



AAFCPAs

Topic 842 - Leases

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Understanding what it takes to ensure a successful implementation...



Speakers:
Jeffrey Mead,
CPA, CGMA
Olga Yasinnik,
CPA, MBA



Poll 1/4: Where are you
now with your adoption of
the Lease Accounting
Standard?



Agenda



WHAT DOES TOPIC 842
MEAN TO ME AND MY
COMPANY?



A SUMMARY OF USEFUL
EXPEDIENTS AND POLICY
TIPS



HOW DO I MANAGE THE
ADOPTION OF THIS NEW
STANDARD?



AAFCPAs'
IMPLEMENTATION
SUPPORT & SOLUTIONS





What does Topic 842 Mean to Me and My Organization?





ASU 2016-02, Topic 842, Leases

Topic 842, Leases (New Standard), replaces Topic 840, Leases (Old Standard) in its entirety

Effective Date

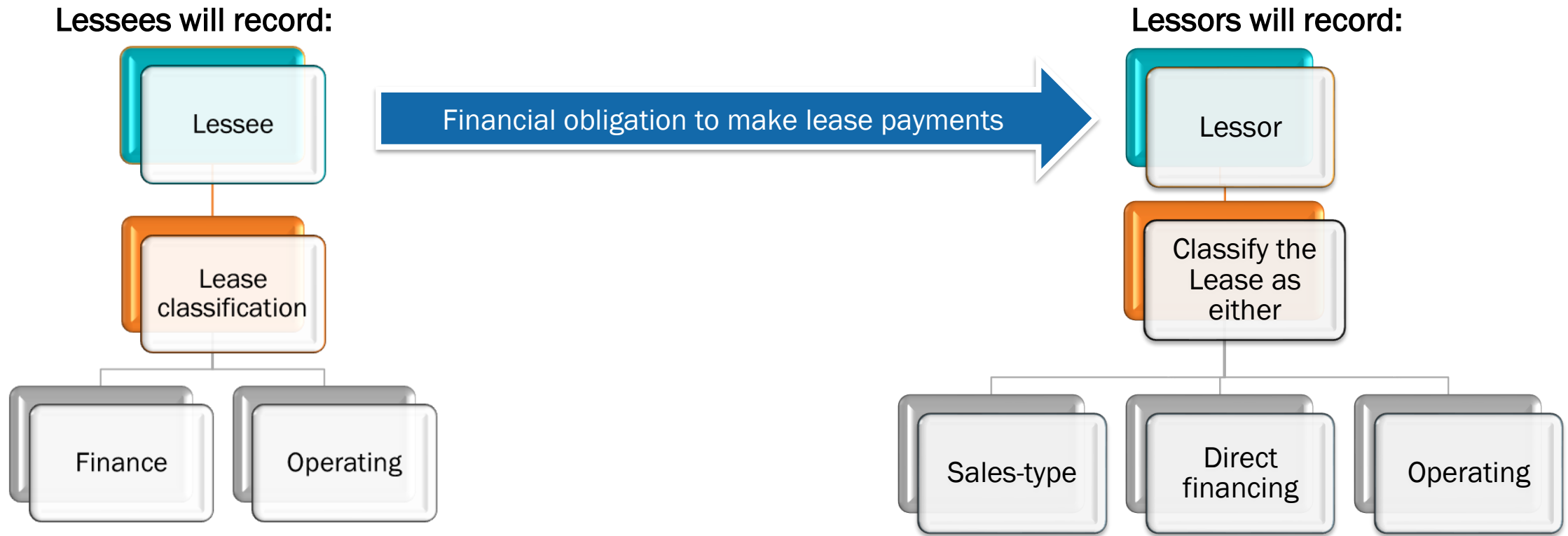
- For public companies, the ASU was effective for years beginning after December 15, 2018
- For all other non-registrants, Topic 842 is effective for **calendar** year ends in beginning January 1, **2022**, **fiscal** year ends July 1, **2023** (June year ends)
- Early application is permitted for all organizations



Lease Model Under Topic 842



- New terms: Record a “right-of-use (ROU)” asset and “lease liability (LL)”



