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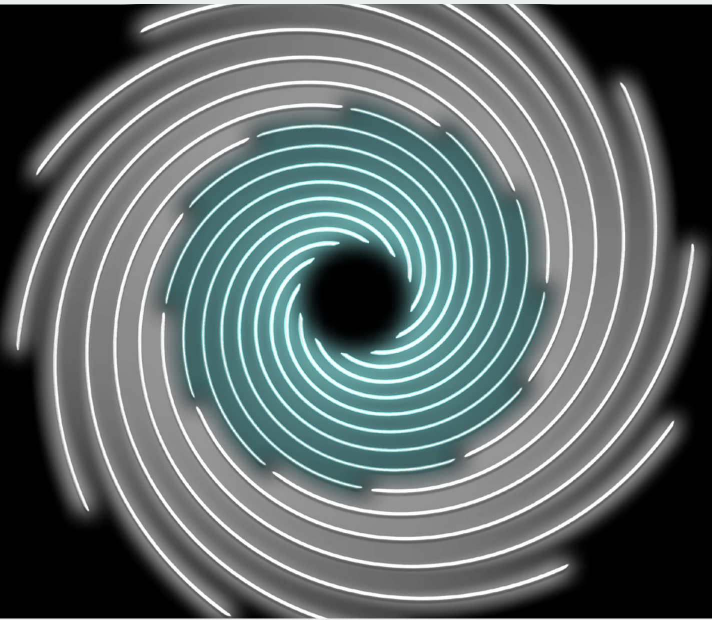
Deloitte.

Gearing up for the new lease accounting standard

Choosing an approach and technology platform to meet the new requirements



For public companies, the new lease accounting standard ASC 842 goes into effect for the calendar year starting January 1, 2019, and time to prepare is quickly running out. Achieving compliance could be a complex challenge that may require major changes to systems and processes. Now is the time to act.

Although this change likely provides investors and other stakeholders with a fuller and more transparent view of a company's financial position, for many it will require a lot of work to achieve compliance. Companies likely need to revise their internal controls and related business processes for capturing, calculating, and accounting for lease agreements. Depending on the nature and complexity of a lease agreement, up to 100 data elements may need to be captured (some of which are not contained within the lease contract).

Today, many companies do not have systems or technology solutions to effectively manage lease agreements. Even among those that do, however, leases are often not administered centrally. In addition, in many cases lease contracts exist only in hard copy—in multiple languages, locations, and currencies—making it difficult to ensure all agreements have been identified and to extract the information necessary for the accounting and reporting requirements under the new standard.

The new standard will likely dramatically affect how companies account for lease arrangements, requiring systems and processes to capture relevant lease data, integrate lease data with business processes, and generate accurate and actionable lease-related information for financial reporting. Doing so means overcoming some obstacles that have emerged as key operational challenges related to implementation:

- Data challenges
- IT systems
- Timeline for adoption

Today, many companies do not have systems or technology solutions to effectively manage lease agreements.

Potential challenges associated with implementing the new lease standard

1

Data challenges: Consolidating and organizing a high volume of data—which may be maintained on a decentralized basis in a variety of systems, formats, currencies, and languages—can be manually intensive, time consuming, and result in errors.

Number of new data elements	Data housed in various systems	Information isn't all in one agreement	High volume of data fields	Multiple languages/ contracting practices
Multiple currencies	Lack of resources	New analytics or metrics needs	Agreements aren't electronic	SOX regulations

2

IT systems: Current/legacy lease systems may need modifications to address new reporting and disclosure requirements, or completely new systems may be required.

3

Adoption timeline: Data abstraction and migration and system implementation are commonly the most challenging and time-intensive aspects of implementation.

The data being collected may be in a variety of formats, thus increasing the complexity and cost of organizing the data.

Choosing an approach

Lease accounting or lease administration?

The first strategic question you may want to consider is whether to limit the scope of the technology solution to *lease accounting* or to pursue a solution that covers the broader scope of *lease administration*. The latter option can offer more benefits and enhancement opportunities; however, it likely will require more time, effort, and investment.

Centralized or decentralized?

Another strategic question to consider is whether to *centralize* or *decentralize* the systems and processes related to leases. A decentralized approach is typically more flexible and responsive to local needs. It tends to be less efficient and consistent, however, and it may require more time and effort to implement due to the increased challenges of coordinating and driving multiple initiatives across organizational and geographic boundaries.

It is important to find a technology solution that fits each company's unique needs and operating model. For example, a centralized model requires a platform that can effectively support a *single global instance*, while a decentralized model might favor a platform designed around a *distributed architecture*.

In-house or outsourced?

A third strategic question to consider is whether to handle lease accounting and related activities *in-house* or to *outsource* some (or many) to a third party. Outsourcing can allow a company to capitalize on a vendor's deep experience and economies of scale. Insourcing provides more direct, hands-on control, but it requires dedicated resources as well as technical and lease accounting experience.

Choosing a platform/vendor

Another important consideration is whether to use a cloud-based platform (e.g., Software-as-a-Service) or to build and maintain an on-premise solution. The pros and cons are similar to those associated with the outsourcing/insourcing decision. One potential advantage of the cloud in this situation is that software updates tend to be more timely and efficient, making it easier for a company to stay compliant. Many platforms have the ability to support the broader scope of lease administration, not just lease accounting; however, some platforms are more capable and broad than

others, so it is important to choose wisely. It is also critical not to ignore fundamental vendor-selection criteria such as:

- **Financial and technical resources.** Does the vendor have sufficient financial and technical resources to keep its platform and features up to date and viable?
- **Testing and certification.** Has the platform been tested and certified? The requirements of the new lease standard are detailed and highly complex, so it is important to know that the underlying accounting rules are being applied correctly.
- **Total cost.** What will be the platform cost to implement and operate on an ongoing basis? To make a more informed decision, all expected costs should be considered, including first-year implementation expenses, annual licenses, and maintenance fees.

