HOW TO JUMP START YOUR ASC 842 LEASE ACCOUNTING PROJECT

WEBINAR – MARCH 14 2018
Today’s Panelists

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Polling Question #1

How familiar are you with the ASC 842 leases standard?

a) Extremely familiar, we’re already implementing

b) Very familiar, I know what we have to do, but I’m unclear on a few issues

c) I have heard of it, but I really don’t know where to start

d) Completely in the dark--What is 842?
OVERVIEW OF THE STANDARD
Overview of key changes - Lessees

Recognition of all leases with an original term of greater than 12 months on balance sheet

• The critical accounting determination will be whether a contract contains a lease. The lease classification distinction will affect how lessees measure and present lease expense and cash flows – not whether the lease is on or off-balance sheet as it does under current U.S. GAAP.

• Classification as operating or finance lease is based on criteria similar to, but not identical to, those in current U.S. GAAP.

• A lessee will recognize a right-of-use (ROU) asset and a lease liability for all leases, including operating leases, with a term greater than 12 months.
  - Entities will be required to perform ongoing evaluation of ROU assets for impairment

• The new standard has a narrow definition of initial direct costs. Some costs incurred in negotiating and arranging a lease that are capitalized under current U.S. GAAP will now be expensed when incurred.
Separation of lease and non-lease components

- If there are lease and non-lease components (e.g., services), an entity applies the new standard to the lease components and other U.S. GAAP to the non-lease components, unless a lessee elects (by class of underlying asset) to account for non-lease components as part of the lease component to which they relate.

- The consideration in the contract is allocated to the lease and non-lease components on a relative standalone price basis, maximizing the use of observable information.

- Executory costs that do not represent payments for a good or service (e.g., payments to cover the lessor’s costs of ownership, such as property taxes or insurance) are not considered non-lease components and, therefore, will be allocated to the lease and non-lease components in the same manner as all other payments in the contract (i.e., will not be excluded from lease accounting as they are under current U.S. GAAP).
Overview of key changes - Lessees

Expanded disclosures

• The disclosure objective of ASC 842 is to provide the financial statement users sufficient information to assess the amount, timing and uncertainty of cash flows arising from leases.

• Qualitative disclosures, such as information about the nature of leases (terms and conditions of variable lease payments, extension and termination options, purchase options, residual value guarantees, etc.).

• Quantitative disclosures, such as operating lease cost, amortization of finance lease ROU assets and interest on finance lease liabilities, variable lease cost, weighted-average remaining lease term, weighted-average discount rate, and a maturity analysis of lease liabilities.
Overview of key changes - Lessees

Other transactions

• ASC 842 eliminates sale-leaseback accounting as an off-balance sheet financing proposition as the seller-lessees will recognize a ROU asset and a lease liability for the leaseback.

• The new standard eliminates the current build-to-suit lease accounting guidance and, instead, stipulates that a lessee is the accounting owner of an asset under construction when it controls that asset before the lease commencement date rather than whether the lessee takes on risks during the construction period.
  – Under ASC 842, if the lessee controls the asset during construction, the asset is capitalized as construction-in-progress and is subject to the sale and leaseback guidance at the end of construction.

• The transition provisions of the new standard will permit many entities to derecognize build-to-suit assets and liabilities that have remained on the balance sheet after the end of the construction period under current U.S. GAAP.
Overview of key changes - Lessees

Financial metrics, key performance indicators and capital structure impact

- Return on assets, debt-to-equity ratios and liquidity
- Debt covenants, interest coverage ratios and EBITDA/EBIT levels
- Recognition of foreign currency remeasurement gains and losses related to lease liabilities that are denominated in a currency that is different from a Company’s functional currency

Tax

- Recognition of lease-related assets and liabilities that are not on the balance sheet today would impact certain aspects of accounting for income taxes, such as:
  - Recognition and measurement of deferred tax assets and liabilities
  - Assessment of recoverability of deferred tax assets and liabilities
- Uncertainty around whether the ROU asset would be:
  - State and local tax: Included in the property factor for apportionment of income
  - Sales and use tax: Subject to sales tax
  - Property tax: Included in property tax base
Overview of key changes - Lessors

Same basic lessor accounting model is retained with some nuances

Lease classification

• A lessor will classify leases as (1) sales-type, (2) direct financing or (3) operating using criteria similar to current U.S. GAAP. Leveraged lease classification, however, will be eliminated prospectively. Unlike current U.S. GAAP, leases with predominantly variable payments may be classified as sales-type or direct financing leases.

