

AP 5D/FASB MEMO 143 - ACCOUNTING FOR PURCHASE OPTIONS - APPENDIX B

MARCH 9, 2011 FASB EDUCATION SESSION, WEEK BEGINNING 14 MARCH 2011 JOINT MEETING

Appendix B - illustration of approaches in a lease with a bargain purchase option

EXAMPLE 1:

A lease of equipment calls for five annual payments of \$100. At the end of five years, the lessee has an option to purchase the underlying asset for \$10. At inception, the value of the underlying asset in five years is expected to be \$225; therefore, the lessee determines it has a significant economic incentive to exercise the purchase option. The lessee's incremental borrowing rate is 7%. The following tables show the accounting for the transaction under Approach A and Approach B:

APPROACH A - Include Purchase Option										
Year	Lease Payments	Lease Obligation	ROU Asset	Amortization	Interest Expense	Lease Expense	Fixed Asset	Depreciation	Total Expense	
		417.15	417.15							
1	100.00	346.35	375.43	41.71	29.20	70.92	-	-	70.92	
2	100.00	270.59	333.72	41.71	24.24	65.96	-	-	65.96	
3	100.00	189.54	292.00	41.71	18.94	60.66	-	-	60.66	
4	100.00	102.80	250.29	41.71	13.27	54.98	-	-	54.98	
5	110.00	-	208.57	41.71	7.20	48.91	208.57	-	48.91	
6	-	-	-	-	-	-	166.86	41.71	41.71	
7	-	-	-	-	-	-	125.14	41.71	41.71	
8	-	-	-	-	-	-	83.43	41.71	41.71	
9	-	-	-	-	-	-	41.71	41.71	41.71	
10	-	-	-	-	-	-	-	41.71	41.71	
	510.00			208.57	92.85	301.43		208.57	510.00	

APPROACH B - Exclude Purchase Option										
Year	Lease Payments	Lease Obligation	ROU Asset	Amortization	Interest Expense	Lease Expense	Fixed Asset	Depreciation	Total Expense	
		410.02	410.02							
1	100.00	338.72	328.02	82.00	28.70	110.71	-	-	110.71	
2	100.00	262.43	246.01	82.00	23.71	105.71	-	-	105.71	
3	100.00	180.80	164.01	82.00	18.37	100.37	-	-	100.37	
4	100.00	93.46	82.00	82.00	12.66	94.66	-	-	94.66	
5	100.00	-	-	82.00	6.54	88.55	10.00	-	88.55	
6	-	-	-	-	-	-	8.00	2.00	2.00	
7	-	-	-	-	-	-	6.00	2.00	2.00	
8	-	-	-	-	-	-	4.00	2.00	2.00	
9	-	-	-	-	-	-	2.00	2.00	2.00	
10	-	-	-	-	-	-	-	2.00	2.00	
	500.00			410.02	89.98	500.00		10.00	510.00	