Operating Leases *Used* to Be the Easy Ones

By Walter R. Teets and Matthew Hoag

Curriculum: Accounting and Auditing

Level: Intermediate

Designed For: Business and industry; public practice (audit)

Objectives: Explain and illustrate new requirements for accounting for operating leases under FASB Accounting Standards Codification Topic 842, Leases

Key Topics: Capitalization of ROU asset and lease liability; determination of ROU asset amortization directly, rather than as a plug; illustration of complexity added increasing-payment leases; illustration of complexity added by initial direct costs and lease incentives

Prerequisites: Basic knowledge about leases and leasing transactions

Advanced Preparation: None

Under the new lease accounting guidance issued by the Financial Accounting Standards Board (FASB) in 2016, the accounting for operating leases is set to change considerably. Operating leases will require straight-line lease expense recognition, similar to the current guidance, but companies will be required to capitalize lease liabilities and right-of-use (ROU) assets. A lease liability will be reported at the present value of the future lease payments and the ROU asset will be reported at the value of the lease liability, adjusted for items such as unamortized lease incentives or initial direct costs. Therefore, the ROU asset value is inextricably linked to the lease liability value. The new lease guidance requires the effective interest method of accounting for lease liabilities, which implies asset amortization will follow a decelerated pattern not before used in the accounting for long-term assets.

In this article, the determination of the yearly asset amortization is illustrated for increasingly complex (and realistic) leases. The asset amortization is calculated directly, rather than as a change in ROU asset balance sheet values, as is done in the FASB guidance and in other material explaining the new standard.

Leases that will be used in the development of an understanding of the requirements of the new standard include three leases consistent with FASB's numerical example, starting at Accounting Standards Codification™ paragraph 842-20-55-40, which has lease payments at the end of the period, and three leases with payments at the beginning of the period.

A. Leases with payments at the end of the period:

- A level-payment lease with no initial direct costs or lease incentives
- An increasing-payment lease with no initial direct costs or lease incentives
- An increasing-payment lease with initial direct costs and lease incentive

B. Leases with payments at the beginning of the period:

- A level-payment lease with no initial direct costs or lease incentives
- An increasing-payment lease with no initial direct costs or lease incentives
- An increasing-payment lease with initial direct costs and lease incentive

Overview

The new lease accounting guidance for operating leases, at a high level, has two requirements: (1) a lease liability must be capitalized, along with a related right-of-use (ROU) asset and (2) a periodic lease expense must be recognized as a single amount on a straight-line basis. While these two requirements seem straightforward individually, putting them together leads to some surprising results.

The capitalization of an ROU asset and a lease liability are quite familiar from current guidance on accounting for capital leases. But a single straight-line lease expense – conceptually consisting of interest expense on the liability and amortization expense on the asset – is new. The guidance stipulates that the lease liability should be accounted for using the effective interest method, so the interest component of the straight-line lease expense is well known. But coupling this requirement with the requirement of a single straight-line lease expense implies that the amortization of the asset must follow a decelerated pattern not seen before in long-term asset accounting.

The new guidance focuses on end-of-period liability and asset values, but it is the *changes* in those values that are used in journal entries. Specifically, the end-of-period lease liability is defined as the present value of remaining lease payments in Accounting Standards Codification™ (ASC) paragraph 842-20-35-3(a) and the end-of-period asset value is defined as the end-of-period liability value, adjusted for prepaid or accrued lease payments, and unamortized lease incentives and initial direct costs in ASC 842-20-35-3(b). Given the end-of-period asset and liability values for consecutive periods, it is, of course, trivial to determine the changes in those values. But it seems preferable to determine the amortization amounts directly. The examples that follow illustrate how simple extensions of familiar amortization tables can be used to determine the ROU asset amortization amount directly, rather than as the difference between two end-of-period ROU asset values.

All examples assume operating lease treatment is appropriate. They also assume there are no ROU asset impairments or modifications to the lease, which raise issues beyond the scope of this article.

