

Implementing ASC 842

Lease Accounting Basics,
Impacts, & Adoption Tips

Presenters



FRANK BALESTRERI

» Partner

With almost 30 years of experience, Audit & Consulting Partner, Frank Balestreri, specializes in serving private and public clients in the retail, consumer products, manufacturing, distribution, energy and alternative energy industries. Frank has significant experience with both primary and secondary equity offerings, debt offerings, private placements, consolidations, internal controls, and SEC reporting. He has consulted on business combinations, divestitures, impairments and revenue recognition.



KEVIN SHIVES

» Partner

Kevin has over 25 years of experience helping clients optimize their people, processes and systems for competitive advantage. Prior to joining SSF, Kevin has held senior finance and management positions in multiple companies in the SF Bay Area. In his current role as Technology Partner, he works with clients to develop highly effective and cost-efficient corporate governance, internal audit, Sarbanes-Oxley (SOX), accounting systems and process optimization solutions.

Presenter



JOE BRUNEL

» Sr. Manager, Audit

With over 15 years of experience, Senior Audit Manager Joe Brunel specializes in delivering financial statement audit and review services for privately-held businesses. His expertise includes limited scope audit services related to employee benefit plans including 401(k), 401(a), 403(b), and full scope audit services for ESOP plans. He has worked extensively in the manufacturing, distribution, and construction industries.

Guest Presenter



LEASECRUNCH

JESS VENTO

» Senior Director of Accounting | Client Success

Jess has a knack for operations, process improvement, and helping her staff exceed expectations. Jess has an MBA in Leadership and Management and a BA in Accounting, both from Ottawa University's Brookfield, WI campus. Jess' varied professional experience includes working for companies like US Bank, Harley-Davidson Motor Company, Burke Properties, and Founders 3 Real Estate Services. She has spent the last few years working directly with clients to meet and exceed their goals while leading a large accounting team.

At LeaseCrunch, she serves as the go to resource for CPA firms, coordinating what they need to successfully implement the new lease standard and adopt lease accounting software. Jess has been President of the Accounting & Financial Women's Alliance (AFWA) Milwaukee Chapter where she is still a member and is also a member of TEMPO Milwaukee's Emerging Women Leaders group.

In her free time, she enjoys live music of her husband's band, helping out her daughter's sports teams and improving her golf game.

Firm Overview



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Audit • Assurance • SOX Compliance
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TECHNOLOGY CONSULTING

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- » US & International Clients
- » Thousands of hours dedicated to community service each year
- » Five locations throughout California



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LEASERUNCH

Agenda



- Key Definitions
- Lease Accounting Overview
- Adoption Requirements & Considerations
- Six Steps to Success
- Demo of LeaseCrunch
- Q&A

Key Definitions

Finance Lease: A lease that meets one or more criteria in paragraph 842-10-25-2 (Think capital lease)

- Ownership Transfer
- Option to purchase
- PV of payments plus residual is substantially FV
- Lease term for “major part” of asset life
- Specialized nature – no alternative use

Operating Lease: Any lease other than a financing lease

Commencement Date: Date on which the underlying asset is available for use

Economic Life: The period that the asset is expected to be economically usable by one or more users

Key Definitions

Lease Term: Noncancellable period where the lessee has the right to use the asset, including:

- Option periods if they are reasonably certain to exercise
- Option periods to terminate if it is reasonably certain to NOT exercise
- Option periods to extend or terminate where the decision is held by the lessor

Discount Rate for the Lease Liability:

- The rate implicit in the lease unless indeterminable
- Incremental borrowing rate
- *For private companies, policy election to use the risk-free rate*

Incremental Borrowing Rate: Rate of interest a lessee would have to pay to borrow

Key Definitions

Right of Use Asset (ROU): An asset that represents the Lessee's right to use the underlying asset for the lease term

Initial Direct Costs: Incremental costs that would not have been incurred if you didn't enter the lease (commissions, architect fees)

Residual Value Guarantee: Guarantee of value made to the lessor at the end of the lease term

Lease Liability: Obligation to make required payments and reasonably certain extension options

Lease Modification: Change to the terms and conditions that results in a change in scope or the consideration for a lease

Short-term Lease: A lease that at the commencement date has a lease terms of 12 months or less and does not include an option to purchase the assets that the lessee is reasonably expected to exercise

Lease Accounting Overview

EFFECTIVE DATE	
Public and international companies: FISCAL YEAR AFTER DEC. 15, 2018	Private organizations: FISCAL YEAR AFTER DEC. 15, 2021

- ASC 842 replaces ASC 840
- In ASC 840, capital leases were recorded on the balance sheet, while operating leases were disclosed as a footnote in financial statements. These “Off – Balance Sheet” operating leases were thereby excluded from important financial ratios that would allow stakeholders to evaluate a company’s performance
- The goal of ASC 842 is to overcome this blind spot and provide increased visibility into leasing obligations on financial statements

Adoption Requirements

- Lease policies and practical expedients are selected and disclosed in the footnotes
- Right of use asset and lease liability are computed and recorded on the balance sheet using a discounted present value
- Operating and Financing leases are to be reported separately on the balance sheet and in the footnote disclosures
- Select an adoption reporting method
 - **Effective date method:** Comparative periods are unchanged (Retrospective application at the beginning of the period of adoption)
 - **Comparative method:** The earliest comparative period is restated (Retrospective application to each prior period presented)

Things to Consider

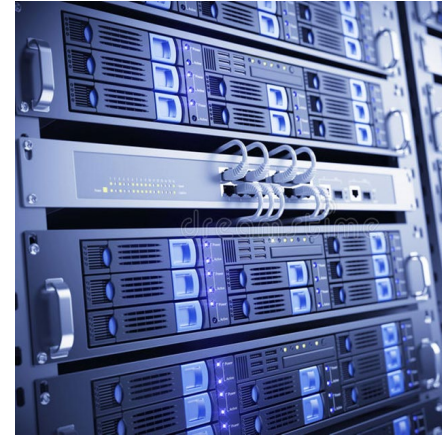
New standards are challenging to adopt.

