



# The Ultimate Lease Accounting Guide

Maintaining ASC 842 Compliance  
Refreshed for 2026



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# Introduction: ASC 842 in Practice



## Problem

ASC 842 fundamentally changed how organizations account for leases. Since its implementation, effective for public companies in 2019 and private companies in 2022, finance and accounting teams have navigated the ongoing challenges of maintaining compliance with this standard.

## Goal

Unlike legacy ASC 840, which allowed most operating leases to remain off balance sheet, ASC 842 requires companies to recognize right-of-use (ROU) assets and lease liabilities for virtually all leases. This shift has increased transparency into leasing obligations and transformed how financial statement users assess organizational risk and financial position.

## Benefits

This guide serves as an educational resource for finance and accounting professionals responsible for lease accounting compliance. Whether you're managing a portfolio of real estate leases, equipment leases, or both, understanding the requirements and best practices for ASC 842 is essential to maintaining audit-ready records and accurate financial reporting.

# Understanding ASC 842: The Current Standard

ASC 842 represents the Financial Accounting Standards Board's (FASB) response to the need for greater transparency in lease accounting. The standard applies to all entities that enter into lease agreements—from large publicly traded companies to small private businesses.

## Key Requirements Under ASC 842

The standard requires lessees to recognize lease assets and lease liabilities on the balance sheet for leases with terms exceeding 12 months. This applies to both operating and finance leases, though the subsequent accounting treatment differs between the two classifications.

- **Balance Sheet Recognition:** Right-of-use assets and lease liabilities must be recorded for all leases (except short-term leases where the practical expedient is elected)
- **Enhanced Disclosures:** Companies must provide detailed qualitative and quantitative information about leasing arrangements, including weighted average discount rates, weighted average remaining lease terms, maturity analysis, and lease-related expenses
- **Lease Identification:** The standard broadens the definition of a lease, requiring companies to evaluate whether contracts contain embedded leases in service agreements, IT contracts, and other arrangements
- **Ongoing Compliance:** Lease modifications, remeasurements, and changes in lease terms require careful tracking and accounting adjustments throughout the lease lifecycle

## How ASC 842 Differs from Legacy Standards

Understanding the shift from ASC 840 to ASC 842 helps contextualize the current requirements:

ASC 840 (Legacy GAAP)	ASC 842 (Current Standard)
Operating leases: Off balance sheet	Operating leases: On balance sheet as ROU assets and lease liabilities
Capital leases: On balance sheet	Finance leases: On balance sheet (similar treatment to old capital leases)
75% lease term test 90% present value test	Major part of economic life test Substantially all fair value test (bright-line thresholds removed)
Limited disclosure requirements	Enhanced qualitative and quantitative disclosures required



# Lease Classification Under ASC 842

Proper lease classification is the foundation of accurate lease accounting. Under ASC 842, lessees classify leases as either finance leases or operating leases based on specific criteria.

## Finance Lease Criteria

A lease is classified as a finance lease if it meets any one of the following five criteria at lease commencement:

- **Transfer of ownership:** The lease transfers ownership of the underlying asset to the lessee by the end of the lease term
- **Purchase option:** The lease grants the lessee an option to purchase the underlying asset that the lessee is reasonably certain to exercise
- **Lease term:** The lease term is for a major part of the remaining economic life of the underlying asset (FASB allows use of 75% bright-line threshold from ASC 840)
- **Present value:** The present value of lease payments equals or exceeds substantially all of the fair value of the underlying asset (FASB allows use of 90% bright-line threshold from ASC 840)
- **Specialized asset:** The underlying asset is so specialized that it is expected to have no alternative use to the lessor at the end of the lease term

## Operating Lease Classification

If a lease does not meet any of the five finance lease criteria, it is classified as an operating lease. Operating leases represent the majority of lease arrangements for most organizations, particularly for real estate and shorter-term equipment leases.

