



Introduction to ASC 842 and EZLease



Financial Computer Systems Inc.

www.ezlease.net

(203) 652-1375

The road to ASC 842

- Begun in July 2006; joint project of FASB & IASB
- Primary purpose: Put lessee operating leases on balance sheet ✓
- Secondary purpose: Converged standard ☒
- Exposure drafts in 2010 & 2013
- Final release: February 2016
- Implementation: 2019 for public companies
 - Year end 2020 for non-public entities
 - Restate prior comparative years (usually 2)



New terminology

FAS 13	ASC 842
Capital lease	Finance lease
Gross asset	Right-of-use asset
Obligation	Liability
Capital rate	Discount rate
Tenant allowance	Lease incentives
Contingent rent	Variable lease payments
Executory costs	Nonlease components (new definition)



New definitions

- Lease: “a contract, or part of 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.”
 - Exclusions: intangible assets, biological assets, inventory, assets under construction, exploration or use of minerals, oil & gas, etc.



New definitions

- Initial direct costs: “Incremental costs of a lease that would not have been incurred if the lease had not been obtained.”

Included	Not included
Commissions	Legal fees and tax advice
Incentives to vacate	Overhead expenses, employee pay, depreciation
	Advertising



Nonlease components

- Replacement for executory costs
 - Existing leases keep executory costs until expiration or ASC 842 modification
 - Put executory costs on operating leases
- Not capitalized
- “Transfer a good or service to the lessee”
- Practical expedient option not to separate components: everything capitalized
 - Chosen by class of underlying asset



Nonlease components

Qualifies

- Service contract
- Consumables
- Common area maintenance

Does not qualify

- Administrative fees
- Reimbursement of costs (taxes, insurance)

