



**DZA**

DINGUS, ZARECOR &  
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# Leases – Almost Here

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# Overview

- Big picture
- Objective, impact, and implementation
- Government Accounting Standards Board (GASB)
  - Rules for Hospital Districts and County Hospitals
- Financial Accounting Standard Board (FASB)
  - Rules for not-for-profit and for-profit entities
- Implementation

# Big Picture

- Organizations will recognize lease assets and lease liabilities on the balance sheet for virtually all leases
- Balance sheet will change
  - More property
  - More debt
- Expenses will not change significantly for most not-for-profit leases
  - Classification changes among lease, depreciation, and interest expense
- The timing of expenses over the life of a lease may change for governmental entities

# Objective

- To increase transparency and comparability among organizations
- Foundational principle that leases are financing of the right to use an underlying asset
  - Operating leases are currently “off-balance” sheet financing
  - Operating lease obligations will become liabilities on the balance sheet

# Improved Lease Accounting

- More faithful representation of a lessee's rights and obligations
- Fewer opportunities for organizations to structure leasing transactions to achieve a particular outcome on the balance sheet
- Improves understandability and comparability of financial statements
- Enhanced disclosures in the notes to the financial statements

# Impact on Financial Ratios

- Debt to Equity – the debt to equity ratio will increase (more liabilities with no change in equity)
- Return on Assets – the return on assets ratio will decrease (more assets with no additional net income)
- Working Capital – the working capital ratio will decrease (more current liabilities for current portion of lease liability)

# Debt Covenants

- Will increase assets and liabilities on the balance sheet
- Net income may change due to timing of asset amortization, but many debt covenants exclude amortization in the ratio calculation
- Need to prepare pro forma debt covenant calculations to determine any potential compliance issues – then work with creditor to modify
- Creditors will understand

# GASB vs. FASB

- GASB uses a single model – all leases are accounted for the same
- FASB still has some distinctions between a finance and operating lease



# FASB and GASB

- FASB – applies to not-for-profit and for-profit entities
- GASB – applies to governmental entities
- The overall substance and impact of both standards are similar, but there are differences in the details
- We will address the GASB Standard first

# GASB Leases

- All leases will be recorded on the balance sheet with the exception of short term leases

# GASB Effective Dates

- Fiscal years beginning after June 15, 2021:
  - June 30, 2022
  - September 30, 2022
  - December 31, 2022

# GASB—Lease Definition

- A contract that conveys control of the right to use another entity's nonfinancial asset (the underlying asset) as specified in the contract for a period of time in exchange or exchange-like transaction
- A contract that conveys control of the right to use the underlying asset should have **both** of the following:
  - Right to obtain the present service capacity
  - Right to determine the nature and manner of use

# GASB — Applicability

- All leases and subleases of property, plant, and equipment
- Not applicable to:
  - Leases of intangible assets
  - Leases of assets under construction
  - *Leases in which the underlying asset is financed with outstanding conduit debt, unless both the underlying asset and conduit debt are reported by the lessor*
  - ***Leases that automatically transfer ownership of the asset*** – *are considered financed purchases*
    - *A nominal purchase price is not considered an automatic transfer*

# GASB —Initial Recognition

- Lease liability at the present value of the lease payments not yet paid for the lease term, using the discount rate for the lease, and the lease term
- Right-of-use asset amount calculated for the lease liability plus any amounts paid at or before the beginning of the lease

# GASB—Lease Term

- Noncancellable period of the lease, plus the following:
  - Periods covered by lessee's option to extend the lease *if it is reasonably certain, based on all relevant factors*, the lessee will exercise the option
  - Periods covered by a lessee's option to terminate the lease *if it is reasonably certain, based on all relevant factors*, the lessee will **not** exercise the option
  - Periods covered by a lessor's option to extend the lease *if it is reasonably certain, based on all relevant factors*, the lessor will exercise the option
  - Periods covered by the lessor's option to terminate the lease *if it is reasonably certain, based on all relevant factors*, the lessor will **not** exercise the option

# GASB—Lease Term

- Other
  - Periods in which both the lessee and the lessor have the option to terminate the lease are excluded from the lease term
  - A fiscal funding law that allows governments to cancel a lease if funds are not appropriated for the lease only affects the lease term if it is reasonably certain the clause will be exercised



