

Implementation of the New Lease Accounting Standard, ASU 2016-02

What's the Impact on Your Health Care Organization?

June 7, 2017

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AGENDA

Introduction by Monique Showalter, AHA Health Forum

Implementation of the New Lease Accounting Standard, ASU 2016-02
What's the Impact on Your Health Care Organization?

Kelly Thompson, CPA

Principal

The Bonadio Group

Question and Answer Session

ABOUT THE AHA ENDORSEMENT

Health Forum is dedicated to identifying solutions that help hospitals in their efforts to support the Triple Aim of better care, better health and lower cost.

Through the proprietary *AHA Signature Due Diligence Process*[™], we assess products and services with rigor and award the AHA exclusive endorsement to the solutions that excel in all areas of the evaluation process.



Equipment Financing from First American Healthcare Finance have earned the exclusive Endorsement of The American Hospital Association.

ABOUT THIS WEBINAR

This educational event has been developed by the AHA, together with **First American Healthcare Finance** and **The Bonadio Group**. We thank these organizations for their willingness to share their expertise.



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CPE Requirements

- Three participation/poll questions must be answered to receive CPE credit
- Complete the evaluation after the course
- You will receive your CPE certificate from First American Healthcare Finance within the next week



Kelly Thompson

Kelly has been with The Bonadio Group since 2000. She is a principal in the Professional Excellence Division. Her experience includes financial statement audits, technical quality control reviews, single audits, financial reporting, and other compliance and regulatory reporting for health and human service organizations, foundations, healthcare, and educational institutions.

She also heads up the firm's continuing professional education function, which includes compliance monitoring, and planning and development of the firm's training curriculum.

Kelly has been presenting on various topics to audiences within and outside of the firm for over ten years. Kelly received her BS degree in accounting from SUNY Geneseo, and she is a member of the American Institute of Certified Public Accountants and New York State Society of CPAs.



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What's the Impact on Your Health Care Organization?

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Effective Dates



- Public Business Entities*
 - Years beginning after December 15, 2018

- All Other Entities
 - Years beginning after December 15, 2019

* NFP conduit bond obligors are included in earlier effective date

What does Year 1 Look Like?

- At implementation date, all existing leases will be recorded on your statement of financial position
 - Right of Use (ROU) Asset
 - Lease Obligation Liability
- Restatement of prior periods shown
- Increased disclosures

Polling Question #1

Did you attend last summer's AHA webcast or any other webcast on the new lease standard?

1. Yes
2. No

Overview

- Primarily affects lessees
- Lessor accounting mostly unchanged
- What does it NOT apply to?
 - Intangible assets
 - Mineral, oil, natural gas exploration
 - Biological assets (timber)
 - Inventory
 - Assets under construction

Overview (Cont.)

- Majority of leases will result in the following balance sheet changes:
 - Right-of-use asset
 - Lease obligation
- Exception for leases 12 months or less
- New definition of a lease

Definition of Lease

A contract, or part of a contract, that conveys the right to control the use of identified property, plant, or equipment (an identified asset) for a period of time in exchange for consideration



Identified Asset



- Stated explicitly or implicitly
 - May be a portion of a larger asset
- No substantive substitution rights for lessor

Identified Asset (Cont.)

Are there *substantive substitution rights*?

Yes if the lessor has both of these:

- Practical ability to substitute
- Economic benefit from substitution

Lessor can substitute for operational failure without triggering these criteria

Control

Does Lessee have **control**?



Customer must have both of these:

- Substantially ALL economic benefit of asset
 - Direct or indirect uses
- Right to direct use of asset
 - Protective rights okay

Finance Leases

- The lease transfers ownership of the asset to the lessee by the end of the lease term
- The lease grants the lessee an option to purchase the asset that the lessee is reasonably certain to exercise
- The lease term is for the major part of the remaining **economic life** of the underlying asset
- The present value of the sum of the **lease payments** equals or exceeds substantially all of the **fair value** of the asset
- The asset is of such a specialized nature that it is expected to have no alternative use to the lessor at the end of the lease term

Polling Question #2

Do you think you have contracts that are currently classified as leases that won't be under the new standard?

