

The webcast will start at 1:00 p.m. Eastern

- Visit capincrouse.com/untangling-leases to access these materials from today's webcast:
 - Handouts
 - Recording
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Untangling Leases: A Step-by-Step Guide to Implementing ASC 842

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Learning Objectives

- Organize and evaluate the key decisions that need to be made upon implementation
- Identify the practical expedients allowed under the new lease standards
- Apply the implementation guidance for both operating and financing leases
- Illustrate the initial and subsequent journal entries for both operating and financing leases

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Polling Question 1

Do you want CPE?

- Yes
- No

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ASC 842 – Overview

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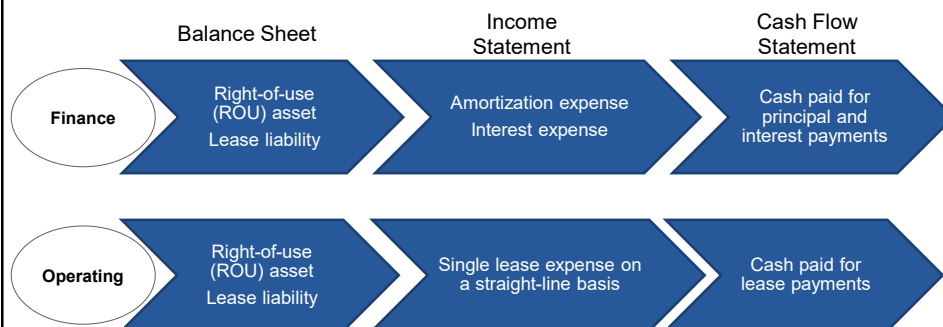


- Lease commitments and rights to use will be recognized on the balance sheet
- Determination if agreement is a lease determines if it is on or off the balance sheet
- Operating versus financing determination affects statement of activities, cash flows, and disclosure
- Lessor accounting largely unchanged

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ASC 842 – Overview

Lessee Accounting Overview



Classification between finance and operating is similar to current lease classification in Topic 840 between capital and operating.

ASC 842 – Overview

Lease Definition

What is a lease?

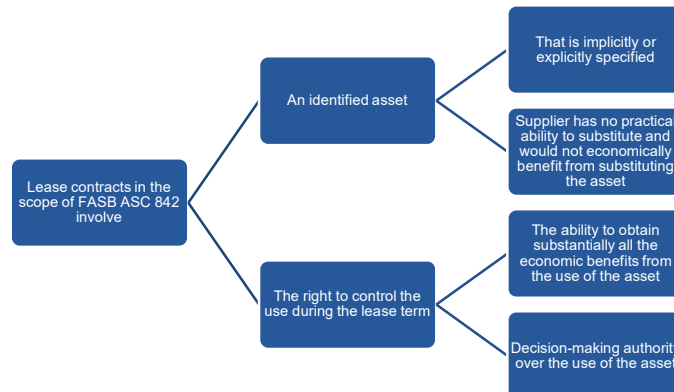
Previous GAAP Definition	New GAAP Definition (ASC 842)
An agreement conveying the right to use property, plant, or equipment (land and/or depreciable assets), usually for a stated period of time	A contract, or part of a contract, that conveys the right to control use of identified property, plant, or equipment (an identified asset) for a period of time in exchange for consideration
Critical determination – capital or operating lease?	Critical determination – whether a contract is or contains a lease

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ASC 842 – Overview

Identifying a Lease

Definition: **A contract, or part of a contract**, that conveys the right to **control the use of identified property, plant, or equipment** (an identified asset) for a period of time in exchange for consideration.



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ASC 842 – Overview

Lease Definition, Scope

- Applies to leases and subleases of property, plant, and equipment based on a contract that conveys control to the lessee for a period of time
- ASU 2016-02 does not apply to:
 - Leases of intangible assets
 - Leases to explore for or use minerals, oil, natural gas, timber, and similar resources
 - Leases of inventory or assets under construction

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ASC 842 – Overview

Determine Lease Population

- Getting a complete population of leases may not be an easy task! Start early!
- Scan general ledger detail for any recurring payments
 - Includes those that are a set recurring amount, OR
 - Consider those that also have variable payments (e.g., common area maintenance)
- Talk to other departments – facilities, IT, other offices
- Organizations may have more leasing transactions than were identified under ASC 840

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Polling Question 2

Where are you in the lease implementation process?

- Haven't thought about it until now
- Have started to determine lease population
- Have begun the initial calculations
- We've fully implemented!

