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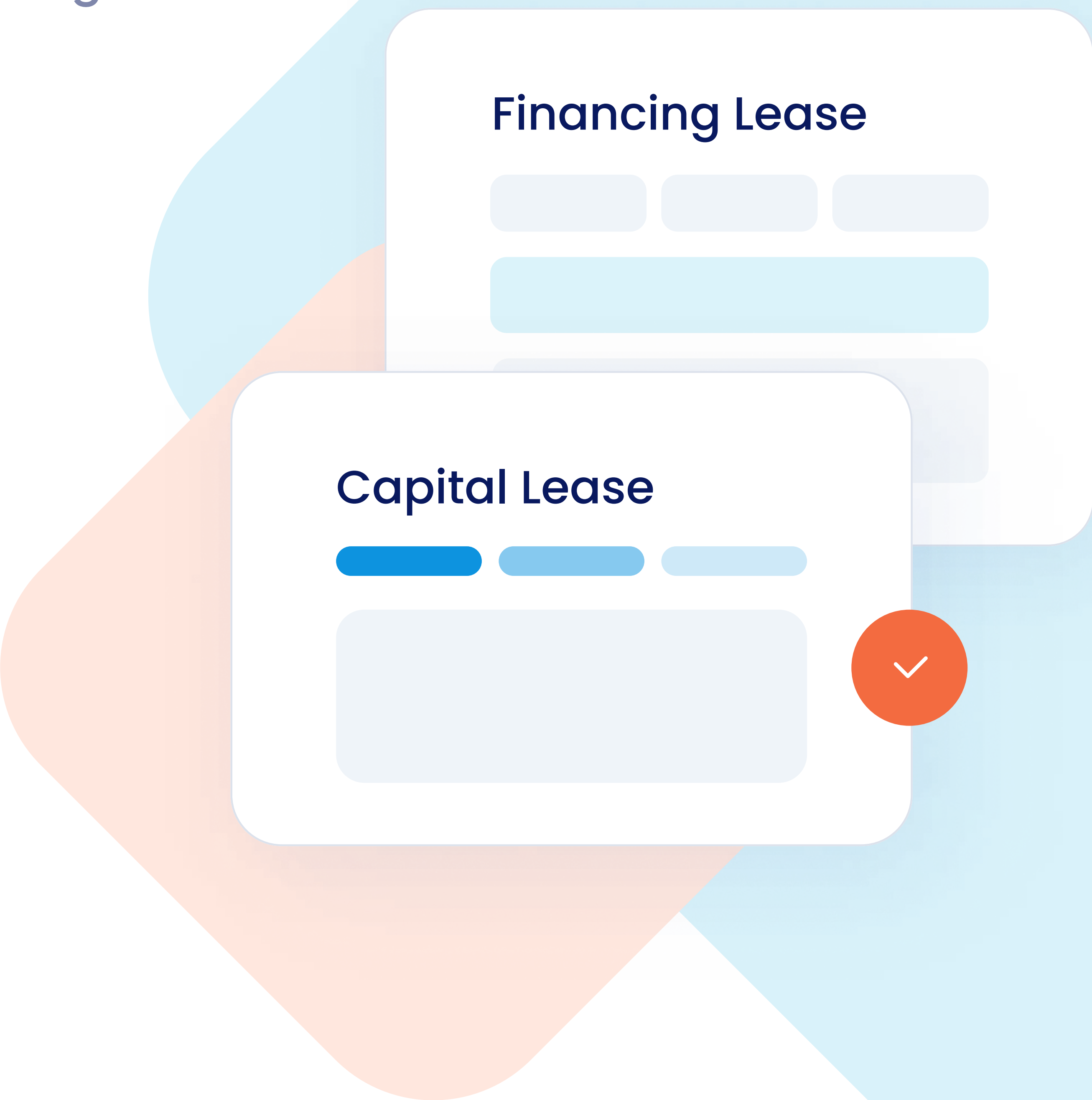


Successfully transitioning to the new lease accounting standard

Content

Chapter 1

Understanding ASC 842, IFRS 16 & GASB 87

If your business deals with leases, your team needs a good grasp on the new lease accounting standard that's relevant to you (ASC 842, IFRS 16 or GASB 87). As of January 2022, businesses must keep in-depth records for leases to stay compliant. We're here to help you navigate these new standards. Read on to understand why lease auditing has changed or skip to the specifics of the ASC 842, IFRS 16 or GASB 87.

Background

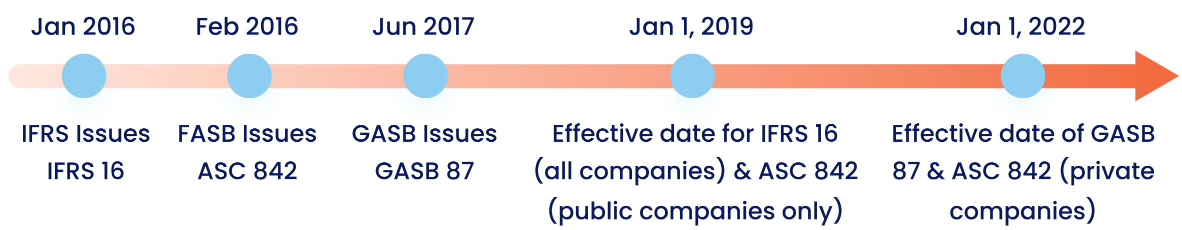
Back in 2006, the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) agreed to prioritize the convergence of lease accounting. At that time, many prominent businesses leveraged loopholes in the old standard to structure lease agreements to keep them off the balance sheet and skew financial ratios in a more favorable direction. Because of this abuse, the Security and Exchange Commission (SEC) sent a letter to the FASB and IASB asking them to take action and develop a standard that more accurately reflects a company's true liabilities.

At this point, the SEC, the FASB and IASB initiated a joint project to develop a new lease standard but parted in 2016 due to differing opinions on whether or not to maintain lease classifications (operating versus financing) in the new standard.

Shortly after the issuance of new IASB and FASB guidance on lease accounting (IFRS 16 & ASC 842), the Govermental Accounting Standards Board (GASB) followed suit and issued new guidance of their own in June 2017.

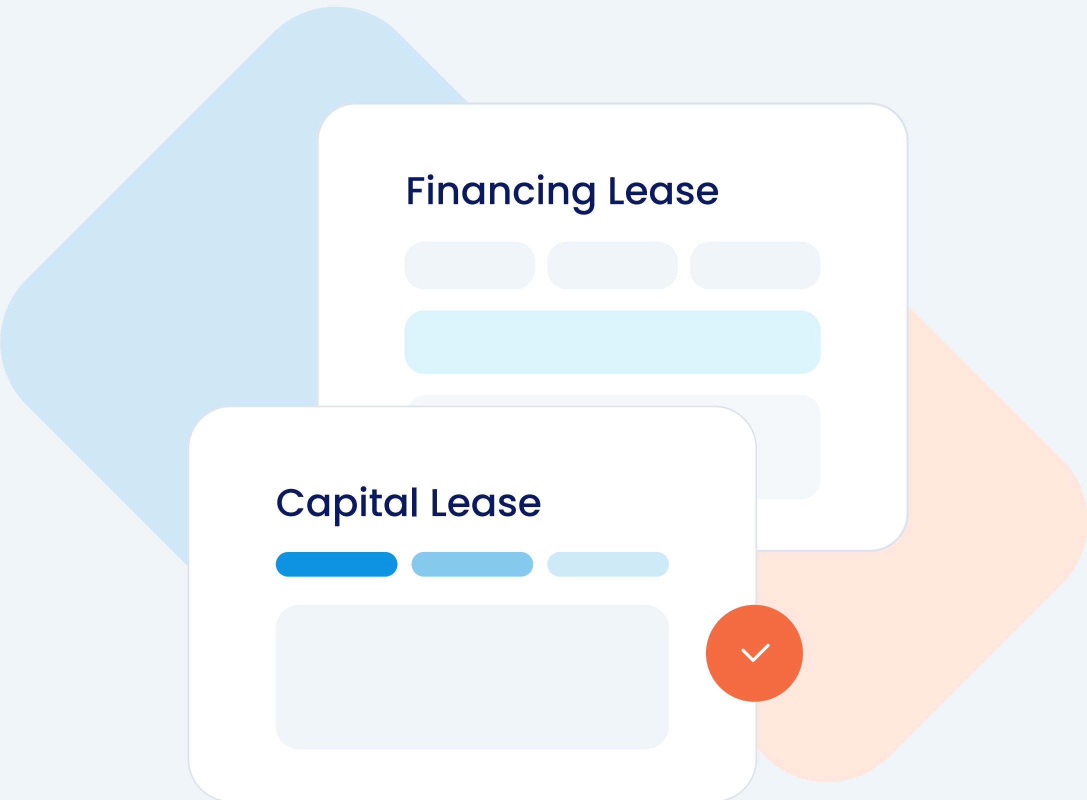
Here’s a timeline of the new standards:

When do companies need to be compliant?



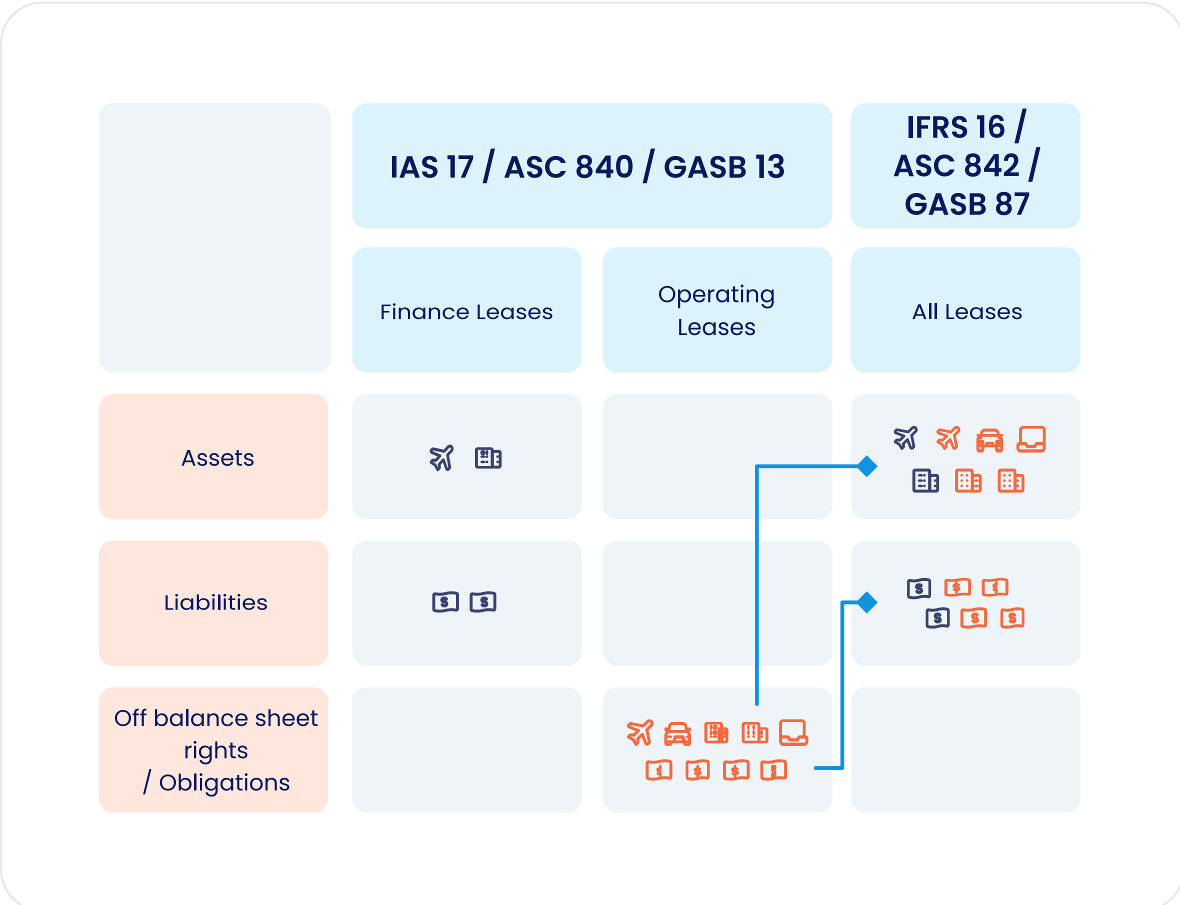
What changed

Under the old standard (ASC 840/IAS 17/GASB 13), only capital leases were captured on the balance sheet, while operating leases were off-balance sheet, reflected only in the P&L. There were strict thresholds ("bright lines") that clearly classified each lease as operating versus capital. This definitive classification gave companies the ability to structure lease agreements to qualify as operating leases when they, in substance, more closely aligned to a capital lease (financing the acquisition of assets through debt). By classifying these leases as operating, companies kept the future lease obligations off the balance sheet, which masked their true liabilities and made key ratios appear more favorable.



