Leases

Other Lease Accounting Issues

Executory Costs
These are the normal costs of ownership and include such things as maintenance, insurance, taxes, etc. Executory costs are normally paid by the lessee. In some lease agreements the lessor pays certain executory costs and is subsequently reimbursed by the lessee. In this situation, the lessee expenses such costs as paid and the lessor treats this as a pass through cost, not part of the lessor’s expenses.

Discount Rate
The lessee is required to use the lower of the interest rate implicit in the lease or the lessee’s incremental borrowing rate.

Lessor’s Initial Direct Costs
Initial direct costs are those costs such as legal fees, commissions, etc. that are incurred by the lessor in order to originate the lease. These costs are handled differently depending on how the lessor classifies the lease.

1) Operating Leases: initial direct costs are capitalized (as an asset) and amortized over the life of the lease.
2) Direct Financing Leases: initial direct costs are deferred by reducing the lessor’s unearned interest revenue. The amortization of unearned interest revenue includes both the recognition of interest earned and the expensing of the initial direct costs.
3) Sales-Type Leases: initial direct costs are expensed at the recognition of the transaction as selling costs.