

# MaherDuessel

Pursuing the profession while promoting the public good®

[www.md-cpas.com](http://www.md-cpas.com)

## Leases

---

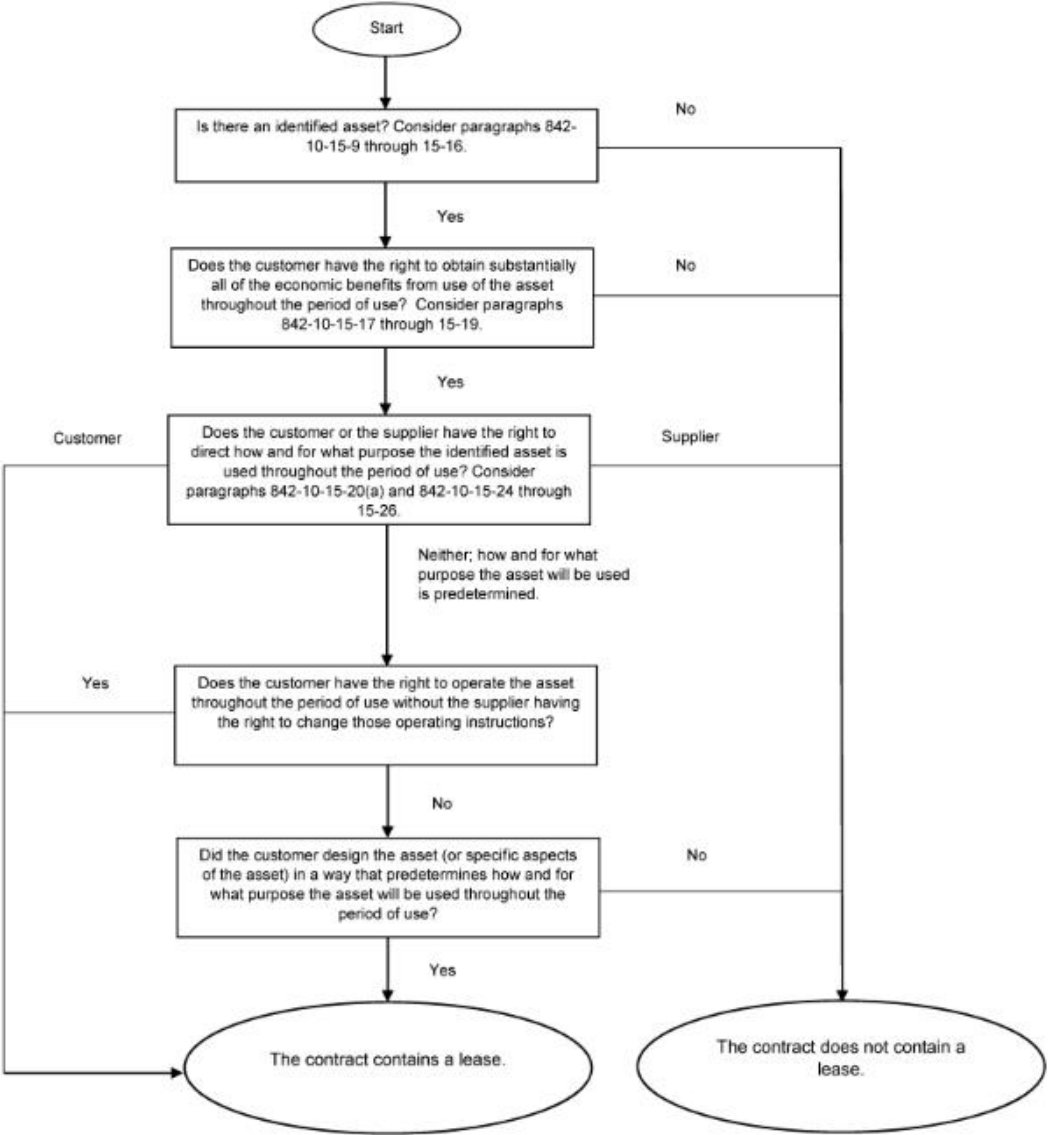
NIKKI L. WALTON, CPA, SENIOR MANAGER

**Non-Profit Update – July 2021**



---

## WHAT MAKES A LEASE A LEASE?



# Lease?

---

- ❑ Customer enters into a contract with a ship owner to transport its cargo
- ❑ The contract specifies the cargo to be transported on the ship and the dates of pickup and delivery
- ❑ Customer's cargo will occupy substantially all of the capacity of the ship and therefore obtains all of the economic benefits
- ❑ The specific ship is identified in the contract and cannot be replaced
- ❑ The ship owner will operate the ship and is responsible for the cargo
- ❑ The ship owner limits the use of the ship in bad weather conditions

# Lease?

---

- ❑ Customer does not obtain the right to control the ship because it does not have the right to direct its use, therefore, not a lease
- ❑ Limits of use due to weather conditions and the ship owner operating the ship does not disqualify the contact as a lease
- ❑ Note – the key elements to define a lease are:
  - Right to control the use
  - For a period of time
  - For consideration



---

## CURRENT LEASE ACCOUNTING

# Lease Type Criteria

---

## FASB codification Topic 840

- Capital lease criteria
  - Lease transfers ownership by the end of the term
  - Lease contains a bargain purchase option
  - Lease is 75% or more of the estimated economic life of the leased property
  - Present value of the minimum lease payments equals 90% of the fair value of the property
- Operating leases
  - Anything not meeting the criteria of a capital lease

# Capital Leases

---

- ❑ Value equal to the present value of the minimum lease payments or fair value of the asset leased (whichever is lower)
- ❑ Lease liability amortized
- ❑ Lease asset depreciated
  - Life of the asset or term of the lease depending on the criteria met
- ❑ Disclose future minimum payments



# Operating Leases

---

- ❑ No liability or asset recorded
- ❑ Lease payments are expensed
- ❑ Disclose future minimum payments
  - If long-term and noncancelable



---

## LEASE ACCOUNTING UNDER FASB TOPIC 842

Passcode #1

# Scope and Effective Date

---

