APAC LEASE ACCOUNTING

PROGRESS REPORT 2020

lease accelerator

TABLE OF CONTENTS

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EXECUTIVE SUMMARY

The day-one compliance deadline for IFRS 16 has come and gone across APAC. LeaseAccelerator's latest report focuses on day-two (post-adoption), capturing the new challenges and opportunities for accounting, finance, treasury, FP&A, procurement and legal teams and sharing these insights with the wider industry. This research study, conducted with over 100 senior finance and accounting professionals (vice president and C-suite level) from companies across Asia Pacific, covers the period after the first reporting season in 2019 to January 2020.

The report found that APAC companies are still grappling with the complexities of the new standard, with some yet to implement it despite deadlines having well and truly passed. However, recognition of broader business benefits to be gained from implementation is a growing theme. Companies no longer view lease accounting as just a compliance project, but rather as an optimisation project as they find efficiencies, business gains and cost reduction opportunities from the unearthed treasure trove of new data.

This report follows a May 2019 study conducted by LeaseAccelerator with over 60 senior finance and accounting professionals from Australian companies, which provided a quantitative progress report on the status of compliance efforts prior to the deadline. Our key findings then showed that most companies surveyed believed they were on track, but one-third expected to struggle to achieve compliance. Most project teams were focused on simply complying with the new implementation deadlines but felt that another set of challenges awaited around day-two and beyond. At that time, LeaseAccelerator recommended that project teams should implement long-term business processes, policies, and controls to ensure that their lease accounting remained accurate after day-one and positioned businesses to realise additional benefits from day-two and beyond.

To gain deeper insight as to what companies experienced during and after implementation of IFRS 16, the survey questions for the 2020 progress report focused on perceived benefits, expected challenges, and past experiences.

A summary of the findings is outlined below:

KEY FINDINGS

1. It's not over yet – 25% of respondents yet to adopt the standard!

One quarter of respondents are yet to adopt AASB 16/NZ IFRS/IFRS 16.

In our May 2019 study, 32% of companies were behind schedule or had not started, which may indicate why 25% of companies are yet to adopt the standard. It appears there has been a catch up in the implementation project for some organisations.

In addition, just under half (48%) of companies surveyed say that they are still completing the implementation project and transitioning to AASB 16/NZ IFRS/IFRS 16. This indicates some companies are still fine-tuning their compliance, specifically to automate the maintenance and accuracy of data moving forward (refer to Key Finding 2).

2. Tracking changes to the lease portfolio will be the greatest challenge going forward.

In our May 2019 survey, we advised that project teams should implement long-term business processes, policies, and controls to ensure that their lease accounting remains accurate after day-one. Day-one compliance is considered the beginning of the lease accounting and lifecycle management journey, not the end.

In our recent study, this has been recognised by participants as the biggest challenge, with 68% selecting tracking changes as one of their top challenges on day-two. Over half (53%) indicated that improving lease administration processes to track portfolio changes is a key focus for 2020.

The primary objective for controllers must be to ensure a reliable, repeatable, and accurate global close process that works well within existing month-end close time frames, and does not strain human capital beyond their limits. This process must now occur in the context of compliance with the new lease accounting standards. Initially, many firms thought that compliance would simply be a question of applying known calculations against the data in their lease portfolio. Depending on the state of their data, this was indeed the case for many in achieving initial day-one compliance.

But as we've seen, these organisations are now finding that maintaining the completeness and accuracy of this data is an extremely complex process of considerable scale. We estimate that the average lease portfolio is modified between 25 and 50 percent each year due to numerous regular changes to lease contracts and underlying assets that can materially affect the reporting required by the regulations. Many of these changes can only be accounted for by communicating with all of the lease owners and asset users across the organisation. What's more, once these changes are recorded, they must be analysed, the proper judgements and decisions applied, and any resulting changes booked into the system with applicable audit support. In order to properly adhere to corporate governance goals, these judgements and decisions must be applied consistently based on strict policies and controls.

This is consistent with our findings in the May 2019 report where survey respondents identified modifying business processes, policies, and controls (38%) as the second most significant implementation challenge after data collection and abstraction (55%).

The bottom line is that attempting to support a regular close process in a timely and accurate manner without automation is labour and cost-intensive and introduces great potential for human error.

3. Improved lease administration is expected by 65% of respondents.

The majority (90%) of respondents believe that they will realise cost and efficiency benefits to the business beyond mere compliance once they are automated. Improved management of the lease portfolio has been shown to increase savings by providing the data needed to secure better deals, eliminate wasteful practices, and reduce the need for manual intervention.

