



# Lease Accounting:

Top items to discuss with your auditors  
at year end

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# Presenters



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# Learning objectives

- Review key differences between ASC 842 and ASC 840
- Analyze auditor considerations for the new lease accounting standard as 2017 closes
- Determine conversations to have with auditors regarding the leasing standard

# Background

## Overview

- Balance sheet recognition of liabilities related to operating leases
- Definition of a lease
- Lessee accounting
  - Operating leases
  - Finance leases
- Lessor Accounting
- Sale and Leaseback

# Three key components

## Definition of a lease

### Identified asset

- Physically distinct
- Explicitly or implicitly identified
- No substantive substitution rights

### Right to control use of the asset

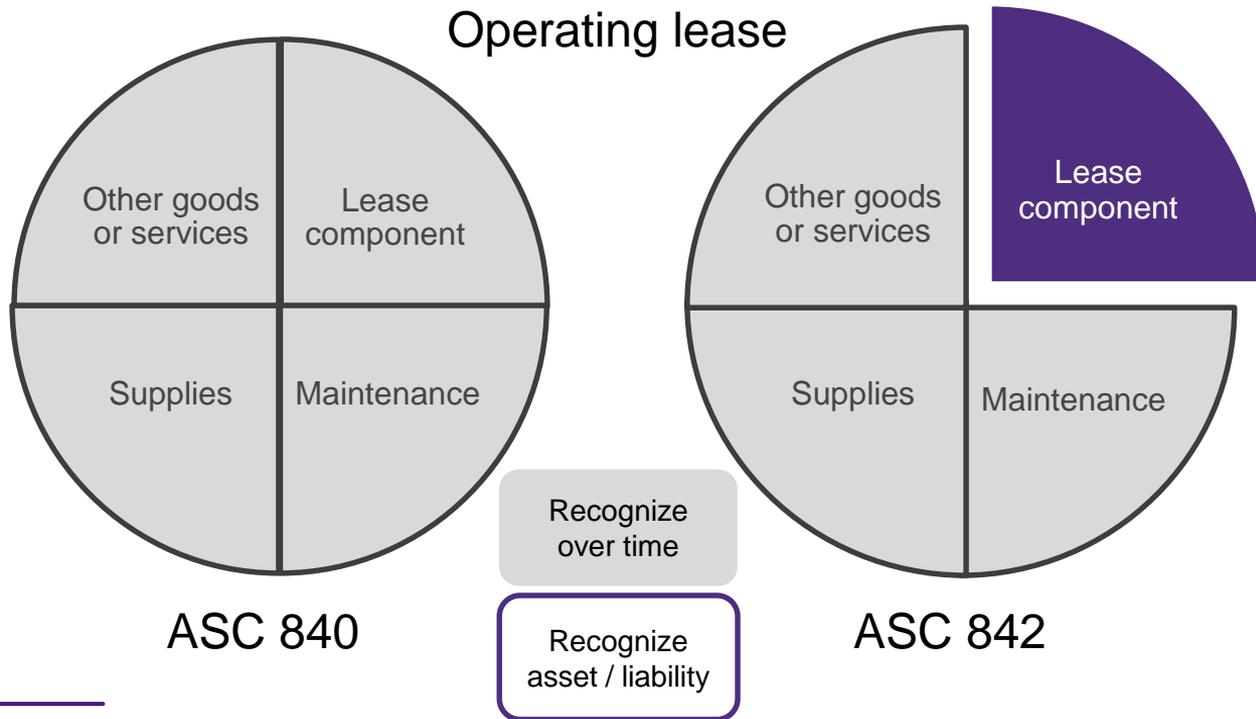
- Right to obtain substantially all economic benefits from use
- Right to direct the use