- ❑ FASB Topic 842
- ❑ Effective date – reporting period beginning after December 15, 2021
- ❑ How does this improve accounting and financial reporting?
  - Improves transparency and comparability among organizations by recognizing lease assets and lease liabilities.

# Definition of a Lease

---

- A contract that conveys the right to control the use of identified property, plant, or equipment for a period of time in exchange for consideration.

# Excluded from Scope

---

- ❑ Leases of intangible assets
- ❑ Leases of biological assets (timber, plants, animals)
- ❑ Leases to explore for or use minerals, oil, natural gas, etc.
- ❑ Leases of inventory
- ❑ Leases of assets under construction

# Short-Term Lease

---

- ❑ Option to elect an accounting policy to exclude short-term leases
- ❑ Lease term
  - Maximum possible term under the lease contract of 12 months including options to extend
  - Leases cancelable by either party such as month-to-month or year-to-year leases
    - Maximum possible term is the noncancelable period (including notice periods)



---

## LONG-TERM LEASES



# Finance/Sales-Type Lease

---

- ❑ The lease transfers ownership of the underlying asset by the end of the term
- ❑ The lease grants an option to purchase the underlying asset and it is reasonably certain to exercise
- ❑ The lease term is a major part of the economic life of the underlying asset
- ❑ The present value of the lease payments equals or exceeds the fair value of the underlying asset
- ❑ The underlying asset is specialized and there is no alternative use to the lessor at the end of the lease term

# Operating Lease

---

- ❑ All other leases not meeting the finance/sales-type criteria

# Lease Term

---

- The period during which a lessee has a noncancelable right to use an underlying asset, plus:
  - Periods covered by a lessee's or lessor's option to extend the lease if it is reasonably certain
  - Periods covered by a lessee's or lessor's option to terminate the lease if it is reasonably certain
  - Period for which both the lessee and lessor have an option to terminate without permission from the other party (or if both have to agree to extend) are cancelable periods and are excluded from the lease term (rolling month-to-month lease)

