



## **Course «Investment project management»**

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# SIMPLE LEASE EXAMPLE

Equipment costs \$30,000 new, LESSEE leases the equipment for 3 years, payments at the END of the year. Lessee expects a residual value of \$20,000 at the end of the 3 years and wants to earn 10%/year. The equipment has a 7 year life.

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# SIMPLE LEASE EXAMPLE

HOW MUCH ARE THE ANNUAL  
LEASE PAYMENTS?





## SIMPLE LEASE EXAMPLE

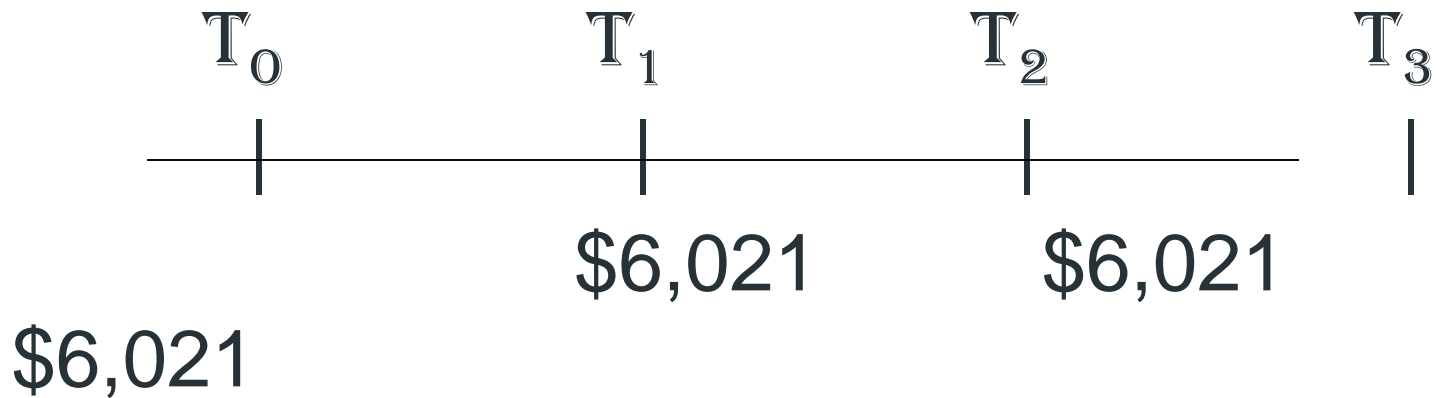
**If you were the CEO of a publicly traded company leasing this equipment, would you like to record this equipment as your asset and liability?**

# SIMPLE LEASE EXAMPLE

Suppose you “believed” the equipment was *not* your asset so you did not record the asset or liability - in financial reporting terminology you would be saying the lease was an “**operating lease.**”

# SIMPLE LEASE EXAMPLE

if it is an Operating Lease



How should you record the lease payments?

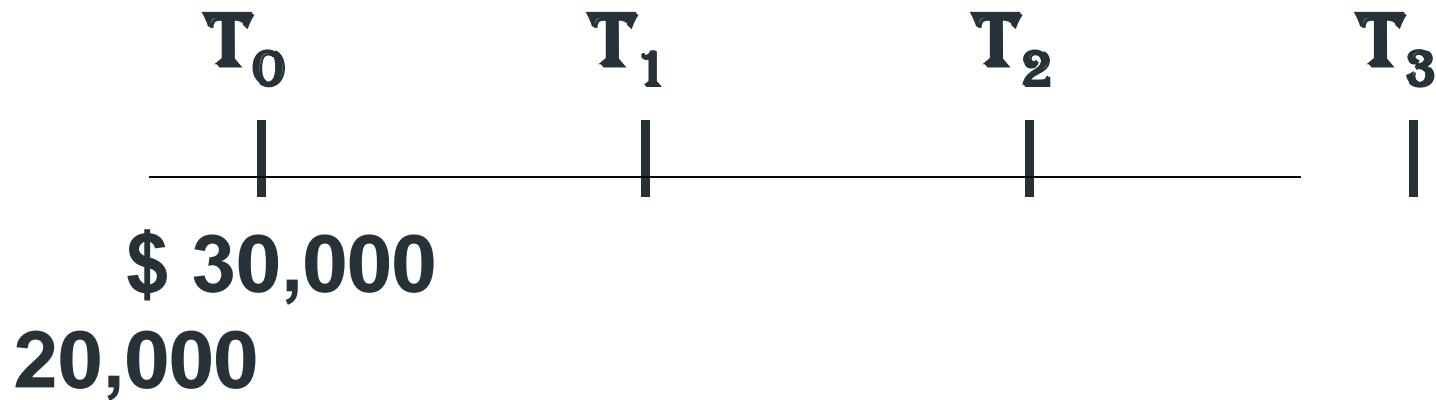
# SIMPLE LEASE EXAMPLE

if it is a capital Lease

Now, suppose you believed the equipment was your asset - in reporting terminology you would be saying the lease were a “capital (or finance) lease.”

