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## Accounting by lease brokers; Issues paper (1980 June 20)

American Institute of Certified Public Accountants. Accounting Standards Executive Committee

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ISSUES PAPER

Accounting by Lease Brokers

Prepared by  
The Task Force on Accounting by Lease Brokers  
Accounting Standards Division  
American Institute of Certified Public Accountants

830215

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## INTRODUCTION

1. A party, called a lease broker for purposes of this paper, serves as an intermediary between a lessor and a lessee for a fee. The fee may be a cash payment at the closing of the lease transaction, rights to share in the proceeds from the sale or release of leased assets (share of the residual value) at the end of the initial lease term, or both. A lease broker may provide various related services to lessors, lessees, and third party financiers (lenders), may assume various risks related to the lease transactions, may receive several additional benefits, and may receive his compensation in various forms.

2. Lease brokers currently account for transactions in which they are involved in various ways. This paper discusses the issues surrounding the nature and characteristics of transactions of lease brokers and the accounting for such transactions.

3. Transactions in which lease brokers act as intermediaries span a spectrum. At one end, the lease broker acts purely as an intermediary, bringing together parties to leases. Or, he may participate in the lease rights and duties to a greater or lesser extent. At the other end of the spectrum, the lease broker's participation in the terms of the lease may be so great that he appears to be a lessor or lessee and not merely an intermediary, and his accounting may be guided by FASB Statement No. 13, "Accounting for Leases."

4. A lease broker may, in form, be a lessor, but since he has little or no continued involvement in the lease, he may, in substance,

be a broker. Conversely, although a lease broker may in form be an intermediary, he may, in substance, be a lessor or a lessee because of the responsibilities he assumes.

5. For purposes of this paper, a lease broker transaction is one in which a lease broker acts, in substance, as an intermediary between a lessor and a lessee, and his involvement is not sufficient to qualify the transaction as one that he should account for under FASB Statement No. 13. Conditions to determine whether his involvement is sufficient are discussed in this paper.

#### BACKGROUND

6. The lease brokerage industry originated from the need of parties not in the leasing business to obtain the services of parties knowledgeable in leasing to assist them in arranging leasing transactions. As leasing activities increased, more lease brokers entered the industry and competition increased. Lease brokers began to offer more services and assume greater risks to accommodate lessees and lessors.

#### Services Provided by Lease Brokers

7. A lease broker may provide a combination of the following services:-

- a. Locates assets to be leased.
- b. Locates a lessee for the assets.
- c. Locates a lessor-investor.
- d. Negotiates the terms of the lease between the lessor and lessee.
- e. Assists in obtaining IRS tax rulings for the transaction and processes other necessary documentation.

- f. Arranges for financing.
- g. Guarantees that the lessee will make the payments called for during the initial lease term.
- h. Guarantees to the lessor a specified residual value of the leased assets at the end of the initial lease term.
- i. Obtains insurance on the residual value.
- j. Guarantees that a renewal lessee will make specified payments called for during the renewal lease term.
- k. Remarkets the leased assets during the initial lease term if the lessee defaults.
- l. Remarkets the leased assets at the end of the initial lease term if the lessee does not renew.
- m. Provides administrative services to the lessor or lender, such as handling billings, collections, and property taxes.
- n. Services, inspects, and maintains the leased property.

8. In some transactions, the lease broker may assume no risks that extend beyond the beginning of the initial lease term. Alternatively, in other transactions, he may assume various risks related to future guarantees. A lease broker may also participate both as an equity investor and as intermediary in the same transaction.

9. Examples of transactions in which lease brokers participate are presented in Appendix I.

#### Benefits Received by Lease Brokers

10. Lease brokers may receive benefits in one or a combination of the following forms of consideration:

- a. Cash fees paid at the closing of the transaction (beginning of the initial lease term) or over the initial lease term.
- b. All or a percentage of the residual value of the leased assets, payable at the end of the initial lease term.
- c. The right to become the lessee at the end of the initial lease term at less than a fair market rental (bargain rental) and sublease the assets at the market lease rate and retain the excess.
- d. The right to become the owner of the leased asset at the end of the initial lease term at less than fair market value (bargain price).

#### Money-over-Money Transactions

11. Lease brokers are sometimes involved in transactions called "money-over-money," in which the lease broker purchases an asset, obtains a lessee, and sells or assigns, on a nonrecourse basis, his right to receive rentals for the leased asset to unrelated third party financiers for an amount that exceeds his investment in the leased asset. For example, the lease broker purchases an asset for \$100,000, leases it to a lessee, and sells or assigns on a nonrecourse basis the right to receive rentals to a financier for \$105,000. The lease broker receives \$5,000 in excess of his cost at the beginning of the lease term plus he may also receive the right to the asset at the end of the initial lease term.

12. In a similar form of money-over-money transactions, the lease broker may pledge his right to receive rental payments and



his residual value interest in the leased asset as collateral for a nonrecourse loan from an unrelated third party while retaining title to the leased asset.

13. The cash income to the lease broker for arranging the transaction is the excess of cash at the beginning of the lease term from the sale or assignment of the rental payments over his cost of the assets leased. The lease broker may also retain title to the leased asset (and thus have a right to the residual value) and receive income tax benefits, for example, investment tax credits and depreciation expense deductions.

#### PRESENT PRACTICE

##### Recording Fee Income

14. Frequently, a lease broker performs various services, with fees paid partly in cash at the beginning of the lease term and partly in rights to share in the proceeds from the sale or release of the assets at the end of the lease term. For the service of bringing together a lessor and a lessee and arranging the lease (brokerage service), lease brokers generally record as income the total cash fee plus the present value of the rights to the estimated residual value when the brokerage service is provided (at the beginning of the initial lease term). However, a few lease brokers recognize in income only the cash fee for brokerage services when the transaction is completed (at the beginning of the lease term) and recognize their share of the residual value when they receive the cash from disposing of the residual value.

