



LEASES

Presented By
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October 3, 2017



Objectives

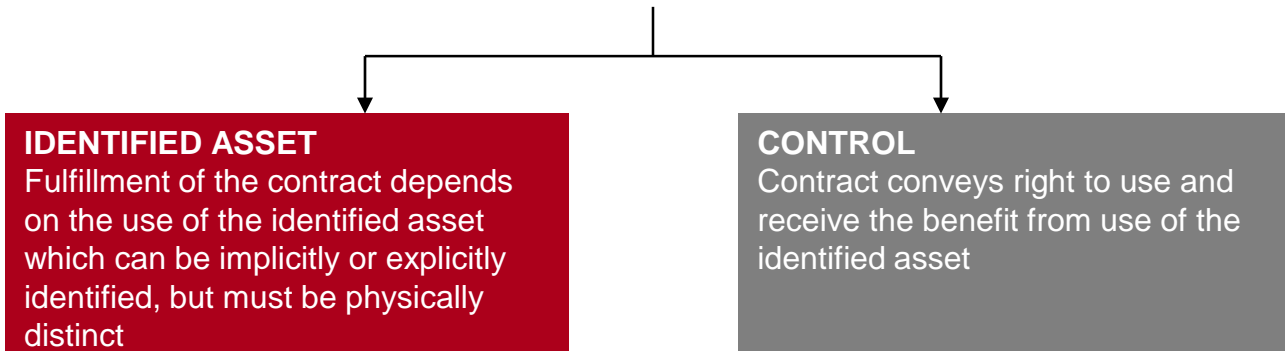
1 OVERVIEW OF NEW
LEASES ASU

2 ILLUSTRATIVE
EXAMPLES

LEASE =

“a contract, or part of a contract, that conveys the right to control the use of identified asset for a period of time in exchange for consideration”

A contract is a lease if both of the following criteria are met



CURRENT FINANCE LEASE:

- Recognize asset and liability
- Interest on liability recognized separately from amortization of asset
- Cash flow –
 - Financing activities – Principal portion of lease liability
 - Operating activities – Interest payments on lease liability and variable lease payments

CURRENT OPERATING LEASE:

Monthly lease/rent expense

FUTURE FINANCE LEASE:

- Recognize asset and liability
- Interest on liability recognized separately from amortization of asset
- Cash flow –
 - Financing activities – Principal portion of lease liability
 - Operating activities – Interest payments on lease liability and variable lease payments

FUTURE OPERATING LEASE:

