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Leases for Dealerships – Part 2

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Meet Your Facilitators…

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Agenda

A. Walk through lease topics in further detail

B. Discuss lease transition and practical examples

C. Identify tax implications

D. Discuss solutions and tools

Lease Accounting Deep Dive

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Do I Have a Lease?

ASC 840	ASC 842
A lease is an agreement conveying the right to use property, plant, or equipment (land and/or depreciable asset) usually for a stated period of time.	A lease is a contract, or part of a contract, that 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.

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Lease Classification Criteria

ASC 842: Finance Lease	ASC 840: Capital Lease
Transfer of ownership: Lease transfers ownership of property to lessee by end of lease term.	Transfer of ownership: Lease transfers ownership of property to lessee by end of lease term.
Purchase option: Lease grants purchase option that is reasonably certain to be exercised.	Bargain purchase option: Lease contains a bargain purchase option.
Lease term: Lease term is for the major part of remaining economic life of underlying asset (unless near the end of estimated economic life).	Lease term: If lease is equal to 75% or more of the estimated economic life of the lease property (unless in last 25% of total estimated economic life)
Minimum lease payments: PV of sum of lease payments and residual value guarantee equals or exceeds substantially all of the FV of the asset.	Minimum lease payments: Present value at beginning of lease term of the minimum lease payments equals or exceeds 90% of excess of fair value
Specialized nature: No alternative use to lessor at end of lease term.	

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Lease Term (ASC 842)

- Lease term is determined at the lease commencement date and is the:
  - Non-cancelable period over which lessee has right to use asset
  - Period covered by option to extend if lessee is ***reasonably certain*** to exercise
  - Period covered by option to terminate if lessee is ***reasonably certain*** not to exercise
  - Period covered by renewal or extension options at the ***option of the lessor***

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How to Evaluate Reasonably Certain

Consider *all economic factors* relevant to the assessment: contract based, asset based, market based, entity based, etc. Examples of economic factors:

Reasonably certain is a high hurdle; requires a compelling economic incentive

Asset-Based Factors
- Location of asset
- Leasehold improvements?
- Relocation costs?

Market-Based Factors
- Market rate for comparable asset?

Contract-Based Factors
- Requirement to return asset in certain condition?

Entity-Based Factors
- Importance of asset to business operations?
- Tax consequences?

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Incremental Borrowing Rate vs. Risk Free Rate

- Incremental borrowing rate:
  - Lender quote – request a quote
  - Use existing debt arrangements
    - Is the collateral on the debt similar to collateral of leased asset?
    - What are differences between term of lease and term of debt?
    - Is debt recent enough to reflect current market rates?
  - Establish a range of reasonableness – market data
- Risk free rate – easier to determine but results in higher ROU asset and lease liability

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Related Party Leases

- Loosely defined or documented leasing arrangements
  - Limited impact as we approach the effective date (e.g. generally carry forward certain key decisions and determinations under ASC 840).
  - Could have major impact upon adoption depending on which expedients are elected (e.g., hindsight).
- Post adoption
  - Risk of undesirable accounting outcome significantly increases (e.g. Reassessment/remeasurement events)
- Recommendation
  - Nothing is an issue until it is an issue. Don't let it become an issue!
  - Formalize and clearly define these arrangements in writing

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Related Party Leases

- September 2022 FASB voted to approve new exposure draft
  - Terms & conditions to be considered for arrangements between entities under common control
  - Accounting for leasehold improvements (lessees)

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Back to Basics Example

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Operating Lease Example

<u>Facts:</u>

- **Lease term**: 6 years
- **Lease payments**: $40,000 annually paid at end of each year
- **Initial direct costs**: $1,500
- **Discount rate**: 9%

Lease Liability

Period	Lease Payment
Year 1	40,000
Year 2	40,000
Year 3	40,000
Year 4	40,000
Year 5	40,000
Year 6	40,000
Total	$ 240,000
PV at 9%	**$ 179,437**

ROU Asset	
Lease liability	$ 179,437
+ initial direct costs	1,500
+ lease prepayments	-
– lease incentives received	-
= ROU Asset	**$ 180,937**

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Operating Lease Example

Facts:

- **Lease term**: 6 years
- **Lease payments**: $40,000 annually paid at end of each year
- **Initial direct costs**: $1,500
- **Discount rate**: 9%

Entry to record the lease

Account	Debit	Credit
Right-of-Use Asset	180,937	
Lease Liability		179,437
Cash (or Deferred Initial Direct Costs)		1,500

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Operating Lease Example

<u>Facts:</u>

- **Lease term**: 6 years
- **Lease payments**: $40,000 annually paid at end of each year
- **Initial direct costs**: $1,500
- **Discount rate**: 9%

