

ASC 842: Lease Accounting Standard

How will this affect your bonding?

New accounting rule – effective January 1st, 2022.

A very brief summary:

- MOST leases (including office/real estate leases) greater than 12 months will be booked as debt on your balance sheet.
- The primary objective is to improve the accounting for leases to maximize the transparency of a company's obligations.
- This has the potential to dramatically affect the underwriting of your bond line, by decreasing working capital and net worth.
- A lessee is required to recognize all lease contracts, both operating and financing leases, on the balance sheet with the exception of certain short-term leases.
- A significant impact will hit contractors who hold real estate in separate entities and lease the property back to the construction company. This may require significant capitalization and debt to be shown on the construction company's balance sheet. This could negate one of the major attributes for holding real estate in a separate entity.

How will the surety companies underwrite these change?

Most sureties have not formed a formal position. CBI has been in discussion with all major sureties. Possible approaches could be handled by (a) allowing a departure from GAAP standards, (b) applying underwriting adjustments for a period to period comparison or (c) overlook it if the changes are minimal.

What should you do about this change?

Early communication will be the key.

- Reach out to your CPA to discuss how this will affect your balance sheet; especially if you have significant leases with real estate in related entities you own.
- Get in touch with your bond agent so they can interact with your CPA to get a proforma picture of how your balance sheet will change.
- Have your agent determine how this may affect your surety relationship and what is needed to preemptively put measures in place to protect your bonding.

If you need guidance in any of these areas, feel free to reach out to me to discuss what strategies would best serve your needs.



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