

ASK THE EXPERTS WEBINAR

*ASC 842: Preparing for a Successful
Transition*

November 14, 2019

PRESENTERS



Helen Mason *MANAGING DIRECTOR*

Years of Experience: 14

Expert Areas: New accounting pronouncement adoptions, complex business transaction and capital markets

Industries Served: Manufacturing, technology, and energy



Aditya Mehta *MANAGING DIRECTOR*

Years of Experience: 20

Expert Areas: Technical accounting, GAAP conversions, revenue recognition, lease accounting, and working across borders on large scale global engagements

Industries Served: Oil and gas, chemicals, and manufacturing



Steven Sayewitz *SENIOR MANAGER*

Years of Experience: 12

Expert Areas: ASC 842, global Fortune 100 lease adoption, abstraction, system implementation, technical accounting and future state process design

Industries Served: Oil and gas, finance

KEY REMINDERS

- ▶ Riveron webcasts – past and upcoming
- ▶ 4 polling questions must be answered to obtain CPE
- ▶ If you have questions, feel free to ask in Q&A option in Zoom
- ▶ Webinar evaluation form & CPE certificate will be emailed to you
- ▶ On demand video is not eligible for CPE
- ▶ You will receive a follow up email including:
 - ▶ Access to this webinar recording and deck
 - ▶ The ability to join our Webinars Mailing list to receive future invites
 - ▶ Presenter contact info

LEARNING OBJECTIVES

- 1 EXPLAIN THE BALANCE SHEET AND INCOME STATEMENTS IMPACTS OF ASC 842
- 2 ANALYZE THE MAJOR TYPES OF CONTRACTS/ AGREEMENTS WITH EMBEDDED LEASES
- 3 UNDERSTAND THE PROCESS, KEY CONSIDERATIONS AND IMPACTS ON ADOPTING ASC 842 AND THEREAFTER
- 4 PUBLIC COMPANY ADOPTION LESSONS

ASC 842 – ACCOUNTING FOR LEASES OVERVIEW

KEY CHARACTERISTICS

- ▶ Moves most leases to the balance sheet
- ▶ Retains distinction between “capital” and “operating” leases, which will drive income statement recognition
- ▶ Eliminates the required use of bright-line tests to determine lease classification
- ▶ Makes identifying embedded leases critical to avoid misstating the financial statements
- ▶ Requires companies to keep an organized, consolidated listing of their lease portfolios
- ▶ Enhances lease disclosures to include both qualitative and quantitative information
- ▶ Require significant judgment in a number of areas
 - ▶ Lease term
 - ▶ Distinguishing leases from services
 - ▶ Lease classification
 - ▶ Ability to direct the use of the asset
 - ▶ Accounting policy determinations, including separating lease and non-lease components

ASC 842 – ACCOUNTING FOR LEASES OVERVIEW

	PUBLIC COMPANIES	OTHER NON-PUBLIC COMPANIES
EFFECTIVE DATE FOR IMPLEMENTATION*	<ul style="list-style-type: none">▶ January 1, 2019 for annual periods beginning after December 15, 2018.	<ul style="list-style-type: none">▶ January 1, 2021 for annual periods beginning after December 15, 2020.
COMPARABLE PERIODS REQUIRED FOR DISCLOSURE^	<ul style="list-style-type: none">▶ Balance sheet: FY19▶ Income statement: FY19	<ul style="list-style-type: none">▶ Balance sheet: FY21▶ Income statement: FY21

* Early adoption permitted for all entities

^ In July 2018, the FASB granted relief on the comparative periods. Initially, companies were required to present comparative periods, including disclosures, in accordance with current lease guidance; under the current transition option, the cumulative effect adjustment would be made at the effective date and not the earliest period presented.