# GASB—Reasonably Certain

- A judgement made based on the relevant factors

# GASB—Relevant Factors

- Factors can be contract-based, underlying-asset-based, market-based, or government-specific
- Examples include:
  - Significant economic incentive, such as contract terms and conditions for the optional periods that are favorable compared with current market rates
  - Significant economic disincentive, such as costs to terminate and sign a new lease
  - History of exercising options
  - Extent to which the underlying asset is essential to the provision of government services

# GASB—Short-term Leases

- Maximum possible term of 12 months or less, including any options to extend regardless of their probability to be extended.
- For leases cancellable by either the lessee or lessor, such as rolling month-to-month or year-to-year, the maximum possible term is the noncancellable period, including any notice periods
- Expense based on payment provisions (not on straight-line basis)

# GASB— Separating Lease and Non-lease Components

- Many contracts contain a lease component and non-lease components
  - Maintenance agreement
  - Supplies
  - Training
  - Services
- In practice, these contracts have largely been ignored because, up to now, they have been an expense regardless of classification (lease expense or purchased service or supplies – no impact on balance sheet or net income)

# GASB—Separating Lease and Non-lease Components

- Lease component now needs to be capitalized – an asset and liability will need to be recognized
- Other components are expensed
  - Allocated based on “stand-alone” prices
- If components cannot be separated, the entire contract is considered a lease

# GASB—Lease Liability

- Present value of payments expected to be made during the lease
- Includes the following:
  - Fixed payments
  - Variable payments that depend on an index rate (CPI or market interest rate) initially measured using the index or rate at the lease term commencement
  - Variable payments that are fixed in substance
  - Amounts reasonably certain to be paid under residual value agreements
  - Exercise price of a purchase option if it is reasonably certain the lessee will exercise the option
  - Termination penalty payments – if the lease term reflects the lessee exercising an option to terminate
  - Lease incentives received from the lessor
  - Any other payments reasonably certain of being required

# GASB—Variable Payments

- Variable payments based on future performance of lessee or usage of the underlying asset are NOT included in the measurement of the lease liability
- These variable payments are recognized as expense in the period incurred
- If the variable payment is fixed in substance, it would be part of lease liability measurement
- However, significant variable payments need to be disclosed in the footnotes to the financial statements

# GASB—Interest Rate

- Rate implicit in the lease
- If not implicit, lessee's estimated incremental borrowing rate



# GASB—Lease Asset

- Sum of the following:
  - Amount of the initial measurement of the lease liability
  - Lease payment made to, or lease incentive received from, the lessor prior to commencement of the lease term
  - Initial direct costs that are ancillary charges necessary to place the lease asset into service

# GASB—Lease Asset

- Initial direct costs considered debt issuance costs would be an expense in the period
- Lease asset amortized in systematic and rational manner over shorter of lease term or useful life
- Amortization expense may be reported with depreciation expense
- If a purchase option determined to be reasonably certain to be exercised: amortize over useful life
- Lease asset would be adjusted by same amount as lease liability if remeasured

# GASB—Lease Term Reassessment

- Reassess only if:
  - Option exercised was previously determined to be reasonably certain not to be exercised
  - Option not exercised was previously determined to be reasonably certain to be exercised
  - An event specified in the lease contract that requires an extension or termination of the lease takes place

# GASB — Modification is a Separate Contract

- Account for the modification as a separate contract when both of the following conditions are present:
  - Modification grants the lessee an additional right-of-use not included in the original lease (example – an additional asset)
  - Lease payments increase commensurate with the stand-alone price for the additional right-of-use

# GASB—Lease Remeasurement

- Lessee should remeasure the lease liability if one or more of the following changes have occurred:
  - Lease term changes
  - Residual value guarantee being paid has changed from reasonably certain to not reasonably certain (or vice versa)
  - Purchase option to be exercised has changed from reasonably certain to not reasonably certain (or vice versa)
  - Change in estimated amounts already included in the measurement
  - Change in the interest rate the lessor charges the lessee if used as the initial discount rate
  - A contingency upon which some or all of the variable payments to be paid over the remainder of the lease are resolved so that they now meet the criteria to be included in the measurement

