

Navigating the New FASB Lease Standard: Simplifying Recording and Financial Storytelling

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Agenda for Today

- Overview of Changes and Related Impact
- Getting Started - Transition to new Standards
- Practical Considerations

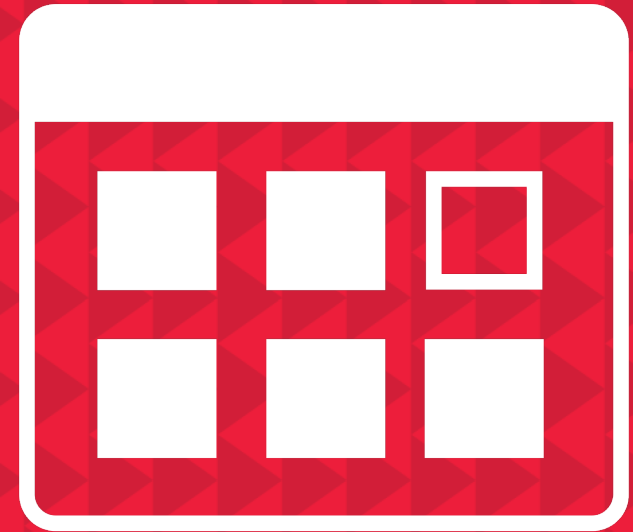
“Chat” your questions throughout!

WITH YOU TODAY



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Managing Director, BDO

Overview of Changes and Related Impact



Overview of Changes

Background

- ❖ Financial Accounting Standards Board (FASB) establishes GAAP (generally accepted accounting principles) in the United States.
- ❖ GAAP is organized within the ASC (Accounting Standards Codification) and dictates accounting and financial reporting standards.
- ❖ If your organization is required to produce financial statements in accordance with GAAP, it is required to follow these standards.
- ❖ Materiality is a relative concept and always a consideration, both quantitatively and qualitatively, when determining permissible accounting and financial reporting.



Overview of Changes

WHAT?

- ASC Topic 842 (Leases)
- FASB ASU 2016-02 (Issued February 2016)

WHY?

- Reduce “off balance sheet” risk.
- Accounting and reporting will better reflect substance of leasing transactions.



Overview of Changes

	Former Guidance	New Guidance
Lease Types	Capital lease and operating lease.	Finance lease and operating lease.
Certain Features	Capital leases required a lessor to record a fixed asset and capital lease liability. Lease payment resulted in reduction of liability and related interest expense.	Finance leases are similar to former capital leases.
	Operating leases had no balance sheet effect. Lease payments resulted in rent expense. Might have required “straight-lining” the rent expense.	Operating leases now require recording the related asset and lease liability. Amortization of both is not the same approach as with a finance lease.

How and When to Adopt?

- ▶ Two transition methods to choose from
 - Modified retrospective transition with initial application at beginning of earliest period presented - i.e., prior periods and current period are under ASC 842
 - Modified retrospective transition with initial application at adoption date - i.e., prior periods still under ASC 840
- ▶ General objective of transition: run-off accounting for existing leases (except for recognition of operating leases on balance sheet for lessees)
- ▶ Assess the election of the various practical expedients available
- ▶ Specific transition guidance on sale-leaseback transactions and build-to-suit arrangements



EFFECTIVE DATES (Nonprofit specific)

