

**Overview of the Final Lease Accounting Standard Web Seminar
February 9, 2016
Q&A Transcript**

- **Why did the FASB target Leveraged Lease accounting? Is there a chance to repeal this view before the implementation date?**
 - There were several reasons. They said that there is no other situation where netting of non-recourse debt is allowed, where income was allocated on an after tax basis, it is very complicated, and some did not fully understand the basis for the accounting. In the end 3 board members voted to keep it.

- **Is there a possibility that the FASB could revisit this position at some point and consider preserving Leveraged Lease Accounting?**
 - No. It is extremely doubtful they will take up the issue again.

- **What is the last expected date to execute Leveraged Lease transactions and still qualify for grandfathering?**
 - The day before the transition date is the last day a lessor can do a leveraged lease and get it grandfathered. The transition date is 1/1/2019 for companies with calendar year ends.

- **After the effective date, can a grandfathered Leveraged Lease be sold to a third party where the buyer is able to continue Leveraged Lease Accounting?**
 - Yes, we believe a leveraged lease retains its classification when sold.

- **Is the treatment of RVG for IFRS Lessee accounting the same as FASB Lessee accounting, which is to recognize “Expected Payment under RVG”?**
 - Yes.

- **How can a lessee evaluate “Expected Payment under RVG” for Lessee accounting? Is the third party appraisal by Lessee required?**
 - The lessee will have to support its valuation and external data usually carries the most weight. There may be published data to rely on or possibly recent sales. A lessee may be able to use information from dealers, appraisers, auctioneers, etc.

- **Is the RVG in any way encompassing the Significant Economic Incentive concept?**
 - No connection.
- **How often does a lessee (or lessor) need to reevaluate how much the lessee is expected to pay under a residual value guaranty by lessee (i.e., a split TRAC)**
 - Whenever they report earnings to the public.
- **Can you please clarify treatment of IDC? Will it only be Third Party costs that are now allowed?**
 - IDC will be very limited in the future. Sales force bonuses will be included, but legal fees will generally be excluded.
- **Please repeat new accounting of an operating lease.**
 - The initial accounting is to measure the amount to be booked by present valuing the lease payment using the lower of the lessee's incremental borrowing rate or the implicit rate in the lease if known (most often that rate is not known as the lessee does not know the lessor's residual assumption – exceptions are in a TRAC, synthetic or split-TRAC leases where the lessee knows the TRAC amount). The P&L will reflect the level rent expense, similar to today's accounting. The balance sheet accounts will not need to flow through/articulate through the P&L.
- **What is an EBO?**
 - An EBO is an early buyout option. It is a fixed price non – bargain purchase option that may be offered by the lessor or may be asked for by the lessee. Since it is set at an amount that at inception is not considered a bargain it is not included as a lease payment
- **Will EBOs be treated the same as end-of-term Fixed Price Purchase Options?**
 - Yes, the treatment is meant to be the same as under today's rule. The treatment of any purchase option depends on whether the lessee is reasonably assured to exercise it.
- **Will conditional sales leases be accounted for as leases or loans?**
 - Conditional sale leases will be accounted for as leases, but will be considered Finance Leases. The asset will be a ROU (right of use) finance lease asset and the lease liability will be reported as debt.

- **Can we get a little more specific about the implications of structural changes on the sale leasebacks for lessors?**
 - The key element that the new rules is that the Revenue Recognition rules will generally govern sale treatment determination. A fixed price lessee purchase option will prevent sale treatment while a FMV option will not preclude sale treatment. If the lease contains a fixed price purchase option it may be possible to assert the lessee is acting as an agent rather than a principal in the transaction that originated shortly after the asset is delivered. If the lessee is merely acting as an agent, then the transaction is not a sale leaseback but rather it is merely a lease. To be considered an agent there can be no profit element, the transaction has to occur at or near delivery of the asset and there has to be an agent agreement in place.

- **If all leases are now on balance sheet, why are we still using the term "operating lease" since this is synonymous with "off balance sheet?" Why don't we use "capital lease" and "capital lease w/FMV option" as an example?**
 - The FASB has decided to keep the “2 lease” model to differentiate finance leases from operating as their economic substance is different. They decided to keep the current terminology.

- **Can you expand on the implications for sale type leases under the new standard?**
 - Under Topic 842, only those leases that qualify for classification as a finance lease without the use of third party involvement (i.e., residual insurance) are sales type leases for which the lessor can recognize the gross selling profit up front. Those leases that qualify as a finance lease through the use of third party residual insurance will still be classified finance leases, but the “selling profit” will be recognized as part of finance lease interest revenue over the lease term. This is still a better outcome than if the lease is an operating lease where the gross profit is straight lined over the lease term.

As a result of the change, lessors who regularly use third party residual insurance to qualify for sales-type lease accounting should review the impact on sales and revenue projections. One alternative to accelerate the selling profit under Topic 842 is to use a third party vendor lessor and sell them the asset or the leases. The tradeoffs in using a third party vendor lessor may be loss of control of the customer relationship, loss of deferred margin credit and loss of finance and residual upside revenues, but those arrangements may be structured in many ways to overcome the tradeoffs. Come to the March 2 ELFA conference in Baltimore for more details.

