



PRACTICAL TIPS FOR IMPLEMENTING THE NEW LEASE ACCOUNTING STANDARD

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1. Overview of Accounting Changes

2. Practical Tips



1. OVERVIEW OF ACCOUNTING CHANGES

LESSEES

Most leases on balance sheet

Two types:

- Finance
- Operating

Recognize a right to use asset and lease liability

Income statement recognition pattern will depend on lease type

LESSORS

Similar to ASC 840

Three types:

- Operating
- Direct finance
- Sales-type

Initial selling profit deferred if lessor does not transfer control

Leveraged lease model is eliminated

ASC 842 and IFRS 16 not converged

SCOPE & DEFINITION

Scope applies to all leases except those related to:

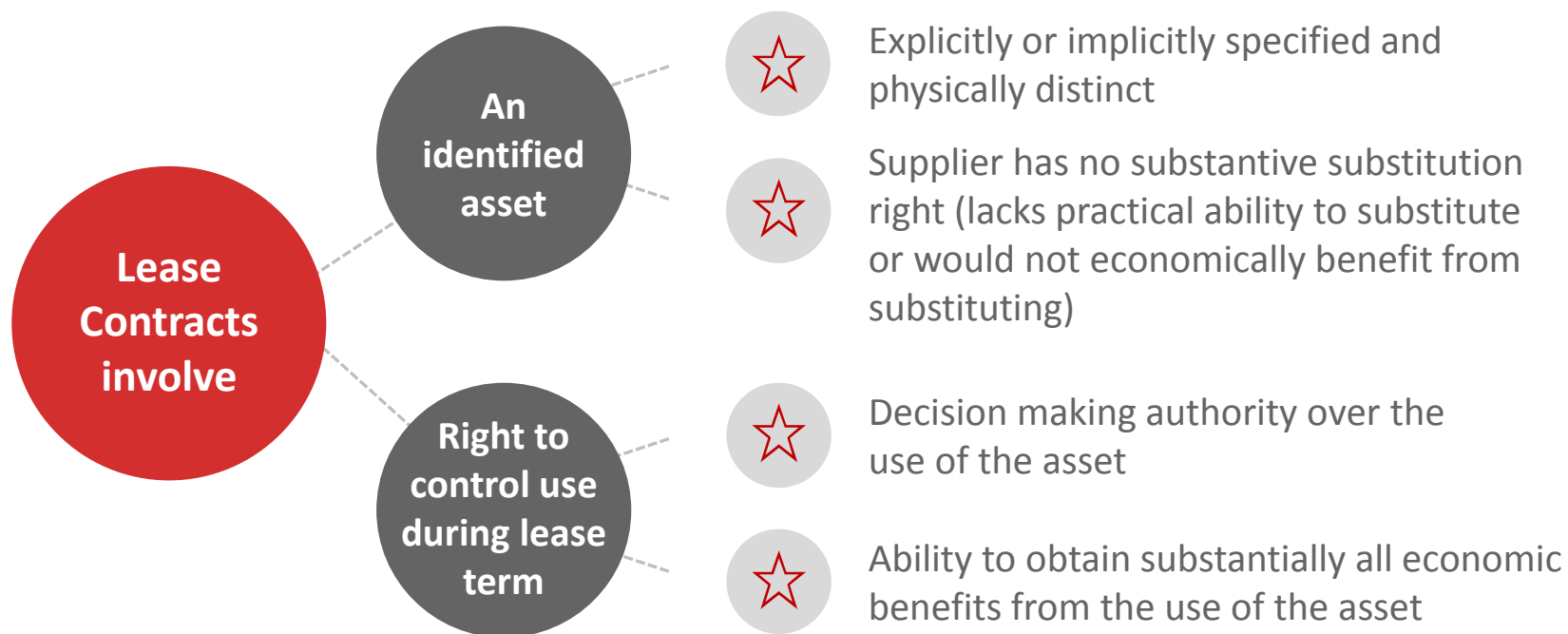
- Intangible assets
- Natural resources
- Biological assets
- Inventory
- Assets under construction

A lease is defined as a contract that conveys the right to use an asset for a period of time in exchange for consideration.

