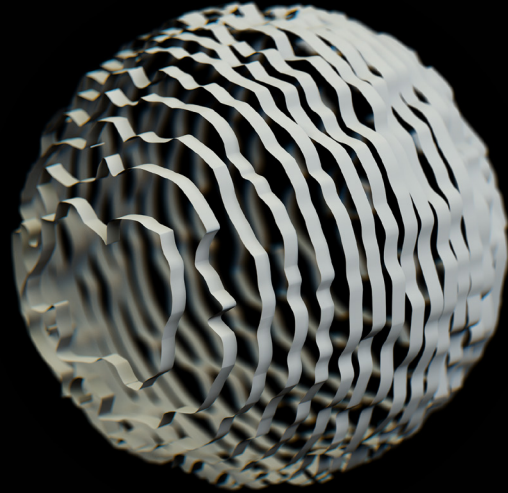


More than a footnote

Disclosure is a complex challenge that requires early attention when adopting the new lease accounting standard



Disclosures under the new lease accounting standard (ASC 842) are intended to give financial statement users a better understanding of an entity's leasing activities, helping them "assess the amount, timing, and uncertainty of cash flows arising from leases."¹ However, achieving that objective and satisfying the new standard's disclosure requirements can be a significant challenge.

Although disclosure was also a critical aspect of ASC 840, many users found the required information to be inadequate. ASC 842 therefore contains new and expanded disclosure requirements that are significantly more comprehensive and complex than before.

Learning from revenue recognition

When adopting the new revenue recognition standard, many companies didn't consider disclosures until late in the implementation process. For many, their main focus was on implementing complete and accurate accounting models for recognition and measurement, which left them scrambling at the deadline to meet the disclosure requirements.

As with revenue recognition, qualitative disclosures under the new lease accounting standard are extensive and require technical analysis and a deep understanding of quantitative models. To avoid last-minute fire drills, companies should make an active effort to understand the disclosure requirements early in the implementation process—ideally prior to selecting a technology vendor and platform. This early effort might even include drafting qualitative disclosures to gain a first-hand understanding of the requirements and challenges.

"To avoid last-minute fire drills, companies should make an active effort to understand the disclosure requirements early in the implementation process."

Common pitfalls in disclosure planning—and how to avoid them



Not giving disclosure requirements a "seat at the table" when performing technology selection.

A vendor's technology platform might be able to produce the required journal entries—but can it produce the disclosures? Can it produce them accurately? Consider testing the output from software vendors' demo environments to specifically ensure they can satisfy the disclosure requirements.



Failing to consider materiality of disclosures.

Disclosure requirements are extensive and open-ended; however, more is not necessarily better. Disclosing immaterial information is not only a waste of time and effort, it can obscure the disclosures that truly matter. When deciding what information to disclose—and how much detail to provide—carefully consider what is most appropriate and useful for meeting the disclosure objectives.



Thinking that interim disclosure requirements apply for the first quarter of adoption.

ASC 842 allows entities to skip some of the prescribed disclosures for interim financial statements; however, SEC rules and staff interpretations require SEC registrants to provide both interim and annual disclosures in the first interim period after adopting a new accounting standard (and in each subsequent quarter in the year of adoption). As a result, a calendar-year-end SEC registrant will need to comply with ASC 842's full suite of disclosure requirements for every quarter of the first year, starting with the quarter ended March 31, 2019.



Believing the new disclosure requirements only affect lessees, not lessors. Although it is true that the new standard's changes have a much bigger impact on lessees from a financial statement perspective (i.e., many more leases will be captured on the balance sheet), lessors may need to make changes as well. In many cases, lessors will already have the required information but need to assemble it in different ways. For example, they will need to show the components of net investments in leases for sales-type and direct financing leases.



Assuming disclosure requirements only apply to leases reported on the balance sheet. There is a common misconception that disclosures are not needed if a lessee elects to exercise the short-term lease exemption. In reality, lessees are required to disclose the amount of the lease expense associated with short-term leases. Similarly, variable lease expense is not included in the right-of-use (ROU) asset and lease liability, but must be disclosed.



Forgetting about pre-adoption disclosures for public companies. SEC regulations require pre-adoption disclosures to include a description of: (1) the effect of any accounting policies the registrant expects to select upon adopting the ASU; (2) how such policies may differ from the registrant's current accounting policies; and (3) the status of the registrant's implementation process—including the nature of any significant implementation matters that have yet to be addressed. Also, disclosures are expected to be more robust as ASC 842's effective date approaches.



Failing to address recently approved changes to the transition and other lease accounting areas. Amendments to the leasing standard often affect disclosure requirements. One example is the practical expedient exempting companies from reflecting the application of ASC 842 in their comparative period reporting. Despite the exemption, the prior year ASC 840 future minimum rental table must be repeated in year-of-adoption financial statements as part of the transition election disclosure. Also, companies must ensure their lease disclosures in 2018 are complete and include all contracts that may contain leases. Another example is the practical expedient for lessors regarding separation of lease and non-lease components. Expedient elections might reduce the burden of certain recognition and measurement requirements, but could require a company to provide more expansive disclosures related to the expedients elected.

