



Achieving SOX Compliance *and* Financial Performance: The Lessee's Guide

Get The Results You Need to Satisfy Your Auditors and Your Shareholders -

19 Best Practices for Your Leasing Operations

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I. EXECUTIVE SUMMARY

Are you ahead of the game in terms of SOX compliance? Consider your leasing operations. Today, for many post-SOX-projects lessees, the leasing process remains an opaque, complex area of corporate finance that often involves poor lease accounting, decentralized management, broken processes, and incomplete systems. These issues can lead to costly financial mistakes and a variety of control and compliance problems.

Compelled by the compliance requirements of SOX, finance executives of lessees are now focusing on how to manage their leasing operations with the proper rigor and improve their financial performance in the process. SOX legislation raises the bar and the stakes by introducing criminal penalties for executives if the information in financial statements does not fairly represent the financial condition and results of the company. The truth is that finance executives lack the visibility, controls, and resources needed to manage their leasing operations properly, resulting in cost leakage, financial losses, and compliance exposure.

The purpose of this guide is to provide timely, practical know-how and insight to financial executives of lessees to help them:

- understand the laws and compliance standards related to their leasing operations,
- get the latest information about SOX's impact on lease operations, accounting, and reporting
- identify the problems with their leasing operations typically found in lessees,
- know what to demand from their team to fix their operations and drive bottom-line results,
- apply the best practices, and
- build a business case for improving compliance and the financial performance of their leasing operations

With best practices in place, finance executives can then focus on their other objectives with the confidence that their leasing operation can and will deliver.

II. THE OBJECTIVE: SARBANES-OXLEY COMPLIANCE AND FINANCIAL PERFORMANCE

Compelled by the compliance requirements of the Sarbanes-Oxley Act (SOX) of 2002, financial executives of lessees are now focusing on how to manage their leasing operations with the proper rigor and improve their financial performance in the process.

Lessees of all types and sizes all over the world use equipment leasing as a major means to acquire the use of equipment. Annual lease volume in the United States has grown steadily to an estimated \$244 Billion in new equipment in 2002. Many lessees in the US and Canada have used leasing to finance their capital expenditures for many years and they have executed many successful leasing transactions with a variety of lessors. However, the leasing process in these companies is typically highly decentralized and fragmented because of the organic way that leasing has grown in their firms. This decentralization and fragmentation increase the risks and complexities of leasing and can lead to financial mistakes, economic losses, audit deficiencies and fraud.

The Sarbanes-Oxley Act (SOX) of 2002 is a complex piece of legislation that affects all companies listed on US stock exchanges that have a market capitalization of over US \$75 million. Instigated by scandals at companies such as Enron, WorldCom and Tyco, SOX has resulted in a sweeping change in corporate governance. This Act requires public companies to report their financial results in a clearer, faster and more cost-efficient manner. Section 404 of SOX is one of the most challenging aspects of the legislation. SOX Section 404 mandates that companies affected by the law establish, assess and report about internal controls and procedures for their organizations. Section 404 places a higher level of responsibility and accountability for accurate financial reporting on a public company's executives, board of directors, internal resources and others involved in corporate reporting.

A. So what impact does SOX have on leasing?

For lessees, historically, the costs of non-compliance and poor management in your leasing operations has been monetary, regardless of whether you inadvertently miscalculated a number in your footnotes, overlooked a statute, missed a tax filing deadline, or breached a contract. SOX legislation raises the bar and the stakes by introducing criminal penalties if the information in financial statements does not fairly represent the financial condition and results of the company. This whitepaper assumes that lessees want to operate within the law, comply with standards, and honor contracts, but they may not have the know-how, resources, infrastructure, or time to stay on top of it all.

The SOX legislation treats current accounting guidelines and public reporting requirements on operating leases with the same scrutiny and skepticism as other off-balance sheet mechanisms, such as pension plans, derivatives, and special purpose entities. This “off-balance sheet” area of lease accounting has been particularly scrutinized in recent years, as analysts and investors have complained that companies purposely structure leases to keep payment obligations and operating lease liabilities off their balance sheets. According to the SEC (June, 2005), 77 percent of the 200 companies it reviewed have off-balance-sheet operating leases in the amount of \$1.25 trillion.

Despite the increased focus by accounting authorities on off-balance sheet transactions, especially the related lease accounting, many finance executives of lessees have not yet turned their attention to their leasing operations in their pursuit of SOX compliance. The reasons for this are clear. Over the last several years, given the cloudy economic climate, finance executives and financial teams have been called on to do more with less – finance teams have been extremely busy with the responsibilities of just running the business. In addition, they have had to devote all of their spare resources to the new, dynamic, and expensive requirements of SOX compliance. In this endeavor, finance executives have focused first on their highest priorities in their financial operations – those priorities that have the highest compliance risks and that revolve around the general ledger, its core subledgers, and the flow of cash in and out of the company.

However, as companies complete this first round of intensive SOX compliance projects and their first and second annual public reports, the leasing process (aka capital expense finance process) and the related leasing operations are now becoming an increasingly important priority for finance executives. And when it becomes their focus, financial executives will find that fixing the problems in their leasing process and operations is a difficult and daunting task and achieving the desired “state of full compliance” means much more than just compliance to SOX. It means compliance to the lease agreements and the many other standards that guide leasing, accounting, and asset management (discussed in II.) Moreover, any executive who is making changes to meet the SOX requirements in leasing operations must look beyond and consider how to leverage any investment to improve the performance of the business (discussed in Section IV). If done properly, changing your leasing operations to become SOX compliant and adopting the related best practices can also make you more competitive. Once you understand the value of the best practices, you can build a clear business case (discussed in Section V), build consensus, and put the best practices to work in your leasing operations.

III. COMPLIANCE REQUIREMENTS FOR YOUR LEASING OPERATIONS

Understanding the many compliance standards, laws, and business requirements that apply and how they impact your leasing operations is the first step in changing your leasing processes so you can maintain a predictable, steady state of compliance and strong financial performance.

A. Master Lease Agreements (MLA)

Many companies suffer economic losses related to their leasing because they do not manage their MLAs properly. Complying with MLAs becomes increasingly complex as you increase the number of MLAs and the variation among them.

Many companies that regularly require different types of equipment at varied times may be served by signing a Master Lease Agreement (MLA) with a lessor. MLAs are established to provide a consistent legal platform that enables companies to lease equipment on a continuous basis according to their needs over a specific period of time. MLAs allow lessees and lessors to negotiate the legal details of their relationship at one time upfront and then add equipment to the lease when it suits the lessee. For lessors, the “hell-or-high-water” clause in a lease, which reiterates the unconditional obligation of the lessee to pay rent and fees for the entire term of the lease, regardless of any event affecting the equipment or any change in the circumstances of the lessee, is critically important. Essentially, lessors just want to get paid consistently and on-time – that is a lessor’s core motivation and it’s a reasonable one. Depending on the leverage of the lessee (credit rating quality, transaction size, degree of competition), in principal, many of the other dimensions of a lease are negotiable to some extent. The other legal details you will find in an MLA include each parties obligations, covenants, representations, and warranties, fees, terms of default, remedies, ownership, insurance, and acceptance and return of equipment.

Additions of new equipment are typically made in the form of a lease schedule, which specifies the financial terms, such as the commencement date, term, residual, and rate, and lists the equipment with the appropriate details. Schedules are added to the MLA and then become subject to the terms of the MLA.

Lessees maintain compliance with their lease agreements if they perform the following consistently to the letter of the MLA:

- Pay your lease payment and any fees on time regardless of the circumstances. Lessees often allow lessors to automatically debit their checking accounts to reduce the administrative burdens and ensure consistency and compliance.
- Ensure proper accounting treatment and payment calculations are made by lessors, this includes sales and property taxes (more on this below.)
- Pay and file all personal property taxes as specified (more on this below).
- Maintain adequate insurance.
- Manage your assets carefully. Track asset changes, such as changes in location or enhancements, upgrades, and other alterations. Properly notify lessor of changes pursuant to the MLA. Test for the appropriate classification of assets. This will help you improve the accuracy of annual insurance premiums based on replacement value of assets within a certain geographical area and/or legal entity, if lessor’s book values are requested.
- Maintain equipment in good working order. Lessees are typically responsible for any damage, loss, or repairs. Maintenance agreements may be required.
- Adhere to the material adverse change clauses and financial performance requirements in the MLA, if any.
- Complete all notifications as specified prior to the deadlines. This is especially important prior to the end-of-term to avoid penalties and/or being locked into further payments beyond the term.

As will be discussed later, taking a consistent, portfolio management approach will facilitate compliance and improve the cost-effectiveness of your leasing operations management.

B. Uniform Commercial Code (UCC) in the US

If your lessors are filing inappropriate liens on your equipment or failing to release liens on a timely basis, your existing lessors are creating unnecessary obstacles to closing new financing with new lessors, who will find it difficult and costly to register new liens, creating the risk that your new funding sources will back away from future finance transactions or increase their pricing to offset their additional costs. You must make sure that you routinely manage and clean up the security interests that lessors and other lenders have in your assets.

For lessees, conforming to the UCC revolves around the terms of your MLA. You must make sure your lawyer structures the agreement to leverage the sections of 2A that will protect you. The Uniform Commercial Code (UCC) was created by two private institutions, the National Conference of Commissioners on Uniform State Laws (NCCUSL) and the American Law Institute

(ALI), in order to streamline and standardize the law of sales and other commercial transactions in the U.S. The Code is not itself the law; it only has the force of law if enacted by states. The Code has been enacted in 49 of the 50 states (Louisiana is the exception).

1. UCC Article 2A: Leases

Article 2A of the Code covers leases. Lessors are adamant about ensuring that their lease agreements and contracts conform to the sections of 2A that protect them and will often refer to the specific language of the UCC of a specific US state that applies within their MLA. Of course, lessors are not likely to look out for your interests. Lessees need to ensure that their lease agreements and contracts conform to the sections in 2A that protect them. Your attorney who prepares or reviews your lease agreements should have sufficient knowledge of the UCC and Article 2A in order to ensure your compliance and protection.