SHORT TERM LEASES

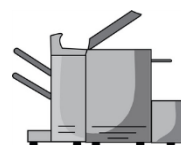
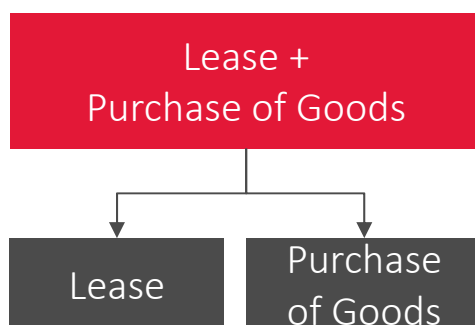
- Accounting policy election
- Similar to current operating leases
- Term of twelve months or less, determined consistent with other leases
 - Lease term would include periods covered by renewal options that are reasonably certain to be exercised
 - Also would include periods covered by termination options that a lessee is reasonably certain NOT to exercise

IDENTIFYING A LEASE



SEPARATING LEASE & NON-LEASE COMPONENTS

- Separating lease from non-lease components – based on relative standalone price of components (lessee).



Example: Copier and a service agreement

Practical Expedient – accounting policy election to account for entire contract as a lease (*MAY BE available to both lessee and lessor)

NOTE: Activities/costs that do not transfer a good or service are NOT components of a contract and receive no allocation of the consideration.

SEPARATING LEASE & NON-LEASE COMPONENTS – CON'T

Rights to Use Multiple Assets.
Assets are separate leases if:

Lessee can
benefit from
the use of the
asset on its
own

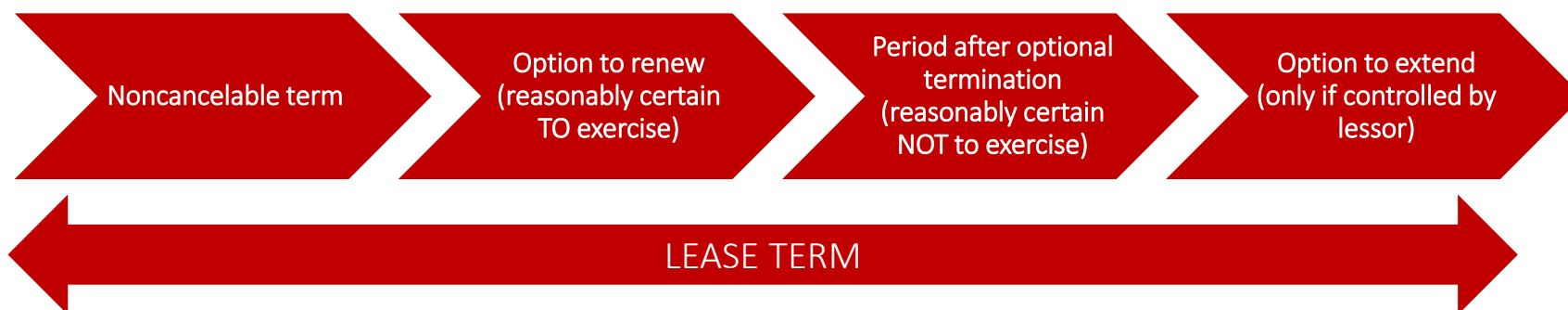
The underlying
asset is neither
dependent on,
nor highly
interrelated
with,
the other
assets

Example:
Warehouse and
a parking lot



LEASE TERM

Determined at the lease commencement date and based on the noncancelable term of the lease, together with the following:



Lease term determination should remain mostly unchanged from current GAAP.