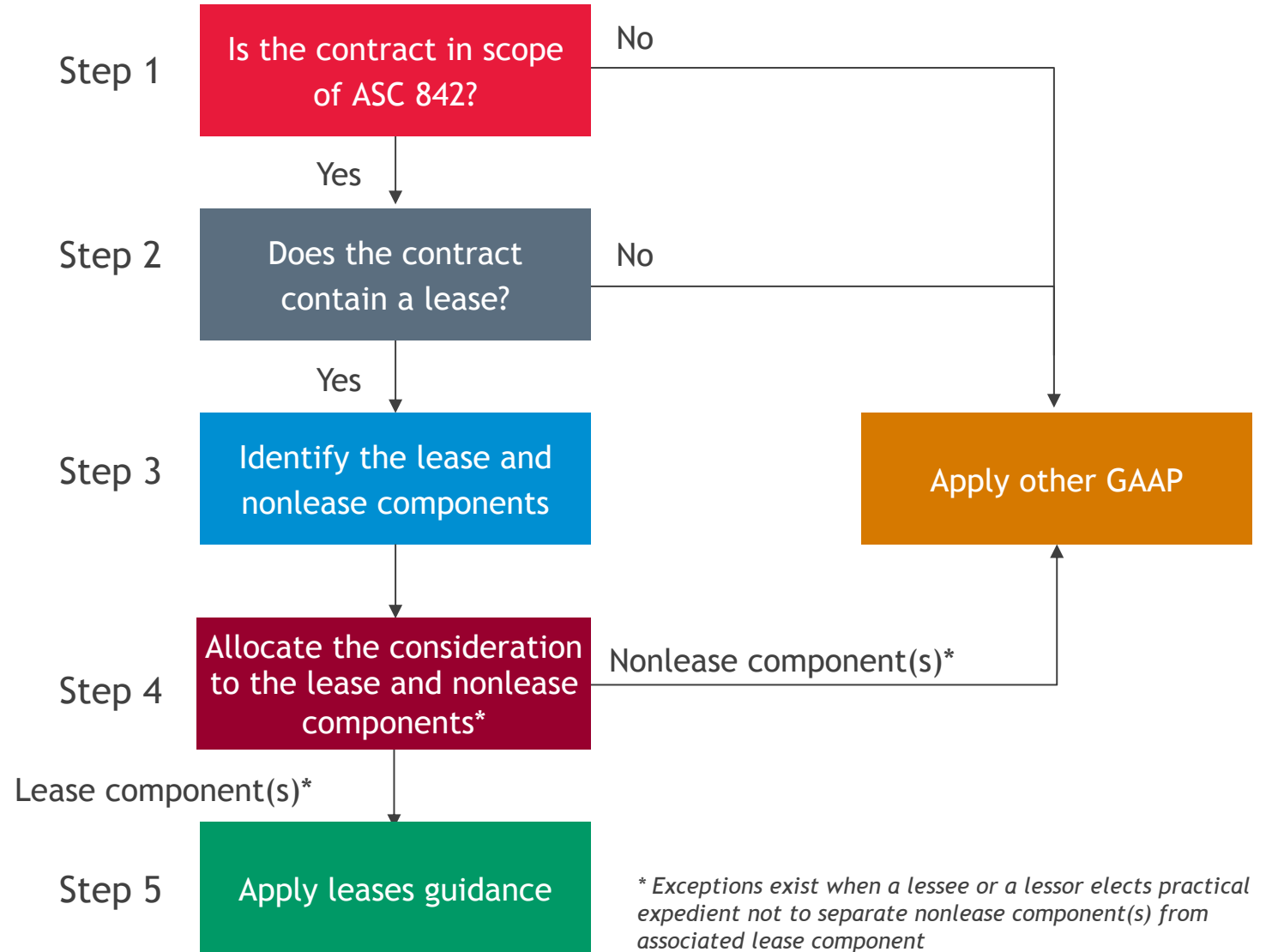
- ▶ Certain NFPs (principally those with conduit debt)
 - Calendar 2019 or Fiscal 2020
- ▶ All Other Nonprofits
 - Calendar 2022 or Fiscal 2023

*CHANGES NOW EFFECTIVE
FOR ALL, WITH FY23 REPORTS
THE LAST TO TRANSITION*

Getting Started



Getting Started In a Nutshell...



