

About the Firm

- › Lucas Horsfall is a CPA firm headquartered in Pasadena, California with two additional offices in Encino and Los Alamitos, California. We are one of the largest independent public accounting firms in the Los Angeles area.
- › At Lucas Horsfall, we believe that the experience we have gained from serving our clients will allow us to bring to you the expertise needed to conduct informative financial assurance services, as well as address other service needs. Over the years we have been able to use this experience to our clients' benefit. Our success is attributable to our hard work and in the values, we practice; competency, creativity, communication, and teamwork.
- › Our firm is composed of a wide range of accounting professionals that are specialized in the areas of accounting/auditing, tax, bookkeeping and business advisory services. We employ over 100 people, which includes 8 partners and 6 directors.
- › We focus on a collaborative approach, working closely with business owners and their accounting team. Our team is comprised of seasoned, experienced professionals, well-versed in accounting and internal control matters.
- › We embrace diversity and have many professionals who speak a multitude of languages, including German, Spanish, Cantonese, Mandarin, and Hindi. Our team has experience in dealing with foreign-owned and multi-national companies, with headquarters in Switzerland, United Kingdom, India, Iceland, Israel, Germany, South Korea, and Mexico.

Impacts on Financial Statements From New Lease Accounting

Mark Hagander, CPA
Nancy Ambrossi, CPA
Jesse Yang, CPA

Leases (ASC 842)

Overview on Lease Standards:

- Legacy Guidance – ASC 840
- New Guidance – ASC 842
- Financial Statement Impact and Financial Ratios
- Accounting Entry - Examples

Legacy Guidance – ASC 840

- Lease Definition: An agreement conveying the right to use property, plant or equipment (land or depreciable assets or both) usually for a stated period of time.
- Classification of Leases:
 - Capital Lease
 - Operating Lease
- Accounting Treatment of Leases:
 - Capital Lease
 - Operating Lease – including deferred rent asset (liability)
- Financial Statement Presentation
 - Capital Lease
 - Operating Lease

New Guidance – ASC 842

- What is considered a lease under the new guidance?
 - All leases that are over 12 months
 - What makes it an operating lease as opposed to a finance lease?
 - If lease meets any of the criteria below, then it's a finance lease
 - Same criteria as Legacy lease – 2 changes to vocab and one add on.
 - 75% has been replaced by the words **Major part**
 - 90% has been replaced by the words **Substantially all**
 - Asset is specialized in nature that there's no alternative use to the lessor at the end of the lease term
 - If lease meets none of the criteria, then it's an operating lease
 - What's same and different about the two?
 - Same: Both will PV asset (same PV calculation method) both will have a liability.
 - Different: Operating leases have a lease expense, and
 - Finance leases have interest expense and depreciation expense

<u>ASC 840</u>		<u>ASC 842</u>	
ABC Test Company, Inc.		ABC Test Company, Inc.	
Balance Sheet		Balance Sheet	
As of December 31, 2018		As of December 31, 2018	
Assets		Assets	
Current Assets		Current Assets	
Cash and Equivalents	6,500,000	Cash and Equivalents	6,500,000
Accounts Receivable	1,250,000	Accounts Receivable - net	1,250,000
Prepaid Expenses	150,000	Prepaid Expenses	150,000
Other Current Assets	25,000	Other Current Assets	25,000
Total Current Assets	7,925,000	Total Current Assets	7,925,000
Long Term Assets		Long Term Assets	
Fixed Assets - Net	1,750,000	Fixed Assets - Net	1,750,000
Capital Lease Asset - Net	1,110,000	Finance ROU Asset - Net	1,110,000
Total Assets	10,785,000	Total Assets	10,785,000
Liabilities & Equity		Liabilities & Equity	
Current Liabilities		Current Liabilities	
Accounts Payable	860,000	Accounts Payable	860,000
Accrued Expenses	450,000	Accrued Expenses	450,000
Short-Term Deferred Revenue	2,650,000	Short-Term Deferred Revenue	2,650,000
Short-Term Capital Lease Liability	250,000	Short-Term Finance Lease Liability	250,000
Other Current Liabilities	300,000	Other Current Liabilities	300,000
Total Current Liabilities	4,510,000	Total Current Liabilities	4,510,000
Long Term Liabilities		Long Term Liabilities	
Long-Term Deferred Revenue	1,250,000	Long-Term Deferred Revenue	1,250,000
Long-Term Capital Lease Liability	775,000	Long-Term Finance Lease Liability	775,000
Total Long Term Liabilities	2,025,000	Total Long Term Liabilities	2,025,000
Equity		Equity	
Members Capital	3,000,000	Members Capital	3,000,000
Retained Earnings	1,100,000	Retained Earnings	1,100,000
Net Income	150,000	Net Income	150,000
Total Equity	4,250,000	Total Equity	4,250,000
Total - Liabilities & Equity	10,785,000	Total - Liabilities & Equity	10,785,000

