

Give Your Practice a New Lease on Life

Understanding and Applying the New Lease
Provisions

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Excluded

- Leases of intangibles – Topic 350
- Leases for mineral or resource exploration – Topic 930
- Leases for biological assets – Topic 905
- Leases for inventory – Topic 330
- Leases of assets under construction – Topic 360

Finance Leases

- Similar to capital leases
- Any of following criteria
 - Title transfers to lessee by end of term
 - Purchase option likely to be exercised
 - Lease term for major part of remaining economic life, provided not nearly over
 - Sum of present value of lease payments, including residual value guaranteed by lessee, equals or exceeds substantially all of property's fair value
 - Asset not likely to have use after lease term

Lessee Provisions

- Obligation to make lease payments and right-of-use asset
 - Payments for optional periods, either extension or early termination, considered only if reasonably certain of use
 - Purchase options considered only if reasonably certain of exercise

- Variable payments, other than those based on index or rate that are substantially fixed payments, are excluded
- May elect not to recognize lease asset and obligation for leases with term of 12 months or less

Short-Term Leases

- Requirements
 - Lease term of 12 months or less
 - No purchase option reasonably expected to be exercised
- Lessee may elect not to recognize asset or liability
- Rents recognized as expense on straight-line basis

Finance Lease Accounting

- Interest on lease obligation recognized under interest method
- Amortization of asset based on pattern of use
- Repayments of principal classified as financing and payments of interest classified as operating
- Right-of-use asset and lease obligation measured at present value of lease payments

Operating leases

- Right-of-use asset and lease obligation measured at the present value of lease payments
- Interest expense and amortization of asset calculated such that total amount, reported as single lease cost, recognized on a straight-line basis over term of lease
- All cash flows classified as operating

Lessor Accounting

- Apply same criteria as lessee
 - If any met, classified as sales-type lease
 - If none met, classified as direct financing or operating lease

Sales-Type Lease

- Underlying asset derecognized
- Net investment in lease recognized:
 - Lease receivable equal to present value of lease payments and residual value guarantees; and
 - Present value of unguaranteed residual value
 - Selling profit or loss
- Initial direct costs
 - Expense if fair value of asset does not equal carrying cost
 - Deferred and included in net investment in lease if equal

- Selling profit or loss
 - Use lower of:
 - Fair value of underlying asset; or
 - Sum of lease receivable and amounts prepaid by lessee
 - Reduced by carrying value of underlying asset
 - Net of unguaranteed residual value
 - Net of initial direct costs deferred
- If collectibility of rents not probable
 - Collections recognized as lease deposit liability
 - Collectibility reassessed on ongoing basis

- Direct financing if both:
 - Sum of present values of lease payments and any guarantees of residual value equal or exceed substantially all the property's fair value; and
 - Probable that lessor will collect lease payments and residual guarantees

- Income statement items will include:
 - Interest income on net investment
 - Variable lease payments not included in calculation of net investment
 - Possible impairment loss on net investment
- Net investment in lease
 - Increased by interest income
 - Decreased by collections

Direct Financing Leases

- Requires recognition of net investment in lease
 - Lease receivable at present value of lease payments and residual value guarantee; and
 - Present value of unguaranteed residual value; minus
 - Selling profit
- Selling loss recognized
- Selling gain and initial direct costs deferred

Operating Leases

- Asset not derecognized
- Initial direct costs deferred
- Rental income recognized consisting of:
 - Lease payments and deferred initial direct costs recognized straight-line
 - Variable lease payments recognized in period in which conditions requiring payment are met

- Miscellaneous Provisions

- At inception, must determine if arrangement conforms to definition of a lease
- Lease components required to be separated from nonlease components such as maintenance
- May elect not to separate nonlease components recognizing all components as single lease component
- Model for leveraged leases continues to apply to leveraged leases commencing before the effective date of changes

Sale and Leaseback Transactions

- Must determine if sale qualifies as sale under revenue recognition principals
 - If not, treated as financing transaction
 - Repurchase option also generally precludes sale accounting