

LEASES UPDATE

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OVERVIEW

- Scope and Definition
- Embedded leases in service agreements
 - See flowchart
- Classification
 - Finance vs. Operating
- Accounting
 - Finance vs. Operating
- GASB 87

SCOPE AND DEFINITION

- Applies to all leases, including subleases, except:
 - Intangible assets
 - Exploration of minerals, oil, natural gas, etc.
 - Biological assets, including timber
 - Inventory
 - Assets under construction
- Definition
 - Lease is a contract or part of a contract
 - Conveys right to control identified asset for a period of time in exchange for consideration

EMBEDDED LEASES

- Embedded leases in service agreements
 - Specific identified asset - explicit or implicit
 - Substantially all economic benefits from asset
 - Right to direct use of identified asset
 - Right to operate identified asset
 - Customer predetermines design
- See flowchart

CLASSIFICATION

- Prior classification criteria
 - Asset ownership reverts to customer
 - Bargain purchase option
 - Present value of future minimum lease payments 90% or more of fair value of asset
 - Lease term 75% or more of assets useful life
- FASB wanted to do away with "bright lines"
 - Leases structured to 89% or 74%...

CLASSIFICATION

- New classification criteria
 - Lease transfers ownership to lessee
 - Option to purchase "reasonably certain to exercise"
 - Present value of sum of lease payments equals or exceeds substantially all fair value of asset
 - Lease term major part of remaining useful life
 - Asset of specialized nature - no alternative use
- Has it changed? Bright lines are gone, right?

CLASSIFICATION

- Requirements just reviewed in ASC 842-10-25-2
- A little further, in ASC 842-10-55-2:
 - "...reasonable approach to assessing the criteria... would be to conclude: 75% or more... is a major part... 90% or more... substantially all the fair value..."

CLASSIFICATION

SO...

If everything now goes on the balance sheet, why do we care if it's classified as a Finance Lease or an Operating Lease?

ACCOUNTING - SHORT-TERM

- Short-term leases
 - Less than 12 months
 - May be expensed

ACCOUNTING - FINANCE

- Finance leases - balance sheet
 - Calculate lease obligation liability
 - PV of payments, including contractual options to extend that are reasonably expected to be incurred
 - Calculate "right-to-use" asset
 - Amount of lease obligation liability
 - Plus initial direct costs (installation, etc.)
 - Plus any payments made up front (down payments)

ACCOUNTING - FINANCE

- Finance leases - income statement
 - Calculate amortization/depreciation of leased asset
 - Generally straight-line - same as historically done
 - Calculate interest expense
 - Effective interest method - same as historically done
- Really, no change from the past capital leases

ACCOUNTING - OPERATING

- Operating leases - balance sheet
 - Calculate lease obligation liability
 - PV of payments, including contractual options to extend that are reasonably expected to be incurred
 - Calculate "right-to-use" asset
 - Amount of lease obligation liability
 - Plus initial direct costs (installation, etc.)
 - Plus any payments made up front (down payments)
 - Same as finance leases

ACCOUNTING - OPERATING

- Operating leases - income statement
 - Single rent expense
 - Reported like old operating leases but calculated differently
 - Sum of all payments made divided by number of reporting periods
 - Unique issue
 - Effective interest method used on balance sheet obligation
 - Results in amortization expense that is rather like the converse of a declining-balance method

ACCOUNTING - OPERATING

- Review Case information
 - Annual payments \$12,000, 3 yrs, 6% rate
 - PV = \$32,076 liab;
 - Plus initial direct costs \$5,000 = \$37,076 asset
 - \$36,000 total payments + \$5,000 =
\$41,000 total lease costs / 3 yrs =
\$13,667 annual rent expense

ACCOUNTING - OPERATING

**Lease Obligation
Amortization Table**

			32,076
12,000	1,925	10,075	22,001
12,000	1,320	10,680	11,321
12,000	679	11,321	(0)

Journal Entries

yr 1			
rent exp		13667	
	accum dep		11742
lease obligation		10075	
	cash		12000
yr 2			
rent exp		13667	
	accum dep		12,347
lease obligation		10,680	
	cash		12000
yr 3			
rent exp		13667	
	accum dep		12,987
lease obligation		11,321	
	cash		12000

**Leased Asset
Amortization Table**

	37076		Acc dep
25,334	11,742	11,742	
12,987	12,347	24,089	
(0)	12,987	37,076	

GASB 87

- Single model
 - Lessee
 - Lease liability and right-to-use asset
 - Lessor
 - Lease receivable and a deferred inflow of resources
 - Lease term
 - Period with noncancelable right to use plus options, if reasonably certain

GASB 87

- Short-term lease
 - Maximum possible term of 12 months or less
 - Including any options to extend
 - Regardless of probability of exercise
 - Lessees and lessors
 - Recognize as outflows or inflows of resources

GASB 87

- Single model
 - Lessee
 - Liability and asset recognized similar to FASB
 - Expenses recognized similar to old capital lease approach
 - Transfers ownership - report as financed purchase of asset
 - Lessor
 - Lease receivable and a deferred inflow of resources
 - With certain exceptions - investments, regulated leases, etc.
 - Interest revenue and inflow of resources from deferred
 - Transfers ownership - report as sale of asset
- Effective periods beginning after Dec 15, 2019

SUMMARY

- Questions?