### Period of use

- Time
- Output

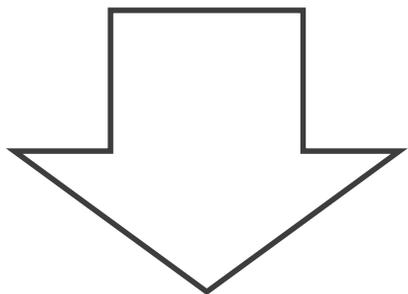
# Change in practice

## Components of the contract



# Practical expedient

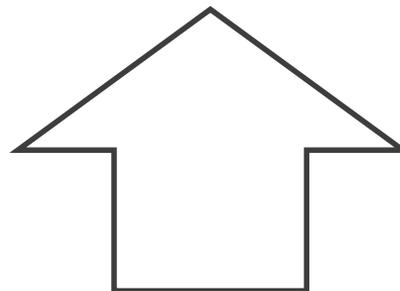
## Components of the contract



Less effort to  
combine lease and  
nonlease  
components ...

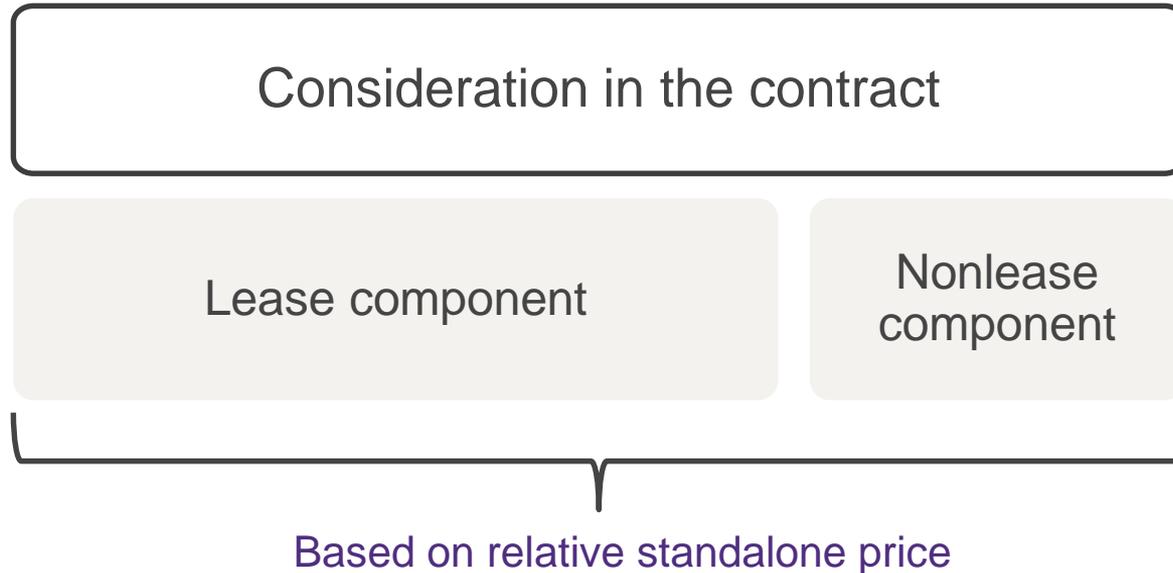


... but the initial  
measurement of  
liability and asset  
will increase.



# Allocate consideration

## Components of the contract



# Lease payments

## Components of the contract

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Lease  
payments

Fixed payments, including in-substance fixed payments, less  
lease incentives

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Variable lease payments that depend on a rate or index

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Exercise price of option reasonably certain of exercise

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Termination penalty if lease term assumes termination option  
exercised

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Structuring fees paid to SPE owners

