+

GWSCPA Nonprofit Symposium
Leases Overview

Presenters:
Richard Cole, Partner, FORVIS
Paul Preziotti, Partner, Johnson Lambert

Presenter Bios

Richard Cole, CPA, CGMA
Partner
richard.cole@forvis.com
646-253-5230

Rick is a partner with FORVIS (which is the result of a merger between BKD and DHG) with more than 25 years of experience serving not-for-profit organizations. He is based in the firm's New York office and is a member of FORVIS' Higher Education Center of Excellence, which is an internal committee focused on addressing issues important to the higher education industry. Rick focuses on audits and advisory services for not-for-profit and higher education organizations.

Prior to this role, he worked at the FASB, where he served as a supervising project manager for almost six years. In that role, he was the project manager on Accounting Standards Update (ASU) 2016-14, Presentation of Financial Statements of Not-for-Profit Entities; ASU 2018-08, Clarifying the Scope and Accounting Guidance for Contributions Received and Contributions Made; and ASU 2019-03, Updating the Definition of Collections. He also was coordinator for FASB's NFP Advisory Committee and Private Company Council. Before joining the FASB, Rick was vice president and controller at a large national museum in New York for seven years and a senior manager with a large international accounting firm where he worked for 14 years and specialized in audits of higher education institutions and other not-for-profit organizations.

Rick is a member of the AICPA Not-for-Profit Expert Panel. He is a lecturer at Columbia University's School of Professional Studies in their Non-Profit Management program. He also has been a frequent speaker with NACUBO, the American Institute of CPAs (AICPA), and various state CPA societies.

He is a CPA in New York and New Jersey and is a member of the AICPA and New York State Society of Certified Public Accountants. Rick is a graduate of Montclair State University, New Jersey, with a B.S. degree and an M.B.A. degree.

Presenter Bios

Paul Preziotti, CPA, is a Partner for the multi-office CPA firm, Johnson Lambert LLP. He is responsible for providing audit and consulting services to not-for-profit entities and employee benefit plans. He has significant experience serving as an advisor for organizations on a variety of issues including risk assessment, governance, compliance and internal control considerations.

Paul received his Bachelor of Science in Accounting and Bachelor in International Business degrees from the University of Maryland, and he joined Johnson Lambert after graduating. He is a frequent speaker on audit and accounting topics at various industry conferences and seminars. He is an alumnus of the AICPA Leadership Academy, an honor for which less than 40 people are recognized nationally each year. He received the GWSCPA's 2018 Outstanding Member in Public Practice Award for his contributions to the growth and enhancement of the accounting profession. Furthermore, he is a current member of the AICPA's Not-for-Profit Advisory Council and a past chair for the GWSCPA's Nonprofit Finance & Accounting Symposium. Additionally, Paul serves as a board and audit committee member for St. John's Community Services and a member of the governance structure for the Radiation Effects Research Foundation.

Paul Preziotti, CPA
Partner
PPreziotti@JohnsonLambert.com
703-842-1158

Today's Agenda

1. Background on ASU 2016-02 (Topic 842)
2. Accounting for Leases & Calculation of Values
3. Presentation & Disclosure Overview
4. Adoption Considerations & Lessons Learned

+

Background on ASU 2016-02 (Topic 842)

