

DON'T WAIT!

Here's the first lesson of the
new lease accounting standards:
There's no time to lose in
implementation



Time to get started

ASC 842 is finally a reality for nonpublic organizations — and they need to get on it fast, say experts

By Antoinette Alexander

The time has come. The Financial Accounting Standards Board's decision to not defer the effective date for the new lease accounting standard a third time for private companies and not-for-profit organizations means that now is the time to make ASC 842 a top priority and set in motion lessons learned from public entities that have made the adoption.

"If you get started now, it will be easier. Pay attention, make sure you understand the policies that you need to do, how you're going to set this up, and get started earlier so that it will be easier for you. ... There's a lot of resources out there available to help you understand it and help you to get going with confidence," said Ane Ohm, co-founder and CEO of LeaseCrunch, a provider of cloud-based lease accounting software for CPA firms.

As reported by *Accounting Today*, a request for another delay had come from the Pennsylvania Institute of CPAs, which wanted a two-year postponement until fiscal years beginning after Dec. 15, 2023, and interim periods within fiscal years beginning after Dec. 15, 2024.

In 2019, FASB granted a one-year delay to give private companies more time to adjust, and then granted another delay in 2020 due to the impacts of the COVID-19 pandemic. However, FASB denied the request for a third deferral.

"We got into this past year and people knew that this date was coming but there was a lot of talk, there was chatter around: 'Well, will it actually get delayed again or not because there's still a lot going on in our world, right?' So, the FASB came out [in November 2021] and very clearly said, 'No, we are not delaying again,'" Ohm explained. "They said there are always going to be things happening and we need to get this implementation going. And one of the big reasons to do that, to get it happening, is that there is a difference now between public and private company financials and so we want to get those back into alignment."

This means that the standard takes effect for private companies and not-for-profit organizations for fiscal years starting after Dec. 15, 2021, and for interim periods within fiscal years starting after Dec. 15, 2022. For public companies, the standard became effective in 2019.

Don't wait

As many public companies have learned firsthand during their implementation process, it is easy to underestimate

the time required and the complexities of implementation.

"I think the reality of it is, unlike public companies who have quarterly reporting, most of the private companies don't have that type of reporting. ... So, they really have until the end of their fiscal year 2022, whenever their financial statements are due to auditors, to adopt 842," said Jennifer Booth, vice president of accounting for LeaseQuery, a provider of lease accounting software. "So they have a little bit more time, but I think the big caution is that private companies definitely need to get started now because public companies demonstrated that there was a lot more work to do than they thought. And so private companies should not get complacent and think they have until the beginning of 2023 when their 2022 financial statements are done."

In fact, a LeaseQuery survey conducted in fall 2021 found that many private companies predict a challenging road ahead as they gear up for adoption in correlation with significant changes to their financials during the last year. As outlined in the survey, the top three concerns that may impact lease accounting compliance include:

► **COVID-19 pandemic lease modifications:** 73% of respondents said that their lease accounting transition had been deprioritized, or that resources were deployed to other priorities during the pandemic.

► **Staffing challenges:** 25% reported having to deploy staffing resources to other priorities, forcing them to reimagine, redesign and redeploy their lease accounting processes.

► **Going it alone:** While deciding to add new team members to complete the ASC 842 transition comes down to the way companies use technology or lease accounting partners, 26% of companies have either added to their lease accounting transition team or are actively searching for the right fit.

So how far along are private companies in their implementation process? Based on survey findings, there remains much work to be done to meet the transition deadline. Those entities that make ASC 842 a priority, evaluate their current processes, and leverage the right tools and resources undoubtedly stand to benefit.

A survey conducted in spring 2021 by Visual Lease, a lease accounting software company, found that many of the privately held companies surveyed were not yet fully compliant, and felt unprepared and lacked confidence to adopt ASC 842. According to the findings, a significant

Spotlight on

LeaseCrunch



Ane Ohm
Co-founder and CEO

What's the most important advice you can offer to organizations looking to better manage their lease accounting?

Simplify adoption by following these three steps:

1. Leverage practical expedients to streamline implementation;
2. Start early to avoid a last-minute time crunch; and,
3. Find an easy-to-use and comprehensive software that guides you toward accurate calculations and push-of-a-button footnote disclosures. Spreadsheets take more time, introduce version control risk, and are difficult to maintain for ongoing lease accounting.

