

# The Private Angle

Starting the journey to implement the new leases standard

Updated January 2022

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## What you need to know

- Based on the experience of public companies, implementation often required more time and resources than many entities anticipated. Given that and an effective date for calendar year-end private companies of 1 January 2022, if you haven't started yet, you need to start planning soon.
- To get started, you need to understand the requirements of the new standard, establish a project team and prepare a project plan.
- You will need to identify a complete population of leases, which is often one of the most challenging aspects of implementing the standard.
- You will need to change your accounting policies and consider whether to make a number of policy elections, including whether to use several transition practical expedients.
- Because the new standard requires companies to gather more data to account for and disclose information about their leases, you may need to implement an IT solution to track this information.

## Overview

Implementing the new leases standard, which is effective for calendar year-end private companies in 2022,<sup>1</sup> will be a significant accounting challenge for private companies.

One of the biggest changes is that Accounting Standards Codification (ASC) 842, Leases, requires lessees to record most operating leases on the balance sheet. While lessees with significant operating leases will be most affected, all lessees and lessors will have to make changes to their accounting policies and processes, and possibly to their information technology (IT) systems.

Implementing the standard may require the same extent of planning as the implementation of ASC 606, Revenue from Contracts with Customers. That is, private companies need to focus on understanding the new requirements and the effects on their financial statements and related disclosures, operations, and communications with various stakeholders.

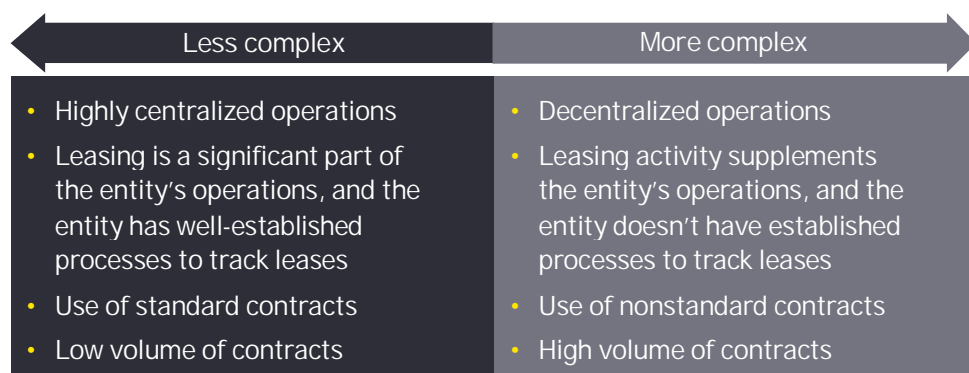
Based on our experience with companies that have adopted the new leases standard, implementing it often requires more effort than management initially anticipated. Many companies have experienced difficulty determining whether their lease population is complete, collecting the data they need to account for and disclose information about their leases under the new standard, and developing IT solutions to track the information and perform key calculations. Thus, it is important that you start planning now.

This is the first in a series of two publications to help private companies plan for a smooth transition to the new leases standard. The second in the series available now is [The Private Angle: navigating the accounting requirements of the new leases standard](#).

## What should you do now?

### Draft your project plan

Implementing the new standard will likely require more effort and more resources than you may think. Some areas that could make implementing the standard more or less complex include the following:



The first steps are understanding the requirements of the new leases standard, establishing a project team and preparing a project plan. An important consideration is assessing whether the company has sufficient and competent resources to effectively implement the standard or whether it will need to engage an advisor. It is also important to engage with internal stakeholders (e.g., IT, legal, lease procurement, business operations, tax) early in the process.



Identifying a complete population of leases is often one of the most challenging aspects of implementing the standard.

