

ASC 842, IFRS 16, and GASB 87: The Dramatic Impact of the New Lease Accounting Standards



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As new lease accounting standards go into effect, an estimated \$3 trillion in additional debt will begin appearing on corporate and government balance sheets this year. That's how much the International Accounting Standard Board estimates that businesses and public entities currently hold in lease obligations.

For decades, anything that fell under the broad category of "operating leases" didn't have to be reported on balance sheets. That explains why so many multinational corporations with seemingly strong financials suddenly imploded during the 2007 financial crisis. Since the crisis, though, the accounting industry has been working to make financial statements more transparent, and the effects of those efforts beginning to be felt.

Referred to as ASC 842, IFRS 16 and GASB 87, these new standards are designed to create a more level playing field across public, private and international accounting standards for reporting lease obligations. For entities that use leases and their accountants, these standards add complex new layers to both gathering and reporting lease information.

Here's what you need to know.

ASC 842: New Lease Standards for GAAP

The Financial Accounting Standards Board (FASB) spent nearly a decade working on new standards that would pull most leases into the balance sheet, shedding new light on financial liabilities that had remained in the shadows for decades. Under these new guidelines, all companies that report under FASB ASC 842 must report right-of-use (ROU) assets and liabilities for almost all leases, with the exception of short-term leases of 12 months or less.

ASC 842 requires that all leases, including operating leases, be recognized as assets or liabilities on balance sheets using the present value of lease payments. And when measuring the value of the assets and liabilities, the lessee (and the lessor) should include "reasonably certain" lease extension periods and "reasonably certain" asset purchase options.

These changes cover not only big-ticket real estate leases, but leases for technology and office equipment, vehicles, construction equipment and other leased assets. So for companies that conduct a significant portion of their business using leases, these changes are already starting to have a major impact on their balance sheets.

Public entities had to begin operating under these new rules for reporting periods beginning on Jan. 1, 2019. Private businesses have until reporting periods beginning Jan. 1, 2021 to begin using these standards.

IFRS 16: The New International Lease Standard

Issued by the International Financial Reporting Standards Foundation, IFRS 16 was designed to align foreign accounting standards with GAAP accounting rules, but there are some significant differences between GAAP and IFRS lease accounting standards.

The biggest difference is that IFRS introduces a single lessee accounting model, treating all leases as finance leases. The sweeping scope of these changes include all contracts that convey the right to use a specific asset for some specified time period in exchange for a consideration. An exception to this is non-traditional lease agreements, such as licensing for films and media, leases of biological assets and even oil and gas leases.

Another key difference between the GAAP and IFRS standards centers on the question of variable lease payments. Lessees are required to measure these variable lease payments initially using the benchmark index or the rate on the starting date of the lease.

The recalculation of these payments, however, differs under the two bases of accounting. Under GAAP, a lessee remeasures the payments only when it is required to reassess the lease obligation for other purposes. IFRS, however, requires an entity to remeasure these payments every time an adjustment to the lease payments takes effect.

GASB 87: New Government Lease Standard

These standards, which were issued by the Governmental Accounting Standards Board (GASB) to align GASB standards with FASB rules, impact a wide range of government entities. Industries that are covered include state and local governments, state-owned hospitals and health care facilities, and public utilities, along with state-funded commercial enterprises and higher education institutions.

In its summary of the new standards, the GASB limits the scope of its rules to leases of nonfinancial assets, such as land, buildings, equipment and vehicles. Importantly, though, the rules exempt certain regulated leases, such as aviation leases between airports and airlines in which the cost recovery is controlled.

The new standards, which went into effect on Jan. 1, 2020, require lessees to recognize ROU assets and liabilities for each lease agreement. Lessors are required to recognize a deferred inflow of resources as well as lease receivables.

Exemptions Vary Considerably

On the surface, all three of these new standards seem to cover the same general ground, but there are some important differences, particularly when it comes to exceptions. For example, all three new standards exempt short-term leases (those with lease terms equal to or less than 12 months).

The IFRS standards maintain an exemption on low-value assets, such as telephones and computers, with a value of less than \$5,000. The U.S. GAAP standard doesn't specify a cost level, it but allows for assets that are considered "immaterial".

