Apel Manufacturing?

Topic: Accounting for Leases

Characters: Jon, recently hired controller for Apel Manufacturing
Rex, CEO of Apel Manufacturing

Apel Manufacturing is a small nonpublic manufacturing company with plans to automate its production process and add a third production shift. Management thinks the improved technology and increased production are the only feasible ways the company can remain competitive. All of Apel's buildings are owned by the controlling shareholders and leased to the company on a yearly basis. The leasing arrangement was established eight years earlier to maximize tax benefits; as long as Apel needs the facilities, they will be available to the company. Apel's financial statements have not shown a lease liability during that period.

After a few years of public accounting experience, Jon recently joined Apel as controller. Jon is presently reviewing the financial statements to prepare for the upcoming audit and to begin making the needed loan application. In Jon's opinion, there is no doubt the building lease should be treated as a capital lease.

John decided to discuss the lease accounting with Rex, Apel's CEO. When shown the requirements of Statement of Financial Accounting Standards No. 13, Rex insisted that the lease not be classified as a capital lease. Rex stated his belief that the lease meets none of the four criteria used for lease classification in Statement No. 13, and he made it clear to John that a capital lease liability should not be shown on the financial statements. He said that Apel could not afford to jeopardize its loan application in any way.

Jon is concerned that Rex's direction for reporting the lease is not fair disclosure. Given that he is a new employee, John is confused about how to proceed.

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