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# Balance *sheet*

## PLANNING FOR THE NEW LEASE ACCOUNTING STANDARDS

By Doug Schleucher, CPA

Back in 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2016-02, Leases (Topic 842), also known as ASC 842, to “increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing transactions.” The new lease standards apply to all entities that prepare financial statements in accordance with generally accepted accounting principles (GAAP). Last year, in response to the outbreak of COVID-19, the FASB delayed the effective date of ASC 842 for private companies and nonprofit entities until the year 2022.

The new standards represent a major change in lease accounting as significantly more leasing arrangements will need to be reported on the balance sheets of lessees. While the accounting for a finance lease under the new rules will be very similar to the current standards, accounting for operating leases will undergo a significant change, as those leases will now result in the recognition of a right-to-use asset and a lease liability on the entity’s balance sheet. As reported by Bloomberg Tax, “Under long-standing lease accounting rules, companies kept most of these liabilities off their balance sheets, out of sight of investors and creditors.”



The new standards also apply to any type of contract that may have an embedded lease. These embedded leases can be difficult to identify. Large hospitals, for example, often have industrial size ice machines on the premises that are owned by an outside vendor with whom they have an ice service contract. The “lease” of the ice machine is embedded in the service contract and could be subject to the new lease accounting rules.

In some cases, implementing the new lease accounting standards will be quite challenging. A good starting place for implementation is to compile a complete listing of all known lease contracts. A broad review of contracts will be required since leases can be embedded in all types of contracts. The best place to start is to review all expense accounts and look for recurring payments, because these often have the potential to have contracts that contain a lease. Review any contracts associated with these recurring payments to identify any embedded leases. If the contract meets the elements of a lease, it should be added to the list.

If you are subject to these new rules and need some help, please let us know. We are here to help.

Items presented are not intended to be technically complete. Additional information may be required to make an informed decision.  
You cannot rely upon this information for avoiding tax penalties.a