WILLIAMS MARSTON

August 2018

ASC 842: Implementing the new lease accounting standard

Executive Summary

- Applicable for calendar year end public companies beginning January 1, 2019
- For lessees, operating leases will be recorded as right-of-use assets and lease liabilities on the balance sheet
- Right-of-use assets must be monitored for impairment
- Companies should perform an exhaustive search to identify leases and embedded leases
- Once the population is identified, companies should classify their leases

Overview

The new lease accounting standard, Accounting Standards Codification ("ASC") 842, *Leases*, is effective for public entities for annual periods beginning after December 15, 2018 and interim periods therein. For all other entities, ASC 842 will be effective for annual periods beginning after December 15, 2019 and interim periods thereafter. Early adoption is permitted. The only acceptable transition method originally was the modified retrospective method. Although not yet codified, the FASB recently approved a new optional method to use the effective date for the initial application of the new standard. Companies electing this transition method will not need to adjust their comparatives or make the new required disclosures for periods before the effective date.

Under ASC 842, lessees will be required to recognize right-of-use assets and lease liabilities on their balance sheet for operating leases and disclose enhanced information about leasing arrangements. The lessor model was also updated to align with the new lessee model and the new revenue recognition standard, ASC 606. While some preparers believe ASC 842 will be less onerous to implement than other recently issued accounting standards, the level of effort for some companies is expected to be significant. Regulators are urging public entities that have not yet started their assessment, to do so as soon as possible. This white paper outlines some of the key steps to implement the new leasing standard.

- Once classified, companies can determine the appropriate recognition and measurement steps for each lease type
- New controls and best practices should be implemented to ensure that lease accounting is properly monitored on an ongoing basis

Step 1 – Lease Identification

The first step in implementing ASC 842 is to identify a complete population of lease arrangements, including both traditional leases and leases embedded in other arrangements such as service contracts. Identifying every potential lease arrangement can be a time-consuming process. Companies that do not have a centralized contract repository may have lease arrangements in many different locations and languages. Companies without a centralized contract list, should begin by reviewing expenses by vendor to identify any potential obligations that could be subject to the new standard.

In determining whether each contract contains a lease, companies should assess whether there is an identified asset and whether the contract includes the right to control the use of that asset for a period of time in exchange for consideration. If it is determined that a contractual obligation contains a lease, further analysis of the lease terms is required.

Step 2 – Lease Classification

Once all lease obligations are identified, the next step is to determine the appropriate classification. ASC 842 provides for the following lease types:

Lessee Types	Lessor Types
Operating	Sales-Type
Finance	Direct Financing
	Operating

As Companies are analyzing their lease obligations, they should aggregate key contractual provisions that were not considered leases under ASC 840 to determine potential impact under ASC 842. Each contractual obligation must be separated into lease and non-lease components, with consideration allocated amongst the various components. Lease components must be classified as either operating or finance leases to determine the appropriate balance sheet presentation and expense recognition model. Areas of focus should include extension options, discount rates, lease and non-lease components, and income tax considerations.

Step 3 – Recognition and Measurement

The most significant change under ASC 842 will be that lessees will recognize a right-of-use asset and a lease liability for operating leases. The lease liability is subsequently measured as the present value of the remaining lease payments using a discount rate determined at inception. The right-of-use asset is subsequently adjusted to the lease liability balance, adjusted for certain other items including lease incentives and other items that may cause uneven payments. The new standard also requires enhanced disclosures enabling financial statement users to better understand the amount, timing, and uncertainty of cash flows arising from leases. Qualitative and quantitative information will be required from both lessees and lessors to outline significant judgments and estimates inherent in applying the new standard.

Step 4 - Ongoing considerations

Throughout implementation, Companies must consider the effect of ASC 842 on their accounting policies, procedures, controls, and systems. The new standard presents an opportunity to improve procurement processes and centralize its contracts which can yield cost savings and other efficiencies. ASC 842 may also create the need for more sophisticated accounting software to address its requirements. Evaluation and enhancement of internal processes and controls is imperative to ensure complete and accurate financial reporting.

Although companies are required to classify leases at inception of the arrangement, they must also reassess their leases throughout the life of the arrangement in particular if the lease is modified in any way. Even if a lease is not modified, there are scenarios where a lessee could be required to remeasure lease payments. For example, a lessee is required to reassess the lease term or its option to purchase the underlying asset in certain cases. Companies should add controls to their monthly close to ensure that these on-going considerations are being addressed timely, throughout the year.

WilliamsMarston LLC

- Former Big Four experts with deep industry, operational and technical accounting expertise
- We provide actionable insights into the latest technical accounting and financial reporting developments

How we can help

With offices in Boston and New York, WilliamsMarston LLC is comprised of former Big Four accounting experts. We routinely advise pre-IPO and public companies on the accounting and reporting for complex transactions, including initial public offerings, mergers and acquisitions, revenue recognition, debt and equity instruments, variable interest entities, and stock-based compensation amongst many others. Chief Financial Officers and Controllers rely on WilliamsMarston's professionals for assistance with their most complex accounting and reporting initiatives.

Boston Office
265 Franklin Street
4th Floor
Boston, MA 02110
www.williamsmarston.com

New York Office
205 E 42nd Street
19th Floor
New York, NY 10017

Landen C. Williams
Partner – Boston
Phone: (617) 306-0951
landen@williamsmarston.com

Michael R. Donoso
Managing Director – New York
Phone: (646) 757-0572
mdonoso@williamsmarston.com

Jonathan T. Marston
Partner – Boston
Phone: (617) 851-0891
jon@williamsmarston.com