



Preparing for the new ASC 842 Leasing Standard *Challenges and Solutions*

August 24, 2017

Learning objectives

- Define leasing implications related to recently revised FASB standard
- Differentiate between new and existing leasing standard
- Describe four pillars of compliance to address the standard
- Assess the impact of the new standard on the business
- Identify areas for change and benefits



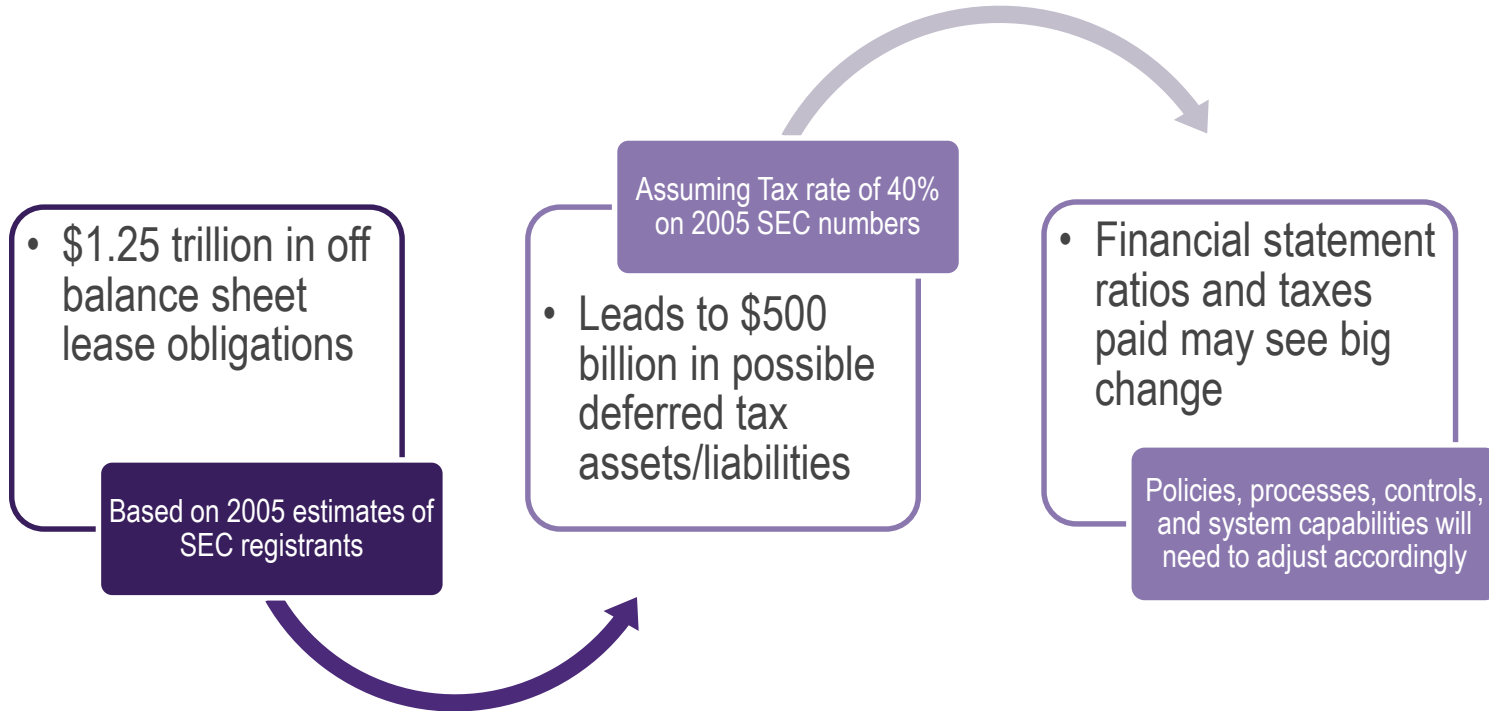
Understanding the new leasing standard

Understanding the new leasing standard

- ✓ Requires lessees to put most leases on their balance sheets but recognize expenses on their income statements in a manner similar to today's accounting
- ✓ Requires entities to classify leases to determine how to recognize lease-related revenue and expense
- ✓ Entities may be required to develop new processes and controls or adjust existing processes and controls to identify and account for leases
- ✓ Allows entities to make policy choice to apply existing lease identification and classification conclusions; however asset and liabilities must still be booked on balance sheet (part of a package of transition-related expedients)
- ✓ FASB standard is not fully converged with IFRS 16 issued by International Accounting Standards Board (IASB)

OVERVIEW OF NEW FASB STANDARD FOR LEASES

WHAT IS THE IMPACT TO COMPANIES?

