NEW LEASE ACCOUNTING STANDARD – IMPLEMENTATION ISSUES (ASU 2016-02)

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Daniel Owens, CPA and Nathan Paden, CPA

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OlsenThielen CPAS AND ADVISORS

BSGM

Are we STILL talking about Leases!?

- Exposure Draft originally issued in August 2010
- 2nd Exposure Draft in May 2013
- Issuance of ASC 842 2016-02 in February 2016

Are we ever going to actually implement this standard? Yes! It is actually right around the corner!

With so much time to prepare everyone is ready for this right?

- (CFO) March 30, 2018 – With about nine months to go before the new lease accounting standard for publicly-traded companies must be adopted, only about one-fifth of finance leaders surveyed by the Deloitte Center for Controllership say they are “prepared” or “very prepared” to comply with it.

What should I do if I’m not “prepared” or “very prepared”?

Sean Torr, Deloitte Risk and Financial Advisory managing director, had some advice for issuers:

“I’d aim to have all leases centralized and in an electronic format as quickly as possible to avoid compliance timeline risk. Further, finance and accounting teams need time with the data to conduct their own analyses and calculations for financial reporting purposes.”

FASB still making changes!

New Exposure Draft Issued January 5, 2018 (more on that later in the presentation)

Any other potential exposure drafts between now and implementation???

So that means I don't have to pay attention for another year?

NO!

Eventually you are going to actually have to implement this standard.

You should be one of the ones that are "prepared" or "very prepared" to implement it!

When is the change?

- Public business entities – annual periods beginning after December 15, 2018 (2019)
- For privately held companies and cooperatives, reporting periods beginning after December 15, 2019 (2020)
- For companies presenting comparative financial statements, the 2019 financial results will be recast to reflect the new standard in the 2020 reporting period.
  - Ability to present single year presentation?
    - Not for RUS….

Instructor Posed Question

Have any public companies with SIC Codes 4800 or 4810 early adopted the Lease Standard?

Public Company Responses

- "The Company is evaluating the effect that ASU 2016-02 will have on its consolidated financial statements and related disclosures." (3-16-2018 10-K)

alaska COMMUNICATIONS.

- "The Company is evaluating the requirements of this guidance and has not yet determined the impact of the adoption on the Company's consolidated financial position or results of operations." (3-13-2018 10-5)

Otelco

Public Company Responses (continued)

- "We are currently evaluating the population of our leases and anticipate that most of our operating lease commitments will be recognized on our consolidated balance sheets. We plan to adopt this update effective January 1, 2019 and are continuing to assess the potential impact of this update on our consolidated financial statements and related disclosures." (3-1-2018 10-K)

Consolidated communications

Public Company Responses (continued)

“ Frontier is in the initial stages of evaluating the potential impact this new standard may have on the consolidated financial statements.” (3-1-2018 10-K)

Frontier

“We will adopt ASU 2016-02 effective January 1, 2019, and we are currently assessing the impact the new standard will have on our consolidated financial statements.” (2-28-2018 10-K)

windstream.

Why the Change?

- The primary reason for the change is to bring the statement users the ability to identify all operating lease commitments on the Balance Sheet.
- Previously, the operating lease commitment disclosures were only disclosed in the financial statement footnotes.
- Eliminate bright line tests that companies could manipulate
- Alignment with revenue recognition and IFRS convergence (but there are differences)
  - IFRS – Principle based. US GAAP – Rules Based
  - Do you prefer principles or rules?
- First substantive update in 40 years

What is a Lease?

- **Per ASC Topic 842, a lease is "a contract, or part of a contract that conveys the right to control the use of an identified asset for a period of time in exchange for consideration."**

  - ***Identified Asset***
  - ***Control***

- **NOTE: The new lease standard does not apply to intangible asset leasing arrangements such as wireless spectrum, inventory, lease of assets under construction, or biological assets. PPE Only**

Key lease factors (identification and control)

1) ***Use of an identified asset***

- Lessor's ability to substantitute asset or not

AND

2) ***Convey the right to control the use***

a) Right to obtain substantially all of the economic benefits from asset use $$$$

AND

b) Right to direct the use of the asset over the lease term

Lease Payments

- **Lease payments for consideration include the following:**
  1) **Payments specified in lease agreement (fixed)**
  2) **Payments that depend on index or a rate such as CPI (variable) – do not include property taxes and insurance**
  3) **Initial direct costs**
  4) **Payments based on usage or performance are excluded**
  5) **ROU asset reduced for any lease incentives received by lessee**
  6) **Residual value guarantees of lessees at end of lease term**
  7) **Purchase/termination option – dependent on whether lessee is reasonably certain to exercise or not**

Lots of judgment here

Nonlease Components

- Practical Expedient exists to include nonlease components in lease calculation
  - CAM
  - Supplies
- If practical expedient not elected, then required to split up lease portion and non-lease separately on income statement.

