LEASE ACCOUNTING

WHERE DO WE GO FROM HERE?
Leases Move onto the Balance Sheet

S&P 500

- Have Filed 10-Qs under ASC 842
- Added Balance Sheet Line Items for ROU Assets or Liabilities
- Included Leasing Footnote
Agenda - Where Do We Go From Here?

1. WHERE ARE WE TODAY?
   1ST QUARTER
   Complexity & Automation

2. WHAT'S NEXT – YEAR ONE?
   1ST YEAR
   Lease Accounting 2.0

3. CASE STUDY: S&P 500
   Journey towards Compliance
Today’s Speakers

Robert Kugel
SVP & Research Director

Michael Keeler
CEO and Founder

Len Neuhaus
Lease Accounting Consultant
Poll #1

Which of the following best describes the approach you are taking to systems to perform lease accounting under ASC 842?

a) Early in the project, no systems strategy yet

b) Primarily spreadsheets

c) Mix of spreadsheets and enterprise software

d) Primarily enterprise software
A New Era Dawns in Accounting
The New Standards Add Complexity

- New conceptual frameworks
- Intricate transactions recording
- Analytical processes
- More interpretive
- Review and remeasurement required
- Principles based

“Professor Butts and the Self-Operating Napkin” (1931) by Rube Goldberg
OK.

You can keep your darn spreadsheets.

(Just not all of them.)
Managing complicated processes consistently with controls while documenting compliance requires information technology.
The Wrong Tool for the Job

- Revenue and lease accounting require a higher level of data collection.
- Companies must be able to reliably capture financial and non-financial data.
- Companies must be able to accurately and consistently perform analyses and calculations.
- Spreadsheets are unreliable and time consuming.

Errors in Spreadsheets
Errors are more frequent than most assume

<table>
<thead>
<tr>
<th>Error Type</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Data errors</td>
<td>35%</td>
</tr>
<tr>
<td>Formula errors</td>
<td>26%</td>
</tr>
<tr>
<td>Format errors</td>
<td>19%</td>
</tr>
</tbody>
</table>

Source: Ventana Research Spreadsheets in Today's Enterprise Benchmark Research © Ventana Research 2016; All Rights Reserved
Spreadsheets don’t work.

1. Review and remeasure regularly
2. Cross-functional processes
3. Controlled and consistent accounting
What’s Different?

- Complex, intricate transactions
- Cross-functional collaboration
- Control, review and approvals
- Consistency of treatments
- Consistency of process
- Consistency of analyses
- Defined roles and responsibilities
- Periodic remeasurement
- Disclosures

You need software.

(And more.)
Poll #2

What is your greatest challenge with lease accounting?

a) Processes, policies, and controls
b) Talent, staffing, and training
c) Systems and automation
d) Accounting complexity
Register Online at www.leaseaccountingsummit.com

Enterprise Lease Accounting Summit 2019: Dallas-Fort Worth

June 11-13th, 2019 | CPE Credits Available
RACE TO THE STARTING LINE
Day Two and Beyond - Key Issues

CENTER OF EXCELLENCE
- Talent
- Recruiting
- Training
- Turnover

LEASE ADMINISTRATION
- New Leases
- Changes to Leases
- End of Term Decisions
- Reasonably Certain

QUARTERLY CLOSE
- Subledger Cutoff
- Cycle Time
- New Disclosures

VALUE & COST SAVINGS
- Cost Savings
- Performance Management
- Financial Position & Ratios

SYSTEMS & DATA
- Software Upgrades
- Regression Testing
- Data Integrity across Systems

FINANCIAL & SOX AUDITS
- Completeness
- Accuracy
- Policies and Controls
- Statutory Audits
The Lease Accounting Journey

Day One
- Future State Design
- Data Collection & Cleansing
- Software Configuration & Testing
- Communications & Training

Day Two
- New Leases & End of Term
- Modifications & Reassessments
- Monthly Close & Quarterly Reports
- Substantive & SOX Audit Preparation

Day Three
- Competitive Sourcing of Financing
- Lease versus Buy Analysis
- End of Term and Evergreen Management
- KPIs & Stakeholder Scorecards