2. UCC Article 9: Secured Transactions; Sales of Accounts and Chattel Paper

Article 9 relates to lessees in terms of compliance to the terms of their MLA. Your lessor must comply with Article 9: Secured Transactions; Sales of Accounts and Chattel Paper in order to declare and perfect a security interest in the equipment you are leasing from them. As a requirement of your MLA, you are likely required to assist the lessor in perfecting their interest and may be asked to assist in the search and filing processes. More importantly, you may also be asked to assist your new lessors in getting waivers representing that your existing lessors and lenders have no security interest in the new equipment you are financing. For example, your mortgagor may hold blanket liens on the assets, in which case you may have to “carve out” leased assets from your other agreements. You can reduce your administrative burden by monitoring the outstanding liens that lessors and lenders have related to agreements that have come to term.

C. Sales Tax

The tax compliance process can be complex, tedious and time-consuming. That's probably why lessors sometimes get it wrong. If the lessor gets the calculation wrong, especially if they have underbilled, the lessor will come back and expect the lessee to pay the difference. This obligation of the lessee is typically captured in the master lease agreement (MLA). If this is a systemic and recurring mistake by the lessor, then it could become a significant liability for the lessee. To mitigate this risk, you need to calculate the sales and use taxes yourself. Automating this control as an extension of your lease accounting is the easiest, lowest cost way of mitigating the risks and maintaining compliance.

In order to calculate sales tax accurately, you need to track current sales and use tax rates for every taxing jurisdiction in the U.S. and Canada, which is more than 7,000 locations and 60,000 potential jurisdictions (as several may apply simultaneously). You also need to analyze each transaction to determine whether it is intrastate or interstate, which taxing jurisdictions are involved, and the applicable maximum tax base and excess amounts. You should calculate the taxable, nontaxable and exempt amounts separately at every state and local level. You need to track the order-acceptance location as well as ship-to and ship-from locations in order to ensure you conform to the taxing rates for each jurisdiction. On top of that, you need to be able to track credits and adjustments.

Lessors typically have the option either to pay tax to the vendor at the time of the purchase of the property, collect use tax from lessees on lease receipts, or timely pay use tax on the purchase price of the property leased. In the last two cases, lessors have the responsibility of calculating the sales and use taxes that they charge the lessee and remit to each jurisdiction. Most lessees are content to rely on the lessor's calculation. Lessees of tangible personal property do not have the election of paying tax on the lessor's purchase price or lease payments. Lessees are governed by the reporting procedure chosen by the lessor. It is important to note that lessees cannot extinguish their tax liability unless they have receipts showing payment of tax to lessors. In many states, regulations require that lessors who hold a seller's permit are required to issue receipts to their lessee. A lease agreement granting the lessee an option to purchase the property

results in a sale when the option is exercised. The tax applies to the amount required to be paid by the purchaser upon exercise of the option. The tax would apply to the sale to the lessee regardless of whether the lessor has paid tax on the cost of the equipment at the inception of the lease or on rental receipts.

D. Property Tax (US) or Capital Tax (Canada)

Property taxes are a similar challenge to sales taxes, given the tens of thousands of jurisdictions in the U.S. alone. With property taxes, the lessee sometimes has the added burden of filing. Not only must you track the changing tax laws and keep up-to-date with the assessment and filing deadlines, you must also make sure that each filing is accurate and complete. Your team will need to establish the fair market value of your property, manage appeals, create and accrue tax estimates and process your property tax bills in order to stay in compliance and minimize your exposure

Ad valorem property taxes are based on ownership of the property, and are payable regardless of whether the property is used or not and whether it generates income for the owner (although these factors may affect the assessed value). The most frequent use of property taxes in the U.S. is by municipal governments, authorized to generate necessary revenue in this fashion under state law.

In general, machinery, equipment, fixtures and furniture are considered personal property unless permanently affixed to real property. Leased equipment, including equipment leased under a lease transaction, is subject to the personal property tax and must be listed with the assessor for each jurisdiction. Either the lessor or the lessee is responsible for listing the equipment, based upon the terms of the lease. Under a lease transaction, the legal owner of the property is ultimately responsible for the filing and payment of property tax, although most leases pass the financial burden back to the lessee. Additionally, the lessee is required to report information regarding leased equipment on their personal property tax return, including the lessor's name and address. So, if you miss a filing, there is a good chance the state will catch you.

E. Corporate Tax

You also must track organizational changes and asset changes and test for the appropriate classification of assets and transactions to remain in corporate tax compliance. These actions will reduce allocation errors between legal entities (overstatement and understatement of sales and corporate tax liability) and allocation errors due to incorrect physical location or coding, and will ensure continued auditability of your lease and asset portfolio. In addition, many lessees lack the corporate tax reports and related accounting reports in order to determine the deferred income taxes in a cost-effective manner. Maintaining supporting evidence of deferred income tax entries related to lease transactions (which are often highly complex) over the required SOX period is a fundamental requirement that is often lacking.

F. U.S. Financial Accounting Standards Board No. 13 (FAS 13), Canadian Institute of Chartered Accountants (CICA Section 3065), and the International Accounting Standards Board No. 17 (IAS 17)

FAS 13, CICA Section 3065, and IAS 17 are explicit about how companies must fully disclose lease obligations in the footnotes of their annual reports. In order to maintain compliance, lessees must follow these standards strictly. Many lessees rely on their lessors to perform the FAS 13 tests for ownership when considering lease transactions, However, their lessors can easily make mistakes, resulting in misclassification and misstatements by the lessee. Most lessees struggle to maintain an accurate accounting of their lease portfolio and also invest considerable time recreating reports using spreadsheets every time they publish a financial statement. From a SOX perspective, using spreadsheets to prepare disclosure information is insufficient – as there are uncontrolled risks of human error, especially if you lease tens of millions of dollars of assets in many geographic locations. From an auditors perspective, the high-level numbers reported in your financial statements must be backed up by the details of each transaction to the asset-level.

Most lessees up until now have not focused on this level of auditability and do not have the necessary infrastructure to meet the compliance standards.

Financial Accounting Standards Board (FASB) publishes the Statement of Financial Accounting Standards No. 13, and the International Accounting Standards Board (IASB) publishes the International Accounting Standard No. 17 – both are entitled “Accounting for Leases”. These statements establish standards of financial accounting and reporting for leases by lessees and lessors. FASB first published their standard in 1976. Using substantially the same approach, both statements clarify how lessees must classify a lease (an operating lease or a capital lease) based on specific criteria and how to account for and report on each lease classification.

The theoretical basis for the criteria is ownership of the asset, which requires that the owner takes on a sufficient portion of the economic risks of ownership. FAS 13 have well established and understood tests to indicate ownership. If a lessee does not own the property, the lessee does not capitalize the equipment under lease. For the lessee to capitalize the equipment it does not own would be a misrepresentation. If FAS 13 tests of ownership indicate that the lessee is the owner, the company must capitalize the equipment.

Performing these tests rigorously upfront and documenting your work is fundamental to maintaining FAS 13 compliance. Keep in mind that the calculations require that you use your incremental borrowing rate, which is typically confidential. Many lessees rely on their lessors for these tests and simply trust their calculations, even though the lessor may not have complete information required to perform the tests accurately.

FAS 13 requires detailed disclosure of lease terms including duration, obligations, options and any guarantees by a lessee. This requires that you maintain an up-to-date financial accounting of your entire lease portfolio. It also requires that you prepare summary reports for every financial statement. For example, on a quarterly basis at least, you need to produce an accurate note disclosure for minimum lease payments.

By automating the capturing of the portfolio information, the accounting, and the reporting, a lessee can exploit the technology to simplify the controls, mitigate risks and ensure compliance. While most Enterprise Resource Planning systems have a fixed asset subledger associated with the general ledger, these subledgers typically do not handle the recording of lease information well. As a result, it typically takes considerable human involvement to aggregate the data required for disclosure. Public disclosure of five-year minimum lease payments should be fully auditable with detailed back-up available down to the debits and credits for each asset. How your company is performing against compliance standards should be easily viewable through key performance indicators and reports. With SOX, getting these disclosures incorrect could cost the CEO and CFO their jobs.

G. Generally Accepted Accounting Principles (GAAP)

Financial accounting for leases (FAS 13) has been in place as US GAAP for over 25 years.

H. Sarbanes-Oxley Act (SOX) – Sections 302, 401, 404, 801, 802, 803, and 906

For lessees, SOX puts a spotlight on the risks of a decentralized and fragmented leasing process, in which the potential for losses, fraud and non-compliance are high. For example, in such a liberal leasing environment, swashbuckling individuals can complete deviant transactions that are opaque to the company’s financial stewards. SOX requires that you tighten up if not transform your leasing operations by properly controlling them with clear, documented policies, processes, controls, and authorities. Achieving SOX compliance may be best achieved by standardizing, centralizing, and automating your leasing operations, while still enabling users to request and complete transactions in distributed geographic locations (discussed later).

SOX established new standards for corporate accountability and new penalties for acts of wrongdoing. SOX changes how executives, directors, and auditors must interact with each other.

It holds CEOs and CFOs accountable for the accuracy of financial statements and eliminates the defense of "I did not know about financial issues". SOX also defines new financial reporting responsibilities, including adherence to new internal controls and procedures designed to ensure the accuracy of corporate financial records.

SOX requires all financial reports to include an internal control report. This is designed to demonstrate that the company's financial data is accurate and the company has confidence in them because adequate controls are in place to protect financial data. Annual financial reports must include an assessment of the effectiveness of the internal controls. The company's auditing firm is then required to attest to that assessment by reviewing controls, policies, and procedures in a Section 4040 audit, completed along with a traditional financial audit.

