



# ASC 842 Leases

# Lessee Accounting - Introduction

## (OLD) Accounting Standards Codification (ASC) 840, Leases

- ▶ Criticized for not always providing a faithful representation of leasing transaction.
- ▶ Did not require lessees to recognize assets and liabilities arising from operating leases on the balance sheet.

## (NEW) ASC 842, Leases

- ▶ Financial Accounting Standards Board (FASB) released Accounting Standards Update (ASU) No. 2016-02, Leases (Topic 842) in February 2016.
- ▶ Requires most leases to be recognized on **the balance sheet** with enhanced disclosures.
  - ▶ Right to use assets
  - ▶ Lease obligations
- ▶ Greater transparency about lessee's obligations and leasing activities
- ▶ Lessors → No significant changes

# Lessee's Accounting for Operating Leases Summary

- ▶ Off Balance to On Balance
  - ▶ Recognize Right of Use Assets and Lease Liabilities
  - ▶ Same as IFRS
  
- ▶ USGAAP adopts Dual Model
  - ▶ Operating Lease:           Straight-Lined (SL) Rental Expense Recognition
  - ▶ Finance Lease:           Interest Expense under Interest Method & Depreciation Expenses
  
- ▶ Under IFRS, it adopted “Single Model” and all leases are recorded with Interest Expenses under Interest Method & Depreciation Expenses on Right of Use Asset
  - ▶ In general, higher expenses in early stage of the lease term due to higher balance of lease liability with higher interest expenses while depreciation is calculated under straight line.

# Review of OLD Lease Actg (Operating Lease)

Year 1	\$ -
Year 2	10,000
Year 3	20,000
<b>Total</b>	<b>\$ 30,000</b>

J/E	
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<Dr.>	<Cr.>
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Year 1:			
<Dr.>	Rent Expense	10,000	Record SL Rent Exp
<Cr.>	Deferred Rent	10,000	Plug Number
Year 2:			
<Dr.>	Rent Expense	10,000	Record SL Rent Exp
<Cr.>	Cash	10,000	Cash Payment
Year 3:			
<Dr.>	Rent Expense	10,000	Record SL Rent Exp
<Dr.>	Deferred Rent	10,000	Plug Number
<Cr.>	Cash	20,000	Cash Payment

T-Accounts			
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CASH (B/S)	DEF RENT (B/S)	RENT EXP (P/L)
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		10,000
0	10,000	
		10,000
10,000		
		10,000
20,000	10,000	
30,000	0	30,000

# New Lease Actg

Lease Term (Yrs) 3  
 Discount Rate 6.55%  
 Total Lease Pmt 30,000

**Balancing Adjustment to maintain SL Rent Exp**

Current GAAP (ASC 840 / IAS 17)			New USGAAP (Operating Lease)				New USGAAP (Finance Lease) / New IFRS (IFRS 16)				
*2		(P/L)	*2		*3	(P/L)	*4		*3	*4	*3
(B/S)	(B/S)	(P/L)	(B/S)	(B/S)	(B/S)	(P/L)	(B/S)	(B/S)	(B/S)	(P/L)	(P/L)
CASH	DEF RENT	RENT EXP	CASH	ROU	LIAB	RENT EXP	CASH	ROU	LIAB	DEP'N EXP	INT EXP

Recognition (\*1)  
 YR. 1 Journal Entry  
 End of YR. 1  
 YR. 2 Journal Entry  
 End of YR. 2  
 YR. 3 Journal Entry  
 End of YR. 3  
**CUMULATIVE P/L**

Beg Bal \$27,000  
6.55%  
 Int Exp \$ 1,770

Beg Bal \$28,770  
 Pmt <10,000>  
 Aftr Pmt 18,770  
6.55%  
 Int Exp \$ 1,230

Beg Bal <\$28,770>  
 Payment 10,000  
 Acc Int < 1,230>  
 End Bal <\$20,000>

	Amount	PV
1	-	-
2	10,000	9,385
3	20,000	17,615
	<u>30,000</u>	<u>27,000</u>

PMT < EXP  
 PMT = EXP  
 PMT > EXP

\*2 Balancing ADJ (Def Rent & ROU Asset Adjustment)  
 \*3 Interest Method (Liab Bal <less Pmt> \* Int %)  
 \*4 Straight Line Depreciation of ROU Asset

**No Change on Finance Lease**

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Discount Rate 6.55%  
Total Lease Pmt 30,000