STEP 1

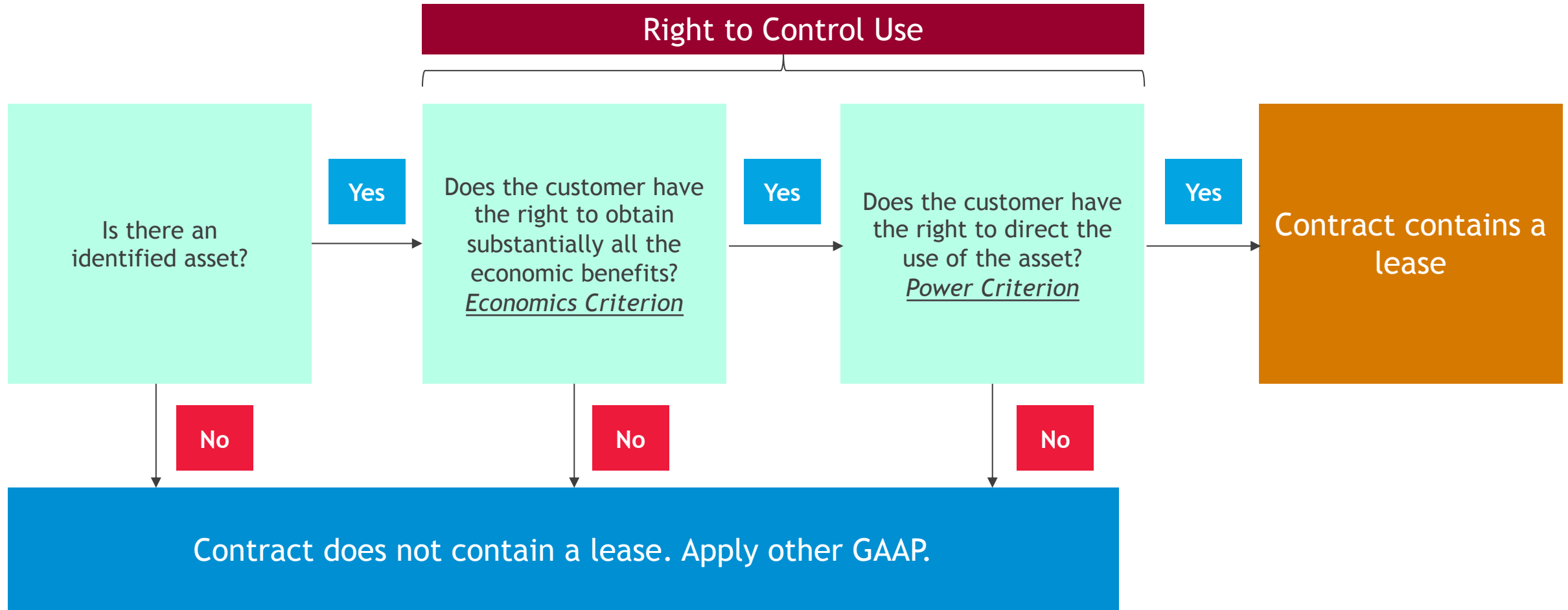
Is the contract in scope of ASC 842?

What's In and What's Out?

- ▶ Leases guidance applies to rights to use property, plant and equipment
- ▶ Means the following are excluded from the lease's guidance
 - Leases of intangible assets
 - Leases to explore for or use minerals, oil, natural gas, and similar nonregenerative resources
 - Leases of biological assets, including timber
 - Leases of inventory
 - Leases of assets under construction

If in scope of ASC 842, then the entity goes to Step 2 to determine if the contract is or contains a lease

Step 2 - Is There a Lease?



