

The webcast will start at 1 p.m. Eastern

Please note:

- **Handout** – You can print or download the webcast handout at <https://capincrouse.com/webcast-lease-accounting>
- **CPE** – CPE certificates will be emailed to you within the next few weeks. To receive CPE credit you must respond to the polling questions, which are not available on mobile devices. Therefore, in order to receive CPE credit you must log in via a computer.
- **Recording**– A recording of today's webcast will be available at capincrouse.com. Click **Nonprofit Resources**, and then select **Webcast: Recorded** from the list on the right.



What Nonprofits Need to Know About the New Standards for Lease Accounting

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10.26.17



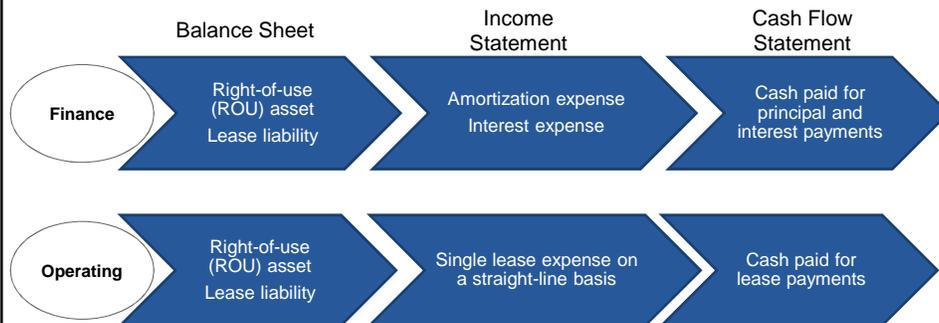
Agenda

- Why Is FASB Issuing This Accounting Standards Update?
- How Does This Differ from Current GAAP?
- Accounting and Disclosure Treatment
- Examples

Why Is FASB Issuing This Accounting Standards Update?

- ASU No. 2016-02 Leases Topic 842: issued in February 2016
- Increased transparency and comparability
- Previous guidance did not always provide faithful representation of leasing transactions
- Lessor accounting largely unchanged
- Excludes short-term leases (lease term of 12 months or less)

Lessee Accounting Overview



Classification is similar to current lease classification in Topic 840

Recognition and measurement exemption for short-term leases

Other than public business entities may use risk-free rates for measurement of all lease liabilities

Leases

- A contract, or part of a contract
- Conveys the right to control the use of identified property, plant, or equipment (an identified asset)
- For a period of time
- In exchange for consideration

Operating Lease

- From the perspective of a lessee, any lease other than a finance lease
- From the perspective of a lessor, any lease other than a sales-type lease or a direct financing lease

Finance Lease

- Ownership transfers to the lessee at the end of the lease
- Lease includes a purchase option that the lessee is reasonably certain to exercise
- Lease term is a major part of the remaining useful life of the lease
- The present value of the lease payments exceeds substantially all of the fair value of the underlying asset
- The 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

Accounting Treatment

Both classes of leases create:

- Right-of-use asset (ROU-a) – an asset that represents a lessee’s right to use an underlying asset for the lease term
- Lease liability – a lessee’s obligation to make the lease payments arising from a lease, measured on a discounted basis

Initial Measurement – Operating Lease

- Lease liability measured at present value of lease payments not yet made discounted using the discount rate for the lease at commencement
- Right-of-use asset recognized based on the initial lease liability, plus payments before or at commencement and initial direct costs
- Discount rate (risk-free rate):
 - Implicit rate if known
 - Organization’s incremental borrowing rate if unknown

Subsequent Measurement – Operating Lease

- Right-of-use asset: Measured at the current lease liability
- Operating lease liability: Present value of lease payments
- Lease expense: Recognized on a straight-line basis

Statement of Activities and Statement of Cash Flows – Operating Lease

Statement of Activities

- Lease expense: recognized on a straight-line basis

Statement of Cash Flows

- Cash paid for lease payments (operating activities)

Example – Operating Lease

Example

- Five-year office lease with monthly payments of \$10,000
- Total payments are \$600,000
- Discount rate of 2%
- Right-of-use asset and lease liability of ~\$571,000

Example – Operating Lease

Initial Measurement:

Right-of-use asset	\$571,000
Lease liability	\$571,000

Example – Operating Lease

Subsequent Measurement (month 1):

Lease liability	\$9,050
Right-of-use asset	\$9,050
Lease expense	\$10,000
Cash	\$10,000