## Why Classification Matters

While both finance and operating leases require balance sheet recognition, the subsequent accounting treatment differs significantly:

- **Finance leases:** Interest expense on the lease liability and amortization of the ROU asset are recognized separately on the income statement, resulting in a front-loaded expense pattern.
- **Operating leases:** A single lease expense is recognized on a straight-line basis (typically) over the lease term, similar to the historical treatment under ASC 840.

# Initial Measurement and Recognition

At lease commencement, the date when the lessor makes the underlying asset available for use, lessees must measure and recognize the lease liability and ROU asset on the balance sheet.

## Measuring the Lease Liability

The lease liability is measured as the present value of the remaining lease payments, discounted using either:

- **Rate implicit in the lease:** The rate the lessor charges the lessee, if readily determinable
- **Incremental borrowing rate (IBR):** The rate of interest that a lessee would have to pay to borrow on a collateralized basis over a similar term an amount equal to the lease payments in a similar economic environment
- **Risk-free rate (private companies only):** Private companies may elect a practical expedient to use a risk-free discount rate for all leases

## Lease Payments to Include

When calculating the lease liability, companies must include:

- Fixed lease payments (including in-substance fixed payments)
- Variable lease payments that depend on an index or rate
- Exercise price of purchase options reasonably certain to be exercised
- Payments for penalties for terminating the lease (if reasonably certain to occur)
- Amounts probable of being owed under residual value guarantees





## Measuring the ROU Asset

The ROU asset is calculated as:

**Lease Liability + Prepaid Lease Payments + Initial Direct Costs - Lease Incentives**

- **Initial direct costs:** Incremental costs of a lease that would not have been incurred if the lease had not been obtained (primarily commissions in most cases)
- **Lease incentives:** Payments made to or on behalf of the lessee by the lessor, such as tenant improvement allowances, moving expense reimbursements, or assumption of existing lease obligations

Prepaid lease payments: Any lease payments made to the lessor at or before lease commencement, less any lease incentives received

# Subsequent Measurement and Ongoing Accounting

After initial recognition, lessees must continue to account for lease liabilities and ROU assets throughout the lease term. The accounting treatment depends on lease classification.

## Operating Lease Subsequent Accounting

For operating leases, lessees recognize a single lease expense on a straight-line basis over the lease term. This is accomplished through:

- **Lease liability:** Increase the liability for interest accretion and decrease it for lease payments made
- **ROU asset:** Amortize the asset so that the combined effect of interest on the liability and ROU asset amortization results in straight-line total lease expense
- **Income statement:** Recognize a single lease expense (typically classified as operating expense)

## Finance Lease Subsequent Accounting

For finance leases, lessees recognize interest and amortization expenses separately:

- **Lease liability:** Reduce the liability using the effective interest method
- **ROU asset:** Amortize the asset generally on a straight-line basis over the shorter of the lease term or the asset's useful life
- **Income statement:** Report interest expense on the lease liability and amortization expense on the ROU asset as separate line items

## Variable Lease Payments

Variable lease payments that do not depend on an index or rate are not included in the initial measurement of the lease liability. Instead, these payments are recognized as incurred, typically as variable lease expense. Common examples include:

- Percentage rent based on retail sales
- Common area maintenance (CAM) charges based on actual costs
- Usage-based payments (e.g., per-copy charges for copier leases)

# Lease Modifications and Remeasurements

Throughout the lease lifecycle, changes occur that require accounting adjustments. Understanding when to remeasure and how to account for modifications is critical to maintaining compliance.