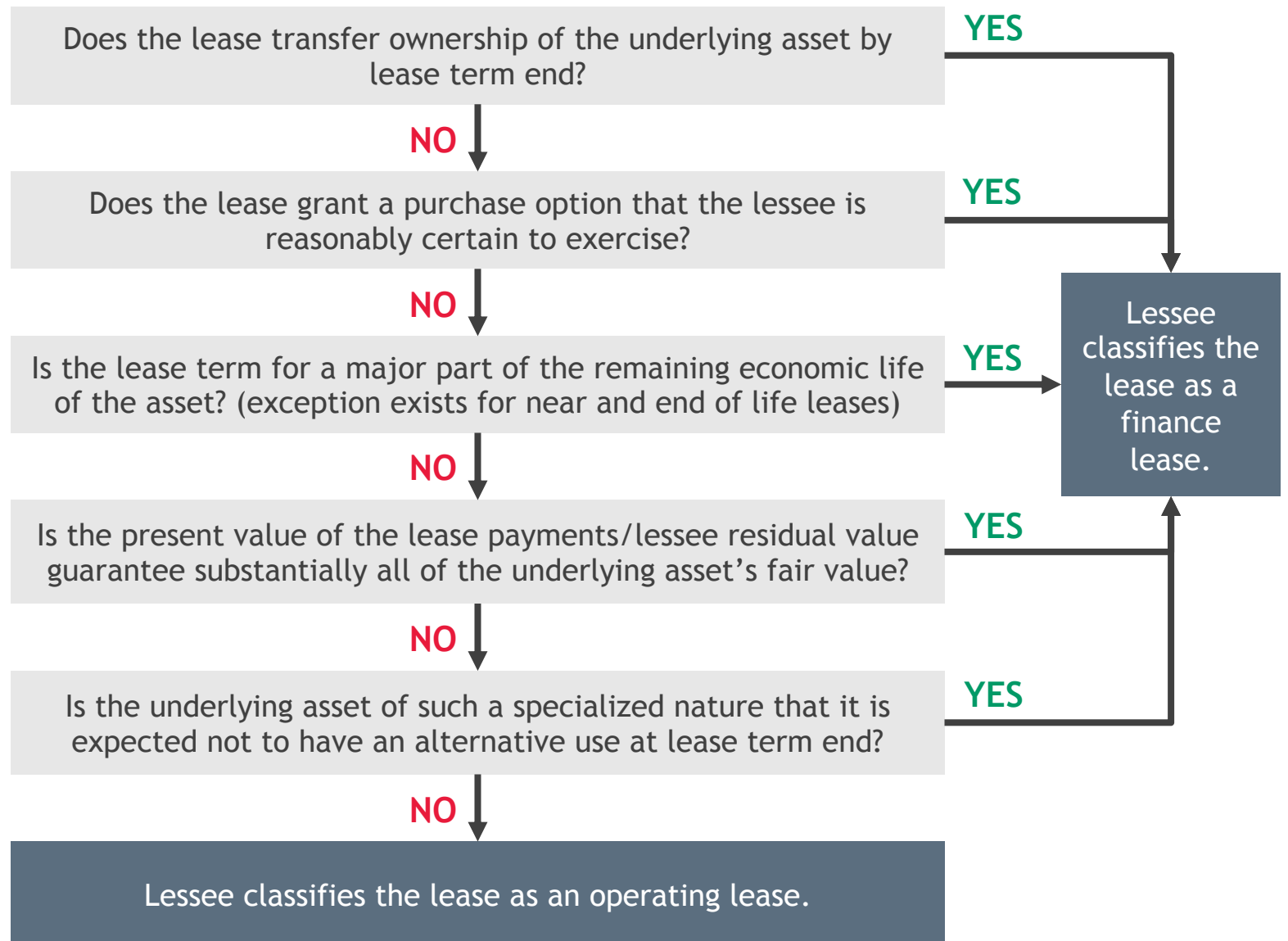
Step 3 - Identify Lease and Nonlease Components

What Are The Components of The Contract?

- Components of a contract include only those items or activities that transfer a good or service to the lessee

Lease component examples	Nonlease component examples	Noncomponent examples
 Right to use real estate, such as a retail store.	 Repairs and maintenance, common area maintenance.	 Certain administrative tasks to initiate the contract (e.g., set up activities).
 Right to use computer equipment.	 Other goods or services provided to the lessee, such as security services, operating the asset (e.g., a vessel, a drilling rig), sale of consumables, etc.	 Reimbursement of lessor costs related to ownership of the leased asset (such as property taxes and insurance that protects the lessor's asset).
 Right to use a vehicle, such as a truck.		

Step 5 - Lease Classification



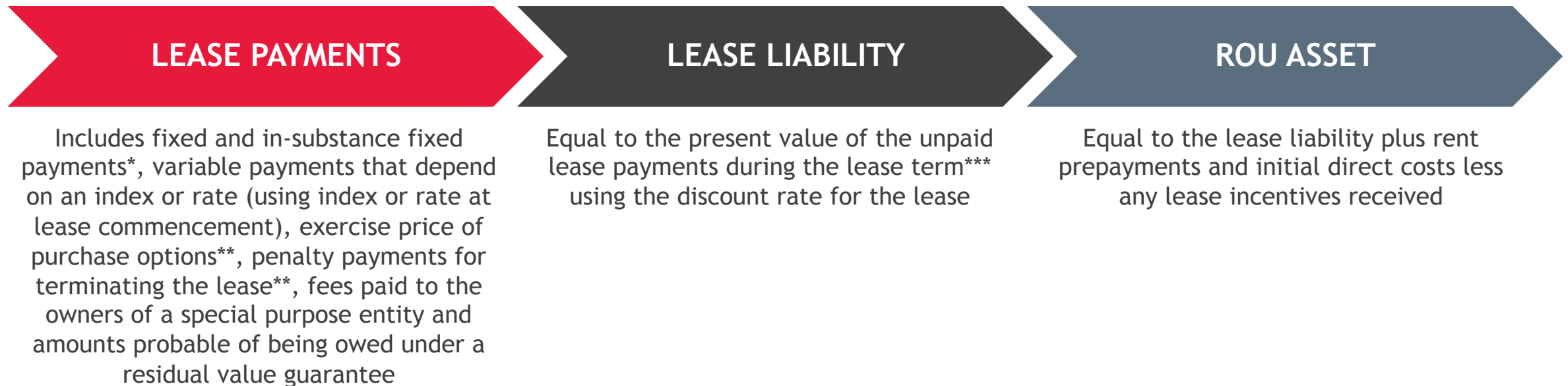
Lessee Accounting



LESSEE (FINANCE & OPERATING)