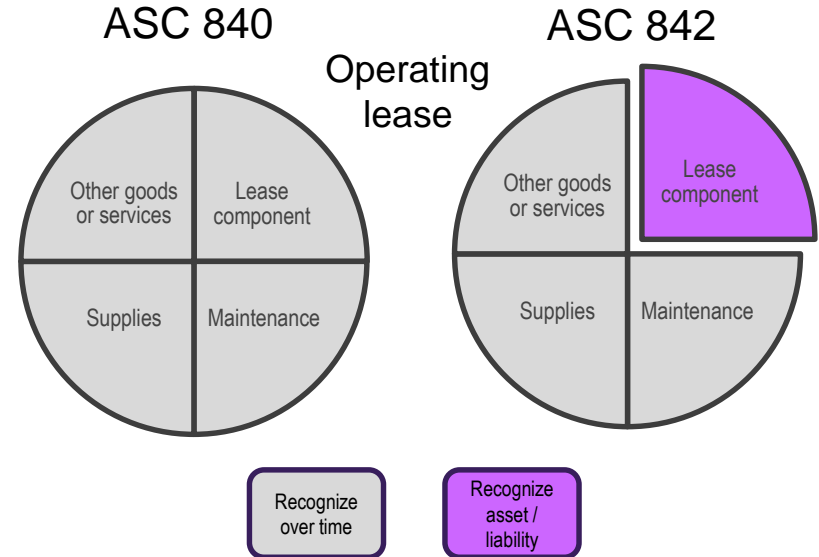


Technical Accounting Topics – Part 1

Definition of a lease – key components

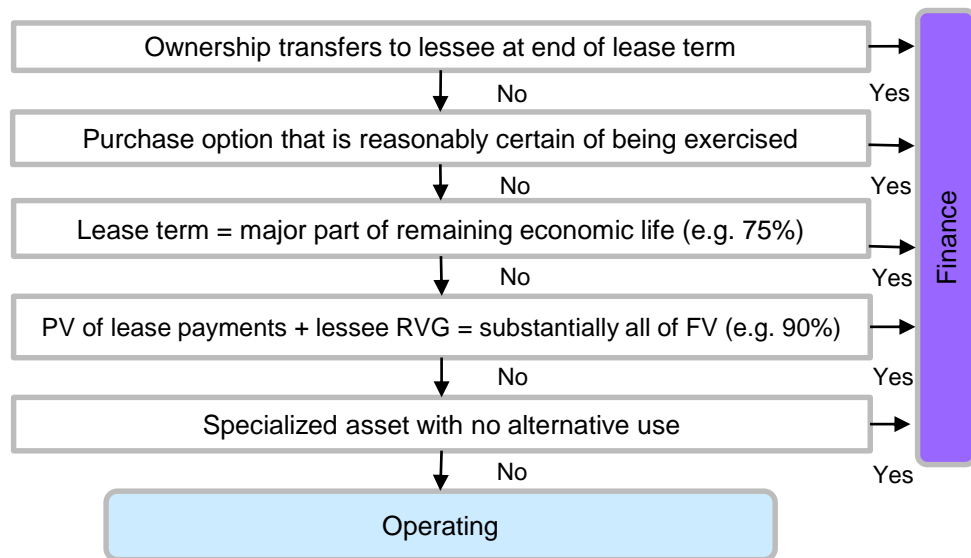
Identified asset	Right to control use of the asset	Period of use
<ul style="list-style-type: none">• Physically distinct• Explicitly or implicitly identified• No substantive substitution rights	<ul style="list-style-type: none">• Right to obtain substantially all economic benefits from use• Right to direct the use	<ul style="list-style-type: none">• Time• Output

