Wolcott Wheeler wolcottwheeler@gmail.com

1 Riverside Drive, #24 (914) 826-5188

Sleepy Hollow, NY 10591 October 21, 2018

**Lease Accounting: Key Challenges in Complying**

If your company holds lease contracts (as many do), you have until December 31, 2019 to comply with the Accounting Standards Update (ASU) for lease accounting issued by the Financial Accounting Standards Board (FASB) in February 2016, known as Topic 842. Although companies have had over two-and-a-half years to comply with the new standards, many have taken little if no action, simply because there have been other priorities.

We have good news: it is not too late to start mobilizing your organization to meet the new standards. However, we advise you start acting *now*, because in our estimation, you should assume that six months will be necessary for your company to be assured of compliance; this factors in inevitable delays and complications. Since you have only a little over a year left, we recommend you take immediate action, because while the process of conforming with the new rules is less complex than the revenue reconciliation remediation you might have just undergone recently, it is a great deal more time-consuming, and it will entail considerably more work.

Here is the reason why: the new ASU changed the definition of what constitutes a lease, along with the classification criteria. Previously, only capital leases, which the ASU refers to as “finance leases,” had to appear on balance sheets as liabilities. Now operating leases also have to be calculated as liabilities. As a result, you are required to recognize lease assets and lease liabilities related to operating leases.

Under the new standards, there are a host of hidden issues. In this article, we will outline some of the major challenges your company will be facing in adjusting to Topic 842, so you will know where to get started and where you might need help. Fortunately, at CohnReznick, we have experience in tackling these complex accounting issues, and we can enable you to get this done. Below are some of the challenges that possibly you have not considered.

First and foremost, *do not underestimate* the formidable amount of time and resource management that this project will require. While you are evaluating and adjusting your policies and procedures, you will need to allow time to organize and build out a project team, hire additional staff, put proper IT systems in place, and locate all of your leases (including embedded ones). The process is going to have to be accomplished in stages. With these considerations, we recommend setting aside a solid six months after you have contacted, vetted, and hired an external vendor like us to assist you with the project, because regardless of how organized you are, you will encounter unexpected challenges that will burn up a great deal of time. It is best if you have clean records with audited financial statements. However, we know that many companies lack copies of their lease agreements, because so many go so far back in time.

How are you going to get this done? As experts in handling these convoluted accounting issues, we can undertake the entire process done for you, and we can advise you concerning how to adopt new policies and procedures.

Have you considered the complicated technology issues involved? Complying with Topic 842 will require you to immediately identify issues with existing systems. If your company is not technologically advanced, the process will take longer than expected. Can your existing ERP system handle the new demands? Where are you locating the data center? What tools are you going to use to accomplish the accounting? Rule out Excel, because it presents an internal control risk, and for this purpose, it is neither sustainable nor scalable.

What platform do you plan to use? Hosts of technology companies are now offering a multiplicity of lease accounting software and platforms. With so many options available, which will be the best for your organization? How do you judge key specifications to look for within the new platforms and assess why they are necessary? In addition, you will have to factor in additional costs, the necessary time and training needed to deploy, and unavoidable delays in the timeline. We can help you prioritize how to tackle all the technical issues involved. At the beginning of the process, we can advise your ERP team how to get everything done, including staffing, a viable timeline, and budgeting.

Have you taken an inventory of your leases yet? It is crucial to do so. Some clients have come us and admitted that possibly they have been unable to identify all their leases, because some of them reach so far back into the past. But under the new regulations, embedded leases are a major issue. For embedded leases, such as for a specific piece of equipment, the accounting will be different from a procedural standpoint. Since your leases could be concealed in transactions, they can be much more difficult to spot. We can assist with the laborious job of tracking down your current leases and taking a throughgoing inventory. By providing you with an AI tool such as Leverton, we can help review all of your leases and save you a great deal of time.

Because many of your leases might be month-to-month, the concept of materiality comes into play. Under the new rules, if they are worth $5,000 or less, they qualify for an exemption. The problem is, U.S. GAAP provides scant guidelines; there is no bright line for guidance. In a complicated situation like this, our expertise becomes useful. A tax issue is also involved, because you may be able to avoid taxes if a certain cap threshold exists. Again, this is a highly technical issue where our accounting skill comes into play.

These are some of the challenges where we can help. In our follow-up article, we will focus on the unforeseen risks your company might run if it waits too long to align with Topic 842 and show how we can enable you to avoid them.

[Are there any useful graphics we can include with the article?]