

Leases: Implementing the New Standard

What is the new standard?

The FASB's new lease accounting standard (Topic 842) enhances the transparency of material lease obligations by requiring lessees to recognize most leases (including operating leases) on their balance sheets (by recording a right-of-use asset and a lease liability) but to continue recognizing expenses on their income statement consistent with existing lessee accounting.

Lessees can make an accounting policy election for short-term leases to continue accounting for the lease under existing guidance, provided that the lease term is 12 months or less. Changes to the lessor accounting model were not as significant with changes to lease classification criteria and disclosures for sales-type and direct financing leases and the elimination of levered leases going forward. The new standard also eliminates previous real estate specific guidance for leases.

When is it effective?

Topic 842 is effective for calendar year-end public business entities in the first quarter of 2019 (2020 for non-public entities). Early adoption is permitted. Lessees and lessors must apply a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. Some transition relief is available but must be elected as a package.

Assess the Impact

30%

- Establish cross-functional project team (including coordination with the auditors) to manage the impact assessment.
- Obtain an understanding of the requirements of Topic 842 and update existing or develop new accounting policies for leases. Make key policy decisions (e.g., transition relief).
- Re-evaluate the lease vs buy decision framework for lessees and lessors and the impact on lease terms and conditions.
- Identify the inventory of existing leases by type.
- Perform high level assessment of accounting impacts and resulting impacts on systems, processes, controls, etc.
- Assess technology strategy. Consider acquiring or updating lease accounting software, depending on volume and customization of lease agreements.
- Establish project plan for remainder of implementation effort.

Implementation

50%

- Separate lease and non-lease components in contracts.
- Classify leases based on the new guidance.
- Evaluate sale-leaseback criteria, when applicable, including sale criteria in Topic 606.
- Apply new lease guidance to lessor and lessee accounting including recognition and initial and subsequent measurement:
 - Identify new data point requirements.
 - Develop data repository and process for validation.
 - Develop or revise existing accounting calculators (e.g., spreadsheets, external software or internally developed applications) and test outputs.
- Document conclusions and coordinate with auditors.

Governance & Disclosure

20%

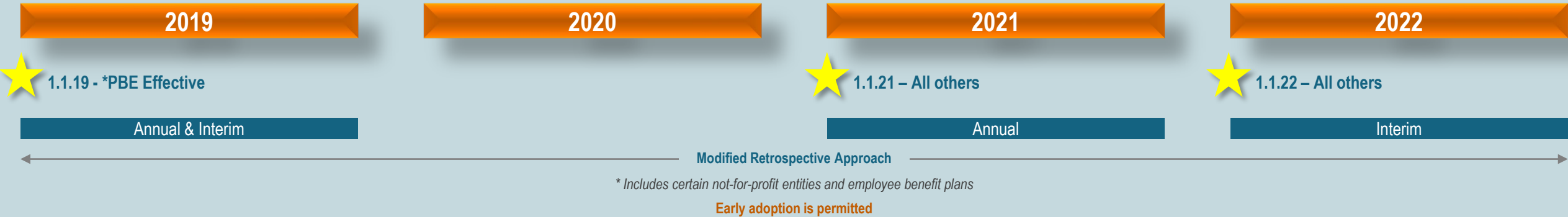
- Establish a cross-functional steering committee and overall project governance structure.
- Update controls and SOX documentation.
- Prepare skeleton disclosures and identify data gaps.
- Evaluate impact on debt covenants.
- Evaluate impact on income taxes and deferred tax assets/liabilities.
- Communicate with stakeholders (boards, investors, analysts).

Project Management

Training

Prepare and deliver customized training throughout the implementation period to all impacted groups throughout the organization.

A Timeline...



The New Lease Accounting Model

	Lessee		Lessor		
	Finance Leases	Operating Leases	Sales-Type Leases	Direct Financing Leases	Operating Leases
Balance Sheet	<ul style="list-style-type: none">Right-of-use (ROU) asset (non-financial)Lease liability (financial)	<ul style="list-style-type: none">Right-of-use (ROU) asset (non-financial)Lease liability, not debt (financial)	<ul style="list-style-type: none">Net investment in leaseDerecognize underlying asset	<ul style="list-style-type: none">Net investment in leaseDerecognize underlying assetSelling profit and IDC are deferred at commencement date and included in net investment in lease	<ul style="list-style-type: none">Continue to recognize underlying assetDefer IDCs
Income Statement	<ul style="list-style-type: none">Amortization of ROU asset (operating expense)Interest expense on lease liability (interest expense)Variable lease payments (when incurred if not included in lease liability)	<ul style="list-style-type: none">Lease expense (single line item including accretion of discount on lease liability and amortization of ROU asset) (operating expense)Variable lease payments (when incurred if not included in lease liability)	<ul style="list-style-type: none">Selling profit or loss at lease commencement date (operating income)Initial direct costs (IDC) expensed if fair value (FV) of underlying asset differs from carry value (CV) but if FV = CV, defer IDC and include in net investment in leaseInterest income on net investment in lease (interest income)Variable lease payments in income (when earned if not included in net investment) (operating income)	<ul style="list-style-type: none">Selling loss, if any, arising from lease at lease commencement dateInterest income on net investment in lease (interest income)Variable lease payments in income (when earned if not included in net investment) (operating income)	<ul style="list-style-type: none">Recognize lease income generally on a straight-line basis over lease term (operating income)Variable lease payments in income (when earned if not included in net investment) (operating income)Expense IDCs over the lease term on same basis as lease income is recognized
Other	<ul style="list-style-type: none">Impairment of ROU asset is assessed under Topic 360, Impairment or Disposal of Long-Lived AssetsLease costs are front-loaded	<ul style="list-style-type: none">Impairment of ROU asset is assessed under Topic 360Lease costs generally straight-lined over lease term	<ul style="list-style-type: none">Impairment of net investment in lease is assessed under Topic 310, Receivables	<ul style="list-style-type: none">Impairment of net investment in lease is assessed under Topic 310	<ul style="list-style-type: none">Collectability of lease payments is assessed under ASC 842Impairment of underlying asset is assessed under ASC 360

Note: Lessee or lessor may elect to continue accounting for all short-term leases (maximum possible lease term of 12 months or less), within a class of underlying assets, consistent with current accounting guidance.