WEBINAR

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Telecom Accounting Challenges and Strategies

July 12, 2022

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Meet the Presenters

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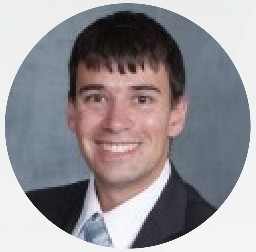

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AGENDA

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- Introductions
- Investments
- Property, Plant, and Equipment
- Grant Accounting
- Revenue Recognition
- Leases
- Closing and Q&A

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Investments

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Investments

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Determining Methodology

- Post ASU 2016-01
  - Consolidation (ASC 810): Ownership > 50%
  - Equity Method (ASC 323): ≤50% & Significant influence
    - + Fair Value Option
  - Fair Value: Catch-all
    - + Measurement alternative (Similar to historical “Cost” methodology)

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Investments

Equity Method: Significant Influence Indicators

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- Significant Influence
  - Quantitative: > 20% ownership
    - + ASC 323-30-s99-1: Investments in limited partnerships > 3%
    - + Larger ownership % than other individuals in concentrated group
  - Qualitative
    - + Governance influence
      - > Board seats
      - > Significant voting rights
    - + Management participation
    - + Operational / Technology dependence
    - + Investee Sales Concentration

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Investments

Codification Changes

- ASC 320 – Historically covered all financial assets
  - 2016-01 = Split out Equity Securities
    - ASC 320 – (Financial Assets other than equity Securities) – i.e. Debt Securities
      - Trading – Fair Value Through Net Income (FVTNI)
      - Available for Sale – Fair Value Though Other Comprehensive Income (FVTOCI)
      - Held to maturity – Amortized Cost
  - ASC 321 – Equity Securities
    - No Categories
      - FMV Changes accounted through Net Income

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Investments

Measurement Alternative

- Equity Securities without a readily determinable fair value
  - Telecom Default Option
  - Practical Expedient - Alternative
    - + Measure at “cost: impairment +- observable price changes.”

- Not available if NAV practical expedient already elected. (Intuitive)

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Investments

Practical Expedient: Net Asset Value per Share (NAV)

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- NAV Practical Expedient for fair value
  - Available for investments that:
    - Is a separate legal entity
    - Its primary business activity involves investing its assets for current income, appreciation or both
    - Ownership in the entity is represented by units of investment (e.g., shares of stock, partnership interests, membership interests, etc.) to which proportionate shares of net assets can be attributed
    - The funds of the entity's owners are pooled to avail owners of professional investment management
    - The entity is the primary reporting entity
  - Separate disclosure requirements apply
    - Settlement at value other than FMV expected
    - FV Hierarchy separate column – Reconciliation to Face FS

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Investments

Accounting for Distributions

- Equity Method
  - Reduction of investment (Credit 1406.xxx / 1410.xxx A/C)
- Fair Value
  - Dividend Income. (7300.xxx A/C)
- Measurement Alternative (Cost Method)
  - Dividend Income (7300.xxx A/C)

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Investments

Mutual Funds: Dividends vs Returns of Capital

- Tax 1099s: reclassification of dividends to nondividend distributions / returns of capital.

  - Update current year financials.

  - If books are closed, account for prospectively as change in estimate.

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Investments

Patronage Capital / Credits

- Generally - Lack of Fair Market Value
  - Measurement alternative
    - + Patronage allocation – Income
    - + Distributions – Reduction of basis
    - + Patronage allocation retained by investee

Example:
1,000 patronage allocation of which 300 distributed in cash

Cash	$300
Investment	$700
Dividend income	$1,000

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Property Plant and Equipment

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Property Plant and Equipment

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Work Order Closings: Tracking

- **Issue:** Source transactions not closed to appropriate in-service account.
  - Invoice breakdown not properly segregated
    - + ONTs – 2232 A/C (ILEC Only)
    - + Lack of allocation of labor and overheads
- **Recommendation:** Separate spreadsheet tracking
  - Assignment of closing GL code to each source transaction.
  - Reconciliation back to GL accounts
  - Review – Vendor specificity

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Property Plant and Equipment

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Work Order Closings: Timeliness

- **Issue:** Work Orders are not closed timely
  - Close WO on date asset is placed into service.
    - + Depreciation implications

- **Recommendation:**
  - At least quarterly review open work orders for any projects that have been completed (service that has been “turned on.”)

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Interest During Construction

- **Issue:** Interest during construction not calculated / recorded
  - Interest incurred during construction period needs to be capitalized. (ASC 835)
    - + Cannot exceed interest expense incurred.
    - + Dollar-for-Dollar reimbursement for cost companies from NECA pools.

