



I D C M A R K E T S P O T L I G H T

Enterprise Lease Accounting Software: Making IFRS 16 and ASC 842 Compliance Easy

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IFRS 16 and ASC 842 are new lease accounting standards with which corporations must comply in the next two years. This Market Spotlight examines the ramifications of IFRS 16 and ASC 842 on companies. The paper also looks at the role of lease accounting software in meeting these strategically important business process and financial statement reporting requirements.

Introduction

In early 2016, the IASB published a new lease accounting standard, IFRS 16. Just a few weeks later, the FASB introduced a new lease accounting standard, ASC 842, mirroring IFRS 16 with a few additional differences. Both standards are changing how leases are recorded on corporate balance sheets. Currently, companies report financial leases on the balance sheet. Companies are also able to report operating leases off the balance sheet and disclose the information in the notes of the financial statements. However, the new standards nullify this activity in the future. This practice of reporting off the balance sheet has made it difficult for investors to compare companies. According to IFRS, companies must move to a single accounting model for all leases with two exceptions: short-term leases and low-value assets. U.S. GAAP will require companies to classify leases as "operating leases" or "finance leases."

The new standards were enacted to improve the financial transparency of businesses. Now, companies are required to capitalize many of their operating leases and record them as assets and liabilities on the balance sheet. In addition, the disclosure of information related to leasing arrangements will be required. The new standards will look at how and when revenue from long-term contracts, leases, and exchanges will be recognized. Assets such as real estate, airplanes, office equipment, manufacturing machines, and technology will be part of a company's balance sheet. This move will bring billions and even trillions of dollars to the balance sheet. According to the new standards:

- Full compliance for public companies is expected by December 2018.
- Full compliance for private companies is expected by December 2019.
- Requirements include a three-year look-back period for income statements and a two-year look-back period for balance sheets.

These new standards represent the perfect opportunity for businesses to update their lease accounting practices, including better business processes guided by lease accounting software.

Compliance Requires Control

Complying with the new standards will not be easy because most companies have leases scattered virtually everywhere. From real estate to manufacturing and office equipment to vehicles and technology, businesses have a multitude of leases. Unfortunately, the lease documentation may be held across the company in various departments such as human resources; finance; legal; manufacturing; supply chain; logistics; maintenance, repair, and operations; and facilities. For large organizations, the data collection of the lease documentation required to be compliant is a daunting effort.

In addition, the level of sophistication with the record keeping of lease agreements varies by company and department. Most companies do not have a centralized repository for this information or even uniform reporting standards. In fact, just these two aspects can have multiple business processes across many functions. Real estate may be part of facilities, legal, finance, and operations and have multiple requirements and paths to completion. Transportation may be a corporate function that varies by divisions and business units. IT infrastructure may be tied to corporate divisions, regions, and functions with many disparate processes. When these issues are coupled with different ledger systems such as Excel, Google documents, hardcopies, and technology systems, the compliance issues related to the new regulations triple. The need for additional accounting and finance professionals to help find and pull together the data leads to even more expenses in order to become compliant with the new standards.

If integrated correctly into an ERP system, enterprise lease accounting software can help solve many of these challenges by improving the efficiency of data capture, visibility, and transactions as well as enhancing audit processes. Enterprise lease accounting software also will help centralize all the strategic data related to acquisitions. These types of efforts will lead to more transparency in three key areas:

- **Procurement.** A centralized view of all assets, terms, and costs across the organization will increase efficiencies about all aspects of the life cycle and reduce costs associated with IT assets and termination procedures.
- **Accounting.** Revenue recognition and multiple subledgers for real estate, IT equipment, office equipment, and other items will help with compliance management, financial reporting, and global lease accounting, among other things. However, it is also important to keep in mind that most companies have two types of accounting asset management products — one to manage real estate and the other to manage IT infrastructure equipment. Leveraging transparency is essential across all asset types, not just those that have specific accounting applications to track them.
- **End-of-life management.** Most organizations do not have an established protocol for end-of-life procedures. Thus the processes around notification, return policies, security protocol, disposal, and compliance with lease deadlines are inefficient. Often, this inefficiency leads to missing end-of-lease deadlines and triggers a shift from month-to-month payment schedules.

The bottom line: Complying with IFRS 16 and ASC 842 requires exceptional enterprise business processes enabled by enterprise lease accounting technology.