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Key Decisions Upon Implementation

Leases – Effective Date

Nonprofit Organizations

- Fiscal years beginning after December 15, 2021 (calendar year 2022; fiscal year 2023)
- If the organization has conduit debt or securities that are traded, listed, or quoted on an exchange or an over-the-counter market and have not issued their December 31, 2019 financial statements, fiscal years beginning after December 15, 2019 (calendar year 2020; fiscal year 2021)

Early Application

- Permitted for all organizations

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Key Decision #1 – Determine Your Transition Method

Modified Retrospective Approach

- Restate prior periods in comparative financial statements

Adoption Date Approach

- 842 for current year and 840 for prior year (disclosure for both ASC topics required)

- Who is using the financial statements?
- Will not issuing comparative approaches confuse the readers?
- Will adjusting the prior period have additional ramifications?

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Key Decision #2 – Short-term Leases Accounting Policy Election

- Definition – 842-20-10 – 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
 - Remember what defines the lease term
 - Election is to be made by class of underlying asset
- Adopting this policy election often leads to a simpler implementation

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Key Decision #3 – Identify and Elect a Policy for Lease Components

Components are items or activities that transfer a good or service to the lessee.

Lease Components	Nonlease Components	Not a Separate Component
<ul style="list-style-type: none"> • The right to use an asset • If multiple assets, each underlying asset should be a separate lease component when both of the following criteria are met: <ul style="list-style-type: none"> • The lessee can benefit from the right of use either on its own or together with other resources that are readily available to the lessee • The right of use is neither highly dependent on nor highly interrelated with the other right to use underlying assets in the contract 	<ul style="list-style-type: none"> • Lessor-provided services • Examples: <ul style="list-style-type: none"> • Service contracts for leased assets (e.g., maintenance, supply of utilities) • Common area maintenance 	<ul style="list-style-type: none"> • Items that do not transfer goods or services to the lessee • Examples: <ul style="list-style-type: none"> • Administrative tasks to set up a contract or initiate the lease • Reimbursement or payment of the lessor's costs

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Key Decision #3 – Identify and Elect a Policy for Lease Components

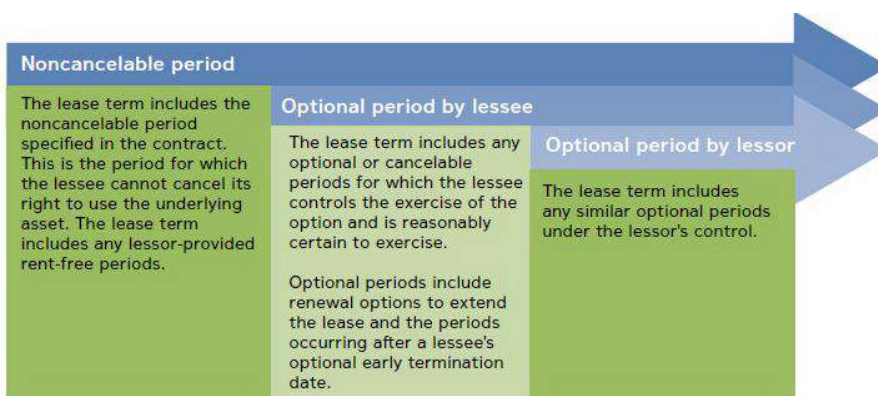
Lessees can make an accounting policy election by class of underlying asset to treat both lease and nonlease elements as a single lease component.

- Effects of adopting this policy:
 - Easier implementation (less administrative work)
 - Larger asset and liability
- **BE AWARE!**
 - Embedded leases – a component within a contract that provides for the use and control of a particular asset by the user

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Key Decision #4 – Determine the Lease Term

This decision must be made for each lease.



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Key Decision #4 – Determine the Lease Term

Factors to consider for determination of “reasonably certain to exercise” —

- The pricing of the lease renewal option vs. other viable options
- The importance of the leased asset to the organization’s operations
- The organization’s ability to continue to make the required payments on the lease

Impact: The longer the lease term, the larger the right-of-use (ROU) asset and liability.

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Key Decision #5 – Determine the Discount Rate

- The discount rate for the lease initially used to determine the present value of the lease payments for a lessee is calculated on the basis of information available at the commencement date. (FASB ASC 842-20-30-2)
- A lessee should use the rate implicit in the lease whenever that rate is readily determinable. If the rate implicit in the lease is not readily determinable, a lessee uses its incremental borrowing rate (FASB ASC 842-20-30-3) unless it elects to use the risk-free rate.
 - Secured rate, over a period comparable with that of the lease term

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Key Decision #5 – Determine the Discount Rate

- Amended with ASU 2021-09 – can elect to use a risk-free discount rate by class of underlying asset.
- The risk-free rate should be determined using a period comparable to that of the lease term.
- Impact: This election would typically have the effect of a higher ROU asset and liability. However, this election simplifies the calculation of the discount rate.

