****

**Take Control of your Real Estate**

# **ASC 842 LEASE ACCOUNTING MEMO**

**Instructions:** This ASC 842 Accounting Memo Template for Lessees should be used as a guide when your accounting team is assessing the impact of ASC 842 to their business. While this memo addresses many items in ASC 842, this template may not address a topic specific to your Company. Therefore, it is important your Company also develops an understanding of ASC 842 to identify additional items critical to your accounting policy. Throughout this memo template, it is expected your Company will insert relevant information relating to your lease portfolio and processes.

Throughout this guide, there will be text in colors denoting different items.

**Black Text:** ASC 842 guidance referenced

**Red Text:** Items requiring additional attention from the accounting team. This may include subjective areas or areas suggested to provide more information surrounding your Company’s lease accounting process.

**Company Name**

**Lease Accounting Policy**

**ASC 842**

**Table of Contents**

1. **Purpose and Background**
2. **Executive Summary**
3. **Guidance & Resources**
4. **ASC 842 Scope**
5. **Chart of Accounts**
6. **Systems**
7. **ASC 842 Key Terms**
	1. Lease Identification
	2. Lease Term
	3. Incremental Borrowing Rate
	4. Initial Direct Costs
	5. Lease Incentives
8. **Accounting Policy Elections**
	1. Determination of Asset Classes
	2. Implementation Date Practical Expedients
	3. Accounting Policy Elections
9. **Financial Statement Impact**
	1. Materiality
	2. Income Statement
	3. Balance Sheet

# **PURPOSE AND BACKGROUND**

For many reporting entities, leasing is an important way to obtain access to property. It allows lessees to finance the use of necessary assets, often simplifies the disposal of used property, and reduces a lessee’s exposure to the risks inherent in asset ownership. Leasing guidance (before the issuance of ASU 2016-02) required lessees to classify leases as either capital or operating leases. Lessees recognized assets and obligations related to capital leases; expenses associated with capital leases were recognized by amortizing the leased asset and recognizing interest expense on the lease obligation. Many lease arrangements were classified as operating leases, under which lessees would not recognize lease assets or liabilities on their balance sheet, but rather would recognize lease payments as expense on a straight line basis over the lease term. The leasing guidance was often criticized for not providing users the information necessary to understand a reporting entity’s leasing activities, primarily because it did not provide users with a comprehensive understanding of the costs of property essential to a reporting entity’s operations and how those costs were funded. Users frequently analyzed information from a reporting entity’s lease related disclosures to compare that reporting entity’s performance with other companies. The user community and regulators frequently called for changes to the accounting requirements that would require lessees to recognize assets and liabilities associated with leases.

The FASB issued ASU 2016-02 in February 2016, which was amended in some respects by subsequent Accounting Standards Updates (collectively the “leases standard” or “ASC 842”). Although the project began as a joint project, the boards diverged in some key areas. Most significantly, the boards did not agree on whether all leases should be accounted for using the same model. After significant deliberation, the IASB decided that lessees should apply a single model to all leases, which is reflected in IFRS 16, Leases, released in January 2016. The FASB decided that lessees should apply a dual model. Under the FASB model, lessees will classify a lease as either a finance lease or an operating lease, while a lessor will classify a lease as either a sales-type, direct financing, or operating lease.

Under the FASB model, a lessee should classify a lease based on whether the arrangement is effectively a purchase of the underlying asset. Leases that transfer control of the underlying asset to a lessee are classified as finance leases (and as a sales-type lease for the lessor); lessees will classify all other leases as operating leases. In an operating lease, a lessee obtains control of only the use of the underlying asset, but not the underlying asset itself. A lease may meet the lessor finance lease criteria even when control of the underlying asset is not transferred to the lessee (e.g., when the lessor obtains a residual value guarantee from a party other than the lessee). Such leases should be classified as a direct finance lease by the lessor and as an operating lease by the lessee. The dual model does not affect a lessee’s initial recognition of assets and liabilities on its balance sheet, but differentiates how a lessee should recognize lease expenses in the income statement. The accounting for lessors is largely unchanged under the FASB and IASB models.