Discount Rate for PV computations

1. If interest rate is stated in contract, then use the stated rate (more common for vehicles/equipment)
2. More likely however (especially for real estate, fiber), will use incremental borrowing rate (current RUS/CoBank/bank/LOC rate). If no debt on books, then risk free rate. (US Prime Rate 4.75% as of 3-33-2018)

   2. Only reassess rate used when there is a change in lease term

Lease Term

- All qualifying lease arrangements with terms $\geq$ 12 months will be capitalized on the balance sheet.
- For all leases, the company will need to identify the non cancellable portion of the lease term.
- If the lessee is reasonably certain to exercise the options, the option should be included in determining the lease term.
- There is a four factor test for judging whether the company is reasonably certain to exercise the option.

4 Factor Test – Reasonably Certain to Exercise

1. Contract-based factors
   - Existence of bargain renewal option, contractual requirement to incur substantial restoration costs prior to returning
2. Asset-based factors
   - Significant leasehold improvements, absence of facilities in geographically desirable location
3. Entity-specific factors
   - Historical practice, management's intent, common practice
4. Market-based factors – market rentals, etc.

Lease term - reassessment

- Significant event or change in circumstances occurs that lessee controls, such as exercising option to extend the lease, purchase underlying asset, or terminate lease
- Contract term imposition to extend or terminate
- Lessees elects to (1) exercise an option to renew that was previously determined not reasonably certain to be exercised, or (2) not exercise an option to terminate the contract that it had previously determined was reasonably certain to be exercised

Lease Classification

- Two types of leases with different accounting treatment:
- Finance Lease (f/k/a Capital Lease)
- Operating Lease (f/k/a Operating Lease)

  - NOTE: some companies may have a mixture of both types of leases recorded on their books. Case study will show this in play.

Finance vs. Operating Lease

- Finance lease (lessee) or sales-type lease (lessor)
  - Lease transfers ownership of asset to lessee by/at end of lease term
  - Lease grants lessee a purchase option of the underlying asset that the lease is reasonably certain to exercise
  - Lease term is for a *major part* of the remaining economic life of the underlying asset
  - PV of lease payments and any residual value equals or exceeds fair value of the underlying asset
  - Leased asset is of a specialized nature that no alternative use to lessor
  - Finance lease has higher expense profile early part of lease

Case Study

- We will show how a Balance Sheet and Income Statement for a sample company pre and post implementation of the lease standard for both Finance and Operating Lease
- Assumptions # 1 (Finance Lease) and #2 (Operating Lease) on the following page
- See slide for annual journal entries on operating lease
- See slides for current and future year presentation

Finance Lease Liability– See Case Study

- Lease obligation liability is recorded at lease commencement date
- Use the present value of future lease payments using lease’s stated interest rate or the company’s incremental borrowing rate.
- The liability will be reduced by each payment made on the lease.
- Interest expense recorded on income statement

Finance Lease (ROU asset) – See Case Study

- Right to use-asset is recorded on the asset section of balance sheet.
- The asset is amortized through the life of the lease term by reducing the right-to-use asset on a monthly basis.
- Record amortization expense on the Income Statement

Assumption #1 Finance Lease

- Company has a capital lease obligation (existing standard) for a printer that qualifies as a "finance lease" (new standard).
  - Total Lease Obligation Liability at 12/31/19 is $39,100
  - Stated Interest Rate of 3.5%
  - Future Minimum Lease Payments are:
    - $14,500 2020
    - $14,500 2021
    - $12,100 2022
      - (including interest payments of $2,000)
  - Gross Cost of Asset $39,100 at 12/31/19
    - Journal entry on next slide

