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Implementing ASC 842 Leases—Challenges and Benefits

Clive Nair

Borough of Manhattan Community College, New York, NY, USA
Email: cnair@bmcc.cuny.edu

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Abstract

ASC 842, which stands for Accounting Standards Codification 842, is a set of accounting standards issued by the Financial Accounting Standards Board (FASB) that specifically addresses lease accounting. The purpose of ASC 842 is to provide comprehensive guidance on how organizations, both lessees and lessors, should account for leases in their financial statements (FASB, 2023). An abstract for ASC 842 would summarize its key principles and requirements, which include: *Classification of Leases*: ASC 842 outlines criteria for lessees to determine whether a lease should be classified as an operating lease or a finance lease, which has implications for how lease assets and liabilities are recognized and measured. *Lease Recognition*: The standard requires lessees to recognize both a right-of-use asset and a lease liability on their balance sheets for most leases, fundamentally changing the way leases are reported compared to previous accounting standards. *Lease Measurement*: ASC 842 prescribes how lessees should measure the right-of-use asset and lease liability, including initial recognition, subsequent measurement, and revaluation. *Lease Disclosures*: The standard mandates increased disclosures in financial statements, providing stakeholders with more transparency about a company's lease commitments and related financial impacts. *Transition and Implementation*: ASC 842 provides guidance on how companies should transition to the new lease accounting rules and what practical expedients may be available to ease the adoption process. *Lessors*: The standard also addresses accounting for lessors, with specific guidance on lease classification and measurement. ASC 842 was introduced to bring greater transparency and comparability to financial statements, as it requires companies to reflect their lease obligations more prominently on their balance sheets. This abstract highlights the key aspects of ASC 842, which is essential for companies and stakeholders to understand and comply with to ensure accurate financial reporting regarding leases. Compliance with ASC 842 may have significant implications for a company's financial position and performance, making it a

critical accounting standard for financial professionals and organizations to adhere to.

Keywords

Operating Lease, Finance Lease (Formerly Known as Capital Lease), Right-of-Use (ROU) Asset, Lease Amortization

1. Introduction

Implementing ASC 842, the Financial Accounting Standards Board (FASB) standard for lease accounting, involves several steps and considerations. This standard primarily affects companies that lease assets, such as real estate, vehicles, or equipment. Here's a high-level overview of how to implement ASC 842:

1) *Understand ASC 842 Requirements*: Familiarize yourself with the ASC 842 standard and its specific requirements. ASC 842 requires lessees to recognize lease liabilities and right-of-use (ROU) assets on their balance sheets, which fundamentally changes how leases are accounted for compared to the previous standard, ASC 840.

2) *Identify Your Leases*: Determine which leases are subject to ASC 842. This includes identifying leases of tangible and intangible assets that meet the definition of a lease under ASC 842. Some contracts may contain embedded leases, so carefully review all lease agreements.

3) *Gather Lease Data*: Collect all relevant lease data, including lease agreements, terms, payment schedules, renewal options, and other relevant lease terms. You'll need this information to calculate lease liabilities and ROU assets accurately.

4) *Lease Classification*: Determine whether each lease is classified as a finance lease or an operating lease. The classification impacts the accounting treatment, including the initial recognition, measurement, and presentation of lease assets and liabilities.

5) *Calculate Lease Liabilities and ROU Assets*: Calculate the present value of future lease payments using the appropriate discount rate. This involves estimating the future cash flows associated with the lease and discounting them to their present value. This calculation is essential for recognizing lease liabilities and ROU assets on the balance sheet.

6) *Establish Accounting Policies and Procedures*: Develop accounting policies and procedures that comply with ASC 842. Ensure consistency in how leases are identified, classified, and accounted for within your organization.

7) *Implement Accounting Software or Systems*: Many companies use lease accounting software or integrated enterprise resource planning (ERP) systems to streamline the implementation process. These systems can help with data entry, calculations, and reporting under ASC 842.

8) *Adjust Financial Statements*: Update your financial statements and disclosures to reflect the changes brought about by ASC 842. This includes reporting lease liabilities and ROU assets on the balance sheet, as well as providing additional disclosures in the notes to the financial statements.