# **Executive Summary**

ASC 842 is effective for Company Name (“Company Name”, “we”, “us”, “our”, or the “Company”) for our annual reporting period beginning <January 1, 2022>, and interim reporting periods beginning January 1, 2022.

The purpose of this accounting policy memo is to document the Company’s (1) process for evaluating the impact of adopting the lease standard, (2) analysis of the key aspects of the lease standard on its contracts, and (3) establishment of accounting policies under the new standard.

Insert description of lease portfolio. Items to consider adding in description:

* Types of leases
* Types of leased assets
* Typical lease terms

# **Guidance and Resources**

Throughout this memo, we leveraged the following resources:

* [Accounting Standards Codification 842 (ASC 842)](https://asc.fasb.org/topic%26trid%3D77888249)
* [Deloitte A Roadmap to Applying the New Leasing Standard (2020) (DTT)](https://drive.google.com/file/d/1H5VZUKtCJRf49m5UAW5uCHYpn59LzWBc/view)
* [PwC Leases October 2020 (PwC)](https://drive.google.com/file/d/1GpQDg8vzdgSswTnC7mSPRszmyEDUxCuk/view?usp=sharing)

# **ASC 842 Scope**

A lease conveys the right to use an underlying asset for a period of time in exchange for consideration. At the inception of an arrangement, the parties should determine whether the contract contains a lease by assessing both of the following:

1. Whether there is an identified asset
2. Whether the contract conveys the right to control the use of the identified asset in exchange for consideration for a period of time

An arrangement contains a lease only when such arrangement conveys the right to “control” the

use of an “identified asset” to a customer and the customer obtains substantially all its economic benefits.

The leases standard does not require lessees to reflect lease assets and liabilities on the balance sheet for arrangements with a lease term of 12 months or less permitted the company elects this option.

In addition, certain arrangements are outside the scope of the leases standard, including:

* Leases of inventory or of construction in progress
* Leases of intangible assets, including licenses of internal-use software
* Leases to explore for or use natural resources
* Leases of biological assets
* Service concession arrangements within the scope of ASC 853, Service Concession Arrangements

# **Chart of Accounts**

The list below includes the chart of accounts impacted by the Company’s lease accounting process:

| **Description** | **Account Name** | **Account ID** |
| --- | --- | --- |
| ROU Asset |  |  |
| Lease Liability  |  |  |
| ROU Asset Amortization |  |  |
| ROU Asset Accumulated Amortization |  |  |
| Lease Expense  |  |  |
| Interest Expense  |  |  |
| Prepaid Rent  |  |  |
| Other  |  |  |

# **Systems and People**

The list below includes the systems utilized in the lease accounting process:

| **System**  | **Use** |
| --- | --- |
| ERP System | Records monthly lease accounting journal entries |
| AP System  | Approves and remits payments for leases |
| Lease Software | Stores all leasing information, including all relevant documents and critical terms, and calculates monthly journal entries and footnote disclosures.  |
| Other  |  |

The list below lists the people involved in the lease accounting process:

| **Name** | **Role** |
| --- | --- |
| Staff Accountant  | Reviews monthly lease activity and records the monthly journal entries by extracting the journal entry from the Lease Software and importing into the ERP system. If a new contract is entered into during the period, the Staff Accountant reviews the contract to determine if the contract is or contains a lease.  |
| Accounting Manager | Reviews monthly journal entries prepared by the staff accountant. |
| General Counsel  | Notifies the Finance team once a contract has been signed.  |
| Real Estate Expansion Team | Manages the retail location pipeline. Once a lease is executed or modified, the Real Estate Expansion Team enters the critical lease information into the Lease Software.  |
| Facilities Manager | Manages the corporate offices. If a new lease is executed or modified, the Facilities Manager enters the critical lease information into the Lease Software.  |
| Head of Manufacturing | Manages the Manufacturing facility lease and the underlying equipment leases.. If a new lease is executed or modified, the Head of Manufacturing enters the critical lease information into the Lease Software.  |
| Other  |  |

# **ASC 842 Key Terms**

**Lease Identification**

Whenever a contract is executed, the General Counsel notifies us At contract execution, the General Counsel notifies the Finance team. The Staff Accountant assesses if the contract is or contains a lease in accordance with ASC 842-10-55 by following the flowchart below.

