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Agile Lease Accounting During Uncertain Times

An e-Book publication sponsored by VISUAL LEASE

About us

COMPLIANCE WEEK

Compliance Week, published by Wilmington plc, is a business intelligence and information service on corporate governance, risk, and compliance that features a daily e-mail newsletter, a bi-monthly print magazine, industry-leading events, and a variety of interactive features and forums.

Founded in 2002, Compliance Week has become the go-to resource for chief compliance officers and audit executives; Compliance Week now reaches more than 60,000 financial, legal, audit, risk, and compliance practitioners. www.complianceweek.com

VISUAL LEASE

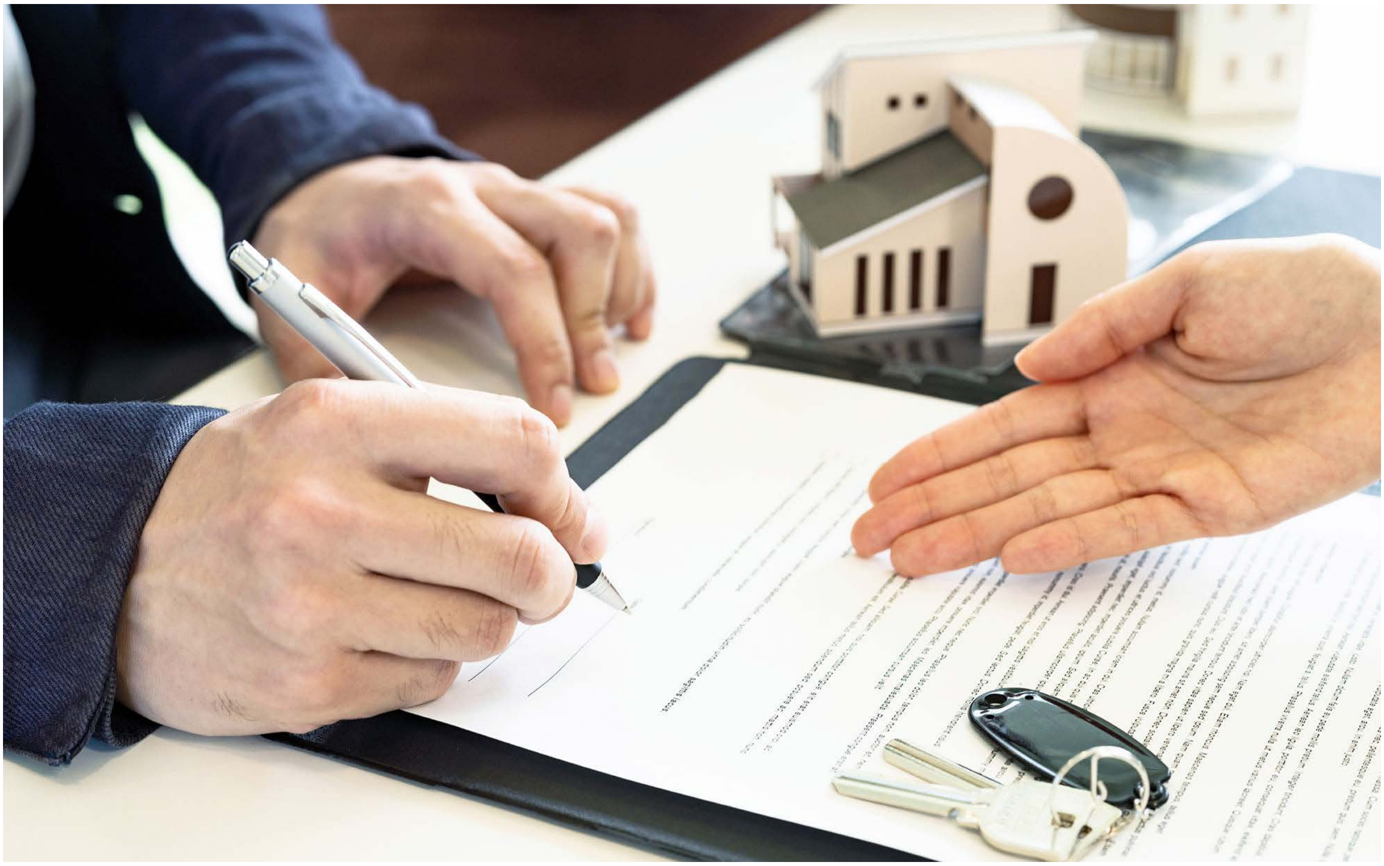
Visual Lease provides lease accounting and lease administration solutions to help companies manage, analyze and report on their leased assets, including real estate, equipment, vehicles and more. The company's SaaS platform enables users to achieve visibility, control and compliance across their lease portfolio.

