



New leases standard has arrived

Operationalizing may be a challenge

The looming update to lease accounting has arrived. Over the course of the past decade, the Financial Accounting Standards Board has deliberated changes to current lease accounting. The primary focus has been to establish a new accounting model for lessees that would provide greater transparency by eliminating off-balance sheet leasing transactions.

The new leases standard (new standard) requires that lessees apply a “right-of-use asset” model that would recognize an asset on the lessee’s balance sheet, representing its right to use the leased asset over the lease term, and recognize a corresponding liability to make lease payments. As such, a lessee’s current operating lease accounting model will be significantly changed. Furthering the complexity of the new standard, lease arrangements will continue to be classified into types of leases: finance leases and operating leases. The income statement reporting for leases will differ depending on the classification of the

lease. Finance leases will separately recognize interest expense on the lease liability and amortization expense on the right-of-use asset. Operating leases will recognize a single lease expense that is straight-lined over the lease term. The lessor accounting model will largely be unchanged from that applied under current guidance. The changes aim to primarily align with the newly issued revenue recognition guidance, as leasing is fundamentally a revenue-generating activity for lessors. The new standard will also require additional disclosures related to the lessor’s exposure to asset risk and credit risk.

Though the accounting change seems intuitive, the data and systems challenges it will bring to entities are significant and, without preparation, may be overwhelming.

Operational and implementation challenges may be significant

The new standard will likely present several key implementation challenges for lessees in addition to technical accounting challenges.

These potential operational challenges include:

- **Data challenges**—Many companies have numerous lease agreements across multiple decentralized locations and, in many instances, the lease data is maintained in spreadsheets or manual documents. Consequently, the collection and abstraction of data can be a resource-intensive effort and may represent a longer lead-time activity for companies with higher lease volumes. Companies may have certain elements of lease data in an electronic format; however, such data may not have been subjected to Sarbanes-Oxley internal control procedures, may reside in disparate systems, and is likely to be incomplete when considering the calculation requirements of the new standard. A centralized information repository may be critical to the development of a complete inventory of leases.
- **Information Technology (IT) systems**—The new standard will likely require enhancements to a company’s existing IT infrastructure to comprehend the storage, calculation, and reporting requirements.

Companies should consider whether to develop functionality within an existing enterprise resource planning system or implement new modules or systems in order to comply with the new standard. Given the long lead times of system initiatives, other bridge solutions may also be needed.

- **Process**—The efforts to migrate to the new system or change over the existing system are often given primary consideration, but the vital component of data maintenance cannot be overlooked. Companies should also consider establishing new controls, overcoming design challenges, creating customized reports, and conducting adequate training when outlining the implementation process. Furthermore, asset valuation frequently proves to be a challenge. Our team includes valuation specialists with relevant professional credentials and state required licenses. We offer property and equipment valuation services for the purpose of measuring fair value and remaining economic lives, while also providing a consistent valuation framework and delivering ongoing support. All these activities require significant resources and, in particular, time.
- **Limited time frame**—Time is truly of the essence. As the December 15, 2018, effective date approaches, the most important action an entity can take is to start the efforts related to this accounting change now. It can be a challenge to anticipate the data gaps and overcome the data abstraction hurdle. But with adequate support and sufficient time, it can be achieved.

Deloitte tools

Deloitte has developed a suite of tools to help companies maintain lease data and perform lease calculations under the new standard. These tools include the ability to automate the process of analyzing and abstracting lease contracts; manage a centralized, secure repository; and facilitate the adoption of the new standard. These tools are user-friendly with a web-based interface. Tools are readily available to help organizations jumpstart the process of identifying and addressing key data deficiencies regarding leases.

Getting started

Some effective first steps to consider as you begin to evaluate the implications of the new standard may include:

- Perform a current state assessment of the company's lease landscape, including lease volumes and types; availability of electronic lease data and data gaps; and consideration of any potential accounting, tax, and process-related challenges
- Identify resources and development of a cross-functional project team to coordinate implementation activities
- Establish a granular project plan and roadmap to manage the effort as needed across multiple functions, business units, and countries
- Develop approach and resources for the lease data abstraction efforts
- Determine the company's specific system requirements and develop a plan for enhancing system capabilities to comprehend the new storage, calculation, and reporting requirements of the new standard

How Deloitte can help

Deloitte has an experienced team of professionals, both in the US and globally across the member firms of Deloitte Touche Tohmatsu Limited. Equipped with the latest tools and technology, our professionals can assist in developing an action plan to help you implement the new standard.

These capabilities include the full breadth of services, tools, technology, and competencies needed to help clients address these issues, such as accounting interpretation assistance; help with process revisions; support in making system changes (including development of system business requirements); new system implementations; identification of federal, state, and international tax issues including book/tax differences; and other matters. Some adaptations of these services may be required to conform to professional standards for Audit clients.

Contact us:

Peter Wilm
Managing Director
Deloitte Risk and Financial Advisory

Deloitte & Touche LLP
Tel: +1 215 246 2446
Email: pwilm@deloitte.com

Sean Torr
Managing Director
Deloitte Risk and Financial Advisory
Deloitte & Touche LLP

Tel: +1 615 259 1888
Email: storr@deloitte.com

Mojgan Vakili
Partner
Deloitte Risk and Financial Advisory
Deloitte & Touche LLP

Tel: +1 213 593 3674
Email: mvakili@deloitte.com

James Barker
Partner
Deloitte & Touche LLP

Tel: +1 203 291 9245
Email: jabarker@deloitte.com

Jeanne McGovern
Partner
Deloitte & Touche LLP

Tel: +1 201 572 2511
Email: jmcgovern@deloitte.com

Jodie Beining
Managing Director
Deloitte Tax LLP

Tel: +1 414 347 7902
Email: jbeining@deloitte.com

Joyce Welch
Managing Director
Deloitte Tax LLP

Tel: +1 619 237 6586
Email: joycewelch@deloitte.com

John Solomon
Managing Director
Deloitte Risk and Financial Advisory
Deloitte Transactions and
Business Analytics LLP

Tel: +1 202 378 5172
Email: jsolomon@deloitte.com

Jean Chick
Principal
Deloitte Consulting LLP

Tel: +1 312 486 2794
Email: jchick@deloitte.com

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