Initial Accounting

At the commencement date, a lessee recognizes a lease liability and corresponding right-of-use (“ROU”) asset



* Less any lease incentives paid or payable

** Must be reasonably certain of exercise

*** Includes the noncancelable period plus any period covered by an option to extend the lease if the lessee is reasonably certain to exercise the option or if the exercise of the option is controlled by the lessor. Additionally, the lease term includes periods covered by an option to terminate the lease if the lessee is reasonably certain not to exercise that option.

LESSEE

Subsequent Accounting

	Finance Leases		Operating Leases	
	ROU Asset	Lease Liability	ROU Asset	Lease Liability
Balance Sheet	Typically amortized on a straight-line basis to the earlier* of the end of its useful life or lease term	Increases to reflect interest using the effective interest method and decreases for lease payments made	Amortize based on the difference between periodic straight line lease cost (including amortization of initial direct costs) and the periodic interest accretion	Increases to reflect interest using the effective interest method and decreases for lease payments made
Income Statement	Recognize amortization expense**	Recognize interest expense on the lease liability and any variable lease payments incurred	Recognize straight-line lease expense and any variable lease payments incurred and not included in the lease liability	

* If the lease transfers ownership of the underlying asset to the lessee or the lessee is reasonably certain to exercise an option to purchase the underlying asset, the lessee amortizes the right-of-use asset to the end of the useful life of the underlying asset.

Booking the General Journal Entries

Operating Lease Subsequent Accounting May Look Like This:

	DR	CR	
Lease expense	\$ 2,241		<i>Income Statement Effect</i>
Lease liability	1,763		
Cash		\$ 2,000	
Right-of-use asset		2,004	

Your organization will have a worksheet to follow that details the breakdown of each rent payment (similar to a loan amortization schedule). In this example, the monthly rent is \$2,000 and they followed their worksheet to record that month's reduction to both the lease liability and the ROU asset.

Typically, lease expense is straight-line (e.g., same every month) over the life of the lease. ROU asset and lease liability are reduced when rent is paid, based on the amortization schedule.

Reminder: Transition of Leases Existing at Commencement Date

- ▶ Two transition methods to choose from:
 - Modified retrospective transition with initial application at beginning of earliest period presented - i.e., prior periods and current-period are under ASC 842 OR
 - “Transition alternative” - Modified retrospective transition with initial application at adoption date - i.e., prior periods still under ASC 840.
- ▶ Several transition practical expedients available.



What is affected by these choices?

- When this new accounting begins.
- Potentially affects whether any cumulative effect adjustment to net assets is recorded (based on election of transition practical expedients).

Practical Considerations



Practical Considerations - Initial Info to Gather and Questions to Ask

- ▶ Gather all lease documents and other contracts that may contain leases.
- ▶ Consider organizing information by creating a summary matrix that abstracts info from each contract and documents management's related evaluations and decisions:
 - Follow Steps 1-5 noted on Slide 9 and document results.
 - Decide on election of “practical expedients” and document results.
- ▶ Consider transition method for leases existing on commencement date (i.e., when the standard is implemented).
- ▶ Determine discount rate. Nonprofits may utilize the “risk-free rate” as the discount rate.

Remember - your auditor can assist in understanding the options, explaining the standards and provide template and tools. Your auditor should not decide which option to take but can describe the differences in accounting and reporting among the various options.

Practical Considerations - Practical Expedients

Select Practical Expedient (summarized)	If elected...
Option to not recognize short-term leases on the balance sheet	Leases with original lease terms of 12 months or less that does not include an option to purchase the asset that is reasonably certain to be exercised is expensed on the straight-line basis (same as prior standard).
Option NOT to separate nonlease components from lease components.	If certain conditions are met, may treat separate nonlease components and lease components as one item.
“Package” of 3 transition related practical expedients	For expired or existing leases: Will not reassess for existence of leases; will not reassess lease classification; will not reassess initial direct costs.

