

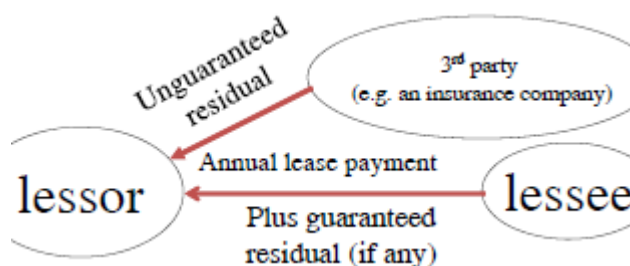
EXTRACT*Eg) Fourten Ltd as a Lessor**

Tenfour Ltd agrees to lease a truck from Fourten on 1/7/20X0 involving annual payments of \$20,000 (paid at the end of each yr) for the next 4yrs. At the expiration of this finance lease, the lease has an unguaranteed residual value of \$5,000. The estimated useful life of the truck is 6yrs. The rate of interest implicit in the lease is 12%. The lessor has the truck in inventory at \$60,000 (Fourten is a manufacturer lessor). Both the lessee and the lessor recognise the lease as a finance lease. Record all journal entries for the lessor for the 20X1 financial yr.

- Determine the PV of lease receivable or gross investment to Fourten. This must include the PV of the UR.
 - This is bc the UR is a value guaranteed to the lessor and forms part of the lease receivable to the lessor. **The gross investment or lease receivable must account for the PV of the UR.**

	PV Factor	PV
Annuity of \$20,000 in arrears for 4 years @12%	3.037	60,740
Unguaranteed residual of \$5,000 payable at the end of 4 years @ 12%	0.636	<u>3,180</u>
Present Value of the lease		63,920

- The lease receivable by Fourten is \$63,920 which is diff to the lease liability recognised by TenFour.



- The **lease receivable in the lessor's book ≠ lease payable in the lessee's book**. This is bc the presence of the unguaranteed residual that is provided to the lessor by a 3rd party that is independent to the lessee. They could be an insurance co or a financial institution. The 3rd party is unrelated to the lessee. Therefore, the UR is not included in the MLP and not part of the lessee's obligation.
- However, the UR impacts the manufacturer lessor's recognition of income from outright sales;

When Fourten is a Manufacturer Lessor**1/7/20X0**

- Dr Lease Receivable 63,920
- Cr Sales 60,740*
- Dr COGS 56,820**
- Cr Inventory 60,000
- Sell the inventory and record the lease.

***FV or if lower PV of MLP to lessor (\$63,920 – \$3,180).**

- The UR is provided to the lessor by a party who is related to the lessor. The sales should only recognise the amount gained at arm's length transaction with an external party. The sales amount should be the lower of the asset's FV or the PV of the MLP. This is bc the manufacturer sometimes quotes artificially low rates of interest in order to attract customers and the use of such a rate will result in an excessive portion of the total income from the transactions being recognised at the time of sale. I.e. inflate the income from the outright sale.

****Cost of CA of the leased asset less PV of UR (\$60,000 – \$3,180).**

- The COGs must also account for the PV of the UR to reflect the fact that the lessor anticipates to get back at the end of the term a leased asset that is worth a value equivalent to the UR.
- Bc of the UR, the interest income the lessor recognised each yr is > the interest expense recognised by the lessee. Notice that the cash inflow in the last yr is \$5,000 more than the cash outflow of \$20,000 previously.

(1) Year	(2) PV of Receivable =(2)–(5)	(3) Interest revenue =12%×(2)	(4) Cash receipt	(5) Reduction in Receivable =(4)–(3)
20X1	63 920	7 670	20 000	12 330
20X2	51 590	6 191	20 000	13 809
20X3	37 781	4 534	20 000	15 467
20X4	22 315	2 678	25 000	22 322 <small>(including rounding error)</small>

- In periods subsequent to the lease inception and before the end of the lease, the journal entries in the lessor's book are exactly the same in the lessee's book except for the value diff caused by the UR.

30 June 20X1

- Dr Cash 20,000
Cr Interest Revenue 7,670
Cr Lease Receivable 12,330
- Record the lease receipt and interest revenue.

When Fourten is a Financier Lessor

- Assume Fourten in the prev eg was a finance dealer that acquired the truck for \$60,000;
- Dr Asset 60,000
Cr Cash/payables 60,000
- Record initial acquisition of asset.
- Dr Lease receivable 63,920
Cr Asset 63,920
- Record lease receivable at inception.
- Note: No sale is recorded; the lessor only derives finance income through periodic interest revenue.
- In subsequent periods, the entries are the same as those for a manufacturer lessor.
- Dr Cash 20,000
Cr Interest revenue 7,670
Cr Lease receivable 12,330
- Record receipt of lease payments; same as manufacturer lessor.

❖ **SALES AND LEASEBACK**

- **Sales and Leaseback transaction:** Occurs when the owner of a property (seller/lessee) sells the property to another party, and simultaneously leases it back from the purchaser/lessor (the legal owner).
- The original owner becomes the lessee but the asset itself does not move. The asset is sold for a price equal to or greater than FV and is leased back for lease payments sufficient to repay the purchaser, including a return.
- This gives access to CFs while retaining the use of the asset. It is common for banks and franchise fast food outlets.

Entries for Sale and Leaseback in a Finance Lease

- To record sale of asset:
 - Dr Cash
Dr Acc. Depn
Cr Asset
Cr **Deferred Gain**
- Similar to PPE except no gain is recognised in the i/s. A liability of deferred gain is recognised instead.
- Each lease period needs to amortise deferred gain on sale and leaseback:
 - Dr Deferred gain
Cr **Profit on Sale of Leased Asset** (i/s)