Non-compliance penalties vary from loss of D&O insurance and the loss of exchange listing, to fines and long-term imprisonment. Non-compliance can also result in a lack of investor confidence. If a CEO or CFO submits an incorrect certification, they may be subject to a fine up to \$1 million and imprisonment for up to ten years. If the CEO or CFO submitted an incorrect certification "willfully", the fine can be increased up to \$5 million and the prison term can go up to twenty years. Below are the sections that apply to leasing.

Section 302: Corporate Responsibility For Financial Reports: The "principal executive officer and principal financial officer" shall prepare a statement along with the quarterly and annual report to certify the "appropriateness of the financial statements and disclosures contained in the periodic report, and that those financial statements and disclosures fairly present, in all material respects, the operations and financial condition of the issuer."

Section 401(a): Disclosures In Periodic Reports; Disclosures Required: Each "financial report . . . shall disclose all material off-balance sheet transactions" with "unconsolidated entities" that may have a material current or future effect on the financial condition of the company.

Section 404: Management Assessment Of Internal Controls: Requires each annual report to include an "internal control report", which shall:
(1) state the responsibility of management for establishing and maintaining an adequate internal control structure and procedures for financial reporting; and
(2) contain an assessment, as of the end of the issuer's fiscal year, of the effectiveness of the internal control structure and procedures of the issuer for financial reporting.

Section 802: Criminal Penalties For Altering Documents: "Whoever knowingly alters, destroys, mutilates, conceals, covers up, falsifies, or makes a false entry in any record, document, or tangible object with the intent to impede, obstruct, or influence the investigation or proper administration of any matter within the jurisdiction of any department or agency of the United States shall be fined under this title, imprisoned not more than 20 years, or both." More importantly, it directs the SEC to establish "rules and regulations, as are reasonably necessary, relating to the retention of relevant records such as workpapers, documents that form the basis of an audit or review, memoranda, correspondence, communications, other documents, and records (including electronic records) which are created, sent, or received in connection with an audit or review and contain conclusions, opinions, analyses, or financial data relating to such an audit or review, which is conducted by any accountant who conducts an audit of an issuer of securities."

Section 906: Criminal penalties imposed if information does not fairly represent the financial condition and results of the company.

I. Securities and Exchange Commission (SEC) – the latest on SOX and Leasing

On June 15, 2005, the SEC identified lease accounting as an area in particular need of increased transparency in its report on the use of off balance sheet financing arrangements by public companies. The SEC asserted that accounting authorities should reconsider current guidance on how to report the financial results of leases and consider the possibility "of reporting all financial

instruments at fair value". For lessees, the conclusion here is straightforward: get your leasing operations into a state of compliance now, so that you can easily adapt to any changes in accounting or reporting requirements later.

The report was mandated by Section 401c of the Sarbanes-Oxley Act of 2002. The report was prepared by the Office of the Chief Accountant, the Office of Economic Analysis and the Division of Corporation Finance. It includes an analysis of the filings of issuers and an analysis of pertinent U.S. accounting principles and Commission disclosure rules. The report encourages the U.S. Financial Accounting Standards Board and the International Accounting Standards Board to pursue a joint project to reconsider the accounting for leases. In the report, the SEC recognizes that such a project "would also likely take a significant amount of time as well as necessitate a substantial commitment of FASB resources". However, the SEC believes the project is required to eliminate the "bright line tests [that] have served to facilitate significant structuring of leases to obtain particular financial reporting goals." According to the report, one hundred companies moved nearly \$8 billion in assets with outstanding liabilities off their balance sheets. By contrast, retained interests reported on balance sheets of those same companies equaled about \$1.6 billion.

The report explains that current rules treat lease contracts as if either all or none of the performance occurs at the beginning of a lease. That approach does not allow the balance sheet to reflect the fact that both parties in a lease agreement have some interest in the assets, receivables, or payables associated with the lease. The approach ends up with economically similar arrangements receiving different accounting treatments depending upon which side of the all-or-nothing performance at the beginning of the lease each party falls. The impact of this is significant. In the companies studied, about \$16 billion in cash flows related to capital leases were undiscounted. 77 percent of 200 companies the SEC reviewed have off-balance-sheet operating leases in the amount of \$1.25 trillion.

In the report, the SEC identified four goals for improving transparency in public reporting and disclosures:

1. Discourage transactions and transaction structures motivated primarily by favorable accounting and reporting implications rather than economics;
2. Expand the use of objectives-oriented standards;
3. Improve the consistency and relevance of disclosures; and
4. Focus financial reporting on communication with investors, rather than just compliance with rules.

The report acknowledges that such changes would be a complex and controversial project for the Financial Accounting Standards Board (FASB). The report does not set a timetable for consideration of a new standard. While both standards-setting bodies have stated their objectives to revise the current lease accounting framework globally, for the moment, neither FASB nor IASB have planned a formal project. The only activity in this regard has come from the standards-setters in the UK, who have been involved for several months in a lease accounting "research project".

J. The Committee of Sponsoring Organizations of the Treadway Committee's (COSO) Enterprise Risk Management (ERM) Framework

You can apply the COSO ERM Framework to change your leasing operations to comply with SOX. If your firm already uses COSO, then you can leverage your company's compliance experience by focusing on applying the principals of COSO to the processes and controls of your leasing operations. Best practices in this regard are discussed later. Here we introduce the COSO ERM Framework and discuss the elements of it that are relevant to your leasing operations.

SOX requires public companies to develop an accounting control framework for the purpose of fraud risk mitigation and the protection of shareholders. However, SOX provides no guidance as

to standards for fraud risk mitigation and compliance. COSO's Enterprise Risk Management (ERM) Framework has become the commonly accepted model for discussing and evaluating the organization's risk management processes and is the most widely accepted tool for Section 404 remediation among all publicly traded companies. It is designed to raise a consistent "risk and control consciousness" throughout the enterprise.

According to the COSO ERM, 'internal control' is a process designed to provide reasonable assurance regarding achievement of objectives in the following three categories:

- effectiveness and efficiency of operations
- reliability of financial reporting
- compliance with laws and regulations

Using the COSO framework effectively, companies are expected to be able to accelerate the controls development and Section 404 compliance process – reducing cost and achieving compliance more quickly. Relevant to our discussion about changing leasing operations to achieve compliance and improve financial performance, the COSO framework recommends that a company must have all of the following capabilities for effective internal controls:

- a control environment,
- risk assessment,
- control activities,
- an information system, and
- communications and monitoring.

K. Compliance Issues Related to Asset Disposal

An increase in public attention to financial disclosures and corporate governance issues and SOX are driving greater scrutiny of methods for quantifying and disclosing potential environmental and data security liabilities related to the disposal of assets. The Gartner Group writes that many companies store their retired technology assets rather than face the complex tasks of environmentally safe disposal. SEC rules for disclosure of environmental liabilities require publicly held companies to evaluate and, if material, to disclose liabilities from actual or threatened legal proceedings, and financial impacts that may result from emerging trends in these regulations.

In most cases, liability is not related to ownership, so you can't bury your head in the sand and write it off as the lessor's problem. For lessees, the bottom-line is this: make sure you track all of your assets, whether you own them or not, through their complete lifecycle until you return them. When dispossessing or disposing of assets, make sure you properly transfer the liabilities to the next owner or get the appropriate certifications of their destruction to ensure compliance with federal, state and local laws. Here is a quick survey of the laws and the compliance requirements that apply to your leasing operations with regard to the disposal of assets.

1. Environmental Laws and Disclosure Rules

- a) *Resource Conservation and Recovery Act (RCRA)* - RCRA gave the EPA the authority to control hazardous waste from "cradle-to-grave." This includes the generation, transportation, treatment, storage, and disposal of hazardous waste. It is not just companies that can be held liable but also "a corporate officer who is either personally involved in actual company decisions regarding the handling of solid or hazardous wastes, or in charge of and directly responsible for a company's operations with the ultimate authority to control the disposal of such wastes". Please note: the EPA is not required to prove that the person had control over the activities that create the endangerment or to show negligence or willful misconduct.
- b) *Toxic Substances Control Act (TSCA)* - The act authorizes EPA to secure information on all new and existing chemical substances and to control any of these substances that could cause an unreasonable risk to public health or the environment.

- c) *Comprehensive Environmental Response Compensation and Liability Act (CERCLA) and the Superfund Amendments and Authorization Act (SARA)* – These laws provided broad Federal authority to respond directly to releases or threatened releases of hazardous substances that may endanger public health or the environment. Subchapter I of the 1983 amendments established a comprehensive system to react to releases of hazardous substances and to determine liability and compensation for those affected. The U.S. Fish and Wildlife Service is responsible for conducting assessments to establish injury and the dollar equivalent of that injury for collection of damages from parties responsible for releasing hazardous materials. Keep in mind, many landfills will not accept toxic waste, this includes certain kinds of electronic waste – like monitors and computers – because of the toxic chemicals involved. Computers can contain toxins including lead, mercury, and even arsenic, all of which can leach into the soil if they are disposed of in landfills. For lessees, the concern about this potential liability is derived from the strict liability imposed on "owners and operators". Under CERCLA, if there is a release of a hazardous substance, owners or operators of a facility at the time of a disposal, transporters of hazardous substances, and generators of hazardous substances are strictly liable for cleanup costs.

In certain true lease cases, the EPA has deemed lessors liable for cleanup costs. The EPA amended CERCLA a few years ago to codify an EPA enforcement rule that exempted lessors from much of the liability. The amendments provides an exemption to lenders and lessors from the strict liability provisions of CERCLA if: 1) lessor's retained interest in leased property is primarily for the purpose of securing the repayment of the lease obligations, rather than speculation on the residual value; and 2) the lessor does not participate in the management of the equipment. Nonetheless, two concerns remain if the lessor takes possession of the financed collateral: A) the lessor has to try to resell or re-lease the property at the earliest practicable time after foreclosure or other repossession. The EPA has deemed this to be twelve months. B) the lessor may still be held accountable if it transported or arranged for the disposal of a hazardous substance.

