted by the definition of ASC 842, for example:

- ▶ Fixed payments
- ▶ Indexed payments
- ▶ Lease incentives
- ▶ Renewal options
- ▶ Purchase options
- ▶ Fixed non-lease payments (e.g., insurance, maintenance and taxes).

FINANCING LEASE VS. OPERATING LEASE

Leases that meet any of the following criteria are treated as finance leases (also called capital leases or sales leases):



REVIEW OF GENERAL LEDGER

- ▶ Fixed recurring and variable payments for existing leases
- ▶ Embedded leases (i.e., contract terms that determine the lessee's use and control over an identified asset)

Continued on next page.

ASC 842: WHAT TO LOOK FOR WHEN REVIEWING LEASES,

continued from previous page.

FIXED LEASE PAYMENTS VS. VARIABLE LEASE PAYMENTS

- ▶ Fixed lease payments are recurring payments that are the same amount each month. This category includes some payments that may seem to be variable, for example: (1) payments that increase by a fixed percentage amount on set anniversary dates and (2) certain payments that have minimum payment amounts each period, but the exact payment amount may vary each period.
- ▶ Variable lease payments are payments based on an index (e.g., the Consumer Price Index (CPI) or an unknown future rate (e.g., the prime interest rate). Variable lease payments that do not depend on an index or a rate are generally expensed as incurred as a variable lease expense and disclosed within the financial statements.

POLICY ELECTION OPTIONS TO CONSIDER

- ▶ Combine fixed lease and non-lease payments
- ▶ Use the interest-free rate to avoid determining the discounted rate
- ▶ Exclude leases with payments of twelve months or less
- ▶ Apply the same discount rate to a class of assets or assets with a similar lease term

PRACTICAL EXPEDIENT ELECTIONS TO CONSIDER

MUST ELECT AS A GROUP

Not to reassess:

- ▶ Expired or existing contracts that contain leases under ASC 842
- ▶ Operating and capital leases under ASC 840 that will be operating and financing leases under ASC 842
- ▶ Initial direct costs for existing leases

SEPARATE ELECTION

May elect to use hindsight to reassess leases for determining:

- ▶ Lease term
- ▶ Purchase options
- ▶ Termination payment

FINANCIAL STATEMENT ADOPTION OPTIONS TO CONSIDER

- ▶ Effective Date Method
- ▶ Comparative Method

OTHER CONSIDERATIONS

- ▶ Impact on the bonus structure contained in employment agreements

Continued on next page.

ASC 842: WHAT TO LOOK FOR WHEN REVIEWING LEASES,

continued from previous page



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