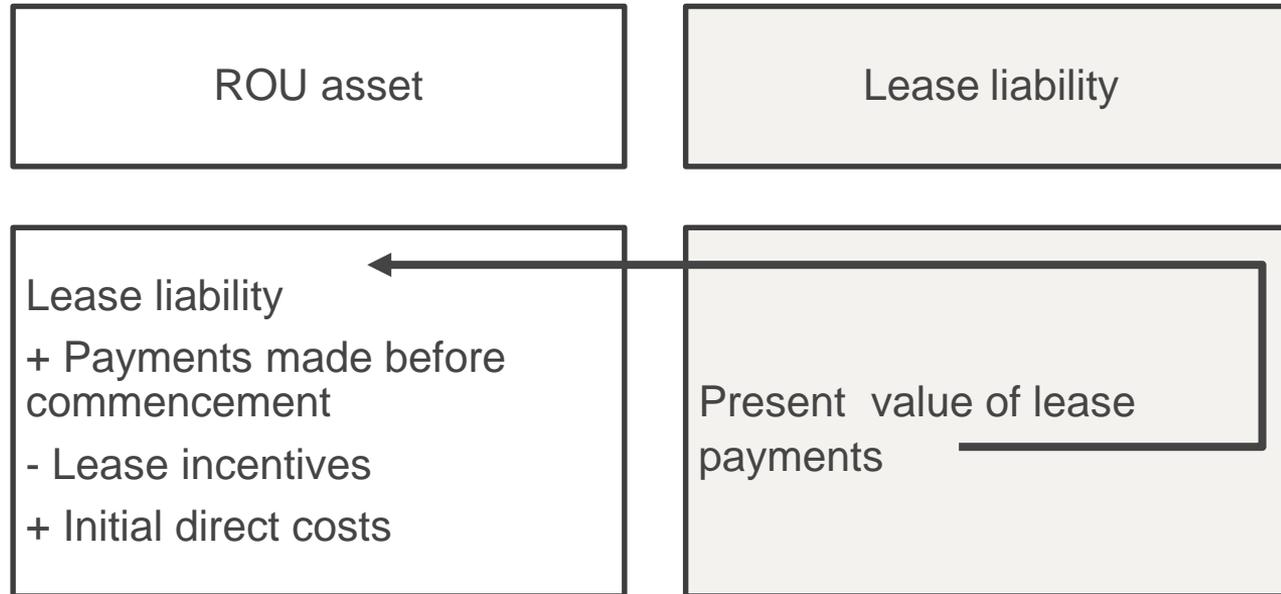
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Amounts probable of being owed under residual value  
guarantee

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# ROU asset and lease liability

## Initial measurement



# Initial direct costs

## Initial measurement

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Incremental costs of a lease that would not have been incurred if the lease had not been obtained

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Broker  
commissions



Legal costs  
for structuring  
transaction

# Short term leases

## Initial measurement

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Can elect to account for short term leases "off balance sheet"

Lease term 12 months or less

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Policy election by class of underlying asset

