

Lessor Example – Derecognition Approach

**Disclaimer – The exposure draft received nearly 700 letters of comment through the comment period ended December 15, 2010. There is some expectation that key features of the standard will be modified as a result of constituent response. As a result, these illustrative examples will not likely be accurate or appropriate to rely upon after issuance of the final standard. We have provided these as an educational tool only and do not represent these examples to be accurate under current or future final standards. Any templates used in the examples below are for internal use only and are not available for distribution.

Leasing Example – Lessor Perspective – Derecognition Approach

Subject:

ABC Corporation has entered into an agreement to lease a printing press machine to General Company, LLC.

Details:

The lease terms are as follows:

Lessor:	ABC Corporation (ABC)
Lessee:	General Company, LLC (GP, LLC)
Leased Equipment:	Printing press machine
Lease Term:	Non-cancellable for 5 years with no renewal options or residual value guarantees
Expected Life of Equipment:	5 years
Lease Date:	December 1, 2009
Commencement Date:	January 1, 2010
Payments:	60 monthly payments of \$5,000 beginning on January 1, 2010
Maintenance Arrangements:	No
Security Deposit:	No

Other relevant assumptions:

Incremental borrowing:	The incremental borrowing rate of ABC Corporation is 8%
Reassessment:	Throughout the period, no reassessment of contingent rentals, residual value guarantees or impairment occur
Carrying Amount of Underlying Asset at Date of Inception:	\$275,000
Fair Value of Underlying Asset at Date of Inception:	\$325,000

Comparison of Financial Statement Impact for Life of the Lease

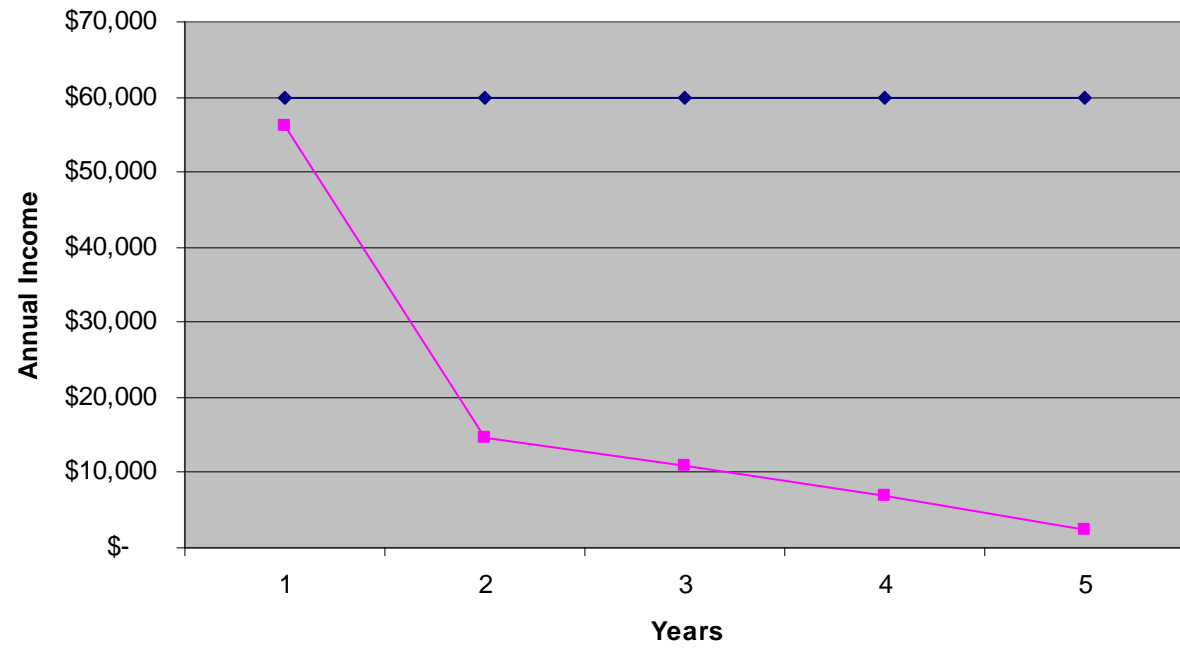
Detailed balance sheet comparisons follow, but the summary impact of key elements are listed below:

Year	Lease Revenue vs. Interest Income and Lease Income		Straight Line Rent Receivable vs. Right to Receive Asset		Derecognized Underlying Asset / Lease Expense Recorded at Inception (Not Recorded Under Current Accounting)	
	FASB 13 (Current)	ASC840 (Proposed)	FASB 13 (Current)	ASC840 (Proposed)	FASB 13 (Current)	ASC840 (Proposed)
2010	\$60,000	\$18,217	None	\$204,809	None	\$(208,654)
2011	\$60,000	\$14,749	None	\$159,559	None	None
2012	\$60,000	\$10,994	None	\$110,553	None	None
2013	\$60,000	\$6,926	None	\$57,479	None	None
2014	\$60,000	\$2,521	None	None	None	None
Totals	\$300,000	\$53,407				
Average Balance			None	\$35,493	None	N/A

Note – The portion of the underlying asset derecognized would be calculated at the date of inception of the lease as follows:

Fair value of the right to receive lease payments x carrying amount of the underlying asset
Fair value of the underlying asset

Impact on Net Income



Comparison of Financial Statement Impact for Life of the Lease – Detailed by Year

December 31, 2010

	FASB 13 (Current)		ASC840 (ED - Proposed)	
	Income Stmt	Balance Sheet	Income Stmt	Balance Sheet
Income Statement				
Lease Income	\$(60,000)		\$(246,592)	
Lease Expense	\$--		\$208,654	
Interest Income	\$--		\$(18,217)	
Impact on Net Income	\$(60,000)		\$(56,155)	
Balance Sheet				
<i>Assets</i>				
Underlying Asset		\$--		\$(208,654)
Straight Line Lease Asset		\$--		\$--
Right to Receive Asset		\$--		\$204,859

- Note that cash impacts are the same under both sets of accounting.
- Note that cash flows from leasing under current standards are part of operating income on the cash flow statement, but are separate out as financing cash flows under the proposed standard.

December 31, 2011

	FASB 13 (Current)		ASC840 (ED - Proposed)	
	Income Stmt	Balance Sheet	Income Stmt	Balance Sheet
Income Statement				
Lease Income	\$(60,000)		\$--	
Lease Expense	\$--		\$--	
Interest Income	\$--		\$(14,749)	
Impact on Net Income	\$(60,000)		\$(14,749)	
Balance Sheet				
<i>Assets</i>				
Straight Line Lease Asset		\$--		\$--
Right to Receive Asset		\$--		\$159,559

- Note that cash impacts are the same under both sets of accounting.
- Note that cash flows from leasing under current standards are part of operating income on the cash flow statement, but are separate out as financing cash flows under the proposed standard.

December 31, 2012

	FASB 13 (Current)		ASC840 (ED - Proposed)	
	Income Stmt	Balance Sheet	Income Stmt	Balance Sheet
Income Statement				
Lease Income	\$(60,000)		\$--	
Lease Expense	\$--		\$--	
Interest Income	\$--		\$(10,994)	
Impact on Net Income	\$(60,000)		\$(10,994)	
Balance Sheet				
<i>Assets</i>				
Straight Line Lease Asset		\$--		\$--
Right to Receive Asset		\$--		\$110,553

- Note that cash impacts are the same under both sets of accounting.
- Note that cash flows from leasing under current standards are part of operating income on the cash flow statement, but are separate out as financing cash flows under the proposed standard.