Reasonably Certain = Reasonably Assured

CALCULATING THE LEASE LIABILITY

The present value of unpaid lease payments, measured at the commencement date

Discount rate

- Implicit rate in the lease
- Incremental borrowing rate
- Risk-free rate (non-PBEs)

INCLUDE

- Fixed lease payments, less any lease incentives
- Variable lease payments that depend on an index or a rate
- In-substance fixed lease payments structured as variable payments

LESS

- Lessor-provided incentives
- The exercise price of a purchase option if the lessee is reasonably certain to exercise that purchase option
- Payments for penalties for terminating a lease (if term reflects termination option exercise)
- Amounts expected to be payable under residual value guarantees (“probable”)

REASSESSMENT

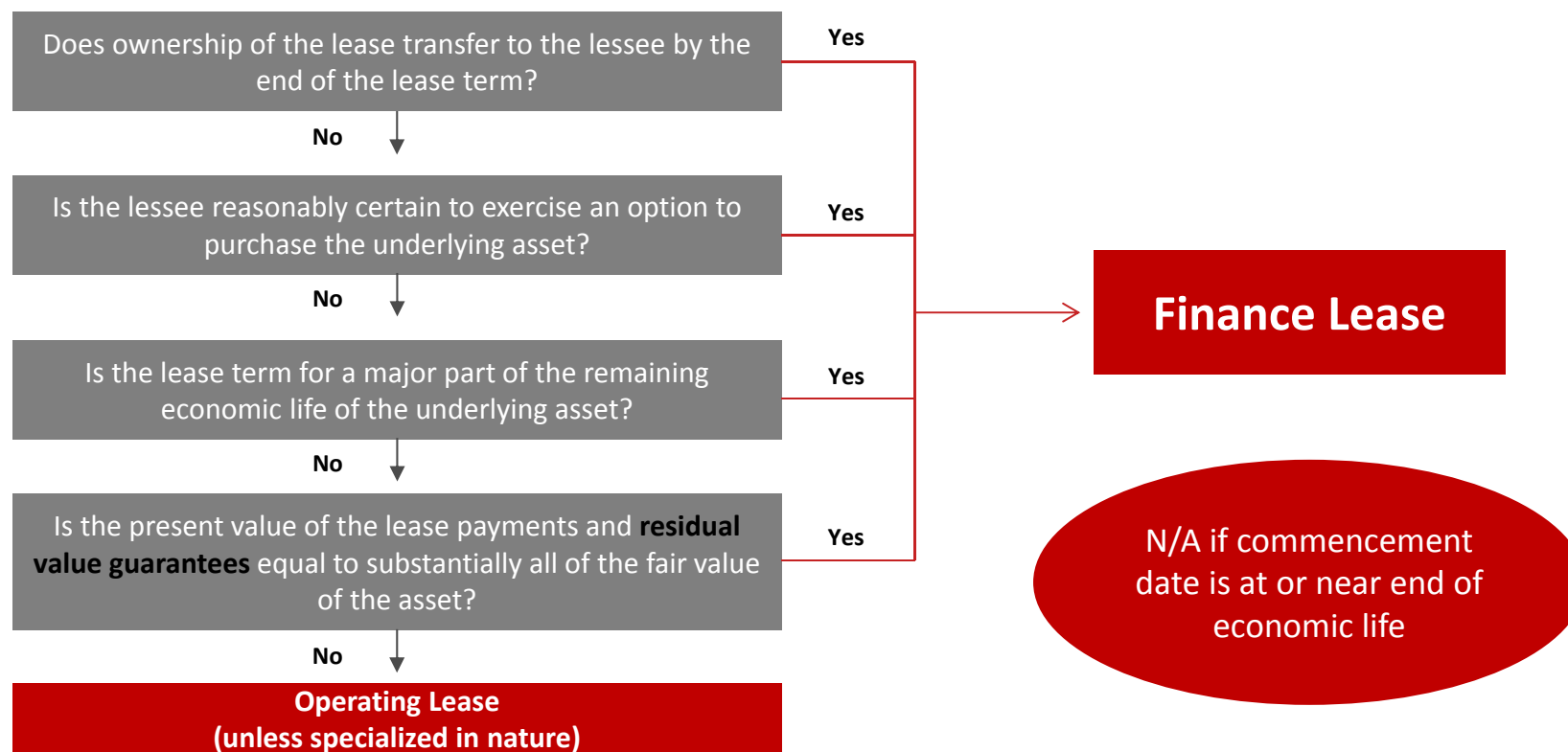
LESSEES

- Required to remeasure lease payments in certain circumstances
 - Lease term or purchase option reassessment
 - Resolution of contingencies
 - Change in amounts probable of being paid under Residual Value Guarantee (RVG)
- Variable lease payments based on rate or index would need to be remeasured
- Updated discount rate and classification
- Adjust Right of Use (ROU) asset until reduced to zero, then P&L