Journal Entry – Finance Lease Obligation

1) Record ROU and Lease Obligation at **12/31/2019**			**Dr**	**Cr**
	ROU Asset		**$39,100**	
	Lease Obligation			**($39,100)**
2) Record **2020** Activity				
a) Accrue Interest	Interest Expense		**$1,112**	
	Lease Obligation			**($1,112)**
b) Amortize ROU Asset	Amortization Exp		**$15,490**	
	A/D ROU Asset			**($15,490)**
c) Record Cash Payments	Lease Obligation		**$14,500**	
	Cash			**($14,500)**

Operating Lease Obligation – See Case Study

- Same liability recording rules as finance lease.
- Lease obligation liability is recorded at lease commencement date
- Use the present value of future lease payments using lease's stated interest rate or the company's incremental borrowing rate.
- The liability will be reduced by each payment made on the lease.

Operating Lease Right of Use Asset– See Case Study

- Corresponding right-to-use asset is recorded on the asset section of the Balance Sheet. A/C 1410??
- UNLIKE a FINANCE LEASE, there will be no explicit interest and amortization component presented on the Income Statement.
- Monthly expense will be captured in the company's existing general ledger accounts used for existing leasing arrangements.
- Monthly expense will be recognized evenly on a straight line basis over the term of the lease. (No more deferred rent – (common in space leases)

Assumption #2 Operating Lease

- Company enters into an operating lease obligation (existing standard) for fiber that qualifies as a "operating lease" (new standard).
  - Organizational Incremental Borrowing Rate of 3.5%
  - Lease term expires December 2022 (no renewal options)
  - Future Lease Payments are $142,000 2020, $146,000 2021, and $151,200 2022 (average of $146,400)
  - Present value of future lease payments at 12/31/19 is $416,700 – Asset equals liability at lease inception. This changes throughout course of lease until lease is terminated.

Journal Entry – Operating Lease Obligation

1) Record ROU and Lease Obligation at **12/31/2019**			**Dr**	**Cr**
	ROU Asset		**$416,700**	
	Lease Obligation			**($416,700)**
2) Record **2020** Activity				
a) Accrue Interest	Buried Fiber Expense		**$12,288**	
	Lease Obligation			**($12,288)**
b) Amortize ROU Asset	Buried Fiber Expense		**$134,112**	
	A/D ROU Asset			**($134,112)**
c) Record Cash Payments	Lease Obligation		**$142,000**	
	Cash			**($142,000)**

Sample Balance Sheet - Assets

	12/31/19 Existing	12/31/19 Future	12/31/20 Future	12/31/21 Future	12/31/22 Future
CURRENT ASSETS:					
Cash	$ 436,500	$ 436,500	$ 436,500	$ 436,500	$ 436,500
Accounts Receivable	10,379	10,379	10,379	10,379	10,379
Accounts Receivable - Related Party	36,610	36,610	36,610	36,610	36,610
Prepaid Expenses	45,514	45,514	45,514	45,514	45,514
Total Current Assets	529,003	529,003	529,003	529,003	529,003
OTHER ASSSETS:					
Right of Use Asset - Operating		416,700	416,700	416,700	416,700
Less Accumulated Amortization - Operating Lease		–	134,112	272,906	416,700
Total Other Assets		416,700	282,588	143,794	–
PROPERTY AND EQUIPMENT:					
Building	106,045	106,045	106,045	106,045	106,045
Office Equipment	721,719	677,834	677,834	677,834	677,834
Buried Fiber	1,250,000	1,250,000	1,250,000	1,250,000	1,250,000
Right of Use Asset - Finance Lease	-	43,885	43,885	43,885	43,885
Total Property in Service	2,077,764	2,077,764	2,077,764	2,077,764	2,077,764
Less Accumulated Depreciation	422,062	422,062	534,597	647,132	759,667
Net Property and Equipment	1,655,702	1,655,702	1,543,167	1,430,632	1,318,097
TOTAL ASSETS	$2,184,705	$2,601,405	$ 2,354,758	$ 2,103,429	$ 1,847,100

