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The New Lease Accounting Standard is Fast Approaching: What Trucking Companies Should Be Doing Now

As the pandemic evolved over 2020 and 2021, it created an even greater reliance on the transportation industry to deliver much-needed supplies throughout the country. As we settle into the new normal, trucking companies now need to be aware of a significant change coming right around the corner regarding the tracking and accounting for leased assets. We've included in this white paper information about the standard, how it will impact the financials and what you should be doing now to prepare.

Purpose

The Accounting Standards Update (ASU) 2016-02, Leases (Topic 842), better known as Accounting Standards Codification (ASC) 842, was created by the Financial Accounting Standards Board (FASB) to appropriately record the committed liabilities related to leased assets used within an organization. ASC 842 is effectively replacing ASC 840, which accounted for only capitalized finance type leases on the balance sheet. The new standard is correcting the substantial loophole in ASC 840 regarding off-balance-sheet operating leases. Unlike the old standard, ASC 842 requires the majority of leases to be recorded on the balance sheet.

Timing

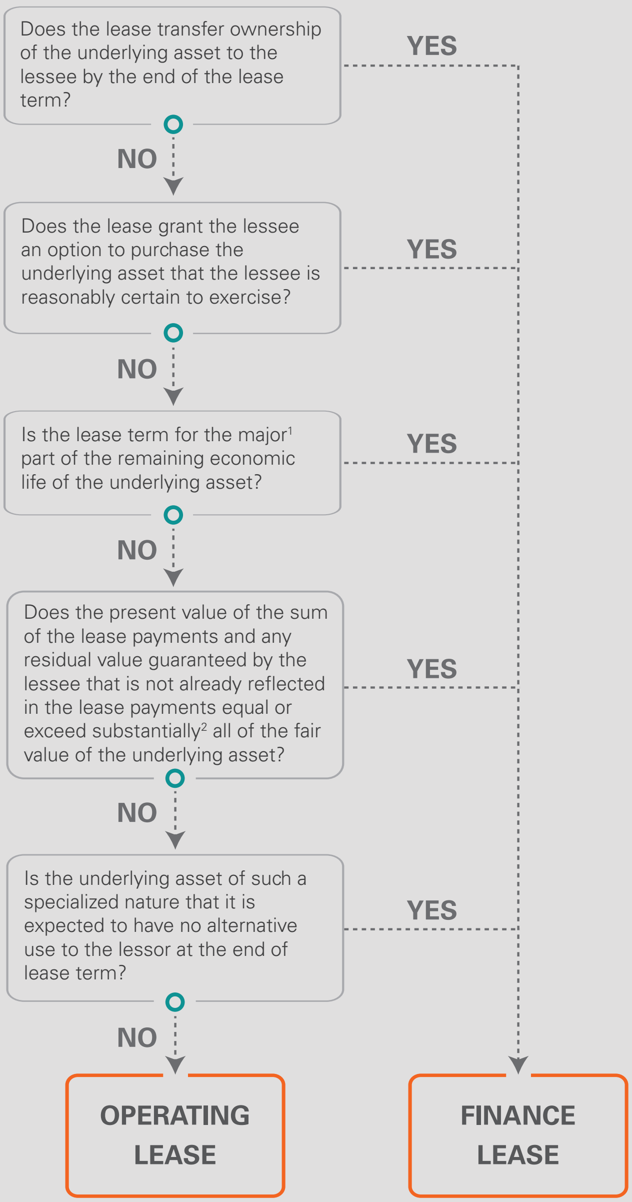
In February of 2016, FASB issued the new standard. The initial plan was for public entities to adopt in 2019 and private entities to adopt in 2020. To everyone's glee, after the public companies had adopted the standard, private company adoption was postponed a year simply due to the complexity of executing the change. Then, because of the pandemic, the standard was postponed a second time. Now, the time has finally arrived to record leases under ASC 842.

For private entities, fiscal years that start after December 15, 2021 will need to include the recording of all leased assets and lease liabilities on the balance sheet. For calendar-year organizations, this will require recording leases on the balance sheet for year-end 2022. For fiscal-year companies, the recording responsibility will start for the year that begins in 2022. For many organizations, there are only a couple of months left before this recording requirement.