<u>Calculation of straight-line lease expense for operating lease</u>

Sum of lease payments (six payments of $40,000)	$ 240,000
+ Initial direct costs	1,500
= Total remaining lease costs	241,500
÷ Lease term	6 years
= Straight-line total lease expense	$ 40,250

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Operating Lease Example

Operating Lease		*Liability Amortization*[2]			*ROU Asset Adjustment*			
	A	B	C	D	E	F	G	H
	Lease Payment	Beginning Lease Liability	Liability Accretion	Ending Liability *B–(A–C)*	Beginning ROU Asset	ROU Asset Adjustment[3] *H–C*	Ending ROU Asset *E–F*	Lease Expense[4,5]
Year 1	40,000	**179,437**	16,149	155,586	**180,937**	24,101	156,836	40,250
Year 2	40,000	155,586	14,003	129,589	156,836	26,247	130,589	40,250
Year 3	40,000	129,589	11,663	101,252	130,589	28,587	102,002	40,250
Year 4	40,000	101,252	9,113	70,365	102,002	31,137	70,865	40,250
Year 5	40,000	70,365	6,333	36,698	70,865	33,917	36,948	40,250
Year 6	40,000	36,698	3,302	-	36,948	36,948	-	40,250
Total	240,000		60,563			180,937		241,500

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Operating Lease Example

Operating Lease		*Liability Amortization*[2]			*ROU Asset Adjustment*			
	A	B	C	D	E	F	G	H
	Lease Payment	Beginning Lease Liability	Liability Accretion	Ending Liability *B–(A–C)*	Beginning ROU Asset	ROU Asset Adjustment[3] *H–C*	Ending ROU Asset *E–F*	Lease Expense[4,5]
Year 1	40,000	**179,437**	16,149	155,586	**180,937**	24,101	156,836	40,250

Operating Lease

Account	Debit	Credit
Lease Expense	40,250	
Lease Liability		16,149
ROU Asset Reduction		24,101
Lease Liability	40,000	
Cash		40,000

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Transitioning to ASC 842, *Leases*

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Transition Method

- Comparative vs Effective Date (Non-Comparative)
  - Comparative – beginning of earliest period presented
  - Effective date – beginning of period of adoption (1/1/2022 for most private companies)

**Most companies will likely select the effective date method

Overview of Practical Expedients

Transition Practical Expedients

Package of Three

- Lease identification
- Lease classification
- Initial direct costs

Hindsight

- Lease term
- Lease payments
- Potentially lease classification

Land Easements

- Lease identification

Ongoing Practical Expedients

Discount rate

- Risk free rate
- Magnitude of lease liability and ROU asset

Lease Components

- Lease payments
- Magnitude of lease liability and ROU asset

Short Term Leases

- Balance sheet presentation

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Package of Transition Practical Expedients

The package of three practical expedients must be selected together and include:

1. Reassess whether expired or existing contracts are or contain leases	2. Reassess the lease classification for any expired or existing leases	3. Reassess initial direct costs for any existing leases

Substantially all public business entities adopted the package of three transition practical expedients

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Lease Term at Transition

Example 25 – Lease Term at Transition

Wonka Candy Company (Wonka) is adopting ASC 842 on January 1, 2021 and has elected the noncomparative transition approach. Therefore, Wonka will not restate prior periods. Wonka has elected the package of three transition practical expedients and therefore will not reassess whether the contract is or contains a lease, will not reassess lease classification, and will not reassess initial direct costs. Wonka has not elected the use of the hindsight practical expedient.

The original lease commenced on January 1, 2015 with an initial term of 10 years. The lease also provides for two 5 year renewal options. At lease inception, Wonka determined that it was not reasonably assured of exercising the renewal options and therefore used a ten year term under ASC 840. During 2018, Wonka decided to expand and now plans to exercise both 5 year renewal options.

Question:

1. When transitioning to ASC 842, what term should Wonka use when calculating the initial lease liability?

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Lease Term at Transition

Example 25 – Lease Term at Transition: Answer

Wonka should use a 4 year remaining term when transitioning to ASC 842 because they did not elect the use of hindsight. The remaining lease term, as determined under ASC 840, is 4 years, and therefore this term will be used when calculating the initial lease liability.