- **Recommendations:**
  - Check if accounting software has built-in functionality to calculate.
  - Prepare spreadsheet to calculate weighted-average
  - Materiality / Cost-benefit considerations

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IDC Calculations

		12/31/2021					
	Open WOs > $100k						
	Avg. Interest Rate	2.55%					
	Monthly Work	Work Order # / Closing Account / Closing Date					
	WO Reference	7755	7844	7887	11318	11354	11369
	In-service A/C	12.00.2232.04	12.00.2232.04	12.00.2423.01	00.01.2423.01	00.02.2423.01	00.01.2124
	Closing Month	12	12	12	12	12	12
	Month						
0	Balance Forward	276,540.63	1,011,860.16	23,043.89	60,310.33	(58,111.50)	-
1	January		9,031.49	19,613.66	2,831.13	6,493.01	-
2	February		1,345.39	8,527.44		7,528.08	4,174.65
3	March		-	48.09		591.30	72,556.81
4	April		7,680.76	22,153.44		334.00	-
5	May		-	26,473.15		57,695.34	32,007.24
6	June		-	53,146.89	2,618.00	5,280.73	308.59
7	July		3,762.91	90,198.90		1,542.70	
8	August		14,112.11	29,243.39	1,366.79	2,176.65	
9	September		10,958.29	11,481.73	1,046.37	1,900.46	
10	October		-	28,652.83	2,758.14	-	
11	November		5,711.65	27,325.65		1,382.34	
12	December			109,497.45	5,592.32	44,159.94	
	Total	276,540.63	1,064,462.76	449,406.51	76,523.08	70,973.05	109,047.29

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IDC Calculations

	Labor & OH Spread						
	Month	7755	7844	7887	11318	11354	11369
	Total Labor/OH	3,855.47	21,227.00	229,255.44	120,283.55	32,672.26	3,409.74
0	Balance Forward	3,855.47	20,178.02	11,755.36	94,799.38	(26,751.48)	-
1	January	-	180.10	10,005.50	4,450.14	2,989.04	-
2	February	-	26.83	4,350.10	-	3,465.53	130.53
3	March	-	-	24.53	-	272.20	2,268.74
4	April	-	153.17	11,301.12	-	153.76	-
5	May	-	-	13,504.73	-	26,559.90	1,000.82
6	June	-	-	27,111.79	4,115.13	2,430.97	9.65
7	July	-	75.04	46,013.10	-	710.18	-
8	August	-	281.42	14,917.91	2,148.40	1,002.02	-
9	September	-	218.52	5,857.17	1,644.75	874.87	-
10	October	-	-	14,616.65	4,335.41	-	-
11	November	-	113.90	13,939.62	-	636.36	-
12	December	-	-	55,857.86	8,790.34	20,328.91	-
	Total	3,855.47	21,227.00	229,255.44	120,283.55	32,672.26	3,409.74
	Check	-	-	-	-	-	-
	Total Costs	280,396.10	1,085,689.76	678,661.95	196,806.63	103,645.31	112,457.03
	Total per PBC	280,396.10	1,085,689.76	678,661.95	196,806.63	103,645.31	112,457.03
	Check (SB $0)	-	-	-	-	-	-

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IDC Calculations

		Interest During Construction - Done on Running Balance					
	In-service A/C	12.00.2232.04	12.00.2232.04	12.00.2423.01	00.01.2423.01	00.02.2423.01	00.01.2124
	Closing Month	12	12	12	12	12	12
	Interest Rate	2.55%	2.55%	2.55%	2.55%	2.55%	2.55%
1	January	596.00	2,213.00	137.00	345.00	(160.00)	-
2	February	596.00	2,216.00	164.00	345.00	(137.00)	9.00
3	March	596.00	2,216.00	164.00	345.00	(135.00)	168.00
4	April	596.00	2,232.00	235.00	345.00	(134.00)	168.00
5	May	596.00	2,232.00	320.00	345.00	45.00	238.00
6	June	596.00	2,232.00	491.00	359.00	61.00	239.00
7	July	596.00	2,240.00	780.00	359.00	66.00	239.00
8	August	596.00	2,271.00	874.00	367.00	73.00	239.00
9	September	596.00	2,295.00	911.00	373.00	79.00	239.00
10	October	596.00	2,295.00	1,003.00	388.00	79.00	239.00
11	November	596.00	2,307.00	1,091.00	388.00	83.00	239.00
12	December	596.00	2,307.00	1,442.00	418.00	220.00	239.00
	Total	7,152.00	27,056.00	7,612.00	4,377.00	140.00	2,256.00

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Property Plant and Equipment

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Retirements:
Unrecorded

- **Issue:** Equipment retirements are not recorded in accounting records.
  - Losses on retirement – Income Tax Benefits
  - Property tax savings
- **Recommendations:**
  - Annual review of CPRs
  - Review plant additions from “trade-ins”
  - Review fiber builds replacing copper facilities