Visual Lease embeds decades of industry-leading guidance into an easy-to-use, modern platform that combines GAAP, IFRS and GASB-compliant lease accounting controls with sophisticated and flexible lease portfolio administration. Providing an unparalleled customer experience, Visual Lease serves thousands of users across more than 700 publicly-traded and privately-owned organizations around the globe.

The platform adapts to customer needs and integrates with existing ERP and financial systems, as well as with hundreds of third-party applications, for added flexibility and ease of use. Rapid implementation, professional services and training support from the Visual Lease team ensure that the cloud-based solution is up and running quickly, for a rapid ROI.

Visual Lease is loved by customers and recommended by experts because of its deep domain expertise, powerful and innovative technology and unparalleled customer service. The firm is committed to providing progressive, effective and reliable solutions that help organizations improve transparency and maintain control over complex business transactions.

Inside this e-Book



Survey: How COVID-19 has impacted companies' leases

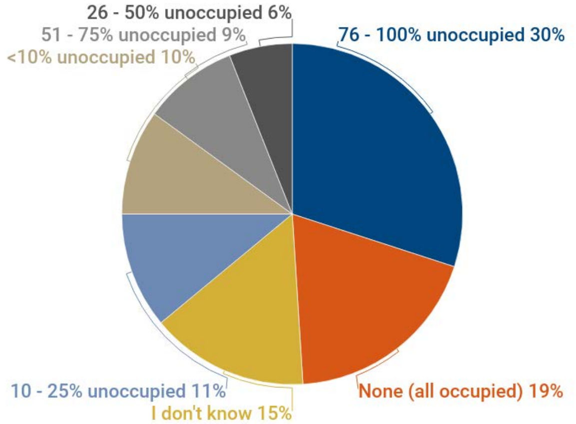
A new study from Compliance Week and Visual Lease reveals how companies are tackling leasing issues in the "new normal," **Maria L. Murphy** reports.

COVID-19 has already impacted the market for leased real estate and companies' plans for leasing. In fact, 30 percent of 109 respondents to a recent survey conducted by Compliance Week and Visual Lease indicated more than 75 percent of their leased real estate properties were unoccupied due to the coronavirus pandemic. In addition, more than 60 percent said they plan to change their approach to leasing business assets.

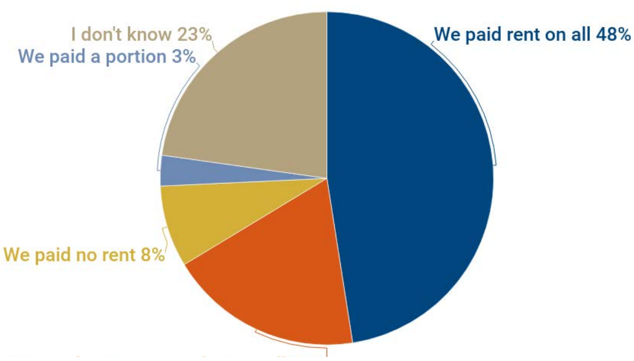
"We are all living with the impacts of COVID-19, and no one really knows when things will improve," Visual Lease Founder and CEO Marc Betesh said. "The market response is a lot of vacancies. Leases are in place, but space is not occupied. We are all hoping there will be some semblance of normalcy by this fall."

