ASSET-LEVEL LEASE ACCOUNTING

Why It's Required by the IFRS 16 Lease Standard

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Section One:
Executive Summary

This white paper considers why and how the IASB standard requires asset-level lease accounting for on-balance sheet leases. Asset-level lease accounting is the process of recording transactions by generating debits and credits for each asset on a lease contract. Variations in asset scenarios are common with equipment leases and complex real estate leases. If you perform asset-level lease accounting, you can treat each asset as its own lease and capture the variability that naturally occurs in your operations.

Asset-level decisions and events are driven by accounting, tax, reporting, and savings requirements. For example, under the new lease accounting standards, when booking a new lease, lessees must report the present value (PV) of the lease payments, requiring asset-level determinations about term, purchase option, residuals, penalties, and lease rate factors by the asset owner. Lessees also need to separate lease components and service components of bundled leases, capitalising the lease portion and accounting for the non-lease portion appropriately (if the practical expedient to separate lease and non-lease components by asset class is not elected). This too is an asset-level exercise.

Lessees must address the two fundamental challenges of operationalising the new standards: accurate calculations and data quality. A single, global, asset-level lease accounting subledger will calculate the accounting and financial reporting for all lease types (real estate, equipment, and embedded leases) for all accounting standards. This kind of enterprise lease accounting (ELA) solution will manage the millions of monthly asset-level journal entries in multiple ledgers, insulate the lessee's ERP platforms from the complexity, enable period-to-period reporting, and automatically generate the audit trail at the asset level. This solves the problem of accurate asset-level calculations, allowing you to focus your resources on the data quality problem – a much bigger challenge in many ways.

Today, most lessees are only thinking about the data required at the start of a lease. However, lessees are required to make certain asset-level determinations as situations arise, decisions are made and events happen not only at lease start, but also during the term and at the end of term. Asset owners must interact with your global leasing process and communicate a decision or event on an asset-by-asset basis to ensure timely, accurate, and complete data for your lease accounting and financial reporting.

The new standards will increase asset-level audit scrutiny and controls testing due to the associated liability. Yet, given the decentralization, people must be relied on to record transactions in the field. This requires lessees to define clear policies and procedures for capturing data from the original transaction documents and throughout the life of a lease. Controlling the processes for real estate, equipment, and embedded leases requires specialization, distinction, and expertise to ensure data quality.

Given the number of contracts, assets, and stakeholders involved in lease management, a top-down compliance mandate alone will not solve the data quality problem. The pursuit of savings will motivate stakeholders and their supervisors in the leasing process to deliver the quality asset-level data that controllers need for public financial reporting on a monthly basis.

Section Two:
Asset-Level versus Contract-Level Lease Accounting

The New Lease Accounting Standard

The new lease accounting standard requires lessees to capitalize all leases longer than 12 months and greater than low-value assets (provided these practical expedients are selected), moving them from the footnotes to the balance sheet. This white paper considers why and how the IASB standard requires asset-level lease accounting for on-balance sheet leases. It investigates the asset-level decisions and events across the lease lifecycle that depend on asset-level lease accounting, and, finally, the white paper discusses how lessees can address the two fundamental challenges of operationalising the new standards: accurate calculations and data quality.

Table 1: Previous versus New Lease Accounting Standards

Previous Lease Accounting Standards	New Lease Accounting Standards
IAS 17, ASC 840 (US GAAP)	IFRS 16, ASC 842 (US GAAP)

What is asset-level lease accounting?

Asset-level lease accounting, also known as asset lease accounting, is the process of recording transactions by generating debits and credits for each asset on a lease contract.

What is contract-level lease accounting?

Contract-level lease accounting, also known as contract lease accounting, is the process of recording transactions by generating the debits and credits for each lease contract.

Contract-level vs. asset-level lease accounting: where do they fit?

From an accounting compliance perspective, contract-level lease accounting can be an acceptable approach when there are no asset-level variations. Contract lease accounting is often used for real estate leases, which typically have one asset per lease contract (for example, a land parcel or a building segment). Contract lease accounting can also be used for monolithic equipment leases in which: (a) there are no asset-level variations throughout the life of the lease and (b) an asset management system maintains basic

Figure 1: Asset-Level Lease Accounting

CONTRACT

Aggregation
of asset-level journal entries

ASSET ⟶ Accounting calculations
Happen at the asset level

Figure 2: Contract-Level Lease Accounting

CONTRACT ⟶ Accounting calculations
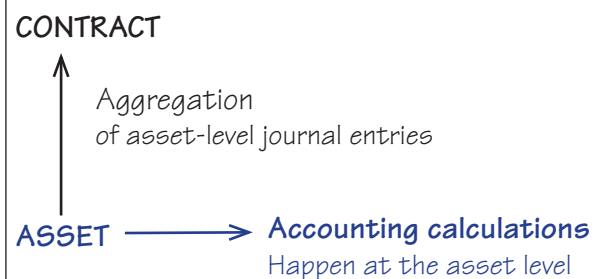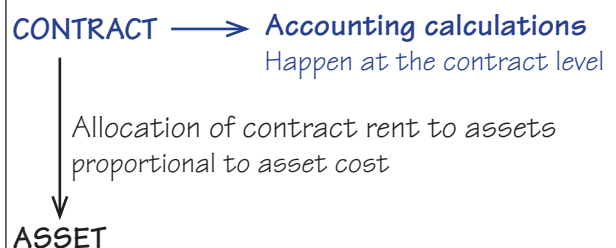Happen at the contract level

Allocation of contract rent to assets
proportional to asset cost

ASSET

non-financial information on the assets for physical existence tests in audits. When there are no asset-level variations, contract-level lease accounting can be used to calculate the asset-level rent by allocating the contract-level lease rent amount proportionally to the cost of the assets.

Conversely, when there are asset-level variations (caused by asset-level decisions, judgments, or events required for accounting or savings), contract-level accounting is ineffective. In these cases, contract-level lease accounting results in manual calculations that are prone to error, require significant trained resources to maintain, and ultimately become unmanageable.

When asset-level decisions or events are required, asset-level lease accounting is the only effective approach. It can be used for equipment leases, which often have multiple assets per lease contract (for example, 10 forklifts, 100 routers, or 1,000 laptops on one lease). It can also be used for more complex building leases, which might include multiple building segments of different dimensions with different service levels (for example, office space or a loading dock) and non-building assets (for example, parking spaces or signage) in the same lease. The asset-level debits and credits can then be aggregated to calculate the contract-level journal entries.

Example 1: Blade Servers – An Example of Asset Lease Accounting

Below is an example of an equipment lease that has three assets. The three computer servers, called Blade Servers, were procured on the same lease and provided internally to three different asset owners: IT managers in infrastructure, engineering, and finance. The accounting here follows the current IFRS 16 standard, and the three servers are treated as separate leased assets. Here is a summary of the lease transaction, when the lease started:

Assets Financed:
- Blade Server A – Asset #1631
- Blade Server B – Asset #1632
- Blade Server C – Asset #1633

Net Amount Financed: $25,000

Terms: 36 Monthly Payments in Advance

End-of-Term Date: 31 August 2022

Total Monthly Payments (Net of Taxes): $614.22

End-of-Term Purchase Option: Fair Market Value (FMV)

Mid-Term/End-of-Term Options:
1. Renewal for 6 months at End of Term; Terms: Payments of FMV, capped at 1.387%
2. Buyout at End of Term; Terms: Purchase of FMV, capped at 11.97% of the Amount Financed
3. Renewal at End of Term; Terms: Payments of FMV until terminated (Evergreen)
4. Return at End of Term

End-of-Term Decisions

Six months before the end of the lease, each IT manager received an automated notification requesting that they make a decision about their asset so that the lessors could be notified on time, pursuant to the lease agreement, 60 days prior to end of term. The options permitted in this lease include: return the equipment, renew the lease at a lower rate, continue month-to-month at the same rate, or buyout the assets at FMV. Attached to the automated notification, the IT managers received the terms and conditions and an economic analysis of each option.

The IT manager in the infrastructure group decided, "Yes, we plan to return the server (asset #1631), but we need another 6 months. Given the cash flow issues and budget cycle, we need a 6-month renewal with

quarterly payments." The lessor was notified of a 6-month renewal, and the renewal was renegotiated as quarterly payments. The IT manager in engineering never made a decision, so that server (asset #1632) went into month-to-month renewal – also known as "evergreen" payments. The IT manager in finance decided, "This server (asset #1633) is now in a critical production role hosting our enterprise resource planning (ERP) application; we will not be returning it." So, the third server was bought out.

End of Term – Partial Events

Here is a summary of the partial end-of-term events:
1. Asset #1631: 1. Asset #1631: Partial Fixed-Term Extension; 2 quarterly payments of $312.00; commencing 1 September 2022
2. Asset #1632: Partial Month-to-Month/Evergreen Renewal; payments of $204.74 per month; commencing 1 September 2022
3. Asset #1633: Partial Buyout at FMV for $750.00; effective 31 August 2022

Payment Schedule Impacts

In this example, each asset owner made a different decision, but all of the assets are on the same lease contract. The resulting payment schedule appears below.

Table 2: Payment Schedule for Blade Servers (Example 1)

Due Date	Amount	Due Date	Amount
01/01/2022	$614.22	01/08/2022	$614.22
01/02/2022	$614.22	**01/09/2022**	**$516.74**
01/03/2022	$614.22	**01/10/2022**	**$204.74**
01/04/2022	$614.22	**01/11/2022**	**$204.74**
01/05/2022	$614.22	**01/12/2022**	**$312.00**
01/06/2022	$614.22	01/01/2023	$0.00
01/07/2022	$614.22	01/02/2023	$0.00

Renewal – Partial Termination – Evergreen

In this payment schedule, each month of the original term of the lease shows a monthly payment of $614.22. But as shown at the bottom of the right-hand column, things changed beginning with the September 2022 payment. One asset was bought out, leaving two assets: a quarterly payment and a monthly "evergreen" payment that add up to $516.74. Today's date is October 12th, so we can predict "evergreen" monthly payments of $204.74 for October and November because there is a 30-day notice requirement. In December, we can forecast only the quarterly payment of $312.00 from the 6-month renewal because we don't know what will happen with the server that moved into month-to-month "evergreen" status. The table below splits out the rental for the three assets for the respective months.