## What Constitutes a Lease Modification?

A lease modification is a change to the terms and conditions of a contract that results in a change in the scope of or the consideration for a lease. Examples include:

- Adding or terminating the right to use one or more underlying assets
- Extending or shortening the lease term
- Changing the amount of lease payments not already included in the contract
- Adding or removing options (e.g., purchase, extension, or termination options)

## Remeasurement Events

Certain events require remeasurement of the lease liability and ROU asset even if they don't constitute a formal modification:

- **Change in lease term:** When the lessee's assessment of whether it is reasonably certain to exercise an extension or termination option changes
- **Change in purchase option assessment:** When the lessee's assessment of whether it is reasonably certain to exercise a purchase option changes
- **Change in amounts probable under residual value guarantee:** When there's a change in the amounts the lessee expects to pay
- **Change in lease payments due to index or rate:** When there's a change in the cash flows resulting from a change in an index or rate used to determine lease payments

## Accounting for Modifications

When a modification occurs, the accounting treatment depends on whether the modification is accounted for as a separate contract or as a modification to the existing contract. The lessee must reassess lease classification and remeasure the lease liability using an updated discount rate at the effective date of the modification.

# Common Challenges in Maintaining ASC 842 Compliance

Finance and accounting teams face several recurring challenges when maintaining ongoing compliance with ASC 842. Understanding these pain points helps organizations implement more effective processes and controls.



## 1. Scattered Lease Data and Documentation

One of the most significant compliance risks is maintaining centralized, accessible lease data. Common issues include:

- Lease agreements stored across email, shared drives, physical files, and individual computers
- Lack of standardized lease abstraction or data extraction processes
- Difficulty tracking amendments, renewals, and modifications over time
- Multiple stakeholders (Real Estate, Procurement, Legal) maintaining separate records
- Missing or incomplete lease documentation creating audit risk

## 2. Cross-Functional Coordination Gaps

ASC 842 compliance requires collaboration between Real Estate and Finance teams, but these groups often operate in silos:

- Real Estate executes lease transactions without consistently notifying Finance
- Finance lacks visibility into lease execution timelines and terms
- Disconnect between operational lease management and accounting requirements
- Real Estate may not understand which lease details Finance needs for compliance
- Inconsistent processes for communicating lease modifications and amendments

## 3. Tracking Critical Dates and Events

Managing ongoing compliance requires vigilant monitoring of key lease dates:

- Lease commencement dates triggering initial recognition
- Rent escalation dates requiring remeasurement
- Option exercise deadlines affecting lease term assessments
- Modification effective dates requiring accounting adjustments
- Variable payment true-ups and reconciliations

## 4. Discount Rate Determination

Determining appropriate discount rates remains a complex and often subjective process:

- Rate implicit in the lease is rarely readily determinable
- Incremental borrowing rate (IBR) requires significant judgment
- IBR must be reassessed at modification dates
- Documentation requirements for rate determination methodology
- Audit scrutiny over discount rate assumptions and calculations

## 5. Audit Preparation and Support

Annual audits place significant demands on finance teams to demonstrate ASC 842 compliance:

- Providing complete, accurate lease population and abstracts
- Supporting discount rate calculations and assumptions
- Reconciling lease accounting to source documents
- Explaining lease classification judgments
- Demonstrating effective internal controls over lease accounting

# ASC 842 Disclosure Requirements

ASC 842 significantly expands disclosure requirements compared to ASC 840, requiring both qualitative and quantitative information about leasing arrangements.

## Qualitative Disclosures

Companies must provide information about:

- Nature of leasing activities
- Significant assumptions and judgments made in applying ASC 842
- Terms and conditions of leases, including:
  - Existence and terms of options
  - Variable lease payment arrangements
  - Residual value guarantees
  - Restrictions or covenants imposed by leases

## Quantitative Disclosures

Required quantitative disclosures include:

- **Balance sheet information:** Finance and operating lease ROU assets and lease liabilities (separately presented or disclosed)
- **Lease cost:** Finance lease costs (amortization and interest), operating lease cost, short-term lease cost, and variable lease cost
- **Weighted averages:** Weighted average remaining lease term and weighted average discount rate for finance and operating leases
- **Cash flows:** Cash paid for amounts included in lease liabilities, broken down by operating and financing cash flows
- **Maturity analysis:** Five-year schedule of undiscounted cash flows for operating and finance leases, reconciled to lease liabilities recognized on balance sheet

# Best Practices for Maintaining ASC 842 Compliance

Successful ongoing compliance with ASC 842 requires robust processes, cross-functional collaboration, and appropriate technology solutions.