Leases with Payments at End-of-Period

Example 1: A lessee enters into a 10-year operating lease requiring $10,000 in annual lease payments. The lessee's implicit rate is assumed to be 6 percent and the lessor's rate is unknown. Therefore, the beginning lease liability is the present value of the 10 $10,000 payments, discounted at 6 percent, or $73,601. The new guidance prescribes the initial asset value should be equal to the amount of the initial measurement of the lease liability, plus any lease payments made to the lessor at or before the commencement date, minus any lease incentives received, plus any initial direct costs incurred by the lessee. For simplicity, in this example, we assume no up-front payments, lease incentives or initial direct costs incurred; the initial asset value is therefore simply equal to the initial lease liability, $73,601.

The difficulty in the new standard is not in determining the straight-line lease expense that should be recognized; as under current guidance, it is simply the sum of all lease payments, divided by the number of periods under the lease. In the case of a level-payment lease, this is simply equal to the periodic cash payment. The difficulty lies in determining the periodic reductions in the lease liability and the ROU asset. However, the lease liability amortization table, familiar from current capital lease treatment, provides the needed values. See Table 1.

Conceptually, the straight-line lease expense consists of two components, the interest on the lease liability and amortization of the asset cost. At a high level, this is familiar from current capital lease treatment. However, in current capital lease treatment, the interest expense and the asset amortization are not related to each other and

Table 1

Year	Lease Liability, BOY	Interest	Cash Payment	Lease Liability Amortization
1	73,601	4,416	10,000	5,584
2	68,017	4,081	10,000	5,919
3	62,098	3,726	10,000	6,274
4	55,824	3,349	10,000	6,651
5	49,173	2,950	10,000	7,050
6	42,123	2,527	10,000	7,473
7	34,650	2,079	10,000	7,921
8	26,729	1,604	10,000	8,396
9	18,333	1,100	10,000	8,900
10	9,433	567	10,000	9,433
Total			100,000	73,601

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the combined lease expense will vary from period to period. In the new operating lease treatment, the sum of the periodic interest expense and asset amortization must be constant each and every period. The new guidance stipulates that the lease liability be accounted for using the effective interest method. Therefore, the first component of the lease expense is the interest cost for the period. This amount will decrease over time as the periodic cash payments reduce the liability. Given a straight-line lease expense, the asset amortization component must therefore *increase* over time.

Since the operating lease guidance defines the ROU asset value in relation to the lease liability value, the *change* in the ROU asset must be related to the change in the lease liability value. The change in the lease liability for an end-of-period-payment lease is simply the lease liability amortization, provided in the last column in Table 1. Therefore, the ROU asset amortization must be related to lease liability amortization. In the case of a level-payment lease with no initial direct costs or lease incentives, the ROU asset amortization is exactly equal to the lease liability amortization.

If one were to consider only the asset amortization, it follows a pattern not seen before: decelerated (as opposed to accelerated) amortization. The change in ROU asset value is lower in early years and increases over the life of the lease.

The journal entry at inception of the lease is:

ROU Asset	73,601	
Lease Liability		73,601

The journal entries throughout the lease are shown in Table 2.

Table 2

Year	Lease Expense Dr	Lease Liability Dr	Cash Cr	ROU Asset Cr
1	10,000	5,584	10,000	5,584
2	10,000	5,919	10,000	5,919
3	10,000	6,274	10,000	6,274
4	10,000	6,651	10,000	6,651
5	10,000	7,050	10,000	7,050
6	10,000	7,473	10,000	7,473
7	10,000	7,921	10,000	7,921
8	10,000	8,396	10,000	8,396
9	10,000	8,900	10,000	8,900
10	10,000	9,433	10,000	9,433
Total	100,000	73,601	100,000	73,601

Example 2: This example uses the same basic lease used in Example 1, but incorporates a lease feature common in practice, increasing lease payments. The lease payment is $10,000 in the first year; payments increase by 5 percent each subsequent year for the 10-year lease term. The total lease payments are $125,780; that total is recognized straight-line across the 10-year lease period, resulting in a $12,578 lease expense per year. In an increasing payment lease, the annual cash payments are not equal to the year-by-year straight-line lease expense. Under current operating lease accounting, this difference between cash payment and lease expense is recognized as a lease payable.

