LEASE ACCOUNTING
Top 5 Lessons Learned From Public Company ASC 842 Implementations

As is typical of anything new, whether it's a software upgrade or the latest diet craze, lessons are learned by the first adopters. The same is true for adoption of new accounting standards. As public companies with calendar year-ends wrap up their implementations of ASC 842 – the new lease accounting standard – to comply with the 2019 effective date, private companies are watching to fully leverage best practices for their 2020 effective date. RGP has helped more than 230 companies become compliant with the new guidance, and would like to share the following top five frequently encountered challenges to watch for, along with proven solutions.

1. DATA GATHERING WILL TAKE LONGER THAN YOU THINK

Do you know where your leases are? That question struck fear in many companies as they started their projects. If you don't know, you're not alone. The nature of lease origination, particularly for equipment leases, being scattered throughout an organization, drives a lack of transparency at the corporate level. Never before has it been so important to know where your leases are. Gathering leases and extracting applicable data is the activity that takes the longest for every project. This includes not only obtaining the final and current lease contracts, with amendments, but also any contracts containing embedded leases. **Your auditors will require you to prove completeness of your lease population.** Save valuable time by properly scoping your leases (identifying whether each contract is a lease or not), applying appropriate materiality, and using techniques such as analysis of recurring payments to help ensure you start with a complete population.

The most challenging contracts are in foreign languages, those that are old and modified through the years, and those in hard copies located in file cabinets. Depending on the system you choose and your requirements, there may be as many as 70 fields necessary for generating lease journal entries, and only some of those come from the agreements. You'll need help from others such as your Treasury department and your bank to get inputs regarding incremental borrowing rate, if necessary, and business managers for decisions regarding exercise of renewal, purchase and termination options.

For data abstraction, a manual or automated (using artificial intelligence) approach may be better, depending on your lease structure and portfolio. Many companies assume that if their leases are being managed by a third party or in existing systems, the data will be complete, accurate and easily exported to upload into a software tool. Unfortunately, we found many instances where only basic data fields were updated and significant data gaps remained. The importance of data accuracy and validation prior to uploading into your system cannot be underestimated.

2. SELECT YOUR SOFTWARE CAREFULLY

Most companies do not have all their leases in an existing database or software, and those that do typically have only used software to manage their real estate leases. Leasing processes have generally been owned by legal, procurement, or real estate, with little oversight from the Controller's group. Now that the maintenance of accurate data for all leases is imperative to record the journal entries, companies with more than about 50 leased assets (note there may be multiple assets per lease) will need a software solution to ensure ongoing, sustainable compliance.

When selecting the best software, you'll need to gather input from all stakeholders regarding the outputs and features necessary for their purposes, whether it's facility or equipment planning, tax or regulatory compliance, or financial reporting. The capabilities, ease of use and cost of the systems available in the marketplace vary significantly. Some things to consider include:

- Makeup of your portfolio (lessor or lessee, sublease activity, and real estate or equipment assets)
- Need for accounting and/or life cycle management; level of detail required (asset-level, cost center)
- Cloud versus on-premise
- Licensing and implementation cost
- Integration with other systems (ERP, legacy, Accounts Payable)
- Vendor stability and client references
- Ease of use (batch upload capability, dashboards, automated lease classification, workflow management, built-in controls and audit trail)

You'll also want to consider whether the software has been tested by a reputable accounting firm for calculation accuracy and internal controls. Before signing any contract, check with references and ensure you are comfortable with the output (including journal entries) from your own transaction use cases. With a little planning and diligence up-front, you'll pick the right software – *the first time*.

3. CONSIDER OPTIONS FOR POLICY & IMPLEMENTATION DECISIONS

As data gathering has proven to take the most time in a project, you'll want to ensure you only spend time on relevant contracts. Therefore, **scoping may be the most important activity to gain efficiencies for your project.** First, it's important to identify your reporting languages, whether US GAAP, GASB, IFRS or statutory/tax, and effective date (2020 for private companies). Next, consider whether practical expedients could streamline your implementation or cause additional administrative work to operationalize. For instance, the short-term lease expedient may gross down your balance sheet, but will cause additional work to track due to reassessment and disclosure requirements. Conversely, the package of transition expedients and newest transition option consistently reduce implementation time. Considering pros and cons of practical expedients, concluding on technical questions regarding embedded leases and outlining your lease policy will help ensure you haven't missed anything.

Policy decisions impact the amount capitalized on the balance sheet and expensed in the income statement and thus affect EBITDA and other metrics important to debt covenants and executive compensation. If you're implementing a software solution, you may want to consider prioritizing leases to input into the system, depending on complexity of the contracts, decisions regarding short-term exclusions, integrations with accounts payable and materiality. Most companies are finding that automation is a journey longer than just the planned implementation timeframe.

4. PROJECT & CHANGE MANAGEMENT ARE KEY TO STAYING ON TRACK

Aside from strong executive support, **managing the project plan and embedding change through the organization may be the most critical success factors.** Such transformation projects affect many stakeholders in an organization, requiring a detailed plan and diligent management of milestones. Without the direct focus and effort of management, operations, treasury, IT, procurement and accounting, errors and delays could occur at the most inopportune times. Accountability is key to help ensure all individuals contribute in a timely manner. With a short runway to compliance, the workstreams to assess the impact, collect data, select and implement software, train staff and design Day 2 processes and controls must be carefully managed. While it may be only a part-time role, dedicated resources are best rather than adding the responsibilities to someone's already full-time job.

5. PLAN FOR DAY 2 TO ENSURE SUSTAINABLE COMPLIANCE

Most companies realize the importance of processes and controls to make the leasing cycle efficient and maintain compliance post-implementation. The problem is that many companies focused only on the implementation project and raced to the effective date that they left the sustainability part to the end. In reality, the effective date, like Cinderella's wedding day, is actually the beginning of the work and not the end. Planning for this should not be underestimated. The fairy tale ending is only possible with careful design of processes, roles and controls, assisted by automation.

Achieving sustainable compliance for Day 2 operations may involve establishing a Center of Excellence (COE) and includes:

- reviewing your strategy regarding which assets are purchased or leased and implementing an effective lease/buy process;
- evaluating organizational design of roles for lease origination in procurement, legal or business units,
- extracting, inputting and maintaining accurate lease data,
- designing controls to prevent and detect accounting errors, ensure lease population completeness, and provide effective end-of-term management to capture some return on your investment.

Now that's a compelling "*Happily Ever After*."

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