NEW

LEASE ACCOUNTING STANDARDS

2016 ACTION AND IMPLEMENTATION PLAN

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INTRODUCTION

On February 25, 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-02, Leases (Topic 842). Under the new ASU, lessees will be required to recognize lease assets and liabilities for all leases, with certain exceptions, on their balance sheets.

For nonpublic and all other organizations, the ASU on leases will take effect for fiscal years beginning after December 15, 2019, and for interim periods within fiscal years beginning after December 15, 2020. The ASU on leases will take effect for public companies for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018.

That means an effective date of January 1, 2020, for nonpublic entities with a December 31 year end, as public entities start a year earlier (2019) to adopt. All entities may elect to adopt the standards early.

In transition, lessees and lessors are required to recognize and measure leases at the beginning of the earliest period presented using a modified retrospective approach. The modified retrospective approach includes some optional practical expedients. These practical expedients relate to:

- The identification and classification of leases that commenced before the effective date,
- Initial direct costs for leases that commenced before the effective date, and,
- The ability to use hindsight in evaluating lessee options to extend or terminate leases or to purchase the underlying asset.

An entity that elects to apply the practical expedients will, in effect:

- Continue to account for leases that commence before the effective date in accordance with previous GAAP unless the lease is modified, (except that lessees are required to recognize a right-to-use (ROU) asset) and,
- A lease liability for all operating leases at each reporting date based on the present value of the remaining minimum lease payments that were tracked and disclosed under previous GAAP.

There is also specific transition guidance for sale and leaseback transactions, build-to-suit leases, leveraged leases, and amounts previously recognized in accordance with business combinations guidance for leases.

Accounting for leases was a joint project of the FASB and the IASB. There are some significant differences between the two boards' final standards, however. This Learning and Implementation Plan focuses on the FASB's standard; the AICPA Financial Reporting Brief Leases highlights significant differences between the two standards.

Use this "roadmap" to ensure that your company, as well as its management team and staff, do the following:

1. Understand the changes to current GAAP based on FASB ASU 2016-02, Leases.
2. Understand the transition requirements and determine how your company will adopt the new standard.
3. Find resources to help train your professional staff to ensure effective and efficient implementation of the leases standard.
4. Educate users and other stakeholders about the changes they can expect in your company's financial statements.

The following six action items are ones that nonpublic entities can begin to take today and continue throughout the balance of 2016 to implement the new leases standard (nonpublic entities have an additional year to adopt the new guidance).

Step 1:

Assign individual company staff or form a task force to become experts and take the lead on understanding and implementing the new leases standard. The input may be necessary for a broad range of functions, including finance, accounting, and legal personnel.

Description and Considerations

The core principle is that lessees should recognize the assets and liabilities arising from leases on the balance sheet. The new standard retains the distinction between finance leases and operating leases, based on criteria that are substantially similar to the criteria for distinguishing capital leases from operating leases under current GAAP.

Step 2:

Update lease inventories.

Gaining a handle on all of the company's leases, wherever records of those leases are kept in the company, is necessary for compliance.

Step 3:

Decide on transition method.

Decide whether or not to elect the optional practical expedients for applying the modified retrospective approach.

> *With the modified retrospective approach, also known as the Modified-Retrospective Method ("MRM"), and sometimes called the Cumulative-Effect Adjustment Method, the prior years' data is not recast. Instead, a single adjustment is made to equity (usually retained earnings) at the beginning of the initial year of application. For example, an entity presenting comparative statements for the years ending Dec. 31, 2016, 2017, and 2018 would make the single cumulative adjustment to the beginning equity of year 2018 without recasting 2016 and 2017 financial data. This single entry should adjust the beginning equity balance to what it would have been if the entity had applied ASC 606 to either (a) all unfinished contracts (unfinished under ASC 605) as of the beginning of the current period, or (b) all contracts pertaining to the years presented. Entities are free to choose either of these options.*

Step 4:

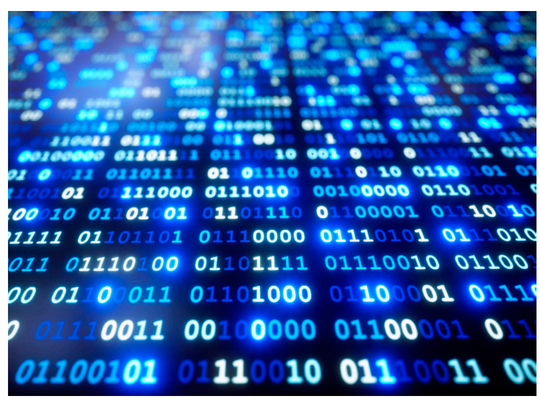
Review legal agreements and debt covenants

Changes to the balance sheet may affect contractual agreements or debt covenants. Organizations should work with lenders through the proper course of business to amend debt agreements, if necessary before the standard is adopted to avoid losing access to financing or violating loan covenants.

Step 5:

Consider IT needs

Consider whether improvements to the company's IT system are required. Companies may be able to leverage their existing IT systems to perform the necessary accounting and reporting, or the company may decide that efficiencies may be gained by investing in technology.



Step 6:

Discuss with stakeholders

Recognizing assets and liabilities for operating leases can have a significant effect on the balance sheet. Having early conversations with stakeholders such as the board of directors, investors, and lenders about the potential effects of the new standard may ease the transition.

The new Leases Accounting Standard can be confusing. We understand the need to provide companies with the clarity and understanding of what the update means for your bsuiness and, how it may affect the treatment of lease assets and liabilities.

If you have any questions or would like to meet for a no obligation consultation to discuss your situation, please don't hesitate to contact me or any of the professionals at Zinner & Co. at 216.831.0733 or gadler@zinnerco.com.

ABOUT THE AUTHOR

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Gabe Adler has 38 years of experience in public accounting. He merged his practice with Zinner & Co. in 1996. Gabe's client base includes owners of closely held businesses and professional service companies, whom he counsels in areas of accounting, tax, auditing, mergers and acquisitions, and how to transfer a business to the next generation. He has a diverse clientele with a specialty in real estate.

He advises many property owners, managers, and developers in developing their real estate tax strategies and has spoken to the Rotary club on tax laws and planning, and to the chief executive board on estate planning techniques. He is also a trustee and past officer for his synagogue. Gabe graduated from Cleveland State University with a degree in business.

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