



VISUAL LEASE



Healthcare Lease Accounting Insights:

How two organizations got compliant and stay audit-ready all year long



PennState Health





Healthcare organizations need to be prepared to transition to lease accounting standards (ASC 842, IFRS 16 or GASB 87), and ideally, have a plan for compliance before adoption dates kick in.

ASC 842	Effective date for public organizations	Fiscal years beginning after December 15, 2018
	Effective date for private organizations	Fiscal years beginning after December 15, 2021
GASB 87	Effective date for organizations	Fiscal years beginning after June 15, 2021

In this whitepaper, we will describe what you should be aware of to get compliant. Two major healthcare organizations, Montefiore Health System and Penn State Health will share their own experiences and will provide insight into how you can stay audit-ready as your leases change throughout the year.

We'll take a closer look at:

- Common challenges with achieving compliance
- How to sustain compliance throughout the year
- Industry best practices and tips

The following is transcribed from a live webinar presentation, featuring a question-and-answer format from the following speakers:



Fred Berardinone

Vice President, Finance,
Montefiore Health System



James Rogers

Senior Financial Analyst,
Penn State Health



Joe Fitzgerald

Senior Vice President, Lease
Market Strategy, Visual Lease



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Healthcare organizations that have not yet adopted will likely need to follow either ASC 842 or GASB 87.

Joe Fitzgerald, Visual Lease:

James and Fred, could you speak to which standard your organization follows, and why?



**James Rogers,
Penn State Health:**

At Penn State Health, we adopted ASC 842 as of July 1, 2019. We did not have to address the IASB

(international) or GASB (government) standards, but we did give ourselves a little bit of a runway in achieving compliance.



**Fred Berardinone,
Montefiore
Health System:**

Montefiore Health System has publicly-issued debt and we're required to follow the

public timeline on ASC 842. So, we started our implementation in May of 2019 and were fully implemented for December 31st, 2019.

Keys to successful lease accounting

Preparing for lease accounting

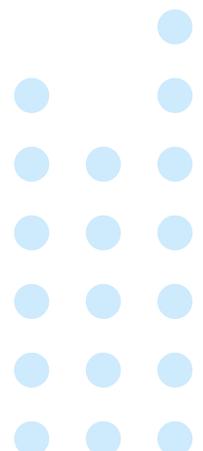
Joe Fitzgerald, Visual Lease:

To meet the effective date for compliance, there are things healthcare organizations should keep in mind to be successful.

First, you need to develop a **robust project plan**, and pull together a well-rounded cross functional team.

Then next, you need to get your lease population in order. You need to consider if you're going to use any third-party service providers for such things as data abstraction, technical accounting advisory or project management. You may need to license a technology solution that can enable successful adoption of the lease standard.

How did your organizations get there? What were some of the things you used to your advantage?





Fred Berardinone, Montefiore Health System:

A key ingredient to our success was early adoption of the lease accounting standards. We looked at it in four phases – **I.)** assessment and readiness planning, **II.)** development of policies and procedures, **III.)** lease abstraction and data storage, and **IV.)** solution implementation.

In phase one, we looked at our governance structure and put together a project team. The project team was across all areas of the health system -- accounting, IT (on both the technical and operational side), change management, procurement, treasury, real estate, etc. We had an executive sponsor and a project steering committee, which included parties from those departments. We had a director, a project director and a project manager to cover our transition and implementation.

From there, we went through five objectives: **I.)** building our cross-functional team **II.)** collecting and organizing contracts, **III.)** determining if the contract was or contains a lease, **IV.)** capturing lease data, **V.)** automation with software.

Also, our auditors were well-involved throughout the whole thing, since they were going to be responsible for auditing. We kept them involved in our whole process, to let them know where we stood, how we were viewing the standard and what we were doing, to have their blessing throughout.



James Rogers, Penn State Health:

Fred covered it nicely at that high level. In terms of building a team, one thing I would stress is educating that team. Make sure that they're aware of the ongoing guidance because this is new guidance that is still developing. Build up that team cross-functionally, then educate them.