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Case Study: Transition to ASC 842

- Accounting under ASC 840
- Election of Practical Expedients
- Transition calculations and entries
- Prospective accounting
- Disclosure

Case Study: Introduction

- ABC is a nonpublic business entity
  - Applying standard January 1, 2019 (early adoption)
  - Presenting two years of comparative statements
- ABC elected noncomparative transition method
  - Prior periods will not be restated
- Elected package of three practical expedients
  - Will not re-evaluate whether expired or existing contracts are or contain leases.
  - Will not reassess classification for any expired or existing leases.
  - Will not reassess whether initial direct costs continue to qualify

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Transition Step 1: Establish Completeness of Lease Population

IDENTIFY

Identify the current lease population

- These are the leases you've known about all along
- Conduct interviews or surveys of employees regarding additional leases

EVALUATE

Evaluate completeness of population

- Group expense accounts by natural classification (e.g., Payroll, Maintenance, IT support, etc.)
- Rating (High, Medium, Low) for each expense classification
- Examine general ledger detail for all High and Medium risk ratings

SUMMARIZE

Summarize population of contracts and evaluate whether they include leases

- Use lease identification criteria in either ASC 840 or ASC 842 depending on whether package of practical expedients is elected

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Basic Lease Terms and Assumptions

- ABC enters into lease commencing 1/1/2016 for 50,000 sq. ft. property
- Initial term is 10 years (120 mo.) with 5-year renewal option
- 6 mo. free rent as incentive to sign lease
- $250,000 tenant improvement allowance for build-out of space
- 3% escalation per year

Year	Period	Base rent
1	January 1, 2016 to December 31, 2016	1,250,000
2	January 1, 2017 to December 31, 2017	1,287,500
3	January 1, 2018 to December 31, 2018	1,326,125
4	January 1, 2019 to December 31, 2019	1,365,909
5	January 1, 2020 to December 31, 2020	1,406,886
6	January 1, 2021 to December 31, 2021	1,449,093
7	January 1, 2022 to December 31, 2022	1,492,565
8	January 1, 2023 to December 31, 2023	1,537,342
9	January 1, 2024 to December 31, 2024	1,583,463
10	January 1, 2025 to December 31, 2025	1,630,966
	TOTAL	14,329,849

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Basic Lease Terms and Assumptions

- ABC is responsible for paying its share of real estate taxes and insurance based on amounts billed to lessor. ABC received $45,000 bill for 2019.
- At the commencement date (1/1/16), ABC determined it was an operating lease.
- ABC has elected to early adopt ASC 842 effective January 1, 2019 using the non-comparative method.

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Identify the Lease Term

- At commencement (1/1/16), 5-year renewal option was not reasonably certain of exercise.

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Identify Lease Payments and Calculate Straight-Line Expense

- ABC has uneven rents (6 months free with 3% escalation)
- ABC recognizes these expenses under ASC 840 on straight-line basis.

Total cash payments	÷	Total months	=	Monthly SL base rent
13,704,849.30	÷	120	=	114,207.08

Base Rent

	B	C	D	E
h	Annual sum of cash payments	Base monthly rent expense	Annual base rent expense	Deferred monthly rent
				A - C
.67	625,000.02	114,207.08	1,370,484.93	(10,040.41)
.67	1,287,500.04	114,207.08	1,370,484.93	(6,915.41)
.42	1,326,125.04	114,207.08	1,370,484.93	(3,696.66)
.73	1,365,908.76	114,207.08	1,370,484.93	(381.35)
.50	1,406,886.00	114,207.08	1,370,484.93	3,033.42
.72	1,449,092.64	114,207.08	1,370,484.93	6,550.64
.45	1,492,565.40	114,207.08	1,370,484.93	10,173.37
.86	1,537,342.32	114,207.08	1,370,484.93	13,904.78
.22	1,583,462.64	114,207.08	1,370,484.93	17,748.14
.87	1,630,966.44	114,207.08	1,370,484.93	21,706.79
.30	13,704,849.30		13,704,849.30	0.00

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Determine Remaining Lease Payments

- ABC is first applying the standard as of January 1, 2019 (rather than retrospectively applying to prior comparative period).
- From January 1, 2019 to December 31, 2025, 84 lease payments remain totaling $10,466,224.

Base Rent				
A	B	C	D	E
Monthly cash payment	Annual sum of cash payments	Base monthly rent expense	Annual base rent expense	Deferred monthly rent
				A - C
113,825.73	1,365,908.76	114,207.08	1,370,484.93	(381.35)
117,240.50	1,406,886.00	114,207.08	1,370,484.93	3,033.42
120,757.72	1,449,092.64	114,207.08	1,370,484.93	6,550.64
124,380.45	1,492,565.40	114,207.08	1,370,484.93	10,173.37
128,111.86	1,537,342.32	114,207.08	1,370,484.93	13,904.78
131,955.22	1,583,462.64	114,207.08	1,370,484.93	17,748.14
135,913.87	1,630,966.44	114,207.08	1,370,484.93	21,706.79
	10,466,224.20			0.00

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Calculate the Initial Lease Liability

- ABC chose not to utilize the risk-free rate practical expedient noting it was lower than its incremental borrowing rate and therefore would result in a larger liability.
- ABC recently entered into a 10 year collateralized Capex line with a similar term to the lease with sufficient excess capacity at a rate of 5%. ABC will utilize its incremental borrowing rate as the rate implicit in the lease is not available.