Almost every state has enacted similar legislation, albeit on a much smaller scale. Many state laws similarly hold a lessor accountable only if it is involved in the management of and/or cause the contamination. Conclusion: The potential liability for a lessor for any repossession or return of the equipment may still exist. However, at both the federal and state level, lessees as the "owner and/or operator" bears the brunt of the liability for proper disposal and need to manage their risks accordingly.

- d) *Electronic Waste* – Several states, including California, have already passed laws intended to ensure environmentally safe recycling and disposal of electronic equipment. The legislation identifies what equipment is covered and clarifies the recycling fee collection and remittance process with much of the burden placed on lessors and lessees – not manufacturers. By contrast, the Council of State Governments - Eastern Regional Conference (CSG-ERC), which includes 15 member jurisdictions within the United States and Canada, have prepared model legislation that relies on manufacturers to compensate government for costs of product recycling and disposal with allowance given manufacturer product take back programs. State legislators have planned to release the final draft bill on October 1, for immediate introduction in Connecticut, Delaware, Maine, Massachusetts, New Hampshire, New Jersey, New York, Pennsylvania, Rhode Island and Vermont.
- e) *SEC Environmental Disclosure Requirements, Regulation SK* –
- ii. Item 101 of Regulation S-K, 17 C.F.R. § 229, requires a company to disclose material effects of compliance with environmental laws.
 - iii. Item 103 of Regulation S-K requires a description of "any material pending legal proceedings, other than ordinary routine litigation incidental to the business, to which the registrant or any of its subsidiaries is a party." Item 103 specifically requires that a description of any administrative or judicial proceedings arising under federal, state, or local environmental laws or regulations be included if the

proceeding is material. It also requires disclosure of any enforcement proceedings that reasonably may be expected to result in sanctions of \$100,000 or more, regardless of materiality.

- iv. Item 303 of Regulation S-K, concerning MD&A, contains a general requirement to disclose “any known trends, demands, commitments, events or uncertainties” that are reasonably likely to have a material effect on a company’s bottom line. The SEC has developed a two-part test to aid companies in determining whether disclosure is required in MD&A. Management must first determine whether the trend or event is not reasonably likely to occur, in which case, no disclosure is required. If management cannot make that determination, then disclosure is required unless management can determine that, assuming it occurs, such trend or event is not reasonably likely to be material.

2. Data Protection and Privacy Laws and Data Erasure Standards

- a) *Gramm-Leach & Bliley Act* – This law imposes stringent requirements to protect consumer data from release and includes three key rules related to asset disposition and disposal. The Privacy Rule governs the collection and disclosure of customers' personal financial information. The Safeguard Rule requires all financial institutions to design, implement and maintain safeguards to protect customer information. The Pretexting Rule protects consumers from individuals and companies that obtain personal information under false pretenses. Key takeaway for lessees: don't let company issued palm pilots or laptops go to resale or disposal without ensuring proper hygiene, i.e. delete it right.
- b) *Health Insurance Portability and Accountability Act (HIPAA)* - This law imposes privacy obligations on healthcare and insurance companies. An essential component of data risk mitigation is erasure verification and an audit trail.
- c) *Department of Defense(DOD) and National Security Agency(NSA) Data Erasure Standards* - Data that has only been written over once or twice is susceptible to recovery. For this reason the DOD and NSA have promulgated secure delete standards, which specify how to overwrite disk drives in order to render the data completely unrecoverable. Conventional manual erasure techniques at the desktop or in the data center will leave data on most of the systems. Deleting the sensitive files will not protect them from recovery. Operating systems may maintain unidentified copies of these files and passwords in unused parts of your computer. The potential civil and criminal liabilities are significant, not to mention the possible damage to your corporate reputation should a loaded hard drive end-up in the wrong hands. Data erasure of a given hard drive is not sufficient unless the corporate owner is able to prove it was erased.

L. The Issue of Materiality

Management must have their eyes open and be willing to see reality in order to avoid bad consequences when making “materiality” judgments. The issue of materiality applies to many of the situations in which companies may or may not be in compliance with the laws, standards, and requirements above. In many situations when identifying risks and evaluating their significance, whether a company chooses to disclose certain liabilities turns on whether the company deems them to be “material.” Generally, an issue is material if there is a substantial likelihood that a “reasonable investor” would view its disclosure as having significantly altered the “total mix” of information. The SEC has consistently warned firms that materiality has no quantitative threshold, noting that even relatively small numerical differences could influence investors significantly. The SEC has warned companies, in fact, not to make materiality determinations based solely on quantitative “rules of thumb,” such as 3% or 8% of total assets. Please see SEC Staff Accounting Bulletin No. 99 (SAB99) (www.sec.gov/interps/account/sab99.htm). The SEC has also repeatedly stated that the purpose of disclosure requirements is to permit an investor to see inside the company through management’s eyes.

IV. PROBLEMS WITH LESSEES LEASING OPERATIONS – WHAT ABOUT YOUR COMPANY?

In many public and private companies today, the leasing process is an opaque, complex area of corporate finance that often involves poor accounting, decentralized management, broken processes, and incomplete systems. These issues can lead to costly financial mistakes and a variety of control and compliance problems. So fixing your leasing operations involves overcoming challenges of expertise, policy, process, technology, and corporate politics.

A. How bad is it?

Most problems in leasing operations involve sins of omission because financing capital expenditures are typically viewed as the poor step child of corporate finance. This is the reality: many finance executives lack the visibility, controls, policy, technology, and resources needed to attend to their leasing operations, resulting in sub-optimal economics, cost leakage, and compliance exposure. In most companies, leasing is a decentralized activity without any centralized controls. In some companies, the financing model is not the best fit for their business strategy. The accounting detail for each transaction is often widely distributed in many spreadsheets and inaccessible. Often the lack of standardization and error checking leads to poor data quality and unuseable reports. As a result, finance executives often have no idea who is leasing what to whom, lack the confidence that the right decision-making is in place for incremental financings, and lack the information required to measure and communicate effectively. In some cases, many employees have buying authority but lack clarity about what finance's requirements are with regard to capital expenditures and who has authority to finance them. In some cases, leasing is managed by a specific department, such as the IT organization, without a clarified financing strategy promoted by the finance team.

Decentralized management and fragmented systems likely means that controls and compliance management are in poor shape. Transactions lack traceability. Policies, procedures, and controls may be poorly designed, incomplete, and unclear creating an environment in which opportunistic individuals pursue crafty transactions that are not in the company's best interests or intentionally bamboozle budget limits through financing. In many situations like this, financing decisions are based on personal relationships rather than shrewd economics. This can cause costly errors, such as questionable off-balance sheet structure or pricing. Insufficient internal controls and audit procedures result in unreliable financial reporting and an inability to provide stakeholders with reasonable assurance regarding achievement of objectives in equipment finance.

In this section, we will break down the problems and analyze each of them and their significance carefully. With this understanding, we can then evaluate the gap with current standards and discuss best practices and their benefits.

B. Lack of Executive Attention and Visibility

Let's start with you – the "finance executive" of a lessee. In companies of all sizes, leasing lacks executive attention and visibility. Quite often leasing transactions just "happen", with no overall strategy or policy. Because leasing has grown organically based on local relationships, management of the leasing process is decentralized and executives do not know who is leasing what with whom. The people who are actually executing the leases may be unclear about their authority. As a result, finance executives lack confidence that the incremental decision-making about economics and the terms and conditions of transactions is being carried out properly.

Here's the catch-22: When a company has a decentralized financing process for capital expenditures and lacks controls and automation, executives do not have the information required to:

- understand people's needs related to leasing, form policy, and automate,
- improve policies and procedures incrementally,
- measure performance of the leasing process, and
- communicate the leasing strategy effectively to the rest of the company.

C. Insufficient Lessor Management

Most lessees do not manage their lessor relationships sufficiently. In some cases, the financing model may not be the best fit for the strategy of the business. For example, some lessees have an exclusive relationship with one large lessor out of convenience, resulting in monopolistic rates and terms. While others use 30 or 40 different lessors, each with different terms in the Master Lease Agreement, resulting in a higher cost of capital, poorly negotiated terms and conditions, and unnecessary inefficiency, complexity, and administration costs. Problems with the lessor relationships, the lessor model, and the economics of transactions are interrelated and may result from a lack of expertise, experience, or interest on the part of whoever is negotiating agreements. They may also result from the lack of time or resources required to manage the process. Regardless, poor management of the financing relationships can lead to a host of problems, including:

- a lack of access to capital due to unforeseen exposure issues with a particular lessor;
- vendor payment issues that may impact your credit rating,
- insufficient customer service that increases errors and inefficiency of the process and
- incorrect invoices or tax calculations.

D. Poor Transaction Execution and Contract Management

Many companies suffer from poor transaction execution. If no one in the company is rigorously performing FASB 13 tests (and documenting/archiving the math) at the time of the transactions, for example, the off-balance sheet nature of the transaction can be called into question. Even when a confidential person in the company determines that a transaction passes the FASB 13 test, if the other terms of the transaction do not substantively support the lessors ownership and economic risk in the transaction, such as strict return provisions, an auditor can force a company to recognize the transaction on their balance sheet. Poorly tracked and managed documentation can lead to significant cost leakage. For example, if the line items on Purchase Orders, Invoices, the actual equipment received and tested, and the Certificate of Acceptance are not properly reconciled at the time of the transaction, a lessee might pay too much without knowing it.

E. Insufficient Asset and Portfolio Management

When managing individual assets across their lifecycle and managing the entire portfolio (all of the financial and logistical dimensions of leases and assets) several critical problems are endemic in companies. Assets are often incorrectly encoded (Serial Number, General Ledger Code, Business Unit, Legal Entity, Cost Center, etc.). Assets can also be misclassified, leading to complications in accounting, tax, and budgeting, inappropriate disclosure on financial statements, and significant exposure issues with lessors and external authorities. If the lessee upgrades an asset or moves the asset to another location and does not disclose the change to their lessor, the lessee will likely be out of compliance with their MLA and have tax exposure from the change in jurisdiction.

