



**FASB: It's Here; What Now?**

**Accounting for Leases – Overview**

*September 14<sup>th</sup>, 2016*

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# Today's Participants

## Moderator

**Gregory Kraut, Principal**  
Avison Young



## Panelists

**Erik Lange, Partner – Accounting Advisory Group**  
KPMG LLP



**Marc Betesh, President**  
KBA Lease Services



**Christopher McKenna, Managing Director**  
JPMorgan Chase & Co.

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**Alan Scott, Managing Director – Corporate Services**  
Deutsche Bank



**Richard Podos, CEO & President**  
Lance Capital

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# Current Lease Accounting

Focus on whether the arrangement transfers the substantive risk and reward of a physical fixed asset to the lessee

- Lease Classification Tests
  1. Transfer Titles
  2. Bargain Purchase Option
  3. 75% Useful life Test
  4. 90% Cost Recovery Test

If any of the classification tests are met, Lessee recognizes the **Asset**.

**Asset Focused**

# New Lease Accounting Standard

## Don't Account for the Asset; Account for the Contract

- Been Accounting for the wrong “thing” all along
- Have you entered into a contract to utilize a physical fixed asset for a defined period of time that obligates you to make payments over the contract term?

Then account for that obligation to make payments as a Liability

**Liability Focused**

# Scope

Within scope	Scope with exceptions	Outside scope
<ul style="list-style-type: none"><li>Leases of assets</li><li>Long leases of land</li><li>Sale-leasebacks</li><li>Subleases</li><li>In-substance purchases / sales</li></ul>	<ul style="list-style-type: none"><li>Short-term leases (lease term <math>\leq</math> 12 months)</li><li>Small-ticket leases (IASB only)</li></ul>	<p>Leases of:</p> <ul style="list-style-type: none"><li>Intangibles (other than ROU assets)</li><li>Natural resources and exploration</li><li>Biological assets</li></ul>

## Comparison to Current U.S. GAAP

- The scope of the new leases standard is substantially aligned with current U.S. GAAP.

# Lease Definition

A contract that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration.

Definition focuses on control over the use of an identified asset.

## Identified asset

- Asset is physically distinct – applies to distinct portions but not generic capacity, and
- Supplier does not have a substantive right to substitute another asset

## Control over use

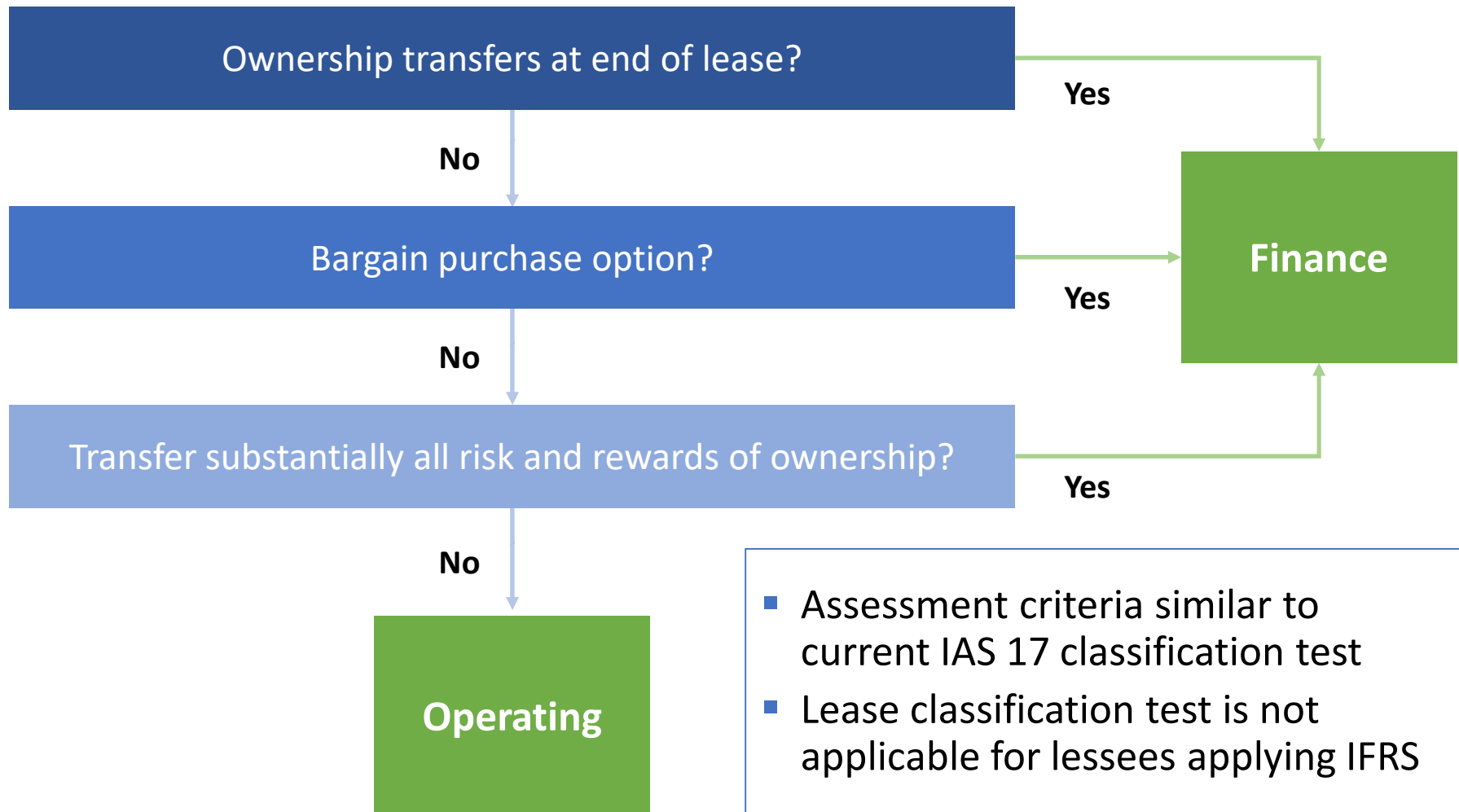
- Customer has the right to
  - Direct (including the right to *change*) how and for what purpose the asset is used *throughout the period of use*, and
  - Obtain substantially all of the economic benefits from directing the use of the asset