9) *Train Personnel*: Ensure that your accounting and finance teams are trained on ASC 842 and understand the new accounting rules and procedures. It's essential to have the right expertise within your organization to handle lease accounting under the new standard accurately.

10) *Monitor and Maintain Compliance*: ASC 842 requires ongoing compliance. Monitor your lease portfolio, reassess lease terms and classifications as necessary, and keep your financial statements and disclosures up to date.

11) *Seek External Assistance*: If you find ASC 842 implementation challenging or if you have complex lease agreements, consider seeking assistance from accounting firms, consultants, or software providers specializing in lease accounting compliance.

12) *Perform Regular Audits*: Conduct regular audits to ensure that your lease accounting remains in compliance with ASC 842 and that any changes in your lease portfolio are accounted for appropriately.

Remember that ASC 842 implementation can be complex, especially for organizations with a large number of leases. It's crucial to plan and execute the implementation carefully to ensure accurate financial reporting and compliance with the new lease accounting standards. Consulting with accounting professionals and leveraging technology can be valuable in this process.

2. Challenges

Implementing ASC 842, the new lease accounting standard, can be a complex and challenging process for organizations, particularly for those with a significant number of lease arrangements. Some of the key challenges that organizations may face when implementing ASC 842 include:

1) *Data Gathering and Management*:

Gathering and organizing lease data from various sources can be time-consuming and challenging. Many organizations have leases scattered across different departments and locations, making data collection and centralization difficult.

2) *Lease Identification*:

Identifying all lease contracts, including embedded leases within service agreements, can be challenging. Properly classifying lease contracts is essential to determine which leases need to be accounted for under ASC 842.

3) *Lease Term and Renewals*:

Determining the lease term, including potential renewal and termination options, requires careful analysis and judgment. Accurately estimating the likelihood of exercising renewal options can impact the lease liability and right-of-use asset calculations.

4) *Discount Rate Determination*:

Calculating the appropriate discount rate (the lessee's incremental borrowing rate) can be complex, as it often involves estimating an interest rate that reflects the specific terms and conditions of each lease.

5) *Lease Accounting Software*:

Implementing new lease accounting software or adapting existing systems to comply with ASC 842 may require significant time and resources. Ensuring that the chosen software adequately supports the standard's requirements is crucial.

6) *Internal Controls*:

Establishing internal controls to ensure compliance with ASC 842 is essential. Organizations need to implement processes to capture and report lease data accurately and consistently.

7) *Training and Education*:

Training finance and accounting teams to understand the nuances of ASC 842 and how to apply it correctly is crucial. Inaccurate application of the standard can lead to financial misstatements.

8) *Financial Statement Impact*:

ASC 842's impact on financial statements, particularly the balance sheet, can be substantial. Organizations may need to communicate the changes to stakeholders and investors to avoid misunderstandings.

9) *Transition and Comparative Reporting*:

Organizations must decide how they will transition to ASC 842, whether through the modified retrospective or full retrospective approach. Preparing comparative financial statements can be challenging, as prior periods may need restatement.

10) *Ongoing Compliance*:

ASC 842 requires ongoing monitoring and reassessment of lease contracts, especially when significant changes occur, such as lease modifications, renewals, or terminations. Maintaining compliance over time is a continuous challenge.

11) *Coordination with Stakeholders*:

Collaboration between finance, accounting, legal, procurement, and other departments is crucial for ASC 842 implementation. Effective communication is needed to ensure that all relevant stakeholders understand their roles and responsibilities.

12) *Documentation and Disclosure*:

Meeting the enhanced disclosure requirements of ASC 842, including providing detailed information about lease arrangements in financial statements and footnotes, can be demanding.

To address these challenges, organizations should plan their ASC 842 implementation carefully, allocate sufficient resources, and consider seeking assistance from external experts or consultants with expertise in lease accounting. Compliance with ASC 842 is not only a regulatory requirement but also a means to improve transparency and accuracy in financial reporting.

3. Measures to Handle Challenges

ASC 842, or Accounting Standards Codification 842, is a set of accounting rules that govern how companies should account for leases on their financial statements. Implementing ASC 842 can be challenging, especially for organizations with many leases or complex lease structures. Here are some measures to handle the challenges of ASC 842 implementation:

1) *Establish a Cross-Functional Team*:

Create a dedicated team with representatives from finance, accounting, legal, IT, and real estate departments. This team should work collaboratively to ensure a comprehensive understanding of the new standard and its implications.

