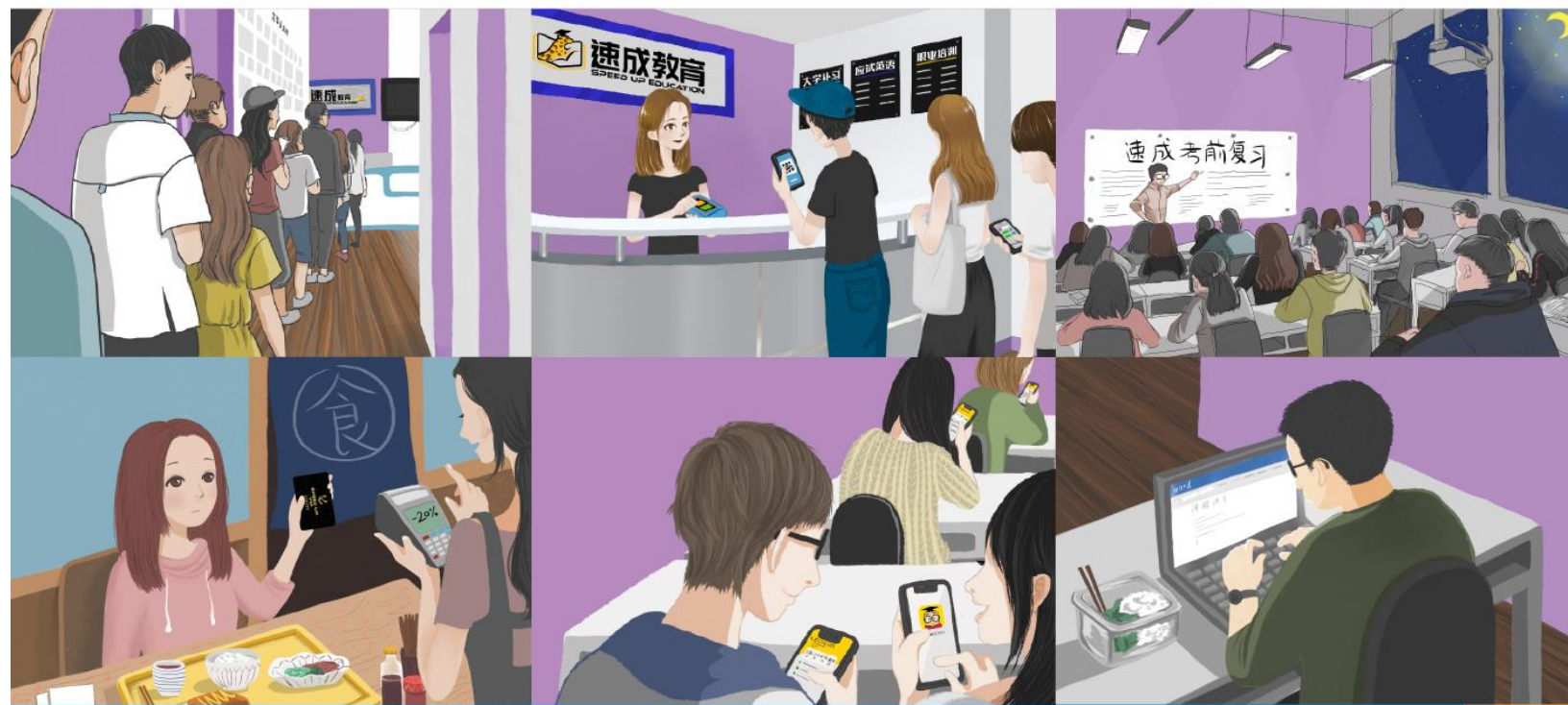




速成教育
SPEED UP EDUCATION



BUS 321

Intermediate Financial Accounting

导师: **ALEX**

SFU Week 4 Class | 2022/6/3

S P E E D U P E D U C A T I O N

Lecture 3 Lease

A lease is a contractual agreement between a lessor and a lessee

Which gives the lessee the right to use specific property (owned by the lessor) In return for lease payments

Advantages of Leasing

- 100% financing at fixed rates with no money down and fixed payments
- Protection against obsolescence: passes the risk of obsolescence to the lessor (although residual values can often produce large profits)
- Flexibility: less restrictive provisions than other debt arrangements
- Less costly financing for lessee; tax incentives for lessor
- Off-balance sheet financing: (now A S P E only) leases are not included as debt on the S F P which allows companies to increase borrowing capacity