Other factors to consider include ease of integration with current systems, the implementation timeline, anticipated release of required functionality, and the ability to customize the technology solution to your company's needs.

If a vendor is gaining popularity in your industry, it may be a sign that its platform is a good fit; however, that does not replace the need to conduct your own careful selection process.

Trends come and go, but nothing should matter more than how well a platform fits a company's unique needs.

Choosing an interim solution

Companies may benefit most from a comprehensive, fully integrated platform for lease accounting (or lease administration, which is even broader). However, depending on the complexity of a company's needs—and in which stage of the decision process it is—there might not be enough time to fully implement such a platform before the new lease accounting standard adoption deadline. As such, some companies may need to implement a temporary technology solution that can promptly satisfy the new standard's minimum reporting requirements by layering on top of existing systems and processes.

When implementing an interim solution, it is recommended companies strive to reduce duplication and rework. Thus, data portability should be a top priority. Cleansing and extracting lease data from existing systems and processes is typically the most time- and resource-intensive step of achieving compliance; therefore, it is a good idea to attempt to do it only once. That means extracting all the information necessary for the long-term technology solution, not just satisfying the immediate needs of the interim solution. It also means choosing an interim solution that allows data to be promptly and efficiently transferred to other platforms.

Taking action now

The time available to achieve compliance with the new lease accounting standard is less than many people realize. For public companies, the new standard goes into effect for the calendar year starting January 1, 2019; however, the required systems and processes should be up and running well before that date to allow sufficient time for testing, training, and debugging.

Any company that is not already well down the path to implementation should consider promptly developing a clear strategy and timeline for achieving compliance—and then aggressively managing its efforts against that timeline.

The clock is ticking, and there's no time to lose.

Let's talk

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Weary from accounting change, companies prep for lease standard

With year-end reporting and revenue recognition implementation nearly complete, firms are preparing for their next accounting freakout—this time over leases. **Tammy Whitehouse** reports.

With year-end reporting and revenue recognition implementation nearly complete, public companies are preparing for their next accounting freakout—this time over leases.

Recent polls suggest companies have a lot of work to do to get ready for the next big rule, Accounting Standards Codification 842 on leasing, which takes effect Jan. 1, 2019, for public companies. A KPMG survey found that only 15 percent of companies had completed their preparations, and not quite half had implementation activity under way. The rest were still assessing or hadn't even started to prepare.

Another poll by software provider LeaseAccelerator said most firms were finding the work to adopt the new lease accounting rules to involve as much heavy lifting as they undertook to adopt the new revenue recognition standard. And a poll from Deloitte & Touche says only about 21 percent of companies are confident they can get the job done on time, says James Barker, a senior consultation partner at Deloitte.

Coming out of the year-end reporting season and revenue recognition implementations, companies are turning their attention back to the lease accounting standard, says Barker. "As they are re-focusing, they're realizing they're very close to the mandatory adoption date and very concerned about

system readiness," he says.

Angela Newell, a national assurance partner at BDO USA, says the largest companies that are likely to see the biggest impact from the standard are much further along in their preparation. That includes retail companies or restaurant chains, for example, that have large lease portfolios and were less affected by the new revenue rules. "They had less to do to adopt the new revenue standard, so it gave them more flexibility and more bandwidth to start looking at the leasing standard," she says.

In theory, the leasing standard should be easier to adopt than revenue recognition, Newell says, because the new lease accounting requirements are not as different from the historic rules as the new revenue recognition rule was. The big challenges with the leasing standard is simply gathering all the data companies need and then implementing the necessary systems to do the accounting.

Sheri Wyatt, a partner at PwC, says she sees companies falling into one of three major categories as it pertains to their readiness for the new standard. One group is fairly early in its implementation planning, perhaps dusting off project plans they developed last year but hadn't yet put into motion.

A second group is evaluating and selecting software or systems vendors, and a third group is implementing new systems or software and is perhaps importing data from its lease inventory. "It's really all over the board at this point," says Wyatt. By mid-March, she was expecting to be "drowning" in lease accounting inquiries, but the pick-up has been a little slower than she envisioned.

Wyatt also sees the pressure that's developing on systems implementation issues, as vendor resources are tightening under the increased demand for help. "When you have a standard that affects essentially all companies, that means all companies are looking to get an accounting solution," she says. Michael Keeler, CEO at LeaseAccelerator, says anecdotally he would estimate perhaps 15 percent to 20 percent of the largest companies have selected a vendor. Companies have some different options to consider in terms of how they choose to address the technological aspects of implementation, he says

Big 4 firms are developing "homegrown" transitional software that they are providing to clients as part of their services, says Keeler. Some solutions also are emerging from vendors that provide integrated workplace management systems, which have been used to manage real estate properties. "Some of those are actually pretty mature in terms of the lease accounting calculation engine," but they only work for real estate leases, not equipment leases or for leases embedded in service contracts.

