LEASE ACCOUNTING

Abbott, Stringham & Lynch

New Leasing Standard – Fast Approaching

The new leasing standard (ASC 842) is applicable to all public entities starting with calendar year-end 2019 and calendar year-end 2020 for all non-public entities. With the transition period fast approaching, it is a good time to review and assess your current leasing arrangements and other applicable contracts to determine the impact the changes in the leasing standard will have on your financial statements.

What Will Change?

Current Leasing Guidance (ASC 840)	New Leasing Guidance (ASC 842)
Operating lease obligations are not recorded on the balance sheet and only leases meeting the criteria of a capital lease are recorded as liabilities in the company's financial statements.	Operating leases with terms greater than one year will have to be reflected on the balance sheet as both assets and liabilities somewhat similar to the treatment of capital leases under current guidance.

The implementation of the new leasing standard also introduces new concepts and terminology that will drive the determination of the application of the new leasing standard as well as classification of leases on the balance sheet as either operating or finance leases.

New Definitions and Terminology:

The new lease standard redefines what constitutes a leasing arrangement. A lease is a contract, or part of a contract, that conveys the right to control the use of an explicitly or implicitly identified asset for a period of time in exchange for consideration. One of the biggest challenges in applying the new lease standard is determining whether an arrangement or portion of an arrangement is a lease. For example, a service agreement for the use of servers at a data center is not considered to be a lease under the current rules. However, such agreement will need to be reevaluated in detail to determine if the use of these servers falls within the newly defined concept of control and leads to potential capitalization.

In addition, the standard also divides leasing arrangements into the following two components:

1. **Lease component:** represents the right to use the underlying assets, which will be used to calculate the *Right of Use Asset* and *Lease Liability*, based on the estimated term of the lease and the incremental borrowing rate.
2. **Non-lease component:** represents the goods and services provided to the lessee that are separate from the right to use the asset (for example maintenance, security and cleaning) which will be expensed as incurred.

As you can see, the process of determining whether a leasing arrangement exists, determining and allocating amounts between lease and non-lease components, estimating the term of the lease and the incremental borrowing rate, all involve considerable judgment. It is critical that you collaborate with your accounting professional from the beginning of your implementation phase.

Why Start Now?

Starting now will allow ample time to resolve issues smoothly, and deliver peace of mind well before the implementation deadline. We will be glad to help you review the particulars of your situation to determine the extent to which you will be affected. We understand the unique and complex accounting rules associated with the new lease accounting standard and are well-prepared to help you with the transition and implementation.

Abbott, Stringham & Lynch
CERTIFIED PUBLIC ACCOUNTANTS & BUSINESS ADVISORS

For more information, please contact us:
408.377.8700 | info@aslcpa.com
1530 Meridian Ave., 2nd Floor | San Jose, CA 95125