


Deloitte.



2016 Deloitte Alternative Energy Seminar

Setting new sights
November 14-16, 2016

Deloitte Center *for*
Energy Solutions



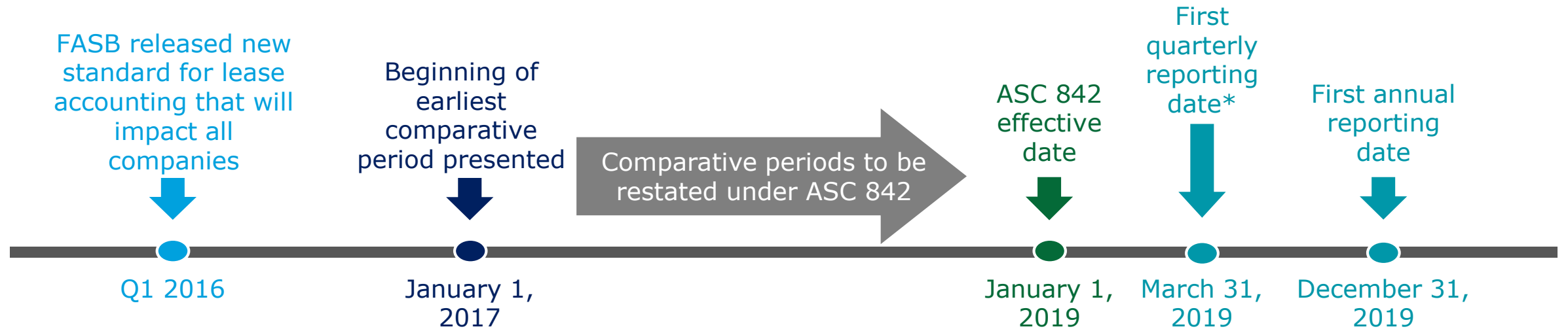
Lease
accounting and
implementation
considerations
for ASU 2016-02

Agenda

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Overview of ASC 842

Timeline



**ASC 842
issued on
Feb 25, 2016**

ASC 842 transition considerations:

- Apply requirements to leases in effect at or after the start of the earliest comparative period
- Practical expedients available to alleviate certain reassessments for leases entered into prior to the effective date
- Early adoption is allowed

**Assuming early adoption is not elected*

What's in and what's out?

Scope

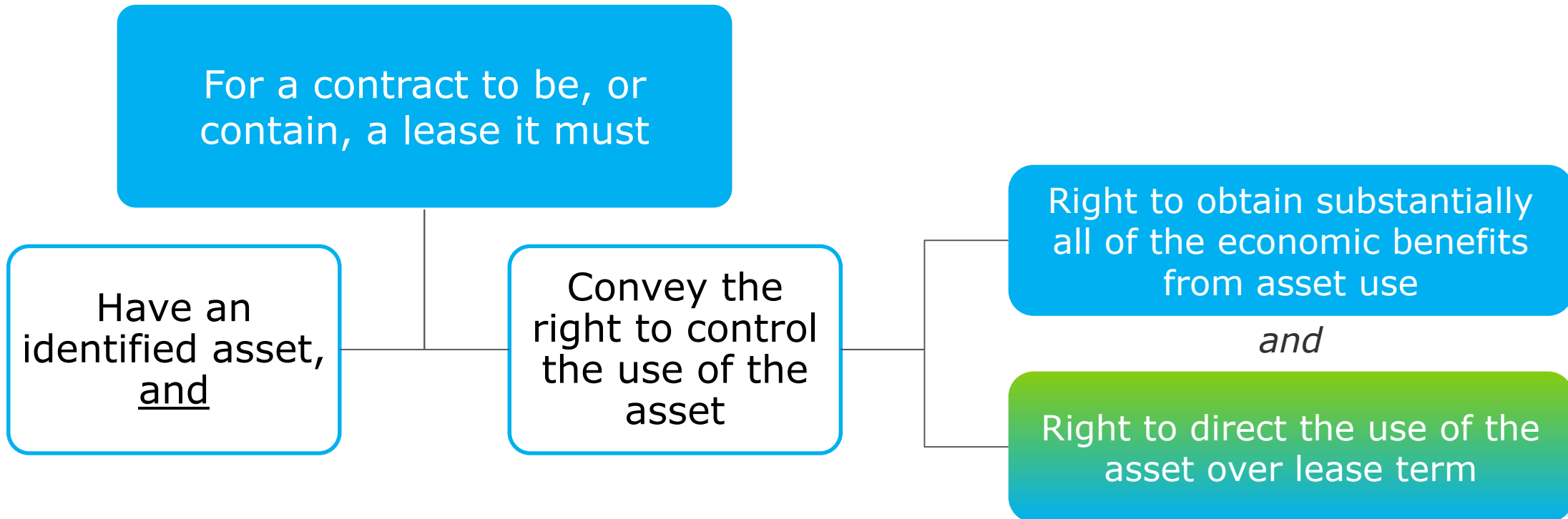
Applies to leases of property, plant, or equipment