2) *Inventory and Data Gathering*:

Identify and compile a complete inventory of all leases, including lease agreements, terms, payments, and critical lease data. Ensure that lease data is accurate and up-to-date, and consider using lease management software to streamline data collection and storage.

3) *Lease Classification*:

Carefully review lease agreements to determine if they meet the criteria for classification as operating or finance leases as per ASC 842. Document the rationale for each classification decision and ensure consistency in applying the criteria.

4) *Implement Lease Accounting Software*:

Consider adopting lease accounting software or lease management systems that can automate calculations, generate financial statements, and ensure compliance with ASC 842. Choose a software solution that fits the needs and complexity of your lease portfolio.

5) *Data Transition and Historical Data*:

Ensure a smooth transition from the previous lease accounting standards (e.g., ASC 840) to ASC 842 by accurately recording opening balances and historical data. Maintain records and documentation of the transition process for audit and compliance purposes.

6) *Financial Statement Impact Assessment*:

Conduct a thorough assessment of how ASC 842 will impact your financial statements, including balance sheets, income statements, and cash flow statements. Consider the potential impact on key financial ratios and communicate these changes to stakeholders.

7) *Training and Education*:

Provide training to relevant staff members to ensure they understand the new standard, its implications, and their roles in compliance. Stay updated on any amendments or clarifications issued by the Financial Accounting Standards Board (FASB).

8) *Engage External Experts*:

If needed, seek assistance from external experts, such as accounting firms or consultants, who specialize in ASC 842 implementation to ensure accuracy and compliance.

9) *Continuous Monitoring and Auditing*:

Regularly review and update lease data, processes, and controls to ensure ongoing compliance with ASC 842. Conduct internal and external audits as necessary to validate lease accounting accuracy and compliance.

ASC 842 implementation requires careful planning, coordination, and ongoing monitoring to ensure compliance and accurate financial reporting. It's crucial to start the process early and allocate the necessary resources to address the challenges effectively.

4. Goals and Intentions behind ASC 842

The intention behind Accounting Standards Codification (ASC) 842 was to improve financial reporting for leases. ASC 842, also known as the new lease accounting standard, was issued by the Financial Accounting Standards Board (FASB) in February 2016 and became effective for public companies in fiscal years beginning after December 15, 2018. For private companies, it became effective for fiscal years beginning after December 15, 2019 (Davis & McGovern, 2023).

The main goals and intentions behind ASC 842 were as follows:

1) *Transparency*:

ASC 842 aimed to increase transparency in financial reporting by requiring companies to recognize lease assets and lease liabilities on the balance sheet for most leases. This change aimed to provide users of financial statements with a more accurate picture of a company's financial position, as it required the recognition of both the right to use an asset (lease asset) and the associated obligation to make lease payments (lease liability).

2) *Consistency*:

ASC 842 sought to improve consistency in lease accounting by eliminating off-balance-sheet financing arrangements, such as operating leases, which were previously not required to be reported on the balance sheet. By bringing leases onto the balance sheet, it aimed to make financial statements more comparable across different companies and industries.

3) *Improved Disclosures*:

The standard also required enhanced disclosures related to leases, helping stakeholders better understand the nature and terms of lease agreements, as well as the potential impact of those leases on a company's financial position, performance, and cash flows.

4) *Convergence with International Accounting Standards*:

ASC 842 aimed to align U.S. Generally Accepted Accounting Principles (GAAP) with international accounting standards, specifically International Financial Reporting Standards (IFRS). This convergence was part of a broader effort to improve the consistency and comparability of financial reporting on a global scale.

In summary, the intention behind ASC 842 was to enhance financial reporting by providing a more accurate representation of a company's lease-related obligations and assets on the balance sheet, improving transparency, and aligning U.S.

GAAP with international accounting standards. This change was significant for companies with lease arrangements, as it required them to reassess their accounting practices and make adjustments to comply with the new standard.