"Then you had other companies that started from scratch in 2015," says Keeler. Often in tandem with enterprise resource planning platforms, accounting calculation engines are emerging that will facilitate the lease accounting requirements, he says, but those are the solutions that in many cases are not yet fully developed.

Keeler says the typical enterprise software adoption lifecycle is five to seven years, which is far less time than companies were given when the Financial Accounting Standards Board adopted the major new standards. The enactment of the Tax Cuts and Jobs Act at the end of 2017 further piled onto financial reporting workload, he says.

"What these accounting standards have done is narrow the bell curve," says Keeler. "Instead of having five to seven years, you have a three-to-five-year window, and we're in year two. Companies just can't get to the finish by the deadline. The marketplace is constrained for expertise and talent. There's a certain mindshare limitation that all corporate controllerships face."

Some companies already are looking for "plan B, or even plan C," says Deloitte's Barker. "Plan B and C could be less comprehensive systems, more temporary fixes as opposed to permanent solutions. Plan C could even be a manual approach to adoption—something that gets you one year of accounting and hopefully bridges you to something more permanent."

Yet, regardless of any concerns about system readiness, some companies are still behind on collecting the data they need to put into any new accounting system, says Sean Torr, managing director

with Deloitte Advisory. "One of the things companies are underestimating is the level of effort to abstract the data," he says.

And it's not just a matter of finding and reading lease contracts, Torr points out. Fair market values for leased assets, for example, along with discount rates used to perform lease accounting calculations, come from sources other than the lease contracts themselves. "It takes a high degree of planning and coordination to make sure the resources are sufficiently allocated," he says.

Daryl Buck, national managing partner at Grant Thornton, sees plenty of companies turning their attention as quickly as their limited resources will allow to the lease implementation effort. "For companies that have the luxury of having different resources working on different projects, it's perhaps not as difficult, but for many it's been quite challenging," he says.

Recognizing the challenges and hearing early calls for a deferral in the effective date, FASB recently indicated it will provide some significant transition relief, primarily by permitting companies to adopt the rules on a prospective, or go-forward basis. That means they can opt to leave historic periods in financial statements reflecting lease obligations in footnotes as they have historically, applying the new accounting only to remaining and new lease obligations in periods beginning Jan. 1, 2019, and going forward. The board also approved a practical expedient for land easements.

Although he's a former member of FASB, Buck says he has no insight into whether the board will entertain any further calls for relief or deferral. "My guess is for some companies I'm sure more time would be helpful, but I don't think it's all that likely," he says. "I think they're trying to be helpful with what is already proposed, but my guess is personally I wouldn't expect much more than that."

That doesn't mean companies can't ask, says Barker. "We're telling our clients if they have serious concerns about their ability to adopt on time, they should be telling FASB and telling them why," he says. "FASB can only work with what they know." ■

What is the nature of the sanctions regime in the U.K.?

The leasing model will likely require operational and system changes potentially impacting many areas in the organization, including accounting, finance, financial reporting, taxes, and technology among others. Operational considerations include:

- challenges in data collection and aggregation across multiple locations and technology platforms;
- technology capabilities to store lease data and perform calculations, including calculations during the look-back period (comparative prior periods)
- review of lease tax classification and other factors; any changes in classification require IRS consent
- enhanced disclosure requirements
- changes to financial ratios with potential impacts to debt covenants or other guarantees
- impact of limited resources and ongoing business needs on timeline for adoption
- transforming from paper documents to sustainable technology solutions

Source: Deloitte & Touche

Lease accounting relief will ease adoption a little

With work winding down to get ready for the massive shift in how to recognize revenue, the next major accounting change exercise still awaits—lease accounting, writes **Tammy Whitehouse**.

With work winding down to get ready for the massive shift in how to recognize revenue, the next major accounting change exercise still awaits—lease accounting.

Accounting Standards Codification Topic 842, which contains the new rules that bring virtually all leases onto corporate balance sheets, takes effect Jan. 1, 2019. Staff members at the Securities and Exchange Commission are practically pleading with preparers to make progress sooner rather than later, so that any accounting or systems issues can be raised and addressed along the way.

At a recent national accounting conference, Sagar Teotia, deputy chief accountant at the SEC, said companies really need to dig into their lease contracts, and even executory or other service-oriented contracts, and figure out where the provisions of Topic 842 apply. “Doing that work will let you know how much more work you have to do,” he said, such as whether a given company can handle the new accounting with existing systems or will need to invest in new technology.

The SEC, the major accounting firms, and the Financial Accounting Standards Board are standing by to answer questions and address problems, said Teotia, but they can’t address them if they aren’t alerted to them, he said. “I would encourage preparers to flush out their questions now,” he said. “Look at your leases. If you think there’s an accounting question in them, take them to your accounting firm, to us, to FASB.”

FASB recently signaled that it plans to give companies some major relief to ease their transition to the new accounting rules, which require companies to bring leased assets and their related liabilities into accounting systems with greater precision than they’ve perhaps used in the past. Leases have always been subject to footnote disclosure, but now companies need to add them to the balance sheet and reflect the cash flow effects in the income statement.

While the adoption of any new accounting standard would normally involve the application of the new rules to all periods presented in the primary financial statements, FASB is planning to change the lease rules to permit companies to adopt the new accounting beginning in 2019 without requiring restatement of historic periods. Investors would have to rely on historic footnote disclosures, as they do currently, to understand a company’s lease obligations.

“We screamed with joy when we realized the possibility” of such relief, said Adena Lerner, controller at General Dynamics Mission Systems, at the same accounting conference. The joy was short-lived, however, as the task at hand was still daunting enough, she said.

