IMPLEMENTING ASC 842

LEASES

Focus areas for contractors

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The intent of this whitepaper is to provide further insight to some of the key areas that you should be aware of when implementing the new FASB ASU 2016-02, *Leases* (ASC 842) standard.

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As we approach the end of 2021, it is time for contractors to get serious about FASB ASU 2016-02, *Leases* (ASC 842). The contractor's focus should be on the impact the lease standard will have on the company, specifically bank and surety considerations, as well as specific attributes of the standard such as embedded leases, related party leases, and consolidation (when there is a variable interest entity (VIE)) and how to apply the lease accounting standard to these situations. This whitepaper will provide further insight to some of the key areas that you should be aware of when implementing the new standard.

ASC 842 is set to replace the legacy rules under ASC Topic 840. ASC 842 is now effective for private companies and nonprofit organizations annual reporting periods beginning after December 15, 2021. This change will mean that under the new standard, companies will have to capitalize all leases with terms greater than 12 months, creating a new asset and liability on the balance sheet. In addition, all leases will be classified as operating or financing leases ("capital lease"). A key element of this standard is that it does not grandfather existing leases.

According to ASC 842, a lease is defined as the right to control or use an identified asset for a period of time in exchange for consideration. Now, let's revisit the criteria for determining the proper classification of a lease as either financing or operating.

Financing vs Operating

If a lease meets any of the following criteria, it will be treated as a finance lease:

- Transfers ownership of the underlying asset.
- Grants the option to purchase the underlying asset that the lessee is reasonably certain to exercise.
- Major part of the remaining economic life, essentially excluding the last 25% of the economic life.
- Present value of the lease payments and any additional residual value guaranteed by the lessee equals or exceeds 90% or more of the fair value of the underlying asset.
- The underlying asset is specialized in nature, meaning there is no alternative use to the lessor at the end of the lease.

Leases that do not meet any of the above criteria are considered to be operating leases.

Under ASC Topic 840, the current and long-term obligations of financing leases were shown on the face of the contractor's balance sheet with the commitments under operating leases being disclosed in the footnotes. With the implementation of ASC 842, both operating and financing leases will be reported on the balance sheet, which raises some issues that the contractor needs to consider.

Banking and Surety Considerations

The contractor's financial statements will be analyzed by both bankers and sureties when requesting bonds as well as short and/or long-term financing. So, how do these changes under the new standard ultimately shake out for the banker, surety, and contractor?

In short, the adoption of ASC 842 will change a company's financial metrics overnight. The contractor's balance sheet is the most impacted statement. Financial ratios and other components that affect the contractor's financials and ultimately change how a bank and surety will evaluate the contractor's financials include, but are not limited to, the following: the contractor's debt-to-equity ratio could increase; interest coverage could potentially decrease, especially if leases are determined to be operating leases; return on assets will decrease; debt coverage ratio could significantly be impacted; and finally, bonding capacity could potentially go down. These items could potentially influence bank loans, including financial covenants and borrowing capacities. They can also affect outcomes of employment agreements, including those with bonuses tied to measures of income.

Outside of changes to financial metrics, one of the biggest impacts is the loss of off-balance sheet financing. Starting with the adoption date, contractors should reevaluate their leasing strategies to determine if the benefits of leasing still outweigh ownership and available debt terms. Either way, contractors will now have to update their accounting systems and internal controls to address the new complexities of the standard, especially as it relates to completeness of records, determining present values of rent payments, interest rate determination and likelihood of lease term considerations.

