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Advanced Lease Systems, Inc.

Memo

To: ALS Customer
From: ALS Customer Support
CC: Correspondence File
Re: Earned/Unearned Income Calculations

Advanced Lease Systems uses the following basic¹ calculation for computing initial unearned income on a lease at its inception, which is in accordance with GAAP for leases:

$(\text{Base Rent} \times \text{Lease Term}) + \text{Residual Value} + \text{Cap. Reduction} + \text{Trade In Amount} - \text{Acquisition Cost} - \text{Financed Sales Tax} - \text{Financed Luxury Tax} - \text{Initial Direct Income} - \text{Commission}.$

The following is a general explanation of the method that Advanced Lease Systems uses to earn income over the term of the lease:

Earned Income Calculation:

The earned income on a finance lease is computed using the beginning book value, monthly effective base rent and the Accrual (ACR) rate on the lease. In addition, earnings on a finance lease are earned daily, and earnings begin on the Lease's Start Date. For book earned income, the book balance is reduced by a payment on the anniversary of the lease start date, regardless of actual payment due date, and income is accrued on a 30/360 basis. (i.e. 30 days a month are accrued regardless of the actual days in a month, and it is assumed that the year contains 360 days).

Example 1 shows the computation if lease payments are made in advance. This example assumes that the A.C.R. Rate (accrual rate) has been computed using a financial calculator such as an HP12c, or any other industry standard calculator observing the 30/360-day method of rate computation, which also takes payments in advance into account.

Example 2 shows the computation if lease payments are made in arrears. This example assumes that the A.C.R. Rate (accrual rate) has been computed using a financial calculator such as an HP12c, or any other industry standard calculator observing the 30/360-day method of rate computation, which also takes payments in arrears into account.

¹ The formula for basic unearned may also be affected by the method of commission amortization and/or additional lessor costs such as holdbacks, reserves or residual value insurance.

Example 2 (payments in arrears):

Book Value = 10,000.00
A.C.R. Rate = 12.00
Monthly Base Rent = 220.00

$$\begin{array}{r} 10,000.00 \text{ (Beginning book value)} \\ (10,000*.01) = 100.00 \text{ (earned income for 1}^{\text{st}} \text{ Month)} \\ \hline = \mathbf{10,100.00} \text{ Book Value in month 1} \end{array}$$

$$\begin{array}{r} (10,100.00 - 220) = 9,880.00 \text{ (book value after payment)} \\ (9,880.00*.01) = 98.80 \text{ (earned income for 2}^{\text{nd}} \text{ Month)} \\ \hline = \mathbf{9,978.80} \text{ Book Value in month 2} \end{array}$$

$$\begin{array}{r} (9,978.80 - 220) = 9,758.80 \text{ (book value after payment)} \\ (9,758.80*.01) = 97.59 \text{ (earned income for 3}^{\text{rd}} \text{ Month)} \\ \hline = \mathbf{9,856.39} \text{ Book Value in month 3} \end{array}$$

As stated prior to the above examples, income is actually earned daily beginning on the lease start date. For example, in month one (1), example 1, the income would actually be taken at a rate of \$3.26 (97.80 / 30) in the form of a daily accrual entry (debiting unearned income and crediting earned income). Any adjustments necessary due to rounding are taken in the final month of a lease.

On a past term lease Earned Income is accrued once a month on the lease's payment due date. The general ledger entries generated are: a debit to Lease Payments Receivable for the monthly base rent, a credit to Residual Receivable for one month's depreciation and a credit to Earned Income for the difference between the Base Rent and Monthly Depreciation. When the residual balance is reduced to zero the Earned Income credit will be the same amount as the monthly base rent. These entries are made on an accrual basis (i.e. even if the customer does not make the payment). When the payment is made the general ledger entries are a debit to cash and a credit to lease payments receivable.

If you have any further questions, please do not hesitate to contact our support department.