At Penn State Health, we brought on consultants from Grant Thornton who managed the project. They brought us tools, such as a centralized lease repository tool, which is key because depending on where you're at in implementation, this is the first time organizations have really had to capture all of their lease agreements and look for **embedded leases**. That centralized data repository was key for us.

To educate yourself on the guidance, there's a lot of good publications out there. Also, be aware of the **practical expedients** that are available to you – they can cut implementation costs and minimize the scope of the project.



Compiling a complete lease population



Joe Fitzgerald, Visual Lease:

Let's talk about some keys to success. There are main things you should have, regardless of the standard you need to meet.

The first one is complete lease data. It's no surprise that having comprehensive lease data is critical to lease accounting. You need to gather all lease types including common leases, such as real estate, equipment, land, fleet.

But you also need to deal with the less common leases, like embedded leases and subleases.

Can you speak to what you did to ensure a complete lease population?



James Rogers, Penn State Health:

It was very extensive. At Penn State Health, we started with capturing all our real estate leases and known leases. The reason we did that is because, for lack of a better term, it is low-hanging fruit. For those agreements, we were able to put our hands on them pretty quickly. So we captured those lease agreements and started data extraction on our known population. That allowed us to really dig into the search for embedded leases.

Embedded leases are new to everyone. For those who aren't familiar with embedded leases, at a high-level, they are when you are receiving a piece of equipment within a contract. For example, you'll see a lot in certain healthcare departments, such as pathology, contain a lot of embedded leases. There were certain methodologies that were used by Grant Thornton and myself to identify them.

We performed targeted department searches, reaching out to financial liaisons at Penn State Health who are responsible for knowing the operations for the department. We also worked with accounts payable to identify recurring payments. Those are just some of the things that we did to identify embedded leases. A significant amount of time was spent, I would say, by Penn State Health in that embedded lease search.





Fred Berardinone, Montefiore Health System:

We had two beginning points on capturing our lease data.

We looked at our 2018 audited financial statement and our operating lease footnote and the support that went behind that. On the main entity under Montefiore, we had an existing lease admin tool that captured all our real estate leases. But the member hospitals did not have a lease admin tool; it was more manual.

To capture that information, I met with stakeholders, real estate and accounts payable to go through AP reoccurring payments, footnotes support for their audited financial statements and interviewed the stakeholders under real estate purchasing, IT, lab facilities, legal, radiology and surgical services to identify our strong lease population as our beginning point.

Once we had that, we did all the tests. We partnered up with Ernst and Young; we partnered with them on testing for embedded leases and carving through our population of equipment leases, as opposed to the real estate leases that we felt we already had a hold of. From there, we were able to carve through our lease population.

Managing changes to leases



Joe Fitzgerald, Visual Lease:

Another key to success is accurate calculations and reporting.

Leases are dynamic – new leases come on and old leases come off all the time. Companies take on new spaces, scale back or renegotiate, and you have to account for every change. This has especially been true during COVID.

Equipment leases come with their own complexity, as assets are often leased as a group and individual assets get switched out or moved to different locations.

Could you talk about some of the challenges that you had in addressing the changes to your leases?

Accurate calculations and reporting depend on having correct, complete and timely lease information. Further, lease accounting regulations continue to evolve, particularly because they're so new.



**Fred Berardinone,
Montefiore Health
System:**

It was really a two-fold approach, one on the real estate side and one on the equipment lease

side. On the real estate side, we had an outside consultant who did all our lease abstraction, and they would manage all the leases working with the landlords and the real estate group on any lease changes or anything like that.

On the accounts payable side, we had to build in a tool on our GL side for any changes that triggered a change that requires finance to review with procurement before moving on.

James Rogers, Penn State Health:

The real estate leases were probably the biggest change. We'll get into maintaining compliance later, but your real estate lease population will probably be impacted the most. We built upon the communications between the real estate lease coordinators and finance in maintaining compliance and making any necessary re-measurements or modifications into our lease accounting software (Visual Lease) database.