General Dynamics has 26,000 leases throughout its “highly decentralized” organization, said Lerner. Each one must be read and analyzed, looking for any number of dozens of terms and conditions that must be reflected under the new accounting. The relief proposed and likely to be approved by FASB “simplifies the dual reporting,” said Lerner, “but we are not taking our foot off the gas.”

With the relief from historic period recognition, FASB also is proposing to simplify the accounting for lessors, dropping a requirement to separately recognize lease and non-lease components in rental agreements. Cathy DeGenova, director of SEC reporting and technical accounting at Avis Budget Group, said she was “still smiling” over that additional planned modification of the original requirements.

Neither accommodation, however, will alter Avis’ planned implementation, DeGenova said. “It simplifies it a bit but it does not alleviate the effort to comply,” she said. “The timeline won’t change.”

Avis began its implementation activity in Au-

gust 2016, said DeGenova, by assessing its global lease population, which consists of 4,000 leases. The company gathered lease information from its asset registers, spreadsheets, and its profit and loss information.

The company began with the "gorilla leases," said DeGenova, or the obvious ones that were most critical in the company's portfolio. Then it worked through the P&L and accounts payable systems from a materiality perspective to find more and more leases. Through the process, the company centralized and digitized its leases, "which was a very helpful process," she said.

The process involved a good dose of education within the organization to assure accounting and real estate professionals understood the technical requirements of Topic 842, said DeGenova. It also involved some outreach to folks in operational roles as well. "It was important to convince others of the value of this project," she said. "Historically accounting change projects are handled from accounting, but there are operational benefits to have leases handled from a central process. This project is critically dependent on other people."

At General Dynamics, the biggest challenge in preparing for the new lease standard has been the gathering up of all leases, the data collection, and the centralization of the process, said Lerner. "Finding all the leases was one thing, but then you have to get the actual document," she said.

Are they legible? Are they in a foreign language? The company opened a cloud-based platform into which lease data could be input and assembled, Lerner said.

If the initial push to gather lease data wasn't enough, the company also needed to establish a way to assure new lease data would continually be added to the system as it is created. "That's constantly in the back of my mind," said Lerner. "Who are the touch points? We have to ensure they're comfortable that this is not a one-time call for data. It's ongoing."

Resource constraint has been a big concern at General Dynamics, said Lerner. "We heard a quote in 2016 that for every lease it would take two to three hours of analytics to get the terms into the system," she said. "Sadly, that held true." The company had to engage outside help through PwC to achieve the task, she said.

General Dynamics has also made a push to educate those in procurement and legal functions who are entering into lease arrangements on behalf of the company to understand the accounting implications of what they establish, said Lerner. Those negotiating terms and conditions need to understand the positive and negative implications to the company of agreeing to certain terms, she said.

Michael Berrigan, professional accounting fellow at the SEC, said at the conference it's important for companies to engage in "thoughtful planning and timely implementation" of the standard. Just as with the revenue recognition implementation, companies need to give themselves plenty of time to apply the new requirements and arrive at the necessary judgments, not to mention establish the necessary internal controls.

"Identification of contracts that represent or contain a lease is a key step," said Berrigan, necessary to fully assess the scope of contracts that are subject to the new standard. "Once the complete inventory of contracts is identified and analyzed, I believe a company can, among other things, better assess the additional levels of effort required for implementation."

James Barker, a senior consultation partner at Deloitte & Touche, said the relief provisions FASB is preparing represent "a big deal" for companies in transitioning to the new lease accounting. But they should not slow their implementation efforts as a result of it. "Don't take this as a gift as if things will magically come together," he said.

He sees many companies underestimating the effort that will be necessary to collect lease data and aggregate it into a centralized system, not to mention determining whether they have adequate systems to accomplish the new accounting or they may need to invest in something new. "All of those things are still out there," he said. ■

SEC consultation on a lease accounting question

Minimum Rental Payments

The first transition topic I will discuss relates to the lessee's determination of remaining minimum rental payments for purposes of the lessee's transition entry upon the adoption of ASC 842, for arrangements historically accounted for as operating leases.

The transition guidance in ASC 842 requires the lessee to initially measure the lease liability using the remaining minimum rental payments (as defined by ASC 840). One accounting question raised to the staff related to whether the lessee's initial lease liability recognized in transition should include or exclude the portion of the fixed, gross rental payments that represent executory costs, such as insurance, maintenance and/or taxes.

Registrants sought clarification from the staff on this issue as the measurement of the lease liability recognized in transition is directly impacted by the entity's determination of remaining minimum rental payments.

It was observed that under existing GAAP, some lessees currently account for the entire rental payment as a minimum lease payment while others exclude from the minimum lease payment the portion representing executory costs connected with the leased asset.

Some registrants concluded that executory costs should be included in minimum rental payments in transition consistent with their existing accounting policy to include executory costs as a portion of minimum lease payments under ASC 840. Those expressing this view asserted that "remaining minimum rental payments" should be derived from the definition of "minimum lease payments" in ASC 840, which they historically viewed as inclusive of payments attributable to executory costs as the guidance in ASC 840 refers to executory costs as a portion of minimum lease payments.

