ASC 842 – What to expect after implementation and more

May 17, 2022

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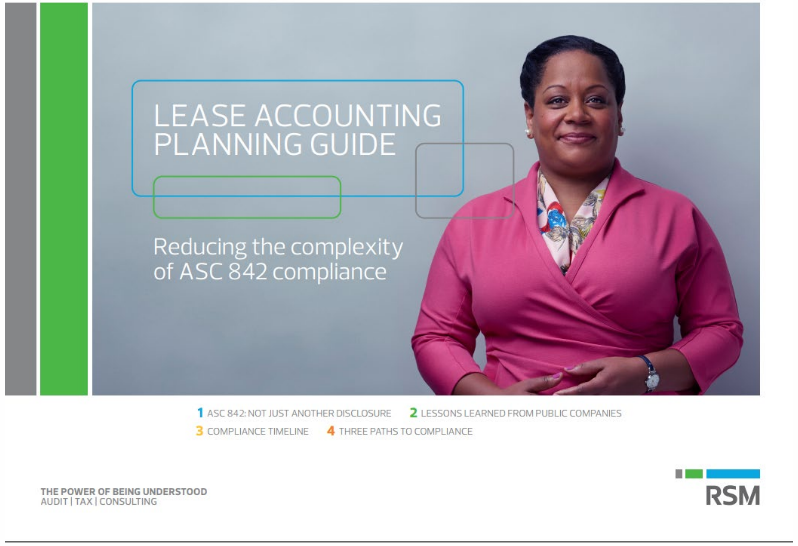
Quick overview of ASC 842 adoption activities

Note: This slide illustrates the workstreams in the overall implementation effort.

Helpful insights on ASC 842 from RSM

You will find a link to both of these e-books in the **RESOURCES** section to the right of your screen.

Lease Accounting planning guide



ASC 842 software selection guide

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Polling Question #1

How many leases do you estimate you have in your lease portfolio?

a) 0 – 5 leases
b) 6 – 20 leases
c) 21 – 100 leases
d) 100+ leases

Day Two activities and complexities

Monthly/quarterly and annual management and reporting

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Day Two detailed activities

Lease Collection

- Preparation and organization of Lease Collection Workbooks (“Workbooks”) each quarter
- Coordination, tracking and collection of leases across the enterprise
- Resolution of issues (i.e., missing Workbooks, incomplete or missing information, etc.) directly with Operating Companies

Lease Software Updates

- Upload of abstraction templates each quarter
- Quarterly updates in lease accounting software to support lease accounting entries (IBRs, foreign exchange rates, etc.)
- Generation of journal entries and reports by segment
- Generation of recalculations needed for lease modifications or terminations

Valuation

- Preparation of USD and any foreign currency IBRs each quarter
- Determination of fair value for new real estate leases (lease classification test)
- Ad-hoc fair value requests, such as valuation of tenant improvements

Lease Abstraction

- Abstraction of new and modified leases into lease accounting software templates each quarter
- Abstraction of certain vendor lease reports obtained directly from vendors (e.g., fleet, copiers)
- Coordination of lease-specific questions that arise during abstraction with the operating companies

Technical Accounting

- Reviews of new/modified service arrangements for embedded leases each quarter
- Analysis of immaterial embedded leases each quarter
- Quality review of abstracted leases compared to source documents

Financial Reporting

- Preparation and organization of Lease Disclosure Workbooks for annual disclosures
- Coordination, tracking and collection of Lease Disclosure Workbooks from operating companies
- Reconciliation of G/L detail provided by operating companies to lease accounting software and/or vendor reports to calculate short-term & variable lease expense
- Preparation of annual ASC 842 disclosures

Month-end or quarterly close activities

Key activities

On a monthly and quarterly basis, all organizations (public or private) will need to update their lease accounting software with **additions**, **modifications** and **changes to leases** as well as **create journal entries** for these activities. Public entities and quarterly filers will also need to create the **financial reporting documentation** for their quarterly filings.