15. Practice also varies as to the recognition of total fee income if a lease broker provides services in addition to bringing

together the lessor and lessee and arranging the lease. Lease brokers may recognize all the fee income, some of the fee income, or none of the fee income at the inception of the lease depending in part on whether, in addition to brokering the lease, they have also agreed to remarket (paragraph 20), provide some form of guarantee (paragraph 21), or provide other services (paragraph 22). For example, if a lease broker provides a combination of services for a single fee (cash and a residual value share), practice varies as to whether and to what extent the lease broker allocates the single fee to the various services and recognizes the fee income when the related service is rendered ("unbundling" - also see paragraph 19).

#### Money-over-Money Transactions

16. Money-over-money transactions are generally accounted for as brokerage transactions, that is, the excess of the cash received from third party financiers or lessees over the cost of the assets leased is recorded as fee income at the beginning of the lease term. Any residual value retained is generally discounted and also recorded as fee income at the inception of the initial lease term. However, some account for money-over-money transactions as leases, recognizing the excess cash received in income over the lease term.

17. Practice also varies as to the balance sheet presentation for money-over-money transactions. Some reflect the transaction "net" (the nonrecourse borrowing offset against the lease receivable), consistent with the concept that the transaction is a brokerage transaction. A few, while they recognize fee income at the inception of the lease, reflect the transaction "broad" on the balance

sheet, that is, they do not offset assets and the nonrecourse borrowing. Others reflect the transaction "broad" and recognize the fee income over the lease term.

#### Both Lessor and Lease Broker

18. The lease broker may not only locate outside investors to participate in a lease transaction but sometimes may also retain an equity interest in the leased asset. Practice varies in accounting for the fee the lease broker receives at the beginning of the lease term for locating the other equity participants. Frequently, lease brokers recognize the fee income at the beginning of the lease term. A few lease brokers, however, defer such fees and recognize them in income over the initial lease term.

#### Unbundling of Services

19. The lease broker frequently provides a combination of services for a single fee--cash at the beginning of the lease term plus a share of the leased asset's residual value at the end of the lease term. Practice varies as to whether lease brokers "unbundle" (see paragraph 15) the services and the fees associated with each service. Some lease brokers "unbundle" and some do not (see paragraphs 20, 21, 22).

#### Remarketing

20. As part of arranging the lease package, the lease broker may also agree to remarket the leased asset at the end of the initial lease period. Practice varies in accounting for the income related to such services. Some lease brokers do not allocate a portion of

the fee to the service of remarketing. Others do allocate a portion of the fee and recognize it at the end of the lease term when the remarketing service is rendered. Still others use estimates in recording their residual value share fee income that they believe implicitly allocate a portion of the fee income for recognition at the end of the lease term when the remarketing service is rendered and the residual value is realized.

#### Guarantees

21. In addition to arranging the lease, the lease broker may guarantee to the lessor (a) a stipulated residual value at the end of the lease term, (b) payments by the lessee during the initial period, or (c) payments by the initial lessee or another lessee during a renewal period. Practice varies in accounting for the income related to such guarantees. Some brokers do not allocate any of the fee to the guarantee service and recognize all the income on the entire transaction at the beginning of the initial lease period. Others use estimates in recording their rights to the residual value share that they believe implicitly defer a portion of the fee for recognition at the end of the lease term. Others explicitly allocate a portion of the fee income for recognition in income at a later date. Still others defer recognizing all income on the transaction until the guarantee responsibilities have been passed on to others (for example, through reinsurance) or eliminated.

#### Other Services

22. Practice varies as to the time at which lease brokers recognize income from other services that are in addition to arranging

the lease, such as billing, obtaining insurance coverage, or administering payment of property taxes for the lessor. Such income may be recognized

- a. At the inception of the initial lease, except to the extent of the costs to be incurred in providing the additional services.
- b. At the inception, with no provision for costs to be incurred in providing the additional services, on the assumption that such costs are insignificant.
- c. Over the initial lease term, with the costs expensed when incurred.
- d. At the end of the initial lease term, with the direct costs to render the services deferred until that time.

#### Interest Rate to Be Used

23. If the present value of the estimated residual or other future value is recorded at the time the brokerage transaction is completed (at the beginning of the initial lease term), various rates are used in practice to discount the future values, such as the lease broker's incremental borrowing rate, the rate of the nonrecourse debt associated with the transaction, or the rate implicit in the lease.

#### Accretion

24. If the fees paid in the form of rights to the residual value are recorded at present value, practice varies as to whether lease brokers accrete that value to the full estimated residual value over the term of the lease. Some lease brokers accrete to full

value over the lease term, while others recognize at the end of the lease term a gain or loss equal to the difference between the residual value share realized at the end of the initial lease term and the original present value of the estimated residual value.

#### MAJOR ISSUES

25. The major issues in accounting for transactions of lease brokers are

- Identifying Lease Broker Transactions. To what types and extent of involvement by a lease broker should a transaction be confined to qualify it as a lease broker transaction and thereby exempt it from FASB Statement No. 13 treatment?
- Recognizing Fee Income at the Beginning of the Initial Lease Term. In what circumstances should a lease broker recognize fees for a lease broker transaction as income at the beginning of the initial lease term? Should the answer differ depending on the form of the consideration, the risks and responsibilities assumed by the lease broker, the time services are rendered, or the time fees are paid to the lease broker?
- Both Lessor and Lease Broker. Should an intermediary be permitted or required to account for a transaction as both a lessor and a lease broker?
- Unbundling. If a lease broker charges one fee for a combination of services, should he "unbundle" (paragraphs 15 and 19) the services to determine the applicable income from each of the services?

- Interest Rates to Be Used. If fees paid over the lease term or at the end of the lease term should be recognized at the beginning of the initial lease term, what rates should be used to discount the payments?
- Accreting Residual Value. If fees measured by a share of the residual value of the leased asset are recognized at the time the lease is negotiated, should the lease broker accrete the present value to the full estimated residual value over the lease term?

#### Considerations in Identifying Lease Broker Transactions

26. Whether a transaction should be accounted for as a lease broker transaction depends on the relationships of the lease broker to the leased assets, his participation in the rights and duties under the lease or to the parties to the lease, the services he provides, the risks he assumes, and the benefits he receives.