Base Rent							
	A	B	C	D	E	F	G
Date	Monthly cash payment	Annual sum of cash payments	Base monthly rent expense	Annual base rent expense	Deferred monthly rent	Deferred annual rent	Cumulative deferred rent
					A - C	B - D	
12/31/2016	104,166.67	625,000.02	114,207.08	1,370,484.93	(10,040.41)	(745,484.91)	(745,484.91)
12/31/2017	107,291.67	1,287,500.04	114,207.08	1,370,484.93	(6,915.41)	(82,984.89)	(828,469.80)
12/31/2018	110,510.42	1,326,125.04	114,207.08	1,370,484.93	(3,696.66)	(44,359.89)	(872,829.69)
12/31/2019	113,825.73	1,365,908.76	114,207.08	1,370,484.93	(381.35)	(4,576.17)	(877,405.86)
12/31/2020	117,240.50	1,406,886.00	114,207.08	1,370,484.93	3,033.42	36,401.07	(841,004.79)
12/31/2021	120,757.72	1,449,092.64	114,207.08	1,370,484.93	6,550.64	78,607.71	(762,397.08)
12/31/2022	124,380.45	1,492,565.40	114,207.08	1,370,484.93	10,173.37	122,080.47	(640,316.61)
12/31/2023	128,111.86	1,537,342.32	114,207.08	1,370,484.93	13,904.78	166,857.39	(473,459.22)
12/31/2024	131,955.22	1,583,462.64	114,207.08	1,370,484.93	17,748.14	212,977.71	(260,481.51)
12/31/2025	135,913.87	1,630,966.44	114,207.08	1,370,484.93	21,706.79	260,481.51	-
Total		13,704,849.30		13,704,849.30	0.00	0.00	

$8,763,726.12 *Present value of remaining minimum rental payments (see Exhibit B)*

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Calculate the Initial Right-of-Use (ROU) Asset

Initial Lease Liability

+ −

Prepaid Rent / Accrued Expenses

+

Unamortized Initial Direct Costs

−

Unamortized Lease Incentives Received

=

Right of Use Asset

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Calculate the Initial Right-of-Use (ROU) Asset

Base Rent							
	A	B	C	D	E	F	G
Date	Monthly cash payment	Annual sum of cash payments	Base monthly rent expense	Annual base rent expense	Deferred monthly rent	Deferred annual rent	Cumulative deferred rent
					A - C	B - D	
12/31/2016	104,166.67	625,000.02	114,207.08	1,370,484.93	(10,040.41)	(745,484.91)	(745,484.91)
12/31/2017	107,291.67	1,287,500.04	114,207.08	1,370,484.93	(6,915.41)	(82,984.89)	(828,469.80)
12/31/2018	110,510.42	1,326,125.04	114,207.08	1,370,484.93	(3,696.66)	(44,359.89)	(872,829.69)
12/31/2019	113,825.73	1,365,908.76	114,207.08	1,370,484.93	(381.35)	(4,576.17)	(877,405.86)
12/31/2020	117,240.50	1,406,886.00	114,207.08	1,370,484.93	3,033.42	36,401.07	(841,004.79)
12/31/2021	120,757.72	1,449,092.64	114,207.08	1,370,484.93	6,550.64	78,607.71	(762,397.08)
12/31/2022	124,380.45	1,492,565.40	114,207.08	1,370,484.93	10,173.37	122,080.47	(640,316.61)
12/31/2023	128,111.86	1,537,342.32	114,207.08	1,370,484.93	13,904.78	166,857.39	(473,459.22)
12/31/2024	131,955.22	1,583,462.64	114,207.08	1,370,484.93	17,748.14	212,977.71	(260,481.51)
12/31/2025	135,913.87	1,630,966.44	114,207.08	1,370,484.93	21,706.79	260,481.51	-
Total	13,704,849.30	13,704,849.30	13,704,849.30	13,704,849.30	0.00	0.00	

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Calculate the Initial Right-of-Use (ROU) Asset (cont.)

