

Case 92-8

Accounting for a Floating Asset

Your client, MaxiCorp, and two unrelated entities owned 100 percent of the partnership interests in Central Corp. MaxiCorp held a 1 percent interest in the partnership. Central was formed to acquire and hold title to a ship, which was leased to MaxiCorp's wholly owned subsidiary, Seaward Corp. Central financed a significant portion of the purchase price of the ship through nonrecourse debt. Based on the guidance in FASB Statement No. 13, *Accounting for Leases*, Central, the lessor, accounted for the lease as a direct financing lease and Seaward, the lessee, accounted for it as an operating lease. Accordingly, at the inception of the lease, Central removed the ship from its books and recorded as its gross investment in the lease, a receivable for the present value of the future minimum lease payments as well as the unguaranteed residual value of the ship accruing to the partnership's benefit.

Earlier this year, Central sold the direct financing lease receivable to an unrelated third party in accordance with the provisions in FASB Statement No. 77, *Reporting by Transferors for Transfers of Receivables with Recourse*, and used the proceeds from the sale to extinguish the debt through which it financed the purchase of the ship.

Before year-end, MaxiCorp acquired the other partners' interests in Central. The form of the lease agreement between Central and Seaward was unaffected by that transaction or by Central's sale of the lease receivable. Further, Central will continue transmitting Seaward's lease payments to the third-party purchaser of the lease receivable.

MaxiCorp's controller believes that because the form of Seaward's lease agreement with Central has not changed, the company can continue to account for the lease as an operating lease in the consolidated financial statements.

Required:

- What is the effect, if any, of MaxiCorp's purchase of the other partners' interests in Central on the accounting for the lease in consolidation?