# GASB—Lease Remeasurement

- If lease is remeasured: lease liability should also be adjusted for any change in index or rate used
- No remeasurement should be made solely for a change in the index rate (or for a change in the lessee's incremental borrowing rate)

# GASB—Lessee Accounting: Statement of Revenues, Expenses, and Changes in Net Position

- Operating Expenses

	December 31,	
	2022	2021
<i>Operating expenses:</i>		
Lease	\$ 2,000	\$ 2,000
Depreciation	100,000	100,000
Amortization - Right-of-use asset	43,831	43,831
Interest	4,224	6,758

*Note: Lease expense would be applicable to any short term leases of 12 months or less*

# GASB—Lessee Accounting: Statement of Net Position

- Intangible right to use asset (aka capital asset)
- Lease liability

	2022	2021
<i>Capital assets and right-of-use assets, net</i>		
Capital assets	\$ 1,000,000	\$ 1,000,000
Less: accumulated depreciation	(200,000)	(100,000)
Right-of-use assets	131,493	131,493
Less: accumulated amortization	(87,662)	(43,831)
Total capital assets and right-of-use assets, net	\$ 843,831	\$ 987,662
<i>Current liabilities</i>		
Lease liability	\$ 46,475	\$ 43,776
<i>Noncurrent liabilities</i>		
Lease liability	-	46,475



# Example 1

- Facts
  - Leased office space for business office and accounting department
  - 10-year lease with two 5-year extensions
    - \$5,000/month for entire term
  - Reasonably certain to exercise extensions
  - Lessor cannot terminate early
  - Incremental borrowing rate is 6%
  - Ownership does not transfer at end of lease

# Example 1

- Net Present Value of Payments
- Tip – Use Amortization Software such as TValue

The screenshot displays the TValue software interface. At the top is a blue toolbar with icons for New, Open, Save, Print, Insert, Delete, Expand, Sort, Calculate, and Rounding. Below the toolbar are two tabs: 'Cash Flow Data' (active) and 'Amortization Schedule'. Under the 'Cash Flow Data' tab, there is a 'Label' field containing 'Example 1', a 'Compounding' dropdown menu set to 'Monthly', and a 'Nominal Annual Rate' field set to '6.000 %'. To the right of these fields is a tooltip that reads: 'Choose a selection that specifies the period of time between periods. This field is used if the number is greater than one'. Below the input fields is a table with the following data:

	Event	Date	Amount	Number	Period	End Date
1	Loan	01/01/2020	Unknown	1		
2	Payment	01/31/2020	5,000.00	240	Monthly	12/31/2039

# Example 1

- Hit “Calculate”
- Net present value is \$697,951.43

NewOpenSavePrintInsertDeleteExpandSortCalculateRounding

Cash Flow Data

Amortization Schedule

Label: Example 1 >>

Compounding: Monthly Nominal Annual Rate: 6.000 % >>

Choose a selection that specifies the period of time between period. This field is used if the number is greater than one. (

	Event	Date	Amount	Number	Period	End Date
1	Loan	01/01/2020	697,951.43	1		
2	Payment	01/31/2020	5,000.00	240	Monthly	12/31/2039

# Example 1—Journal Entries

- Journal entry to record lease:
  - DR Right to use asset – \$697,951.43
  - CR Lease liability – (\$697,951.43)
- Year 1 entry to amortize lease asset:
  - DR Amortization expense – \$34,897.57
  - CR Accumulated amortization – (\$34,897.57)
  - $\$697,951.43 / 20 = \$34,897.57$
- Monthly entry to record lease payment:
  - DR Lease liability and interest expense
  - CR Cash
  - Follow amortization schedule

# GASB—Lessor Accounting

- The lessor accounting for a lease that meets the qualification of lease for the lessor is basically the mirror image of the accounting for the lessee.
- Journal entry to record lease:
  - DR Receivable – \$697,951.43
  - CR Deferred Inflow – (\$697,951.43)
- Year 1 entry to amortize deferred inflow:
  - DR Deferred inflow – \$34,897.57
  - CR Rent Revenue – (\$34,897.57)
  - $\$697,951.43 / 20 = \$34,897.57$

