Special Accounting Problems with Leases

Residual Values
- The lessor may want the assurance of a set value of the leased asset to be returned at the end of the lease term if there is no title transfer or BPO.
- A guaranteed residual value by lessee is to make up the deficiency if the assets FMV is below a stated amount at the end of the lease term.
- FMV of leased asset less the PV of residual value = amount to be received by lessor through payments.
- The lessee adds PV of a guaranteed residual value to MLP.

Sales Type Lease
- Lease receivable = PV of MLP + PV of unguaranteed residual value.
- Sales price = Present Value of Minimum Lease Payments.
- Cost of Goods Sold = Cost of the Asset.
- Lessor Recognizes Profit or Loss (Sales less Cost of Goods Sold, above).

Bargain Purchase Option
- Increase PV of MLP by PV of option price.
- Depreciation term for guaranteed residual value and BPO:
  - Lease term for residual value.
  - Economic life for BPO.

Initial Direct Costs (Lessor)
- Incremental Direct Costs are paid to independent third parties.
  - Include costs such as appraisal, credit checks, and brokers.
- Internal direct costs include evaluation of lessee, recording, collateral checks, terms negotiation, document preparation.
- Do not include indirect costs such as advertising, credit policies, etc.
- For an operating lease, defer initial costs and allocate over lease term.
- For a sales-type lease, expense in year of incurrence.
- For direct financing leases, add costs to net investment and amortize.

Current and non-current portions
- For a current liability portion, rework PV based on an ordinary annuity.
  - Balance at the end – balance at the end of next year = current.

Footnote disclosures:
- future payments, contingencies, subleases, restrictions.

Sale-leasebacks are where the lessee sells asset and leases it back; no gain or loss is recognized unless the seller gives up right to use; if FMV < BV, recognize loss.