Initial Measurement – Finance Lease

- Lease liability measured at present value of lease payments not yet made discounted using the discount rate for the lease at commencement
- Right-of-use asset recognized based on the initial lease liability, plus payments before or at commencement and initial direct costs
- Discount rate (risk-free rate):
 - Implicit rate if known
 - Organization's incremental borrowing rate if unknown

Subsequent Measurement – Finance Lease

- Right-of-use asset is amortized over:
 - lease term
 - useful life of the underlying asset if:
 - the lease transfers ownership
 - the lessee is reasonably certain to exercise an option to purchase the asset
- Finance lease liability: measured at the initial lease liability plus interest on the liability less payments

Statement of Activities and Statement of Cash Flows – Finance Lease

Statement of Activities

- Amortization expense: amortization of the right-of-use asset
- Interest expense: interest on the finance lease liability

Statement of Cash Flows

- Cash paid on lease liability (financing activities)
- Interest payments (supplemental disclosure)

Example – Financing Lease

Example

- Seven-year copier lease with monthly payments of \$1,000
- Total payments are \$84,000
- Discount rate of 2%
- Right of use asset and lease liability of ~\$78,000

Example – Financing Lease

Initial Measurement:

Right-of-use asset	\$78,000
Lease liability	\$78,000

Example – Financing Lease

Subsequent Measurement (month 1):

Lease liability	\$870
Interest expense	\$130
Cash	\$1,000
Right-of-use asset	\$870
Amortization expense	\$870

Presentation Matters

The organization can elect to present the following in the statement of financial position (SFP) or notes to the financial statements:

- Finance lease ROU-a and operating lease ROU-a separately from each other and from other assets
- Finance lease liabilities and operating lease liabilities from each other and other liabilities
- If not shown separately, the organization must disclose which line items on the SFP include ROU-a and lease liabilities

Presentation Matters, continued

In the statement of financial position, a lessee is prohibited from presenting:

- Finance lease ROU-a in the same line item as operating ROU-a
- Finance lease liabilities in the same line item as operating lease liabilities

Disclosure Requirements

Objective of disclosures:

- Enable users to assess the amount, timing, and uncertainty of cash flows from leases

Therefore, it must disclose:

- Its leases
- Significant judgments
- Amounts recognized in the financial statements

Disclosure Requirements, continued

Information the lessee shall disclose:

- General description of lease
- Basis of determination of variable lease payments
- Existence and terms and conditions of options to extend or terminate the lease
- Existence and terms and conditions of residual value guarantees
- Any lease restrictions or covenants (including subleases)

Disclosure Requirements, continued

Information the lessee shall disclose, continued:

- Any leases not yet commenced but that will have significant impact for lessee
- Significant judgments involved:
 - Whether a contract contains a lease
 - Allocation of consideration between lease and nonlease components
 - Determination of discount rate

Disclosure Requirements, continued

For each period presented:

- Finance lease costs, segregated between amortization of ROU-a and interest on liability
- Operating lease cost
- Short-term lease costs (excluding leases less than one month)
- Variable lease costs
- Sublease income (disclosed on gross basis) separate from finance and operating lease expense

Disclosure Requirements, continued

For each period presented, continued:

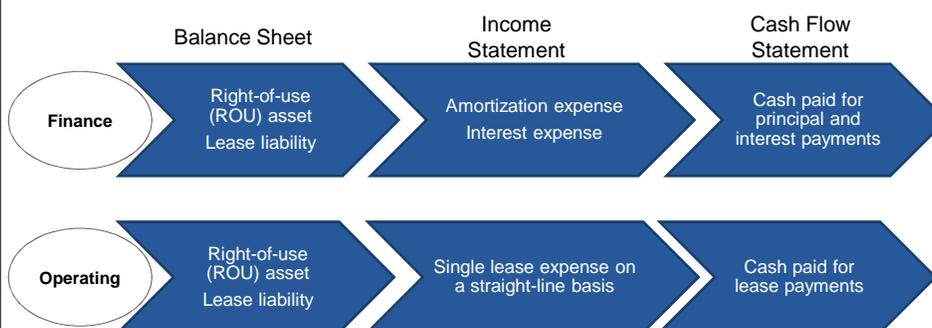
- Amounts segregated between finance and operating leases:
 - Cash paid for amounts included in measurement of lease liabilities
 - Supplemental noncash information on lease liabilities arising from obtaining ROU-a
 - Weighted average remaining lease term
 - Weighted average discount rate

Disclosure Requirements, continued

Other disclosure matters:

- Disclose separate maturity analysis of its lease liabilities for **undiscounted** cash flows for first five years and then thereafter, with reconciliation between undiscounted cash flow to actual lease liabilities
- Disclose leases with related parties
- Disclose if the practical expedient has been elected and to which class(es) of underlying assets

Lessee Accounting Overview



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Recognition and measurement exemption for short-term leases

Other than public business entities may use risk-free rates for measurement of all lease liabilities

Leases – Effective Date

Nonprofit Organizations

- Fiscal years beginning after December 15, 2019 (calendar year 2020; fiscal year 2021)
- Fiscal years beginning after December 15, 2018 (calendar year 2019; fiscal year 2020) if the organization has conduit debt or securities that are traded, listed, or quoted on an exchange or an over-the-counter market

Early Application

- Permitted for all organizations



Additional Examples

Example – Contract for Network Services (A)

Customer enters into a contract with a telecommunications company (Supplier) for network services for two years. The contract requires Supplier to supply network services that meet a specified quality level. To provide the services, Supplier installs and configures servers at Customer's premises; Supplier determines the speed and quality of data transportation in the network using the servers. Supplier can reconfigure or replace the servers when needed to continuously provide the quality of network services defined in the contract. Customer does not operate the servers or make any significant decisions about their use.

Example – Contract for Network Services (A)

The contract does not contain a lease. Instead, the contract is a service contract in which Supplier uses the equipment to meet the level of network services determined by Customer.

Customer does not control the use of the servers because Customer's only decision-making rights relate to deciding on the level of network services (the output of the servers) before the period of use — the level of network services cannot be changed during the period of use without modifying the contract.

Example – Contract for Network Services (B)

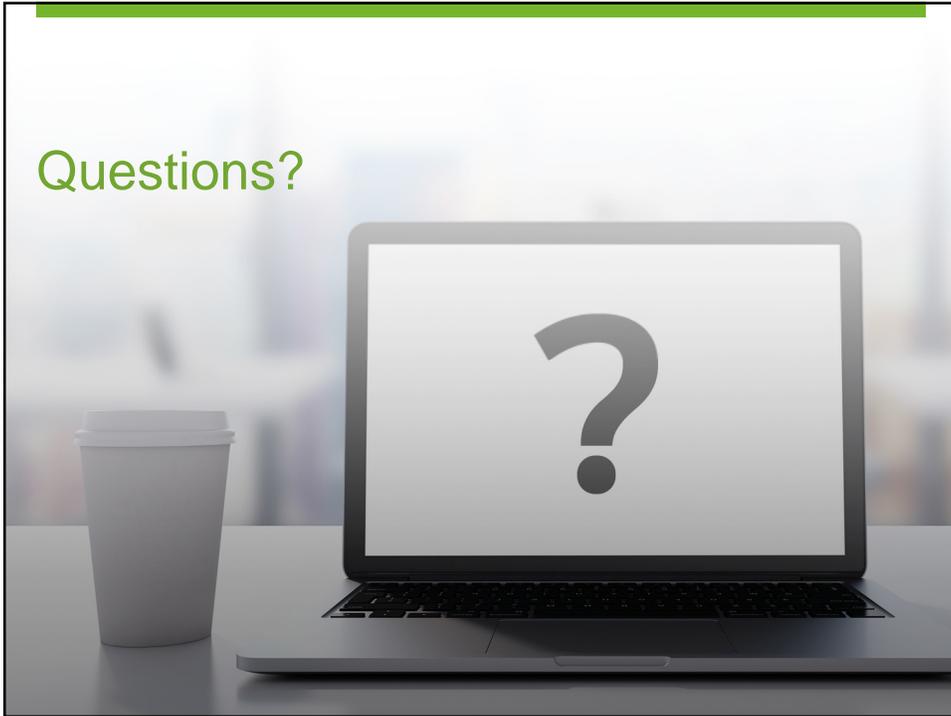
Customer enters into a contract with an information technology company (Supplier) for the use of an identified server for three years. Supplier delivers and installs the server at Customer's premises in accordance with Customer's instructions and provides repair and maintenance services for the server, as needed, throughout the period of use. Supplier substitutes the server only in the case of malfunction. Customer decides which data to store on the server and how to integrate the server within its operations. Customer can change its decisions in this regard throughout the period of use.

Example – Contract for Network Services

The contract contains a lease.

- There is an identified asset. The server is explicitly specified in the contract. Supplier can substitute the server only if it is malfunctioning.
- Customer has the right to control the use of the server throughout the three-year period.

Questions?



Thank you.

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