Finish Line

Start Line

You are here
# Preparing for the Audit

<table>
<thead>
<tr>
<th>Assertions</th>
<th>LeaseAccelerator Control Features</th>
</tr>
</thead>
<tbody>
<tr>
<td>Completeness and Accuracy</td>
<td>• Automated Data Capture and Validation</td>
</tr>
<tr>
<td></td>
<td>• Straight-Through Processing</td>
</tr>
<tr>
<td></td>
<td>• Roll-Forward Reporting</td>
</tr>
<tr>
<td>Existence or Occurrence</td>
<td>• Deal History</td>
</tr>
<tr>
<td></td>
<td>• Document and Communications History</td>
</tr>
<tr>
<td></td>
<td>• Asset Attestations</td>
</tr>
<tr>
<td>Rights and Obligations</td>
<td>• Detail Lease Terms</td>
</tr>
<tr>
<td></td>
<td>• Date Tracking (i.e., commencement, acceptance, booking, funding, original end, effective end)</td>
</tr>
<tr>
<td>Valuation or Allocation</td>
<td>• Policy Settings (i.e., IBR, Reasonably Certain Holding Period, Reasonably Certain EOT Option,</td>
</tr>
<tr>
<td></td>
<td>Classification Test Thresholds)</td>
</tr>
<tr>
<td></td>
<td>• Asset Based</td>
</tr>
<tr>
<td></td>
<td>• Rule-Based Accounting Engine (ROU Asset Adjustments, Modifications)</td>
</tr>
<tr>
<td></td>
<td>• Embedded PV Calculations (Frequency, Adv/Arr)</td>
</tr>
<tr>
<td>Presentation and Disclosure</td>
<td>• GL Configuration and Account Setup</td>
</tr>
<tr>
<td></td>
<td>• Detail Classification Testing</td>
</tr>
<tr>
<td>Authorization</td>
<td>• Audit Trail, Access Level, Scope of Access, and Segregation of Duties</td>
</tr>
<tr>
<td></td>
<td>• Workflow</td>
</tr>
</tbody>
</table>
Is Your Lease Population Complete?

Leasing Subledger

IT & Data Center
Real Estate
Material Handling
Office Furniture
Vehicle Fleet
Medical Equipment
Retail Store Equipment
Aircraft
Manufacturing Equipment
Tracking Events throughout Lifecycle

REAL ESTATE LEASE CHANGES
- Change from Variable to Fixed
- Performance Based
- CPI
- LIBOR/SOFR
- Early Termination
- Floor Space Contraction
- New Sub Lease
- Floor Space Expansion
- Leasehold Improvements
- Change to Business Plans
- Location Change
- Impairment
- Change to Residual Value
- Cost Center Change
- Partial Termination (Asset Removed)
- Lost or Stolen
- Evergreen
- Partial Renewal
- Buyout
- Termination
- Renewal
- Early Buyout
- Early Full Termination
- New Asset Added

EQUIPMENT LEASE CHANGES
- Change to Residual Value
- Cost Center Change
- Impairment
- Partial Termination (Asset Removed)
- Lost or Stolen
- Evergreen
- Partial Renewal
- Buyout
- Termination
- Renewal
- Early Buyout
- Early Full Termination
- New Asset Added

LEASED ASSET
- Change to Residual Value
- Cost Center Change
- Impairment
- Partial Termination (Asset Removed)
- Lost or Stolen
- Evergreen
- Partial Renewal
- Buyout
- Termination
- Renewal
- Early Buyout
- Early Full Termination
- New Asset Added
Periodic Attestation

- Data Center
- Logistics
- Operations
- Manufacturing
- Corporate IT

End of Term Plans
- Who to Ask?
  - Monthly
  - Quarterly
  - Semi-Annually

Physical Location
- When to Ask?
  - Monthly

Accounting Cost Center
- How Many to Verify?
  - 100 assets
  - 500 assets

Guaranteed Residual Value
- How Frequently to Remind?
  - Weekly
  - Daily

Configurable Business Rules
- Who to Ask?
  - Asset Owner
  - Asset Users
Day 1 vs Day 2

