Lease Accounting

Present value of lease payments
- Minimum lease payments:
  - Composed of minimum rent payments, a guaranteed residual value, penalties for failure to renew or extend the lease, and the BPO
- Executory costs: if lessor retains responsibility, a portion of payment that includes these costs should be excluded
- Discount rate: present value of payments uses lessee’s incremental borrowing rate (the rate that would have been incurred to borrow funds on similar repayment terms)
  - Exception: if lessee knows the lessor’s implicit rate and it is less than the incremental rate, use the lessor’s rate
- Present value = Fair market value of property (minimum payments and unguaranteed residual)

Initial Asset and Liability for Capital Lease

<table>
<thead>
<tr>
<th>Initial JE of lessee</th>
<th>Leased Equipment under capital lease</th>
<th>xxx</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Lease Liability</td>
<td>xxx</td>
</tr>
<tr>
<td></td>
<td>The lower of PV of MLP or FMV of leased asset at the start</td>
<td></td>
</tr>
</tbody>
</table>
- The amount of the liability is the minimum lease payments
  - (Rent payment – executory costs) x PV of annuity due of 1 (#per, rate)

<table>
<thead>
<tr>
<th>Initial JE of lessor</th>
<th>Lease Receivable</th>
<th>xxx</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Asset</td>
<td>xxx</td>
</tr>
<tr>
<td></td>
<td>Remove asset from books</td>
<td></td>
</tr>
</tbody>
</table>

Depreciation (for asset) and recognition of principal and interest with payments are independent accounting processes
- If the lease transfers ownership or has a BPO → use economic life of asset
- Otherwise use the term of the lease
- There is no depreciation for the lessor in a capital lease or operating lease

<table>
<thead>
<tr>
<th>Depreciation</th>
<th>Depreciation Expense-Capital Lease</th>
<th>xxx</th>
</tr>
</thead>
<tbody>
<tr>
<td>(lessee)</td>
<td>Accumulated Depr- Capital Lease</td>
<td>xxx</td>
</tr>
</tbody>
</table>

Recording Receipts by Lessor

1st receipt
- Cash | xxx |
- Lease Receivable | xx |
- Property taxes payable | x |
- Reduce Receivable and record liability for executory cost | 

1st yr revenue
- Cash | xxx |
- Lease Receivable | xxx |
- Interest Revenue | xx |
- Executory Costs payable | x |
- Notice this contains interest revenue for first year | 

If asset is sold at end
- Cash | xxx |
- Gain on sale of leased equipment | xxx |

Recording Payments by Lessee

1st payment
- Property Tax Expense | xxx |
- Lease Liability | xxx |
- Cash | xxx |

Yearly payment
- Property Tax Expense | x |
- Interest Expense | xx |
- Lease Liability | xxx |
- Cash | xxx |

- Interest expense is by the effective interest method
  - Expense = lease liability carrying value x rate