Lease lifecycle management and administration, covering the collection of new lease data and the tracking of changes to leases, is not only the area of major and immediate benefit (65%) but also the biggest future challenge facing companies. Thus, over half of the companies say it is a key focus for them during 2020.

Most of the companies that didn't see themselves realising any business benefits were small companies with small lease portfolios. In our last report we found that many project teams that were focused on simply complying with the new implementation deadlines had not included day-two considerations in their project plans. The fact that these respondents haven't focused on day-two considerations such as ongoing automation, combined with their lack of leasing complexity, may be a reason they do not expect any benefits.

4. Companies are recognising that including broader business analysis in the compliance project has its own benefits.

With many organisations around the world passing their day-one compliance more than a year ago, a huge lesson has been to run the project as a change management and operations project and embrace it as an opportunity, rather than a burden. When future opportunities and benefits were identified and incorporated into the project from the start, the project realised these business benefits sooner.

The process of compliance itself has produced business benefits with over one third (37%) saying they have already realised or will realise these within the next six months, particularly in the area of lease administration.

It seems companies are learning from those who have gone before. Over half of the companies still completing the implementation project are working on realising business benefits. Simultaneously, they are automating their reporting and the monthly close, improving lease administration processes, and analysing lease contracts to identify cost saving opportunities.

5. Accounting function is taking ownership of the ongoing lease accounting project.

The accounting/financial reporting department is leading the charge with over half the projects (52%) solely managed by them. Only 5% of organisations do not have accounting involved, and in those cases IT or corporate real estate are leading the project.

The remaining respondents (43%) indicate they employ a multi-disciplinary project team including one or a combination of IT, supply chain, treasury, and/or corporate real estate.

With half the projects being solely run by accounting, one of the top anticipated challenges is enforcing governance, policies, and controls (40%). This would be easier with executive buy-in from all departments that use leases or are involved in the lease management workflow.

6. Leasing compliance project more complex than revenue recognition.

Compared to the IFRS 15 revenue recognition accounting standards, 91% of APAC companies are finding AASB 16/NZ IFRS/IFRS 16 to be just as complex or more challenging. This is about the same response we collected prior to day-one (93%) indicating that challenges persist post implementation. In fact, implementing local equivalents of IFRS 16 has been, and continues to be, complex overall. Companies face new challenges and complexities for day-two as they optimise and fine tune their solution and sustain new business processes.

Little regard was paid to the underlying complexities of maintaining compliance in day-two and beyond. A great deal has been learned by these firms around the complexity of lease accounting. Having now undergone a few cycles with their systems, many are now seeking solutions that leverage advanced automation to address these tedious, repetitive, and often large-scale processes.

For over one-third (37%) of companies, the level of complexity increases with the need to provide external financial reporting that complies with multiple lease accounting standards, including NZ IFRS, IFRS, and US GAAP.

The significant trend here is that firms of all types and sizes now realise that the complexities of lease accounting are indeed far more daunting than first anticipated. The incremental work required to sustain complete and accurate lease data for accounting purposes has resulted in manual processes that are time-consuming, expensive, and risky.

RECOMMENDATIONS

Automation and change management are key to achieving accuracy and completeness of lease accounting data

Maintaining complete and accurate lease accounting data requires the ability to constantly capture and record all the changes that are reasonably certain to occur to a lease and/or underlying assets over the lease lifecycle. This requires regular communication with right-of-use (ROU) asset owners and users to confirm contract and asset status. For any reasonably sized portfolio, this becomes unscaleable as a manual process.

For many firms, compliance initially appeared simply to be a question of applying known calculations and judgements against the data in their lease portfolio. What these organisations are now finding is that maintaining the completeness and accuracy of this data is an extremely complex process of considerable scale, requiring many process changes and controls. In addition, the scope of responsibility in lease accounting is often very broadly shared among many titles and roles. This calls for solutions that not only automate the process, but also enforce role-based access and defined workflow.

Fortunately, applying user-defined policies repeatedly with consistency and accuracy to the entire lease portfolio is something that software is very good at. Software solutions need to take complexity away from people's jobs, not add more opportunities for manual error. To effectively evaluate the ability of a software solution to provide accurate and reliable results on an ongoing basis, look for things such as automated judgments and decisions based on centrally defined and managed policies and controls. Further, look for a system that employs automated workflows to regularly collect asset and lease status, communicates with asset and lease owners using simple systems familiar to them such as email and spreadsheets, and solves the entire lease lifecycle - from sourcing to sunset.

