

ASK THE EXPERTS WEBINAR

*The Time is Now: Private Company
Adoption of ASC 842*

July 29, 2021

PRESENTERS



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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

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MARKET UPDATE

Polling Question #1

To determine the lease classification under ASC 842, how many criterion need to be reviewed?

- A. Three
- B. Four
- C. Five
- D. None, ASC 842 does away with lease classifications





FASB OBJECTIVES OF THE NEW STANDARD

In 2005 the SEC asked for greater transparency in financial reporting, which included the accounting treatment of leases. Historically, lease accounting was criticized by stakeholders and financial statement users for not depicting a clear view of a company's leasing activities. As a result, the new standard requires companies to recognize virtually all leases as assets and liabilities on the balance sheet.

THE NEW LEASE STANDARD

Provides greater transparency into a company's leasing activities – by moving the assets and liabilities onto balance sheets



Requires companies to keep an organized, consolidated listing of their lease portfolios – including related lease assets at the asset level



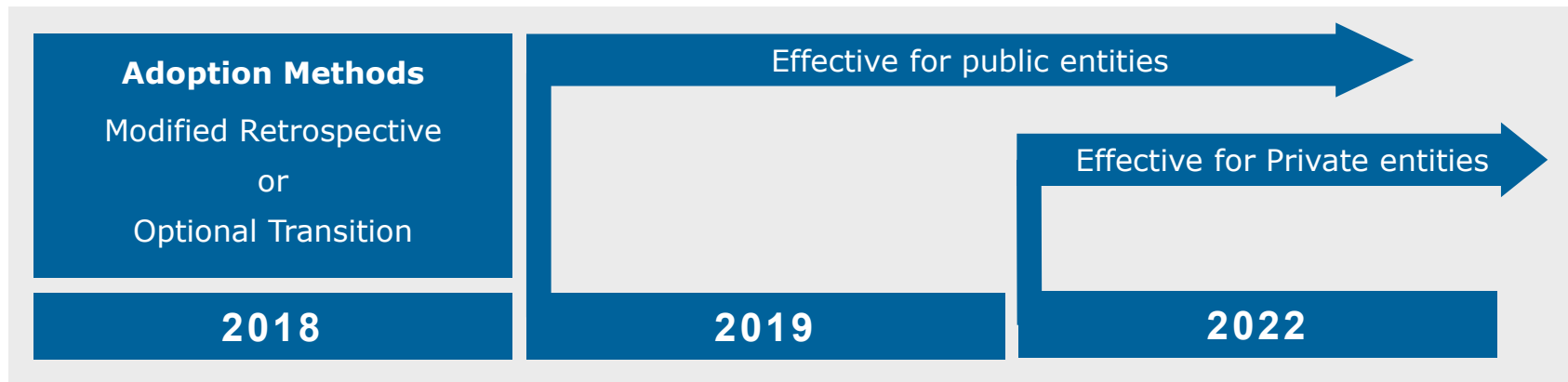
Enhances lease disclosures to include both qualitative and quantitative information





TIMELINE & ADOPTION

- ▶ Public entities: January 1, 2019 with annual periods beginning after December 15, 2018.
- ▶ All other nonpublic entities: January 1, 2022 for entities with annual periods beginning after December 15, 2021.



- ▶ Initially the transition method outlined in ASU 2016-02 required **modified retrospective** application to each comparative reporting period presented in the financial statements.
- ▶ In March 2018 the FASB approved an **optional transition method** that allows companies to use the effective date as the date of initial application. This can be done by booking a cumulative-effect adjustment to retained earnings in the period of adoption. The new method means entities may disclose comparative periods under ASC 840 and “simply” apply ASC 842 in the year of adoption.

