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# Turn new standards for lease accounting into an opportunity for efficiency

*A C-Suite guide to the impact of the new lease accounting standard*

## Highlights

- A new lease accounting standard will add billions in assets and liabilities to balance sheets and create significant accounting complexity
- Smarter companies will move beyond compliance alone with impending FASB and IASB lease accounting standards
- IBM delivers solutions to accelerate preparedness with the new standard, simplify complexity and increase return on assets

The impending change in global accounting standards requires capitalization of all operating leases—including real estate, equipment and IT infrastructure—on the corporate balance sheet. This will transform what traditionally has been an everyday administrative function to a front-and-center concern that will affect entire companies in the US, Europe and many other countries.

For the Chief Financial Officer or Chief Accounting Officer who must provide accurate statements about the company's financial performance, the real estate executive who must minimize any detrimental impact of real estate on the company's financial performance and the Chief Information Officer who must ensure the availability and integrity of lease, asset and financial data, the issues only begin with the core questions of whether to buy or lease and how to report the financial outcomes of those decisions.

The addition of operating leases to the balance sheet will add billions in new assets and liabilities to the holdings of mid- to large-sized companies, while it creates a significant increase in complexity across the board. But smarter organizations will move beyond compliance alone. Executives across the C-Suite can use the coming requirements and deadlines as springboards to transform the way they manage all their assets—owned and leased—to achieve increased asset efficiencies, more effective utilization and greater financial return than ever before.

And the time to begin is now. While the effective date for the new standard may be several years away, there is a lot to be done—including deploying new IT capabilities. There is also a lot to be gained—including protection of the company's return on assets ratio through increased utilization of leased assets before their recalculation generates a detrimental impact on the balance sheet.

## Be forewarned and forearmed: Implications of the new standard

Expected to come into play in 2015 or 2016, a new joint lease accounting standard from the United States-based Financial Accounting Standards Board (FASB) and the European-based International Accounting Standards Board (IASB) is intended to increase transparency for investors and credit agencies into a company's assets and liabilities. But for the company itself, the standard will significantly increase the complexity of its acquisition, management and reporting functions for business assets.

Yet in a recent IBM survey, 92 percent of respondents said they are not prepared to capture, organize and report the balance sheet impact of the new standard on their company, or to implement processes to manage or reduce its impact in an ongoing manner. More than 50 percent said they would need between six months and two years to prepare.[1]

It is unlikely that this lack of preparedness originates in a lack of awareness of the standard's importance. While some 60 percent of surveyed executives expected no impact on market capitalization or credit ratings, more than half expected that return on assets and debt-to-equity ratio would decline, at least temporarily. Between 70 and 80 percent expected to make moderate or substantial changes in accounting and compliance processes. And some 60 percent expected changes to their IT systems.[1] Rather, in many cases the slowness to act comes from the perception that the matter is limited to accounting operations, reporting and compliance and is not an urgent, enterprise-wide issue.

The greatest challenge, in fact, comes in the application of the new standard to the asset class with the greatest value contribution to the balance sheet—real estate. Nearly half of executives surveyed expected the addition of real estate operating leases to increase their balance sheet by more than 10 percent.[1] The financial requirements to monitor and report lease expenses, facilities requirements to manage assets for the greatest efficiency, and IT requirements to gather, analyze and report data to support optimum decision making all will combine to create unprecedented complexity for finance, real estate and asset management functions. And each will demand a combined effort from C-Suite executives to resolve issues and realize benefits.