In the aftermath of day-one, more and more companies are finding that the upfront cost of a sophisticated system that can be configured with your organisation's rules, judgements, decisions, lease/non-lease components, and IBR yields a lower cost-of-ownership than maintaining teams of people to do these jobs.

Organisation wide effort = organisation wide benefits

Even though accounting is usually in the driver's seat, the scope of IFRS 16 and its local equivalents cannot be confined within the four walls of the controller's office. Participation from the day-to-day users of the leased assets, including real estate, corporate IT, fleet, operations, and logistics, will be required along with support from corporate functions such as treasury, procurement, and accounts payable.

With the participation of business units other than accounting and a clear vision of the organisation's optimal future state – often referred to as 'day-three' – preferred outcomes can be identified and built into the project from the start, including bottom-line cost savings from more efficient lease management processes. Better management decision-making benefits all departments – particularly analysing lease contracts for better negotiations. In addition, now that owned and leased equipment and properties are sitting side-by-side on the balance sheet, analysts and investors have transparency into an entity's financial position. Business unit lessees and procurement teams have the information right in front of them to make better lease versus buy decisions for the company.

To mitigate the risk of project delays, accounting organisations should appoint a formal executive sponsor who will seek out budget and resource commitments across the business as well as sell the benefits of adhering to the new rules and processes to all involved. A project manager should also be appointed to ensure smooth, ongoing operations. Depending on the size of the lease portfolio, a project management office may be appropriate.

It's not too late to plan for day-two and beyond

Lessons have been learned and technology solutions put to trial. Lease accounting is an ongoing process that can be optimised and fine-tuned over time. Acknowledging that benefits exist outside of mere compliance makes it easier to work with other teams and departments involved in the lease ecosystem and include day-three outcomes into the day-one implementation project or even in day-two optimisation projects.

RESEARCH REPORT
SURVEY DEMOGRAPHICS

This research study was conducted with over 100 senior (vice president and C-suite level) finance and accounting professionals from companies across Asia Pacific, covering the period after the first reporting deadline in 2019 to January 2020.

Two demographic questions were asked – annual revenue and number of leases. While it may be expected that either a large revenue or a large lease portfolio contributes to complexity, there is in fact no relationship between the number of leases an organisation holds and its size/revenue. Certain very large organisations have relatively small lease portfolios and vice versa.

Chart 1: Please indicate your organisation's annual revenue.

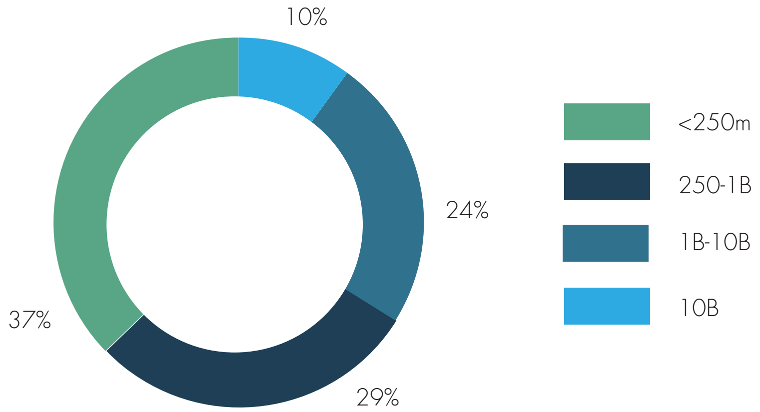
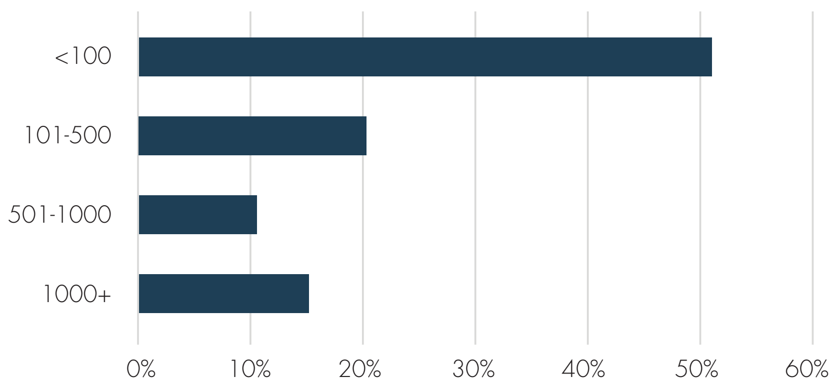


Chart 2: How many total leases do you have across your business?