Does *not* apply to:

- Leases of intangible assets
- Leases to explore for or use nonregenerative resources
- Leases of biological assets
- Leases of inventory
- Leases of assets under construction

Short term lease exception: a lessee can elect (by asset class) not to record on the balance sheet a lease whose term is 12 months or less and does not include a purchase option that the lessee is reasonably certain to exercise.

Lease identification



Identified asset

Contract must depend on use of identified asset

- Asset must be explicitly or implicitly identified
- Physically distinct portion of a larger asset may be an identified asset
- Capacity portion of a larger asset is generally not an identified asset, unless it represents substantially all of capacity of the asset

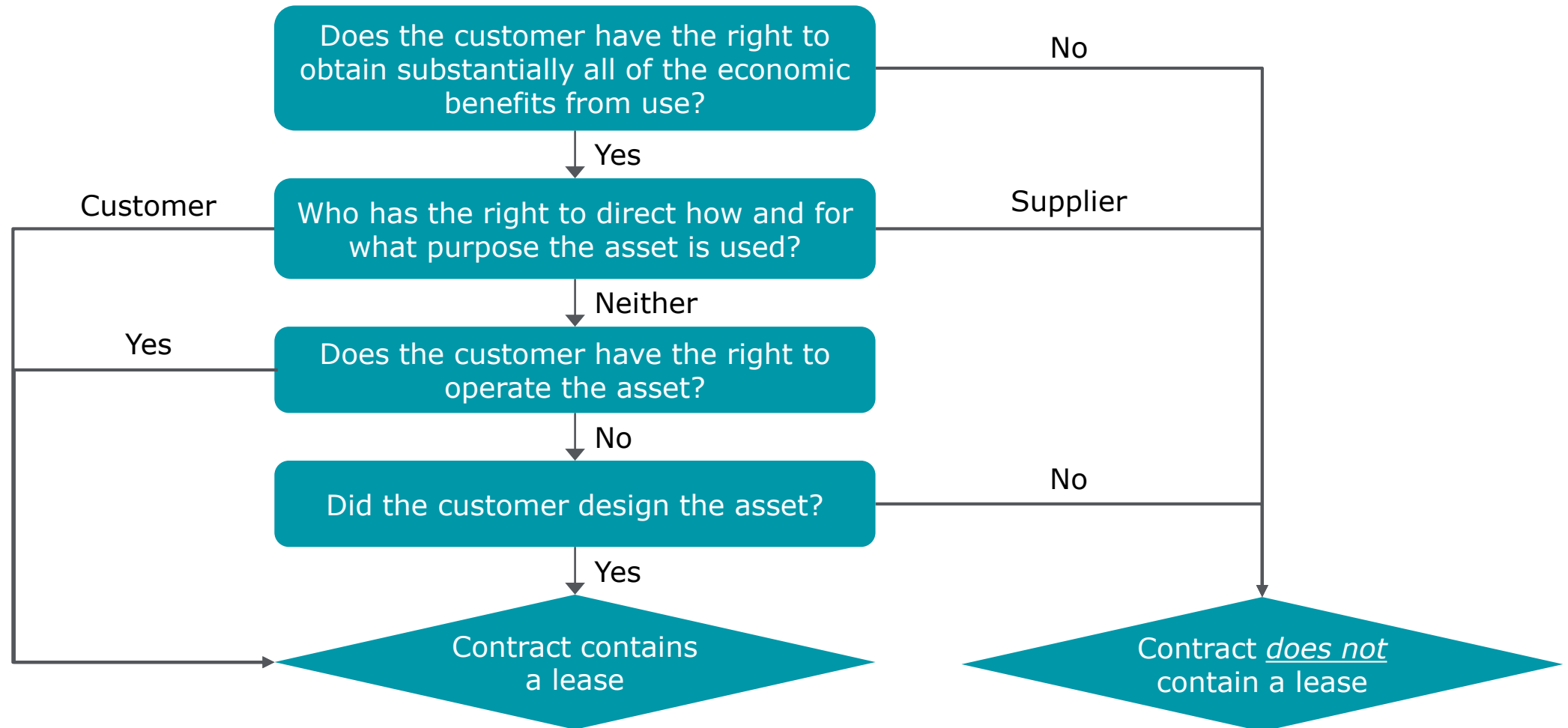
Right of substitution

- Would result in the asset not being deemed a specified asset
- Substitution would be considered substantive if . . .
 - Lessor has the practical ability to substitute the asset
 - Lessor would benefit from exercising its right of substitution

Warranty or upgrade considerations

- Supplier's right or obligation to substitute an alternative asset due to operational failure does not mean the asset is not an identified asset
- Supplier's right or obligation to upgrade the asset similarly does not mean the asset is not an identified asset

The right to control the use of the asset



Key impacts of ASC 842

- Key impacts for lessees
 - Leases classified as **operating leases** or **finance leases**
 - Most leases will be on balance sheet (similar to today's capital leases)
 - **Right-of-use (ROU) asset**
 - **Lease liability**
