FEI CCR Leases Working Group Debrief and Q&A

24 October 2019 | 2:00 – 3:00 PM ET

Agenda

Background

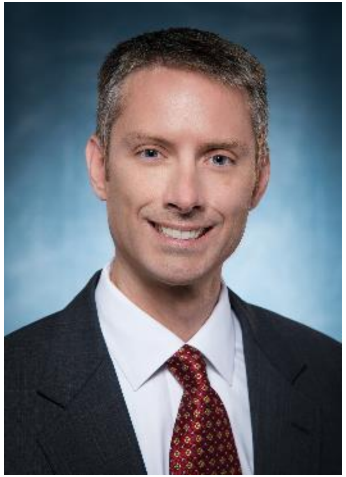
Firm Update

IASB

FASB

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

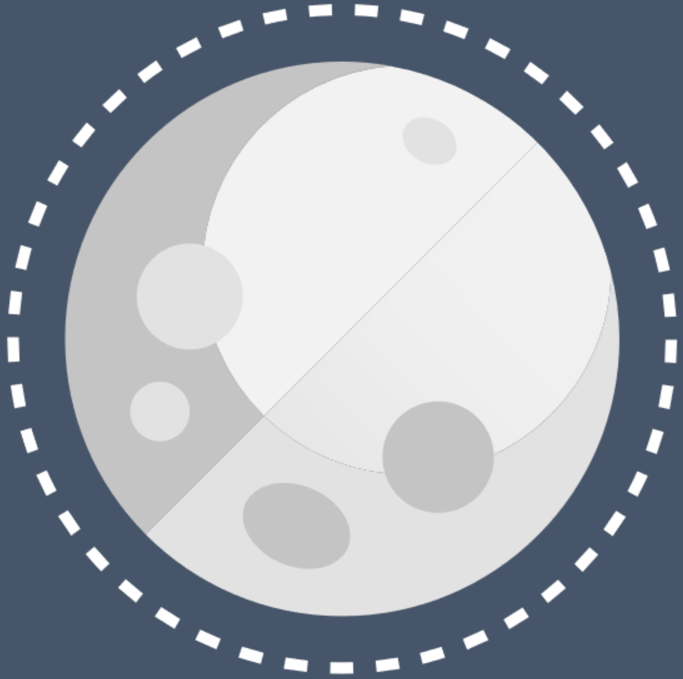
Polling Question

Have you combined the lease and nonlease components?

a) Yes, for all class of assets

b) Yes, for some class of assets

c) No, not for any class of assets



Firm Debrief

Firm Debrief

- Can lessor under 842 continue to have general allowance for doubtful accounts?
  - 842 does not address a general notion of allowances on a pool of leases where overtime some leakage on a set of accounts may occur. So, could lessors continue to record a general allowance or limited to specific lease allowance?
  - FASB has permitted a policy choice to either only apply collectability in 842 and not have general reserve or continue to have general reserve under topic 450 (contingencies) could continue to use general reserve (also not CECL).
  - This would have 842 guidance on specific leases and 450 for a general reserve and if equipment lessor with direct financing, those would be CECL applicable.
  - If general reserve, contra revenue or bad debt? This is company election. If bad debt, specific receivables go where?
- Asset purchase versus 805 bus comb – standard specifies when a company acquires leases through a bus combination, acquirer retains acquired company lease classification. What about an asset acquisition? Check with auditors as some firms analogize to bus combs and retain classification and others view as sublease transaction and classify at acquisition date.
- What if company A has adopted 842 and acquired company not yet adopted? One view is that this if acquired company not under 842, they are not under your US GAAP, and it is like acquiring a company under other GAAP and you would transition them to your GAAP. Still being discussed, so no consensus position yet.

Firm Debrief

- Bus combination implications of lease and nonlease election to combine
  - Acquire target company with similar leases but one company has combined lease and nonlease and triggered finance classification, but the acquiring company has not combined for similar leases and have them as operating leases
  - Guidance tells us carry forward their decision on classification. Do we carry forward as finance and then conform the accounting for lease/nonlease accounting and no longer combine the lease and nonlease and account for it that way or do we first conform and then classify?
  - Fairly uniform view that bus comb guidance applies and keep classification of the target and continue to be finance leases but conform the accounting and not combine the lease and nonlease. Measure lease liability with discount rate as of today and adjust asset for favorable and unfavorable and difference creates goodwill. Use finance lease model.
- ROU asset plan to abandon but not impaired –Consensus is that depreciating a ROU asset, have to be cognizant of useful life, that the expense pattern has to be accelerated. Three methods identified (assume 4 years left in lease term and plan to abandon after 2 years):
  - Analogize to 842 for impaired asset and delink amortization from liability and depreciate straight-line over remaining two years and interest expense over 4 years
  - Use single lease expense over 2 years - Asset not impaired, so therefore cannot under delink the expenses, so continue to use single lease expense, but need to do over 2 years following operating lease methodology over 2 years and no expense over final 2 years.
  - Hybrid – during first 2 years continue to follow SL expense model for amortization and interest to keep asset and liability linked, and only recognize interest expense in last 2 years.