Factors to be considered are whether

- a. The lease broker has or participates in title to the lease assets.
- b. He is in form the lessor for a part of the lease term.
- c. He has an investment in the leased assets through use of his own funds or through his credit.
- d. He receives tax benefits related to the leased assets.
- e. He is a party to a related financing obligation as debtor and guarantor.
- f. His obligation is with or without recourse.
- g. He has assumed obligations that involve primary or market risk, for example, guarantee of a specific amount of residual value.

- h. He has assumed a secondary credit risk by guaranteeing payments by the lessee under the initial lease.
- i. He has agreed to remarket the assets at the end of the initial lease term.
- j. He has reinsured the primary market or secondary credit risks he has assumed.

27. Some believe the guarantee responsibilities assumed by a lease broker in a transaction may be so significant that the lease broker is in substance a lessee and a sublessor and should account for the transaction under FASB Statement No. 13. Others believe the form of the transaction should generally govern and the lease broker need not follow FASB Statement No. 13 unless he is stated to be the lessee or lessor.

#### Money-over-Money Transactions

28. Some believe that, although, in form a lease broker in a money-over-money transaction is the lessor-owner of the assets, in substance the excess cash he receives is the same as the cash fee he receives at the beginning of the initial lease term for negotiating a lease broker transaction. They argue that since the financing is nonrecourse, the lease broker assumes no risk. Furthermore, he does not use the assets in his trade or business. The lease broker in effect retains no cash investment in the leased assets because the proceeds from the financing, borrowing, or assignment of the lease are equal to or in excess of the cost of the assets. They also argue that the lease broker locates all the parties to the transaction at the inception of the lease as in a lease broker



transaction, and he could obtain the form of an intermediary by transferring the title while retaining a bargain purchase option to the leased asset at the end of the lease term. They further argue that this accounting is consistent with paragraph 20 of FASB Statement No. 13 relating to sale and assignment of leases.

29. Others argue that money-over-money transactions are similar to leveraged leases and the accounting should be analogous to that under FASB Statement No. 13, by deferring the income and recognizing it over the term of the lease.. Others counter that a money-over-money transaction differs from a leveraged lease in that, in a money-over-money transaction, the broker has no net cash investment in the asset while in a leveraged lease he has such an investment.

30. Still others believe the nonrecourse financing associated with a money-over-money transaction should be accounted for as a borrowing. Those holding this view believe the borrowing should be shown as a liability regardless of whether the borrowing is recourse or nonrecourse, and the borrowing should not give rise to immediate profit recognition. They argue that this position is consistent with accounting in other areas, since the accounting literature has not permitted nonrecourse debt to be shown net of the related asset and to influence profit recognition except for leveraged leases.

#### Time to Recognize Fee Income under Lease Broker Transactions

31. Once a transaction has been identified as a lease broker transaction, the question arises as to the timing of the recognition of the fee income. The major factors to be considered are

- a. The form of the consideration to the lease broker.
- b. The nature and extent of uncertainties related to obligations of or guarantees by the lease broker.

32. Form of Consideration. Some believe the form of the consideration, whether cash or the rights to a share of the residual value, should not influence the time at which the lease broker recognizes the related fee income. Others believe that if rights to a residual share are part of the fee, this part of the fee is a contingent asset, which should not be recognized until realized in cash.

33. Uncertainties. Obligations or guarantees assumed by the lease broker as part of arranging a lease may be grouped into the following types: (a) primary or market obligations or guarantees such as a guarantee that the asset will be released at the end of the initial lease term, a guarantee that the residual value of the asset will be a specified amount, or a primary obligation to make lease payments as lessee and (b) credit guarantees such as a secondary obligation in the form of a guarantee that the initial lessee will pay during the initial lease term.

34. Some believe any obligations or guarantees assumed by the lease broker are merely contingent liabilities. They believe all fee income should be recognized at the beginning of the initial lease term because the fees relate primarily to the services provided in arranging the lease.

35. Others believe that if lease broker guarantees are present, the transaction should be "unbundled" (see paragraphs 15, 19, and 43). The fee attributable to the brokerage services would be recognized at the beginning of the initial lease term and the fee attributable to the various types of guarantees would be recognized either over the period of risk or at the date the risk is removed.

36. Some believe a lease broker may assume guarantee responsibilities and still account for substantially all the fee at the beginning of the initial lease term if the guarantee responsibilities are minor. Those holding that view believe that if the lease broker is not "too involved" in the transaction, a guarantee of minor responsibilities should not preclude him from recognizing fee income at the beginning of the lease term.

37. Some would make the distinction by analyzing the underlying lease. For example, if the underlying lease is a direct financing lease, the broker may recognize fee income at the inception of the initial lease even if he has assumed guarantee responsibilities. They argue that if, in the underlying lease, substantially all risk and rewards have passed to the lessee, the lease broker risk would be minor.

38. Others emphasize primary or market obligations and guarantees and believe that permitting a specified minor level (for example, a percentage) of primary or market type guarantee responsibilities and still recognizing the fee income at the beginning of the initial lease term is impracticable and arbitrary. Even a minor amount of such guarantee responsibilities in relationship to the specific transaction can be significant to the fee income from the transaction or the broker's financial position. They believe the only meaningful resolution is to preclude recording fee income at the beginning of the initial lease when primary or market risk responsibilities are retained by the broker and have not been passed on to others (for example, by reinsurance).

39. Some believe a secondary credit risk differs, in substance, from a primary or market guarantee. They argue that the lease broker should still be permitted to recognize income at the beginning of the initial lease term if his only risk is credit risk.

Both Lessor and Lease Broker

40. Some believe the lease broker may recognize the fee income he receives at the beginning of the lease term for locating all the outside equity participants to a lease transaction even though he retains an equity interest in the leased asset. They argue that if the lease broker's rights in the leased asset are the same as the other equity participants and are in proportion to his equity interest, such fees are in substance compensation for the lease broker's services.

41. Others argue that whether the lease broker is, in substance, a lessor or a lease broker depends on the percentage of equity interest he retains in the leased asset. They argue that only if the lease broker retains a minor equity interest in the lease asset should he be permitted to recognize fee income at the beginning of the lease term.

