How private companies can meet the ASC 842 compliance challenge
Leverage public company lessons to meet the compliance deadline

The FASB delayed the effective date for to comply with Accounting Standards Codification (ASC) 842 until Jan. 1, 2022. While that gives private companies some breathing room, companies should not relax. The additional time was provided because of the COVID-19 pandemic and because many are still struggling with their compliance efforts, so the challenge remains urgent. By leveraging the lessons the public companies have learned, private companies can better target their compliance efforts.

Success, strategy and using data analytics
The accounting changes required to comply with ASC 842 are not the most difficult part of compliance. Gathering all the data necessary to accurately reflect those changes is the biggest challenge. Here are five points to consider:

1. All leases are not created equal. At most organizations, real estate leases can be complex, but tend to be more managed in a centralized fashion. Equipment leases can be problematic. Terms for those can vary widely and such leases traditionally have been managed in a decentralized manner. There is also the misconception that for master leases, you don’t need to be concerned with the individual underlying assets. This is not true, especially for complex asset schedules with different values, start and end dates, end of term options or other characteristics.

2. Equipment leases may also be embedded in other contractual agreements. While embedded leases aren’t new, many organizations have paid little attention to them. Under ASC 842, however, you will now have to recognize them. Companies need to analyze service contracts to find such leases, separate the lease from the non-lease components, extract the information necessary to calculate the present value of the right of use asset and lease liability and then make the proper calculations for the balance sheet.

3. Tracking down all of your organization’s leases can require scouring information from accounts payable, asset ledgers and other records from across your organizations, including those from subsidiaries and foreign offices. Some lease records will be on paper only, others may be digital—but just because a lease is digital doesn’t mean that the data is ready for use. For all leases, you will need an audit trail for any changes made to the lease.

4. For international organizations, leases may need to be translated from foreign languages. Foreign leases documents may be structured differently and use different terms. They also may be denominated in foreign currencies, which will require conversion.

5. Not only do you need to reach across geographical boundaries and down into subsidiaries, your lease accounting effort should also cross functional boundaries. Real estate and legal are obviously involved, but as you consider and address how various leasing terms will affect you not just now but going forward, you’ll want to educate procurement and IT and other operational groups. This will include facilities, office management, manufacturing, supply chain and distribution, food services or other operational groups specific to your industry.
Data management tips

• As you track down your lease data, collect it in a single, centralized repository. This is a vital key control that your external auditors will expect. Consolidating your data will help to avoid duplications and will help standardize the fields and terms for all lease data. This will not only help with initial compliance efforts for ASC 842, but will also provide the foundation to more effectively manage all of your lease data going forward, making compliance in future years much easier and allowing you to better manage your leasing at all levels.

• Data analytics can help with your data gathering effort, especially when it comes to confirming you have captured your company’s complete lease population.

• Grant Thornton’s Lease Playbook can help you from Kickoff to Compliance with a number of tools and resources to help ensure a successful adoption of ASC 842.

Software helps, but it has limits

Most organizations are implementing software designed specifically to address the new challenges presented by ASC 842. Many ERP and other software vendors are offering add-on modules to their existing products that couple the necessary calculation capabilities with additional lease management functions. This marks a change at many companies, as most organizations have traditionally managed lease data through spreadsheets. Unfortunately, those spreadsheets have tended to be decentralized. Often each subsidiary maintained its own leasing records. In addition to decentralization, which makes it more difficult to track down your entire lease population, spreadsheets require constant manual updating, which increases the risk of errors. They also aren’t set up to perform the calculations that will be necessary to post your lease data to the balance sheet or populate required financial statement disclosures.

As mentioned previously, real estate leases have tended to be tracked separately from other leases. Many organizations with large real estate portfolios use software for lease administration. While they often have lease data, much of it is primarily operational in nature, meaning the information required for transition adjustment calculations is incomplete or inconsistent with the contract documentation.

The accompanying box spells out seven tips for picking the right software.
7 Software selection tips
The following seven questions can help guide your software selection efforts:

- Does it support dual reporting for US GAAP and IFRS?
- Will it support foreign currency needs?
- Will it capture items required for the new disclosure requirements (i.e. variable lease payments, weighted average discount rate, etc.)?
- Does it support tracking and recording of the impairment of right-of-use assets?
- Will it help prepare journal entries
- Will the product be updated regularly as additional interpretive guidance and best practices emerge?
- How well does the product integrate with your ERP package?

ASC 842’s silver lining—better lease management

Until now, most organizations have not followed uniform practices for requesting, initiating, tracking and managing leases. Now, with leases reported on the balance sheet, that has to change. The tools and processes you develop to comply with the standard don’t just need to work through the transition, they have to support your lease accounting going forward. The good news is this provides real opportunities to improve your leasing and lease management processes. Opportunities for improvement:

- Use centralized data to centralize leasing decisions. Having all the data in one place can drive better lease versus buy decisions, and could give you leverage to gain better terms from your lessors.
- Standardize your lease negotiation, approval and management practices, controls and technology to be more consistent with capital request and other spend categories.
- Better align the negotiation of your leases with your business objectives.
- Analyze your lease portfolio to evaluate rates, determine risks associated with lessor concentration, ensure timely action on expired or about-to-expire leases, and manage other issues.