Day 1 Objective: Get compliant = initial balance sheet entries for portfolio
Day 1 vs Day 2

What is database?
2000 leases
47 countries
200 stakeholders

Objective: Get compliant = initial balance sheet entries for portfolio

2018 Close
Dec 31

US Public & IFRS Deadline
Jan 1

Day 1 Project

Audit 10K
**Day 1 vs Day 2**

**What is database?**
- 2000 leases
- 47 countries
- 200 stakeholders

**Objective:** Get compliant = initial balance sheet entries for portfolio

---

**Can do on manual spreadsheet**
Day 1 vs Day 2

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Day 1 Project
Audit 10K

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What is database?
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What were changes?
- 2000 leases
- 47 countries
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Can do on manual spreadsheet
Day 1 vs Day 2

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What were changes?
- 2000 leases
- 47 countries
- 200 stakeholders

Objective: Get compliant = initial balance sheet entries for portfolio

US Public & IFRS Deadline
- Jan 1

Close #1
- Jan 31

Close #2
- Feb 28

Close #3 Q1
- Mar 31

Changes?
- 2000 leases
- 47 countries
- 200 stakeholders

Can do on manual spreadsheet
# Example Lifecycle of One Lease

## Subsequent to initial recognition of ROU asset and liability

<table>
<thead>
<tr>
<th>Change to Lease</th>
<th>Required Accounting</th>
</tr>
</thead>
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<tr>
<td>1. Payment adjustment due to contingency resolution</td>
<td>Remeasure ROU asset/liability</td>
</tr>
<tr>
<td>2. Mid-term partial termination</td>
<td>Remeasure ROU asset/liability (Gain or Loss)</td>
</tr>
<tr>
<td>3. Payment adjustment due to CPI change</td>
<td>Remeasure ROU asset/liability</td>
</tr>
<tr>
<td>4. Change reasonably certain options assessment</td>
<td>Remeasure ROU asset/liability</td>
</tr>
<tr>
<td>5. Renegotiate lease and modifications</td>
<td>Remeasure ROU asset/liability</td>
</tr>
</tbody>
</table>

- **2000** Leases
- **47** Countries
- **200** Stakeholders
- Manual Process
The Result = Expensive Chaos

Subsequent to initial recognition of ROU asset and liability

<table>
<thead>
<tr>
<th>Change to Lease</th>
<th>Required Accounting</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Payment adjustment due to contingency resolution</td>
<td>Remeasure ROU asset/liability</td>
</tr>
<tr>
<td>2 Mid-term partial termination</td>
<td>Remeasure ROU asset/liability (Gain or Loss)</td>
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<tr>
<td>3 Payment adjustment due to CPI change</td>
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<tr>
<td>4 Change reasonably certain options assessment</td>
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<tr>
<td>5 Renegotiate lease and modifications</td>
<td>Remeasure ROU asset/liability</td>
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2000 Leases  
47 Countries  
200 Stakeholders  
Manual Process
Day 1 vs Day 2

Objective: Get compliant = initial balance sheet entries for portfolio

What is database?
2000 leases
47 countries
200 stakeholders

What were changes?
2000 leases
47 countries
200 stakeholders

Can do on manual spreadsheet
Day 1 vs Day 2

**Objective:** Get compliant = initial balance sheet entries for portfolio

**Day 1 Project**

- What is database?
  - 2000 leases
  - 47 countries
  - 200 stakeholders

- What were changes?
  - 2000 leases
  - 47 countries
  - 200 stakeholders

**Day 2 On-going Operations**

- US Public & IFRS Deadline Jan 1
- US Private Deadline Jan 1
- 2018 Close Dec 31
- Close #1 Jan 31
- Close #2 Feb 28
- Close #3 Q1 Mar 31
- Close #4 Apr 30
- Close #5 May 31
- Close #6 Q2 Jun 30
- Close #7 Jul 31
- Close #8 Aug 31
- Close #9 Q3 Sep 30
- Close #10 Oct 31
- Close #11 Nov 30
- Close #12 K Dec 31

