ASC 842 Review Template

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Impact Summary

ASC 842 changes the manner in which operating leases are accounted for by requiring the capitalization of operating leases, which under previous GAAP were not reflected on a Company's Balance Sheet. Similar to accounting for finance leases, ASC 842 would require, at a minimum, the recognition of a lease asset (i.e., the "Right-of-Use" or "RoU" Asset) and lease liability, representing the minimum future payments due under a long-term lease.

Under ASC 842, for leases with terms of 12 months or less, lessees can elect to not recognize lease assets and liabilities. In making this election, lessees should recognize lease expenses on a straight-line basis, generally, over the term of the lease. Here are effective dates:

a. Public business entities, not for profit entities with conduit debt and certain employee benefit plans that file with the Securities and Exchange Commission: Apply ASC 842 for fiscal years beginning after Dec. 15, 2018 and the interim periods within that year.
b. For all other entities: Apply ASC 842 for fiscal years beginning after Dec. 15, 2019 and interim periods for years beginning after Dec. 15, 2020.

The process below reflects how a Company should consider applying ASC 842 to new and existing(1) leases.

0: Identifying the Contract

Under ASC 842, a contract is, or contains a lease if the contract conveys the right to control the use of an identified property, plant or equipment (i.e., an identified asset) for a period of time, in exchange for a consideration. Are there multiple contracts in the arrangement?

1: Identified Asset Analysis

What are the identifiable assets within the contract?

2: Control Analysis

Does the Company / (Customer) control the use of the identified asset(s)?

3: Separation & Allocation

What are the lease components, non-lease components and non-components in this contract? Can contract costs be allocated to the various components?

4: Determine the Lease Term

Identify the lease commencement date. The commencement date is utilized in initial measurement, and the lease term further plays a role in the classification of the lease as Finance or Operating.

5: Determine the Lease Payments

What are the fixed and variable payments, if any? Are there any in-substance fixed costs?

6: Classification

Will the lease be classified a Finance or Operating Lease?

7: Initial Direct Costs

Initial direct costs are defined as incremental costs that an entity would not have incurred if the lease had not been obtained (executed).

8: Measurement of RoU Asset & Liability

Initial Measurement

a. RoU Asset: The RoU asset is valued as the initial amount of the lease liability plus any initial direct costs and payments made prior to the commencement date, minus lease incentives.
b. Lease Liability: The lease liability is calculated as the present value of the lease payments, using the discount rate specified in the lease, or if that is not available, the company's incremental borrowing rate (IBR).

Finance leases require no changes in lease accounting.

Subsequent Measurement

a. RoU Asset:

   Operating Leases: Amortization of the RoU asset for operating leases is not recognized as depreciation expense. For example, in a basic lease (without any incentives, etc.), in each period, the asset is reduced by the same amount as the liability reduction.

   Finance Leases: Recognize amortization of the RoU asset separately from interest on the lease liability in the income statement. The RoU asset is generally amortized on a straight-line basis over the lease term.

b. Lease Liability: Subsequent measurement for the lease liability is identical for Operating and Finance leases and based on the effective interest method.

(1) Practical expedients to consider when transitioning to ASC 842:

- *Upon adoption, an entity is not required to reassess whether any expired or existing contracts are leases or contain leases, the lease classification for any expired or existing leases and the initial direct costs for any existing leases.*
- *An entity is permitted to use hindsight while evaluating the lease term and the impairment of the underlying Right-of-Use asset.*

Each practical expedient must consistently be applied to all leases.

ASC 842 Review Questions

The following is a detailed questionnaire to support the process steps listed on page one. It includes codification guidance in the right column.

0: Identifying the Contract

1. Are there multiple contracts involved in the arrangement? If so, what are they?
2. Should the multiple contracts in the agreement be combined? (See considerations below.)
    - The contracts are negotiated as a package with the same commercial objective(s).
    - The amount of consideration to be paid in one contract depends on the price or performance of the other contract.
    - The rights to use underlying assets conveyed in the contracts (or some of the rights of use conveyed in the contracts) are a single lease component in accordance with paragraph 842-10-15-28.