Everything is on the balance sheet

The new standards now require virtually all leases to be reflected on the balance sheet. A "lease liability" is recorded at lease commencement, and a new "right of use" (ROU) asset account is introduced for all lease types. The resulting change has the biggest impact on what were previously operating leases, as shown in the diagram below.



The P&L presentation changes with IFRS 16 and GASB 87

The primary area where the IASB and FASB had their “great schism” on lease accounting is in determining whether there should be separate presentation for operating or financing leases on the income statement. The FASB elected to maintain a clear distinction between Operating Leases (with expenses recorded as operating costs and included in EBITDA) and Financing Leases (where amortization and interest expenses are below EBITDA). The IASB and GASB decided to reduce complexity, so they eliminated the separate operating classification. The net impact on the P&L for IFRS & GASB is a movement of lease expenses below EBITDA, as shown in the diagram below.

	IAS 17 / ASC 840 / GASB 13		IFRS 16 / GASB 87	ASC 842	
	Finance Leases	Operating Leases	All Leases	Finance Leases	Operating Leases
Revenue	×	×	×	×	×
Operating Costs (excluding depr. & amort.)	....	Single Expense	....	....	Single Expense
EBITDA			↑ ↑	↔	↔
Depreciation & Amortization	Depreciation	....	Depreciation	Depreciation	
Operating Profit			↑	↔	↔
Finance Costs	Interest	....	Interest	Interest	
Profit Before Tax			↔	↔	↔

More accounting is required

Previously, a fixed-payment operating lease was simple, and monthly entries were all the same, as shown below.

Lease Scenario

- 3 year fleet vehicle lease
- $500/Month
- $0 Down payment
- Operating lease

Initial & Monthly Entries	DEBIT:	Vehicle expense	$500
	CREDIT:	Accounts payment	$500

Now, it is much more complex.

- **Initial Measurement:** On the commencement date, a lease liability is recorded as the present value of all future lease payments. A right of use asset is recorded at the same amount, adjusted for initial direct costs, prepayments or incentives.

- **Subsequent Measurement for Finance Leases:** Accounting for finance leases under the new standard is similar to capital leases under the old standard. The lease liability is treated as debt and accounted for using the effective interest method, where interest expense is incurred monthly and the liability is reduced as payments are made against the liability. The capitalized right of use asset is treated like a fixed asset and amortized on a straight-line basis over the lease term. See initial and monthly entries below.

Lease Scenario

- 3 year fleet vehicle lease
- $500/Month
- $0 Down payment
- Finance lease under IFRS 16 or GASB 87

Initial Entry	DEBIT:	Right of use asset	$16,683
	CREDIT:	Lease liability	$16,683
Month 1 Entry	DEBIT:	Amortization expense	$463
	DEBIT:	Lease liability	$430
	DEBIT:	Interest expense	$70
	CREDIT:	ROU accum. amort.	$463
	CREDIT:	Accounts payable	$500
Month 2 Entry (changes each subsequent month)	DEBIT:	Amortization expense	$463
	DEBIT:	Lease liability	$432
	DEBIT:	Interest expense	$68
	CREDIT:	ROU accum. amort.	$463
	CREDIT:	Accounts payable	$500

- **Subsequent Measurement for Operating Leases (ASC 842 only):** Accounting for operating leases is a new concept to get your arms around. Lease expenses are still required to be recorded on a straight-line basis, and the lease liability is required to be brought down using the effective interest method. This imbalance between decreasing interest accretion and a constant expense requires you to "plug" your monthly draw-down of your ROU asset (via accumulated amortization). The plug amount will typically increase over the lease term, as shown below.

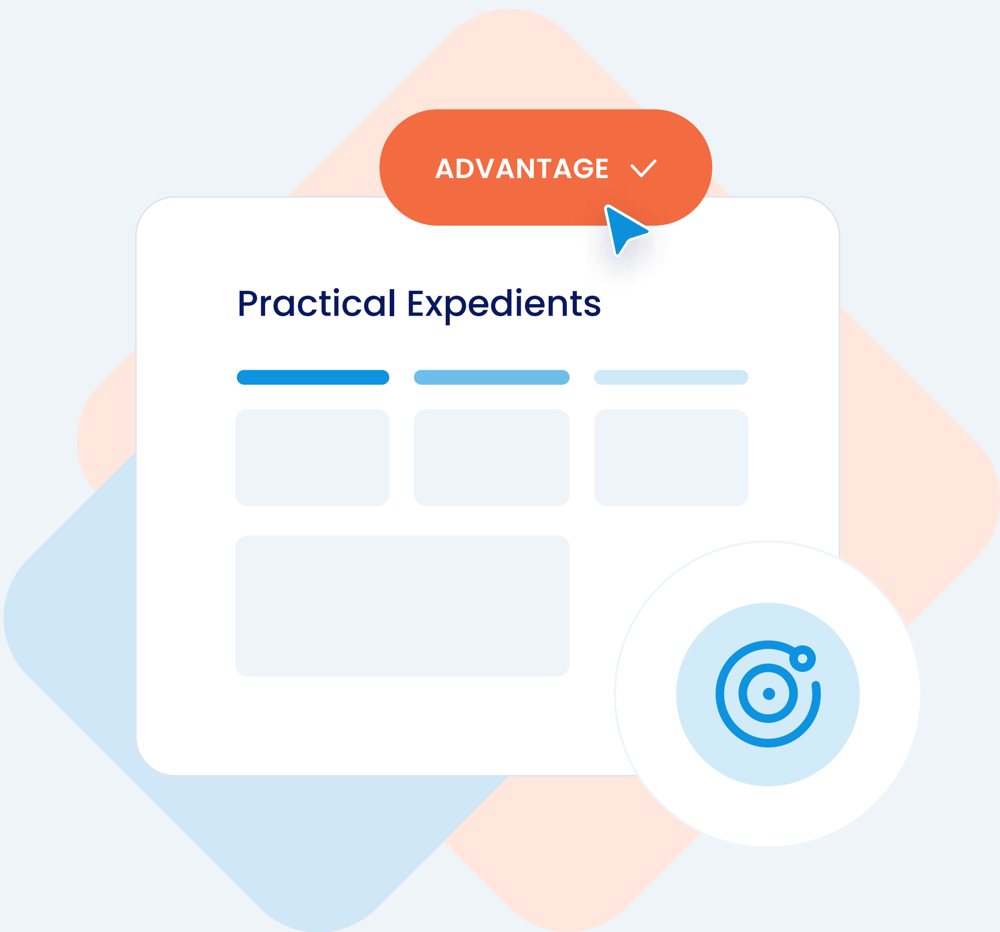
Lease Scenario

- 3 year fleet vehicle lease
- $500/Month
- $0 Down payment
- Finance lease under ASC 842

Initial Entry	DEBIT:	Right of use asset	$16,683
	CREDIT:	Lease liability	$16,683
Month 1 Entry	DEBIT:	Lease vehicle expense	$500
	DEBIT:	Lease liability	$430
	CREDIT:	ROU accum. amort.	$430
	CREDIT:	Accounts Payable	$500
Month 2 Entry (changes each subsequent month)	DEBIT:	Lease vehicle expense	$500
	DEBIT:	Lease liability	$432
	CREDIT:	ROU accum. amort.	$432
	CREDIT:	Accounts Payable	$500

Take advantage of practical expedients

The standard bodies tried to make your transition to the new standard a bit easier by providing a few practical expedients and other relief. In the sections below you can learn about relief specific to the ASC 842, IFRS 16 and GASB 87.



Next steps:

Start the implementation process of the new standard as soon as possible. Early adopters of the new standard reported that more time and resources were required than anticipated.

Review all debt covenants that require a specific debt-to-equity ratio. Additional liabilities will now be on the balance sheet under the new standard, which could potentially impact those covenants.

Evaluate potential software solutions. The right solution can handle the hard work at a low cost. Depending on the size of your company and the number of leases you have, a high-value solution like NetLease can help you save on additional staff or outsourcing to a CPA firm.

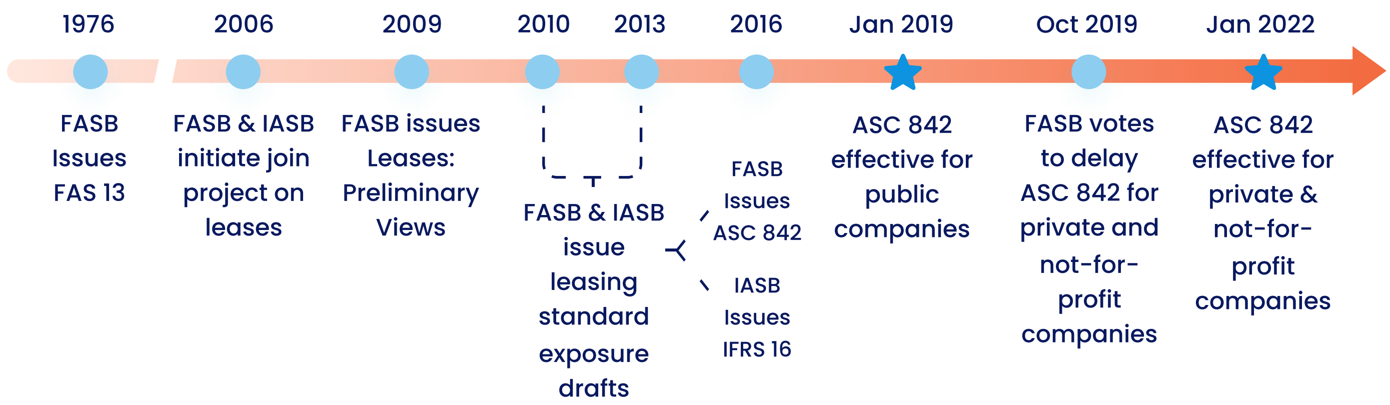
An overview of ASC 842

The ASC 842 is intended to paint a clearer picture of a company's true liabilities by placing (nearly) all leases on the balance sheet. Since many companies are still reeling from ASC 606 (the new revenue recognition standards) it may take some time to fully adopt the new ASC 842 standards. This quick guide can help you understand and plan for the change.

History

This new lease accounting standard has been in the works for almost 15 years. With a nudge from the SEC in 2006, the FASB and IASB initiated a joint project to develop a new lease standard. When the FASB first issued the new standard, ASC 842 was to be effective for public companies on January 1, 2019, and for private and not-for-profit organizations on January 1, 2020. However, after seeing the difficulties public companies faced in adopting the new standards, the FASB voted to give private & not-for-profit companies an additional year to comply.

