FEI CCR Leases Working Group Debrief and Q&A

30 January 2020 | 2:00 – 3:00 PM ET

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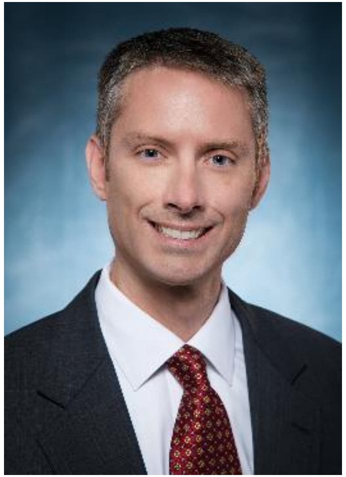
Agenda

- Background
- FASB Update
- Firm Debrief
- Companies

Background

Speaker



Shawn Husband

Senior Director, Lease Center of Expertise at Walmart

Shawn Husband is the Senior Director, Global Lease Center of Expertise at Walmart. In his role, Shawn oversees accounting for all leases executed, provides accounting guidance on leases and is leading the adoption of the new IFRS and US GAAP lease standards while guiding markets on internal controls and processes related to leases. During Walmart's transition to the new lease accounting standards, Shawn has taken on leadership roles to chair the FEI Leases Working Group as well as two lease accounting software user groups.

FEI Committee on Corporate Reporting

Leases Working Group

LWG Background

Purpose: Discuss and resolve topics of interest to attending companies, including:

- Technical Accounting
- Process
- Systems
- Internal Controls

Typical Agenda:

- FASB Staff Update
- Firm Update
- General LWG Discussion

Polling Question

How many leases does your company have?

a) 1-1,000

b) 1,000-10,000

c) 10,000+

d) N/A

FASB Update

FASB Update

- Nothing from a technical point of view the FASB Staff are dealing with at the time of the meeting
- Planning to have roundtable of leases at start of Q2 of next year from the current outreach (4/9)
- Group from CCR came to share some issues and guidance and talked to large firms and some other preparer groups
- Will compile issues that need to be discussed at roundtable and based upon what learn there will use that forum to decide which items perhaps will be standard set, which through Q&A and which resolved in roundtable itself
- As going through process, FASB Staff doesn't want to disrupt the implementation efforts of those that have already adopted and will evaluate alternative and costs and benefits.
- LWG highlighted that timing is of concern as the more time that passes the more disruptive change is to those that have adopted

Polling Question

From a system perspective, how well does your current system solve your needs?

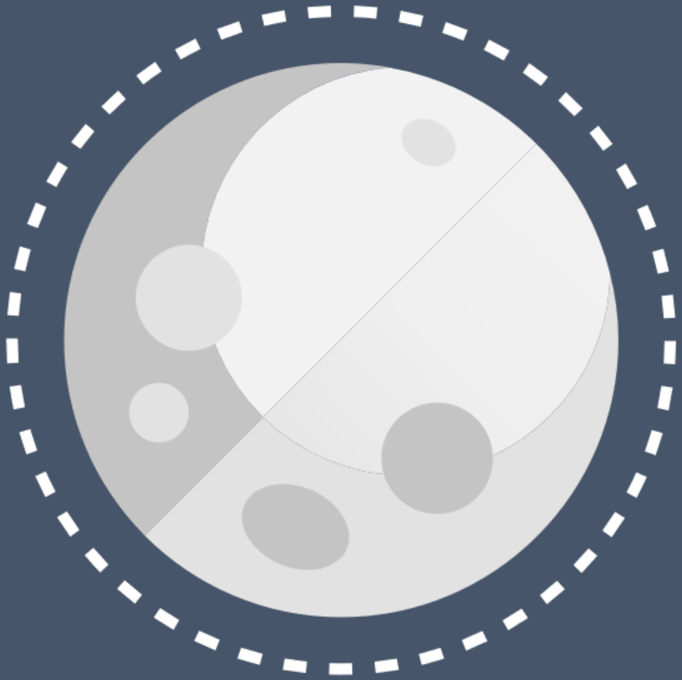
a) We have our end state solution in place and pleased with performance

b) We are implementing our end state system

c) We are evaluating our approach as our current system/vendor is not functioning as planned or we are choosing our first tool

d) We have chosen not to use a lease software tool (Excel, database, etc.)

e) N/A



Firm Debrief

Firm Debrief

- Sale-leaseback accounting
  - Failed sale-leasebacks with repurchase options – when do classification test for operating or finance, one view is that have to do that at legal date of sale leaseback and other is at date sale actual occurred
  - Firms to decide if diversity in practice acceptable or will raise to FASB Staff
- AICPA conference lease issues and SEC comments
  - OCA actively engaged in advancing implementation of the standards through consultations and panels; open to consultations
  - Two consultations noted
    - Lessor collectability – SEC Staff objected to conclusion that collectability of lease payments for collection of payments on lease equipment at time of signing based upon deposit and collection strength of credit quality and historical collection for similar leases. Not a reasonable basis for certainty on collection; lack of collection was so high that company hadn't done enough to support assertion that collectible at lease commencement
    - Sale and leaseback – objected that control had transferred under ASC 606 due to specific circumstances that could result in lessee regaining control of the asset (specific fact pattern for this lessee)
  - Overall, SEC has not issued many comments on 842; focus on completeness of disclosures and comments on judgments, etc. (e.g. how determine IBR?)
    - As previously noted, if you don't show comparative periods, you must reproduce the ASC 840 future commitments table in your disclosures; omission has drawn comments

