

Leases – Using a Tailored Software and Approach Versus Manually-Oriented Methods

FASB Accounting Standards Codification 842 (Issue Date: February 2016)
[Link to Standard: Update No. 2016-02](#)

Overview

In February 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-02, *Leases (Topic 842)*, which replaced Accounting Standards Codification (ASC) 840. The two most impactful parts of this new standard is the classification criteria for operating and financing leases for lessees, and the treatment of operating leases on the balance sheet. Public entities must start reporting leases under ASC 842 in fiscal years beginning after December 15, 2018; all other entities have an additional year to conform. For more information on the financial statement impact of the new standard, please see Fidato Partners' whitepaper entitled *Leases (Topic 842) Targeted Improvements – Modified Retrospective Transition Method*.

Since the deadline for compliance has arrived, it is necessary for companies to assess the impact to their financial statement and overall accounting policies and procedures. The critical first step in implementing the new standard is the assessment of the organization's lease population. Once the population is identified, although time-consuming, the next step is the collection and management of associated agreements, documents, and other data to be used in the lease administration process and the determination of any underlying systems to support the effort. Prior to fully embarking on these activities, it is prudent for companies to carefully consider the processes and systems to be employed to assure completeness and accuracy of the document and data collection effort and management, and to allow for the necessary calculations to support financial statement disclosure.

Background

The standard's required changes to lease classifications and financial statement disclosures make it necessary to track lease data at a more granular level. Operating leases must now be recorded on the balance sheet as a right-of-use (ROU) asset and a lease liability, at the present value of all minimum lease payments. In addition, more detailed disclosures to the financial statements, including qualitative and quantitative impacts due to adoption of the new standard, require extraction of additional details from lease contracts.

For most organizations, the main choice in designing their lease management framework is whether to use an integrated, lease-specific software solution or a more manual approach using a combination of

spreadsheets, such as Microsoft Excel, and file-sharing environments, such as Microsoft SharePoint. Before making this determination, companies need to gain an understanding of their lease population. This can be accomplished through a combination of inquiries of the organization's business and operational staff, and related financial statement analyses around lease expense.

Once the organization has a general understanding of its lease population, there are several factors to consider when determining whether an integrated, lease-specific software solution is the right approach, including:

- Total number of lease contracts
- Types of leased property
- Lease payment terms, including escalating rent clauses
- Security deposits and other initial direct fees
- Ability to enter into contract modifications
- Residual value at the end of the lease

Once the understanding of the lease population has been obtained, extraction of key lease terms can begin. It is important to keep all lease data centralized, and a spreadsheet is a very good starting point to assist with ASC 842 compliance. Contracts should be collected, stored, reviewed, and key terms that would affect the financial statements and their disclosures should be extracted.

At this point, it is possible to continue to use this spreadsheet as part of a full lease administration process. However, many software packages offer tailored lease administration systems that centralize all the main functions of lease accounting processes to help ease the transition to ASC 842. The following summary describes important considerations to be made when developing a lease administration system, with comparisons made between manual and software-based approaches.

Function	Manual Approach	Software-based Approach
Access to lease data and documents	Each component of the overall lease administration system will need built, with appropriate consideration for data and document administration. This usually results in limited integration across components.	Approved users are set up within the software, and controls over data entry, data manipulation, and contract viewing are integrated within the system.
Document storage	Lease contracts and amendments, once converted to an electronic format, are typically stored within a newly created file structure within the current network. Documents housed in a network drive are much more prone to change or removal, unless additional controls to monitor file changes are implemented.	Documents related to a lease can be attached directly to the corresponding data in the software system, and each document will retain its attachment to the correct lease, regardless of how the data is reorganized. Controls over adding and deleting documents are integrated within the system.
Lease classification (operating vs. financing)	A spreadsheet is typically designed to identify the five criteria associated with classification between an operating and financing lease, and to record decisions reached for a particular lease against the criteria.	The system automatically performs the required calculations and provides detailed analysis using the data and terms initially extracted from the lease.
Lease payment schedules and journal entry calculations	For simple leases with static payments, an additional few columns in a spreadsheet can suffice for these calculations. Ideally, each lease should have its own tab within a workbook to use as an amortization schedule.	All payment information, including escalation clauses and variable considerations, is included within the lease data. Amortization schedules for cash payments and all relevant amortization entries can be automatically generated in minutes.

Function	Manual Approach	Software-based Approach
Financial reporting	Calculations for required financial statement disclosures, including non-financial information such as weighted-average lease terms, can be manually built into a spreadsheet	Canned reports within the system include all required financial statement information and disclosures.
Updates to accounting guidance	When the FASB issues new guidance, any spreadsheets will need to be manually updated.	Updates pertaining to new accounting guidance are handled behind the scenes by software administrators for a smooth transition.

As with any software solution, there will be additional costs to the company to purchase licenses for all relevant users within the business. In addition, team members must be trained in the use of these software packages. Alternatively, while utilization of a spreadsheet approach would require training to ensure team members understand the calculations and determinations, most members of the team will already be familiar with the spreadsheet tool, which would reduce overall training time versus a software-based approach.

Insights

Tailored software solutions are not recommended for every situation. Management within individual companies must weigh the cost against the benefits of using a software versus manual solution. Companies with a small quantity of leases, those with non-complex leases or those with non-variable lease payments may effectively manage the process using a spreadsheet approach for a lease administration process. Those companies with high volumes of complex leases, spread among numerous locations, may find a software-based approach to be a better solution.



Final Thoughts

The deadline for adapting the new lease standards under ASC 842 is here. Using tailored software as a lease administration system can help ease the transition to the new guidance and the related ongoing management. As with any solution, companies should assess their lease population and internal accounting policies to determine the best approach.

Please look for future updates on other technical accounting matters at www.fidatopartners.com

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