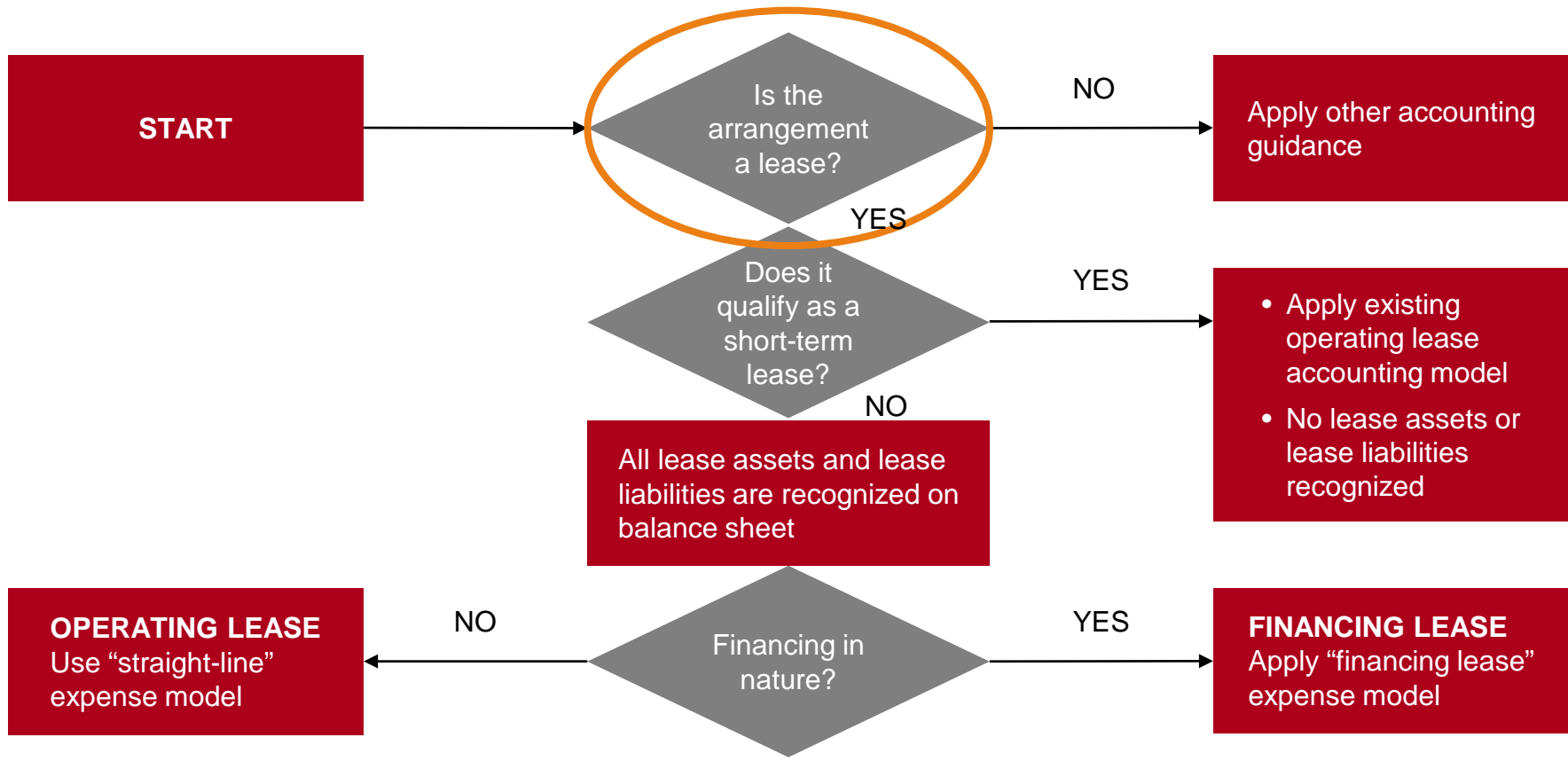
- Recognize asset and liability
- Single lease cost – cost of lease is allocated over lease term on a straight-line basis
- Cash flow – All cash payments within operating activities

Lease Criteria

IF A LEASE MEETS ANY OF THE FOLLOWING 5 CONDITIONS, IT IS A FINANCING LEASE:

- Transfer of ownership
- Option to purchase is reasonably certain
- Lease term is a “major part” of the economic life
- Present value of lease payments is “substantially all” of the fair value
- ***Specialized nature (NEW)***

***KEY TAKE AWAY: FIRST FOUR ARE SIMILAR TO
TODAY’S FAS 13 TESTS***



LESSEE ACCOUNTING

Recognize asset and liability

- Liability –
 - Measured at present value of future minimum lease payments
 - Remeasured at the beginning of each year if any substantial lease modifications
 - Asset – equivalent to the liability, less incentives, plus any initial direct costs
- Measurement includes options to extend or purchase if lessee is reasonably expected to exercise those options
- Accounting policy election regarding leases with terms of less than 12 months

LESSOR ACCOUNTING

No substantive changes

Polling Question

SCENARIO A:

Lease term – 12 months

Renewal option/purchase option – None

Free rent period – None

SCENARIO B:

Lease term – 12 months

Renewal option/purchase option – renew in 12 months

Free rent period – None

SCENARIO C:

Lease term – 12 months (plus 1 month free)

Renewal option/purchase option – None

Free rent period – 1 month

Financial Statement Impact

BALANCE SHEET

- Establish ROU asset
- Capitalize operating lease payments

INCOME STATEMENT

Continue to recognize SL lease expense (like rent expense)

CASH FLOW STATEMENT

Continue to recognize operating outflows for operating lease payments



Ratio Changes

IMPACTED:

- Current Ratio – Worsens
- Quick Ratio – Worsens
- Liabilities to Net Assets – Worsens
- Return on Assets – Worsens

NOT IMPACTED:

- EBITDA
- Gross margin
- Operating ratio
- Net worth
- Debt to Equity
- Return on Equity

DISCLOSURES

Qualitative and non-qualitative

TRANSITION

Modified retrospective approach

- Remeasure leases as of beginning of earliest period presented
- Recognize asset and liability at PV of remaining future minimum lease payments
- Includes amounts probable of being owed under residual value guarantee