GASB 87 provides a long list of exemptions, including for leases in which the ownership of the leased asset is transferred. Also excluded are leases of certain types of intangible assets, such as patents and software licenses, and the rights to explore for or to exploit natural resources, such as oil, gas, and minerals, and similar nonregenerative resources. Leases of biological assets, including timber, living plants, and living animals, and leases of inventory are also exempt.

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The Impact of Implementation

To comply with the new accounting standards, companies and public entities will need to completely overhaul both the type of information they collect on every lease they hold and how that information is gathered and stored. According to PwC research, 39% of companies manage their lease agreements across multiple business units, creating challenges in organizing and standardizing lease data for reporting purposes.

PwC's research also found that two-thirds of companies still manage leases manually using spreadsheets, making access to data even more challenging. And because leases were not subjected to reporting in the past, most companies don't have established procedures for monitoring existing leases.

As a result, compliance will require new lease accounting procedures. For example, depending on the scope of their operations, companies may have lease agreements that fall under more than one of these new standards, which means that they may have to keep multiple sets of books to comply with different reporting requirements.

Compliance is More Than Numbers

Extracting data for compliance is more than a numbers game. In addition to the dates and payment amounts associated with your leases, there are more complex quantitative data points that will need to be captured from lease documents. Some will need to be calculated based on specific lease terms, such as breakdowns of lump-sum rent payments and rates tied to Consumer Price Index (CPI) increases.

Another complication is that some qualitative data points won't be found in the lease documents themselves. Instead, they might come from your real estate team or lease administration partners. You may also need help from outside resources to understand the legal and accounting implications of all lease conditions.

The right partner can help companies transitioning to a new lease accounting system by providing:

- A single, centralized system for data collection, providing easy tracking, audit and accounting capabilities.
- Compliant reporting under each accounting standard.
- A single system for financial entries that can capture all payment or income streams relevant for each lease and use the data to populate lease accounting calculations and journal entries.
- Streamlined calculations that can easily generate lease accounting calculations, including new lease transitions and reassessments of lease values.

The new lease accounting standards will give the public and investors better insight into the actual financial obligations that companies and governments owe. To accomplish that goal, though, the standards specify more than 40 different types of data that must be tracked to do the required calculations. The right lease accounting software can deliver the tools for inputting and reporting on all the financial aspects of leases to meet the new compliance requirements.

How the New Standards Stack

	ASC 842	IFRS 16	GASB 87
Effective Date	Deadline for Public Companies: Calendar Periods Beginning on January 1, 2019; Deadline for Private Companies: Calendar periods beginning on January 1, 2021	Calendar periods beginning on January 1, 2019	Calendar periods beginning on January 1, 2020
Entities/Industries Impacted	Industrial manufacturing, technology, media, telecommunications, real estate, retail, airlines, professional services, lodging	Global companies with international operations	State, local or municipal government; publicly funded hospitals/healthcare; housing authorities; publicly funded higher education; public utilities, Native American tribes
Types of Leases Impacted	Real estate, office space, equipment, vehicles	Real estate, office space, equipment, vehicles	Real estate, office space, equipment, vehicles
Financial information that needs to be collected	Weighted average discount rate; Weighted average remaining lease term; Cash paid for amounts included in lease liabilities; A more descriptive maturity analysis, which must be also be tied back to the balance sheet; Expenses for short-term leases.	Weighted average discount rate; Weighted average remaining lease term; Cash paid for amounts included in lease liabilities; A more descriptive maturity analysis, which must be also be tied back to the balance sheet; Expenses for short-term leases; Expenses for low-value leases.	Total amount of lease assets and related accumulated amortization; Total amount of lease assets by major classes of underlying asset; Cash outflows for variable payments not included in lease liabilities; Principal and interest requirements to maturity (presented separately); Components of impairment losses.



About Visual Lease

Visual Lease is a NJ-based software company that simplifies lease portfolio management – providing a robust and intuitive SaaS platform that takes the complexity out of managing a company's lease portfolio, from real estate to equipment and other assets. The Visual Lease platform streamlines the process of gathering, interpreting and reporting on lease data, to make lease administration and accounting more efficient, consistent and precise. The platform also adapts to customer needs and integrates with existing ERP solutions, financial systems and third-party applications, for maximum flexibility and ease of use.

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