SOFTWARE REQUIREMENTS FOR TRANSITION LEASE ACCOUNTING
TRANSITIONING TO THE NEW STANDARDS

One of the greatest challenges with adopting the new lease accounting standards will be managing through the transition period. US GAAP filers adopting FASB’s new ASC 842 will be required to provide a modified retrospective approach, which includes three years of comparative reporting for the income statement and two years of comparative reporting for the balance sheet. The challenge for most companies will center upon the reporting for the existing portfolio of leases. Due to the historical off-balance treatment of operating leases, most companies do not have a centralized repository of documentation and data about their existing portfolio. With the retrospective period having already started, many companies will be in the unenviable position of having to capture the data needed for comparative reporting during the transition period. The data collection is just one of three key challenges that organizations will face with the transition.
THREE
KEY CHALLENGES
CHALLENGE #1
TRANSITIONING THE EXISTING LEASE PORTFOLIO

Most large companies have a portfolio of hundreds, if not thousands, of existing leases that will need to be transitioned to the new standard. The requirements for transitioning this existing portfolio of leases will vary based upon the start and end dates relative to the Date of Initial Application and the Effective Dates for ASC 842. With respect to those two dates, there are six variations of leases that may occur, each of which will have slightly different requirements.

SIX SCENARIOS FOR TRANSITIONING YOUR LEASE PORTFOLIO

<table>
<thead>
<tr>
<th>SCENARIO</th>
<th>DESCRIPTION</th>
<th>REQUIREMENT</th>
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<tbody>
<tr>
<td>Leases Expiring before the Date of Initial Application</td>
<td>These leases are scheduled to expire before the Date of Initial Application of the new standards. For example, a photocopier lease might have already expired on 12/1/2016.</td>
<td>Current standards (ASC 840)</td>
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<tr>
<td>Leases Ending during the Transition Period</td>
<td>These leases start before the Date of Initial Application and end before the Effective Date. For example, a delivery vehicle lease might have started on 7/1/2015 and expire on 6/30/2018.</td>
<td>Current standards (ASC 840) New standards for comparative reporting (ASC 842)</td>
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<tr>
<td>Leases Contained within the Transition Period</td>
<td>These leases start after the Date of Initial Application and end before the Effective Date. For example, a real estate lease for temporary office space might start on 4/1/2017 and end on 3/31/2018.</td>
<td>Current standards (ASC 840) New standards for comparative reporting (ASC 842)</td>
</tr>
<tr>
<td>Leases Spanning the Transition Period</td>
<td>These leases start before the Date of Initial Application and end after the Effective Date. For example, a real estate lease for corporate headquarters might have started on 9/1/2010 and end on 8/31/2040.</td>
<td>Current standards (ASC 840) New standards (ASC 842) Comparative reporting</td>
</tr>
<tr>
<td>Leases Starting after Date of Initial Application</td>
<td>These leases start after the Date of Initial Application and end after the Effective Date. For example, a lease with 10 material handling equipment assets might start on 10/1/2018 and end on 9/30/2023.</td>
<td>Current standards (ASC 840) New standards (ASC 842) Comparative reporting</td>
</tr>
<tr>
<td>Leases Starting after Effective Date</td>
<td>These leases start after the Effective Date. For example, a lease for a rack of blade servers might start on 4/1/2019 and end on 3/31/2022.</td>
<td>New standards (ASC 842)</td>
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In the examples, we assume a Date of Initial Application of 1/1/2017 and an Effective Date of 1/1/2019.
A significant amount of work will be required to apply the new standards to these existing leases. Specifically, additional data and supporting documentation will need to be collected and uploaded into a lease accounting system. New information such as reasonably certain holding periods will need to be captured. Whereas schedule level data may have been acceptable in the past, asset-level details are required going forward.

**SIX SCENARIOS FOR TRANSITIONING YOUR LEASE PORTFOLIO**

Practical expedients and exemptions offered by the standards board can considerably reduce the amount of accounting work necessary. For example, the package of three practical expedients offered under ASC 842 can free companies from having to evaluate contracts for embedded leases, reclassify existing leases and recalculate initial direct costs.

