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FASB Accounting Standards Update 2016 – 02 Leases

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Outline

- Why Change
- Key Points and Who is Affected
  - Effect on Lessors
  - Effect on Lessees
    - Lessee Example
- IFRS Comparison
- Summary, Questions, and Contact Info

POLLING QUESTION #1

Have you reviewed the impact that the new leasing standard will have on your organization?

- Yes
- No
- Briefly
- Unsure

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Why Change?

- Improve presentation of rights and obligations arising from leases by lessees
- Improve comparability of lessees' financial commitments
- Clarify definition of lease
- Provide fewer opportunities to structure leasing transactions to achieve a particular accounting outcome on the balance sheet

Key Points

- Defines a lease as a contract that conveys the right to control the use of identified property, plant, or equipment (an identified asset) for a period of time in exchange for consideration
- Control is:
  – The right to obtain substantially all of the economic benefits from use of the identified asset
  – The right to direct the use of the identified asset

Who is Affected?

- Lessors
- Lessees
- Financial Institutions
- Lenders and Borrowers

Effect on Lessors

- Largely unchanged
  - Continue to recognize lease income on straight-line basis
  - Previously classified operating leases will remain operating leases
- Maintains three classifications:
  - Sales-Type
  - Direct Financing
  - Operating Leases

Effect on Lessors – Potential Differences

- Some variable lease payments that were previously classified as operating leases may now be classified as sales-type or direct financing leases.
- Initial direct costs are now more limited so certain costs may now have to be expensed.
- The timing of recognition of a profit or loss resulting from a sales-type lease may be different.

POLLING QUESTION #2

Have you taken any steps (such as implementing a software solution) to account for your leases going forward?

- Yes
- No
- Don’t know where to start
- Unsure

Effect on Lessees

- Maintains two lease classifications:
  - Financing leases – similar to previous definition of capital leases
  - Operating leases
- **Key change: Operating leases will now be included on the balance sheet**

Effect on Lessees

- Certain bright-line tests for determining lease classification are not included in new guidance
- Lessee and Lessor are required to consider whether lease renewal and termination options are reasonably assured to be exercised.
- Overall, there will be more judgment in determining lease classification.

Effect on Lessees – Finance Leases

- Recognize a right-of-use asset and a lease liability, initially measured at the present value of the lease payments, in the statement of financial position
- Recognize interest on the lease liability separately from amortization of the right-of-use asset in the income statement
- Classify repayment of the principal portion of the lease liability within financing activities and interest payments within operating activities in the statement of cash flows.

Effect on Lessees – Operating Leases

- Recognize a right-of-use asset and a lease liability, initially measured at the present value of the lease payments, in the statement of financial position
- Recognize a single lease cost, calculated so that the cost of the lease is allocated over the lease term generally on a straight-line basis
- Classify all cash payments within operating activities in the statement of cash flows.

Effect on Lessees – Example Financing vs. Operating Lease

- Term – 3 year lease with annual payments of $10,000, $12,000,and $14,000
- No purchase option, payments prior to commencement, or initial direct costs
- Initial measurement of right-of-use-asset - $33,000 using a discount rate of 4.235%.
- Scenario A – Financing Lease of Equipment
- Scenario B – Operating Lease of Office Space

Time	Lease Liability	Accrued Rent*	ROU Asset	Interest Expense	Amort. expense	Total Expense
Scenario A - Financing Lease of Equipment						
Initial	33,000		33,000			
Year 1	24,398		22,000	1,398	11,000	12,398
Year 2	13,431		11,000	1,033	11,000	12,033
Year 3	-		-	569	11,000	11,569
				3,000	33,000	36,000
Scenario B – Operating Lease of Office Space						
Initial	33,000	-	33,000			
Year 1	24,398	(2,000)	22,398			12,000
Year 2	13,431	(2,000)	11,431			12,000
Year 3	-	-	-			12,000
						36,000

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*Prepaid and accrued rent amounts would not be presented separately on the balance sheet. Instead, the ROU asset would be presented on the balance sheet net of cumulative prepaid or accrued amounts

Effect on Lessees – Other Considerations

- Short term leases - accounting policy election can be made to not recognize lease assets and liabilities for leases less than 12 months.
- Private companies can use risk-free rates when determining the present value of lease liabilities.

POLLING QUESTION #3

The FASB's objective for the new standard is to increase the comparability of financial statements surrounding leasing transactions. Do you feel this new standard will accomplish this goal?

- Yes
- No
- Unsure

Effective Dates and Transitions Guidance

- Public Companies
  - Annual and interim periods beginning after December 15, 2018
- Non-public Companies
  - Annual periods beginning after December 15, 2019
  - Interim periods beginning with fiscal years beginning after December 15, 2020

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Effective Dates and Transitions Guidance

- Modified retrospective approach
- Practical Expedients (if elected, must be applied as a package and consistently to all lease) – No need to reassess:
  - Whether existing contracts contain leases
  - Lease classification for existing leases
  - Initial direct costs for existing leases

US GAAP vs IFRS

- Overall, US GAAP and IFRS will be generally similar.
- Differences that could be significant to some companies include:
  - IFRS has exception for low value leases
  - IFRS permits recognition and measurement to certain lease of intangible assets
  - IFRS does not permit nonpublic companies to use risk-free rate for discounting
  - IFRS does not does not distinguish between sales-type and direct financing lease

POLLING QUESTION #4

Do you think your customers will be adequately prepared to adopt this new change?

- Yes
- No
- Unsure

Summary

- Most significant effect is operating leases will now be included on balance sheets of lessees
- Companies should begin accumulating lease data to determine the effects
- Stayed tuned for regulatory guidance that could impact capital calculations

Questions?

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