Forty percent of respondents indicated that more than half of their leased real estate is unoccupied, reflecting the reality

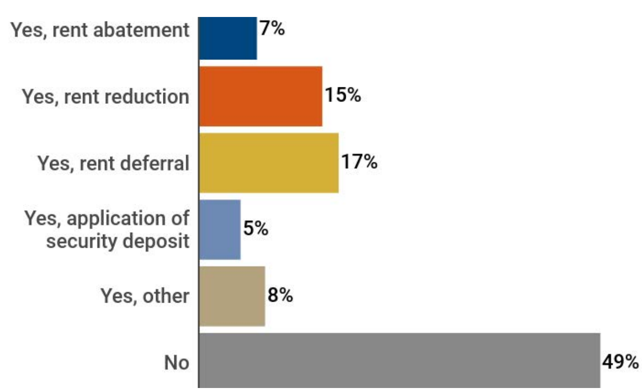
What percentage of your company's leased real estate properties are unoccupied due to COVID-9?



Has your company paid rent on your unoccupied properties?



Have you, or do you plan to ask for any concessions for your commercial leases from service providers or landlords due to the impact of COVID-19?



that more people are working from home. "I believe the market for office space overall will contract 8-10 percent, which is a huge number, mostly due to people working remotely," Betesh said. "But then it should stabilize in 6-9 months."

Betesh expects more of a decline in demand in bigger cities, with an increase in the suburbs as firms migrate to smaller locations closer to employees' homes to save money and reduce commuting. Retail will likely suffer more than office space.

Of respondents who indicated more than 50 percent of their leased real estate was unoccupied due to COVID-19, 63 percent said they continued to pay all of their rent. Betesh was a bit surprised the number was that low, since leases are a legal contractual obligation.

"I wouldn't expect landlords to approach tenants right now under these difficult circumstances, even though they are under tremendous pressure to pay mortgages and loans," he said. In fact, 17 percent of respondents indicated their landlords approached them to offer rent relief. "As a result of deferred rent arrangements, I actually expect the number of tenants paying their rent is actually higher than 63 percent," Betesh said.

Update on concessions

More than 50 percent of survey respondents said they asked for and received concessions in various forms.

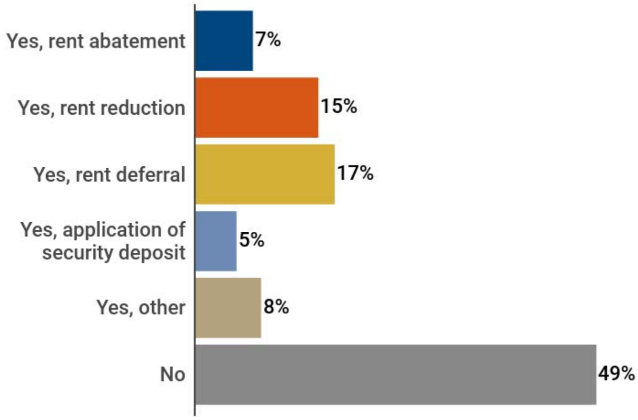
"A lot of tenants are straining economically, looking for cash flow and ways to reduce or defer expenses, and rent is one of the biggest expense items other than personnel for most companies," Betesh said. The majority of concessions requested by survey respondents were rent deferrals (18 percent) or reductions (16 percent). Only eight respondents indicated they received abatements, and most of those were for 120 days or less.

In response to the number of lease concessions as a result of COVID-19, the Financial Accounting Standards Board (FASB) issued a Q&A in April that provides relief and changes the existing requirement in the lease accounting standard relating to lease modifications. For concessions related to effects of COVID-19 that do not result in a substantial increase in the lessor's rights or the lessee's obligations, companies will not have to analyze each lease contract and can elect to apply or not apply lease modification guidance to those leases.

