

## ASC 842 Implementation Issues & Resources

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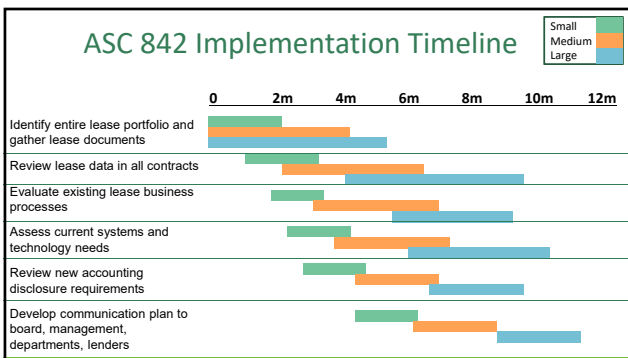
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### When Should You Start?

Lease Portfolio Size	Implementation Duration	Implementation Start Date
Small	6-10 months	March-July 2019
Medium	8-12 months	January-May 2019
Large	12+ months	December 2018 (or sooner)



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### Old vs. New Lease Accounting

<b>Old Lease Accounting (ASC 840)</b> <ul style="list-style-type: none"><li>▶ Four "red line" criteria</li><li>▶ Operating vs. Capital</li><li>▶ Only capital has BS impact</li></ul>	<b>New Lease Accounting (ASC 842)</b> <ul style="list-style-type: none"><li>▶ Old four criteria + 1 new</li><li>▶ Removes "red lines"</li><li>▶ ST vs. Operating vs. Financing</li><li>▶ Both operating &amp; financing have BS impact</li><li>▶ Additional Disclosures</li></ul>
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 Cherry Balmont  
CPA, Chartered

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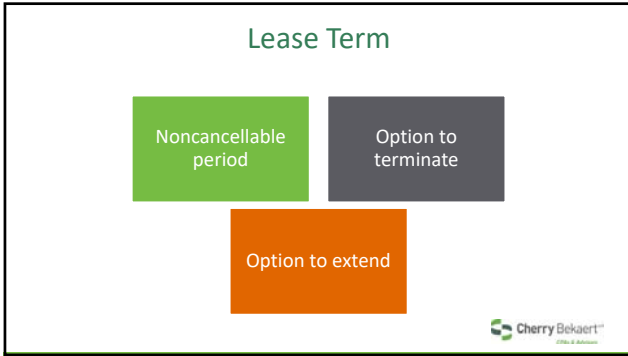
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- ### “Reasonably Certain”
- ▶ Contractual terms (e.g. penalties)
  - ▶ How important the leased property is to the entity
  - ▶ How unique the leased property is
  - ▶ Availability of replacements
  - ▶ Leasehold improvements
  - ▶ Below market rates
  - ▶ Cost of moving (direct and indirect or opportunity)
  - ▶ Past history isn't primary consideration\*
  - ▶ Tax implications
- Cherry Bekaert™

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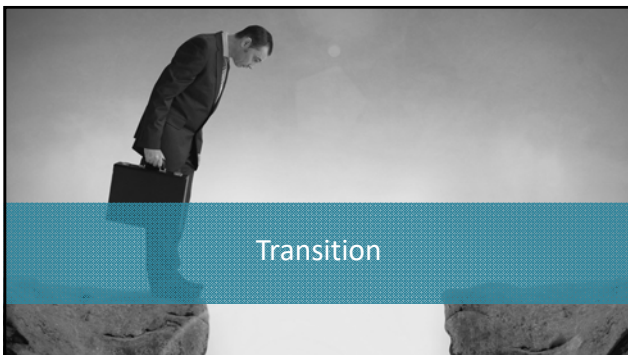
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### When Do I Have to Do Anything?

Public Entities	All other Entities
• FYB > 12/15/18	• FYB > 12/15/19

Early adoption is permitted



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### Transition = Modified Retrospective Approach

Comparative Periods Adjusted	Cumulative Catch-up Year of Adoption
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PRACTICAL EXPEDIENTS

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**Practical Expedient Package**

No need to reassess:		
Whether an arrangement is (or contains) a lease	Lease classification	Initial direct costs
All 3 or nothing election	Must be applied to all leases	



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**Hindsight Practical Expedient**

Applies to assessment of:	
Lease term	Impairment of right to use assets
Separate from practical expedient package	Must be applied to all leases



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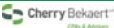
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**Short-Term Leases**

A lease that, at the commencement date, has a **lease term of 12 months or less** and does not include an option to purchase the underlying asset that the lessee is reasonably certain to exercise.