- Recognize right-of-use (ROU) assets and lease liabilities
- Pattern of expense recognition is similar to legacy GAAP

- Similar to legacy GAAP with some changes





NOT IN SCOPE OF TOPIC 842

- Leases of intangible assets (Topic 350, Intangibles — Goodwill and Other)
- Leases to explore for or use minerals, oil, natural gas, and similar nonregenerative resources Topics 930, Extractive Activities — Mining, and Topic 932, Extractive Activities — Oil and Gas)
- Leases of biological assets, including timber (Topic 905, Agriculture)
- Leases of inventory (Topic 330, Inventory)
- Leases of assets under construction (Topic 360, Property, Plant, and Equipment)

Embedded Leases



- Certain arrangements that are not structured as leases may contain embedded leases.
- Types of contracts that often contain embedded leases include:



IT and office
equipment;
cloud service
agreements



Medical equipment
contracts



Logistics and
warehousing



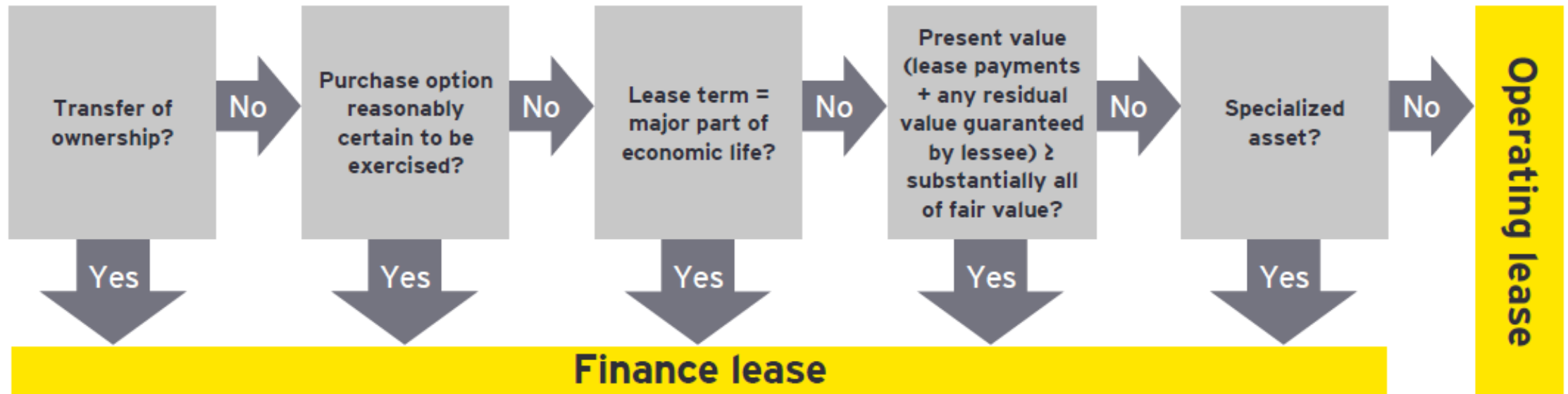
Advertising

- If a contract contains a lease, it does not automatically indicate that the entire contract is a lease, i.e., it may also contain nonlease components.





Lease Classification for Lessees





What's the Accounting? Simply put:

	Balance Sheet	Income Statement	Cash Flow Statement
Finance	<ul style="list-style-type: none">• Right-of-use (ROU) asset• Lease liability	<ul style="list-style-type: none">• Amortization expense• Interest expense	<ul style="list-style-type: none">• Principal-financing• Interest-operating
Operating	<ul style="list-style-type: none">• Right-of-use (ROU) asset• Lease liability	<ul style="list-style-type: none">• Single lease expense on a straight-line basis	<ul style="list-style-type: none">• Lease expense-usually operating



Initial Measurement of ROU Asset and LL



- Measure LL at PV of the lease payments to be made over the lease term by using a discount rate*

*DISCOUNT RATE

- The rate implicit in the lease
- Incremental borrowing rate
- The risk-free rate

- Recognize ROU asset and a LL



- Capitalize initial direct costs as part of the ROU asset
- Assess the ROU asset for impairment annually





