

You Should Know

News Item: The new topic 842 lease classification rules are virtually the same as former GAAP (topic 840/FAS 13)

The new lease accounting rules (topic 842) classification tests are as follows:

842-10-25-2 A lessee shall classify a lease as a finance lease and a lessor shall classify a lease as a sales-type lease when the lease meets any of the following criteria at lease commencement:

- a. The lease transfers ownership of the underlying asset to the lessee by the end of the lease term.
- b. The lease grants the lessee an option to purchase the underlying asset that the lessee is reasonably certain to exercise.
- c. The lease term is for the major part of the remaining economic life of the underlying asset. However, if the commencement date falls at or near the end of the economic life of the underlying asset, this criterion shall not be used for purposes of classifying the lease.
- d. The present value of the sum of the lease payments and any residual value guaranteed by the lessee that is not already reflected in the lease payments in accordance with paragraph 842-10-30-5(f) equals or exceeds substantially all of the fair value of the underlying asset.
- e. The underlying asset is of such a specialized nature that it is expected to have no alternative use to the lessor at the end of the lease term. ***[NOTE: This is the ONLY significant change to previous GAAP and it is rarely the case]***

842-10-55-2 When determining lease classification, one reasonable approach to assessing the criteria in paragraphs 842-10-25-2(c) through (d) would be to conclude:

- a. Seventy-five percent or more of the remaining economic life of the underlying asset is a major part of the remaining economic life of that underlying asset.
- b. A commencement date that falls at or near the end of the economic life of the underlying asset refers to a commencement date that falls within the last 25 percent of the total economic life of the underlying asset.
- c. Ninety percent or more of the fair value of the underlying asset amounts to substantially all the fair value of the underlying asset.