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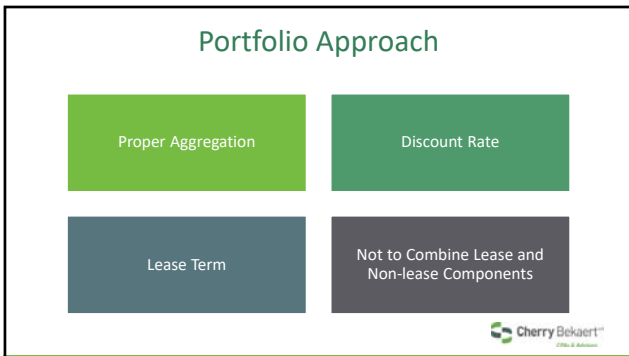
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How much information from each lease is needed?

**55**  
pieces of information



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Challenges

Where do I begin?	How do I track all of this new information?	Which policy elections or practical expedients should I adopt?
How do I know if I have captured all leases?	How should I update my accounting policies and processes related to leases?	How do I educate the users of my financial statements on the changes they will see?

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How Can Accounting Firms Help?

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### Implementation Assistance Services

All Companies

- Assist with development of implementation plan (checklists, questionnaires)
- Provide training and education
- Hold brainstorming sessions to assist in identifying unique terms in leases
- Provide access to lease maintenance software
- Analyze potential impact on financial statements, debt covenants, and income taxes



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### Implementation Assistance Services

Non-Attest Clients Only

- Draft accounting policies and manuals
- Analyze contracts or input data from known leases into lease maintenance software
- Assist in the identification of all leases
- Draft new financial statement disclosures



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Cherry Bekaert | Services | Assurance | Lease Accounting




**cbh.com**

[www.cbh.com/services/assurance-accounting/lease-accounting/](http://www.cbh.com/services/assurance-accounting/lease-accounting/)

### Lease Accounting

*Are you ready for the new Lease Accounting Standard? We can help!*



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88% of spreadsheets have errors	<b>Accuracy</b>	All calculations and formulas are <b>systematically</b> applied
Difficult to enforce specific spreadsheet workflows and versions, which <b>limits efficiency</b>	<b>Scalable Workflows and Audit Control</b>	Designed workflows bring <b>economies of scale</b> and <b>faster audits</b> , with data always up-to-date and accessible
Team must be trained on the standard itself, along with spreadsheet form and function. All <b>calculations must be created</b> and checked for accuracy	<b>Ease of Use</b>	<b>Wizards, alerts, and tips</b> ensure accurate lease data entry, with journal entries and footnote calculations <b>instantly available</b>
When leases are remeasured, impaired or modified, <b>inputs and calculations</b> must be properly updated	<b>Lease Modifications</b>	Users are <b>guided through steps</b> for each lease modification scenario
<b>Nearly impossible</b> to ensure security of spreadsheets	<b>Security</b>	<b>Password-protected system</b> access protects sensitive client data
Spreadsheets require <b>manual entry</b> into accounting systems	<b>Integration</b>	Downloads can be <b>configured for upload</b> into accounting systems

<http://www.leaseflow.com/2018/08/08/Leasing-Substitution.html>

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**Description & Term**

Lease Name: Espresso machine

Description: Serial Number, Number of assets in this lease, security deposit amount, etc.

Manufacturer: Barista

Asset Type: Equipment Add

Size:  (e.g. sqft or m<sup>2</sup>)

Location: That Place Add

Lease: Barista Add

Start Date: 01/01/2019 End Date: 12/31/2021 Run Lease Term Guidance Wizard

Term: 36 in full months (1 day in a month = full month)

**Cherry Bazaar**  
What's New

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**Lease Term Wizard Information**

Start Date: 1/1/2019

End Date: 12/31/2021

Term: 36 (Months)