Components of contract – change in practice

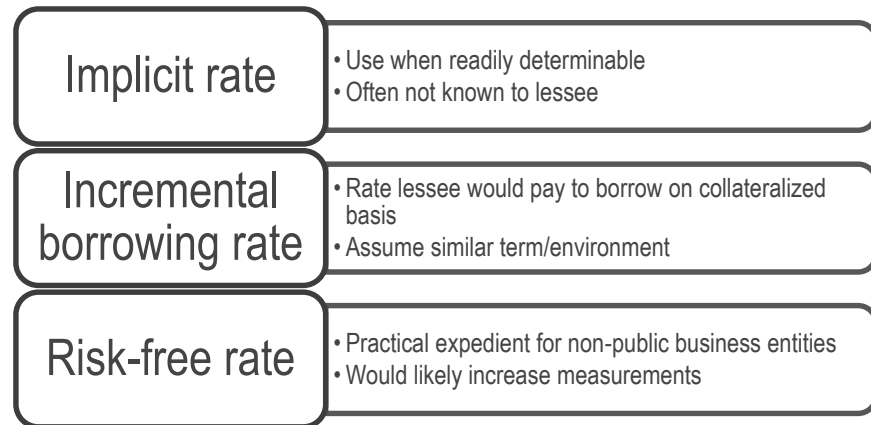


Technical Accounting Topics – Part 2

Classifying a lease – finance or operating

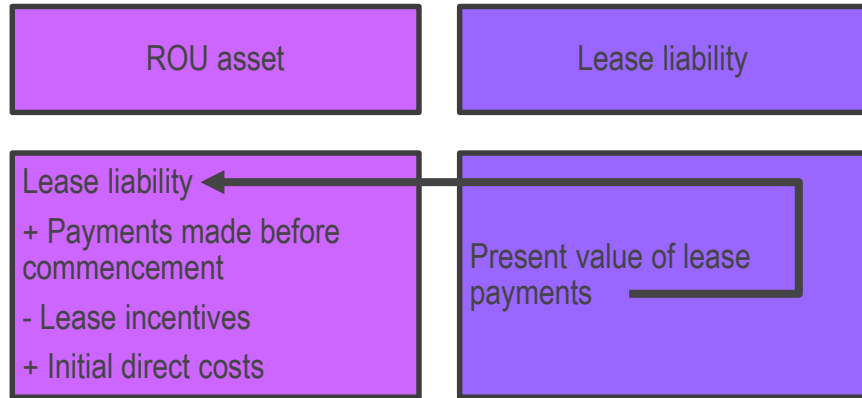


Classifying a discount rate



Technical Accounting Topics – Part 3

Measuring ROU assets and lease liabilities



*Note: Can elect to account for short term leases "off balance sheet"

	Operating Lease	Finance Lease
ROU asset	Lease liability + prepaid rent - accrued rent - remaining incentive + unamortized initial direct costs - impairment	Previous carrying amt - accumulated amortization - impairment
Lease liability	PV of remaining lease payments	Previous carrying amt + interest expense - lease payments

Technical Accounting Topics – Part 4

Disclosures – enable users to assess cash flows from leases

Qualitative disclosures	<ul style="list-style-type: none">• General description of lease• Basis and terms and conditions of variable lease payments, extension and termination options, and residual value guarantees• Restrictions or covenants imposed by leases• Significant assumptions and judgments made in identifying a lease, allocation of lease consideration, lease term, and discount rate• Significant rights and obligations for leases not yet commenced
Quantitative disclosures	<ul style="list-style-type: none">• Finance lease cost (separating amortization and interest cost)• Operating lease cost• Short-term lease cost• Variable lease cost• Separately for finance and operating leases: cash paid, weighted-average remaining lease term, weighted-average discount rate, supplemental noncash information about lease liabilities recognized from obtaining ROU assets, maturity analysis of undiscounted lease cash flows and a reconciliation of undiscounted cash flows to lease liabilities

Transition – Practical Expedients

Modified retrospective application, with certain practical expedients

Elect not to assess

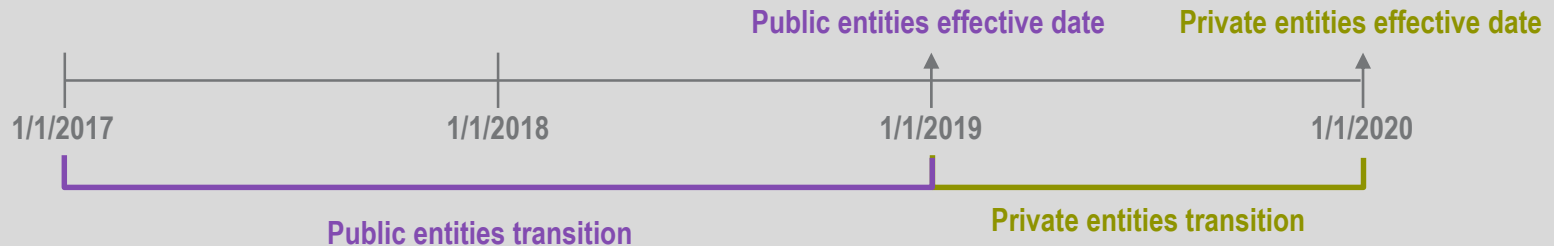
- Whether expired/existing contracts are or contain leases
- Classification of any expired/existing leases
- Whether initial direct costs for existing leases qualify for capitalization