Alternatively, others concluded that executory costs should be excluded from minimum rental payments consistent with their existing accounting policy to exclude executory costs from minimum lease payments under ASC 840. Those expressing this view generally agreed that the "remaining minimum rental payments" should be derived from the definition of "minimum lease payments" but concluded that executory costs were excluded from minimum lease payments as they viewed the guidance in ASC 840 as emphasizing the exclusion of executory costs from minimum lease payments.

In considering each view, the staff observed that the term "minimum rental payments" is not explicitly defined in ASC 840. As a result, the staff did not object to registrants consistently applying their historical accounting policy conclusions regarding the composition of minimum lease payments when concluding whether executory costs should be included in remaining minimum rental payments for purposes of establishing the lease liability in transition.

Source: SEC staff speech by Professional Accounting Fellow Michael Berrigan

FASB simplifications will help companies ease into new lease standard

The lease accounting standard is about to get easier to adopt when it takes effect in 2019, but that doesn't mean companies should slow their preparations. More from **Tammy Whitehouse**.

The lease accounting standard is about to get easier for companies to adopt when it takes effect Jan. 1, 2019, but that doesn't mean companies should slow their adoption preparations.

The Financial Accounting Standards Board has decided it will issue a proposed update to accounting standards that would provide some optional transition relief for companies as they prepare to adopt the new requirements to bring virtually all leases on to corporate balance sheets.

The simplification will allow companies to apply the new lease accounting requirements on a go-forward basis from the date of adoption. That means companies will not have to apply the new rules to prior periods in financial statements, leaving those obligations reflected under current rules.

The FASB also decided to propose some additional transition relief—to lessors only—with respect to their adoption of the standard as well. The board proposes lessors should not be required to provide comparative period financial statements under the new lease accounting rules.

In addition, the board plans to propose a practical expedient that would allow lessors to not separate lease components from non-lease components if certain conditions are met. The provision could be elected by class of underlying assets. If elected, companies would have to meet some separate disclosure requirements.

The board also plans to simplify the transition for existing land easements, applying the rules only to new land easements going forward.

"This is big relief for companies," says Sean Torr, managing director with Deloitte & Touche. Companies are facing big challenges in preparing for the standards based in part on the availability of information technology solutions, he says.

Facing a Jan. 1, 2019, effective date for the new lease accounting requirements, which will bring virtually all leased assets on to corporate balance sheets, public companies ideally would be running parallel systems on 2017 lease obligations to prepare that data for historic periods in financial statements at the adoption date. Yet companies have had difficulties getting technology solutions up and running and in dealing with foreign exchange rates, says Torr.

"This new rule basically will look at only those contracts in existence at the effective date and ac-counting for those contracts under the new rule at that point in time," says Torr. The transition relief will not require any extraordinary transition disclosures to explain prior periods, as companies will simply continue to present the footnote disclosures on prior periods as they are presented in financial statements today, he says.

"There's still a tremendous amount of work that has to be done by companies, irrespective of this transition relief ... to be ready for this standard," says Torr. "This is certainly not a reason to stop or pause the readiness activities." ■

FASB makes decisions on leasing standard simplification

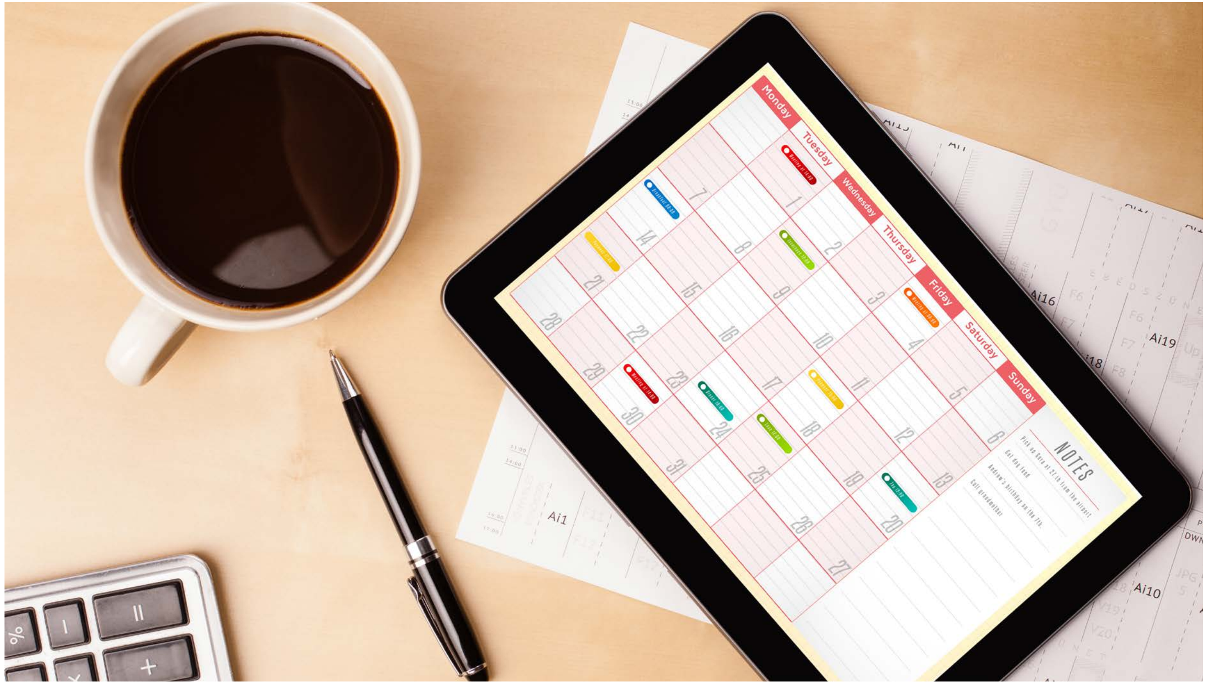
Land easements: The board decided to proceed with the issuance of a final Accounting Standards Update (ASU) that:

- Provides an optional transition practical expedient that, if elected, would not require an organization to reconsider their accounting for existing land easements that are not currently accounted for under Topic 840
- Clarifies that new or modified land easements should be evaluated under Topic 842 (the leases standard), once effective.