****

**A** An asset is identified in a contract either:

* **Explicitly** by serial number, VIN, GPS coordinates, etc

 **or**

* **Implicitly** based on whether a particular asset is required to fulfill a contract from commencement

For portions of an asset not physically distinct, it is not an identified asset unless it represents substantially all of the capacity of the asset. Although ASC 842 does not define "substantially all", entities are permitted to use a 90% threshold test which aligns to the lease classification test. We have determined this threshold to be appropriate when determining if the asset represents substantially all of something.

**B** To convey the right to control the use of an identified asset for a period of time (or amount), the customer must have BOTH of the following:

1. **Right to obtain substantially all of the economic benefits** from the use of the identified asset
	1. We can obtain economic benefits from use of an asset directly or indirectly in many ways, such as by using, holding, or subleasing the asset. Examples include:
		1. Primary outputs (e.g., physical receipt of the widgets produced by or at a widget factory).
		2. By-products (e.g., physical receipt of the steam produced as a by-product of the manufacturing process in the widget factory).
		3. Cash flows derived from primary outputs and by-products (e.g., cash flows derived from the supplier’s selling, on the customer’s behalf, of widgets produced by or at the widget factory).
	2. In determining this, we first identify all economic benefits resulting from the use of an asset then determine which of those benefits are within the scope of our right to use the asset in the contract.
2. The **right to direct the use of the identified asset**
	1. We have the right to direct the use of an identified asset throughout the period of use if **either** of the following situations:
		1. We have the right to direct how and for what purpose the asset is used throughout the period of use
		2. The relevant decisions about how and for what purpose the asset is used are predetermined (see ASC 842-10-15-21) and at least one of the following conditions exists:
			1. We have the right to operate the asset (or to direct others to operate the asset in a manner that it determines) throughout the period of use without the supplier having the right to change those operating instructions.
			2. We designed the asset (or specific aspects of the asset) in a way that predetermines how and for what purpose the asset will be used throughout the period of use.
	2. We do not have the right to use an identified asset if the supplier has the substantive right to substitute the asset throughout the period of use. A supplier’s right to substitute an asset is substantive only if **both** of the following conditions exist
		1. The supplier has the **practical ability** to substitute alternative assets throughout the period of use
		2. The supplier would **benefit economically** from the exercise of its right to substitute the asset

Only decisions made during the period of use (and not before) should be considered unless we designed the asset in a way that predetermines how and for what purpose the asset will be used. If the right to control the use of an identified asset is only for a portion of the contract term, the contract contains a lease for that portion of the contract.

Elaborate on how this is incorporated into the lease accounting process, potentially listing specific controls within the contract execution process.

## Lease Commencement Date

At the lease commencement date, the date on which the lessor makes an underlying asset available to the lessee, the Right of Use (ROU) Asset and Initial Liability will be recognized on the balance sheet. The amount is calculated below:

**Lease Liability**= Present Value of remaining lease payments at the Discount Rate

**Right Of Use (ROU) Asset** = Lease Liability + Initial Direct Costs - Lease Incentives Received + Prepaid Rent

The remaining sections will discuss each of these terms in more depth.

## Lease Term

**Guidance Referenced:**

* ASC 842-10-Glossary
* ASC 842-10-20
* ASC 842-10-30-1
* ASC 842-10-55-25
* ASC 842-10-55-26
* PwC 3-7

The lease term begins at the commencement date and includes any rent-free periods provided to the lessee by the lessor. When considering the lease term, the term starts with the noncancellable period for which a lessee has the right to use an underlying asset, together with all of the following:

1. Periods covered by an option to extend the lease if the lessee is **reasonably certain** to exercise that option
2. Periods covered by an option to terminate the lease if the lessee is **reasonably certain** not to exercise that option
3. Periods covered by an option to extend (or not to terminate) the lease in which exercise of the option is **controlled by the lessor**.

The lease term begins at the commencement date and includes any rent-free periods provided to the lessee by the lessor.

