



CLARK SCHAEFER HACKETT
BUSINESS ADVISORS

The Leasing Standard

May xx, 2022



Presented by:

Michael Cullum

CPA, CCIFP
mcullum@cshco.com

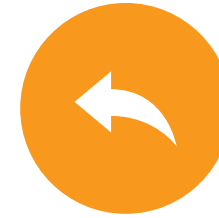
LEARNING OBJECTIVES

- Learn how FASB ASU No. 2016-02 – Leases (Topic 842) differs from prior authoritative guidance
- Distinguish between financing and operating leases
- Understand potential impact to financial statements

QUICK DETAILS



ASU 2016-2 was issued in February 2016, delayed several times



ASC 842 Leases – replaces ASC 840



Public companies and NFP's with conduit debt have already implemented



Non-public companies and NFP's without conduit debt need to implement for FY beginning after 12/15/2021

IS ANYTHING BROKEN?



Issues with current standard

- Operating leases are the largest issue
- Differences with International Standards
- Activities can be structured to achieve a particular accounting result



Items not changing

Economics of leases can be different – so distinction between financing and operating leases are not changing

DON'T BURY THE LEDE

- We move from determining whether to “record” a lease to which type a lease might be
- Critical determination is now whether a **contract** is or contains a lease – nearly all leases are required to be reported
- Leases vs. Service Agreements

ASC 840 – CURRENT GAAP

- Current standard (as amended) from 1976
 - Capital lease vs. operating lease
 - Four-part test – Bright line test vs. substance of transaction
 - Conveys ownership at the end
 - Bargain purchase option at the end
 - 75% or more of the economic useful life
 - PV of rents is 90% or more of FMV

ASC 840 – FINANCIAL STATEMENT PRESENTATION (CURRENTLY)



Capital lease

- Equipment
- Capital lease obligation
- Depreciation expense
- Interest expense

Operating lease

- Rent expense
- No balance sheet effect (unless escalating rent)

ASC 840 – DISCLOSURES (CURRENTLY)

Capital lease

- Equipment cost
- Depreciation expense
- Accumulated depreciation
- Future minimum lease payments (5 Years)
- Imputed interest

Operating Lease

- Future minimum lease payments (5 Years)
- Current period lease expense

CURRENT DISCLOSURE EXAMPLE

6. LEASE OBLIGATIONS:

Operating Leases

The Club has non-cancelable operating leases for various golf carts, lawn-care equipment, and copy machines that have various expiration dates through May 2021. Rent expense incurred on all operating leases for the years ended December 31, 2018 and 2017 was \$84,557 and \$79,812 respectively.

The following is a schedule of future minimum lease payments for operating leases as of December 31, 2018:

| | |
|------|-------------------|
| 2019 | \$ 93,682 |
| 2020 | 97,285 |
| 2021 | <u>11,440</u> |
| | <u>\$ 202,407</u> |

Capital Leases

The Club has non-cancelable capital leases for lawn-care equipment through 2021. The following is a schedule of future minimum lease payments for the capital lease as of December 31, 2018:

| | |
|---|-----------------|
| 2019 | \$ 58,417 |
| 2020 | 40,489 |
| 2021 | <u>13,496</u> |
| Total | <u>112,402</u> |
| Total minimum payments required | 112,402 |
| Less: Amounts representing interest | <u>(6,261)</u> |
| Present value of minimum lease payments | 106,141 |
| Less: Current portion | <u>(54,292)</u> |

The gross cost of assets under capital lease totaled \$311,263 and \$188,711 as of December 31, 2018 and 2017, respectively. Related accumulated depreciation totaled \$106,162 and \$88,655 as of December 31, 2018 and 2017, respectively.

WORTH MENTIONING:



What is not included

- Intangible assets, biological assets, mineral exploration, inventory, assets under construction

Issues the FASB needed to consider:

- Inception vs. Commencement
- Cost-effective implementation

ASU 2016-02 – THINGS TO CONSIDER

**Lease
determination**

**Lease/non-lease
components**

**Total lease
consideration**

**Lease
classification**

**Reporting of
leases**

**Lease
modifications**

**Lessor
accounting**

**Implementation
guidance**

ASU 2016-02 – LEASE DETERMINATION

- Prior focus was on capital vs. operating
- Since an asset/liability is created either way now, focus now moves to determination whether a contract contains a lease
- Inception date vs. commencement date
- Lease = the right to control the use of identified property, plant, or equipment (an identified asset) for a period of time in exchange for consideration

ASU 2016-02 – DETERMINE A LEASE (cont.)