PRACTICAL EXPEDIENTS

- No reassessment of whether expired or existing contracts are or include leases
- No reassessment of lease classification for expired or existing leases
- No reassessment of initial direct costs



**ADOPTION
DATE**

- Effective for years beginning after December 15, 2018 for NPOs with conduit bond obligations (fiscal 2020)
- All other NPOs have an additional year
- Early adoption permitted

**TRANSITION
METHOD**

- Modified retrospective approach
- May apply hindsight to existing leases to determine lease term and asset impairment

**RELIEF
PACKAGE**

AT ADOPTION DO NOT REASSESS:

- Whether an arrangement is, or contains, a lease
- Lease classification
- Whether initial direct costs would qualify for capitalization under the new standard



Things to Consider

- Appropriate capitalization threshold
- Embedded leases
- Components
- Renewal options
- Variable lease payments
- Need for a new lease accounting system?
- Debt covenants
- Where do I begin?

Examples



Example 1

FACTS:

- Office space
- 3-year lease
- \$12,000 per year
- 6.25% annual borrowing rate
- No option to transfer ownership
- No option to purchase
- Lease term is not a major part of the economic life
- PV of lease payments is not substantially all of the fair value
- Not specialized in nature

Operating Lease

	INCEPTION	YEAR 1	YEAR 2	YEAR 3	TOTAL
Income statement					
Lease expense		\$12,000	\$12,000	\$12,000	\$36,000
<i>Lease expense is comprised of:</i>					
<i>Interest expense (declines over time)</i>		1,757	1,098	397	3,251
<i>Amortization expense (increases over time)</i>		10,243	10,902	11,603	32,749
		12,000	12,000	12,000	36,000
Balance sheet					
Right-of-use asset	\$32,749	\$22,506	\$11,604	–	
Liability to make lease payments	\$(32,749)	(\$22,506)	(\$11,604)	–	
Cash flow statement					
Operating outflows		\$12,000	\$12,000	\$12,000	\$36,000

KEY POINT:

interest expense + amortization expense =
lease payment amount

Example 2

FACTS:

- Office space
- 3-year lease
- \$12,000 per year
- 6.25% annual borrowing rate
- No option to transfer ownership
- Option to purchase
- Lease term is not a major part of the economic life
- PV of lease payments is not substantially all of the fair value
- Not specialized in nature

Finance Lease

	INCEPTION	YEAR 1	YEAR 2	YEAR 3	TOTAL
Income statement					
Interest expense		\$ 1,757	\$ 1,098	\$ 396	\$ 3,251
Amortization expense		10,916	10,916	10,917	32,749
Total expense		\$12,673	\$12,014	\$11,313	\$36,000
Balance sheet					
Right-of-use asset	\$32,749	\$21,833	\$10,917	—	
Liability to make lease payments	\$(32,749)	(\$22,506)	(\$11,604)	—	
Cash flow statement					
Operating outflows (interest expense)		\$ 1,757	\$ 1,098	\$ 396	\$ 3,251
Financing outflows (principal)		10,243	10,902	11,604	32,749
Total cash outlays		\$12,000	\$12,000	\$12,000	\$36,000

Example 3

FACTS:

- Office space
- 10-year lease with option to extend 5 years
- Annual Rent Cost:
 - Years 1-10 - \$50,000
 - Years 11-15 - \$55,000
- \$15,000 initial direct costs
- 5.87% - initial annual borrowing rate
- Option to own at end of lease term
- Payments made at beginning of each year
- At end of year 6, lessee makes significant improvements adding economic value
- As a result, the remaining lease term is 9 years
- 7.83% - subsequent annual borrowing rate

Finance Lease

	END OF YEAR 6	REMEASURE	YEAR 7	YEARS 8-15	TOTAL
Income statement					
Interest expense			\$-	\$ 119,810	\$ 119,810
Amortization expense			37,114	296,909	334,023
Total expense			\$37,114	\$416,719	\$453,833
Balance sheet					
Right-of-use asset	\$162,807	\$334,023	\$296,909	—	
Liability to make lease payments	(\$183,973)	(\$355,189)	(\$305,189)	—	
Cash flow statement					
Operating outflows (interest expense)			\$ -	\$ 119,810	\$ 119,810
Financing outflows (principal)			50,000	305,190	355,190
Total cash outlays			\$50,000	\$425,000	\$475,000



Contact Us



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Reviewed:
09/27/17