ASC 842 – ACCOUNTING FOR LEASES OVERVIEW

IDENTIFYING A LEASE

LEASE IS PRESENT IN A CONTRACT IF THE CONTRACT INCLUDES BOTH:

AN IDENTIFIED ASSET

Is explicitly or implicitly specified in the contract

Supplier does not have substantive right to substitute the asset i.e. practical ability to substitute and economic benefit from substituting



THE RIGHT TO CONTROL USE OF THE ASSET DURING THE TERM

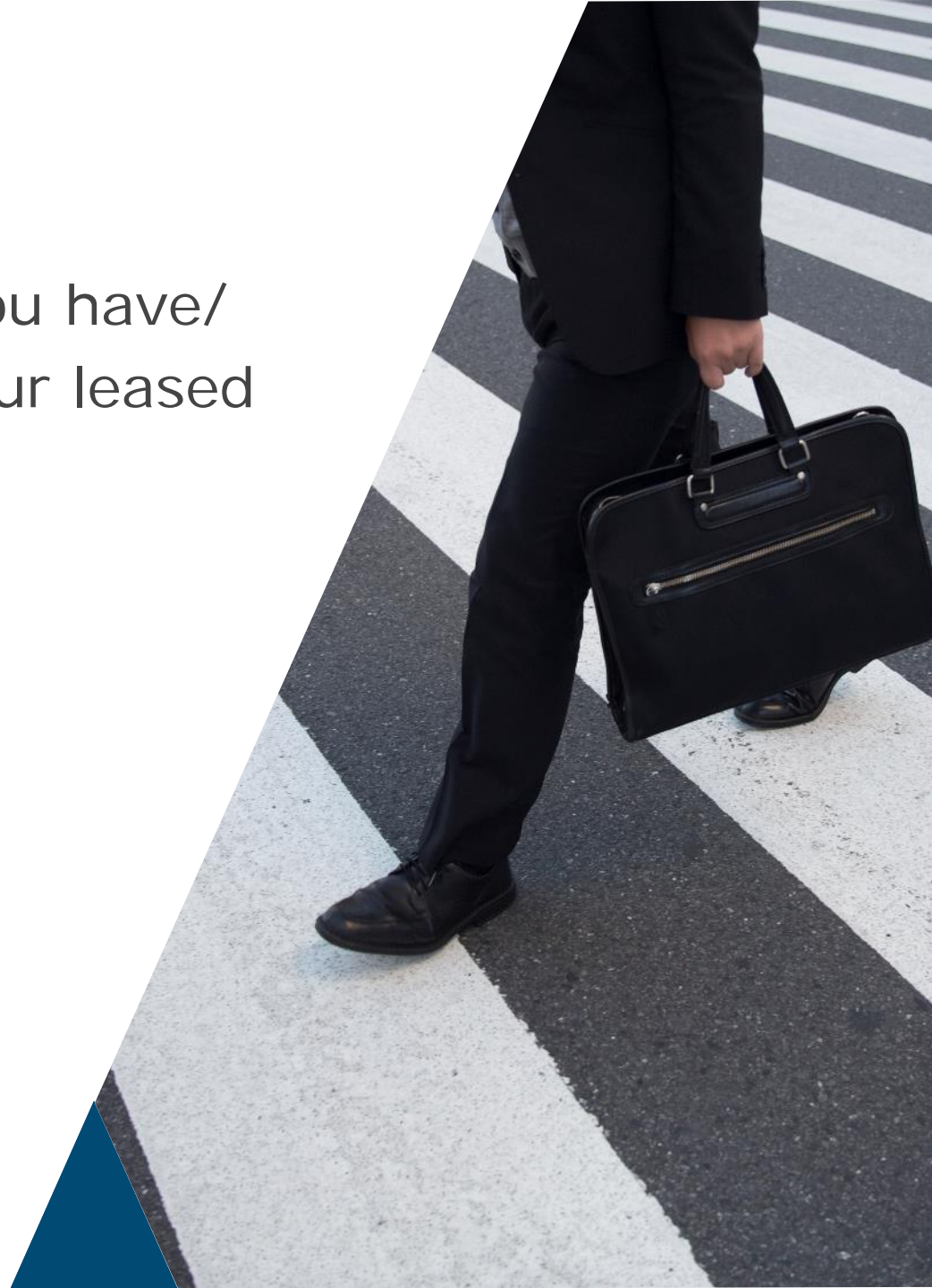
Decision-making authority over the use of the asset