# GASB—Lessor Accounting

- Year 1 entry to record cash:
  - DR Cash – \$60,000
  - CR Interest Income – (\$42,319.79)
  - CR Receivable – (\$18,680.21)
- Note – you keep the leased asset on your books and continue to depreciate it
  - Unless the lease agreement calls for the asset to be returned to you in the same condition at the end of the lease as at the beginning (rare)

# Implementation

- Adoption applied retroactively by restating financial statements, ***if practicable***
  - If not practicable, restate beginning net position, AND
  - Disclose reason for not restating in the notes
- Measure the asset and liability as of January 1 of the year of adoption based on future payments from that date.

# Effective Dates—FASB

- Fiscal years beginning after December 15, 2021, (for most organizations):
  - December 31, 2022
  - June 30, 2023
  - September 30, 2023



# Effective Dates—FASB

- Fiscal years beginning after December 15, 2019, for any of the following:
  - A public business entity (excluding not-for-profit and employee benefit plans)
  - A not-for-profit entity that has issued, or is a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or over-the-counter market
  - An employee benefit plan that files financial information with the SEC

# Effective Dates—FASB

- Not-for-profit business entity that has issued, or is a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or over-the-counter market
- Indicators
  - Debt issued by a state or local governmental entity for a specific third party (the conduit bond holder)
    - Private placements don't qualify
    - Nonpublic offerings don't qualify
    - Limitations of certain investors or large denominations don't qualify

# FASB—Lease Definition

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

# FASB—Identifying a Lease

- Lease contract
- An identified asset
  - Explicitly or implicitly specified
  - Supplier has no practical ability to substitute, and would not economically benefit from substituting the asset
- The right to control the use during the lease term
  - Decision-making authority over the use of the asset
  - Ability to obtain substantially all economic benefit from the use of the asset

# FASB—Identifying a Lease

- Determine whether a contract is a lease
  - Could be an “embedded” lease
  - Look for implicitly identified assets

# FASB—Identifying a Lease

- **Right to control** to direct the use of the asset through the period of use in **either** of the following situations
  - The entity has the right to direct how and for what purpose the asset is used throughout the period
  - Or—
  - Decisions about how and for what purposes the asset will be used are predetermined, and at least one of the following conditions exist:
    - The entity has the right to operate the asset (or direct others to operate) throughout the period of use without the supplier having a right to change those operating instructions
    - The customer designed the asset (or specific aspects of it) in a way that predetermines how and for what purpose the asset will be used throughout the period of use

# FASB—Applicability

- All leases and subleases of property, plant, and equipment
- Not applicable to:
  - Leases of intangible assets
  - Leases of assets under construction

# FASB—Separating Lease and Non-lease Components

- Many contracts contain a lease component and non-lease components
  - Maintenance agreement
  - Supplies
  - Training
  - Services
- In practice, these contracts have largely been ignored because, up to now, they have been an expense regardless of classification (lease expense or purchased service or supplies)



# FASB—Separating Lease and Non-lease Components

- Lease component now needs to be capitalized – an asset and liability will need to be recognized
- Allocated based on “stand-alone” prices
- If components cannot be separated, the entire contract is considered a lease

# FASB—Lessee Accounting: Statement of Financial Position

- Right-of-use asset
- Lease liability
- Finance AND operating leases
- Finance and operating leases must be separately presented on statement of financial position or in the notes

# FASB—Lessee Accounting: Statement of Financial Position

## FASB Nonprofit Hospital

### Schedule of Items Appearing on the Statement of Financial Position

December 31, 2022 and 2021

	2022	2021
<i>Property, Plant, and Equipment</i>		
Property, plant, and equipment	\$ 1,000,000	\$ 1,000,000
Less: accumulated depreciation	(200,000)	(100,000)
Property, plant, and equipment, net	800,000	900,000
<i>Finance and Operating Lease Right-of-Use Assets</i>		
Finance lease right-of-use assets	250,000	250,000
Less: accumulated depreciation - finance lease right-of-use assets	(200,000)	(100,000)
Operating lease right-of-use assets	40,000	60,000
Total finance and operating lease right-of-use assets	90,000	210,000
<i>Current liabilities</i>		
Finance lease liability	\$ 100,000	\$ 100,000
Operating lease liability	20,000	20,000
<i>Noncurrent liabilities</i>		
Finance lease liability	-	50,000
Operating lease liability	20,000	40,000