Many companies depend on their lessors/lessors to document a transaction, calculate the taxes and payments correctly, and provide them with reports. Several problems arise with this approach to portfolio management. If a lessor makes a mistake in their calculations, it could result in the company overpaying for the lease or underpaying the taxes, both of which would not be internally controlled. If the lessor is performing the reconciliation of the PO-Invoice-CofA, the lessee is subject to the discipline and quality controls of each lessor. If the lessor makes a mistake, the lessee has the exposure, resulting in overpayment, underpayment, or paying for something you did not receive. If a lessor does not provide easy access to all of the documents and data related to the transaction, it becomes difficult for the company to develop compensating internal controls and the transaction becomes fundamentally unauditible. If a company uses multiple lessors, the company must then access the stovepipe system of each lessor in order to aggregate and report on their overall portfolio. Within the lessees organization, there exists no centralized source for all of leases and assets, as each lessor uses different systems, creating unwanted complexity and bureaucracy for the company's treasury, controllers, users, and auditors.

Many companies run into problems because they can't get the right information. On the one hand, some lessees rely on their lessors to provide them with the information they need, only to find that there are severe limitations with most lessor systems. Typically, the lease accounting system of lessors only record transactions at the schedule level because lessors only need to track the basic financial terms of the lease in order to send you a bill, such as original cost, lease rate, date, and term. On the other hand, some lessees generate schedule level information internally and capture it in the general ledger. In this case, the information is created with a scenario similar to this:

1. your payables clerk gets the PO information from your purchasing department with the basic lease information;
2. calculates and inserts a monthly expense payment in the GL for the term of the lease (such as 36 months); and
3. writes a memo to the entry in order to record the basic lease information along with the entry.

In either case, schedule level information is insufficient for controlling your leasing process and ensuring compliance. For example, when an asset is moved, lost ("misplaced"), or damaged and these changes are undocumented and undisclosed, a lessee may be out of compliance with their master lease agreement and/or can face sales and/or property tax exposure. If there are any mid-term events, such as a partial buyout, either the lessee will have to depend on the lessor's calculation (which was done by hand outside of their "schedule-based" lease accounting system), or the lessee will have to make a change to their GL without the ability to back-up the calculation with the proper asset detail, or the change will simply not be reconciled properly with the GL. Moreover, if the lessee does not properly manage organizational changes such as reorganizations, mergers, and acquisitions, then assets and lease payments can be misassigned or misallocated, or even overlooked, resulting in problems with internal budgeting, P&L analysis, and balance sheet integrity.

Finally, managing poorly the end-of-term of the lease or the end-of-life of the asset, especially its disposition, may result in significant risk exposure and economic loss. Most lessors make their money at the end of term. In a decentralized leasing process with poor controls and documentation, it is easy to miss required notifications regarding the end-of-term, resulting in automatic extensions or renewals, penalties, and overpayment. Even if a lessee executes the required notification and chooses to pay the "fair market value" at the end of a lease, if the lessee does not have the resources to negotiate what that "fair market value" is, the lessor will demand and get the terms that are favorable to them and sometimes at egregious, abusive rates. Also, lessees that buy some or all of the assets at the end-of-term and fail to perform the proper inventory accounting may face audit and compliance challenges. Regarding asset disposition, as discussed exhaustively above, there are many state and local regulations designed to address environmental pollution, data security, and data privacy. If your leasing operations does not adhere to the rules, you could be exposed – as an individual and a company.

F. Ineffective and Inefficient Leasing Operations; Dependence on Spreadsheets

Many companies today suffer from fragmented systems, including stovepipe home grown software applications created to solve narrowly defined problems, such as an access database created to track key lease terms; third party ERP systems or asset management software; and ad hoc spreadsheets - by far the most prevalent. The fragmentation may result in the following:

- a dependence on spreadsheets as the core analytical tool and data store,
- a lack of an overarching leasing strategy and process,
- missing functionality needed to close the gap between the functionality of the components and the automation requirements of the overarching process,
- a lack of integration of the components,
- a lack of a centralized database for the data, and
- a lack of reconciliation with key internal systems (like the GL) and external systems, like the lessors lease accounting systems.

- multiple people performing the same tasks/function in different parts of the organization resulting in duplication of work (like re-keying data) and costs.

Process and system fragmentation and missing automation results in redundant data entry (often 3 and 4 times), poor data quality and integrity, and poor data security – all of which reduce productivity. This makes for a challenging decision-making environment, as the reporting and analytics are then inconsistent and the data suspicious - further degrading company performance.

Many firms run their leasing operations on spreadsheets. This involves checking and rechecking homegrown financial calculations, demands considerable maintenance, and, because of errors or omissions, is a source of risk. Clearly, spreadsheets alone don't work. Spreadsheets also do not provide executives or any other stakeholders with the visibility into operational performance or control risks that could result in financial restatements or fraud.

As expected by SOX and related standards, executives of public companies must evaluate their company's effectiveness and efficiency of operations in their capital expense finance/leasing process and provide reasonable assurance regarding achievement of objectives. Those executives who fail to address the operational and automation requirements of their leasing process may be at risk.

G. Poor Controls and Compliance Management

One of the most significant thrusts of recent corporate legislation is the clear accountability of individuals for their decisions and actions. Poorly designed, incomplete, or unclear policies, processes, technology systems, internal controls, and audit procedures for leasing operations create uncertainty and a vacuum of accountability. These conditions encourage swashbucklers to pursue transactions on their own without oversight. Under these conditions, management has little to no visibility. This can lead to intentional dodging of budget limits, such as transactions driven by personal relationships with lessors rather than objective financial stewardship as evidenced by a competitive funding process; failure to comply with laws and agreements; and in the worst cases, fraud and embezzlement.

Sole accountability then rests with the CFO and CEO. Historically, for example, in the notes of their public financial statements, a company's executives have only been required to disclose their five-year minimum lease obligations for operating leases, and properly account for their capital leases on their balance sheet. Today, by contrast, executives must also evaluate their internal controls, audit procedures, governance, and ethics in their capital expenditure financing process and change them to ensure SOX compliance, and disclose any material risks or failures to comply. The bottom line is this: executives that are not able to track and trace every person, event, document, asset, and data for each transaction and all related communications for on balance sheet or off balance sheet lease transactions; provide lease accounting at the asset level fully reconciled with their general ledger; and demonstrate the reliability of their financial reporting (especially for off-balance sheet transactions like operating leases) face risks, material deficiencies or non-compliance, and the potential for litigation, fines, and imprisonment.

V. APPLY THE 19 BEST PRACTICES: WHAT FINANCIAL EXECUTIVES MUST DEMAND

Finance executives should demand more than just compliance from their SOX initiatives; they should demand measurable improvement in the performance of their organization. In order to manage lessors, transactions, leases, assets, and the portfolio over their lifecycles, finance executives should adopt best practices that guide them in deploying their lease accounting expertise, policies and procedures, processes, and technologies. When best practices are applied, management will bring these benefits to their leasing operations: savings, visibility, insight, controls, change management, compliance assurance, and stakeholder fulfillment.

In this section, we will examine the 19 best practices for lessees in leasing operations and how they meet financial executives demands for the following:

- A. *Control and Automation* – get the process, policy, and information systems right
- B. *Visibility, Insight and Transparency* – let everyone see what's happening so they can do their jobs
- C. *Lifecycle Accountability* – make sure people do their jobs right
- D. *Improved Financial Performance* – demand improved economics, efficiency, and savings

Lessees need to continuously apply and improve best practices in order to drive company performance and continually meet related corporate objectives. Finance executives can then focus on their strategic objectives with the confidence that their leasing operation can and will deliver.

A. Control and Automation

1. Clarify, document, and communicate strategy, processes, and policies.

Financial executives first need to define and document the strategy for their leasing operations. Why do you lease equipment? Why does your leasing operations exist? How does leasing support the CEO's company strategy and CFO's finance strategy? Once the strategy is written-down, it is vital that everyone on your finance team is able to explain it to the rest of the stakeholders in your business. You can make it easy for anyone involved in leasing in your company to read it by publishing the strategy on your intranet. This is the easiest way to bring about alignment of the leasing operation with the rest of the company and begin to drive value.

2. Identify the key processes of your leasing operations.

Next, identify the key processes of your leasing operations. How does a lease flow through your company? For example, who can initiate a lease? Who in your company is responsible for making a lease vs. buy decision for each asset type and lease type? Is it Treasury, the Controllers in each Business Unit, or the IT organization? Construct the framework of the processes by defining the who, what, why, how, when, and where and be clear about objectives. As you describe processes, define the policies that will control them. Also, as you describe processes, assign individual employees as owners. Then, link the processes to the financial statements that they ultimately affect. For example, one common misconception is that for capital leases, these processes, policies, controls, and responsibility allocations are the same as those put in place for purchased assets. This oversight is a result of virtually identical accounting and disclosure treatment of capital leases, until the end of lease term. However, capital leases (just like operating leases) create very unique issues at the end of lease term. While purchased assets continue to be passively depreciated, leased assets must be pro-actively acted upon. If the equipment is bought out at FMV, or if the equipment is returned, adjustments to the capitalized F/S values must occur. There must be processes in place, and appropriate authority levels handling the end-of-term process, such as arms-length determination of FMV, auditable support of re-capitalized amounts, approved G/L entries, communications with Lessors of intentions, and determination of revised depreciation methodologies. Controls surrounding these events are essential to support management assertions as to the accuracy and completeness on the financials, and demonstrate to all stakeholders that the company is acting to reduce unnecessary costs such as overpaying FMV's (overstating balance sheet) or going on month-to-month lease charges after normal lease term (impacting long term profitability).