Initial Direct Costs			
Date	Monthly IDC amortization	Annual amortization	Unamortized IDC
			125,000.00
12/31/2016	1,041.67	12,500.00	112,500.00
12/31/2017	1,041.67	12,500.00	100,000.00
12/31/2018	1,041.67	12,500.00	87,500.00
12/31/2019	1,041.67	12,500.00	75,000.00
12/31/2020	1,041.67	12,500.00	62,500.00
12/31/2021	1,041.67	12,500.00	50,000.00
12/31/2022	1,041.67	12,500.00	37,500.00
12/31/2023	1,041.67	12,500.00	25,000.00
12/31/2024	1,041.67	12,500.00	12,500.00
12/31/2025	1,041.67	12,500.00	-
Total		125,000.00	

Incentives			
Date	Monthly incentive amortization	Annual amortization	Unamortized incentives
			250,000.00
12/31/2016	2,083.33	25,000.00	225,000.00
12/31/2017	2,083.33	25,000.00	200,000.00
12/31/2018	2,083.33	25,000.00	175,000.00
12/31/2019	2,083.33	25,000.00	150,000.00
12/31/2020	2,083.33	25,000.00	125,000.00
12/31/2021	2,083.33	25,000.00	100,000.00
12/31/2022	2,083.33	25,000.00	75,000.00
12/31/2023	2,083.33	25,000.00	50,000.00
12/31/2024	2,083.33	25,000.00	25,000.00
12/31/2025	2,083.33	25,000.00	-
Total		250,000.00	

Initial lease liability	-	Deferred rent liability	+	Unamortized Initial direct costs	-	Unamortized lease incentives	=	ROU asset
8,763,726.12	-	872,829.69	+	87,500.00	-	175,000.00	=	7,803,396.43

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Record the Transition Entry

The following entry is made on January 1, 2019 (initial application date) to record the initial ROU Asset and lease liability and remove previously recorded asset and liability balances prior to transition.

Account	Debit	Credit	Description
ROU asset	7,803,396.43		To record the initial ROU asset.
Deferred rent liability	872,829.69		To remove the deferred rent liability previously recorded under ASC 840.
Unamortized incentives	175,000.00		To remove the unamortized lease incentives previously recorded under ASC 840.
Lease liability		8,763,726.12	To record the initial lease liability.
Unamortized IDC		87,500.00	To remove the unamortized IDC previously recorded under ASC 840.
Total	8,851,226.12	8,851,226.12	- *Check*

In the case of ABC there is no cumulative effect adjustment to the opening balance of equity on January 1, 2019. This is primarily due to the practical expedients elected.

Had ABC not elected the package of three expedients, there would have been a cumulative effect adjustment for initial direct costs.

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Prepare New Amortization Schedule for the Remaining Lease Term

New amortization and accretion schedule will be necessary to track the balance of the lease liability and ROU asset.

Lease Calculations											
ROU Asset Amortization Schedule							Lease Liability Accretion Schedule				
		A	B	G	C	D	E	F	G	H
	Date	ROU Asset Opening Balance	Annual Lease Cost	Annual accretion	ROU Amortization	ROU Asset Closing Balance	Lease Liability Opening Balance	Annual Rents Paid	Annual Accretion	Lease Liability Closing Balance
					B - G	A - C				E - (F - G)
						7,803,396.43				8,763,726.12
12	12/31/2019	7,803,396.43	1,357,984.92	416,627.93	941,356.98	6,862,039.45	8,763,726.12	1,365,908.76	416,627.93	7,814,445.30
24	12/31/2020	6,862,039.45	1,357,984.92	367,108.69	990,876.23	5,871,163.22	7,814,445.30	1,406,886.00	367,108.69	6,774,667.99
36	12/31/2021	5,871,163.22	1,357,984.92	312,930.92	1,045,054.03	4,826,109.19	6,774,667.99	1,449,092.64	312,930.92	5,638,506.27
48	12/31/2022	4,826,109.19	1,357,984.92	253,792.51	1,104,192.43	3,721,916.76	5,638,506.27	1,492,565.40	253,792.51	4,399,733.38
60	12/31/2023	3,721,916.76	1,357,984.92	189,374.01	1,168,610.91	2,553,305.85	4,399,733.38	1,537,342.32	189,374.01	3,051,765.07
72	12/31/2024	2,553,305.85	1,357,984.92	119,337.66	1,238,647.27	1,314,658.58	3,051,765.07	1,583,462.64	119,337.66	1,587,640.09
84	12/31/2025	1,314,658.58	1,357,984.92	43,326.35	1,314,658.57	0.01	1,587,640.09	1,630,966.44	43,326.35	0.00
		Totals	9,505,894.44	1,702,498.08	7,803,396.42		Total	10,466,224.20	1,702,498.08	

Note that the straight-line monthly expense did not change. This is primarily the result of the practical expedients that were elected and no change in lease term.