- **Can we see the slides?**
 - Replay is available:
<https://www.youtube.com/watch?v=TY8nABFnJNU&feature=youtu.be>

- **Can you confirm IASB will require operating leases be labeled as debt on the lessee balance sheet and included in debt/equity ratio calculations per slide 24?**
 - The IASB does not term the obligation debt and the standard provides that “lease liabilities [will be presented] separately from other liabilities. If the lessee does not present lease liabilities separately in the statement of financial position, the lessee shall disclose which line items in the statement of financial position include those liabilities.”

- **To what extent do you expect tax and contract law will follow lease accounting changes in particular with the changes to sale leaseback changes.**

Do you expect any changes to tax laws related to tax leases?

 - We do not expect tax or commercial law to change.

- **What are the effects if any on the tax status of a lease? Will they eventually remain the same?**
 - There will be no change in the IRS or state/ local tax views of leases.

- **Is Interim rent calculated in the 90% test?**
 - It should be included

- **Would subsidies/blind discounts impact the implicit rate, similarly how IDC will now?**
 - Subsidies and discounts are reflected in the cost of the equipment used to calculate the implicit rate in the lease.

- **Why is the current and quick ratio impacted under FASB rules? This is listed as a long term liability, right?**
 - The short term portion of the lease liability will be included in current liabilities.

- **Will the Lessor be able to amortize lease direct costs over the term of the Lease?**
 - Yes as long as they qualify as initial direct costs under the new definition. If the lease is a finance lease, the costs will be factored into the lessor’s implicit rate.

- **Question on "6 things lessee should know" "#4 Expected payment under RVG is a lease payment". To make sure, what's the implication of this? Does this mean Expected payment under RVG has to be on-balance sheet or vice versa? If it has to be on-balance, if there any consideration of economic disincentive to exercise purchase option?**
 - The implication is - despite the fact that operating lease payments will be capitalized (put on balance sheet) only the EXPECTED payment – as opposed to the maximum amount which is used for lease classification today -- under a lessee residual guarantee is considered a payment to be capitalized under the new rules. This is good news as one could imagine the alternative view that the full amount of the guarantee should be capitalized. If there is a purchase option present in the lease, the lessee must assess whether it is reasonably certain that they will exercise it, meaning it is a bargain or they are economically compelled to exercise it - if so it would be included as a lease payment and capitalized (this is no different than the current rules).

- **What are the criteria re: Leveraged Lease grandfathering (especially in terms of future sales of a grandfathered leveraged lease).**
 - A leveraged lease that is in existence at the lessor's transition date will remain classified as a leveraged lease. The classification also survives for any subsequent buyer of that lease.

- **What is the best write up or white paper that is current for us in the industry to read for more detail and examples to what you have covered today.**
 - The ELFA issued a white paper
http://www.elfaonline.org/Issues/Accounting/EC/AcctgWhitePaperLeasingBenefits_final.pdf.
 - For more information look at the following websites:
<http://www.elfaonline.org/Issues/Accounting/> and <http://www.leasing-101.com/>

- **Is it correct that IDC for leases will be different than IDC that we currently see for loans?**
 - Yes as the current concept draws on the Revenue standard guidance. IDC will therefore be different from the definition applied to loans.

- **Lessor Question: Please elaborate on what will be considered IDC under new rules and what happens to IDC capitalized under old rules sitting on the balance sheet (grandfathered?).**
 - Under the new rules only third party costs incurred in winning and executing the lease are deferred. If you take advantage of the transition relief package you do not have to go back on existing leases and restate IDC for the new definitions.

- **Will the new standards end the need for split-TRAC leases on transportation equipment?**
 - No a split-TRAC will be an operating lease under the new rules (not debt and with straight line rent expense) while a TRAC lease will be a finance lease (the liability is debt and the P&L cost is front loaded. Both will be capitalized but the lessee will still be motivated to do the split-TRAC.

- **For the Operating Lease treatment - I assume the Asset will need to be amortized and the lease liability will need to be reduced over the term. What is the basis of the breakout of the Single lease expense between accumulated amortization and lease liability reduction?**
 - The asset and liability will not articulate through the income statement. There will not be amortization and interest expense in the P&L.

- **If interim rent is documented in a separate agreement for a period not defined in the lease then would it still be considered when determining if the lease is an operating lease?**
 - The FASB combines relates contracts so that is not a solution. They look at the substance of the contracts.

- **Do you need to make the same election as both lessee and lessor for the FASB relief package?**
 - Yes

- **Any guidance on construction term accounting for real estate assets expected in the new draft?**
 - We are not sure what will be included for build to suit leases.

- **Where can I read about the new rules for IDC capitalization?**
 - For more information look at the following websites:
<http://www.elfaonline.org/Issues/Accounting/> and <http://www.leasing-101.com/>

- **Does the determination of the discount rate for purposes of calculating present value of rent payments change?**
 - No, it is the lower of the lessee's incremental borrowing rate or the implicit rate in the lease if it is known to the lessee.