42. Still others argue that if the lease broker is an equity participant in a lease transaction, he is in fact solely a lessor and he should therefore follow the guidance in FASB Statement No. 13 in accounting for leases and recognize the fee income over the term of the lease.

Unbundling of Services

43. If the lease broker provides a combination of services and charges a single fee -- cash at the beginning of the lease term

plus a share of the leased asset's residual value at the end of the lease term, some believe the lease broker should "unbundle" the services and the fees associated with each service and recognize in income the fees for certain services at the time the service is rendered. They argue that unbundling is consistent with the position taken in the FASB Invitation to Comment, "Accounting for Service Transactions." They also argue that the lease broker can objectively determine the fees charged for each service based on "relative sales value."

44. Others argue that unbundling is impractical and the total fee should be recognized at the time the lease is negotiated, since that is when the lease broker has substantially performed.

#### Measurement of Fee Income

45. Cash Fees. Cash received at the closing of the lease transaction presents no measurement problem. However, if cash fees are received over the term of the lease and are to be recognized in income at times other than when received, there is general agreement that the cash fees should be recognized at their present values.

46. Estimating Residual Values. If the fee income is based on the residual value of the leased assets and the lease broker recognizes it other than when he receives the cash from disposing of the asset, he needs to estimate the amount of the residual value. Issues related to estimating residual values in these circumstances include those related to estimating residual values in accounting by lessors under FASB Statement No. 13, for example, issues involving technological and physical obsolescence. If the fee is based on a spread between the fair market rental rate and bargain rental rate, the

lease broker may also need to estimate the residual value of the leased assets as a method of computing the present value of the spread to measure the income at the beginning of the lease term. Also, if the fee is the right to purchase the leased assets at the end of the lease term at a bargain price, the lease broker needs to estimate the residual value of the leased assets to compute the present value of the spread at the end of the lease term to measure the income at the beginning of the lease term.

47. Effect of Remarketing. Those who believe fees related to remarketing services should be unbundled believe that lease brokers should reduce the estimated "retail" residual value by an estimate of the cost to sell or release, the cost to restore, and an amount for profit. Alternatively, some lease brokers use an estimated "wholesale" residual value. A "wholesale" value reflects the assumption of a zero to minimal remarketing effort and therefore if the lease broker remarkets the residual value, the proceeds he receives from disposing of it should cover the cost of remarketing and profit. Others, however, believe remarketing costs are minimal and should not be a consideration when measuring fee income at the beginning of the lease term.

48. Present Values. In addition to estimating the amount of the residual value, there is general agreement that if the amount is recognized other than at the date it is realized in cash, it should be recognized at its present value.

49. Limitations on Residual Rights. If the lease broker has rights to share in the residual value proceeds only if the leased asset is remarketed within a specified time, some believe the proper

estimate of the value of such rights at the beginning of the lease term is zero. Others believe recording an estimate of the residual value share other than zero is appropriate in these circumstances except if the time is unreasonably short.

Interest Rate to Be Used

50. Some believe the lease broker should use a current market interest rate to compute the present value of payments received over the lease term or at the end of the lease term. They argue that the market interest rate relates to the lease broker transaction and it is sanctioned by the accounting literature in FASB Statement No. 15, "Accounting by Debtors and Creditors for Troubled Debt Restructurings," and APB Opinion No. 21, "Interest on Receivables and Payables." Others believe such rates are not objectively determinable.

51. Some believe the lease broker should use his incremental borrowing rate to compute the present value because that rate relates to the lease broker and it is objectively determinable. Others believe the lease broker's incremental borrowing rate is unrelated to the lease broker transaction.

52. Some believe the lease broker should use the interest rate implicit in the lease to compute the present value. They argue that the implicit interest rate relates to the risks inherent in the lease broker transaction and it is objectively determinable. Others argue that the rate implicit in the lease is unrelated to the lease broker.

53. Some believe the interest rate on related debt, such as on the leveraged lease nonrecourse debt, should be used to compute present

values since that rate is known and it is an objectively determinable rate. Others believe those rates are related to the lessee rather than the lease broker.

54. Still others believe the lease broker's cost of capital, as defined in SOP 75-2, "Accounting Practices of Real Estate Investment Trusts," should be used to compute present values. They argue that this rate is related to the lease broker. Others argue that this rate is unrelated to the lease broker transaction.

#### Accretion

55. If a lease broker records the present value of his share of the estimated residual value of the leased asset as fee income at the beginning of the lease term, some believe the present value amount should be subsequently accreted to full estimated residual value over the lease term. Those who believe the lease broker should accrete argue that

- a. Since the residual value is initially recorded at present value, accretion follows.
- b. A share of the residual value may be viewed as a long-term receivable.
- c. FASB Statement No. 13 provides for accretion of residual values on sales-type and direct financing leases.

Others believe the lease broker should not accrete the residual value over the term of the lease. They argue that

- a. A residual value in a leased asset is a long-term nonmonetary asset and such assets generally are not accreted.



- b. Even though the measure of current values for non-monetary assets may involve discounting, the discount is generally not accreted.

Still others believe the lease broker should accrete for some types of assets but not others, for example, high technology equipment because of the high risk associated with estimating the residual value of these assets.

#### OTHER ISSUES

56. The following are other issues involved in lease broker transactions:

- How should subsequent changes in residual value estimates due to changes in the value of the leased asset be accounted for?
- How should the recovery of the residual value by the lease broker at the end of the lease term be accounted for if it is not received in cash (for example, if recovery is by release)?
- What special types of information should the lease broker disclose in his financial statements?

\* \* \* \* \*

#### ADVISORY CONCLUSIONS

57. The following paragraphs present the advisory conclusions of the Task Force on Accounting by Lease Brokers on the issues raised in this paper and the advisory votes on these conclusions of the Accounting Standards Executive Committee.