Joe Fitzgerald, Visual Lease:

Let's talk about internal controls and guardrails. There are many stakeholders involved with leasing, each with their own processes, systems and silos – (such as brokers, procurement, legal operations, accounting, tax, IT, you name it).

You need to make sure you're maintaining an accurate **audit trail** and implementing guardrails so that the changes that are being made by everybody are by the book.

Can you share your considerations regarding cross-functional changes that affect accounting?



**James Rogers, Penn
State Health:**

A lot of times, we found it's believed that [lease accounting] is just a finance function. But finance relies heavily on supply chain,

real estate and other departments when identifying leases.

To successfully work cross-functionally, we've set in place processes and policies, including ongoing communication between the real estate lease coordinators and finance - built around our Visual Lease solution.

You really have to take some time determining policies and procedures because the process flow or the workflow will inevitably change with this new guidance, and you will be leaning on this to help stay compliant.





Fred Berardinone, Montefiore Health System:

The importance of us leveraging automated lease accounting software was to have a centralized lease management system that we can build workflows to our policies.

Similar to James, it's all really finance's domain, we would say liaison in this. But once again, this goes back to all the parties involved.

It's important to build automation from the data in the solution into the general ledger and accounts payable, so that information is blessed by lease administration and finance.

So just as James mentioned, it's about building that workflow, building those policies and procedures, and going back to test them. We had internal audit take a look at our policies too, just verify that that's how the system was working.

Building a sustainable, ongoing lease accounting process



Joe Fitzgerald, Visual Lease:

It sounds like what you both did at the start of the project, in terms of working with the other folks, has really paid off as you move forward in terms of cooperation and collaboration, that's great.

So with that, let's move on to talk about sustainable ongoing processes.

As we just mentioned, lease terms change all the time. You need to account for every change and manage your month and month-end close at the same time. It's not scalable if you don't have the right people or have processes in place.

Unlike those who have yet to go through this, both Penn State Health and Montefiore Health System have been through two year-ends now reporting under the new lease standard. ***What's made your process sustainable through those two reporting periods?***



Fred Berardinone, Montefiore Health System:

For Montefiore, it's been the ongoing communication between real estate and finance. We're keeping communication open monthly. We have our quarterly filings that we're looking at, looking at roll forwards and changes in our filing. It's really constant communication, for the most part, between finance, real estate and procurement. So it's that constant workflow across the board. This is an organizational thing, as James mentioned, it's not a finance thing. This is really an organizational thing. It's really staying on top of all the parties involved.



James Rogers, Penn State Health:

I don't have too much more to add there except again, you're hearing common themes between Fred and I.

Real estate will be your heavy hitter. Build up that relationship with your real estate lease coordinators. Your monthly leases are the most impacted here. It'll have the most impact on your financial statements, so have that mechanism in place. Real estate lease coordinators should communicate with you monthly, if not more regularly, about any modifications or re-measurements, which is what we're talking about when we're talking about real estate leases.

Fred Berardinone, Montefiore Health System:

Exactly. Just to add on, the accuracy of the output is really dependent on the accuracy of the input. That input is coming in on the front-end from lease administration.

Joe Fitzgerald, Visual Lease:

With this, we can transition to our next question. ***Before you transitioned to ASC 842, what was your biggest anticipated concern with achieving lease accounting compliance?***



Fred Berardinone, Montefiore Health System:

The most significant challenge we saw, especially on the member hospitals without a lease admin tool, was getting our hands around the high volume of lease agreements and ensuring completeness of the data.

Also, the data migration from our old lease admin tool into the new lease admin tool was a big lift that needed outside consultants, a ton of testing and extracting the data into the new system.

We knew this was going to be a big lift. We were backed into a corner on our timeline – the timeline was a challenge.





Joe Fitzgerald, Visual Lease:

It's interesting, Fred, you mentioned the bankers - this is the first time we've talked about that. I know,

for public companies, it's obvious, right? Their financial statements are out there in the public sphere. But for private entities, they do have other stakeholders that need to be kept in the loop here and will be interested in the results of this standard. For private entities, they need to make sure that they have kept them properly informed along the way, particularly in their bank.