Transition approach, and separation of non-lease components from lease components for lessors only: The Board directed the staff to draft a proposed ASU, with a comment period of 30 days, that would:

- Add an option for transition to Topic 842 that would enable an organization to not provide comparative period financial statements. Instead, an organization would apply the transition provisions of the leases standard at its effective date.
- Add a practical expedient that would permit lessors not to separate non-lease components from the related lease components if certain conditions are met. This practical expedient could be elected by class of underlying assets, and if elected, certain disclosures would be required.

Source: FASB



Four reasons firms are lagging in lease adoption and how to get on track

Companies are slipping behind in implementing the new lease accounting standard, and the call for deferral in the effective date may be getting under way. **Tammy Whitehouse** has more.

In a perfect world, companies would be all over the new lease accounting standard that takes effect in 2019 to assure their financial statements fully and accurately reflect their lease obligations. But indicators suggest companies are slipping behind, and perhaps even mounting a call for a delay in the effective date.

A recent survey by Deloitte says roughly half of C-suite executives are concerned they don't have enough time to do an adequate implementation. "It's one thing to implement, but it's another to have a quality implementation," says James Barker, a senior consultation partner at Deloitte. "That means getting everything right, not rushing through it, not cutting corners or making sacrifices."

The Financial Accounting Standards Board adopted the new accounting requirements in early 2016 to tell companies to take inventory of their leases and add them to the balance sheet by 2019. Now compa-

nies are beginning to tell the FASB they don't have enough time. In fact, the American Petroleum Institute has gone on record with the FASB and the Securities and Exchange Commission to formally request a delay in the effective date.

The API letter cites many of the same concerns that accounting experts are seeing as they help guide companies through the implementation. Four key factors are making it difficult for companies.

Factor #1: Technical accounting questions. Companies are finding they have a lot of questions about how to transition to the new guidance, says Eileen Chan, executive director in financial accounting advisory services at EY. "We are seeing sometimes there are different interpretations," she says.

The standard contains some provisions that were intended to make it easier for companies to transition to the new standard, but they're not entirely clear, says Chan. The Financial Accounting Standards Board has heard the clamor and has begun addressing questions.

"There's one paragraph in the standard that addresses transition but it has numerous subparagraphs," says Rich Stuart, a partner at audit firm RSM. "Depending on what position you're coming from, there are a number of potential items that can trip you up in transition. With any guidance of this magnitude, there are going to be questions that pop up after issuance."

The board determined recently it will make a change to the transition provisions to give companies a practical expedient. It is expected to say that in cases where companies have land easements or rights to use land that are not currently accounted for as leases, they will not be required to treat them as leases under the new standard.

Getting on track

Where companies may be lagging in their effort to adopt the new lease accounting standard, experts say the only real answer to get the implementation on track is to devote more resources to the effort.

Rich Stuart, partner at audit firm RSM: "If you haven't started, give serious thought to starting now. The sooner you start, they better off you'll be. If you need to find outside resources, they may not be available to you if you wait."

Paul Noring, managing director at audit firm Navigant Consulting: "People are underestimating the effort and are going to be in for much more of a scramble when it comes to ensuring they're compliant and ready for implementation."

Chris Stephenson, principal at Grant Thornton: "A lot of companies are shifting from revenue recognition to leasing, and they're probably a little tired. As you look at leasing solutions, don't underestimate the amount of hours. Make sure you're talking to your groups and not just reacting."

Eileen Chan, executive director, EY: "We're seeing in recent studies many companies have started to prepare, but some still have not yet started. Those are the ones that are more concerning. You really need to start. If you haven't, you don't have too much more time to procrastinate."

James Barker, senior consultation partner at Deloitte: Because software vendors are facing plenty of demand, "focus on the things that require long lead times. We're encouraging companies to focus on that as soon as they possibly can."

> "Every company is organized and structured differently, and they have different controls. They may have people entering into leases all over the company. Trying to corral and identify all those leases is bit of a hunting and pecking exercise. There's a lot of looking under rocks."
>
> Paul Noring, Managing Director, Navigant Consulting

That may help companies that are interpreting the technical requirements to potentially apply to obscure obligations that have not been considered leases in the past. The classic example is a right to post advertising signs or billboards on the exterior of buildings that the company does not otherwise lease.

In part, the fact that technical questions are surfacing is an indicator that companies are digging into the details and thinking about how it will affect their particular transactions, and that's a good thing. "Part of it is people didn't look at it early enough," says Stuart. "Now they're saying this isn't as clear as we thought."

Factor #2: Revenue recognition. It's through "no fault of their own" says Stuart, that companies may have taken some time before they cracked the spine on the new leasing standards. Companies had their hands full in 2017 adopting even bigger new accounting requirements around when and in what amounts to recognize revenue in financial statements. That massive new standard took effect Jan. 1, 2018, and experts say companies spent too long dragging their feet and studying how they would be affected by that standard before developing the processes and controls necessary to comply.