**Objective:** Take cost, risk, and time out of the monthly close process

- Today
- Day 1 Project
  - Audit 10K Jan 1 - Feb 15
  - Audit Q1 Apr 1 - May 16
  - Audit Q2 Jul 1 - Aug 15
  - Audit Q3 Oct 1 - Nov 15

- Day 2 On-going Operations
  - Can NOT do manual
  - Audit K Jan 1 - Feb 15

- Can do manual
Now It’s Time for

LEASE ACCOUNTING 2.0
Automation vs FTEs

Manual Tasks = More People
- Timely tracking of new leases, changes, end of term
- Interacting with stakeholders for updates, approvals, recordation
- Reconciliation and tie-ups
- Manual allocation to cost centers, profit centers, project codes, etc.
- Upload of journal entries to ERP
- Manual controls and supervision

Automated Tasks = More Software
- IFRS 16 and ASC 842
- Asset-level lease accounting subledger
- Automated Lease classification
- Lease vs buy analysis
- Multiple parallel ledgers and charts of accounts
- Flexible GL coding for automated allocation
- Bulk data loader
- Fast integrations for GL, A/P, upstream systems
- Automated notifications and mailback
- Workflow and segregation of duties

Lower Cost of Ownership


Less Expensive. Lower Risk.
Straight Through Processing

ASSET MANAGEMENT
- Real Estate Administration
- IT Asset Management
- Fleet Management

LEASE ACCOUNTING SUBLEDGER
- Reconciliations
- Integration and APIs

PROCUREMENT
- Contract Management
- Procurement & Sourcing

ERP APPLICATIONS
- General Ledger
- Accounts Payable

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The Leasing Center of Excellence

**LEASE DEFINITION**
Testing of embedded leases for inclusion. Classification as operating or finance lease.

**INITIAL RECOGNITION & MEASUREMENT**
Classify and record initial journal entries after assessing commencement, term, payments, reasonably certain plans, IBR.

**MODIFICATIONS & REASSESSMENTS**
Rent and contractual changes. Reasonably certain end of lease plans.

**END OF LEASE RECORDATION**
Recording of journal entries to reflect end of lease renewal, termination, or buyout.

**MONTHLY CLOSE**
Subledger cutoff. Reconciliation and adjusting entries. General ledger upload.
The Big Challenge with Talent

2015

250 Experts

2020

250,000 Experts
Developing a Training Strategy

What?
- Business Impacts
- New Software
- Process Changes
- Policies and Controls

Who?
- Center of Excellence
- Asset Users

How?
- Online
- In Person Classroom
Potential Savings Opportunity

Over 15 Cost Savings Opportunities

Commercial Banks
Vendor Captives
Independents

Business Unit A
Business Unit B
Business Unit C
Business Unit D

Real Estate
Material Handling
IT and Data Center
Vehicle Fleet
Transportation
Poll #3

How will the time and effort your organization spends on lease accounting change in the first year after adoption?

a) Decrease - We will spend **Less** time

b) Increase - We will spend **More** time

c) No Change - We will spend the **Same** amount of time
International Flavors & Fragrances, Inc.

Company Snapshot
- 130 Year History
- $5 Billion Sales Revenue
- 13,000 Employees
- Located in 37 Countries
- Serving 162 Countries
- 90,000 Products
- 39,000 Customers

NYSE: IFF
Listed 54 Years
IFF was successful in complying with the new ASC 842 standard

No concerns from PwC, the auditor for IFF
The Project Management Office

**DATA COLLECTION**
Trained 60 individuals globally to gather leases and lease information

**SYSTEM EXPERTISE**
Gained expertise on the use of system to accomplish the goal of creating lease accounting information

**TRAINING**
Training on both the accounting standard and how to best gather lease accounting information

**COMPLIANCE**
Complied with ASC842 and to generate the footnote disclosure for the From 10-Q
Key Challenges to Overcome

60 GLOBAL COLLEAGUES

50 LEGAL ENTITIES

35 FOREIGN CURRENCIES

CENTRALIZED TREASURY

COMPLETENESS & ACCURACY

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Key Processes

- Lease Info from Local Teams
- Disbursement journals & Accounts Payable
- Practical Expedients
- Incremental Borrowing Rates
- System Inputs & Outputs
- Recalculate Lease Liabilities & ROU Assets
- Completeness of Population in System
- Cradle-to-Grave Ledger Export Testing
- Posting by Entity in LC
IFF’s March 2019 10-Q