Are you reasonably certain you will bypass any early termination option(s)? Yes

Are you reasonably certain to exercise a renewal option(s)? No

Based on your answers, we're going to use the original End Date: 12/31/2021

**Cherry Bazaar**  
What's New

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Year	GL Number	GL Description	Debit	Credit	Values	Debit Credit
2019-01	18400-100-ROU Asset		49,805.35	0.00	49,805.35	Debit
2019-01	18400-101-ROU Asset		19,774,764.46	0.00	19,774,764.46	Debit
2019-01	18400-102-ROU Asset		192,289.33	0.00	192,289.33	Debit
2019-01	18400-103-ROU Asset		877,207.96	0.00	877,207.96	Debit
2019-01	18400-104-ROU Asset		108,846.96	0.00	108,846.96	Debit
2019-01	18400-105-ROU Asset		892,099.43	0.00	892,099.43	Debit
2019-01	18400-106-ROU Asset		61,527.32	0.00	61,527.32	Debit
2019-01	18400-108-ROU Asset		332,851.75	0.00	332,851.75	Debit
2019-01	18400-109-ROU Asset		9,614.94	0.00	9,614.94	Debit
2019-01	18400-110-ROU Asset		336,155.83	0.00	336,155.83	Debit
2019-01	18400-111-ROU Asset		542,458.20	0.00	542,458.20	Debit
2019-01	18400-112-ROU Asset		1,242,445.70	0.00	1,242,445.70	Debit
2019-01	18400-114-ROU Asset		437,537.58	0.00	437,537.58	Debit
2019-01	18400-116-ROU Asset		494,485.79	0.00	494,485.79	Debit
2019-01	18400-117-ROU Asset		81,201.50	0.00	81,201.50	Debit
2019-01	18400-120-ROU Asset		9,473.95	0.00	9,473.95	Debit
2019-01	18400-121-ROU Asset		83,205.32	0.00	83,205.32	Debit
2019-01	18400-126-ROU Asset		14,708.83	0.00	14,708.83	Debit
2019-01	18400-127-ROU Asset		5,420.63	0.00	5,420.63	Debit
2019-01	18400-124-ROU Asset		172,189.29	0.00	172,189.29	Debit
2019-01	18400-124-ROU Asset		35,527.40	0.00	35,527.40	Debit
2019-01	25060-100-Deferred Rent - Granddora		13,847.53	0.00	13,847.53	Debit
2019-01	25070-100-Deferred Rent-Richard(see note)		4,308.442.13	0.00	4,308,442.13	Debit
2019-01	25071-100-Deferred rent Richard (311 mgis)		1,470,315.11	0.00	1,470,315.11	Debit
2019-01	25080-100-1.1 Lease Liability		0.00	(48,805.35)	(48,805.35)	Credit
2019-01	25080-101-1.1 Lease Liability		0.00	(13,883,521.70)	(13,883,521.70)	Credit
2019-01	25080-102-1.1 Lease Liability		0.00	(192,289.33)	(192,289.33)	Credit
2019-01	25080-103-1.1 Lease Liability		0.00	(877,207.96)	(877,207.96)	Credit
2019-01	25080-104-1.1 Lease Liability		0.00	(108,846.96)	(108,846.96)	Credit
2019-01	25080-105-1.1 Lease Liability		0.00	(892,099.43)	(892,099.43)	Credit
2019-01	25080-106-1.1 Lease Liability		0.00	(61,527.32)	(61,527.32)	Credit



FAOB ASC 842 Footnote	Year Ending	2019-12
<b>Lease expense</b>		
Finance lease expense		0.00
Amortization of ROU assets		0.00
Interest on lease liabilities		3,362,876.92
Operating lease expense		0.00
Short term lease expense		0.00
Variable lease expense		0.00
Sublease income		0.00
<b>Total</b>		<b>3,362,876.92</b>
<b>Other information</b>		
Cash paid for amounts included in the measurement of lease liabilities		0.00
Operating cash flows from finance leases (i.e. Interest)		0.00
Financing cash flows from finance leases (i.e. principal portions)		3,376,313.17
Operating cash flows from operating leases		0.00
ROU assets obtained in exchange for new finance lease liabilities		19,560,153.71
ROU assets obtained in exchange for new operating lease liabilities		0.00
Weighted-average remaining lease term in years for finance leases		4.94
Weighted-average discount rate for finance leases		0.00%
Weighted-average discount rate for operating leases		5.35%
<b>Maturity Analysis</b>		
	Finance	Operating
2020-12	0.00	3,306,818.33
2021-12	0.00	3,068,149.97
2022-12	0.00	2,760,644.10
2023-12	0.00	2,498,987.17
2024-12	0.00	2,401,712.80
Thereafter	0.00	4,047,057.34
Total undiscounted cash flows	0.00	14,255,231.69



-22  
days



344  
days



ASC 842  
Implementation  
Issues &  
Resources

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Cherry Bekaert  
CPAs & Advisors

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Example

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### Dexter Laboratories

Dexter Laboratories enters into a 3-year lease. Annual payments are as follows:  
Year 1 - \$20,000, Year 2 - \$22,000, Year 3 - \$24,000

Ex. 1 – Underlying asset is a hovercraft named “Slice of Life”.  
Estimated FV 70,000

Ex. 2 – Underlying asset was an abandoned warehouse.  
Estimated FV 500,000

No transfer of ownership, no options to purchase.