Background on ASU 2016-02

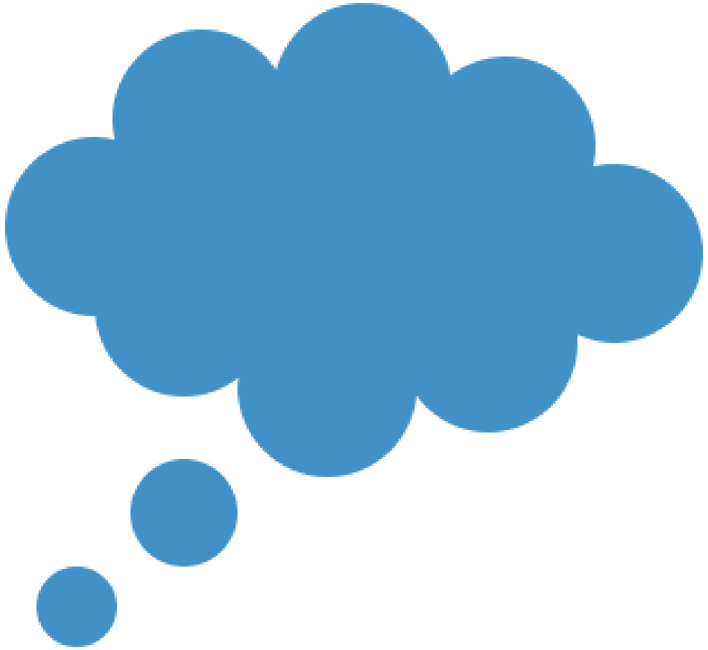
- Lease guidance has had limited changes since FASB 13 issued in November 1976
- Decade-long joint project between FASB & IASB
- Issued February 2016
- Codified into ASC 842 (superseding ASC 840)
- Lessor accounting remained relatively unchanged
- FASB voted in July 2019 to extend application for nonpublic organizations by one year
- FASB provided COVID-19 relief & provided an additional year to apply the standard if you have not yet applied the standard (including NFP conduit bond obligors)

FASB's Reason for New Standard

- Increase comparability & transparency among entities
- Significantly reduce off-balance-sheet risk
- More reflective of true substance of leasing transactions

Additional Perspectives

- " … More faithful representation of an organization's leasing activities … "
- SEC – largest form of off-balance-sheet financing
- 2005 SEC estimate – **$1.25 trillion** off-balance-sheet operating lease commitments for SEC registrants
- Amount increases when you consider all entities impacted (public & nonpublic)



Effective Dates – ASC 842

Prior to June 2020 ASU

Public Entities & NFP Conduit Bond Obligors
Annual & interim reporting periods beginning after December 15, 2018

All Other
Annual reporting periods beginning after December 15, 2020

If elect deferral in June 2020 (ASU 2020-05)

Public NFPs & NFP Conduit Bond Obligors
Annual & interim reporting periods beginning after December 15, 2019

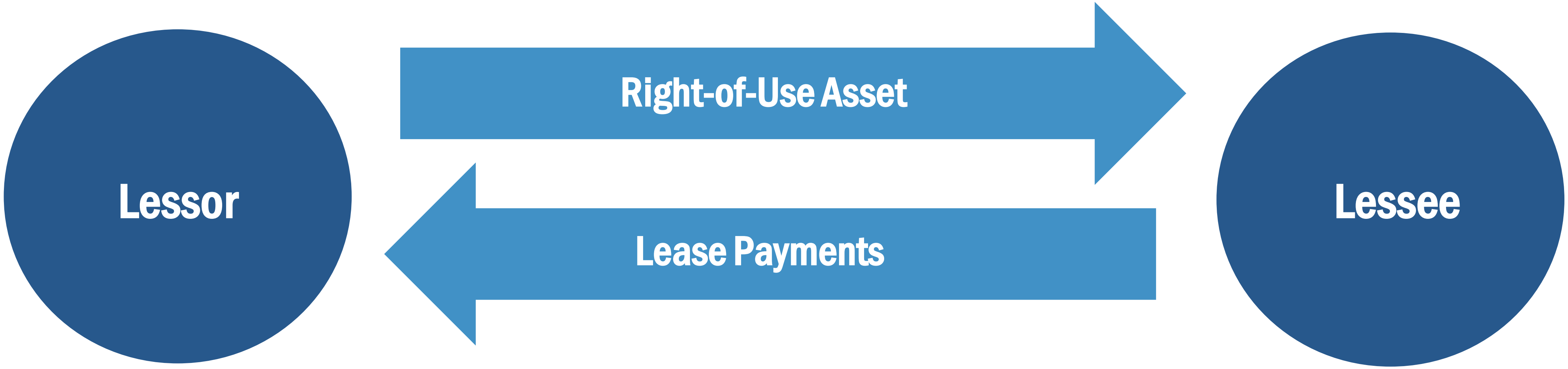
Private Companies & NFPs
Annual reporting periods beginning after December 15, 2021

