Leases

RESIDUAL VALUE AND BARGAIN PURCHASE OPTIONS

Residual Value
The estimated fair value (salvage value) at the end of the term of the lease is the residual value. If title to the leased property transfers to the lessee the residual value is not considered in computing the lease payments. If the title remains with the lessor the fair market value (amount to be recovered) is reduced by the present value of the future residual value.

Guaranteed Residual Value: The residual value is treated as an additional lease payment that will be paid at the end of the lease term. This amount is included in the payment stream.

Unguaranteed Residual Value: From the lessee’s perspective unguaranteed residual value is the same as no residual value. It does not have any effect on the lessee’s computation of the minimum lease payments or the capitalization of the leased asset and obligation. From the lessor’s perspective the unguaranteed residual increases the Lease Receivable for the gross amount of the estimated residual value and decreases cost of goods sold and sales revenue by the present value of the unguaranteed residual.

Bargain Purchase Option
In a bargain purchase option the lessee has the option to purchase the property at the end of the lease term at below expected fair value. The present value of the minimum lease payments is increased by the present value of the bargain purchase option price. It is treated as an additional payment at the end of the lease term. In computing annual depreciation, the lessee uses the economic life of the asset as the service life by both the lessee and the lessor.