



ACCOUNTING FOR LEASES: ASC 842 CHANGES THE RULES

WHY THE CHANGE?

Historically, the accounting for many leases has been straightforward: Determine whether you have a capital or an operating lease. In the latter case, disclose future commitments as an “off-balance sheet” operating expense. This off-balance sheet treatment has created challenges for analysts and investors trying to understand a company’s financial obligations. The new lease standard seeks to solve those challenges by changing the accounting view and the way we think about future leasing transactions. Companies should inventory current leases and assess the effect of the new guidance on financial statements and the resulting impact on key metrics, agreements, and operations.

WHAT IS CHANGING?

- Modified retrospective transition method of adoption is required as of the earliest period presented.
- New definitions as to what constitutes a lease as well as what are considered as initial direct costs.
- Practical expedients are available for those leases existing upon adoption as well as several policy elections.
- Lessees will recognize a right-of-use asset and a lease liability on the balance sheet for ALL leases >12 months.
- New requirements increase judgment and disclosure in accounting for leases and changes in detailed calculations.
- Under finance leases, expenses will be front-loaded and, therefore, have a front loaded income statement impact.
- Real estate specific and “build-to-suit” guidance will be eliminated and leveraged leases will be grandfathered in.

HOW DO I DETERMINE THE IMPACT OF THESE CHANGES?



DEBT COVENANTS, RATIOS & OTHER METRICS

Review key metrics and act upon change before it's too late.



NEW TRANSACTIONS, PROCESSES, SYSTEMS & CONTROLS *Include internal controls in your strategic plan.*



LEASE VS. BUY ANALYSIS

Reconsider your leasing strategy: "off balance sheet" financing no longer permitted



CONSTRUCTION PROPERTY

Take advantage of reducing debt on the balance sheet via early adoption.

WHEN IS THIS CHANGE TAKING PLACE?

The new lease standard goes into effect for calendar year-end publicly traded companies and certain other entities beginning on January 1, 2019, including interim periods, and for all other entities beginning January 1, 2020, and interim periods the year thereafter.

WHAT NEXT STEPS SHOULD I TAKE?

- Understand new requirements under ASC Topic 842.
- Inventory lease population and required data.
- Evaluate lease data in light of accounting requirements.
- Assess capabilities of existing technology and whether it will meet the future accounting and disclosure requirements.
- Determine how new guidance affects current negotiations on lease extensions or new leases.
- Consider effects on existing policies and procedures and related controls.
- Calculate preliminary impact on debt covenants and other financial metrics.

UNDERSTAND

ASSESS

IMPLEMENT

As you evaluate the new revenue standard, ASC Topic 606, Revenue from Contracts with Customers, don't fall behind in your basic understanding of ASC Topic 842. The new lease guidance requires fundamental changes in accounting for leases, increased use of judgment, expansive disclosures, and may require changes to your current system or the implementation of new systems. While ASC Topic 606 allows companies to restate prior periods or apply the standard in the first year of adoption only, ASC Topic 842 allows no such election. Companies must restate all prior comparative periods. Restating prior periods two years in a row could be avoided by adopting both standards simultaneously.

HOW MORGANFRANKLIN CAN HELP:

The new lease standard affects leasing transactions, but it doesn't need to interrupt operations. MorganFranklin can help familiarize your organization with the new requirements, gauge the impact, and propose adoption strategies to stay ahead of the curve and drive better business outcomes.

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