5. ASC 842 GAAP vs. IFRS

ASC 842 under U.S. Generally Accepted Accounting Principles (GAAP) and the International Financial Reporting Standards (IFRS) 16 both deal with lease accounting and have some similarities, but there are also significant differences between the two standards. Here is a comparison of ASC 842 under GAAP and IFRS 16:

1) *Recognition of Lease Liabilities and Lease Assets*:

- ASC 842 (GAAP): Under ASC 842, lessees are required to recognize lease liabilities and right-of-use (ROU) assets on the balance sheet for most leases. There are exceptions for short-term leases and leases of low-value assets.
- IFRS 16: IFRS 16 also requires lessees to recognize lease liabilities and ROU assets on the balance sheet for most leases. It does not have specific exceptions for short-term leases, but it does have an exemption for leases of low-value assets.

2) *Classification of Leases*:

- ASC 842 (GAAP): ASC 842 retains the classification of leases into finance leases and operating leases for lessees, with different accounting treatments for each.
- IFRS 16: IFRS 16 eliminates the distinction between finance leases and operating leases for lessees. Instead, all leases are treated as finance leases, and lessees recognize interest and depreciation expenses.

3) *Initial Measurement of Lease Liabilities and ROU Assets*:

- ASC 842 (GAAP): Lease liabilities and ROU assets are initially measured at the present value of lease payments. The discount rate used is the lessee's incremental borrowing rate unless the rate implicit in the lease is readily determinable (FASB, 2016).
- IFRS 16: Lease liabilities and ROU assets are also initially measured at the present value of lease payments, using the rate implicit in the lease if it is readily determinable. If not, lessees use their incremental borrowing rate.

4) *Subsequent Measurement*:

- ASC 842 (GAAP): Lessees continue to amortize the ROU asset and recognize interest expense on the lease liability over the lease term, with specific guidance for different types of leases.
- IFRS 16: Lessees recognize a straight-line lease expense for the lease liability and a depreciation expense for the ROU asset, resulting in a front-loaded expense profile.

5) *Sale and Leaseback Transactions*:

- ASC 842 (GAAP): ASC 842 retains the existing guidance for sale and leaseback transactions, with specific rules for recognizing gains and losses.

- IFRS 16: IFRS 16 has more stringent criteria for sale and leaseback transactions, making it more challenging for lessees to achieve sale treatment.

6) *Disclosures*:

- Both ASC 842 and IFRS 16 require enhanced disclosures related to lease arrangements, including information about lease terms, cash flows, and significant judgments made by management.

While there are similarities between ASC 842 and IFRS 16, the key differences in the treatment of leases, such as the classification of leases, initial measurement, and subsequent measurement, can result in differences in financial reporting between companies that follow these two accounting standards. It's essential for companies with international operations or stakeholders in multiple jurisdictions to be aware of these differences and their potential impact on financial statements.

Implementing ASC 842 involves creating various tables and schedules to track lease data, calculate lease liabilities and right-of-use (ROU) assets, and provide the necessary disclosures. Below are sample tables that can be used as a starting point for ASC 842 implementation. Keep in mind that the specific format and content may vary depending on your organization's needs and the complexity of your lease portfolio.

This table shows the schedule of lease payments and how they are allocated between principal (reduction in the lease liability) and interest (finance cost).

5.1. Lease Amortization Schedule

Lease Payment Date	Payment Amount	Interest Expense	Principal Reduction	Lease Liability
[Date]	[$Amount]	[$Amount]	[$Amount]	[$Amount]
[Date]	[$Amount]	[$Amount]	[$Amount]	[$Amount]
[Date]	[$Amount]	[$Amount]	[$Amount]	[$Amount]

(FASB, 2023).

5.2. Lease Liability Reconciliation

This table summarizes the changes in the lease liability during the reporting period.

Reporting Period	Beginning Balance	New Leases	Lease Payment	Interest Expense
[Date]	[$Amount]	[$Amount]	[$Amount]	[$Amount]
[Date]	[$Amount]	[$Amount]	[$Amount]	[$Amount]
[Date]	[$Amount]	[$Amount]	[$Amount]	[$Amount]

(FASB, 2023).

5.3. Right-of-Use Asset Amortization Schedule

This table shows how the ROU asset is amortized over the lease term.