Collectibility uncertainties

• Unlike current U.S. GAAP, a lease with collectibility uncertainties can be classified as a sales-type lease. If collectibility of the lease payments, plus any amount necessary to satisfy a lessee residual value guarantee, is not probable for a sales-type lease, lease payments received are recognized as a deposit liability (i.e., not recognized as lease income) and the underlying asset is not derecognized generally until collectibility of the remaining amounts becomes probable.

• Collectibility uncertainties for a lease that otherwise would be a direct financing lease result in operating lease classification. Lease income recognized for operating leases when collectibility is not probable is limited to cash received from the lessee until collectibility of the remaining lease payments becomes probable.
Overview of key changes - Lessor

Expanded disclosures

Qualitative

- Information about leases
- Nature of variable payment arrangements
- Termination, renewal, and purchase options
- Information about how the lessor manages residual asset risk, including information about residual value guarantees and other means of limiting that risk
- Significant accounting judgments and estimates

Quantitative

- Maturity analysis of lease receivables for sales-type/direct financing leases and of lease payments for operating leases
- Table of lease income
- Selling profit (or loss) recognized at lease commencement and interest income for sales-type/direct financing leases
- Operating lease income
- Variable lease income
Polling Question #2

Approximately how many leases do you have?

a) Under 100
b) 100-500
c) Over 500
d) Unsure
TRANSITION TO THE NEW STANDARD
• The transition provisions are applied using a modified retrospective approach.

• The FASB issued a proposed ASU in 1/18 to allow another transition method in addition to the existing requirements to transition to the new lease standard by recognizing a cumulative effect adjustment to the opening balance of retained earnings in the period of adoption consistent with the request by preparers. This additional transition method would change when an entity would be required to initially apply the transition requirements of the new lease standard; it would not change the date of adoption or how those requirements apply.

• Private companies are required to adopt on 1/1/20
Practical expedients

- Lessees and lessors are permitted to make an election to apply the package of practical expedients and/or the hindsight practical expedient

<table>
<thead>
<tr>
<th>Package of expedients (1) (2)</th>
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</thead>
<tbody>
<tr>
<td>• Do not re-assess:</td>
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<tr>
<td>- Whether contracts are or contain leases</td>
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<td>- Lease classification</td>
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<tr>
<td>- Whether initial direct costs qualify for capitalization</td>
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</tbody>
</table>

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<thead>
<tr>
<th>Hindsight expedient</th>
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<tbody>
<tr>
<td>• Use hindsight when determining the lease term and assessing impairment of ROU assets (lessees only)</td>
</tr>
</tbody>
</table>

(1) Practical expedient may be elected separately or in conjunction with the hindsight expedient.
(2) Must elect as a package and must be consistently applied to all leases.

Note: Land easements--optional transition practical expedient that will permit an entity to continue applying its current policy for accounting for land easements that existed as of, or expired before, the effective date of ASU 842. If elected, will apply it to all of its existing or expired land easements that were not previously assessed under today’s lease guidance. Entities that elect the practical expedient will still need to evaluate whether land easements entered into or modified on or after the effective date meet the definition of a lease under ASC 842.
Accounting policy elections--lessees

• Certain accounting policy elections related to leases must be made and documented:
  - Short-term leases (term of less than 12 months) are excluded from recognition and recognized over the lease term
    - Requires careful evaluation of renewal options
  - By class of underlying asset, choose not to separate nonlease components from lease components
  - Discount rate (non-Public Business Entities)—can choose to use a risk-free discount rate for the lease, determined using a period comparable with that of the lease term, instead of incremental borrowing rate related to leased asset
  - Portfolio approach--may apply guidance to a portfolio of leases with similar characteristics (size and composition) if reasonably expect that the application of the leases model to the portfolio will not differ materially from the application to the individual leases in that portfolio.
HIGH LEVEL COMPARISON OF ASC 842 AND IFRS 16
## Comparison of ASC 842 and IFRS 16—Key considerations