 - Operating leases
 - Generally straight-line income statement expense
 - Lease liability relieved following interest method; amortization of ROU asset is balancing amount
 - Finance lease accounting similar to existing capital leases. Front loading expenses; straight-line ROU asset amortization
 - ROU assets subject to impairment assessment
- Impacts also affecting lessors
 - Explicit guidance on **nonlease components** of contracts (lessees may elect to not separate such components; lessors may not)
 - Different **presentation** requirements
 - Additional qualitative and quantitative **disclosures** regarding the amount, timing, and uncertainty of cash flows

Measurement considerations

Lease term

- Noncancelable period *plus* renewal options for those period(s) in which the lessee is reasonably certain to exercise the options
- Lessees would reassess lease term upon occurrence of a significant event or change in circumstances under the control of the lessee
- Lessors would *not* be required to reassess lease term

Lease payments

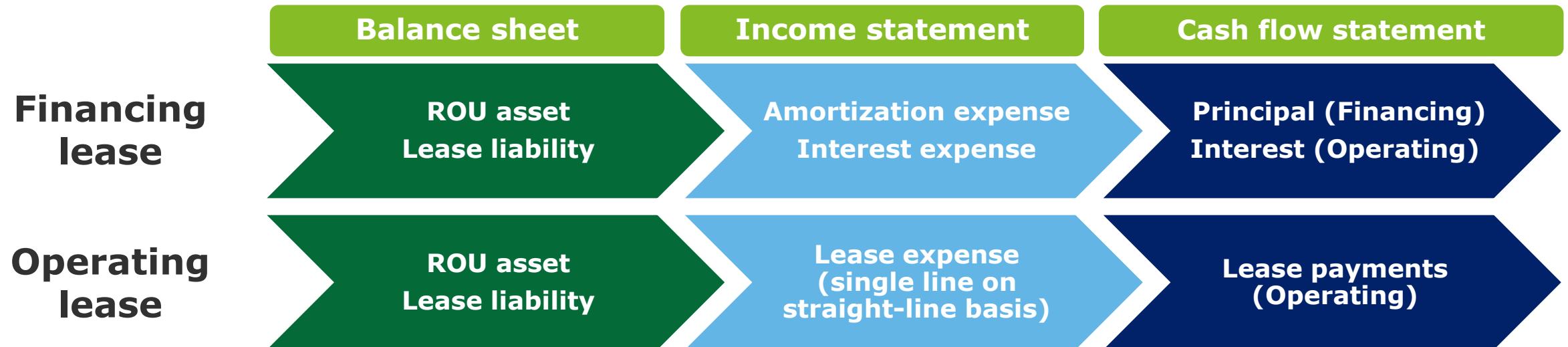
- Fixed payments included within lease agreement
- Variable payments based on an index/rate
- Residual value guarantees based on amount expected to be paid
- Purchase or termination options if lessee is reasonably certain to exercise said options

Discount rate

- Rate the lessor charges the lessee when available, which would be the rate implicit in the lease
- Incremental borrowing rate when the rate the lessor charges the lessee is *not* available
- Reassessment required in certain instances (change in lease term, certain modifications, change in purchase option considerations)