Table 3: Asset-Level Payment Schedule for Blade Servers (Example 1)

Payment Date	Asset ID		
	1631	**1632**	**1633**
01/08/2022	204.74	204.74	204.74
01/09/2022	312.00	204.74	n/a
01/10/2022	0.00	204.74	n/a
01/11/2022	0.00	204.74	n/a
01/12/2022	312.00	TBD	n/a
01/01/2023	0.00	TBD	n/a
01/02/2023	0.00	TBD	n/a

Asset-Level Accounting Revealed

The asset-level debits and credits for 3 months of the transaction are presented below. In July and August, each asset is treated as a lease asset under IFRS 16. At the end of August, asset #1633 is bought out at FMV for $750.00. In September, this asset no longer appears and asset #1632 moves off-balance sheet because the initial term has ended and the asset is in evergreen. Asset #1631 has a renewal period of 6 months and that renewal remains on balance sheet until end of the renewal term.
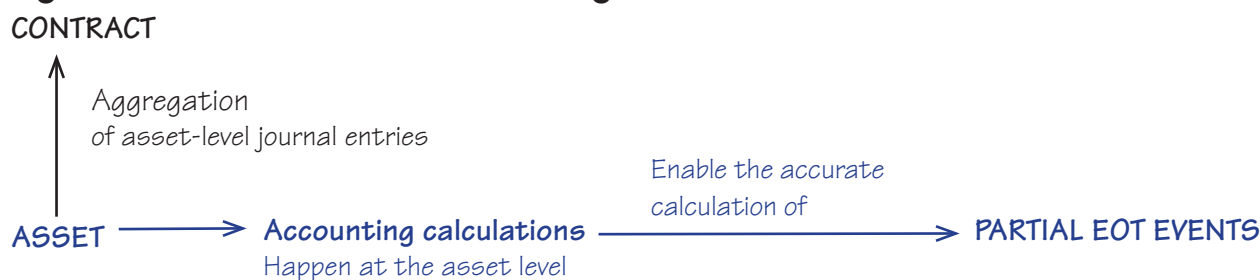
Table 4: Asset-Level Accounting Journal Entries for Blade Servers (Example 1)

Ledger Date	Account Code	Account Description	DR	CR	Comments	Outcome
01/07/2022	2610	Lease obligation - short term (ST)	$405.34		Asset 1631 on Schedule Blade Servers	
01/07/2022	2600	Lease obligation - long term (LT)		$405.34	Asset 1631 on Schedule Blade Servers	
01/07/2022	2300	Interest accrued	$2.75		Asset 1631 on Schedule Blade Servers	
01/07/2022	2600	Lease obligation - LT	$201.99		Asset 1631 on Schedule Blade Servers	
01/07/2022	2000	Accounts Payable		$204.74	Asset 1631 on Schedule Blade Servers	
01/07/2022	2610	Lease obligation - ST	$405.34		Asset 1632 on Schedule Blade Servers	
01/07/2022	2600	Lease obligation - LT		$405.34	Asset 1632 on Schedule Blade Servers	
01/07/2022	2300	Interest accrued	$2.75		Asset 1632 on Schedule Blade Servers	
01/07/2022	2600	Lease obligation - LT	$201.99		Asset 1632 on Schedule Blade Servers	
01/07/2022	2000	Accounts Payable		$204.74	Asset 1632 on Schedule Blade Servers	
01/07/2022	2610	Lease obligation - ST	$405.34		Asset 1633 on Schedule Blade Servers	
01/07/2022	2600	Lease obligation - LT		$405.34	Asset 1633 on Schedule Blade Servers	
01/07/2022	2300	Interest accrued	$2.75		Asset 1633 on Schedule Blade Servers	
01/07/2022	2600	Lease obligation - LT	$201.99		Asset 1633 on Schedule Blade Servers	
01/07/2022	2000	Accounts Payable		$204.74	Asset 1633 on Schedule Blade Servers	
31/07/2022	5050	Interest expense	$1.38		Asset 1631 on Schedule Blade Servers	
31/07/2022	2300	Interest accrued		$1.38	Asset 1631 on Schedule Blade Servers	
31/07/2022	5020	Depreciation expense	$182.32		Asset 1631 on Schedule Blade Servers	
31/07/2022	1050	Accumulated depreciation		$182.32	Asset 1631 on Schedule Blade Servers	
31/07/2022	2600	Lease obligation - LT	$203.36		Asset 1631 on Schedule Bladeserver	
31/07/2022	2610	Lease obligation - ST		$203.36	Asset 1631 on Schedule Blade Servers	
31/07/2022	5050	Interest expense	$1.38		Asset 1632 on Schedule Blade Servers	
31/07/2022	2300	Interest accrued		$1.38	Asset 1632 on Schedule Blade Servers	
31/07/2022	5020	Depreciation expense	$182.32		Asset 1632 on Schedule Blade Servers	
31/07/2022	1050	Accumulated depreciation		$182.32	Asset 1632 on Schedule Blade Servers	
31/07/2022	2600	Lease obligation - LT	$203.36		Asset 1632 on Schedule Blade Servers	
31/07/2022	2610	Lease obligation - ST		$203.36	Asset 1632 on Schedule Blade Servers	
31/07/2022	5050	Interest expense	$1.38		Asset 1633 on Schedule Blade Servers	
31/07/2022	2300	Interest accrued		$1.38	Asset 1633 on Schedule Blade Servers	
31/07/2022	5020	Depreciation expense	$182.32		Asset 1633 on Schedule Blade Servers	
31/07/2022	1050	Accumulated depreciation		$182.32	Asset 1633 on Schedule Blade Servers	
31/07/2022	2600	Lease obligation - LT	$203.36		Asset 1633 on Schedule Blade Servers	
31/07/2022	2610	Lease obligation - ST		$203.36	Asset 1633 on Schedule Blade Servers	
August						
01/08/2022	2610	Lease obligation - ST	$203.36		Asset 1631 on Schedule Blade Servers	
01/08/2022	2600	Lease obligation - LT		$203.36	Asset 1631 on Schedule Blade Servers	
01/08/2022	2300	Interest accrued	$1.38		Asset 1631 on Schedule Blade Servers	
01/08/2022	2600	Lease obligation - LT	$203.36		Asset 1631 on Schedule Blade Servers	
01/08/2022	2000	Accounts Payable		$204.74	Asset 1631 on Schedule Blade Servers	

Ledger Date	Account Code	Account Description	DR	CR	Comments	
01/08/2022	2610	Lease obligation - ST	$203.36		Asset 1632 on Schedule Blade Servers	
01/08/2022	2600	Lease obligation - LT		$203.36	Asset 1632 on Schedule Blade Servers	
01/08/2022	2300	Interest accrued	$1.38		Asset 1632 on Schedule Blade Servers	
01/08/2022	2600	Lease obligation - LT	$203.36		Asset 1632 on Schedule Blade Servers	
01/08/2022	2000	Accounts Payable		$204.74	Asset 1632 on Schedule Blade Servers	
01/08/2022	2610	Lease obligation - ST	$203.36		Asset 1633 on Schedule Blade Servers	
01/08/2022	2600	Lease obligation - LT		$203.36	Asset 1633 on Schedule Blade Servers	
01/08/2022	2300	Interest accrued	$1.38		Asset 1633 on Schedule Blade Servers	
01/08/2022	2600	Lease obligation - LT	$203.36		Asset 1633 on Schedule Blade Servers	
01/08/2022	2000	Accounts Payable		$204.74	Asset 1633 on Schedule Blade Servers	
31/08/2022	5020	Depreciation expense	$182.32		Asset 1631 on Schedule Blade Servers	
31/08/2022	1050	Accumulated depreciation		$182.32	Asset 1631 on Schedule Blade Servers	
31/08/2022	1050	Accumulated depreciation	$6,563.48		Asset 1631 on Schedule Blade Servers	
31/08/2022	1200	Lease asset		$6,563.48	Asset 1631 on Schedule Blade Servers	
31/08/2022	5020	Depreciation expense	$182.32		Asset 1632 on Schedule Blade Servers	
31/08/2022	1050	Accumulated depreciation		$182.32	Asset 1632 on Schedule Blade Servers	
31/08/2022	1050	Accumulated depreciation	$6,563.48		Asset 1632 on Schedule Blade Servers	
31/08/2022	1200	Lease asset		$6,563.48	Asset 1632 on Schedule Blade Servers	
31/08/2022	5020	Depreciation expense	$182.32		Asset 1633 on Schedule Blade Servers	
31/08/2022	1050	Accumulated depreciation		$182.32	Asset 1633 on Schedule Blade Servers	Bought Out
31/08/2022	1000	Purchased asset	$750.00		Asset 1633 on Schedule Blade Servers	
31/08/2022	2016	Accounts Payable - Purchased Assets		$750.00	Asset 1633 on Schedule Blade Servers	
31/08/2022	1050	Accumulated depreciation	$6,563.48		Asset 1633 on Schedule Blade Servers	
31/08/2022	1200	Lease asset		$6,563.48	Asset 1633 on Schedule Blade Servers	
September						
01/09/2022	1200	Lease asset	$622.92		Asset 1631 on Schedule Blade Servers	
01/09/2022	2600	Lease obligation - LT		$622.92	Asset 1631 on Schedule Blade Servers	Six Month Renewal with Quarterly Payments
01/09/2022	2600	Lease obligation - LT	$312.00		Asset 1631 on Schedule Blade Servers	
01/09/2022	2000	Accounts Payable		$312.00	Asset 1631 on Schedule Blade Servers	
01/09/2022	5300	Lease rental expense	$204.74		Asset 1632 on Schedule Blade Servers	
01/09/2022	2400	Deferred rent		$204.74	Asset 1632 on Schedule Blade Servers	Month-to-Month Evergreen
Renewal						
01/09/2022	2400	Deferred rent	$204.74		Asset 1632 on Schedule Blade Servers	
01/09/2022	2000	Accounts Payable		$204.74	Asset 1632 on Schedule Blade Servers	
30/09/2022	5050	Interest expense	$0.72		Asset 1631 on Schedule Blade Servers	
30/09/2022	2300	Interest accrued		$0.72	Asset 1631 on Schedule Blade Servers	
30/09/2022	5020	Depreciation expense	$103.82		Asset 1631 on Schedule Blade Servers	
30/09/2022	1050	Accumulated depreciation		$103.82	Asset 1631 on Schedule Blade Servers	
30/09/2022	2600	Lease obligation - LT	$310.92		Asset 1631 on Schedule Blade Servers	
30/09/2022	2610	Lease obligation - ST		$310.92	Asset 1631 on Schedule Blade Servers	