Under the new guidance (specifically ASC paragraph 842-20-35-3(b)(1)), the difference is not included as part of the lease liability, which measures the present value of future lease payments at the reporting date. Rather, the difference should be netted with the ROU asset. Since the cumulative difference is generally a credit, it reduces the ROU asset. In the journal entry, that ROU asset reduction is accomplished through the credit effecting the asset amortization. An expanded amortization table is required, given the increasing lease payments.

Table 3

	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Year	Lease Liability, BOY	Interest	Cash Payment	Lease Liability Amortization	Straight-line Lease Expense	Increase (Decrease) in "Lease Payable" included in ROU Asset	ROU Asset Amortization
Computation		(1) × .06		(3) – (2)		(5) – (3)	(4) + (6)
1	90,434	5,426	10,000	4,574	12,578	2,578	7,152
2	85,860	5,152	10,500	5,348	12,578	2,078	7,426
3	80,512	4,831	11,025	6,194	12,578	1,553	7,747
4	74,318	4,459	11,576	7,117	12,578	1,002	8,119
5	67,201	4,032	12,155	8,123	12,578	423	8,546
6	59,078	3,545	12,763	9,218	12,578	(185)	9,033
7	49,860	2,992	13,401	10,409	12,578	(823)	9,586
8	39,451	2,367	14,071	11,704	12,578	(1,493)	10,211
9	27,747	1,665	14,775	13,110	12,578	(2,197)	10,913
10	14,637	877	15,514	14,637	12,578	(2,936)	11,701
Total			125,780	90,434	125,780	0	90,434

As observed in Table 3, the difference between the lease payment and the straight-line lease expense adjusts the lease liability amortization, to arrive at the asset amortization. In the early years, the lease payments are smaller than the straight-line lease expense requiring an additional credit entry (i.e., additional asset amortization). In later years, the lease payments will be larger than the straight-line expense resulting in reduced asset amortization.

At the inception of the lease, the lease liability and ROU asset are recorded at the present value of the increasing lease payments, discounted at the lessee's implicit rate (6 percent):

ROU Asset	90,434	
Lease Liability		90,434

The journal entries throughout the lease are shown in Table 4.

Example 3: This example builds upon Example 2, adding both initial direct costs and a lease incentive. The initial direct costs are assumed to be $5,000 and the lease incentive is assumed to be $10,000. Both cash flows are assumed to have occurred prior to the date the

Table 4

Year	Lease Expense Dr	Lease Liability Dr	Cash Cr	ROU Asset Cr
1	12,578	4,574	10,000	7,152
2	12,578	5,348	10,500	7,426
3	12,578	6,194	11,025	7,747
4	12,578	7,117	11,576	8,119
5	12,578	8,123	12,155	8,546
6	12,578	9,218	12,763	9,033
7	12,578	10,409	13,401	9,586
8	12,578	11,704	14,071	10,211
9	12,578	13,110	14,775	10,913
10	12,578	14,637	15,514	11,701
Total	125,780	90,434	125,780	90,434

ROU asset and liability are recorded; when the cash flows occurred, deferral accounts were established.

The journal entry at inception is:

ROU Asset	85,434	
Deferred Lease Incentive	10,000	
Lease Liability		90,434
Deferred Initial Direct Costs		5,000

Per ASC paragraph 842-20-30-5, the initial direct costs and lease incentive are embedded in the cost of the ROU asset, as adjustments to the initial lease liability. Since these items are included in the initial measurement of the ROU asset, they will affect the amortization of the ROU asset.

Per ASC paragraphs 840-20-25-6 and 25-8, the lease expense is equal to the total lease payments, plus initial direct costs, less the lease incentive, recognized on a straight-line basis over the life of the lease (unless another pattern better reflects the benefits derived from the ROU asset).

An expanded version of the lease liability amortization table used in Example 2 can be used to determine the values needed to account for this more complicated, and more realistic, lease.