At the Transition Date

IFF recorded a

- Right of use asset of ~$308 million
- Total operating lease liabilities of ~$313 million

All the data was generated through the use of LeaseAccelerator
# IFF Balance Sheet Highlights

**Lease liabilities of ~$390M**

**ROU assets, net of depreciation ~$300M**

---

Supplemental balance sheet information related to leases was as follows:

<table>
<thead>
<tr>
<th>(Dollars in Thousands)</th>
<th>March 31, 2019</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Operating Leases</strong></td>
<td></td>
</tr>
<tr>
<td>Operating lease right of use assets</td>
<td>$300,888</td>
</tr>
<tr>
<td><strong>Other current liabilities</strong></td>
<td>37,198</td>
</tr>
<tr>
<td>Operating lease liabilities</td>
<td>266,569</td>
</tr>
<tr>
<td><strong>Total operating lease liabilities</strong></td>
<td>$303,767</td>
</tr>
</tbody>
</table>
### IFF Footnote Disclosure

**ROU Assets disaggregated by region for footnote disclosure**

Right of use assets by region were as follows:

<table>
<thead>
<tr>
<th>Region</th>
<th>March 31, 2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>North America</td>
<td>$142,748</td>
</tr>
<tr>
<td>Europe, Africa and Middle East</td>
<td>$120,785</td>
</tr>
<tr>
<td>Greater Asia</td>
<td>$23,151</td>
</tr>
<tr>
<td>Latin America</td>
<td>$14,204</td>
</tr>
<tr>
<td><strong>Consolidated</strong></td>
<td><strong>$300,888</strong></td>
</tr>
</tbody>
</table>
Operating lease cost ~$12.4M
Operating cash flows from operating leases ~ $11.1M

(DOLLARS IN THOUSANDS)

<table>
<thead>
<tr>
<th>Description</th>
<th>Three Months Ended March 31, 2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operating lease cost</td>
<td>$12,469</td>
</tr>
</tbody>
</table>

Supplemental cash flow information related to leases was as follows:

(DOLLARS IN THOUSANDS)

<table>
<thead>
<tr>
<th>Description</th>
<th>Three Months Ended March 31, 2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash paid for amounts included in the measurement of lease liabilities:</td>
<td></td>
</tr>
<tr>
<td>Operating cash flows from operating leases</td>
<td>$11,076</td>
</tr>
</tbody>
</table>

Supplemental balance sheet information related to leases was as follows:
IFF Quantitative Disclosures

Weighted average remaining lease term 11.9 years
Weighted average discount rate 3.75%

<table>
<thead>
<tr>
<th></th>
<th>Weighted Average Remaining Lease Term (in years)</th>
<th>Weighted Average Discount Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operating leases</td>
<td>11.9</td>
<td>3.75%</td>
</tr>
</tbody>
</table>

Maturities of lease liabilities were as follows:

(DOLLARS IN THOUSANDS)                                                                 |
| Less than 1 Year         $37,680                                                       | March 31, 2019 |
| 1-3 Years                77,037                                                       |
| 3-5 Years                65,087                                                       |
| After 5 years            211,387                                                      |
| Less: Imputed Interest   (87,424)                                                        |
| Total                    $303,767                                                      |
Poll #4 - Presentation

How will you present your Operating ROU assets and Lease Liabilities on your statement of financial position?

a. Separate line item for ROU assets and separate line items for the current and the long-term Operating Lease Liabilities
b. Everything is combined with other line items on the statement of financial position (PPE, current or long term liabilities) and we disclose details in a separate Lease footnote only

Our ROU Asset is separately disclosed, but only the long-term Operating Lease Liability is separately disclosed. We combine the current Operating Lease Liability with another line item such as “other current liabilities”

d. Other presentation

(ASC 842-20-45-1 permits disclosure in the notes in lieu of separate presentation on the balance sheet)
Questions
Contact Information

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