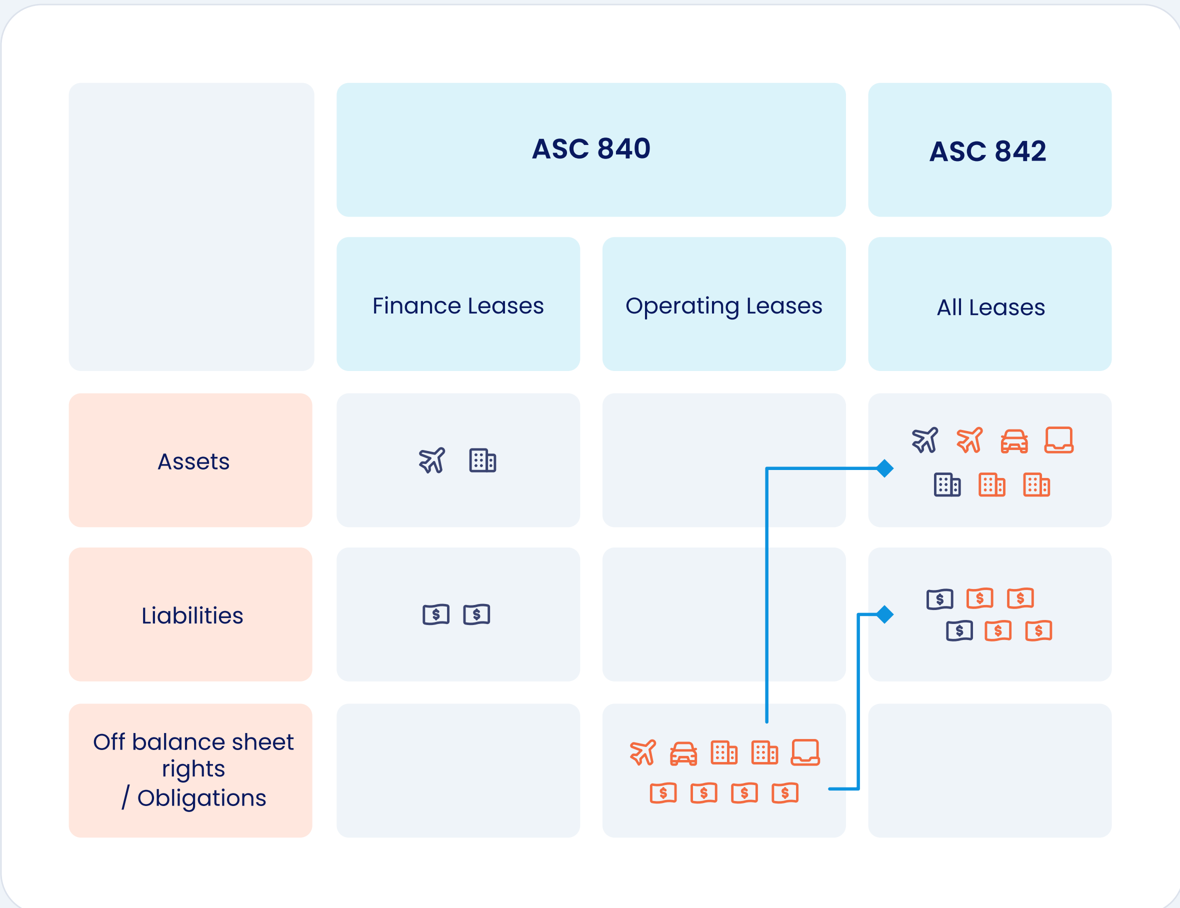
ASC 842 Timeline & Effective Date



What changed

Under ASC 840, only capital leases were captured on the balance sheet, while operating leases were on the off-balance sheet and reflected only in the P&L. Leases were classified based on strict guidelines, called “bright lines.” This classification system gave companies the ability to generate lease agreements so that they would qualify as an operating lease, when, in substance, they more closely resembled a capital lease, and therefore remained off the balance sheet.

Now, under ASC 842 virtually all leases must be reflected on the balance sheet. At the time the lease is commenced, a new “right of use” (ROU) asset account is introduced for all lease types, and a “lease liability” is recorded. The biggest impact of this change is on operating leases. Here’s a summary of this change:



The P&L

For the presentation of operating and finance leases on the income statement, the FASB elected to maintain a distinction between operating and finance leases. In the case of operating leases, an operating cost expense is recorded and included in EBITDA. For financing leases, depreciation and interest expenses are recorded below EBITDA.

More accounting is required

Under the old standard, a fixed-payment operating lease was simple, and monthly entries were all the same:

Lease Scenario

- 3 year fleet vehicle lease
- $500/Month
- $0 Down payment
- Operating lease

Initial & Monthly Entries	DEBIT: CREDIT:	Vehicle expense Accounts payment	$500 $500

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Under ASC 842, the same scenario is much more complex:

Lease Scenario

- 3 year fleet vehicle lease
- $500/Month
- $0 Down payment
- Finance lease under ASC 842

Initial Entry	DEBIT:	Right of use asset	$16,683
	CREDIT:	Lease liability	$16,683
Month 1 Entry	DEBIT:	Lease vehicle expense	$500
	DEBIT:	Lease liability	$430
	CREDIT:	ROU accum. amort.	$430
	CREDIT:	Accounts Payable	$500
Month 2 Entry (changes each subsequent month)	DEBIT:	Lease vehicle expense	$500
	DEBIT:	Lease liability	$432
	CREDIT:	ROU accum. amort.	$432
	CREDIT:	Accounts Payable	$500

Under the new standard, there's an initial journal entry and subsequent journal entries that change each month:

- **Initial Journal Entry:** When the lease is commenced, a lease liability is recorded, which is equal to the present value of all future lease payments. A right of use asset is recorded for the same amount and adjusted for initial direct costs, prepayments or incentives.

- **Subsequent Journal Entries:** Accounting for operating leases is a new concept to understand. Lease expenses must still be recorded on a straight-line basis, and the liability is brought down using the effective interest method. The imbalance between decreasing interest accretion and a constant expense requires companies to "plug" their monthly draw-down of their ROU asset via accumulated amortization. The plug amount will typically increase over the lease term, as shown in the example above.

Practical expedients & other transition relief

In order to make the transition to ASC 842 a little easier, the FASB has provided some practical expedients and other transition relief. Here are a few to be aware of:

Contract Assessments

Companies are not required to reassess whether a contract is or contains a lease at the date of initial application. This must be disclosed and consistently applied.

Hindsight

This allows companies to maintain the current accounting based on their original assessment of lease terms. This can be applied on a lease-by-lease basis.

Cumulative Catch-Up Versus Full Retrospective

Full retrospective requires that companies prepare financial statements as if ASC 842 has always been in effect for all periods presented. To make this easier, companies can use a cumulative catch-up approach where the cumulative effect of adopting ASC 842 is recorded against retained earnings at the date of initial application. Whichever option is selected must be disclosed and consistently applied.

Discount Rates

When you are not able to determine the rate implicit in the lease, companies can use their risk-free interest rate. This can be applied on a lease-by-lease basis.

Combination of Lease & Non-Lease Components

Instead of separately allocating the lease and non-lease components of each lease, companies can elect to combine all payments and reflect that in the ROU asset, lease liability, and monthly lease expense.

Short Term Leases

Leases with terms under one year can be accounted for under the old method.

Next steps:

Identify Leases – Start reviewing contracts and identify any that meet the definition of a lease under the new accounting standards.

Evaluate Potential Software Solutions – Lease accounting solutions can take care of the heavy lifting at a much lower cost with lower risk than Excel.

Start the Implementation Process ASAP – After identifying leases and selecting a software solution, begin gathering lease data in order to start the implementation of the new standard. Give your business enough time to run several rounds of journal entries before your official transition date.

An overview of IFRS 16

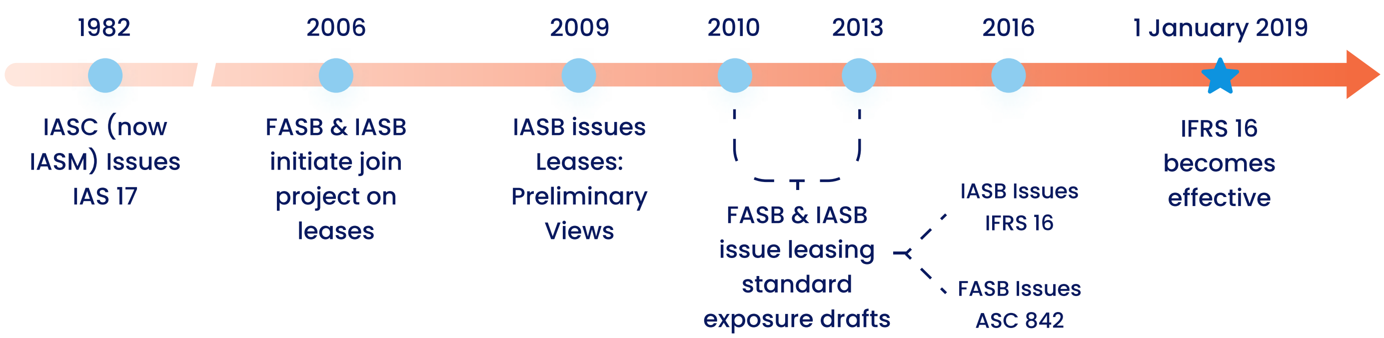
The IFRS 16 became effective for annual reporting periods beginning on or after January 2019. This also applies to companies subject to AASB 16 (Australia), PFRS 16 (Philippines), JMIS (Japan), Hong Kong FRS or similar governing bodies. Despite the passing of the effective date, companies still have a lot of work ahead to comply with IFRS 16.

Here's what you need to know for compliance with IFRS 16.

History

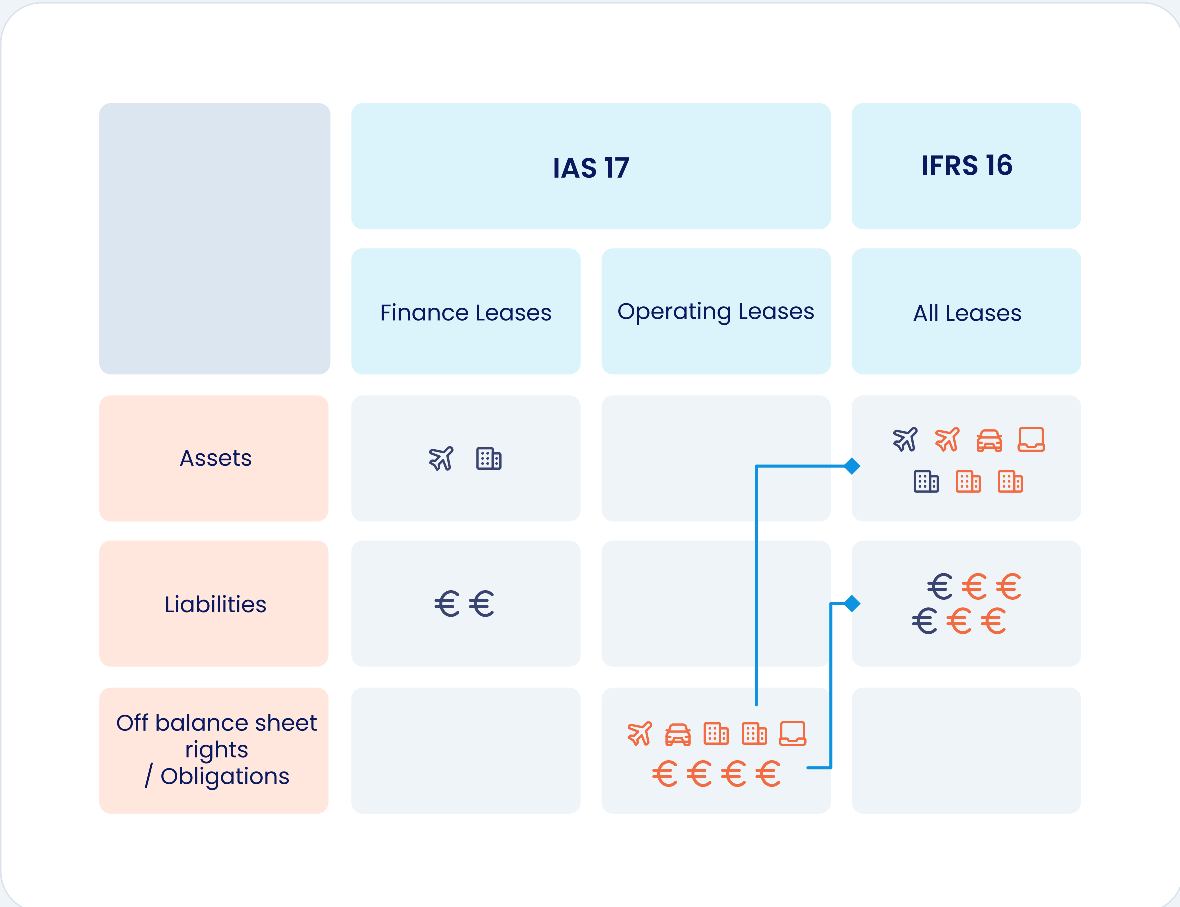
Starting in 2006, the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) initiated a joint project on leases so balance sheets would more accurately reflect a company's true long-term liabilities. Thirteen years later, these standards are finally beginning to take effect.