Note the difference in column headings for column (5) in Table 5 for example 3 and Table 3 for example 2. Example 3 adds initial direct costs and a lease incentive; the lease expense is affected by those items, but the payments to the lessor are not. The "lease payable" amount relates to the difference between the cash paid to the lessor and the straight-line cost of the lease payments. In example 2 (Table 3), there are no initial direct costs nor lease incentive, so the straight-line lease expense and the straight-line cost of the lease payments were the same. Finally, note that column (10) may also be calculated as (3) + (6) + (7) – (8).

Table 5

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
Year	Lease Liability, BOY	Interest	Cash Payment	Lease Liability Amortization	Straight-line Cost in Lease Payments	Increase (Decrease) in "Lease Liability" included in ROU Asset	Amortization of Initial Direct Costs	Amortization of Lease Incentive	ROU Initial Amortization	Straight-line Lease Expense
Computation		(1) × .06		(3) – (2)		(5) – (3)			(4) + (6) +(7) - (8)	(5) + (7) - (8)
1	90,434	5,426	10,000	4,574	12,578	2,578	500	1,000	6,652	12,078
2	85,860	5,152	10,500	5,348	12,578	2,078	500	1,000	6,926	12,078
3	80,512	4,831	11,025	6,194	12,578	1,553	500	1,000	7,247	12,078
4	74,318	4,459	11,576	7,117	12,578	1,002	500	1,000	7,619	12,078
5	67,201	4,032	12,155	8,123	12,578	423	500	1,000	8,046	12,078
6	59,078	3,545	12,763	9,218	12,578	(185)	500	1,000	8,533	12,078
7	49,860	2,992	13,401	10,409	12,578	(823)	500	1,000	9,086	12,078
8	39,451	2,367	14,071	11,704	12,578	(1,493)	500	1,000	9,711	12,078
9	27,747	1,665	14,775	13,110	12,578	(2,197)	500	1,000	10,413	12,078
10	14,637	877	15,514	14,637	12,578	(2,936)	500	1,000	11,201	12,078

Based on the information from the above table, the journal entries throughout the lease are shown in Table 6.

Note that the difference in total lease expense over the 10 years, $120,780 and total cash paid out over the 10 years, $125,780, is explained by the $5,000 initial direct costs included in the lease expense, but not in the total cash paid out, as well as the $10,000 lease incentive, again included in the total lease expense, but not in the cash paid out. Those two items also explain the difference between the initial lease liability and initial ROU asset.

Table 6

Year	Lease Expense Dr	Lease Liability Dr	Cash Cr	ROU Asset Cr
1	12,078	4,574	10,000	6,652
2	12,078	5,348	10,500	6,926
3	12,078	6,194	11,025	7,247
4	12,078	7,117	11,576	7,619
5	12,078	8,123	12,155	8,046
6	12,078	9,218	12,763	8,533
7	12,078	10,409	13,401	9,086
8	12,078	11,704	14,071	9,711
9	12,078	13,110	14,775	10,413
10	12,078	14,637	15,514	11,201
Total	120,780	90,434	125,780	85,434

Leases with Payments at Beginning-of-Period

When lease payments occur at the beginning of the period, the only shift in thinking required is to recognize that the amortization of the lease liability in the typical leasing schedule occurs in two pieces: reduction of the lease liability, followed by an increase due to accrued interest during

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Table 7

Year	Payment	Beg. Liability after payment	Interest	End. Liability	Liability Amortization
0				78,017	
1	10,000	68,017	4,081	72,098	5,919
2	10,000	62,098	3,726	65,824	6,274
3	10,000	55,824	3,349	59,173	6,651
4	10,000	49,173	2,950	52,123	7,050
5	10,000	42,123	2,527	44,650	7,473
6	10,000	34,650	2,079	36,729	7,921
7	10,000	26,729	1,604	28,333	8,396
8	10,000	18,333	1,100	19,433	8,900
9	10,000	9,433	567	10,000	9,433
10	10,000	0	0	0	10,000
Total	100,000				78,017

