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THE HIDDEN COSTS OF THE LEASE- ACCOUNTING PROPOSAL

Is Your Business Prepared?

WHILE MANY IMPACTS OF THE LEASE-ACCOUNTING RULE CHANGES proposed by the Financial Accounting Standards Board (FASB) and International Accounting Standards Board (IASB) are still unknown, what is clear is that the changes are likely to result in significant costs to lessors. Many of these costs are obvious. Others are less so. This article identifies some of the easily identifiable out-of-pocket costs and, more important, the many hidden costs of complying with the changes.

AN ENTITY-WIDE CONCERTED EFFORT

The accounting rule changes will, in some way, affect almost every department in an equipment leasing and finance organization. For example, the board of directors will need to be briefed about the changes, the cost of compliance, the impact to the customers and the ongoing change in expected profitability. The newest employee will need to be educated as part of his or her introduction to the equipment leasing and finance industry. In short, everyone in your business will need to be aware of the impacts of the changes and how their jobs will be affected.

Bringing focus to the pervasive impacts of the accounting changes will be a project for every lessor, similar to projects convened to address other significant systemic changes, such as a new software system, an acquisition or a re-organization. The easiest way to begin the project is to follow your established protocol for major changes. For most lessors that will mean appointing a project leader who can function as the single point of reference. The project leader may be the controller, deputy controller or a senior player on the accounting team, depending upon the size of the organization. Larger lessors may look to the accounting policy staff, the internal audit staff or a central project management function, as examples.

Once a project leader is named, he or she will need to determine the approach required for every department of your organization. In fact, this project, with such a pervasive impact, will likely spawn project offspring with their own project leads. For larger lessors, the scope of activity could include multiple domestic divisions as well as many global subsidiaries, with sub-projects and leaders. For smaller lessors, the approach may be limited to the controller interacting with a few other departments. While approaches may differ, it is critical that once the final rules are issued, project teams are quickly mobilized to ensure successful implementation.

DIRECT AND INDIRECT IMPACTS

While much of the discussion about the proposed accounting rule changes over the past several years has revolved around debits and credits, footnotes, disclosures, conformance, restatements, software upgrades and tangible costs that lessors must incur, there are many equally burdensome costs that may not have received sufficient attention—yet. By identifying these hidden costs early, you will be prepared.

Table 1 depicts some of the costs that a lessor may face—those that are easily identifiable and others that are more obscure. Depending upon the size of the lessor, all or only a few will be applicable. However, early consideration of these costs will place your organization in a better position to adequately plan for this project.

EASILY IDENTIFIABLE POTENTIAL COSTS

Software Upgrades

We know that the new rules will call for software upgrades. In general, systems that employ a more configurable and flexible design should be able to support required changes in the least disruptive and most cost-effective manner. You should consult with your software provider to understand what, if any, expense your company will be responsible to incur, and what is the responsibility of your software provider. Will you need implementation assistance from your vendor? You should also understand what version the upgrade modification is being applied to and whether that is compatible with your version in use. If you are operating on an older version, your upgrade path may be more complicated. You should also make an assessment of your software provider's ability and commitment to deliver the required modifications in the time frame you deem necessary.

Table 1. Pervasive Cost Impact

Easily Identifiable Costs Hidden Costs Attributes of Both

	Acctg/Tax	Operations	Sales	Technology	Legal	Funding
Software Upgrade	Easily Identifiable	Easily Identifiable	Easily Identifiable	Easily Identifiable		
IT Modifications	Hidden	Easily Identifiable	Hidden	Attributes of Both	Hidden	Hidden
Professional Fees	Easily Identifiable	Attributes of Both		Easily Identifiable	Hidden	Hidden
Temp. Help	Easily Identifiable	Hidden		Easily Identifiable	Hidden	
Technical Accounting Education	Easily Identifiable	Hidden	Hidden			Hidden
Processes	Easily Identifiable	Easily Identifiable	Hidden		Hidden	Hidden
Controls	Hidden	Hidden		Hidden	Hidden	Hidden
Reporting	Attributes of Both	Hidden	Hidden		Hidden	Hidden
Staff Training	Attributes of Both	Attributes of Both	Easily Identifiable	Hidden	Hidden	Hidden
Customer Education			Easily Identifiable			
Financial Products	Hidden	Hidden	Easily Identifiable	Hidden	Hidden	Hidden

The less obvious activities and potential costs include ancillary reporting systems and databases as well as the general ledger and credit reporting systems.