Presentation requirements

Lessee model



Lessor model

Presentation consistent with current lessor model:

- **Balance sheet**—Presentation depends on lease classification
- **Income statement**—Profit or loss recognized in a manner consistent with business model
- **Cash flow statement**—Recognized as cash inflows from operating activities

Disclosure requirements

Disclosure objective

Enable financial statement users to assess the amount, timing, and uncertainty of cash flows arising from leases

Lessee disclosures

- Nature of its leases
- Information about significant leases that have not yet commenced
- Related-party lease transactions
- Accounting policy election regarding short-term leases
- Finance and operating lease costs
- Short-term and variable lease costs
- Sublease income
- Gain or loss from sale-and-leaseback
- Maturity analysis for lease obligations
- Weighted-average remaining lease term
- Weighted-average discount rate

Lessor disclosures

- Nature of its leases
- Significant assumptions and judgments used
- Related-party leases transactions
- Tabular disclosure of lease-related income
- Components of the net investment in a lease
- Information on the management of risk associated with residual asset
- Maturity analysis of operating lease payments and lease receivable
- Information required by ASC 360

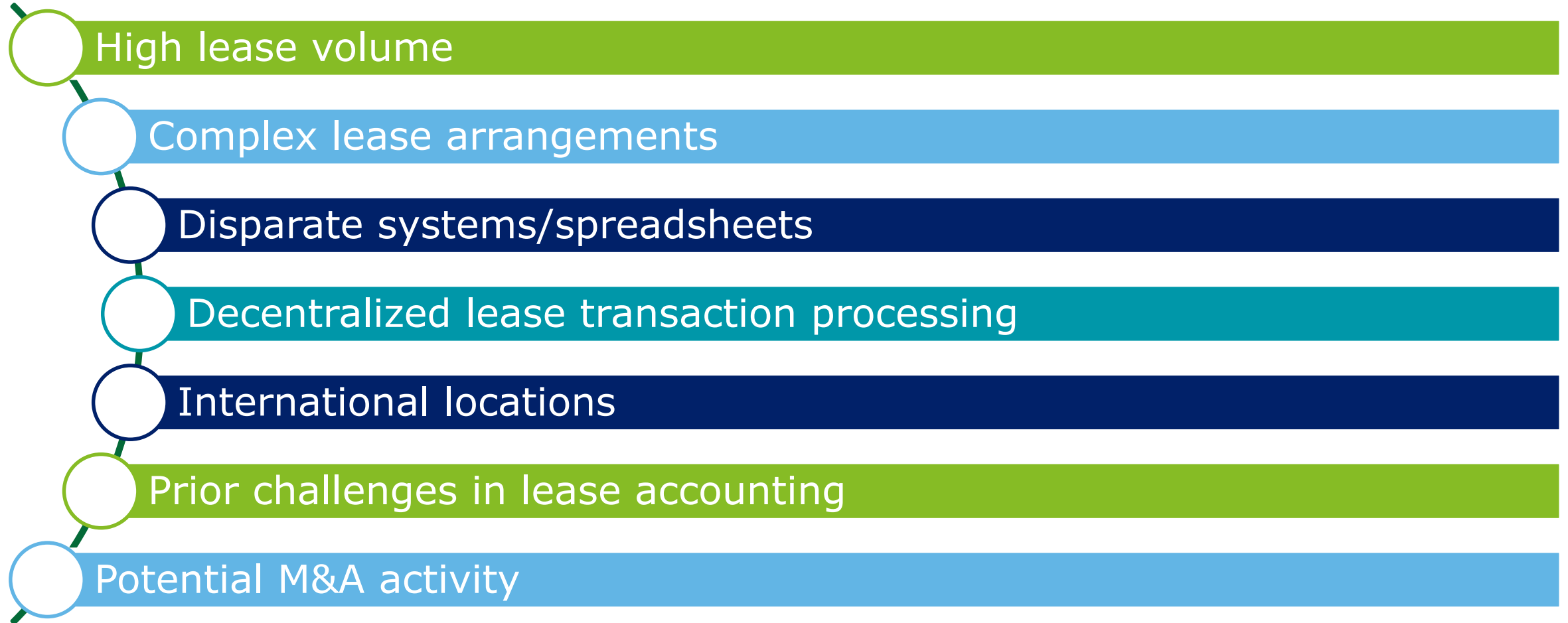
Practical expedients

- ASC 842 allows practical expedients to implementing the new standard, however, the practical expedients must be elected as a package and applied consistently to all leases.
 - An entity need not reassess whether any expired or existing contracts are or contain leases
 - An entity need not reassess the lease classification for any expired or existing leases
 - An entity need not reassess initial direct costs for any existing leases
- An entity also may elect a practical expedient to use hindsight in determining the lease term and in assessing impairment of the entity's right-of-use assets. This practical expedient may be elected separately or in conjunction with the practical expedients above.
- Lessees may make an accounting policy election by class of underlying asset not to separate lease components from nonlease components
- Companies shall disclose if they use the practical expedients