SUMMARY OF KEY CHANGES IN LEASE ACCOUNTING GUIDANCE



AREA	OLD LEASE RULES ASC 840 (SFAS NO. 13)	NEW LEASE RULES ASC 842, LEASES	CHANGES
Lease Classification Criteria	<ul style="list-style-type: none"> ▶ 4 criteria ▶ "Bright lines" test 	<ul style="list-style-type: none"> ▶ 5 criteria (new criterion for specialized nature of asset) ▶ No "bright lines" test 	<ul style="list-style-type: none"> ▶ No "bright line" tests and added 5th criterion ▶ Can use thresholds as indicators
Lessor Perspective – Two Types of "Finance" Leases: (1) Sales Type or (2) Direct Financing If neither, an Operating Lease	<ul style="list-style-type: none"> ▶ If a finance lease, derecognize asset and record lease receivable, gain/(loss) and interest income; financing and operating cash flows ▶ If operating lease, keep asset and record lease income on S/L basis; cash flows are operating 	<ul style="list-style-type: none"> ▶ Sales type leases distinguished by transfer of ownership indicators ▶ If collectability is probable, recognize upfront profit on sales type leases ▶ Direct financing lease recognizes gain over lease term 	<ul style="list-style-type: none"> ▶ Definitions. If classified correctly, no significant changes in accounting ▶ No need to break out in lease class testing ▶ Accounting for sales type and direct financing is distinguished by upfront profit
Lessee Perspective – (1) Finance Lease (2) Operating Lease	<ul style="list-style-type: none"> ▶ (Capital lease i.e., finance lease): asset and lease liability; amortize and interest expense; financing and operating cash flows ▶ (Operating lease): rent expense recognized on a S/L basis over lease term; operating cash flows 	<ul style="list-style-type: none"> ▶ Balance sheet is same: ROU asset and liability (PV of lease payments) ▶ (Finance Lease): amortization and interest expense; financing and operating cash flows ▶ (Operating lease): rent expense recognized on a S/L basis over term; operating cash flows 	<ul style="list-style-type: none"> ▶ All leases (>12 months) now recorded on balance sheet of lessee ▶ Additional disclosures are required in audited financial statements



MEASUREMENT & RECOGNITION – LESSEE

- ▶ Right-of-use (ROU) Asset = PV Lease liability + Prepaid Lease Payments - Lease Incentives + Initial Direct Costs
 - ▶ Discount rate: Implicit in lease contract or incremental borrowing rate
 - ▶ Nonpublic companies can elect to use the risk free rate as a practical expedient
 - ▶ Lease contracts may contain both lease and non-lease components. ASC 842 requires a reporting entity to allocate the contractual consideration between components of the arrangement
 - ▶ Lease Term: Non-cancellable period of the lease.
 - ▶ Renewal/Option year = Include option years if lessee is reasonably certain it will exercise
- ▶ Lease Liability is measured at the Present value of lease payments not yet paid. Discount rates and lease term considerations are the same as above
 - ▶ Lease Payments: Include fixed, variable payments that depend on index/rate, in-substance fixed payments, option year payments (consistent with lease term used), residual value guarantees

LESSEE	BALANCE SHEET	INCOME STATEMENT	CASH FLOW STATEMENT
Finance Lease	Right-of-use asset & lease liability	Amortization expense	Principal = Financing
		Interest expense	Interest = Operating
Operating Lease		Straight-line lease expense	Operating



POLICY ELECTIONS/DECISIONS TO BE MADE

#	ELECTION DESCRIPTION	BEST PRACTICE
1	Use of bright-line thresholds	Yes
2	Lease & non-lease components	
3	Package of practical expedients	Yes
4	Hindsight	
5	Land easements	
6	Expense leases under specified threshold	Yes
7	Determine treatment of short-term leases	Yes
8	Determine asset classes	Yes
9	Determine economic life by asset class	Yes
10	Definition of reasonably certain	
11	Determine policy parameters around development of incremental borrowing rate / risk-free rate	Yes
12	Separating land and building components	



