Lease Implementation Issues

Kirk Crews
Vice President, Controller & Chief Accounting Officer
NextEra Energy, Inc.

June 12, 2018
Agenda

- Highlights of New Lease Standard
- Industry Issues
- NextEra's Implementation Approach
- Observations and Lessons Learned
The key takeaway from the 485 page lease standard is that operating leases are now reported on the balance sheet

**Highlights of New Standard**

- **All operating leases on balance sheet**
- **Definition of a lease now requires**
  - Identified asset (same)
  - Customer gets substantially all economic benefits (same)
  - Customer has right to direct the use of the asset (new!)
- **Most variable lease payments are excluded when measuring**
  - Lease obligations
  - ROU assets for lessees
  - Lease receivables for lessors
- **No longer required to transfer title for real estate or integral equipment to be the subject of a sales-type lease**
  - Consistent with the real estate sales rules being eliminated by the new revenue standard
The new standard provides a number of transition options and practical expedients to ease implementation

**Transition Options**
- Option to not restate comparative periods (pending)
- “Package of 3” – eliminates need to reassess
  - Whether a contract contains a lease
  - Classification of existing leases
  - Initial direct costs
- Land easements that were not accounted for as leases may continue current accounting
- Can use hindsight in determining lease term and impairment of ROU asset

**Other Practical Expedients**
- Leases with term < 12 months need not be recorded on the balance sheet
- Lessees need not separate lease and non-lease components
  - Account for whole contract as a lease
- Lessors need not separate lease and non-lease components if certain criteria are met (pending)
  - Account for whole contract based on predominant feature
- Apply guidance at portfolio level if not materially different
Polling Question

**Lease Adoption**

Do you currently anticipate utilizing the “package of 3” transition practical expedient when adopting the lease standard?

1. Yes, it will save a lot of work
2. No
3. Undecided, we are still evaluating
Agenda

- Highlights of New Lease Standard
- Industry Issues
- NextEra's Implementation Approach
- Observations and Lessons Learned
EEI has used its Lease Task Force to address industry issues and help build consensus.

**Lease Task Force Process**

**Lease Task Force**
- Identify issues
- Reach conclusions
- Draft industry position paper

**Accounting EAC**
- Reviews paper, provides comments
- Reach consensus, if possible
- Approves for sharing with Big 4

**Big 4 Group**
- Firms are represented by lease and industry experts
- Reviews paper, provides comments
- Reach consensus, if possible

**The goals of the task force are to:**
- Reach reasonable, consistent industry accounting interpretations
- Educate and influence the views of the accounting firms on issues affecting our industry
- Identify and share best practices in implementation
A number of the industry issues have dealt with the new definition of a lease

Implementation Issues - Definition

- Effect of curtailment rights in renewable PPAs
- How to evaluate customer involvement in design for renewable PPAs
- "Last mile" assets (pipeline laterals, electric service drops, etc.)
- Shared-use land easements (unable to reach consensus among Big 4)
- Other secondary use property (pole attachments, rooftop solar, etc.)
- Are PTCs considered economic benefits under the new guidance?
Measurement issues have also been identified and are being addressed

**Implementation Issues - Measurement**

- Do guaranteed minimum production levels in renewable PPAs create “fixed payments”?
- Potential day-one loss if all payments are variable
- Are capacity payments “fixed” if they can be reduced for unavailability? (2 views documented)
- How to account for future capital expenditures when a PPA is determined to contain a sales-type lease
- Accounting for a lease executed to satisfy an asset retirement obligation
Agenda

• Highlights of New Lease Standard
• Industry Issues
• NextEra's Implementation Approach
• Observations and Lessons Learned
NextEra Energy established its implementation approach in 2016

Our Implementation Approach

- Established strong governance structure
- Approached the revenue and lease implementations together, then looked at leases in two distinct workstreams
- Engaged a third party to build and implement a system to track and account for leases
- Actively involved with EEI Lease Task Force to quickly identify issues affecting the industry
- Tentatively selected practical expedients and transition methods, but retained ability to be flexible

Early engagement with our auditor on material interpretive matters has been important
The project structure was designed for strong oversight, centralized PMO and technical accounting support
We approached the implementation of the new lease standard in two distinct workstreams

**Energy Contracts**

- All PPAs and other energy contracts were reviewed once for both revenue and lease changes
- Determined accounting as:
  - Revenue from Contracts with Customers
  - Lease (under old & new rules)
  - Derivative
  - Multiple elements
- Implementation of lease standard results in second wave of revenue implementation
  - Many renewable PPAs that were leases under ASC 840 will not be leases under ASC 842

**Other Leases**

- Identified areas of the company where leases are executed
- Education sessions held with each area
  - Particular focus on contracts not readily identified as leases
- Technical Accounting assisted in initial identification of lease types
- Developed checklists to help in reviewing specific contracts
- Information entered on templates for upload into system
Polling Question

System Readiness

How would you describe your company’s status in implementing a lease system?

1. Our lease system is up and running with no problems
2. Our lease system is up and running and we are working out the kinks
3. Our lease system is under development
4. We are in the process of selecting a vendor for our lease system
5. We plan to use Excel spreadsheets
We decided early that we needed a system to track and account for leases

**New Lease System**

- Cross-functional team explored available software solutions (Nov 2016 to Jan 2017)
- Identified top three candidates and requested proposals
  - Each vendor provided demos
  - Each solution was quantitatively scored and qualitatively evaluated
- **Strategic objectives for the new system included:**
  - Centralized repository to maintain all leases across enterprise
  - Functionality such as lease accounting, reporting, and forecasting
  - Convert manual processes related to lease accounting into automated, standardized processes, reducing risk of error
  - Needed lessor as well as lessee functionality
  - Integration with SAP and other existing applications
- **Project kicked-off in April 2017**
  - System went into production in May 2018
Agenda

- Highlights of New Lease Standard
- Industry Issues
- NextEra's Implementation Approach
- Observations and Lessons Learned
While the lease implementation effort is ongoing, the following observations have emerged

**Observations**

- **We approached the implementation of the revenue and lease standards as one joint project, with common oversight**
  - Primary reason was to evaluate energy contracts one time
  - Added benefit was that we were focused on leases earlier than if we had waited until the revenue implementation was complete

- **While the execution of leases is decentralized throughout the company, we are centralizing the accounting for leases**
  - Property Accounting, a centralized, corporate department will “own” lease accounting going forward

- **Because of decentralization in executing leases, ensuring completeness of the lease population has been a focus**
  - Education sessions held throughout the company
  - Worked closely with our Integrated Supply Chain team to enhance controls around entering leases
  - Searched general ledger accounts for any description involving the words “lease” or “rent”
Observations

• Really, no one cares about the copiers
  – Applied thresholds, documented judgments, and moved on
• While the project is being led and supported by Technical Accounting, practically every aspect of the business is playing a part in bringing the project to completion
  – Information Technology is leading the implementation of the new lease software
  – Financial Reporting, Tax, and SOX groups are all actively tracking changes
  – High level of subsidiary/business unit involvement in identifying all potential leases
• Keeping senior management and the Audit Committee aware of interpretive issues has been important
We have learned some lessons, both from the revenue implementation and our experience to date with leases

**Lessons Learned**

- Communication with team at all levels is critical
- We are focused on disclosure requirements for leases much earlier than we were for revenue
- Audit testing needs to be built into the project plan
- Project management is necessary, and the right professionals to lead implementation may not be accountants

SAB 74 disclosure is important, but retain flexibility
Questions?