<table>
<thead>
<tr>
<th>IFRS 16</th>
<th>ASC 842</th>
<th>Key Considerations</th>
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</thead>
<tbody>
<tr>
<td><strong>Effective date</strong></td>
<td>The new standard is effective for annual periods beginning on or after January 1, 2019. Early adoption is permitted if the new revenue standard is also adopted.</td>
<td>ASC 842 is effective for annual periods beginning after December 15, 2018 (public business and certain other entities) and after December 15, 2019 for other entities. Early adoption is permitted.</td>
</tr>
<tr>
<td><strong>Transition approach and comparatives</strong></td>
<td>Full retrospective approach, or modified retrospective approach with practical expedients available.</td>
<td>Modified retrospective transition is required for all leases existing at, or entered into on or after, the beginning of the earliest comparative period presented in the financial statements—a.i.e. comparative information is restated.</td>
</tr>
<tr>
<td><strong>Leases recognized on the balance sheet</strong></td>
<td>The modified retrospective approach is based on leases at the date of initial application and comparative information is not restated. Instead, the effect of adopting the new standard is recognized in opening retained earnings (or other equity component as appropriate) at the date of initial application.</td>
<td>Practical expedients are available on transition, which are less extensive than those under IFRS.</td>
</tr>
<tr>
<td><strong>Lease classification</strong></td>
<td>Lessees may elect to apply the recognition exemption for leases of ‘low-value’ assets—i.e. underlying assets with a value ≤ $5,000 when new, even if they are material in aggregate.</td>
<td>There is no exemption for leases of low-value assets.</td>
</tr>
<tr>
<td><strong>Remeasurement assessment for leases tied to an index or rate</strong></td>
<td>There is a dual classification on-balance sheet lease accounting model for lessees: finance leases and operating leases. Lease classification affects measurement of the right-of-use asset, lease expense, and income statement presentation.</td>
<td>Adjustments to an index or rate do not constitute a reassessment event.</td>
</tr>
<tr>
<td><strong>Sale-leaseback transactions</strong></td>
<td>If the seller-lessee has a substantive option to repurchase the underlying asset, the transfer is not a sale.</td>
<td>If the seller-lessee has a substantive option to repurchase an underlying asset that is not real estate, the transfer may be a sale under certain circumstances.</td>
</tr>
<tr>
<td></td>
<td>The seller-lessee measures the right-of-use asset at the retained portion of the previous carrying amount of the underlying asset (i.e. at cost). Only the amount of any gain or loss related to the rights transferred to the buyer-lessee is recognized.</td>
<td>If the leaseback would be classified as a finance lease by a seller-lessee (or as a sales-type lease by the buyer-lessee), then sale recognition is automatically precluded. The seller-lessee measures the right-of-use asset at the present value of the lease payments in the same way as any other lease. A gain or loss is recognized for the difference between the sale proceeds and the carrying amount of the underlying asset.</td>
</tr>
<tr>
<td><strong>Subleases</strong></td>
<td>Unless the sublessor for the head lease applies the recognition and measurement exemption applicable to short-term leases, a sublessor classifies a sublease by reference to the right-of-use asset arising from the head lease.</td>
<td>A sublessor classifies a sublease by reference to the underlying asset.</td>
</tr>
</tbody>
</table>
Polling Question #3

Approximately how long will it take to fully implement the new standard at your organization?

a) 1 month
b) 3-6 months
c) 12 months
d) 5 years
PROJECT APPROACH
ASC 842 Approach

**Assessment and Strategy**

- **Project Initiation and Planning**
  - Plan impact assessment
  - Understanding of business strategy, organizational overview, business systems

- **Business Requirements**
  - Current lease portfolio
  - Contracts deep dive
  - Current org design
  - Current tech landscape
  - Current biz processes

- **842 Impact Assessment**
  - Key impacts of ASC 842
  - Critical gaps
  - External auditor findings

- **Operational & Technology Strategy**
  - Define requirements
  - Evaluate vendors
  - Select vendor
  - Define implementation scope, timeline and budget

**Implementation Management**

- **Business Process & System Design**
  - Detailed system design
  - Templates and tools
  - Stakeholder impact (tax, treasury)

- **Lease Abstraction & System Config**
  - Configure software
  - Abstract leasing data
  - Feedback from external auditors

- **System Testing and Validation**
  - Testing plan
  - Execution of test plan
  - Validation of lease calculations
  - Issue tracking

- **Deployment, Training and User Adoption**
  - Training for accounting users (optional)
  - Training for procurement users (optional)
  - Internal controls (optional)

**Project Management, Communication and Change Enablement**
Integrated implementation timeline - SAMPLE

<table>
<thead>
<tr>
<th>Phase</th>
<th>Month Ending</th>
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</thead>
<tbody>
<tr>
<td>Assessment &amp; Strategy</td>
<td>MoYr MoYr MoYr MoYr MoYr MoYr MoYr MoYr MoYr MoYr</td>
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<tr>
<td>Initiation and Planning</td>
<td></td>
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<tr>
<td>Business Requirements and Contracts Analysis</td>
<td></td>
</tr>
<tr>
<td>Define 842 Impact</td>
<td></td>
</tr>
<tr>
<td>Operational and Technology Strategy</td>
<td></td>
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<tr>
<td>Implementation and Adoption</td>
<td></td>
</tr>
<tr>
<td>Project and Change Management</td>
<td></td>
</tr>
</tbody>
</table>

