

Myths and risks of using spreadsheets for lease accounting

From design flaws to accounting weaknesses and technology gaps





Back in 2013, Forbes published an article entitled “Microsoft’s Excel Might Be The Most Dangerous Software On The Planet”. The article referenced the “slapdash manner”¹ in which the product is used for complex processes and cited European financial services agencies that warned against its use:

“When relying on manual processes, desktop applications, or key internal data flow systems such as spreadsheets, banks and insurers should have effective controls in place that are consistently applied to manage risks around incorrect, false, or even fraudulent data”²

It’s no wonder that such warnings are given. The list of companies that have attributed financial and accounting mistakes to the use of spreadsheets include JP Morgan,

Fidelity, Citibank, Barclays Bank, Goldman Sachs, Eastman Kodak, AstraZeneca, and Marks & Spencer. These mistakes always come with significant risks to organizational effectiveness, operating costs, and reputation.

The accountants and leasing experts at EZLease would paraphrase Mr. Worstall with a much more definitive statement: A spreadsheet is **absolutely** the most dangerous lease accounting software on the planet. The global standards now in effect – ASC 842 and IFRS 16 – have been called the most complex accounting change in history by PwC. The AICPA recently stated that lease accounting is “significant and complex”.³ Using an ill-designed tool to comply with a mission-critical accounting edict will exacerbate those significant risks to organizational effectiveness, operating costs, and reputation.

While many companies consider the usage of spreadsheets for lease accounting to be simply a function of portfolio size, the accountants and leasing experts at EZLease have a simple guideline: a portfolio of a single lease requires an application designed to manage compliance, reporting, operations, and the multi-user complexities of the standards.

EXHIBIT ONE

Real-world deficiency story – control risks

A company with \$1B USD in annual sales had a single real estate lease for their headquarters. The lease was signed in 2014 and over a 5-year period, the lease was renegotiated to include reception space, parking spaces, and additional floors.

Managing this now-complex lease in a spreadsheet became impossible. The company tried to calculate the accounting entries for each asset (parking, reception, and multiple floors) on one worksheet and use a separate worksheet for the monthly rental expense by asset. Let's put aside for a moment that the company was trying to do complex accounting in a tool that was designed for data analysis and decision support. The additional risks of human error and total lack of proper controls

became overwhelming. Copy-and-paste attempts often neglected to change formulas in the rent worksheet. When the company grew and the lease was extended, updating the new effective rental date in the spreadsheet did not cascade across the system and update the references.

The proper accounting for free rent periods associated with the lease extension could not be achieved. And, since spreadsheets have no version control, the audit trail containing the who, when, and why around the changes was non-existent.

The company's auditor prepared a new spreadsheet for this single office lease to see if EZLease would arrive at the same right-of-use asset value.

EZLease found multiple errors in the auditor's spreadsheet. The auditor was a CPA and recognized lease accounting expert who was shocked by both the number of errors and the high likelihood that they would have never been discovered in a normal audit.

The lesson learned

The dynamic and ever-changing nature of leases means that even a single lease can be far too complex and far too risky to manage in a spreadsheet. Extrapolate that single lease to 50, 250, or 1000 leases and imagine how much more risk is introduced. Using spreadsheets for this task overwhelms company resources and makes it impossible to build and enforce proper policies and controls.

Avoid risk and errors

A spreadsheet is a great tool for data analysis and decision support. Its danger is brought front-and-center when it's used to manage processes for which it was not designed -- like accounting. The harsh reality is the tool is not to blame for the multitude of errors that result from its use on the wrong task. Rather it's the people who choose to use an ill-designed tool for a complex task that are to blame.

A partial list of the companies that have publicly blamed an accounting or significant financial error on their use of spreadsheets is shown above. However, the list of companies that have experienced the same problems but not made a public disclosure is much, much longer.

The accountants and leasing experts at EZLease group the problems into 3 buckets:

DESIGN FLAWS

1. Not a multi-user tool:

Spreadsheets are a fine single-user product in which the individual defines the processes and calculations. But lease accounting is enterprise in scope, multi-user in practice. That flaw will severely expose and magnify every lease accounting risk.

2. Non-existent governance:

A spreadsheet's governance is whatever the user deems to constitute governance. Accordance with company policies is generally voluntary or accidental.

3. Built for arithmetic:

The importance of this basic point can't be overstated. Spreadsheets can deliver perfect arithmetic, but lease accounting requires complex accounting and journal entries that span the life of the lease. Simple arithmetic won't come close to getting the job done and would introduce significant risk if it was tried.



ACCOUNTING WEAKNESSES

1. Not a system-of-record:

Compliance with the global lease standards absolutely requires a system-of-record to manage assets, lease lifecycles, and reporting.

2. No controls:

The standards require reporting that is a fair reflection of the business, transparent, and with proper levels of management controls. A spreadsheet was never designed for this requirement and level of sophistication.

3. No audit trails:

Leases are highly dynamic and managed by many people, including many that are not in the accounting department. A complete and accurate audit trail is a fundamental requirement to achieving compliance.



TECHNOLOGY GAPS

1. Data stewardship gaps:

Data management is a broad and complex issue. Up to 100 data fields per lease may need to be collected and tracked for accurate disclosures. A spreadsheet falls far short of even basic disclosure requirements.

2. Inability to handle volume of data:

It is common to totally underestimate the data volumes associated with medium and large lease portfolios. Companies with 10,000 leases may need to track up to 100 data fields per lease. This requires advanced management tools and journal entry capabilities.

3. Integration:

Lease Lifecycle Automation systems coexist and integrate with multiple applications in the financial portfolio. The scope, security, and frequency of the integration is well beyond what a spreadsheet can do.