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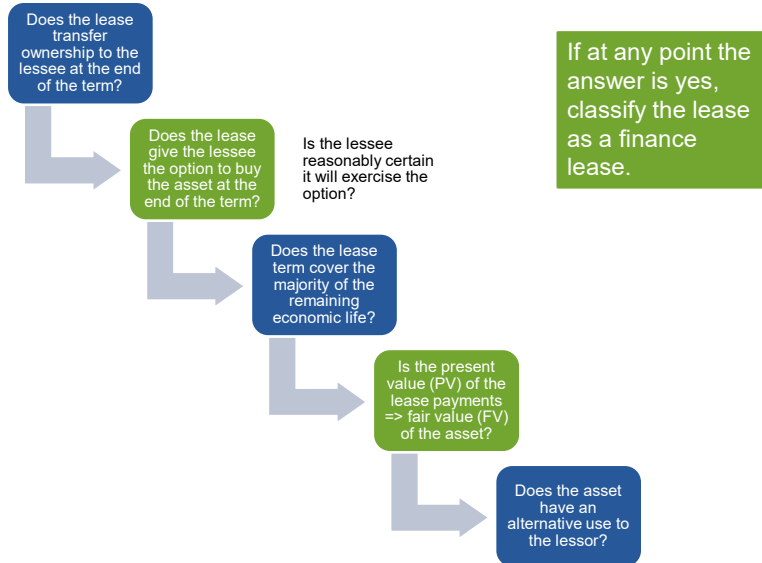
Polling Question 3

How many leases do you have that will be subject to ASC 842?

- Fewer than 5
- Between 5 – 15
- More than 15

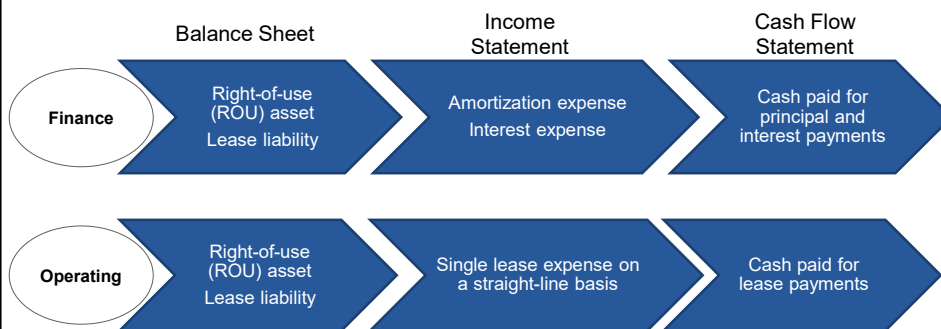
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Key Decision #6 – Financing or Operating Lease




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Key Decision #6 – Financing or Operating Lease



Operating Lease: From the perspective of the lessor, any lease that is not a financing lease.



Practical Expedients

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Practical Expedients

Package

ASC 842-10-65-1: Lessee may elect to apply the following transition reliefs for leases commenced before the standard's effective date. However, they must be elected as a package and apply to all leases:

- Lessee need not reassess whether any expired or existing contracts are or contain leases
- Lessee need not reassess the lease classification for any existing or expired leases
- Lessee need not reassess initial direct costs for any existing leases (whether those costs would have qualified for capitalization under the new lease accounting standard)

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Practical Expedients

Hindsight

ASC 842-10-65-1: Can be elected (or not elected) separately from the package of expedients

- Lessee **uses hindsight** with respect to lease renewals and purchase options when determining the lease term
- Lessee **uses hindsight** in assessing impairment of a ROU asset

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Practical Expedients

Short-Term Accounting Policy Election

Elect by class of underlying asset to not record leases with a term of 12 or fewer months on the SFP.

Easements

ASC 842-10-65-1: Lessee may elect to not assess whether **existing or expired land easements** that were not previously accounted for under Topic 840 are or contain a lease under Topic 842.

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Practical Expedients

Discount Rate

- Transition guidance requires organizations to determine the discount rate at the transition date (vs. the inception date of the lease). However, it does not specify...
 - Calculated based on initial term of the lease at inception, OR
 - The remaining term of the lease as of the date the organization is adopting the standard
- Once chosen, this policy must be applied consistently.

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Practical Expedients

Capitalization Policy

- Not specifically referenced or stated in the ASC
- Similar to a capitalization policy for property, plant, and equipment (PPE)
 - Used to reduce the administrative burden and cost of applying the guidance while being careful to maintain that the financial statements are not materially misstated
 - Need to consider if a cap policy for leases should be different than PPE (don't blindly accept)
 - Consider the impact on the financial statement (FS) and ultimately the user's interpretation of the FS
 - Any covenants or ratios that will be impacted?
 - By setting a certain threshold, will the FS still be materially misstated in the aggregate?