- New lease and modified lease abstraction
- Accounting for key events
- Monthly journal entries for existing leases, lease modifications, and new leases
- Balance sheet reconciliations
- Payment clearing account reconciliations
- Reporting package (system lease reports, roll-forwards, modifications and lease completeness/embedded leases)
- Lease administration reporting – notifications on renewals, terminations, options

Reconciliations – Lease system to general ledger

Leasing activities are generally posted monthly from the lease system. Unless integrations were developed between the lease system and your ERP, ASC 842 accounting for fixed rents are generally recorded through flat file import of lease system entry export.

Out of balances between the general ledger and lease system balance generally indicates your lease liability, ROU Asset and rent expense account activities have not been isolated to lease system generated entries.

Reconciliations – General ledger lease clearing account

Majority of lease system implementations did not include the integration of a company's ERP accounts payable within the lease system, nor the inclusion of variable or short term rents within the lease system.

This necessitates the use of a lease clearing general ledger account to coordinate lease payment accounts payable processing with lease system processing of fixed rent amounts on long term leases.

General Ledger Lease Clearing Account → **Naturally a $0 or Debit Balance** → **May Not be Straight Forward**

A debit balance would represent prepayment of rents and/or misclassifications of variable and/or short-term lease payments.

Reconciliations – General ledger lease clearing account

- The key to maintaining a $0 balance within the general ledger lease clearing account is establishing unique general ledger accounts for:
  - Variable rent payments
  - Short-term rental payments
- Establishing, and effectively utilizing these accounts facilitates preparing ASC 842 footnote disclosure requirements.
- Instructions and training of accounts payable personnel in the processing of lease accounts payables is critical in maintain a $0 balance within the lease clearing account.
- Only base rents and/or other fixed charges should be coded to your lease clearing account.

Year end support

Key activities

- ASC 842 disclosure footnote and supporting reports
- Centralized documentation – existence assertion
- Qualitative and quantitative disclosures – cutoff assertion
- Reconciliation detail - accuracy assertion
- Technical accounting support – lease completeness assertion
- Audit support – occurrence assertion

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Some specific **Day Two** topics to consider

1. **New leases** – Lease commencement date
2. **Option periods impact** on existing lease period
3. **Acquisition of a business** (purchase accounting)
4. **Impairment of ROU** asset considerations
5. **Modifications and terminations** of lease

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1 **New leases** - Lease commencement

Leases are classified and recorded at the accounting lease commencement date:

- The date on which a lessor makes an underlying asset available for use by a lessee

The commencement date of the lease may be before the date stipulated in the lease agreement (e.g., the date rent becomes due and payable

- If a lessee takes possession of, or is given control over, the use of the underlying asset before it begins operations or making lease payments under the terms of the lease, the lease term has commenced
- “Control” is determined in the same manner as determining if an arrangement contains a lease:
  - Lessee obtains substantially all of the benefits of an asset
  - Lessee direct the use of an asset

2 Option periods impact on existing lease terms

When to reassess?

- When a **triggering event within a lessee's control** has occurred that directly affects whether the lessee is reasonably certain to exercise or not exercise an option to extend or terminate the lease
  - Note**:** A **triggering event** only occurs to the extent an event **within the lessee's** control happens (A change in external or market-based factors should not, in isolation, trigger reassessment of the lease term)

When to remeasure?

- A lessee is **REQUIRED** to remeasure the lease term, the related lease liability and adjust the related right-of-use asset upon the occurrence of a triggering event, if the triggering event impacts whether renewal or purchase options are reasonably certain of being exercised.
- Examples of triggering events that trigger reassessment include:
  - Constructing significant leasehold improvements that are expected to have significant economic value for the lessee when the option becomes exercisable
  - Making significant modifications or customizations to the underlying asset
  - Subleasing the underlying asset for a period beyond the exercise date of the option.

ASC 842-10-35-1, 842-10-55-28, 842-10-55-29

3 Acquisition of a business (Purchase accounting)

Acquirer

- Does not reassess lease classification (unless the lease is modified in connection with the acquisition)
- Aligns acquiree’s lease accounting policies with those of the acquirer
- Does reassess lease term and purchase options
- Remeasures lease liability based on the present value of the remaining lease payments using the acquirer’s applicable discount rate
- Measures the ROU asset at an amount equal to lease liability, adjusted for off-market terms
- The acquirer may elect, by class of underlying asset and applicable to all of the entity’s acquisitions, not to recognize assets or liabilities at the acquisition date for leases that, at the acquisition date, have a remaining lease term of 12 months or less.