Variations in asset scenarios are common with equipment leases. If you perform asset-level lease accounting, you can treat each asset as its own lease and capture the variability that naturally occurs. In Example 1 (Blade Servers), the asset-level debits and credits enable the accurate calculation of the partial end-of-term events: partial buyout, partial renewal (deliberate), and partial renewal (unintended "evergreen").

Figure 3: Asset-Level Lease Accounting and Partial End-of-Term Events

CONTRACT

Aggregation
of asset-level journal entries

Enable the accurate
calculation of

ASSET ⟶ Accounting calculations ⟶ PARTIAL EOT EVENTS

Happen at the asset level

Further, you can then aggregate the asset-level debits and credits into the contract-level debits and credits. Below are the contract-level debits and credits for this transaction.

Table 5: Contract-Level Roll Forward Report for Blade Servers (Example 1)
Account Roll Forward Report

Default Ledger for Blade Servers

Starting Month 31/08/2019   Ending Month: 30/09/2022

Description	Account Code	Ending Balance 31/08/2019	Ending Balance 28/02/2023	Calculated Increase (Dec)	Percent Change
Account Payable	2000	($20,883.43)	($22,735.92)	($1,852.49)	8.87%
Account Payable - Purchased Assets`	2016		($750.00)	($750.00)	0.00%
Accumulated depreciation	1050	($18,596.52)	$0.00	($19,219.44)	-100.00%
Deferred rent	2400		$0.00	$0.00	0.00%
Depreciation expense	5020	$18,596.52	$20,312.33	$1,769.66	8.71%
Interest accrued	2300	($8.26)	$0.00	($6.10)	-100.00%
Interest expense	5050	$2,417.29	$2,423.59	$6.30	0.26%
Lease asset	1200	$19,690.43	$0.00	$20,313.36	-100.00%
Lease obligation - LT	2600	$0.00	$0.00	$0.00	0.00%
Lease obligation - ST	2610	($1,216.03)	$0.00	($1,216.03)	-100.00%
Lease rental expense	5300		$0.00	$204.74	0.00%
Purchase asset	1000		$750.00	$750.00	0.00%
Total:		**$0.00**	**($0.00)**	**($0.00)**	

In Example 1, we kept it relatively simple – the deviation was strictly based on end-of-term decisions for three assets treated as finance leases under IFRS 16.

Lease asset accounting under IFRS 16, requires lessees to maintain the linkage between the asset and liability net book values on a monthly basis over the life of the lease at the asset level.

Section Three:
Decisions, Judgments, and Events

The Asset-Level Decisions and Events that Require Asset-Level Lease Accounting

Today, most lessees are only thinking about the data required at the start of a lease. However, lessees are required to make certain asset-level determinations as situations arise, decisions are made, and events happen not only at lease start, but also during the term and at the end of term. Asset owners must interact with your global leasing process and communicate a decision or event on an asset-by-asset basis to ensure timely, accurate, and complete data for your lease accounting and financial reporting.

Four Drivers

There are four overlapping corporate drivers that propel asset-level decisions, judgments, and events:

1. Financial accounting and reporting compliance requirements
2. Tax accounting and reporting compliance requirements
3. Management accounting and reporting requirements
4. Savings-generating requirements

Corporate lessees that follow IFRS 16 need to clarify their processes and controls and sharpen their practices now in order to be able to demonstrate compliance.

ASSET-LEVEL DECISIONS AND EVENTS AT LEASE START

Aggregated Spend

One of the reasons that lessees have many assets per lease is convenience — it reduces paperwork. Another reason is the pursuit of savings. "Aggregate the spend to drive down the buy" is a proven procurement/sourcing mantra that experienced lessees apply to equipment leasing.

Example 2: Aggregated Spend in Material Handling

For example, instead of bidding a lease transaction among a group of lessors for every forklift at $25,000 each, lessees have learned that they can estimate the number of forklifts the firm will need per year and issue a larger bid for the lease capital that drives greater savings. In this example, the company estimates that it needs 100 new forklifts per year. The lessee bids out a 2-year, $5,000,000 forklift deal. The larger deal attracts more bidders and intensifies the competition because the bidders want to fight harder to win the more lucrative deal.

While the lessee is able to drive 3 to 4 percent greater savings from the increased competition, the aggregation results in more assets per lease contract. Larger contracts cover more assets, locations, business units, and cost centres, likely leading to substantial variations at the end of term.

This complexity demands asset-level lease accounting. To drive even more savings, some companies have expanded the scope of aggregation from all forklifts to all material handling, which matches the broad category of

specialization of several expert, niche lessors. In this case, it might result in a $20,000,000 deal and even more savings – and even greater management and accounting complexity given the many asset-level variations on one lease.

Lease Payment

When booking a new lease under the new lease accounting standards, lessees must report the PV of the lease payments, requiring the following asset-level determinations:

- **Term:** How long you are reasonably certain to lease the assets. Under IFRS 16, the recognised lease term includes the non-cancellable period plus any optional periods where it is reasonably certain the lessee will exercise the option to renew (or not terminate) the lease.

- **Purchase Option:** The exercise price of a purchase option if exercise is reasonably assured.

- **Residual:** The guarantee payment that you are reasonably certain to make.

- **Penalties:** If the term is assumed not to be renewed or extended, a lease may be subject to termination penalties, which must also be included in the lease payment schedule.

- **Lease Rate Factors:** If assets have different lease rate factors within the same lease, these differences need to be captured to calculate the true rental for each asset.

These amortization variations are driven by the asset-level determinations of asset owners in the field who understand the past corporate behaviour regarding these assets and can evaluate the intended application of the assets looking ahead.

Varying Lives

Varying the term of a lease on an asset-by-asset basis means that you can have assets on the same schedule with different lives and amortization schedules. Consider that with 100 or 1,000 assets on one schedule, the assets are likely going to multiple organizations, each of which may have different track records for when they return equipment. The expected holding period may vary from organization to organization or location to location, thus affecting the accounting term of the assets. Your auditors may examine the prior holding pattern to determine if your term decisions are reasonable.

Varying Amortizations

Varying purchase options, residual values, penalties, or lease rate factors at the asset level means that you can have assets with the same original cost and the same accounting term but variation in the amount that is amortized, due to the inclusion of the additional amounts in the PV calculation.

Non-Lease Components

Under the new standard, lessees need to separate lease components and service components of a gross billed or bundled billed lease unless they elect to combine the lease and non-lease components by asset class under the practical expedient, capitalizing the lease portion and accounting for the non-lease portion in accordance with its own accounting standard. This is an asset level exercise. If the lessee does not have access to the breakdown, lessees may estimate the breakdown but the estimate has to be supported by relative standalone pricing for the lease or non-lease components. The asset-level breakdown may be audited. The lessee may elect by asset class to capitalize the full amount of the bundled payment, but that will increase the amount capitalized, thereby reducing their return on assets (ROA).