Table 9

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Year	Payment	Beginning Liability, after payment	Interest	Ending Liability	Lease Liability Amortization	Straight-line Lease Expense	Increase (Decrease) in "Lease Payable" included in ROU Asset	ROU Asset Amortization
Computation		Previous (4) - (1)	(2) x .06	(2) + (3)	(1) - (3)**		(6) – (1)	(5) + (7)
0				108,929				
1	10,000	98,929	5,936	104,865	4,064	14,486	4,486	8,550
2	10,800	94,065	5,644	99,709	5,156	14,486	3,686	8,842
3	11,664	88,045	5,283	93,328	6,381	14,486	2,822	9,203
4	12,597	80,731	4,844	85,575	7,753	14,486	1,889	9,642
5	13,605	71,970	4,318	76,288	9,287	14,486	881	10,168
6	14,693	61,595	3,696	65,291	10,997	14,486	(207)	10,790
7	15,868	49,423	2,965	52,388	12,903	14,486	(1,382)	11,521
8	17,137	35,251	2,115	37,366	15,022	14,486	(2,651)	12,371
9	18,508	18,858	1,130	19,988	17,378	14,486	(4,022)	13,356
10	19,988	0	0	0	19,988	14,486	(5,503)	14,486
Total	144,860				108,929	144,860	0	108,929

** *These numbers can also be calculated as Previous (4) – Current (4), that is, last year's ending liability balance less this year's ending liability balance.*

the period. The following examples go into this in more detail.

Example 4: An example of a leasing schedule that might be prepared for a lease with payments at the beginning of the period follows. Table 7 includes two columns relating to the lease liability. The first is the beginning of the year liability, after reflecting the payment, upon which the interest cost is computed. The second is the end of period liability after accretion due to the interest cost. An additional column has been added, which highlights the lease liability amortization. The amounts in this column are determined by subtracting the current year ending liability from the previous year ending liability. They can also be determined in the same way as for end-of-period payments, where the cash payment for the period, less the interest for the period, provides the liability amortization amount. The example assumes a 10-year lease with $10,000 payments at the beginning of the year, and an interest rate of 6 percent.

The $78,017 in the "Ending Liability" column for year 0 is the present value at 6 percent of the 10 required payments of $10,000. The journal entry made at lease inception is:

ROU Asset	78,017	
Lease Liability		68,017
Cash		10,000

The journal entries at the beginning of each year, years 2 through 10, when the payments are made are simply:

Lease Liability	10,000	
Cash		10,000

The journal entries at the end of each year (a) recognize the straight-line lease expense of 10,000; (b) increase the liability by the amount of the interest accrued; and (c) amortize the asset by the amount of the liability amortization. The schedule of entries is shown in Table 8.

Table 8

Year	Lease Expense Dr	Lease Liability Cr	ROU Asset Cr
1	10,000	4,081	5,919
2	10,000	3,726	6,274
3	10,000	3,349	6,651
4	10,000	2,950	7,050
5	10,000	2,527	7,473
6	10,000	2,079	7,921
7	10,000	1,604	8,396
8	10,000	1,100	8,900
9	10,000	567	9,433
10	10,000	0	10,000
Total	100,000		78,017

Example 5: This example moves a little bit closer to leases observed in practice, in that an escalator of 8 percent per year is included in the leasing contract. Once again, the initial payment is $10,000 and the lease is a 10-year lease. The straight-line lease expense is $14,486, the sum of the lease payments ($144,860) divided by 10. The present value of these payments at a 6 percent implicit rate is $108,929.

Table 9 provides the values needed to account for this example. It is a typical lease amortization table for beginning-of-period payments, with the amortization highlighted in an additional column. Another additional column is added, tracking the difference between the straight-line cost of the lease and the increasing payments.

