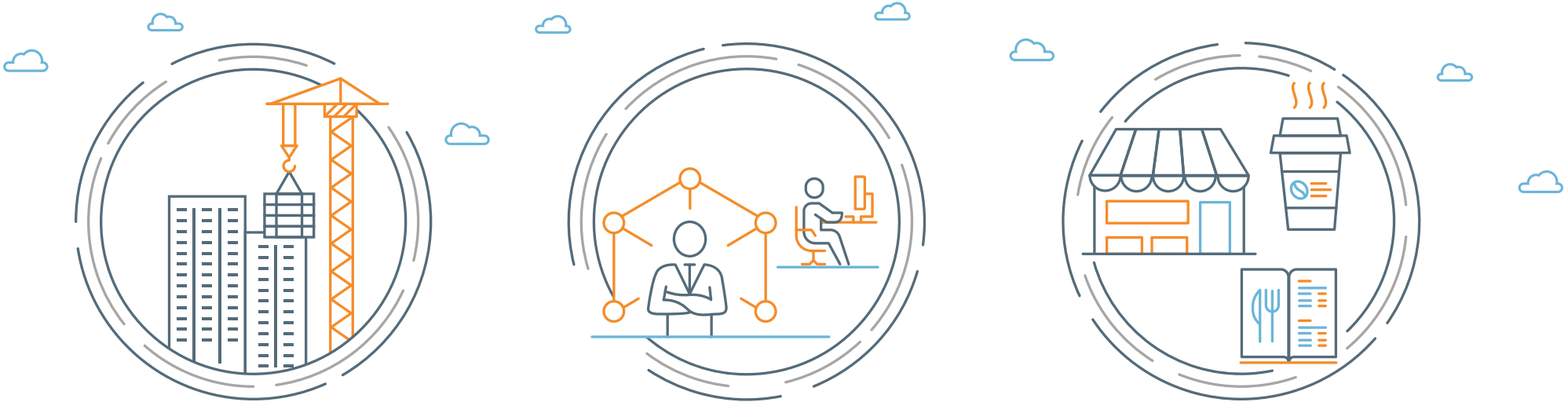


BEYOND COMPLIANCE: AN OPPORTUNITY TO GROW YOUR PORTFOLIO

HOW LESSORS CAN CAPITALIZE ON LEASE ACCOUNTING CHANGES



IDS[™]

Asset Finance
Technology

REDPATH
AND COMPANY

Learning from Early Adopters

HOW TO RESPOND PROFITABLY TO LEASE ACCOUNTING CHANGES IN 2020

This transition is going to be more complicated than it seems for your clients. It's going to have an impact on your business as a lessor, too. The question is, will the recent lease accounting changes accelerate or inhibit your growth? From our early experiences with lessors of all sizes, there's clear potential for both outcomes. It all depends on which changes you choose to make.

This ebook offers tips for making sure your transition to FASB ASC 842, IFRS 16, and GASB 87 goes smoothly. Because even small disruptions can have an ugly impact on the cost of origination, portfolio management and other aspects of your daily operations.

Perhaps more importantly, this ebook provides you with ideas for leveraging these changes in the lease accounting standards to grow your business. As your clients implement and understand the guidelines, their behaviors are likely to change. Anticipating that change and developing the processes and systems to simplify life for lessees could provide real advantages in a competitive market.

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Thanks, Enron

QUICK REVIEW OF THE NEW REGULATIONS

The various financial scandals of the 1990s and 2000s prompted the U.S. Congress and the SEC to pass the Sarbanes-Oxley Act. The goal, clearly, was to fight corporate fraud. As part of this movement, FASB took a fresh look at accounting regulations and, among other things, determined that off-balance sheet leases created a loophole in the financial reporting process.

It took most of a decade, but now FASB has effectively rolled out a new U.S. GAAP standard that requires lessees to reflect a lease liability and right-of-use asset on their balance sheets for all contracts that span a year or more. In short, this means that organizations that use leases to finance the acquisition and use of assets will show significant increases in their liabilities.

While that overview sounds fairly simple, ASU 2016-02 is rife with accounting complexities. For example, the new standard creates three types of leases. Short-term leases include terms of less than one year. Finance leases are similar to traditional capital leases, in that they result in transfer of ownership at the end of the term or include an option to purchase that is likely to be exercised. Operating leases cover all other contracts not in these first two categories.

Every company has addressed these accounting changes with their own sense of urgency. But a majority of organizations have inventoried their leases, made adjustments to their balance sheets and begun to think about broader implications on their business — particularly how their financials look in the eyes of investors, lenders and lessors.

