

# What Is a Right-of-Use Asset?

## Worksheet

The right-of-use asset is initially measured at the amount of the lease liability, plus any initial direct costs, prepaid lease payments and estimated restoration costs, minus any lease incentives received.

$$\text{ROU Asset} = \text{PV(Lease Payments)} + \text{Direct Costs}$$

## Questions

1. What is included in the initial measurement of a right-of-use asset?
  - A) Lease liability + initial direct costs + prepayments incentives
  - B) Only the lease liability
  - C) Only cash paid to date
  - D) Fair value of the underlying asset
2. Lease liability = \$100,000, initial direct costs = \$2,000, prepayments = \$3,000, incentives received = \$1,000. What is the ROU asset?
  - A) \$104,000
  - B) \$106,000
  - C) \$100,000
  - D) \$99,000
3. How is the ROU asset usually subsequently measured?
  - A) Straight-line amortization over the lease term (or useful life if shorter)
  - B) Revalued to fair value every year
  - C) Left at initial cost forever
  - D) Amortized using the effective interest method
4. Why do the ROU asset and lease liability balances diverge over the lease term?
  - A) Amortization is straight-line while interest on the liability is front-loaded
  - B) They are always identical
  - C) The ROU asset never changes
  - D) The liability is never reduced
5. A lease liability is measured at \$103,908. The lessee also pays \$2,000 in legal fees (initial direct costs) and receives a \$1,500 lease incentive from the lessor, with no prepayments. What is the initial ROU asset?
6. The ROU asset above (\$104,408) is amortized straight-line over the 5-year lease term with no residual value. What is the annual depreciation?
7. After year 1, the ROU asset has been depreciated by \$20,882 and the lease liability has accrued \$5,195 of interest but been reduced by a \$24,000 cash payment (opening liability \$103,908). What are the year-end ROU asset and lease liability balances?
8. Define: What is a right-of-use asset?
9. Define: How is the ROU asset initially measured?
10. Define: How is the ROU asset subsequently measured?

## Answer Key

1. A) Lease liability + initial direct costs + prepayments incentives - The ROU asset starts at the lease liability, adjusted for direct costs, prepayments and incentives.
2. A)  $\$104,000 - 100,000 + 2,000 + 3,000 - 1,000 = \$104,000$ .
3. A) Straight-line amortization over the lease term (or useful life if shorter) - The ROU asset is typically depreciated straight-line, unlike the lease liability which uses effective interest.
4. A) Amortization is straight-line while interest on the liability is front-loaded - Straight-line depreciation is level each period, but interest expense declines as the liability balance falls, so the two paths diverge.
5. ROU = Lease liability + IDC + Prepayments Incentives ROU =  $103,908 + 2,000 + 0 - 1,500 = \$104,408$
6. Annual depreciation =  $104,408 / 5 = \$20,881.60$   $\$20,882$  per year
7. ROU asset =  $104,408 - 20,882 = \$83,526$  Lease liability =  $103,908 + 5,195 - 24,000 = \$85,103$  (The two balances start close together but diverge because depreciation is straight-line while interest is front-loaded.)
8. A lessee's recognized right to use a leased asset over the lease term, capitalized on the balance sheet.
9. = lease liability + initial direct costs + prepayments incentives received.
10. Generally amortized (depreciated) on a straight-line basis over the shorter of the lease term or useful life, and tested for impairment.

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