

REMINDERS FOR THE CONSTRUCTION AND REAL ESTATE INDUSTRY: END OF YEAR LEASE ACCOUNTING

The lease accounting standards under FASB ASC 842 are now in effect for most entities, and with the end of 2022 coming up, the time is now to put an implementation process in place if you haven't already. Below, we list 10 considerations and reminders for a successful implementation before the new year.

1. BUILD AN IMPLEMENTATION TEAM

Depending on your construction company's lease portfolio, implementation of the lease accounting standards can be a significant undertaking. Implementation efforts will be more successful with an identified project manager and a cross-functional team to help identify leased assets and focus on urgent priorities.

2. UNDERSTAND THE NEW REQUIREMENTS

Take the time to understand the accounting requirements. If you're seeking resources, Sikich has prepared an [ASC 842 Lessee Handbook](#) that provides you with the foundational understanding and confidence to tackle implementation.

3. MAKE DECISIONS ABOUT POLICY ELECTIONS

ASC 842 provides several [practical expedients](#) for lessees that can have a significant impact on recorded balances. It's important to understand the impacts of these policy elections and document your decisions. The [ASC 842 Lessee Handbook](#) includes a two-page policy election template to make this easier.

4. DISCUSS IMPACTS WITH BUSINESS PARTNERS

There are a number of [implications](#) of adopting the new lease accounting standards. If you have creditors or other business partners who utilize your financial statements, it is vital to have a conversation about the impacts on your financial statements and ratios before year-end.

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5. IDENTIFY LEASE CONTRACTS

Identifying the population of lease contracts is more challenging in large, decentralized construction companies. A potential challenge for all businesses is ensuring “[embedded leases](#)” have been identified and properly accounted for. Consider any contracts that enable you to control or direct the use of assets that are owned by others.

6. REVIEW EXISTING BALANCES REPORTED UNDER ASC 840

Existing balances related to lease accounting under ASC 840 are critical parts of implementing ASC 842. Balances – such as deferred rent, prepaid rent, unamortized lease incentives, capital lease liabilities, capital lease assets and related accumulated amortization, ASC 420 exit obligations, and more – are part of determining beginning balances under ASC 842. You may need to correct errors in these existing balances, if significant, before application of the new standards, as they are not to be included as part of the cumulative effect adjustment upon adoption.

7. DETERMINE DISCOUNT RATES

Determining the discount rate for each lease may be a challenge based on the type of discount rate that you’re required to use. Read more about implicit rates, incremental borrowing rates and risk-free rates in [this prior article](#).

8. DOCUMENT RELATED PARTY LEASE AGREEMENTS

[Related party leases](#) continue to be a bit of a “gray area.” While ASC 842 is clear that related party leases are in scope and should be accounted for on the basis of legally enforceable terms and conditions (same as leases between unrelated parties), the nature of related party relationships may make what is “legally enforceable” less clear. We recommend that businesses formalize and document related party leases, using terms that are reasonable considering all other factors, to reduce the burden of making these assessments on your accounting teams and auditors.

9. CONSIDER LEASEHOLD IMPROVEMENTS

Leasehold improvements have always been required to be amortized over a period that does not extend beyond the final ending date of the related lease. However, this requirement is likely to face greater scrutiny under ASC 842, especially when entities need to make determinations about the likelihood to exercise lease renewal options. These determinations become particularly difficult when dealing with related party leases. Now may be the time to correct and change amortization periods for leasehold improvements.

10. SELECT A LEASE ACCOUNTING SOFTWARE SOLUTION

A software solution is highly recommended, as it will help ensure accurate calculations, aggregate data for note disclosures and support ongoing compliance efforts. Software solutions are not one-size-fits-all, as discussed in [this prior article](#). To simplify the process, Sikich developed an easy-to-use, Excel-based solution, [Lessee Ledger](#).

Implementing the new lease accounting standards can be a daunting task for leaders in the construction and real estate industry, and Sikich’s professionals are here to help. Contact our experts to learn more about the new lease accounting standards and our lease accounting solution, [Lessee Ledger](#).



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