Sample Balance Sheet – Liabilities and Equity

	12/31/19	12/31/19	12/31/20	12/31/21	12/31/22
CURRENT LIABILITIES:	Existing	Future	Future	Future	Future
Accounts Payable	$2,064,064	$2,064,064	$ 1,960,277	$ 1,859,948	$ 1,765,559
Current Portion of Capital Lease Obligation	13,360	–	–	–	–
Current Portion of Finance Lease Obligation	-	**13,360**	**15,000**	**10,740**	–
Current Portion of Operating Lease Obligation	-	**142,000**	**146,400**	**151,200**	–
Accrued Expenses	44,171	44,171	44,171	44,171	44,171
Total Current Liabilities	2,121,595	2,263,595	2,165,848	2,066,059	1,809,730
NON CURRENT LIABILITIES:					
Deferred Rent	27,370	–	–	–	–
Capital Lease Obligation	25,740	–	–	–	–
Finance Lease Obligation	-	**25,740**	**10,740**	–	–
Operating Lease Obligation	-	**274,700**	**140,800**	–	–
Total Non-Current Liabilities	53,110	**300,440**	**151,540**	-	-
STOCKHOLDERS' EQUITY	10,000	37,370	37,370	37,370	37,370
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$2,184,705	$2,601,405	$ 2,354,758	$ 2,103,429	$ 1,847,100

Sample Income Statement – Operating Lease Presentation

	12/31/19 Existing	12/31/19 Future	12/31/20 Future	12/31/21 Future	12/31/22 Future
REVENUES:	$3,738,557	$3,738,557	$3,738,557	$ 3,738,557	$ 3,738,557
EXPENSES:					
Plant Specific(includes lease expense of $146,400)	2,806,949	2,806,949	2,806,949	2,806,949	2,806,949
Plant Support	649,564	649,564	649,564	649,564	649,564
Depreciation and Amortization	112,535	112,535	112,535	112,535	112,535
Customer	94,697	94,697	94,697	94,697	94,697
Corporate	28,745	28,745	28,745	28,745	28,745
Other Services	15,208	15,208	15,208	15,208	15,208
Other Taxes	30,859	30,859	30,859	30,859	30,859
Total Expenses	3,738,557	3,738,557	3,738,557	3,738,557	3,738,557
NET INCOME	–	–	–	–	–
STOCKHOLDERS' EQUITY at Beginning of Year	10,000	37,370	$ 37,370	$ 37,370	$ 37,370
STOCKHOLDERS' EQUITY at End of Year	$ 10,000	$ 37,370	$ 37,370	$ 37,370	$ 37,370
Lease Expense - Amortization of Asset (PLUG)			134,112	138,794	143,794
Lease Expense - Effective Interest			12,288	7,606	2,606
Total Straight Line Lease Expense			**146,400**	**146,400**	**146,400**

Lease Accounting – Telecom Considerations

- **Contracts for Fiber or Network Capacity**
  - **May or may not qualify for lease accounting treatment depending on facts and circumstances**
  - **Situation A - A lessee has entered into a dark fiber contract over a 5 year period that contains four specifically identified and dedicated fiber strands that are used and *supplier can only substitute fibers for repairs or maintenance purposes* and the customer has the decision making ability to light the fibers and decide how much data can be transmitted. In this case, the arrangement will likely qualify as a lease and be accounted for as such.**

Lease Accounting – Telecom Considerations

- **Situation B –** A lessee has entered into a capacity fiber contract over a 5 year period that gives the lessee the ability to use up to four fibers of capacity, however supplier can freely switch which fibers are used and supplier lights the fibers and makes the decisions on how much data can be transmitted. In this case, the arrangement will likely not qualify as a lease due to supplier control of the asset and it will be considered a contract and not a lease, and the accounting treatment will be the same as existing practice.

Lease Accounting – Telecom Considerations

- Group Discussion:

Does Wireless Equipment placed on towers qualify for lease accounting?

Related Party Leases

- Only agreements with written contracts would be affected.
- Only Leases with a term of more than 12 months would be recorded on the balance sheet.
- Lease term would include renewal options only if the lessee is reasonably certain to exercise an option to extend the lease (or not to exercise an option to terminate the lease).

USAC Considerations

- Related Party Leases have been a focus on recent USAC audits.
- § 32.27 Transactions with affiliates.
  - For all other services received by a carrier from its affiliate, the service shall be recorded at the lower of fair market value and fully distributed cost, except that services received by a carrier from its affiliate that exists solely to provide services to members of the carrier's corporate family shall be recorded at fully distributed cost.