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Disclosures Depend on Transition Method

Comparative Transition	Noncomparative Transition
• ASC 842 – All periods presented	• ASC 842 – Year of adoption • ASC 840 – All prior periods presented

Disclosure Requirements

General description of leases
Basis, terms, and conditions for determining variable lease payments
Existence, terms, and conditions of any options to extend or terminate
Existence, terms, and conditions of residual value guarantees
Restrictions or covenants imposed by leases
Leases that haven’t commenced yet but create significant rights and obligations
Significant assumptions and judgments in application of GAAP for leases

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Disclosure

Adoption of New Accounting Standards

On January 1, 2019, the Company adopted the requirements of Accounting Standards Update ("ASU") 2016-02, *Leases* (Topic 842). The objective of this ASU, along with several related ASUs issued subsequently, is to increase transparency and comparability between organizations that enter into lease agreements. For lessees, the key difference of the new standard from the previous guidance (Topic 840) is the recognition of a right-of-use (ROU) asset and lease liability on the balance sheet. The most significant change is the requirement to recognize ROU assets and lease liabilities for leases classified as operating leases. The standard requires disclosures to meet the objective of enabling users of financial statements to assess the amount, timing, and uncertainty of cash flows arising from leases.

As part of the transition to the new standard, the Company was required to measure and recognize leases that existed at January 1, 2019 using a modified retrospective approach. For leases existing at the effective date, the Company elected the package of three transition practical expedients and therefore did not reassess whether an arrangement is or contains a lease, did not reassess lease classification, and did not reassess what qualifies as an initial direct cost. Additionally, the company elected, as a practical expedient, to use hindsight for purposes of determining lease term.

The adoption of Topic 842 resulted in the recognition of an operating ROU asset and operating lease liability of $7,803,396 and $8,763,726, respectively as of January 1, 2019.

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Disclosure

Significant Accounting Policies

Leases

At lease inception, the Company determines whether an arrangement is or contains a lease. Operating leases are included in operating lease right-of-use ("ROU") assets, current operating lease liabilities, and noncurrent operating lease liabilities in the consolidated financial statements. ROU assets represent the Company's right to use leased assets over the term of the lease. Lease liabilities represent the Company's contractual obligation to make lease payments over the lease term.

For operating leases, ROU assets and lease liabilities are recognized at the commencement date. The lease liability is measured as the present value of the lease payments over the lease term. The Company uses the rate implicit in the lease if it is determinable. When the rate implicit in the lease is not determinable, the Company uses its incremental borrowing rate at the commencement date of the lease to determine the present value of the lease payments. Operating ROU assets are calculated as the present value of the remaining lease payments plus unamortized initial direct costs plus any prepayments less any unamortized lease incentives received. Lease terms may include renewal or extension options to the extent they are reasonably certain to be exercised. The assessment of whether renewal or extension options are reasonably certain to be exercised is made at lease commencement. Factors considered in determining whether an option is reasonably certain of exercise include, but are not limited to, the value of any leasehold improvements, the value of renewal rates compared to market rates, and the presence of factors that would cause a significant economic penalty to the Company if the option were not exercised. Lease expense is recognized on a straight-line basis over the lease term. The Company has elected not to recognize an ROU asset and obligation for leases with an initial term of twelve months or less. The expense associated with short term leases is included in lease expense in the statement of income.

To the extent a lease arrangement includes both lease and non-lease components, the Company has elected to account for the components as a single lease component.

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The Company has an operating lease of office space with a remaining lease term of 7 years. The lease includes a renewal option for an additional 5 years.

The components of lease expense were as follows:

	December 31, 2019
Operating lease cost	$ 1,357,985(a)
Short-term lease cost	23,000
Variable lease cost	45,000
Total lease cost	$ 1,425,985

Supplemental cash flow information related to the lease was as follows:

Cash paid for amounts included in the measurement of lease liabilities	
Operating cash flows from operating leases	1,365,909(b)

Supplemental balance sheet information related to leases was as follows:

Operating Lease	
Operating lease right-of-use assets	6,862,039(d)
Current operating lease liabilities	1,039,777(f - e)
Noncurrent operating lease liabilities	6,774,668(e)
Total operating lease liabilities	$ 7,814,445(f)