# FASB—Lease Accounting: Statement of Activities

- Finance
  - Depreciation or amortization expense (of right-of-use asset)
  - Interest expense
- Operating
  - Single lease expense on the straight-line basis

# FASB—Lease Accounting: Statement of Activities

**FASB Nonprofit Hospital**  
**Schedule of Items Appearing on the Statements of Activities**  
**and Changes in Net Assets**  
**Years Ended December 31, 2022 and 2021**

	<b>December 31,</b>	
	<b>2022</b>	<b>2021</b>
<hr/>		
<i><b>Operating expenses:</b></i>		
Lease	\$ 20,000	\$ 20,000
Depreciation and amortization	100,000	100,000
Interest	9,000	10,000
	<hr/>	

*Note: Lease expense would be applicable to operating leases*

# FASB—Lease Accounting: Cash Flow Statement

- Finance
  - Principal: financing activity
  - Interest: operating activity
- Operating
  - Lease: usually operating activity

# FASB—Initial Recognition

- Lease liability at the present value of the lease payments not yet paid, using the discount rate for the lease
- Right-of-use asset
- Same as how capital leases are recognized currently

# FASB—Finance Lease

- Classified as a finance lease when it meets any of the following criteria:
  - Ownership of the underlying asset transfers to lessee by the end of the lease term
  - Lease grants lessee an option to purchase the underlying asset the lessee is reasonably certain to exercise
  - Lease term is the major part of the remaining economic life of the underlying asset
  - Present value of the sum of the lease payments and any residual value guarantees by the lessee equals or exceeds substantially all of the fair value of the underlying asset
  - The underlying asset is of such a specialized nature that it is expected to have no alternative use to the lessor at the end of the lease term



# FASB—Finance Lease

- Formerly known as a “capital” lease
- Similar criteria except for no “bright lines”
  - No 75% of useful life and 90% minimum lease payment thresholds
  - Although these could be “one reasonable approach”
- “Bargain purchase option” term is not used
- Additional criteria for a specialized asset

# FASB—Operating Lease

- All other leases

# FASB—Lease Term

- The lease term is the sum of the following:
  - Noncancellable period of the lease
  - Any periods covered by an option to extend the lease if the lessee is *reasonably certain* to exercise the option
  - Any options to extend controlled by the lessor

# FASB—Payments

- Include payments made during the lease term
- Optional payments to purchase the underlying asset should be included **if** the lessee is reasonably certain to exercise that option

# FASB—Variable Lease Payments based on Index or Rate

- Examples – CPI or a market interest rate
- Measured using index or rate at the commencement date
- Not updated unless a remeasurement event takes place

# FASB—Other Variable Lease Payment

- Variable lease payments are recognized when achievement of the specified target becomes probable
- Residual value guarantees are included in lease payments when they are considered probable of being owed

# FASB—Discount Rate

- Rate implicit in the lease contract
- If not determinable, the entity should use its incremental borrowing rate

# FASB—Lease Remeasurement

- Remeasurement should occur if any of the following occur:
  - Lease is modified and not accounted for as a separate contract
  - Contingency resolved so that some or all variable payments become fixed payments
  - Change in assessment of lease term
  - Change in assessment of whether the lessee is reasonably certain to exercise or not exercise a purchase option
  - Change in amount probable of being owed by lessee under residual value guarantees



# FASB—Lease Remeasurement

- Reassess the lease term or a lessee option to purchase the underlying asset only if, and at the point in time, any of the following occur:
  - There is a significant event or a significant change in circumstances within the control of the lessee that directly affects the reasonable certainty of the lessee to exercise an option to extend or terminate the lease or to purchase the underlying asset
  - There is an event written into the contract that obliges the lessee to exercise (or not exercise) an option to extend or terminate the lease
  - The lessee elects or declines an option differently than previously determined not to

