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## Readiness is the Best Game Plan



**BUSINESS**

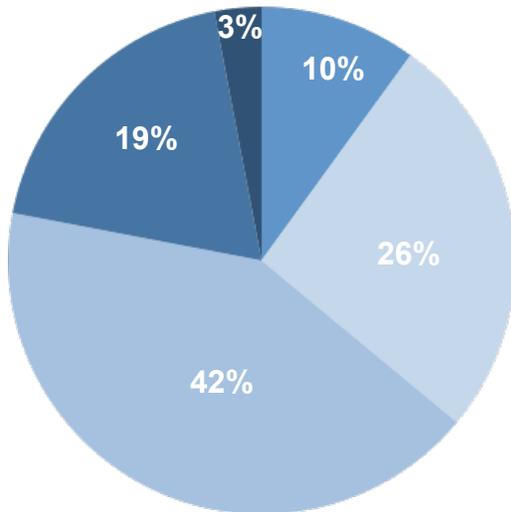
**DATA**

### ***Get your lease management house in order to prepare for the anticipated FASB lease accounting changes***

by Tanya Nebo, Esquire, Lead Senior Analyst and John Seckman, Product Manager

If you are feeling ill prepared for the coming Financial Accounting Standards Board (FASB) lease accounting changes, you are not alone. In a recent “Trends in Real Estate Information Management” survey conducted by Virtual Premise, two-thirds of respondents admitted to being unprepared for the pending FASB changes. While a great deal of uncertainty remains around the ultimate outcome of the new standards, one thing is certain — FASB changes are coming, ready or not.

And that means making sure your lease management house is in order before the changes hit. Although details about how it will all work remain cloudy, the relevant question at this point is: how do you get ready for the inevitable? Virtual Premise recommends focus in two primary areas: first, get your business ready and second, get your lease data ready. This focus will help ensure that your response to the coming FASB lease accounting changes will be proactive, rather than reactive.



## My Organization is Prepared for Upcoming FASB Changes

According to the Virtual Premise “Trends in Real Estate Information Management” survey, 2/3 of respondents admit to being unprepared for FASB changes.

- Strongly agree – 10 %
- Agree – 26%
- Neutral – 42%
- Disagree – 19%
- Strongly disagree – 3%

## Get Your Business Ready

### Assess the Impact

Get your business ready by first creating a cross-functional team to identify and address all affected areas of the business. This cross-departmental collaboration should minimally include colleagues from real estate, accounting, IT, legal, compliance, risk and financial reporting. There are many questions the team will have to answer:

- ◆ Are we ready for the transition?
  - Do we have an inventory of all our leases?
  - Do we have dependable, complete data?
  - Do we have the resources to apply to the transition project?
  - Have we assessed the financial reporting impact?
- ◆ Are we ready to defend it?
  - Will any new processes and procedures comply with Sarbanes Oxley?
  - Will we have an audit trail?
  - Will we have secured our data and restricted access to it?

### ◆ Are we ready to prepare our financial restatements?

- Can we produce restatements for three years or more?
- Do we have the ability to produce financial statements supporting both the old and new standard?
- Do we have all the detailed lease data?
- Are we able to reverse the effect of the old standard before applying the new standard?

### Streamline the Lease Recognition Process

Up-front planning can mitigate the transition workload and streamline lease recognition. Because every lease in your portfolio must be reviewed at the individual lease level, you need to acknowledge the volume of work this will mean and the resources you will need to dedicate to this effort.

As you work through the lease recognition process for each and every lease, you may find yourself making the same decisions repetitively for certain types of like-kind leases. If you can define these similar

## Recognizing Leases

Today, leases that meet the FAS 13 capital lease tests are included on the balance sheet. Operating leases are disclosed in financial reporting footnotes. In the proposed lease accounting changes, all leases over 12 months in length should be recognized and included on the balance sheet as assets and liabilities. Recognizing a lease as an asset and a liability requires determining an initial value. FASB refers to this process as initial measurement. Then, upon lease commencement, the asset and liability values are decremented or amortized. FASB refers to this process as subsequent measurement. Recognizing a lease under the prospective standard will involve both initial and subsequent measurement using the methods to be specified in the final standard.

decision choices ahead of time, you can quickly apply these profiles to your leases, as applicable. The result is an aggregation of common lease recognition decisions which greatly speeds data entry, ensures consistency and improves accuracy. Here are five areas in which you can apply this profiling method:

### 1. General Ledger Accounts

Today, paying lease expenses is straight forward. Choose a single account, say rent, to pay rental expense. Recognizing leases under the prospective standard will be more complex and will involve multiple accounts. The accounts used may differ from lease to lease. You may notice that for a certain type of lease, you are using the same group of accounts. For instance, there may be accounts used to recognize a real estate lease and different accounts to recognize an equipment lease. To avoid human error when choosing accounts, define the group of accounts used to recognize each type of lease as a profile. That profile can then be used by anyone needing to account for leases so the task is easier, more consistent and ensures accuracy.