# Reassessment of the Lease Term

---

- If the following occur:
  - The lessee or lessor elects an option that was not previously determined to be exercised
  - An event specified in the lease contracts that requires an extension or termination of the lease takes place

Passcode #2



---

## LEASE LIABILITY

# Measurement

---

- ❑ Measured at the present value of payments expected to be made during the lease term
- ❑ The discount rate used for measurement should be the rate implicit in the lease, unless that rate cannot be readily determined
- ❑ If an interest rate is not determined by the lessee, the estimated incremental borrowing rate should be used

# Future Payments Included in the Measurement of the Lease Liability

---

- ❑ Fixed payments
- ❑ Variable payments that depend on an index
- ❑ Variable payments that are fixed in substance
- ❑ The exercise price of the purchase option if it is reasonably certain that the lessee will exercise the option
- ❑ Payments for penalties for terminating the lease



# Remeasurement of the Lease Liability

---

- ❑ Change in the lease term
- ❑ Likelihood of purchase option being exercised has changed
- ❑ Change in the estimated amount of payments
- ❑ Change in variable payments that were contingent on the performance or use of the asset become fixed



---

## LEASE ASSET (RIGHT TO USE ASSET)

# Measurement

---

- Measured as the sum of the following:
  - The amount of the initial measurement of the liability
  - Lease payments made to the lessor at or before the commencement of the lease term, less any incentives
  - Initial direct costs

# Amortization

---

- ❑ Systematic and rational manner over the shorter of:
  - Lease term
  - Useful life of the asset
- ❑ If a purchase option is reasonably certain of being exercised:
  - Amortize over the life of the asset
- ❑ Operating lease – combined with rent interest
- ❑ Sales type lease - recorded as amortization expense

# Adjustments to the Lease Asset

---

- ❑ Same factors as the lease liability
- ❑ If value of asset is reduced to zero, remaining liability is removed and recognized as a gain
- ❑ Impairment of asset
  - Change in time the asset can be used
  - Decline in utility of the asset



---

# FINANCIAL STATEMENT PRESENTATION

# Lessee - Operating

---

- ❑ Lease Asset (Right to Use)
  - Present value of the lease payments
  - Amortize over life of lease
  
- ❑ Lease Liability
  - Present value of the lease payments
  - Amortize on the effective interest method over life of the lease
  
- ❑ Lease expense is incurred on the straight line basis and includes both amortization and interest

# Lessor – Operating Lease

---

- ❑ Lease Revenue
  - Recognized over the life of the lease on the straight-line basis
- ❑ Underlying Lease Asset
  - Do not derecognize



# Lessee – Finance Lease

---

## □ Lease Asset

- Present value of the lease payments
- Amortize on the straight-line basis over life of lease

## □ Lease Liability

- Present value of the lease payments
- Amortize on the effective interest method over life of the lease

# Lessor – Finance Lease

---

- ❑ Net Investment in Lease
  - Present value of the lease payments due
- ❑ Underlying Lease Asset
  - Derecognize
- ❑ Interest income
  - Recognized over the life of the lease on the effective interest method on the carrying value of the net investment in the lease



---

## EXAMPLES

# Terms of Leased Asset

---

## □ Terms

- Total lease payments - \$500,000
- \$15,000 of direct costs
- 10 years
- Interest rate 5.87% (incremental borrowing rate)

## □ Present value

- \$362,093 Lease liability (first payment made at start of lease)
- \$407,017 Right to use asset

# Lessee – Finance Lease

---

- First year
  - Debit - Right to use asset \$407,017
  - Debit interest expense \$20,076
  - Credit - Lease Liability \$362,093
  - Credit – Cash \$65,000

# Lessee - Finance Lease

---

## □ Annual Entries

- Lease Asset
  - Debit – Amortization Expense \$40,702
  - Credit - Right to use asset \$40,702
- Lease Liability
  - Debit – Lease Liability \$29,924 (changes each year)
  - Debit – Interest Expense \$20,076 (changes each year)
  - Credit – Cash \$50,000

