

CPA Firms:

Help Your Clients Now With Lease Accounting Policy Decisions

A critical part of implementation planning is making the policy elections that are required under the new lease accounting standard. Although the new lease standard doesn't go into effect until 2021, CPA firms and their clients should start discussing these policy elections now because these decisions impact both the transition and day one accounting.

SHORT TERM LEASES

By definition, a short-term lease has a maximum term of 12 months or less and does not include a purchase option that the lessee is reasonably certain to exercise. Lessees may make a policy election not to apply the standard (that is, not recognize a right of use asset or lease liability) to short-term leases for all classes of underlying assets. If this election is made, the lessee would recognize the lease payments as operating expense straight-line over the lease term. This election saves time in accounting for these leases, but the disadvantage is that different accounting policies and processes need to be in place for short-term and longterm leases. Lessees must still disclose short-term lease cost - except for leases with terms of one month or less - for each period presented.

[\(ASC 842-20-25-2\)](#)

NONLEASE COMPONENTS

Components of a contract include only those items or activities that transfer a good or service to the lessee. Examples of nonlease components in a real estate lease include items such as common area maintenance or parking. A lessee may choose, as a practical expedient by class of underlying asset, to account for the lease and nonlease components as a single combined lease component. If this election is not made, the lease payments are allocated to the separate lease and nonlease components, using relative standalone prices (estimated if not readily available). While this expedient saves time, the lessee will have a larger liability (and ROU asset) by treating nonlease components as lease components.

[\(ASC 842-10-15-37 and ASC 842-10-55-131 through 140\)](#)



CLASSIFICATION CRITERIA

If any of the five criteria in ASC 842-10-25-2 were met, a lessee would classify the lease as a finance lease. One of these evaluation criteria is whether the lease term is for a major part of the economic life of the underlying asset. Lessees can make a policy election, by class of asset, to define what percentage constitutes a major part. Although the FASB did not include a bright-line percentage in ASC 842 as in prior guidance, it has indicated that 75% of the asset's remaining economic life is a reasonable approach.

Another of the five evaluation criteria is to determine whether the present value of the sum of the lease payments equals or exceeds substantially all of the fair value of the underlying asset. Lessees can make a policy election, by class of asset, to define what percentage constitutes substantially all. Although the FASB did not include a bright-line percentage in ASC 842 as in prior guidance, it has indicated that 90% of the fair value of the underlying asset is a reasonable approach.

The advantage of defining major part and substantially all using 75% and 90% respectively, is consistent accounting application across the client's lease portfolio.

(ASC 842-10-25-2(c), ASC 842-10-55-2)

DISCOUNT RATE

At the lease commencement date, lessees determine the present value of the lease payments to calculate the ROU asset and lease liability using the rate implicit in the lease. If the rate implicit in the lease is not readily available, nonpublic business entities can make a policy election to use the risk-free rate in lieu of determining an incremental borrowing rate. This election saves time and reduces audit risk, because determination of a lessee's incremental borrowing rate requires research, judgment, documentation, and review. However, the risk-free rate will likely be a lower rate than the incremental borrowing rate, creating a larger lease liability.

(ASC 842-20-30-3)

PRESENTATION OF ROU ASSETS AND LEASE LIABILITIES

Lessees can make a policy election on how to present their finance and operating lease ROU assets and lease liabilities in their statements of financial position and related notes. They can elect to present separate statement of financial position line items for finance lease ROU assets, operating lease ROU assets, finance lease liabilities, and operating lease liabilities. Or they can disclose in the footnotes, where each of these types of assets and liabilities have been included in the financial statement line items. If leases are not significant, clients may find disclosure in notes to be a better election.

(ASC 842-20-45-1)

TRANSITION RELIEFS

A number of practical expedients are available for lessees to apply to leases that commenced before the standard's effective date. Each practical expedient must be elected as a package and applied to all leases.

Lessees can elect not to assess whether expired or existing contracts are or contain leases, lease classification for any existing or expired leases, and whether initial direct costs would have qualified for capitalization for any existing leases.

(ASC 842-10-65-1(f))

Another expedient that can be elected for existing leases at transition is to use hindsight regarding lease renewals and purchase options when determining the lease term and in assessing impairment of the ROU asset. This relief can be elected independently of the previous practical expedient, but it must be applied consistently to all leases.

(ASC 842-10-65-1(g))

Lessees may apply a single discount rate to a portfolio of leases with reasonably similar characteristics (such as a similar lease term for a similar class of asset). A single discount rate cannot be applied to the entire lease portfolio.

(ASC 842-20-55-17)

POLICY DECISION GUIDE

While these policies are a lot for clients to think about, the good news is that you can offer them your expert advice and resources to help them with these decisions. Much of this work can be provided outside of busy season, providing you with additional off-peak, billable hours. The time is now to start talking to your clients about the new lease standard, and **LeaseCrunch can help.**

ACCESS THE FULL LIST

To receive a detailed checklist of policy decisions for the new lease standard for FASB or IFRS, [contact us](#). Our lease standard policy checklist is designed to guide your clients through each policy election, complete with pros and cons to make the best decision for them. We look forward to hearing from you!



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