How are you helping them manage their lease portfolios?

LeaseCrunch allows CPA firms and organizations to implement the new standards without being experts in them. Our easy-to-use solution is comprehensive and cost-effective, even for one lease. Users can take advantage of in-app help links, wizards and technical guidance to get started. The software offers validation checks to improve data input accuracy and ensure compliance with relevant standards. When ready, journal entries, footnote disclosures, full amortization schedules and more can be generated with one click.

LeaseCrunch, the easiest lease accounting software on the market, is a comprehensive, cloud-based solution. LeaseCrunch helps organizations implement the new lease accounting standards, ASC 842, GASB 87, GASB 96, and IFRS 16. A simple but powerful tool, LeaseCrunch significantly reduces the time needed to transition, account for, and maintain leases.



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majority of privately held companies surveyed (75%) were not yet fully compliant with the new lease accounting standard. In fact, of the 500 senior finance and accounting professionals polled, 30% said they were less than halfway to full compliance, and 5% hadn't even started.

Furthermore, 45% of respondents gave their industry a grade of C or lower for its ability to comply with lease accounting standards — including nearly one in five (19%) who gave their industry a D or F. Reasons for the unfavorable outlook included:

- ▶ The pandemic delayed the process (43%);
- ▶ It's taking more time than expected (42%);
- ▶ All of the necessary lease data is not gathered (41%);
- ▶ They are still learning all of the requirements (39%);
- ▶ They lack the necessary people, resources and technology (36%); and,
- ▶ It is a low priority (21%).

"They are not as knowledgeable about the standard itself and, again, I think that's just a resource issue. They just don't have as many folks that can focus on this alone. The other thing we know from experience is that the wave will start toward the end of this year. They are underestimating what is involved and there will be a scramble later in the year to really get to this," said Joe Fitzgerald, senior vice president of lease market strategy for Visual Lease. "So, we do tend to warn folks — regardless of whether it is software, or it's services, or whatever it is — there's only so much resources available in the market."

Echoing the sentiment, Michael Stevenson, national practice leader for Top 10 Firm BDO USA's accounting and reporting advisory services group, said, "The best words of wisdom I could give would be to start early. Plan for the adoption to take anywhere from probably four to nine months, depending on how significant the lift will be."

Continued Stevenson, "And then make sure that you identify and put in place the right project team internally. ... If you don't have the ability internally to do that, make sure you identify some external resources to assist because, I think, as you get longer down the road and closer to year-end for 2022, you are going to see those resources, from an external perspective, become much more challenging to probably get in your corner."

Begin data collection

As private companies begin the implementation process, they may soon realize that gathering all of their leases and abstracting the incremental data required for ASC 842 is easier said than done. According to the Visual Lease survey, 41% of respondents said they were not yet fully compliant because they had not gathered all the necessary lease data. Too often, relevant lease contracts are decentralized and scattered across various departments within an organization. Furthermore, 8% of respondents said they were still using outdated spreadsheets to manage leases.

When collecting lease data, uncovering embedded leases can prove especially tricky and time-consuming. An embedded lease is essentially a lease within a larger contract or arrangement; however, it may not have the word "lease" in it, making it harder to identify.

"The embedded lease is technically not a new concept under ASC 842. ... However, because it wasn't on balance sheet, it wasn't really attended to as well. ... So, that's really been a challenge for companies, that these agreements always existed and technically they probably should have been considered previously but, for whatever reason, they were ignored," Fitzgerald said.

As outlined by Big Four firm Deloitte, several common areas where embedded leases could be hiding include:

- ▶ Information technology contracts (e.g., servers);
- ▶ Transportation and delivery services (e.g., railcars);
- ▶ Contract manufacturing arrangements (e.g., dedicated tooling);
- ▶ Cable and satellite services (e.g., set-top boxes);
- ▶ Advertising (e.g., billboards); and,
- ▶ Power purchase arrangements (e.g., power plants).

Said Stevenson of BDO, "I think understanding the complete lease population is one of the challenges, and I think that goes along with the embedded leases. ... Companies really need to do a [more] robust evaluation as to whether their contracts do contain a lease or not."

Matt Waters, the director of lease accounting with CoStar, a provider of lease accounting and lease administration software, pointed out the importance of looking at practical expedients, which are considerations companies can elect to help ease their burden in the adoption of the new lease accounting standard.