# Lessee – Operating Lease

---

- First year
  - Debit - Right to use asset \$375,593
  - Debit - Lease expense \$51,500
  - Credit - Lease Liability \$362,093
  - Credit – Cash \$65,000

# Lessee - Operating Lease

---

- Annual Entries
  - Debit Lease expense - \$51,500
  - Debit Lease liability \$29,924
  - Credit Lease asset \$31,424
  - Credit Cash \$50,000





---

## FINANCIAL STATEMENT PRESENTATION - LESSEES

# Notes to the Financial Statements

---

- Basis and terms of the lease
- Existence and terms and conditions to extend or terminate
- The terms and conditions of residual value guarantees
- Restrictions and covenants imposed

# Notes to the Financial Statements

---

- ❑ Finance lease cost – segregated between the amortization of the right-to-use asset and lease liability
- ❑ Operating lease cost
- ❑ Maturity of undiscounted lease liabilities (finance and operating separately) on an annual basis for 5 years and the total remaining after
- ❑ Reconciliation of undiscounted cash flows to lease liability recognized

# Statement of Financial Position

---

- ❑ Finance and operating leases presented separately
  - Right-to-use asset
  - Lease liability
  - May combine asset and liability but must include footnote to categorize



---

## FINANCIAL STATEMENT PRESENTATION - LESSORS

# Notes to the Financial Statements

---

- ❑ Basis and terms of the lease
- ❑ Existence and terms and conditions to extend or terminate
- ❑ Existence and terms and conditions of options for a lessee to purchase the underlying asset

# Notes to the Financial Statements

---

- Lease income recognized
  - Sale-type/financing leases
    - Profit or loss recognized at the commencement date
    - Interest income
  - Operating lease
    - Lease income relating to lease payments
  - Lease income relating to variable lease payments not included in the measurement of the lease receivable

# Notes to the Financial Statements

---

- ❑ Maturity of undiscounted lease receivables on an annual basis for 5 years and the total remaining after
- ❑ Reconciliation of undiscounted cash flows to lease liability recognized



Passcode #3



---

## OTHER ITEMS TO CONSIDER

# Lease Incentives

---

- ❑ Payments to or on behalf of the lessee by the lessor
- ❑ Considered a rebate or discount to the lease obligation
- ❑ Include in the initial measurement
  - Applied as a reduction in lease payments for the period in which the incentive payment will be provided

# Lease Modifications

---

- ❑ Treat as a separate lease if the following are present:
  - The modification gives the lessee an additional lease asset by adding additional underlying asset(s)
  - Increase in lease payments correspond with the standalone price for the additional right of use
- ❑ Otherwise remeasure the current lease

# Lease Termination

---

- ❑ Decrease in the lessee's right to use the underlying asset
  - Shortened term
  - Decrease in the number of underlying assets
  - Include partial or full lease termination
- ❑ Reduce lease asset and liability and report gain/loss for difference



---

## IMPLEMENTATION AND PRACTICAL CONSIDERATIONS

# Implementation

---

- ❑ Implemented retroactively by restatement, if practical for all periods presented
  - Little impact on statement of activities
- ❑ Do not apply to immaterial items
  - Consider the underlying asset leased

# Implementation

---

- Gather information for all outstanding leases and evaluate the terms and conditions and identify:
  - Length of lease
  - Interest rate to apply
  - Useful life of the asset



# Implementation

---

- Compile information for disclosure
  - Roll forward of leases
  - Future payments schedule
  - Any other payments made/received

# Practical Considerations

---

- ❑ Assess lease agreements
  - Are terms month-to-month or less than 12 months? Can they be amended to do so?
  - Does the lease include cancelable terms?
- ❑ Evaluate what is material to the users of the financial statements
- ❑ Evaluate current capitalization policies and thresholds

Passcode #4

# Questions?

---

Nikki L. Walton, CPA – Senior Manager

[nwalton@md-cpas.com](mailto:nwalton@md-cpas.com)

412-535-5513

Source: Financial Accounting Standards Board Statement,  
*“Leases,” Topic 842*