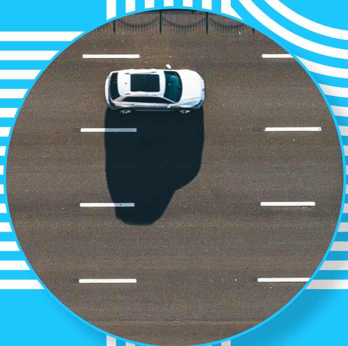
EZLease

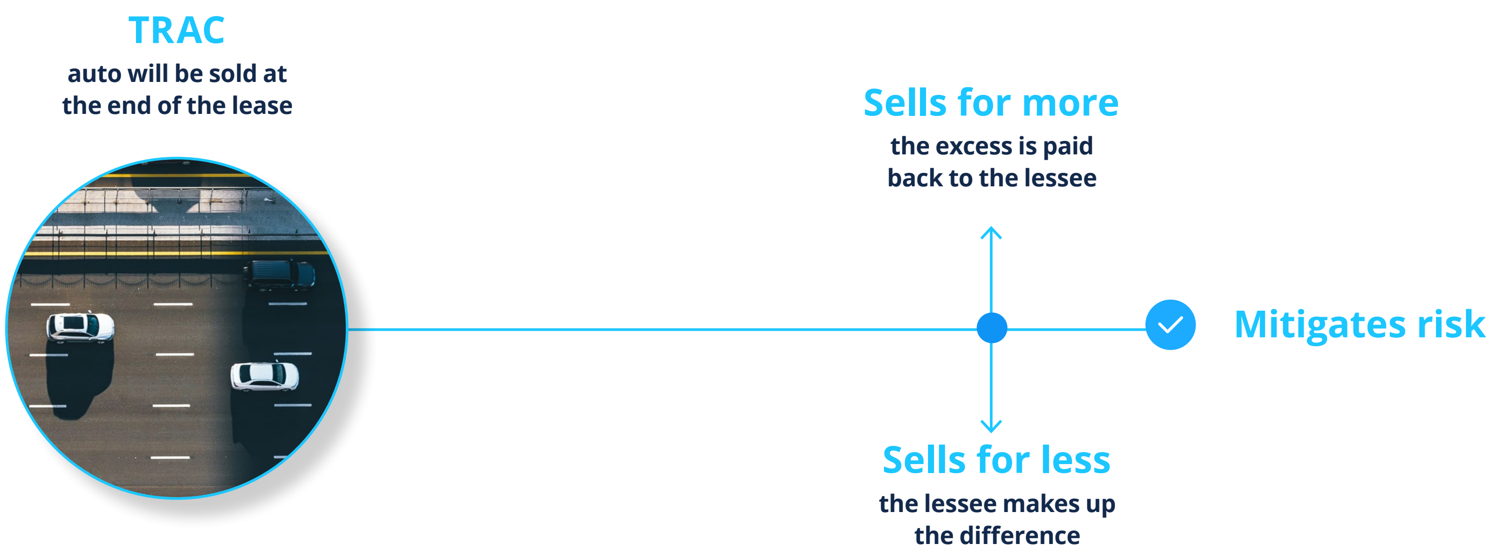


Vehicle (TRAC)

Lease accounting example

Many companies lease cars and trucks. This allows them to use late-model vehicles without worrying about disposing of the vehicle a few years down the road. Often auto leases for businesses come with a TRAC (Terminal Rental Adjustment Clause), which specifies that the auto will be sold at the end of the lease. If the auto sells for a lower price than anticipated, the lessee makes up the difference, while, if it sells for more, the excess is paid back to the lessee. This means that the lessor essentially has no risk and is simply providing financing and management of the vehicle.

If a lessee prefers operating leases, some lessors will adjust the TRAC so that 10.1% of the value of the vehicle is at risk (not covered by the guarantee), which keeps the lease's present value below 90% of the fair value. This is called a "Split TRAC" lease. Under ASC 842, there are fewer incentives to execute Split TRAC leases than there were under ASC 840, as the lease is still on the balance sheet.



Split TRAC lease

Let's take an example of a Ford Focus sedan leased for three years using a split TRAC lease. We'll look at it from the lessee's side of the transaction. The purchase price (fair value) after rebates would be $16,100. The lease calls for payments of $189/month for 36 months. The TRAC clause stipulates a final estimated value of $10,955, of which $9,075 is guaranteed and $1,880 is unguaranteed. Your incremental borrowing rate (the interest rate you would pay to finance a purchase of the car) is 4%. Let's assume the Focus has a 7-year economic life.

Ford Focus sedan lease

TRAC lease

3 years

Payments of $189/month for 36 months

TRAC estimates value of $10,955, of which $9,075 is guaranteed and $1,880 is unguaranteed.

4% incremental borrowing rate

3 years

$16,100

(fair value) purchase value after 3 years lease

Under ASC 842

The lease is considered operating, and is capitalized at the present value of the rent plus the expected guaranteed residual payment. If it is expected, at the inception of the lease, that the car will sell for at least the $10,955 estimated value, then only the rent is used for capitalization. If the initial direct costs are unknown, we use the incremental borrowing rate of 4% as the discount rate, and the ROU asset and liability are $6,422.91. In either case, the liability and net asset will be the same throughout the life of the lease, amortized using the interest method.

Sample lease journal entries, first month:

Account	Debit	Credit
Initial booking		
Right-of-use asset	6,422.91	
Operating current liability		2,065.06
Long-term liability		4,366.85
Monthly rent payment		
Operating current liability	168.22	
Operating lease cost	189.00	
Operating accumulated depreciation		168.22

Account	Debit	Credit
Cash operating rent payment		189.00
Liability reclassification, long-term to current		
Long-term liability	175.08	
Current liability		175.08

For this lease, the journal entries for month two's rent payment would be:

Account	Debit	Credit
Current liability	168.78	
Operating lease cost	189.00	
Operating accumulated depreciation		168.78
Cash operating payment		189.00
Operating long-term liability	175.65	
Operating current liability		175.65

Under ASC 842, you have to disclose a maturity analysis of your future lease payments separately from other liabilities.

So, as of the end of year one, the disclosure would be:

The following is a schedule by years of minimum future payments on noncancelable leases as of Dec. 31, 2019:

Account	
Year ending Dec 31	
2020	2,268
2021	2,268
Total lease payments required	4,536
Less amount representing interest	169.15
Present value of net minimum lease payments	4,366.85

Under IFRS 16

Given that the lease is not a low-value lease and doesn't qualify as a short-term lease (recognition exemptions), it must be recognized as a lease. The calculated initial ROU asset and liability are the same as for ASC 842. However, during the life of the lease, the asset is depreciated on a straight-line basis, while the liability is amortized using the effective interest method, which will cause the remaining liability always to be larger than the net ROU asset.

To enter this lease in EZLease, follow these steps*:

- Enter a Lease Number or name
- Enter a Begin Date of January 1, 2019
- Double-click on the Base Term; in the box that appears, enter 36
- If not already, displayed, click on the Main data tab, in the Rent Steps grid, enter Gross Rent of 189
- Enter a Current Economic Life of 84
- Enter a Lessee's Guaranteed Residual of 9,075
- Click on the Inception tab
- Enter an Incremental Borrowing Rate of 4%
- Enter Fair Value of Building/Equipment of 16,100
- Enter an unguaranteed residual of 1,880
- Click Save Lease. Note that the system automatically classified this as an Operating lease at a discount rate of 4% for FASB and a Finance lease under IFRS.
- Try running a Journal Entry

* System settings are 12/31 Year End with an ASC 842 Implementation Date of 1/1/2019 or earlier.