The ability to obtain substantially all economic benefits from the use of the asset

Polling Question 1

How many assets do you have/
believe you have, in your leased
asset portfolio?

- A. 0 – 50 assets
- B. 51 – 100 assets
- C. 101 – 500 assets
- D. Greater than 500 assets



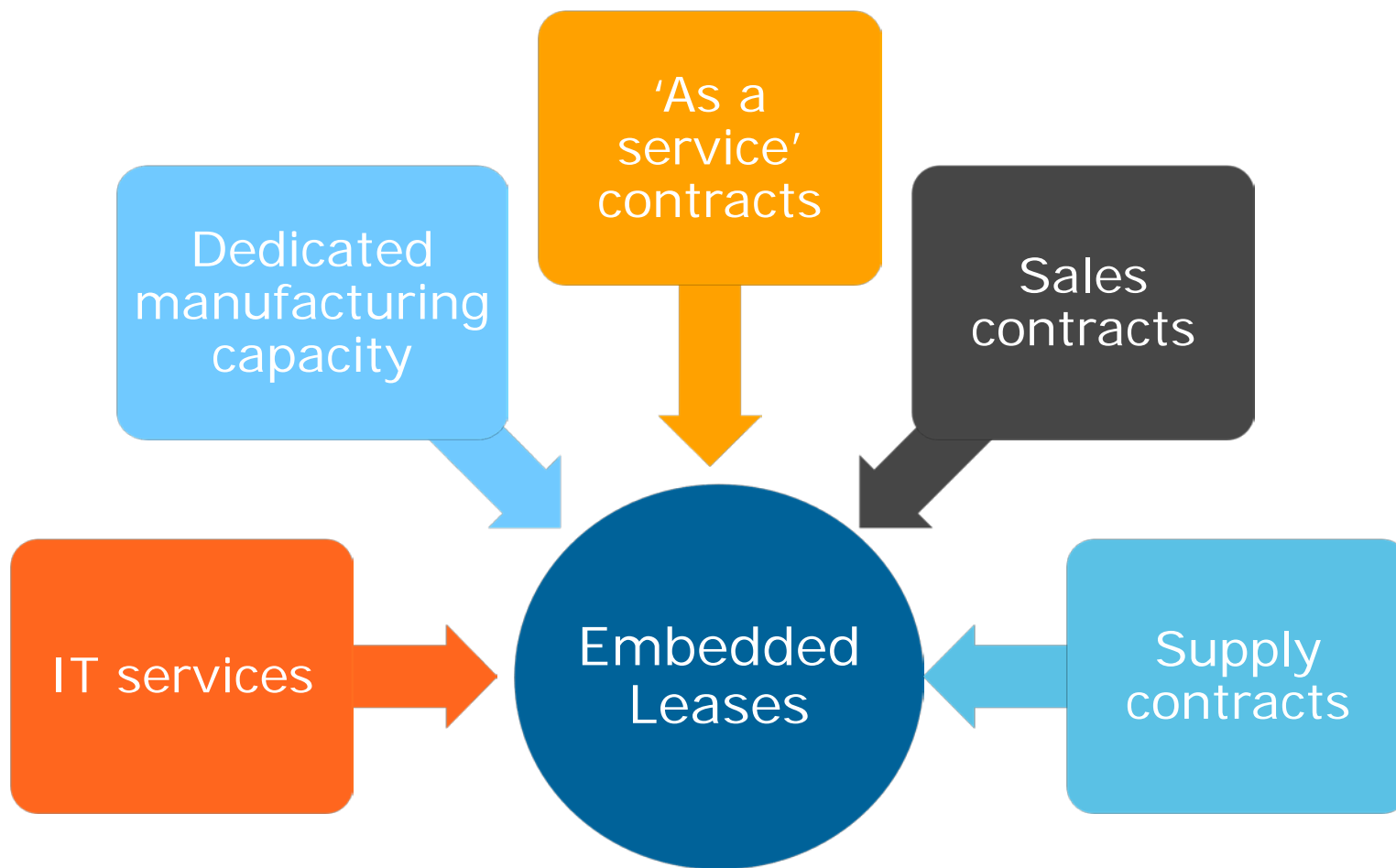
EMBEDDED LEASES - OVERVIEW

- ▶ Under new ASC 842 guidance, a lease exists if:
 1. There is an explicitly or implicitly defined asset in an agreement (an 'identified asset').
 2. The customer controls the right to use the identified asset.
- ▶ An embedded lease exists if:
 1. An agreement contains, or makes reference to, a specific asset (or group of assets).
 2. The use of this specific asset is required to fulfil the obligation set forth in the agreement.
 3. The customer of the agreement has control over the specific asset throughout the entire noncancelable term of the agreement.
- ▶ An agreement does not need to contain the word 'lease' to be considered a lease.



- Many companies failed to correctly identify embedded leases under ASC 840 but the overall impact was typically not material because operating leases did not need to be capitalized on the balance sheet.
- Much bigger issues under ASC 842 as new standard brings operating leases onto the balance sheet.

EMBEDDED LEASES - WHERE CAN ONE FIND THEM?



EMBEDDED LEASES: WHAT IS THE REAL CHALLENGE?

- ▶ There may be embedded leases in existing contracts that were previously not identified
 - ▶ Did you historically consider whether an 'identified asset' existed within a service contract, software license agreement, etc.?
- ▶ Many times, the contracts will not use the terms "lease" or "rent" that allow for easier identification
 - ▶ Have you considered a 'complete' population of potential leases?
- ▶ Contracts may require critical evaluation of whether they create a right to control the use of an asset