Reporting Period	Beginning Balance	Amortization Expense	Ending Balance
[Date]	[$Amount]	[$Amount]	[$Amount]
[Date]	[$Amount]	[$Amount]	[$Amount]
[Date]	[$Amount]	[$Amount]	[$Amount]

(FASB, 2023).

5.4. Lease Disclosure Table

This table provides the necessary lease-related disclosures required by ASC 842.

Lease Details	**Amount**
Total lease liabilities	[$Amount]
Total lease assets (ROU)	[$Amount]
Lease term	[Years]
Discount rate used	[%]
Future minimum lease payments	[$Amount]
Weighted - average remaining lease term	[Years]
Weighted - average discount rate	[%]

(FASB, 2023).

5.5. Additional Information Table

Include any additional information or notes that may be relevant to your organization's lease accounting, such as lease options, contingent payments, or lease-related assumptions.

Description	**Details**
Contingent lease payments	[$Amount] **(if applicable)**
Lease options	[Details of options] (**if applicable**)
Lease - related assumptions	[Assumptions used in calculations]

(FASB, 2023).

These sample tables are intended to provide a starting point for ASC 842 implementation. Depending on your organization's specific lease portfolio and reporting requirements, you may need to customize these tables and create additional ones to ensure compliance with the standard and meet your financial reporting needs. Additionally, it's advisable to work closely with your organization's accounting and finance team, as well as potentially consult with external experts, to ensure accurate implementation of ASC 842.

6. CPAs Reactions

The opinions of Certified Public Accountants (CPAs) on ASC 842, the new lease accounting standard, can vary depending on their specific roles, experiences, and the industries they serve. However, there are some common themes and considerations that CPAs often discuss regarding ASC 842:

1) *Increased Complexity*:

Many CPAs acknowledge that ASC 842 introduced increased complexity to lease accounting. The requirement to recognize lease liabilities and right-of-use assets on the balance sheet, along with new disclosure requirements, has made lease accounting more intricate than under the previous standard (ASC 840).

2) *Transition Challenges*:

CPAs often emphasize the challenges associated with transitioning to ASC 842. This includes the need to gather and evaluate lease data, determine appropriate discount rates, and make adjustments to financial reporting processes and systems.

3) *Data Management*:

CPAs frequently highlight the importance of effective data management when implementing ASC 842. Maintaining accurate and up-to-date lease data is crucial for compliance and ongoing reporting.

4) *Impact on Financial Statements*:

CPAs point out that ASC 842 can have a significant impact on financial statements, particularly the balance sheet. It can result in a substantial increase in assets and liabilities, which may affect financial ratios and key performance indicators.

5) *Internal Controls*:

CPAs stress the importance of establishing robust internal controls to ensure compliance with ASC 842. Adequate controls are necessary to prevent errors and misstatements in financial reporting.

6) *Software and Technology*:

CPAs often discuss the role of lease accounting software and technology solutions in implementing ASC 842. Many organizations invest in specialized software to facilitate lease data management and calculations.

7) *Documentation and Disclosures*:

CPAs emphasize the need for thorough documentation of lease agreements and enhanced disclosures in financial statements to meet the requirements of ASC 842. Detailed disclosures are essential for transparency and compliance.

8) *Collaboration with Cross-Functional Teams*:

CPAs highlight the importance of collaboration between finance, accounting, legal, procurement, and other departments within an organization. Effective communication and coordination are essential for successful ASC 842 implementation.

9) *Ongoing Compliance*:

CPAs emphasize that ASC 842 compliance is not a one-time effort but an ongoing process. Lease portfolios should be continuously monitored and reassessed for changes that may impact accounting and reporting.

10) *Education and Training*:

CPAs recognize the need for training and education, both within their organizations and among clients, to ensure that accounting teams have a solid understanding of ASC 842 and can apply it correctly.

11) *Industry-Specific Considerations*:

CPAs often consider industry-specific nuances and challenges when implementing ASC 842. Different industries may have unique lease arrangements that require specialized expertise.

Overall, while ASC 842 presents challenges, CPAs generally view it as a necessary step toward improving transparency in financial reporting and bringing lease obligations onto the balance sheet. CPAs play a crucial role in guiding organizations through the implementation process, helping them understand the implications of the standard, and ensuring compliance with its requirements.

