

TEXAS STATEWIDE TELEPHONE COOPERATIVE, INC.

Finance/Marketing/Commercial
Conference - 2013

Accounting For Leases



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EXPOSURE DRAFT - HISTORY

- History of Proposed Lease Accounting
 - Issued 8/17/2010 – Proposed Standards Update (ASU) No. 1850-100
 - Issued 10/19/2010 – Discussion Paper No. 1890-100
 - Issued 4/21/2011 – Memorandum of Understanding (MoU) – Progress Report on IASB-FASB convergence work
 - Issued 10/21/2011 - Proposed Standards Update (ASU) No. 2011-210, Real Estate – Investment Property Entities
 - Issued 12/20/2012 - Proposed Standards Update (ASU) No. 2012-260, Financial Instruments – Credit Losses
 - Issued 5/16/2013 - Proposed Standards Update (ASU) No. 2013-270, Leases (Topic 842) revision of the proposal.

LEASES

- Latest Development:
 - Accounting Standards Update – No. 2013-270 issued 5/16/2013.
 - Comments due September 13, 2013
 - Questions for Respondents
 1. Identifying a lease
 2. Accounting Model (lessee and lessor accounting)
 3. Classification of Leases
 4. Measurement
 5. Lease Terms
 6. Transition
 7. Disclosure
 8. Related Party Leases

LEASES

- Would effectively **end off-balance reporting** for leases.
- Affects existing leases at transition and **no leases would be grandfathered.**
- The Boards planned to issue final standards by June 30, 2011, however they extended this timeline until December, 2011 and now **comments on ASU 2013-270 are due September 13, 2013.**
- When will it be issued and what will be the effective date? – No indications, however both the **FASB and IASB are committed to issuing this standard.**

LEASES

- **WHY CHANGE???**
 - Failure of to provide faithful representations of leases transactions (i.e. modifying agreements to meet outcome intent)
 - Omit reporting of rights and obligations (i.e. off balance sheet financing)
 - Lack of comparability (capital vs operating)

LEASES - DEFINITIONS

- Key Definitions
 - Lease – A contract in which the right to use a specified asset is conveyed, for a period of time, in exchange for consideration.
 - Determine at the date of a contract as determined on the basis of the substance of the contract by assessing whether:
 - (a) the fulfillment of the contract depends on **providing a specified asset** or assets; and
 - ❖ An asset is **implicitly implied** if it is impractical for the lessor to provide alternative assets. If the lessor as the right to substitute assets the contract is (**not a lease**). However, if this right exist only when the asset is not operating properly, the contract may be a lease.

LEASES - DEFINITIONS

- Key Definitions
 - Lease – A contract in which the right to use a specified **asset is conveyed**, for a **period of time**, in exchange for **consideration**.
 - (b) The contract conveys the **right to control** the use of a specified asset for an agreed period of time.
 - ❖ **Right to Control** – Conveyed if (1) ability of right to operate in a manner it determines, or (2) right to control access, or (3) obtain all but an insignificant amount of the output.
 - Lease Term – The longest possible term that is **more likely than not to occur**.

LEASES - LESSEE

- Key Provisions:
 - Lessees and lessors would apply **a right-to-use model** in accounting for all leases.
 - Under this model, a lessee would recognize
 - a. **An asset** representing the right to use the leased asset for the lease term (PV of lease payments plus initial direct cost).
 - b. **A liability** to make lease payments (PV of lease payments).

LEASES - LESSOR

- A Lessor would recognize an asset representing its right to receive lease payments and depending on its exposure to risks or benefits related to the asset would either:
 - a. Recognize a lease liability and the underlying asset (**a performance approach**), **or**
 - b. Derecognize the rights in the underlying asset that it transfers to the lessee, and then recognizes the residual value of the underlying asset. (**a derecognition approach**).

LEASES - LESSOR

- Derecognition Approach:

- The approach is used when:

- ☐ Lessor **does not** retain exposure to significant risk or benefits.