Identifiable asset:

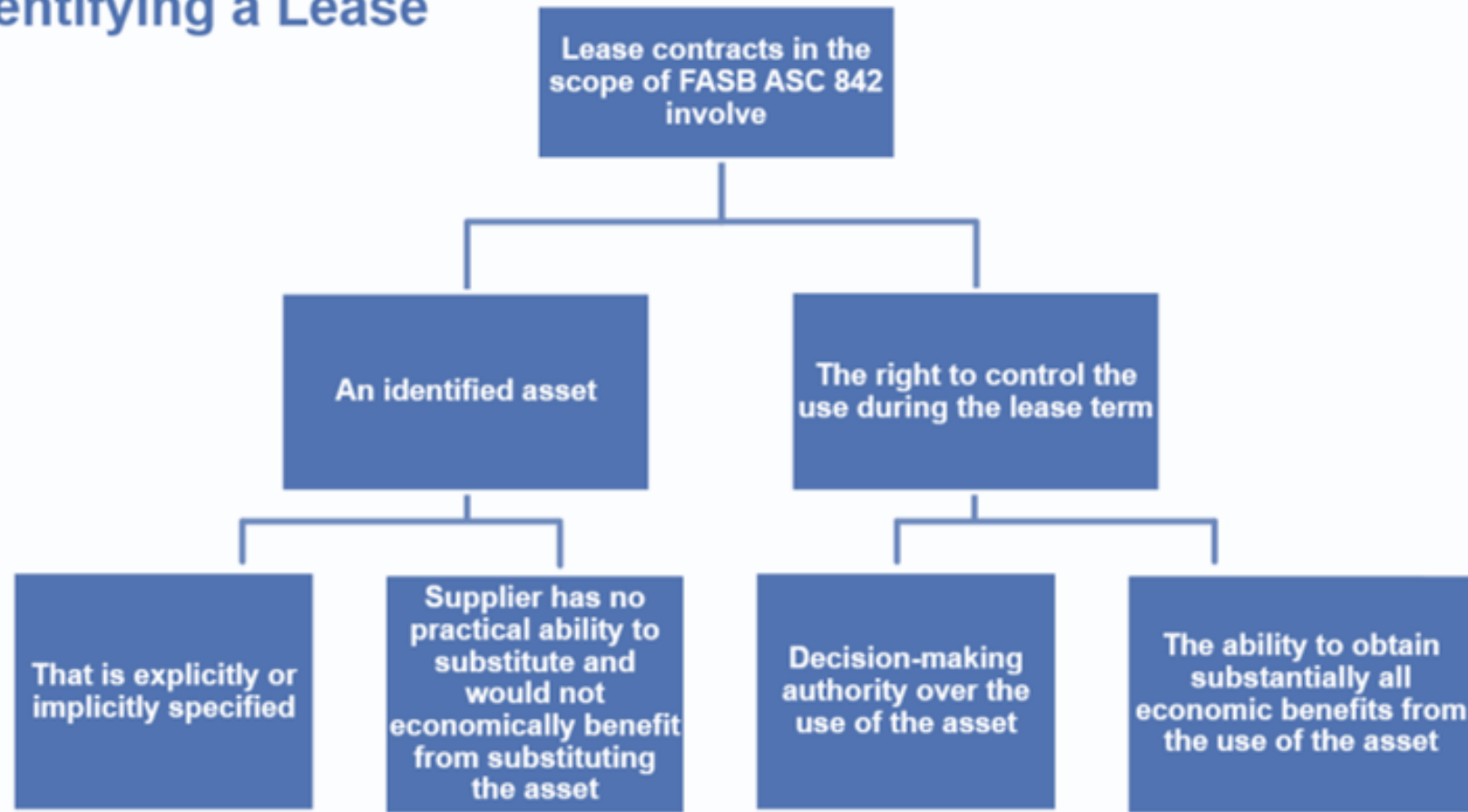
- Must be explicitly identified
- Must be distinct
- Substitution rights

Throughout the period of use,
consider whether you have:

- The right to substantially all of the economic benefits
- The right to direct the use of the identified asset
(where, when, whether, what)