# Agreements with Lease and Non-Lease Components

	Lessee	Lessor
When there is an observable standalone price for each component	Unless accounting policy elected (see below), separate and allocate based on relative standalone price of components – maximize the use of observable information	Always separate and allocate using the revenue recognition standard’s guidance (i.e., on a relative selling price basis)
When there is not an observable standalone price for some or all components		
Taxes and insurance on the property	Activities (or costs of the lessor) that do not transfer a good or service to the lessee are not components in a contract	
Accounting policy election by class of underlying asset	Account for lease and non-lease components together as a single lease component	

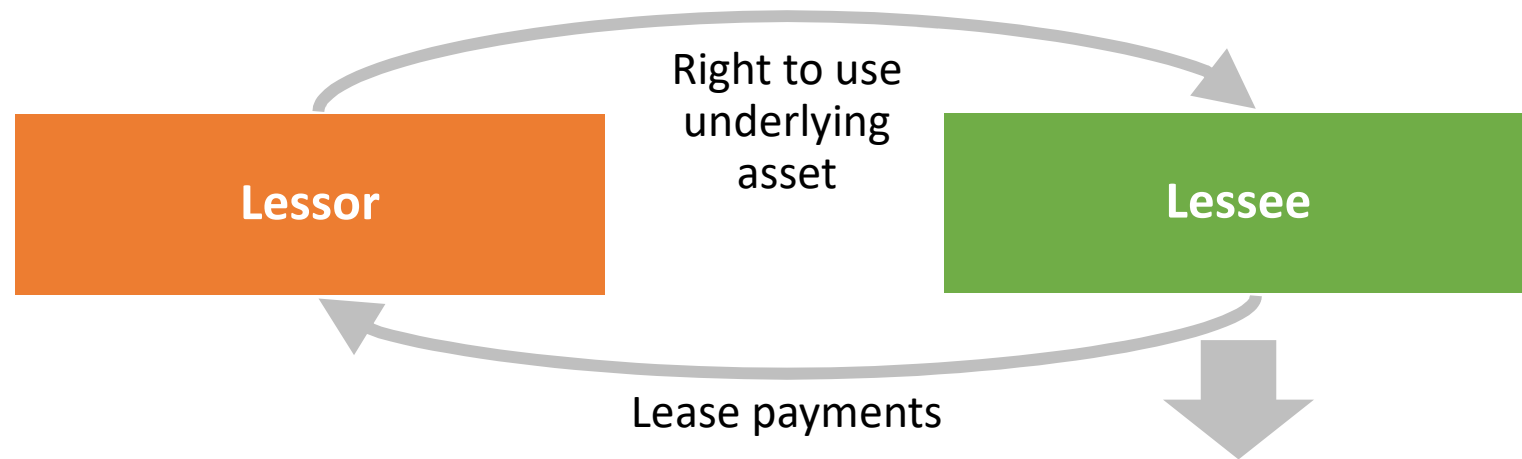


# Lease Classification Test



- Assessment criteria similar to current IAS 17 classification test
- Lease classification test is not applicable for lessees applying IFRS