**Reasonably Certain**

When evaluating periods that contain option periods, “Reasonably Certain” is considered a high threshold of probability under ASC 842. At the commencement date, an entity assesses whether the lessee is reasonably certain to exercise or not to exercise an option by considering all economic factors relevant to that assessment — contract- based, asset-based, market-based, and entity-based factors. An entity’s assessment often will require the consideration of a combination of those factors because they are interrelated. Examples of economic factors to consider include, but are not limited to, any of the following:

a. Contractual terms and conditions for the optional periods compared with current market rates, such as:

 1. The amount of lease payments in any optional period

 2. The amount of any variable lease payments or other contingent payments, such as payments under termination penalties and residual value guarantees

 3. The terms and conditions of any options that are exercisable after initial optional periods (for example, the terms and conditions of a purchase option that is exercisable at the end of an extension period at a rate that is currently below market rates.)

b. Significant leasehold improvements that are expected to have significant economic value for the lessee when the option to extend or terminate the lease or to purchase the underlying asset becomes exercisable.

c. Costs relating to the termination of the lease and the signing of a new lease, such as negotiation costs, relocation costs, costs of identifying another underlying asset suitable for the lessee’s operations,

or costs associated with returning the underlying asset in a contractually specified condition or to a contractually specified location.

d. The importance of that underlying asset to the lessee’s operations, considering, for example, whether the underlying asset is a specialized asset and the location of the underlying asset.

Describe processes for how the company will determine if something is reasonably certain to occur. In addition, describe any relevant lease clauses related to lease terms that are exhibited in the company’s lease portfolio.

**Termination Rights:**

If termination rights are symmetrical (both parties have the unilateral right to terminate the arrangement), the lessee and lessor should determine if terminating the lease would result in either party incurring more than an insignificant penalty, as defined in. If the termination rights are symmetrical with no more than an insignificant penalty, the lease term is limited to the period up to the time those symmetrical rights are exercisable.

When evaluating whether the lessee or lessor would incur more than an insignificant economic penalty, they should consider not only cash payments required to be made upon exercise of the termination options, but also other penalties, such as the cost of abandoning leasehold improvements or the disruption caused by relocating employees.

## Lease Consideration

**Accounting Guidance Referenced:**

* ASC 842-10-30-5
* ASC 842-10-55-31
* ASC 842-10-55-30

At the commencement date, the Company will include lease payments consisting of the following payments relating to the use of the underlying asset during the lease term:

1. Fixed payments, including in substance fixed payments, less any lease incentives paid or payable to the lessee
	1. In Substance Fixed Payments
		1. Payments that may, in form, appear to contain variability but are, in effect, unavoidable. In substance fixed payments for a lessee or a lessor may include, for example, any of the following:
			1. Payments that do not create genuine variability (such as those that result from clauses that do not have economic substance)
			2. The lower of the payments to be made when a lessee has a choice about which set of payments it makes, although it must make at least one set of payments.
	2. Lease Incentives Paid or Payable
		1. Lease incentives include both of the following :
			1. Payments made to or on behalf of the lessee
			2. Losses incurred by the lessor as a result of assuming a lessee’s pre existing lease with a third party
2. Variable lease payments that depend on an index or a rate (such as the Consumer Price Index or a market interest rate), initially measured using the index or rate at the commencement date.
3. The exercise price of an option to purchase the underlying asset if the lessee is reasonably certain to exercise that option
4. Payments for penalties for terminating the lease if the lease term reflects the lessee exercising an option to terminate the lease.
5. Fees paid by the lessee to the owners of a special-purpose entity for structuring the transaction.
6. For a lessee only, amounts probable of being owed by the lessee under residual value guarantees

Only payments allocated to the lease should be considered for purposes of classifying the lease.

 **Example of Lease Consideration:**

* Non-refundable lease Payments (Fixed Payment)
* Monthly fixed lease payments (Fixed Payment)
* Lessor reimbursement of moving costs (Incentive)

**Examples of Non Lease Consideration:**

* Refundable lease payments
* Payments based on a change in an index or a rate
* Real estate taxes as they do not provide a separate good or service
* Leasehold improvements paid for by the lessee and not specifically required in the lease contract
* Lease payments tied to sales amounts, regardless of historical and projected performance even if

Describe what types of lease consideration the Company has and how these payments will be treated in accordance with ASC 842. In addition, explain how contracts will be reviewed to ensure all types of lease consideration are completely and accurately abstracted.