Forget the controls, it's all about the accounting

The lack of proper accounting controls in spreadsheets is easy to identify. The lack of complete accounting capabilities is easy to underestimate.

The Big 4 accounting firms released guidebooks for the global standards. The average guidebook was 658 pages. Simply stated, this is a complex accounting edict and absolutely needs to be managed via an enterprise-class system, specifically designed for lease accounting.

The scope and complexity of the standards are the precise reason why there is a delay in the deadline for private company compliance. The recommended delay is intended to allow private companies the time they need to complete 3 critical tasks:

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- **Define future state processes and controls**
 - **Hire and train staff**
 - **Implement the enabling systems**
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Public company deployments provide great insight and lessons learned to guide their private company counterparts.

The key takeaways are 1) each of those three tasks is a critical and demanding deliverable, and 2) maximizing project success while minimizing costs and cycle times requires an enterprise-class Lease Lifecycle Automation system, specifically designed for lease accounting. Given the already time-consuming tasks associated with adopting the standards, it's also paramount to avoid the incredible waste associated with replacing a weak and ill-designed tool, like a spreadsheet, partway through the implementation.



EXHIBIT TWO

Real world deficiency story – IBR complexity

A company with \$500 Million in annual sales has a lease portfolio of 300 equipment leases and 10 real estate leases. Prior to the ASC 842 standard, they managed the asset locations, periodic lease payments, and expiration dates of this seemingly small lease portfolio using spreadsheets.

In preparation for generating the required ASC 842 accounting disclosures, the very skilled users enhanced their spreadsheet to include the required accounting tables and calculations. But then, the ASC 842 complexity emerged. The first major challenge was using and storing IBRs (incremental borrowing rates) which are needed to calculate the present value (PV) of lease liabilities at the transition period and to make future lease liability calculations.

The company's lease accountants learned that IBRs varied by entity, country of lease origin, and lease term. And then, the ASC 842 complexity exploded. Their finance department established a policy for IBRs to be updated every month, spanning new leases and all modifications. Faced with this information, the users contemplated how to create a reliable method to perform accurate lookup formulae across four dimensions: entity, country, term, and period. After a few attempts they realized that Finance did not always provide rates across all four dimensions each month, meaning they had to alert the user that a value may be missing when entering or editing a lease. Finally, they recognized that for the 840/842 transition liability PV calculations, the IBR often falls between two rates given

by Finance. For example, 42 months remaining on a lease would fall between the 36- and 48-month rates, requiring the user to interpolate the IBR.

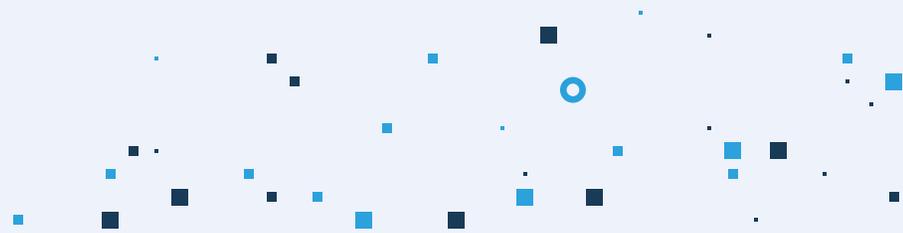
The users received the rates from Finance and printed separate rate tables each month. The correct rates were manually entered into the spreadsheet and then copied into the lease detail tab. With the many steps required, a checklist was also laid out in the calculation tab to reduce errors. These extra steps reduced but didn't eliminate the errors. The solution, of course, was an enterprise-class system from EZLease that totally insulated users from these complex calculations, generated a 95% reduction in professional time spent on the task, and eliminated all errors.

The lesson learned

The lease accounting standards were introduced to get an accurate picture of lease liabilities. Using spreadsheets to track the month-to-month updates in the data used to generate accurate liability calculations is not only a waste of valuable time, but also error prone. Trying to manage these changes in a spreadsheet will increase money spent on hiring additional resources and cleaning up mistakes before an audit.

To summarize

Choose the right tool for the job. By automating lease accounting and the full lease lifecycle, your audit process will be easier and you'll achieve sustainable compliance.



Sources

¹ **Tim Worstall, "Microsoft's Excel Might Be The Most Dangerous Software On The Planet," Forbes, February 13, 2013** <https://www.forbes.com/sites/timworstall/2013/02/13/microsofts-excel-might-be-the-most-dangerous-software-on-the-planet/#62a66bd1633d>

² **Vic Daniels, "Regulators Warn On Spreadsheet Risks In Quest For Data Excellence," HITC, October 16, 2012** <https://www.hitc.com/en-gb/2012/10/16/regulators-warn-on-spreadsheet-risks-in-quest-for-data-excellenc/>

³ **Michael A. Westervelt, Chair of AICPA PCPS Technical Issues Committee, to Shayne Kuhanek, Acting Technical Director of FASB, May 13, 2019, in AICPA Private Companies Practice Section** <https://www.aicpa.org/content/dam/aicpa/interestareas/privatecompaniespracticesection/qualityservicesdelivery/keepingup/ticcommentletters/downloadabledocuments/20190513-fasb-delay-on-leases-standard-comment-letter.pdf>



About EZLease

EZLease provides fast, simple lease accounting software for ASC 842, GASB 87 and IFRS 16 that ensures long-term compliance across equipment and real estate assets for lessees and lessors. With over 15 years of implementations across private, government and public organizations of all sizes, EZLease manages and automates lease data management and lease accounting and reporting processes, leveraging customer-first support and deep accounting expertise.

Learn more at EZLease.com