# SIMPLE LEASE EXAMPLE

if it is a capital Lease



At  $T_0$ : (Assume for now, the residual value was not guaranteed by the lessee.)

How should you record signing of the lease?

# SIMPLE LEASE EXAMPLE

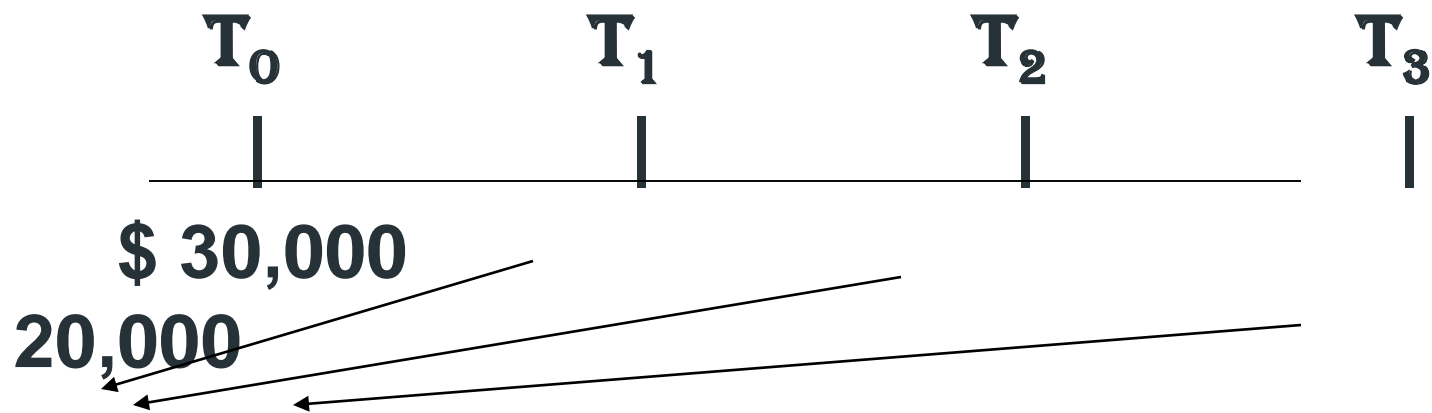
if it is a capital Lease

Lessee is making 3 payments of \$6,021 - a total of \$18,063; the liability is recorded at \$14,974.

The difference of \$3,089 represents what?

# SIMPLE LEASE EXAMPLE

if it is a capital Lease



At  $T_1 - T_3$  : How should you record the lease payments?

And what else should you do at the end of each year?

# COMPARISON OF INCOME STATEMENTS

**WHICH HAS MORE EXPENSE OVER THE 3 YEAR LIFE OF THE LEASE?**

# LEASES – REPORTING SUMMARY

**Balance sheet:** capital lease increases liabilities (and the “worst ones” at that) and increases non-current assets.

**Income statement:** capital lease reduces income more in the early years of the lease.

**Cash flow statement:** capital lease payments divided between operating activity

# LEASES – WHICH IS IT? (OR WHAT TO DO TO AVOID capital LEASES)

Can the lessee cancel the lease?

yes

Does title transfer at the lease end?

no

**CAPITAL**

Is there a bargain purchase option?

no

**LEASE**

Is the lease for  $\geq \frac{3}{4}$  of the asset's useful life?

no

Is the PVMLP  $\geq 90\%$  assets fair value?

no

no

and

yes

yes

yes

yes

**BOO**

**HURRAY!  
OPERATING  
LEASE**

# LEASES

## Additional Considerations

**Residual value -  
unguaranteed or guaranteed**

**Executory costs**

**Lessee's interest rate -  
incremental borrowing rate unless...**

# LEASES

## Additional Considerations

### Lessor Accounting

**Lessor's Initial Direct Costs (IDC)  
incremental costs &  
internal costs  
(internal *indirect* costs -  
which are not IDC-so expense  
immediately)**



# LEASES

## Additional Considerations

### Real Estate

### Sale and Leaseback



A decorative network diagram in the top right corner, consisting of various sized circles (nodes) connected by thin lines (edges). Some nodes are solid grey, while others are hollow with a grey outline. The connections form a complex, branching structure.