## Discount Rate

**Guidance Referenced:**

ASC 842-10 — Glossary

ASC 842-20-30-2

ASC 842-20-30-3

PwC 3.3.4.6

DTT 7.2.3, 7,1,2, Q-A 7-2, Q&A 7-4

The discount rate for a lease is initially used to determine the present value of the lease payments for a lessee is calculated on the basis of information available at the commencement date. A lessee should use the rate implicit in the lease whenever that rate is readily determinable. If the rate implicit in the lease is not readily determinable, a lessee will use its incremental borrowing rate

**Rate Implicit in the Lease**

The rate of interest that, at a given date, causes the aggregate present value of

(a) the lease payments and

(b) the amount that a lessor expects to derive from the underlying asset following the end of the lease term to equal the sum of (1) the fair value of the underlying asset minus any related investment tax credit retained and expected to be realized by the lessor and (2) any deferred initial direct costs of the lessor. However, if the rate determined in accordance with the preceding sentence is less than zero, a rate implicit in the lease of zero shall be used.

If a lessee can ascertain the fair value of the underlying asset, the residual value estimated by the lessor, and initial direct costs incurred by the lessor, it can calculate the lessor’s implicit rate. However, such information is rarely available to the lessee considering the sensitive nature of the information to the lessor and the potential impact it could have on existing or future lease negotiations. Accordingly, lessees and lessors will often use a different discount rate for the same lease.

**Incremental Borrowing Rate**

The Incremental Borrowing Rate is the rate of interest that a lessee would have to pay to borrow on a collateralized basis over a similar term an amount equal to the lease payments in a similar economic environment .

A lessee that is not a public business entity is permitted to use a risk-free discount rate for the lease, determined using a period comparable with that of the lease term, as an accounting policy election for all leases. We have determined we will utilize the risk-free rate for our incremental borrowing rate **OR** We have outlined them steps we will utilize to determine the incremental borrowing rate:

In determining the incremental borrowing rate, we evaluated the collateral considered for the borrowing as follows:

1. We start with a rate that is obtained for a general, unsecured, recourse borrowing and should adjust that rate for the effects of collateral. We have utilized recent financing rounds, as appropriate, as our starting point.
2. We assume full collateralization and do not assume under- or over-collateralization.
	1. The collateral considered does not have to be the leased asset. It can be the leased asset, but it may also be any form of collateral that a creditor would be expected to accept to secure a borrowing for a similar term (i.e., collateral that is at least as liquid as the leased asset).
3. For leases denominated in a foreign currency, we calculate its incremental borrowing rate by using assumptions that would be consistent with a rate that it would obtain to borrow, on a collateralized basis and in the same currency in which the lease is denominated.

*A determination of the lessee’s incremental borrowing rate at the commencement date of a lease may be difficult. If a lessee did not incur borrowings at or near the commencement date of a lease that were for a term similar to the lease term, the lessee may need to determine its incremental borrowing rate through discussions with bankers, or other lenders, or by reference to obligations of a similar term issued by others with a credit rating similar to that of the lessee. The incremental borrowing rate should be an effective borrowing rate that takes into account any compensating balance or other requirements affecting the stated interest rate. When the lessee obtains a third-party guarantee of its lease payments, it should adjust its incremental borrowing rate to reflect the impact of that guarantee if obtaining a third-party guarantee for a similar borrowing that could have been used to purchase the leased asset would have affected the lessee’s borrowing rate for that debt. If a lessee is not able to obtain financing from a third party because of its overall financial condition and creditworthiness, the incremental borrowing rate may not be readily available. In such circumstances, the lessee should use, as its incremental borrowing rate, the interest rate available for the lowest-grade debt in the marketplace, adjusted for the effects of collateral.*

## Initial Direct Costs

**Guidance Referenced:**

* ASC 842-10-Glossary
* ASC 842-10-30-9
* ASC 842-10-30-10

Initial direct costs are incremental costs of a lease that would not have been incurred if the lease had not been obtained. Initial Direct costs for a lessee may include either of the following:

* Broker Commissions
* Payments to an existing tenant to incentivize that tenant to terminate its lease

| Costs to negotiate or arrange a lease that would have been incurred regardless of whether the lease was obtained, such as fixed employee salaries, are not initial direct costs. The following items are examples of costs that are not initial direct costs: * General overheads, including, for example, depreciation, occupancy and equipment costs, unsuccessful origination efforts, and idle time
* Costs related to activities performed by the lessor for advertising, soliciting potential lessees, servicing existing leases, or other ancillary activities
* Costs related to activities that occur before the lease is obtained, such as costs of obtaining tax or legal advice, negotiating lease terms and conditions, or evaluating a prospective lessee’s financial condition.
 |
| --- |

Describe how this applies to the lease portfolio and how the Company will identify initial direct costs within leases.

## Lease Incentives

**Guidance Referenced:**

ASC 842-10-55-30

PwC 3.3.4.2

DTT Q&A 6-5

A lease agreement may include incentives to encourage a lessee to sign the lease, such as an up-front cash payment to a lessee, payment of lessee costs (such as moving expenses), or the assumption by a lessor of a lessee’s pre-existing lease. When a lessor assumes a lessee’s pre-existing lease with a third party, the lessee should independently estimate any loss associated with the assumption.

Lease incentives are not always paid by the lessor to the lessee before lease commencement. In some cases, a lessor may make a payment to the lessee during the lease term. Payments made by a lessor to a lessee, regardless of the timing of the payment, should be accounted for as lease incentives that reduce the lessee’s lease payments.

**Reimbursement for Leasehold Improvements**

Lessor reimbursement for some (or all) of the costs a lessee incurs to complete leasehold improvements is a common example of a lease incentive. These payments may be calculated as a certain amount per square foot or a fixed amount regardless of the level of improvements undertaken by a lessee.

To determine whether a payment from the lessor to the lessee represents a lease incentive, a reporting entity must determine whether it represents a lessee or a lessor asset. If an improvement represents a lessee asset, the lessor payment is a lease incentive that should be recorded as a reduction to fixed lease payments. On the other hand, when a lessee pays for an improvement that is a lessor asset, the expenditure is prepaid rent rather than a lease incentive; the reimbursement is a reduction to prepaid rent. If a lessee was not fully reimbursed, the difference between the costs incurred and the reimbursements received would be included in lease payments.

If a lessor agrees to pay a fixed or formula-based amount to the lessee once the lessee provides evidence of the expenditures and the contract does not specify the nature of the improvements to be completed, it is reasonable to conclude that the improvements represent lessee assets. However, if the amount a lessee will receive is based on the actual costs incurred on improvements that are specified in the contract, judgment will be required to determine whether the improvements represent lessee or lessor assets.

Describe how this applies to the lease portfolio and how the Company will identify lease incentives within lease documents and how it will account for the changing of receipt of lease incentives impacts the lease consideration.

#  **Accounting Policy Elections**

## **Determination of Asset Classes**

**Accounting Guidance**

* DTT 4.3.3.1

Certain accounting policy elections can be applied based on the class of underlying assets. Within this section, describe if the Company will segregate the lease portfolio into separate classes of underlying assets and how the Company made this determination. While ASC 842 does not address what is meant by the phrase “class of underlying assets", two views have emerged:

• View 1 — The class of underlying asset is determined on the basis of the physical nature

and characteristics of the asset. For example, real estate, manufacturing equipment, and

vehicles would all be reasonable classes of underlying assets given their differences in

physical nature. Therefore, irrespective of whether there are different types of similar

assets (e.g., within the real estate class, there may be retail stores, warehouses, and

distribution centers), the class of underlying asset would be limited to the physical nature

as described above.

• View 2 — The class of underlying asset is determined on the basis of the risks associated

with the asset. While an asset’s physical nature may be similar to that of other assets (e.g.,

retail stores, warehouses, and distribution centers are all real estate, as discussed above),

each has a different purpose and use to the lessee and would therefore have a separate

risk profile. Therefore, for example, it could be appropriate for the lessee to disaggregate

real estate assets into separate asset classes by “type” of real estate — to the extent that

the different types are subject to different risks — when applying the practical expedients

in ASC 842-10-15-37 and ASC 842-20-25-2.