So, let's take a look at what the impact will be on the financial statements under the old and new standard:

Side by Side Comparison
Balance Sheet

	Old Standard	New Standard
Assets		
Cash	$ 2,000,000	$ 2,000,000
Accounting receivable	11,500,000	11,500,000
Contract asset	1,500,000	1,500,000
Prepaid expenses and other current assets	500,000	500,000
Total Current Assets	15,500,000	15,500,000
Property and Equipment	10,279,000	10,000,000
Operating Lease Right of Use Asset	--	5,805,000
Financing Lease Right of Use Asset	--	279,000
Total Assets	$ 25,779,000	$ 31,584,000
Liabilities and Stockholder's Equity		
Line of credit	$ 3,500,000	$ 3,500,000
Current portion of operating lease liability	--	510,000
Current portion of financing lease liability	--	92,000
Current portion of capital lease obligations	92,000	--
Accounts payable and accrued expenses	7,000,000	7,000,000
Contract liability	2,000,000	2,000,000
Total Current Liabilities	12,592,000	13,102,000
Operating Lease Liability, less current portion	--	5,295,000
Financing Lease Liability, less current portion	--	191,000
Capital Lease Obligations, less current portion	191,000	--
Total Liabilities	12,783,000	18,588,000
Stockholder's Equity	12,996,000	12,996,000
Total Liabilities and Stockholder's Equity	$ 25,779,000	$ 31,584,000

Side by Side Comparison
Income Statement

	Old Standard	New Standard
Revenues Earned	$ 40,000,000	$ 40,000,000
Cost of Revenues Earned	35,000,000	35,000,000
Gross Profit	5,000,000	5,000,000
General and Administrative Expenses		
Office salaries, payroll taxes and benefits	3,400,000	3,400,000
Rent	595,000	--
Operating lease	--	595,000
Travel and entertainment	300,000	300,000
Depreciation and amortization	248,850	248,850
Office expense	200,000	200,000
Total General and Administrative Expenses	4,743,850	4,743,850
Income from Operations	256,150	256,150
Other Expense		
Interest expense	11,150	11,150
State Income Tax Expense	50,000	50,000
Net Income	$ 195,000	$ 195,000

Next, let's look at the impact on certain financial ratios under the old and new standard:

	Old Standard	New Standard
Debt to Equity Ratio		
Total Liabilities	12,783,000	18,588,000
Total Equity	12,996,000	12,996,000
Debt to Equity Ratio	0.98	1.43

Debt Coverage Ratio

	Old Standard	New Standard	What Banks Should Do
Debt Coverage Ratio			
Net Income	195,000	195,000	195,000
Plus: Interest expense	11,150	11,150	11,150
Plus: Taxes	50,000	50,000	50,000
Plus: Depreciation and amortization	248,850	248,850	248,850
Plus: Operating lease expense	--	--	595,000
EBITA	505,000	505,000	1,100,000
Current debt and capital/financing leases	92,000	602,000	602,000
Interest expense	11,150	11,150	11,150
Debt Service	103,150	613,150	613,150
Debt Coverage Ratio	4.90	0.82	1.79

Impact on Bonding Capacity

	Old Standard	New Standard
Bonding Capacity		
Equity	12,996,000	12,996,000
Bonding multiplier	10	10
Bonding capacity	129,960,000	129,960,000
Working capital	2,908,000	2,398,000
Bonding multiplier	10	10
Bonding capacity	29,080,000	23,980,000
Reduction in bonding capacity (assuming a 10% multiple of working capital)		5,100,000

While some of the end points will be the same, i.e. there is no change in ending equity or net income, as one can see the adoption of ASC 842 will impact some of the financial ratios a construction contractor's bank or surety will rely on. From the preceding examples one can see:

- On the balance sheet, working capital is reduced by $510,000, representing the current portion of the operating lease liability. While there is no financial impact, it should also be noted that the capital lease obligations, current and long-term, are re-categorized to financing lease liabilities.
- The income statement does not experience a reduction in net income but rent expense is re-categorized to operating lease expense. And while the gross profit from construction remains unchanged in this example, the construction financial professionals must consider the impact to this metric as it relates to leased equipment on the job sites as well as transportation fleets.
- Debt to equity is clearly impacted. While most industry data suggests a debt to equity ratio of under 3 is acceptable for the construction industry, the impact of ASC 842 changes this leverage ratio which could impact future credit decisions.