ASC 842 ADOPTION CHECKLIST

- ☒ Identify **key stake holders** to own the analysis and implementation processes
- ☒ **Gathering the data**; challenges can be decentralized leasing process, asset level tracking & embedded/complex leases, identifying embedded leases
- ☒ **Validate completeness and accuracy of collected data** by completing quality checks, normalize data, abstract data into analysis tool/technology
- ☒ Review practical expedients and **formulate adoption policies** that are reasonable with respect to the current and future state of the lease portfolio
- ☒ Identify and evaluate key **commercial terms & conditions** in the lease agreements
For example: lease term, interest rate, required lease payments, etc.
- ☒ Determine **classification** of leases and **measure and recognize** assets and liabilities based on new requirements in ASC 842
- ☒ Develop **financial reporting tools** with key leasing metrics to ensure compliance with ASC 842 disclosure requirements
- ☒ **Consider investing in lease software** to allow for an expedited transition as well as increased organization and automation in adding new leases to your portfolio

Polling Question #2

As you're evaluating ASC 8 you intend to adopt using:

- A. MS Excel
- B. Lease specific software
- C. Uncertain
- D. We already have a software



FINANCIAL TECHNOLOGY HAS ENTERED A NEW ERA



DATABASES



CLOUD



**AI &
ALGORITHMS**

YET THE FLOW OF FINANCIAL DATA IS OFTEN SILO-ED



Source Data

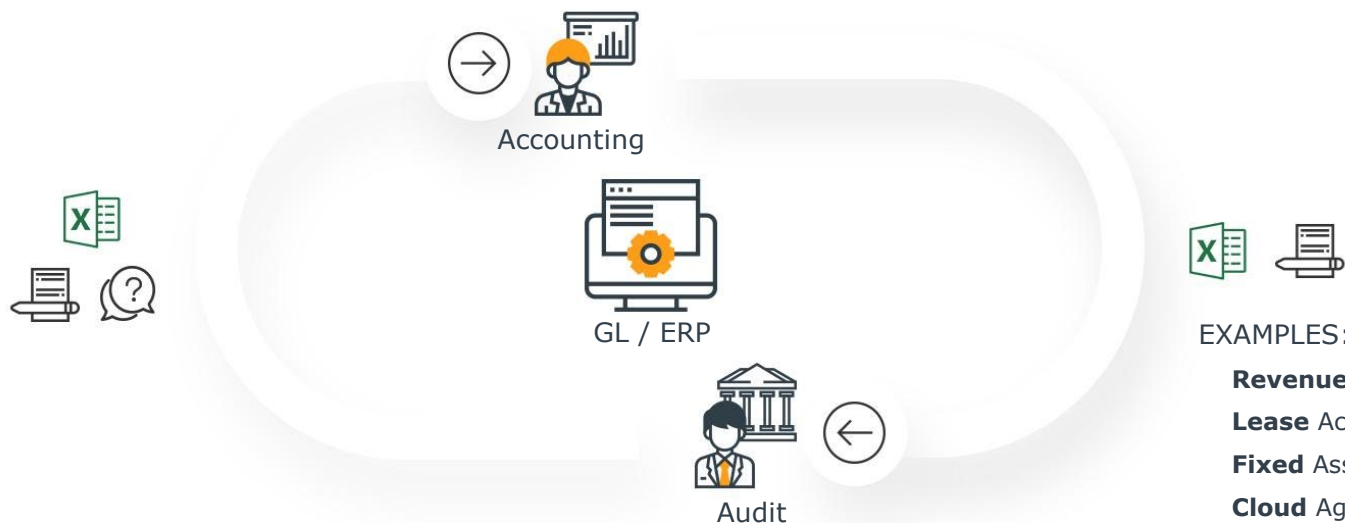
Accounting

GL / ERP

Audit

Stakeholders

NEW ACCOUNTING STANDARDS ARE INCREASING IN COMPLEXITY, CREATING RISK OF MORE MANUAL PROCESSES



EXAMPLES:

- Revenue** Recognition
- Lease** Accounting
- Fixed** Assets
- Cloud** Agreements

COULD A.I. ENABLE MORE ACCURACY?