When the question "how many leases do you have?" was first asked in 2019, it was a difficult one for many companies to answer. Under IFRS 16 companies are now required to report the total contractual obligations for their leasing portfolio. However, companies were never previously required to have an exact count of their leasing contracts. Large, multinational organisations have leases for a wide variety of assets, including land, buildings, computers, furniture, forklifts, photocopiers, servers, trucks, rail cars, shipping containers, and aircraft. As a result, it is not uncommon for companies to underestimate their lease population by hundreds if not thousands of leases.

However, one of the key benefits of the lease accounting project is the identification of the complete population of leases across the enterprise and the tracking of all contracts in a single, centralised repository. As many companies have now completed this process across the region it can be expected that these results are quite accurate. It's not the value of a lease that causes complexity for organisations implementing IFRS 16, it is the number of leases which hampers scalability and accuracy of lease accounting.

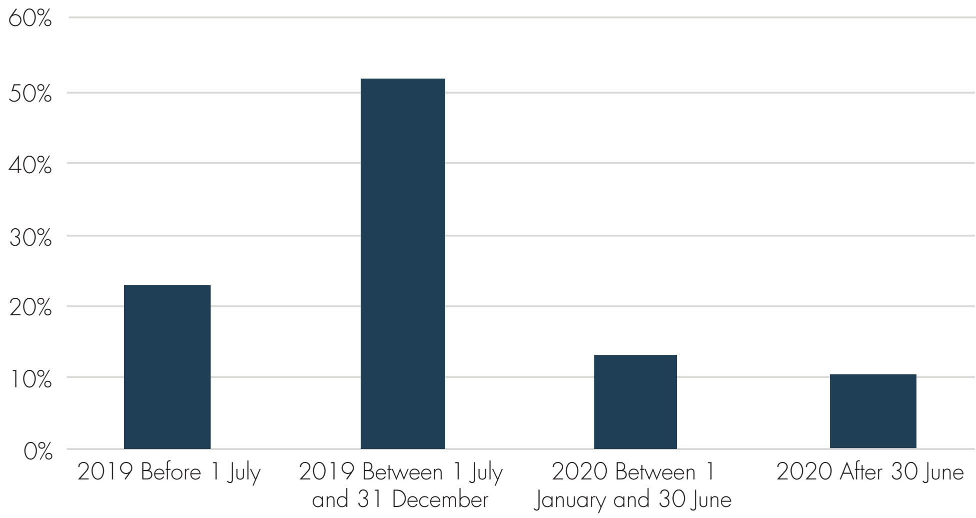
LEASE ACCOUNTING READINESS

ON TRACK

When we ran our first survey one month before the first implementation deadlines on 1st of July 2019, we asked whether respondents were ahead of, on, or behind schedule with the implementation project. Alarmingly, one-third were behind schedule.

The good news is that more recently surveyed companies appear to have caught up with their lease accounting projects, but 25% are still to adopt the standard across the region.

Chart 3: During what period did you adopt (or do you expect to adopt) AASB 16/ NZ IFRS 16/IFRS 16?



DAY-TWO PROJECT COMPLEXITY – MAINTENANCE AND OPTIMISATION

Compared to the revenue recognition accounting standards, 81% of companies have found implementing IFRS 16 and its local equivalents to be just as complex or more challenging.

The lease accounting market has seen numerous changes since its inception. In that time, buying behaviours have changed substantially. Prior to the January 2019 implementation deadline for US public companies, these (typically) larger firms were primarily purchasing solutions as a legal requirement, and so were concerned with achieving initial compliance as a straightforward project with an end date.

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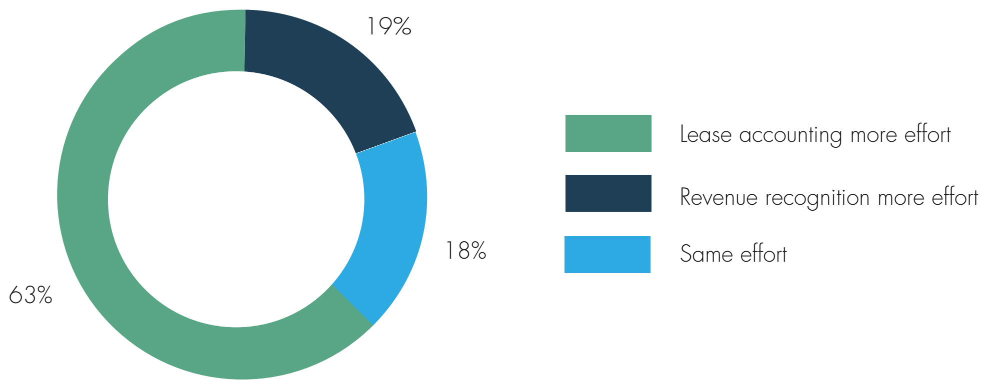
Chart 4: How does the level of effort for lease accounting compare to the level of effort for revenue recognition?