Reconsider only when terms
of the contract change

Identifying a Lease



ASU 2016-02 – LEASE COMPONENTS

- Important to consider since an asset and liability are being recorded
- Identify separate lease components and consider separately
- Assess non-lease components – i.e. maintenance
- Allocation of lease consideration
 - Relative to stand-alone prices of each component

TO INCLUDE IN TOTAL LEASE CONSIDERATION

Fixed payments

Variable payments

• Index linked payments

Fees paid by the lessee

Exercise price options

Payment of penalties

Lessees only – amounts probable to
be paid for residual guarantees

**NOTE: Reconsider only if a contract
modification**

ASU 2016-02 – LEASE CLASSIFICATION

On the lease commencement date, must determine the **classification**:

Financing lease (fka capital lease)

- Transfer of ownership
- Option to purchase
- Term is for “major part” of the economic life
- Lease payments + residual value \geq the fair value
- Asset would have no alternative use to the lessor at lease end

Operating Lease

ASU 2016-02 – LEASE CLASSIFICATION (Cont.)



- Leases less than 12 months are excluded (accounting policy election)
- Eliminated bright-line tests
 - (i.e. transfer of ownership, BPO, 75%, 90%)

ASU 2016-02 – LEASE TERMS

On the lease commencement date,
must determine the lease term:

- Non-cancellable period with right to use and
- Optional periods for which it is **reasonably certain** the option will be exercised

Required to reassess if:

- Significant change in circumstances,
- Specific term changes, or
- Election to exercise option or terminate which was previously determined to be uncertain

ASU 2016-02 – LEASE TERMS (Cont.)

Lease term reassessment example:

- On June 1, 20X1, ABC Company leased a warehouse for a 10-year term with two 5-year renewal options. On this date, ABC was not reasonably certain that it would exercise the options. The term is 10 years.
- On June 1, 20X6, ABC installed leasehold improvements with a 10-year useful life. ABC reassessed the warehouse lease and they are now reasonably certain they will exercise the first of two renewal options.

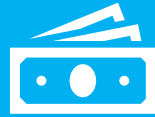
Reassessment is needed as a result of management being reasonably certain of a change in the length of lease.

ASU 2016-02 – LEASE TERMS (Cont.)

Lease term reassessment example:

- On June 1, 20X1, ABC Company leased a warehouse for a 10-year term with \$200,000 due on June 1st and to be adjusted **by the change** in CPI annually. ABC records a lease liability, a “Right-of-use” asset and prepaid rent.
- On June 1, 20X2, ABC determined the CPI adjustment to be 12.5% $((126-112)/112)$ resulting in a new lease payment of \$112,500 (\$100,000 fixed + \$12,500 variable).
 - *No assessment is needed because the change in CPI is a variable lease payment.*

ASU 2016-02 – REPORTING OF OPERATING LEASES



Net Present Value of the Lease (present value of future cash flows)



Liability

- Consider what it includes
- Discount rate



Right of use asset

OPERATING LEASE EXAMPLE

- Payments of \$10,000 annually for five years
- Interest rate at 5%

| Year | Lease Liability | Cash Paid | Interest Accretion | Right-of-Use Asset | Amortization of Right-of-Use Asset (PLUG) | Straight Line Lease Expense |
|-------|-----------------|-----------|--------------------|--------------------|---|-----------------------------|
| | | | A | | B | A+B |
| 0 | \$43,295 | | | \$43,295 | | |
| 1 | \$35,460 | \$10,000 | \$2,165 | \$35,460 | \$7,835 | \$10,000 |
| 2 | \$27,232 | \$10,000 | \$1,772 | \$27,232 | \$8,228 | \$10,000 |
| 3 | \$18,594 | \$10,000 | \$1,362 | \$18,594 | \$8,638 | \$10,000 |
| 4 | \$9,524 | \$10,000 | \$930 | \$9,524 | \$9,070 | \$10,000 |
| 5 | \$0 | \$10,000 | \$476 | \$0 | \$9,524 | \$10,000 |
| Total | | \$50,000 | \$6,705 | | \$43,295 | \$50,000 |

OPERATING LEASE EXAMPLE (cont.)

| Year | Lease Liability | Cash Paid | Interest Accretion | Right-of- Use Asset | Amortization of Right-of- Use Asset (PLUG) | Straight Line Lease Expense |
|------|-----------------|-----------|--------------------|---------------------|--|-----------------------------|
| | | | A | | B | A+B |
| 0 | \$43,295 | | | \$43,295 | | |
| 1 | \$35,460 | \$10,000 | \$2,165 | \$35,460 | \$7,835 | \$10,000 |

