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BDO **FLASH** REPORT CORPORATE GOVERNANCE

SUBJECT

PREPARING FOR THE LEASES ACCOUNTING STANDARD: A TOOL FOR AUDIT COMMITTEES

SUMMARY

The new lease accounting standard begins to take effect in January 2019. In an environment laden with significant new accounting guidance and disclosure requirements, a new tool issued by the Center for Audit Quality aims to assist audit committees in their oversight of the lease standard implementation by providing an overview of the standard and questions audit committees should be asking, together with specific considerations to ensure a successful implementation.

DETAILS

Background

In April 2018, the Center for Audit Quality (CAQ) released a new tool, [Preparing for the New Leases Accounting Standard – A Tool For Audit Committees], as a resource for audit committees in their oversight of the implementation of FASB ASC 842, a standard that fundamentally changes the accounting for leases. The implementation of the new standard will take significant effort, will affect multiple functional areas, and comes on the heels of the extensive requirements of the new revenue recognition standard. The standard is effective for calendar year-end public companies as of January 1, 2019; all other entities are required to apply the leasing standard for annual periods beginning after December 15, 2019. Earlier application is permitted.

The tool provides guidance and sample audit committee questions organized into four sections:

1. **Understanding the New Leases Standard** – summarizes *Accounting Standards Update* (*ASU*) *No. 2016-02, Leases*, and highlights the fundamental changes in accounting and reporting

2. **Evaluating the Company's Impact Assessment** – provides questions to facilitate discussion between management, auditors, and the audit committee to evaluate the company's specific degree of impact from the new standard

3. **Evaluating the Implementation Project Plan** – facilitates discussions between management, auditors, and the audit committee to understand management's implementation plan, milestones, and current status regarding implementation

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4. **Other Implementation Considerations** – highlights additional considerations including, but not limited to, transition methods and disclosures.

Management, with board oversight, needs to communicate transparently with shareholders and other stakeholders as to how the implementation of the new leasing standard impacts the financial statements. Audit committees, of both public and private entities, should ensure not only that the accounting has been done properly but also that new disclosures being provided are understandable to analysts and the investing communities. Equally as important is the consideration of the controls that support the accounting and reporting for the new standard.

Key Areas Identified From Each Section of the Publication

Understanding the New Leases Standard
ASU No. 2016-02, Leases, changes the accounting for leases primarily by requiring the lessee to recognize on the balance sheet the assets and liabilities arising from all lease arrangements. The standard also includes less significant changes to lessor accounting. Audit committees need to understand these changes together with the expectation that certain systems, processes, and controls will likely need to be timely updated to correspond with the new standard. The audit committee should further be aware that the new standard requires significant judgement. Additional considerations pertain to the identification and measurement of contracts and the related assets and liabilities.

Evaluating The Company's Impact Assessment
When evaluating the company's impact analysis, audit committees may want to ask a number of detailed questions aimed at understanding how the assessment was performed, who was consulted within the scope of the assessment, what factors were considered, what "outside" considerations (e.g. debt covenants, income tax effects) exist, when pro-forma/draft financials will be available to the audit committee, and details of conversations with auditors.

Evaluating the Implementation Project Plan
The complexity of the estimates and the effect on multiple functional areas encourage companies to develop a project plan that is communicated to the audit committee. Questions and understanding should be reached in the following areas:

- The timing and scope of the implementation project plan
- Adequacy of the culture (e.g., tone at the top) and resources to support the plan
- Involvement of stakeholders
- Changes to accounting policy and significant accounting judgements required
- Changes to systems and controls governing data collection/processing, accounting, reporting and disclosures

Other Implementation Considerations
Audit committees will want to understand management's transition method[1] and understand certain judgements regarding practical expedients. These judgements should be incorporated into the project. Similarly, audit committees will want to ensure that preparers are transparent in the process and results of implementation. They should be able to articulate in relevant disclosures the impact (estimated when applicable), all relevant facts, and demonstrate a comprehensive analysis of the different accounting alternatives in arriving at reasonable judgements. Audit committee should further keep in mind that additional disclosures are required both before and after adoption. Refer to BDO's Flash Report: SEC SAB 74 Disclosures and Controls for New Accounting Standards. Finally, thought should be given to company-specific considerations including but not limited to control-readiness and any statutory reporting requirements.

Next Steps

This resource was designed by the CAQ and serves as a valuable resource to audit committees in the execution of their oversight duties with respect to increasing transparency, consistency and reliability within the financial reporting chain.

BDO continues to provide financial reporting resources, specifically related to the new lease standard including our BDO Knows Topic 842, Leases publication explaining the new standard, which is continually supplemented with additional alerts. Please also refer to our educational resources related to the new lease standard. We commend the CAQ for continuing to produce valuable tools and resources on this topic and will continue to highlight these and other activities, trends, and relevant discussion points to our client audit committees and management teams through our Center for Corporate Governance and Financial Reporting.

1 Note: As of April 2018, upon transition under ASC 842, companies are required to adopt a modified retrospective method that results in a restatement of prior years presented. There is a pending FASB proposal that would allow an alternative transition method to record a cumulative effect adjustment in the year of adoption.