Impairment of ROU asset considerations

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When to apply ASC 420 vs ASC 360

ASC 420 – Exit or disposal cost obligations

- Applies to **operating leases only before the adoption of ASC 842**
- Restructuring liability is an opening adjustment to the transition ROU asset

ASC 360 – Property, plant and equipment

- Applies to capital/financing leases before and after adoption of ASC 842
- Applies to **operating leases after adoption of ASC 842**

ASC 360 impairment model

START

Determine the asset group

Evaluate impairment triggering events

Perform "recoverability" test
Compare undiscounted cash flows of the asset group to carrying amount of the asset group

Measure impairment
Compare fair value of the asset group to carrying amount of the asset group

FINISH

4 Impairment triggering events

Impairment testing triggering events may include:

- A significant decrease in the market price of an asset
- A significant adverse change in the extent or way an asset is being used or in its physical condition
- A significant adverse change in legal factors or in the business climate that could affect the value of an asset

If the new ROU asset is its own asset group, or the predominant asset in the group either of the following would likely constitute a triggering event:

- Entering into a loss-making sublease
- Ceasing use of the asset when facts and circumstances call into question the lessee's ability to obtain a favorable sublease

4 Interaction of impairment and subleasing

Process for evaluating impairment of ROU assets in connection with subleasing:

1. Determine if the existing asset group should be tested for impairment on the date the lessee decides to vacate / sublease space

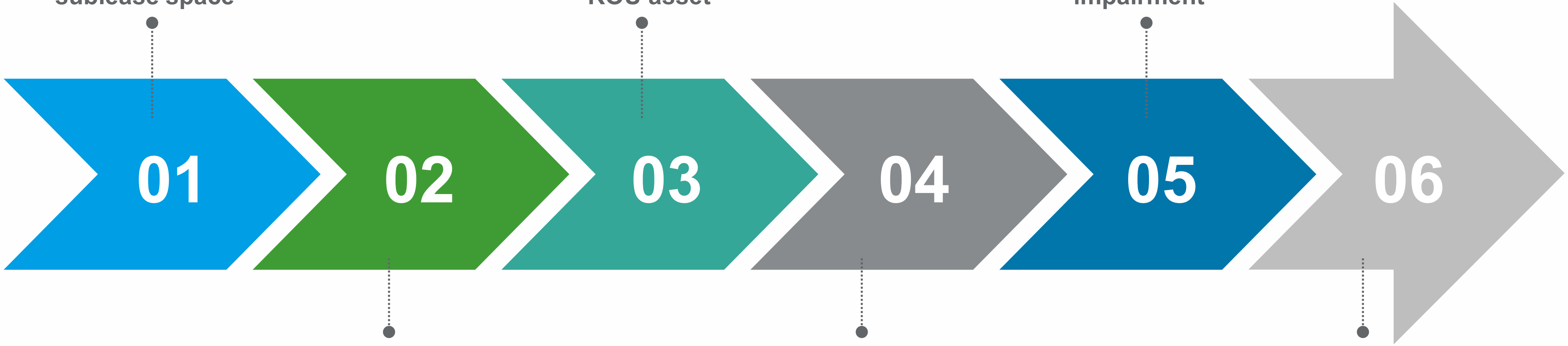
2. Reassess asset groupings on the earlier of the date the sublease is executed or space is vacated

3. Evaluate impairment triggering events for separate asset group that includes the ROU asset

4. Perform "recoverability" test

5. Measure impairment

6. Reassess go-forward ROU asset accounting



5 Modifications of leases

A **lease modification** is a change to the terms and conditions of a contract that results in a change in the scope of or the consideration for a lease

Examples of lease modifications

- Changing the lease term (extending or reducing)
- Changing the consideration (increased or reduced rental payments)
- Adding to or reducing the amount of leased space

Key considerations in modification accounting

- Determining the lease term
- Assessing the lease classification
- Allocation of the lease consideration
- Identification of lease and non-lease components
- Determination of the discount rate
- Whether or not the modification results in a separate contract

Remeasurement of the lease liability and ROU asset – Lessee

This is a summary of the conditions that would require a lessee to reassess and remeasure the lease liability and ROU asset in the lease.