As in example 4, Table 7, the 108,929 in the "Ending Liability" column for year 0 is the present value at 6 percent of the 10 required payments. The journal entry at the beginning of year 1, when the lease is signed, is:

ROU Asset	108,929	
Lease Liability		98,929
Cash		10,000

Note that the total of the "Lease Liability Amortization" column in Table 9 is 108,929, which is $10,000 more than the amount at which the original Lease Liability was recorded. The $108,929 does match the present value of the 10 lease payments, but that amount is never recorded, since there is an up-front cash payment at lease inception. Column (5) does not provide the basis for debits to the lease liability in the following journal entries. Rather, it serves as a basis for determining the credits to the ROU asset, shown in column (8).

The remaining journal entries all use numbers from the above extended amortization table. Table 10 incorporates these journal entries, in two sets of columns. The journal entries made at the beginning of the year record the yearly payments; the journal entries at the end of the year record the straight-line lease expense, the increase in the lease liability (from the interest column above) and the ROU asset amortization, equal to the liability amortization plus the change in the "lease payable."

Note that the cash credits included in Table 10 total to $134,860, which is $10,000 less than the total Lease Expense of $144,860. This is because the cash paid at the inception of the lease is not included in Table 10, but is clearly part of the overall lease cost.

Table 10

	Beginning of year		End of year		
Year	Lease Liability Dr	Cash Cr	Lease Expense Dr	Lease Liability Cr	ROU Asset Cr
1			14,486	5,936	8,550
2	10,800	10,800	14,486	5,644	8,842
3	11,664	11,664	14,486	5,283	9,203
4	12,597	12,597	14,486	4,844	9,642
5	13,605	13,605	14,486	4,318	10,168
6	14,693	14,693	14,486	3,696	10,790
7	15,868	15,868	14,486	2,965	11,521
8	17,137	17,137	14,486	2,115	12,371
9	18,508	18,508	14,486	1,130	13,356
10	19,988	19,988	14,486	0	14,486
Total		134,860	144,860		108,929

Example 6: In this example, initial direct costs and a lease incentive are added. The extended amortization Table 9 used in example 5 is the basis of the numbers used in this example, as well. The initial direct costs and lease incentive adjust the initial asset value recorded at lease inception. The journal entry at inception (again assuming the cash flows associated with the initial direct costs and the lease incentive occurred earlier and were recorded in deferral accounts) is:

ROU Asset	103,929	
Deferred Lease incentive	10,000	
Cash		10,000
Lease Liability		98,929
Deferred Initial Direct Costs		5,000

Since the initial direct costs and lease incentive are embedded in the initial asset value, and are amortized on a straight-line basis, the initial direct costs increase the asset amortization shown in example 5 by $500 per period, while the lease incentive reduces the asset amortization by $1,000 each period, for a net decrease of $500. In addition, the initial direct costs increase the overall lease cost by $5,000, while the lease incentive decreases the overall cost by $10,000, a net decrease of $5,000. Therefore, the straight-line lease expense is $500 per year lower than that shown in Table 9, or $13,986 instead of $14,486.

The journal entries at the end of year 1, and during years 2 through 10, are shown in Table 11. Note that the numbers are identical to those for example 5, except the credit to the ROU Asset is $500 less each period, as is the debit to Lease Expense.

Table 11

	Beginning of year		End of year		
Year	Lease Liability Dr	Cash Cr	Lease Expense Dr	Lease Liability Cr	ROU Asset Cr
1			13,986	5,936	8,050
2	10,800	10,800	13,986	5,644	8,342
3	11,664	11,664	13,986	5,283	8,703
4	12,597	12,597	13,986	4,844	9,142
5	13,605	13,605	13,986	4,318	9,668
6	14,693	14,693	13,986	3,696	10,290
7	15,868	15,868	13,986	2,965	11,021
8	17,137	17,137	13,986	2,115	11,871
9	18,508	18,508	13,986	1,130	12,856
10	19,988	19,988	13,986	0	13,986
Total		134,860	139,860		103,929

A Foundational Understanding

With the accounting for operating leases set to change considerably, this article should assist practitioners in developing a foundational understanding of the new leasing standard before its mandatory adoption by public companies for fiscal years beginning after Dec. 15, 2018. ■

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By Walter R. Teets and Matthew Hoag

