Manhattan

SERVICE ORGANIZATION CONTROLS REPORT
SOC 1 TYPE 1
CERTIFIED

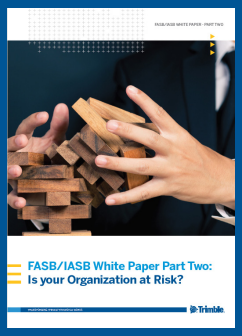
FASB & IASB Compliance Guide

Part 1: The Revolution in Lease Accounting

Trimble

Introduction

#1 - The Revolution in Lease Accounting



#2 - Is your Organization at Risk?

#3 - The Value of Manhattan

This is the first in a series of white papers that examine the likely impact of the new lease accounting standards on organizations that lease real estate, vehicles and equipment.

This paper looks at the key steps that every lessee company should take in order to be ready for the introduction of the new standards on either December 15, 2018 or January 1st, 2019 for FASB and IASB (ASC 842/IFRS 16/AASB 16) respectively.

The second paper assesses the potential risks associated with the revolution in lease accounting, and highlights 10 major mistakes that you should try to avoid to minimize the dangers to your company.

The third paper looks at how the Manhattan system from Trimble is uniquely placed to ensure a smooth, risk-free transition to the new standards. It answers some of the key questions that are frequently asked by organizations that will be affected by the lease accounting revolution.

Questions?

Ready to evaluate Manhattan?

Looking to submit an RFP?

To arrange a demonstration of Manhattan or ask a question please use the contact form on our website or call your regional office.

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Time is running out ... are you ready?

"By failing to prepare, you are preparing to fail."

— Benjamin Franklin

If your organization leases commercial real estate, your whole approach to lease accounting and financial reporting — and even the necessary capabilities of your accounting technology — will never be the same again after 15th December, 2018 and 1st January 2019. That's when the new lease accounting standards set by the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) respectively will come into effect worldwide.

"In a study by Deloitte, 88% of respondents predicted the new standard will place a "significant" reporting burden on lessees of real estate."

According to some estimates, the new lease accounting rules could add as much as $2 trillion to the balance sheets of companies in the United States ... and over £60 billion in the UK.

The new FASB/IASB (ASC 842/IFRS 16/AASB 16) standards will fundamentally transform the rules that govern accounting for almost all types of leases, including real estate, vehicles and equipment leases. In addition to some low dollar value and short term leases, only service agreements — which sometime look and feel like leases — are excluded.

The changes are expected to have far-reaching implications in areas such as accounting, finance and reporting, real estate and tax.

Even lease accounting technology — such as financial management software — will be affected.

In a study by Deloitte, 88% of respondents predicted the new standard will place a "significant" reporting burden on lessees of real estate. This means you will not only have to increase the efficiency and accuracy of your data collection and data abstraction processes, your lease administration team will require far more sophisticated lease accounting skills in future.

Under the new rules, companies will no longer be able to treat operating leases as a period rent expense. Instead, you'll have to show them on the balance sheet as an obligation and its related right of use asset. Some experts believe this

could make financial statements much more volatile in future – and may have a substantial impact on an organization's Debt/Equity ratio. It could also affect a company's overall credit worthiness.

Will your organization be ready to produce the more accurate financial reporting and forecasting required under the new rules?

Will you be ready to provide the pro forma statements that will be requested by investors and lenders in the months leading up to the reporting deadline?

And will your accounting technology be up to the task of implementing the new lease accounting best practices?

If you're not ready to adopt and comply with the new standards by either December 15, 2018 or 1st January 2019 for FASB and IASB respectively, experts warn there could be severe consequences for your business – including a potential loss of shareholder confidence if auditors decide not to issue an opinion on your financial statements, or if they choose to deliver an adverse opinion.

What's driving the changes?

> Under the new guidance, financial statements should give investors and others a better understanding of a company's financial soundness "

In 2006, the FASB and IASB set out to revise lease accounting standards with the aim of giving investors a more transparent view of companies' leasing activities. A decade later, the resulting changes are intended to improve the accuracy of financial reporting about lease liabilities.

The previous lease accounting guidance had been criticized for allowing leased assets and, more importantly, obligations for future lease payments to be excluded from a company's balance sheet. There was also concern about the manipulation of 'bright-line' thresholds that could lead to significantly different accounting for transactions that were basically similar.

The most significant driver for change, though, was the need to bring operating leases onto the balance sheet. Historically, they had always been treated as an 'off-balance sheet' obligation. Under the new guidance, financial statements should give investors and others a better understanding of a company's financial soundness — thus enhancing their ability to make better investment decisions.