- **Assessment & Strategy Phase**
- **Implementation and Adoption Phase**
- **Go-Live and Adoption**
## Estimated Resource requirements by phase

### Estimated level of resource effort

<table>
<thead>
<tr>
<th>Technical Accounting Phases</th>
<th>&lt;client name&gt; requirements</th>
</tr>
</thead>
<tbody>
<tr>
<td>Initiation and Planning</td>
<td>Low</td>
</tr>
<tr>
<td>Business Requirements and Contracts Analysis</td>
<td>Medium</td>
</tr>
<tr>
<td>Define 842 Impact</td>
<td>Low</td>
</tr>
<tr>
<td>Develop Technology and Implementation Strategy</td>
<td>Medium</td>
</tr>
<tr>
<td>Implement 842</td>
<td>High</td>
</tr>
</tbody>
</table>

### Level of effort estimate (% of time)

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<tbody>
<tr>
<td>Low</td>
</tr>
<tr>
<td>Medium</td>
</tr>
<tr>
<td>High</td>
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</tbody>
</table>
Polling Question #3

What are you planning to do from a technology perspective?

a) Utilize an excel workbook
b) Purchase a lease accounting system
c) Outsource lease accounting
d) Unsure at this time
LEASE ACCOUNTING SOFTWARE
Enterprise Lease Accounting

Lease Classification
For operating and finance leases with ability to configure policy thresholds and make overrides

Lease Accounting Engine
Asset-level lease accounting sub-ledger that can generate debits and credits for export to the GL

Financial Disclosures
For IFRS and US GAAP. Support for the new lease accounting standards and the current standards

Management Accounting
Reconciliation and roll forward reporting; portfolio and schedule level trial balance reporting
Enterprise Lease Accounting

DEFINING SUCCESS

PASSING FINANCIAL AUDIT
System: Functional and complete reporting developed for over 8 years
Internal Controls for Financial Reporting

PROCESS TRANSFORMATION
Decentralized leasing program becomes part of monthly close
System provides visibility and automation

COST SAVINGS
Competitive capital sourcing for equipment
Effective end-of-term management

ENDER LEASE MANAGEMENT
Lease vs Buy
Automated Attestations & Notifications
Operating Lease
Finance Lease

ASSET-LEVEL ACCOUNTING
Cost-Center Allocations
Modifications & Impairments
Audit trails

CONFIGURABLE POLICIES & CONTROLS
Centralized Policies
Segregation of Duties

LEASE ACCOUNTING SUB-LEDGER
ASC 842
ASC 840
IFRS 16
IAS 17

Real Estate
Equipment
Embedded Leases

COMPLIANCE REPORTING
Journal Entries
Disclosures
Maturity Analysis

CENTRALIZED POLICY ELECTIONS
Comparative Reporting

GENERAL LEDGER & A/P INTEGRATIONS
SAP
Oracle
Others

AUTOMATED LEASE CLASSIFICATION

AUTOMATED TRANSITION ACCOUNTING

SYSTEM: FUNCTIONAL AND COMPLETE REPORTING DEVELOPED FOR OVER 8 YEARS
INTERNAL CONTROLS FOR FINANCIAL REPORTING

DECENTRALIZED LEASING PROGRAM BECOMES PART OF MONTHLY CLOSE
SYSTEM PROVIDES VISIBILITY AND AUTOMATION

COMPETITIVE CAPITAL SOURCING FOR EQUIPMENT
EFFECTIVE END-OF-TERM MANAGEMENT

DEFINING SUCCESS

PASSING FINANCIAL AUDIT

PROCESS TRANSFORMATION

COST SAVINGS
Most Companies Will Need a Subledger

ASSET MANAGEMENT
- Real Estate Administration
- IT Asset Management
- Fleet Management
- Contract Management
- Procurement & Sourcing

PROCUREMENT

ERP APPLICATIONS
- General Ledger
- Accounts Payable

ENTERPRISE LEASE ACCOUNTING
Decisions and Events Across Lifecycle

**Lease Start**
- Aggregated Spend
- Cost-Center Allocation
- Super-Asset Aggregation

**During the Term**
- Reorganization Allocation
- Merger & Acquisition Allocation

**End of Term**
- Buyouts & Renewals
- Return Performance
Accounting Classification Analysis

<table>
<thead>
<tr>
<th>Standard</th>
<th>Current Standard</th>
<th>New Standard</th>
</tr>
</thead>
<tbody>
<tr>
<td>ASC 840</td>
<td>US GAAP</td>
<td>US GAAP</td>
</tr>
<tr>
<td>IAS 17</td>
<td>International</td>
<td>International</td>
</tr>
<tr>
<td>ASC 842</td>
<td>US GAAP</td>
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</tr>
<tr>
<td>IFRS 16</td>
<td>International</td>
<td>International</td>
</tr>
</tbody>
</table>