- **Are there any software products you know to manage these new processes?**
 - Yes, there are a number of lessor and lessee accounting systems – see the ELFA website for help: http://www.elfaonline.org/cvweb_elfa/cgi-bin/organizationdll/List? MULTIPLE_ORGCLASSSTT=SF&ISMEMBERFLG=Y&NOWEBFLG=N&RANGE=1%2F10&SORT=ORGNAME&WBP=OrgMemberListing.htm&WHP=SF_header.htm

- **Short Term Rental exemption, is that for leases with less than 12 months remaining when the new rules are effective, or must the lease docs reflect a 12month or less lease term?**
 - It will determine when a NEW lease should be capitalized. It will be based upon the accounting determination of lease term. Renewals are only included if they are considered to be reasonably assured.

- **If a lessee sells and leases back an asset with a fixed price purchase option resulting in a failed sale and leaseback, what happens if the lease payments are substantially less than the sales price of the asset? Example, leaseback is only 50%.**
 - The asset remains on the lessee's books and the lease is treated as a loan – in the case cited the loan amount would be 50% of the asset's value.

- **How does interim rent affect classification?**
 - An interim rent is a lease payment and must be included in the classification test calculations as well as the calculation to book capitalize the lease. The same rules exist now but people erroneously/conveniently ignore interim rents today.

- **Going forward, should we use the term finance leases or capital/DFL leases?**
 - For lessees the terms will be Finance or Operating
 - For lessors the terms will be Direct Finance or Operating

- **Will the residuals for open ended FMV lease transactions need to be accounted for the same as residual value guarantees?**
 - For lessors yes. For lessees – no accounting for FMV residuals; for RVGs only book the amount you expect to have to pay.

- **Re leveraged leases ...if I enter into a lev lease in 2017 can I use the current method forever?**
 - Yes, but we believe changes in the lease may cause a lessor to lose leveraged lease accounting

- **Will a test be done to determine what constitutes a Sale Lease Back?**
 - Yes. The first test is whether or not there is a sale (the lessee must transfer risks and rewards and not keep control as would be the case if they had a right to buy the asset back for a fixed price). Assuming the sale criteria are met, then the leaseback is tested to see if it is a finance lease or operating lease.

- **On leases that include service or maintenance or other pass through charges and the payment appears on the lease agreement as one payment, do these lease document now need to have the payments broken out on the agreement or is it only at the request of the lessee if they are trying to determine the classification.**
 - The lease need not breakout the components of the payment but it is in the best interest of the lessee to separate the components as it means that less is capitalized as a lease payment. The lessee is likely to ask for a breakdown to do the calculation and support it to its auditors.

- **My focus is specific to the large truck leasing business, but will operating leases that have maintenance included? Most have flat monthly fees and also mileage rates, so it doesn't seem to be clear how this will change. Thanks.**
 - For full service bundled payment the lessee will want to separate the components and only capitalize the lease component. The non-lease components (service, maintenance) will be off balance sheet and accounted for on a cash basis (that is when they are incurred/paid). Taxes and insurance may need to be a component of the lease liability.

- **My understanding is that to get benefit of operating lease that is under 12 months, that must include ALL renewal terms, so it won't matter what historical pattern or expectation is because if the renewal option is there, my understanding is that it won't be treated as less than 12 months lease. Is that true?**
 - The term in the twelve month lease exemption includes only renewals that are reasonably expected to be exercised. This means you exclude non-bargain renewals and renewals where the lessee is not economically compelled to renew. There will be more scrutiny of the lease term due to the fact that operating leases with terms longer than twelve months are capitalized. We expect that if a lessee under a 12 month lease with options to renew always renews beyond twelve months, the auditor will consider that and set a longer lease term to test lease classification and to capitalize the lease.

- **Can a Lessor who operates globally adopt either Standard - IASB or FASB?**
 - The lessor must adopt the standard that its parent company reports under or what is also required in its separate financial statements, locally. If it has no parent company it uses the standards it reports under when it prepares financial statements.

- **Can you restate for the impact of residual value insurance on the lessor in transition?**
 - Any lease that had RVI purchased at its inception will continue to account for that lease without reconsidering the classification in transition if it is a direct finance lease. If the RVI was needed to get sale-type lease classification, then the lessor must adopt the transition relief package to avoid having to reassess the lease classification and lose (restate for) the upfront gain recognition.

- **Clarifying interim rent, is interim rent included with the PV of rents for the Oplease vs Caplease test?**
 - Yes, interim rent is a rent payment for classification test purposes and for calculating the capitalized amount to book the operating lease on balance sheet.

- **How will computer related operating leases be defined going forward? Still via the PV of 90% and 75% useful life?**
 - Yes, the FASB is keeping in the basis for conclusion the guidance that one can use 90% when judging the PV of payments vs the fair value/cost and 75% when judging the term vs the useful life. This guidance is expected to be in the basis for conclusions and will not be in the core standard.

- **Lessor Question: Are Operating leases still capitalized and depreciated on P&L like they currently are?**
 - Yes – no change to operating lease accounting for lessors.