An additional challenge will be tracking any changes to leases that have been modified or require reassessment under the new standards.
CHALLENGE #2
MODIFICATIONS AND REASSESSMENTS DURING TRANSITION

The existing portfolio of leases does not remain static during the transition period. There will be changes during the transition period that will need to be tracked to perform accurate comparative reporting. Examples of changes during the transition period might include:

EXPIRING LEASES
Some leases will be renewed. Others will be terminated. And, in other cases, the underlying assets will be purchased at lease end. Each of these events will need to be properly accounted for under the current and new standards.

NEW LEASES
New leases will be signed. These new contracts will need to be properly accounted for under the current and new standards.
Due to the prior off-balance sheet nature of operating leases, most companies historically have not invested in the systems, processes and controls that exist for their on-balance sheet assets and liabilities. For example, many companies have been calculating the lease obligations for financial disclosures using spreadsheets. With the new standard, we expect companies will use lease accounting software applications that will produce more accurate accounting based upon centralized policies and standard calculations. The result will be numerous inconsistencies which will need to be reconciled and offset with adjusting entries prior to transition.
There are three critical requirements for lease accounting software packages to enable the transition to the new standards. First, users should be able to centrally manage policy elections such as the Date of Initial Application, Effective Date and choice of practical expedients. Second, the application should support multiple lease accounting subledgers for the current standard, new standard and comparative reporting. Third, the software should include a transition accounting engine that can automatically generate transition subledgers, adjusting entries and the information needed for financial disclosures.

THREE KEY REQUIREMENTS FOR LEASE ACCOUNTING SOFTWARE

**TRANSITION POLICY MANAGEMENT**
- Date of Initial Application
- Effective Date
- Full of Modified Retrospective
- Practical Expedients
- Exemptions

**TRANSITION ACCOUNTING ENGINE**
- ASC 840
- IAS 17
- ASC 842
- IFRS 16
- Calculate True-Up Entries
- Re-measurement of Assets
- Auto-Generation of Transition Ledgers

**TRANSITION ACCOUNTING SUBLedgers**
- ASC 840 Legacy Subledger
- ASC 842 New Subledger
- Comparative Reporting Subledger
- Modeling “What If” Subledger
The lease accounting software application should enable you to centrally manage all policy elections related to the transition to the new standards. Users should be able to input the Date of Initial Application and Effective Dates. Additionally, users should be able to select whether they will elect the various practical expedients available for the transition.

## PRACTICAL EXPEDIENT OPTIONS FOR ASC 842

<table>
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<tr>
<th>REQUIREMENT #1</th>
<th>TRANSITION POLICY MANAGEMENT</th>
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<tr>
<td><strong>LEASE DEFINITION</strong></td>
<td>Not to reassess whether expired or existing contracts contain leases under ASC 842’s new definition.</td>
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<td><strong>LEASE CLASSIFICATION</strong></td>
<td>Not to reassess lease classification for expired or existing leases.</td>
</tr>
<tr>
<td><strong>INITIAL DIRECT COSTS</strong></td>
<td>Not to reassess whether previously capitalized initial direct costs would qualify for capitalization under the new standard.</td>
</tr>
<tr>
<td><strong>END OF TERM DECISIONS</strong></td>
<td>Use hindsight when considering the likelihood that a lease will be extended, terminated or the underlying asset will be purchased at end of term.</td>
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**PACKAGE OF THREE**
The “Package of Three” practical expedients allows companies to avoid reassessing:

1. Whether expired or existing contracts contain leases under ASC 842’s new definition
2. Lease classification for expired or existing leases
3. Whether previously capitalized initial direct costs would qualify for capitalization under the new standard

Another policy election companies can choose is to use hindsight when considering the likelihood that a lease will be extended, terminated or the underlying asset will be purchased at end of term.
REQUIREMENT #2
TRANSITION ACCOUNTING SUBLLEDGERS

The lease accounting software application should offer multiple subledgers to support the transition. At a minimum, you will need two dedicated subledgers - one for the current standards and another for the new standards. LeaseAccelerator also recommends deploying two additional ledgers to support modeling and comparative reporting.