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### Dexter Laboratories

Financing (Hovercraft)

ROU Asset	\$ 60,000	
Lease Liab		\$ 60,000
At inception		

Operating (Warehouse)

ROU Asset	\$ 60,000	
Lease Liab		\$ 60,000
At inception		

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### Dexter Laboratories

Financing (Hovercraft) Lease						
Yr	Beg Lease Liab	Interest Exp	Payment	Amort Exp	Ending Liability	ROU Asset, net
0	0				60,000	60,000
1	60,000	2,862	20,000	20,000	42,862	40,000
2	42,862	2,045	22,000	20,000	22,907	20,000
3	22,907	1,093	24,000	20,000	0	0
		6,000		60,000		

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### Dexter Laboratories

Operating (Warehouse) Lease						
Yr	Beg Lease Liab	Lease Exp. <sup>A</sup>	Accretion	Amort Calc <sup>B</sup>	End Liab	ROU Asset, net
0	0				60,000	60,000
1	60,000	22,000	2,862	19,138	42,862	40,862
2	42,862	22,000	2,045	19,955	22,907	20,907
3	22,907	22,000	1,093	20,907	0	0
		66,000		60,000		

<sup>A</sup> - The annual straight-line lease expense is \$22,000/year [(20,000+22,000+24,000)/3].

<sup>B</sup> - Change in ROU Asset is calculated by subtracting the accretion of the lease liability (i.e. the interest expense) from the straight-line lease expense each year.

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### Dexter Laboratories

Financing (Boat)			Operating (Warehouse)		
ROU Asset	\$ 60,000		ROU Asset	\$ 60,000	
Lease Liab		\$ 60,000	Lease Liab		\$ 60,000
At inception			At inception		
Amort XP	20,000		Lease XP	22,000	
Interest	2,862		Lease Liab	17,138	
Lease Liab	17,138		Accum Amort		19,138
Accum Amort		20,000	Cash		20,000
Cash		20,000			
Year 1			Year 1		

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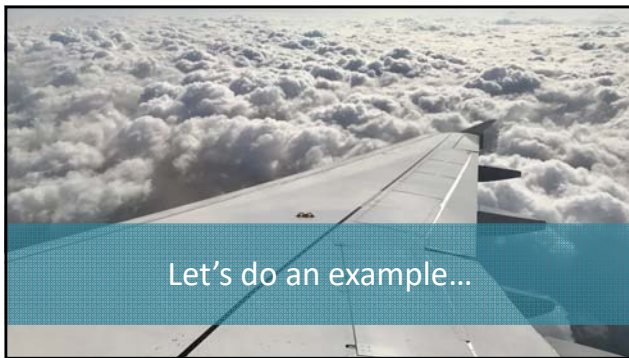
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As of January 1, 20X0, CB Inc. has a 4-year contract for the use of a private jet. CB intends to use the jet to shuttle those in this CPE class between CB HQ and other expensive cities to find additional donors. Here are the terms of the contract:

- The jet is identified by its serial number. The supplier cannot substitute the jet except for maintenance and repairs. This jet has a remaining economic useful life of 10 years.
- CB has exclusive use of the jet for the contract period.
- CB determines the destinations and timetable for the flights.
- When the jet is not in use, the supplier is not permitted to use the jet.



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Here are the terms of the contract (continued):

- The supplier will operate the jet using its own flight crew.
- The supplier will perform all maintenance and repairs.
- The supplier will handle all insurance.
- CB will pay a fixed amount of \$6M over the course of the contract. \$1.5M at the beginning of each year. The fixed amount compensates the supplier for use of the jet up to a designated number of flight hours.
- If CB exceeds the designated number of flight hours, CB will pay a variable amount based on the number of excess flight hours.
- The supplier retains ownership of the jet at the end of the contract period.
- There is no formal option for CB to purchase the jet.



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## What questions do we need to ask?

1. Does a lease exist?
2. What non-lease components need to be separated?
3. If this is a lease, is it financing or operating?
4. If this is a lease, how are the RTU liability and asset calculated?
5. How does CB account for this over the life of the contract?