IFRS 16 Timeline & Effective Date



What changed

IFRS 16 requires that virtually all leases be reflected on the balance sheet. To do so, a “lease liability” is recorded at the commencement of a lease, and a new “right of use” (ROU) asset account is introduced for all lease types. This has the biggest impact on what were previously considered operating leases. The diagram below illustrates this change:



The P&L

The IASB decided to reduce complexity and eliminate the separate operating classification of operating and finance leases. The net impact on the P&L is that expenses for leases previously classified as operating will now be recorded as amortization/depreciation and interest, as shown in the diagram below.

	IAS 17		IFRS 16
	Finance Leases	Operating Leases	All Leases
Revenue	×	×	×
Operating Costs (excluding Depr. & Amort.)	....	Single Expense	....
EBITDA	....		↑ ↑
Depreciation & Amortization	Depreciation	....	Depreciation
Operating Profit			↑
Finanse Costs	Interest	....	Interest
Profit Before Tax			↔

How much more accounting is required?

Lease Scenario

- 3 year fleet vehicle lease
- €500/Month
- €0 Down payment
- Operating lease

Initial & Monthly Entries	DEBIT:	Vehicle expense	€500
	CREDIT:	Accounts payment	€500

Prior to IFRS 16, a fixed-payment operating lease was simple, and monthly entries were all the same.

Under IFRS 16, the same lease now requires an initial entry and subsequent entries that change each month:

Lease Scenario

- 3 year fleet vehicle lease
- €500/Month
- €0 Down payment
- Finance lease under IFRS 16

Initial Entry	DEBIT:	Right of use asset	€16,683
	CREDIT:	Lease liability	€16,683
Month 1 Entry	DEBIT:	Amortization expense	€463
	DEBIT:	Lease liability	€430
	DEBIT:	Interest expense	€70
	CREDIT:	ROU accum. amort.	€463
	CREDIT:	Accounts payable	€500
Month 2 Entry (changes each subsequent month)	DEBIT:	Amortization expense	€463
	DEBIT:	Lease liability	€432
	DEBIT:	Interest expense	€68
	CREDIT:	ROU accum. amort.	€463
	CREDIT:	Accounts payable	€500

- **Initial Entry:** On the date, a lease is commenced a lease liability is recorded at the present value of all future lease payments. A right of use asset is also recorded at the same amount, adjusted for initial direct costs, prepayments or incentives.

- **Subsequent Entries:** Accounting for finance leases under IFRS 16 is similar to capital leases under IAS 17. The lease liability is accounted for using the effective interest method, where interest expense is incurred monthly and the liability is reduced as payments are made against the liability. The capitalized right of use asset is treated like a fixed asset and amortized on a straight-line basis over the lease term.

What practical expedients & transition relief was provided?

In an attempt to make your transition to IFRS 16 a little easier, IASB is providing a few practical expedients and other relief. Here are a few worth noting.

Grandfather Contract Assessments

Companies are not required to reassess whether a contract is, or contains a lease at the date of initial application. This must be disclosed and consistently applied.

Hindsight

Companies are not required to reconstruct the accounting based on its original assessment of lease terms, but they can make an assessment at the transition date. This can be applied on a lease-by-lease basis.

Choice Between Full Retrospective & Cumulative Catch-Up

Full retrospective requires you to prepare your financial statements as if IFRS 16 has always been applied, for all periods presented. As relief, you can use a cumulative catch-up approach, where the cumulative effect of adoption is recorded against retained earnings at the date of initial application. For finance leases, existing balances remain and are now classified as ROU asset and lease liability. Whichever option is selected must be disclosed and consistently applied.

Low Value & Short-Term Lease Exemption

If the fair value of the leased asset is less than US$5,000, you are not required to apply IFRS 16. If the original lease term or remaining lease term at the date of transition is under one year, no adjustments are required. This can be applied on a lease-by-lease basis and may trigger disclosure requirements.

Right of Use Asset Measurement

At the date of initial application, the right of use asset can be recorded at the lease liability balance adjusted by the amount of any prepaid or accrued lease payments related to the lease immediately prior to the transition date. Initial direct costs can also be excluded.

Single Portfolio Discount Rates

Application of a single discount rate to a portfolio of leases is allowed if they have similar characteristics (ex: remaining lease term, economic environment, class of underlying asset). This can be applied on a lease-by-lease basis.

Combination of Lease & Non-Lease Components

As opposed to separating out lease and non-lease components of each lease, companies can combine all payments and reflect that in the ROU asset, lease liability, and monthly lease expenses.

Next steps:

Though the effective date of IFRS 16 has passed, many businesses are not yet properly complying with the new standards or leveraging a sustainable system to account for leases in the future. If you haven't done so already, evaluate potential software solutions that can perform the proper calculations and reduce the risk of error associated with spreadsheets.

Chapter 4

An overview of GASB 87

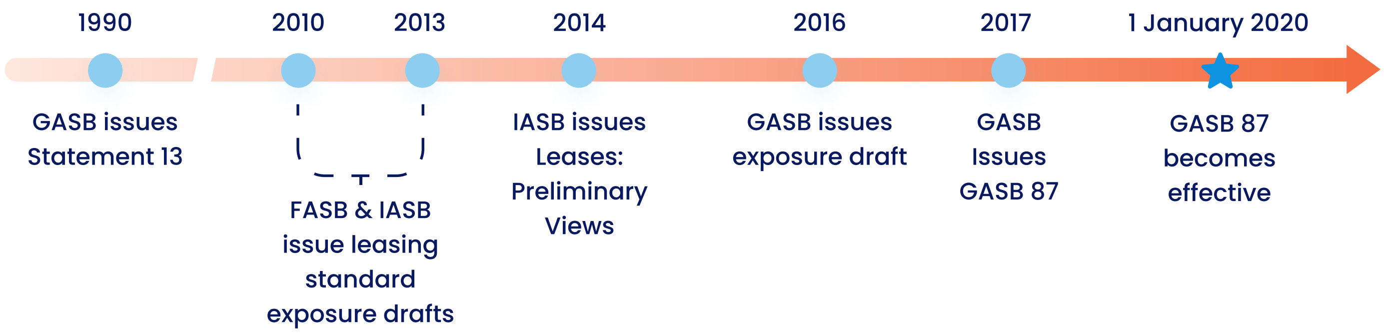
Most state and local government entities that deal with leases are required to comply with a new lease accounting standard, GASB 87 as of June 15, 2021. This new standard brings leases onto the Statement of Net Assets that previously were not. Although the effective date has passed, many agencies are still struggling to implement the new standard. They're not alone, international and public companies are also transitioning to their own new lease accounting standards (IFRS 16 and ASC 842).

Here's a quick summary of the key components of GASB 87 that all government agencies should know.

History

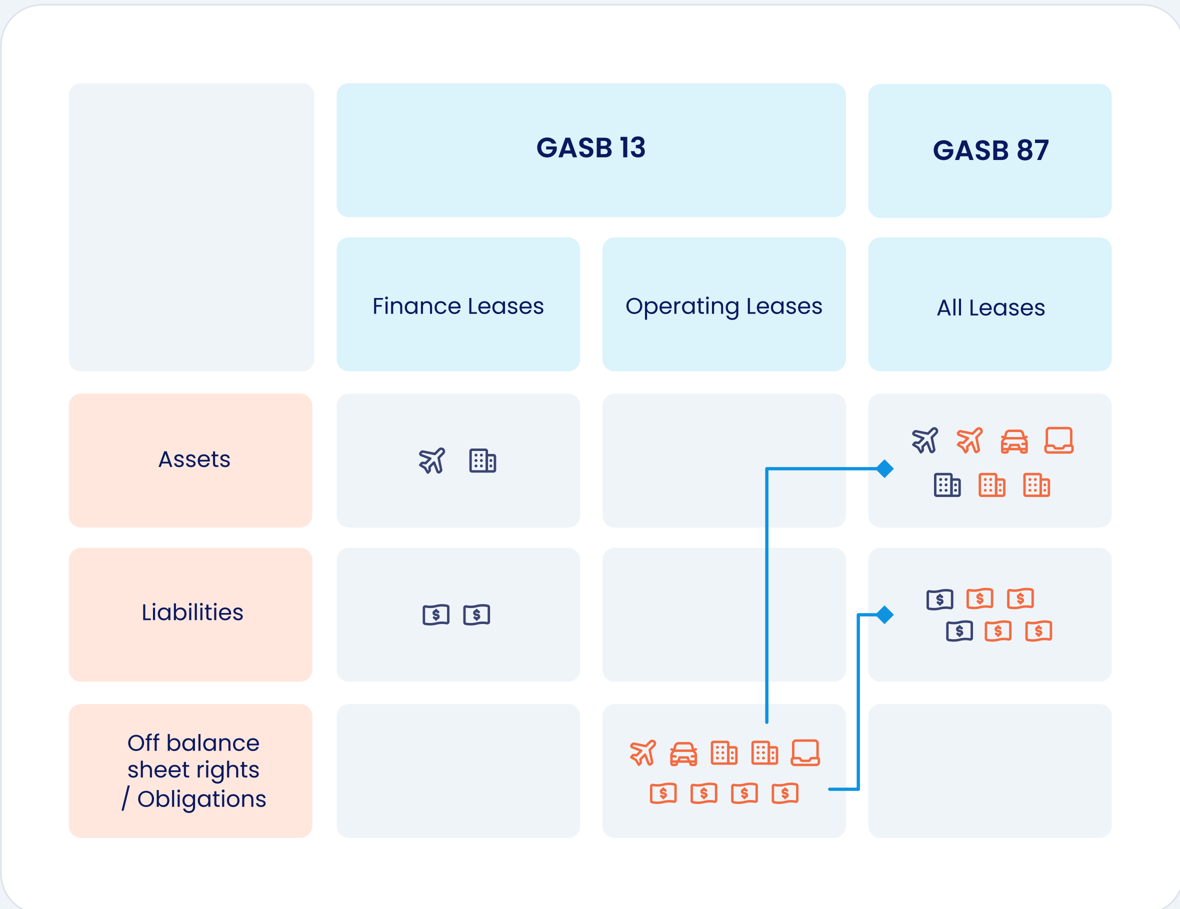
The GASB first issued a lease accounting standard (GASB 13) in 1990 that closely resembled the FASB's guidance on lease accounting. Shortly after the issuance of new IASB and FASB guidance on lease accounting (IFRS 16 & ASC 842), the GASB followed suit and issued new guidance of their own in June 2017. Here's a brief history of GASB 87, and when government agencies need to be compliant:

GASB 87 Timeline & Effective Date



What changed

The new standard requires virtually all leases to be reflected on the Statement of Net Assets. Therefore, a lessee will recognize a lease liability, right of use (ROU) asset and amortization expense for each lease. GASB 87 has the biggest impact on what were previously considered operating leases, as shown below:



P&L presentation under GASB 87?