For over one-third (37%) of companies, the level of complexity increases with the need to provide external financial reporting that complies with multiple lease accounting standards, including NZ IFRS, IFRS, and US GAAP.

Chart 5: Which accounting standard does your organisation use for external financial reporting?

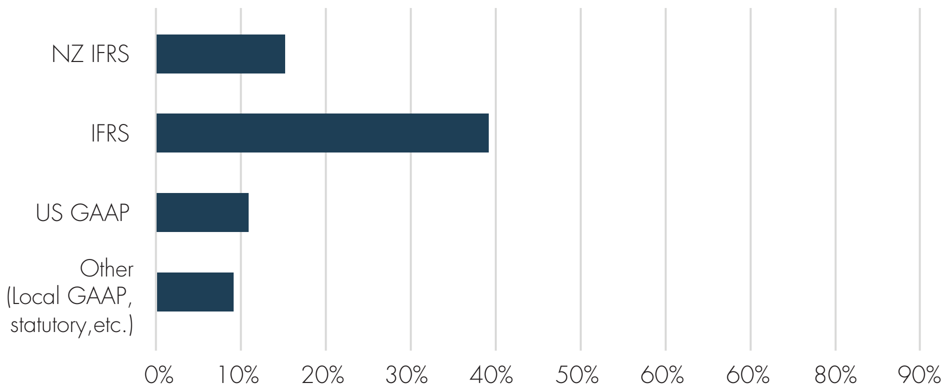
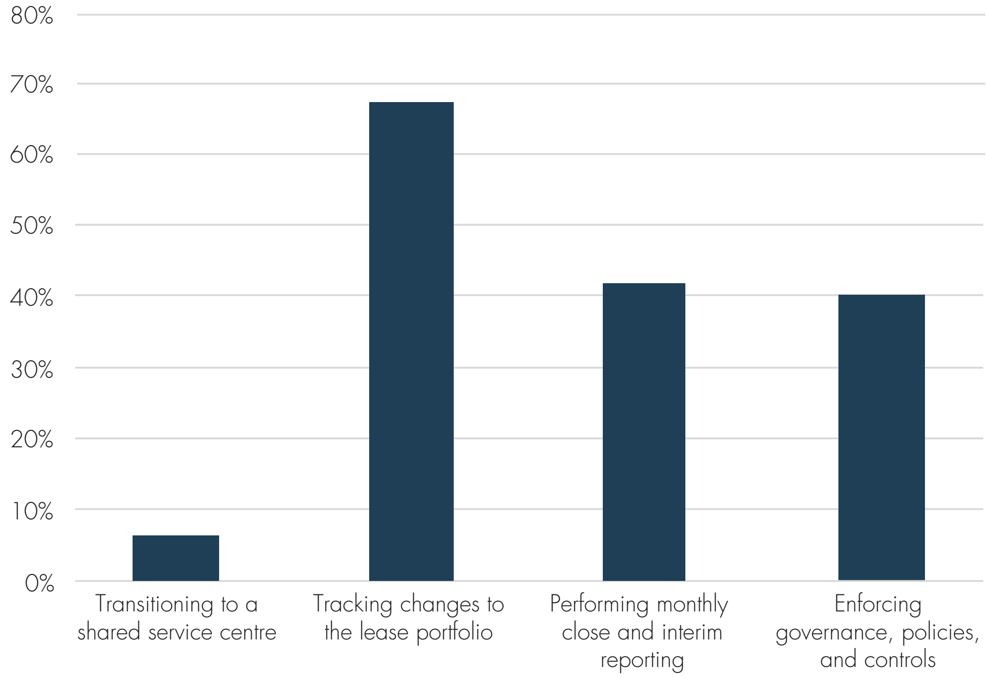


Chart 6: What do you anticipate the biggest challenge with lease accounting on day-two?