<u>ASC 840</u>		<u>ASC 842</u>	
ABC Test Company, Inc.		ABC Test Company, Inc.	
Balance Sheet		Balance Sheet	
As of December 31, 2018		As of December 31, 2018	
Assets		Assets	
Current Assets		Current Assets	
Cash and Equivalents	6,500,000	Cash and Equivalents	6,500,000
Accounts Receivable	1,358,610	Accounts Receivable	1,358,610
Prepaid Expenses	150,000	Prepaid Expenses	150,000
Other Current Assets	25,000	Other Current Assets	25,000
Total Current Assets	8,033,610	Total Current Assets	8,033,610
Long Term Assets		Long Term Assets	
Fixed Assets - Net	1,750,000	Fixed Assets - Net	1,750,000
Total Assets	9,783,610	Operating ROU Asset	2,046,217
		Total Assets	11,829,827
Liabilities & Equity		Liabilities & Equity	
Current Liabilities		Current Liabilities	
Accounts Payable	860,000	Accounts Payable	860,000
Accrued Expenses	450,000	Accrued Expenses	450,000
Short-Term Deferred Revenue	2,650,000	Short-Term Deferred Revenue	2,650,000
Other Current Liabilities	300,000	Short-Term Lease Liability	233,672
Total Current Liabilities	4,260,000	Other Current Liabilities	300,000
Long Term Liabilities		Total Current Liabilities	4,493,672
Long-Term Deferred Revenue	1,250,000	Long Term Liabilities	
Deferred Rent	23,610	Long-Term Deferred Revenue	1,250,000
Total Long Term Liabilities	1,273,610	Long-Term Lease Liability	1,836,155
Equity		Deferred Rent	-
Members Capital	3,000,000	Total Long Term Liabilities	3,086,155
Retained Earnings	1,100,000	Equity	
Net Income	150,000	Members Capital	3,000,000
Total Equity	4,250,000	Retained Earnings	1,100,000
Total - Liabilities & Equity	9,783,610	Net Income	150,000
		Total Equity	4,250,000
		Total - Liabilities & Equity	11,829,827

Impact on Financial Statements

- Balance Sheet
 - Lessees should either present the assets or liabilities for finance and operating leases as separate line items on the balance sheet or disclose them separately
 - Finance and operating leases cannot be combined in the balance sheet
 - Lease liability should be classified as current/non-current.
 - ROU asset will all be classified as non-current.

Impact on Financial Statements

- Income Statement
 - Finance Lease
 - Interest expense and amortization expense should be classified consistent with how the lessee classifies similar expenses on its income statement I.e. depreciation and interest expense related to the financed purchase of PP&E.
 - Operating Lease
 - Should be recorded part of its continuing operations I.e. rent expense.
- Cash Flow Statement
 - Finance Lease
 - Principal payment recorded as financing activity, interest expense and amortization recorded as operating activity.
 - Operating Lease
 - Lease payments are recorded as an operating activity.

Impact on Financial Ratios

- Financial Ratios:

Ratios will be mostly affected by operating leases. No significant impact from financing leases.

- Current Ratio:

- Decrease in ratio as current portion of the Company has an operating lease liability. Current portion of lease liability will decrease the ratio. Deferred rent will be derecognized.

- Debt/Net Worth Ratio

- Increase in liability and slight increase in net worth (difference b/w lease liability and ROU asset), therefore impact will be an increase in the ratio.

- Business Debt Coverage Ratio

- New lease guidance can impact this ratio depending on whether current portion of operating leases are included in the ratio.

- Profitability

- No significant change in profitability

Accounting Entry-Examples

- Initial Recognition of ROU Asset and Lease Liability
 - Initial recognition of a finance or operating lease is similar
- Lease liability:
 - Initial measurement of the lease liability lessee payments not yet paid discounted using an acceptable discount rate.
- ROU asset:
 - Initial balance of lease liability
 - + Lease payments already made to the lessor on or before the commence date
 - + Any initial direct costs incurred by the lessee
 - Any lease incentives received from lessor on or before the commencement date
 - Initial balance of the ROU Asset

Accounting Entry-Examples

- Initial Recognition Example:
- Terms of Lease:
 - Rent payment in arrears
 - Rent payments: 2022 - \$100k, 2023 - \$105k, 2024 - \$110k
 - Discount rate: 8%
 - PV of annual lease payments: \$269,935
 - ROU Asset: \$254,935 (\$15k deferred rent liability)

2022	Debit	Credit
ROU asset	254,935	-
Deferred rent liability	15,000	-
Lease liability	-	269,935

Accounting Entry-Examples

- Subsequent Accounting for a Finance Lease
 - Lessee amortizes the ROU asset over the shorter of lease term or useful life of the asset
 - Amortization is straight lined
 - Lease liability are reduced by payments less accretion of interest expense.

2023	Debit	Credit
Lease liability	89,678	-
Amortization expense	84,978	-
Interest expense	15,322	-
Cash	-	105,000
ROU asset	-	84,978

Accounting Entry-Examples

- Subsequent Accounting for Operating Lease
 - Lessee determines total lease cost over term of lease which will be expensed over the shorter of lease term or useful life of asset. Lease expense will be recognized on a straight line basis.

2023	Debit	Credit
Lease liability	89,678	-
Lease expense	100,000	-
Cash	-	105,000
ROU asset	-	84,678

Accounting Entry-Examples

- Lease Liability Schedule:

Lease Liability	2022	2023	2024
Beginning Balance	269,935	191,530	101,852
Plus accretion of interest	21,595	15,322	8,148
Minus lease payment	100,000	105,000	110,000
Ending Balance	191,530	101,852	-

Accounting Entry-Examples

- ROU Asset Amortization Schedule:

- Finance Lease

Net ROU Asset	2022	2023	2024
Beginning Balance	254,935	169,957	84,979
Minus Amortization	84,978	84,978	84,979
Ending Balance	169,957	84,979	-

- Operating lease

Net ROU Asset	2022	2023	2024
Beginning Balance	254,935	176,530	91,852
Minus Amortization	78,405	84,678	91,852
Ending Balance	176,530	91,852	-



Wrap Up and Questions

Contact Information:

Mark Hagander, CPA: mark@lhmp.com

Nancy Ambrossi, CPA: nambrossi@lhmp.com

Jesse Yang, CPA: jyang@lhmp.com



Thank You!