- Debt coverage (or service) is also impacted. Under the new standard, $602,000 of debt is factored into the service equation, severely reducing the ability of the contractor to meet this requirement, down 4.65 points. In instances such as this, the construction financial professional must be proactive and advocate that an additional EBIDTA add back of the related operating lease expense of $505,000 is warranted. Doing so will pull the ratio back above 1.
- The reduction of bonding capacity is also evident. Assuming a 10% multiplier to the working capital casted under ASC 842, a contractor could experience a reduction of $5,100,000, which for many middle market construction companies is a "sweet spot" job.

Awareness and education will be the construction financial professionals' most powerful tool in guiding the contractor's banker and surety in analyzing, understanding and adjusting to these changes.

Understanding Related Party Leases under ASC 842

Related party leases under ASC Topic 840, current GAAP, require entities to consider the economic substance of the contract when evaluating the existence of a lease. Related party leases can be for real estate, offices, warehouses, yards, and equipment. However, under ASC 842, there have been significant modifications to the treatment of related party leases.

ASC 842-10-55-12 states:

> "Leases between related parties should be classified in accordance with the lease classification criteria applicable to all other leases on the basis of the legally enforceable terms and conditions of the lease. In the separate financial statements of the related parties, the classification and accounting for the leases should be the same as for leases between unrelated parties."

Basically, this means that leases with related parties should be treated no differently than if they were leases with an unrelated party, except with regard to a specific aspect of accounting for a sale-leaseback transaction.

Unfortunately, related-party transactions are not always formally documented and the terms and conditions may not be at arm's length. Under current GAAP, accounting for leases based on the economic substance of the arrangement can be difficult when there are no legally enforceable terms and conditions in the contract. Such difficulties include related party leases that are month to month and/or related party leases that are contingent on cash availability to make payment amounts. Also, lease contracts can be verbal and lease terms may be explicit or implicit outside of a formal lease contract. You should not conclude that a related party lease would not need to be considered due to the lack of terms being formally documented, as unwritten terms can create enforceable rights and obligations. There may even be other agreements separate from the lease contract, such as management or operating agreements, that include terms and conditions that create enforceable rights and obligations for the parties subject to the lease. For example, a lease contract may be explicitly limited to six months. However, there are factors outside of the contract that may indicate this term should be longer.

So, when trying to understand the legally enforceable terms and conditions of a lease, one may need to consider whether there are any ***implicit*** legally enforceable terms or conditions.

To understand implicit legally enforceable terms or conditions, let's consider some examples:

Example 1:

A lessee rents construction equipment on a month-to-month basis from a related party. The equipment will be used over the period of construction of a building that is expected to take two years to complete. One should consider whether there are implicit legally enforceable terms and conditions that would result in the lease term needing to be evaluated as two years as opposed to one month.

Currently, payments on month-to-month equipment rental agreements are being expensed directly to job cost. If it is determined that the expected lease term will extend beyond 12 months, this lease will need to be recognized and measured on the balance sheet with an allocation of expense to job cost over the lease term. The lease term would be the period of time that the equipment will be used on the job.

Example 2:

A lessee leases a manufacturing facility from a related party for five years with no option to renew. Significant costs are incurred by the lessee related to leasehold improvements that will retain significant value over a useful life of 20 years. One should consider whether there are implicit legally enforceable terms and conditions that would result in the lease term needing to be evaluated as 20 years instead of five years. Existence of leasehold improvements in the leasing arrangement, absent a formal lease contract, may provide indication of legally enforceable rights and obligations. Assuming the leasing arrangement will continue until the cost of the leasehold improvements have been fully amortized, companies may need to consider the amortization period for leasehold improvements when determining the lease term.