	Lease modification not accounted for as a separate contract	Change in the lease term or assessment of purchase option exercise	Change in the amount probable of being owed by a lessee under a residual value guarantee	Variable payments become lease payments due to the resolution of a contingency
When to reassess?	When the modification occurs	Only when there is a triggering event (as defined)	Whenever relevant facts and circumstances change	
	What to update during remeasurement?			
Lease payments	✓	✓	✓	✓
Consideration in the contract	✓	✓	✓	✓
Allocations of consideration in the contract	✓	✓	✓	✓
Discount rate	✓	✓	✗	✗
Lease classification	✓	✓	✗	✗

Summary of common **"Day Two"** challenges

1. Resource constraints
2. Ongoing collection and abstraction of new leases
3. Maintaining skills in lease abstraction and working with lease system
4. Modifications, re-measurements and reassessment events
5. Internal reporting
6. Financial statement disclosure
7. Review of service contracts for embedded leases
8. Keeping up with the latest discount rates as you add new leases

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Polling Question #2

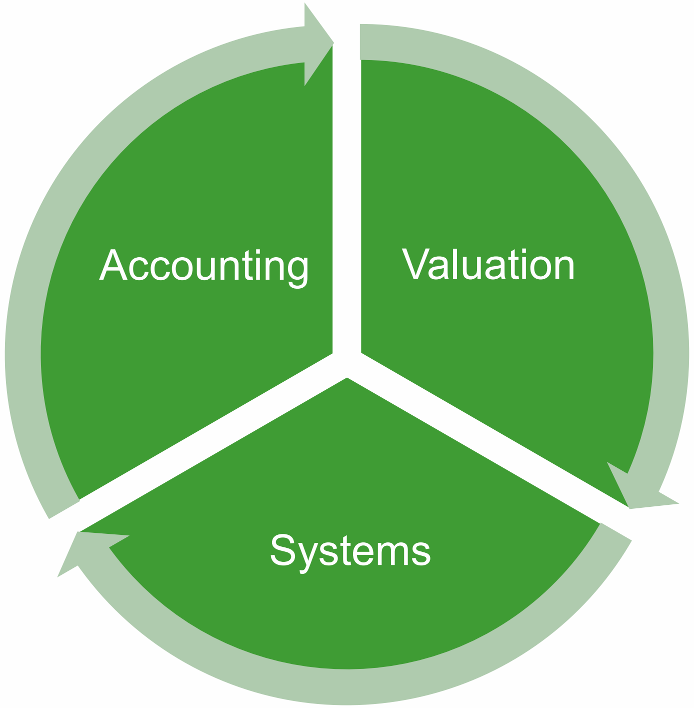
What do you find to be the biggest challenge in maintaining ongoing compliance with ASC 842?

a) Completeness of the lease population, including identification of embedded leases
b) Determining IBRs on an ongoing basis
c) Limited resources to support compliance (including resources to perform data abstraction)
d) Finalizing Implementation of software
e) Have not run into any problems yet

