

Leases

Topics to be Discussed

Leases

Accounting for lessees

Capital leases

Operating leases

Accounting for lessors

Direct financing lease

Sales-type lease

Operating lease

Leases

Definition

A lease is a contractual arrangement by which the holder of the property (the lessor) permits its use by another party (the lessee) for a contracted period of time

Advantages of leasing (lessee)

1. leasing frequently permits 100% financing (i.e., no down payment required) versus 60% to 80% under purchasing, thus conserving cash and working capital
2. leasing permits rapid changes in equipment, thus shifting the risk of obsolescence, inadequacy and decline in residual value to the lessor
3. for tax purposes, the lessee is allowed to write off the full cost of the asset (including land and residual values), and the deductions often may be taken over the lease period, which may not be as long as the economic life of the asset
4. a lease contract is frequently more flexible and may contain fewer restrictive provisions than alternative debt agreements
5. leasing in a certain manner may lead to junior claims, may not add debt on a balance sheet, and does not affect financial ratios; hence it may add to borrowing capacity

Growth in use of leasing contracts

Year	Percent of Companies Indicating Long-Term Leases
1951	33
1960	37
1965	48
1970	60
1975	82
1980	92
1985	92
1990	88
1995	91
2000	93

Accounting for Leases

Capital Lease (capitalization method)

the lessee shall record a capital lease as an asset and an obligation at an amount equal to the present value at the beginning of the lease term of minimum lease payments during the lease term, excluding that portion of the payments representing executory costs such as insurance, maintenance, and taxes to be paid by the lessor

Leased Equipment [PV of future payments]	100,000	
Obligation Under Capital Leases		100,000
Property Tax Expense	2,000	
Obligations Under Capital Leases	23,982	
Interest Expense	7,602	
Cash		33,584
Depreciation Expense - Capital Lease	20,000	
Accumulated Depreciation - Capital Lease		20,000

Operating Lease (noncapitalization method)

rental on an operating lease shall be charged to expense over the lease term

Rent Expense	33,584	
Cash		33,584

Conceptual Views of Lease Accounting

1. do not capitalize any leased asset
 - lessee does not have ownership of the property
 - lease is an executory contract requiring continuing performance by both parties
2. capitalize those leases similar to installment purchase
 - substance over form - a lease has characteristics similar to installment purchases
3. capitalize all long-term leases
 - capitalize long-term right to use property

Objective of SFAS 13

a lease that transfers substantially all of the benefits and risks incident to the ownership of property should be accounted for as the acquisition of an asset and the incurrence of an obligation by the lessee

Requirements of SFAS 13

If, at date of lease agreement, lessee meets one or more of the following criteria, arrangement is a capital lease:

1. the lease transfers ownership of the property to the lessee
2. the lease contains a bargain purchase option
 - bargain purchase option* - a provision allowing the lessee, at his/her option, to purchase the leased property for a price which is sufficiently lower than the expected fair value of the property at the date the option becomes exercisable that exercise of the option appears, at the inception of the lease, to be reasonably assured
3. the lease term (including any bargain renewal options) is equal to 75% or more of the estimated economic life of the leased property
 - bargain renewal option* - a provision allowing the lessee, at his option, to renew the lease for a rental sufficiently lower than the fair rental of the property at the date the option becomes exercisable that exercise of the option appears, at the inception of the lease, to be reasonably assured
4. the present value of the minimum lease payments (excluding executory costs) equals or exceeds 90% of the fair value of the leased property
 - executory costs* - obligations for taxes, insurance, and maintenance related to the leased property

Summary of SFAS 13

Lease agreement is a capital lease if one or more of the following criteria are met:

1. the lease transfers ownership of the property to the lessee
2. the lease contains a bargain purchase option
3. the lease term (including any bargain renewal options) is equal to 75% or more of the estimated economic life of the leased property
4. the present value of the minimum lease payments (excluding executory costs) equals or exceeds 90% of the fair value of the leased property

Principal Disclosure Requirements

The FASB requires that the following information with respect to leases be disclosed in the lessee's financial statements or in the footnotes:

for operating leases

- future minimum rental payments in the aggregate and for each of the five succeeding fiscal years
- rental expense for each period for which an income statement is presented

for capital leases

- the gross amount of assets recorded under capital leases, in the aggregate and by major classes according to nature or function
- the amount of accumulated amortization in total
- future minimum rental payments in the aggregate and for each of the five succeeding fiscal years

for all leases

- a general description of the lessee's leasing arrangements including:
 - ▶ the existence and terms of renewal or purchase options and escalation clauses
 - ▶ restrictions imposed by lease agreements, such as those concerning dividends, additional debt, and further leasing

