

Lease Accounting: What's Next after Spreadsheets?

Enterprise Lease Accounting Software
Supports Efficient, Sustainable Processes

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Sustainably Efficient and Accurate Lease Accounting

New standards for accounting for leases went into effect at the start of 2019 for public companies using a calendar fiscal year and will take effect for private companies in 2020. (For companies in the United States the new standards are laid out in ASC 842 and for most companies outside the U.S. in IFRS 16.)

Companies with more than a handful of operating and real estate leases have been busy preparing for the new standards. But despite their best efforts at preparing for compliance, it's likely that most will confront issues around:

- the software they use to manage lease accounting.
- the management of lease-related data.
- leasing and lease accounting processes.
- lease management organizational structure.

Even though they will have invested considerable time to comply with the new standards, organizations must go further and assess whether their initial effort will be sustainably efficient and accurate over the long run. If they have more than a few dozen equipment and real estate leases in force and their process is supported by spreadsheets, it almost certainly isn't. They should consider what some call enterprise lease accounting software to support their processes.

Accounting Standards Require Systems

The recent major shifts in accounting standards for both leasing and revenue recognition are a significant break from the past in that desktop spreadsheets can no longer be used as they are seriously deficient for managing or supporting compliance. Organizations with more than a handful of operating and real estate leases must address the demand that modern accounting information systems be used to achieve reliable and cost-effective compliance. Auditors today recognize that calculations and controls are sufficiently accurate and consistent and far less vulnerable to errors and manipulation only when managed by an application. Moreover, third-party lease accounting applications are updated as lease accounting standards evolve over time and benefit from ongoing refinements and professional testing.

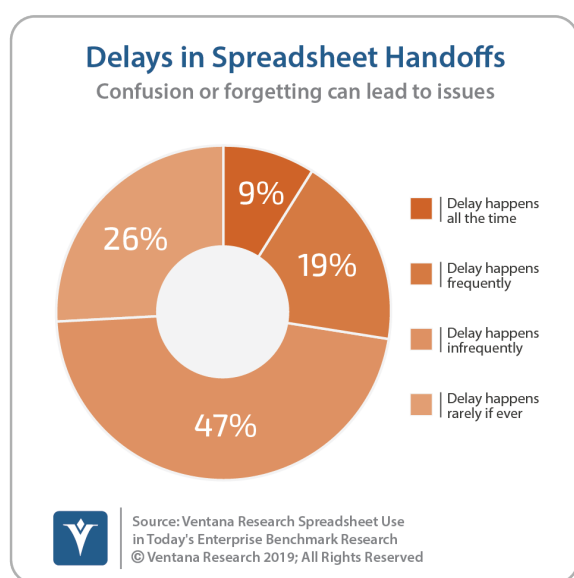
Spreadsheets may be useful for prototyping and therefore adequate for initial compliance, but they aren't a practical long-term solution. Four aspects of lease accounting under the new standards make spreadsheets the wrong technology.

- Data is collected from multiple points in the organization and the process of collecting it must ensure accuracy and timeliness.
- The volume of detailed data and calculations becomes unwieldy when there are more than a handful of leases.



- The processes related to lease management must be consistent across an enterprise.
- Lease valuations require periodic review and remeasurement when conditions warrant.

Data Accuracy and Timeliness: Lease accounting is typically a cross-functional process because in most companies the data required for recording and valuing the lease is collected by multiple business units and then passed on to the accounting department. Although it's not impossible to handle this with attachments to emails, experience shows that this approach is time-consuming for the accounting staff, difficult to control and makes internal and external auditing unnecessarily difficult and, again, time-consuming. Moreover, our research finds