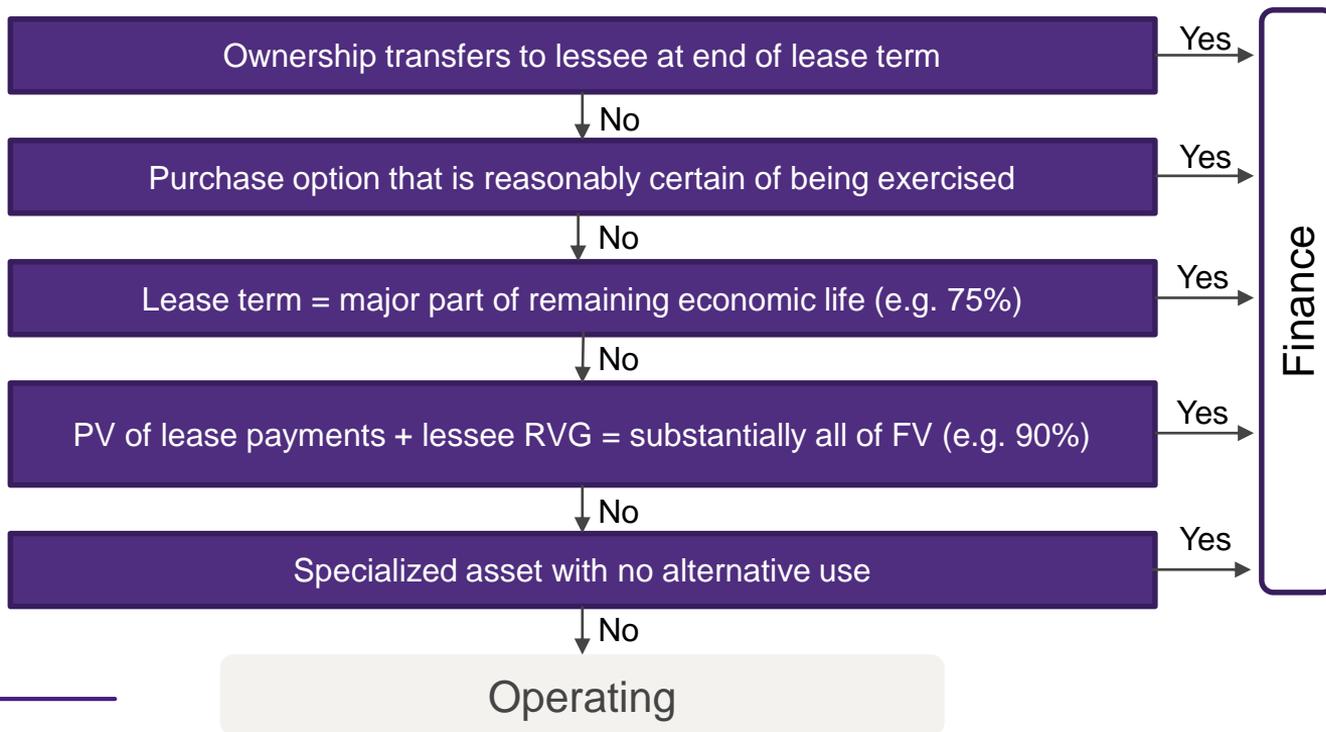
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Similar to old operating lease accounting

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# Finance or operating

## Classification



# Lease term definition

## Classification

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Non-cancellable period for which lessee has the right to use underlying asset, plus...

Periods covered by renewal option if lessee **reasonably certain** to exercise

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Periods covered by option to terminate if lessee reasonably certain **not** to exercise

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Periods covered by renewal or termination options **controlled by the lessor**

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# Discount rate

## Classification

Implicit rate

- Use when readily determinable
- Often not known to lessee

Incremental borrowing rate

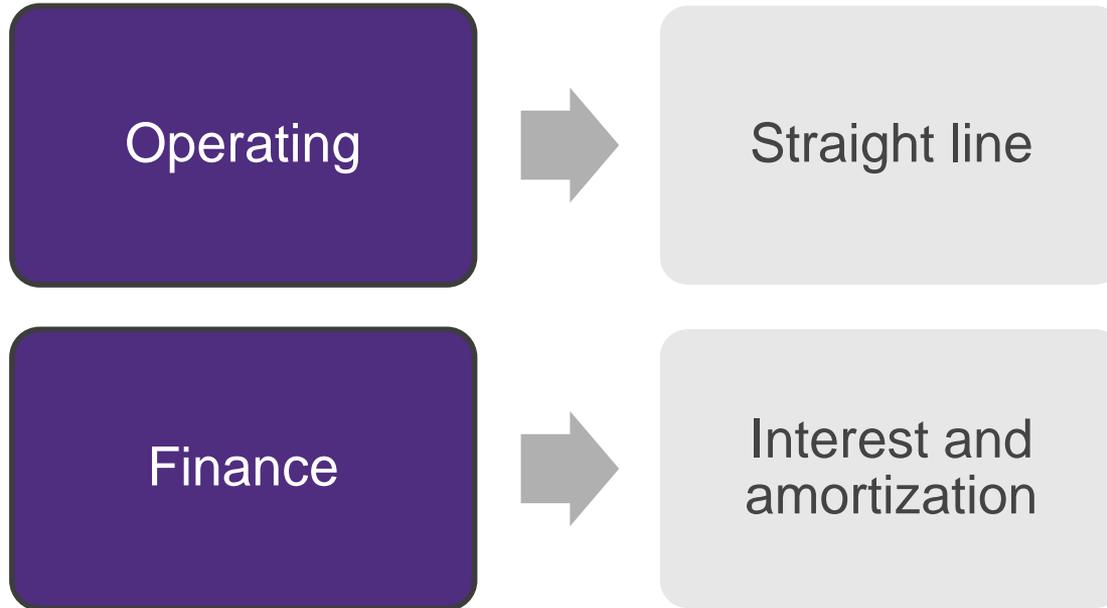
- Rate lessee would pay to borrow on collateralized basis
- Assume similar term/environment