Comparing insourcing vs. outsourcing

Reasons to take an outsourced approach

Accounting for leases under ASC 842 requires expertise in multiple areas

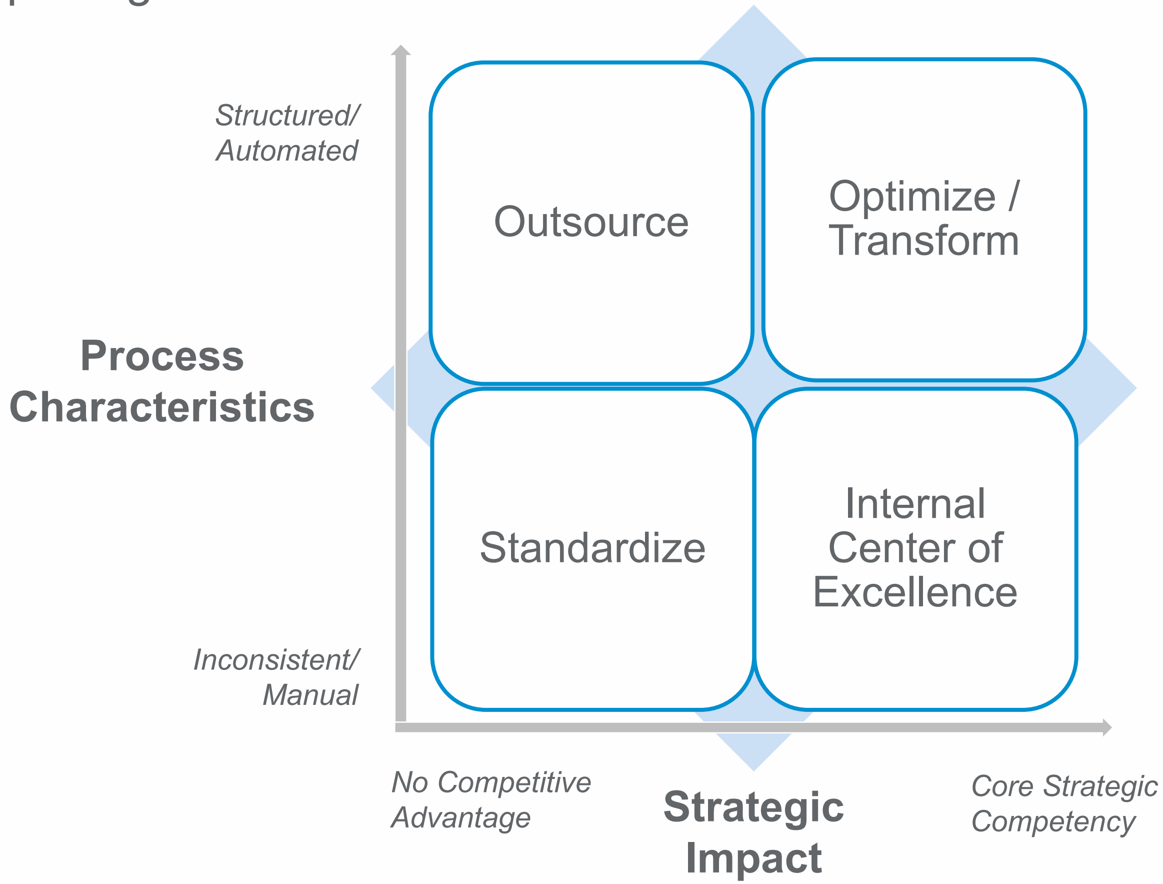


Considerations

- Implementing the standard often requires multiple FTEs on a full-time basis for several months or longer
- Ongoing compliance may require one or more additional FTEs
- It may not be practical to maintain internal staff that possess all necessary skillsets
- Accounting compliance may not be a strategic priority

Approach: Using a rationalization model

Determining whether to build internal capabilities or outsource is often based on the strategic value/impact and process characteristics of the work activities. This generally applies for lease accounting and reporting as well.



Strategic impact and value

Does leasing of real estate or equipment drive a significant impact on your operations, revenue production and overall economics of your business? Should lease accounting and administration be a core competency of your business?

If **"yes"** -- the strategic value and impact of leasing activities on your business enterprise most likely **warrants developing the internal capabilities to manage ongoing lease accounting and lease administration and reporting.**

If the answer is **"no" or not obvious** -- further analysis of insourcing vs. outsourcing should be considered for **both initial adoption as well as ongoing compliance**:

- Internal level of effort for "Day 2"
- Total cost for "Day 2" ongoing activities (e.g., internal labor cost, technology costs, external fees)
- Timeline and other competing internal priorities

Level of effort: Illustrative comparison

Note: Approximate illustration based on a lease portfolio of 50 centrally managed mix of real estate and equipment leases. Actual results will vary and should be based on a tailored implementation plan for your organization.