Professional Fees and Temporary Help

Projects of this nature and size will most likely require outside services. Be prepared to engage various consultants for a variety of specialized skills, such as lease accounting, process documentation, system development, etc., as well as to hire temporary help to research lease documentation and perform restatement analyses.

POTENTIAL HIDDEN COSTS

The opportunity costs of staff reassignment, which could extend for the next three or more years, are more significant than the potential cash expenditures discussed above. Staff resources will have to be diverted from their normal activities to the accounting rule project. Some companies may want to secure temporary staff to assist or replace their experienced staff that would then focus on the project, while staffs in other companies will simply focus less on normal activities. Given that some of these normal activities are revenue producing, the opportunity costs could be very large.

Technical Accounting Education

Following the identification of the project departmental team leads, educating these project members on the new accounting rules and implications to their business is a crucial early step. Departmental-specific educational materials may be necessary to convey the meaningful impacts to the specific departments. The key takeaway for most employees who will be affected is determining how the change will impact what they do today. Thorough understanding of the proposed rules and their application (as well as how the rules are applied today) is essential in identifying the compliance requirements across the enterprise that will need to be addressed. Certain team members may need to collaborate with their internal accounting standards groups, internal and external auditors, regulators and software providers to ensure agreement with how the new rules are applied, and how that drives the revisions to software systems.

IT Modifications and System Changes

Many of the larger software providers have multiple customers whose compliance requirements will likely match. For those requirements that do not match, specific company advocacy may be required to ensure the software developer delivers upgraded software that fits your company's interpretation of the new rules.

ELFA Equipping You for Success

Leading up to and during the release of the new lease-accounting rules (expected in 2014), ELFA will provide educational training and resources to help equipment finance companies prepare for the transition. The new rules are expected to take effect in 2017 or later.

Once you have verified that your software revisions meet the new accounting rule's requirements, you must ensure that the modified version effectively interfaces with your other previously integrated software. It will also require testing and validation prior to rollout, which usually can only happen during certain times of the year.

Processing and Operational Changes

Second to accounting and reporting, perhaps the most affected function is operations. As software will be modified to fit the new standard, so will the processes that book, monitor and dispose of transactions. Expect rewrites of process flowcharts, internal controls and policies and procedures.

Controls

As processes change, key controls will need to change as well. Internal audit staff will need to be trained and will likely need to alter their testing procedures.

Staff Training

The most effective training involves the development of custom-tailored training materials. The development of these materials will help flush out bottlenecks and process misses that would otherwise create operational inefficiencies, mistakes or errors.

Reporting

Reporting issues are often left to the last task in system upgrades and can consume resources for an indefinite period of time. Both internal and external reporting will need to be addressed.

Customer Education

Customers are interested in knowing what is happening with the new accounting rules, but generally have been staying on the sidelines to date. Soon there will be a rush for information, and your sales teams should be ready. Just as with lessors, the impact of the new accounting rules for lessees will be more far-reaching than many of your customers realize. Customers will look to lessors to help them understand the changes and

impacts for both new and existing leases. Increased transparency and countering the administrative burden lessees face will top the list of issues the sales teams will need to deal with.

Modifying Financial Products

Understanding the proposal's impact on the customer, and revisiting your suite of financial products as a result, is likely to be a crucial component of your organization's "go to market" strategy. Writing new lease documentation, producing marketing tools and creating new products and modifying existing ones will not only consume staff time, but also may be costly should you need to hire legal counsel.

IS IT TIME TO INNOVATE?

At innovative companies, innovation happens incrementally every day. Sometimes innovative ideas occur to people randomly; sometimes there is a catalyst. As all of the downstream effects of the accounting rule changes are considered, it may be that one or more of them will be an ideal catalyst to make a change that has been under consideration or to fix a problem that has now become more problematic.

Now may be an excellent time to review the efficiency and effectiveness of all of your processes and systems. Perhaps there are some operational processes, software systems or financial products that could now be more easily changed given the breadth of work that the accounting project will require.

We hope that this article will be a useful guide for you in preparing your budgets and operating plans for 2014 and beyond. The impact of the proposed changes—should they ultimately be adopted—will be far-reaching. It will be necessary to consider all costs in formulating your go-forward financial plans and business strategy. ■



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