Nature of lease

- Do Not Capitalize Any Leased Assets—Executory Contract Approach
- Capitalize Leases That Are Similar to Instalment Purchases—Classification Approach
 - ❖ ASPE
- Capitalize All Leases—A Contract-Based Approach
 - ❖ IFRS – Right to use

Current Standards

ASPE uses the **classification** approach

- A lease that transfers substantially all the benefits and risks of property ownership should be capitalized (classified as finance/capital lease)
- A lease where benefits and risks of ownership are not transferred is classified as operating lease

The newly introduced standard (IFRS 16) adopts the **contract-based** approach, based on the view that:

- Lease contracts create assets and liabilities that should be recognized
- Almost all leases would be capitalized
- Contract-based approach can also be used under A S P E
- Capitalization--present value of future rental payments
 - Generally representative of the asset's fair value
 - Lessee records an asset and a liability; recognizes depreciation
 - Lessor and Lessee book rent as receipt/payment of interest and principal
 - Lessor removes asset from books; replaces with a receivable
- If benefits and risks are not transferred, the lease is classified as an operating lease
 - By the lessee (ASPE); by the lessor (ASPE and IFRS)
 - Under an operating lease: lessee records rent or lease expense; lessor recognizes rental or lease income

Under IFRS 16, from lessee's standpoint, all leases are capitalized and placed on the SFP.

Exceptions permitted only when:

- The lease is for a term of 12 months or less
- The underlying asset is of low value

Determination of Rental Payments

- Lessor determines rental amount on the basis of rate of return expected on leasing the asset
- Key variables in determining the rate of return:
 - Lessee's credit standing
 - Length of the lease
 - Status of residual value (guaranteed or unguaranteed)
 - Income tax effects
- Initial costs of negotiating and arranging the lease are added to the investment to be recovered
- Deducted from the investment to be recovered:
 - P V of an end of the lease purchase option
 - P V of the residual value

Example

A lessor expects to earn a 10% return on a \$100,000 investment in an asset that is to be leased for 5 years. Annual rent is due in advance each year (annuity due). There is no purchase option, bargain purchase option, or residual value.

Lease Criteria

Lease Criteria for Lessees (I F R S 16)

- Under I F R S 16, companies must first assess whether the contract is (or contains) a lease A contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration

All leases under I F R S 16 are contract leases except for short-term leases (12 months or less) or leases of low value

Lease Criteria for Lessees (A S P E)

- Uses the classification approach
- Transfer of ownership test: reasonable assurance the lessee will take ownership at the end of the lease term
 - Transfer with no additional payment, or
 - Through a bargain purchase option (price significantly lower than expected fair value)
 -
- Economic life test: if the lease period is equal to, or greater than 75% of the asset's economic life, it is assumed ownership has passed
- Recovery of investment by lessor test: if the present value of the payments is reasonably close to the asset's market price
The present value of the minimum lease payments is equal to **90%** or more of the fair value of the leased asset

Journal Entry

1. Minimum lease payments: from a lessee perspective
 1. Minimum rental payments – the payments that the lessee makes or can be required to make to the lessor
 2. Amounts guaranteed—related to residual value
 1. Maximum amount lessor can require lessee to pay
 2. Unguaranteed amount—not guaranteed by the lessee, or is guaranteed through a third party
 3. Bargain purchase option
2. Executory costs: any recovery included in the rent should be deducted before calculating the minimum payments
3. Discount rate: two rates are important
 - Implicit rate: makes the PV of the minimum lease payments plus any unguaranteed residual value = fair value of the underlying leased asset (rate required by I F R S, if known)
 - Lessee's incremental borrowing rate—interest rate that would apply if a lessee borrowed the equivalent funds for a similar term and with similar security
 - A S P E specifies the lower of the two rates be used

	Included in Capitalized Asset Cost	Depreciable Amount	Depreciation Period
Lessee retains asset at end of lease term:			
Title is transferred, no purchase option	Minimum rental payments (ASPE) or lease payments* (IFRS 16)	Full capitalized amount minus estimated residual value, if any, at end of useful life	Useful life of asset
Title is transferred when purchase option is exercised	Minimum rental payments plus BPO (ASPE) or lease payments* (including purchase option if lessee is reasonably certain to exercise the option) (IFRS 16)	Full capitalized amount minus estimated residual value, if any, at end of useful life	Useful life of asset
	Included in Capitalized Asset Cost	Depreciable Amount	Depreciation Period
Asset reverts to lessor at end of lease term:			
Lessee does not guarantee any residual value	Minimum rental payments (ASPE) or lease payments *(IFRS 16) value	Full capitalized amount	Lease term
Lessee guarantees a residual value	Minimum rental payments plus residual value guarantee (ASPE) or lease payments* (includes amounts expected to be paid under a residual value guarantee) (IFRS 16)	Full capitalized amount minus any undiscounted guaranteed residual value included as part of cost calculation	Lease term

