



# Procurement Activity Workshop

Presented by Sean O'Connell



# Accounting for leases

Currently, there are two lease categories:

- Operating lease
- Capital lease (an in-substance purchase or sale of the asset)

US GAAP provides bright-line tests to distinguish between the two

Future lease commitments are disclosed in footnotes to a Company's financial statements



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# Joint project to change lease accounting standards

- Financial Accounting Standards Board (FASB)
- International Accounting Standards Bd (IASB)
- Change would affect all companies that enter into leasing arrangements
- Existing leases will not be grandfathered



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# 5 Reasons for change

1. Small differences in lease terms can determine whether or not balance sheets are impacted
2. Structuring lease terms allows opportunities for lessees to achieve a particular accounting outcome
3. Economically similar transactions may be accounted for in dramatically different ways, reducing comparability between entities



# Reasons for change *(continued)*

4. Financial statement users need to estimate the effect of a company's leverage and other financial metrics
5. Although many leases include variable features (such as renewal options or contingent rentals), current standards generally account for those features on an outcome basis (as they occur), making it more difficult for users to assess the effects of those features on future cash flows.



# Timeline of developments

- March, 2009 – FASB and IASB issued Discussion Paper on Leases
- August 17, 2010 – FASB and IASB issued Exposure Draft on Leases (Topic 840)
- December 15, 2010 – comment deadline
- March, 2011 – FASB and IASB boards met to discuss their joint project on leasing. They expect convergence
- 2014 – likely effective date



# Short term lease accounting

- A maximum possible lease term – including any options to renew or extend – of 12 months or less
- “Lease payments should be recognized by a lessee and a lessor on a straight-line basis in the income statement unless another systematic and rational basis better represents the time pattern in which use is derived from the underlying asset”
- (Similar to existing guidance for operating leases)



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# Lease accounting standard - lessees

- All lessees would use a single method of accounting for all leases
- Assets – a bundle of rights to use the leased asset
- Liabilities – arising from lease contracts at the present value of the expected lease payments



# Lease accounting standard - lessors

- Accounting would reflect its exposure to the risks or benefits of the underlying leased asset
- A lessor that has transferred significant risks or benefits would recognize a gain or loss upon lease commencement.
- When the lessor retains significant risks or benefits in the leased asset, it would recognize income over the lease term



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# Accounting for purchase options

- Include options in the lease payments where there is significant economic incentive to exercise the option, such as a bargain purchase option



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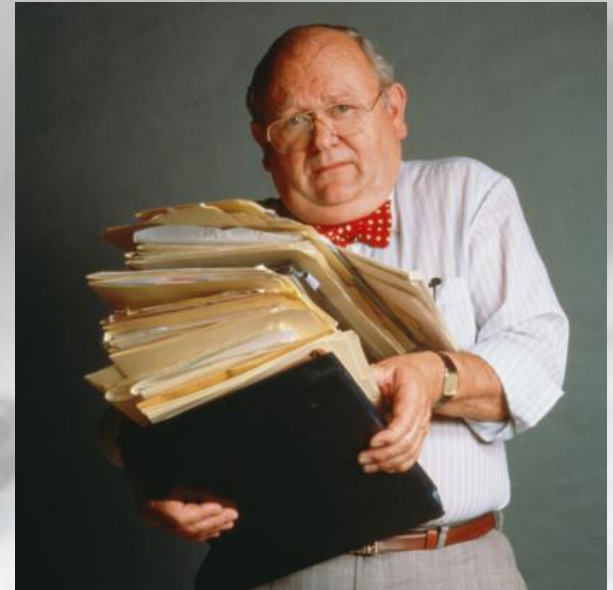
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# Comments from Professional Community

“Dear friends at the FASB: I am concerned that you good folks have lost touch with reality, as evidenced by your latest proposal to treat virtually every lease as both an asset and a liability. This proposal would needlessly raise the complexity level for financial reporting with no real value. The fictional assets and liabilities that you would force entities to recognize are not substantive.



Michael E. Batts, CPA  
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Orlando, Florida



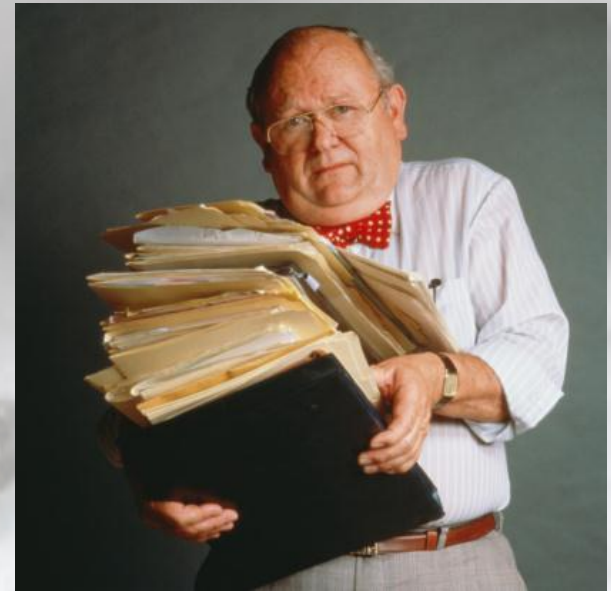
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# Comments from Professional Community

“If you are going to pursue this fiction, why stop with leases? Why not require every organization that hires a new employee to recognize an asset and liability equal to the estimated present value of the compensation of that employee over the estimated employment period? That way, companies could add trillions of dollars to their balance sheets.



Michael E. Batts, CPA  
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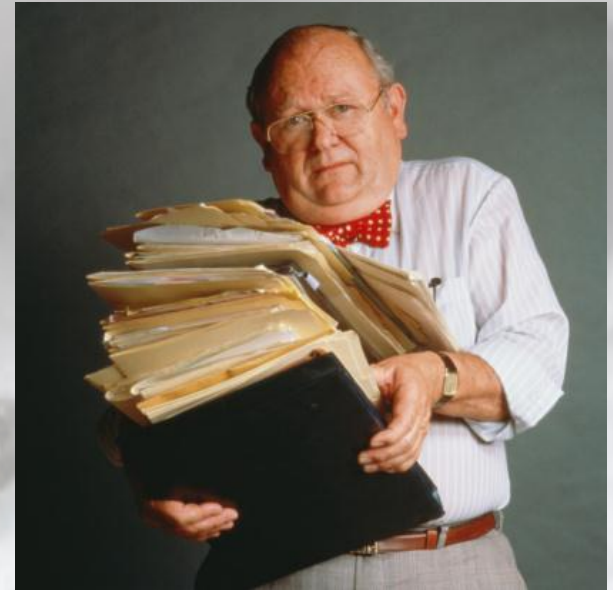
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# Comments from Professional Community

“I guess we will need to do the same with utility expenses (electricity, etc.), telephone expenses, and any other obligation that is expected to continue for some period of time. As a matter of fact, why don't we just go ahead and estimate the net income of an entity for the rest of its life, and go ahead and capitalize that? Please get a grip. Simplicity is a virtue. Complexity is the enemy of good, reliable information.”  
Best regards, Mike Batts



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