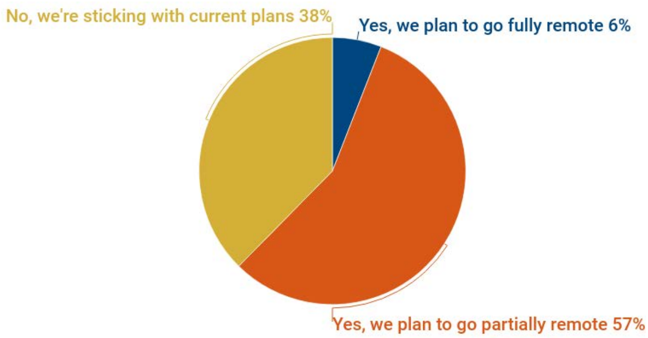
What's your approach?

Although 37 percent of respondents said they had no plans to change their approach to leasing assets, more than 60 percent indicated there would be some change: 31 percent plan to reduce facilities leases, 30 percent plan to reduce commercial office leases, and 23 percent plan to reduce equipment leases.

Given the current economic climate, is your organization planning to change its approach to leasing assets (Choose all that apply).



Has the shift to a remote workforce made you reconsider your leases/plans to get out of leases and go full or partially remote?



"These results indicate that companies wherein more employees can work remotely will be most impacted. This reflects trends we've already seen in the market, as many people are working efficiently remotely," Betesh explained. "Even if offices reopen, the need for physical space will be much less than before."

Betesh noted that when people do return to offices there may be a need for less total space as employees continue to work from home, but social distancing requires more area per employee and more collaboration and meeting space so the net impact on leased space is unknown. In addition, he said, there may also be a reduction in demand for city space with a high concentration of offices and with an increase in dispersed smaller suburban offices each holding fewer people.

Betesh said he does not expect adoption of the new lease accounting standard to change companies' behavior or drive lease transactions, which will be driven by business needs and cash flows. "They will lease space if they need space and buy buildings if they need to control the asset," he said.

Betesh believes there may be some changes in lease versus buy decisions for non-real estate assets as a result of having to present the full-term lease liability on the balance sheet.

Remote possibilities

While only 6 percent of respondents said they plan to go fully to working remotely post-pandemic, 57 percent intend to remain partially remote. Betesh believes this has significant implications for and puts a big strain on companies' IT and HR departments.

"Every aspect of work needs to be accommodated, and the right balance between collaborative and independent work needs to be found for each organization depending on the nature of the work," Betesh says. "It also changes where employees work, which gives companies the opportunity to hire from anywhere in the country or the world," he adds.

The shift to remote work opens up the talent pool for growing organizations—as well as potential opportunities for candidates.

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Marc Betesh, Chief Executive Officer, Visual Lease

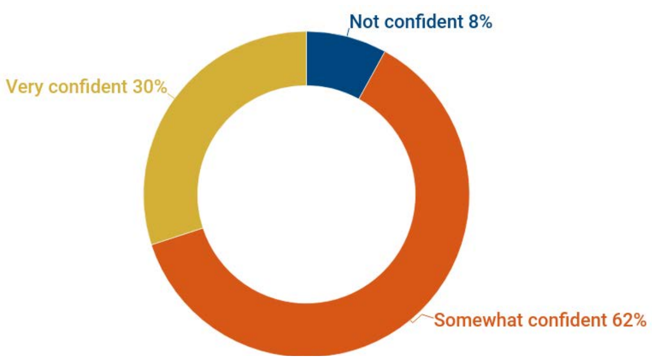
Facing tough decisions

Most survey respondents said they were confident in making COVID-19-related legal, operational, and financial decisions, with 61 percent indicating they were "somewhat confident" and 30 percent "very confident." However, Betesh warned, "People think they have enough information but will be surprised by the myriad of new issues they will face."

He recommends companies focus on their business operations and what makes them effective and not do things that undermine their position in the marketplace. "Most companies' results are suffering in some way, so they must identify cost savings and find new revenue opportunities," he said.