This is the last group

ASU 2018-11: Transition Options

Lease Accounting	FY 20X1 (Comparative Period)	FY 20X2 (Year of Initial Adoption)
Original transition method provided in ASU 2016-02	842 Cumulative-effect adj. 1/1/X1	842
Additional transition method provided in ASU 2018-11	**840**	842 Cumulative-effect adj. 1/1/X2

Leases (ASU 2016-02, Topic 842)



A lease contract conveys the right to use an asset (the underlying asset) for a period of time in exchange for **consideration**

FORVIS

Core Principle – Right-of-Use Model

A lessee should recognize the right-of-use (ROU) assets & liabilities that arise from leasing arrangements. All leases create an asset & a liability for the lessee in accordance with FASB Concepts Statement No. 6, *Elements of Financial Statements*, &, therefore, recognition of those lease assets & lease liabilities represents an improvement over previous GAAP, which did not require lease assets & lease liabilities to be recognized for most leases

Comparison of Lessee Accounting Models

Finance Lease	Operating Lease
+ **Balance sheet**	+ **Balance sheet**
+ Right-of-use (ROU) asset	+ Right-of-use (ROU) asset
+ Lease liability	+ Lease liability
+ **Income statement**	+ **Income statement**
+ Interest expense (on lease liability)	+ Lease/rent expense (straight-line)
+ Amortization expense (on ROU asset)	
+ **Cash flow**	+ **Cash flow**
+ Cash paid for principal payments (financing activities)	+ Cash paid for lease payments (generally operating)
+ Cash paid for interest payments & for variable lease payments (operating activities)	

FORVIS

Accounting for Leases & Calculation of Values

Identifying a Lease

The New Primary Determinant for On-/Off-Balance Sheet Treatment)

Identified Asset

- Explicitly or implicitly specified
- Not able to substitute

\+

Right to Control

- Decision-making authority
- Substantially all the economic benefits

Lease

An Identified Asset

Explicitly, e.g., by a serial number

Implicitly, e.g., the only asset that would satisfy the lease contract

Supplier does not have practical ability to substitute alternative asset, e.g., customer can prevent substitution

Supplier would not benefit from substituting alternative asset

A physically distinct portion of a larger asset could represent a specified asset, e.g., one floor of a building. A capacity portion of a larger asset generally is not a specified asset, e.g., percentage of a storage tank

Right to Control the Use of the Asset

A lease contract conveys the right to control the use of the identified asset for a specified period of time.

+ A customer controls an identified asset when the customer has both of the following
  - **Right to direct its use**: The right to direct how & for what purpose the asset is used, including the right to change how & for what purpose the asset is used
  - **Right to obtain substantially all economic benefits from its use:** By having exclusive use of the asset throughout the period

Short-Term Leases

+ Leases, at commencement date, have a term of 12 months or less & do not include option to purchase underlying asset that the lessee is reasonably certain to exercise
+ This policy election must be disclosed in the financial statements

Warning: The existence of lease extensions & the likelihood of extending the arrangement must be considered in determining the term

Entities can make a formal policy election to not recognize short-term leases on the balance sheet

FORVIS

Related-Party Leases

Old Guidance – ASC 840

+ Used substance over form in evaluating the existence of a lease

New Guidance – ASC 842

+ Use the legally enforceable terms & conditions of the agreement

In the separate financial statements of the related parties, the classification & accounting for the leases should be the same as for leases between unrelated parties

Contracts with Multiple Components

Lease Component

- A separate ROU for an asset
- Lessee can benefit from the ROU of the underlying asset either on its own or together with other readily available resources. The use is neither highly dependent on nor interrelated with other assets
- Payments accounted for as a separate lease

Nonlease Component

- An activity that transfers a separate good or service to the customer, *e.g.*, supplies/disposables
- **Includes maintenance services**
- Allocated payments are nonlease period expense

Not a Separate Component

- Related to administrative tasks to initiate the lease & payment of lessor costs that do not transfer a separate good or service separate from the ROU asset
- **Includes payments for insurance or property taxes**
- Payments are part of lease payment, not separately allocated

Lease Classification

How to determine the accounting for your lease?