- Companies will need to address policies, procedures and internal controls
- Variable and embedded leases will pose a challenge
- Incorrect assessment of contract terms for lease qualification
- Incomplete or inaccurate financial statement presentation and disclosure
- Updated GL chart of accounts
- Potential impact to loan covenants
- Avoid the Excel pitfall
- *And because this is a multi-step process, errors early on will compound*

What is a Lease Under ASC 842?

Lessee must have the **right to control** the use of the asset.

- Control exists if you have both of the following:
 - Right to obtain substantially all the economic benefits through the agreement term
 - Right to direct the use of the **identified asset**
- Lessor does not have substantial substitution rights
- Must be a physical asset explicitly or implicitly identified





Six Steps to Success

1. Review Your General Ledger Accounts

Look specifically for fixed recurring and variable payments for existing leases and other contracts, which may have embedded leases under the new standard.

Embedded leases are determined by the lessee's use and control over any identified assets in the agreement. The most common embedded lease is typically within an IT service contract if it specifies underlying hardware that may be included.

2. Inventory Contracts: Review Key Terms & Payments

Create an inventory of your contracts and review key information in those contracts, including:

- Fixed payments
- Indexed payments
- Renewal options
- Residual guarantees
- Initial direct costs
- Lease incentives
- Options to purchase

In addition, payments to the lessor may include fixed non-lease payments such as insurance, maintenance, and taxes. There is a policy election that allows these costs to be included should a company desire to do so.

3. Separate Fixed and Variable Payments

Fixed lease payments are those recurring payments that are the same amount each month, including payments with a fixed percentage increase based on specified dates or anniversaries.

In contrast, a payment based on an unknown future rate such as the CPI index or lessee's sales are considered variable. These are treated differently under the new standard.

4. Consider Policy Elections & the Election of Practical Expedients

Policy Election Options:

- Combine fixed lease and non-lease payments
- Use the risk-free interest rate to avoid determining the discounted rate
- Exclude leases with payments of twelve months or less
- Apply the same discount rate to a class of assets or assets with a similar lease term

4. Consider Policy Elections & the Election of Practical Expedients (continued):

Practical Expedients Options:

- Must elect as a group
- Not to reassess expired or existing contracts that contain leases under ASC 842
- Not to reassess operating and capital leases under ASC 840 that will be operating and financing leases under ASC 842
- Not reassess initial direct costs for existing leases

Separate Election

- May elect to use hindsight to reassess leases for determining the lease term, purchase options, and termination payment

5. Evaluate Contracts to Determine Financing Lease Vs. Operating Lease Classification

Financing Lease

- Transfers ownership to the lessee
- The purchase option is reasonably sure to be exercised
- The lease term is the major part of the economic life of the asset
- The present value of the lease payments and residual value is substantially all the asset fair value
- The asset is specialized in nature for the lessee and has no alternative use

Operating Lease

- Ownership stays with the lessor
- There is no option to purchase the asset
- The lease term is not a major part of the asset's economic life
- The value of the lease payments does not equal or exceed the fair value of the underlying asset
- The asset is not so specialized to only have use for the lessee

6. Evaluate Financial Statement Adoption Options

Effective Date Method – The comparative reporting period is unchanged, and any cumulative effect is applied at the beginning of the adoption period. This eliminates the need to restate the prior period presented

Comparative Method – The earliest period presented is restated at the beginning of the period

Our Offering & Approach

We provide a scaled approach to meet our clients lease accounting needs. From consulting and guidance to fully outsourced lease accounting implementation and administration—and everything in between.



Assessment, Planning & Support Services

We help develop an effective implementation plan, including practical expedients, to meet new requirements now and in the future.



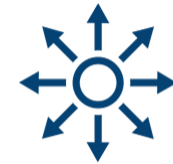
Financial Reporting

We help the clients team optimize the time-consuming and complex work needed to gather and analyze the lease data required for effective financial reporting.



Software Implementation

Our consultants help streamline, simplify and automate compliance by implementing a lease accounting solution for adoption and ongoing administration and reporting.



Full Outsourced Administration

Eliminate the burden on staff and management with fully outsourced lease compliance and administration.



LeaseCrunch Demo

Recap

- ASC 842 is effective beginning January 1, 2022, for calendar year-end private companies and nonprofits
- Focus on the six steps
 - Review your GL accounts
 - Inventory your contracts
 - Separate fixed and variable payments
 - Consider policy elections and practical expedients
 - Evaluate the classification – Finance or Operating
 - Choose implementation method
- Reach out with questions, or if you need support, etc.
www.ssfilp.com/lease-accounting-advisory

Topics for our next webinars

- Lease modifications
- Sale/leaseback accounting
- Practical expedients
- Transition guidance
- Lessor accounting

Chat in additional topics you would like us to cover related to ASC 842



Questions?

Thank You!

For questions, contact us:

Frank Balestreri | (925) 726-9030 | fbalestreri@ssfllp.com

Kevin Shives | (408) 673-2996 | kshives@ssfllp.com

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