# Lessees – Recognition



## Comparison to Current U.S. GAAP

- All leases of lessees (other than short-term leases) will be recognized on the balance sheet
- Presentation of interest expense in the income statement depends on lease classification

***ROU asset***  
Right to use  
underlying asset  
during lease term

***Lease liability***  
Obligation to make  
future lease payments

# New Lease Accounting Implications

- Capital lease accounting unchanged (now called “Finance Leases”)
- Operating Lease Accounting the same in the Income Statement and statement of cash flows
  - All Leases presented on Balance Sheet
- Classification test largely remain unchanged
  - Now drives presentation in Income Statement and not whether on Balance Sheet or not
- Change in scope for determining whether an arrangement contains a lease

# Effective Date

Question	The entity is ....	
	... a public business entity	... any other type of entity
When does Topic 842 take effect?	Annual and interim periods in fiscal years beginning after 12/15/2018	<ul style="list-style-type: none"><li>■ Annual periods beginning after 12/15/2019</li><li>■ Interim periods in fiscal years beginning after 12/15/2020</li></ul>
Can entities early adopt?	Yes, all entities can adopt Topic 842 immediately	
What is the transition method?	Modified retrospective, with elective reliefs, which requires application of the new guidance for all periods presented	

# Transition

**The modified retrospective approach includes elective reliefs that all lessees may apply in transition. These include:**

<b>Must be elected as a package</b>	<ul style="list-style-type: none"><li>▪ At the adoption date, the entity may elect not to reassess:<ul style="list-style-type: none"><li>- Whether expired or existing contracts contain leases under the new definition of a lease;</li><li>- Lease classification for expired or existing leases; and</li><li>- Whether previously capitalized initial direct costs would qualify for capitalization under the new standard</li></ul></li></ul>
<b>May be elected individually or with the other practical expedients</b>	<ul style="list-style-type: none"><li>▪ The entity may use hindsight in determining the lease term and in assessing impairment of right-of-use (ROU) assets</li></ul>

**Election of all practical expedients will allow for all leases to be accounted for under current GAAP\*, except that lessees are required to:**

- Recognize a ROU asset and a lease liability for all operating leases at each reporting date based on the present value of the remaining minimum rental payments under current U.S. GAAP; and
- Apply the new requirements with respect to changes in estimates that affect lease accounting during the lease term (i.e., reassessments as discussed further below) beginning on the effective date.

\* Unless modified on or after the effective date

# Implementation of the New Revenue Recognition and Leasing Standards

## Accounting, Tax, and Reporting

- Accounting policies
- Historical results and transition
- Reporting differences
- Disclosure of expected impact
- Tax reporting
- Tax planning

## Systems and Processes

- Impact on ERP system
- General ledger, subledgers and reporting packages
- Supporting transition process
  - New processes
  - SOX compliance

## Business

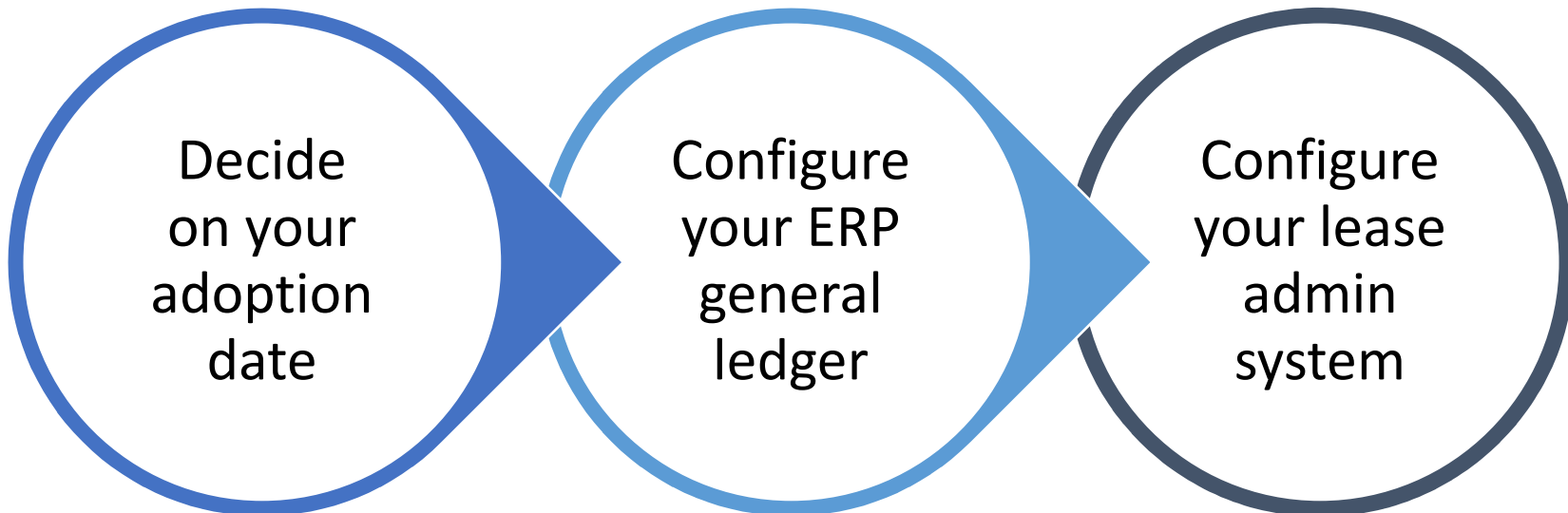
- Impact on business practices
- Budget and management reporting
- Communication with financial markets
- Covenant compliance
- Opportunity to rethink business practice
- Coordination with other strategic initiatives