1. Yes
2. No
3. Not sure yet

Statement of Financial Position

- ROU Asset = Lease obligation
- Measured at the **Present Value** of lease payments
 - Fixed payments
 - Variable payments based on index
 - Option to purchase
 - Other items

Statement of Activities

- Finance Leases:
 - Amortization of ROU asset
 - Interest on lease liability

- Operating Leases:
 - Single Lease cost



Easy Lease Example

Leased equipment for 10 years
Payments of \$10,000 annually
Incremental borrowing rate of 5%

Initial Entry:

DR: ROU Asset \$77,217

CR: Lease obligation \$77,217

Operating Lease Example

Entry for First Payment:

DR: Lease expense	\$10,000
CR: Cash	\$10,000
DR: Lease obligation	\$6,139
CR: ROU Asset	\$6,139

Operating Lease Example

Entry for Second Payment:

DR: Lease expense	\$10,000
CR: Cash	\$10,000
DR: Lease obligation	\$6,446
CR: ROU Asset	\$6,446

Finance Lease Example

Entry for First Payment:

DR: Interest expense	\$3,861
DR: Amortization expense	\$7,722
DR: Lease obligation	\$6,139
CR: ROU Asset	\$7,722
CR: Cash	\$10,000

Finance Lease Example

Entry for Second Payment:

DR: Interest expense	\$3,554
DR: Amortization expense	\$7,722
DR: Lease obligation	\$6,446
CR: ROU Asset	\$7,722
CR: Cash	\$10,000

Easy Lease Example Comparison

	Operating	Finance
Initial Liability and ROU	\$77,217	\$77,217
Lease expense- Year 1	10,000	\$11,583
Liability- After Year 1	\$71,078	\$71,078
ROU- After Year 1	\$71,078	\$69,496
Lease expense- Year 2	10,000	\$11,276
Liability- After Year 2	\$64,632	\$64,632
ROU- After Year 2	\$64,632	\$61,774

Components of a Contract

- Required to separate components of a contract between lease and nonlease components
- Allocate consideration of contract to lease and nonlease components
 - Standalone price of components
- Practical expedient



Lease Example with Components

Leased equipment and maintenance service for 10 years

Payments of \$10,000 annually

Incremental borrowing rate of 5%

	Equipment	Maintenance
Standalone prices	\$ 9,000	\$ 2,000
Percentage of total	82%	18%
% of total payments of \$10,000	\$ 8,182	\$ 1,818

Lease Example with Components

Initial Entry:

DR: ROU Asset \$63,178

CR: Lease obligation \$63,178

Operating Lease with Components

Entry for First Payment:

DR: Lease expense	\$8,182
CR: Cash	\$8,182
DR: Lease obligation	\$5,023
CR: ROU Asset	\$5,023
DR: Maintenance expense	\$1,818
CR: Cash	\$1,818

Finance Lease with Components

Entry for First Payment:

DR: Interest expense	\$3,159
DR: Amortization expense	\$6,318
DR: Lease obligation	\$5,023
CR: ROU Asset	\$6,318
CR: Cash	\$8,182
DR: Maintenance expense	\$1,818
CR: Cash	\$1,818

What if we didn't separate components?

	Oper- separate	Oper- not separate	Finance- separate	Finance- not separate
Initial Liability and ROU	\$63,178	\$77,217	\$63,178	\$77,217
Lease expense- Year 1	\$8,182	10,000	\$9,477	\$11,583
Liability- After Year 1	\$58,155	\$71,078	\$58,155	\$71,078
ROU- After Year 1	\$58,155	\$71,078	\$56,860	\$69,496

Polling Question #3

What do you think will be the most time-consuming item for implementation?

1. Gathering all of your lease agreements
2. Determining whether the definition of lease is met
3. Categorizing between finance and operating
4. Figuring out the journal entries/ amounts

Start Preparing Now!

- Gather all of your lease agreements
- Look for payment components/
complex items
- Review your processes
- Assess technology needs



Debt Covenants

Will my existing covenants be affected by the new lease standard?

- Review your agreements
 - Frozen GAAP
 - Debt vs. other liabilities
 - Talk to your lenders



WE INVITE YOUR QUESTIONS!

To submit a question, please type your question on the left-hand side of your presentation screen.

CONTACT US!

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