Polling Question

How are you showing accrued interest on operating leases on your balance sheet?

a) In other current liabilities (accrued liabilities)

b) In short-term operating lease liabilities

c) Other

d) Don't know

e) N/A

General Discussion Topics

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- Treatment of termination payments in asset upgrade (lessor accounting)
  - Background: Bring old machine back and upgrade and terminate lease; amounts owed under existing lease rolled into new lease. If a sales type lease portion related to terminated lease recorded as loan receivable not lease receivable; what if an operating lease since no receivable with asset on books?
  - Modification model for lessors aligned with 606 and take all consideration in contract into fold in new lease - consideration of subsequent contract would consider rights given up in previous contract.
  - Generally view as tied to new lease as part of transaction as terminating lease in conjunction with obligation to enter new lease and termination penalty not appropriate to just isolate to old lease
- Implications of upgrading an underlying asset (lessor accounting)
  - From lessor accounting, how consider modification of existing agreement or termination and new lease when enhance existing machine or bring in a new machine (e.g. upgrading technology)?
  - Significant enhancement to an asset could be a termination of an agreement; significant judgment in determining how significant it needs to be. There is no specific framework.
  - For example, in one fact pattern were able to conclude that a power plant that was considered sold under a sales type lessor lease that had significant maintenance to prepare for next use at the end of the original lease agreement could be capitalized for the costs incurred through ASC 360

General Discussion Topics

- Consideration of fair value when a portion of an asset (lease 2 floors on 30 floor building)
  - Large accounting firms have discussed recently and agreed that there isn't safe harbor like position for portions of a larger asset; must do something to determine FV or demonstrate why not due to cost and effort.
  - If a large longer-term lease, determine the FV of the floor on a perceived value basis, which is not pure Sq. ft. For lower value leases will not go through the effort.
  - Put parameters on when more detailed analysis required
  - Paragraph 842-10-55-3 has language that is relevant to whether undue cost or effort with sliding scale on importance
  - One company approach has been to use capitalization rates to estimate the fair value of the floors they occupy. They divide the annual rent by the capitalization rate to calculate the fair value. It is not a precise test but close enough.

General Discussion Topics

- Held for Sale accounting impact on ROU asset depreciation
  - Write disposal group of assets held for sale to FV, assessed impairment and at least a portion unimpaired. What about day 2? Fixed assets stop depreciating as held for sale. Same with intangibles being amortized. What about ROU asset? Have to continue interest expense on effective interest method, but depreciation on asset, does that stop?
  - Firms aligned in comments that should stop amortizing ROU asset for operating or finance leases, whether or not asset group impaired, but continue interest expense recognition similar to abandonment; interest expense necessary to get liability to the right spot; have to record changes in value of asset depending on other assets in group so could get catchups
  - Alternative view is 842 requires straight-line if not impaired, so should continue deprecation. This could be an acceptable approach given conflict between 842 and ASC 360. Conflict was raised in FASB Outreach program

General Discussion Topics

- Determining fair value of land leases
  - If intend to develop land, do you use fair value as is or value if developed? What do you do with costs to develop (LHI or lease payments)?
  - FV is as of lease commencement date so can't anticipate future actions when determining fair value. Also, fair value can be derived under different methods, but objective is to determine what an objective third party would purchase the land for. That would assume the best use of that land, so if it is a spot ripe for development that would raise its FV and would be included in the value. In other words, you shouldn't have to choose between as is or developed.
  - For what do to with land development costs need to determine if improving lessor asset or lessee asset (covered in prior meetings). If deemed lessor asset need to include in lease payments and either it is variable lease expense if view as not a modification or consider contingent payment becoming fixed and remeasure if consider modifying lessor lease to require at least tacit lessor approval. If lessee asset, then treat as LHI. Lage company speaking considers the land development costs as part of lessee asset spend and capitalizes those costs and amortizes over lease term.

General Discussion Topics

- Key items shared on comparing company processes
  - Policy – some companies doing separate polices for lessee and lessor and some combined. Some have US GAAP with IFRS differences at end and some highlight differences in each relevant section
  - Low value threshold – some have no threshold, and some set up a global threshold below which markets could exclude and markets are permitted to account for leases below that threshold, if desired.
    - Consider operational needs to track assets
    - Consider AP ability to pay invoice properly if some to clearing account and some to P&L
  - Differences in companies between centralization and decentralization of processes
  - Outsourcing – not prevalent, but noted use of shared services internally which may be off-shore
  - Statutory audit central or local? Mix of testing centrally by auditors or performed by local teams
  - IBR -many challenges by local auditors on IBR rates for IFRS in local markets as opposed to parent company IBR even if set for what parent could borrow for locally; challenging both whether market should use local borrowing rate instead of parent IBR and calculation of parent IBR even if it is the appropriate rate

Polling Question

How are you calculating the disclosure for ROU Assets Obtained in Exchange for New Lease Liabilities?

a) Calculate starting with ROU assets added during the period (adjusting for prepaids, incentives, etc.)

b) Calculate using lease liabilities added during the period

c) Other

Q & A