"As companies get into their project, they have to really think through and stop and think, 'OK, if we use this practical expedient, does it make things easier now, but could it potentially make things harder later on?' The one I'm thinking of there is the practical expedient to combine lease and nonlease components," said Waters. "A lot of companies say, 'Well, it's easier, so let's just go for it, let's combine lease and nonlease components.' The consequence of that is they end up with a higher liability on their balance sheet and so they have to think about it."

In reference to practical expedients, Ohm said, "One of the big things that organizations need to pay attention to are the practical expedients that the FASB allows for when there are transition leases. ... If you were properly identifying leases before then, you don't have to go through and reidentify your leases under 842 because there are slight differences; it's not huge but there are slight differences. You don't have to go through a whole reassessment of those leases already identified."

Added Ohm, "You also don't have to relook at your classifications. So, if you have a lease properly classified as an operating lease under ASC 840, it is an operating lease under ASC 842. A capital lease under ASC 840 is a

Spotlight on

Visual Lease



Joe Fitzgerald
Senior vice president of lease market strategy
What's the most important advice you can offer to organizations looking to better manage their lease accounting?

Prioritize the right solution. According to a recent survey, 46% of private companies identified education as a top challenge associated with maintaining lease accounting compliance. This is because post-adoption, companies must be informed of key considerations and milestones, which points toward a critical need for streamlined processes and increased visibility. Dedicated software solves this need through automated calculations, which reduce the risk of manual error, and audit trail functionality, which ensures modifications are recorded and fully auditable.

How are you helping them manage their lease portfolios?

Some companies manage their leases via spreadsheets. While this can work for companies with very small lease portfolios, it's time-consuming and will increase the likelihood of human error. Visual Lease provides companies with one secure and centralized location to store, manage and report on their leases. The unique level of control that we offer allows them to automate crucial parts of the lease accounting process, stay on top of important deadlines, confidently report on their leases, and maintain visibility across their portfolios.

Visual Lease is the No. 1 lease optimization software provider. We help organizations become compliant with FASB, IFRS and GASB lease accounting standards, while simultaneously improving the financial, legal and operational performance of their leases. Our easy-to-use SaaS platform is embedded with more than three decades of best practices from major corporations and leading industry professionals. Our award-winning solutions are used by 1,000+ organizations to manage 500,000+ real estate, equipment and other leased assets. Visual Lease helps organizations transform their lease compliance requirements into financial opportunities. For more information, visit visuallease.com.



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finance lease under ASC 842. And the way that you calculate initial direct costs is different under 842. ... I've seen organizations do this. They feel like they have to do everything under 842, and so then they start redoing work and they do not have to."

It should also be noted that, in November 2021, FASB issued revised discount rate guidance for lessees that are not public business entities — including private companies and not-for-profit organizations.

FASB originally provided nonpublic entities with a practical expedient that allowed them to make an accounting policy election to use a risk-free rate as the discount rate for all leases. This was to relieve those lessees from the cost and complexity of having to calculate an incremental borrowing rate. However, some private company stakeholders expressed reluctance to use the risk-free rate election for all leases out of concern that using it could increase an entity's lease liabilities and right-of-use assets.

To address these concerns, the new amendments allow lessees that are not public business entities to make the risk-free rate election by class of underlying asset, rather than at the entitywide level, according to FASB. It also requires that, when the rate implicit in the lease is readily determinable for any individual lease, a lessee use that rate (rather than a risk-free rate or an incremental borrowing rate), regardless of whether it has made the risk-free rate election.

"[This] means for smaller leases you can use that risk-free rate because it's probably not going to be that material, but for larger leases you put the effort in to figure out your collateralized borrowing rate. ... That flexibility of being able to determine the discount rate by asset class is a big deal," Ohm said.

Said LeaseQuery's Booth of the revised discount rate guidance, "I think that's a very helpful accommodation to private companies. Private companies may want to think through: Are there certain asset classes that they can use that risk-free rate for? Yes, it's lower than an incremental borrowing rate would be and, therefore, the asset would be discounted less and the liability would be discounted less, but it would be so much easier for private companies to calculate that. They may want to think through for certain of their asset classes if that ease is worth it."