In getting to day-one, the biggest implementation challenge was collecting all the lease data. This would have been particularly hard for large lease portfolio holders. As we look at day two and beyond, data accuracy is still the biggest challenge facing organisations with 68% selecting tracking changes to the lease portfolio.

Updates to business processes and controls will be critical to ensure that accounting and leasing data remains accurate after the implementation date. This is recognised by many companies, with 40% saying that enforcing governance, policies, and controls will be a challenge in the post-adoption phase.

THE PROJECT TEAM

BEYOND THE FOUR WALLS

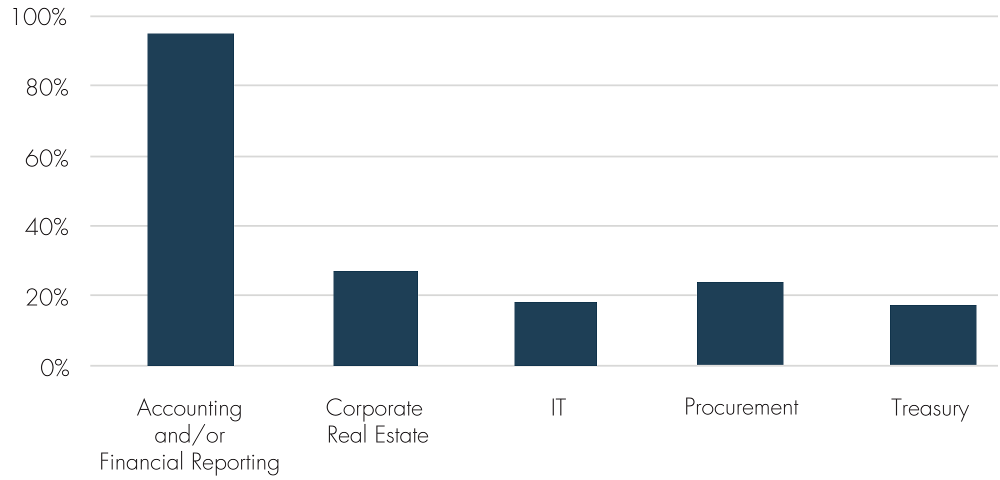
Unlike many other accounting change initiatives, which could be managed within the four walls of the accounting function, IFRS 16 and its local versions will require a cross-functional, enterprise-wide project.

The users and owners of leased assets span almost every function in the business. Corporate IT owns laptops, servers, fibre cables, satellites, and data centre gear. Real estate owns buildings, factories, and warehouse properties. Logistics owns material handling, railcar, aircraft, and shipping containers. Fleet owns company cars, repair trucks, and delivery vans. These functions are distributed across different business units, operating companies, and legal entities around the world.

The roles touching leases throughout their lifecycle represent almost every corporate function in the business. Legal and procurement negotiate the pricing and terms for new leases. Treasury manages credit relationships with lessors, hedging activities for leases in foreign currencies, incremental borrowing rates, and the insurance policies for leased assets. Accounting owns invoice processing, sublease collections, and financial reporting. Finance (FP&A) owns budgeting, planning, and forecasting for leasing programs. Tax is responsible for state, local, and federal property obligations for leased assets.

Investor relations will be required to communicate the impact of the new right-of-use assets and related lease liabilities on the balance sheet. Human resources will need to evaluate the impact of executive compensation agreements based on impacted financial metrics, along with the human capital needed to sustain the lease accounting and management program. Internal audit will review the policies, controls, and governance aspects of the compliance effort.

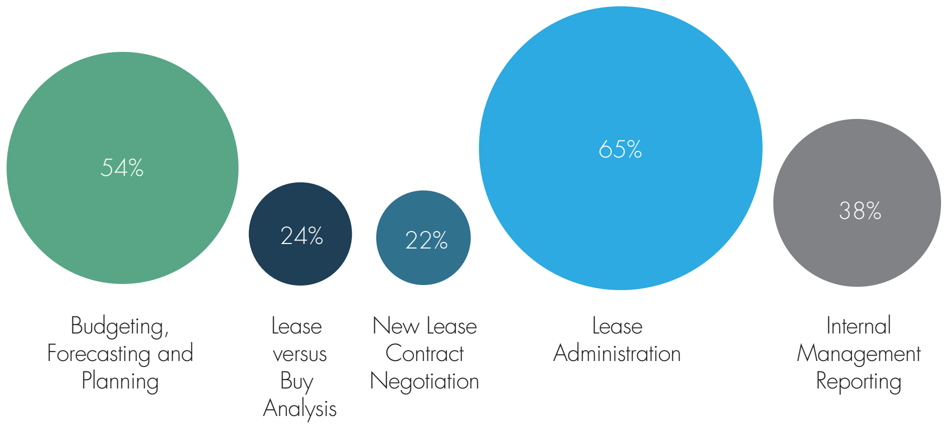
Chart 7: Which of the following groups are playing a strategic role in your lease accounting project?