A “practical expedient” is like a short-cut to make a standard easier to adopt. Organizations need to elect to use a practical expedient.

See “Other Topics and Resources: section to follow for additional details on these practical expedients.

Sample Matrix

A simple summary of all leases can help organize the information in one place

Lease Summary	Office Lease #1		Office Lease #2
Determine classification - financing or operating	Operating lease		
Determine if electing practical			
Package of transition practical expenditures (all 3 or none).	Yes		
Combine nonlease and lease components	Yes		
Key information			
Agreement date	4/28/2011		
Commencement date	8/1/2011		
Expiration date	6/30/2027		
Lessor	ABC LLC		
Lessee	Nonprofit Organization		
Identified asset	19th floor; 120 Main Street		
Lease term	15 years and 11 months		
Lease payments	\$5,495/mo	8/1/11-1/31/17	
	\$5,576/mo	2/1/17-1/31/22	
	\$6,656/mo	2/1/22-6/30/27	
Identified other lease components?	Yes		
Identified non-lease components?	Yes		
Identified non-components?	Yes		
Renewal option	1 10-yr. option to extend		
Reasonably certain to exercise the option?	NO		
Discount rate	Not explicit		
Risk-free rate*			
Prepaid (Deferred) Rent at 12/31/21	\$xxx		

What Have We Seen?

Transition Observations

Many nonprofits elected:

- Transition alternative.
- Package of three practical expedients.



- Assumes entity had done a complete and robust assessment of its lease population under ASC 840
- Search for leases in transition should be assessed under ASC 840 definition

- Other expedients (combining lease/nonlease components, short-term leases) widely elected.



- Leases with original terms of more than 12 months do not qualify for the short-term lease transition exemption even if the remaining term at the adoption date is 12 months or less

- Discount rate set at risk-free rate by asset class.

From a practical perspective:

- P&L expense is relatively unchanged.
- Existing prepaid or deferred rent (on the balance sheet) will be reduced to zero.

Reflections from the group

Practical Considerations - How to Tell Your Financial Story

Understand the financial statement impact:

- How are assets and liabilities affected?
- Are income statement labels line items the same or different?
- Was there any restatement of net assets?
- Does your organization have any bank covenants or other ratios affected by these changes?

Who are the users of your organization's financial statements and what are they interested in?

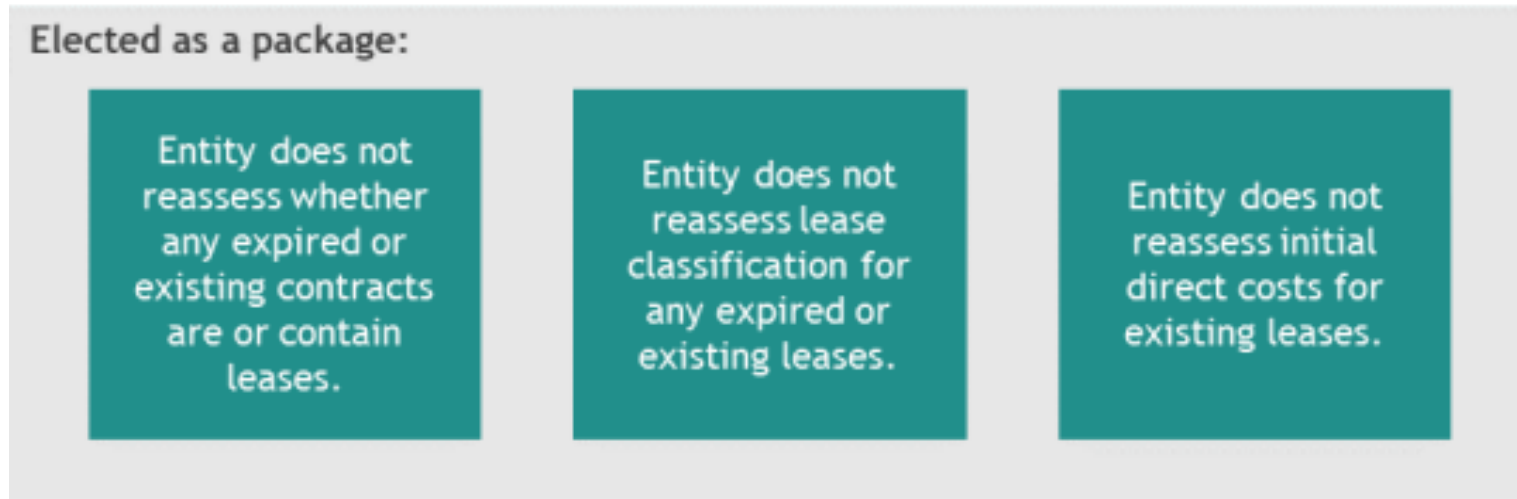
Practical Considerations - Complexities and Lease Terms to Identify