Before compliance, your organization's state of readiness to adopt is a common, universal overall challenge.

What does your current state look like and what does your future state need to be? From this comparison, you can identify the gaps that exist beforehand, including getting complete lease data. Post-compliance, there are still challenges, probably more than you think. By identifying those areas now, upfront and being aware of them, you can be better prepared as they come up.

Could you talk a little more about some of the challenges before compliance? I'd like to understand the way that you both approached staffing for the data extraction component of your project.

Fred Berardinone, Montefiore Health System:

Sure. As mentioned before, compliance required involvement of the entire organization. Prior to that, real estate signed the lease, finance received a copy, and it was processed to accounts payable.

But now it goes back to that involvement across the organization, post-compliance. We've been testing this now for close to two years. We had minimal errors, but it was that constant communication between mainly real estate, finance and procurement.

The use of technology really was important, too. If we were to do this through Excel, which we did on some of the smaller hospitals for just maybe five or six leases, still was a major process and a ton of room for error. So, it is really necessary to capture all that lease data through the use of technology.



James Rogers, Penn State Health:

One major gap that we experienced at Penn State Health, we lacked a robust contract management system. Penn State Health

used ASC 842 as an opportunity to build not only the lease management team, but also develop contract management more. Again, I think this is the first time in a long time that organizations have had to really search for every lease.

You may run across the same challenges when you go to ask your contract specialists for every equipment lease. They've never had to organize their leases in such a way to put their hands on it, at least that was the situation at Penn State Health.

Fred Berardinone, Montefiore Health System:

Same at Montefiore. We started using the GL in other ways that we haven't used it before to identify these contracts.

Joe Fitzgerald, Visual Lease:

Yeah, it's interesting how many clients or companies we come across that don't have contract management systems in place, right? The lease project was really the first time to get a real centralized contract management approach that they can then build on for other types of agreements and contracts.

Fred Berardinone, Montefiore Health System:

Yeah, we saw that our contract management system really didn't speak to the GL also. So this was a way to bridge that, too.

Common challenges for healthcare organizations



Joe Fitzgerald, Visual Lease:

Got it. The leasing standard really hits everybody, regardless of your industry. But next I want to talk about some common healthcare challenges – not that they are exclusive to healthcare. But there are things that we see in healthcare more often than maybe some other industries? For example, these intercompany leases, particularly between hospitals within a group.

There are separate company financial reporting that goes on with some hospital systems. We talked about lease population – sometimes there's challenges just because of all the hospital consolidation that's going on, the hospitals buying physician groups or other ancillaries. Then, leases are commonly left in file drawers at the old location.

In addition, there's other healthcare specific challenges. I'm curious if there are any concerns related to HIPAA. We talked about embedded leases a bit. James gave a great example of a type of embedded lease that we see more often in healthcare than really anywhere else. Plus healthcare, as I like to say, they're reluctant landlords. Not only do they have large real estate portfolios as lessee, they're also landlords and lessors. They also have a very diversified equipment portfolio.

James, maybe you could start by just expanding on a couple of the points I just touched on or any others that you think are specific to healthcare in terms of challenges.



James Rogers, Penn State Health:

At Penn State Health, we're now at over 150 real estate leases. We have approximately 75 known finance leases. When I say known, I mean, capital leases under the old guidance. Then we found 50 to 60 potential embedded leases. It actually got us to a population of 25 embedded leases when we were going through the project and adopting the guidance. Some embedded leases have expired since then.

In healthcare, at least at Penn State Health, we are trying to get away from embedded leases. But they are very common in the healthcare industry. So, I'm just going to touch on determining the lease population completeness because of all those leases, that's where we spend a lot of the time. I can tell you that probably the majority of the time you're going to spend on the project and the resources involved will be with determining the lease population.

At Penn State Health, we're not really experiencing any of the other challenges here, but I know they are common at places. Having individual hospitals report separately, we do have different entities that report separately, but then they get consolidated. So we didn't run into issues in financial reporting.



