Leases: Where We (Think) We Are Now

Generally, for Bible Colleges and Seminaries who have years that ended at December 31, 2022 or fiscal years ended in 2023, the new lease requirements under ASC 842 will kick in. This has been a MAJOR change in accounting.

The accounting profession worked hard to prepare for the implementation of the lease standard. However, many were surprised by some “unexpected” nuances. Chief among these were leases with multiple amendments, institutions who had prior “deferred rent” related to existing leases, and “embedded” leases/contracts.

Institutions are now required to record a new “Right of use asset” and corresponding “Lease liability” for ALL leases (including “embedded leases”) that have a duration of more than 1 year. There is an exception for “short-term leases.” Note that a 365-day lease – exactly – would be considered a short-term lease.

Under the new standards, there are three types of leases:

1. Financing leases (much like former “Capital leases”)
2. Operating leases (more than 1-year leases that do not meet the criteria for Financing leases)
3. Short-term leases (terms of 1-year or less)

Ultimately, Financing leases are recorded as if the property was “purchased” with a “note.”

For Operating leases – which are a “thing” with many Bible Colleges and Seminaries – the present value (using an amount stated/implied in the contract or) of the lease would be recorded as a “Right of Use Asset” and a “Lease liability” that are both amortized over the life of the lease.

Embedded leases – that are treated like leases – might be found in contracts for technology (servers, communications equipment, trash containers, etc.) that meet the criteria for this type of “lease.”

To qualify as a Financing Lease, the contract must meet at least one of the following criteria:

1. Ownership of the underlying asset is transferred to the lessee
2. Purchase option is reasonably certain to be exercised.
3. Term of the lease is a major part of the economic life of the asset (usually equal to or greater than 75% of the life)
4. Present value of the lease payments – plus any guaranteed residual value – is equal to or greater than substantially all of the fair value of the underlying asset (use 90% as a benchmark)
5. Underlying asset is specialized in nature and not expected to have an alternative use to the lessor at the end of the lease.

Here is a quick, very simplified example of an Operating Lease that may be relevant to "our size" schools…

> Marathon Bible College has entered into a lease for classroom space for the period of five years, commencing on July 1, 2023 (the first day of their fiscal year). Lease payments are $2,000 per month for 60 months. MBC's Accounting Team determined to utilize a "risk-free" rate* of 4.191% as the present value factor (based upon Treasury bill rates at the date of lease commencement).
>
> At July 1, 2023, MBC would record a Right of use asset AND a Lease liability for the present value of $120,000 = $108,092.
>
> Then, on a periodic basis, MBC would "amortize" these items with an – monthly – entry as follows:
>
> Debit: Lease liability $1,801.53 ($108,092/ 60 months)
>
> Credit: Right of use asset $1,801.53
>
> For Statement of Activities purposes, the monthly payments would continue to be recorded as expenses throughout the life of the lease/contract.

Finally, with the appearance of a new – sometimes substantial liability on your Statement of Financial Position - be very aware of any debt covenants your institution may be required to meet. Also, carefully navigate the Department of Education's financial stability indicator reporting.

*The risk-free rate is the rate investors expect to earn from an investment that carries zero risk over a period of time, such as a government treasury bill.

For more on ASC 842 – Leases, refer to that section at:

"2024 – XII Things"

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