



# Lease Accounting SEcREts

Private Companies Can Learn From Public Companies





# Companies were not just ready to close, but *slam*, the books on 2020.

The bright side is that a hard year also brought many lessons learned for the future. For example, private companies can learn a lot from how public companies handled and reported critical challenges. While private companies have different responsibilities than public filers, they have one challenge in common: **implementing the new lease accounting rules.**

Now, there's more proof of the technical challenges companies face even after adoption. LeaseQuery evaluated recent SEC comment letters\* on lease accounting disclosures across a range of industries.

The comment letters provide insight into some of the challenges private companies may face on the other side of implementation and give clues to help avoid them.

**Public companies have warned that the path to implementation is more challenging than anticipated.**

**37%**

of companies in early stages of lease accounting transition anticipated a difficult transition

**67%**

of companies in later stages actually experiences difficulty

Learn more in our free guide, ***The Accountants' Journey to Adoption***

\*Research Methodology: LeaseQuery evaluated SEC comment letters on lease accounting disclosures from public companies' 2019 and 2020 filings across a range of industries. The SEC issues comment letters on public financial filings when they conclude disclosures need clarification or correction. Filers then have the opportunity to respond to the SEC and provide additional information or propose amended disclosures. Both the SEC's original comment letter and the filer's response are made public when the SEC is satisfied that the comments have been addressed.

# Bring Clarity to COVID-19 Concessions and Changes

Public companies received broad guidance from the SEC on clearly communicating COVID-19 impacts across their business, including revenues, operations and the balance sheet. As many companies reconsider their real estate footprint and renegotiate lease terms in light of the crisis and changing needs, items like asset valuation and properly accounting for rent concessions must be considered.

The SEC has stated the importance of companies disclosing the impacts of COVID-19 on its business within public filings. There will likely be companies that are not as thorough with these disclosures as the SEC anticipated, therefore, as public companies file their 2020 Form 10-Ks, **the SEC is expected to issue additional comment letters related to COVID-19**. Public companies should be transparent and thorough in their disclosures, and private companies should watch closely for issues they may face in accurately accounting for the pandemic effects.

COVID-19 has added new, unplanned challenges to an already complex rule change. The number of changes to contracts and lease agreements will cause additional hurdles for private companies in advance of the transition. **According to LeaseQuery's COVID-19 Lease Impact Report, 29% of companies asked for rent concessions in 2020, and another 31% are currently renegotiating for more favorable terms.**

Whether a lessee or lessor, private companies should ensure their implementation process includes a thorough review of lease changes and concessions. To ease the burden of the pandemic, the FASB issued optional relief for COVID-19 related rent concessions. In short, companies can elect to treat certain pandemic-related lease concessions as if they existed in the original contract, rather than as a lease modification. Modification accounting under the new guidance is quite complex and requires a remeasurement of the lease liability and adjustment to the ROU asset, as well as re-evaluation of lease classification and the discount rate applied to the lease. The relief guidance, however, provides three simplified approaches to accounting for rent concessions, each with their own advantages.



## SAMPLE ISSUES FLAGGED IN SEC COMMENT LETTERS

Assess the impact of COVID-19, specifically addressing how it will affect assets on the balance sheet, as well as the impacts to revenue, earnings and liquidity.

Explain whether significant changes in judgments used to determine asset fair value have occurred or if there has been a significant change in the way assets are used.

Disclose if impairment assessments for real estate and ROU assets were conducted.

Disclose if the FASB's optional relief guidance for COVID-19 related rent concessions was adopted and the impact of concessions on operations and cash flows.

## CHALLENGES FOR PRIVATE COMPANIES TO CONSIDER

How to assess the effects of significant uncertainties related to COVID-19 for areas like operations, business strategy and demand

How COVID-19 has affected the value of real estate and ROU assets

How to account for COVID-19 related lease modifications and concessions



# Get Descriptive When Documenting Discount Rates

Discount rates are a vital part of ASC 842 accounting. They are used to determine both the lease liability recorded on the balance sheet and lease classification.

It's important for companies to thoroughly document policies, such as how they determined the incremental borrowing rates applied to their leases, and if discount rates are applied using the optional portfolio approach or on a lease-by-lease basis.