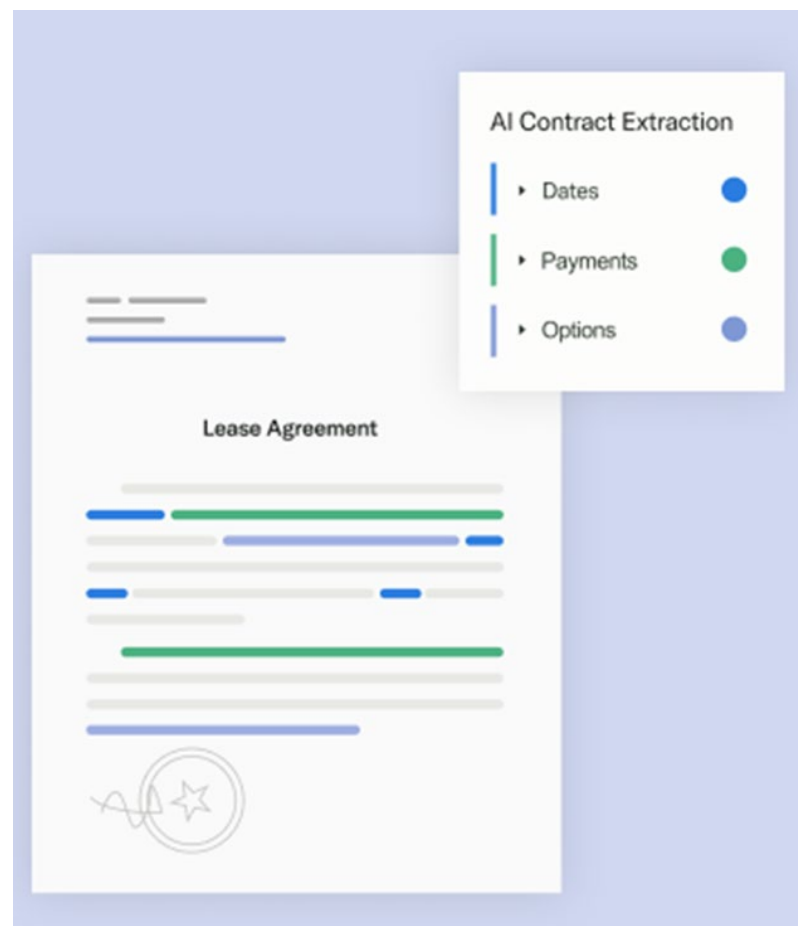


Types of AI:

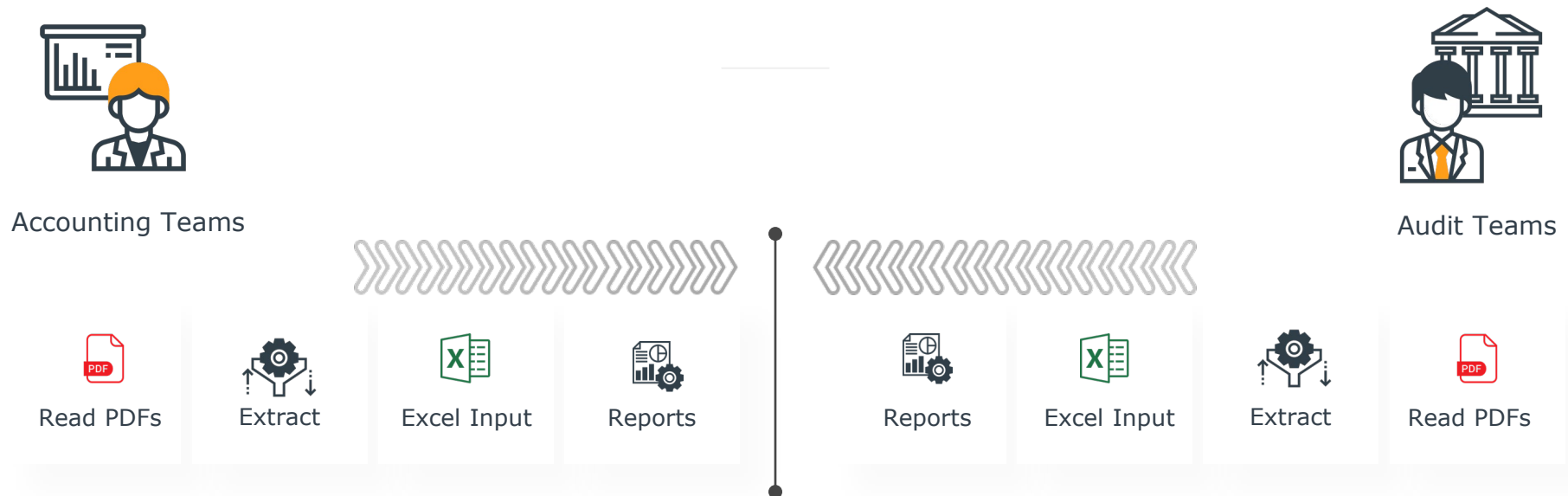
- ▶ Image Recognition / OCR
- ▶ Natural Language Processing (“NLP”)
- ▶ Machine Learning

