ASC Topic 842 and Lessor Software Systems

Perspectives from the equipment finance software providers

WHILE MANY LESSEES were, or are about to be, required to procure new software systems or tools in order to comply with the new lease accounting standard ASC Topic 842 (the Standard), lessors were left wondering how their current software accounting applications would manage the comparatively smaller changes required on their side of the equation. Even though lessor accounting is substantially unchanged—using the same lease type classification names and general lease accounting methodology as set forth in ASC Topic 840—there are still key accounting changes and disclosure requirements that lessors must adopt. These changes, which could involve coding changes depending upon the level of configurability in the software application, include, but are not limited to, the recognition of selling profit arising from a direct financing lease, initial direct cost definition and recognition, allocation of consideration and non-lease components in a lease contract and sale leaseback accounting. The purpose of this article is to provide anecdotal viewpoints from the providers of the lessor accounting software systems used in the equipment finance industry about their experiences with conforming their software to the new Standard.

Timing of the Standard

As stipulated in the Standard, the effective date of compliance for public companies is for fiscal years beginning after Dec. 15, 2018. Privately held companies may delay compliance until the end of their fiscal year 2020. Based on an anecdotal review of the major lessor systems used by equipment finance lessors in the United States, *most software vendors released modifications to their applications well in advance of calendar year end 2018* to give lessors adequate time to test and implement the software modifications. However, as one vendor commented, "This became somewhat tricky because some of our customers are non-adopters in 2019; therefore, our release process had to accommodate both customers who required accounting under the new Standard as well as others who are still applying ASC 840." Another vendor said they solved this not-so-insignificant problem by "adding an enterprise switch—either Topic 842 accounting is On or Off."

Clarity of the Standard

Anyone who has been involved in a software implementation that included modifications to the generic software will tell you that a comprehensive and clearly written requirement document is the crucial first step in delivering a high-quality, compliant system. When ASC

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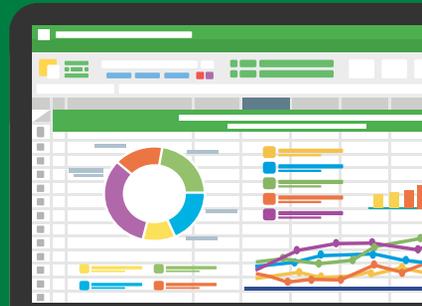
Topic 842 was published, lessors were presented with their "requirements document." To determine whether software providers found this "requirements document" effective, the authors of this article asked several to opine on the clarity of the Standard and the ease of turning it into a software requirement document. A recurring theme emerged: While many elements of the Standard were detailed and extremely clear, others were vague, leaving them open to various interpretations. Some of these open elements have been settled in subsequent updates from the FASB, but the treatment of too many others will not be settled until debated by accountants and auditors in practice, which could lead to additional software modifications during the next few years. One vendor commented, "While this more judgmental approach may be preferred by the

accountants, it will most likely require multiple coding enhancements and lessor implementations, costing both of us extra time and money."

Software Modification Approach

"How about I rotate the tires and check the brakes for you while I have your car up on the lift?" How many times have you heard that during an oil change? That's because in most cases it makes economic sense to add incremental work to an existing job since the sunk cost of getting "that car up on the lift" has already been incurred. Similarly, several software service providers had to "lift the car up" to make changes to their core systems for the Standard, and they took the opportunity to release additional technical and functional enhancements to their applications. Most were able to fit all of these updates into a scheduled quarterly or annual release, albeit a release that demanded "closer attention," as one service provider noted.

Software Modification Challenges

Implementing regulatory modifications to a software solution carries with it a number of challenges including a finite deadline, new business requirements that have yet to be put into practice requiring multiple judgements, consultations with accounting experts, and difficulty in prioritizing resources for non-revenue producing modifications, among others. Based upon the authors' conversations with software vendors, the consistent theme was that "the modifications necessitated by the Standard were not easy." This is evidenced in thoughts from three of the equipment finance software providers:

> "The most challenging aspect was simply getting our arms around what we needed to do. We did this by working with our customers to come to a common understanding of lessor requirements under the standard, identifying which requirements should be addressed by our system—judgement calls are harder to "systematize"—and determining the broad architectural changes needed to handle them. This was a time-consuming and laborious process but something that we felt was a necessary pre-condition to successfully adapting to the standard. We released our modified software in 2018 and so far our customers are happy with it."

> "ASC Topic 842 required changes to our user interface, calculations and reports, and these affected many areas of our complex software application. Maintaining the integrity of our existing features while adding the new functionality

was challenging. We spent almost two years perfecting our solution and were glad to release it prior to year-end 2018."

> "We have a large and diverse set of customers that utilize our full lifecycle solution across a wide range of use cases in support of their business objectives. The most challenging aspect of implementation was in providing a comprehensive solution across these use cases, which also minimized disruption to our customers' current business practices. In working in close partnership with our customers, across their business, accounting, and technology teams, we were able to provide solutions aligned with customers' business processes."

What is on the Horizon?

Fortunately, most software vendors believe their already released solutions are compliant and effective. Some software applications were sufficiently configurable enough such that no coding enhancements were necessary. However, as one software vendor commented, "We may need to make additional software modifications as lessor practitioners and auditors continue to fine-tune our collective understanding and interpretation of the Standard and the FASB issues additional clarifications and/or changes."

Another software vendor commented: "Right now, we have only one specific open item related to ASC Topic 842, which will be addressed in our upcoming 2019 release. However, we do expect that we and/or our customers are likely to identify modest enhancements which will require additional modifications." ☰

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Related Resource

For more on the new standard (ASC 842), see "The Silver Lining of Lease Accounting: What Organizations Should Know About the New Standard" at *www.elfaonline.org/ leaseaccountingtools*.