The profile of groups playing a strategic role in lease accounting remains similar to the research done by LeaseAccelerator pre day-one, with the accounting function taking the lead in nearly all cases and only 5% not involving accounting at all. The lease accounting lifecycle touches so many parts of the organisation, ensuring everyone involved complies with the new processes and controls relies on input, early buy-in, and goal setting from a multi-disciplinary leadership team.

BENEFITS BEYOND COMPLIANCE

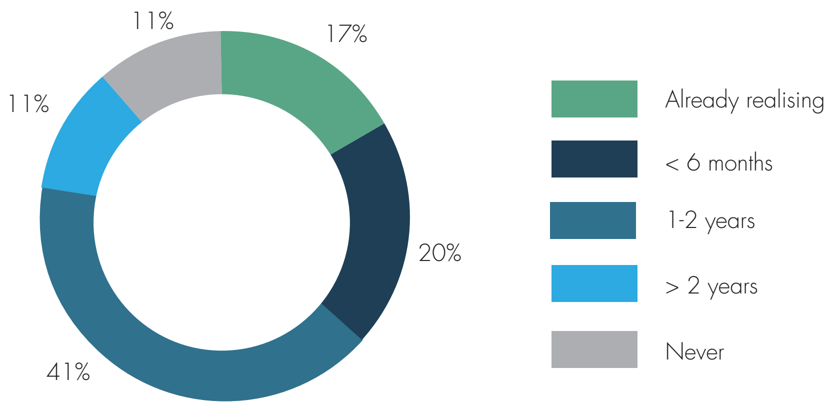
Chart 8: Which areas, beyond compliance, do you believe will realise benefits from enhancing systems, processes, and controls?



The majority of respondents feel they will realise benefits to lease administration in terms of cost and efficiency. All the companies who are already experiencing benefits cite lease administration improvements as well as budgeting, forecasting, and planning. The act of finding all leases and documenting them indicates the process itself provides benefits.

Higher-level business benefits of lease versus buy analyses or improved lease contract negotiation emerge when companies feel they will realise benefits in 1-2 years' time.

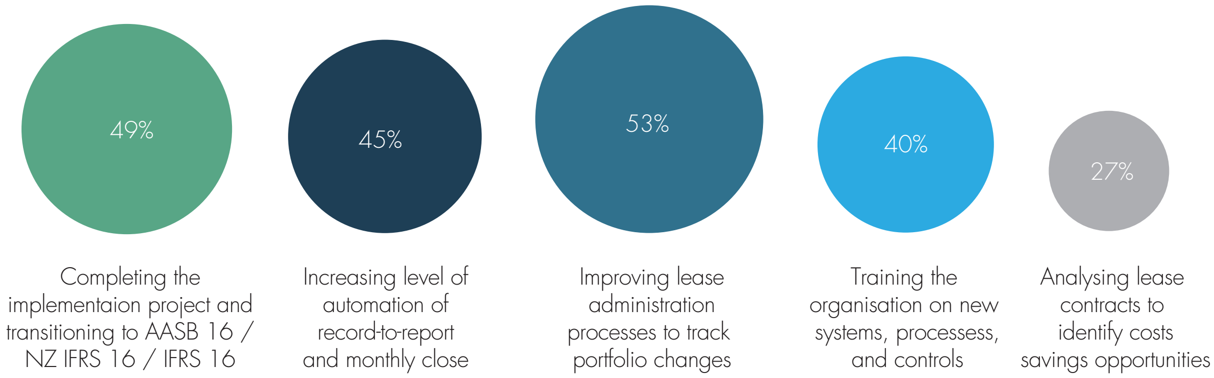
Chart 9: Please indicate when you expect to realise the benefits?



Almost 20% of respondents are already experiencing benefits from implementing the standard, with a further 20% expecting to see benefits within less than six months. Interestingly, only 10% feel that they will never realise benefits beyond compliance. As previously noted, these organisations tended to have smaller lease portfolios and a lower level of overall organisational complexity.

2020 VISION

Chart 10: Which areas will be a focus for 2020?