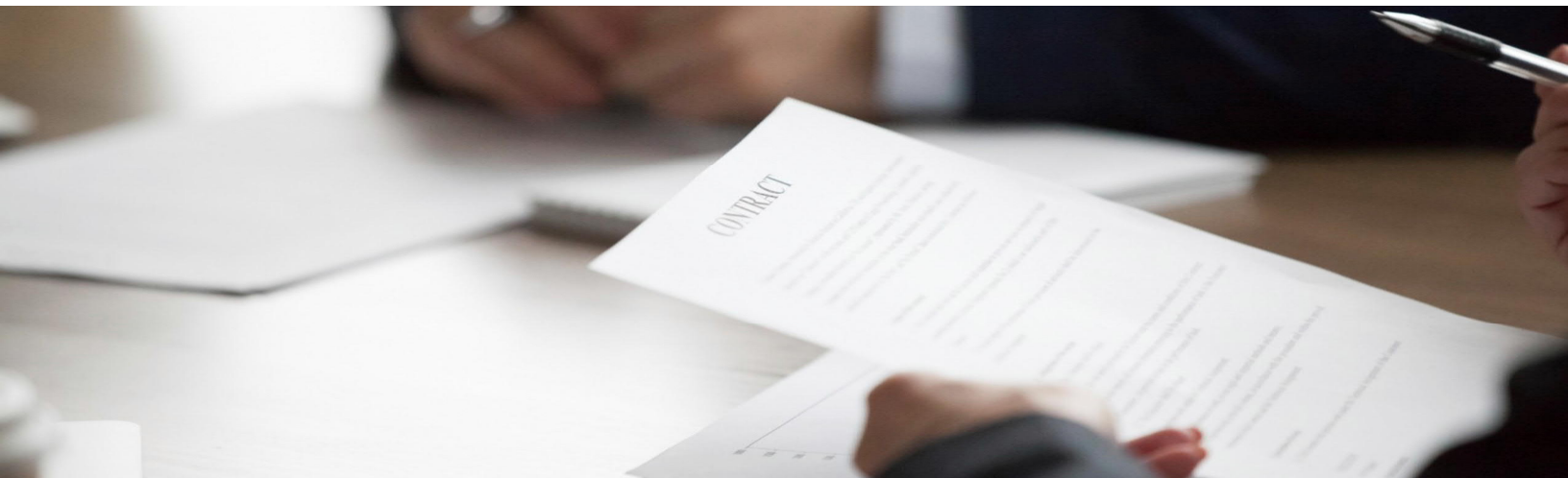
The table below lists activities you should consider as you develop your project plan for the key phases of the implementation.

Diagnostic phase	Design and plan for implementation phase	Implementation phase
<ul style="list-style-type: none"> <li>• Understand your current leasing activities and processes, and determine what needs to change</li> <li>• Identify resources to implement the standard</li> <li>• Understand your leases and identify a complete population of leases (including leases embedded in service or other contractual arrangements)</li> <li>• Perform a preliminary accounting and disclosure gap analysis</li> </ul>	<ul style="list-style-type: none"> <li>• Design changes to your lease processes for both the transition accounting and accounting for new and modified leases after adoption</li> <li>• Consider which practical expedients and policy elections to apply</li> <li>• Determine how you will track the information you need to account for leases (e.g., modify or add an IT system, use Excel spreadsheets)</li> <li>• Determine the data needed to comply with the new disclosure requirements</li> </ul>	<ul style="list-style-type: none"> <li>• Finalize changes to your lease processes</li> <li>• Implement your plan for any changes to IT systems</li> <li>• Finalize your policies for transition accounting and accounting for new and modified leases after adoption</li> <li>• Compute the transition adjustments</li> </ul>

### Understand your leases and identify a complete population of leases

Identifying a complete population of leases is often one of the most challenging aspects of implementing the standard. To start, you need to confirm your understanding of your current leasing activities and processes, and consider whether you have operating leases embedded in service contracts or other arrangements. This may be more complicated than you think. That is, you may not have robust processes in place to distinguish between leases and service contracts because, under the legacy guidance in ASC 840, Leases, the treatment of these arrangements is similar.