Figure 4: Asset Lease Accounting at Start of Lease

CONTRACT

↑ Aggregation
of asset-level journal entries

ASSET → Accounting calculations → NON-LEASE COMPONENTS
Happen at the asset level → PENALTIES
→ RESIDUAL GUARANTEE
→ PURCHASE OPTION
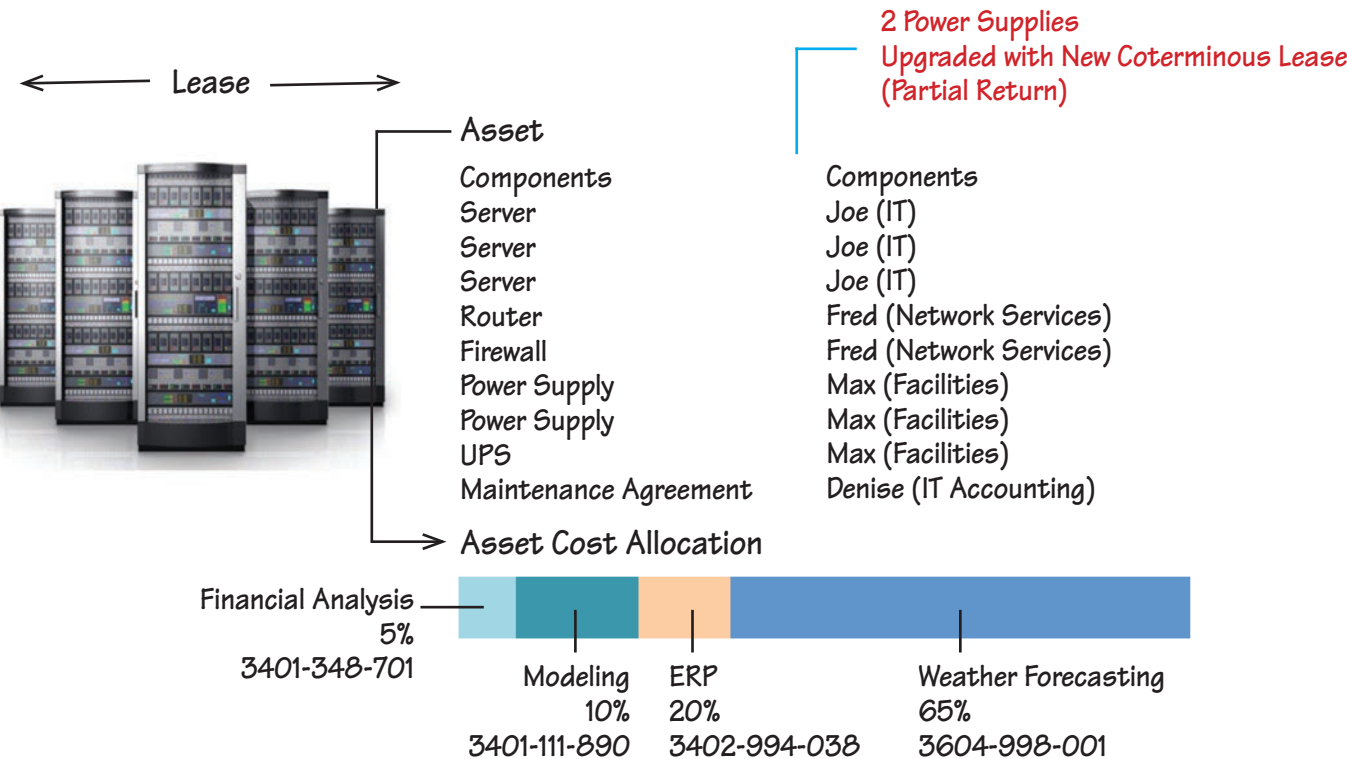→ TERM
→ PARTIAL EOT EVENTS
→ AGGREGATED SPEND

Super-Asset Aggregation

Lessees and lessors do not always think about leased assets in the same way in terms of the granularity of the asset information. A lessor might include detailed asset information in a lease that a lessee does not value.

Example 3: Rack-n-Roll Data Centre Equipment Lease

Consider the example of a "rack-n-roll" lease with five computer racks, each pre-populated with a set of technology elements that together comprise a complete web server solution with hardware redundancy. Operationally, the lessee's data centre manager records each computer rack in her IT asset management system (ITAM) as one asset, whereas the lessor considers each piece of equipment in the rack an asset, as each has its own serial number. Lessors want to make sure that they get back the exact rack of equipment that they leased, so they have to track the details. The asset manifest included in the lease agreement reflects the lessor's asset-level details. The different elements in the rack – for example, servers, routers and storage arrays – may have different economic lives, and auditors may want to see this reflected in the accounting. In this situation, the lessee should account for each of the individual assets on the lease using the lessor's view in order to comply with the lease terms and to address audit expectations. Using the asset-level accounting information, the lessee can construct a super-asset that reconciles with the data centre manager's view by aggregating the individual debits and credits for each rack.

Figure 5: Asset-Level Aggregation of a Rack-n-Roll Data Centre Equipment Lease

2 Power Supplies
Upgraded with New Coterminous Lease
(Partial Return)

← Lease →

Asset

Components	Components
Server	Joe (IT)
Server	Joe (IT)
Server	Joe (IT)
Router	Fred (Network Services)
Firewall	Fred (Network Services)
Power Supply	Max (Facilities)
Power Supply	Max (Facilities)
UPS	Max (Facilities)
Maintenance Agreement	Denise (IT Accounting)

Asset Cost Allocation

Financial Analysis
5%
3401-348-701

Modeling
10%
3401-111-890

ERP
20%
3402-994-038

Weather Forecasting
65%
3604-998-001

Cost Centre or Project Allocation

Lessees often use internal and/or external charge-back models to allocate costs in the business. Most large companies will apply segments of their general ledger (GL) string to allocate costs to legal entities, business units, departments, and cost centres. Consulting, outsourcing, and law firms use project allocation techniques to allocate costs of shared assets to customers, which is often accomplished using another segment of the GL code. By accounting for assets at the asset level, you can employ nuanced breakdowns to reflect how each asset is shared, applying the GL string for management accounting and reporting.

Usage Parameterization

These breakdowns and allocations of a shared asset can get complicated but may be essential to accurately capture the financial accounting. This is often the case with the oil and gas industry and with the logistics industry where pipelines, containers, warehouses, ships, and aircraft often have shared usage among different lessees, making each individual lessee's lease calculation complicated. These cases typically involve leases embedded in service agreements, which require a careful study of the description of the arrangement by a trained accountant in order to discern and parameterize the right-of-use (ROU) asset within each asset under the new standards. Some of the arrangements will involve spatial measurements (square feet, square meters, square hectares, etc.), while others are volumetric (gallons, liters, etc.) or temporal (days, weeks, hours) and sometimes include elaborate contingencies. The challenge here is to reflect the appropriate measurement of the swath, slug, patch, portion, partial breakdown, or component and its value in order to calculate the accurate accounting. In these situations, asset-level lease accounting is required for accuracy.

Figure 6: Asset-Level Lease Accounting at Start of Lease
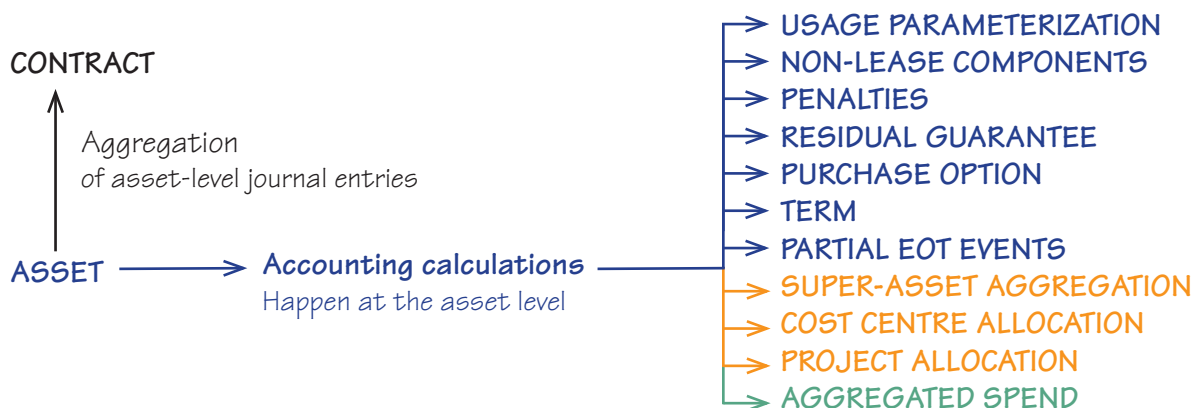
ASSET-LEVEL DECISIONS AND EVENTS DURING THE TERM

Modifications & Reassessments

There are a variety of scenarios when a lessee is required to remeasure lease payments during the term of the lease without a modification, which triggers a remeasurement of the lease liability at the current discount rate and a commensurate adjustment in the ROU asset. These requirements resemble the asset-level decisions and events at the start of a lease, as previously described. The lessee must:

- Reassess the lease term or option to purchase assets if:
  – a significant event or a change in circumstances within the lessee's control occurs
  – a contractual event arises requiring the lessee to exercise (or not) an extension or termination option
  – the lessee decides to exercise an option that was previously not reasonably certain or vice versa, causing a change in the lease term, which requires a remeasurement of the lease payment and reassessment of the lease classification

- Respond to certain events and circumstances that can trigger a reassessment, such as:
  - significant leasehold improvements expected to have significant economic value for the lessee when the option becomes exercisable
  - significant changes to an asset (for example, upgrade, install, or swap) which may require tracking changes to its components, as a change to a component can change the value of an asset or impact the lease compliance requirements
  - a business decision that is related to the lessee's ability to exercise an option (or not)
  - subleasing an asset beyond the exercise date of the option

- Remeasure variable lease payments that depend on an index or rate when that index or rate changes

- Remeasure lease payments when there is a resolution of a variable lease payment contingency causing the variable lease payment to meet the definition of a lease payment

- On an ongoing basis, reassess if there is a change in the amounts expected to be paid under residual value guarantees and remeasure the lease payments to reflect the change

Tax Timing Differences

The single model applied by IFRS 16 will result in an increased number of timing differences at the asset level. These timing differences need to be tracked for deferred income tax purposes and are critical in supporting deferred income tax entries with asset-level reporting on accounting depreciation. Lessees will frequently need their accounting policy for the depreciation of assets incorporated into the company's lease accounting software so that the appropriate depreciation methodology is applied to the individual asset categories. For example, you can have assets on the same lease contract that are depreciated on different terms, following your internal policy (for example, networking equipment over 60 months and computer servers over 48 months). This is particularly relevant for leases with automatic transfer of ownership.

Location Changes

Lessees must track changes in the location of each asset because moves can impact insurance, taxes, and lease compliance and may require reassessments, depending on the asset, how it is used in the company, and the conditions/environment of the new location. Generally, real estate assets and their leases have longer lives and their locations are fixed, whereas equipment assets can move physically and logically within an organization over their relatively shorter lives. The more locations per lease contract, the greater the propensity for variability in end-of-term behaviour and the expected holding period, which results in differing timing, amounts, and accounting treatment at the asset level.