1. The lease term is five years, the lease agreement is non-cancellable, and it requires equal rental payments of \$25,981.62 at the beginning of each year (annuity due basis), beginning January 1, 2020. The lease contains no renewal options, and the equipment reverts to Lessor Corporation at the end of the lease.
2. The equipment has a fair value of \$100,000 on January 1, 2020, an estimated economic life of five years, and no residual value. Lessee Corporation uses straight-line depreciation for similar equipment that it owns.
3. Lessee Corporation pays all executory costs directly to third parties except for maintenance fees of \$2,000 per year, which are included in the annual payments to Lessor Corporation.
4. Lessee Corporation's incremental borrowing rate is 11% per year. Lessor Corporation set the annual rental to earn a rate of return on its investment of 10% per year; this fact is known to Lessee Corporation.

Accounting for Residual Values/ No residual value

Example: Lessor wants to recover net investment of \$100,000 and earn 10%. **Guaranteed residual value** of \$5,000 included in the lease (lessee pays for any loss). Expected residual value = \$5,000.

Lessee's Capitalized Amount (10% Rate) (Annuity due basis; guaranteed residual value)		Total amount to be amortized
PV of five annual rental payments of \$23,237.09, <i>i</i> = 10%: ($\$23,237.09 \times 4.16986$, Table A.5)	\$ 96,895.40	
Add: PV of guaranteed residual value of \$5,000 due at end of five-year lease term: ($\$5,000 \times 0.62092$, Table A.2)	3,104.60	
Lessee's capitalized amount	\$100,000.00	

Example: Lessor wants to recover net investment of \$100,000 and earn 10% with **unguaranteed residual value** (A S P E) and residual value amount not expected to be payable by lessee (I F R S 16).

Lessee's Capitalized Amount (10% Rate) (Annuity due basis, unguaranteed residual value)

PV of five annual rental payments of \$23,237.09, $i = 10\%$, $\$23,237.09 \times 4.16986$ (Table A.5)	\$96,895.40
Unguaranteed residual value is not included in minimum lease payments	-0-
Lessee's capitalized amount	<u>\$96,895.40</u>

	Guaranteed		Unguaranteed
Jan 1, 2020: Capitalization of lease First payment	<div> <div>Equipment under Lease</div> <div>Maintenance and Repairs Expense</div> <div>Obligations under Lease</div> <div>Cash</div> <div>100,000</div> <div>2,000</div> <div>76,763</div> <div>25,237</div> </div>	→	<div> <div>Equipment under Lease</div> <div>Maintenance and Repairs Expense</div> <div>Obligations under Lease</div> <div>Cash</div> <div>96,895</div> <div>2,000</div> <div>73,658</div> <div>25,237</div> </div> <div>←</div>
Dec 31, 2020: Adjusting entry for accrued interest	<div> <div>Interest Expense</div> <div>Obligations under Lease</div> <div>7,676</div> <div>7,676</div> </div>		<div> <div>Interest Expense</div> <div>Obligations under Lease</div> <div>7,366</div> <div>7,366</div> </div>
Dec 31, 2020: Record Depreciation	<div> <div>Depreciation Expense</div> <div>Accumulated Depreciation—Leased Equipment</div> <div>19,000</div> <div>19,000</div> </div>	→	<div> <div>Depreciation Expense</div> <div>Accumulated Depreciation—Leased Equipment</div> <div>19,379</div> <div>19,379</div> </div> <div>←</div>
	<div> <div>(\$100,000 - \$5,000)/5 = \$19,000</div> </div>		<div> <div>\$96,895/5 = \$19,379</div> </div>

Accounting for Operating (ASPE) and Short-Term/Low Value (IFRS) Leases

- Asset and liability not recognized in the accounts—lease is treated like an executory contract
- Lease payments are treated as rent expense (A S P E), and short-term or low-value lease expense (I F R S)
- Lease rentals recognized on a straight-line basis over the term of the lease