LESSORS

- Not permitted to reassess lease term, variable rent or discount rate
- Reassess only on modification (ex: extending lease term) – use updated assumptions at date of modification

LEASE CLASSIFICATION (LESSEE)

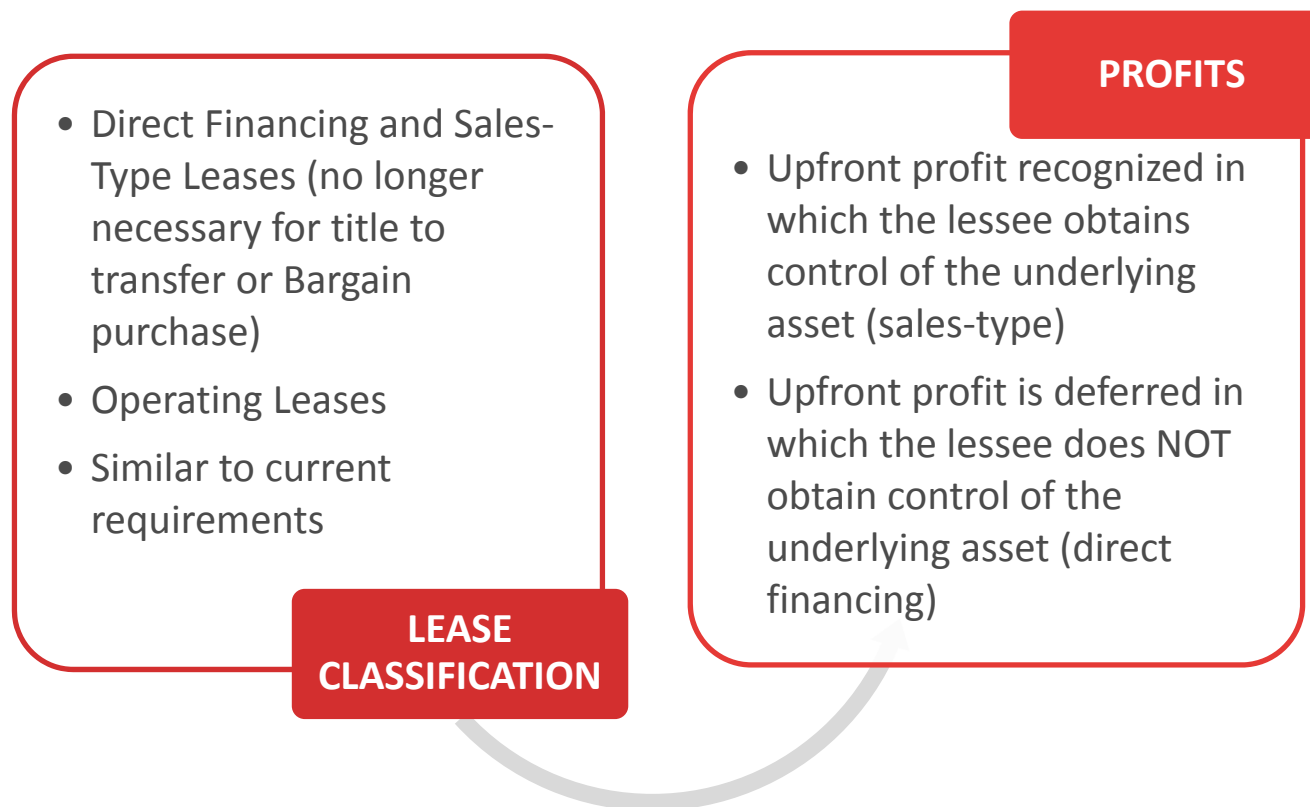


LESSOR ACCOUNTING

Lessor accounting is mostly unchanged from current GAAP, except:

- Definition of initial direct costs
- Alignment with ASC606 (new rev rec guidance), especially for sale/leasebacks
- No differentiation between leases of real estate and other assets

LESSOR MODEL



EFFECTIVE DATE & TRANSITION



Companies with calendar year-ends will need to adopt on or before January 1, 2019, while U.S. private companies are allowed a year deferral.

Optional practical expedients – all or nothing:

- Identifying leases
- Lease classification
- Initial direct costs

Use of hindsight (lease renewals and purchase options)

Easements

Retrospective Transition (*FASB finalizing option for cumulative effect at date of adoption)



2. TEN PRACTICAL TIPS

1. HAVE A PLAN & STICK TO IT, REASSESS AS NECESSARY



- Stakeholder alignment on objectives
- Identify and scope lease agreements
- Sample lease agreement review
- Disclosure and transition evaluation
- Gap analysis

- Draft accounting policies
- Transition method and disclosure analysis
- Draft business requirements for software selection
- Finalize data requirements
- Develop data gathering approach and initiate data collection process

- Application development and build out
- Data import into application
- Integration tests and UAT signoff
- Updated procedures and controls
- Cumulative adjustment calculation

PROJECT MANAGEMENT | TRAINING & CHANGE MANAGEMENT | CROSS-FUNCTIONAL COORDINATION

2. GATHER THE RIGHT STAKEHOLDERS



Accounting & Finance

- Financial statements
- Governance
- Tax, FP&A and internal audit

HR

- Policies and procedures
- Organizational design

Assets & Facilities

- Equipment
- Buildings
- Lease contract management & administration

Procurement & Sourcing

- Acquisition of new leases

Sales & Marketing

- Negotiations
- Close processes

IT

- Systems
- Data and integrations

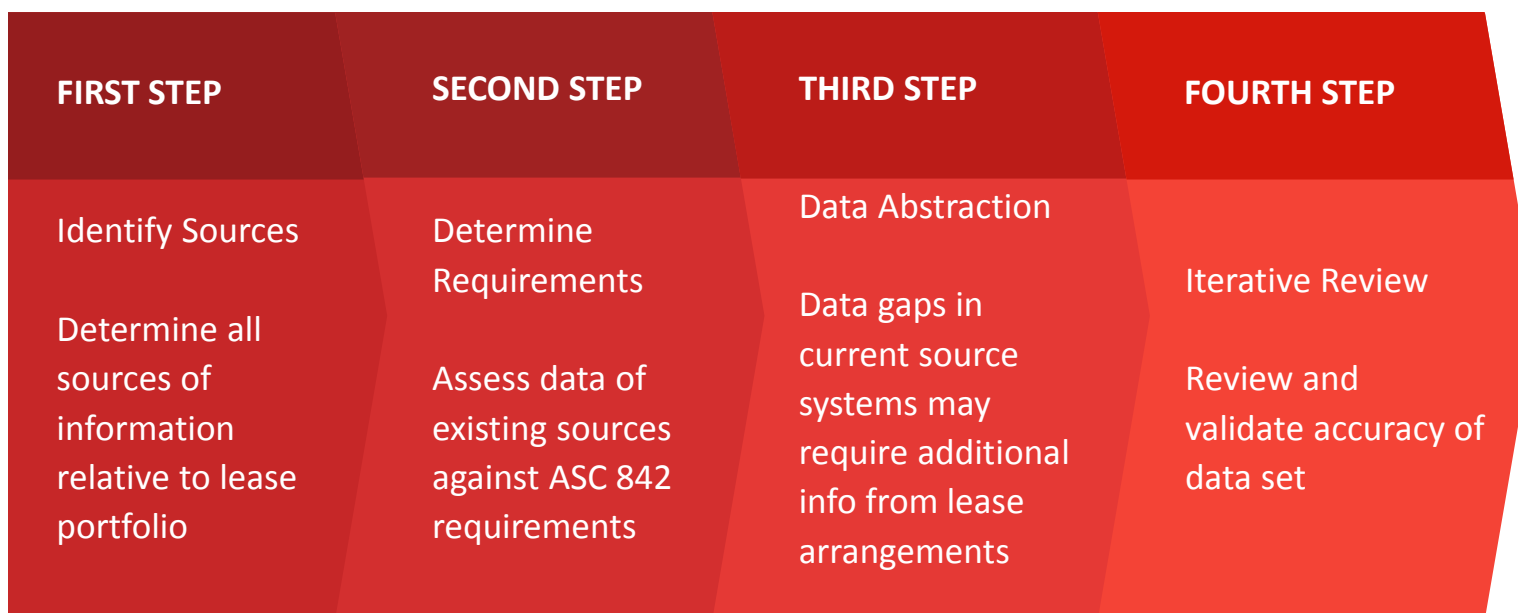
Real Estate

- Lessees/lessors

Legal

- Lease review and approval

3. DATA GATHERING WILL TAKE MORE TIME THAN YOU THINK



3. DATA GATHERING WILL TAKE MORE TIME THAN YOU THINK – CON'T

CHALLENGES:

- Completeness
- Amendments/Modifications
- Location/form
- Language
- Accuracy of data in systems
- Most cost-effective way to abstract (AI?)
- Structured vs unstructured
- Not all data comes from the contract
- Which fields are necessary (prioritize)
- Scoping – embedded leases
- Materiality

4. DEFINE YOUR REQUIREMENTS BEFORE SELECTING SOFTWARE

- Lessor/Lessee
- Equipment vs. Real Estate