Are the new FASB and IASB standards the same?

When FASB and IASB began their joint project to revise lease accounting standards, the intention was to produce a standard that would provide consistent accounting for leases on a global basis. However, they have not been able to fully achieve this goal.

The biggest difference between the two new standards relates to the way in which lessee operating leases are treated from an income statement perspective. While both standards require companies to reflect virtually all these leases on their balance sheet, the two boards take a different approach to the lessee income recognition model.

Outside the United States, the IASB standard treats almost all leases (apart from short term ones) like today's finance or capital leases. This means the lessee's expense is front-loaded over the term of the lease.

The FASB, meanwhile, has retained a dual approach to the classification of leases, one of which, treats the expense of operating leases on a straight-line basis. Guidance similar to the classification model under the current generally accepted accounting principles in the United States will be used to decide whether a lease is a finance lease or an operating lease.

Because all leases will be classified as finance leases for IASB (but may be viewed as operating leases for FASB), the way in which they are subsequently amortized and shown on a company's Income Statement will be completely different.

"First and foremost, it's all about planning and making sure all the people who should be thinking about it are thinking about it...

...You have to come up with a comprehensive, all-inclusive, well-thought-out plan for both preparedness for the transition and then for adoption."

Al Dente, FASB/IASB Lease Accounting Expert, Trimble

What are the key changes?

The most dramatic change — both in the United States and around the world — is the requirement for all lease assets with terms longer than 12 months to be recorded as an obligation and a related asset on a company's balance sheet.

At present, leasing costs are typically treated as a rent expense and companies don't have to show the total obligation for operating leases on their financial statements. A company is only required to report the impact on the profit and loss (P&L) account during the current year of the lease. Later years obligations are only mentioned as a footnote.

> "The most dramatic change — both in the United States and around the world — is the requirement for all lease assets with terms longer than 12 months to be recorded as an obligation and a debt on a company's balance sheet."

Under the new FASB and IASB standards, though, operating leases (thought to account for about 85% of all current leases) must be brought onto the balance sheet. The remaining 15% of leases are mostly finance leases which are not affected because they already meet FASB/IASB reporting requirements.

The second biggest change is in the way operating leases in IASB territories must now be recorded on the P&L statement. It's a shift that will have a major impact on P&L figures for multinational companies that lease real estate across multiple countries.

Historically, the cost of operating leases has always been shown on the P&L statement on a straight-line basis throughout the full term of the lease. This practice will continue under FASB in the United States. But in the rest of the world, IASB now insists that interest leasing costs must be front-loaded. As a result, leasing expenses recorded on the P&L will be greater in the first years of the lease and lower in the remaining years. This should be considered by investors and others for a better understanding of a company's profitability after taking the leases into account.

Another significant change is the requirement for public companies to provide side-by-side comparable accounting data for the 'transition' period leading up to the year in which they adopt the new standard. Under FASB, this means up to two years of historical reports for balance sheets, and up to three years of historical reports for income statements. Under IASB, the comparative requirements for the 'transition period' are one year for balance sheets and two years for income statements. This comparable accounting data will typically be reported in the footnotes to the financial statements in the year of adoption.

How will the changes affect you?

The new FASB/IASB leasing model is expected to have a profound impact on a company's overall capital structure as well as requiring a fresh approach to lease accounting and lease administration.

At the same time, adding future lease obligations to the balance sheet will have a major impact on leverage and liquidity ratios and could potentially affect your company's credit rating.

This dramatic shift is likely to result in substantial operational and system changes which will potentially impact on many functional areas within your organization — including corporate real estate, financial reporting, corporate accounting, treasury, financial planning and analysis, and accounting technology.

Major operational considerations will include:

- New technology capabilities to store lease data and perform calculations, including comparative balance sheet calculations during the 'transition' period leading up to adoption of the new standard.
- Challenges in data collection and aggregation across multiple locations and technology platforms.
- Enhanced disclosure requirements.
- Financial ratios may change with potential impacts on debt covenants or other guarantees.
- Impact of limited resources and ongoing business needs on the timeline for adoption.
- The need to re-train your lease administration team to give them more sophisticated lease accounting skills.
- The need to transform your accounting system from paper documents to a sustainable and future-proofed technology solution.

All of which means it will be more critical than ever to make sure your finance/accounting and real estate departments work closely together to integrate their data. This will be essential if you are to meet the challenges of the 'transition' period and produce the more accurate reporting required by FASB/IASB in future.

Can your lease accounting software rise to the challenge?