USAC Considerations

- **Fully Distributed Cost**
  - **Can and should include a rate of return**
  - **Should be calculated net of depreciation**
  - **Monthly/Annual payments would vary depending on lease term**
- **Should not be charging market based rates for related party leases.**

USAC Considerations – Example

Example 1:

Trencher with a cost of $150,000 and an estimated life of 7 years is purchased by a subsidiary and leased to the regulated Telco.

Note that Rate of Return is being reduced by .25% per year over the next several years until it gets to 9.75%. For simplicity I will use 9.75% as the rate of return component

USAC Considerations – Example

If setup as a 7 year lease you could compute the lease payment and keep it the same for the entire 7 year period. For simplicity sake we will assume zero salvage value.

Simply run a loan amortization on $150,000 for 7 years with an interest rate of 9.75%. The monthly payment would be $2,395.09. That would be the lease amount to be charged for 7 years.

USAC Considerations – Example

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7
Cost	150,000.00	150,000.00	150,000.00	150,000.00	150,000.00	150,000.00	150,000.00
Accum Depr	21,428.57	42,857.14	64,285.71	85,714.29	107,142.86	128,571.43	150,000.00
NBV	128,571.43	107,142.86	85,714.29	64,285.71	42,857.14	21,428.57	-
Average NBV	139,285.71	117,857.14	96,428.57	75,000.00	53,571.43	32,142.86	10,714.29
Rate of Return	9.75%	9.75%	9.75%	9.75%	9.75%	9.75%	9.75%
ROR to Recover	13,580.36	11,491.07	9,401.79	7,312.50	5,223.21	3,133.93	1,044.64
Total Depreciation	150,000.00						
Total ROR Recovery	51,187.50						
Total to be recovered	201,187.50						
Divided by 84 Months	2,395.09						

USAC Considerations – Example

If setup as an annual lease that may or may not be renewed each year, you would need to compute the payment amount annually.

The ROR would be higher in the initial years because the NBV of the equipment is more. As the NBV of the equipment drops the ROR calculated would be reduced. Over the 7 year period it would be the same.

USAC Considerations – Example

Using my example trencher, If computing it as an annual lease, I calculated out a $2,917.41 payment in year 1 and if you still were leasing it in year 7 the monthly payment would drop down to $1,872.77.

The total amount recovered over the 7 year period would be the same if the regulated Telco continued to renew the lease each year.

USAC Considerations – Example

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7
Cost	150,000.00	150,000.00	150,000.00	150,000.00	150,000.00	150,000.00	150,000.00
Accum Depr	21,428.57	42,857.14	64,285.71	85,714.29	107,142.86	128,571.43	150,000.00
NBV	128,571.43	107,142.86	85,714.29	64,285.71	42,857.14	21,428.57	-
Average NBV	139,285.71	117,857.14	96,428.57	75,000.00	53,571.43	32,142.86	10,714.29
Rate of Return	9.75%	9.75%	9.75%	9.75%	9.75%	9.75%	9.75%
ROR to Recover	13,580.36	11,491.07	9,401.79	7,312.50	5,223.21	3,133.93	1,044.64
Depreciation	21,428.57	21,428.57	21,428.57	21,428.57	21,428.57	21,428.57	21,428.57
Total ROR Recovery	13,580.36	11,491.07	9,401.79	7,312.50	5,223.21	3,133.93	1,044.64
Total to be recovered	35,008.93	32,919.64	30,830.36	28,741.07	26,651.79	24,562.50	22,473.21
Divided by 12 Months	2,917.41	2,743.30	2,569.20	2,395.09	2,220.98	2,046.88	1,872.77

Other Considerations

- Rural Utilities Service and FCC reporting in future years.
- Cost Study implications of proper accounting for operating lease assets.
- Income tax considerations – should be neutral
- Greater risk of asset impairment with additional assets recorded on the books.
- Variable lease payments and non-lease components such as maintenance contracts.