Definitions

- International Financial Reporting Standards (IFRS) are designed as a common global language for business affairs so that company accounts are understandable and comparable across international boundaries. The standards are a consequence of growing international shareholding and trade and are particularly important for companies that have dealings in several countries.
- Generally accepted accounting principles (GAAP) are accounting standards, rules, and procedures defined by the professional accounting industry that have been adopted by nearly all publicly traded U.S. companies.
- The Financial Accounting Standards Board (FASB) is a private, nonprofit market regulator whose primary purpose is to establish and improve GAAP within the United States that are in the public's interest.
- Accounting Standards Codification (ASC) is the single source of authoritative U.S. accounting and reporting standards, other than guidance issued by the Securities and Exchange Commission, as approved by the FASB on July 1, 2009.
- The International Accounting Standards Board (IASB) is an independent, private sector body that develops and approves IFRS. The IASB operates under the oversight of the IFRS Foundation.

Benefits

Enterprise lease accounting software aids accounting and finance professionals by saving them time in business processes, reducing human touch points and errors, increasing productivity, and bringing visibility to all aspects of the lease. With enterprise lease accounting software, professionals can view, approve, track, monitor, and value lease assets across the organization.

The best lease accounting software is SaaS or cloud based, and it enables a company to track leases at the portfolio, schedule, and asset levels. All data elements must be tracked for each asset, including the judgments, calculations, emails, and supporting documentation. In addition, activities supporting each leased asset must be tracked, such as upgrades, swaps, partial buyouts, returns, and renewals. When this extremely detailed information is available, all debits and credits can be produced to meet the needs of the new standards. In addition, income statements, balance sheets, and cash flow statements can be generated so that a company can look at the impact of the new standards and the current standards as well as the impact of running both in parallel.

The right business processes and supporting lease accounting software are required, but visibility across the enterprise is also needed, as is the ability to quickly update business processes based on nuances as the standards become significant. Accounting and finance professionals need to ensure their organizations are compliant with the standards by incorporating the right software.

Considerations

IFRS 16 and ASC 842 are new regulations that must be followed by companies. Because these regulations represent such a major change to what is now put on the balance sheet, companies will be scrambling in 2018 to quickly become compliant. The scramble is a short-term exercise, and it requires investment by businesses and cooperation by different teams within organizations, such as procurement, treasury, accounting, operations, and IT. But once the exercise is complete, and a technology is updated or adopted to handle the new regulations, it will no longer be a major factor for businesses to solve. IDC believes this is a short-term financial compliance requirement, and if businesses select a cloud-based solution to assist with the change, then further changes will be nothing more than upgrades to the system and information will be readily available.

Lease accounting software packages offer a business the following benefits:

- The ability to monitor all aspects of the acquisition experience as well as detailed metrics about asset location, usage, costs, and renewal details
- A centralized view of all lease contracts within the company regardless of region, thus assisting with tax issues by country
- The ability to set up alerts about lease deadlines so that decisions can be made about whether to extend a lease, purchase the asset, or return the asset (The possibility of overpayment is reduced because of evergreen terms.)

Trends

Unfortunately, the new standards are a headache for most companies because their leases are scattered across the enterprise, and neither the number nor the monetary amount of leases is known or tracked. Compounding this challenge are the various types of leases within the company and the many changes that occur to these leases. Many of the industries most impacted by the new lease accounting standards have on-premises systems that have not been configured to handle the leases, which means investments in changes to existing software globally. The new standards have become severe investment expenses; however, there are alternatives.

Because the new accounting standards require swift and complete compliance with minimal expenditure, SaaS products are the key. Such products are quickly configured, easily adaptable, and updated on a regular basis by the technology vendor. In IDC's 2016 *CloudView Survey*, 58% of all organizations surveyed said they are embracing cloud applications. IDC finds that the demand for cloud-based applications continues to grow because of the ability to access and analyze massive amounts of data in near real time across a multitude of systems, which makes a cloud-based model the answer to reducing the complexity and addressing the issues surrounding IFRS 16 and ASC 842.

Conclusion

Compliance with IFRS 16 and ASC 842 is not easy given the many hundreds of leases across an organization. In addition, the new standards require more visibility and accountability, so business processes and underlying technology must be cohesive, concise, and transparent. Defining ownership and accountability within an organization is the key to a successful business change. Lease accounting software is uniquely positioned to solve visibility and compliance tracking concerns for enterprises. IDC believes that such solutions are poised to grow in the coming years to help enterprises handle the challenges posed by the new IFRS 16 and ASC 842 lease accounting standards.

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