

ASC 842 (Lease) Overview for Lenders

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Today's Presenters



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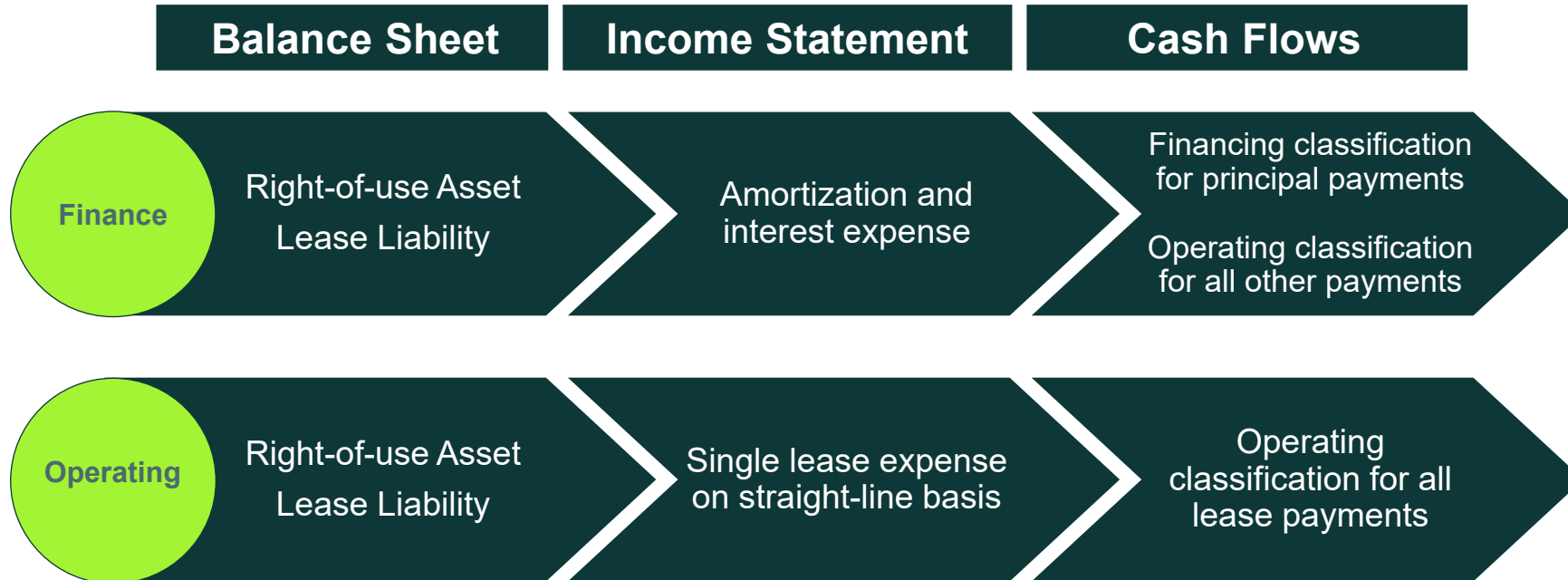


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Lessee – Financial Statement Impacts



**Recognition and measurement option for short-term leases*

Financial Statement Presentation

Operating Lease

Finance Lease

Gross presentation of ROU assets and lease liabilities for operating and finance leases
(comingling prohibited)

Single straight-line lease expense
(payments)

Front-loaded interest and straight-line
amortization expense (ROU asset)

Operating cash flow classification for all
payments

Financing cash flow classification for
principal payments; operating classification
for interest and variable payments

Lease liability is not “debt or debt-like”

Lease liability is the equivalent of debt



Finance Lease Example

	Beginning of Year 1	End of Year 1	End of Year 2	End of Year 3	Total
Income Statement					
Interest expense		\$1,482	\$1,007	\$511	\$3,000
Amortization expense		\$15,000	\$15,000	\$15,000	\$45,000
Total period expense		<u>\$16,482</u>	<u>\$16,007</u>	<u>\$15,511</u>	<u>\$48,000</u>
Balance Sheet					
Right-of-use asset (noncurrent)	<u>\$45,000</u>	<u>\$30,000</u>	<u>\$15,000</u>	<u>-</u>	
Finance lease liability – current portion	\$14,518	\$14,993	\$15,489	-	
Finance lease liability – noncurrent portion	<u>\$30,482</u>	<u>\$15,489</u>	<u>-</u>	<u>-</u>	
Total period expense	<u>\$45,000</u>	<u>\$30,482</u>	<u>\$15,489</u>	<u>-</u>	
Statement of Cash Flows					
Operating Cash Flows - Interest remains in cash flows from operating activities and disclosed as cash paid for interest		\$1,482	\$1,007	\$511	\$3,000
Financing Cash Flows – Finance lease “principal payments”		\$14,518	\$14,993	\$15,489	\$45,000
Total cash outflows		<u>\$16,000</u>	<u>\$16,000</u>	<u>\$16,000</u>	<u>\$48,000</u>

Assumes: Three year equipment lease with annual payment amount of \$16,000 due at end of each year, approximate interest rate of 3.3%, equals present value of \$45,000. Lease commencement is day 1 of Year 1, no lease incentives or IDCs.



Operating Lease Example

	Beginning of Year 1	End of Year 1	End of Year 2	End of Year 3	Total
Income Statement					
Lease expense		\$16,000	\$16,000	\$16,000	\$48,000
Balance Sheet					
Right-of-use asset (noncurrent)	\$45,000	\$30,482	\$15,489	-	
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Operating lease liability – noncurrent portion	\$30,482	\$15,489	-	-	
Total period expense	\$45,000	\$30,482	\$15,489	-	
Statement of Cash Flows					
Operating Cash Flows – Lease payments remain in cash flows from operating activities		\$16,000	\$16,000	\$16,000	\$48,000

Assumes: Three year office lease with annual payment amount of \$16,000 due at end of each year, approximate interest rate of 3.3%, equals present value of \$45,000. Lease commencement is day 1 of Year 1, no lease incentives or IDCs.



Comparison – Finance vs. Operating

	Beginning of Year 1	End of Year 1	End of Year 2	End of Year 3	Total
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Operating Lease					
Operating Cash Flows – Lease payments remain in cash flows from operating activities		\$16,000	\$16,000	\$16,000	\$48,000



Impact on Ratios

FINANCIAL RATIO	IMPACT
Current Ratio (current assets / current liabilities)	DECREASE: addition of noncurrent asset and current/noncurrent liability
Fixed Charge Ratio (total fixed charges / EBITDA)	UNCHANGED: dependent on definition of EBITDA and what is included within “fixed charges.”
Debt/Tangible Net Worth: (debt / tangible assets less total liabilities)	INCREASE: right of use asset not considered a tangible asset, but lease liability included in liabilities. Dependent on definition of “debt.”
Leverage Ratio: (debt minus cash / EBITDA)	LIKELY INCREASE: dependent on what is included within the definition of “debt.”



What We've Seen With Clients

- 1) Companies were slow to adopt internally, often resulting in posted audit adjustments to record the adoption.
- 2) Often an annual exercise, which may affect interim financial reporting to lenders.
- 3) Not all debt covenants are written/treated equally.
4. Lease transactions (economics) have NOT changed, just the required accounting.





QUESTIONS?



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THANK YOU