



Your Comprehensive Guide to Implementing the New Lease Accounting Standard – ASC 842

The new ASC 842 standard contains significant changes in how to account for leases for lessees, and more targeted changes in how to account for leases for lessors. It is very important that companies take action now to ensure that they will be in compliance with all the new requirements.

— Overview —

In February 2016, The Financial Accounting Standards Board (“FASB”) issued a new accounting standard, Leases (ASC 842). This new standard requires all leases with a term of more than one year to be recorded on a company’s balance sheet. The leases will now be recorded as “right-of-use assets” with a corresponding lease liability. Income statement recognition of lease related expenses for lessees will depend on whether the lease is classified as an operating or a financing lease.

While the amount of expense recognition may be similar to how lease expense is currently recognized under existing US GAAP, the amount of expense will most likely differ due to how certain elements of the rent costs are currently being recorded.

Lessors accounting for leases is similar to current US GAAP under the existing lease accounting standards (ASC 840). However, changes have been made to the lease standards to be in line with the new revenue recognition standards ASC 606.

Effective Date and Implementation Timeline

Below are the effective dates for both public and private companies.

NOTE: Early adoption is permitted for all entities but the new revenue recognition standard ASC 606 must also be adopted as well if the new lease standard is adopted early.

For Public Business Entities:

This new guidance will go into effect for fiscal years and interim periods within those fiscal years beginning **after December 15, 2018.**

For Private/All Other Entities:

This new guidance will go into effect for fiscal years beginning **after December 15, 2019** and interim periods for fiscal years beginning **after December 20, 2020.**

Adoption Timeline Options

Modified VS. Transition Method

ASC 842 can be adopted using a [modified retrospective](#) approach OR [the transition method](#).

The Modified Retrospective Approach:

Under the modified retrospective approach, an entity can reflect the impact of initially applying ASC 842 as of either (a) the beginning of the year of adoption or (b) the earliest comparative period presented.

The entity will recognize the right-of-use assets and lease liabilities measured under the new Standard on the balance sheet and the related cumulative effect on earnings as an adjustment to equity, as of the adoption date.

The Transition Method:

Using the transition method, the entity would apply ASC 842 on the date of adoption. If an entity chooses the transition method, it is required to provide footnote disclosures for all comparative periods under the ASC 840 legacy lease requirements.

How to Implement ASC 842

The level of effort to adopt the new lease standard is significant and will involve multi-functions within an entity's organization.

It is critical for companies to have a plan and strategy in place to address all of the key elements needed to be successful in complying with the new lease standard.

Implementing ASC 842 will likely present significant challenges and will likely require substantial resources to accomplish complete compliance. Therefore, it is important to have a solid strategy in place prior to beginning the implementation process.

It will be critical to obtain buy-in and approval from the senior executive leadership at the company. Their approval should include:

- ▶ Prioritization of the project
- ▶ Involvement of multiple department functions and personnel
- ▶ Resources
- ▶ New or enhanced systems
- ▶ Timeline
- ▶ Deliverables

Project Timeline

It is highly recommended to create a **minimum project timeline of 4 to 6 months** in order to effectively identify all the required information and establish all the necessary reporting systems that will need to be in place.

The plan and strategy should include the following elements:

Step 1: Organize a Project Team

This team will be responsible for the implementation and must include representatives from all departments and functional groups that are involved or impacted by lease activities.

Among these groups are:

- ▶ Accounting
- ▶ Financial Reporting
- ▶ Tax
- ▶ Finance
- ▶ Treasury
- ▶ Real estate
- ▶ Facilities management
- ▶ Regulatory compliance
- ▶ Information technology & systems
- ▶ Marketing
- ▶ Internal Audit

Step 2: Develop a plan for addressing the information and key factors needed

Note: Companies will face significant challenges in most of the categories noted below.