Lease and Non-Lease Components

- **Lease components** Leases which provide the rights to use multiple assets (not land), the right to use each asset is considered a **separate lease component** if certain criteria are met:
 - The lessee can benefit from ROU either on its own or together with other goods or services that are sold or leased separately
 - The ROU asset is not dependent or interrelated with other ROU assets
- **Non-lease components** A good or service to the lessee which is separate from the underlying ROU asset (for example, maintenance, CAM, etc.)
- ASC 842 provides a **practical expedient** that permits lessees to make an accounting policy election (by class of underlying asset) to account for each separate lease component of a contract and its associated non-lease components as a single lease component.
- Lessee's payments for Lessor's real estate taxes and insurance related to the leased asset are **not components of the contract** because they do not represent payment for goods or services, in addition to the right to use the space, transferred to the lessee.

Lease Incentives and Improvements



- Payments made to or on behalf of the lessee represent incentives that the lessee should consider reductions of the right-of-use asset and rental expense over the term of the lease. Incentives should be straight-lined over the term of the lease.
- Leasehold improvements – are capitalized separately from the ROU and depreciated over the shorter period of the useful life of the LHI or the term of the lease (including an extension of the lease term if that is expected to be exercised)



Whose
improvement is it?
Lessee's? Lessor's?

Consider this:

- What happens to the improvements at the end of the lease term (i.e., are they removed or preserved for the landlord)?
- Are the improvements unique (e.g., décor & logo, or general-purpose)?
- Which party is supervising construction (i.e., is the lessee acting as an agent or actively involved in design)?
- Which party bears all costs of the improvements, including risk of cost overruns?
- Which party owns the improvements?



Lease Commencement Date

- Date on which the lessor makes an underlying asset (i.e., the property, plant, or equipment subject to the lease) available for use by the lessee. Or, lessee takes possession.
- Commencement date of the lease may be before the date stipulated in the lease agreement (e.g., the date rent becomes due, payable). This often occurs when the leased space is modified by the lessee prior to commencing operations (e.g., leasehold improvements).
- Because lease commencement date is aligned with the lessee taking control (possession) of the underlined asset, the straight-line rent computation for operating leases may include a rent holiday period.



Below-Market Leases

- Donated leases are NOT in scope of new ASU
- Consideration = lease payments
- ROU calculation does NOT include donated rent

$$\text{Fair Rental Value} - \text{Lease Payments} = \text{Donated Rent}$$





Leases with Related Parties



- The recognition and measurement requirements for all leases should be applied by lessees and lessors that are related parties based on legally enforceable terms and conditions of the arrangement
- In the separate FSs of the related parties, the classification and accounting for the leases should be the same as for leases between unrelated parties
- Must also apply disclosure requirements of FASB ASC 850, Related Party Disclosures



Poll 2/4: how many
leases do you have?





USEFUL EXPEDIENTS AND POLICY TIPS



Practical Expedients and Policy Elections

Package deal for any expired or existing leases to skip the reassessment of:

- Whether a contract is or contains leases
- Lease classification:
 - operating leases remain operating
 - capital leases classified as finance leases
- Initial direct costs





Practical Expedients and Policy Elections

- Discount rate to be applied by class of underlined asset
- Accounting policy election (by class of underlying asset) to account for each separate lease component of a contract and its associated non-lease components as a single lease component



Short-Term Leases

- Two criteria:
 - Lease term of 12 months or less, AND
 - No option to purchase underlying asset that lessee is reasonably certain to exercise
- You may elect to exclude those identified short term leases from Topic 842. Accounting looks like this:
 - Recognize lease payments in P&L on straight-line basis
 - Recognize variable lease payments as they are incurred
- Accounting policy must be made by class of underlying asset and disclosed

Transition/Implementation –
Example (1)

Modified Retrospective Approach (1): lessees and lessors are required to recognize and measure leases at the beginning of the earliest period presented:



<u>FS</u>	Topic 842 <u>2022</u>	Topic 842 <u>2021</u>
ROU Asset	A2	A1
Lease Liability	L2	L1
Equity Adjustment		A1-L1

Transition/Implementation – Example (2)



Modified Retrospective Method (2) to present the first comparative period in the FSs the year before adoption in accordance with the Old Standard (Topic 840).