- Lease will be classified as finance lease if it transfers substantially all risks & rewards of ownership (meets one of the five criteria on the next page)
- Bright-line tests are not required; can be used as a reasonable approach/policy
- All other leases will be classified as operating leases

Finance Lease Criteria (Similar to Capital Lease)

1. Ownership of asset transfers to lessee by end of lease term

2. Lessee has purchase option that it is reasonably certain to be exercised

3. Lease term is for major part of economic life of asset (n/a for leases that commence "at or near the end" of the underlying asset's economic life, *e.g.*, in the final 25 percent of an asset's economic life)

4. PV of minimum lease payments amounts to at least substantially all of fair value of leased asset

5. NEW: Underlying asset is of such a specialized nature that it is expected to have no alternative use to the lessor at the end of the lease term

Lessee Model – Initial Measurement

Lease liability (obligation to make the lease payments)

- Measured at the present value of the future minimum lease payments

Right-of-use asset

- Lease liability + initial direct cost + lease prepayments – lease incentives received

Discount rate

- Use the rate charged by the lessor if known
- The incremental borrowing rate
- All private companies & NFPs **may elect** to use the risk-free rate rather then its borrowing rate (& can use both by class of underlying asset)
- Can use the rate as of the implementation date (no need to go back in time)

Lessee Model – Subsequent Accounting

Annual expense recognition & subsequent amortization of ROU asset depends on lease classification

Finance lease

- Unwind liability using the effective interest method
- Front-loaded expense pattern similar to today's capital leases with interest & amortization recognized separately
- Interest determined on the lease liability in each period during the lease term as the amount that produces a constant periodic discount rate
- ROU asset generally amortized on a straight-line basis

Lessee Model – Subsequent Accounting

Operating lease

+ Unwind liability using the effective interest method
+ Straight-line expense over term
+ ROU asset: Reduced by the difference between the annual straight-line lease expense & the annual interest cost on the lease liability, i.e., amortize the asset to achieve straight-line total lease expense

Lease Concessions & COVID-19 Relief

April 2020 FASB Staff Q&A

+ Discusses implications to lease arrangements as a result of the COVID-19 pandemic
  - Accounting for the deferral of rent payments
  - Accounting for lease concessions & consideration of lease modification accounting guidance

Presentation & Disclosure Overview

Lessee Balance Sheet Presentation

The below table shows acceptable and unacceptable ways to present these balances on the lessee's balance sheet (note that for simplicity this is an unclassified balance sheet).

Separate Presentation *Acceptable*		**Presentation with Other Assets and Liabilities and Disclosed Separately** *Acceptable*		**Combined Presentation** *Not Acceptable*	
Balance Sheet Period Ended December 31, 20X1		Balance Sheet Period Ended December 31, 20X1		Balance Sheet Period Ended December 31, 20X1	
ROU assets – operating leases	25,000	ROU assets – operating leases	25,000	ROU assets	25,900
ROU assets – finance leases	900	Property, plant and equipment	2,000	Property, plant and equipment	1,100
Property, plant and equipment	1,100				
Operating lease liabilities	25,150	Operating lease liabilities	25,150	Lease liabilities	26,000
Finance lease liabilities	850	Other liabilities	1,850	Other liabilities	1,000
Other liabilities	1,000				
		<u>Disclosure</u> For the period ended December 31, 20X1, right-of-use assets from finance leases of $900 are included as part of property, plant and equipment. For the period ended December 31, 20X1, lease liabilities from finance leases of $850 are included as part of other liabilities.			