## **Implementation Date Practical Expedients**

At the ASC 842 transition date, there are transition elections available to be applied on an entity- wide basis for all leases. The chart below describes these practical expedients and the Company’s election decision.

| **Practical Expedient** | **Definition** | **Elected by the Company?** |
| --- | --- | --- |
| Hindsight Practical Expedient*ASC 842010-65-1* | Company may elect to use hindsight “in determining the lease term . . . and in assessing impairment” of ROU assets. | Yes/No |
| Practical Expedient Package of Three*ASC 842-10-65-1* | An entity may elect the following practical expedients, which must be elected as a package and applied consistently by an entity to all of its leases (including those for which the entity is a lessee or a lessor), when applying the pending content that links to this paragraph to leases that commenced before the effective date:1. An entity need not reassess whether any expired or existing contracts are or contain leases.2. An entity need not reassess the lease classification for any expired or existing leases (for example, all existing leases that were classified as operating leases in accordance with Topic 840 will be classified as operating leases, and all existing leases that were classified as capital leases in accordance with Topic 840 will be classified as finance leases).3. An entity need not reassess initial direct costs for any existing leases. . . .If this is not elected, the lease should be classified in accordance with the ASC 842 lease classification criteria and facts and circumstances as of the later of the (1) lease commencement date or (2) date the lease was last modified in accordance with ASC 840. If a lease was renewed or extended before the date of initial application, the renewal or extension date would be considered the lease commencement date for this purpose unless the renewal was assumed to be reasonably certain as of the initial lease commencement date. | Yes/No |
| Land Easements*ASC 842-65-1 gg* | Provide a transition practical expedient for existing or expired land easements that were not previously accounted for in accordance with ASC 840. The practical expedient would allow entities to elect not to assess whether those land easements are, or contain, leases in accordance with ASC 842 when transitioning to ASC 842.Land easements entered into (or existing land easements modified) on or after the effective date of ASC 842 must be assessed under ASC 842.  | Yes/No |

## Accounting Policy Elections

| **Policy** | **Definition** | **Elected by the Company?** |
| --- | --- | --- |
| Separation of consideration in the contract between lease and non lease components by class of underlying asset *ASC 842-10-15-37* | A lessee may, as an accounting policy election by class of underlying asset, choose not to separate non lease components from lease components and instead to account for each separate lease component and the nonlease components associated with that lease component as a single lease component. | Yes/No |
| Portfolio Approach*ASU 2016-02* | ASC 842 permits a lessee to account for its leases at a portfolio level provided that the leases commenced at or around the same time and the resulting accounting at this level would not differ materially from the accounting at the individual lease level. We therefore believe that this approach would be permitted when the portfolio includes leases that are (1) similar in nature (e.g., similar underlying assets) and (2) have identical or nearly identical contract provisions.  | Yes/No |
| Short- term lease exemption by class of underlying asset*ASC 842-20-25-2* | A lessee may elect not to apply the recognition requirements in this Subtopic to short-term lease, a lease that at the commencement date, has a lease term of 12 months or less and does not include an option to purchase the underlying asset that the lessee is reasonably certain to exercise .Instead, a lessee may recognize the lease payments in profit or loss on a straight-line basis over the lease term and variable lease payments in the period in which the obligation for those payments is incurred.  | Yes/No |
| Discount Rate (nonpublic entities)*ASC 842-20-30-2* | A lessee that is not a public business entity (PBE) is permitted, as an accounting policy election, to use a risk-free discount rate in lieu of its incremental borrowing rate when assessing lease classification and when measuring its lease liabilities.  | Yes/No |

# **Financial Statement Impact**

## **Materiality Influenced Judgments**

Describe materiality thresholds and basis of determining why these thresholds were appropriate, if applicable. While ASC 842 does not contain a specific exemption, an entity is not required to apply U.S. GAAP to immaterial items; therefore, materiality is always a consideration in the preparation of financial statements. However, an entity should not simply default to its existing capitalization threshold for PP&E for the following reasons:

* The existing capitalization threshold for PP&E is unlikely to include the effect of the additional asset base introduced by ASC 842. The addition of leased assets to the balance sheet may require a refreshed analysis of the entity’s capitalization thresholds to ensure that the aggregated amounts will not become material.
* The existing capitalization threshold for PP&E does not take into account the liability side of the balance sheet. Under ASC 842, if an entity wishes to establish a threshold that will be used to avoid accounting for both ROU assets and lease liabilities on the balance sheet, it must consider the materiality, in the aggregate, of all of its ROU assets and related lease liabilities that would be excluded when it adopts such a threshold.