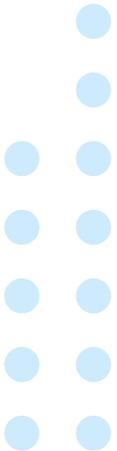
Fred Berardinone, Montefiore Health System:

Sure. We did not have any intercompany leases between any of the Montefiore or their affiliates. But we do have a separate company financial report. Besides Montefiore Medical Center, there's three separate audited financial statements that go out. They are separate boards too at the financial statements roll up to for review. So we had that challenge between Montefiore Health, the Medical Center, and what we call them the member hospitals, because there was no centralized leasing tool.

We had about 400 real estate leases all-in, and the bulk of them, 70%, was in Montefiore's original lease admin tool. But the other leases, like you mentioned before Joe, were stored in drawers.

We had to reach out to landlords and manually go through the leases. So that was definitely a challenge.

For the embedded leases, we definitely did a good amount of testing. We didn't find anything that was material, but as James mentioned before, it was really that data challenge, looking at all our data across the board and making sure we had our complete data within material aspects of the health system.





Joe Fitzgerald, Visual Lease:

Any issues pushing down ASC 842 to the member hospitals that they were reporting separately, or did you have a way to deal with that?

Fred Berardinone, Montefiore Health System:

No. Well, we had to do a few of them in Excel, and really got to learn the calculation on the required disclosure. But no, everyone was on board. There were really no issues for that.

Joe Fitzgerald, Visual Lease:

James, as you mentioned, this industry is ripe with embedded leases. I worked with a number of health systems, and I did see a variety of embedded leases, so folks should get started on that early. That's one place I did see companies look to bring in outside assistance in the accounting advisory area to help them with as well.

James Rogers, Penn State Health:



Absolutely, because embedded leases are not as identifiable as I made it seem to be. Embedded leases are new. There's a lot of publications out there on embedded leases. My suggestion would be to read up on that guidance because a lot of your time will be spent on that embedded lease search.

Maintaining lease accounting compliance

Joe Fitzgerald, Visual Lease:

Let's talk about how to maintain lease accounting compliance. Maintaining and sustaining lease accounting compliance is sometimes called Day Two. Because once you're compliant, a lot of people don't think about what comes next. It's critical to stay compliant all year long, and not run into issues. ***How does your organization maintain compliance all year long and deal with it throughout your audit?***



Fred Berardinone, Montefiore Health System:

As we mentioned before, for post-implementation, the key to success is ongoing communication. We have our quarterly filings, so we're looking at this quarterly. We run it monthly for our monthly internal financial statements. But it's really constant communication with real estate.

Pre-implementation, ledger work for us and link it between the new software tool and the GL. We go back quarterly, and we test it and look at any changes and make sure that we captured everything. As a result, we had minimal errors so far in the past three years.

Joe Fitzgerald, Visual Lease:

Fred, you mentioned accounts payable. *Is your software solution integrated with your GL and AP?*

Fred Berardinone, Montefiore Health System:

It does. We integrate a payment file through accounts payable for them to process the payment after it gets approved from real estate admin and finance.



James Rogers, Penn State Health:

You don't want to get stuck thinking this is just a project where you're gathering leases and you're entering it somewhere, hopefully not an Excel spreadsheet, and then you're done.

You should be thinking and developing those policies and procedures health system-wide. To be quite frank, to stay compliant, depending on how large you are, you would want to consider getting away from Excel spreadsheets.

Joe Fitzgerald, Visual Lease:

Looking back, is there anything you would have done differently?

Fred Berardinone, Montefiore Health System:

Yes, we would have handled the data abstraction from our old lease system to the new software differently. We would have visited that a little more. We had to hire a consultant who had to help us out with that. We ideally should have visited that more on the front-end because that took up a majority of data abstraction. The conversion from our old leasing system to the new leasing system. So that was probably number one on our list, that would be.



Joe Fitzgerald, Visual Lease:

James, how about yourself?

James Rogers, Penn State Health:

You can tell Fred and I have had very similar experiences. If there was one thing that I could change, it would be the data extraction. We had a team of 10 temps come in and extract the least data components for over 200 leases. Had time permitted, I would have had more validation checks on the lease data.