Polling Question

Which standard applies to your company?

a) US GAAP

b) IFRS

c) Both US GAAP and IFRS

IASB Highlights

Highlights of IASB Discussion

- Surveyed 30 large companies (out of 30,000 IFRS filers globally) - all indications went well with minimal adoption issues
- Interpretation committee has covered six questions (interpretation of existing standard goes to IFRIC first)
  - Subsurface rights – tangible asset so in scope
  - Incremental borrowing rates – maturity date in 5th year or duration of three years in five-year lease – standard does not give clear guidance so both reasonable and widely used and acceptable
  - Lease term cancelable leases in November (ED outstanding) – matter is how to view reasonably certain definition as narrow or broader with business context and economic compulsion, etc. Half the comment letters did not agree broad definition. Board advisors and committees interpreting saw as broad. Narrow would be against the tenor of IASB. Will be covered in November.
  - Deferred taxes – do you put deferred assets on both asset and liabilty. Yes, would have own lives.
- IFRS impairment reversals
  - Impairment reversals – more of a reserve you can reverse; bottom line comfortable with Walmart analysis and agree with the conclusions. Leases with mods, impairments, etc. are separate phenomenon with own separate life in lease runoff.

General Discussion Topics

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- US GAAP implications of index rate change on lease/nonlease election
  - If declare nonlease components as an element of MLP and gets remeasured, this will pull nonlease components into lease measurement
  - If an IFRS lease, an index or rate change triggers remeasurement and when remeasure the lease liability the if nonlease is part of MLP (elected to combine), then nonlease would be included at the index/rate change date.
  - Election to combine, combines lease and nonlease for all intents and purposes in the arrangement as lease so any contractual changes to consideration would follow leases model, but firms have not considered the topic specifically.
- Negative rates – Won't accept rate implicit in lease as negative, but not addressed whether IBR could be negative. Some bank lessees borrow at negative rate, however skepticism that fees and charges truly would have a negative rate as presumption is that lending institution is for profit.
- Lease classification in a modification or reassessment – recognition that many lease systems are not calculating properly as only included NPV of future payments and not including payments prior to the mod date in the lease classification test.
  - When a lease modified and revisiting classification, that would include remaining unamortized balance or prepaids, incentives and higher payments earlier in lease as separate line items.
  - Discounting of amount would just include the remaining unamortized balance and not adjust for discounting as payment as date of mod.

General Discussion Topics

- Disclosures
  - SEC too soon to have perspective on disclosures. Comment letters have been very few so far on disclosures. 606 timing was after first batch of 10ks. Comment letters not trended so far. Expect volume to pick up on 842 reviews next year.
  - Two areas of comment noted are (1) more detail than boiler plate comment and (2) statement of cash flows citing amortization instead of single lease expense.

Polling Question

Which aspects of the lease standards apply to your company?

a) Lessee accounting

b) Lessor accounting

c) Both lessee and lessor accounting

FASB Outreach

FASB Outreach Topics

1. Adjusting leasehold improvement lives for changes in assessment of lease terms adds undue complexity and cost.
2. Practical expedient for index-based rent
3. Allow flexibility to use lessee determined Implicit Rate
4. Multiple views to accelerate amortization on an abandoned asset
5. Lease classification treatment of payments prior to commencement
6. Changes in classification subsequent to lease commencement

FASB Outreach Topics

7 Unexpected P&L profile change due to different rules of lease exits under ASC 840/ASC 420 vs. ASC 842

8 Discount rate complexity

9 The Fair Value Challenge

1 Lessor – partial terminations of lease components on an MLA

2 Lessor – Sale-and-Leaseback (SLB) transactions - symmetry in conclusions

3 Lessor – Extension of term in DFL / STL

Polling Question

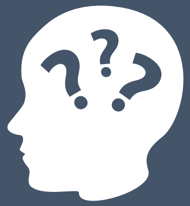
Do you disclose accumulated amortization either on balance sheet or in the footnotes?

a) Yes, for both finance and operating ROU assets

b) Yes, but only for finance leases

c) We do not disclose either

d) Haven't determined/ unsure



Q & A