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Lease Calculations														
ROU Asset Amortization Schedule									Lease Liability Accretion Schedule					
		A	B		C	D	E		F	G		H	I	
	Date	ROU Asset Opening Balance	Annual Lease Cost		Annual Accretion of Lease Liability	Annual Adjustment of ROU Asset	ROU Asset Closing Balance		Lease Liability Opening Balance	Annual Rents Paid		Annual Interest Component	Lease Liability Closing Balance	
							7,803,396.43	(c)					8,763,726.12	
12	12/31/2019	7,803,396.43	1,357,984.92	(a)	949,280.83	941,356.98	6,862,039.45	(d)	8,763,726.12	1,365,908.76	(b)	416,627.93	7,814,445.30	(f)
24	12/31/2020	6,862,039.45	1,357,984.92		1,039,777.31	990,876.23	5,871,163.22		7,814,445.30	1,406,886.00	(g)	367,108.69	6,774,667.99	(e)
36	12/31/2021	5,871,163.22	1,357,984.92		1,136,161.72	1,045,054.03	4,826,109.19		6,774,667.99	1,449,092.64	(h)	312,930.92	5,638,506.27	
48	12/31/2022	4,826,109.19	1,357,984.92		1,238,772.89	1,104,192.43	3,721,916.76		5,638,506.27	1,492,565.40	(i)	253,792.51	4,399,733.38	
60	12/31/2023	3,721,916.76	1,357,984.92		1,347,968.31	1,168,610.91	2,553,305.85		4,399,733.38	1,537,342.32	(j)	189,374.01	3,051,765.07	
72	12/31/2024	2,553,305.85	1,357,984.92		1,464,124.98	1,238,647.27	1,314,658.58		3,051,765.07	1,583,462.64	(k)	119,337.66	1,587,640.09	
84	12/31/2025	1,314,658.58	1,357,984.92		1,587,640.09	1,314,658.57	0.01		1,587,640.09	1,630,966.44	(l)	43,326.35	0.00	
		Totals	9,505,894.44		8,763,726.12	7,803,396.42			Total	10,466,224.20		1,702,498.08		

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ASSURANCE

Disclosure

	December 31, 2019
Other information:	
Weighted average remaining lease term - operating lease	7 years
Weighted-average discount rate – operating lease	5%

Lease Liability Maturities:

	December 31, 2019
2020	$ 1,406,886(g)
2021	1,449,093(h)
2022	1,492,565(i)
2023	1,537,342(j)
2024	1,583,463(k)
Thereafter	1,630,966(l)
Total	9,100,315
Less: Interest	(1,285,870)
Total lease cost	$ 7,814,445(f)

As of December 31, 2019, the Company has no operating leases that have not yet commenced.

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Tax Implications

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Tax Implications

- ASC 842 does not impact lease accounting for federal income tax return purposes
- For C Corporations with income tax accounting on the financial statements – can lead to timing differences and additional deferred tax items

Solutions / Tools

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Solutions / Tools

- LeaseVision
  - FORVIS provided solution, FORVIS can help throughout
- 3rd Party Software (LeaseCrunch)
  - Recommend for Company's with 5 or fewer simple leases. Cost is traditionally per lease per year.
- Excel
  - Not highly recommended as it is a big undertaking

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LeaseVision

- FORVIS provided excel based lease tool
- It provides client with list of entries for implementation, as well as recurring entries for every subsequent year
- FORVIS can assist with input of information from leases once information is provided
- For Assurance clients, this saves time and money when it comes to auditing inputs and outputs as compared to other products/options

Other Options

- 3rd Party Software (i.e. LeaseCrunch)
  - Recommend for Company's with 5 or fewer simple operating leases. Cost is traditionally per lease per year. Software will provide the entries once information is input.
- Excel
  - This involves creating everything from scratch or from an acquired template. This requires a significant time commitment and undertaking, it also requires a significant amount of time to audit all inputs, calculations, and outputs.

What is LeaseVision

- A one-stop lease standard implementation solution which includes
  - Implementation Roadmap
  - Artificial Intelligence Software (KIRA) to read contracts and extract terms
  - Excel-based Tools

What is LeaseVision

- Implementation Roadmap
  - It is a comprehensive roadmap providing details on the how/what/why for implementing ASC 842
- KIRA
  - AI software that reads contracts and extracts key lease terms to assist in the data entry into LeaseVision.
  - KIRA license is held by FORVIS, and only FORVIS can access
  - Output from KIRA is in both Word and Excel formats

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What is LeaseVision

- Excel-based Tools
  - Includes technical guidance & tips throughout
  - Built-in how-to instructions
  - Include transition guidance & customizable journal entry sections
  - Comprehensive tool to calculate entries, maintain amortization schedules & accumulate disclosure information
  - Client owns the tool after purchase
  - Training video link also provided to the client upon delivery of the tool