## Establish a Centralized Lease Repository

Maintain a single source of truth for all lease-related information:

- Store all executed lease agreements, amendments, and related documents in one accessible location
- Implement consistent lease abstraction processes to capture all ASC 842-relevant data
- Maintain audit trails of document uploads and changes
- Ensure both Real Estate and Finance teams have appropriate access

## Build Cross-Functional Processes

Create clear workflows connecting Real Estate execution and Finance accounting:

- Define which lease actions require Finance notification (new leases, amendments, early terminations, option exercises)
- Establish service level agreements for communication between teams
- Implement approval workflows that include Finance review before lease execution
- Schedule regular sync meetings between Real Estate and Finance stakeholders

## Implement Automated Reminders and Tracking

Reduce the risk of missed events with proactive monitoring:

- Set up automated alerts for critical dates (commencement, rent escalations, option exercise deadlines)
- Create workflows to ensure timely accounting treatment of lease events
- Track modification and remeasurement history for each lease
- Monitor lease population changes month-over-month

## Leverage Purpose-Built Technology

Spreadsheets cannot scale to meet the demands of ongoing ASC 842 compliance. Purpose-built lease accounting software provides:

- Automated calculations for lease liabilities and ROU assets
- Built-in workflows for modifications and remeasurements
- Audit trail of all accounting entries and changes
- Automated disclosure report generation
- Integration capabilities with existing ERP and financial systems

## Document Policies and Judgments

Maintain clear documentation to support your ASC 842 accounting:

- Document practical expedient elections and policies
- Maintain support for discount rate determinations
- Record rationale for lease term and option exercise assessments
- Keep audit-ready documentation of lease classification decisions



# How Occupier Supports ASC 842 Compliance

Occupier's lease management platform is purpose-built to solve the challenges finance and accounting teams face in maintaining ASC 842 compliance.

## Trusted, Validated Lease Data

Occupier serves as a single source of truth where Real Estate and Finance teams collaborate on lease data:

- Real Estate teams manage the operational aspects of leases—dates, terms, options, and amendments—within their natural workflow
- Finance teams access the same validated lease data for ASC 842 calculations without manual data transfers
- Both teams work from the same lease abstracts and source documents, eliminating version control issues
- Automatic notifications when Real Estate updates lease information, keeping Finance informed in real-time





## Portfolio-Wide Visibility

Gain complete transparency into your lease portfolio and its accounting implications:

- Dashboard views of lease liability and ROU asset balances across the portfolio
- Track upcoming rent escalations, option exercise deadlines, and other critical dates
- Monitor lease population changes and their balance sheet impact
- Identify leases requiring remeasurement or reassessment

## Proactive Compliance Management

Stay ahead of compliance requirements with automated workflows:

- Automated reminders for critical lease events
- Guided workflows for lease modifications and remeasurements
- Built-in controls to ensure consistent application of ASC 842 requirements
- Exception reporting to flag missing data or potential compliance issues

## Audit-Ready Compliance

Simplify audit preparation with comprehensive documentation and reporting:

- Complete audit trail of all lease accounting entries and calculations
  - Source document storage linked to each lease
  - Automated generation of ASC 842 disclosure reports
  - Support for lease classification judgments and discount rate documentation
  - Historical versioning of lease data to support prior period analysis
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## Purpose-Built for Commercial Tenants

Occupier is designed specifically for commercial tenants managing 30-500 leases. This focus means you get:

- Rapid implementation without complex IT projects
- Intuitive interface that both Real Estate and Finance teams can use effectively
- Pricing that makes sense for your organization size
- Support team with deep expertise in tenant lease management and ASC 842 compliance

**Ready to simplify your ASC 842 compliance?**  
**Visit [www.occupier.com](https://www.occupier.com) to learn more or schedule a demo.**