Current Applications:

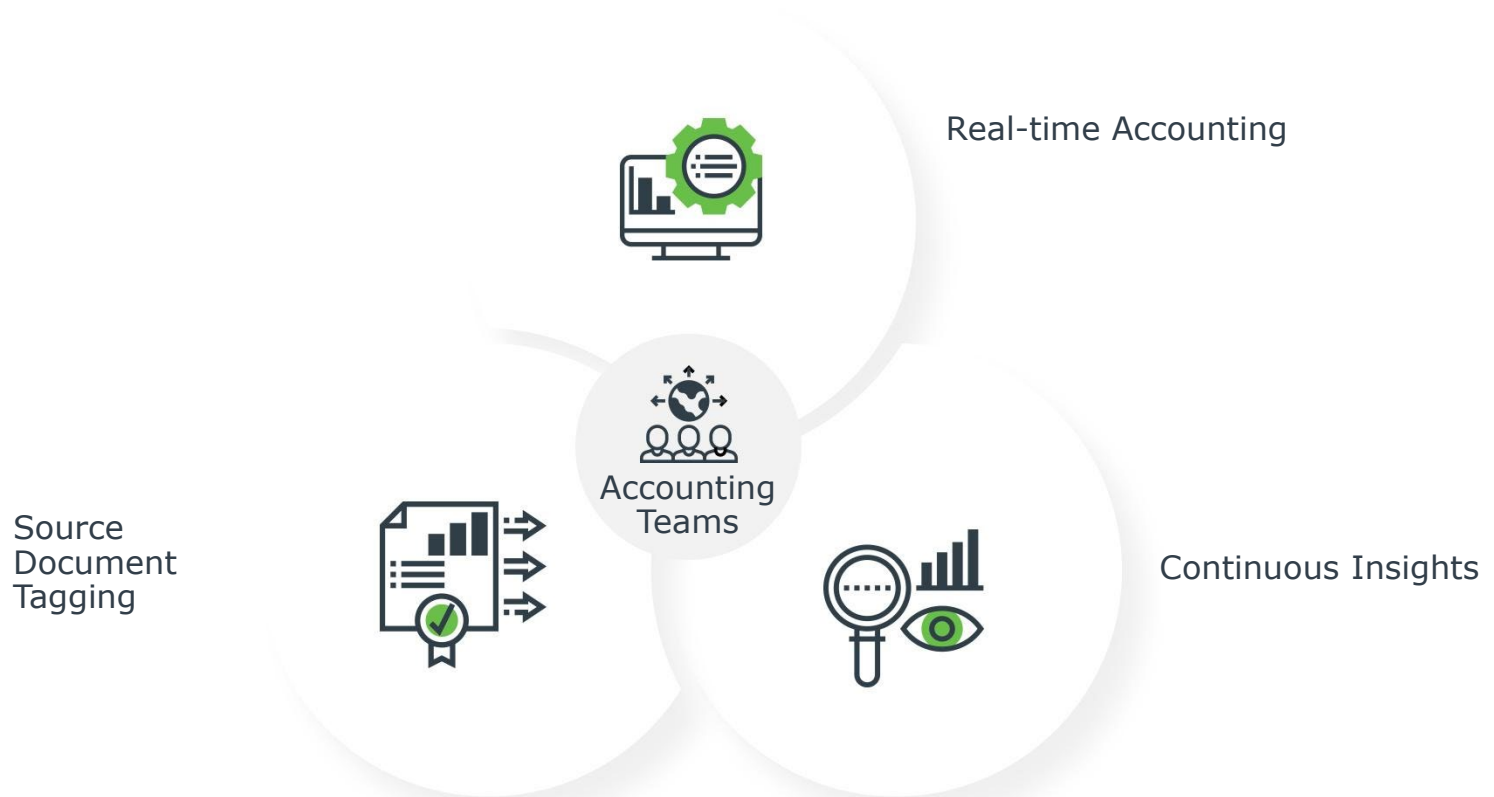
- ▶ Structured - Invoices
- ▶ Semi-Structured - Contracts, ie. Employee, Sales, Leases, Vendors, etc.
- ▶ Unstructured - Verbal agreements, e-mails, board meeting notes, handwriting, etc.