 - ▶ Protective rights (maintenance, safe operation, etc.) do not represent control



Multi-function involvement will be key

EMBEDDED LEASES - QUESTIONS TO CONSIDER

1. Is there an identified asset?
2. Is the asset on premise at the customer's location?
3. Does the customer have the right to obtain substantially all of the economic benefits from use of the identified asset throughout the period of use?
4. Does the customer or the supplier have the right to direct how and for what purpose the identified asset is used throughout the period of use? Or, are the rights pre-determined within the contract?
5. Does the customer have the right to operate the asset throughout the period of use without the supplier having the right to change those operating instructions?

EMBEDDED LEASES - QUESTIONS TO CONSIDER (CONTINUED)

6. Did the customer design the asset (or specific aspects of the asset) in a way that predetermines how and for what purpose the asset will be used throughout the period of use?
7. Does the customer have the ability or right to control physical access while obtaining or controlling more than a minor amount of the asset's output?
8. Is there only a remote possibility that one or more parties, other than the customer, would take more than a minor amount of the output and the price that the customer would pay for the output was neither contractually fixed per unit of output nor equal to the current market price per unit of output as of the time of delivery of the output?

Polling Question 2

Which of the following areas do you expect to be the biggest challenge facing your organization in relation to embedded leases?

- A. Ensuring we are analyzing a complete population of potential leases.
- B. Deciphering the technical guidance points on what constitutes an embedded lease.
- C. Identification of embedded leases on a go-forward basis after adoption.
- D. I do not expect identification of embedded lease to be a major challenge for my organization.



