UserCo enters into a three-year service agreement for a cloud computing arrangement provided by TechCo wherein TechCo will provide data storage services for UserCo. The service agreement specifies a monthly fee of $1,000. UserCo incurs initial direct costs of $5,000 to install systems at its site as well as the necessary security measures for the transfer of data. UserCo has an incremental borrowing rate of 6%.

UserCo is very concerned about data security and doesn't want to share a server with any other TechCo customer. Therefore, as part of the service agreement, TechCo provides UserCo a specific server which is wired directly to UserCo and no other TechCo customer can access that server. UserCo has complete decision authority over what is stored on that particular server. TechCo does provide a back-up process whereby the info on each of its servers is backed up to a data tape daily and maintained at an offsite location. However, TechCo cannot substitute any other server for UserCo's designated server except for very short periods of time when maintenance or repairs may be required. If there is any damage to the server, TechCo is responsible for any repairs cost and is also responsible for regular maintenance costs. With regular maintenance, the server is expected to have a useful life of eight years.

In early 2016, the FASB issued ASU 2016-02—Leases. Please answer the questions assuming the ASU is in effect. For the last question, however, you will need to have an understanding of the old lease standard (ASC 840) as well as the new standard (ASC 842).

- Is there an embedded lease in this service agreement? Explain reasoning for position taken.
- If there is a lease, is it an operating or finance lease? Why?
- Prepare and present the journal entries, as well as the balance sheet and income statement amounts for each of the three years of the agreement.
- Do you believe lease guidance in ASC 842 provides more useful information for financial statement readers than previous guidance? Why?