Most public companies have found that meeting the ASC 842 challenge has taken more time and effort than they anticipated. Private companies should learn from their experience and start their ASC 842 efforts in earnest now. Grant Thornton offers deep experience with ASC 842 and is ready to help.
Frequently asked questions about ASC 842

Why did the FASB and the IASB change the accounting for leases?
A 2005 SEC survey estimated the off-balance sheet obligation associated with operating leases for public companies at $1.25 trillion. In 2016, the FASB and IASB issued new standards to bring these obligations on the balance sheet.

While the FASB and IASB standards are similar, there are differences between them. Both will mostly affect lessee accounting. The principal difference between the two standards is that the FASB standard retains a dual lease classification model that preserves the current lessee expense recognition pattern for operating (straight-line) and capital (accelerated) leases, whereas the IASB standard moves to a single model with one expense recognition pattern for lessees. (For more information on the differences, please see the “Summary” section, pages 7–9 from Accounting Standards Update (ASU) 2016-02, Section A – Lease Amendments to the FASB Accounting Standards Codification.)

When do I need to be compliant with ASC 842?
Public companies already must be in compliance. Private companies are required to adopt in calendar year 2022. Early application is permitted for all organizations.

What happens to the straight-line provision in the income statement?
The straight-line provision relates to the current pattern of expense recognition for operating leases. This pattern will not change for operating leases under ASC 842.

Do I really have to gather all lease information, or can I estimate? Is there a materiality threshold?
Under International Financial Reporting Standard 16, low-value assets do not need to be recognized on the balance sheet. The IASB has indicated that low-value assets are those valued under $5,000 when new (as indicated by IASB). The guidance in ASU 2016-02, however, does not provide such an exemption, although, as with implementation of any accounting standard, materiality should be considered. Many companies are considering whether a capitalization threshold, similar to what is used for property, plant, and equipment, can be applied for leasing.
Will I need software to track and account for leases under the new standard?
Software selection often is an important part of implementing the leasing standard, and should be front of mind for any company undergoing this transformation. We typically recommend that our clients develop a listing of key business requirements that they are looking to obtain from the software - some compliance related, some business related. Then we suggest that they view at least three demos before making a decision. There are a lot of providers in the market, be sure to know what you need and ask detailed questions.

Going forward, will we need to change our approval process for new leases to ensure that we account for them at the appropriate time?
It is important that you catch your leases upstream by thinking proactively of any new leases you are entering into from now on. Going forward, account for leases and put them on the balance sheet as soon as you contract them. This is important because it will not only ensure your future compliance, but also speed up your company’s transition process to the new standards. The first step toward implementing these proactive measures is to educate the people at your company’s various locations by establishing a process they can use to identify new leases. The second step is to assess the level of centralization of your operations. To acquire the best efficiency and to capture your data adequately, centralization may make sense. So, if not already there, your company might need to identify the necessary future steps it needs to move in this direction.

We have lots of groups negotiating leases; how do we find them all?
Ensuring a complete population tends to be a heavy lift for companies. There are many steps that companies are taking to help ensure that the population is complete at the effective date, but also remains complete from a process and control standpoint.

The natural starting point is to utilize the data used to prepare the five-year footnote table under ASC 840. Once you have compiled the known population, it is important to look for the unknown, or embedded, leases that often were missed under ASC 840. Generally, we take a two-step approach to identifying embedded leases:

1. Identify lease owners within the company, which allows you to have catalogued all groups negotiating leases. Then inform and train all these individuals on the lease standard, and request that they verify and confirm that they forwarded all leases within their control.

2. Perform a completeness check by searching accounts payable for recurring payment streams.

These two steps will ensure that your company can make a positive, confident statement regarding the completeness of your identified leases.
Finally, your company needs to plan for centralizing the review process once these groups are located. The key to this part of the process is finding the proper time to centralize contract reviews - such as legal review or procurement signoff - and ensure that all contracts go through that checkpoint going forward.

**What departments in my company will be affected? Can finance manage this transition alone? Who should be part of the team for this initiative?**

Several departments in your company will be affected by the changes in lease accounting, including the finance department, but not exclusively. For example, with the addition of leases to the balance sheet, organizations should review existing contractual agreements, such as lending covenants, to seamlessly adjust to the new standard. Accordingly, it may be wise to include treasury, legal departments and others as part of a transition team.

For example, your company will have to take into account the impact on the following:

- **Treasury.** The new standards will trigger the loss of the off-balance sheet benefit for operating leases, so your company might need to reconsider debt covenant compliance.

- **IT/Operations.** Your company will probably need new processes, systems and controls to gather lease data and account for current leases, as well as for future ones.

- **Tax.** Your review of leases may uncover the need to book tax differences and taxes that have no basis in either the right of use asset or in the lease obligation, resulting in deferred assets/liabilities associated with every lease. In addition, there will be significant uncertainty regarding the way states will treat new assets for income, sales and property tax issues.

- **Regulatory compliance.** Since leases will be recorded as new assets and liabilities on the balance sheet, this will have an impact on regulated companies, such as banks and others. To ensure compliance, these companies can anticipate additional scrutiny from regulators and should start preparing for the standard now, as well as start planning for more regulatory capital.

**How do I know if I have an embedded lease?**

Your company will have to identify and record all leases on the balance sheet, so this means that you may need to reconsider your contracts not labeled as lease agreements (e.g., service agreements) to identify any embedded leases you might not previously have accounted for separately. For example, if you have agreements with third-party contractors, do these include the exclusive use of an identified asset? If the answer is yes, then the contract might contain an embedded lease.
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