Furthermore, lessees are required to calculate and disclose the **weighted-average discount rate** for their lease portfolio, segregated between operating and finance leases. Within the comment letters, the SEC asked public companies to provide more details around the calculations surrounding discount rates.



[READ THIS ARTICLE](#)  
*ASC 842 Disclosure Requirements: Example and Explanation*

## SAMPLE ISSUES FLAGGED IN SEC COMMENT LETTERS

Explain how incremental borrowing rates are determined and if applicable the extent to which experts were used in the process and how they were deemed an expert

Clarify how weighted-average discount rates were calculated for operating and finance leases

## CHALLENGES FOR PRIVATE COMPANIES TO CONSIDER

Determination of the incremental borrowing rates applied to the lease portfolio

How to calculate the weighted-average discount rate under ASC 842

# Track Terms and Understand Value of Variable Rent Payments

Many lease contracts contain variable or contingent rent provisions tied to factors such as sales, usage rates, property value fluctuations or inflation. These arrangements can introduce judgments and estimates into the forecasting and budgeting process. They are also accounted for differently than fixed rent payments.

While fixed, or base rent payments, are included in the calculation of the lease liability, generally, variable rent payments are not a part of the lease liability and are expensed when incurred.

## SAMPLE ISSUES FLAGGED IN SEC COMMENT LETTERS

Present additional details on lease agreements structured with a fixed base rent periodically adjusted for changes in the fair market value of the underlying real estate.

Provide additional details on lease agreements with contingent rent payments, tied to the achievement of a specific event or target.

Address whether lease agreements include variable lease payments tied to an index or a rate.

## CHALLENGES FOR PRIVATE COMPANIES TO CONSIDER

How to track and calculate rent payments tied to contingent events.

How to determine changes in the fair market value of underlying leased assets for lease agreements impacted by changes in fair market value.

How to properly account for variable lease payments

Variable contracts are likely to increase in popularity after the events of 2020, so private companies should be clear on the terms and how to account for payments if they change over time. The added complexity of calculating and reconciling variable rent payments makes it even more essential for companies to ensure their processes and infrastructure are up to the challenge. Implementation teams must be able to effectively and accurately capture and classify all lease payments to ensure compliance.



# Treat ROU Right, or Risk Non-compliance

The right-of-use (ROU) asset represents the lessee's right to use a leased asset over the lease term. Under the new guidance, ROU assets must be recorded for both operating and finance leases.

## SAMPLE ISSUES FLAGGED IN SEC COMMENT LETTERS

Clarify where the ROU assets for both operating and finance leases are reported on the balance sheet.

Describe the amount of ROU assets and lease liabilities, as well as the amount of finance and operating lease costs to prove whether or not ASC 842 had a material impact on financial statements.

## CHALLENGES FOR PRIVATE COMPANIES TO CONSIDER

How to present ROU assets on the balance sheet

How to calculate ROU assets

How to assess the materiality of ROU assets

Calculating the ROU asset is a common challenge of complying with the new standard. It is critical for private companies to understand how items like prepaid rent, initial direct costs and lease incentives impact the ROU asset. Understanding the impact lease modifications have on both the lease liability and ROU asset is also central to a successful transition.



[READ THIS ARTICLE](#)  
*Right-of-Use (ROU) Asset and Lease Liability under ASC 842 and IFRS 16*



# Looking Ahead

Companies' lease portfolios and business needs are changing rapidly, compounding the existing challenges of complying with the new standard. Looking ahead, private companies need to quickly centralize their lease data, understand the details of their lease portfolio and ensure they have the right technology and technical resources in place to identify and problem-solve for these potential issues before they become a reality.

***Schedule a demo*** to learn more about LeaseQuery's best-in-class solution.



## About LeaseQuery

LeaseQuery is an accounting technology company built by accountants for accountants. More than 10,000 finance professionals globally rely on LeaseQuery's cloud-based platform for accounting compliance, financial decision-making, data centralization, lease management and lease accounting. Learn more about LeaseQuery's core lease accounting product focused on easing the mandatory transition to ASC 842, GASB 87 and IFRS 16, or explore additional accounting tools. For more information, visit [LeaseQuery.com](https://leasequery.com).