

ACCOUNTING FOR LEASES – CHANGE IS UPON US

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At the end of February, the Financial Accounting Standards Board (FASB) issued the long-awaited new lease standard, Leases ASC 842. So what does this mean for lessors and lessees?

Little changes for lessors

Lessor accounting under the new model remains similar to the previous model with updates to coincide with certain changes to the lessee model and the new revenue recognition standard (a topic for another day). Lessors will continue to classify leases as operating, direct financing or sales-type.

Big changes for lessees – especially for operating leases

Lessee accounting under the new standard looks a bit different from the current model. Lessees will need to record a “right-of-use” asset and a lease liability for all leases (operating or finance) with a term greater than 12 months. The liability will be equal to the present value of the lease payments. The asset will be based on the lease liability and adjusted for certain items such as initial direct costs.

The income statement treatment depends on whether a lessee records an operating or finance lease. Operating leases will be expensed on a straight-line basis, similar to current operating leases. Finance leases will be expensed in a front-loaded expense pattern, similar to current capital leases. The criteria used to classify operating and financing leases are similar to those applied in current lease accounting but the explicit lines of distinction are absent in the new model.

What’s the effective date?

The standard is effective for US GAAP public companies for fiscal years, and interim period within those fiscal years, beginning after December 15, 2018. For private companies, the standard is effective for fiscal years beginning after December 15, 2019 and interim periods beginning the following year. Early adoption is permitted.

I have just scratched the surface here. Taking a more in-depth look at the new standard’s impact on your situation as well as planning for the transition would be worthwhile sooner rather than later. The effective date will be here before you know it!