“Identifying a complete population of lease agreements can be challenging. Companies will need to go through a process of reconciling lease agreements to rent expense accounts to determine that they have a complete population of leases. Companies should also be reviewing expense accounts for recurring expenditures that could be indicative of a lease agreement.”

-Jill M. Noack, Redpath and Company CPAs

The Problem with Spreadsheets

IMPACT ON YOUR CUSTOMERS & PROSPECTS

Many organizations have been a little slow to dig into ASC 842 and make the necessary changes to their systems and processes. One thought is that the new rules aren't terribly complex from an accounting perspective, so there hasn't been a widespread sense of urgency to act. But once companies do start digging into the new standards, they tend to be a bit alarmed by the complexities that stretch beyond accounting.

FOR STARTERS, HERE ARE THREE SOMEWHAT UNEXPECTED AREAS THAT REQUIRE ATTENTION:

1. (Dis)organization of Lease Data

Complying with ASC 842 requires — above all — access to accurate lease data. This simply isn't possible in most organizations. Lease data typically isn't stored or tagged properly, so even if it exists it's nearly impossible to find. There's no central repository in most cases. The disorganization is worse when divisions or subsidiaries manage their own leases. Lessees need to address the lease data management issue.

2. Lifecycle Management of Leases

Most companies don't follow a standard process for requisitioning or monitoring lease assets. Now that lease payments are a regular part of financial statements, there will need to be more process and accountability. As a result, this will lead most companies to develop standard approaches to processes such as negotiations, bookings and terminations.

3. A Spreadsheet is Not a System

A 2019 study by PWC found that about two-thirds of companies today use spreadsheets to manage leases. It's a poor practice and the primary cause of the data siloes noted earlier. Using spreadsheets on either side of the deal — by lessees or lessors — creates an unmanageable number of manual touchpoints that leads to errors, incomplete data and unnecessary operating costs. Moving to a software-based system, most likely a cloud-based solution, seems to be a necessity for any organization that manages a large number of leases. From a lessor perspective, integrating with these systems will likely become a requirement when closing deals.

Tactical Considerations

IMPACT ON LESSOR OPERATIONS

While some lessors are quick to dismiss the upcoming ASC 842 requirements as minor accounting changes, many of the new requirements can have far-reaching implications for pricing, customer contracts and portfolio management. For one, ASC 842 includes targeted changes for financial statements that mirror lessee data reporting requirements. For example, you may have to recognize some lease payments as deposit liabilities if collectability is questionable. You may also need to separate non-lease components — such as consumables or service contracts — from the lease components.

The most significant change will be driven by lessee expectations. As your customers and prospects move to comply with the new requirements, they almost certainly will ditch their spreadsheets and adopt cloud-based accounting tools. The idea will be to automate lease data collection so that they have fewer manual processes and less opportunity for error in their operations.

The key result of this customer-driven change?

“We believe — and we’ve been planning for — the fairly rapid emergence of highly connected lessor-lessee ecosystems. This means that a prerequisite to winning deals with almost any lessee will be the ability to connect seamlessly and securely with their cloud-based accounting systems.”

-Kristi Kosobuski, CLFP, IDS Senior Director Product Management



Tactical Considerations

TIME TO MOVE TO THE CLOUD

The PWC survey (that found two-thirds of lessees using spreadsheets) didn't include lessors. But it's likely the same reality exists among asset finance companies — lots of spreadsheets and older on-premises software solutions that would be difficult to integrate with new cloud-based systems on the lessee side.

“Many organizations have not yet created a project plan for the implementation of the new standard, let alone a budget for additional expenses, such as software. Companies should evaluate the cost of implementation, including the cost of using spreadsheets on a go forward basis or implementation of new software.”

-Jill M. Noack, Redpath and Company CPAs

While this connectivity barrier will provide one hurdle for winning new business in the future, it's other considerations that will be more impactful. For example, because lease information is now so central to financial statements, lessees will likely choose asset finance providers who can provide them with a variety of on-demand reports throughout the year. Extracting this information from spreadsheets or legacy on-prem software systems will likely not meet lessee expectations. Another factor impacting the ability to win deals, in addition to connectivity, is user experience. As your customers and prospects move to the cloud, they'll increasingly expect every step of the process — from origination to end-of-term — to be personalized, digital, mobile and otherwise modern. Lessors will need a cloud-based origination and portfolio management platform to deliver this level of experience.