### 2. Projected Growth

The prospective FASB standard may require estimating future expenses that are not known today. Grouping growth estimates by type of asset (real estate, equipment, etc.) or geographical region will streamline this exercise. For example, say you have five people projecting the growth prospects for a portfolio of leases. Growth estimates will probably be consistent for each person, but may be very inconsistent across the department. Consider defining profiles for estimating growth rates based on lease type, geographical location, or any number of possible attributes. By using a limited number of defined growth template profiles, lease recognition will be more consistent and defensible.

### 3. Direct Costs

Direct costs are the expenses incurred to acquire a lease. The prospective standard requires these expenses to be included in the initial measurement for lease recognition. These charges will be scrutinized since they will affect the balance sheet. It will be important to account for all of the charges that may be incurred to acquire a lease consistently. Use a profile to drive consistency and ensure you have gathered all expense items for which acquisition costs have been incurred.

Alternatively, you may decide to allocate fixed costs. Some lease acquisition scenarios may require more time and resources. For instance, equipment leases that can be attached to existing master agreements are simpler to execute than leases requiring a new master agreement. To better model these differences, you may want to create multiple profiles to model the differences in expenses.

#### 4. Discount Rate

To recognize a lease carried on the balance sheet, you need to know the discount rate at lease commencement. Prepared companies will provide a single reference source for current discount rates for the lease recognition process. If you select a discount rate based on a lease profile, for example a ten-year term, you can ensure the correct discount rate is used.

#### 5. Review

Periodic review of lease recognition is likely to be required. For some leases, more frequent review makes sense. Leases with contingent rent or Consumer Price Index (CPI) based charges in areas where market conditions are changing may need more frequent review than ten-year leases with level payments in well-established locations. You can create review profiles based on these lease attributes or location. The use of a pre-defined profile will drive consistency and direct your review time to the right leases.

### Get Your Data Ready

The second area to focus is making sure your data is ready. As lease recognition moves from the financial footnotes to the front pages of a company's financial report, the need for good, reliable lease data becomes imperative.

With lease files that are complete, organized, accurate and accessible, you are in the best position to comply

with the new changes promulgated by FASB. And remember – you need to get data ready for both real estate *and* non-real estate leases. This represents a great deal of work due to the sheer volume of leases, so start now to develop a collaborative approach among all cross-departmental groups in your company that deal with the leasing of all assets.

As with the necessity for getting your business ready, getting your data ready for the prospective lease accounting changes is just good business. Adopt the perspective that these changes present a valuable opportunity for you to get your lease management house in order and you'll be ready when the final FASB standard is released. That way you'll be assured of paying expenses accurately, without risk of long-term over-payments. The dilemma for many companies is where to begin. Do you have a complete and accurate inventory of every lease in your portfolio? Is the information you have captured for each location or asset reliable? Is the information readily accessible? Assess your data readiness level by answering these critical questions, then use the following best-practices recommendations to ensure your data is in great shape for the new lease accounting guidelines:

#### 1. Create a Comprehensive Inventory

The more you are familiar with the assets you have, the better prepared you will be to manage them. While you might think that goes without saying, it is not uncommon for asset management departments to substantially under (or over) estimate the size of the company's portfolio. At Virtual Premise, we have numerous clients, who, at the outset of a data management project, did not have a comprehensive view of all of the lease assets the company holds.

## Level of Confidence in Real Estate Information

	No Confidence	Very Little Confidence	Somewhat Confident	Very Confident
Data Accuracy	0%	10%	42%	35%
Consistency	0%	6%	45%	42%
Completeness	0%	16%	35%	39%

According to the Virtual Premise “Trends in Real Estate Information Management” survey, only about 1/3 of respondents are very confident in their lease data.

Be warned: this can be a laborious and time-consuming process. When the Virtual Premise team assists clients in compiling complete inventories, we recommend that every inventory line item has supporting documents and, likewise, that every set of documents has a supporting line item in the inventory. This ensures that there is a legal foundation for every portfolio asset. Because this is a necessary process, we recommend that asset managers consider this a critical operational event, and schedule specific deadlines to ensure this task is completed on a timely basis.

One way to conquer this task is to assemble a team dedicated to identifying each company asset and assembling the documents associated with it. This will involve reconciling existing document inventories with documents that support each of the separate locations and/or assets.

Remember to also account for assets that are not real estate leases. We have found non-real estate leases (i.e., equipment, copiers, vehicles, etc.) to be decentralized and, therefore, less organized and

monitored than real estate leases. After the FASB changes, these leases are likely to become much more significant and will need to be accounted for accurately. There are generally large numbers of such leases to be accounted for.

### 2. Ensure Your Data Is Reliable

#### ***Accurate Data***

The most critical element of reliable data is accurate data. Can you depend on what is there? How do you know? When was the last time it was independently reviewed?