- Accounting (ASC 842/ IFRS 16) vs. life cycle management
- Subledger / single source of truth
- Size of portfolio and cost (licensing and implementation)
- Cloud vs on-prem
- Integration with other systems (ERP and legacy)
- Vendor presence and stability
- Potential independence concerns
- Detail level
- Upload capability
- Potential ROI

Participation of
all stakeholders

Define transaction
use cases to
evaluate systems

5. YOUR PROJECT MAY COST MORE AND TAKE LONGER THAN YOU EXPECT

- Allow time for negotiating contracts (software, service providers)
- Auditor response time or change in position
- Documents off-site or in storage
- Number of leases often underestimated
- Numerous assets per lease
- Try to get budget approval for the whole project
- Don't skimp on project and change management – dedicated resources are best
- Unforeseen staff issues
- Data gathering & policy decisions – determination of incremental borrowing rate

6. THIS COULD GET POLITICAL

- Many stakeholders involved in the leasing process (cross-organizational)
- Executive support is critical for allocations of internal and external resources
- Ensure you know who makes the ultimate decision on policy issues, software and advisor selection, and process/roles
- Change management through communication and training

7. YOU MIGHT FIND ERRORS

- Evaluation of materiality (qualitative too – other regulatory?)
- Discussion with auditors
- Could affect practical expedient election on transition

8. CHOOSE POLICY & IMPLEMENTATION DECISIONS CAREFULLY

- Accounting policy will be different for US GAAP vs IFRS – try to minimize differences where possible
- Materiality
- Implementation date
- Portfolio approach
- Practical expedients: Short-terms leases, separation of lease/non-lease, use of hindsight, package of transition expedients
- Software implementation decisions:
 - Integration with AP (load embedded leases? Payment timing? Reconciling)
 - One or more software solutions, or more than one instance
 - Immaterial?
 - Short-term leases

9. CONSIDER OTHER IMPACTS

- EBITDA
- Debt covenants
- Executive compensation
- Statutory/tax

10. OPERATIONALIZE FOR DAY 2

- Clearly define process and responsibilities for ownership
- Introduce control without crippling the business (Center of Excellence)
- Consider lease/buy strategy
- Continue automation journey
- Outsourcing?

QUESTIONS?

Thank you



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