A. Data strategy (initial compilation and analytics and completeness and accuracy).

DATA CHALLENGES INCLUDE: *(This will be a significant effort)*

- ▶ Identifying all leasing arrangements/contracts
- ▶ Increase data needs
- ▶ Different data sources
- ▶ Identifying what data is needed
- ▶ How to source the data
- ▶ Where is the data located (in what documents/agreements)
- ▶ Changes in data (modifications to contracts/agreements)
- ▶ Resolutions to judgments on how to identify and resolve missing information
- ▶ Process flow for capturing all the current and ongoing data accumulation requirements

B. Training and education of company personnel that will be impacted by ASC 842 on its requirements and issues.

TRAINING/EDUCATION CHALLENGES INCLUDE:

- ▶ Leasing definitions and terms
- ▶ Lease and non-lease components
- ▶ Embedded leases in arrangements (service contract)
- ▶ Modifications
- ▶ Discount rates for classification and measurement
- ▶ Key Assumptions
- ▶ Impact assessment and quantification
- ▶ Lease commencement date
- ▶ Initial direct costs
- ▶ Lease term (renewal, termination & purchase options)
- ▶ Fixed variable payments
- ▶ Build to suit
- ▶ Sale-Leaseback
- ▶ Sub-lease accounting
- ▶ Ongoing re-assessments
- ▶ Disclosure requirements

C. Budget requirements for internal and external resources

D. Systems and lease accounting software needs

SYSTEM CHALLENGES INCLUDE:

- ▶ Implementing a new lease management system
- ▶ Modifying existing systems
- ▶ Developing in-house solutions

E. Integration and systems changes requirements

F. Timeline and key milestones for adoption

G. Internal controls assessment and changes

INTERNAL CONTROLS CHALLENGES INCLUDE:

- ▶ Operational process and systems
- ▶ Data collection – accuracy and completion
- ▶ Change controls
- ▶ Framework for reporting disclosures
- ▶ Financial reporting adoption
- ▶ Compliance with legal agreements and documents

H. Testing of system changes

I. Determining the accounting impact of adoption on the financial statements, debt covenants, loan agreements, earn outs, employee compensation and bonus arrangements, and any other agreements that maybe impacted by the changes to the lease accounting.

New Opportunities in Leasing Strategies

This new lease standard provides companies with opportunities to make better business and economic decisions in its leasing strategies.

These include:

1. Lease vs. Buy

- ▶ Off balance sheet no longer a consideration

2. Negotiation of key terms

- ▶ Fixed vs. variable payments
- ▶ Incentives
- ▶ Non-lease components
- ▶ Renewal, purchase and early termination options

3. Capturing lease arrangements

- ▶ Centralized vs decentralized purchasing and negotiation
- ▶ Abandonment vs repurposing

4. Lessor Concentration

5. Benchmarking of Terms

6. Rate Analysis by Lessor

7. Site Level Operating Expense Visibility

8. Process Optimization and Insight

- ▶ Centralization
- ▶ Standardization
- ▶ Automation

The new leasing standard is complex and will require a company to focus on its provisions and requirements. It is imperative that companies start assessing the standard now and develop a solid strategy and plan to accomplish absolute compliance.

There are many resources available to assist companies in all aspects of compliance with the new standard.

CNM LLP has extensive experience in assisting companies with the adoption of new accounting standards, including ASC 842, as well as the effect on internal controls and financial reporting requirements.

Headquarters

A | 21051 Warner Center Lane
Suite 140
Woodland Hills, CA 91367
o | 818.999.9501

Orange County

A | 6 Venture
Suite 365
Irvine, CA 92618
o | 949.299.5582

www.cnmlp.com



Restriction on Disclosure and Use of Information – This material contains confidential and proprietary information of CNM LLP, the unauthorized disclosure of which would provide a competitive advantage to others, as a result the recipient of this document shall not disclose, use, or duplicate this document, in whole or in part, for any purpose other than for the recipient's evaluation of CNM LLP's materials.