The GASB's old lease accounting rule (GASB 13) was derived from the FASB's statement No. 13 and therefore, GASB and FASB entities reported leases similarly. However, under the new standards, FASB and GASB entities will apply different accounting for operating type leases. Similar to IFRS 16, GASB 87 eliminates the classification of an operating lease (unless it's short-term).

Accounting for a lease under GASB 87

Previously, a fixed-payment operating lease was simple, and monthly entries were all the same:

Lease Scenario

- 3 year fleet vehicle lease
- $500/Month
- $0 Down payment
- Operating lease

Initial & Monthly Entries	DEBIT:	Vehicle expense	$500
	CREDIT:	Accounts payment	$500

Now the accounting is much more complex:

Lease Scenario

- 3 year fleet vehicle lease
- $500/Month
- $0 Down payment
- Finance lease under GASB 87

Initial Entry	DEBIT:	Right of use asset	$16,683
	CREDIT:	Lease liability	$16,683
Month 1 Entry	DEBIT:	Amortization expense	$463
	DEBIT:	Lease liability	$430
	DEBIT:	Interest expense	$70
	CREDIT:	ROU accum. amort.	$463
	CREDIT:	Accounts payable	$500
Month 2 Entry (changes each subsequent month)	DEBIT:	Amortization expense	$463
	DEBIT:	Lease liability	$432
	DEBIT:	Interest expense	$68
	CREDIT:	ROU accum. amort.	$463
	CREDIT:	Accounts payable	$500

Here's a breakdown of the accounting under the new standard:

- **Initial Journal Entry:** When the lease is commenced, a lease liability is recorded, which is equal to the present value of all future lease payments. A right of use asset is recorded for the same amount and adjusted for initial direct costs, prepayments, or incentives.

- **Subsequent Journal Entries:** Accounting for operating leases is a new concept to understand. Lease expenses must still be recorded on a straight-line basis, and the liability is brought down using the effective interest method. The imbalance between decreasing interest accretion and a constant expense requires companies to "plug" their monthly draw-down of their ROU asset via accumulated amortization. The plug amount will typically increase over the lease term, as shown in the example above.

Next steps:

Unlike the lease standards issued by the other accounting standards boards (IASB & FASB), the GASB has provided limited practical expedients and transition relief to GASB 87 entities. Therefore, it's even more critical for government entities to respond early. Evaluate software solutions specifically developed for GASB 87 that can perform the proper calculations, without the need for manual calculations in Excel.

Chapter 5

New disclosures required under ASC 842, IFRS 16 & GASB 87

Under the new standards, more disclosures are required. Often when a new accounting standard is implemented, disclosures are an afterthought. The result can be a last-minute scramble to be in compliance fraught with error.

The smarter approach is to consider disclosures early in their adoption process. Disclosure compliance should be the main consideration when selecting a technology platform for accounting. It must collect the right information to support disclosures on the front end, so you are prepared for reporting on the back end.

Future minimum payments were always a required disclosure under the old lease accounting standards. But now, under ASC 842, IFRS 16, and GASB 87 disclosures have become more complicated. Here’s a list of some of the new disclosures required under the new standards for lessees:

1. Lease general description disclosure

Under the new standards, qualitative disclosures are more extensive. First, lessees must disclose information about the nature of the company's leases. This includes:

- A general lease description or lease type (ex: real estate, equipment, etc.)
- The basis on which variable lease payments are determined
- Terms & conditions of options to extend or terminate leases
- Lease restrictions or covenants, and residual value guarantees

2. Assumptions & judgments

Companies must outline any significant assumptions or judgments made in identifying and treating leases. Explanations for the following are necessary:

- How contracts containing leases were identified
- How allocations of consideration in a contract were made
- How the discount rate was determined

3. Lease options

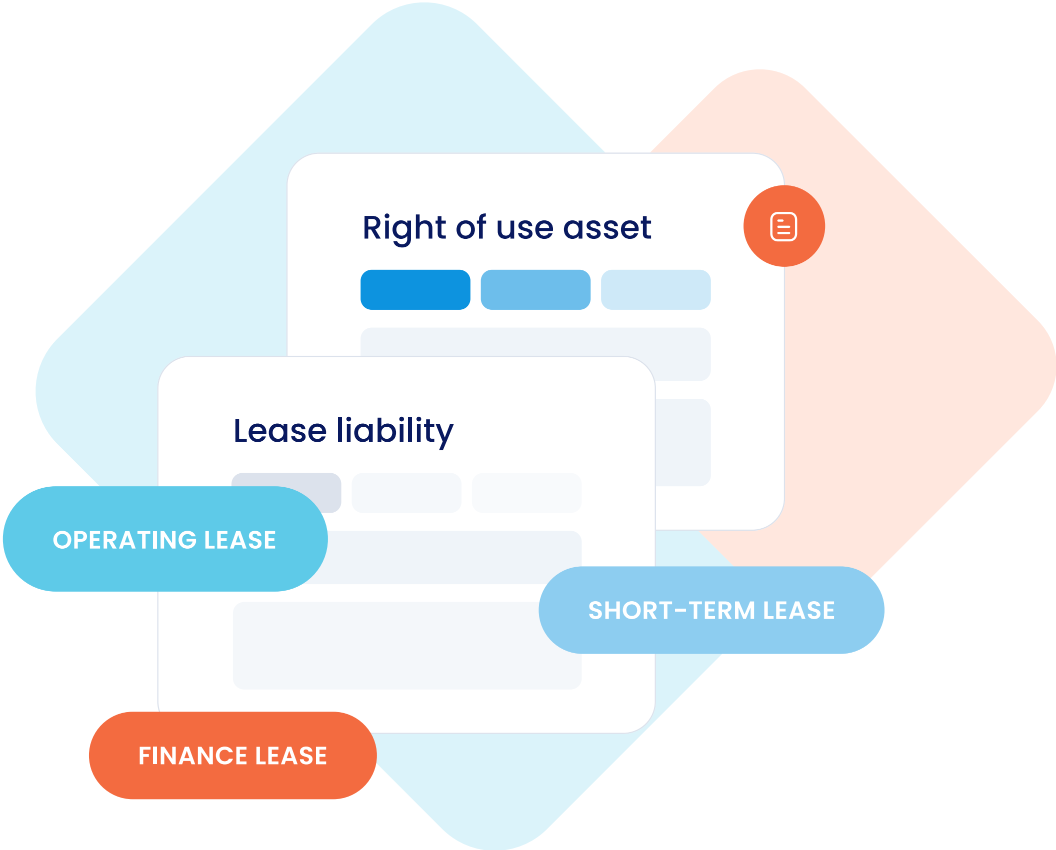
Leases have a variety of options including renewal, expansion, termination and purchase. Any applicable options must be outlined along with details of those options, exercise dates and the likelihood of exercising the option. In the case of renewal, you must disclose any leases that auto-renew.

4. Short term lease census

Many companies think that because a short-term lease is not reported on the balance sheet, no disclosure is required. However, if you exercise any short-term lease exemptions, you must disclose the amount of the lease expense associated with these short-term leases.

5. Financial statement values and disclosures

The purpose of the new lease accounting standards is to more accurately represent a company's true liabilities and leasing activities. Therefore, there are several new values that must be reported on financial statements. There is, of course, the right of use asset and corresponding lease liability (broken out between current and long term). However, this also includes all costs associated with leases: operating lease costs, finance lease costs (ASC 842), short-term lease costs and variable lease costs. Additionally, income from subleases, net gains or losses from sale and leaseback transactions, cash paid for measurement of lease liabilities, supplemental non-cash information, weighted average remaining lease terms and weighted average discount rates must all be disclosed.



6. Practical expedients

To ease the transition for companies, the FASB and IASB issued several practical expedients and transition relief. If companies elect any of these expedients they must also be disclosed. For example, short-term lease exemption, separating lease components, election not to restate comparative periods upon adoption and hindsight.

7. Other disclosures

In addition to the disclosures above, additional detail is required, including maturity analysis of liabilities and lease transactions with related parties.

Read on to learn about lease-accounting software options that support disclosures.

Five paths to lease accounting compliance

The first step to becoming lease accounting compliant is to understand the lease accounting standards including ASC 840, ASC 842 and IFRS 16. When you become acquainted with the new standard, you will be able to identify how the new standards apply to your company and leases. Understanding how the standard applies to your company will give you a better understanding on which route you want to take in becoming lease accounting compliant.

The different paths to becoming compliant range from performing all duties in house to completely outsourcing all processes. This article will present the different avenues available to companies and their pros and cons.

Become an expert – in house

After taking the time to read through the standards and applying them to your business, you may think you can do this in house. You may have a robust accounting department, or you may not have many instances where the standard applies to you. In this instance, you are assuming the role of leaving the responsibility to your accounting team to build your processes from scratch without third-party partnerships or lease accounting software.

PROS:

More Control

A benefit to performing your lease accounting in house is that your accountants are in office. They are able relay questions to each other and are available to each other. They have the ability to pop their head into a colleague's office (or zoom call) and ask a question.

Accounting Team Growth

By giving the responsibility to your accounting team, you are allowing them to take ownership and grow. Developing your accounting team to be experts can lead to success in more areas than just lease accounting.

CONS:

Time and Effort

When performing lease accounting in house, not only do you need to understand the standards, but you should also become an expert. Becoming an expert requires reading the standard, being aware of updates, reading standard interpretations, compiling data, building out lease accounting processes, and training staff. Each of these tasks requires a good amount of work and in the end, you may not have the time or the resources to do each one effectively.

Spreadsheets

One large (seriously large) part of doing in-house lease accounting are the number of spreadsheets used. The sheer number of spreadsheets and tabs to track lease information is frightening enough, let alone the process to create lease schedules and maintaining them. A vast amount of time is spent opening, closing, and reopening spreadsheets just for your accountant to post a journal entry. We all know the amount of human error that goes into creating useful standard spreadsheet templates.

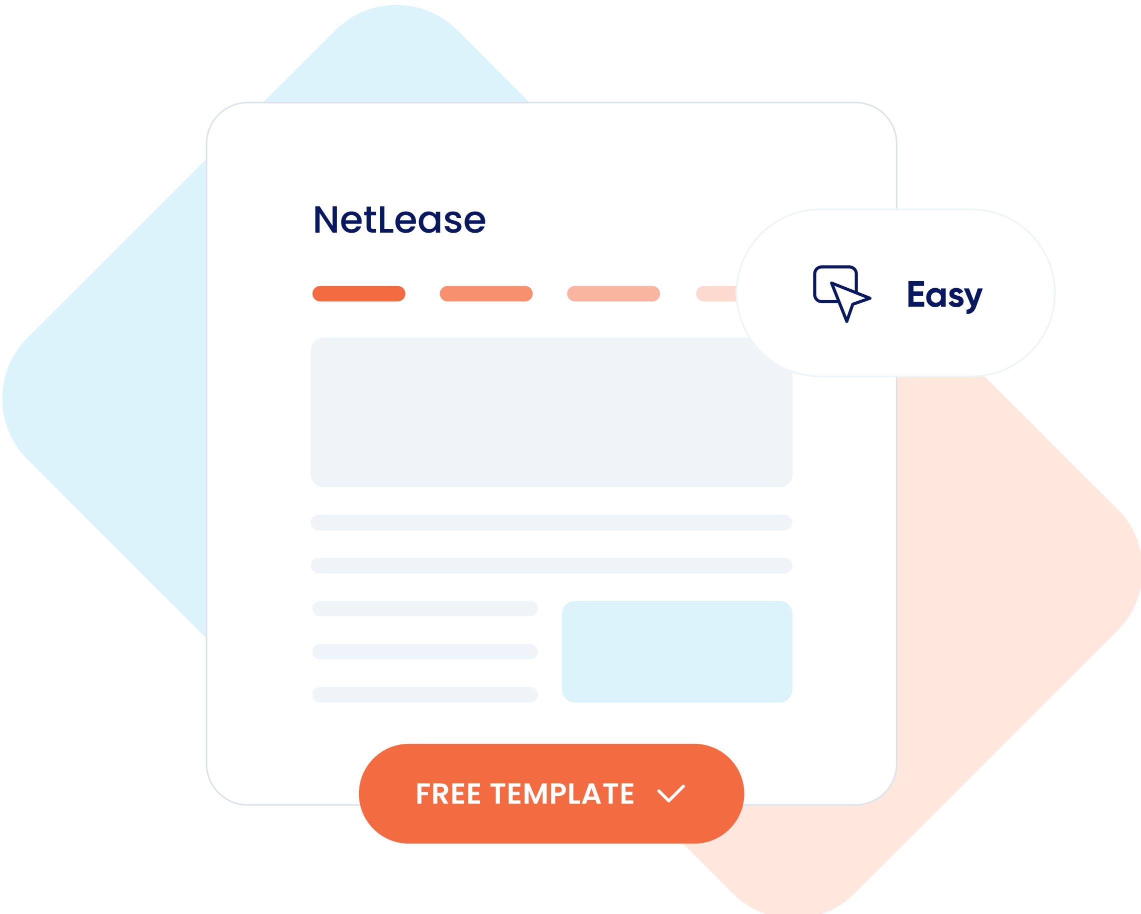
Costs

When we quantify the time spent to DIY your lease accounting process and lease spreadsheets, we are looking at a big number. That number gets bigger when we add the amount of time spent on becoming an expert and then to train. Time is money and the cost to do in house may exceed budget.