The new FASB/IASB lease accounting standards will put a significant new reporting and forecasting burden on all lessees of real estate, vehicles and equipment. This, in turn, will place greater demands on the capabilities of an organization's accounting technology.

Being able to fully comply with the new FASB/IASB requirements will depend on having instant access to comprehensive, pristine data within a system that can manage analyses and reporting effectively. As a result, many existing lease accounting systems may need to be updated, or even replaced altogether because they've been made obsolete by the new compulsory rules.

> "Manhattan is currently the only solution with a Financial Management module which uniquely provides an embedded subledger that supports all leased assets with the functional capabilities of an enterprise resource planning (ERP) General Ledger"

To help modernize the management of your lease portfolio and lease accounting, you will need a future-proofed system capable of rapidly identifying, compiling, processing and analyzing all of the important lease data that the financial reporting and accounting departments will require. Paper documents and spreadsheets will in almost all instances no longer be sufficient.

Increasing the efficiency and accuracy of your data storage, data collection and data abstraction processes should be a top priority. And your accounting software must be comprehensive enough to be able to perform complex calculations — including the comparative balance sheet calculations required during the 'transition' period leading up to adoption of the new standard.

After consulting with many client organizations likely to be affected by the FASB/IASB changes, Trimble has put a great deal of research and development investment into enhancing its Manhattan lease management and lease accounting modules.

Manhattan is a market-leading integrated real estate and workplace management software application for managing the complete real estate and facilities lifecycle — from financial management and budgeting, to project management and real estate and portfolio management, through to capital asset planning, space planning, space scheduling, operations and maintenance.

Significantly, Manhattan was designed and built with financial management and financial accounting at its core. That's why Manhattan is currently the only solution with a Financial Management module which uniquely provides an embedded subledger that supports all leased assets with the functional

capabilities of an enterprise resource planning (ERP) General Ledger. This is a capability that will be essential to ensure full compliance with the new reporting standards.

Manhattan's advanced software is now able to support lessees during the complex FASB/IASB preparatory, pre-transition, transition and final adoption periods ... and beyond.

In fact, Manhattan has been specially designed to support retrospective processing of all lease transactions regardless of the date of implementation. The software is uniquely able to support both the future FASB/IASB requirements and the current FASB/IASB standards concurrently. This means Manhattan can be implemented after the start of the transition period, and then retrospectively process transactions in accordance with the new standards.

What should you be doing to prepare for the changes?

If you haven't done so already, you urgently need to form a cross-functional FASB/IASB project team — comprising key people from your real estate, finance and IT departments (and possibly other functional departments too). This team of experts should be tasked with thoroughly reviewing your existing lease accounting processes to identify the changes that need to be made.

It's also essential to compile a complete list of your real estate, vehicle and equipment leases and create a compliance plan — paying particular attention to how your current lease portfolio (and any new leases in the pipeline) will be impacted by the new financial reporting requirements.

You should also be taking steps to evaluate lease management and lease accounting systems, such as Manhattan, that will offer you the highest level of support as you prepare for the new standards. Implementing your new lease administration system prior to the rollout of the new rules will help to make the transition process much easier.

Remember, failing to comply with the new standards by either 15th December 2018 (FASB) or 1st January 2019 (IASB) could put your company at risk ...

Next Paper

Now read our second paper that assesses the potential risks associated with the revolution in lease accounting, and highlights 10 major mistakes that you should try to avoid to minimize the dangers to your company.

http://go.trimble.com/10-risks-fasb-iasb-compliance

Contact Us - Demo of Manhattan

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/ FASB/IASB White Paper - Part One

Trimble / Real Estate & Workplace Solutions

Transforming the way the world plans, manages and optimizes real estate portfolios

About Trimble Real Estate & Workplace Solutions

Founded in 1978, Trimble (NASDAQ: TRMB) is a global leader in technology solutions that help businesses significantly improve efficiency and productivity. Trimble Real Estate & Workplace Solutions, a segment of Trimble's Buildings group, is committed to transforming the way real estate, people and facilities are managed and optimised, wherever they are located.

As a specialist in the real estate industry, we deliver advanced, intuitive technologies and scalable enterprise software solutions that provide deep functionality and help streamline communication and collaboration throughout the real estate management lifecycle. Our Manhattan and CenterStone software applications assist in reducing costs, increasing performance, enabling visibility and maximising utilisation. Solutions include Integrated Workplace Management, Lease Administration & Accounting, Space Planning & Management, Operations & Maintenance Management, Room & Desk Booking, and Real Estate Investment Management.

With offices around the world, Trimble Real Estate & Workplace Solutions employs dedicated professionals and supports clients in over 140 countries.