1: Identified Asset Analysis

3. What are the assets that are explicitly or implicitly specified in the contract?
4. If one or more assets are implicitly identifiable within the contract, please explain the rationale and offer a description of the implicit asset(s).
    - An asset is implicitly specified if the supplier does not have a substantive right to substitute alternative assets to fulfill the contract (e.g., supplier has only one asset to fulfill the contract).
5. Does the supplier have the legal right and practical ability to replace (i.e., substitute) the assets that the Company has a right to use with alternative assets?
    - Note: if the supplier/vendor has the ability to substitute an asset on a particular date (post-commencement of the contract), or at the occurrence of a particular event, this would generally not be considered a substantive right because the supplier/vendor is restricted as to when they can substitute the asset(s).
    - If so, which assets may the Supplier/Vendor substitute? Please define the specifics as well.
6. If substitution rights exist, would substitution be economically beneficial to the supplier/vendor (i.e., the economic benefits that would be derived from substituting the asset exceed the costs of the substitution)?
    - Examples of costs to consider when determining economic benefit include transportation/relocation costs of the original/new asset. Generally, if the asset sits on the Company's premises, it would not be economically beneficial for the supplier/vendor to substitute.
7. If the answers to (6) and (7) are "Yes" (for any identifiable asset), can the Company prevent the supplier from substituting the asset?
    - Note: if the Company is unable to determine the answers to either questions (6) or (7), the supplier's/vendor's substitution rights are not deemed to be substantive (i.e., this does not preclude the Company from having an identified asset).

Codification Guidance

1. ASC 842-10-25-19
2. ASC 842-10-25-19
3. ASC 842-10-15-19
4. ASC 842-10-15-19
5. ASC 842-10-15-10
   ASC 842-10-15-11
   ASC 842-10-15-15
6. ASC 842-10-15-12
   through
   ASC 842-10-15-13
7. ASC 842-10-15-15

ASC 842 Review Questions

The following is a detailed questionnaire to support the process steps listed on page one. It includes codification guidance in the right column.

2: Control Analysis

DETERMINE THE SCOPE OF THE COMPANY'S RIGHT TO USE WITHIN THE CONTRACT

8. Does the contract grant the Company a limited or a restricted right to use one or more assets (i.e., does the contract dictate how the Company may use the identifiable asset(s))?
    - If so, what are the restrictions, and what assets do they apply to?
9. Does the contract contain any terms or conditions that are designed to protect the supplier from the Company's use of the identified assets?
    - For example, do terms prevent the Company from using, occupying or operating the identified asset(s) in a way that protects the supplier's personnel, compliance with laws and regulations, or any other reasons?
    - If so, what are they? Do the restrictions leave the Company with no substantive decision-making authority (i.e., to determine when and how the identified assets are used) or does the the Company still get to make substantive decisions about the use of the asset?

IDENTIFY THE ECONOMIC BENEFITS FROM THE COMPANY'S USE OF THE IDENTIFIED ASSET

10. What are the economic benefits the Company obtains from using the identified asset(s)?
    - ASC 842 explains that the Company should consider direct benefits from using, holding or subleasing the identified asset(s) that could be realized in a commercial/arm's length transaction (e.g., renewable energy credits, or by-products arising from the use of the asset(s).
11. Is the Company the sole/main economic beneficiary from the use of the asset(s)?
    - Does the contract allow parties other than the Company to economically benefit from the asset(s)?
12. Does the Company have to pay a significant portion of the cash flows derived from use of the asset(s) to the supplier?
    - For example, if the Company achieves certain economic efficiencies or savings as a result of using the identified asset(s), does the Company owe a rebate/payment to the supplier?
    - If so, what asset(s) do these payments relate to?

Codification Guidance

8. ASC 842-10-15-20
9. ASC 842-10-15-23
10. ASC 842-10-15-17
11. ASC 842-10-15-18
12. ASC 842-10-15-19

ASC 842 Review Questions

The following is a detailed questionnaire to support the process steps listed on page one. It includes codification guidance in the right column.

2: Control Analysis (cont'd)

DOES THE COMPANY HAVE THE RIGHT TO DIRECT THE USE OF THE ASSET?

13. Does the Company have the right to direct how and for what purpose the asset(s) is/are used throughout the period of use (e.g., the ability to decide how leased space in an office building or data center is used)?