However, there may be situations where there are minimal leasehold improvements or none, and the renewal option is annual. This will require more judgment in determining a reasonable estimate of the lease term. One may also consider the client's strategic plan and if their facility accommodates planned

expansion or other needs. Also, things to consider may be how long the lessee has been in the facility and any plans to relocate. Are there cost constraints to relocate that could play into the determination of a lease term that exceeds an annual renewal?

Annual or month-to-month lease renewals for a facility from a related party does not eliminate the treatment of this lease under ASC 842. If there are any implicit legally enforceable terms or conditions of a lease, management's estimate of the lease term should be based on the implied intentions of the leased property.

It is important to consider all facts and circumstances that may create legally enforceable rights and obligations under related party leases. There could be considerable judgment involved in these assessments as well as the need to consult with a subject matter expert.

While related party lessees and lessors are expected to apply the guidance in ASC 842 to all of their leases, there may be circumstances when this is not applicable due to the lack of legally enforceable terms and conditions. However, as a reminder, all related party relationships, transactions and balances must be disclosed under ASC 850, Related Party Disclosures. These disclosures provide information necessary for the financial statement user to understand the nature of the related party leasing arrangements whether or not they are recognized and measured on the balance sheet under ASC 842.

Identifying Contracts with Embedded Leases

An embedded lease is a component contained within a larger agreement or contract that provides for the use of an asset. Under ASC 842, the lease component of a contract should be recorded. Remember, under ASC 842, a lease must include the right to control or use an identified asset for a period of time in exchange for consideration.

Below is a breakdown of each component of this definition to be considered when trying to determine if an embedded lease exists.

1. **The asset can be identified.** The specific asset must be identified in the contract – either implicitly or explicitly – for there to be a lease. If the asset can be replaced or substituted without the lessee's consent, the contract likely does not contain an embedded lease.
2. **You have the right to control the asset.** To be considered a lease, the customer must have the right to use the asset, control the asset, or direct how the asset is used.
3. **The lease term is identified.** The lease term must be for a specified period of time.
4. **There was an exchange of consideration.** For there to be a lease, the customer must pay to use or control the asset.

Consider the following example:

A general contractor has a contract to build a new high-rise office building. The contractor signs an agreement with a subcontractor to provide and erect scaffolding. During the project, the contractor can direct the subcontractor to move the scaffolding or change its configuration, and at the end of the three-year estimated build time, the subcontractor will disassemble it and remove it from the construction site. Is use of the scaffolding considered an embedded lease?

1. **Is there an identified asset? *Yes.***

   The scaffolding that will be used in the project is unlikely to be replaced with different scaffolding, and once it is on site, the scaffolding will be used *only* in this project.

2. **Does the contractor have the right to control or use the asset? *Yes.***

   As part of the agreement, the contractor can ask the subcontractor to move or alter the scaffolding to fit its needs.

3. **Is there a set lease term? *Yes.***

   The contractor can use the scaffolding for the entire three years stated in the contract.

4. **Did the contractor pay for the use of the asset? *Yes.***

Under current GAAP, the contractor would charge the invoice obtained from the subcontractor to the project on a monthly basis. Under ASC 842, the contract with the subcontractor is considered an embedded lease. Therefore, the scaffolding lease would be recorded as an operating lease right to use asset and a corresponding lease obligation. The contractor would amortize the lease cost over the three-year term of the lease to the project.

A big challenge under the new standard will be to identify embedded leases that can often be buried in other types of agreements such as:

Service contracts. Service agreements could include identified leased assets. For example, if you contract with a company to provide information security, you may have an embedded lease of a server. Ask yourself: *Does the IT company dedicate one server to only our company? Can we direct the IT company's use of that server? Can our server easily be replaced with another server?*

Equipment rental agreements. Like the example above for scaffolding, a general contractor contracts with a crane company for the equipment and crane operator for a long-term construction project, you may have an embedded lease. Ask yourself: *Is the crane an identifiable asset being leased? Does the contractor have control over the use of the crane and operator during construction? Can the crane be easily replaced with another crane during the term of the project?*

Other potential rental agreements to consider for embedded leases include dumpsters, temporary fencing, trailers, copiers, postage machines, vending machines, water coolers, and coffee machines.