# FASB—Lease Remeasurement

- Lease classification and discount rate are remeasured when:
  - Lease is modified and not accounted for as a separate contract
  - Triggering event takes place, which causes the lease term or purchase option to be reassessed

# FASB—Modification is a Separate Contract

- Account for the modification as a separate contract when both of the following conditions are present:
  - Modification grants the lessee an additional right-of-use not included in the original lease
  - Lease payments increase commensurate with the stand-alone price for the additional right-of-use

# FASB—Lease Modifications

- “Remeasurement event”
- A change to the terms and conditions of a contract that results in a change in scope of, or the consideration for, the lease
- Examples include a change in the underlying assets or changes that shorten or lengthen the lease term

# FASB—Modification is Not a Separate Contract

- Reassess lease classification (finance or operating) as of the effective date of the modification based on the modified terms and conditions
- Remeasure variable lease payments based on the index at the remeasurement date and update the discount rate

# FASB—Modification Requires Remeasurement

- Grants the lessee an additional right-of-use not included in the original contract
- Extends or reduces the terms of an existing lease other than through the exercise of a contractual option to extend or terminate the lease
- Changes in consideration in the contract only
- Fully or partially terminates an existing lease

# FASB—Short-term Leases

- Accounting policy election to not recognize lease assets and lease liabilities with a term of 12 months or less
- Lease expense is generally recognized on a straight-line basis
- Election needs to be consistently applied for similar leases

# FASB Financing Lease Example

- See example 1
  - The accounting for FASB Finance Leases and GASB Leases is the same



# Example 2 – FASB Operating Lease

- Facts
  - A not-for-profit hospital is leasing a CT Scanner
  - \$4,000 per month payment, includes 20 scans per month
  - \$500 per scan after 20 scans
  - Term is 3 years, renewal must be renegotiated
  - Ownership does not transfer at end of lease term

# Example 2—Nonprofit Hospital

- For a not-for-profit hospital:
  - Operating lease:
    - Lease expense is recorded using straight line method of total payments
      - $\$144,000 / 3 \text{ years} = \$48,000 \text{ per year}$
    - Lease liability is reduced by the principal portion of the payment
    - Right to use asset is reduced based on the net of the lease liability reduction, lease expense, and cash payment.

# Example 2

- Net present value = \$131,493.03

The screenshot displays a financial software interface with a blue header bar containing icons for New, Open, Save, Print, Insert, Delete, Expand, Sort, Calculate, and Rounding. Below the header, there are two tabs: "Cash Flow Data" (active) and "Amortization Schedule".

**Cash Flow Data**

Label:  >>

Compounding:  Nominal Annual Rate:  >>

	Event	Date	Amount	Number	Period	End Date
1	Loan	01/01/2020	131,493.03	1		
2	Payment	01/31/2020	4,000.00	36	Monthly	12/31/2022

# Example 2—Journal Entries

- Journal entry to record lease:
  - DR Right to use asset – \$131,493.03
  - CR Lease liability – (\$131,493.03)
- Yearly to record lease:
  - DR Lease expense – \$48,000
  - DR Lease liability – \$41,241
  - CR Cash – (\$48,000)
  - CR Right to use asset – (\$41,241)

# Example 2

- 25 scans done in first month of the lease
  - 25 scans less 20 included in lease = 5 scans
  - 5 scans x \$500 each = \$2,500
  - “Additional” lease expense – \$2,500
- 18 scans done in second month of the lease
  - Included in the 20 per month
  - Nothing additional to record

# Example 3 – FASB Changing Lease Payments

- Facts
  - Leased office space for business office and accounting department
  - 10-year lease with two 5-year extensions available to the Hospital
    - \$5,000/month for years 1-10
    - \$6,000/month for years 11-15
    - \$7,000/month for years 16-20
  - The lease is expected to be renewed for both extensions

# Example 3

- For a not-for-profit hospital:
  - If operating lease:
    - Lease expense is recorded using straight line method of total payments
      - $\$1,380,000 / 20 \text{ years} = \$69,000 \text{ per year}$
    - Lease liability is reduced by the principal portion of the payment
    - Right to use asset is reduced based on the net of the lease liability reduction, lease expense, and cash payment
      - In this example, the right to use asset is reduced by a different amount than the reduction in the lease liability due to the varying payments over the lease term and the straight line lease expense

# Example 3

- Net Present Value of Payments

NewOpenSavePrintInsertDeleteExpandSortCalculateRounding

Cash Flow Data

Amortization Schedule

Label: Example 2 >> Choose a selection that specifies the period of time between periods. This field is used if the number is greater than one.

