

Lease Accounting Changes and the Challenges Ahead

Michael Muna | Lease Administration Services

Changes are ahead in the reporting of real estate leasing costs on financial statements, and corporations are scrambling to meet the upcoming deadline. During the process of conforming to the new standards, these companies are also discovering this is an opportunity to transform their business with improved systems and processes that can result in cost reductions and better efficiencies.



Issued by the Financial Accounting Standards Board (FASB), ASC 842 will require companies to put their lease obligations on the balance sheet as a liability and asset ("Lease Liability" and "Right of Use Asset"). Up to this point, almost all lease costs were limited to the income statement and might only appear on the balance sheet as a footnote. The new standard takes effect January 1, 2019 for public companies and January 1, 2020 for private companies.

Those companies that have started the implementation process are coming to the realization that the preparation required is more demanding than anticipated. A recent EY survey stated that only 27% of organizations believe they are on track and confident of meeting the deadlines. On the upside, 63% of organizations said they see this as an opportunity to deliver transformation.

Gathering and Abstracting

The initial and perhaps biggest challenge companies are facing is gathering and abstracting lease documents for the necessary information required for the new standards. While this process is a challenge and time consuming event in itself, a common misconception is that all the information necessary is easily accessible from the lease document.

In addition to evaluating the rent stream, several aspects of the lease need to be taken into consideration: including how the lease is structured, costs and allowances involved in the initial transactions and implication and interpretation of renewal options.

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This process is best performed by a lease administration partner that understands the lease structure and factors that go into the rental economics.

Team Effort Required

The proper capitalization of the lease for the financial statements will require the input of multiple parties, including the company's management team and auditors. Working with the lease administrator, the management team will provide information not available in the lease, such as the desired discount rate and costs that may have been incurred during the original lease negotiation.

Software Solutions

With the amount of information required to capitalize the leases for financials statements, the days of running Excel models are coming to an end for companies with several sites to manage. There are many software solutions being marketed to help manage leases and calculate the capitalized value for the financial statements and it is critical that companies pick the right platform that can deliver results in the end.

Your lease administrator can be a resource to help evaluate software solutions and can also provide access to such a system as part of its service.

Conclusion

With the required adoption of ASC 842 right around the corner, companies that are not well into the implementation process today will have some catching up to do. At Hughes Marino, our Lease Administration team is going through the process with clients and has systems in place to help companies get on track. The days of managing leases in Excel spreadsheets are coming to an end; companies with a dozen or more locations now need professional help to wrap their arms around what will be a significant addition to their balance sheet. Proactive companies are embracing this reality and finding a lease administration partner, and we would love the opportunity to become an extension of your own team and assist you with the challenges ahead. □

Michael Muna is an associate with Hughes Marino, an award-winning commercial real estate company specializing in tenant representation and lease administration for companies based throughout the United States. Contact Michael at michael.muna@hughesmarino.com or 1-844-NO-CONFLICT to learn more.