Waters also highlighted the importance of setting accounting policies around lease accounting. "For a nonpublic company, they need to decide between typically an incremental borrowing rate and the risk-free rate," said Waters. "Once they set that policy, they have to set a policy around how to collect to their rate, and for different leases the rate will be different. The term of the lease factors into that, so a 10-year lease would have a different rate than a 20-year lease, and so on. A 30-year lease would have a different rate as well. And then that incremental borrowing or that risk-free rate also poten-

tially changes based on currency or geographically, and also can change based on if the leased asset is equipment or real estate. All of those details add up, and that's just one policy around the incremental borrowing rate."

Day Two and beyond

It's easy to focus on Day One, but what about Day Two and beyond? Having a plan and the right technology in place is critical for long-term sustainability. Consider this: According to Visual Lease research, nearly all — 99% — of survey respondents think they will face ongoing challenges maintaining ASC 842 compliance going forward. The top reasons for this include:

- ▶ Tracking and managing modifications to leases (57%);
- ▶ Adoption of new technologies to optimize the process (51%);
- ▶ Execution of new policies and processes (50%);
- ▶ Continued training and education of staff (46%); and,
- ▶ Enforcing process controls (41%).

As some public entities have learned firsthand in their implementation of 842, the project is far from over once the standard is adopted. In fact, some public companies were so focused on Day One implementation they are now having to replace their original lease accounting software with a more robust, full-functioning solution.

"Full lease accounting functionality is table stakes for us or any companies in this market. So, we have all of the features you would expect from a lease accounting perspective," said Fitzgerald of Visual Lease.

Also pointing to the importance of ensuring sustainability, Waters of CoStar said, "Companies should also consider Day Two and get the functionality they need in their software to set them up for success going forward."

Noted Booth of LeaseQuery, "Modifications and terminations — those are very complex accounting transactions. There are nuances in how those are accounted for and that can be very time-intensive for a company to research. So, with our software you click that you had one of these changes, you click that you had a modification or a change in payment terms, and the software will walk you through that change."

Meanwhile, looking to help serve those entities with a smaller number of leases is iLease Management, which recently launched iLeaseXpress, a cloud-based lease accounting solution providing compliance with the ASC 842 leasing standard for private companies that have fewer than 15 real estate and equipment leases.

While the adoption of lease accounting can seem daunting, it is important to keep in mind the benefits to be gained. "The whole lease optimization concept and how to maximize your portfolio is the part that really excites me because you turn compliance into a profit center," said Fitzgerald. "Some people don't like when I say it but that's, in effect, what happens." **AT**

Spotlight on

LeaseQuery



Jennifer Booth
Vice president of accounting
What's the most important advice you can offer to organizations looking to better manage their lease accounting?

Companies that have not adopted the new lease accounting guidance must start accounting for contracts they are aware of now. Gather key figures and, if using a lease software, start populating the data. Use this information to develop policies and determine discount rates. Perform procedures (i.e., embedded lease considerations) to validate the completeness of inventory contracts.

Additionally, companies should implement "Day Two" procedures to ensure the accounting department is aware of lease agreement changes.

How are you helping them manage their lease portfolios?

The pandemic showed lease arrangements are not a "set it and forget it" model. The new guidance complicates accounting for lease changes. LeaseQuery's accounting software simplifies the complex by providing companies the expertise to account for lease modifications and terminations. The software accurately processes these transactions in journal entries and reports. LeaseQuery also has alerts to trigger events, helping users make informed lease renewal and overall lease portfolio management decisions.

LeaseQuery makes accountants' lives easier with user-friendly and trustworthy financial accounting solutions that simplify the complex. Over 28,000 financial professionals globally rely on LeaseQuery's cloud-based, CPA-approved solutions and in-house accounting expertise to comply confidently with various FASB, GASB, and IASB accounting standards. Rated No. 1 for user satisfaction and ease of use for lease accounting software, LeaseQuery's platform helps businesses minimize risk, increase efficiency, and reduce costs by arming their accounting teams with operational tools, data integrity, accounting intelligence, international consideration, and specific disclosure reports required by auditors and regulators.

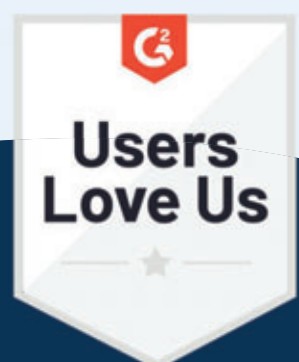




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