LEASE STANDARD ADOPTION | KEY IMPACTS, CONSIDERATIONS AND CHALLENGES

- ▶ Identify the Population – how does one ensure completeness of the lease population?
 - ▶ Identify all potential data sources
 - ▶ Understand current processes
- ▶ Begin Gathering the Data – what are some of the challenges with data collection?
 - ▶ Decentralized leasing process
 - ▶ Asset level tracking
 - ▶ Embedded and complex leases
- ▶ Validate Completeness and Accuracy of Collected Data – how does one validate lease data that has been gathered?
 - ▶ Cleanse data collected from multiple sources
 - ▶ Perform quality checks and normalize data
 - ▶ Abstract data into selected system data upload template

LEASE STANDARD ADOPTION | KEY IMPACTS, CONSIDERATIONS AND CHALLENGES

- ▶ System selection – what are some of the considerations in selecting an appropriate IT solution to account for leases?
- ▶ System configuration and implementation– what are some of the key activities and considerations during this phase?
- ▶ Business process – what are key impacts to existing business processes upon adoption and what are some of the future state design considerations?
- ▶ Accounting policies and elections – what accounting policy elections and expedients are available to help reduce the level of effort/ impact on adoption and thereafter?
- ▶ Accounting impacts upon adoption – what are some of the accounting impacts to consider and plan for on adoption?
- ▶ Audit considerations – what are some of the common questions and documentation requirements that the auditor will require or ask for?
- ▶ Other impacts – are there other impacts that should be considered?

Polling Question 3

How does your company intend to handle and maintain the required accounting once ASC 842 has been adopted?

- A. Leverage a module associated with our existing ERP vendor
- B. Implement an independent lease accounting system vendor
- C. Develop a customized spreadsheet model
- D. We have not determined how we will handle the lease accounting



LEASE STANDARD ADOPTION | KEY IMPACTS, CONSIDERATIONS AND CHALLENGES

- 1 COORDINATING INTERNAL DEPARTMENTS AND FUNCTIONS
- 2 INVESTING SIGNIFICANT TIME AND RESOURCES
- 3 MEETING THE JANUARY 2021 TIMELINE
- 4 MAKING TIMELY ACCOUNTING POLICY DECISIONS
- 5 IDENTIFYING EMBEDDED LEASES
- 6 SELECTING AND IMPLEMENTING LEASE SOFTWARE

POST IMPLEMENTATION CONSIDERATIONS AND CHALLENGES

- 1 AUTOMATING PROCESSES FOR GATHERING LEASE DATA
- 2 CONTROLS OVER THE ENTIRE LEASING ENVIRONMENT AND SYSTEM IMPLEMENTATION CONTROLS
- 3 IDENTIFYING AND ACCOUNTING FOR LEASE REASSESSMENTS AND MODIFICATIONS
- 4 ACCOUNTS PAYABLE SYSTEMS INTEGRATION
- 5 ABSTRACTION OF LEASE DATA FROM NEW AND MODIFIED LEASES
- 6 IMPROVEMENT OPPORTUNITIES - SYSTEMIZED CONTRACT MANAGEMENT AND LEASE MANAGEMENT