CURRENT GAAP ASC 840 LEDGER
This will be the primary subledger for current US GAAP until the Effective Date (e.g., 1/1/2019). Accounting data reported in the footnotes disclosures of SEC filings will be generated by uploading journal entries from this sub ledger into your GL(s). Some companies may need their ASC 840 ledger to continue for several additional years in a legacy (or frozen) GAAP model. For example, certain companies may be required to continue financial disclosures in ASC 840 to support regulatory compliance, insurance or lender requirements.

NEW GAAP ASC 842 LEDGER
After the Effective Data (e.g., 1/1/2019) this will become the primary subledger for US GAAP. ROU assets and liabilities reported on the balance sheet will be generated by uploading journal entries from this sub ledger into your GL(s). A set of adjusting journal entries will need to be applied on the Effective Date to “true-up” the accounting. Additionally, if any changes in estimates from those used in the original takedown or transition are applicable at the effective date another set of adjusting entries to support the re-measurement requirements of ASC 842.

COMPARATIVE REPORTING LEDGER
To support the SEC's comparative reporting requirements under the modified retrospective, companies will need an additional ledger to record a set of transition journal entries. The transition ledger will record how leases during the transition period (e.g., 1/1/2017 to 1/1/2019) that are being reported in current US GAAP would have been accounted for using the new standard. The transition adjusting entry along with the recurring activity which would normally apply during the transition period support the comparative reporting requirements for the modified retrospective. These are the basis for the true-up entry required in the New GAAP 842 Ledger.
 Most companies will also want a test ledger that can be used to perform “what if” analysis. For example, companies may want to model the impacts of various transition options and policy elections on the balance sheet and income statement. Alternatively, a corporate development group might need to model the impact of potential mergers, acquisitions or divestitures. Or a Financial Planning and Analysis team might need to model the leasing portfolio for budgeting or forecasting purposes. Since these type of modeling exercises will focus on the future state, the pro-forma ledger entries will be recorded using the ASC 842 accounting standards. The modeling ledger will primarily be used during the transition period and can likely be deleted after the Effective Date.
REQUIREMENT #3
TRANSITION ACCOUNTING ENGINE

The lease accounting software application should have a transition accounting engine that can automate many of the most time-consuming calculation and reporting requirements for the transition including:

AUTO-GENERATE TRANSITION LEDGERS

The accounting engine should be able to auto-populate the transition ledgers after receiving just a few inputs from an end-user. First, it will extract all the needed data from a source ledger. Then it will apply the transition policy elections and practical expedients. Finally, it will calculate the new journal entries based upon the corresponding commencement date for each lease schedule and asset. As described above, there may be a need to create several transition ledgers to support financial modeling and international reporting requirements.

CALCULATE TRANSITION ADJUSTING AND TRUE-UP ENTRIES

A set of transition adjusting and true-up entries for all the related accounts (including for example, ROU Asset, Lease Obligation, Accumulated Depreciation, lease rental expenses, accounts payable clearing and other accounts) will be needed to true up the sub ledger. The accounting engine should automatically calculate these true-up entries on the Effective Date and insert them into the sub ledger.
RE-MEASUREMENT OF ASSETS

Changes in estimates to your existing lease portfolio may occur during the transition period or at the effective date such as changes to reasonably certain estimates for end of lease options and residual values. If so, then another set of adjusting entries will be required based upon the re-measurement guidelines of the new leasing standards. After receiving inputs from the end users, the transition accounting engine should be able to calculate these re-measurement entries.

DISCLOSURE REPORTING

The Lease Accounting system should generate the required disclosure reports for both the Maturity Analysis and Quantitative Reports along with the required comparative reporting for the financial statements. Lease Accounting systems should also support internal management reporting as well as reporting for other stakeholders may require reporting vs the original as-reported financial statement information. For multinational companies the Lease Accounting and Transition Accounting engines should support the multiple reporting requirements.
ABOUT LEASEACCELERATOR

LeaseAccelerator offers the market-leading SaaS solution for Enterprise Lease Accounting, enabling compliance with the current and new FASB and IFRS standards. Using LeaseAccelerator’s proprietary Global Lease Accounting Engine, customers can apply the new standards to all categories of leases including real estate, fleet, IT, and other equipment at an asset-level. On average, LeaseAccelerator’s Lease Sourcing and Management applications generate savings of 17 percent on equipment leasing costs with smarter procurement and end-of-term management. Learn more at http://www.leaseaccelerator.com/.

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