Compounding: Monthly Nominal Annual Rate: 6.000 % >>

	Event	Date	Amount	Number	Period	End Date
1	Loan	01/01/2020	Unknown	1		
2	Payment	01/31/2020	5,000.00	120	Monthly	12/31/2029
3	Payment	01/31/2030	6,000.00	60	Monthly	12/31/2034
4	Payment	01/31/2035	7,000.00	60	Monthly	12/31/2039



# Example 3

- Hit “Calculate”
- Net present value is \$768,540.81

New
 Open
 Save
 Print
 Insert
 Delete
 Expand
 Sort
 Calculate
 Rounding

Cash Flow Data

Amortization Schedule

Label:  >>
 

Choose a selection that specifies the period of time between periods. This field is used if the number is greater than one.

Compounding: 
 Nominal Annual Rate:  >>

	Event	Date	Amount	Number	Period	End Date
1	Loan	01/01/2020	768,540.81	1		
2	Payment	01/31/2020	5,000.00	120	Monthly	12/31/2029
3	Payment	01/31/2030	6,000.00	60	Monthly	12/31/2034
4	Payment	01/31/2035	7,000.00	60	Monthly	12/31/2039

# Example 3 —Journal Entries

- Journal entry to record lease:
  - DR Right to use asset – \$768,540
  - CR Lease liability – (\$768,541)
- Year 1 to record lease:
  - DR Lease Expense – \$69,000
  - DR Lease Liability – \$14,332
  - CR Cash – (\$60,000)
  - CR Right to use asset – (\$23,332)
- Year 2 to record lease:
  - DR Lease Expense – \$69,000
  - DR Lease Liability – \$15,160
  - CR Cash – (\$60,000)
  - CR Right to use asset – (\$24,160)

# First Year Implementation

- Recognize liabilities and assets at the earliest beginning date presented
- Entities may elect to account for leases that commence before the effective date using previous lease rules
  - Except that lessees are required to record an alt use asset and liabilities based on the present value of minimum rental payments at each balance sheet report date
- New or modified leases must follow the new rules

# FASB—Lessor Accounting

- Largely unchanged
- The new revenue recognition model (Topic 606) is more impactful on lessors than the lease standard
  - Topic 606 provides guidance to determine if a sale has taken place

# Implementation

- DZA can take care of most accounting changes for auditees during financial statement preparation – but not with leases
- Proactive data gathering will be necessary with the lease accounting standard change

# Implementation Strategies

- Need to be ready to account for leases under new standard
- Waiting for the audit will result in material adjustments and delay your audit
- Start right away

# Implementation Strategies

- Develop a system/process for monitoring leases
  - Spreadsheet
  - Software
  - Cover sheet to document decision making
- Update lease inventory
  - Review rent expense, equipment rental, and similar accounts
  - Review/inquire about contracts with an implicit lease
- Opportunity to review lease procurement procedures

# Implementation Strategies

- Capital leases – same as before
  - However, some capital leases for governmental entities may be changed to financed purchases
- Operating leases – need to analyze every lease
  - Some will be short-term
  - Some may be immaterial
- Contracts with lease and non-lease components – almost certainly not currently accounted for correctly



# Materiality Judgements

- Information is material if omitting or misstating it would influence the decisions users make on the basis of financial information about a specific reporting entity
- Quantitative and qualitative judgement
- Individual leases and leases in the aggregate

# Materiality Judgements

- Portfolio approach (FASB)
  - Numerous immaterial lease agreements
  - Apply a single discount rate to all leases within the portfolio
  - Results must not materially differ from individual application

# Materiality Judgements

- Practical matter – will need to establish a dollar threshold
- Practical matter – one “standard” does not fit all entities
  - Bond covenants limiting additional debt?
  - Poor financial condition?
  - May impact creditor determination on future lending?





# DZA

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