

# Lease Accounting Basics for Growing Manufacturers

ASC 842 Implementation & Adoption Tips



**WHEREFOUR**<sup>TM</sup>

# Host



Wherefour was started in 2015 by a team with consulting expertise with CPG companies. We saw the trend of recalls and increasing compliance regulations around "traceability" and realized that existing tools were lacking in capability.

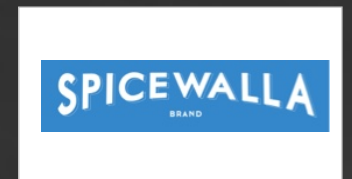
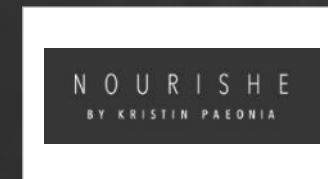
Today, Wherefour's platform is used by companies in 5 countries that make or distribute products in industries such as food, beverage, cannabis, cosmetics, personal care, textiles, machine parts, and natural products.

Wherefour is headquartered in Petaluma, California, with staff in the USA and Canada.



**MATT BROWN**  
CEO, Wherefour, Inc.

## EXAMPLE CUSTOMERS:



# Guest Presenters

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## FRANK BALESTRERI

» Partner, SSF Consulting

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 BURKE

» Sr. Manager, Consulting

With over 25 years of experience, Senior Internal Audit Manager Kevin Burke specializes in Sarbanes Oxley (SOX) implementation and ongoing compliance, operational and financial close process improvement including Blackline implementations. His skills include risk assessment, control design, and optimization. He has worked extensively with midmarket and enterprise organizations, with special emphasis on technology, construction, hospitality, and bio-technology industries.



# Firm Overview



## TAX

Individual & Business • Preparation  
Planning • Representation • Appeals  
M&A • Multi-State & International



## AUDIT

Audit • Assurance • SOX Compliance  
Employee Benefits Plan



## TECHNOLOGY CONSULTING

Assessment • Implementation • Integration • Support



## BUSINESS ADVISORY CONSULTING

Outsourced Accounting • Executive Placement • Internal Audit /  
SOX • Wealth Advisory • Sustainability

## HIGHLIGHTS:

- » 40+ Years in Business
- » Clients Across the US
- » Thousands of hours dedicated to community service each year
- » Five locations throughout California



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# Consulting Overview

## TECHNOLOGY SOLUTIONS

INTERNAL AUDIT / SOX

OUTSOURCED ACCOUNTING



## TECHNOLOGY SERVICES:

- » Assessments
- » Implementation
- » Upgrades
- » Integration
- » Support

## CERTIFIED PARTNER:

sage Intacct  WHEREFOUR™

Avalara  BLACKLINE

Bill.com™  limelight

LEASERUNCH

# Agenda

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

# Lease Accounting Overview

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

- 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

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- 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

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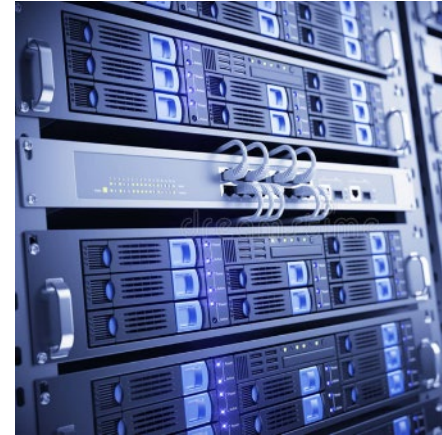
New standards are challenging to adopt.

- 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

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1. **General Ledger Payment Review** - Look for existing recurring fixed and variable lease payments along with other contracts, which may have embedded leases under the new standard.
2. **Inventory Contracts and Document Key Terms** - Review key contract terms and related payment streams. Fixed and index payments, renewal and purchase options, residual guarantees, incentives, direct lease and non-lease costs.
3. **Separate Fixed and Variable Payments** - Fixed payments are the recurring each month or increase by a fixed index. Variable are not determinable such as an increase based on CPI.
4. **Policy Elections** – For example combine lease and non-lease components, use the interest-free rate, exclude leases twelve months or less, take the portfolio approach to a similar class of assets and transition relief from ASC 840 to ASC 842.
5. **Financing or Operating Lease** - Financing lease (only one needs to apply) : Transfers ownership to lessee, lessee exercises a purchase option, the lease term is a major part of the economic life (75%) of the asset, present value is a substantially all (90%) of the asset value, asset is specialized for lessee and has no other use. Operating lease is any other lease.
6. **Adoption Method - Effective date method** the cumulative effect of the change is reported in the beginning of the adoption period.  
**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.



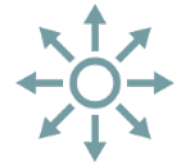
## Financial Reporting

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.



# Recap

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- 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.ssflp.com/lease-accounting-advisory](http://www.ssflp.com/lease-accounting-advisory)



A grayscale photograph of a person in a suit writing on a document with a pen. The image is overlaid with a semi-transparent dark gray filter. A bright green vertical bar is on the left side, and a bright green triangle is in the bottom right corner.

**Questions?**

# Appendix – Key Definitions

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**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

# Appendix – Key Definitions

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**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



# Appendix – Key Definitions

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**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 reasonable certain 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

# | Thank You!

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