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Property Plant and Equipment

Retirements:
Improper Accounting

- Accumulated Depreciation Impacts
  - Regulated
    - Retirement = cost basis of asset
    - Credit salvage amounts received
  - Nonregulated
    - Retire amount attributable to specific asset retired.
    - Gain/Loss

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Grant Accounting

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Grant Accounting

Upcoming Changes

- ASU 2021-10 (ASC 832)
  - Issued November 17, 2021
  - Broadband Grants
    - + Governments are generally not considered a customer
- Adoption
  - Prospectively or
  - Retrospectively

Effective Dates ASU 2021-10 Early Adoption Permitted	All Entities Annual financial statements beginning after December 15, 2021

Grant Accounting

Additional Disclosures

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- Information about the nature of the transactions, including a general description and the form (Ex: cash vs noncash assets) in which the assistance has been received
- **The accounting policies used to account for the transactions**
  - **Grant Model (IAS 20)**
  - **Contribution Model (ASC 958-605)**
- Balance sheet and income statement affected by the grants and the dollar amounts applicable to each financial statement line item in the current reporting period
- Significant Transaction Terms
  - The duration/period of the agreement
  - Commitments made by the parties
  - Provisions for recapture, including the conditions that allow recapture, if any
  - Other contingencies

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Grant Accounting

Grant Model / IFRS Alternative

- IAS 20
  - Recognition = Reasonable Assurance* that:
    - + Conditions attached to assistance will be met, and
    - + Proceeds will be received

- Recognition generally allowed sooner than 958-605 methodology
  - Setup as deferred revenue
    - + Amortize on a systematic basis over the periods in which the entity recognizes as expenses the related costs for which the grants are intended to compensate.

*Similar to "Probable" threshold in US GAAP.

Grant Accounting

Contribution Model / GAAP Alternative

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- ASC 958-605
  - Nonconditional – Recognize upon notification of agreement. (immediate recognition)
  - Conditional contributions
    - + Barrier
      - > Generally, buildout requirements are conditions.
      - > Reporting requirements / Administrative tasks are not a condition.
    - + Right of return

- Recognize in income once conditions are satisfied.
  - Deferral = based on conditions being met
  - NOT based on matching revenues and expenses
  - Barrier analysis is a deterrent to using this method.

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Grant Accounting

Methods

- Deferred Revenue
  - Allowable = ASC 958-605 and IAS 20
  - Amortize over period equal to the life of associated plant

- Proceeds in aid of construction
  - Allowable under IAS 20
  - Required under ASC 980
  - Offset cost basis of associated property
    - + Best Practice – Use Contra-asset accounts to maintain record of historical basis.

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Grant Accounting

Regulated Operations

- **REGULATED OPERATIONS: ASC 980**
  - Regulatory rules override
    - Complexities surrounding what constitutes regulated operations
      - Will the amounts impact your reimbursement rates (Cost-Study)?
  - Use Aid of Construction method.

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Grant Accounting

Takeaways

- IAS 20 recommended option
  - Deferred Revenue

- Start Tracking Now (Additional Disclosures)
  - Progress on projects (Costs incurred to date)
  - Reimbursement requests
  - Cash received
  - Remaining matching contributions

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Revenue Recognition Reminders

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Revenue Recognition

Discount Allocation

- Performance Obligations - Allocation of discounts
  - If the sum of the stand-alone selling prices of a bundle of services exceeds the consideration, then the discount is generally allocated proportionately to all performance obligations in the contract.
  - However, this does not apply if there is evidence that the entire discount relates to only one or more, but not all performance obligations.

- Revisit discount analysis any time bundle pricing changes
  - Easy Button – If services are provided concurrently, Telco can decide that it is acceptable to account for the bundle as one performance obligation.
    - Requires single line presentation on Income Statement

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Revenue Recognition

Discount Allocation

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Not allocating to all performance obligations

ASC 606-10-32-37 states:

“An entity shall allocate a discount entirely to one or more, but not all, performance obligations in the contract if all of the following criteria are met:

a) The entity regularly sells each distinct good or service (or each bundle of distinct goods or services) in the contract on a standalone basis.

b) The entity also regularly sells on a standalone basis a bundle (or bundles) of some of those distinct goods or services at a discount to the standalone selling prices of the goods or services in each bundle.

c) The discount attributable to each bundle of goods or services described in (b) is substantially the same as the discount in the contract, and an analysis of the goods or services in each bundle provides observable evidence of the performance obligation (or performance obligations) to which the entire discount in the contract belongs.”

