

ASC 842, Lease Implementation

**KNOW
GREATER
VALUE**

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Agenda

- Overview & Key Concepts - ASC 842
- Accounting Implications
- Examples
- Adoption Challenges
- Solutions – Key Takeaways

Overview of ASC 842

- What is the purpose of ASC 842?
 - To increase transparency and comparability among organizations by requiring certain leases to be recorded on the balance sheet.
- Effective for nonpublic companies and nonprofits for fiscal years beginning after December 15, 2021 (**January 1, 2022 for calendar year filers**)
- Definition of lease – 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. Excludes:
 - Leases of intangible assets
 - Leases to explore for or use minerals, oil, natural gas, and similar nongenerative resources
 - Leases of biological assets, including plants, timber, and livestock
 - Leases of inventory
 - Leases of assets under construction, such as a building being built
 - Lessor *cannot* have a substantive right of substitution

Key Concepts

- Lease term – the non-cancellable period of the lease including:
 - Periods covered by an option to extend the lease if the lessee is reasonably certain to exercise that option
 - Periods covered by an option to terminate the lease if the lessee is reasonably certain not to exercise that option
 - Periods covered by an option to extend (or not to terminate) the lease in which an exercise of the option is controlled by the lessor
- Initial Adoption Date – Option to adopt as of 1/1/22 (effective date method) or adopt retrospectively and restate prior period (comparative method).
- Commencement Date - the date on which the underlying assets is available for use

Key Concepts

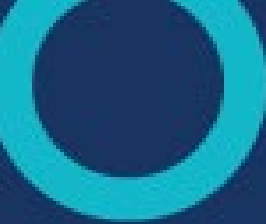
- Lease classification – Finance versus operating lease
- As of the lease commencement date, lessee recognizes (for both finance leases and operating leases):
 - Liability for its lease obligation (initially measured at present value of future lease payments)
 - Asset for its right to use the underlying asset (ROU asset)
 - Equal to the lease liability
 - Adjusted for lease payments made at or before lease commencement, lease incentives, and any initial direct costs
- Practical Expedients – numerous elections to assess (recommend you include your CPA in this assessment).

Key Concepts – Discount Rates

- For a lessee, the discount rate for the lease is the rate implicit in the lease unless the rate cannot be readily determined. In that case, the lessee is required to use its incremental borrowing rate.
 - Implicit rate – defined as the rate of interest at a given date that causes the aggregate present value of (1) the lease payments and (2) the amount that a lessor expects to derive from the underlying asset following the end of the lease term
 - Incremental borrowing rate – defined as the rate of interest that a lessee would have to pay to borrow on a collateralized basis over a similar term an amount equal to the lease payments in a similar economic environment
 - ASC 842 requires the use of a collateralized rate so a line of credit may not be appropriate for this purpose
 - Can use rate on existing debt, borrowing rate of similar entities, rate quoted by a lender, etc.
 - Risk-free rate – practical expedient for private companies. The risk-free rate is the rate of a zero-coupon U.S. Treasury instrument using a period comparable with the lease term

Accounting Implications

- Lease Inventory - Have you performed an internal lease assessment searching for embedded leases?
- Can your accountant reperform your calculation of the ROU Asset and Lease Liability?
- Are you prepared for these questions from your accounting team?
 - How did you determine the Discount rate?
 - What is the likelihood you will exercise renewal options?
 - What practical expedient elections have you made?
 - Have you determined the proper classification of your leases (finance vs operating)?
 - If you have subleases, is an impairment analysis necessary?
- Disclosure requirements – NEW required disclosures regarding leases



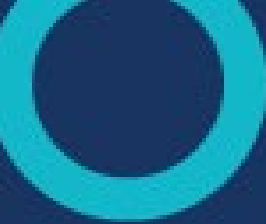
Example – Financial Statement Presentation

Operating Lease Under 840 = Office

	12/31/19	12/31/20
Balance Sheet		
Assets		
{none}		
<hr/>		
Liabilities		
Deferred Rent	\$1,238	\$2,200
<hr/>		
Income Statement		
Operating Lease Expense	\$12,238	\$12,238

Operating Lease Under 842 = Office

	12/31/19	12/31/20
Discount Rate		4.20%
<hr/>		
Balance Sheet		
Assets		
ROU Asset	\$90,960	\$82,430
<hr/>		
Liabilities		
ST Lease Liability - Operating	\$7,567	\$8,172
LT Lease Liability - Operating	\$84,630	\$76,459
	<u>\$92,197</u>	<u>\$84,630</u>
<hr/>		
Income Statement		
Operating Lease Expense	\$12,238	\$12,238



Example – Quantitative Disclosure

	Year Ending December 31,	
	20X2	20X1
Other information		
(Gains) and losses on sale and leaseback transactions, net	\$(XXX)	\$XXX
Cash paid for amounts included in the measurement of lease liabilities	XXX	XXX
Operating cash flows from finance leases	XXX	XXX
Operating cash flows from operating leases	XXX	XXX
Financing cash flows from finance leases	XXX	XXX
Right-of-use assets obtained in exchange for new finance lease liabilities	XXX	XXX
Right-of-use assets obtained in exchange for new operating lease liabilities	XXX	XXX
Weighted-average remaining lease term—finance leases	X.X years	X.X years
Weighted-average remaining lease term—operating leases	X.X years	X.X years
Weighted-average discount rate—finance leases	X.X%	X.X%
Weighted-average discount rate—operating leases	X.X%	X.X%

>>> Example 6 – Lessee Quantitative Disclosure Requirements in Paragraph 842-20-50-4

55-53 The following Example illustrates how a lessee may meet the quantitative disclosure requirements in paragraph 842-20-50-4.

	Year Ending December 31,	
	20X2	20X1
Lease cost		
Finance lease cost:	\$XXX	\$XXX
Amortization of right-of-use assets	XXX	XXX
Interest on lease liabilities	XXX	XXX
Operating lease cost	XXX	XXX
Short-term lease cost	XXX	XXX
Variable lease cost	XXX	XXX
Sublease income	(XXX)	(XXX)
Total lease cost	\$XXX	\$XXX

Adoption Challenges

- Identifying all leases including embedded leases
- Understand practical expedient options and account policies to ensure proper elections are made
- Identifying and extracting all relevant lease data which includes but is not limited too, lease payments, lease incentives, deferred rent, prepaid rent, initial direct costs, discount rates, renewal options, termination options, etc. Some leases are quite complex and the gathering of correct data may be time consuming.
- Who will enter leases, who will approve them, how can you ensure these new accounting entries will remain accurate (new internal control function).

Solutions

- PKFOD can assist with ASC 842 in the form of three options:
 - Option 1 – Fully outsource the function to PKFOD (we will analysis your leases, input them into our software, and provide you with access to the platform to download results)
 - Option 2 – Self service. We will provide you with access to our software to input the information yourself.
 - Option 3 – Self service with consulting. We can provide technical accounting consulting services on an hourly basis as needed.

Final Takeaway

- Start NOW. Most companies are looking to get the work completed by Q3 2022. Waiting until Q4 2022 or Q1 2023 will cause a significant amount of work to be consolidated around an already busy time.
- Create an inventory of your leases - How many leases do I have, where is the information located, do I have complete information?
- Evaluated technological need – Do you have a significant number of leases, are they complex, could the process be simplified by utilizing a software or outsourcing it?
- Select a solution – demo solutions and decide which best fits your organizations needs.
- Implement and validate the data – input all leases into your selected solution and review to ensure accuracy.