Mid-Term Events

Mid-term events include upgrades, swaps, and early buyouts. Upgrades and swaps may or may not have an accounting impact, depending on the terms and structure of the events. Mid-term buyouts are quite common and do impact the accounting. Consider a lease contract for 1,000 laptops. It is highly likely that at least one of those laptops is going to be damaged, destroyed, or lost at some point during the life of the lease. The terms of most leases require an immediate notification to the lessor and a required buyout by the lessee. This one asset needs to be removed from the lease in the same time period. The adjustment to the lessee's books, and the resulting calculations for the ongoing invoice, should be used to ensure that the lessor updates his or her own lease accounting system correctly and bills the lessee for the right amount. Lessors need and use asset-level lease accounting because they encounter the same issues as identified in this paper. Without the control of asset-level adjustments and calculations, the lessee cannot verify the accuracy of the revised invoice. Often, lessees attempt to do this by manually prorating the cost of the surviving assets, but they encounter problems when costs are unknown

or different lease rate factors are applied against different asset categories. Differences between lessor and lessee perceptions of the effective date of the buyout may be difficult to resolve without the asset-level perspective and can impact accounting.

Reorganizations Allocation

Large corporations routinely reorganize, merging or splitting business units and cost centres in the process. Asset-level lease accounting enables the logical reorganization of assets to reflect the corporate reorganization. This requires a change to the GL coding for the assets affected. These changes are then reflected in any management accounting and reporting that employs the GL coding.

Mergers & Acquisition Allocation

When companies buy or sell another company or division of another company, the leases typically transfer with the entity being bought or sold. The selling company must divest the leases, and the acquiring company must acquire and manage the leases. Looking ahead to the new standards, when all leases longer than 12 months and greater than low-value assets will be capitalized, the lease transfers will be balance sheet to balance sheet transactions. Given that leased assets can be spread over multiple locations and business units, dissecting each lease to determine the appropriate distribution of assets to accomplish the merger, sale, or acquisition without asset and liability net book values at the asset level would likely be quite difficult, time-consuming, high-risk, and expensive. For sellers, it could have an adverse impact on the selling price. For buyers, it could drain resources away from more critical strategic tasks associated with merging the entities.

Figure 7: Asset-Level Lease Accounting During the Term
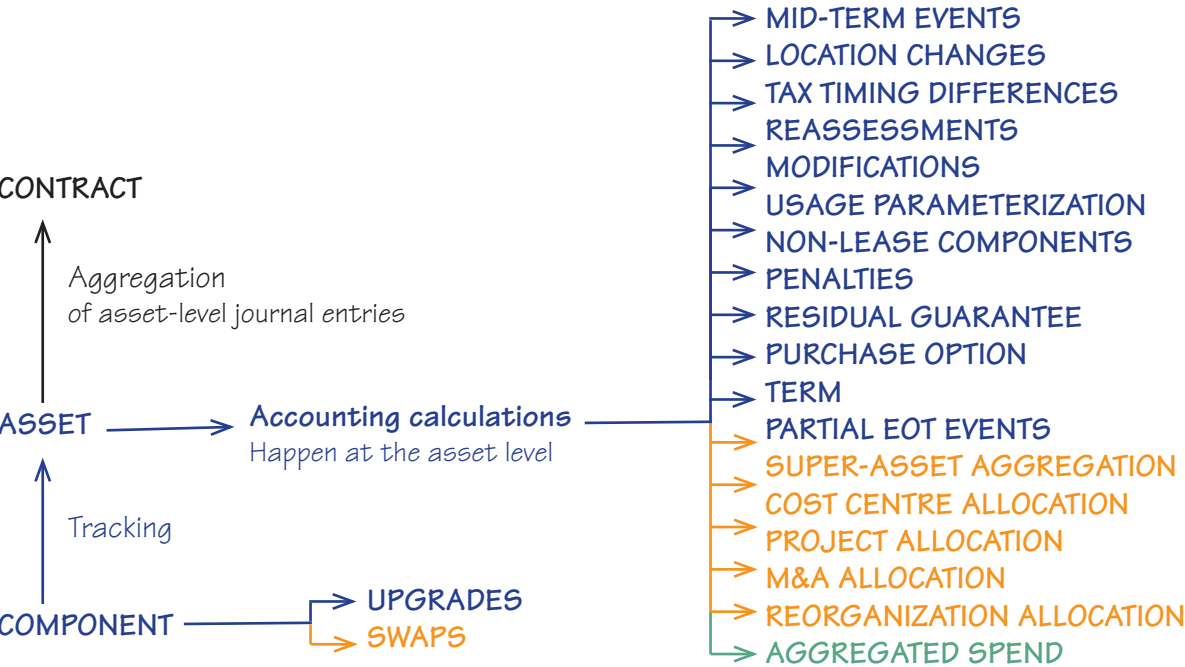
ASSET-LEVEL DECISIONS AND EVENTS AT THE END OF TERM

Partial End-of-Term Events

We launched this paper by introducing asset-level lease accounting with an example of partial end-of-term events (the three Blade Servers), which included a partial return, partial renewal (deliberate), and partial renewal (unintended "evergreen"). There is one more event that we have not yet touched on: returns. Most equipment leases

are established with the explicit intention of returning the equipment at the end of term, a motivation that is reflected in both the lease versus buy analysis and, under the new standards, the term used in the amortization of each asset. Despite these intentions, in practice, lessees struggle to return equipment on time for a variety of reasons, which raises issues of timeliness of event reporting and respecting cut-off for accounting purposes. While lessors may allow a grace period of a few months for returns, this leeway only impacts the economics. For proper accounting, the date that the lessee recognizes the return (booked) and the date that the lessor accepts the return (control) need to be recorded on an asset-by-asset basis. Under the new standards, if you return an asset, it doesn't just change your invoice and payment; you may need to adjust the net book value or accruals of the lease.

Return Performance Measurement

Many lessees lease buildings without clearly indicating their intentions at the end of the initial term. By contrast, most lessees lease equipment with the intention of returning the equipment at the end of the initial term. The end-of-term decision typically must be made at least 60 days before the lease ends so the lessor can be notified pursuant to the contract terms. All too often this process happens inconsistently, late, or not at all. As seen in our Blade Server example, a lack of action at end of term, as with many contracts, can result in an "evergreen" lease that continues month-to-month or quarter-to-quarter until a decision is made and carried out or the equipment fails. Failure to track equipment properly and proactively manage the end-of-term decisions and logistics is the most common and costly mistake, where the magnitude of the cost is often unknown and not readily quantifiable. Many lessors know this and depend on it — it's often part of their business model. As a result, there are many active leases that are far in excess of their original contractual term, even though the lessee intended to return the underlying equipment at lease inception.

Larger companies are the most common self-inflicted victims of end-of-term spend leakage. With asset-level lease accounting, lessees can determine the true financial cost of leasing compared to buying throughout the life of the lease. At lease expiration, lessees can compare these financial results to what was originally intended at lease inception. By calculating the PV of the actual lease payments asset-by-asset and comparing it to the PV expected at the time of lease, as documented and archived in the lease versus buy analysis, lessees can calculate the overspending for each leased asset. Lessees can also compare the PV of actual payments to the cash purchase price. For example, if the PV of cash flows is currently 125 percent of original cost, then the lessee is clearly overpaying. Because the subledger contains the asset-level building blocks, it is easy to aggregate and organize the asset-level data by stakeholder, cost centre, or business unit to produce a scorecard that can be sent to asset owners, supervisors, and managers and escalated to achieve return performance goals. The pursuit of savings through improved return performance and reporting also results in higher quality data for accounting.

Negotiating Buyouts and Renewals

When asset owners decide to buyout or renew a lease, the lessee can adhere to the options in the lease or renegotiate the terms of each option. Most FMV leases call for the lessee to buyout the lease at the then FMV. Most lessees will notify the lessor of their decision to buy out an asset, and the lessor will issue a buyout invoice, which typically reflects the amount that the lessor needs from the lessee to achieve their target internal rate of return (IRR) for that leased asset (or basket of assets). But the FMV is negotiable. In this case, the lessee can leverage asset-level lease accounting to analyze the economics and negotiate a lower buyout amount to drive savings.

With buyouts, it is possible for the lessee to easily calculate the effective rate earned by the lessor. If this rate is excessive, it can be used as ammunition to lower the buyout price. But this can only be done if the rate, cost, and specific lease rate factor that are known at the asset level. Some lessors do not make cost and lease rate factor known upfront, and lessees with contract-level accounting often don't insist on this information because the lease can technically be booked without it. The administrative pain and lack of visibility only become an issue later in the lease, when somebody else in the organization will need to deal with it. Lessors know this, which is why many of them don't want to provide this information in the first place.

The Big Challenges: Accurate Calculations and Data Quality

CONSIDER EVERY ASSET A LEASE

Lessees will adopt the concept that every asset is a lease. In other words, every asset should be accounted for independently of all the other assets on a lease schedule. They will employ asset-level lease accounting in pursuit of compliance with the new standards and specifically in response to their asset-level requirements. A careful reading of the IFRS standard reveals, through many scenarios, that an asset is the optimal unit of measure for lease accounting. After years of thought and discussion and the release of the new standards, this is the level of granularity that the standard-makers in the FASB and IASB arrived at, debated, and agreed was appropriate. Asset-level lease accounting is simply the right tool for the job.

Asset-Level Controls

In order to operationalize the new lease accounting standards, lessees must design asset-level control procedures to process lease transactions correctly, which will in turn produce accurate account balances. In addition to performing substantive audit tests, auditors evaluate a lessee's existing internal controls and assess the risk of a material misstatement related to them. Control objectives ensure that financial statement assertions are correct. They are the inverse of the errors and irregularities that can be found in transactions. As indicated in the table below, control objectives intersect with and are closely related to management's financial statement assertions.