    Below are decision making rights that the Company should consider when determining whether or not they have the right to direct the use of asset:

    - Right to change the type of output produced by an asset
    - Right to change when the output is produced
    - Right to change where the output is produced
    - Right to change whether output is produced and, if so, quantity produced

14. Are there assets where the use and purpose is predetermined in a way that restricts the Company's decision-making rights during period of lease?

    - If so, does the Company still have the right to make *how* and *for what* purpose decisions throughout the period of use?
    - For example, is it a contract to lease a building for a data center with predetermined activity levels, where the Company does not get to control the amount of data in the servers?

3: Separation & Allocation

15. What are the lease components, nonlease components and non-components in this contract?

Codification Guidance

13. ASC 842-10-15-24

14. ASC 842-10-15-25

15. ASC 842-10-15-28 through ASC 842-10-15-31

An element of a contract may be identified as either:

A. Component: An activity that transfers a good or service. Components are then identified as either lease or nonlease components.

(i) Lease component: A lease component is one that provides a customer with the right to use an identified asset.

(ii) Nonlease component: A nonlease component is any component that does not qualify as a lease component yet still provides a good or service to the customer (e.g., maintenance, see below).

B. Non-Component: An element of a contract that does not qualify as a lease or nonlease component. These are activities (or lessor costs) that do not transfer a good or service to the lessee (e.g., real estate taxes and insurance paid by lessor).

Further, ASC 842-10-15-28 states: An entity shall consider the right to use an underlying asset to be a separate lease component (that is, separate from any other lease component of the contract) if both of the following criteria are met:

A. The lessee can benefit from the right of use either on its own or together with other resources that are readily available to the lessee. Readily available resources are goods or services that are sold or leased separately (by the lessor or other suppliers) or resources that the lessee already has obtained (from the lessor or from other transactions or events).

B. The right of use is neither highly dependent on nor highly interrelated with the other right(s) to use underlying assets in the contract. A lessee's right to use an underlying asset is highly dependent on or highly interrelated with another right to use an underlying asset if each right of use significantly affects the other.

Other considerations:

The landlord/lessor of a property may provide maintenance services, such as cleaning services. Under ASC 842, maintenance is not considered a cost of securing the office building and as such is considered a nonlease component.

There are some cases in which certain elements of a contract may not be a component at all because they do not transfer a good or service to the lessee (e.g., reimbursement for the lessor's insurance, interest, taxes, or administrative costs). Under ASC 842, payments or portions of the payments (both fixed and variable) for such costs will be allocated to the lease components of the contract.

ASC 842 Review Questions

The following is a detailed questionnaire to support the process steps listed on page one. It includes codification guidance in the right column.

3: Separation & Allocation (cont'd)

16. Describe the allocation of any other consideration and recognition of the amounts allocated to lease components. Consideration should be allocated to the lease and nonlease components on a relative standalone selling price basis.Does the contract allow parties other than the Company to economically benefit from the asset(s)?

4: Determine Lease Term

DETERMINE THE LEASE COMMENCEMENT

17. What is the date for classification and initial measurement?
    - Note: The date a lessor makes an underlying asset available for use to a lessee; not necessarily the lease inception (i.e., contract agreement date).

DETERMINE ADDITIONAL LEASE PERIODS TO BE CONSIDERED

18. Are there any renewal periods that the Company is "reasonably certain" the Company will exercise?
19. Are there any termination options that are reasonably certain to be exercised?

The lease term is the fixed noncancelable lease term plus all of the following, except as noted in the following paragraph:

A. All periods, if any, covered by bargain renewal options.
B. All periods, if any, for which failure to renew the lease imposes a penalty on the lessee in such amount that a renewal appears, at lease inception, to be reasonably assured.
C. All periods, if any, covered by ordinary renewal options during which any of the following conditions exist:
(i) A guarantee by the lessee of the lessor's debt directly or indirectly related to the leased property is expected to be in effect.
(ii) A loan from the lessee to the lessor directly or indirectly related to the leased property is expected to be outstanding.
D. All periods, if any, covered by ordinary renewal options preceding the date as of which a bargain purchase option is exercisable.
E. All periods, if any, representing renewals or extensions of the lease at the lessor's option.

The lease term shall not be assumed to extend beyond the date a bargain purchase option becomes exercisable.

