Changes in **Accounting for Leases (ASC 842)**

A new reality in lease accounting

While leasing has long been an important means of asset financing, its financial statement presentation has not been considered to be accurately disclosed. Under current accounting standards, assets under operating leases and the related liabilities are not quantified on the balance sheet, and consequently are not fully reflected in the overall picture of a company's financial condition.

In early 2016 the US Financial Accounting Standards Board (FASB) released accounting standards for leasing that will be effective for publicly traded companies as of 1/1/2019, and all others as of 1/1/2020. The new Accounting Standard Codification (ASC 842) will introduce a new chapter in leasing and fundamentally change how companies account for operating leases. (ASC) 842 will create greater transparency and a truer picture of a company's total assets and liabilities.

The new standard – ASC 842

The primary departure from the current standards is that companies reporting under US GAAP (Generally Accepted Accounting Principles) will now be required to account for operating leases with lease terms of more than 12 months on their balance sheets. The new lease standards will be implemented for existing leases as well. Contracts that classified as operating leases and expire after January 1, 2019 (for public companies) or January 1, 2010 (all others) that are currently off the lessee's balance sheet will need to be on the balance sheet for the remainder of the contract.

How the new standard works:

Term Calculation:

Lease Term = Non-Cancellable Period + Renewal Option (if reasonably certain to extend) + Periods after Optional Termination Date (If reasonably certain not to terminate early).

– Excludes short term arrangements (Term + Option < 12 months)

Balance Sheet calculation:

The value of the Right of Use (ROU) of the asset and the related liability will be calculated at the Present Value of the payments over the lease term (typically discounted at the lesses's incremental borrowing rate for borrowings of similar term) excluding service/maintenance and other pass-through type payments.

– ROU and the related liability will be reported on the balance sheet and will amortize in synch over the life of the contract. The liability is presented separately from borrowings (in Other Liabilities)

– Full Maintenance Operating Leases, only the financing part of the Lease will be quantified on the lessee's balance sheet.

The bottom line:

Under ASC 842, mostly all lease accounting remains the same, now with the inclusion of Operating Leases on the balance sheet at the value of the ROU of the asset and the related liability.

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	Old		New	
	Operating Lease	Finance Lease	US GAAP Operating Lease	US GAAP Finance Lease
Balance Sheet	Value reported in Notes to Financial Statements	No change	Value of ROU Asset and related obligation reported on Balance Sheet	No change
Profit & Loss	No change	No change	No change	No change

Consequences of the new standard on leasing

The new standard will launch a new era in leasing. While companies will be required to learn the new standard and implement new processes, leasing will continue to be an attractive solution for financing asset acquisitions. DLL has outlined the benefits of leasing under ASC 842:

Benefits of leasing vs. loan or cash sales:

Reason for (operating) leasing from a Lessee perspective	Details	Status after new rules
Cash flow / raise capital	100% funding (no down payment); Financing entire solution (≥100% of hardware); fixed rate	Still a benefit vs. buying financed by a bank loan or owning the asset
Tax benefits	Faster tax deduction; lease vs. buy analysis shows lease option has lowest after-tax present value cost	Still a benefit
Accounting / regulatory	Off balance sheet treatment	Partial benefit if the PV of the lease payments is less than the cost of the asset, especially the case for high residuals and impact of tax benefits
Financial	Least expensive; lower rental (RV) and no additional collateral	Still a benefit
Technology	Avoiding risk of technological obsolescence	Still a benefit
Flexibility	Flexibility of mid term upgrades and end of term options; Flexible payment structures	Still a benefit
Convenience	Quick and easy financing process often available at point-of-sale; Operating costs (Vs capex) in budget	Quick and easy still benefit, but now capital expenditure
Asset management	No residual value and disposal risk	Still a benefit
End-user requirements	One stop shopping	Still a benefit
	Accommodating the trend from "own" to "use" the asset	

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