Table 6: Management's Financial Statement Assertions

Control Objectives	Existence/ Occurrence	Completeness	Valuation	Rights Obligations	Presentation and Disclosure
Validity	√			√	
Completeness		√		√	
Authorization	√		√	√	
Accuracy			√		
Classification					√
Accounting					√
Proper Period	√	√			

With an eye toward achieving consistently clean audits, designing asset-level controls for the new lease accounting standards can be distilled into two fundamental and interrelated challenges and risks:

1. Accurate Calculations
2. Data Quality

Of course, asset-level controls and calculations can be automated in a software application.
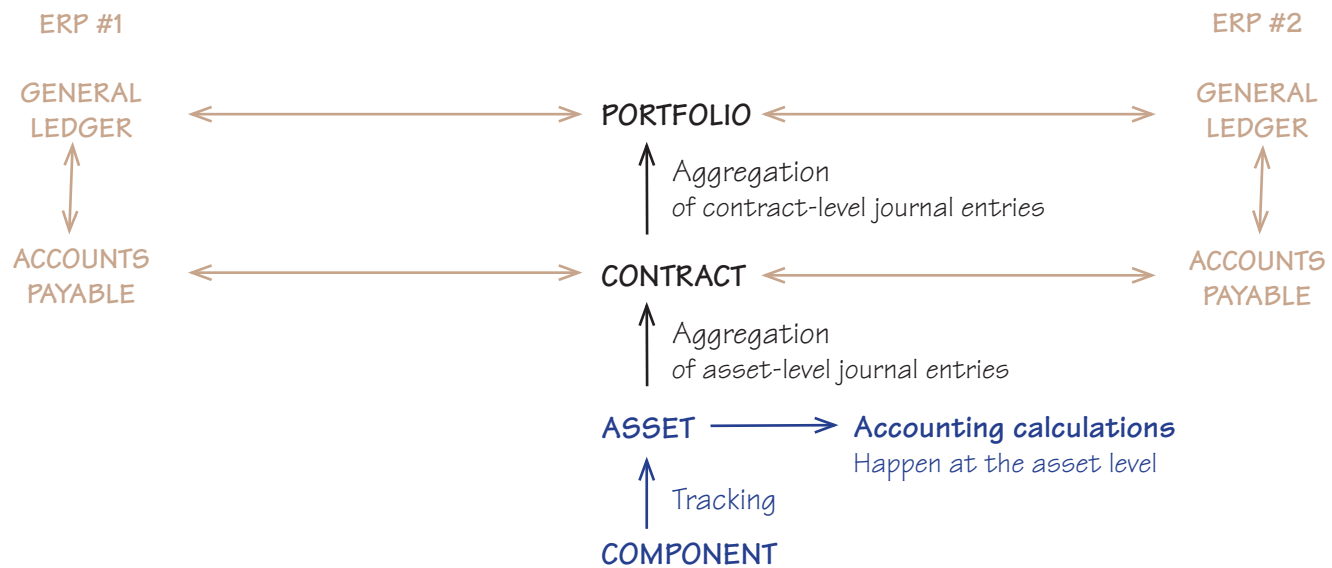
ACCURATE CALCULATIONS

Why Automate for Asset-Level Transactions?

By automating the controls and calculations for asset-level lease accounting, lessees can encapsulate the complexity of implementing each of the lease accounting standards in a commercial software application. This automation effectively removes the first challenge, accurate calculations, from their implementation agenda, enabling lessees to focus their available resources on the other fundamental challenge: data quality. Consider Example 2 on the spend aggregation of forklifts introduced on page 10. If the initial term of a forklift lease is 48 months and the company leases 100 forklifts per year, then the company's portfolio is likely to include approximately 400 forklifts on a rolling basis on average (assuming no annual expansion or contraction in the portfolio). That means there will be monthly journal entries for 400 forklifts for 48 months. This equates to 19,200 asset-level journal entries just like the ones in the finance lease Blade Server example. Any partial events at the end of term will further increase the number of journal entries. Layer on top of this the other possible asset-level variations, and you can begin to understand the complexity involved and will quickly conclude that it is not possible to perform asset-level lease accounting manually. Instead, it requires a software application that encodes all of the rules and requirements in all of the standards (current and old, international and domestic) to automate the lease calculations and controls at the asset level.

A Single, Global Subledger

Automation hides the complexity of the multi-layered, asset-level calculations and the management of the journal entries. A single, global, asset-level lease accounting subledger will generate the accounting and financial reporting for all lease types (real estate, equipment, and embedded leases) of all accounting standards. Such a subledger will manage and control the millions of asset-level journal entries required for compliance with the new standards and insulate the lessee's ERP platforms from the complexity. This kind of subledger integrates and reconciles with the accounts payable subledger at the contract level, as the invoice and payment are contract-level documents. If AP requires purchase order (PO) line item reconciliation between systems, assets can be aggregated to a PO line item instead of, or in addition to, the contract level. It also integrates and reconciles with the GL and provides either portfolio-level or contract-level journal entries, whichever is preferred by the Controllership. The subledger should also facilitate integration and reconciliation with multiple ERP platforms in parallel, as many lessees have grown by acquisition and still use multiple ERP platforms to run their business. The software category that has emerged around these requirements is called Enterprise Lease Accounting (ELA).

Figure 8: Portfolio-Level, Contract-Level, and Asset-Level Lease Accounting

ERP #1 — ERP #2

GENERAL LEDGER ⟷ PORTFOLIO ⟷ GENERAL LEDGER

↑ Aggregation of contract-level journal entries

ACCOUNTS PAYABLE ⟷ CONTRACT ⟷ ACCOUNTS PAYABLE

↑ Aggregation of asset-level journal entries

ASSET ⟶ Accounting calculations
Happen at the asset level

↑ Tracking

COMPONENT

Audit Trail

An asset-level lease accounting subledger, fed by asset-enabled workflow software that automates the leasing lifecycle, can produce a detailed audit trail for each asset and lease. The audit trail is the set of accounting operations from transaction analysis to financial reports. It covers who did what, when they did it, and how they did it. Auditors may follow the audit trail from the source transaction documents to data entry, transaction processing, and ledger account posting — the last from which they will proceed to financial reports. Auditors will also pursue the audit trail backwards (top-down) from the financial reports to the source documents to determine whether the details of the financial reports are supported by relevant source documents. They will follow it forward from source documents to reports to determine that everything that happened was recorded in the accounts and reported in the financial statements. A software application that supports management of the leasing process at the asset level, in addition to calculating the asset-level journal entries, will generate this audit trail automatically by recording the interactions of each stakeholder with a lessee's global leasing process. To support audit tests and audit trails relating to the physical existence and proper GL segment coding of individual assets, your software should be able to generate automated notifications to individual asset owners and users. These notifications should request that they attest to the accuracy of the physical and logical attributes associated with each asset for which they have been identified as an owner. And with proper authorization, they should be able to make changes to those asset attributes, including triggering changes in reallocating ownership to other participants.

Figure 9: Top-Down and Bottom-Up Audit Approaches

Top-Down: Financial system → Contract-level data → Asset-level data → Supporting documentation

Bottom-Up: Supporting documentation → Asset-level data → Contract-level data → Financial system

Period-to-Period Reporting

A typical lease portfolio for a large company (non-retail) includes hundreds of real estate leases and thousands of equipment leases that cover tens of thousands of assets managed by hundreds, if not thousands, of asset owners.

Example 4: Global Industrial Manufacturer

One global industrial manufacturer has 5,500 leases covering approximately 50,000 assets. Their portfolio includes approximately 150 million journal entries. These journal entries need to be stored in a data warehouse and need to be easily accessible using automated reporting and business intelligence (BI) tools for analysis. The Controllership, auditors (internal and external), Financial Planning and Analysis (FP&A), and others will want the ability to analyze the lease data and generate period-to-period reporting.

Fast Accounting at Scale

It is important to have the capability of period-to-period reporting by segmenting the underlying asset-level debits and credits. Accountants need to be able to generate the reporting on a typical portfolio like the example above at a reasonably acceptable speed. The time required to generate the report for a portfolio of 150 million journal entries should be measured in seconds, not hours, if month-end deadlines are to be met with confidence, including generating month-end journal entries at the contract level by aggregating the asset-level journal entries. This requires front-end reporting and analytics tools for articulating a query as well as highly optimized schema and queries and a scalable software architecture. Look for these capabilities and features when selecting an asset-level ELA software application.

Can Contract-Level Real Estate Software Work?

Retrofitting the one-to-one real estate lease management software designed for contract-level lease accounting to accommodate the one-to-many requirements of asset-level lease accounting is a complex, multi-year effort — and a

significant investment in software engineering and technical asset-level lease accounting expertise. Instead, most real estate software vendors have created an asset table for each lease that includes the serial number, description of the asset, and cost of the asset. The software allocates the monthly rental amount in the lease contract proportionally over the assets based on the cost of each asset. This is contract-based lease accounting with asset-level lease allocation, rather than asset-level lease accounting. The debits and credits are still produced at the contract level rather than the asset level.

That being said, it is possible to achieve compliance for operating and finance leases with the new lease accounting standards using contract-level accounting software if: (a) there are no asset-level variations stemming from the asset-by-asset decisions, judgments, and events or (b) the lessee is prepared and properly staffed to perform the appropriate manual calculations (likely using spreadsheets) and controls required to accommodate asset-level variations.