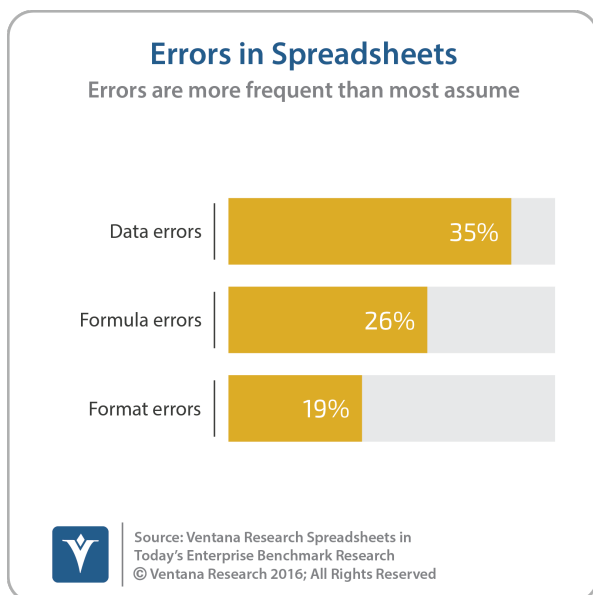


that spreadsheets create delays in completing processes: 28 percent of participants said that their most important process that uses spreadsheets is delayed frequently or all the time because people aren't sure what to do next or forget to pass the spreadsheet on to the next person.

The new leasing standards are principles-rather than rules-based. As such, consistency in measurement and treatment is essential. Our research makes clear that consistency is difficult to control in individual spreadsheets – for example, in ensuring that the same discount rate is used in valuing the lease asset and liability, espe-

cially when remeasurement is required. Thirty percent of research participants reported that they frequently or all the time find that there are multiple, inconsistent versions of a spreadsheet file circulating.

Data Management: Detailed information is required to record and value a lease. Informal systems are adequate if a company manages only a dozen or so leases. However, many companies have hundreds or even thousands of leases outstanding for real estate and equipment. Having a single system for collecting, updating and reporting ensures precision and enhances control. A dedicated application facilitates data collection and maintains data quality throughout the process to limit the need for checks and reconciliations. Ideally, data should be entered only once at the source and reviewed there for accuracy; there should be no need to manually reenter data. Spreadsheets also are notoriously error-prone. More than one-third (35%) of participants in our research said they regularly find data errors in their most important spreadsheet and 26 percent said they find errors in formulas.



Process Design: Defining proper lease accounting processes in workflows in an application ensures that work is performed, reviewed and approved. Software-based workflows serve as a high-level control that limits the need for auditing. Workflows allow supervisors to save time by managing the process by exception rather than having to thrash through emails to confirm that the necessary steps were performed and that issues were dealt with appropriately.

Periodic Review: Lease accounting is a dynamic process. Companies must review all leases on a periodic basis and remeasure

their value if circumstances change, such as when terms are extended (adding value to the lease asset and liability) or if it becomes unlikely that options to renew will be exercised (reducing the asset or liability). Since the impetus for a remeasurement isn't always the result of a transaction, the accounting department must actively solicit information from those managing the lease to determine if a remeasurement is required. Automated workflows substantially reduce the administrative burden and ensure procedures and reviews are followed. When needed, dedicated software can perform remeasurement calculations far faster and with greater reliability than adjusting waterfall calculations in a spreadsheet.

Organizational Considerations

Addressing the new accounting standards is likely to require an assessment of the proper organizational structure to manage leases, as informal and decentralized processes are no longer adequate for compliance. This is because lease accounting requires ongoing cross-functional interactions to handle lease inceptions and periodic reassessment and remeasurement. Organizations therefore must have in place the appropriate controls, supervision and sign-offs.

Some may find it useful to create a center of excellence to manage their equipment leases because it simplifies data collection and lease monitoring compared to a decentralized approach. It may also yield savings by aggregating equipment leases for volume discounts or eliminating duplicative leases.

Entities with real estate departments that manage the operational aspects of real estate leases (such as negotiating, assessing and renewing leased properties) must recognize that these activities are functionally separate from accounting for leases. Similarly, software used by real estate departments that support the



operational aspect of managing leases typically cannot handle lease accounting well. The two systems must work together but each has its own requirements.

A Race to the Starting Line

Corporations have been working on compressed timelines to be prepared to comply with the new lease accounting standards. It's unlikely that the systems and organizational structures they have in place will be adequate over the long term for sustainably efficient and accurate lease accounting. This is especially the case if these processes are supported by spreadsheets.

These companies should recognize that theirs was a race to the starting line and apply what they've learned about process design, data management analysis and reporting to selecting a dedicated lease accounting application. Companies that have already implemented lease accounting software should confirm that they've made the right choice, one that provides the right amount of functionality and scalability to suit their long-term needs.

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