One reasonable approach to developing a capitalization threshold for leases is to use the lesser of the following:

* A capitalization threshold for PP&E, including ROU assets (i.e., the threshold takes into account the effect of leased assets determined in accordance with ASU 2016-02).
* A recognition threshold for liabilities that takes into account the effect of lease liabilities determined in accordance with the ASU.

When evaluating and applying a capitalization threshold for leases determined in accordance with the ASU, entities should consider the following:

* **The gross balance of each side of the lease entry** — It would be inappropriate for an entity to consider only the net balance sheet effect of the lease entry (which is often zero) when assessing materiality.
* **Disclosure requirements** — Entities will often want to omit disclosures about leases that they have determined, on the basis of their use of capitalization thresholds (as discussed above), do not need to be recognized on the balance sheet. While it may be appropriate to omit such disclosures, an entity will need to consider the impact of the omitted disclosures when performing a materiality assessment to establish the thresholds.
* **Implications related to internal control over financial reporting (ICFR)** — As entities revisit and change (or create new) capitalization thresholds for financial reporting purposes, they should be cognizant of the related ICFR implications. In addition, entities should consider the Form 10-K and Form 10-Q disclosure requirements under SEC Regulation S-K, Item 308(c), with respect to material changes in ICFR.
* **SAB Topic 1.M (SAB 99)** — Entities may find the guidance on materiality in SAB Topic 1.M helpful when identifying an appropriate capitalization threshold for leases.

## Balance Sheet

#### **Guidance Referenced:**

ASC 842-20-45-1

PwC 9.2.1.1, 9.2.1.2

A lessee shall either present in the statement of financial position or disclose in the notes all of the following:

1. Finance lease right-of-use assets and operating lease right-of-use assets separately from each other and from other assets
2. Finance lease liabilities and operating lease liabilities separately from each other and from other liabilities.

**ROU Assets on the Balance Sheet:**

* Subject to the same considerations as other nonfinancial assets, such as property, plant, and equipment, in classifying them as current or noncurrent in a classified balance sheet.
* Should generally be classified as non-current for the entire lease term. A right-of-use asset recorded for a lease with an initial term of 12 months or less (i.e., the short-term lease measurement and recognition exemption was not taken) may be classified as current similar to other executory contracts.
* There are certain situations that could cause an individual right-of-use asset to have a negative balance. If this occurs, the negative balance should be presented as a liability separate and apart from the lease liability.
* ROU Assets will be reviewed to determine if impairment indicators exists on an annual basis, if not more frequently
* Detail the accounts that will be on the balance sheet

**Lease Liabilities on the Balance Sheet:**

* Lease liabilities are subject to all of the same considerations as debt instruments in classifying them as current or noncurrent in a classified balance sheet.
* Detail the accounts that will be on the balance sheet

## Income Statement

#### **Guidance Referenced:**

ASC 842-20-45-4

| **Lease Type** | **Statement of Comprehensive Income**  |
| --- | --- |
| Finance Lease | * **Interest expense** (account reference) on the lease liability and
* **Right-of-use asset amortization** (account reference)
* These expenses are not required to be presented as separate line items and shall be presented in a manner consistent with how the entity presents other interest expense and depreciation or amortization of similar assets, respectively.
 |
| Operating Lease | * **Lease expense** (account reference) shall be included in the lessee’s income from continuing operations.
 |

## **Financial Statement Disclosures**

#### **Guidance Referenced:**

ASC 842-20-45-1

ASC 842-20-45-4

ASC 842-20-50-3

ASC 842-20-50-4

ASC 842-20-55-53

Under the new leasing standards, there are enhanced disclosure requirements from both a quantitative and qualitative perspective. To ensure we comply with these enhanced disclosure requirements, we complete a financial statement disclosure checklist for our annual and quarterly reporting.