**Classification Criteria**

- **ASC 840**
  - Short Term Lease
  - Non-Cancellable
  - 90% of Lease Payments
  - 75% of Economic Life
  - Ownership Transfer
  - Bargain Purchase

- **IAS 17**
  - Short Term Lease
  - Non-Cancellable
  - PV of Lease Payments
  - Economic Life
  - Ownership Transfer
  - Bargain Purchase
  - Specialized Assets

- **ASC 842**
  - Short Term Lease
  - Non-Cancellable
  - PV of Lease Payments
  - Economic Life
  - Ownership Transfer
  - Likely Purchase
  - Specialized Assets

- **IFRS 16**
  - Short Term Lease
  - Non-Cancellable
  - Ownership Transfer
  - Interrelated Assets
  - Small Value

Automatically generates recommended classification with option to override.
Responsibility Center Accounting

Assign expenses from leased assets to different responsibility centers

Enterprize Lease Accounting Software

Enables reporting and analysis at multiple levels within the organization
Accounting Reports

ENTERPRISE LEASE ACCOUNTING REPORTS

- Non-discounted future obligations by lease classification
- Maturity Analysis
- Cause of Change
- Reconciliation Report
- ERP Upload
- Quantitative Analysis
- Amortization Schedule
- Payment Schedule
- Accounting Workbook
- Note disclosure summarizing financial statement activities
- Principal, interest, depreciation for leases
- Month-by-month cash flow for lease portfolio
- Bundle of reports for operating and capital leases

Shows lease portfolio at beginning and end with activity in between

Used to reconcile leasing data between different reports

Debits and credits to be uploaded to ERP
Transition Accounting – US GAAP

**ASC 840**
- Date of Initial Application: Eg: 1/1/2017
- Primary Journal Entries uploaded to GL

**ASC 842**
- Effective Date: Eg: 1/1/2019
- What if Analysis

**ASC 842 D**
- DOIA
- Re-Measure
- Transition Entries

**ASC 842E**
- Effective Date
- True-Up
- Effective Adjusting Entries
- Primary Journal Entries uploaded to GL
- Re-Measure
- Changes in Estimates Applied

- “As reported”

May Continue to support Frozen GAAP/IFRS requirements
Continues to Support Comparative Reporting Disclosures

840 Entries
842 Entries
842D Entries

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Audit Support

Reconciliation Reporting

- Compares Reports for Tie-Out
- Asset details
- Ordered items
- Payment schedule
- Leasing summary

“As At” Reporting

- Visibility for a Certain Date
- Balance Sheet Liabilities
- Lease Portfolio

Asset Change Report

- Between Two Periods
- New Leases
- Leases Terminated or Purchased
- Rent and Foreign Exchange Changes

Deal History

- Who did what and when?
- Classification Changes
- Invoice Payments
- Accounting Judgments
- End User Attestations

Document Repository

- All Supporting Documents
- Master Lease Agreements
- Purchase Orders
- Lease Classification Analysis

Asset Level Tracking

- Data tracked for each Asset on Lease
- Economic Life
- Residual Value
- Lease Rate Factor
# Three Golden Requirements

## For an Enterprise Lease Accounting Solution

<table>
<thead>
<tr>
<th></th>
<th>Lease Policy Management</th>
<th>Equipment Lease Data Management</th>
<th>Lease Accounting</th>
</tr>
</thead>
</table>
| 1 | Financial controls and flexible workflow to enable the management of lease and accounting policy and ensure SOX and FASB compliance.  
• Lease vs. Buy  
• Lease Accounting Classification | Manage and track all changes to the leased asset as those changes occur to insure an accurate “system of record” for accounting compliance.  
• Mid-Term changes  
• End-of-Term changes | Perform accounting calculations and journal entries at the asset level. Manage the accounting for individual business needs to ensure complete and accurate accounting  
• Financial Accounting  
• Management Accounting |
|   | ✓ Valuation or Allocation  
✓ Rights & Obligations  
✓ Authorization  
✓ Existence or Occurrence  
✓ Completeness & Accuracy | ✓ Completeness & Accuracy  
✓ Existence or Occurrence  
✓ Authorization | ✓ Valuation or Allocation  
✓ Presentation & Disclosure |
SOX Requires a “Controlled Environment”
Scott Vanlandingham

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