Risk-free rate

- Practical expedient for private companies and not-for-profits
- Would likely increase measurements

# Familiar expense recognition pattern

Subsequent measurement



# ROU asset and lease liability

## Subsequent measurement

	<b>Operating</b>	<b>Finance</b>
ROU asset	Lease liability + prepaid rent - accrued rent - remaining incentive + unamortized initial direct costs - impairment	Previous carrying amt - accumulated amortization - impairment
Lease liability	PV of remaining lease payments	Previous carrying amt + interest expense - lease payments

# Remeasurement

## Subsequent measurement

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Lessee shall  
remeasure lease  
payments when:

Contingency related to variable payments is resolved

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Change in lease term

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Change in assessment whether lessee is reasonably  
certain to exercise purchase option

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Change in amounts probable of being owed by lessee  
under residual value guarantee

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# Summary

## Disclosures

Enable users to assess amount, timing, and uncertainty of cash flows arising from leases

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### Qualitative disclosures

General description of lease

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Basis and terms and conditions of variable lease payments, extension and termination options, and residual value guarantees

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Restrictions or covenants imposed by leases

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Significant assumptions and judgments made in identifying a lease, allocation of lease consideration, lease term, and discount rate

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Significant rights and obligations for leases not yet commenced

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# Summary

## Disclosures

Enable users to assess amount, timing, and uncertainty of cash flows arising from leases

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Quantitative disclosures

Finance lease cost (separating amortization and interest cost)

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Operating lease cost

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Short-term lease cost

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Variable lease cost

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Separately for finance and operating leases: cash paid, weighted-average remaining lease term, weighted-average discount rate, supplemental noncash information about lease liabilities recognized from obtaining ROU assets, maturity analysis of undiscounted lease cash flows and a reconciliation of undiscounted cash flows to lease liabilities

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# Implementation challenges identified

- Identifying the population of contracts
- Determining whether a contract meets the definition of a lease
- Understanding debt covenants
- Balancing resource constraints
- Understanding transition methods and practical expedients available
- Assessing system capabilities / IT needs
- Provide appropriate and evolving transition disclosures along with the impact of the leasing standard. Such disclosure should be subject to effective internal control over financial reporting.

# Status check with the audit committee

- What is the status and progress of implementation efforts?
- What implementation issues/challenges have been identified?
- What significant areas remain?
- What is the company's implementation timeline?
- What is the company's plan for internal controls over the change process?
- Focus on audit committee and investor outreach as well as education.

# ASC 842 results from recent internal survey

Areas of client focus during implementation of ASC 842	Appl. %
Updating financial reporting to reflect proper accounting and required disclosures	62.4%
Modifying existing processes, controls and accounting policies	55.8%
Accumulating the correct data (locating contracts, evaluating duplicate contracts, identifying all the potential sources, etc.)	49.2%
Staffing sufficient internal / external resources	33.0%
Identifying embedded leases	25.9%
Compiling / updating leasing data in leasing software	18.8%
Selecting and implementing new technology / IT system to track	18.8%
Complying with debt covenants	6.1%

# Learn more:

1

Find out how lease data can open new opportunities for your business in “[New lease accounting: Mitigate risks, tap opportunities](#)”

2

Visit “[An integrated approach to lease accounting](#)” for more information about issues and solutions.

3

See “[Lease accounting changes: Frequently asked questions](#)” to read about implications for U.S. leases.

4

For audit-focused tips see, “[Audit committee spotlight: Getting ready for lease accounting changes](#)”

# Presenters



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