ASC 842 PROCESS (MANUALLY)



ASC 842 PROCESS (WITH TRULLION)



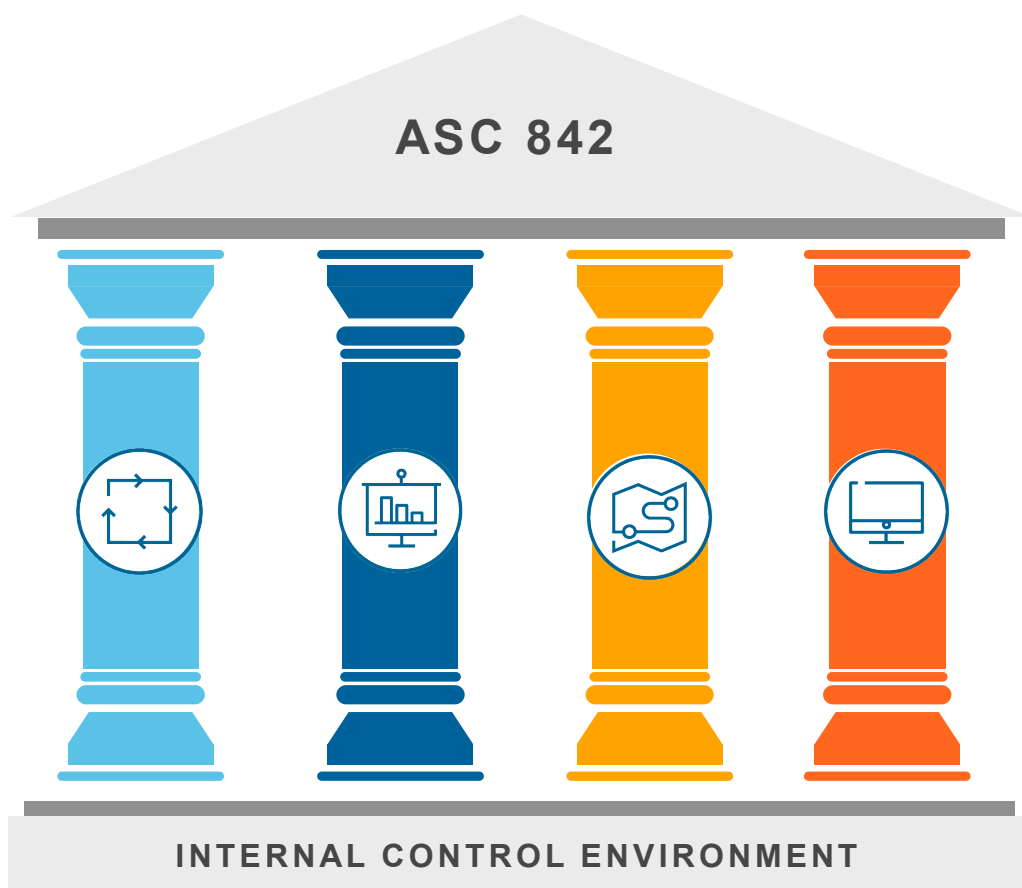
Polling Question #3

How familiar are you that embedded leases may exist your current portfolio?