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## 1. Does a lease exist?

Does the contract involve an identified asset?

- "The jet is identified by its serial number"

Who controls the underlying asset (i.e. substantially all of the economic benefits and right to direct use)?

- "CB has exclusive use of the jet"
- "The supplier is not permitted to use the jet"
- "CB determines the destinations and timetables"

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## 2. Non-Lease Components

What are the various components (lease and non-lease)?

- Right to use the jet for 4 years                      • **Lease**
- Services to operate the jet for 4 years            • **Non-lease**
- Maintenance and repairs for 4 years              • **Non-lease**

How do we allocate between the lease and non-lease components?




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## 2. Non-Lease Components

Based on third party suppliers, it is determined that the standalone selling prices are as follows:

Component	Standalone Price	Relative %	Allocation of Consideration	Annual Allocated Amount
Jet	\$5,500,000	87%	\$5,196,850	\$1,299,212
Service to operate the jet	175,000	3%	165,355	41,339
R&M	675,000	11%	637,795	159,449
<b>Total</b>	<b>\$6,350,000</b>	<b>100%</b>	<b>\$6,000,000</b>	<b>\$1,500,000</b>

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## 3. What type of lease is this?

Does the ownership of the jet transfer to the lessee at the end of the lease term?	Is there a purchase option that the lessee is reasonably certain to exercise?	Does the lease term cover a majority of the jet's remaining economic life?	Does the PV of the consideration exceed substantially all of the jet's FV?	Is the jet specialized that it has no alternative use to the lessor at the end of the lease term?
<b>Nope</b>	<b>Nope</b>	<b>Nope</b>		




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### 3. What type of lease is this?

Let's assume the lessee is not able to determine the rate the lessor charges or the implicit rate in the lease. The lessee's incremental borrowing rate is 6% and there are no initial direct costs or prepayments.

PV of the \$1,299,212 lease portion payment = \$4,722,021

FV of the jet = \$5,500,000




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### 3. What type of lease is this?

Does the ownership of the jet transfer to the lessee at the end of the lease term?	Is there a purchase option that the lessee is reasonably certain to exercise?	Does the lease term cover a majority of the jet's remaining economic life?	Does the PV of the consideration exceed substantially all of the jet's FV?	Is the jet specialized that it has no alternative use to the lessor at the end of the lease term?
Nope	Nope	Nope	Nope	Nope

Ladies and gentlemen, we have ourselves an OPERATING LEASE!




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### 4. What is the RTU liability and asset?

<u>Beginning of Year</u>	<u>Total payment</u>
1 - \$1,299,212	1 - \$1,500,000
2 - \$1,225,672	2 - \$1,415,094
3 - \$1,156,294	3 - \$1,334,995
4 - \$1,090,843	4 - \$1,259,429
<b>Total = \$4,722,021</b>	<b>Total = \$5,509,518</b>

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### 5. How to account for the lease?

	Lease Liability				Right of Use Asset		
	Beg. Balance	Payment	Interest <sup>1</sup>	Ending Balance	Beg. Balance	Amort. <sup>2</sup>	Ending Balance
Year 1	4,772,021	1,299,212	208,369	3,681,178	4,772,021	1,090,843	3,681,178
Year 2	3,681,178	1,299,212	142,918	2,524,884	3,681,178	1,156,294	2,524,884
Year 3	2,524,884	1,299,212	73,540	1,299,212	2,524,884	1,225,672	1,299,212
Year 4	1,299,212	1,299,212	0	0	1,299,212	1,299,212	0

1 – Computed as the beginning balance of the lease liability, less the payment made at the beginning of the year (\$1,299,212) \* 6%  
 2 – Calculated as the difference between the total lease expense and the interest accretion for the year.




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### 5. How to account for the lease?

ROU Asset	\$4,772,021		Lease Expense	\$1,299,212	
Lease Liab		\$3,472,809	ROU Asset		\$1,090,843
Cash		\$1,299,212	Lease Liab		\$208,369
1/1/X0 – Lease payment and initial recognition			12/31/X0 – Year 1 (lease expense)		
Lease Liab	\$1,299,212		Lease Expense	\$1,299,212	
Cash		\$1,299,212	ROU Asset		\$1,156,294
1/1/X1 – Year 2 Lease payment			Lease Liab		\$142,918
			12/31/X1 – Year 2 (lease expense)		




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