In addition, it may be challenging for a company that has a high volume of contracts and decentralized operations to make sure it has identified a complete population of leases.





## Develop new accounting policies

The new leases standard's transition provisions are unique and complex. You can choose to apply the transition provisions at the beginning of the earliest comparative period presented in your financial statements or you can apply them at the date of adoption (i.e., the effective date). The latter option effectively allows you to continue to apply the guidance in ASC 840, including its disclosure requirements, in the comparative periods and may make the transition accounting easier to apply because you would not need to recast numbers for periods before adoption.

Regardless of when you apply the transition provisions, you'll likely apply concepts from both ASC 840 and ASC 842 to leases that existed before the effective date. As a result, you'll need to develop two sets of policies – one to calculate your transition adjustments and to continue to account for leases that commenced before the effective date, and another to account for new or modified leases on or after the effective date.

To reduce the amount of time you will spend re-evaluating your leases, you can elect a package of transition practical expedients. Among other things, this package of practical expedients allows you not to reassess whether contracts that commenced before the effective date are leases or how those leases are classified. We expect most companies to apply this package of expedients.

## Endnote:

<sup>1</sup> In June 2020, the FASB deferred the effective date of the new leases standard for private companies (i.e., entities other than public business entities; not-for-profit entities that have issued, or are conduit bond obligors for, securities that are traded, listed or quoted on an exchange or an over-the-counter market; and employee benefit plans that file or furnish financial statements with or to the SEC to fiscal years) to annual periods beginning after 15 December 2021 and interim periods within annual periods beginning after 15 December 2022. The FASB also deferred the effective date of the new leases standard for not-for-profit entities that have issued, or are conduit bond obligors for, securities traded, listed or quoted on an exchange or over-the-counter market that have not issued (or made available for issuance) financial statements that reflect the new standard as of 3 June 2020 to annual periods beginning after 15 December 2019 and interim periods within those annual periods. Early adoption, including adoption in an interim period, is still permitted.

You can also make several other policy elections in transition that can simplify the application of the new leases standard. For example, private companies that are lessees are permitted to make an accounting policy election, by class of underlying asset, to use a risk-free rate for the initial and subsequent measurement of lease liabilities and right-of-use assets.

While using a risk-free rate might reduce complexity, you should keep in mind that using a risk-free rate would increase the initial measurement of the lease liability and right-of-use asset and thus increase the likelihood of a lease being classified as a finance lease. In addition, if you're considering going public, you may not want to make this election because you would have to retrospectively apply the public entity accounting and reporting requirements to all prior periods presented when you become a public company, and this would mean going back and estimating the discount rate.

Lessors and lessees can also simplify their accounting by making an accounting policy election to not separate their lease and associated non-lease components. Lessors must meet certain criteria to apply this election.

### Determine the effect on IT systems

Today, many companies use Excel spreadsheets for their lease administration and accounting. Because ASC 842 will require companies to gather more data to account for and disclose information about their leases, companies may need to consider implementing an IT

solution. Based on our experience with companies that have adopted the new leases standard, it often took longer than anticipated for their IT solutions to become fully functional.

Companies that decide to implement a new IT system need to design an approach that is right for them. Some of the key decisions include determining:

- Whether the system should be centralized or decentralized
- Whether the system should be developed in-house or outsourced to a third party
- Whether the system can be integrated with the company's current enterprise resource planning system
- Whether the software is scalable to meet the company's needs over time

These decisions can affect the cost of implementation and how soon you need to get started. Understanding your leasing activities will allow you to make the best decisions for your company.

If you determine that your leasing activities are very simple and can be accounted for using spreadsheets, you should consider the risks of using spreadsheets. They include data input errors, accidental changes, unintentional deletions and the potential that incorrect formulas may be used.

## EY resources

Additional resources are available on our AccountingLink website at [ey.com/en\\_us/assurance/accountinglink](https://ey.com/en_us/assurance/accountinglink).

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