<u>FS</u>	TOPIC 842 <u>2022</u>	TOPIC 840 <u>2021</u>
ROU Asset	A1	<i>USE LEGACY</i>
Lease Liability	L1	<i>ACCOUNTING</i>
		<i>NO</i>
Beginning Equity	A1-L1	<i>CHANGE</i>



HOW DO I MANAGE THE ADOPTION?





Information Gathering: Ensure Lease Completeness

KEY TAKEAWAY: The completion of a lease portfolio is critical under ASC 842

- Have you identified all your leases?
 - ✓ Review footnote disclosures
 - ✓ Survey business units
 - ✓ Analyze cash disbursements

Readiness Checklist

- ☐ Inventory of leases
- ☐ Review capitalization policy – materiality*
- ☐ Debt covenants - leverage ratios
- ☐ Use of technology: Excel vs lease software
- ☐ Educate users of FSs
- ☐ Develop implementation plan

*FASB does not define “materiality.” Materiality can be determined by class of underlying asset and must be documented.



What constitutes a class of underlying asset?





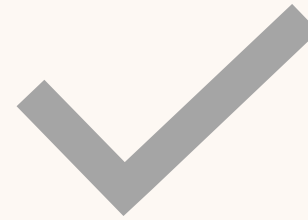
Key Considerations:



Identify: Who (departments) will be impacted by the new standard:

Set up a meeting with facilities, finance, and IT, so all parties involved are familiar with impact

Update internal policies & procedures



Ask: How will technology support our implementation plan?

Ensure appropriate connectivity with GL & AP modules

Consider testing procedures, identify testing team



Lessee Accounting - Disclosures

- Contractual details (lease term, contingent rentals, options, etc.). Accounting judgments made (including any subleases, if applicable)
- Significant leases that have not yet commenced
- Lease liabilities disclosed separately between operating and finance leases:
 - Maturity analyses of undiscounted lease payments
 - Weighted-average remaining lease term
 - Weighted-average discount rate
 - Cash flows and supplemental noncash information
- Lease costs (including any amounts capitalized) and related cash flows, separately for operating & finance leases
- If practical expedients elected, disclose & provide related details
- No specific format required; ASU provides tabular example
- Judgment required to determine level of aggregation or disaggregation

Poll 3/4: How are you
planning to adopt the
new lease standard?





What can AAFCPAs do for you?





How will you approach Implementation?

OPTION 1



**INTERNAL
RESOURCES**

OPTION 2



HYBRID with AAFCPAs
serving as a resource
enhancement on
select services*

OPTION 3



EXTERNAL RESOURCES with
AAFCPAs acting as an
extension of your finance
function, taking the lead--
from implementation through
financial reporting*

AAFCPAs LEASE ASU IMPLEMENTATION CHECKLIST

Comprehensive checklist to help clients understand the scope of implementation:

<https://www.aafcpcpa.com/2021/10/20/lease-accounting-standard-effective-1-1-22/>

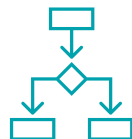
AAFCPAs Shortlist



Identify the entire lease portfolio and gather lease documents



Review lease data in all lease contracts



Evaluate existing lease business processes



Assess current systems & use of tech for lease processing



Review new accounting & disclosure requirements incl. judgment areas



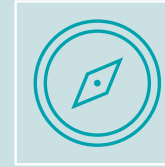
Discuss ASU with stakeholders



AAFCPAs Consulting Services



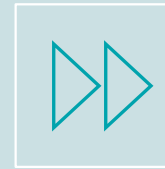
Assessment of the impact, development of implementation schedule



Guidance in reviewing & updating accounting policies & procedures



Review lease agreements, prepare summaries of each agreement, document accounting treatments



Assistance with classifying leases, selecting software, setting up spreadsheets, recurring entries, etc.



Poll 4/4: What is your
key take-away from
today?





Questions?



Jeffrey Mead, CPA, CGMA

774.512.4131

jmead@aafcpa.com



Olga Yasinnik, CPA, MBA

774.512.4082

oyasinnik@aafcpa.com

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