> *"One of the more complicating components of this pronouncement is that it impacts a number of non-accounting functions."*
>
> —Global enterprise Chief Accounting Officer

## Prepare for a financial, facilities and data challenge

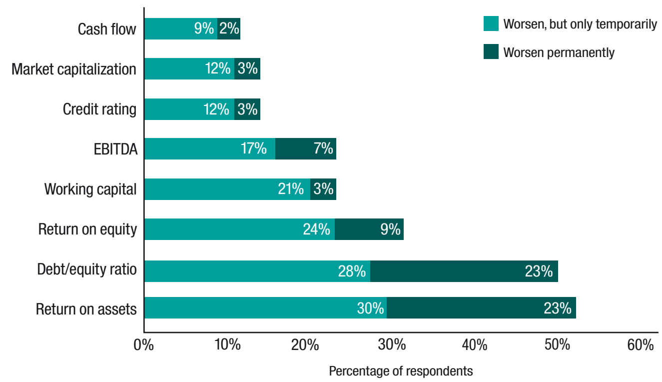
The complexity of lease accounting compliance and of increasing the efficiency of leased assets makes it virtually impossible to manage them in spreadsheets and home-grown systems. Using paper-based leases and spreadsheets to track lease data such as costs, critical dates and location- and asset-related information may work across small numbers of leases, but when the large enterprise is faced with thousands of real property and equipment leases and strict audit requirements, scalability, security and auditability become a must. For while companies have to prepare for increased analysis and complexity in their leasing and purchasing decisions, fewer than half plan to add necessary staff.[1] What begins as an accounting, real estate and asset management challenge rapidly becomes a big data challenge that cannot be met without an effective software solution.

> *"Anyone who is foolish enough to think they can do this on a spreadsheet is only a few quarters away from having a big problem. So, developing transactional systems and contract management systems, and leveraging lease accounting software to do so on a global basis, is first and foremost the most important challenge."*
>
> —Global enterprise C-Suite executive

This is particularly important for the company working to increase its asset efficiency. Executives and their staffs responsible for leases must review financial and operational assumptions on a regular basis. And companies that rely heavily on real estate and other valuable assets will need to spend significant effort to understand the strategic, operational and financial implications of moving their leases onto the balance sheet. The new standard will highlight the difference in capital allocation strategies as never before, creating an opportunity for companies to gain increased investor confidence and competitive advantage through increased asset efficiency—especially in real estate and asset-intensive industries such as retail, financial services, telecommunications, healthcare and transportation.

Preparing for compliance with the new lease accounting standard and capitalizing on the opportunity to gain competitive advantage require software that can increase return on assets. Considering the scope and volume of real estate assets, this focus in turn can generate financial results beyond those from improving other business operations, including personal productivity.

**Expected impact on financial metrics[1]**




## Begin now to meet the new standard

Compliance will require significant time and resources to prepare—so, now is the time to start. To comply with the new accounting standard, companies must consider three key issues:

- **The new standard creates the need for a single consolidated system** that can streamline lease accounting within operational and financial functions. The system must be able to reach across all classes of leased assets, including real property, fleet, equipment and IT infrastructure.
- **Compliance will require new lease accounting fields and processes** that will increase complexity with major new requirements for the management and tracking of financial assumptions related to "significant economic incentives" for renewal or termination of leases.
- **Moving beyond compliance provides an opportunity to eliminate under-utilized assets** from the balance sheet before they impede financial ratios, run afoul of regulatory issues, constrain access to capital or violate debt covenants. Through the divestiture or consolidation of inefficient assets, companies can build efficacy and a competitive advantage, but the step requires cross-functional collaboration, accurate analysis and strategic real estate and asset planning.

### Steps for moving ahead

Though final standards are not yet determined, companies can take steps now to prepare for the necessary management changes:

- **Inventory and understand the company's leases.** How many leases the company has, what kind of leases they are—real property or equipment—their materiality to financial reporting, who is responsible, what terms are affected and other issues all are important. Take a broad look at the impact on the company.
- **Estimate the scope of changes required.** Running pro formas or even keeping parallel books during the interim may be the most prudent course for determining the impacts of change and preparing accordingly.
- **Examine leasing strategies.** Take into account the nature and size of the accounting changes. Understanding the impacts on leasing and financing strategies early can help prevent surprises later.

By starting now to understand and manage change and its effect on processes, people and systems, companies can help reduce the cost and time of compliance—and prepare to take advantage of the benefits created by increased standardization and comparability in leasing strategies.

