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Seven Tips for Getting Lease Compliance Right

BY **PRANAV TYAGI** | SEPTEMBER 2019

The race to compliance is on for the new ASC 842 lease-accounting standard. Earlier this year, Deloitte released the results of a survey that found only 30-percent of private companies planned to adopt ASC 842 by the current January 2020 deadline. Perhaps the survey's most eye-opening discovery is that 77-percent of respondents noted their companies were either "unprepared" or just "somewhat prepared" to comply with the new standard.

With the deadline looming, private companies should be gauging where they are in the compliance process and how long compliance will take to achieve. Luckily, public companies have been working toward this goal for years, and now is an opportune time to analyze both their successes and challenges and to learn critical lessons that will help private companies successfully adopt the new regulations.

For public companies, the deadline by the Financial Accounting Standards Board, or FASB, to adopt the new lease-accounting standard has already passed. Private companies, however, still have time, as FASB recently passed a one-year extension. The new lease-accounting standard requires a shift in mindset because ASC 842 changes how leases are defined and then accounted for. Due to such a fundamental change, everyone from leadership to accountants should understand the implications of the new standard – and the best practices for both ensuring and sustaining compliance.

Companies need to decode the complicated new rules of ASC 842 and develop the best strategy for overcoming common challenges they present. Below are the best practices from global organizations across many industries who have reached successful ASC 842 compliance.

1. **Start early; don't wait.**
   Do not delay beginning the process. Many corporations underestimate the timeframe for implementing FASB's lease-accounting standard, which sometimes leads to costly delays. Firms should plan enough time for unforeseen complications and distractions. They should also assess the resources needed to support their transition to ASC 842,

taking care to factor in other business priorities that might affect the process. Several essential questions will illuminate potential road bumps along the way, such as: *How many departments will be involved? Will the organization use outside help? Who will be the champion of this cause?* Carefully answering these and many other questions will provide a strong foundation for moving forward toward successful adoption.

2. **Asses data-quality issues.**
The new standard requires more information than the old one. It can require as many as 75 data points across all types of leases, including real estate, equipment and embedded. There are many reasons organizations might have data-quality issues. Assessing current systems and gaps will facilitate the adoption and help eliminate unwelcome surprises. For example, there might be no current system of record. Leases might be spread out over several systems and locations. Moreover, the information might only be found inside of lease documents, making it particularly inaccessible. Historically, organizations have focused their previous compliance efforts on real estate leases and have not systematically captured data related to non-real estate leases. The result has been a significant gap in data availability and quality.

3. **Keep it simple.**
Lease accounting has become even more complex with the announcement of ASC 842. The changes to the business processes that arise not only from this new standard – but also from the implementation of new technologies for lease administration and accounting – are often underestimated or overlooked. The choice of adoption method can either streamline or complicate the process. Practical expedients were added to the code to streamline the process and reduce the administrative burden along the way. Choosing a more complicated method should be considered only if the benefits heavily outweigh the increased effort of adoption and accounting maintenance. Organizations should only choose this course if the information and support systems are in place to make such a decision practical.

An example of a choice that might complicate the process would be apportioning partial payments to non-lease components. This will reduce the impact to the balance sheet, but the application of ratios to all bills will complicate the general ledger accounting and the AP process.

With regard to International Financial Reporting Standards, or IFRS, using different initial measurement dates for assets and liabilities provides balance-sheet and income-statement advantages alike. However, it complicates adoption and the disclosures surrounding the impact to retained earnings.

A frequent complication arises when companies stubbornly maintain old account structures and processes while trying to meet the new standard. Specifically, companies attempt to maintain separate accounts for all adjustments to the *Right of Use* asset. Under the simplest scenarios, this seems uncomplicated and it assists in reporting under the old standard. However, it will increase the monthly, quarterly and yearly burden in accounting maintenance and might require additional staff or significant work overtime.

4. **Understand how the organization currently calculates.**
Understanding how an organization's current systems and processes yield today's calculations – whether via spreadsheets or a formal lease administration and accounting solution – is important. *Does it truncate values? Does it round, and where? How many significant digits does it use? Does it provide inconsistent results?*

For operating leases, what is part of the ASC 842 operating-expense calculation – tenant incentive? Direct costs? Favorable or unfavorable accounting? For finance leases, is a present value calculated as if payments are made in arrears or advance calculations? Most systems calculate in arrears because it's the default and because most accounting examples are in arrears for simplicity's sake. Running a fine-toothed comb through leases is standard best practice. Try to find omissions, errors or breaks in spreadsheet formulas that already occur in the accounting now (although the transition to a new system may naturally expose those through updated calculations).

5. **Get familiar with the new standards.**
At their core, the goals of ASC 842 are to increase financial reporting transparency and comparability. But, achieving compliance means heavy demands on companies and their accountants – and an education for all involved. Accountants will need time to get up to speed on the FASB's new lease-accounting standard.

Tango Consulting has experienced challenges when a client doesn't have a minimum level of expertise regarding ASC 842. Decision making is frequently stalled. Retrieving balances needed for calculations might get delayed. The quality, transparency and difficulty of any automated accounting entries might also be affected if the accounting for the standard is not understood at the journal-entry level, which makes reconciliation, error-correction and accounting under different rules challenging.

6. **Decide who is responsible and who has access.**
It's no secret that ASC 842 touches the entire organization. Building a team that reflects the diverse functions, such as legal, IT, treasury, finance, accounting and so on, is standard

best practice on the road to compliance. There are challenges associated with this, as leases might reside in various locations across an organization and be the responsibility of various departments that have not communicated with each other in the past. For example, equipment leases are often handled at local levels while real-estate leases are handled by a dedicated group. Frequently, the real estate group takes on the adoption of the entire portfolio of leases due to the complexity of the new standard. However, local managers might be better suited to making decisions about those leases. Deciding who within the organization will have access to software tools – as well as their level of access – is critical to ensuring a streamlined process.

7. **Understand lease scenarios.**
   At some point, all organizations are going to need a plan to get compliant. Without a thorough understanding of the lease portfolio, that plan might have limited value. It will either be amended repeatedly, delayed or under-resourced, or prove insufficient to the needs of the company, often with expensive repercussions. Therefore, organizations should have a thorough understanding of various lease scenarios and precisely what's in their leases today.

   Some common lease scenarios that often trip up clients as far as process and accounting are allocation of non-lease components from fixed payments, dual cost-center allocation, leases with land and building, make-ready provisions upon exit, and complex currency considerations. Changes in the company's real estate strategy – and how it provides value to the company – should be considered.

   Planning can eliminate a great deal of rework. Additionally, this is also an ideal opportunity to track or to take advantage of lease scenarios you previously haven't been able to, such as co-tenancy provisions, CAM reconciliations, and security deposits. If a new system can manage these scenarios, but you do not plan on how to take advantage of them, money can get left on the table.

Many public companies thought they had a good grasp of the FASB's ASC 842 standard and its challenges, or felt they were sufficiently prepared to comply with the new standard. However, the reality was that they were in uncharted territory. They were often the unwilling trailblazers, and organizations that are now in the process of compliance can benefit from their experiences. Although there's no magic bullet in this process – and looking for one will be fruitless – being disciplined and following the tips above will help mitigate potential problems.

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