Gross lease: All costs (except maintenance) capitalized

Net lease: Taxes and insurance not capitalized

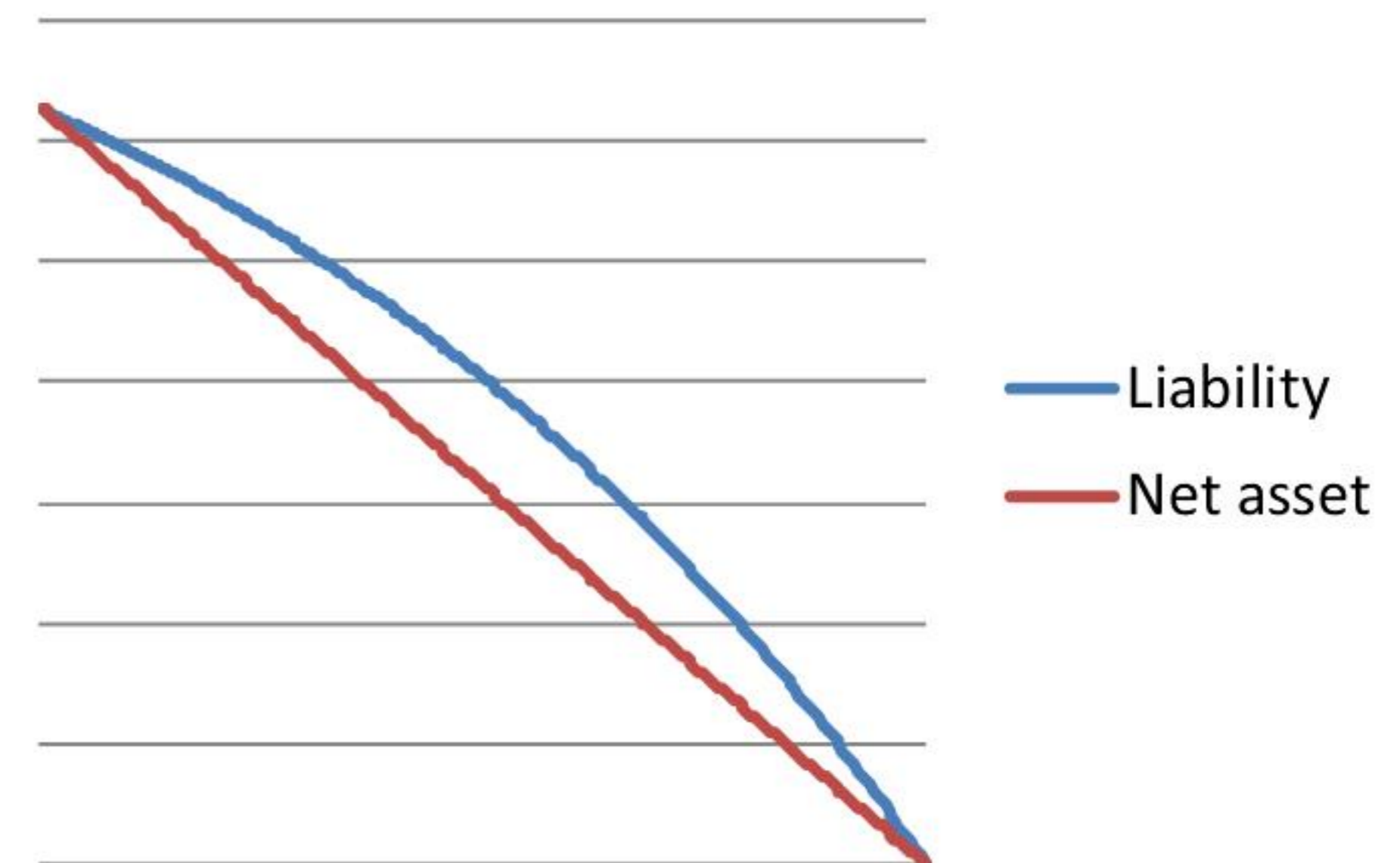
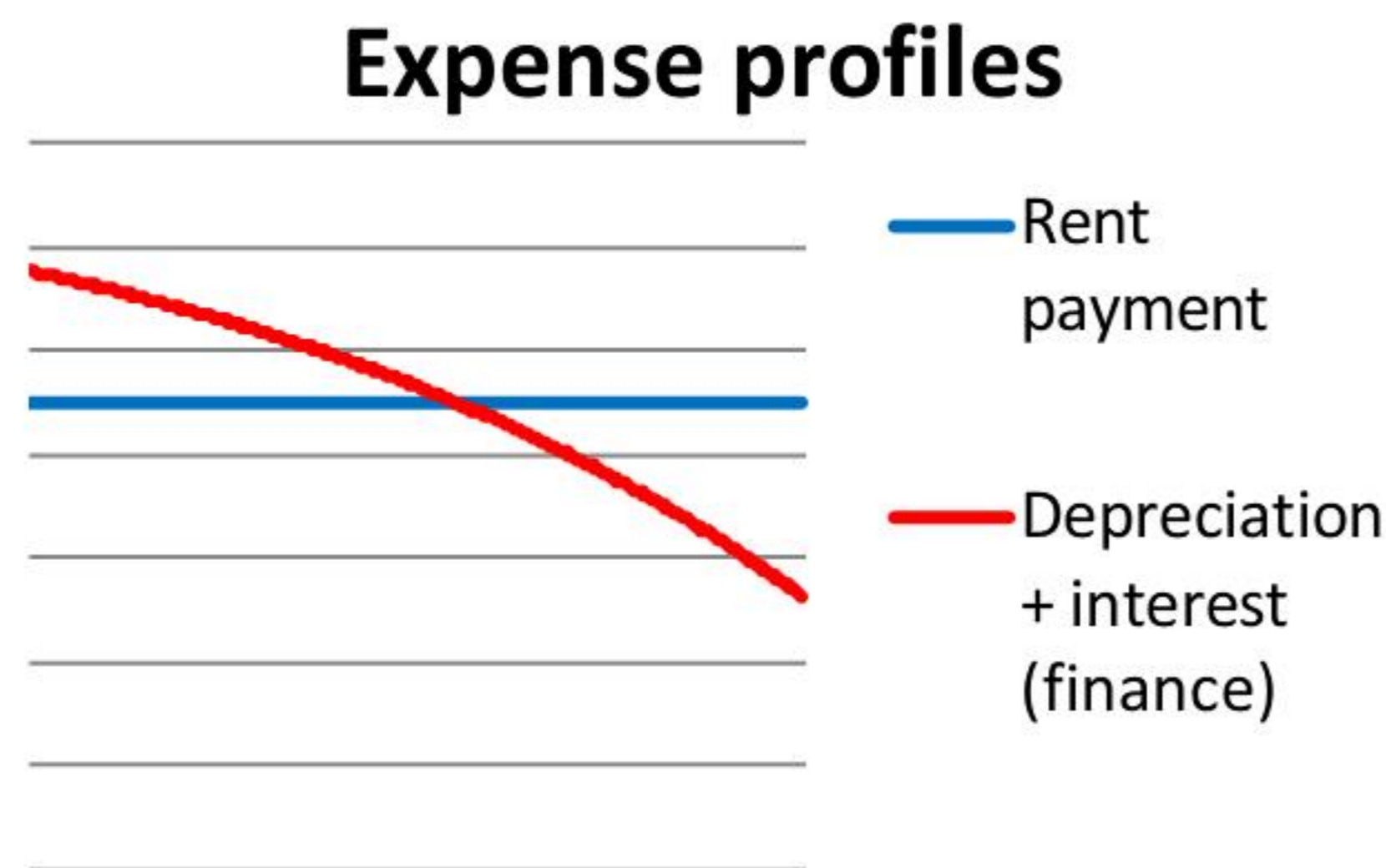
Finance vs. operating

