



ATTACHMENT 3: ILLUSTRATIVE EXAMPLE

On 15 May 2011, *Tropical Shire Council* and the State Government (via the Department of Communities) agreed to enter a 40 year lease of the public housing assets located in the local Aboriginal community (as part of the Indigenous Housing Arrangement initiative).

The following is an extract of the terms agreed to by both parties in the lease agreement:

- Once-off upfront payment \$1 million
- Annual lease payments \$300,000
- Implicit Interest rate 6.06%

Given the Department of Communities will assume substantially all the risks and rewards incidental to ownership including directly managing properties, collecting rental income, performing repairs and maintenance, and building additional and upgrading existing houses in the community for a period of 40 years, the lease arrangement is deemed to be a finance lease.

The accounting records of Tropical Shire Council show that:

- Fair value of Public Housing assets at 15 May 2011 is \$7 million
- Depreciation accumulated on the Public Housing assets to 15 May 2011 is \$1 million

Suggested approach

Initial Accounting Treatment

Step 1: Calculate the value of the receivable associated with the 40 year finance lease

Value of receivable = once-off upfront payment + present value of annual lease payments

Present Value of Annual Lease Payments

$$\text{Annual lease payment} \quad \times \quad \left[\frac{1 - \frac{1}{(1+i)^N}}{i} \right]$$

Where:

- i = annual interest rate agreed to in lease agreement
- n = 40 years (life of lease term and number of periods to discount back)

Therefore:

$$\begin{aligned} \text{Present Value of Annual Lease Payments} &= \$300,000 \times \frac{1 - \frac{1}{(1.0606)^{40}}}{0.0606} \\ &= \$4,479,969 \end{aligned}$$

$$\text{Value of receivable} = \$1,000,000 + \$4,479,969 = \$5,479,969$$



Step 2: Derecognise houses as public housing assets and recognise creation of the lease

Dr	Lease Receivable	\$5,479,969
Dr	Accumulated Depreciation	\$1,000,000
Cr	Public Housing Assets	\$7,000,000
Dr	Loss on Transfer of Public Housing Assets	\$ 520,031

Step 3: Recognise receipt of once-off upfront payment to Council by the State Government

Dr	Cash at Bank	\$1,000,000
Cr	Lease Receivable	\$1,000,000

Subsequent Accounting Treatment

Record receipt of annual lease payments from the State Government in year 1:

The figures below were calculated by using a standard loan repayments schedule.

Dr	Cash at bank	\$300,000
Cr	Lease Receivable	\$ 28,514
Cr	Interest on Lease Receivable	\$271,486