Spreadsheet cheat sheet

One way to save your team time and money is to use our free NetLease Template. You can cut the time used in DIY-ing your own spreadsheets to almost no time by just clicking and downloading. Reassure yourself of the accuracy and trustworthiness of your lease spreadsheets by using the NetLease Template.

https://info.netgain.tech/free-lease-amortization-excel-template



Partner with a consulting group

While you may think the amount of time and effort to become a lease expert is too high or you would like to hire additional help, partnering with a consulting group or an accounting firm could be the answer.

PROS:

Expertise

When utilizing an accounting firm, you can count on the knowledge and experience of their team. They are available to answer tough questions and give insight.

Transfer Workload

Hiring outside consultants gives your accounting team a break from having extensive knowledge, developing lease processes and creating lease spreadsheets. Speaking of spreadsheets, you will most likely need to provide compiled lease data to your consultant.

CONS:

Back and Forth

Working with a consulting group will require a kickoff call followed by recurring status meetings and more. In between meetings your accounting department will be answering the endless stream of questions and providing additional data.

Costly

While it is helpful to have an outside group help in becoming lease accounting compliant, the five or six figure invoice that will be paid may turn you away.

Lease accounting software – automate

In reading the above you can already guess using spreadsheets to manage leases and staying compliant can get messy. The smart option is to implement a lease accounting software such as NetLease to automate lease processes and stay compliant. NetLease is a one-stop-shop for achieving lease accounting capabilities.

PROS:

Streamline

Netlease is simple and automated to provide full lease automation when it comes to inputting lease data, generating lease schedules, managing lease modifications, posting journal entries and running reports.

Training and Support

Netgain has a team of accountants to assist in implementation, training and support to make the lease accounting process as simple and stress free as possible.

Automate Compliance

NetLease stays compliant with ASC 842, IFRS 16 & GASB 87 requirements.

Flexible and Scalable

NetLease can support any industry of any size with the abilities to store and access key details and documents for each lease.

Reporting

NetLease provides a robust end to end audit trail and provides push-button reporting to support FASB, IFRS and GASB disclosures, auditor reconciliations and key decision making throughout the entire lease lifecycle.

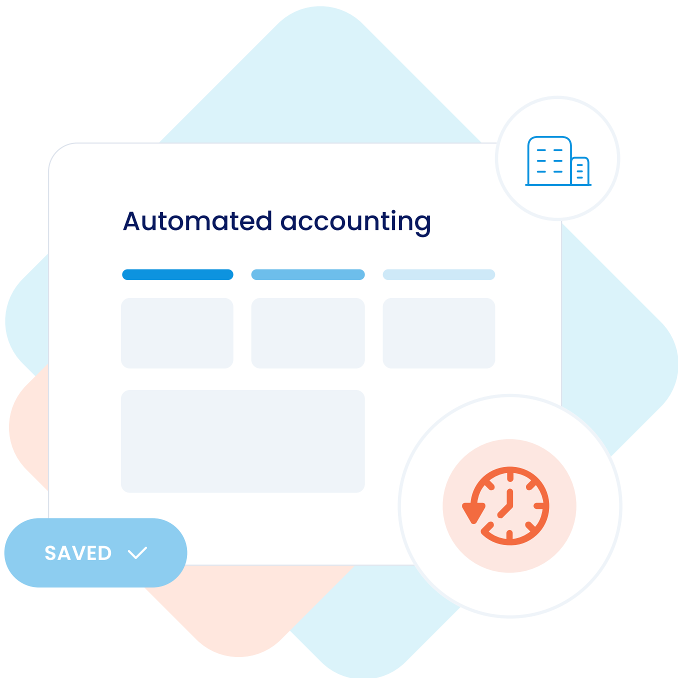
CONS:

Choosing the right software

While it might be obvious that a lease accounting software is crucial to staying compliant, how does one choose the right software? Choosing will require some research and some shopping around.

Sign up for a NetLease demo today

https://netgain.tech/schedule-demo/



Outsource lease accounting

Outsourcing your lease accounting provides the least amount of time and effort by your accounting team. When using an outsourced accounting service such as NetLease Complete, you can receive compliance within 72 hours.

PROS:

Simple Expertise

NetLease Complete is as simple as these few steps:

1. Sign up, choose your lease volume and set your parameters
2. Upload your leases to our customer portal
3. Receive lease schedules and required disclosures for ASC 842, IFRS 16 or GASB 87

Transfer Workload

Outsourcing your lease accounting alleviates your accounting team of the arduous lease accounting tasks. This extra time and effort can be spent in other areas within your company.

Reduce Fraud

With outsourced lease accounting, the ability to commit frauds decreases. The data, schedules and reports are out of the accounting team's hands and with a third party, reducing some of the incentives for fraudulent behavior.

CONS:

Less Control

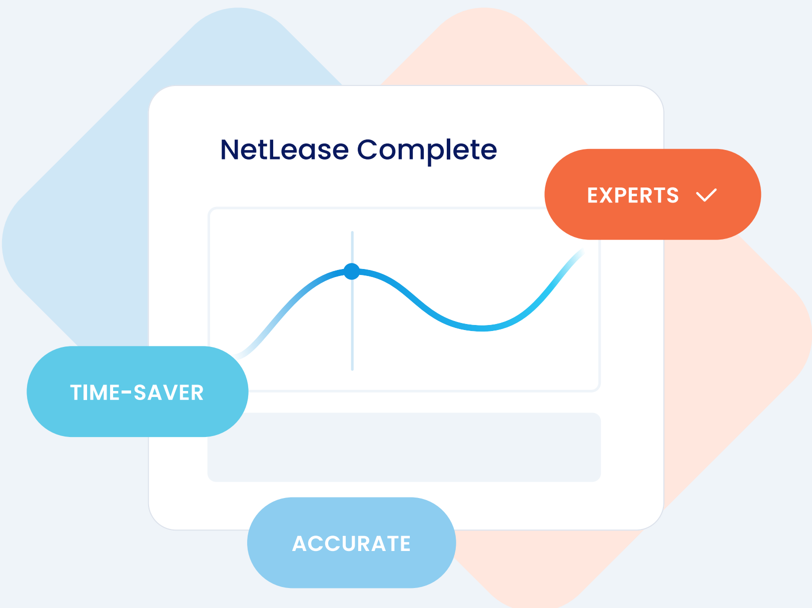
Outsourcing all your lease accounting means you may not be able to customize or address issues as quickly as you would when it is in office. When work is outsourced, you lose control over how the work is being done and misunderstandings may come from irregular communications.

Security

Although most outsourcing firms have appropriate safeguards for your data, there is always an opportunity that confidential information could be compromised.

Learn about Netgain's lease accounting compliance outsourcing solution

HTTPS://NETGAIN.TECH/NETLEASE-COMPLETE/



Chapter 7

The importance of lease accounting software

We have often heard that implementing the new lease accounting standard took far more time, resources and money than companies anticipated. In fact, many public companies with larger lease portfolios have spent millions of dollars implementing. For smaller companies that cost would be unthinkable.

So, what should you do? Will managing your leases in Excel be sufficient, or do you need software? How much will it cost? To help find the answers, ask these questions:

Can Excel cover my needs?

If you're planning on just using Excel, you're not at all alone. A Q4 2018 survey conducted by PwC revealed that 53% of private companies are planning on using spreadsheets. This is more than twice the percentage of public companies planning to use spreadsheets to comply.

While much of that gap may be attributable to company size and lease volume, private companies may be underestimating the impact or overestimating their ability to fully comply while using Excel.

As CPAs who have spent decades manipulating spreadsheets as both public accountants and auditors and closing the books for large companies, we get it. Excel is what we are comfortable and familiar with, and, perhaps, deep down, we think of ourselves as artists. Though not painted on canvas, our work in Excel should be available to be admired by all.

Excel will work if you have a few leases and a lease accounting expert or two on hand, as well as sufficient resourcing and time available to dedicate to ongoing maintenance. If your company only has one or two simple leases and risk is low enough, Excel may indeed be the right answer. Here's a summary of the benefits of Excel:

- Completely customizable
- Easy to send to auditors
- Transparency into formulas (Assuming no hard-coding)
- No extra cost

The limits of Excel

However, there is much more to consider before settling on Excel for more than a small handful of leases. Compliance is not simply developing a lease amortization schedule and booking journal entries against those period balances—this is just one step.

You will ultimately need to report lease amortization, modifications, terminations and aggregation. Relying on Excel will make it difficult to accurately aggregate information and report across a larger number of leases and schedules.

Furthermore, you will need to track additional lease disclosure information such as options (purchases, extensions, modifications, terminations), as well as lease and non-lease components (e.g., base/initial rent, variable payments, other fees such as CAM or taxes and insurance). Your entire schedule will need to be rebuilt when a modification occurs.

Plan to spend time developing required disclosure reports and tracking how your information will be sourced—be prepared to help your auditors tick and tie your schedules to prove out reporting accuracy (e.g., lease schedules, reconciliation reports, disclosure reports, etc.).

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How impacted is my company?

Before building an implementation plan and roadmap, it's important to understand your lease landscape by answering the following questions:

- How many leases do you have? Don't ignore the office you're sitting in.
- Which accounting standards are you subject to – US GAAP, IFRS or governmental?
- How complex are your leases (are there variable terms, renewal options, amendments or other complexities)?
- Do you have an accounting expert in-house who loves accounting research?
- Does your team have enough time to allocate to adoption and implementation?
- Does your team have the bandwidth for monthly lease management activities?
- Have you had adoption conversations with your CPA firm? Have they provided you with a disclosure checklist to review?
- Do you know what lease data will need to be captured and tracked for reporting?