Also, as more lessees and lessors move to the cloud, there will be an expectation of speed — whether it's pricing deals, offering a wider range of asset classes, creating consumer-based models or providing end-of-life options. The only way to deliver these experiences is with a cloud-based system that can integrate not only with the customer's accounting systems, but also services like Vertex, DocuSign and PayNet.

Strategic Opportunities

ANTICIPATING LESSEE CHALLENGES

For most mid-sized to large U.S. companies, ASC 842 represents perhaps the most sweeping and process-altering accounting change in their histories. In addition to moving trillions of dollars onto corporate balance sheets, CFOs and their teams are faced with the monumental task of deploying new accounting systems, designing new business processes and implementing new financial controls.

Process changes will focus on booking processes, lease classification, modification and reassessment of existing contracts and end-of-lease terminations and buyouts. This is not just a heavy lift for corporations — it is a massive transformation that will require these newly formed teams to conduct months-long analyses of lease data that exists in silos throughout their enterprises.



“In a tight labor market where companies are looking to automate more, a system that integrates all of these is necessary.”

-Jill M. Noack, Redpath and Company CPAs

The deployment of new best practices and data collection tools will flow all the way to the lessor’s front door. New financial teams with the responsibility of collecting lease data and analyzing the impact of every deal on a company’s balance sheet will want connectivity and visibility for lessor-driven processes. The expectation will be that lessors will have the technologies and processes in place to enable it.

Strategic Opportunities

CAPITALIZING ON THE CHANGES

The realities of ASC 842 present lessors with a new opportunity. Connecting at a strategic level with the people leading the newly formed lease accounting teams, understanding the specific challenges they have regarding ASC 842 and offering both connectivity with their systems and fast access to accurate lease data may position you as a preferred partner.

At a minimum, demonstrating an understanding of their new challenges and exhibiting a willingness to automate the transfer of accurate data to their systems will provide you with strategic advantages when competing for deals. Moving data from silos and spreadsheets into a cloud-based accounting system represents their heaviest lift. Deploying your own cloud-based origination and portfolio management systems simply makes you a more attractive business partner.

Deploying a cloud-based origination and portfolio management system — and transitioning from spreadsheets or older on-premises software — also creates new opportunities within your own walls. From a business development perspective, it makes it easier to pursue new geographic markets or add new asset classes to your portfolio. From an operational perspective, it reduces manual steps and reduces opportunities for human errors, which will result in significant savings.

DOWNSIDE OF SPREADSHEETS



- **MANUAL**
- **DISPERSED DATA**
- **ERROR-PRONE**

ADVANTAGES OF CLOUD



- **AUTOMATED**
- **CONSOLIDATED DATA**
- **SOURCE OF TRUTH**

Best Practices for Lessors

WHAT WE'VE LEARNED SINCE 2017

When public companies began their ASC 842 implementation efforts in late 2018 to meet a 2019 adoption deadline, quick timelines created significant challenges that impacted many areas of their business. While private companies have been given an additional year to move to the new standards, they risk succumbing to the same fate if they neglect to create and stick to a clear adoption strategy. Here are four lessons lessors should consider to promote a smooth transition as the 2021 deadline approaches.



1. JOIN A PEER GROUP.

One of the simplest steps lessors can take to ensure a smooth transition is connecting with early adopters and other lessors to gain insights to their challenges/struggles. While each lessor's adoption process will look slightly different, comparing notes can help you avoid common pitfalls.



2. CONSIDER THE BUSINESS PROCESS RAMIFICATIONS.

Remember, this is not just an accounting change. ASC 842 will also spur important business process changes. For instance, customer contracts, pricing and how agreements are booked into the portfolio management system may all need to be modified to support the new standards.



3. ENGAGE YOUR CUSTOMERS THROUGHOUT THE CHANGEOVER PROCESS.

While ASC 842 might seem like an internal initiative, it has significant implications for your customers as well. Rolling out a new approach that fails to meet the needs of your customers is a costly mistake you can't afford to make.



4. REACH OUT TO YOUR SOFTWARE PROVIDER(S).

Make sure you understand all of the options and proposed solutions within your lease management application.

Resources for Lessors

HELP MOVING FORWARD

IDS has been working with some of the world's largest asset finance organizations to accommodate all of the operational changes driven by ASC 842. We know what it takes to make a successful transition from spreadsheets to the cloud — or from on-premises software to cloud. We've helped clients reduce costs and improve efficiencies by transforming their origination and portfolio management operations and integrating them into one highly agile platform.

We can do the same for you. No matter how big or small your operations are, we can scale IDScLOUD to meet your exact operational and budgetary requirements. Just as important, we can show you how you can use this powerful and proven SaaS platform to grow your business.



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