FORVIS

Disclosure Objective

Enable users of financial statements to assess amount, timing & uncertainty of cash flows arising from leases

- Policies & nature of leases
- Significant assumptions
- Quantitative disclosure examples
  - Finance lease costs, operating lease costs, short-term lease costs, & variable lease costs
  - Weighted average remaining lease term, weighted average discount rate, & supplemental noncash transaction information
  - More info: Sublease income, sale-leaseback gains, & others

FORVIS

Adoption Considerations & Lessons Learned

Tips for Adoption & Implementation

+ Identify a champion
+ Identify your inventory of leases
+ Determine which practical expedients you will use
+ Determine transition method
+ Determine discount rate
+ Review debt covenants
+ Review capitalization policy/threshold
+ Determine technology needs & tools to use for calculations
+ Consideration of post-implementation process changes

Optional Relief

Optional Relief	
Transition Elections	Accounting Policy Elections
Expedient package – identification, classification, initial direct costs	Separation of lease & nonlease components for both lessee & lessor
Hindsight	Portfolio approach
Land easements	Short-term leases
Prior-period presentation	Materiality thresholds (capitalization policy)
	Discount rate (non-PBEs only)
	Presentation of taxes

FORVIS

ASU 2018-11: Lessor Practical Expedient*

Contract

Lease Component
Would be operating lease

Nonlease Component
Would be under Topic 606

Same timing & pattern of transfer

If nonlease component **is NOT predominant**

Single Combined Component (**Lease**)
Operating lease under Topic 842
Use variable payment guidance in Topic 842
Revenue recognized as "**lease revenue**"

If nonlease component **is predominant**

Single Combined Component (**Nonlease**)
Single performance obligation under Topic 606
Use variable consideration guidance in Topic 606

**A similar option exists for lessees, too*

FORVIS

Complexities & Common Terms

- Renewal term options
- Lease incentives
- Direct costs incurred
- Prepaid rent
- Escalating/variable payments
- Interest rate not included
- Other options
- Lease modifications
- Multiple components
- Inception date different than commencement date
- Subleases
- Free rent or rent holidays
- Other

Thank You

Paul Preziotti, CPA
Partner | Johnson Lambert LLP
ppreziotti@johnsonlambert.com

Richard Cole, CPA, CGMA
Partner | FORVIS
richard.cole@forvis.com

Disclaimer

- This presentation is provided solely for educational purposes to Johnson Lambert LLP's intended audience.
- This webinar is intended to provide general information and may reference information from reputable sources. Although our firm has made every reasonable effort to ensure that the information provided is accurate, we make no warranties, expressed or implied, on the information provided. The information is updated as of the date of the webinar. It may change as situations may continue to evolve and/or new and additional guidance are issued.
- The content contained herein should not be relied upon as accounting or tax advice because it does not take into account any specific organization's facts and circumstances.
- The views expressed by the presenters are not necessarily those of Johnson Lambert LLP
-

Johnson Lambert LLP is a niche-focused CPA and consulting firm, dedicated to serving the nonprofit community, as well as employee benefit plans and insurance entities. The firm provides audit, tax, and advisory services to a national and selectively international client base of 250+ nonprofit entities. Johnson Lambert is also an independent member of DFK International/USA, a worldwide association of independent accounting and management consulting firms. Our membership in DFK enhances our worldwide reach, provides us with additional resources, and expands the world of opportunity for our clients. For more information on our firm, please visit JohnsonLambert.com.

The information set forth in this presentation contains the analysis and conclusions of the author(s) based upon his/her/their research and analysis of industry information and legal authorities. Such analysis and conclusions should not be deemed opinions or conclusions by FORVIS or the author(s) as to any individual situation as situations are fact specific. The reader should perform its own analysis and form its own conclusions regarding any specific situation. Further, the author(s) conclusions may be revised without notice with or without changes in industry information and legal authorities. FORVIS has been registered in the U.S. Patent and Trademark Office, which registration is pending.