

3 MISTAKES TO AVOID IN YOUR LEASE COMPLIANCE PLAN

Whether reporting for GAAP or IFRS financials, be sure to avoid these three common pitfalls as you prepare for new lease standards:

1. Not Starting Soon Enough

Even though the new standard doesn't require adoption until the deadline, it calls for a modified retrospective transition (2-year lookback). That means that public organizations should operate as though the standard went into effect when the lookback period began.

On average, we have found that customers underestimate the time it will take them to transition to the new guidance. In fact, they typically uncovered 2x the expected number of leases. Preparing your organization's lease inventory may be more complicated than it sounds due to embedded leases and the existence of renewal and purchase options, as well as variable payment streams. This could be even more complex if your organization has global or decentralized operations.

The sooner your organization is able to forecast the impact of the change and prepare, the better. Your organization can expect changes on the balance sheet, debt covenants, income statement and 3-5 year plan. Forecasting these changes and communicating them with your key stakeholders is crucial.

2. Not Considering Impacts on Other Departments

While the burden of the lease changes will hit the accounting group the most, it may also have a ripple effect on the budgeting, tax, and regulatory groups.

As the number and impact of leases increases, many organizations will centralize lease activities under one department. That means accounting groups will need to ensure that necessary details are synchronized for proper budgeting and expense distributions, which may impact O&M budgets, capital approval processes and profit and loss metrics tracked by individual departments and business units.

With the new standard, finance and operating leases will require organizations to recognize a deferred tax asset and liability. As such, organizations may see significant impacts on the balance sheet, even if the effect on the income statement is not as significant.

There is still a lot of uncertainty about how regulators will handle these changes, especially around including finance leases in rate base. It is important that the accounting group understands how the regulatory group is recognizing capitalization and amortization for regulators. It is possible that regulators may wait until the last minute to decide how they will treat the lease changes, so it is essential to be aware of potential regulatory impacts.

3. Not Going Deep Enough in Software Evaluations

With so many options in the marketplace, it is important to understand the use cases for not only the straightforward leases, but the complex embedded leases as well. Beyond the specific requirements for your organization, a robust lease accounting solution should be able to systemize all types of leases (e.g. real-estate and equipment, tangible and intangible), manage all lease lifecycle events and calculate the implications of prepayments, payments, impairments, renewals, purchase options and terminations, while also handling the necessary journal entries upon adoption of the new standard.

To effectively manage leases, you should capture all lease information in a centralized location (details such as fair market value, payment amounts, renewal options, residual value, determination value, end of terms, etc.). You will also need a way to track the complexities of different lease types and arrangements, in addition to non-lease components of contracts and variable costs.

Taking advantage of time-saving tools could save your organization headaches – lease templates or upload tools enable users to quickly add or maintain data, while lease analysis tools can classify finance and operating leases. From there, you also need out-of-the-box reports that support disclosure requirements, internal reporting, tax reporting, and 10-K requirements. To aid with the transition to the new guidance, the solution should also provide ASC 842 and IFRS 16 adoption scenario analysis so that organizations can consider timelines to make an informed strategy.

PowerPlan has helped customers manage operating and capital lease accounting for 15+ years. PowerPlan's Lease Accounting solution can help organizations transition to the new standards through its centralized lease repository, which manages the complete lease lifecycle and supports compliance with both new and existing FASB and IASB regulations. For more information, please visit our website or contact us at +1 678.223.2800.

“Having a central repository for recurring lease obligations is huge. It took us a long time to round up all our leases, and this project gave us a head start so we won't have to jump through hoops when the new lease standards go into effect.”

– Energy Services Customer



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