Elect to use hindsight to determine lease term and to evaluate ROU asset for impairment

Timing: it's sooner than you think

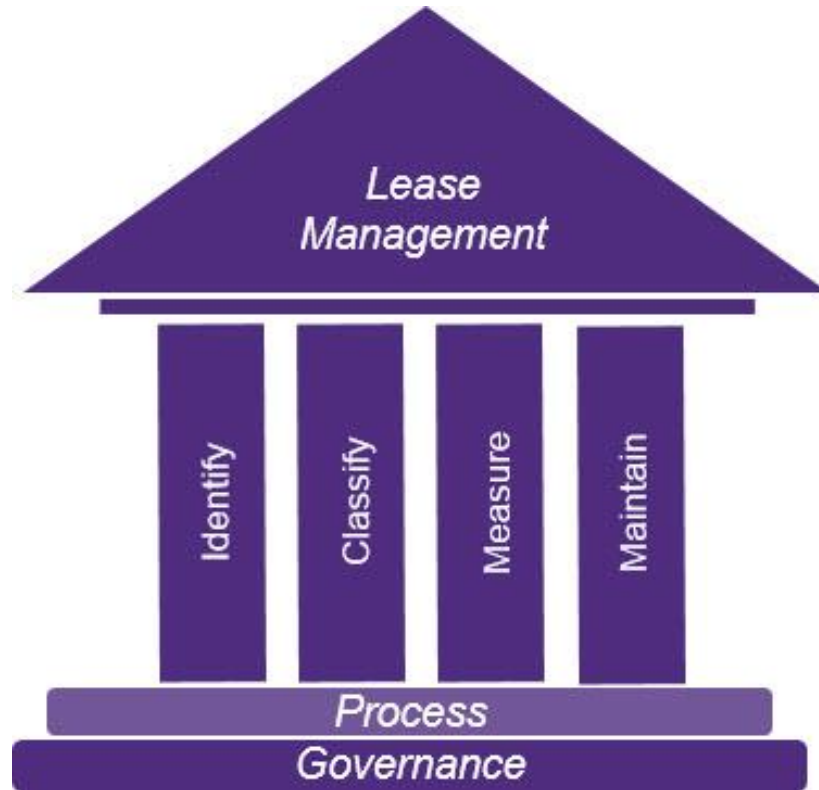
- For public companies repository design/build underway by Q3 2017
- For public companies software selection and integration of repository underway Q4 2017
- Special challenge for public entities: SEC is requiring a comparative reporting period
 - **3 years** for income statements
 - **2 years** for balance sheets

Bottom line: public entities need to begin tracking new data now!



Complying with the new leasing standard:
The 4 pillars

Achieving compliance: the 4 pillars



Pillar 1: Identifying leases



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- Identifying and centralizing all current and relevant lease information
 - Create a custom repository
 - Identify embedded leases
 - Design a future state process to identify leases at time of contract
 - Design policies and procedures to ensure best effort of lease identification is followed
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Pillar 2: Classifying leases

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- Determine the type of leases in scope for the new standard
 - Classify the definition of leases vs. services
 - Recognize the differences in operating leases and finance leases
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Pillar 3: Measuring leases

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- Create the necessary calculation assumptions and templates
 - Ensure the proper information is available to properly complete all calculations
 - Define the required disclosure information
 - Manage all ratio updates and debt covenant requirements
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Pillar 4: Maintaining leases