- Renewal term options
- Lease incentives
- Prepaid rent
- Escalating/variable payments
- Lease modifications
- Multiple components
- Inception date different than commencement date
- Subleases
- Free rent or rent holidays

Other Topics and Resources



Package of Practical Expedients - Specific Transition Election



- If a company elects the package of practical expedients, it does not reevaluate its existing contracts under ASC 842 but rather carries forward its previous conclusions under ASC 840 (prior lease standards).
- This assumes that all leases have been correctly identified and classified under prior lease standards. And may require potentially assesses completeness of lease population under ASC 840 upon adoption of ASC 842.

Lessee Practical Expedient “Not to Separate”

Provides lessees a practical expedient, by asset class, to not separate nonlease component(s) from the associated lease component:

- ▶ No conditions required (e.g., significance of the nonlease component is not relevant).
- ▶ Simplifies application of the lease guidance:
 - Reduces need to estimate standalone prices and to allocate the consideration to the components being combined.
 - Eliminates need to apply other GAAP for the nonlease components combined with the associated lease component.
- ▶ Disclose that the practical expedient was elected and for which asset class.

Subleases

▶ Original Lessor

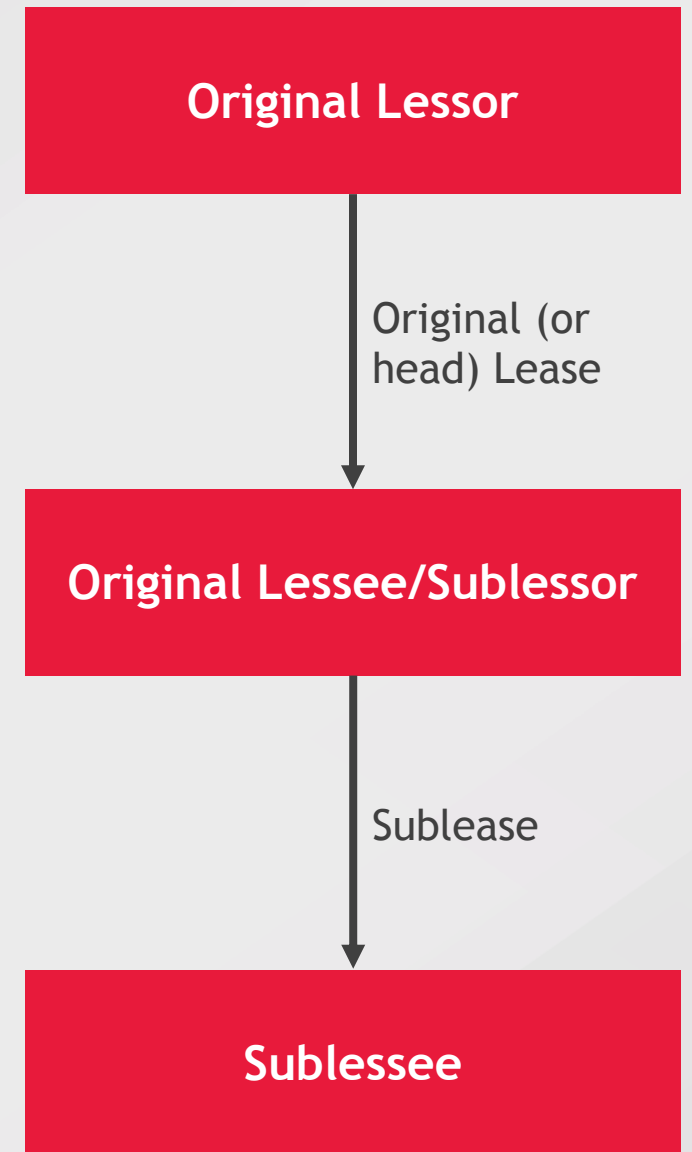
- Continues to account for the transaction as before the sublease, unless the original lease agreement is replaced with a new lessee