Manufacturing contracts. If you contract with a business for the fabrication of a unique item, you may have an embedded lease of the equipment used to produce the fabricated item. Ask yourself: *Do they use this equipment to fabricate items for other customers? If we weren't asking for these custom items, would the third party be able to use their equipment to produce other products?*

Transportation contracts. If you contract with a transportation company for railcars, trucks or barges to move building materials, you may have an embedded lease within the transportation contract. As yourself: *What happens to the railcars/trucks/barges when we aren't using them? Are the railcars/trucks/barges used to transport only our materials or do they transport materials for other businesses, as well?*

Adoption Considerations

Traditionally, companies did not evaluate contracts for embedded leases. However, under the new standard, companies should adopt policies and procedures to identify all leases, including embedded leases. When identifying leases, procedures may include:

- examine contracts that involve the possible use of an asset,
- review general ledger expense account activity,
- review reoccurring vendor payments for service or supply contracts,
- physical inspection of the company office to identify possible leased assets,
- examine costs to complete or in process projects to ensure that the future amortization of the embedded lease is considered to avoid future profit fade, and
- make inquires to identified departments/individuals within the company.

Variable Interest Entity Considerations

Many private companies elected out of consolidating balances of variable interest entities (VIEs) under one of two (or both) accounting elections:

FASB ASU No. 2014-07 *Applying Variable Interest Entities Guidance to Common Control Leasing Arrangements* where a private company could elect to not apply VIE guidance to entities under common control with which they had a leasing arrangement, providing certain criteria were met.

FASB ASU No. 2018-17 *Consolidation: Targeted Improvements to Related Party Guidance for Variable Interest Entities* where a private company could elect out of applying VIE guidance to all legal entities under common control, assuming certain criteria are met, primarily that none were public entities and they were not directly or indirectly financially interrelated.

Remember, though, if a company chooses not to apply VIE guidance and not consolidate, FASB ASC Topic 840 applied regarding capital lease considerations and ASC 842 will still apply. Should the VIE leasing arrangement qualify as an operating or financing lease, they could end up calculating and reporting right of use assets and lease obligation liabilities.

Let's consider this a little further: is reflecting this leasing arrangement as required under ASC 842 advantageous or will reporting it that way negatively impact covenants or other financial metrics? Would a consolidated balance sheet reflect a stronger financial position?

It is true lenders, sureties and bonding agents might want to see stand-alone results of the company and its VIEs. In these cases, consider presenting consolidating financial statements with columns for each included entity, either on the face of the financial statements or as supplementary information. The latter format, as supplementary information, affords easier reporting – the balances and results within each entity's column don't have to reflect U.S. GAAP balances. Adding some simple wording in the section of the auditor's or accountant's report covers that. "The supplementary consolidating balance sheet and consolidating statements of operations are presented for purposes of additional analysis rather than to present the financial position, results of operations and cash flows of the individual entities, and are not a required part of the consolidated financial statements."

Implementing Available Practical Expedients

The standard provides for several practical expedients. Below is a summary of these practical expedients available to companies under the standard.

1. **Evaluation of leases at date of transition.** The following components of this practical expedient must be elected as a package and applied consistently by an entity to all its leases (including those for which the entity is a lessee or a lessor).

    a. Determining whether any leases are included in existing or expired contracts at transition date. FASB provides entities relief from having to determine whether leases are included in existing or expired contracts at the date of transition. Most entities, with many leases existing at that date, would elect this expedient given the significant cost of having to review all contracts to determine whether they do or do not contain a lease or a lease component.

