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Lessors who do only single-asset deals have it good. They never have to worry about whether to account for their leases on a transaction basis or on an asset basis, since they are the same. Those who structure and administer multi-asset leases, however, must decide whether to account for their leases on a transaction (or "contract") basis, or on an asset basis. A transaction basis implies that the accounting statements reflect all of the assets, rents, fees, residual values, and other elements of the transaction, as inseparable parts of the whole. Asset-based accounting, on the other hand, treats each asset separately and allows each to have its own set of accounting statements.

The benefits of asset accounting include easier handling of dispositions (e.g., early terminations or casualties), accommodating fixed asset accounting systems and lease management systems that capture asset level details, and facilitating database functions and queries. It can also help to achieve different structuring objectives for separate assets. The risk, usage, and depreciation characteristics may be a motivation for wanting to separate the accounting of different assets.

A growing portion of the market is shifting to asset-based accounting to realize these benefits, but these players are also learning that they

come with a cost to lease administration: an additional, potentially complex, step of "allocation" of the common elements. Specifically, this involves apportioning the common elements structured at the transaction level, to the asset level to permit individual accounting statements to be produced.

The main task in performing asset-level accounting is allocating the rent. An allocation method useful for rent will provide guidance on other common elements, such as fees, periodic expenses or income, subsidies, security deposits, purchase options, loans, residual guarantees, and residual value insurance.

Some elements of a lease are more easily associated with an individual asset than others. Is an annual insurance premium associated with the transaction or with the assets? It may depend on what the insurance is for. With a monthly maintenance charge, we could again ask whether the maintenance is for a specific asset or common to all of them. How about a security deposit? When is it collected and returned? If its term coincides exactly with the delivery date and residual date of a specific asset, perhaps it should be associated with it. Is a subsidy (an incentive from the manufacturer) individual or common? If it is paid on a specific delivery date and expressed as a % of that asset cost, then it sounds like an individual subsidy, and should stay associated with that asset. If on the other hand it is paid on the rent commencement date and expressed as a %

of the total equipment cost, then it probably is common and should be broken out across all assets.

Residual-related items are clearer, as they are tied directly to an asset. Residual guarantees provided by the lessee or a third-party generally relate to specific assets. Purchase options relate to a specific asset, as they are a provision to purchase that asset on a particular date. Because these are individual items, the association to those assets should be maintained, i.e., those items should not be allocated to other assets. Residual value insurance is an interesting exception, as it is provided to ensure a certain classification of the transaction, and does not relate to a specific asset.

Rent is structured to achieve a certain yield for the lessor while meeting a cost-effectiveness goal for the lessee. This must happen at the transaction level. The lessor expects to earn a certain yield on their overall investment, and the lessee wants to know how much rent they will pay for all equipment, not necessarily each piece individually. A couple of guidelines can help in allocation. First, the sum of the individual rents after allocation should equal the total rent before allocation. This seems reasonable, as we are not trying to change the rents; presumably, they have already been documented and agreed to by lessor and lessee.

Secondly, it seems intuitive that the profitability should be spread equally across the assets. Sounds reasonable, but what does

"profitability" mean? There are several alternatives. It might mean that a specific yield should be equal across the assets, or that the total after-tax cash of each asset should be proportional to its asset amount. Or, we might make it proportional to the asset costs. This guarantees that the total rent will equal the sum of the pieces and it has the benefit of simplicity. A disadvantage of this approach, however, is that it disregards the effect of the residual on the yield. So in a lease with a 10% residual value on one asset and 40% on another, the individual yields will be significantly off-one too low, the other too high.

To address this shortcoming, we could incorporate the residual value into the allocation mechanism, by first reducing the asset cost by the residual value before allocating the rent. The rent allocated to an asset with a large residual, then, would be less than that allocated to an asset with a smaller residual value. The objective is to balance a high residual value with lower rents, and a low residual value with higher rents, to bring the individual yields closer. Furthermore, because the residual takes place some number of years after the delivery, we would probably use a present value of the residual value in this calculation. This gives a more balanced weighting to the elements related to the production of the yield. Care should be taken to select a discount rate close to the lessor's overall portfolio yield.

To produce accounting statements, we need to know the accounting classification. Some of these classification tests are asset-based,

while some are transaction-based. The bargain purchase, last quarter, and economic life tests are performed asset by asset, while the title transfer and present value tests are performed on the full transaction. For the individual income streams to add up to the aggregate stream, the classification of each asset would need to be the same as that of the entire transaction, a tenuous assumption.

Residual value insurance is a feature used to achieve capital (direct finance lease) accounting treatment in many leases. By paying a fee upfront to an insurance provider in return for a guarantee of a portion of the residual value, the minimum lease payments to the lessor (which include this guarantee) will be at least 90% of the equipment cost, per SFAS 13. (As discount rate, the test uses the implicit interest rate, which discounts the minimum lease payments and the economic residual to the equipment cost.)

Because both the residual guarantee and the fee which pays for it are associated with the transaction (and not with the assets), it is difficult to allocate these to the assets, unless we choose to arbitrarily pro-rate it by asset amount, or by some other algorithm. Whatever method we choose, however, the accounting or the economics of each asset (and most likely both) will not match what we had achieved at the transaction level. Thus, residual value insurance presents a special difficulty when doing asset-based accounting.

Distinguishing common items from individual items is important:

Common items need to be allocated to the assets, or at least to those assets which do not yet have an allocation of that category. Individual items are deemed to be associated with a specific asset, and should stay with it for accounting purposes. The question arises, if a specific expense is associated with one asset, and another expense of the same sort is not specifically associated, how should it be allocated?

Let's say that we have 5 assets, of which #1 already has its own allocation of a maintenance charge. An additional maintenance charge is not associated with a single asset. Should we allocate it across all assets, or just to assets #2 through #5, since #1 has already been allocated its own maintenance charge?

So far we have assumed a simple rent structure, but of course in reality things get more complicated. We may have a stepped, saw-tooth, or even prepaid/deferred rent structure. We may have interim rent based on the daily average of the base term rents. Should we allocate interim rent differently than base rent? It would seem reasonable to allocate the interim rent to the deliveries that have already taken place; after all, that is how it is calculated in the first place. Shouldn't we allocate it to the assets similarly? If one delivery takes place on March 1 and the second on May 1, and the interim rent payable on May 1 relates entirely to the first asset, shouldn't it be allocated entirely to it? On the other hand, if we are trying to find a

simple, reliable algorithm for allocating the rent, a single factor to be applied to all rents has a certain appeal.

These questions illustrate the difficulty of trying to lay down general rules for poorly-defined situations. Ideally, costs should be carefully categorized and allocated according to what they were incurred for. If we are having trouble identifying how a cost should be allocated, then we don't clearly understand either why it was incurred, or why certain assets were grouped together under one lease.

Especially in situations where individual assets in multi-asset transactions are treated separately for terminations or other purposes, asset-based accounting can be helpful. It can facilitate lease administration and interfacing with other information management and query systems. On the other hand, it adds complexity and may introduce chances for judgment rather than objective measurement to be used to allocate lease elements. This will make it more difficult to ensure consistency over the long run. Lessors who are able to implement guidelines or methodologies to make the allocation consistent and rational will benefit most from asset-level accounting.