So if you're going to go down the route of bringing in temps to extract that least data, I would stress that one, educate that team very well and bring them up to speed. But then two, have planned systematic validation checks of that data because you want to get it right the first time. You do not want to extract the data, have it uploaded into a system and then have to reconcile it. You want to be very careful with your timelines, and give yourself enough of a runway that you can validate and style that data before go live.



**Fred Berardinone,
Montefiore Health
System:**

We gave ourselves 15 weeks and it went over 15 weeks. It was down to the wire, and it was mainly due to data conversion.



**James Rogers, Penn
State Health:**

Right. To that point, there will be things that come up that you do not see, so build in that wiggle room for the unexpected.

Joe Fitzgerald, Visual Lease:

Any other best practices that we haven't touched on or touched on lightly that you want to re-emphasize?

James Rogers, Penn State Health:

We've covered a lot of the best practices and tips so far, but from my standpoint, I would stress the need to start now. There is no such thing as a runway with this new leasing guidance. You'll want to give yourself adequate time as possible.

Give real consideration to lease accounting and management software that you can utilize, obviously depending on the size of your organization. Then, just mitigate the number of surprises that are coming your way by keeping up on that data extraction. That data is essentially going to dictate how well you implement the guidance and then maintain it going forward.



Fred Berardinone, Montefiore Health System:

Those are great takeaways. I would definitely add on to start education now. If you're talking about timeline, for the most part, this is an accountant thing, but I would definitely start education within the organization now. Get everyone on board, the procurement folks change management and real estate, that was big for us. Start building that cross-functional team. We've mentioned it a ton because it's a joint effort. It's an organizational effort. It's not just a finance effort to start identifying your population.

Joe Fitzgerald, Visual Lease:

So it sounds like no matter how much time you think you got, you can never start too soon. You've really got to hammer home that education communication. I say go down the hall with a big boat, get everybody in the boat for leases, because it's going to require a real cross-functional effort.

Additional questions

Below are additional questions, which were submitted by live audience members during the webinar presentation.

Moderator:

Can you comment, or add anything on managing lease modifications?



James Rogers, Penn State Health:

Managing lease modifications is about getting that communication monthly, if not more regularly.

Have that relationship with your real estate lease coordinator who's going to know any modifications or re-measurements needed and have them communicate those to you on a monthly basis. Then update your leasing software.



Joe Fitzgerald, Visual Lease:

There's three words I always think about with modifications. The data that goes into the system needs to be accurate. It needs to be complete, particularly in real estate where amendments are constantly put in place. You have to make sure you capture all the amendments, and it's got to be timely. That's a commonality that I thought was interesting -- the timeliness was not always there before ASC 842. Folks on the real estate side may get to it when they enter terms into a system. Now, it's got to get in immediately because it's going to impact downstream the accounting folks.

Moderator:

Can each of you share which lease management systems you've chosen, and why?

**James Rogers, Penn State Health:**

Well, we've chosen Visual Lease. It was a great decision. We did come to that decision with the help of our consulting firm, Grant Thornton. It is very intuitive and serves all of our needs. We're also implementing a new ERP to go live in July, so we really looked to build up Visual Lease to integrate with our ERP. We've worked really closely with Visual Lease and building out the platform. We've been very happy with our choice.

**Fred Berardinone, Montefiore Health System:**

Yep, same here. We met with three vendors, had our scorecard to review and included a cross-functional team. We included all parties in the organization, in our product demos and interviews. We ended up going with Visual Lease.

Visual Lease is the #1 lease optimization software provider. We help organizations become compliant with FASB, IFRS and GASB lease accounting standards, while simultaneously improving the financial, legal and operational performance of their leases. Our easy-to-use SaaS platform is embedded with more than three decades of best practices from major corporations and leading industry professionals. Our award-winning solutions are used by 800+ organizations to manage 500,000+ real estate, equipment and other leased assets. Committed to ongoing innovation and unparalleled customer service, Visual Lease helps organizations transform their lease compliance requirements into financial opportunities. For more information, visit visuallease.com.

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