### Considerations in Identifying Lease Broker Transactions

58. In determining whether a transaction should be accounted for as a lease broker transaction or a transaction that should be accounted for under FASB Statement No. 13, the most important factor is the primary or market obligations and guarantees that the lease broker assumes (see paragraph 33). In making that determination, the substance rather than the form of the transaction should govern the accounting for it. A purported lease broker may be so involved in a transaction and assume such risks and obligations that he is in substance a lessee and a sublessor and should follow FASB Statement No. 13 even though he is not the stated lessee or lessor. Alternatively, although he may in form be a lessor, in substance he may serve as an intermediary.

59. The assumption of some primary or market obligations or guarantees does not necessarily lead to the conclusion that the purported lease broker should follow FASB Statement No. 13, but rather his involvement should be material relative to the transaction before he accounts for the transaction under FASB Statement No. 13. However, when the lease broker assumes a portion of the total risk and responsibility, for example, residual value guarantees, such relative involvement should influence when he recognizes fee income (see paragraph 64).

(Paragraphs 58-59 - 11 For, 2 Against, 1 Abstain)

### Money-over-Money Transactions

60. A lease broker should account for a money-over-money transaction as a lease broker transaction if

a. The financing is nonrecourse to the lease broker,

- b. He receives more cash (excluding the amount he recognizes based on his residual value share) from third party financiers or lessees (both on a nonrecourse basis) than he paid for the leased asset,
- c. All parties to the transactions are arranged for at the beginning of the initial lease term, and
- d. The leased asset is acquired at the same time the transaction is arranged.

61. If the transaction meets all those criteria, the lease broker should recognize in income at the beginning of the lease term the sum of the excess of cash he receives over his investment plus the present value of his residual value share. The balance sheet of the lease broker should present only the residual value share retained. Neither the lease receivable nor the nonrecourse financing should be presented.

62. The substance of such a transaction is that the lease broker serves as intermediary for a fee, which should be recognized at the beginning of the initial lease term. The accounting should not differ if he retains the title to the leased assets and the related tax benefits.

63. If the money-over-money transaction is arranged at a later date, (for example, if the lease broker initially warehouses a direct financing or operating lease for future sale and subsequently arranges a money-over-money transaction), he should account for the transaction under FASB Statement No. 13.

(Paragraphs 60-63 - 12 For, 1 Against, 1 Abstain)

Time to Recognize Fee Income under Lease Broker Transactions

64. For income to be recognized at the beginning of the initial lease term in a lease broker transaction, the transaction should in substance meet all the following criteria:

a. The lease broker has no investment in the assets leased through his own funds or through his credit other than as described in paragraph 69.

b. The lessor, the lessee, and the third party financier do not have recourse to the lease broker except for credit risk as described in paragraph 67.

c. The lease broker assumes only minor primary or market type risks and obligations (see paragraph 33) that meet both of the following conditions:

(1) The present value of the total gross amount of payments that the lease broker may be required to make when combined with any investment by the broker in the lease (see paragraph 69) is 10% or less of the fair value (measured at the inception of the lease) of the asset subject to guarantee or obligation.

(2) The amount of the guarantee or obligation is substantially less than the estimated future fair value (estimated at the inception of the lease) of the residual value or renewal period lease payments being guaranteed.

65. Thus, to recognize income at the beginning of the lease term, the broker may not, in excess of a minor amount (see paragraph 64c), (a) guarantee a residual value, (b) provide assurances of a renewal

lease term and the lease payments during that period, or (c) assume primary responsibilities to make lease payments during the initial lease term.

66. Notwithstanding the foregoing, if the cash fee received or the present value of the cash fee guaranteed to be received by the lease broker exceeds the sum of the present value of the gross amount of the lease broker's primary or market type guarantees or obligations and any broker investment in the lease, such excess should be recognized in income at the beginning of the lease term if the other conditions in paragraph 64a and b are met.

67. A lease broker's secondary obligation to make a lessee's payments during the initial lease term (a credit risk) does not preclude recognizing income at the beginning of the lease unless the credit risk assumed cannot be evaluated (see paragraph 68d). Such an obligation, in substance, differs from a guarantee of a specified residual amount or a lease renewal guarantee which involve primary or market risks.

68. Also concerning the recognition of fee income:

- a. Lease brokers should recognize the fee income associated with the brokerage services only after all the substantive brokerage services necessary to obtain contractual rights to such fees have been performed.
- b. If a lease broker has primary or market obligations associated with the leased assets in excess of minor amounts (see paragraph 64c), the lease broker should recognize fee income only as he performs and is relieved of the obligations. Examples of this type of obligation would be a guarantee of the residual value or obligation to

become the lessee after the initial noncancellable lease term.

- c. If significant uncertainties exist in estimating fee income, a lease broker should recognize such income only after the uncertainties are eliminated and the services associated with the fee income have been rendered. For example, if the lease broker cannot reasonably estimate the residual value or the cost of future services to be rendered, he should defer income recognition of the related fees until the residual value or the cost of the services is known and the services associated with the fee income have been rendered.
- d. If the collectibility of the lease payments subject to a secondary credit guarantee by the lease broker are not reasonably predictable (see paragraph 8a of FASB Statement No. 13), the broker should defer total fee income until the uncertainty is resolved.
- e. A lease broker should charge initial direct costs and direct costs associated with a transaction to income at the time the related fees are recognized.
- f. If a lease broker guarantees the initial lessee's credit, he should provide an allowance for estimated amounts to be paid under such guarantees.

Both Lessor and Lease Broker

69. If a lease broker invests (for example, as an equity participant) in a leasing transaction he has also brokered and the sum of

his investment and the present value of the gross payments he may be required to make under a primary or market type obligation does not exceed a minor amount (see paragraph 64c), such investment should not preclude him from recognizing fee income at the beginning of the initial lease term. Otherwise, the fee income should be deferred and recognized in income over the lease term.

(Paragraphs 64-69 - 12 For, 1 Against, 1 Abstain)

#### Unbundling of Services

70. If the lease broker receives fees for services to be performed in the future or for guarantees, he should "unbundle" and allocate a portion of the fee for each service based on the fair value of the services. (The task force did not consider the accounting for such services if they are not offered in combination with arranging the initial leasing transaction since it believes that the accounting is adequately covered in the accounting literature or is being addressed by the Financial Accounting Standards Board.)