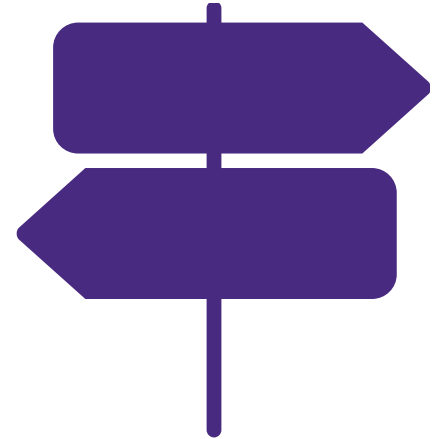


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- Centralize the collection and management of lease information and documentation
 - Align a service or software model to the management of leases and lease calculations
 - Integrate with accounting systems for journal entry and sub-ledger related activities
 - Manage all fiscal and statutory related reporting activities
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Challenges, impact & opportunities
for your organization

What it means to your organization

- Updates to existing financial accounting policies, procedures and systems
- Updates to controls and contracts
- New disclosures and lease management activities



Big impact *throughout* your organization

Primary functions effected

- Finance
- Financial planning & analysis
- Tax
- IT (*identifying technology solutions*)

Functions that will feel the change

- IT (*for leases initiated through IT*)
- Facilities/real estate
- Operating entities
- Procurement
- Legal (contracts)

New process challenges for managing leases

1 Gathering data from decentralized sources

2 Lack of common structure in lease documents

3 Inadequate systems to do the job

4 Inconsistent lease accounting processes

5 Catching all leases before they get into payment system (need policy and process)

6 Managing lease renegotiations

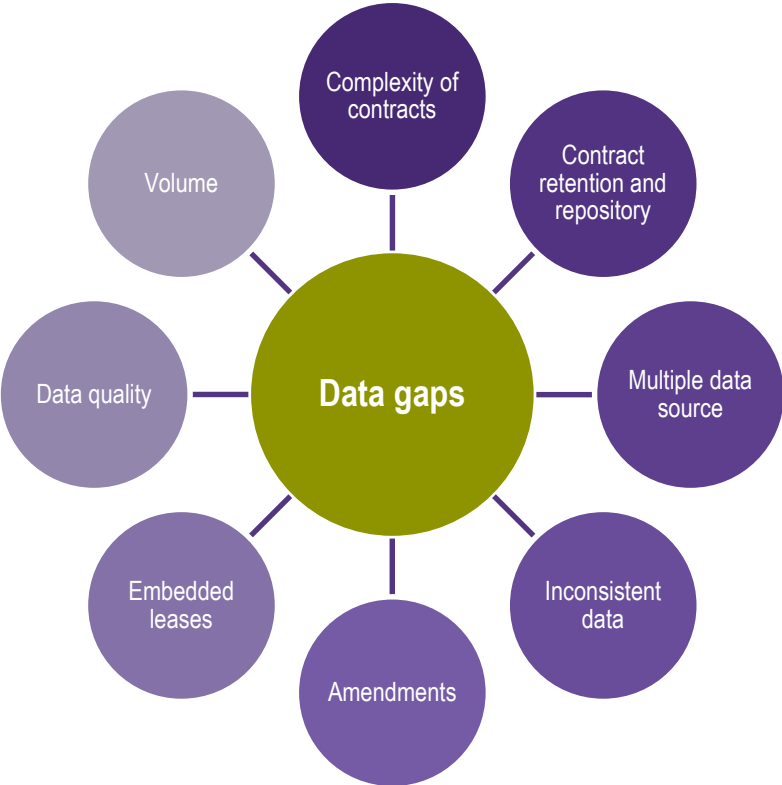
New analytical challenges for managing leases

1 Classifying leases vs. services

2 Identifying lives and discount rates

3 Calculating lease vs. other operating expenses

Closing data gaps



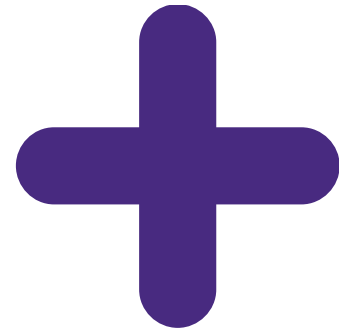
Areas potentially requiring change

- Updated accounting policies and disclosures
- New application of judgment and estimation
- Updates or overhauls to related internal controls
- New systems to capture, process, and maintain lease data
- Adjusted income and other taxes
- Revised debt covenant compliance



Silver linings: unplanned benefits

- Better lease decisions
 - Stronger leverage for lease negotiations
 - Improved systems and lease processes based on best practices
 - Stronger controls and standardized policies
 - Management insight through centralized information
- Better business decisions
 - Clearer decisions on leasing vs. services
 - Stronger debt covenants



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