**Balancing Adjustment to maintain SL Rent Exp**

	Current GAAP (ASC 840 / IAS 17)			New USGAAP (Operating Lease)			New USGAAP (Finance Lease) / New IFRS (IFRS 16)					
	*2 (B/S) CASH	*2 (B/S) DEF RENT	(P/L) RENT EXP	(B/S) CASH	*2 (B/S) ROU	*3 (B/S) LIAB	(P/L) RENT EXP	(B/S) CASH	*4 (B/S) ROU	*3 (B/S) LIAB	*4 (P/L) DEP'N EXP	*3 (P/L) INT EXP
Recognition (*1)					27,000	(27,000)		27,000	(27,000)			
YR. 1 Journal Entry	-	(10,000)	10,000	-	(8,230)	(1,770)	10,000	-	(9,000)	(1,770)	9,000	1,770
End of YR. 1	-	(10,000)	<b>10,000</b>	-	18,770	(28,770)	<b>10,000</b>	-	18,000	(28,770)	<b>9,000</b>	1,770
YR. 2 Journal Entry	(10,000)	-	10,000	(10,000)	(8,770)	8,770	10,000	(10,000)	(9,000)	8,770	9,000	1,230
End of YR. 2	(10,000)	(10,000)	<b>10,000</b>	(10,000)	10,000	(20,000)	<b>10,000</b>	(10,000)	9,000	(20,000)	<b>9,000</b>	1,230
YR. 3 Journal Entry	(20,000)	10,000	10,000	(20,000)	(10,000)	20,000	10,000	(20,000)	(9,000)	20,000	9,000	-
End of YR. 3	(30,000)	-	<b>10,000</b>	(30,000)	-	-	<b>10,000</b>	(30,000)	-	-	<b>9,000</b>	-
<b>CUMULATIVE P/L</b>			<b>30,000</b>				<b>30,000</b>				<b>27,000</b>	<b>3,000</b>

Beg Bal \$27,000  
6.55%  
Int Exp \$ 1,770

Beg Bal \$28,770  
Pmt <10,000>  
Aftr Pmt 18,770  
6.55%  
Int Exp \$ 1,230

Beg Bal <\$28,770>  
Payment 10,000  
Acc Int < 1,230>  
End Bal <\$20,000>

**No Change on Finance Lease**

**\*1 Present Value Calculation**

	Amount	PV	
1	-	-	PMT < EXP
2	10,000	9,385	PMT = EXP
3	20,000	17,615	PMT > EXP
	<b>30,000</b>	<b>27,000</b>	

- \*2 Balancing ADJ (Def Rent & ROU Asset Adjustment)
- \*3 Interest Method (Liab Bal <less Pmt> \* Int %)
- \*4 Straight Line Depreciation of ROU Asset

# Old to New Lease Accounting

Presented in Dr. / <Cr.>		OLD: OPERATING LEASE				NEW: OPERATING LEASE				OLD & NEW: FINANCE LEASE			
		YEAR 1	YEAR 2	YEAR 3	TOTAL	YEAR 1	YEAR 2	YEAR 3	TOTAL	YEAR 1	YEAR 2	YEAR 3	TOTAL
ASSET	CASH	-	(10,000)	(30,000)	(30,000)	-	(10,000)	(30,000)	(30,000)	-	(10,000)	(30,000)	(30,000)
	ROU ASSET	-	-	-	-	18,770	10,000	-	-	18,000	9,000	-	-
LIAB	DEF RENT LIAB	(10,000)	(10,000)	-	-	-	-	-	-	-	-	-	-
	LEASE LIAB	-	-	-	-	(28,770)	(20,000)	-	-	(28,770)	(20,000)	-	-
EQTY	R/E	-	10,000	20,000	-	-	10,000	20,000	-	-	10,770	21,000	-
	CY PROFIT	10,000	10,000	10,000	30,000	10,000	10,000	10,000	30,000	10,770	10,230	9,000	30,000
BAL CHECK		-	-	-	-	-	-	-	-	-	-	-	-
P/L	RENT EXP	10,000	10,000	10,000	30,000	10,000	10,000	10,000	30,000	-	-	-	-
	DEP'N EXP	-	-	-	-	-	-	-	-	9,000	9,000	9,000	27,000
	INT EXP	-	-	-	-	-	-	-	-	1,770	1,230	-	3,000
	NET INCOME	10,000	10,000	10,000	30,000	10,000	10,000	10,000	30,000	10,770	10,230	9,000	30,000
<b>P/L DIFFERENCE vs. OLD OPERATING LEASE</b>						-	-	-	-	770	230	(1,000)	

- ▶ ROU Assets and Lease Liabilities are recognized for both Operating Lease and Finance Lease
- ▶ Straight-Line Rental Expense for Operating Lease
- ▶ Higher Expenses in early stage of the lease term for Finance Lease

# New Lease Actg Adoption

Presented in Dr. / <Cr.>		OLD	NEW	
		END YR 1	BEG YR 2	
ASSET	CASH	-	-	
	ROU ASSET	-	18,770	] Net Bal = Def Rent Liab
LIAB	DEF RENT LIAB	(10,000)	-	
	LEASE LIAB	-	(28,770)	
EQTY	R/E	10,000	10,000	NO EFFECT
	CY PROFIT	-	-	
BAL CHECK		-	-	



# Practical Expedients

- ▶ The Package of Practice Expedients upon Initial Adoption
  - ▶ No Reassessment of Lease Classification
  - ▶ No Re-Evaluation of Embedded Leases
  - ▶ No Reassessment of Initial Direct Costs
  
- ▶ Risk-Free Interest Rate for Private Companies
  - ▶ Upon transition, the discount rate is determined as of the application date of the new guidance.