(Paragraph 70 - 12 For, 1 Against, 1 Abstain)

#### Measurement of Fee Income

71. If the lease broker recognizes income at the beginning of the initial lease term, the fees should be measured as follows:

- a. Cash fees received at the beginning of the lease term should be measured by the amounts received, and cash fees receivable at future dates should be discounted to the beginning of the lease term.
- b. If the lease broker receives rights to the difference between the fair market rental rate and a zero or bargain rental rate during a renewal lease term, he should

- estimate the difference and recognize its present value at the beginning of the initial lease term.
- c. If the lease broker has a right to purchase the leased assets at the end of the initial lease term at a bargain amount, he should recognize the present value of the difference between the estimated residual value and the option price as fee income at the beginning of the initial lease term.
  - d. If the lease broker shares in the residual value of the leased assets, he should compute the present value of the assets' "wholesale" residual value, and if such a value is not available, he should use the assets' "retail" residual value reduced by estimated costs of disposition and profit. This approach results in fees associated with the lease broker's remarketing effort being accounted for separately.
  - e. Fees measured by a share of the estimated residual value should be recognized at the beginning of the lease term only if the lease broker has an unconditional right to the residual value. The right should be for a period long enough to provide the lease broker with enough time to complete any responsibility he may have to remarket the assets. If the lease broker's rights are conditional, the fees should be interpreted to be payment for the remarketing effort and recognized at the time of remarketing.
  - f. Fees associated with other services to be rendered at other than the beginning of the lease term should be



excluded from the fee income recognized at the beginning of the lease term (see paragraph 70).

- g. The market interest rate described in APB Opinion No. 21 should be used for discounting fees recognized before they are received in cash.

(Paragraphs 71a,f,g - 13 For, 0 Against, 1 Abstain  
Paragraphs 71b-e - 8 For, 5 Against, 1 Abstain)

#### Accretion

72. If the lease broker records the present value of his share of the estimated residual value of the leased assets at the beginning of the initial lease term, he should subsequently accrete the value over the term of the lease using the interest method.

(Paragraph 72 - 12 For, 1 Against, 1 Abstain)

#### Other Issues

73. If recorded fee income includes a share of the estimated residual value, that value should be reviewed at least annually. If the estimated residual value has declined and if the revised estimate (before discounting) is between the original estimate (before discounting) and the then current carrying amount, the lease broker should adjust the discount amortization rate prospectively so that the carrying amount of the residual will equal the revised estimate at the end of the initial lease term. However, if the revised estimate (before discounting) is less than the current carrying amount, the lease broker should recognize a loss currently by an amount sufficient to reduce the carrying amount to the revised estimate.

74. If the property is released at the end of the initial lease term, the lease broker should record income or loss on his rights to the estimated residual value in the period in which the release occurs, using the same accounting standards that apply to leases under FASB Statement No. 13.

75. If lease brokerage activities are significant to the reporting entity, its financial statements should disclose

- a. The method used to record lease broker fee income.
- b. The gross amounts before discounting and the present (discounted) values of estimated residual values expected to be realized for each of the five fiscal years after the date of the latest balance sheet presented and in the aggregate for periods thereafter.
- c. The gross amounts before discounting and the present (discounted) values of the estimated residual values broken down by the major classes of assets to which the estimated residual values relate as of the current balance sheet date.
- d. The gross amounts before discounting and the present (discounted) values, as of the current balance sheet date, of any residual value guarantees relating to recorded estimated residual values obtained from unrelated guarantors of economic substance.
- e. Disposition proceeds and gains or losses arising from disposition of residual value rights included in the determination of net income for each income statement presented.

f. The gross amount before discounting and the present (discounted) value of the aggregate maximum amount of primary or market obligations or guarantees assumed by the lease broker.

g. The present value of the aggregate maximum amount of any secondary credit guarantees by the lease broker.

An example of disclosures by a lease broker in accordance with this paragraph is presented in Appendix II.

(Paragraphs 73-75 - 13 For, 0 Against, 1 Abstain)

APPENDIX I

The following are eight sample leasing transactions in which lease brokers participate.

Case One

The lease broker places the lease with an outside lessor, arranges for long-term nonrecourse financing for the lessor, processes the necessary documents for closing, and receives a cash fee at the closing (the beginning of the lease term) and another fee measured by a percentage of the residual value at the end of the lease term. The lease broker also agrees to remarket the asset at the expiration of the initial lease term.

Basic Questions

1. Should the lease broker recognize in income currently the cash fee paid at the beginning of the lease term?
2. Should the lease broker recognize in income currently the present value of fees paid at the end of the lease term measured by a percentage of the residual value and, if so, what rate should be used to compute the present value?
3. How should the lease broker estimate the residual value?
4. Should a portion of the fee be deferred to cover the remarketing services?

Answers to Questions Based on Advisory Conclusions

1. Yes (see paragraphs 64, 68a and 71a).
2. Yes (see paragraphs 64, 68a, 71d and 71e) except to the extent of fees deferred for remarketing (see question 4).  
The market interest rate as described in APB Opinion No. 21 should be used to compute the present value (see paragraph 71g).

3. Using normal procedures now used in estimating residual values under FASB Statement No. 13 (see paragraph 46).
4. Yes (see paragraphs 70, 71d and 71f).

#### Case Two

The lease broker receives a cash fee at the beginning of the initial lease term and an option (not an obligation) to become the lessee at the end of the initial lease term at a "bargain rate" for providing the same services in Case One. Under this arrangement, the lease broker's fee at the end of the initial lease term is the difference between a fair market rental rate and the bargain rental rates for a stated renewal period.

#### Basic Questions

1. Should the lease broker recognize in income currently the cash fee paid at the beginning of the lease term?
2. Should the lease broker recognize in income currently the present value of the estimated fees to be received at the end of the lease term measured by the difference between fair market rental rates and bargain rental rates and, if so, what interest rate should be used to compute its present value?
3. How should the lease broker estimate the fair market lease rate during the renewal period?
4. Should a portion of the total fee be deferred to cover remarketing services?
5. Should the accounting be different if the lease broker has an obligation rather than an option to become the lessee at the end of the initial lease term at a bargain rate?