Potential operational challenges

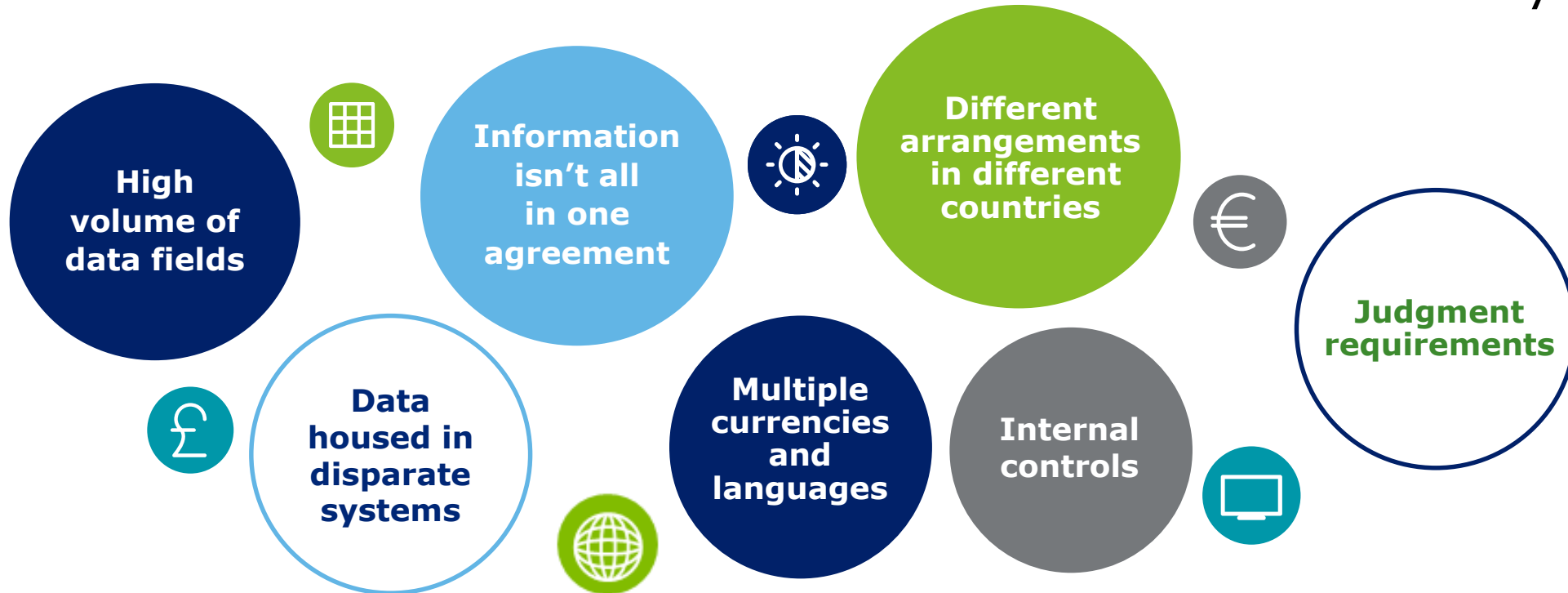
What to look for

As you prepare to implement the new lease accounting standard, the following indicators may suggest a higher level of work effort:

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- High lease volume
 - Complex lease arrangements
 - Disparate systems/spreadsheets
 - Decentralized lease transaction processing
 - International locations
 - Prior challenges in lease accounting
 - Potential M&A activity

Potential operational challenges—Data

The reporting and disclosure requirements of the new lease accounting standard may result in an increase in electronic data needs and a long lead time to abstract and validate data. Factors to consider may include:



During the implementation period, your operations don't cease. New leases are entered into and existing leases are modified or terminated

Potential operational challenges—Technology

As you review your current lease technology capabilities, the following functional requirements should be considered:



Abstraction technology to support efficient data gathering for large volumes of leases



Reporting capabilities to perform necessary calculations and create required disclosures



Storage of electronic lease documents and related data fields



Operational considerations including key event notifications, “what if” analyses, workflow management, and data analytics

Technology changes may be a longer lead time activity which may necessitate a temporary solution to facilitate data capture and pro forma reporting

Potential operational challenges—Other

The following additional challenges should be considered as you plan your implementation roadmap:



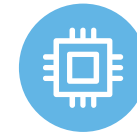
Judgment is often required in the lease assessment; proper documentation is critical

Application of judgment and estimation



Third-party data may be needed to ensure a high level of operational quality and efficiency

Data management



Entities may need to establish change management and employee training programs

Training



Increased scrutiny from auditors and regulators may require entities to reexamine their internal controls and processes

Internal controls and business process environment



Careful examination of the effects of increased leverage and potential debt covenant violations will be required

Debt covenants

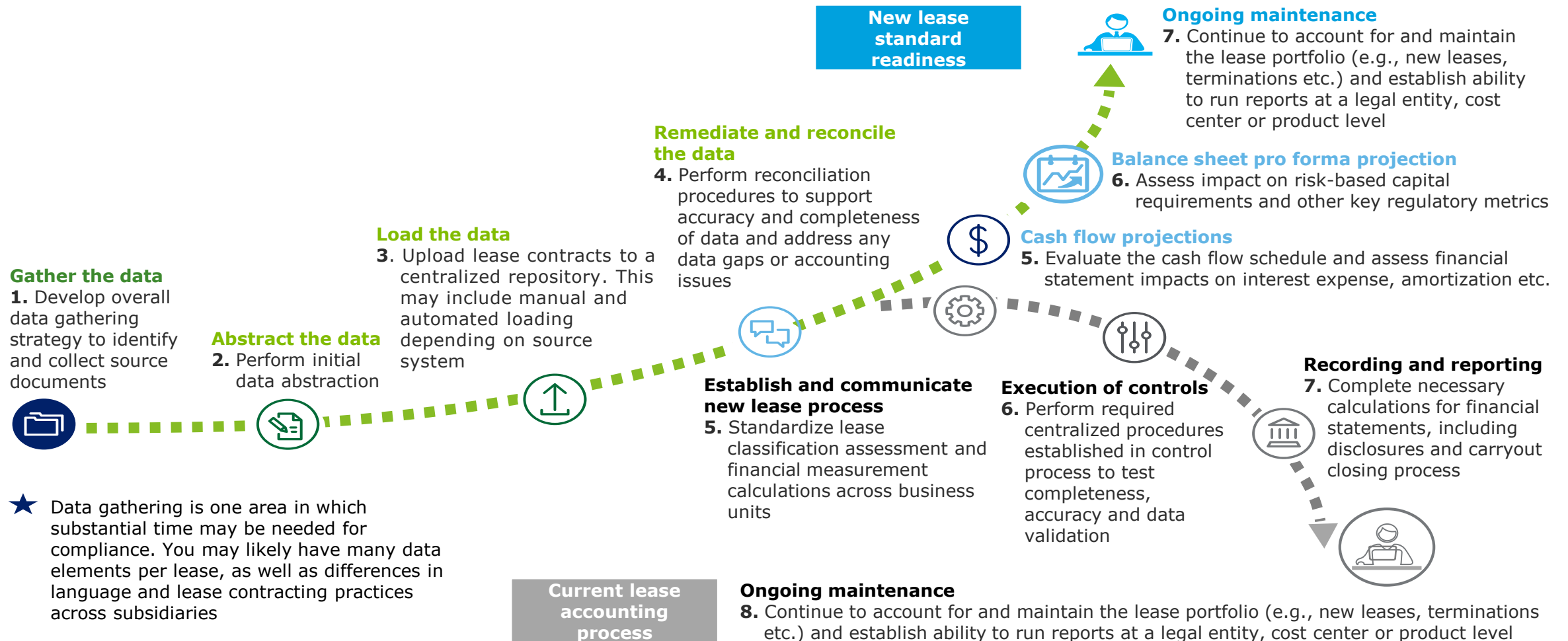


Potential tax implications are situational, which requires entities' tax department involvement

Income taxes

Illustrative lease workflow

Your team will need to determine a method by which they will inventory, organize, and gather data from lease contracts both currently and on an ongoing basis. The following illustrates a potential process for meeting the requirements of both the current Accounting Standards Codification (ASC) 840 and the new ASC 842.