	Insourcing	Outsourcing	
	Est. Hours	Est. Hours	
Ongoing Accounting & Disclosures Lease modifications, re-measurements, journal entries, reporting disclosures, audit readiness	**100 to 300 hours/year**	**40 to 80 hours/year**	**50 to 150 hours/year**

Legend: = Internal = Internal / external mix = RSM or external firm

Polling Question #3

How does your organization plan to handle ongoing ASC 842 accounting?

a) We will be/are handling internally

b) We are handling internally, but are considering outsourcing in the future

c) We have outsourced or plan to outsource our 842 accounting

d) We are still evaluating the best way to handle

Pros and cons

	Insourcing Pros	Outsourcing Pros
Effort	• Level of effort is more significant, but greater opportunity for internal training of personnel • The level of effort for internal resources can be lessened through involvement of external professional service firms specializing in ASC 842	• Template-driven approach to implementation based on best practices – allows for decreased analysis of alternatives • Eliminates system selection effort and time • Shorter implementation lifecycle limited to confirmation of elections/policies and data migration or abstraction • Majority of incremental accounting burden is shifted to outsourced provider
Cost & Risk	• Although the software cost and cost of internal implementation may be higher, total cost of ownership over the long term may be lower if the right mix of FTE's are found and retained	• Shared software model reduces licensing fees • Implementation costs are reduced • Fractional resource model allows for right-sized staffing within outsourced provider • Predictable cost based on monthly/quarterly annuitized fee • Reduced audit risk and staff continuity/retention risk
Organizational Impact	• More self sufficient in ability to manage lease accounting, administration and audit readiness • Can enable more in-depth data analytics and strategic management of leasing activity and economic impacts	• Accelerated implementation lifecycle limits internal resource needs during implementation phase • Shifts both workload and technical expertise to outsourced provider

Summary - Insourcing vs. Outsourcing

When to insource:

- ✓ Leasing activity has significant strategic impact and value on the organization
- ✓ Lease portfolio is large/complex enough to justify internal resource and technology investment
- ✓ You want to have direct in-house control over your lease accounting processes and systems
- ✓ You desire to have internal capabilities to perform data analytics on leases and manage the procurement, lease administration, technical accounting, and economics of your lease portfolio

When to outsource:

- ✓ Accounting for leases under ASC 842 is the main focus – other lease-related activities are secondary
- ✓ Resource constraints limit ability to adopt, implement, account for and report on the standard
- ✓ Focus is on implementing quickly, with minimal organizational impact

Optimizing processes and systems

Polling Question #4

What type of leasing tool are you or will you use to comply with ASC 842 requirements?

a) We are using excel.
b) LeaseQuery
c) Visual Lease
d) Other technology solution that plugs into our ERP, like NetGain for NetSuite
e) None of the above

Utilize a lease accounting software

A lease accounting system vs. excel workbook is more efficient and effective for monthly journal entries, amortization schedules, disclosure reports, rollforward reports, Day 2 events, etc.

Excel is riskier with high chance of calculation errors

- Abstraction misses
- Re-measurement errors
- Incorrect discount rates and exchange rates
- Incorrect lease classification
- Lack of dual reporting, e.g. ASC 842 and IFRS 16