- “Principles-based tests” (842-10-25-2)
 - Ownership transfer
 - Purchase option that lessee is reasonably certain to exercise
 - Lease term for the major part of the remaining economic life of the underlying asset
 - Present value of lease payments and guaranteed residual equals or exceeds substantially all of the fair value of the underlying asset.
 - Specialized asset (no alternative use for lessor)
- “One reasonable approach” is the FAS 13 thresholds for lease term (75%) and present value (90%).
 - EZLease uses this approach
 - Option to override



New accounting methodologies

- Classification: finance/operating
 - Both capitalized; same initial asset & liability
 - Short term: lease term of ≤ 12 months, including recognized options (no BPO): = FAS 13 operating
 - Finance vs. operating expense recognition



Initial measurement

- **Liability:** PV of rent, *excluding* rent paid on or before first day of lease
 - Expected guaranteed residual payment
 - Include variable lease payments based on index or rate at inception
- Discount rate: implicit rate if known (requires unguaranteed residual and lessor's IDC)
 - Otherwise incremental borrowing rate
- **Right-of-use Asset:** Liability, plus prepaid rent, plus lessee's IDC, minus lease incentives



Sale/leaseback transactions

- Not permitted if leaseback would be considered finance lease (by lessee) or sales-type lease (by lessor)
- Not permitted if seller-lessee has option to repurchase the asset unless both:
 - Option exercise price is fair value of asset
 - Alternative, substantially identical assets are readily available—intended as high bar, probably never met by real estate [BC 352]



Transition

- “Practical expedients” package for all leases
 - Maintain classification capital/operating
 - Whether contract is a lease
 - Initial direct costs
- Hindsight practical expedient for all leases
 - Lease term based on subsequent events
 - Impairment
- EZLease assumes practical expedients package without hindsight



Transition

- Existing capital leases: convert to ASC 842 finance with no changes, except adding IDC
- Existing operating leases:
 - Liability: PV of remaining rent, excluding executory costs; only expected guaranteed residual
 - Use IBR at transition date for discount rate
 - ROU Asset: Add deferred & prepaid rent, IDC
- Split capital/operating leases



Revisions

- Retest classification from revision date only
- If classification changes, do it immediately
- Discount rate can change
- Variable lease payments dependent on rate or index (CPI, LIBOR, etc.):
 - Expensed as incurred
 - Lease revised only when other modification (including exercise of option)
- Changed asset scope:
 - Increase: New lease (with allocation if concessionary rent)
 - Decrease: Partial termination with gain/loss



Reporting

- Finance and operating lease balance sheet accounts reported separately
- Operating lease depreciation: sum of:
 - change in liability
 - straight-line of IDC, rent, lease incentives
- Operating lease cost: depreciation plus interest



Reporting: Disclosures

- Future rent commitments: “at least” 5 years
- Cash flows:
 - Finance lease interest: Operating
 - Finance lease principal: Financing
 - Operating lease cost: Operating
- Weighted averages (separate finance/operating)
 - Lease term (by remaining liability)
 - Discount rate (by remaining lease payments)



Lessor accounting

- Virtually unchanged
- Leveraged leasing eliminated for new leases
 - Existing agreements grandfathered
- New definition of distinction between sales-type and direct financing leases:
 - If it meets finance tests based on lessee payments, sales-type
 - If finance only with third-party guarantee, direct finance



Additional information

- **FASB:** <http://fasb.org/jsp/FASB/Page/BridgePage&cid=1351027207574>
- **IASB:** <http://www.ifrs.org/Current-Projects/IASB-Projects/leases-implementation/Pages/IFRS-16-Leases-Implementation.aspx>
- **Deloitte:** <https://www.iasplus.com/en-us/standards/fasb/broad-transactions/asc842>
- **Ernst & Young:** <http://www.ey.com/ul/en/accountinglink/current-topics-leases>
- **KPMG:** <https://frv.kpmg.us/all-topics/leases.html>
- **PWC:** <http://www.pwc.com/us/en/cfodirect/issues/lease-accounting.html>



EZLease demonstration

- Please wait while we switch to a live demonstration of EZLease...

