

PRIVATE COMPANIES AND LEASE ACCOUNTING



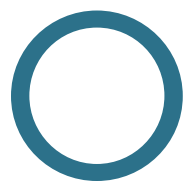
A 2019
PROGRESS
REPORT
EXECUTIVE
SUMMARY

Market Readiness Three Years after
the Publication of ASC 842

lease
accelerator[®]

LEASE ACCOUNTING PROGRESS REPORT 2019

EXECUTIVE SUMMARY



Over three years have passed since the initial publication of the new lease accounting standard (ASC 842) in February 2016. Some have called the new standard the biggest accounting change ever as some \$3 trillion worth of assets transfer onto corporate balance sheets in the coming years. It is not often that new line items are added to the balance sheet. As a result, the new right-of-use assets and liabilities will be heavily scrutinized by shareholders, debt holders, external auditors, and independent board members following adoption. In the US, public companies began adopting the new standard at the start of 2019. All remaining public companies will transition to ASC 842 throughout the duration of the year. A similar wave of adoption will occur next year as the implementation deadlines for private companies commence starting in January 2020.

In an effort to provide a quantitative progress report on the status of compliance efforts for private companies, LeaseAccelerator conducted a research study in late January 2019. Approximately 350 finance and accounting leaders from US-based private companies with \$1 billion or more in revenue were surveyed. We elected not to include any public companies as most were busy closing their books for the first time under ASC 842 during the survey period.

KEY FINDINGS

Almost 40% of Private Companies Have Not Started the ASC 842 Project

Approximately 40% of private companies surveyed are behind schedule or have not started their ASC 842 project - a concerning metric as the first implementation deadlines are quickly approaching. However, 12% indicated that they had already completed the project. Those that have completed include private companies who are planning IPOs in the near future or are in the process of being acquired by a public company. There are also some privately held companies that have registered securities or are SEC filers and so must follow the deadlines for public companies. The remaining 48% of private companies surveyed indicated that they were on schedule or ahead of schedule. However, some of these companies may be underestimating the work effort remaining before Day One compliance, much like their public company counterparts did.

75% Find Leasing Project More or As Complex as Revenue Recognition

Overall, 55% of private companies are finding the lease accounting implementation to be more complex than anticipated. The top implementation challenge cited by more than 40% of respondents was identifying the population of leases and abstracting the data needed for the accounting calculations. Other top challenges cited included modifying existing business processes, project managing the enterprise-wide work effort, and applying new accounting policies. Compared to the revenue recognition accounting standard (ASC 606), 75% are finding the new leasing standard to be just as much effort or more effort.

Equipment Leases are the Most Challenging to Find and Analyze

Although real estate leases represent the largest spend category at most private companies, project teams are not finding these contracts to be the most complex to locate and analyze. Instead, equipment leases, such as IT vehicles, plant, machinery, and transportation assets are proving more challenging. Equipment leases have historically been tracked in spreadsheets with few defined business processes around management. As a result, companies, have to search through vendor invoices, contract repositories, and maintenance records to identify the universe of equipment that is being leased and may need to be transitioned onto the balance sheet. By contrast, real estate leases are typically centrally managed in a business application and are therefore easier to locate.

Almost 80% of Private Companies Have Yet to Select a Software Provider

Enterprise lease accounting software applications from both ERP and new best-of-breed vendors are the most popular choice amongst software applications. Only 10% of private companies are considering real estate administration software vendors as an option. Regardless of vendor preference, significant work remains for private companies as almost 80% of those surveyed have yet to select a lease accounting software vendor. Also noteworthy is that more than 50% of private companies currently are planning to use spreadsheets to perform the accounting calculations which is likely to change post-adoption. While spreadsheets are often the application of choice for financial power-users, they are typically challenging to test, track, maintain, and control over a longer period of time.

ASC 842 is Not an Accounting Project, but an Enterprise-Wide Initiative

More than 60% of private companies have assigned a formal project manager from the accounting or financial reporting team to lead the project. Unlike other accounting change projects that can be accomplished within the four walls of the Controller's organization, ASC 842 requires a truly cross-enterprise effort. Corporate functions such as Procurement, Treasury, Accounts Payable, Tax, and Legal will touch almost every lease throughout its lifecycle. Support from the business units and functions that use the leased assets, such as Operations, Logistics, IT, and Corporate Real Estate will be critical as well. Private companies report that one out of four project teams have the Corporate Real Estate and IT teams playing a strategic role. Gaining support from the business will be a key challenge for most companies as the additional oversight, policies, and governance for leasing will not be welcomed by the users of the leased assets. Over 40% of companies have appointed an executive sponsor to help solicit participation from different stakeholders as well as secure budget and resources for the project.

RECOMMENDATIONS

Private companies will undoubtedly benefit from having one extra year to adopt after public companies. Software applications will be much more mature by early 2020, consultants will be much better versed in leasing processes, and auditors will be more prepared to provide guidance. However, private companies should be careful to avoid the pitfalls that many public companies encountered in their journey towards compliance, especially the three below.

Many Private Companies are Underestimating the Complexity Associated with Implementation

Approximately 50% of private companies indicated that they were either ahead of schedule or on schedule with their lease accounting projects. A similar optimistic sentiment was offered by last year's survey respondents with 60% of public and private companies indicating they were ahead or on schedule. However, at the time of the publication of this study, hundreds of publicly traded companies are closing the books on their first quarter reporting under ASC 842. Very few of these public companies are indicating that the project is anywhere near complete even though they are a few months past the implementation deadline. Most are indicating that a concerted effort will continue to be required throughout most of 2019. Private companies should not underestimate the level of complexity that will be required prior to transition and in the first year after adoption.

Private Companies Should Invest Time in Last Mile Activities such as Testing, Training, and Talent Development

Collecting data, implementing systems, and modifying business processes will be the largest work efforts required prior to Day One. However, there are many additional activities that need to be completed as well, which many public companies underestimated. Most of these fall into the “last mile” of the project in the final 90 days before transition. Testing the accuracy of the accounting is proving to be a formidable challenge for many large public companies. There are over 100 billion combinations of use cases that can exist under ASC 842 when considering the different payment structures and events that can occur throughout the leasing lifecycle. In addition to developing a strong test plan, project teams will need to train end-users and communicate policy changes throughout the organization. Perhaps, most importantly, companies will need to staff a team of lease accountants to perform the ongoing analysis of changes to the portfolio. Some may need to build centers of excellence specifically focused on leasing.

Accounting Teams Should Not Focus on Day One, but Rather Year One Readiness

Although most private companies currently are focused on getting ready for the deadline, the project is not over once the new standard is adopted. In fact, many have described the implementation process as “a race to the starting line.” Public companies in the first quarter of adoption are struggling with issues such as proving the accuracy and completeness of their lease population. Perhaps the greatest challenge, however, is the need to track changes to the lease portfolio. A company with 300 leases will have to track an average of 230 events in a single year as assets come off lease, new leases are signed, and changes occur throughout the term. Real estate leases have frequent rent changes as well as expansion clauses, tenant improvement allowances, and early renewal options that can be executed at various points in a 10-year lease. Equipment assets under lease can be lost, stolen, damaged, purchased, returned, renewed, or upgraded during the relatively short term of a three-year lease. Tracking these activities with spreadsheets and emails will prove challenging even to the most organized of accountants.



LeaseAccelerator Inc.

10740 Parkridge Boulevard Suite 701
Reston, VA 20191

United States

1-866-446-0980

<https://www.leaseaccelerator.com>