Getting disclosure right from the get-go

A preferred approach is to carefully consider disclosure requirements during the planning phase of a lease implementation project. In particular, disclosure should be a key factor when identifying the must-have features of a lease accounting technology platform.

When selecting and implementing a lease accounting solution, compliant disclosures should be viewed as an integral and essential output—not an afterthought. Collecting the right information to support disclosures at the front end can greatly improve efficiency, accuracy, and reliability at the back end.

Identify the necessary data elements—lease contract data, accounting estimates/assumptions, etc.—and then develop clear plans for capturing data from lease contracts, migrating from existing lease accounting databases, and developing key accounting estimates and assumptions. (Note: for many companies, computing the lease portfolio's weighted average discount rate or weighted average remaining lease term is a significant challenge).

For example, under the new standard, a lessee is required to calculate and disclose the weighted average remaining lease term and weighted average discount rate for its lease portfolio. For large lease portfolios, these are highly complex calculations that can be very difficult to manage, monitor, and control using spreadsheet-based solutions.

Incompletely or inaccurately identifying what data is needed not only puts your recognition and measurement model at risk, it also makes the disclosure requirements very difficult to achieve. *Garbage in, garbage out.*

While advanced planning for disclosures is a preferred approach, it's not too late to focus on them now. Quickly evaluating the information available and the capabilities of the technology system are key to determining the appropriate action plan for your company. If there are limits to the disclosure information, you still have time to determine if new reports can be generated or if a manual process needs to be established to compile the required information.

Navigating lease contracts is a complex task that requires both specialized skill and a deep understanding of the disclosure implications. Do not wait until the last minute to determine whether your company has the necessary capabilities and data to produce compliant disclosures. When selecting and implementing a lease accounting solution, make sure your effort is addressing all of the critical requirements—both for accounting *and* disclosure.

A closer look at ASC 842 disclosure requirements

To illustrate the complexity of the challenge, here is a high-level summary of the key disclosure requirements for lessees and lessors under the new leasing standard.

Key disclosure requirements for lessees

The lessee disclosure requirements can be further subdivided into the following topics:

Information about the nature of an entity's leases (including subleases).

- General description of leases.
- Basis and terms and conditions on which variable lease payments are determined.
- Terms and conditions of options to extend or terminate leases.
- Residual value guarantees.
- Restrictions or covenants imposed by leases.

Leases that have not yet commenced.

Significant assumptions and judgments.

- Whether a contract contains a lease.
- Allocation of consideration in a contract.
- Discount rate.

Amounts recognized in the financial statements.

- Finance lease cost.
- Operating lease cost.
- Short-term lease cost.
- Variable lease cost.
- Sublease income.
- Net gain or loss from sale-and-leaseback transactions.
- Cash paid for amounts included in measurement of lease liabilities.
- Supplemental noncash information.
- Weighted-average remaining lease term.
- Weighted-average discount rate.

Maturity analysis of liabilities.

Lease transactions with related parties.

Practical-expedient disclosure related to short-term leases.

Practical-expedient disclosure related to separating lease components.

Electing transition practical expedients:

- Hindsight practical expedient.
- Practical expedient package.

Election not to restate comparative periods upon adoption

Key disclosure requirements for lessors

The lessor disclosure requirements are further subdivided into the following topics:

Information about the nature of an entity's leases.

- General description of leases.
- Basis and terms and conditions on which variable lease payments are determined.
- Terms and conditions of options to extend or terminate leases.
- Existence of terms and conditions for a lessee to purchase a leased asset.

Significant assumptions and judgments.

- Whether a contract contains a lease.
- Allocation of consideration in a contract.
- Amount lessor expects to derive from underlying asset after the end of the lease term.

Lease transactions with related parties.

Residual asset and risk management.

Amounts recognized in the financial statements.

- Sales-type leases and direct financing leases.
 - Tabular disclosures.
 - Components of net investments in leases.
 - Significant changes in the balance of unguaranteed residual assets and deferred selling profit.
 - Maturity analysis of lease receivables.
- Operating leases.
 - Tabular disclosures.
 - Maturity analysis of lease payments.
 - Separate ASC 360 disclosures.

Let's talk:

For additional information regarding the above and other interpretative guidance related to the lease standard, contact:



Jeanne McGovern
Audit & Assurance Partner
Deloitte & Touche LLP
+1 201 761 3625
jmcgovern@deloitte.com



James Barker
Audit & Assurance Partner
Deloitte & Touche LLP
+1 203 761 3550
jabarker@deloitte.com



Sean Torr
Managing Director
Deloitte & Touche LLP
+1 615 479 1459
storr@deloitte.com

www.deloitte.com/us/audit

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