Financials

The biggest impact on the financials will appear on the balance sheet. The net present value of the lease liabilities will show under finance lease liabilities and/or operating lease liabilities, depending on the specific lease terms of the obligations. Finance leases in ASC 842 are equivalent to the prior standard's capitalized leases. Operating leases are equivalent to the previously non-capitalized leases that were simply expensed. Both are now going to be capitalized on the balance sheet. The other side to the liability is the related right of use asset. These assets will also be classified in finance and operating lease buckets. Expect the changes on the balance sheet to cause a decrease in the current ratio (current assets/current liabilities), asset turnover (sales/average assets) and return on assets (net income/assets).

Determining a Finance Versus Operating Lease



[1] Can utilize the previous "the period of the lease encompasses **at least 75%** of the useful life of the asset" rule as a guideline.

[2] Can utilize the previous "the present value of the minimum lease payments required under the lease is **at least 90%** of the fair value of the asset at the inception of the lease" rule as a guideline.

Another change to the financials may appear on the income statement. Organizations that incorrectly characterized leases as operating will see a shift from traditional lease expense to amortization and interest expense. These changes and corrections will impact the EBITA (Earnings Before Interest, Taxes and Amortization) and the EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortization) calculations.

The lease activity will also need to pull to the statement of cash flows. Cash flow financing items will now include the repayment of principal on finance leases. Operating items will now include interest on the lease liability from finance leases, short-term and variable lease payments not in liability accounts, and payments on operating leases.

The notes to the financials will need to report lease activity and assumptions. There is a required disclosure report summarizing the lease activity for the year. In addition to the activity, weighted average calculations are needed for both the discount rates and remaining lease terms. A future payments report is another required report, breaking down payments by year, by lease type (finance or operating), and into principal and interest components. Finally, the statements in the notes will need to include information on leases that have yet to commence, assumptions and decisions made regarding the leases, and basic information on the nature of the leases.

The following page contains a summary of key items by lease type:

	Finance Lease	Operating Lease
Balance Sheet Effect		
Initial Measurement - ROU Asset and Lease Liability	Record the ROU asset and lease liability at the present value[3] of the lease payments not yet paid. Lease ROU assets and liabilities can be presented separately or together with other assets/liabilities. However, if they are not presented separately, a disclosure must be made regarding the amount and line item on the balance sheet in which they are included. Finance lease ROU assets are prohibited from being presented in the same line item as operating lease ROU assets.	
Subsequent Measurement – ROU Asset	Amortize the ROU asset on a straight-line basis over the shorter of the lease term or useful life, similar to that of other nonfinancial assets. This is similar to the previous guidance for capital leases.	Measure the ROU asset at the amount of the lease liability and adjust for cumulative prepaid or accrued rents (i.e., for escalating or uneven payment schedules). Note: The amount recorded as an operating lease ROU asset should be remeasured monthly. (Practically speaking, the remeasurement might occur solely in conjunction with the company's typical external reporting requirements - e.g., quarterly, semi-annually, annually.)
Subsequent Measurement – Lease Liability	Use the effective interest rate method to subsequently account for the lease liability (using the discount rate determined at the start of the lease). This is similar to the previous guidance for capital leases.	Measure the lease liability at the present value of the remaining lease payments (continue to use the discount rate determined at the start of the lease). This liability will not differ from that determined for a finance lease. The difference is that no interest expense is recognized.

	Finance Lease	Operating Lease
Income Statement Effect		
	Interest expense and amortization expense will be recorded and presented separately. Recording will remain consistent with how the organization presents these items for similar expenses. This method of recording is considered to result in a "front-loaded" expense due to the interest component.	A single lease expense will be included within income from continuing operations. The method of recording is on a straight-line basis.

	Finance Lease	Operating Lease
Cash Flow Effect		
Cash transactions	Principal payments will be included within financing activities. Interest payments will be treated similarly to how other interest payments are currently handled.	All lease payments will be included within operating activities.
Non-cash transactions	Both types of leases will require supplemental non-cash disclosure of new leases.	

Short-Term Lease Exception

The FASB does offer some relief in the form of a short-term lease exception. A lessee is permitted to adopt an accounting policy by asset class to not recognize lease assets and lease liabilities for leases with terms of 12 months or less, including any renewal periods that are reasonably certain to be exercised. Organizations making this election are to recognize lease expenses on a straight-line basis over the lease term.