Operating Leases *Used* to be the Easy Ones

All of the following questions assume operating lease treatment under the newly issued (February 2016) lease standard and no modifications to the lease during the lease term

1 **The amortization of the ROU asset follows which of the following patterns over the lease term (assume no up-front payments, lease incentives or initial direct costs)?**

- **A.** Straight-line recognition
- **B.** Accelerated recognition (higher amortization in early years, lower in later years)
- **C.** Decelerated recognition (lower amortization in early years, higher in later years)
- **D.** Cannot determine the recognition pattern without additional information

2 **Loughlin Motors LLC signs a level-payment operating lease with no up-front payments, lease incentives or initial direct costs. Loughlin will account for this lease using the new leasing standard (issued in February 2016). Based on the information provided, the amortization of the lease liability in year one:**

- **A.** Equals the amortization of the ROU asset in year one
- **B.** Exceeds the amortization of the ROU asset in year one
- **C.** Is less than the amortization of the ROU asset in year one
- **D.** Cannot be determined relative to the ROU asset amortization from the information provided

3 **In an escalating/increasing payment operating lease, the lease payable (the difference between the straight-line cost of the lease and the cash paid) for year one is recorded as a:**

- **A.** Credit to lease liability
- **B.** Credit to lease payable
- **C.** Credit to ROU asset
- **D.** Debit to lease liability

4 **In an escalating/increasing payment lease with no initial direct costs or lease incentives, the change in lease payable is computed as the difference between the:**

- **A.** Cash lease payment and the computed interest expense
- **B.** Cash lease payment and the straight-line lease expense
- **C.** Cash payment in the first period and the cash payment in the last period
- **D.** Computed interest expense on the lease liability and the computed depreciation on the leased asset

5 **The new lease guidance essentially spells out multiple requirements for operating leases. Which of the following is NOT one of these requirements?**

- **A.** The lease liability must be capitalized
- **B.** A right-of-use (ROU) asset must be capitalized
- **C.** A periodic lease expense must be recorded as a single amount on a straight-line basis
- **D.** All of the above are requirements spelled out in the new operating lease guidance

6 **In an escalating/increasing payment lease with no initial direct costs, prepayments and/or lease incentives, the amortization of the lease liability will initially be _____ than the ROU asset amortization. In later years, this pattern/relationship _____.**

- **A.** Less; persists
- **B.** Less; reverses
- **C.** Greater; persists
- **D.** Greater; reverses

7 **For leases with beginning-of-period payments, the periodic lease liability adjustment occurs in two steps at different points in time: (1) _____ and (2) _____.**

- **A.** A reduction for the accretion of interest, embedded in lease expense; an increase at the time of the lease payment
- **B.** A reduction corresponding with the recording of the periodic lease expense; an increase for the accretion of interest
- **C.** A reduction at the time of the lease payment; an increase for the accretion of interest embedded in the lease expense
- **D.** A reduction corresponding with ROA asset amortization/depreciation; an increase corresponding with the recording of the periodic lease expense

8 **For leases with payments at the beginning of the period and no initial direct costs, prepayments and/or lease incentives, the initial entry to record the lease liability, ROU asset and first lease payment results in recording _____.**

- **A.** A lease liability that exceeds the ROU asset
- **B.** An ROU asset that exceeds the lease liability
- **C.** A lease liability, but no ROU asset
- **D.** An ROU asset, but no lease liability

9 **Under the new leasing guidance, for operating leases, interest expense is _____.**

- **A.** Only recorded for leases with increasing/escalating payments
- **B.** Only recorded when the lessor's rate is known to the lessee
- **C.** Only recorded when there is an interest rate stated in the lease contract
- **D.** Embedded as a component of the straight-line lease expense

10 **Under the new leasing guidance, leases requiring payment at the beginning of the period require entries to _____ at the beginning of the period and entries to _____ at period end.**

- **A.** Both the lease liability and ROU asset; the ROU asset
- **B.** Both the lease liability and ROU asset; the lease liability
- **C.** The lease liability; both the lease liability and ROU asset
- **D.** The ROU asset; both the lease liability and ROU asset

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