Excel has minimal lease procurement and lease admin benefits

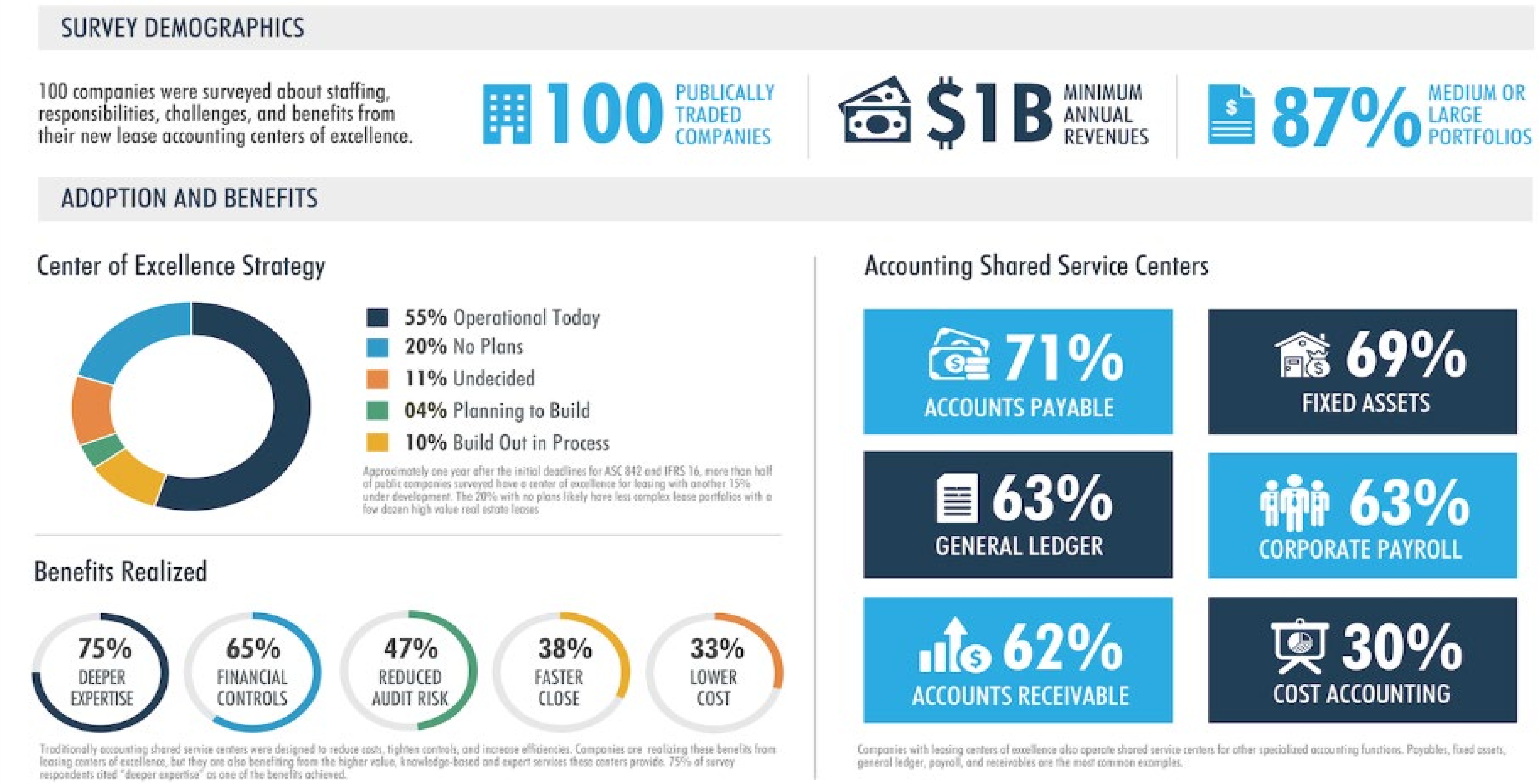
- Approval is less formal
- Critical date management is more manual

Excel will be more costly to maintain

- Manual compilation of disclosure and rollforward under ASC 842 and IFRS 16
- Manual generation of JE's
- Manual creation of re-measurements
- Manual generation of internal reports (e.g. budgeting and forecasting)
- Basic lease accounting software is reasonably low in cost
- Increased audit fees

Centers of Excellence model

Source: Accounting Today, Lease Accelerator Survey



Keep it simple

The new leasing standards are complex, so keep things simple where you can:

- Use one lease accounting and administration system when you can
- Risk-free rate election if you can
- Determine an appropriate capitalization threshold
- Correct immaterial errors prospectively
  - Missed leases
  - Incorrect payment amounts or dates
- Be strategic when negotiating lease agreements

Keep it simple (continued)

The new leasing standards are complex, so keep things simple where you can:

- Keep short-term leases out unless needed for lease administration
  - This reduces the subscription cost and the ongoing maintenance
- Keep variable charges out of the leasing tool, unless the leasing tool is aiding in the calculation of the variable charges (e.g. percent rent or CPI)
- Be strategic about accounting for variable and short-term lease expense account(s)
  - Make a materiality argument when you can
  - Get vendor reports to aid in the collection when you can
  - Create distinct GL accounts to track these expenses for disclosure
- Use an AP clearing account
  - Avoids duplication of expense recorded by AP and the leasing tool
  - Helps identify variable expense that is incorrectly coded

Questions?

Your RSM presenters

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