December 31, 2013

	FASB 13 (Current)		ASC840 (ED - Proposed)	
	Income Stmt	Balance Sheet	Income Stmt	Balance Sheet
Income Statement				
Lease Income	\$(60,000)		\$--	
Lease Expense	\$--		\$--	
Interest Income	\$--		\$(6,926)	
Impact on Net Income	\$(60,000)		\$(6,926)	
Balance Sheet				
<i>Assets</i>				
Straight Line Lease Asset		\$--		\$--
Right to Receive Asset		\$--		\$57,479

- Note that cash impacts are the same under both sets of accounting.
- Note that cash flows from leasing under current standards are part of operating income on the cash flow statement, but are separate out as financing cash flows under the proposed standard.

December 31, 2014

	FASB 13 (Current)		ASC840 (ED - Proposed)	
	Income Stmt	Balance Sheet	Income Stmt	Balance Sheet
Income Statement				
Lease Income	\$(60,000)		\$--	
Lease Expense	\$--		\$--	
Interest Income	\$--			
Impact on Net Income	\$(60,000)		\$(2,521)	
Balance Sheet				
<i>Assets</i>				
Straight Line Lease Asset		\$--		\$--
Right to Receive Asset		\$--		\$--

- Note that cash impacts are the same under both sets of accounting.
- Note that cash flows from leasing under current standards are part of operating income on the cash flow statement, but are separated out as financing cash flows under the proposed standard.

Lessor Current Accounting – Original Lease Term

Lease Life Cycle		FASB 13 (Current)			ASC 840 (ED – Proposed)		
<i>Date</i>	<i>Activity</i>	<i>Accounts</i>	<i>Debit</i>	<i>Credit</i>	<i>Accounts</i>	<i>Debit</i>	<i>Credit</i>
1/1/10	Recognition of Right to Receive Asset and Derecognition of Underlying Asset	None			Right to Receive Asset Lease Expense Lease Income Underlying Asset	\$246,592 \$208,654	\$246,592 \$208,654
2010	Monthly Rental and Income	Cash Rent Income	\$5,000	\$5,000	Cash Interest Income Right to Receive Asset	\$5,000	\$ 1,518 \$3,482
2011	Monthly Rental and Income	Cash Rent Income	\$5,000	\$5,000	Cash Interest Income Right to Receive Asset	\$5,000	\$ 1,229 \$3,771
2012	Monthly Rental and Income	Cash Rent Income	\$5,000	\$5,000	Cash Interest Income Right to Receive Asset	\$5,000	\$916 \$4,084
2013	Monthly Rental and Income	Cash Rent Income	\$5,000	\$5,000	Cash Interest Income Right to Receive Asset	\$5,000	\$ 577 \$4,423
2014	Monthly Rental and Income	Cash Rent Income	\$5,000	\$5,000	Cash Interest Income Right to Receive Asset	\$5,000	\$210 \$4,790

ABC Corporation
Consolidated Balance Sheet
For the Year Ended December 31, 2010

Assets

	FASB 13 (Current)	ASC840 (Proposed)
Current Assets		
Cash and cash equivalents	\$ 235,000	\$ 235,000
Accounts receivable, net	3,250,000	3,250,000
Inventories	5,750,000	5,750,000
Prepaid expenses and other	<u>65,000</u>	<u>65,000</u>
Total current assets	<u>9,300,000</u>	<u>9,300,000</u>
Property and Equipment, At Cost		
Furniture, fixtures and equipment	1,000,000	725,000
Furniture, fixtures and equipment – residual assets		66,346
Right to receive assets	<u>1,000,000</u>	<u>204,810</u>
Less accumulated depreciation and amortization	<u>(100,000)</u>	<u>(100,000)</u>
	<u>900,000</u>	<u>896,156</u>
Total assets	<u>\$ 10,200,000</u>	<u>\$ 10,196,156</u>