Journal Entry at Lease Commencement:

| | |
|--------------------|-----------|
| Right of Use Asset | \$ 43,295 |
| Lease Liability | \$ 43,295 |

Year 1 Journal Entry:

| | |
|--|-----------|
| Lease Expense (amortization of ROU) | \$ 7,835 |
| Lease Expense (accretion of lease liability) | \$ 2,165 |
| Lease Liability | \$ 7,835 |
| Cash | \$ 10,000 |
| Accumulated Amortization (ROU asset) | \$ 7,835 |

OPERATING LEASE EXAMPLE (cont.)

| Year | Lease Liability | Cash Paid | Interest Accretion | Right-of-Use Asset | Amortization of Right-of-Use Asset (PLUG) | Straight Line Lease Expense |
|------|-----------------|-----------|--------------------|--------------------|---|-----------------------------|
| | | | A | | B | A+B |
| 0 | \$43,295 | | | \$43,295 | | |
| 1 | \$35,460 | \$10,000 | \$2,165 | \$35,460 | \$7,835 | \$10,000 |

Ending balances at Yearend 1:

| | |
|--------------------|-----------|
| Right of Use Asset | \$ 35,460 |
| Lease Liability | \$ 35,460 |

Previously recorded cash payment through normal bookkeeping for Year 1:

| | |
|---------------|-----------|
| Lease Expense | \$ 10,000 |
| Cash | \$ 10,000 |

SUMMARY

| | Financial Position | Activities | Cash Flow Statement |
|-----------|---|---|--|
| Finance | <ul style="list-style-type: none">• Financing lease• Financing lease liability | <ul style="list-style-type: none">• Depreciation expense• Interest expense | <ul style="list-style-type: none">• Principal- financing• Interest- operating |
| Operating | <ul style="list-style-type: none">• Right-of-use (ROU) asset• Lease liability | <ul style="list-style-type: none">• Single lease expense on a straight-line basis | <ul style="list-style-type: none">• Lease expense- usually operating |

- Balance sheet presentation - can not present finance leases/operating leases on same line and must break out each on face or in notes
- Balance sheet classification - Financial liabilities (current portion separate)/nonfinancial assets
- Income statement presentation - Single lease expense presented in income from continuing operations for operating

ASU 2016-02 – REPORTING OF LEASES DISCLOSURES

Qualitative

- Nature of leases – terms and conditions of variable lease payments, options to extend or terminate and residual value
- Future leases not yet commenced
- Significant assumptions used
- Terms and conditions of sale/leaseback transactions
- Accounting policy elections

ASU 2016-02 – REPORTING OF LEASES DISCLOSURES

Quantitative

- Lease cost – finance vs. operating
- Current period lease expense
- Variable lease expense
- Sublease income
- Net gain or loss recognized from sale/leaseback transactions
- Amounts segregated between finance and operating leases for cash paid, supplemental cash flow, weighted-average remaining lease term and weighted-average discount rate
- Future minimum lease payment table is still required

ASU 2016-02 – REPORTING OF LEASES MODIFICATION

Significant changes
require a recalculation

Separate lease or
modified lease

Lease re-measurement
• What is impacted

Lease termination

ASU 2016-02 – LESSOR ACCOUNTING

- No significant changes
- Generally, aligns with 606 – Revenue Standard

ASU 2016-02 – IMPLEMENTATION GUIDANCE

- Public (and NFP's with conduit debt): in effect currently
- Non-public and NFP's without conduit debt: Fiscal years beginning after December 15, 2021

ASU 2016-02 – IMPLEMENTATION GUIDANCE

Two transition methods:

- Retrospectively to each prior reporting period presented (must adjust equity and all other comparative amounts)
- Retrospectively at the beginning of the period of adoption through a cumulative effect adjustment

ASU 2016-02 – IMPLEMENTATION GUIDANCE

Practical expedients –

- No need to reassess expired or existing contracts
- No need to reassess existing classifications
- No need to reassess initial direct costs

ASU 2016-02 – IMPACT

May affect compliance with contractual agreements
& loan covenants

Most impacted sectors:

Drugstore & retail chains, telecommunications,
restaurant chains, airlines, banks, grocery stores



CLARK SCHAEFER HACKETT
BUSINESS ADVISORS

Thank you!



Presented by:

Michael Cullum

CPA, CCIFP
mcullum@cshco.com