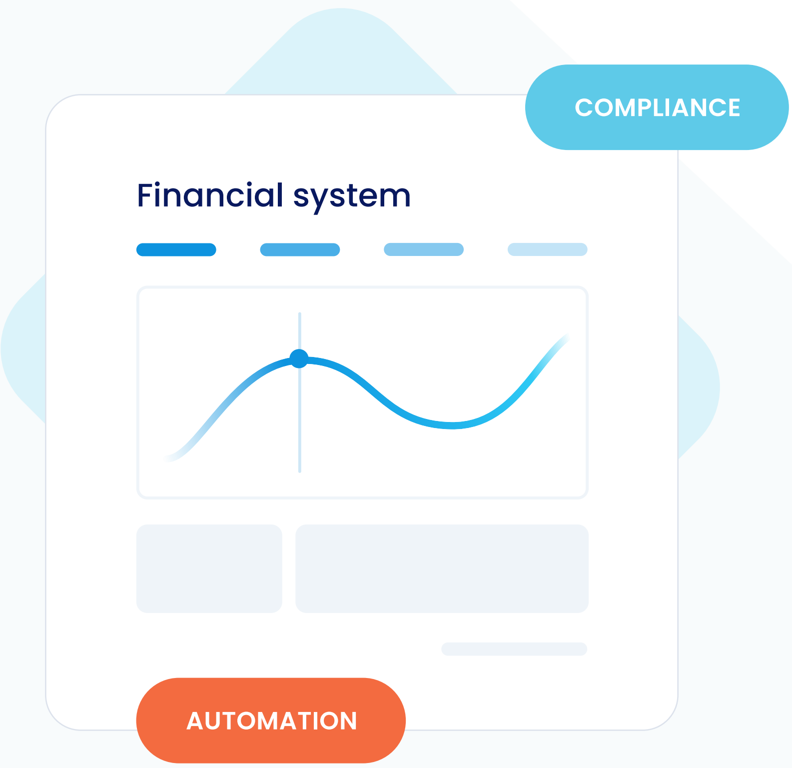
Any of these considerations might require a more robust solution. As you consider investing in a solution, think about your more challenging leases and edge cases. Your solution must include situations like these as they may arise again.

The benefits of software solutions

A technology solution can help centralize all leases onto a single platform, perform calculations, assist with lease administration and provide necessary information for reporting. Here are some of the critical benefits of using a software solution:

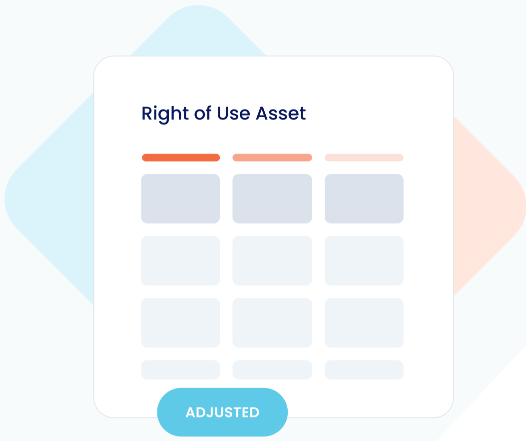
1. Calculate future lease liability

An embedded solution means tracking and automation are built into your core financial system so no integrations or reconciliations are necessary.



2. Calculate the right of use (ROU) asset and amortization

Your ROU balance will need to be adjusted for initial direct costs, incentives and pre-payments. Amortization will differ between operating and finance leases.

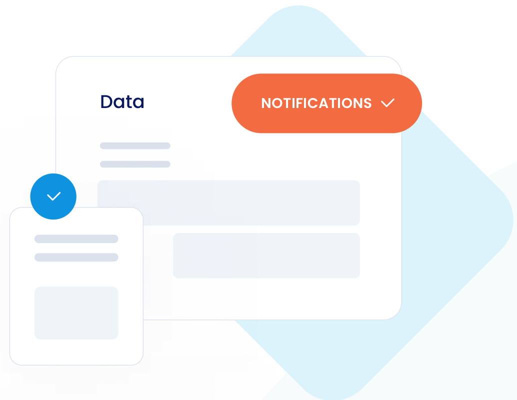


3. Separate lease & non-lease components

Contract terms may include non-lease costs, such as property taxes. Although paid together, they must be accounted for separately.

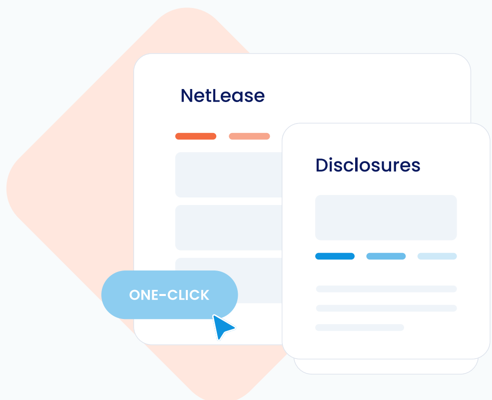
4. Track terms including renewals, options, expirations, etc.

Relevant contract terms can be stored within the system, and notifications can be generated automatically, ensuring that you never miss a key date.



5. More comprehensive disclosure reporting

With all your data in a unified system, you can consolidate and disclose information about your entire lease population with one click. A few of the new disclosures include lease costs, weighted average discount rate, weighted average term, incremental borrowing rate and un-discounted lease maturities.



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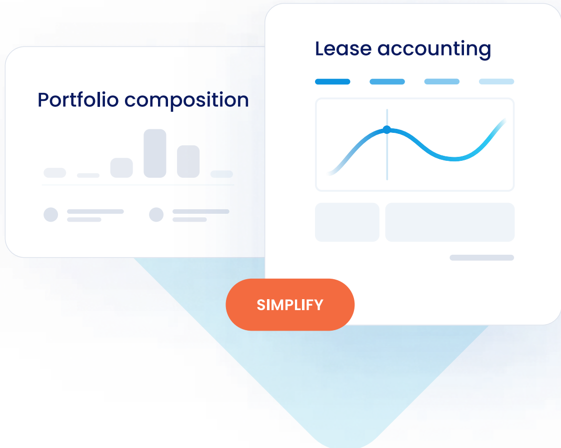
6. Centralize, store and take action across the lease portfolio

Store, track and report on key information, including contract provisions, maintenance schedules, units and usage. Controls can be established throughout the lease lifecycle.



Is software too expensive?

Lease accounting software has become much more affordable as a multitude of lease solution providers compete for new, price-sensitive customers. Because lease solution providers charge based on the number of leases, the cost for companies with fewer leases can be surprisingly affordable.

In addition to reducing your compliance risk, the time saved as a result of automating your lease accounting can easily offset the software cost. Several of the largest CPA firms have found that companies can realize a positive ROI with only a few leases.

Chapter 8

The types of lease accounting software

It can be difficult to choose the right accounting software for your business. This guide can help you determine your needs and what kinds of solutions are best for you.

When making this decision, it's important to list and understand your primary and secondary needs. Consider features like compliance with the new accounting standards, ability to handle capital projects, real estate & lease management, asset maintenance tracking and facilities and space utilization.

Lease accounting software comes in a few more categories. Here are the two major decisions you need to make when considering the types of software available:

Lease accounting or lease management software

Lease accounting solutions are focused on generating the proper journal entries for leases. They are typically built based on guidance from Certified Public Accountants and are primarily focused on compliance with the new accounting standards—ASC 842, IFRS 16 and GASB 87. They also provide financial and disclosure reports to help you comply with the standard. Managing the non-financial aspects of your leases is a secondary consideration.

Lease management software, on the other hand, is first and foremost focused on the real estate, contract management, and lease efficiency side of things. They are generally older software solutions developed by non-accounting, real estate, or equipment industry experts. Accounting under the new standards is a secondary concern. If compliance with new standards is a primary requirement of yours, be wary of lease management solutions.

Here's a summary of the pros and cons of lease accounting versus lease management solutions:

	Lease Accounting	Lease Management
Pros.	Frequently partnered with accounting firms	Depth of real estate & lease mgmt features
Pros.	Journal entries created automatically	Contract managment functionality
Pros.	Easier to use	Ability to capture space utilization
Pros.	Lower relative cost	More mature software
Cons.	Less depth on real estate & lease management	Accounting not a main focus
Cons.	Less contract management functionality	Higher license & implementation costs
Cons.	Less mature software	More complex

Embedded or standalone solution

An embedded solution is built straight into your ERP system and therefore requires no extra integration. A native offering allows you to book journal entries directly to the general ledger and maintain all information in one centralized system.

This helps avoid the dreaded reconciliation between AP and an outside system. Because an embedded solution allows your business to manage everything in one solution, there's less maintenance and risk, less opportunity for downtime and no threat of broken integrations.

Standalone solutions, on the other hand, are built completely outside of your ERP system and require additional integrations or manual uploads to book entries to the general ledger. On at least a monthly basis, you will need to reconcile your AP transactions with the data provided by the standalone solution. This can not only be time-consuming, but it can also produce errors and necessitate re-work during month-end close.

Here's an overview of the pros and cons associated with embedded versus standalone solutions:

Embedded

Pros.

- ✓ Avoid dreaded payment reconciliations
- ✓ Leverage existing financial infrastructure
- ✓ Familiarity with the system
- ✓ Greater internal control
- ✓ No integrations required

Cons.

- ✗ Additional ERP user logins
- ✗ Fewer options

Standalone

Pros.

- ✓ System agnostic
- ✓ More niche solution
- ✓ Subject matter experts
- ✓ Fewer system constraints

Cons.

- ✗ Integrations required
- ✗ More complicated system landscape
- ✗ Higher risk & cost

Chapter 9

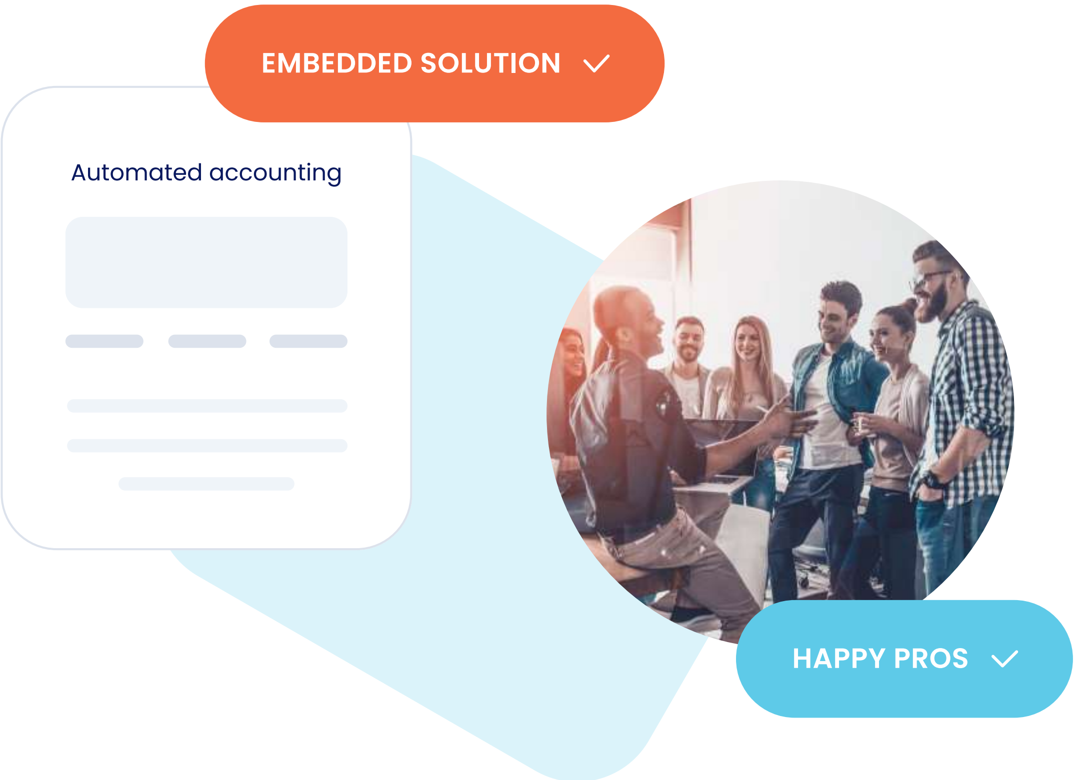
The importance of embedded solutions

At the core of everything in business is the financial system. Within that financial system lies all manner of business operations — HR, CRM, billing, tax, inventory, etc. Having those groups connected to the financial core with an embedded solution and a unified, single database can save time, money and potential frustration.