Shortcuts

The standards are clear about the need for asset-level accounting, and auditors want and need lessees to do things by the book. Auditors take on risks when they make exceptions. Auditors will not ordinarily make recommendations on how to simplify your accounting procedures without taking on their own additional risk. That being said, most auditors are open-minded and will listen to ideas for simplifying your accounting challenges provided you can show them that the simpler approach is not material. You will also need to demonstrate that you are able to measure the amounts involved on an on-going basis, so that you will know if and when the simpler approach becomes material. In most shortcut exceptions, you still have to do much of the work that you would otherwise have to do if you did it the proper way. Your auditor is likely to ask: "Why bother taking shortcuts when there is commercially available software that enables you to do it right on an automated basis and where there would be no additional workarounds or need for shortcuts?" In short, you can use contract-level accounting for compliance if you get the same result from performing the asset-level accounting, recognizing that you have the burden of proof. The new accounting standards provide additional guidance relating to portfolio accounting and its application, but they don't identify all of the potential pitfalls of this approach, what to consider, and when it may break down.

Figure 10: Asset-Level Lease Accounting for Accurate Calculations
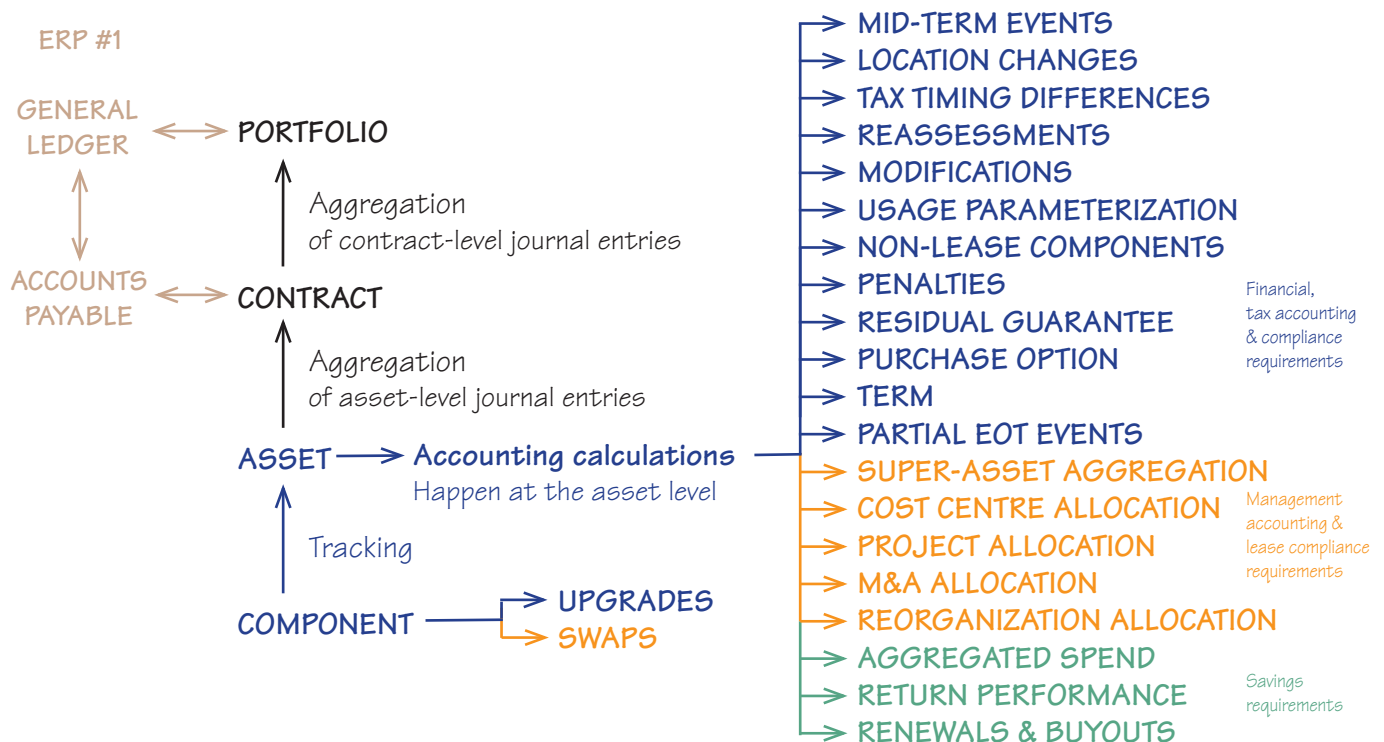
DATA QUALITY

Process Transformation Required

The previous lease accounting standard (IAS 17) required a lessee's operating lease obligations to be expressed as a simple footnote disclosure in the financial statement. For most lessees, their operating lease obligation data was typically entered and maintained in the budget systems of various business units and cost centres, at the contract level, as a monthly expense line item. The controller's office would ask the various cost centres or entities to submit their lease obligation data to the regional controllers or budget holders. This data was then extracted from the budget or other system and collected and consolidated using spreadsheets. The asset-level data typically did not even exist in a database or spreadsheet nor was it reconciled with the contracts. Often there was no information except future cash flows. Critical financial information was missing, not only at the asset level but also at the contract level.

The new standard requires monthly balance sheet accounting for assets and liabilities at the asset level (debits and credits). This brings a commensurate level of asset-level audit scrutiny and controls testing, similar to the audit scrutiny with purchased assets, but with increased testing due to the associated liability and the visibility that the new standards are getting.

Transaction Data Sources

While asset-level calculations and controls can be automated, procedures must be carried out by people, and people must be relied on to record transactions. Necessary transactions include capturing asset-level data from:

- Original transactions documents
- Decisions and judgments
- Events

Decentralized Decisions with Controls

If you have more than a few hundred leases in your portfolio, it will be difficult to centralize management of the transactions because the asset owners — those who are typically the fiduciaries or budget owners of the assets — are often the only ones who can make the asset-level decisions and judgments and who have visibility into events. The transactions are highly decentralized because the many participants and assets are highly decentralized, and the context in which each asset is procured and used is directly relevant to the accounting. The right approach here is to leverage your lease management applications and your single, global ELA subledger to strike the right balance between decentralized decision-making and centralized data and controls.

Figure 11: Asset-Level Decisions and Events Across Lease Lifecycle
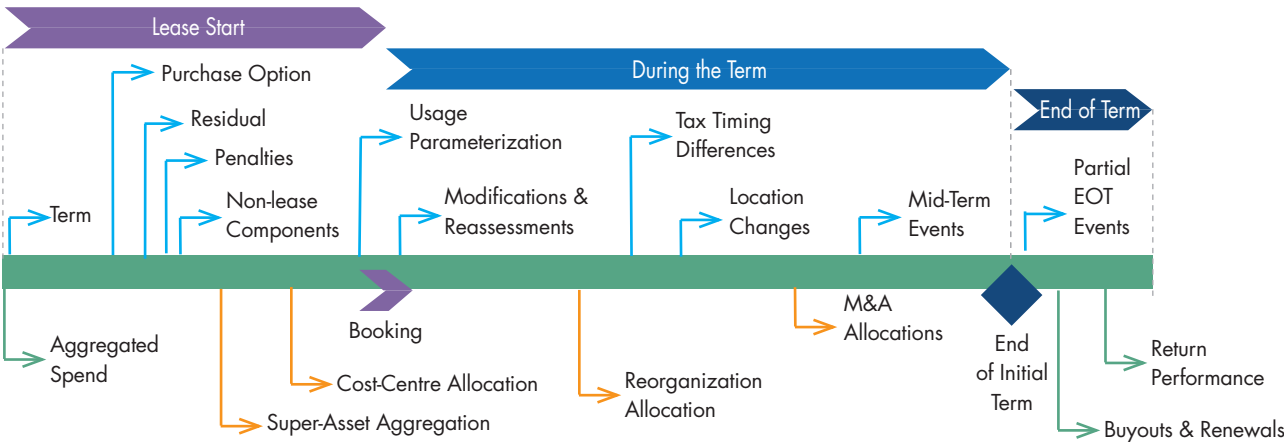
As depicted above, lessees should develop procedures for collecting and validating contract-level and asset-level data at the time of contracting, applying the appropriate procedures to make the required judgments and then booking the complete transaction data set. Lessees will also have to continue enabling their asset owners in the field to update the database with decisions, judgments, and events (each a transaction in the audit sense) throughout the lease lifecycle. In this way, it should be easy for an asset owner to communicate the change in status of an asset. On a monthly basis, with some basic training and plainly written policies, asset owners should be able to use email or a simple web-based tool with the appropriate workflow to attest to the asset-level decision, judgment, or event. Then, when the transaction is validated, the asset-level ELA software should carve out that asset from the lease schedule in the subledger and recalculate the schedule and payment automatically.

Role of Contract Management System

In order to comply with the new accounting standards, some companies are planning to leverage their existing contract management software application. They will capture documents and data at the start of a lease and then feed that data into an ELA subledger to generate their journal entries every month. However, this approach is likely to fail a substantive audit because it won't include the necessary policies, procedures, and controls to capture periodically (monthly or quarterly) the many decisions, judgments, and events at the asset level throughout the term of the lease, as required by the lease accounting standards. Consequently, the data will become increasingly inaccurate over time and the data quality will be insufficient using this approach.

Specialized Controls

Getting quality data into the subledger on a monthly basis from the field depends on the ease and effectiveness of the asset-level lease management software application. The processes and stakeholders involved in managing real estate leases are separate and distinct from the processes and stakeholders involved in managing equipment leases. Different players with different objectives, motivations, budgets, and expertise transact these different types of leases. Therefore, controlling each process requires specialization and distinction, rather than generalization, to ensure data quality.