    b. Reevaluation of existing lease classifications. Entities are also provided relief from having to reevaluate existing lease classifications. All existing leases that were classified as operating leases under previous GAAP will automatically be classified as operating (Type B) leases. All existing leases that were classified as capital leases under previous GAAP will automatically be classified as finance (Type A) leases. A capital lease under ASC Topic 840 would not be significantly affected under the new guidance if it met the criteria for classification as a

finance lease (i.e., the existing lease asset and liability would be renamed during transition), but a reclassification of an operating lease under ASC Topic 840 deemed to meet the criteria of a finance lease would require the entity to make changes to a whole class of similar leases in the income statement. A reclassification of an operating lease under ASC Topic 840 to an operating lease under ASC 842 would have no effect on the income statement. Both reclassifications (finance and operating) would require recognition on the balance sheet as right-of use assets and lease liabilities. In this regard, entities would be well advised to not elect to reclassify and reassess.

c. ***Evaluation for the existence of indirect costs for existing leases.*** Entities are provided relief from having to reevaluate and exclude certain outlays classified as initial direct costs under ASC Topic 840. ASC 842 defines initial direct costs as those that could have been avoided had the entity not entered into a lease agreement. Again, the entity can elect to avoid reassessing these costs during the transition period; however, the entity cannot elect only one or two of the practical expedients but must elect all three of them as a single package.

2. ***Use of hindsight.*** Entities may elect a practical expedient to use hindsight in determining the lease term and in assessing the impairment of the entity's right-of-use assets. This is expected to save entities time during transition by not requiring them to determine the information available at the inception of the leases.

3. ***Accounting Policy.*** Lessees also could make an accounting policy election by class of underlying asset to not record a right-of-use asset and lease liability for short-term leases, which are defined as leases with a lease term of 12 months or less. Instead, those short-term leases would be recorded similarly to operating leases under ASC Topic 840, with the lease payments being recognized into profit or loss on a straight-line basis over the lease term. This election will help entities save the effort and time of maintaining lease schedules for leases of short duration.

4. ***Risk-free rate (applies only to private entities).*** A privately held company can elect to use a risk-free rate (e.g., U.S. Treasury bill rate) to discount the lease payments and avoid the more complicated and problematic determination of a risk-adjusted discount rate (e.g., its incremental borrowing rate). The only downside would be

that the entity would have to report a larger liability associated with the right-of-use asset. On November 11, the FASB issued ASU 2021-09, Leases (Topic 842): Discount Rate for Lessees That Are Not Public Business Entities that allows lessees that are not public business entities—including private companies, not-for-profit organizations, and employee benefit plans—to use a risk-free rate as the discount rate to classify and measure leases by class of underlying asset. Currently, ASC 842 allows lessees to elect the risk-free rate for all leases. The amendments also require that a lessee use the rate implicit in the lease for any individual lease when it is readily determinable, regardless of whether it has made the risk-free rate election. For entities that have not yet adopted ASC 842, the amendments are effective upon an entity's adoption of ASC 842. For entities that have adopted ASC 842, the amendments are effective for fiscal years beginning after December 15, 2021, and interim periods within fiscal years beginning after December 15, 2022. Earlier application is permitted as of the beginning of the fiscal year of adoption.

5. ***Break down consideration paid for contracts with lease and non-lease components.*** Another practical expedient provided in the guidance is an election to avoid having to apply a provision of ASC 842 that requires a lessee to break down consideration paid in connection with a contract into lease and non-lease components. Thus, the lessee is permitted to treat each lease component and its related non-lease components as a single lease component. If not elected, the lessee must apply other guidance with respect to its accounting treatment of non-lease components (e.g., application of ASC 350).