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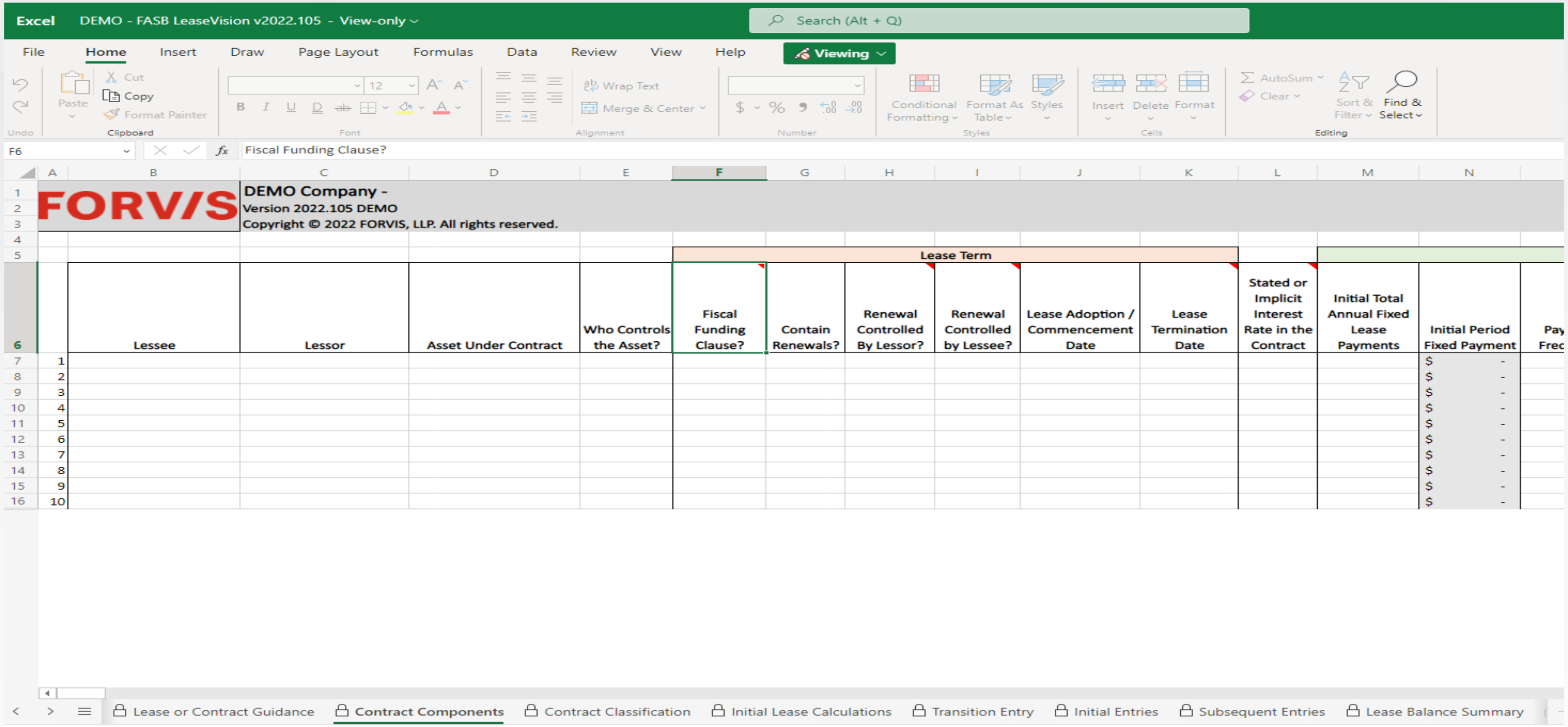
What is LeaseVision



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What is LeaseVision

DEMO Company -
Summary of Subsequent ROU & Lease Liability Entries

Period Ending	Period	Period Between: 11/01/2024 - 04/30/2025
4/30/2025	Semi Annual	($XX) indicates credit, $XX indicates debit

Version 2022.105 DEMO

Department/ Program	ROU Asset Accumulated Amortization	Lease Expense (operating)/ROU Asset Amortization Expense (finance)	Assets that Transfer Ownership at the end of the Lease Term	ROU Asset + Accretion of Interest	ROU Asset Impairment	Interest Expense (Finance)	Accrued Interest Liability (Finance)	Lease Liability + Accretion of Interest	Lease Document Reference
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	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	

DEMO Company -

Semi Annual Entries for the Period Ended		4/30/2025
Entry for Operating Leases		
ROU Asset	$ -	
ROU Asset Accum Amort	-	
Fixed Assets	-	
Lease Liability	-	
ROU Asset Impairment Expense	-	
Lease Expense	-	
To record amortization of ROU assets for operating leases		

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Q&A

- Go to www.FORVIS.com for more information

Thank you!

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Assurance / Tax / Advisory