This includes optimizing their infrastructure and leases. "Companies need to look at their leases and the benefits they have negotiated and make sure they are paying what they are supposed to be paying," Betesh recommended. "Most leases have 20 financial terms other than the rent, but most people don't understand this and only look at the lease terms after the initial negotiation if they have a problem."

How confident are you that you have enough information to inform your COVID-19-related legal, operational, and financial operations?

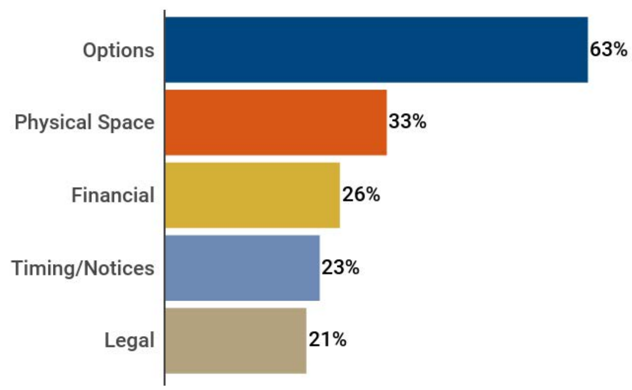


Exploring costs

About 63 percent of respondents indicated they were evaluating options in leases for potential cost savings. "Options are very important to negotiate in new leases," Betesh said. He also advises companies to carefully monitor dates for exercising options in existing leases, so they don't miss opportunities and then have to renegotiate them in the current market.

Betesh recommends companies consider both macro and micro issues. In his experience, there can be significant missed cost savings opportunities from the failure to take a macro approach, like consolidating space, and communicating throughout the organization. "What I always found important as an advisor was the need to get your arms around your lease portfolio to make decisions on a macro level," he said. "Leases are all different. What are the standard key things you need to know about all of your leases? What is meaningful to you?" At the micro level, he recommends looking at controlling lease costs for items other than rent, such as operating costs and taxes. "These can be more complex, but you must control them or they can cost as much as the rent."

What clauses in your leases are you evaluating for potential cost savings? Select all that apply.



FASB accounting standards update

In regard to the implementation of FASB's new lease accounting standard and ASU 2020-05, which deferred the effective date of Topic 842 for an additional year to 2022 for non-public companies and public companies that have not yet adopted it, Betesh said: "FASB provided more time due to COVID-19 because companies are focusing on their operations and staying in business right now, not lease accounting. Some companies think a reprieve is free time, but to avoid a big crunch later, lease accounting implementation should keep moving because of how long it takes to adopt."

He advises the new standard is causing a big shift in how CFOs think about lease management within their organizations. "Corporate real estate management over the past several decades has largely been a function of physical space and managing the facilities. There hadn't been a heavy focus by CFOs about the legal and accounting side of leases," he said. "Now that leases are reported on the balance sheet and have become an integral part of the financial statements, CFOs are getting involved. They are realizing leases are big dollar contracts that may not have been reviewed and approved before like other significant contracts, and now they are waking up to their huge exposures and shifting their focus and resources to better manage them." ■

VISUAL LEASE

The Necessary Steps to Improve Lease Management Practices

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Until recently, many companies were not paying much attention to their property and asset leases beyond paying the bills. Leases were simply considered a cost of doing business, and managing lease terms and obligations was not a priority.

With the establishment of new lease accounting standards that take effect for private companies in 2021, and took effect for public companies in 2019, that mindset is changing fast. Lease management has now become an essential practice that impacts financial reporting and the bottom line.

If your organization is working toward FASB/IFRS compliance, you'll need to establish lease management policies and procedures. Below, we dive into why now is the best time to do it and how to create a streamlined lease management process.

What exactly is lease management and why do you need it?

In a corporate or non-profit organization, lease management means tracking and optimizing every aspect of your portfolio of leased assets. Properly managing leases (not only real estate but also technology, vehicles, and even assets you control as part of service agreements) can help you significantly reduce the expenses associated with leasing. We're not talking about small change here, but a chance to add millions to your bottom line.