# SALE AND LEASEBACK

**FAIRLY COMMON TRANSACTION  
(OR PAIR OF TRANSACTIONS)**

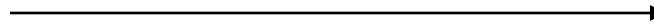
# SALE AND LEASEBACK

Seller / lessee

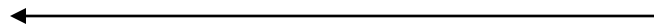
Buyer / lessor



“sells” the asset



leases the asset back



# SALE AND LEASEBACK

**Seller / lessee's accountant looks at it as two (related) transactions.**

**Transaction 1 - the sale - like the sale of PPE in**

**ACCT 3220, but with a difference: gains/losses**

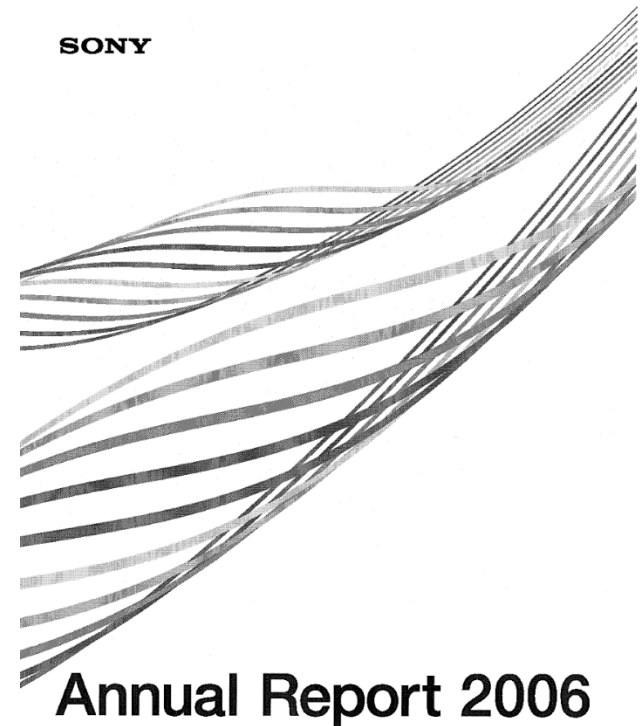
**may or may not be recorded immediately.**

# LEASES – WHAT YOU SHOULD DO WHEN READING FINANCIAL STATEMENTS:

**IAS and American standards differ in detail, but both do give you a method to “undo” management “maneuvers” to avoid capital leases.**

# LEASES – WHAT YOU SHOULD DO WHEN READING FINANCIAL STATEMENTS:

Using Sony Corporation as an example.



<http://www.sony.net/SonyInfo/IR/financial/ar/2006/index.html>

# LEASES – WHAT YOU SHOULD DO WHEN READING FINANCIAL STATEMENTS:

## Sony Corporation Balance Sheet (in \$ million) {original}

Current assets \$ 3,218  
liabilities \$27,352

PP&E 11,868  
liabilities 35,613

Other assets 75,579  
27,700

Total assets \$90,665

Current

Long-term

Owners' equity

Total L & O E

# LEASES – WHAT YOU SHOULD DO WHEN READING FINANCIAL STATEMENTS:

The following is a schedule by year of the future minimum lease payments under capital leases together with the present value of the net minimum lease payments as of March 31, 2006:

	Yen in millions	Dollars in millions
Year ending March 31:		
2007	¥18,322	\$157
2008	9,650	82
2009	5,325	46
2010	3,081	26
2011	2,149	18
Later years	4,725	40
Total minimum lease payments	43,252	369
Less—Amount representing interest	4,972	42
Present value of net minimum lease payments	38,280	327
Less—Current obligations	16,966	145
Long-term capital lease obligations	¥21,314	\$182

were ¥21,843 million (\$187 million). The minimum rental payments required under operating leases that have initial or remaining noncancelable lease terms in excess of one year at March 31, 2006 are as follows:

	Yen in millions	Dollars in millions
Year ending March 31:		
2007	¥ 47,500	\$ 406
2008	34,715	297
2009	26,529	227
2010	16,320	139
2011	11,541	98
Later years	58,932	504
Total minimum future rentals	¥196,537	\$1,671

# LEASES – WHAT YOU SHOULD DO WHEN READING FINANCIAL STATEMENTS:

in \$ million

Year ending	CAPITAL	OPERATING
March 31:	<u>LEASES</u>	<u>LEASE</u>
2007	157	406
2008	82	297
2009	46	227
2010	26	139
2011	18	98
Later years	<u>40</u>	<u>504</u>
<b>Total</b>	<b>369</b>	<b>1,671</b>
less interest	<u>(42)</u>	
<b>Present value</b>	<b>327</b>	
less current portion	<u>(145)</u>	
<b>Long-term portion</b>	<b><u>182</u></b>	



# THE LEASE: LESSOR ACCOUNTING

## LESSEE:

Operating lease

Capital lease

lease

## LESSOR:

Operating lease

Sales type lease  
or  
Direct financing

# THE LEASE: LESSOR ACCOUNTING

In general, if it is a capital lease for the lessee, then the lessor considers the asset to be sold, but not always.

To be considered “sold” the lessor has two additional criteria that must be met.



Thanks for attention!!!