Onboarding leases

On the day of adoption, there likely will be a variance between the right of use asset and lease liability balances. Some of this will be accounted for in deferred rent or tenant allowance accounts. The remaining balances in these accounts on the adoption date will be removed as part of the onboarding entry. The monthly activity previously recorded through these balance sheet accounts will now be embedded into the lease schedules and related journal entries required under the standard. Any remaining variance between the asset and liability balances could be due to prior errors in either classifications of leases or missed deferred rent recording. Due to this, any variances remaining in the onboarding entry will hit the organization's equity balance.

Next Steps

- **Review loan covenants**
  The lease accounting changes could significantly impact your financial covenants. The calculations may include debt to EBITDA, debt to equity or fixed charge coverage. To avoid noncompliance, early conversations with lenders and a review of note covenants are recommended. The banks are familiar with the change and should not be surprised by the conversation.
- **Identify leases in portfolio**
  Understanding the lease portfolio of the organization will contribute to the decision-making process around accounting elections. It will provide a gauge on how the accounting arm of the organization will be impacted and the work involved to monitor leases on an ongoing basis. Familiarity with the type and volume of leases will help assess the tools required to manage the leases and to meet the new accounting requirements.

- **Contact your auditor or consultant**
  Decisions will need to be made around practical expedient adoption, non-lease component treatment, short-term leases and discount/interest rates. There may also be some question as to what qualifies as a lease under ASC 842, as that definition has changed from ASC 840. It would be worthwhile to discuss this with your auditor or a lease consultant to help make the best decisions for your company.
- **Find a tool**
  Each lease will require a schedule to calculate the net present value of the future lease payments. This schedule then builds the associated monthly journal activity required to properly expense the lease and relieve the balance sheet accounts. If the portfolio consists of 10 or fewer leases, Excel may work. Larger portfolios will require a separate system to track leases and calculate the schedules. Now is the time to research what will work best for your organization.

As you navigate through ASC 842 and find that your organization needs some guidance on the technical aspects of lease accounting, Schneider Downs (SD) can help. SD has been tracking and anticipating the changes to lease accounting standards over the years and has worked extensively to understand the specifics and intricacies of the standards. Additionally, SD offers simpLEASE, a software program that provides easy-to-understand guidance to analyze each individual lease. The program was developed in conjunction with the accountants at SD, is easy to use and provides an accurate analysis for all lease computations. For more information on lease accounting, visit the Schneider Downs *Our Thoughts On* blog or reach out to us via email at **contactSD@schneiderdowns.com**.

Ohio Trucking Association

The Ohio Trucking Association is a 100-year-old full-service trade association operating in Columbus, Ohio. With over 815 total members in the trucking, logistics, warehousing and moving industries, our promise to our members is simple: the Ohio Trucking Association will work to improve operational efficiency, profitability and relevancy for all of Ohio's transportation industry. Advocacy, professional development, networking and cost savings initiatives are the keys to carrying out this promise to our members. No matter what the cause, our industry is stronger when operating as one. We encourage you to explore more about becoming involved with the Ohio Trucking Association at **www.joinota.com**.

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Schneider Downs Transportation and Logistics Industry Group

Established in 1956, Schneider Downs has grown to be one of the largest independent public accounting and advisory firms in Columbus, Ohio; Western Pennsylvania and Washington D.C., with nearly 500 personnel in total, including 52 shareholders and partners.

More than 25 years ago, we established the Schneider Downs Transportation and Logistics Industry Group. The group includes assurance, tax, technology and management consulting professionals who combine their individual expertise to serve our wide range of transportation and logistics clients—from local carriers to national enterprises, including: trucking, general freight, flatbed and box, TL, LTL, tank waste brokerage, bulk commodity dump, 3PL, heavy hauling/permitted loads, moving and warehousing. The Transportation and Logistics Industry Group meets on a regular basis to review and analyze issues central to this industry. As a result, our transportation and logistics professionals possess the most current knowledge of transportation issues, regulations and trends. We work with you to seek innovative ways to reach your strategic goals.

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