By linking processes to statements, you can focus on the parts of your leasing operations that are on a critical path toward accounting, financial reporting, and, ultimately, business performance.

3. Identify risks and controls in your leasing operations.

For each activity in the leasing process you describe, identify the risks and the controls for each risk that are relevant to financial reporting and business performance. There exists significant literature on the risks faced by lessors, but very little is ever mentioned about lessee risks. There also exists significant knowledge and expertise within leasing companies. Therefore, an environment exists where experienced individuals, with intricate knowledge of leasing contract

terms, attempt to mitigate their own risk, by passing it on the Lessee, who is typically far less knowledgeable. This, in and of itself, is a significant risk which impacts more specific risk areas, such as restrictive return provisions, burdensome notification requirements, unreasonable interim rent factors, and excessive end-of-term and month-to-month rents. Lessors may provide competitive monthly lease rate factors, but they may attempt to make their profit on the before term, or end-of-term events. Often, Lessees total cost of ownership (TCO) is dramatically higher than originally calculated. The controls to mitigate these risks are often complex, requiring a standardized approach to selecting reputable funding sources for long term relationships, and adhering to strict guidelines for legal, operations, accounting, and tax review of all contracts, looking out for specific risk clauses.

To ensure a consistent and reliable level of financial reporting, assign ownership for each control to an individual who will evaluate the effectiveness of that control. For example, a V.P. in your Legal department may have overall responsibility for approval of all such contracts, after getting sign-off from the various department heads for operations, tax and accounting. Then define procedures for each control that itemize steps for the control owners to follow when evaluating the effectiveness of a control. For example, a contract review checklist may be maintained, requiring the review team to specifically identify areas having a significant impact on the company and its financial reporting. The CFO may be responsible for ensuring that all leases are structured as operating leases, and specify if the terms of a lease contract meet the operating lease criteria before entering into the lease transaction. The determination of the incremental cost of borrowing rates would need to be supported, documented and maintained. The asset management team may have responsibility to sign off that they have the required systems in place to track and report on assets as required under the terms of the master lease agreement, and document the specifics of those procedures, before the Company enters into an agreement, for which they are unable to comply with its terms.

Following a defined schedule, the control owner must judge for the given procedure whether the overall control is successful. Processes and controls can then be evaluated consistently throughout your leasing operations. Financial executives can then connect controls to financial statement assertions. This is fundamental to determine the readiness of the organization's system of internal controls over financial reporting in your leasing operations. The information gathered through this process can also be analyzed through on-line reports, or an executive dashboard, to track key operating metrics and performance criteria. In this way, financial executives can understand the quality of their compliance and the value their leasing operations is driving for the business.

Again, once the processes are described and policies and controls defined for your leasing operations, publish them on your intranet. These will serve as the initial set of requirements for the automation. As we discuss a little later, your leasing automation system should automate the processes and enforce the policies.

4. Connect owners within your organizational structure with controls and reporting.

Next, identify the parts of your organization that are material to the business controls and reporting efforts of your leasing operations. Most companies have defined the structure or hierarchy of their organization and maintain a central electronic representation in one core system (aka the system of record), such as in their ERP system (e.g. PeopleSoft, SAP, Oracle), consolidation and reporting software (e.g. Hyperion), or LDAP server. In this system, you map the hierarchy of business units and subunits to the way your business works. You must also assign individuals ownership for each business unit of your organization.

Whether you build it or buy it, your lease automation software should enable you to define your approach to internal controls for financial reporting related to your leasing operations around your existing corporate structures. In fact, your lease automation software should be easy to integrate with your core reporting platform (eg. ERP, Hyperion, etc.) and automatically update and reconcile when changes are made to the core system due to reorganizations or acquisitions. If

not imported from the core system, the lease automation software should enable you to identify individuals who are assigned ownership of divisions, processes, controls and control evaluations. The lease automation software should help you to classify which business units you consider to be key contributors to the overall assessment of business controls and reporting and which individuals within those business units will be accountable for each component of the assessment. This ability to classify makes it easier for you to define the level of resources and skills of individuals necessary to properly evaluate your underlying business controls.

5. Simplify processes and automate to test compliance and improve efficiency.

To ensure that you are consistently applying controls and testing compliance and that your leasing operations can scale efficiently (without getting mired in paper and spreadsheets), it is important to redesign and simplify processes where possible and then automate them. In considering compliance, automation is essential to enforcing controls, eliminating spreadsheets, and tracking the audit trail for each transaction. Using web-based workflow automation, document management, and transaction processing software, your systems should also accelerate the execution of transactions – from start to finish, improving the productivity of the process for all stakeholders.

Also, to use SOX as a means of improving business performance in your leasing operations, you may need redesigned processes and more powerful tools that reduce your company's administrative burdens. This requires that you consider a leasing automation and lease accounting system from the beginning of the process. The leasing automation software/systems you deploy, and the processes they automate, should meet these objectives:

- allow decentralized purchase requests with optional leasing programs,
- facilitate centralized procurement with optional leasing programs,
- enable centralized document management (include all signed documents which satisfies auditors),
- allow decentralized asset management, wherever the assets are located,
- enable centralized leasing, lease accounting and portfolio management in a shared services model,
- create and maintain synergies among divisions, and detect exceptions and correct errors before they spiral out of control.

Recall that the COSO ERM framework recommends that a company must have all of the following capabilities for effective internal controls:

- a control environment,
- risk assessment,
- control activities,
- an information system, and
- communications and monitoring.

Overlooking how these capabilities impact your overall technology infrastructure can leave you surrounded with ineffective stovepipes of information rather than the desired central repository. You can avoid this pitfall by planning for and adopting a leasing automation and lease accounting system with a centralized database as early as possible. The system should support a centralized (or federated) database (or datawarehouse) model that captures and stores all the detailed data about a transaction and enables detailed lease accounting at the asset level (more on this below). This centralization of data and asset-level accounting simplify the collection and sharing of data in a consistent manner, which is fundamental to building trust in the accuracy of the reporting. Data centralization and accounting also enable companies to take advantage of the economics and effectiveness of a shared services model. When you add to web-based workflow and reporting services, you make it much easier for users to take advantage of your leasing programs to finance capital expenditures wherever they may be, geographically or organizationally. By helping you to document, test and assess your business controls and processes throughout your enterprise, automation of your leasing process will help you with SOX 404 compliance and can help you transform and optimize your business. In short, with these best practices, you can improve controls and productivity simultaneously.

At a minimum, the automation infrastructure you deploy should have these capabilities in order to facilitate compliance and continuously improve financial performance:

- Support the end-to-end process of ordering and receiving equipment, establishing a lease, and tracking assets. Facilitate transactions, document exchanges, and workflow among the multiple parties that participate in transactions. Users should be able to quickly and efficiently work on their appropriate tasks and then resume their day-to-day work activities. Users should be able to create, send, and track acquisition requests, purchase orders, asset assignment and notification documents, certificates of acceptance, and lease schedules. These capabilities reduce paper, accelerate lessor review and acceptance, and improve overall productivity because all stakeholders –internal and external - can collaborate at any time in the lifecycle of a lease or an asset.
- Link together all documents in the supply chain into a coherent audit trail and enable access to documents and data to authorized users through browse and search techniques. Provide traceability of all people, events, docs, data, and communications related to every transaction. Then, by aggregating these data, you can drill down and explore the data. These capabilities provide fast, high-level visibility into the effectiveness of controls and reduce audit errors and compliance deficiencies.
- Facilitate step-by-step line item reconciliation so you pay for only what you ordered and received and eliminate being overcharged or undercharged.
- Track and manage the financial dimensions of all leases and assets, individually and as a portfolio, through an asset-based lease accounting and portfolio management system. This will enable your leasing team to perform accounting at the asset level, including sales and property tax calculations.
- Support Web-based reporting and analytics. Make sure you are able to easily create dashboards that provide a deep view of your lease portfolio and quick identification of leases, assets, leasing business processes, subprocesses, controls, owners, and risks.
- Enable quick and effective evaluations from your staff with little or no interference with their primary responsibilities. With the controls, processes, and systems in place, your leasing team should be able to evaluate their controls in a consistent way. Control owners should be able to access the system, execute evaluations, log out and continue with their work.
- Support the currencies, languages, and accounting requirements in every country in which you operate.
- Support easy integration with internal systems (purchasing, asset management, ERP, G/L, etc.) and external systems (lien management, tax management, etc.) using standards like XML and SOAP. Integrating with your internal systems reduces keystrokes, errors, and improves productivity by eliminating duplicative data entry. It enables you to reduce the high inherent risk of error due to the manual, ad hoc integration of data from different data sources.
- Ensure security at the data, application, system, and network levels and reliability with sufficient fail-over and back-up services

6. Closed-loop, asset-level accounting using a lease accounting subledger.

To ensure accuracy in accounting and tax and demonstrate compliance, especially with SOX and FASB, you must consistently execute a series of accounting processes and controls across the lifecycle of leases and assets as described above, regardless of the whether or not the transactions are off or on balance sheet. The processes and controls of your leasing operations must integrate with your other internal processes and controls, including purchase requests, authorization, ordering, and receiving, on the front-end of the leasing process; and asset-management, accounts payable, general ledger, fixed asset subledger, and consolidation and reporting on the back-end of the leasing process. By connecting these processes together with a seamless flow of data, documents, and the controls to ensure integrity of the transactions, you effectively “close the loop” in your accounting for each transaction and the management of your portfolio over the lifecycle of the leases and assets.

This “closed-loop” asset-level accounting is most easily achieved through automation of the leasing process and integration with your other systems. As discussed, unless your ERP can handle all of the compliance aspects of leasing including asset-level lease accounting, your plans for automation should include deploying a lease accounting subledger (a software application that is designed for asset-level accounting). Such an asset-level, lease accounting subledger generates debits and credits at the asset-level for any type of equipment financing transaction. For example, it allows you to spread all costs, (including taxes, insurance, etc.) over the assets proportionally, giving you accurate “all-in” accounting for each asset and each schedule.