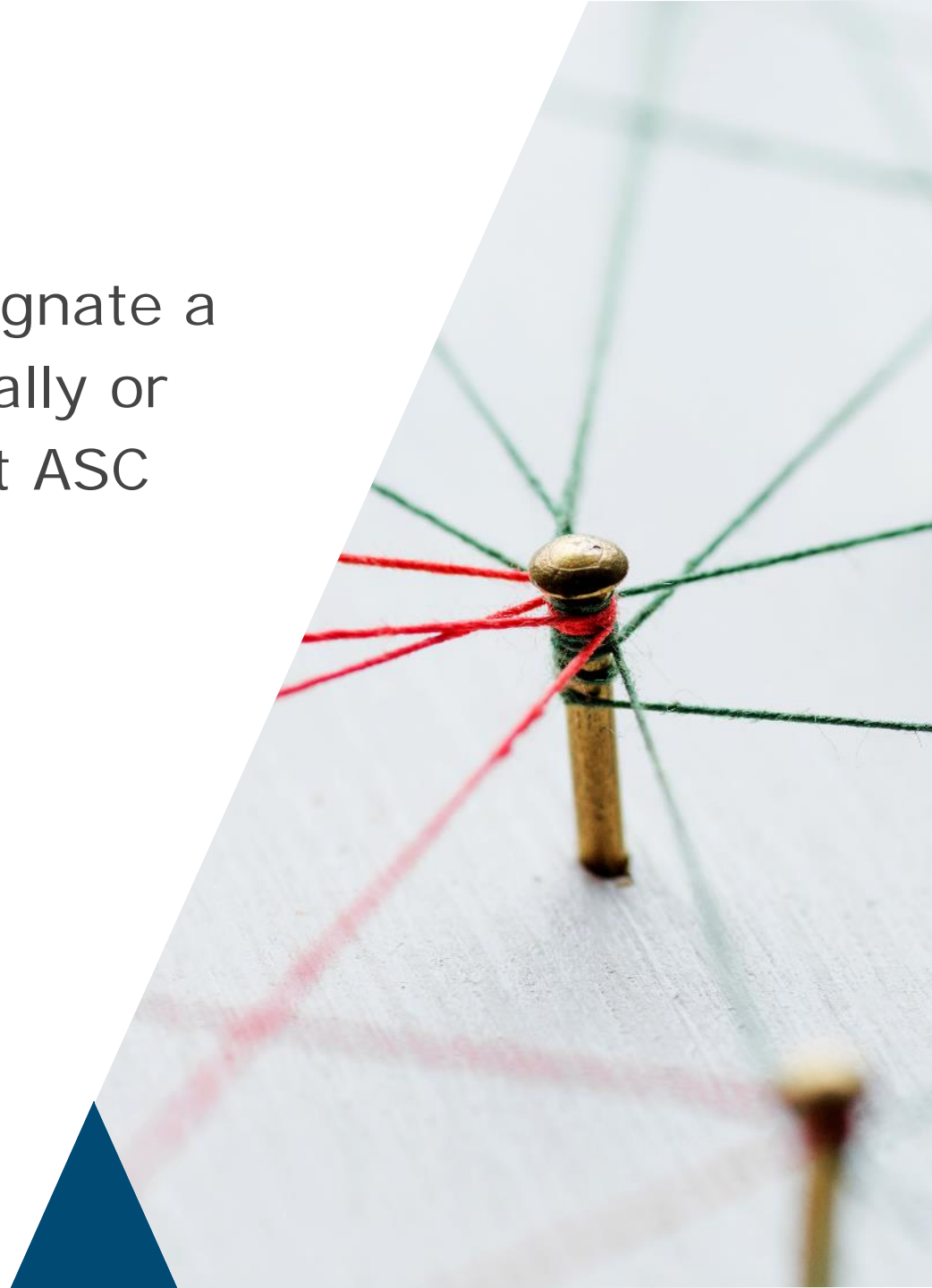
KEY LESSONS FROM PUBLIC COMPANY ADOPTION

- ▶ Importance of initial project planning and inclusion of representatives from all portions of the Company
- ▶ Data aggregation and validation prior to performance of completeness procedures
- ▶ Completeness procedures have taken far longer than initially thought, this is due to a variety reasons
- ▶ Existing agreements may contain embedded leases, introduction of subjective analysis
- ▶ Determination of appropriate go-forward lease tracking mechanism, many system implementations have been more burdensome than expected
- ▶ New and robust processes required to ensure post-implementation compliance with ASC 842

Polling Question 4

Will you or did you designate a project manager internally or externally to implement ASC 842?

- A. Internally
- B. Externally
- C. Combination of both
- D. Not sure yet



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Q&A