Week 5 – DQ 1

What are the differences between a direct-financing and a sales-type lease for a lessor?

Why would a lessor provide direct-financing to a lessee?

What types of organizations provide direct-financing leases?

Response #1 A lease is considered a sales type lease if it meets one or more of the capital lease criteria and a manufacturer's or dealer's profit or loss is given to the lessor. On the other hand, a direct financing lease differs from a sales type lease in that there is no manufacturer or dealer's profit or loss is given to the lessor. A lessor provides direct financing to a lessee for a chance of higher returns from the transaction. Direct-financing leases generally result from arrangements with lessor that are primarily engaged in financing operations. Organizations that provide direct financing leases include banks and even not for profit organizations.

Response #2 The differences between a direct-financing and a sales-type lease for a lessor is a sales-type lease the lessor receives a manufacturer's profit from the sale of the asset. The sales-type lease and direct-financing both receive interest over the term of the lease. A lessor would provide direct-financing to a lessee because of the interest income and tax benefits. After the lessor collects from the lessee and makes payments to cover the cost of the lease, any amount above these costs would be a profit for the lessor. Types of organizations that provide direct-financing leases include banks.

Response #3 A lease is considered a sales type lease if it meets one or more of the capital lease criteria and a manufacturer's or dealer's profit or loss is given to the lessor. A direct financing lease differs from a sales type lease in that there are no manufacturers or dealer's profit or loss is given to the lessor.

A lessor provides direct financing to a lessee for a chance of higher returns from the transaction.

Organizations that provide direct financing leases include banks and even not for profit organizations.

Response #4 A difference between a direct-financing lease and a sales-type lease is the manufacturer's or dealer's profit (or loss). The direct-financing lease does not involve this item, but sale-type leases do. Direct-financing leases find the lessee financing the asset purchase. The lessor records a lease receivable instead of a leased asset. This lease receivable is the present value of the minimum lease payments which include rental payments, guaranteed residual value, and more. The cost of asset equals fair market value. With sales-type leases, the cost of the asset does not equal fair market value. Unlike the direct-financing type of lease, with sales-type leases, the lessor records the sale price of the asset, cost of goods sold and the related inventory reduction, as well as the lease receivable. A lessor would provide direct-financing to a lessee because he or she is in search of higher returns. The asset is purchased by the lessor for the purpose of leasing it. Types of organizations that provide direct-financing leases are institutions like banks that are engaged in financing operations. Sales-type leases, on the other hand, come from dealers and/or manufacturers and it is usually related to the marketing of a product.

Reference: Kieso, D.E., Weygandt, J.J., & Warfield, T.D. (2007). Intermediate Accounting (12th ed.). Hoboken, NJ: John Wiley & Sons.