## Change Management

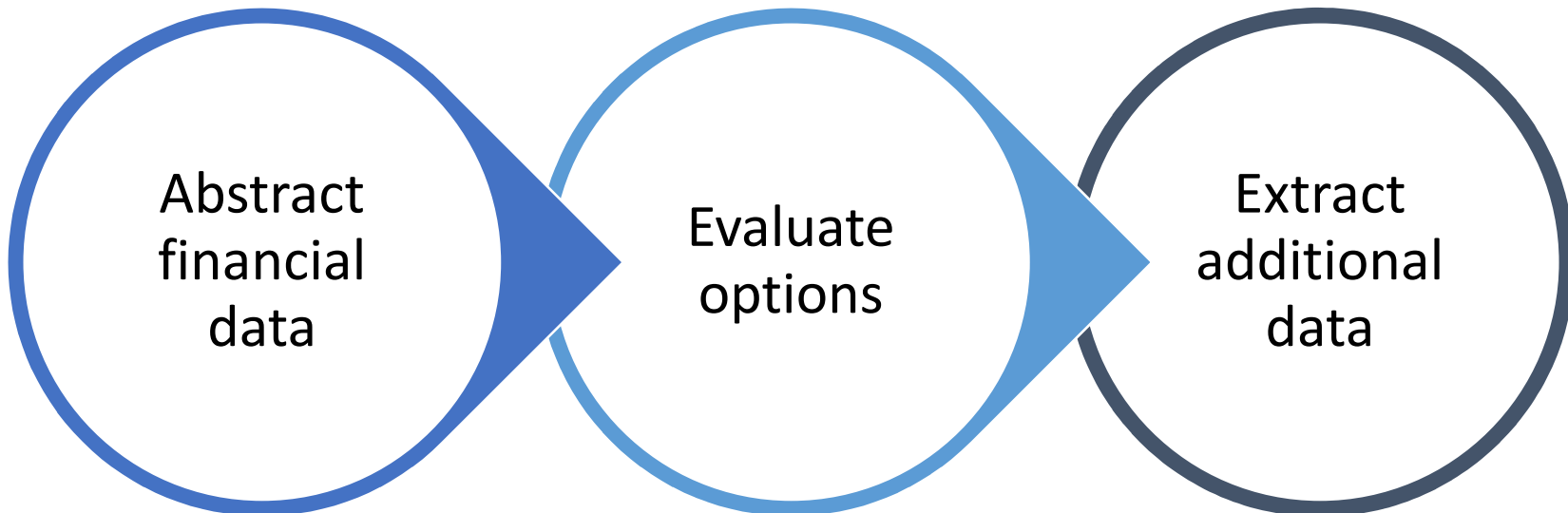
- Project management
- Impact on internal resources
  - Training (accounting, sales, etc.)
  - Revenue change management team
  - Multi-national locations



# FASB – Get Infrastructure Ready



# FASB – Analyze Your Leases



- Separate base rent from service components
- Separate fixed vs. variable components of rent
- Capture and record Initial Direct Costs
- Evaluate likelihood and amount of cancellation penalties
- Identify and calculate residual value guarantees
- Identify and calculate restoration obligations
- Capture and record value of lease incentives



# FASB – Run Your Analyses

```
graph LR; A((Determine if Finance or Operating Lease)) --> B((Calculate Schedules)); B --> C((Send to ERP Accounting System));
```

Determine if  
Finance or  
Operating  
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Calculate  
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# Q & A

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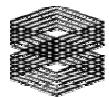
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