Even when revenue recognition was still six months away, it was consuming a great deal of attention and resources, said Paul Noring, managing director at Navigant Consulting, in part because of its potential to change the top line, which could also affect net income. "The leasing standard is probably going to change the balance sheet more than net income," he said. That made the revenue change more profound.

Factor #3: Data collection. Revenue recognition aside, experts says many companies underestimated the amount of work it would take to find all of their leases that might be scattered throughout the organization, bring them into a centralized repository, then gather the data necessary from each lease to perform the required calculations.

"Every company is organized and structured differently, and they have different controls," says Noring. "They may have people entering into leases all over the company. Trying to corral and identify all those leases is bit of a hunting and pecking exercise. There's a lot of looking under rocks."

Chris Stephenson, business consulting and technology principal at Grant Thornton, says the firm has estimated each lease contains 30 to 35 data points that must be gathered and analyzed to determine all the appropriate accounting. Things like timing, payment, classification, location, future cash flow and numerous other aspects of the lease must be studied and considered.

"If you thought of your lease population as a spreadsheet, with every row a lease and every column a data point, companies are missing both rows and columns," says Stephenson. "There are leases they don't know about, and there are entire data sets that haven't been collected historically. It's not technically the hardest part, but it's time consuming."

Factor #4: Software. Software vendors have followed the standard and developed solutions, but there's no single package yet that addresses every aspect of the standard for any given company's needs. "There are a number of products that get you a high percentage of the way there, but we've not yet identified one that gets you 100 percent of the way there," says Stuart.

Some solutions are focused on real estate leases, some on equipment leases, some for the requirements under U.S. GAAP and others for the rules that are a little different under International Financial Reporting Standards. "We haven't identified a silver bullet," says Stuart.

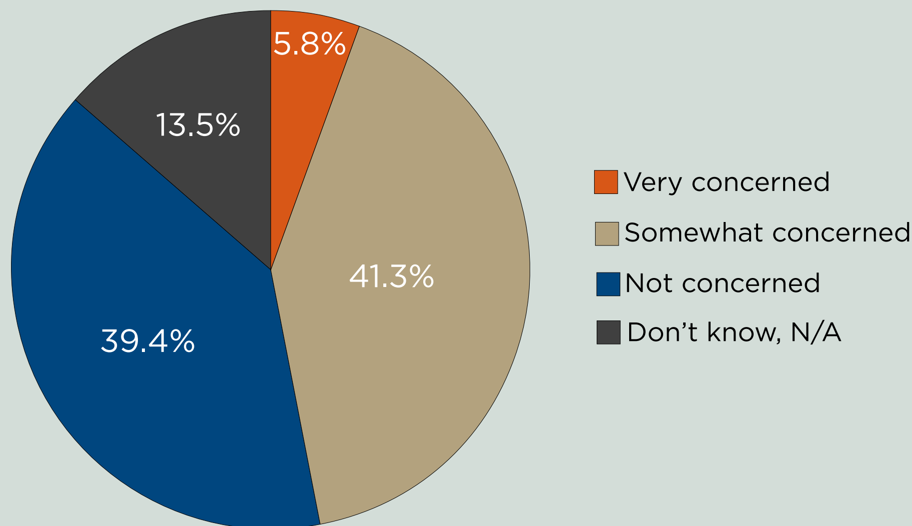
It's an evolving, maturing process, says Chan, and companies are working in the meantime to develop their own additional processes outside of their chosen software. "To the extent certain functionalities are not in the system, they are having to supplement manually."

Ultimately, there's plenty of functionality in the marketplace for companies to adopt the standard, but companies need to be on top of developing whatever supplemental procedures they'll need to comply, Chan says. Barker says vendors are running at full tilt to try to meet the market demand for software installations and upgrades, so companies would be wise to get in the vendor queue to assure they are not shut out by any resource constraints that may be developing.

While the petroleum group is the only one so far to publicly and formally request a deferral in the effective date, Barker says the idea may start to gain some momentum with others who may make similar appeals. "As companies come to a realization they are behind the eight ball, they are going to start to putting pressure to potentially seek deferral." ■

Implementation deadline

Deloitte asked companies how concerned they are with their ability to implement the new lease accounting standard by the chosen required date.



Source: Deloitte

Early work on new lease rules reveals big effort

Waiting in line behind revenue recognition, new requirements to bring leases on to corporate balance sheets are starting to win pockets of attention. **Tammy Whitehouse** explores.

Looming large in the sphere of big accounting changes, new requirements to bring leases on to corporate balance sheets are starting to win pockets of attention. That attention is mixed, however, as companies enter the home stretch in adopting even bigger change to the way they recognize revenue in financial statements.

At a national accounting conference in December, the vice president and corporate controller for Comcast sat on a panel to discuss what companies were accomplishing in preparing for the new lease accounting requirements. Those rules take effect in 2019, a year after the 2018 starting date for the new revenue recognition requirements.

"In terms of where we are in adopting the new lease standard, I'd like to tell you where we are in adopting the revenue standard," said Daniel Murdock, who has since been promoted to senior vice president, chief accounting officer, and controller at Comcast. "We're busy working on revenue recognition."

That's still true for many companies heading into springtime, experts say, although they are beginning to worry about what lies ahead for companies that haven't yet even taken preliminary steps to prepare for

new lease rules. "It's fair to say the average company still has quite a bit of work to do," says James Barker, senior consultation partner for leasing at Deloitte & Touche. "People are still very focused on revenue but companies do need to keep their eye on the ball on this one."