Implementation approach

The lifecycle of a typical lease implementation effort



Key activities

- Understand the accounting requirements
- Lease landscape/portfolio assessment
- Data quality/gap assessment
- Accounting, tax, and process assessment
- Roadmap/work plan development
- Design and develop accounting and reporting solution for transition
- Pro-forma scenario analysis
- Training
- Internal controls design and development
- Lease abstraction
- Data migration from existing systems
- Data sanitization and normalization
- Deploy long-term solution—ranging from handover of transitional solution through implementation of integrated workplace management solution
- Revisions to internal controls design and development as necessary
- Shared services/Center of Excellence development
- Technical accounting assistance

Deloitte lease tool

A variety of technologies are available
These technology accelerators and solutions may be customized to meet your specific lease accounting and lease administration needs.

Need help analysing and abstracting lease contracts?

Abstraction software

- Software that automates the process of reading and extracting critical data from documents and contracts
- Combines machine learning algorithm with human knowledge (contract provisions “trained” by Deloitte domain specialists)
- Increases productivity and delivery speed making it faster, easier, and cheaper to abstract required lease data

Need a solution for lease accounting calculations to facilitate ASC 842 adoption?

Lease tool

- The lease tool is focused primarily on the new lease accounting standard
- The lease tool comes bundled with Deloitte services
- Flexible and customizable for all industries
- Covers real estate leases in addition to other lease types (e.g., equipment, vehicles, etc.)
- Use the lease tool for reporting under current and future rules

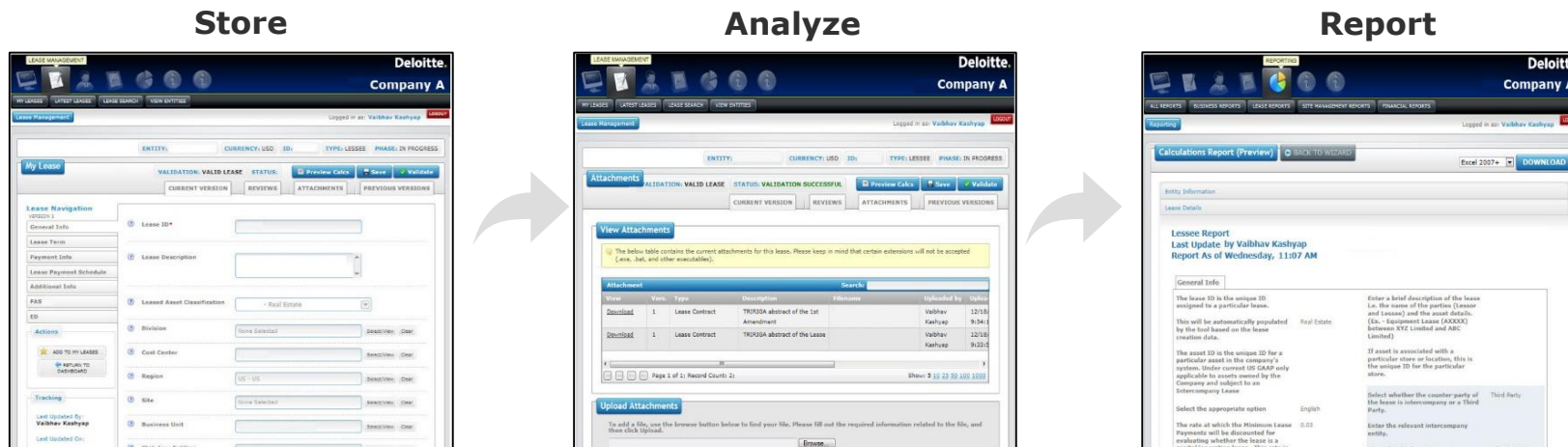
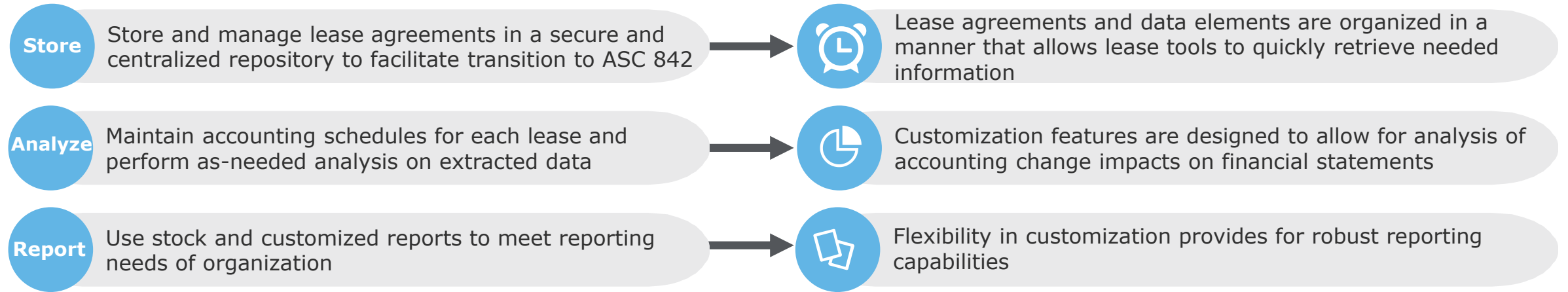
Need to completely rethink workspace management and lease accounting and administration?