5: Determine the Lease Payments

DETERMINE THE LEASE PAYMENTS

20. What are the fixed payments?
21. Are there any payments that depend on index or rate?
22. Are there any payments that change due to factors after commencement (other than passage of time)?

DETERMINE ADDITIONAL LEASE PAYMENTS TO BE CONSIDERED

25. Does the lease include any payments for purchase, renewal, or termination options consistent with lease term?
26. Does the lease include a residual value guarantee (RVG)? If so, what is the full amount of the RVG?
    - Note: Only include probable amounts for the lease liability measurement and exclude lessee guarantees of lessor's debt.

Codification Guidance

16. ASC 842-10-15-33
    ASC 842-10-15-37
17. ASC 842-20-20
18. ASC 842-20-20
19. ASC 842-20-20
20. ASC 842-20-20
    (& ASC 842-10-15-35)
21. ASC 842-10-30-5
    (& ASC 842-10-15-35)
22. ASC 842-10-15-36
23. ASC 842-10-30-5
24. ASC 842-10-55-34
    through
    ASC 842-10-55-36

ASC 842 Review Questions

The following is a detailed questionnaire to support the process steps listed on page one. It includes codification guidance in the right column.

6: Classification

25. Does ownership transfer at the end of the lease?
26. Is there a purchase option that is reasonably certain to be executed?
27. Does the Company lease the asset for the "major part" of the asset's identified life?
28. Is the present value of the lease payments "substantially all" of the fair value of the asset?
29. Is the asset so specialized in nature that only the Company would benefit from use of the asset?

7: Initial Direct Costs

30. Are there any initial direct costs (IDC) associated with the lease?
    - Note: Initial direct costs are defined as incremental costs that an entity would not have incurred if the lease had not been obtained (executed).

8: Measurement of RoU Asset & Liability

DETERMINE THE ACCOUNTING FOR LEASE LIABILITY & RoU ASSET

31. Is the lease a "short-term lease" (i.e., lease term <12 months). If yes, go to question 32; if not, proceed to question 33.
32. Has the Company elected to recognize short-term leases on the balance sheet?
    - Note: Management can elect to not recognize short-term leases on the balance sheet.

DETERMINE THE LEASE LIABILITY TO RECORD ON BALANCE SHEET

33. Does the contract have an implicit rate? If no, does the Company have the necessary information to calculation the incremental borrowing rate (IBR)?
34. Can the Company calculate the present value of the remaining lease payments due over the lease term?
    - Note: The lease payments should be discounted at the implicit rate or lessee's incremental borrowing rate.

DETERMINE THE RoU ASSET TO RECORD ON THE BALANCE SHEET

35. Were any lease payments made on or before the commencement date?
    - If so, what is the amount of lease payments already made?
36. Has the Company considered the amount of initial direct costs as part of the Right-of-Use asset value?
    - Note: The amount identified in process step 7 must be capitalized to the Right-of-Use asset.
37. Were any lease incentives received for signing the contract?
    - Note: Any lease incentives received should be deducted from the Right-of-Use asset amount.

Codification Guidance

25. ASC 842-10-25-2
26. ASC 842-10-25-2
27. ASC 842-10-25-2
28. ASC 842-10-25-2
29. ASC 842-10-25-2
30. ASC 842-10-30-9
31. ASC 842-20-25-2
    through
    ASC 842-20-25-4
32. ASC 842-20-25-2
    through
    ASC 842-20-25-4
33. ASC 842-20-30-3
34. ASC 842-20-30-1
    through
    ASC 842-20-30-6
35. ASC 842-20-30-1
    through
    ASC 842-20-30-6
36. ASC 842-20-30-1
    through
    ASC 842-20-30-6
37. ASC 842-20-30-1
    through
    ASC 842-20-30-6
    (& ASC 842-10-55-30)

Bring in the *Professionals*

If you need ASC 842 support, 8020 Consulting can help. With a team of nearly 100 professionals headquartered in Los Angeles and capable of working remotely to serve companies across Southern California, we can quickly assess and respond to your unique requirements and mandates. Even in this unique time of business, we are ready to apply our commitment to the value of "continuous improvement" and "focus on the critical" to generate immediate results.

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