- ☐ Factor to consider: (considered collectively)

- Significant contingent rentals

- Options to extend or terminate the lease

- Significant lease terms (is the asset used up)

- Residual value guarantees (reduces downside risk)

LEASES - LESSEE

Accounting by Lessee - Right to Use Model

Cash	Assets	Liabilities	Expense	Income
	XXX	(XXX)		
	To record the lease right to use.			
(XXX)		XXX	XXX	- Interest
	To record monthly lease payment.			
	(XXX)		XXX	- Amortization
	Amortize the right to use asset.			

Note - The character of the expense will change from plant specific operations to interest and amortization.

LEASES - LESSEE

Accounting by **Lessee** - Right to Use Model

Financial Statement Presentation

Account

4310	Lease Performance Obligation	\$	(XXXX)
	Present seperately from other liabilities.		
1410	ONA - Right to Use Asset		XXXXX
	Present as an intangible within PP&E section.		

Amortization and interest expense are each reported separately in the statement of income or in the notes to the financials.

Lease payments are classified as financing activities on the cash flow stmt.

LEASES - LESSOR

Accounting by **Lessor** - Performance Obligation Approach

Cash	Assets	Liabilities	Expense	Income
(XXX)	XXX			
	To record the purchase of the leased asset.			
	XXX	(XXX)		
	To record the lease performance receivable and obligation.			
XXX	(XXX)			(XXX) - interest
	To record monthly lease payment received.			
		XXX		(XXX)
	Amortization performance obligation to income.			
	(XXX)		XXX	
	To record depreciation on the leased asset.			

Note - Lease income is still recognized over the term of the lease, however there will now be an interest component in the payment.

LEASES - LESSOR

Accounting by **Lessor** - Performance Obligation Approach

Financial Statement Presentation

<u>Account</u>			
2100	General Purpose Plant Asset	\$	XXXXX
3100	Accumulated Depreciation		(XXXX)
1410	ONA - Long-Term Lease Receivable		XXXXX
4310	Lease Performance Obligation		(XXXX)
	Net Lease Asset (Liability)	\$	<u>XXXXX</u>

Depreciation expense, lease income, and interest income are each reported separately in the statement of income.

Receipts from lease payments are presented as operating activities in the cash flow statement.

LEASES - LESSOR

Accounting by **Lessor** - Derecognition Approach

<u>Cash</u>	<u>PP&E</u>	<u>Asset</u>	<u>Liabilities</u>	<u>Expense</u>	<u>Income</u>
(XXX)	XXX				
	(XXX)	XXX			
XXX		(XXX)			(XXX)
		XXX			(XXX)
	(XXX)			XXX	

Note - Lease income is still recognized over the term of the lease, however there will now be an interest component in the payment.

LEASES - LESSOR

Accounting by **Lessor** - Performance Derecognition Approach

Financial Statement Presentation

Account			
2100	General Purpose Plant Asset	\$	XXXXX
3100	Accumulated Depreciation	\$	(XXXXX)
1410	ONA - Long-Term Lease Receivable	\$	XXXXX

Each is reported seperately in the Balance Sheet

Depreciation expense, lease income, and interest income are each reported separately in the statement of income.

LEASES

- Other Issues

- Short-term leases – May elect, on a lease-by-lease basis, not to recognize in the statement of financial position.

- Measurement dates:

- ❖ Earliest period presented

- ❖ Commence date of the lease

- ❖ When facts or circumstances change

LEASES – IMPLEMENTATION

- What should I do to prepare?
 - ❖ Identify all leasing transactions
 - ❖ Obtain a copy of the agreement
 - ❖ Determine if the agreement is a lease or service contract.
 - ❖ For lease contracts prepare a schedule containing the following:
 - The lessor/lessee
 - Asset being leased
 - Lease term and renewal options

LEASES – IMPLEMENTATION

- What should I do to prepare?
 - ❖ For lease contracts prepare a schedule containing the following:
 - The lease payment stated or expected and frequency (monthly, quarterly, annual, lump-sum)
 - Interest Rate – (likely the incremental borrowing rate)
 - Purchase options
 - Guaranteed residual values