LeasePoint™

- LeasePoint is a cloud-based solution powered by IBM TRIRIGA®
- The solution is focused on real estate and equipment lease administration, payment and accounting functionality
- LeasePoint transmits relevant lease data to a client’s ERP solution for financial reporting and generates information needed for footnotes
- Robust, secure, scalable hosting and application support managed by Deloitte; may also be bundled with Deloitte accounting support services

Deloitte lease tool

Our proprietary lease tool facilitates data gathering, analytical reviews and reporting under current and future rules. The lease tool can assist with implementation efforts by providing a centralized repository to store lease documentation and analyze and report on the information critical to your organization.

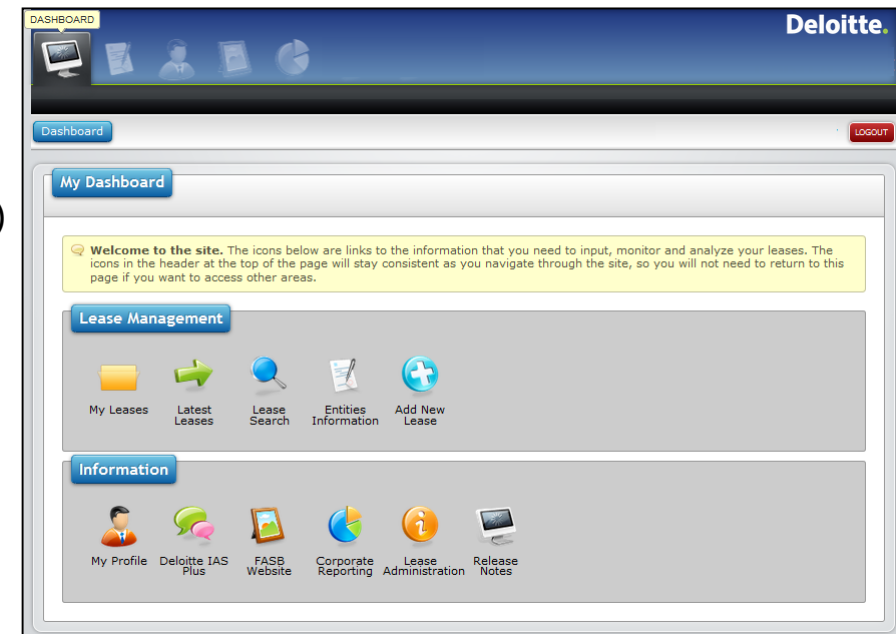


Deloitte lease tool (cont.)

The Deloitte lease tool provides a number of features to enhance an organizations efforts in implementing ASC 842 while providing capabilities to address challenges under the current lease accounting standard. The following highlights some of the key features of the tool:

Key Features

- Web-enabled data aggregation, analytical and reporting capabilities
- Workflow management with signoff/approval tracking
- Project management
- Multiple user environment
- Multiple level reporting (lease level, segment level, consolidated level)
- Supports efficient and effective data migration
- Robust reporting
- Audit trail
- Segregation of duties
- Document management
- Version control and re-assessment capability
- Easily interfaces with end state solution
- Current reporting under US GAAP



Flexible

Ability to easily modify to specifically address your needs



Simple

Easy to use interface that is intuitive



Fast

Ability to quickly implement the lease tool

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