DONOVAN & WATKINS

Exhibit III

ASU No. 2016-02: The New Leases Standard
Discussion Questions

1. What are the major changes brought about by the new leases standard?
    a. Lessees must recognize on the balance sheet assets and liabilities for rights and obligations created by leases for leases with more than 12 months
    b. Measurement and accounting will depend on whether it is an operating lease or a financing lease. It is a financing lease if:
        i. 75% of asset life
        ii. 90% of fair value
    c. Will require additional disclosures, this is more a principal based guideline and so disclosures will be more unique to each company. The disclosures will be more qualitative and quantitative.
    d. Leveraged lease model has been eliminated (existing leveraged leases will be grandfathered).
    e. New model is more reciprocal with lessor and lessee
    f. Some changes to sublease accounting and sales leaseback.
2. What is the scope of the new lease standard? How is a lease defined?
    a. Most leases are subject to the standard except for:
        i. Intangibles
        ii. Biological assets
        iii. Natural resources
    b. A lease is essentially a contract that conveys the right to use an asset for a specified period of time
    c. Will include either an explicitly or implicitly identified asset
    d. The right to control the use of the asset and obtain substantially all the economic benefits
    e. Embedded lease guidance originally issued in EITF 01-8; review supplier contracts to see if you have an embedded lease and it needs to be bifurcated out and recognized. (Good news, most embedded leases are operating leases.)
3. What are the two potential scenarios involved in a typical lease contract?
    a. Operating Lease
    b. Finance Lease
        i. Transfer of ownership
        ii. Option to purchase is reasonably certain
        iii. Lease term is a “major part” of the economic life (75%)

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        iv. Present value of lease payments is "substantially all" of the fair value (90%)
        v. Specialized nature

4. What do lease payments include?
    a. Lease payments include fixed lease payments less any lease incentives.
    b. Lease payments don't include any other variable lease payments
    c. If there is an option likely to be executed, should be included
    d. If lease is likely to be terminated, should include termination penalties
5. What are the definitions of economic life and fair value?
    a. Economic life is the period over which an asset is expected to be economically usable (if lease is for 75% of the economic life, then finance lease
    b. Present value of lease payments and residual value equals total fair value. (if lease payments equal or exceed 90% of fair value, then finance lease.)
    c. Final note: If asset is so specialized that it has no value to the lessor when returned, it is a finance lease.
6. Ratio Changes
    a. Ratios that could be impacted
        i. Current Ratio: Worsens (because ROU asset not current, but liability will have current portion)
        ii. Quick Ratio: Worsens (due to added liability)
        iii. Liabilities to Net Assets: Worsens (due to added liability)
        iv. Return on Assets: Worsens (due to added liability)
    b. Ratios that will not be impacted
        i. EBITDA
        ii. Gross Margin
        iii. Operating Ratio
        iv. Net Worth
        v. Debt/Equity Ratio
        vi. Return on Equity
7. What is the effective date for the leases standard?
    a. For Public Companies, years beginning after December 15, 2018.
    b. Companies can adopt early
    c. Private Companies have an additional year; therefore, years beginning after December 15, 2019.

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8. Implementation Challenges
    a. Disclosures are both qualitative and non-qualitative
    b. Required to Use a Modified Retrospective Approach
        i. Show the cumulative effect of the date of adoption and prospective application
        ii. Must restate 2018 and 2017
    c. Start inventorying your leases and get your data together
    d. Determine who owns the asset
    e. Determine for each lease whether it is a financing lease or an operating lease.
    f. What would be considered an appropriate capitalization threshold for leases?
    g. How granular do I need to get on identifying embedded leases?
    h. Will we need a new lease accounting system?
    i. Will our debt covenants be impacted?