Some companies have taken some significant measures, says Daryl Buck, national managing partner at Grant Thornton. "Some have identified their strategy and their team, and they've mapped out how they are going to get to the finish line," he says. Those tend to be the larger companies with plenty of staffing so they can devote some to revenue recognition and others to the lease standard, he says. "Not everyone has that luxury of having those resources. A lot of companies are using the same people to do both projects."

Companies definitely are tuned into the topic, says Mike Stevenson, national assurance partner at BDO USA, based on much higher-than-usual traffic to a recent webinar, even when no continuing professional education credit was offered. "The interest is there, but what companies are doing depends," he says. "Large companies with large lease portfolios are keenly aware of the task that's ahead. They are asking a lot of questions about not only impacts, but also business process changes and systems changes."

Still, not every company should be concerned about implementing the leasing standard right away, says Alex Zhang, a partner at audit firm UHY. He poses three questions to companies to quickly gauge their exposure and their readiness to apply the new rules: How familiar are you with the new standard? How many leases do you have? What is your approach to adopting the new standard?

"If you don't have a lot of leases, it's not too complicated," he says. "But if you use a lease strategy in your business, you need to be prepared."

At audit firm RSM, partner Rich Stuart says he sees folks who are finding the project more difficult than they initially expected. "They weren't aware of the magnitude of change," he says. "They didn't realize the time it was going to take to get all the information into one place. It's taking more time to adopt, and they've got to get more people involved than they originally thought."

Companies that haven't done much as yet to adopt the standard may find themselves in a pinch for resources, says Stuart. Larger companies with larger groups of people tend to be the early movers on the leasing standard because they have the staffing. Companies starting early are the first ones reaching out to third-party providers for assistance.

As more companies enter the demand stream, they will find themselves at the back of the line, says Stuart. "If you find yourself a couple months to the effective data and you haven't started, then you look for resources, you may find yourself in quite a bind," he says.

In some cases, the companies digging in early are reaching out to industry peers and collaborating on interpretations of the new standard, says Kimber Bascom, a partner at KPMG. While the Financial Accounting Standards Board and the American Institute of Certified Public Accountants formed formal groups and processes for vetting questions and interpretations on revenue recognition, the same mechanism isn't taking shape for the lease accounting standard.

That has prompted companies to reach out to one another, says Bascom. "They are methodically working through questions they have, trying to get to some consensus, and where they don't they're reaching out to FASB or the Securities and Exchange Commission or their auditors to try to work through questions," he says.

Some of the questions surround the very starting point in the standard—defining a lease—so as to understand what arrangements are affected by the new accounting requirements, says Deloitte's Barker. The new standard provides a slightly different definition of a lease compared with historic interpretation or market understanding of what constitutes a lease, leading to some analysis of arrangements that are not traditionally regarded as leases.

That includes, for instance, service arrangements that include use of assets, so the lease is embedded into a service contract, says Barker. Common examples include service agreements involving medical

equipment, or cable plans that include the provision of a cable box. "There are still several of those kinds of things being considered," says Barker.

Companies also are working through interpretations around how to treat variable payment methods compared with fixed payments, says KPMG's Bascom, as well as how to carve up contracts that include both lease and non-lease components. In addition, companies are working through how to transition to the new guidance. "The mechanics of transition in some cases are somewhat challenging," he says.

Sheri Wyatt, a partner at PwC, says the biggest challenge she sees in companies that are preparing is determining exactly what belongs in the lease population and assuring the population is complete. "There's a need for that extra level of comfort around the completeness of information now that leases are going on the balance sheet," she says.

The next challenge is assuring the data is complete, she says. Many companies have long used tools like spreadsheets to keep track of leases for asset management purposes, but those tools likely don't capture the same data now needed to meet the new accounting requirements. "How do I fill those gaps?" she says.

Wyatt is cautioning companies against doing any window shopping for technology solutions be-fore they've done a thorough assessment of their needs. "I've seen a few cases where companies evaluate system solutions but then are not able to make a decision because they hadn't gone through an assessment of their current state," she says. "You need that gap assessment to understand what your business requirements are." ■

What does the new guidance do?

Under the new guidance, a lessee will be required to recognize assets and liabilities for leases with lease terms of more than 12 months.

Consistent with current Generally Accepted Accounting Principles, the recognition, measurement, and presentation of expenses and cash flows arising from a lease by a lessee primarily will depend on its classification as a finance or operating lease. However, unlike current GAAP, which requires only capital leases to be recognized on the balance sheet, the guidance in the ASU will require both types of leases to be recognized on the balance sheet.

The ASU permits private companies to use risk-free rates when determining the present value of lease liabilities.

The ASU also will require disclosures to help investors and other financial statement users better understand the amount, timing, and uncertainty of cash flows arising from leases. These disclosures include qualitative and quantitative requirements, providing additional information about the amounts recorded in the financial statements.

As previously indicated, the accounting by organizations that own the assets leased by the lessee—also known as lessor accounting—will remain largely unchanged from current GAAP. However, the ASU contains some targeted improvements that are intended to align lessor accounting with the lessee accounting model and with the updated revenue recognition guidance issued in 2014.

Source: FASB

Deloitte.

Counting down to the new lease accounting standards:
Are you ready?

The new lease accounting standards will likely impact businesses in almost every industry. What will the most recent guidance look like on your balance sheet?

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