Answers to Questions Based on Advisory Conclusions

1. Yes (see paragraphs 64, 68a and 71a).
2. Yes (see paragraphs 64, 68a and 71b) except to the extent of fees deferred for remarketing (see question 4). The market interest rate as described in APB Opinion No. 21 should be used to compute the present value (see paragraph 71g).
3. Using normal procedures now used in estimating residual values under FASB Statement No. 13 (see paragraph 46).
4. Yes (see paragraphs 70, 71d and 71f).
5. Yes, if the obligation assumed by the lease broker exceeds a "minor amount" (see paragraph 64c). If it does, the fee income should be deferred and recognized in income only as the lease broker performs and is relieved of the obligation (see paragraph 68b).

Case Three

The lease broker charges one total price - a cash fee at the beginning of the initial lease term plus a residual share - for brokering, for guaranteeing either a stipulated residual or a lessee's payments during a renewal period, and for remarketing the asset at the end of the lease term.

Basic Questions

1. Does the lease broker have any primary obligations to the lessor and, if so, is the involvement so significant that he should be considered a lessee rather than a broker?
2. Should the accounting be different if the guarantee represents less than a minor amount (say 10%) of the asset value?

3. Is the guarantee of the rental during the renewal period different from the guarantee during the initial lease term?
4. Should the lease broker unbundle the services and measure the fee by the relative sales value and recognize only the brokerage fee at the beginning of the lease term?

Answers to Questions Based on Advisory Conclusions

1. The lease broker has assumed primary obligations to the lessor and if such obligations are in excess of a "minor amount," fee income should not be recognized at the beginning of the lease term (see paragraph 64c). Additionally, if such obligation were material, the purported lease broker may need to account for the transaction under FASB Statement No. 13 (see paragraphs 58 and 59).
2. Yes. If the guarantee is less than a "minor amount," fee income should be recognized at the beginning of the lease term (see paragraph 64c).
3. Yes. A guarantee of rentals during a renewal period is a primary or market obligation, while a guarantee of rentals during the initial lease term is a secondary credit risk (see paragraphs 33 and 67).
4. Assuming the guarantee is "minor," yes (see paragraphs 68a, 70 and 71f).

Case Four

A lease broker charges a fee, payable in cash at the beginning of the lease term and in a share of the residual value at the end of the lease term, for brokering, guaranteeing a lessee's payments during the renewal period, and remarketing the asset. He reinsures 100% of his guarantee.



Basic Questions

1. Does the reinsurance "cure" the lease broker's primary obligation to the lessor and should he recognize the related income at the beginning of the lease term?
2. How should the premium paid to a third party insurance company be accounted for?
3. Would the accounting change if the lease broker reinsures for only 80% of the guarantee?

Answers to Questions Based on Advisory Conclusions

1. Yes. If the lease broker passes all of his primary or market obligation to a financially responsible unrelated third party, he no longer has assumed obligations in excess of a "minor amount" (see paragraph 64c) and thus should record the fee income associated with the brokerage services at the beginning of the lease term.
2. The premium paid by the broker should be accounted for as a direct cost of the transaction and recognized as an expense at the time the fee income is recognized (see paragraph 68e).
3. Yes, if the net obligation or guarantee exceeds a "minor amount" (see paragraph 64c). If it does, the fee income should be deferred and recognized only as the broker performs or is relieved of the obligation (see paragraph 68b).

Case Five

The lease broker purchases an asset and leases it at a stipulated monthly rental for a period of time. At the same time, he assigns

the lease receivable and the asset on a nonrecourse basis to a third party and receives excess cash consisting of the difference between the proceeds from the assignment and the cost of the asset.

Basic Questions

1. Should the lease broker recognize in income currently the excess cash he receives or should it be deferred and recognized over the lease term?
2. How should the nonrecourse financing be accounted for? Should it be shown "gross?"
3. Is this money-over-money transaction any different from leveraged leasing as described in FASB Statement No. 13?
4. Would the answer be any different if the financing was with recourse to the lease broker?
5. Should the intermediary not be considered a lease broker if he retains the title and the tax benefits in the asset?
6. Should the accounting be different if the proceeds received from the third party are in the form of a non-recourse borrowing?
7. Should the lack of cash investment by a lease broker influence his accounting for the transaction?
8. Should the transaction be viewed as other than a lease broker transaction if the assignment of the right of the leased asset is done at a time other than when the asset is acquired?

Answers to Questions Based on Advisory Conclusions

1. The excess cash should be recognized as fee income currently (see paragraphs 60 and 61).
2. The nonrecourse financing should be reflected "net," i.e., not shown in the lease broker's balance sheet (see paragraph 61).
3. Yes. Under this money-over-money transaction, the lease broker has no investment in the leased asset through his own funds or through his credit (see paragraphs 29 and 60).
4. Yes. If the financing is with recourse, the transaction should not be accounted for as a lease broker transaction (see paragraph 60). Rather, the financing should be accounted for as a borrowing and the lease accounted for under FASB Statement No. 13.
5. Assuming that the financing is nonrecourse, the transaction should still be viewed as a lease broker transaction even if the broker retains title and the tax benefits (see paragraph 62).
6. No (see paragraphs 58 and 60).
7. Yes. If the purported lease broker has a cash investment in the leased asset, the transaction is not a lease broker transaction, but probably is a leveraged lease (see paragraphs 29 and 60b).
8. Yes. If the assignment takes place at a time subsequent to the time the asset is acquired, the transaction should be accounted for under FASB Statement No. 13 (see paragraphs 60d and 63).

Case Six

In addition to bringing together the lessor and lessee, the lease broker provides such services as billing the lessee, administering property tax payments, and obtaining property insurance coverage.

Basic Questions

1. Should the lease broker recognize in income the one price cash fee at the beginning of the lease term?
2. Should he unbundle the services and measure the fee by relative sales values and recognize in income only the brokerage fee at the beginning of the lease term?