6. ***Cumulative Adjustment and Separating Components.*** Entities may record a cumulative adjustment to the opening balance of retained earnings in the year of adoption. Lessors may elect not to separate non lease components from their related lease components.

   a. Cumulative adjustment in period of adoption. This practical expedient relieves the entity from having to apply the provisions of ASC 842 at the beginning of the earliest period presented in the year of adoption. In the initial transition, prior years included in the comparative financial statements can be prepared in accordance with ASC Topic 840.

   b. Option to avoid separating lease from non-lease components. As explained above, ASC 842 provides lessees with an option to avoid separating non-lease components from their related lease components. Similar relief was not originally provided to the lessor, however, thereby requiring the entity to evaluate lease arrangements to determine any lease and non-lease components requiring separation. Without this update, the lessor would have to apply the guidance provided in ASC 842 with respect to any lease components while following the revenue recognition rules in ASC Topic 606, "Revenue from Contracts with Customers," with respect to any non-lease components (or other applicable guidance). ASU 2018-10 grants this relief to lessors if both of the following conditions are met:

   - The timing and pattern of transfer for the lease component and associated non-lease components are the same.
   - The lease component, if accounted for separately, would be classified as an operating lease.

Furthermore, the guidance requires the lessor to follow the guidance related to the predominant component of the combined component. Thus, if most of the consideration is related to the lease component, the lessor would follow the guidance in ASC 842. If most of the consideration received by the lessor is related to the non-lease component, the lessor would follow ASC Topic 606 or other applicable guidance. Of course, if so elected, the lessor would have to apply the same guidance to an entire class of underlying assets.

Documenting your adoption approach is important for becoming compliant with ASC 842. Below is a checklist that you should consider for your lease implementation.

STEP 1: **Identify your Lease Population**

a. Understand the new definition of a lease.
b. Review your contracts and other agreements to identify previously unknown leases – including embedded or in substance leases.
c. Work with local offices, job sites, plants, distribution centers, etc., for information on leases they may have as well.
d. Compile a listing of your identified leases, including significant lease terms such as lease payments, term, options to renew or cancel, and initial direct costs.
e. Document procedures performed to identify your complete lease population, especially key internal controls.

STEP 2: **Technical Analysis and Assessment**

With your full lease population in mind, determine your policy elections and practical expedients

a. Decide on one of the available transition methods and consider discussing these approaches with your financial statement users, stakeholders and peer organizations, if relevant.
    - Modified Retrospective Type 1:
      Under this approach, you are adopting the new lease accounting standards as of the earliest period presented in your financial statements.
    - Modified Retrospective Type 2 (Effective Date Method):
      Using this method, you will adopt the new lease accounting standards on the effective date. The previous year presented on your balance sheet and in disclosures will show accounting based on the old standard.

b. Assess whether your organization's existing systems, internal controls, and processes are adequate or if new systems and tools are required.
c. Draft a lease accounting policy outlining your policy elections and practical expedients, and how they impact your financials.
d. Discuss lease policy decisions with your accountant/auditor.

STEP 3: **Perform Lease Calculations**

a. If your assessment has determined that lease accounting software will be necessary for your implementation, review vendor options, finalize software selection, and start the set-up process.
b. Using data from your total lease population, upload lease details into lease accounting software or run calculations to determine appropriate entries.
c. Consider business process changes that need to be made for the organization's internal control environment around data entry, authority to enter contracts, and review.

STEP 4: **Data Validation**

a. Run a manual test on a population of leases to ensure technology and software systems are accurate.
b. Run applicable historical transactions through new systems and business processes to calculate the effect on prior periods or the cumulative effect upon adoption date.
c. Allow time for your accountant/auditor to test your restated accounts or cumulative adjustment. Prepare new disclosures and ensure accountant/auditor concurrence.

Financial Statement Presentation and Disclosures Under ASC 842

https://www.aicpa.org/cpe-learning/publication/construction-contractors-audit-and-accounting-guide

The AICPA has published the 2021 Construction Contractors: Audit and Accounting Guide that includes sample financial statements reflective of all guidance effective as of the date of the guide. Within the sample financial statements, there are also examples of the effects on the financial statement and footnote disclosures that would be required upon the adoption of ASC 842. Refer to this guide as well as other public company financial reports, that have already implemented this standard, when preparing company financial statements under ASC 842.

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