7. Benefits to Implementing ASC 842

ASC 842, the new lease accounting standard, brings several benefits to both financial reporting and decision-making processes for organizations. Some of the key benefits of ASC 842 include:

1) *Improved Transparency*:

ASC 842 enhances transparency in financial reporting by requiring organizations to recognize lease liabilities and right-of-use (ROU) assets on the balance sheet for most leases. This provides a more accurate representation of a company's financial position by bringing previously off-balance-sheet lease obligations onto the balance sheet.

2) *Enhanced Comparability*:

The standard promotes consistency and comparability across different companies and industries. With lease liabilities and ROU assets now being recorded on the balance sheet, financial statements become more standardized and easier to compare.

3) *Better Decision-Making*:

Decision-makers, including investors and creditors, can make more informed judgments about a company's financial health and risk profile with a clearer view of lease-related obligations and assets. This can lead to better investment and lending decisions.

4) *Reduced Off-Balance-Sheet Financing*:

ASC 842 eliminates the practice of off-balance-sheet financing for operating leases. This change reduces the potential for companies to obscure their true financial obligations, making financial statements more accurate and reliable.

5) *Streamlined Lease Management*:

Organizations may benefit from improved lease management processes as they centralize lease data, assess lease terms, and monitor lease agreements more systematically. This can lead to greater efficiency in lease administration.

6) *Compliance with International Standards*:

ASC 842 aligns U.S. Generally Accepted Accounting Principles (GAAP) with international accounting standards, specifically International Financial Reporting Standards (IFRS). This alignment helps multinational companies maintain consistency in lease accounting practices across jurisdictions.

7) *Better Lease Negotiation*:

Both lessees and lessors may benefit from ASC 842's increased transparency. Lessees have a clearer understanding of their lease-related obligations, which can aid in lease negotiation, while lessors may find that improved disclosure leads to more attractive lease terms.

8) *Improved Risk Management*:

Organizations can more effectively manage their lease-related risks with a comprehensive view of lease agreements and their financial impact. This may include evaluating lease terms, assessing renewal options, and understanding potential lease modification impacts.

9) *Enhanced Audit Trail*:

The standard requires detailed documentation of lease agreements and calculations. This documentation can serve as a robust audit trail, facilitating external audits and ensuring compliance.

10) *Consistency in Financial Reporting*:

ASC 842 brings lease accounting practices in line with other accounting standards, promoting consistency in financial reporting. This consistency can make it easier for financial professionals to understand and apply the standard.

While ASC 842 offers numerous benefits, it also comes with implementation challenges and additional reporting requirements. Organizations should carefully plan and execute their transition to ASC 842 to maximize the benefits while ensuring compliance with the standard's provisions.

8. Conclusion

In conclusion, the implementation of ASC 842, the new lease accounting standard, represents a significant shift in how organizations account for lease arrangements. While it introduces challenges and complexities, it also offers numerous benefits that contribute to improved financial reporting, transparency, and decision-making.

Research on ASC 842 (Accounting Standards Codification 842) implementation and its impact on organizations may provide valuable insights, but it also has its limitations. For example, Limited Data Availability: Researchers may face challenges in accessing comprehensive and up-to-date data on ASC 842 implementation, especially for privately held companies that are not required to disclose their financial statements publicly. This limitation can impact the generalizability of findings. Another area is Evolving Standards: Accounting standards, including ASC 842, can evolve over time due to amendments, interpretations, or changes by standard-setting bodies like the Financial Accounting Standards

Board (FASB). Research findings may become outdated as the standards change, affecting the relevance of the research. Finally, Compliance vs. Strategic Impacts: Research may focus on compliance-related aspects of ASC 842, such as lease accounting changes, while overlooking the strategic implications it may have on organizations' lease portfolios and real estate strategies.

While ASC 842 offers these benefits, organizations should be prepared for the challenges it presents, including data collection, software implementation, and ongoing compliance efforts. Effective planning, communication, and collaboration among various departments are essential for a successful transition to ASC 842 and realizing its benefits. Ultimately, the standard aims to enhance financial reporting accuracy and transparency, which can lead to more informed business decisions and a more reliable financial reporting framework.

Conflicts of Interest

The author declares no conflicts of interest regarding the publication of this paper.

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