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Revenue Recognition

Commission Expenses

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- ASC 340-40-25-2 states, "*the incremental costs of obtaining a contract are those costs that an entity incurs to obtain a contract with a customer that it would not have incurred if the contract had not been obtained (for example, a sales commission)".*
  - *Capitalize and amortize*
    - + *Amortization Period*
      - > *Contract Term*
        - \- *If no contract term, Average customer life*
  - *Practical expedient*
    - + *Expense costs as incurred if amortization period (contract term/average customer life) is one year or less*

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Leases

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Leases

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Background

- Last Call – Effective 1/1/2022
  - All leases will be recognized on the balance sheet of lessees
- Operating leases (NEW)
  - Lease liability
  - Right of Use Asset
- Finance leases (formerly capital leases)
  - Lease liability
  - Lease assets
  - Similar to today's rules

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Leases

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Last Call

- Identify & educate
- Develop timeline & key milestones
- Identify & collect **ALL** leases & relevant data
- Analyze data – key elements
- Implementation – accounting & reporting
- **Ongoing** accounting – centralization, new leases, modifications, monitoring…& much more

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Leases

ASC 842 – Leases

- What arrangements are leases?

ASC 842-10-15-3 states:

"A contract is or contains a lease if the contract conveys the **right to control** the use of identified property, plant, or equipment (**an identified asset**) for a **period of time** in exchange for consideration."

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Leases

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ASC 842 – Leases

- What arrangements are leases?

A lease is present in a contract if it **includes both**:

a) **An identified asset**
   1) Explicitly or implicitly specified (842-10-15-9)
   2) Asset is physically distinct (842-10-15-16)
   3) Supplier does not have a substantive substitution right (842-10-15-10 to 15)

b) **Control of use**
   1) Ability to obtain substantially all economic benefits from use of asset throughout the period of use (842-10-15-17 to 19), AND
   2) Right to direct the use of the asset
      i. How and for what purpose the asset is used (842-10-15-24 to 26), OR
      ii. The relevant decisions about how and for what purpose is predetermined, AND
         1. Customer has the right to operate the asset throughout period of use and supplier does not have the right to change operating instructions, OR
         2. Customer designed the asset in a way that predetermines how and for what purpose the asset will be used.

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Leases

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Substantive Substitution Rights

- Substantive substitution rights
  - Even if asset is specified, if lessor has the substantive right to substitute, the lessee doesn’t have control & there is no lease
- Substantive substitution right occurs only when
  - Supplier has practical ability to substitute (lessee can’t stop it)
  - Supplier would benefit economically from substitution

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Leases

Common Lease Items

- Example Contracts that Commonly Contain Leases
  - Arrangements involving the use of:
    - + Buildings
    - + Equipment
    - + Trucks
    - + Trailers
    - + Outsourced arrangements for business operations & staff (IT function, warehousing)
    - + Data center
    - + Hosting or other IT arrangements
    - + Dark fiber agreements, etc.

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Common Non-lease Contracts

- Contracts not Under ASC 842
  - Leases of intangible assets
  - Leases to explore for or use minerals, oil, natural gas & similar nonregenerative resources
  - Leases of biological assets, including timber
  - Leases of inventory
  - Leases of assets under construction

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Leases

Common Misconception

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- 12 Month Lease Election
  - For a lease with a term of 12 months or less, a lessee is permitted to make an **accounting policy** election not to recognize lease assets & lease liabilities
  - If a lessee makes this election:
    - \+ it should recognize lease expense for such leases generally on a straight-line basis over the lease term
  - Consideration of renewal options…
    - \+ Don't continually renew one-year leases to avoid the Finance Lease accounting
  - Does require some disclosure

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Leases

Impacts

- Consider changes in:
  - Financial
    - \+ Borrowing capacity
      - > Loan covenants
        - \- Financial statement ratios
          - Current ratio
            - Current portion of lease liability
            - No current portion of ROU asset
  - Regulatory
    - \+ Settlements
    - \+ Account Coding

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Operating Lease Accounts

- Operating Lease
  - FCC Report & Order 18-176 – 12/2018 – Adopted GAAP
    - ROU Asset – Other Noncurrent Assets – 1410
    - Lease Liability – Other Long-Term Liabilities – 4300
    - Lease Liability – Current Portion – 4000/4130
    - Lease/Rent Expense – Appropriate expense account
    - Balance sheet accounts related to capitalized operating leases are excluded from any ratemaking calculations

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Leases

Finance Lease Accounts

- Finance Leases
  - ROU Asset – Sub account of telecommunications plant accounts – 2000/2681 & accumulated amortization – 3410
  - Lease Liability – Long-Term Debt – 4200
  - Lease Liability – Current Portion – 4130
  - Amortization Expense – 6560/6563
  - Interest Expense – 7500

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Closing

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Objectives

- Identify: Raise questions in your accounting department
- Learn: Know proper accounting and what alternatives exist.
- Update: Implement best practices

- 2022 Telecom Accounting Seminar
  - August 10^{th}-11^{th}

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QUESTIONS

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