Answers to Questions Based on Advisory Conclusions

1-2. The fee associated with bringing together the lessor and lessee (brokerage services) should be recognized in income at the beginning of the lease term (see paragraph 68a). The fees associated with the other services should be unbundled using relative sales values and recognized in income when the other services are performed (see paragraphs 70 and 71f).

Case Seven

In addition to bringing together the lessor and lessee and arranging the lease as in Case One, the lease broker guarantees the lessee's payments during the initial lease term.

Basic Questions

1. Does such a guarantee constitute a primary obligation?
2. Is the guarantee of initial rentals different from a guarantee after the initial lease term?

3. How should the lease broker account for credit guarantee services that he provides along with brokerage services and should those services be unbundled?

Answers to Questions Based on Advisory Conclusions

1. No (see paragraphs 33 and 67).
2. A guarantee of initial rentals is a secondary credit risk, while a guarantee of rentals during a renewal period or of a residual value is a primary or market obligation (see paragraphs 33 and 67).
3. Credit guarantee services should not preclude recognizing brokerage service fee income at the beginning of the lease term unless the credit risk assumed cannot be measured (see paragraphs 67 and 68d). The fees associated with the credit guarantee services should be unbundled and recognized in income over the lease term (see paragraphs 70 and 71f). The lease broker should provide an allowance for estimated uncollectible amounts (see paragraph 68f).

Case Eight

The lease broker locates someone who needs a specific asset (end user) and purchases the asset with a large proportion of nonrecourse debt from a financial institution. He sells the asset to an equity investor, leases it back, and subleases it to the end user on a direct finance lease.

Basic Questions

1. Should the lease broker be considered merely an agent or should this transaction be accounted for under FASB Statement No. 13?

2. Should the leaseback be shown as a capital lease ("broad" on the lease broker's balance sheet)?
3. Should the accounting be different if the lease broker were only secondarily liable (obligated to pay rent only if the sublessee does not make payments)?

Answers to Questions Based on Advisory Conclusions

1. Since the purported lease broker has assumed material primary and market obligations (i.e., he is responsible for lease payments to the equity investor), the transaction should be accounted for under FASB Statement No. 13 (see paragraphs 58 and 59).
2. Yes, assuming that the leaseback meets one of the criteria in paragraph 7 of FASB Statement No. 13.
3. Yes. This form of transaction is dealt with in FASB Statement No. 13. Specifically, if the lessee/sublessor is only secondarily liable, the accounting would be guided by paragraph 38 of FASB Statement No. 13 and gain or loss recognized. (Note that the financial statement effect of following paragraph 38 of FASB Statement No. 13 would appear to approximate that which would have occurred had the transaction been viewed and accounted for as a lease broker transaction.)

APPENDIX II

The following is an example of disclosures by a lease broker in accordance with paragraph 75 (Advisory Conclusions).

Note 1 - Summary of Accounting Policies - Lease Broker Transactions

Revenue from lease brokerage transactions consists of (a) lease placement fees received at the closing of the lease financing transaction (beginning of the initial lease term), (b) net proceeds from full payout leases assigned to third parties without recourse and (c) additional fees based on the estimated proceeds to be received from disposition of the leased equipment at lease termination. Lease placement fees received by the company and net proceeds from the nonrecourse assignment of full payout leases are generally recognized as revenue at the closing of the lease financing transaction (generally upon installation of the equipment). In addition, the fees based on the estimated proceeds from the disposition of equipment at lease termination (residual values) are recorded in income at their discounted value on the closing of the lease financing transaction and the excess of the estimated fees over their discounted value is recognized as revenue using the compounded interest method over the terms of the related leases.

In connection with certain of the lease brokerage transactions, the company is responsible for assisting with the disposition of the leased equipment at the end of the lease term. In these instances, a portion of the fees received is deferred and recognized as income at the time the equipment is disposed of.



Certain of the lease brokerage transactions unconditionally obligate the lessee to make payments for a period of several years after which the lessee or lessor may request the company to assume certain responsibilities. In these instances, fees received for lease brokerage activities are recognized in income at the closing of the lease financing transaction only if the company has reinsured its responsibilities with unrelated financially responsible third parties or the maximum amount that the company may be obligated for is minor in relation to each transaction.

Note X -- Residual Values on Lease Brokerage Transactions

A significant portion of the consideration received by the company for lease brokerage of equipment is in the form of an estimated fee receivable from the proceeds to be realized upon disposition of such equipment at the termination of the related leases. These residual values are included in income at their discounted present value based upon the best estimate of the equipment's disposition proceeds at the time such estimate was made. The discount factor used varies depending on current market interest rates at the time the transaction is recorded.

As of December 31, 19X3, the gross amounts before discounting and present (discounted) value of the company's share of the estimated disposition proceeds of the residual values and the years of expected realization are as follows:

	<u>Gross Amount Before Discounting</u>	<u>Present Value</u>
19X4	\$ X	\$ X
19X5	X	X
19X6	X	X
19X7	X	X
19X8	X	X
Later years	X	X
	---	---
	\$XX	\$XX
	===	===

Included in the amounts set forth above are X dollars (gross amount before discounting) and Y dollars (present value) for which residual value guarantees have been received by the company from unrelated guarantors.

As of December 31, 19X3, the types of equipment in which the company has recorded residual values and their respective amounts are:

<u>Type</u>	<u>Gross Amount Before Discounting</u>	<u>Present Value</u>
Railroad equipment	\$ X	\$ X
Construction equipment	X	X
Aircraft	X	X
Mining equipment	X	X
. . . . .	X	X
	---	---
	\$XX	\$XX
	===	===

During 19X3, the company realized income of X dollars from sales or new leases of the equipment in which the company has residual sharing rights. The company's share of the proceeds received on such sales or leases totaled Y dollars.

As of December 31, 19X3, the gross amount before discounting and the present value of the aggregate amount of guarantees of equipment residual values rendered by the company to others approximated X dollars and Y dollars, respectively.

At December 31, 19X3, the present value of the aggregate amount of guarantees of credit rendered by the company to others relating to lease payments by third party lessees approximated X dollars.