## Understand the needs of each C-Suite role

Responsibility in the C-Suite for meeting the new lease accounting standard resides jointly with financial and business leaders. Increasingly, real estate executives and asset managers play a role, as do chief information officers. None operates alone, however. In meeting the new standard and using it to create a business advantage, each C-Suite executive and team will require new software solutions integrated across the enterprise.

> *"What you need to centralize is the tool and the internal control functions that enable you to be confident that those judgments are being made accurately and updated in the field."*
>
> —Global enterprise C-Suite executive

Companies will require automated business processes to reduce the time to load necessary lease information, alert to necessary actions, simplify management of complex financial assumptions, and streamline delivery of auditable financial reports. They will need an enterprise-class system that scales beyond the tracking of information for thousands of leases to track hundreds of thousands of data points related to financial and operational assumptions, decisions and data changes.

Preparedness for the new lease accounting standard, in fact, requires new software and a focus on increased return on assets. Finance accounting systems and associated asset management and real estate management systems represent the most immediate needs for meeting the new lease accounting standard.

- **Chief financial and accounting officers:** Two thirds say they will need to make some level of change in financial transaction processing systems. Beyond transactional systems, finance executives also expect to implement changes in planning, budgeting, and forecasting systems, tax planning and compliance systems, and business intelligence or performance reporting systems.[1]

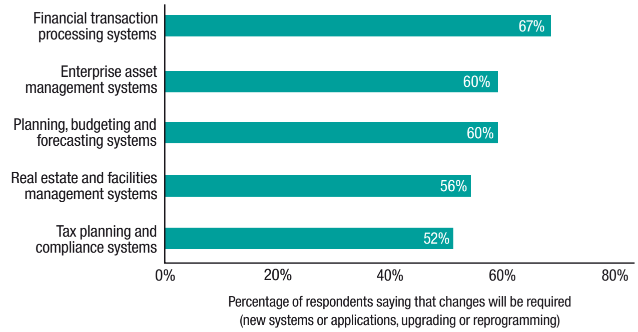
- **Real estate executives and asset managers:** To achieve necessary lease accounting control and compliance with the new standard, more than half of companies identify the need for new or upgraded real estate management systems and asset management systems.[1]
- **Chief information officers:** The new standard creates a significant increase in the volume of information, complexity of processes and need for collaboration between finance and asset management functions. A centralized infrastructure with a global lease accounting system fills a fundamental and critical need for establishing a consistent way to capture the underlying information about contracts globally, including leases and their attendant details.

## Select a comprehensive, proven solution

IBM TRIRIGA® delivers an enterprise-class suite of business applications including lease accounting, real estate management and asset management on a single technology platform and data repository. Designed to help global organizations increase return on real estate assets, reduce operational costs of facilities, and mitigate environmental and financial regulatory risks, IBM TRIRIGA automates time-consuming activities to increase the efficiency and effectiveness of finance, real estate and asset management professionals and executives.

In use at more than one-third of Fortune 100 companies, IBM TRIRIGA was the first software to deliver lease abstraction capabilities compliant and certified with the Open Standards Consortium for Real Estate (OSCRE) Lease Abstract data standard to streamline the exchange of lease details between companies and their service providers.

**Expected changes to information systems and applications[1]**




<50% = Business intelligence or performance reporting systems

IBM TRIRIGA accelerates preparedness with the new FASB and IASB lease accounting standard with pre-built spreadsheets and OSCRE-compliant templates for faster loading of lease information. It provides necessary financial reporting to achieve auditable lease accounting with simple-to-use, pre-built reports and financial assumptions management capabilities. It helps identify and optimize leased real estate assets with advanced strategic facility planning capabilities.

## For more information

To learn more about IBM lease accounting, real estate and asset management solutions, please contact your IBM marketing representative or IBM Business Partner, or visit the following website: **ibm.com**/software/tivoli/lease-accounting

IBM Corporation
Software Group
Route 100
Somers, NY 10589

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[1] CFO Research Services and IBM, Beyond the Balance Sheet: Assessing the Impact of the New Lease Accounting Standard, CFO Publishing, Boston, MA, January 2012, **ibm.com**/tivoli/beyond



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