- A. Not familiar
- B. Somewhat understand that ve contracts need to be assessed
- C. We have already completed ou analysis and have a full popula
- D. What is an embedded lease?



PILLARS OF INTERNAL CONTROLS TO CONSIDER WHEN ADOPTING ASC 842



1. Transition

- ▶ Accurate and complete accounting
- ▶ Documentation/Adoption Memo

2. Reporting

- ▶ New footnote disclosure and checklist
- ▶ Management/Ad-Hoc reports

3. Future Activity

- ▶ Periodic embedded lease review
- ▶ Changes to lease portfolio

4. Technology

- ▶ GITC's to be put in place at transition
- ▶ Appropriate segregation and audit trail

THERE ARE ELEMENTS BENEATH THE SURFACE OF THE ADOPTION THAT ARE COMPLEX



"Adopting the standard is a complex and time-consuming process"

- 1 **Portfolio completeness** ✓
- 2 **Data abstraction/Normalization** ✓
- 3 **Technology adoption/upgrade** ✓
- 4 **Teamwork/Collaboration** ✓
- 5 **Future State Design** ✓

COMPLETENESS OF THE PORTFOLIO



Complexity



- ▶ Embedded lease assessment is a significant lift with no clear S.O.P
- ▶ Data is often in many different locations and will need to be accumulated for the assessment
- ▶ All amendments and renewals need to be included



Approach



- ▶ Begin with vendor assessment
- ▶ Clearly document the embedded lease assessment approach and results
- ▶ Engage auditor to discuss the feasibility of the approach

DATA ABSTRACTION & NORMALIZATION



Complexity



- ▶ A clear and in-depth understanding of the standard is required by those performing abstraction
- ▶ Professional judgement and scrutiny required on many datapoints
- ▶ The effort is often underestimated



Approach



- ▶ Develop cross functional team to work on abstraction
- ▶ Train the team involved in abstraction and assign an SME
- ▶ Develop quality control plan early on

TECHNOLOGY



Complexity



- ▶ Implementation of new system is time consuming
- ▶ Potentially requires customization to accommodate desired future-state
- ▶ MS Excel does works for adoption



Approach



- ▶ Adopt a tool if there is frequent activity or if the portfolio is 10 leases or greater
- ▶ Establish internal controls within the software before go-live
- ▶ Process first, Tech second: Technology does not replace good processes

TEAMWORK & COLLABORATION



Complexity



- ▶ Involves multiple departments, not only accounting (change management)
- ▶ Socializing the desired outcomes of adopting the standard is often neglected
- ▶ The teams understanding of the standard is critical



Approach



- ▶ Appoint cross functional team early including all affected departments
- ▶ Critical roles of leader, change agent and SME needs to be assigned

THINKING BEYOND IMPLEMENTATION



Complexity



- ▶ Adoption of the standard often focuses only on compliance and not sustainable future-state
- ▶ Maintenance of the standard is viewed as a simple task
- ▶ M&A can easily disrupt the process



Approach



- ▶ Let the software do the heavy lifting (JE's and disclosure)
- ▶ Build change management program and consistent review into the future-state process
- ▶ Consider possible M&A activity in near or medium term

Polling Question #4

What is the size of you lease portfolio?

- A. 1 - 10 leases
- B. 10 - 50 leases
- C. 50 - 100 leases
- D. 100+ leases



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Q&A

RIVERON RESOURCES

Related Thought Leadership

[Lease Accounting for Private Companies: Transition Strategies and Impacts](#)

[Changes to the New Lease Accounting Standard: FASB Provides Updates](#)

[Webinar: ASC 842 Updates, Pain Points, and Keys to Success](#)

View additional insights [HERE](#)

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