If your company does not have a quality review process in place, it may be difficult to ensure that your consolidated data is accurate. In the process of auditing client portfolio data, Virtual Premise has uncovered countless situations in which clients had either overpaid rent or had been underpaid in rent for an extended period of time. One recent discovery involved a major retailer who had been overpaying rent on a property for five years! This oversight was due to an initial data entry error – years prior.

Virtual Premise recommends the following tips for creating accurate data:

◆ **Have a Dedicated Quality Control Manager** —

This person's primary function is to periodically, and continually, review lease files to ensure that data has been accurately captured.

◆ **Review All Data** — Your data management process should include more than one person viewing and confirming that the data captured in your system is accurate.

◆ **Document Abstract Process and Instructions** — Ensure that members of your team understand how data should be captured and maintained. Prepare written instructions that can be consistently followed by all team members.

◆ **Provide Written Training Materials** — Without written training materials, vast inconsistencies in data management are likely to appear in your data management system because individuals think differently. Don't just write them down; train and communicate them to the entire team.

◆ **Generate Discrepancy Reports** — Create reports that will help you uncover discrepancies between legal documents and your data. Resolve errors and discrepancies discovered in the quality control process immediately, as delays in fixing errors can reduce revenues and increase costs.

### **Comprehensive Data**

Is important data missing from your lease records? The final FASB standard will likely require that additional information be stored with the lease abstract. For example, while you may have previously captured critical terms like rent and security deposit amounts, you may also need to know more data surrounding options under the new FASB changes. Companies that start now and have already abstracted option information can easily pick out dates and dollars and will have a head start on the transition project. Abstracted payments and information about termination penalties and residual value guarantees may also speed compliance.

Having the necessary data and a system that has the ability to capture the additional data required under the new standard should be the benchmark for preparedness. Gap analysis can then be performed to identify additional data that will be required by the new standard. Additional data that may be required include:

- ◆ Costs to acquire the lease
- ◆ Discount rate at lease commencement
- ◆ Term for which the lease will be recognized

Taking care of this necessary step now will put you further ahead in the inevitable transition process and maximize the time and resources you have to focus on whatever additional requirements comprise the final standard when it is released.

### **3. Make Your Data Accessible**

Ensure that leases are physically accessible and legible. To rely on physical lease files may not be the best approach for practical reasons, such as disaster recovery, easy access from remote offices and concurrent use. In addition, physical lease files could impede secure access to confidential information and diminish collaboration among various team members who need easy access to the same documents.

The fact that your lease abstract data has been systematized does not mean it is usable. If critical dates are buried in large text fields, they will be difficult to locate. For example, renewal options should have start and end dates noted separately from text fields containing comments or conditions of the option so that reports can be run on the dates, without requiring a lease administrator to read blocks of text in order to identify renewal terms. When reviewing your portfolio and how your portfolio data has been captured, consider whether your information is readily available to the appropriate members of your organization when they need it.

## Print this page and use it as your own checklist for making sure you are ready for the anticipated FASB lease accounting changes!

In summary, the prospective FASB lease accounting changes are on the way. Although there is uncertainty surrounding the details, there are actions you can take now to get prepared — regardless of the breadth of the changes. These actions will likely prove to be a tremendous benefit to your company. The planning and workload presented by this event is immense. With any challenge of this magnitude comes opportunity — an opportunity to streamline, organize, and uncover efficiencies will save your organization time and money. You can choose to be reactive or you can proactively seize this unique chance to better position your company for successful financial management.

Use the checklist below and share it with your colleagues to help galvanize the cross-departmental team and create a plan for how your organization will address the upcoming changes.

### Top 12 Action Items for FASB Readiness:

1.  Create a cross-departmental transition team and assign responsibilities.
2.  Establish a timeline with deadlines for completion of all critical actions.
3.  Ensure you will continue to comply with audit standards.
4.  Be ready to restate financial reports using the new standard.
5.  Plan to use like-kind groups of accounts for similar leases.
6.  Facilitate consistency by using predefined growth estimate templates.
7.  Streamline the assignment of direct cost to individual leases by using profiles.
8.  Accurately recognize leases at initial measurement with discount rate profiles based on your specific needs.
9.  Save time by using lease review profiles.
10.  Make sure your lease inventory is accurate and complete.
11.  Perform an analysis to ensure your lease data is compliance-ready by being complete, consistent and accurate.
12.  Ensure the security and accessibility of your lease information to the appropriate people.

Virtual Premise, Inc. Virtual Premise, Inc. is a leading SaaS provider of real estate information management solutions for corporations, retailers, restaurants, landlords and commercial real estate service providers. With Virtual Premise, companies have a smart, easy way to collect, manage and report on complex real estate information from anywhere, at anytime. Virtual Premise technology solutions include strategy and analytics, portfolio management, lease management, lease administration, project management, transaction management, and document management. Virtual Premise also offers a wide range of supporting services to include lease abstracting, document management services, data validation, due diligence support, and best practices consulting. In addition, the company is taking a thought leadership role in preparing its solution for the upcoming FASB lease accounting changes. Virtual Premise is wholly owned by CoStar Group.

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