As you execute the leasing process, you should encode all assets with the appropriate accounting references (such as Serial Number, the GL code, Legal Entity, Business Unit, Department, Cost Center, etc.). This will eliminate any allocation work after the accounting is performed as the expenses are automatically allocated to the appropriate code when a stakeholder generates a report.

By performing closed-loop, asset-based lease accounting (with step-by-step line item reconciliation), you can reconcile all documents and G/L entries through the entire lease and asset life cycle. This eliminates spreadsheets, ensures proper calculation of taxes, eliminates the inefficient and inaccurate process of allocating assets to budgets, and produces a clean and efficient audit process. This ensures a fully supported balance sheet and income statement, with reporting and drill down capabilities, for all internal organizations (corporate, divisional, project, and cost-centers). It also provides G/L schedule-level entries support, by reconciling with asset-level accounting entries. This facilitates reporting at all levels via consistent data element flow through the entire enterprise. It enables financial executives to demonstrate their stewardship function of assets, with the appropriate level of accounting detail. Finally, if ever required by FASB (given the SEC’s recent push for capitalizing lease assets), management will have the ability to reclassify leased assets from operating leases to capital leases (either prospectively or retroactively).

B. Visibility and Transparency

Executives and other authorized stakeholders should have quick and easy access to the data, original documents, audit trail and the reports they need to make decisions and run the leasing operations. The data must be accurate, relevant, timely and available to only approved authorities in the company.

7. Capture your historical portfolio.

If you are starting from scratch, you should collect and organize the original lease documentation for your lease transactions. Technically, you should go back far enough to include all assets that still have economic value (economic life). In practice, you typically only need to capture transactions that occurred over the last five years. When you have the documentation collated, scan it into your central repository and scrape the minimum data elements from each document package required to meet portfolio management and internal and external reporting requirements.

8. Capture complete audit trail.

After the historical portfolio has been captured, you will need to adopt a new process for electronically capturing the remaining data that allow you to manage a single, centralized, up-to-date database of all lease transactions and the related lease and asset portfolio. Capture all of the documents, data, events, communications, time-stamps, statuses, and authority information related to each transaction in order to build a complete audit trail. With a comprehensive portfolio, managing leasing operations and compliance becomes much easier.

9. Build customized dashboards for all stakeholders.

With the documents and data in one place, you now need to allow each group of stakeholders to access the data they need to advance their work. By interviewing and surveying each stakeholder group (such as controllers, treasury, procurement, or IT) you can identify the most important information that each group needs to use on a daily, weekly, monthly, and quarterly basis. Then

driven by their priorities, you can build a dashboard for each group that allows them to track the key performance indicators through a high-level report – and the “dashboard” automatically updates in real-time. From their dashboard, stakeholders can then drill down to explore and download more detailed, related data as needed. By giving each stakeholder group their own dashboard into their centralized repository that automatically updates, you can eliminate ad hoc spreadsheets and databases and give all of the authorized stakeholders the visibility into the leasing processes, controls, and portfolio they need.

Improved visibility means you and your company get better and faster budgeting, allocation, reporting, forecasting, profitability analysis, decision-making, and business performance. For example, these best practices should improve the accuracy of the budgeting process by providing projections of monthly lease payments and buyouts automatically – no spreadsheets required. It also lets you analyze anticipated lease transactions accurately, based on the pipeline of Purchase Orders and Invoices that have not yet been attached to a lease schedule. You can also extract data used to support key company analysis – such as unit costs.

C. Lifecycle Accountability

Executives that take a strategic view of SOX can use the requirements as an opportunity to improve visibility, transparency and accountability in their leasing operations and lease accounting across the leasing lifecycle - and improve performance of their business processes in the process.

10. Engage competent, experienced experts to manage leasing operations.

Great business starts with great people. The capital expenditure financing process should be managed by experienced leasing professionals. While many companies can not afford to hire a dedicated leasing expert, whomever is involved in the leasing process – experienced or not – should be held accountable for their role and responsibilities in the overall process. The appropriate people in your firm should be held accountable for negotiating the lease agreements up-front, analyzing transactions, managing any mid-term events, and managing the health of the portfolio through the end-of-term and end-of-life for every transaction they started.

Whether you train your existing team or hire from outside, having people who are experienced in managing leasing operations for a lessee can make a significant difference in the effectiveness and efficiency of your leasing operations. Lease agreements should be managed and negotiated by trained financial people with the appropriate expertise. Key capabilities to look out for include: a strong lease accounting background; working knowledge of how the leasing industry uses credit analysis, pricing, structuring, and syndication to manage risks and make money; an understanding of how to use policy, controls, and technology to manage financial processes; experience managing lessor relationships; good communications skills; and a positive, service-oriented disposition. Running an effective leasing program requires spending time and understanding the language, priorities, and motivations of the Corporate Controller, the Treasurer, the head of Procurement/Global Sourcing, and the many stakeholders who will take advantage of your leasing programs.

11. Ensure leasing workflow is designed with role-based security and reporting.

Make sure that your leasing workflow, and the software applications that support it, are capable of providing role-based security and reporting. Role-based security and reporting ensures that stakeholders are only allowed access to the workflow and data that corresponds to their level of authority and role in the overall leasing process. This will help you pursue a consistent, organized approach to your leasing operations that can help your business quickly identify issues, hold individuals accountable for their actions, and mitigate risks. When you have role-based security and reporting in place, you define key roles and risks for each process in an organization. You then link the processes to corresponding financial statements. You then check controls you put in place with test cases to validate the effectiveness of financial reporting. Finally, you assign ownership by individuals at each level in the system, so that stakeholders can only focus on the specific controls and processes for which they are ultimately accountable. In this way, role-based

security and reporting will help you respond to SOX quickly and efficiently and improve productivity across the enterprise through role-based interaction and integrated collaboration.

D. Better Financial Performance

Improving financial performance requires better economics and greater efficiency. You need to ensure that the cost of capital and terms of financing are demonstrably competitive and objectively the best the market will bare.

12. Lessor model designed for business strategy.

For the most part, every lessee's lessor requirements are different – there is no one-size-fits-all solution. They do all have one thing in common: lessor competition is fundamental. There are many ways to systematically and consistently compete lessors. However, a blind auction approach will rarely deliver the results required, especially by large, Fortune 1000 companies. The bottom-line is this: each lessee needs a lessor model that supports their corporate strategy and will measurably improve company performance.

13. Lessor selection and performance management driven by your strategy and value.

In order to get the best financial performance, you must compete lessors and manage their ongoing performance to ensure you have the best terms available. Many lessees still work with only one or two lessors, while others have MLAs with more than 30 or 40 lessors. In either case, the finance executives are concerned that the people in their companies that are carrying out leasing transactions are leaving money on the table because they are not demanding the best terms and the lowest cost of capital from the market.

Upfront, it is important to develop a financing strategy that is linked to the goals and objectives set by the CEO and CFO. Then you should use this financing strategy to design a financing process that will deliver to the objectives of the strategy. The process should always be competitive. The number of lessors in the process, how and why lessors are selected and engaged, the nature of the transactions and the volume are key factors in determining the degree of competition that is appropriate and the number of lessors you should engage. These factors will also determine the effectiveness of a financing process, in terms of meeting the objectives of the strategy.

Competition will help lessees break the grip of a monopolistic relationship in which one leasing company dominates your business with uncompetitive rates. However, it is important to note that competition has its own costs. If you think about lessor competition as a spectrum, on the left end of the spectrum is the exclusive relationship with a monopolistic lessor; and on the right end of the spectrum is a pure auction. Holding other things equal, as you move from left to right – from monopoly to pure auction – the cost of capital should decline, however, the cost of engaging in competition should increase. As you increase ticket and program size, the movement of these costs will only intensify as there is an expectation on both sides of the transaction that increasingly more of the terms will be negotiated. Also, as you expand the number of lessors, if your volume does not grow commensurately, your volume per lessor will decrease, which may weaken your negotiating position.

So, it is important to strike a balance between these countervailing costs in such a way that will drive the best value for your leasing operations over time. For example, a company who has master lease agreements in place with 25 different lessors, may want to strengthen their relationships with their bankers in order to honor mutual commitments by limiting the competition to their banking syndicate. In this case, the company will pursue a consolidation strategy and actually reduce the number of lessors with whom they are engaged, gaining the benefits of a lower cost of engagement. In another example, a company with rapidly growing leasing volume needs to move from a duopoly (working with two lessors who specialize in different assets classifications) to a more broadly marketed, more competitive process over a multi-year period in order to systematically use their increasing volume to drive better pricing. Striking a balance with a focus on value, would plot most companies competitive funding strategy somewhere in the middle of the spectrum between these two extremes.

14. Involve those lessors that can best compete for your business.

In order to drive the best value, it is also important to know the lessor landscape and involve those lessors that are most fit to compete for your business. There are thousands of leasing lessors in North America, including banks, independents, niche, captives, brokers, hedge funds, and insurance companies. Each lessor has a different appetite that will vary depending on geography, credit, transaction size, asset type, structure, portfolio exposure, documentation, transaction processing infrastructure, and go-to-market strategy.

For example, if your firm is a “B-” credit rating and you need to acquire and finance a high-volume of low-priced assets from a variety of vendors, you will want to involve those lessors that have the infrastructure to manage a small-ticket, multi-vendor program that can support storied credits. In another example, if your firm has an “A –” credit rating and you acquire and finance a volume of small, medium, and transactions that includes computers and networking equipment, specialized manufacturing equipment, and an industrial vehicle fleet, you will have to engage a variety of different lessors and compete your leasing business based on ticket size, asset type, and likely geography. Those lessors who have organized themselves to serve the specific market segments that match your needs are likely going to have the deepest understanding and experience with your leasing requirements – and therefore should be able to serve them at the lowest cost and with the best terms.