▶ Original Lessee/Sublessor

- Continues to account for the original lease as the lessee unless it is relieved of its primary obligation
- Accounts for the sublease under lessor accounting guidance
- Should consider whether the sublease affects its accounting for the original lease (e.g., lease term, impairment)

▶ Sublessee

- Accounts for the sublease like any other leases in which it is a lessee



Remeasurement of the Lease

Reassess the lease term or lessee purchase option only if one of the following events occurs

There is a significant event or significant change in circumstances that is within the lessee's control that directly affects whether the lessee is reasonably certain to exercise a renewal, termination, or purchase option

There is an event in the contract that obliges the lessee to exercise or not exercise a renewal or termination option

Lessee elects to exercise an option even though it had previously determined it was not reasonably certain to do so

Lessee elects not to exercise an option even though it had previously determined it was reasonably certain to do so

Remeasure lease payments if any of the following occurs

The lease is modified and does not qualify as a separate contract*

A contingency is resolved such that some or all variable payments now meet the definition of lease payments

There is a change in the lease term or a lessee purchase option (see above)

There is a change in the amounts probable of being owed under a residual value guarantee.

* In accordance with ASC 842-10-25-8

Specific Considerations for Land

- ▶ ASC 842 requires a lease of land to be accounted for as a SEPARATE lease component unless separating the land component is insignificant to the accounting.
- ▶ Examples of insignificant accounting effects:
 - Separating the land component does not affect the lease classification of any lease components
 - Amount recognized for land is insignificant
- ▶ Note: a land lease component is required to be assessed for classification using the criteria in ASC 842-10-25-2 through 25-3A.
 - Change from ASC 840 that defaulted to operating lease classification unless there was transfer of ownership or bargain purchase option
- ▶ A lease of land can be explicit or implicit.



How To Apply The Accounting Standard Accurately, From Start To Finish



Scope of ASC 842

First things first: An entity needs to determine whether a contract is within the scope of ASC 842 and understand the scope exceptions. Then it can proceed with examining other key aspects.



Lease Classification and Key Terms

It's important to appropriately identify the commencement date of a lease component and answer other questions — regarding lease term, lease payments, discount rate and more — to perform the lease classification tests.



Other Topics

There are further aspects of ASC 842 related to specific transactions and interactions with other areas of GAAP. These types of transactions include subleases, sale and leaseback transactions, business combinations and income taxes.



Identifying a Lease

It's critical to know whether a contract is or contains a lease. The definition of a lease under ASC 842 is similar to ASC 840, but there are important nuances to grasp.



Accounting for Leases — Lessees

Once a lessee has determined how to classify lease components, the lease can be recognized and measured on balance sheet at the commencement date — unless the practical expedient for short-term leases is elected.



Presentation and Disclosures

ASC 842 includes enhanced disclosure requirements, including an overall disclosure objective and expanded disclosure requirements for leases. The more extensive the entity's leasing activities, the more comprehensive the disclosures are expected to be.



Identifying and Separating Components

Identifying the components of the contract will help determine which GAAP applies to each. A contract may include one or more nonlease components or the lease of more than one asset.



Accounting for Leases — Lessors

Accounting for leases by lessors remains broadly consistent with previous GAAP and varies depending on lease classification. However, aspects of the guidance were aligned between lessees and lessors and with the revenue standard.



Adopting ASC 842

A proactive approach to adoption can be beneficial. For private companies and private nonprofits, ASC 842 will be effective for fiscal years beginning after December 15, 2021. Early adoption is permitted for all entities.

BDO's Blueprint Series Technical Accounting Guidance

<https://www.bdo.com/insights/assurance/accounting-for-leases-under-asc-842>

A tablet computer is shown, displaying a stack of rolled-up blueprints. The blueprints are white with black lines and text, including technical drawings and measurements. A red banner is overlaid on the bottom right of the tablet screen, containing the text "ACCOUNTING FOR LEASES UNDER ASC 842". To the left of the tablet, a white stylus is visible. In the background, a red mug and a portion of a brown object are visible.

**ACCOUNTING FOR LEASES
UNDER ASC 842**

Questions?



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Most commons have a forum where community members can meet to surface mutual concerns and exchange resources. At the Nonprofit Financial Commons, THIS is that space. Any question you have about nonprofit finances, whether it has to do with high strategy or granular practice, can be brought here. Here you can glean the rich wisdom of your peers and share your own hard-won insights and knowledge. Be and spread the change you wish to see.

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