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Implementation Considerations

Operating Leases

- If the lease agreement includes escalating lease payments, ROU assets and lease liabilities will not agree upon implementation
- Consider if there is a deferred rent liability recorded under prior guidance to debit upon implementation

Financing Leases

- All existing capital leases will be reported as financing leases under the new standard
- Recognize a ROU asset and lease liability in transition at their existing carrying amounts as lease assets and capital lease obligations, respectively

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Applying the Implementation Guidance for
Operating and Financing Leases AND Illustrating
the Initial and Subsequent Journal Entries

Applying the Guidance

- Switch to Excel files!

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Polling Question 4

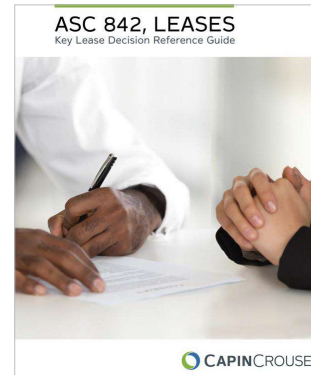
After attending this webcast, what do you feel about implementing ASC 842?

- Like a deer in the headlights
- More prepared, but still uncertain
- A quiet confidence
- Oh, I'm ready!

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CapinCrouse Lease Toolkit

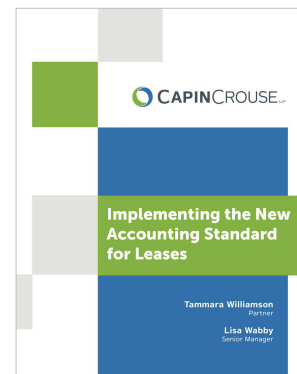
- Designed to help your organization implement the new lease standard efficiently and effectively
- Access your free copy at capincrouse.com/new-lease-toolkit



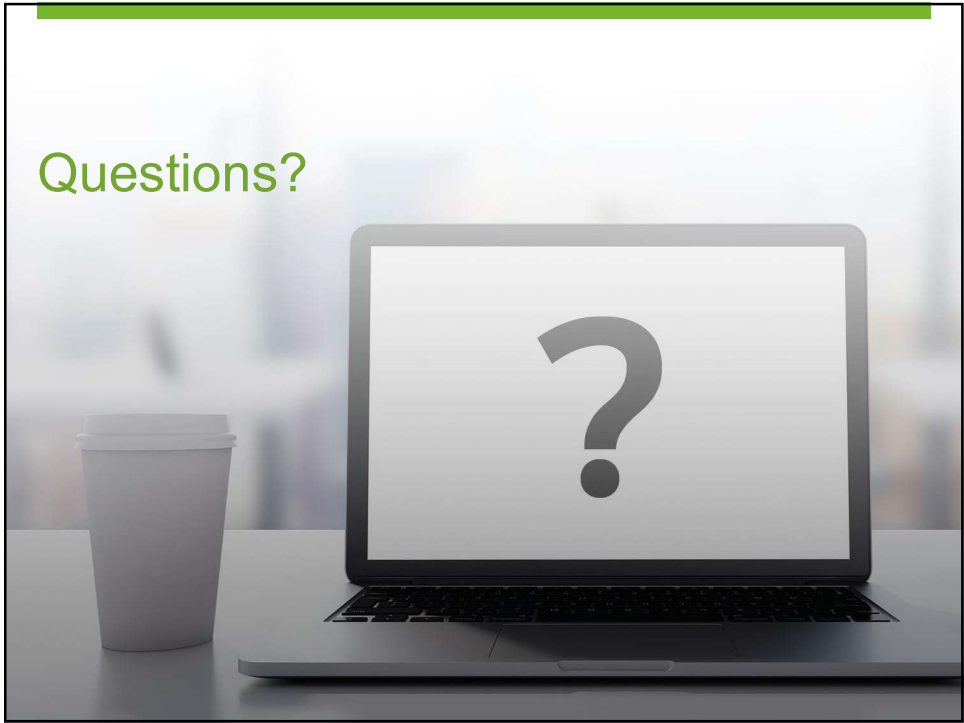
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CapinCrouse Lease Implementation Articles

- Series of four articles to walk you through the steps in the Key Lease Decision Reference Guide
- Important action steps and quick tips to help you adopt the new standard efficiently and effectively
- Access your free copy at capincrouse.com/lease-accounting



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Thank you.

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