Figure 12: Specialization, Distinction, Expertise Required for Each Process
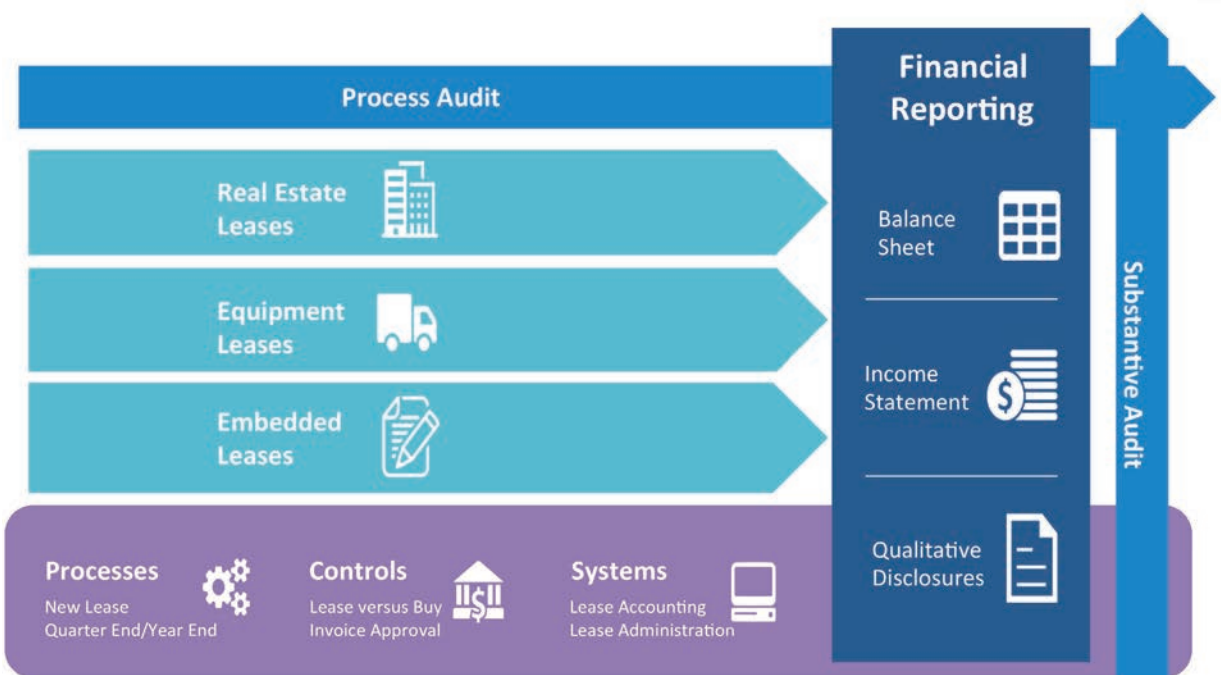
Reconciling Documents

In equipment lease transactions, there can be three or four different parties involved in the transaction, including the manufacturer, a reseller, the lessor, and the lessee. Each party produces documents and data that they struggle to share. It is in this fractured, fragmented ecosystem that budget holders and asset owners within the lessee's organization must transact a lease. The manufacturer negotiates the cash transaction and provides the warranty and support contracts. The reseller ships the equipment to the lessee and has the asset manifest (including serial numbers for what was sent) and the lessor often provides only the lease contract information at the time of booking. In a typical portfolio, transaction document sets may be as simple as a single, standalone schedule with no master lease agreement (MLA) or as complex as a package of twelve distinct document types, each of which may arrive at different points in the transaction process. Often specific data elements on different documents have to be reconciled by the lessee in order to properly book the deal to ensure that what was ordered was shipped, and what was shipped was received and accepted as operational. Reconciling asset-level data for what the reseller and the lessor believe they shipped with asset-level data for what the lessee believes they received, to arrive at a data set that can be booked, for example, is a specialized control required in equipment leasing.
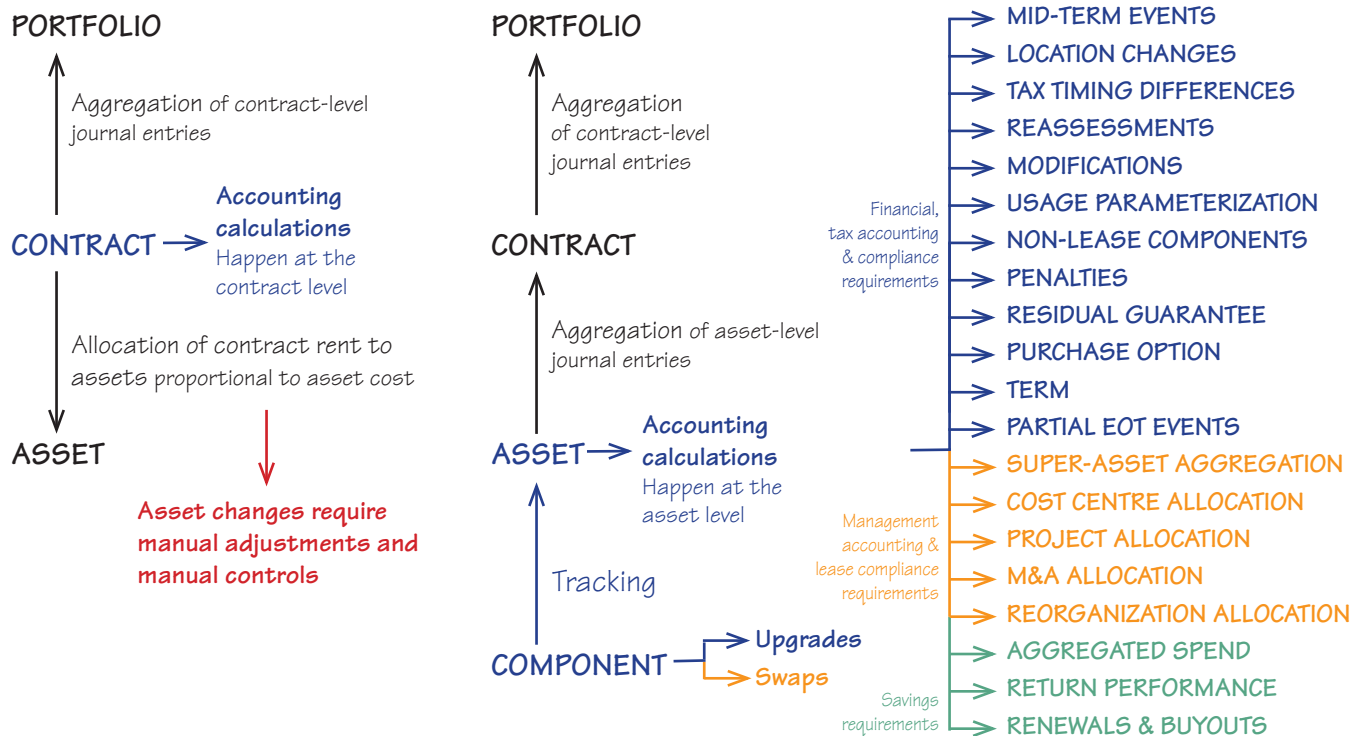
Data Quality Linked to Savings

In pursuit of compliance with the new lease accounting standard, companies can also pursue a return on their investments in new processes and technologies. Unlike other compliance projects, such as revenue recognition, IFRS 16 compliance can and should have a significant upside. Controllers can collaborate with procurement and operations leaders in their hunt for quantifiable savings, including aggregated spend, competitive bidding, and improved return performance. Together, they can establish a business process management practice for the asset-level leasing lifecycle across the enterprise, use competition to shift the work of documenting assembly to their lessors, automate and control the process using an asset-level lease management and accounting solution, and then integrate with other internal systems (for example, an existing real estate management system) to achieve straight-through processing with a single, global subledger.

Given the number of contracts and stakeholders involved in lease management, a top-down mandate alone will not solve the data quality problem. The pursuit of savings and continuous improvement will motivate stakeholders in the leasing process around the world to deliver quality asset-level data on a monthly basis — the same asset-level data that controllers need for public financial reporting under any of the standards, previous or new. In this way, compliance and savings are inextricably linked in solving the data problem in asset-level lease management. The savings that result from transforming the process should pay for the transformation project and positively impact the income statement.

Figure 13: Why Asset-Level Lease Accounting is Required by Lessees

Contract Accounting vs **Asset Accounting**
requires manual workarounds   fully automated

PORTFOLIO

Aggregation of contract-level journal entries

CONTRACT → **Accounting calculations** Happen at the contract level

Allocation of contract rent to assets proportional to asset cost

ASSET

Asset changes require manual adjustments and manual controls

PORTFOLIO

Aggregation of contract-level journal entries

CONTRACT

Aggregation of asset-level journal entries

ASSET → **Accounting calculations** Happen at the asset level

Tracking

COMPONENT → Upgrades / Swaps

Financial, tax accounting & compliance requirements
- MID-TERM EVENTS
- LOCATION CHANGES
- TAX TIMING DIFFERENCES
- REASSESSMENTS
- MODIFICATIONS
- USAGE PARAMETERIZATION
- NON-LEASE COMPONENTS
- PENALTIES
- RESIDUAL GUARANTEE
- PURCHASE OPTION
- TERM
- PARTIAL EOT EVENTS

Management accounting & lease compliance requirements
- SUPER-ASSET AGGREGATION
- COST CENTRE ALLOCATION
- PROJECT ALLOCATION
- M&A ALLOCATION
- REORGANIZATION ALLOCATION

Savings requirements
- AGGREGATED SPEND
- RETURN PERFORMANCE
- RENEWALS & BUYOUTS

About LeaseAccelerator

LeaseAccelerator offers the market-leading SaaS solution for Enterprise Lease Accounting, enabling compliance with the new IASB and FASB standards. Using LeaseAccelerator's proprietary asset-based Global Lease Accounting Engine, customers can account for all categories of leases including real estate, fleet, IT, material handling, and other equipment at an asset level.

On average, LeaseAccelerator's Sourcing and Management applications generate savings of 17% on equipment leasing costs with smarter procurement and end-of-term management.

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