Lease management requires a coordinated effort between the various teams performing these tasks:

- **Lease negotiation and decision making**, including lease structure, lease length, and lease-vs-buy options
- **Lease administration** tasks, such as keeping track of upcoming renewals and exercising options, managing operating expenses, and updating lease data
- **Lease accounting** tasks, including payment of lease-related charges, recording journal entries, calculating asset and liability figures, generating reports, and performing remeasurement when leases change

Why has lease management become so important? Under the old lease accounting rules, leases were not included on balance sheets and had little impact on financial reporting. Under the new lease accounting standards, organizations must record both right-of-use assets and payment liabilities associated with leases on their balance sheets.

This is a big change: adding the value of the entire leased portfolio can make a huge impact on the outcome of financial reports. It also means the risks associated with poor lease decisions and lease management are magnified. That's why financial leaders must now carefully scrutinize and manage leasing decisions, administration practices, and expenses.

Before you make the move to the new lease accounting standards, here's how to get everyone on the same page and your lease management house in order.

How to establish a cross-functional lease management process

In the past, lease negotiation, administration, and accounting were done in silos with little to no coordination between the teams handling each task. That led to inconsistent lease decisions, scattered data, and often, overpayment of lease expenses due to lack of centralized records and audit capabilities.

Effective lease management requires cross-functional collaboration as well as centralized access to lease data and lease management tools.

STEP 1: Centralize lease data and management tools

For teams to work together on lease management, the first step is to gather all lease data in a central repository that creates a single source of truth as well as an audit trail for all lease decisions and changes.

Chances are, you're in the process of centralizing lease payment data for FASB/IFRS compliance right now. To set your teams up for effective lease management, choose a software platform (like Visual Lease) that allows you to centralize ALL data related to lease contracts and provides tools for automating lease administration tasks and auditing expenses.

When everyone managing leased assets is using the same system to update lease data, schedule payments, and create accounting journal entries, everyone is always working with the most current data. And you eliminate data integrity problems that can occur when data is moved between systems.

STEP 2: Develop leasing policies

With centralized lease management tools and technology in place, you can now analyze your lease data and find out which leases are working well and which are costing you more money than you realized. Use those insights to determine how you want to standardize leasing decisions across the organization.

Best practice is for financial leaders to work with lease negotiators, administrators, and accountants to understand current practices and to establish cost-effective policies for leasing.

STEP 3: Create lease requisition and update processes

To ensure your accounting team always has accurate lease information to feed balance sheets and financial reports, it's essential to establish standard practices for every group that's involved in acquiring and maintaining leases, including processing new leases, documenting lease changes, and handling lease terminations.

Here's what you might not know if you're still in the process of consolidating lease data for FASB ASC 842 implementation: every time leases change, your lease accounting must be updated. So, it's smart to minimize the burden on your accounting team by choosing software that automates lease modification and re-measurement.

STEP 4: Set up controls

Adding leases to the balance sheet has increased the complexity of financial reporting. That means more oversight is needed to ensure accounting accuracy. Also, internal

monitoring and process validation are required to ensure your policies and procedures are being followed and are driving better decisions and reduced expenses.

Your lease management software can aid that process in several important ways:

- Documenting the terms of every lease, calculating every payment, and alerting you if payments don't match the lease terms
- Providing audit tools to find overpayments, late fees, and payments that shouldn't have been made at all
- Allowing you to customize approvals required for lease administration and lease accounting tasks
- Providing an audit trail for all lease changes

Tackle lease management along with the lease accounting changes

FASB recently voted to extend the deadline for private companies to implement the new standards to December 15, 2021, and chances are you are breathing a sigh of relief. However, don't make the mistake of underestimating the effort and putting off the problem. Instead, take this opportunity to examine and overhaul your lease management policies and practices while you're working toward lease accounting compliance.

VISUAL LEASE

Gain control of your leases, simply.

Complex lease portfolios should be managed with ease. Visual Lease's industry-leading lease accounting and administration software gives you the tools to easily track your lease changes, while automating ASC 842, IFRS 16 and GASB 87 compliance reports.