Liabilities and Stockholders' Equity

	FASB 13 (Current)	ASC840 (Proposed)
Current Liabilities		
Current maturities of long-term debt	\$ 100,000	\$ 100,000
Accounts payable and accrued expenses	<u>850,000</u>	<u>850,000</u>
Total current liabilities	<u>950,000</u>	<u>950,000</u>
Long-term Debt	<u>4,000,000</u>	<u>4,000,000</u>
Stockholders' Equity		
Common stock	100,000	100,000
Retained earnings	<u>5,150,000</u>	<u>5,146,156</u>
Total stockholders' equity	<u>5,250,000</u>	<u>5,246,156</u>
Total liabilities and stockholders' equity	<u>\$ 10,200,000</u>	<u>\$ 10,196,156</u>

ABC Corporation
Consolidated Income Statement
For the Year Ended December 31, 2010

	FASB 13 (Current)	ASC840 (Proposed)
	<hr/>	<hr/>
Net Sales	\$ 25,000,000	\$ 25,000,000
Cost of Goods Sold	<u>18,000,000</u>	<u>18,000,000</u>
Gross Profit	<u>7,000,000</u>	<u>7,000,000</u>
Operating Expenses		
Salaries	4,000,000	4,000,000
Lease expense	<u> </u>	<u>208,654</u>
Depreciation and amortization	50,000	50,000
Other	<u>100,000</u>	<u>100,000</u>
	<u>4,150,000</u>	<u>4,358,654</u>
Operating Income		
Lease income	<u>60,000</u>	<u>246,592</u>
Interest income	50,000	50,000
Interest income from right to receive assets	<u> </u>	<u>18,216</u>
	110,000	314,808
Other Expense		
Interest expense	250,000	250,000
Other	<u>150,000</u>	<u>150,000</u>
	<u>400,000</u>	<u>400,000</u>
Net Income	<u>\$ 2,560,000</u>	<u>\$ 2,556,154</u>

ABC Corporation
Consolidated Cash Flow Statement
For the Year Ended December 31, 2010

	FASB 13 (Current)	ASC840 (Proposed)
Operating Activities		
Net income	\$ 2,560,000	\$ 2,556,154
Items not requiring (providing) cash		
Depreciation	50,000	50,000
Cash payments received for leases		60,000
Changes in		
Accounts receivable	(850,000)	(850,000)
Inventories	(500,000)	(500,000)
Accounts payable and accrued expenses	(350,000)	(350,000)
Right to receive lease assets		(56,154)
Net cash provided by operating activities	910,000	910,000
Investing Activities		
Purchase of property and equipment	(50,000)	(50,000)
Net cash used in investing activities	(50,000)	(50,000)
Financing Activities		
Payment of dividends	710,000	710,000
Net cash used in financing activities	710,000	710,000
Increase in Cash and Cash Equivalents	150,000	150,000
Cash and Cash Equivalents, Beginning of Year	85,000	85,000
Cash and Cash Equivalents, End of Year	\$ 235,000	\$ 235,000
Supplemental Cash Flows Information		
Interest paid on long-term debt	\$ 246,000	\$ 246,000
Furniture, fixtures and equipment derecognized		\$ 208,654

ABC Corporation
Notes to Consolidated Financial Statements
For the Year Ended December 31, 2010

Note X: Lease Accounting

The Company entered into a non-cancellable lease for a printing press on December 1, 2009 for 5 years with no renewal options or residual value guarantees.

The right to receive assets changed during the period as follows:

	Right to Use Asset
Beginning balance	\$ 0
Recognition of present value of lease payments	246,592
Amortization of the right to receive asset	18,218
Cash payments	(60,000)
Ending balance	\$ 204,810

Lease Impact on Amount, timing and Uncertainty of Future Cash Flows

The rate charged by the lessor for the facility lease at inception was indeterminable, so the discount rate used to compute the present value of lease payments was the best estimate of the Company's incremental borrowing rate of 8%.

Future minimum lease payments, including the renewal term, at December 31, 2010, were:

2011	\$	60,000
2012	\$	60,000
2013	\$	60,000
2014	\$	60,000
2015	\$	0
Later years	\$	0
		\$ 240,000