Financial Statement Disclosure of Leases

		Number of Companies			
		2001	2000	1999	1998
Noncapitalized leases only	.....	330	331	314	324
Capitalized and					
noncapitalized leases	.....	230	215	227	207
Capitalized leases only	.....	6	12	10	10
No leases disclosed	34	42	49	59
Total Companies	600	600	600	600

WINN-DIXIE STORES, INC.
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8. Leases

(a) Leasing Arrangements: There were 1,403 leases in effect on store locations and other properties at June 28, 2000. Of these 1,403 leases, 26 store leases and 3 warehouse and manufacturing facility leases are classified as capital leases. Substantially all store leases will expire during the next twenty years and the warehouse and manufacturing facility leases will expire during the next twenty-two years. However, in the normal course of business, it is expected that these leases will be renewed or replaced by leases on other properties.

The rental payments on substantially all store leases are based on a minimum rental plus a contingent rental which is based on a percentage of the store's sales in excess of stipulated amounts. Most of the Company's leases contain renewal options for five-year periods at fixed rentals.

(b) Leases: The following is an analysis of the leased property under capital leases by major classes:

	2000	1999
	Amounts in thousands	
Store facilities	\$ 38,521	43,451
Warehouses and manufacturing facilities	<u>15,722</u>	<u>15,722</u>
	54,243	59,173
Less: Accumulated amortization	<u>32,951</u>	<u>33,291</u>
	\$ 21,292	25,882

The following is a schedule by year of future minimum lease payments under capital and operating leases, together with the present value of the net minimum lease payments as of June 28, 2000:

	Capital	Operating
	Amounts in thousands	
Fiscal year:		
2001	\$ 7,177	\$ 333,973
2002	7,238	331,137
2003	7,238	327,616
2004	6,633	322,796
2005	6,076	314,406
Later years	<u>25,295</u>	<u>3,110,401</u>
Total minimum lease payments	59,657	<u>4,740,329</u>
Less: Amount representing estimated taxes, maintenance and insurance costs included in total minimum lease payments	<u>1,127</u>	
Net minimum lease payments	58,530	
Less: Amount representing interest	<u>23,448</u>	
Present value of net minimum lease payments	<u>\$ 35,082</u>	

1991 ANNUAL REPORT

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FEDERAL EXPRESS CORPORATION AND SUBSIDIARIES
NOTE 5: LEASE COMMITMENTS

The Company utilizes certain aircraft, land, facilities and equipment under capital and operating leases which expire at various dates through 2021. In addition, supplemental aircraft are leased under agreements which generally provide for cancellation upon 60 days' notice.

Property and equipment recorded under capital leases at May 31 was as follows

In thousands	1991	1990
Flight equipment.....	\$ -	\$ 228,608
Package handling and ground support equipment	370,963	365,901
Computer and electronic equipment	57,922	58,006
Other.....	<u>134,085</u>	<u>134,085</u>
	562,970	786,600
Less accumulated amortization	<u>336,669</u>	<u>331,581</u>
	226,301	455,019

Effective May 1991, modifications to the lease terms for flight equipment under capital leases resulted in their conversion to operating leases.

Rent expense under operating leases for the years ended May 31 was as follows:

In thousands	1991	1990	1989
Minimum rentals	\$ 611,023	\$ 586,834	\$ 374,193
Contingent rentals	<u>144,045</u>	<u>130,609</u>	<u>93,028</u>
	\$ 755,068	\$ 717,443	\$ 467,221

Contingent rentals are based on mileage under supplemental aircraft leases.

A summary of future minimum lease payments under capital leases and non-cancelable operating leases (principally aircraft and facilities) with an initial or remaining term in excess of one year at May 31, 1991 follows:

In thousands	Capital Leases	Operating Leases
1992	\$ 36,811	\$ 411,006
1993	29,784	338,409
1994	25,013	304,702
1995	25,838	285,909
1996	25,309	271,773
Thereafter	<u>532,349</u>	<u>2,586,669</u>
	\$ 675,104	\$ 4,198,468

At May 31, 1991, the present value of future minimum lease payments for capital lease obligations was \$239,254,000.