Other Considerations (continued)

- Related party and Inter-company leases on consolidated financial statements. Related party leasing arrangements should be based on legally enforceable terms and conditions rather than substance of the arrangement.
- Sublease accounting
- Issues surrounding maintenance of financial covenants

Other Considerations (continued)

- FCC is currently requesting comments on Accounting for Capital and Operating Leases.
  - FCC 18-29 (Pages 61 to 63)
  - Published April 25, 2018
  - Comment period ends May 25, 2018

(Google Federal Register FCC 18-29)

Other Considerations (continued)

- Incentive for related party leasing may be going away for some carriers.
- ACAM carriers will no longer see the big recovery on plant specific expenses based on % of local loop plant. May not want to continue to hassle with related party leasing.
- More than likely that Legacy carriers will continue to see a benefit from this for general support assets, however FCC could throw a wrench in this depending on final rules on leases.

Other Considerations (continued)

- Always a good idea to get with your cost consultant to go over these type of options to see how it will affect your company.

Lessors

- No significant changes
- Lessor accounting model intersects with ASC 606 (rev rec)
- Lessor divided into three categories
  1. Sales-Type – Lessee gains control of underlying asset
  2. Direct Financing = Lessee does not obtain control of asset, but lessor relinquishes control
  3. Operating – Lessor retains control of the underlying asset

Lessor (continued)

- Sales–type:
  - Underlying asset is derecognized
  - Net investment in a lease is recognized
  - Selling profit or loss recognized at lease commencement
- Direct financing:
  - Underlying asset is derecognized
  - Net investment in a lease is recognized
  - Profit deferred and amortized into income over the lease term
- Operating:
  - Underlying asset remains on the lessor’s balance sheet
  - Income recognized on a straight-line basis

Transition Requirements

- **Lessees and Lessors:**
  - **Both will apply a modified retrospective transition method for each lease that *existed* at the beginning of the earliest comparative period presented *and* leases entered after that date**
  - **Practical expedients (in a few slides)**
    - **FASB Exposure Draft in January 2018 (may change transition)**

Lessee Transition Requirements (Operating Lease)

- Transition (Operating Leases):
  - Recognize right of use asset and lease liability at later of
    - 1) earliest period presented
    - 2) the lease commencement date
    - Lease liability calculated at present value of sum of remaining payments and residual-value guarantee at appropriate discount rate
      - Difference between ROUA and LL should be adjusted through opening equity
    - Right of use asset should equal lease liability, with following adjustments made:
      - Prepaid or accrued rent
      - Remaining balance on any lease incentives
      - Unamortized initial direct costs
      - Any impairment
      - Any asset or liability associated with ASC 420, Exit or Disposal Cost Obligations

Lessee Transition Requirements (Finance Lease)

- **Transition (Finance f/k/a Capital Leases):**
  - **Reclassify existing capital lease asset as a right of use asset and the existing obligation as a lease liability for each period presented**

Lessor Transition Requirements (Operating Lease)

- If accounting for old standard operating was operating lease and accounting for new standard is an operating lease, then no change!
  - (Unless any amortized initial direct costs that no longer qualify for capitalization under the new lease standard)
- Direct financing or sales-type lease – no changes if lease type the same when the new standard is implemented

Transition Requirements (Practical Expedients)

- ASC 842-10-65-1 – An entity may elect the following practical expedients, *which must be elected as a package* and applied consistently
    1. An entity need not reassess whether any expired or existing contracts are or contain leases
    2. An entity need not reassess the lease classification for any expired or existing leases
    3. An entity need not reassess initial direct costs for any existing leases

FASB still making changes!

New Exposure Draft Issued January 5, 2018

- Add an option for transition that would permit an organization to apply the provisions of the new standard at its adoption date instead of at the earliest comparative period presented in its financial statements.
- Add a practical expedient that would permit lessors to not separate nonlease components from the associated lease components if certain conditions are met.

Lessee Disclosure Requirements

- **Balance Sheet Presentation (on balance sheet or in notes)**
  - Finance lease right to use assets and operating lease right to use assets (separated from each other and from other assets)
  - Finance lease liabilities and operating lease liabilities (separated from each other and from other liabilities)
  - Current and non-current
  - If footnote disclosure only, then include the balance sheet line item that these are included on

Lessee Disclosure Requirements

- Income Statement/Comprehensive Income Presentation
  - Finance lease – no changes from capital lease presentation on income statement
  - Operating lease – regulatory accounting presentation will require disclosure of operating lease expense to remain in footnotes