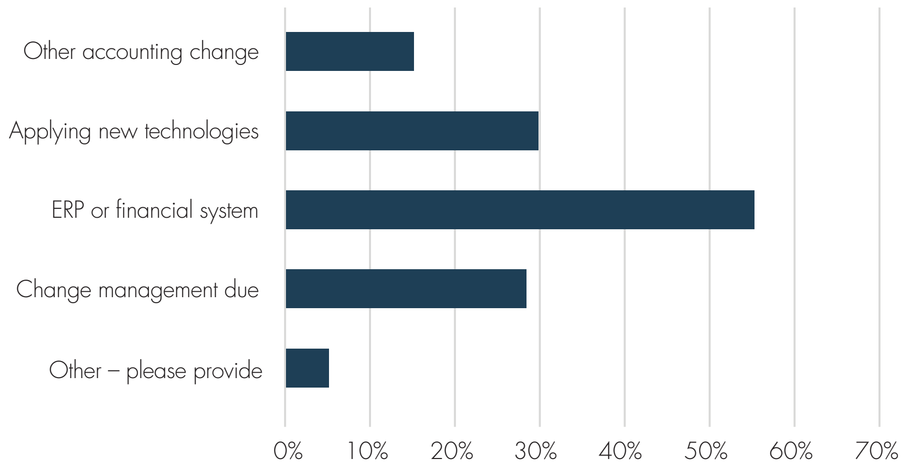
It follows that since organisations feel that tracking changes to the lease portfolio is the biggest challenge, that's where they will focus their efforts in 2020 with 53% of respondents saying that this is a key focus.

Automating processes such as month-end close and reporting was the second most popular area of focus at 45% of respondents. Automating processes is the best way to improve accuracy and compliance. This along with a major focus on training those involved in the lease accounting ecosystem on new systems, processes, and controls (40%) are both targeted at tackling the biggest issue of all - ongoing tracking of changes to the portfolio and data accuracy.

Only 22% of respondents thought they would see a benefit from new lease contract negotiation. This is supported by the low response to lease contract analysis (27%) as a key focus area for 2020. A similar number of respondents also saw conducting lease versus buy analyses as a key benefit. All respondents felt they would realise these benefits after 1 year. So, the apparent lack of focus in 2020 to these areas is more indicative of the maturity of the project than its importance.

Half of respondents are still fine-tuning or even working towards initial compliance. Therefore, it should be no surprise that the focus for 2020 is still on automation of processes as well as training employees on new processes and controls to ensure ongoing, accurate collection of lease data. An encouraging statistic is that 27% of respondents are focusing on analysing lease contacts to identify cost savings and improving lease versus buy decisions in the coming year.

Chart 11: What major projects will you be undertaking in 2020?



However, lease accounting does not live alone in the minds and budgets of the accounting and financial reporting function. 2020 sees a number of organisations looking at IFRS 17 and its Australian equivalent AASB 17 as a major project that could have large, possibly even larger, changes to procedures than IFRS 16. Hopefully the challenges of IFRS 16 compared to IFRS 15 will encourage organisations to prepare in case IFRS 17 is still more challenging.

Updating ERP or other new financial systems and keeping up to date with new technologies like AI, RPA, and Big Data are other major 2020 projects that are competing with lease accounting. 28% of financial departments are also having to undertake change management as a result of reorganisation, mergers, or acquisitions.

SUMMARY

Achieving initial and ongoing compliance with IFRS 16 and its local versions has turned out to be an ongoing change management project where new policies, procedures, and controls have been required across the accounting ecosystem and into the broader business and finance realm.

Rather than simply achieving compliance, many organisations are realising business benefits, resulting in greater efficiencies and reduced costs across the organisation, by leveraging new asset data to inform better business decisions.

Accurate, centralised lease accounting and lease lifecycle administration is providing better support to management, with improved lease analyses, contract negotiation, and lease versus buy decisions having impacts right to the top of the organisation.

Many organisations are already enjoying these benefits or expect to realise some of them in 2020.

ABOUT LEASEACCELERATOR

LeeaseAccelerator offers the market-leading Software-as-a-Service (SaaS) solution for Enterprise Lease Accounting, enabling compliance with the AASB 16, NZ IFRS 16 and IFRS 16 standards. Using LeaseAccelerator's proprietary Global Lease Accounting Engine, customers can apply the new standards to all types of leases including real estate, fleet, IT and other equipment at a asset-level as required by AASB and IASB. On average, LeaseAccelerator's Sourcing and Management applications generate savings of 17 percent with smarter procurement and end-of-term management.

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