Third-party solutions have limitations

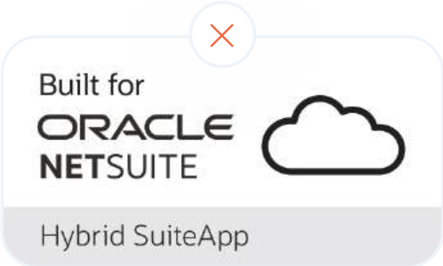
For years, many organizations adopted the notion that “best-of-breed” third-party solutions were the answer. The reasoning stood that while ERPs might be able to offer a wide-reaching solution to help most corporate departments function, these solutions weren’t ideal for handling the more nuanced and specific needs of any one department. So, organizations began adding lots of third-party solutions, each one bringing with it a layer of complexity and cost — not to mention an ever-expansive spaghetti chart.

Now, times are changing. CFOs have grown frustrated with third-party solutions and the associated costs, complications and increased risk to business management. Additionally, auditing becomes more complex and costly because auditors are forced to learn third-party solutions. Many of these issues aren’t factored in when choosing “best-of-breed” solutions, leading to added costs and frustration down the road. For good reason, many CFOs are on a mission to reduce the number of third-party integrations and subledgers in their organizations. Embedded solutions are bringing secure, efficient and cost-effective ways of managing a multitude of corporate departments and functions. And because embedded solutions work seamlessly within a vetted and proven ERP, it makes management easier for IT. And that makes IT happy.

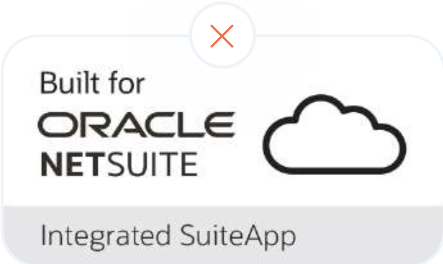


Embedded solutions are the answer

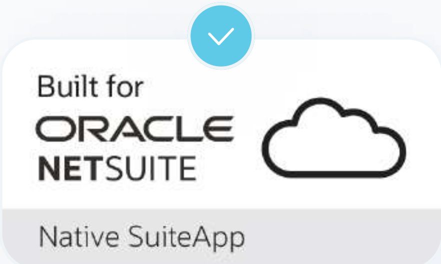
As the world's #1 cloud business management suite, Oracle NetSuite brings with it years of trusted, industry-leading experience, security and access to tools like no other third-party app developer can come close to offering. Netgain is proud to be recognized with two badges of distinction from NetSuite. We are a member of the Suitecloud Developer Network (SDN), NetSuite's dedicated, end-to-end program geared toward developers offering technical services, marketing and sales support. Netgain is also recognized with a Built for NetSuite (BFN) badge.



The Hybrid SuiteApp badge means the solutions are a mix of platform resident components and external components. These are separate solutions integrated with Netsuite via custom UI and/or internal and external data.



The Integrated SuiteApp badge means the majority of the solution resides externally to the NetSuite platform. This is a separate solution with data integration to NetSuite via a custom integration, or via a generic connector.



Netgain is recognized with the BFN Native SuiteApp badge. This means 100% of our solution resides on the SuiteCloud platform. Our app is deployed to customers' accounts via the SuiteBundler. All components are within the scope of the BFN review.

To get the benefits and efficiencies of a truly embedded solution, users should always look for the BFN Native SuiteApp badge and look for Native SuiteApps before considering third-party solutions.

As a 100% native NetSuite verified SuiteApp, Netgain relies on NetSuite's world-class security and data management practices. Netgain manages calculations but doesn't access customer data. That means all data lives securely and separately with NetSuite. With their trusted and proven platform as a foundation, we're able to focus our efforts on creating best-in-class, truly customizable accounting solutions for the smartest finance and accounting professionals and their IT counterparts.

Go native with lease accounting

Managing your leases in a native solution can help your organization in so many ways. Achieve greater efficiency and increased security. Streamline systems and processes with a single database. Reduce complexity, lower costs, save time and eliminate frustrations. And according to experts, embedded solutions help users unlock operational efficiency increases by a factor of seventeen.

Learn more about the benefits of an embedded system here (https://netgain.tech/benefits-of-the-embedded-solution/).

Chapter 10

How to select lease accounting software

Picking the right lease accounting software can be daunting. Most solutions have strong and weak points. Here are some tactics to more effectively and confidently select your lease accounting software.

Step 1: Identify your key business requirements

Start by analyzing your current process. What aspects of your lease operations are essential for compliance and administration? What are the biggest pain points in the current process? Make a list of the essential features that your business is looking for in the new application. Here are some of the common needs to consider:

- Compliant with New Accounting Standards (ASC 842, IFRS 16, GASB 87)
- Real Estate & Lease Management Capabilities
- Asset Maintenance Tracking
- Contract Management
- Capital Project Administration
- Facilities Management & Space Utilization Monitoring
- FX Considerations
- Multi-Book Reporting
- Lessor Accounting Needs

Step 2: Prioritize your needs and assign their relative importance

Software solutions excel in some areas more than others so it's important to identify your primary, secondary and "nice-to-have" requirements. Create a scorecard that lists your required features and assign weight to each feature based on your priorities (See example in Step 5, page 60).

Step 3: Determine what solutions are available

Based on the needs identified in step one, create a short list of solutions that may meet those requirements. Consider vendor solutions, an existing solution provided within your ERP software, Excel and homegrown programming as possible options.

Step 4: Schedule demonstrations & know what to ask

Once you've determined that you need a software solution, identify vendors you'd like to review, and schedule product demonstrations. Leading up to the demonstration, we recommend providing examples of your most complex leases under the new standard. Ensure that the solution is able to properly account for that lease and future leases of similar complexity.

Here are some must-ask questions to address with vendors during the demonstration, and some common areas where solutions fall short:

QUESTION	AREAS WHERE SOLUTIONS FALL SHORT
1. How does the solution automate the accounting for my most complex leases?	Modifications Renewals Escalating payments Impairments Multi-asset portfolios Variable payments Lease & non-lease components
2. Can the system handle the complexity of my accounting operations?	Difference among ASC 842, IFRS 16 & GASB 87 Foreign currency Multi-book accounting Lessor accounting and/of sub-leases
3. How flexible and customizable is the solution?	Error corrections (ex: Change in IBR) Custom fields Data collection
4. How robust are the reporting capabilities?	Pre-built disclosures (ex: Weighted average IBR) Out-of-the-box reports included Custom/ad hoc reporting easy to navigate
5. How does the system integrate with my EPR?	Reconciliations to vendor bills & payments Journal uploads and/or integrations required Cost of building custom intergrations

6. How reliable is the underlying architecture?	Newly built from scratch Fake cloud/un-proven cloud On-premise System roles & security Lack of audit trails Internal controls/Sarbanes-Oxley SOC reports
7. How does it help me manage my leases?	Maintenance tracking Contract management Key lease term tracking Insurance Critical date tracking
8. What's the cost structure?	High annual SaaS license fees High implementation cost Expensive maintenance Greater investment, lower ROI
9. What steps and timing are involved in the implementation?	Long implementations (>3 months) Not plug & play ready Complex implementation Offshore consulting team Inexperienced implementers
10. What is your plan for ongoing maintenance and system updates?	Core requirements still on roadmap No roadmap/reactive
11. How proven is the company and its leadership team ?	Strong in accounting or systrem, not both CPA firm partnerships Customer references

Step 5: Rate vendors in a software solution scorecard

Rate each vendor based on the answers to the above questions. In our basic example below, we're rating two vendors based on four main categories – accounting and compliance, ease of use and implementation, software infrastructure and lease and contract management. Multiply each score by the associated weight percentage created in Step 2 to get category scores based on priority and sum the results. These scores can help you make an informed decision.

Here's a simplified example scorecard to help identify the right lease accounting software:

Category	Weight	Vendor A		Vendor B	
		Score	Weighted score	Score	Weighted score
ACCOUNTING & COMPLIANCE REPORTING	35%	3	1.05	5	1.75
EASE OF USE & IMPLEMENTATION	30%	2	.6	5	1.5
SOFTWARE INFRASTRUCTURE	25%	1	.25	5	1.25
LEASE & CONTRACT MANAGEMENT	10%	4	.4	3	.3
Weighted score:			2.3		4.8

Step 6: Assess the solutions based on weighted scores and cost

At this point, you know what vendor's functionality aligns best with your business priorities. However, we live in the real world and budgets must always be a major consideration when adopting new processes. Assess each vendor based on the value they bring and ensure you have adequate functionality in your budget.

Step 7: Understand vendor support

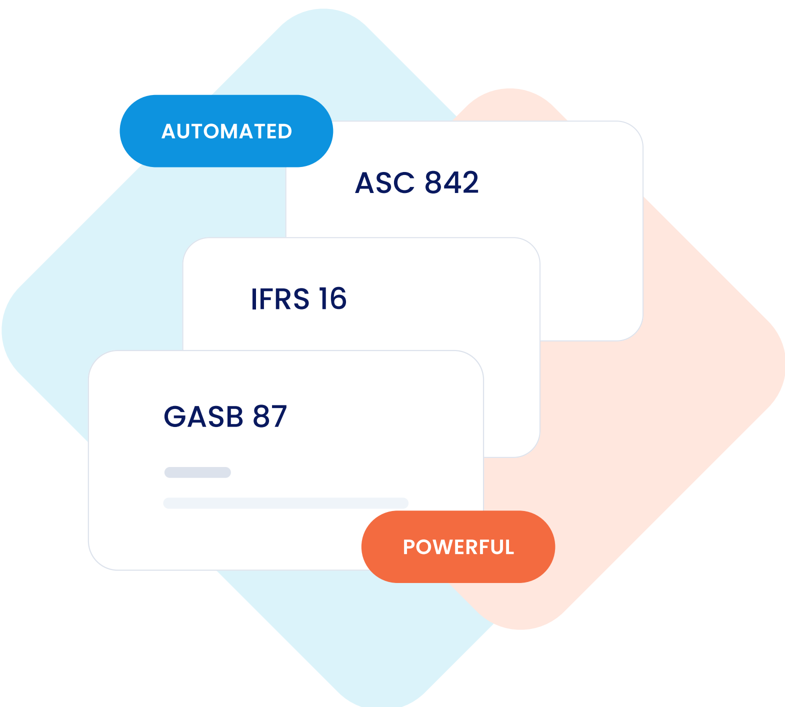
Understand the level and kind of support you'll get from your vendor (including the upgrade process/cadence and support team reliability) before making a decision. Your vendor should have a dedicated support team with the capacity to assist you during implementation and beyond. Also, understand the upgrade process. Is there a history of upgrades affecting the current-state accounting of live customers? How often and in what manner are system upgrades deployed?

NetLease, the stand-out solution

By now, you have a good understanding of how the new lease accounting standards have changed, the benefits of a software solution and the key differences between solutions. You've seen the numerous benefits of an embedded system. The question now becomes: which embedded solution do I want?

All the features you need in one embedded solution

NetLease, the lease accounting solution from Netgain, has the features you need with support you can rely on. It's compliant with the ASC 842, IFRS 16 & GASB 87 requirements, easy to set up and combines reporting with outstanding predictive tools. In short, NetLease covers all the new complexity of lease accounting in a simple but powerful solution.



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Key features

Embedded in NetSuite

NetLease is a native SuiteApp so all your lease accounting and compliance remain in your core financial system, eliminating reconciliations, integrations and safety concerns.

Powerful Lease Tools

Flexible reporting gives you insight into leases throughout their lifecycle so your organization can make informed business decisions in real-time.

Simple Reporting

Reports for disclosures, roll-forward and forecasting are easy to run, including easy-to-understand dashboard reporting. The robust end-to-end audit trail and push-button reporting for disclosures save enormous amounts of time for accountants and auditors.

Solutions for Lessees and Lessors

Regardless of which side of leases your company operates, NetLease has your leases covered. This is especially powerful for organizations that both rent and lease assets.

If your company is on NetSuite and you have leases, NetLease is the must-have solution.

Its systematic approach to lease accounting, robust reporting, automation and built-in architecture can't be beat.