Lessee Disclosure Requirements

- Statement of Cash Flows Presentation
  - Finance lease
    1. Cash payments of principal portion of lease liability – Financing section
    2. Cash payments for interest portion of lease liability – Operating
    3. Variable lease payments and short-term lease payments – Operating
  - Operating lease
    1. Operating section – only adjustment is for improvements would be investing

Lessee Disclosure Requirements

- **Qualitative Disclosures in the Footnotes:**
  a. Information about nature of its leases:
     1. A general description
     2. Basis an terms and conditions on which variable lease payments are determined
     3. Existence and terms and conditions of options to extend or terminate the lease, including disclosure about options that are recognized as part of its right of use assets and lease liabilities and those that are not.
     4. Existence and terms and conditions of residual value guarantees provided by lessee
     5. Restrictions or covenants imposed by leases, for example, those relating to dividends or incurring additional financial obligations

Lessee Disclosure Requirements

- **Qualitative Disclosures in the Footnotes (continued):**
  - b. Information about leases that have not yet commenced but that create significant rights and obligations for the lessee, including the nature of any involvement with construction or design of the underlying asset (leases entered into subsequent to balance sheet date)
  - c. Information about significant assumptions and judgments made in applying the requirements of this Topic
    1. Whether a contract contains a lease
    2. Allocation of consideration in contract between lease and nonlease components
    3. Determination of a discount rate for the lease

Lessee Disclosure Requirements

- **Quantitative Disclosures in the Footnotes:**
  - A. Finance lease cost, segregated between the amortization of the right-of-use assets and interest on the lease liabilities.
  - B. Operating lease cost
  - C. Short-term lease cost
  - D. Variable lease cost
  - E. Sublease Income
  - F. Net gain or loss recognized from sale and leaseback
  - G. Segregated amounts between finance and operating leases for:
    - Cash paid for amounts included in the measurement of lease liabilities, supplemental non-cash information on lease liabilities arising from obtaining right of use assets, weighted-average remaining lease term, weighted average discount rate

Lease Portfolio Size

- Simple Lease Portfolio (1-5 leases)
  - Can effectively prepare amortization schedules on own
- Moderate Lease Portfolio (6-25 leases)
  - Can effectively prepare amortization schedules, but you will begin to be swimming in spreadsheets
- Large Lease Portfolio (greater than 25 leases)
  - Portfolio exception?
    - Leases can be grouped if they have similar characteristics – extensions -, purchase options, and lease term
  - Higher end leasing software solutions?

Audience Discussion

- Polling question for the audience:
  - What has my company done at this point to implement the lease standard?
    - A) What lease standard?
    - B) Thought about it a few times
    - C) Have inventoried all of our leases and began calculations
    - D) Have this new standard nailed. Have ran all calculations and will be Good to Go

Action Items

- **2018–Begin inventorying all relevant contract information (contracts, term, payments, etc). Begin identifying which lease contracts will remain when the leasing standard becomes effective. Will need to determine whether fiber, tower, and capacity contracts qualify for lease or not. Include network engineers and plant operations managers in this process.**
- **2018 and 2019– Begin preparing calculations of lease obligation liability and "right to use" asset. Keep in mind when applying for financing**

Final Takeaway

- Operating leases placed on balance sheet (right to use asset and lease liability)
- No grandfathering of existing lease arrangements (unless they expire or transition relief exercised)
- Pay attention to Debt Covenants (debt service coverage)
- EBITDA ratios, return on assets
- Book to tax issues
- Materiality!!

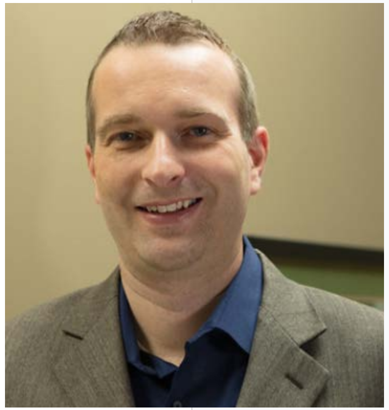
Contact Information

Nathan Paden, CPA

Bolinger, Segars, Gilbert, & Moss, L.L.P

npaden@bsgm.com

806.747.3806, ext 206



Daniel Owens, CPA

Olsen Thielen CPA's

dowens@otcpas.com

651.621.8623