Whenever possible, try to avoid the traditional origination channels by contacting the lessor directly and asking if they have a "buy-desk". If you are successful, you should expect to pay less overall as the lessor avoids paying the internal origination fees to sales people and should pass along savings to you in the form of a lower rate.

15. Manage a professional competitive process to get the best results.

In presenting a transaction or a program opportunity to the funding community, it is most effective to use a Request For Proposal (RFP) that requires all respondents to provide you with the same information. The clarity and thoroughness with which you explain your expectations and standards for performance, especially in longer term leasing programs, will impact the quality of the responses tremendously. In addition to the key financial terms, make sure to get samples of their documentation, as key terms and conditions can change the economics and accounting treatment significantly. When you have received the proposals, prepare a transparent, side-by-side ("apples-to-apples") comparative analysis and discuss the tradeoffs with your team. This will ensure that you decide the best path forward. Also, make sure that you write down your rationale for the decision and save it along with the comparative analysis for compliance and audit purposes. If you can afford the commitment of resources, it pays to negotiate and document relationships with multiple lessors simultaneously because you can use every lessor's best terms to drive the negotiations forward.

16. Manage the end from the beginning.

You will save money by properly managing all dimensions of your leases and assets throughout their lifecycles. However, the value of negotiating in the contracting process can not be understated. This upfront opportunity is what lessees overlook most and where expertise can have the greatest impact on the total cost of your leasing programs. Lessors make most of their money at the end of term when lessees miss their notice requirements, continue to pay invoices beyond the term on a month-to-month basis, or extend the lease. In addition, when lessees do not read or understand the details of their lease agreements, they can often be forced to pay steep penalties for mid-term or partial buyouts, end-of-term balloons, unjustifiably high fair market value quotes, or onerous return provisions. That is why it is vital to minimize any penalties or risks by negotiating carefully the language in the lease agreements. To the degree that you can standardize terms or whole agreements across all the lessors you are engaging, you will enjoy further reduction in the costs of managing your lease and asset portfolio. Your ability to standardize will depend in part on your credit rating and volume of leasing business – essentially how much muscle you have in the capital markets – and how many lessors are competing for the

type of leasing you need. In any case, there are techniques, like requiring the lessors to notify you when the lease is coming due instead of the other way around, that can have a big impact downstream after the lease is booked. Once the agreements are completed, as stated above, it is wise to automate the compliance with the terms of your lease agreements – so nothing can be overlooked later.

17. Understand and evaluate lessor performance.

Once lessors are engaged, it is also important to manage their performance over the life of the program. If you are putting a longer-term program in place, how the lessors perform can be vitally important to the health of your leasing operations. If a lessor is slow in paying your vendors, it could have a negative impact on your firm's credit rating. If you depend on your lessor for calculating taxes and they make an error, it is likely to result in your exposure. If you work exclusively with one lessor, your firm could experience a lack of access to capital when their portfolio becomes saturated with your paper and you may have to scramble under pressure to find a new lessor. Moreover, if you generate significant volumes, and your lessors are assigning your transactions widely in the lessor community, it is important to track the assignments and know who is holding your debt and equity on their balance sheet. In this case, even though you might be engaged with only one lessor, if your volumes are large enough and your primary lessor is assigning your transactions to other lessors, the other lessors could run into exposure issues. The key here is to be clear about your performance metrics upfront and manage the lessors along the way. So, do not be shy about asking for references in the RFP process so you can ask them, preferably your peers in similar firms, about each lessor's performance and hold/sell record and intentions. Also, it is worthwhile to evaluate the performance of your lessors on an on-going basis and share your metrics with the lessors so they understand how to serve you better. This will not only improve their performance and your economic value, but will also bring objectivity and transparency to your competitive leasing programs, reduce risks, and further improve productivity.

18. Routinely compete lessors for best long-term results.

In managing a competitive process on an on-going basis, consider the nature and frequency of your transactions. If you routinely have mid or large ticket straight lease transactions or sale lease backs, you may want to negotiate master lease agreements with several lessors that specialize in the asset types and transaction sizes and compete the business among them. If you need to run a high-volume, small-ticket program, you may want to engage multiple lessors in a long-term program, given the intensive servicing required to keep stakeholders and vendors satisfied. In this case, you will want to compete among the lessors you select on a quarterly basis, rewarding the most competitive lessors with the most volume. You will want to compete the program again with the general market place every one to two years.

19. Manage the end-of-term and end-of-life rigorously.

It is true that most fair market value lessors try to make their margins in leasing at the end-of-term. When a lease comes to term, assuming you have properly notified the lessor by the deadline about how you want to handle the end-of-term, you should have the information you need at your fingertips to ensure you are paying the lowest cost for the equipment based on an arms-length. If you choose to buy the equipment, you should have comparable third-party bids for the equipment in order to negotiate down the lessors proposal. In addition to reducing the lessors quote, this same information enables you to determine if it will be cheaper to buy-back and resell the equipment yourself.

If you choose to buy-out the lease and use the equipment, depending on your lease accounting treatment, you need to either capitalize and depreciate or adjust book values and reassess depreciation methodology. Just prior to the end of life of an asset, you should seek to get competitive bids from companies that specialize in asset remarketing and disposal under the assumption that they would acquire and proactively market the assets.

Through this process, be careful to manage your risks related to the waste stream, while maximizing the residual value you can extract from the asset. Some of these providers will assume the environmental and data security liability and take full legal responsibility for the asset from the time they pick up the equipment at your shipping dock. In these cases, the provider becomes responsible to investigate, litigate, settle and pay claims related to the asset as required. Just make sure you read the fine print as some assume more liability than others. You will want to collect a certificate of destruction for any assets disposed and file them with links to the related lease documents. This will enable you to fend off any claims that your company violated environmental or security laws, ensuring your firm's reputation and good will is protected. Attention to these end-of-term and end-of-life issues will decrease the cost of ownership, bring additional revenue opportunities from the resale, eliminate penalties and disposal risks, and improve inventory and end-of-life accounting and controls.

Many firms like to give away old computers to employees or charity organizations. There are many situations where this has resulted in a significant liability to the company. At the end-of-life of an asset, you must track the assets through the remarketing process and ensure that you document the sale and you are properly indemnified in the transaction for the risks of litigation and fines related to regulations governing environmental waste, confidential information, and data security that are appropriate for the asset type. If the asset has no resale value, you should seek the same protections through the disposal process.

VI. MAKE THE BUSINESS CASE: HOW TO GET YOUR COMPANY BEHIND YOU

Lessees that are ready to improve the financial performance of their leasing operations while bringing them into compliance should create an internal business case. The business case should explore specific problems (use Section III. above) that will have an impact on the viability and quality of the chosen solutions. Through an initial analysis of the organization's situation, you can clearly identify business requirements and develop vision, strategy, and policy accordingly. Creating a business case to support changing your leasing operations management ought to include three basic stages: voice-of-the-customer, ROI analysis, and pilot implementation.

A. What are your company's requirements?

Voice-of-the-customer prioritizes the company's needs and expectations about ways changes to your leasing operations can improve compliance, reduce costs, improve productivity, and offer strategic benefits. The voice-of-the-customer tool, a component of the Six Sigma methodology, provides a structured approach to gathering and quantifying the company's requirements. This approach includes an examination of the following:

- Who uses and is involved in leasing and leasing operations?
- What features of leasing and leasing operations do they use and benefit from?
- What needs to change in order to improve leasing operations?
- What is the value of those changes to the business performance?
- Customer interfaces and business strategies
- Compliance issues and impacts
- Support processes and service levels

B. ROI Analysis – How does this help us perform financially?

Ideally, your approach to the business case will pursue the disciplined Six Sigma methodology, including the customized, total cost of ownership (TCO) and ROI analyses that accurately identify relevant costs and benefits over the lifetime of your company's investment in leasing operations. Important benefits of leasing operations management fall into the following three categories:

- *Hard-dollar savings* – for example, reduced costs of capital, reduced costs of portfolio management
- *Increased staff productivity due to advanced features and services* – for example, elimination of paper processing, head count reduction, consolidation in the number

for lessor relationships

- *Life cycle benefits that are difficult to quantify* – for example, compliance with all laws and standards and the resulting reduction in liabilities, confidence in reporting and disclosures

It is important to focus on hard-dollar savings in the ROI calculation, as well as to estimate and quantify less-tangible benefits that may be relevant to the company's specific business environment.

C. Pilot Implementation – What does the end-to-end process look like with our data and documents included?

Pilot programs are vital to gaining stakeholder acceptance of your leasing operations. For a pilot of your target leasing operations to be successful, the financial team must not only demonstrate the value of the service but also confirm the appropriateness of and understand any issues regarding the underlying operating model and readiness of the existing people, processes, and infrastructure while providing proof of buy-in within the organization.

A pilot should go beyond just basic transaction walkthroughs, which has already been completed in most cases. Everyone should play a role in the success of the pilot. The finance executives in close coordination with other department heads must prepare an overview of its ideal leasing operations management strategy and stakeholder requirements (voice-of-the-customer). Then the financial team responsible for delivering the leasing operations management solution must identify opportunities, conduct the ROI analysis and create the business case. The team should also address program management, creation of the historical portfolio, software selection, installation, and integration, and management of lessors, transactions, and the portfolio, deployment of the new services, and ongoing support.

VII. ABOUT THE AUTHOR

Michael Keeler has served Ecologic Leasing Solutions as the President and CEO since 2003. With offices in the US and Canada, Ecologic Leasing Solutions provides leasing operations, lease accounting, and leasing automation software to public and private companies on an outsourced basis. Michael welcomes any questions or comments about this guide. You can reach Michael by: calling 703-929-8343 (US) or 514-394-7070 (Canada); or emailing: keeler@ecologicleasing.com. You can learn more about Ecologic Leasing Solutions by visiting: <http://www.ecologicleasing.com>.