FINAL EXAM

Course # 171037
Accounting For Leases

based on the electronic .pdf file(s):

Accounting For Leases
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6 CPE Credit Hours
Accounting & Auditing

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Chapter 0 - Course Material

1. Which of the following is an advantage of leasing?

   - ______ A purchase option exists.
   - ______ Immediate cash outlay is not required.
   - ______ There are usually fewer financing restrictions.
   - ______ All of these.

2. The present value of minimum lease payments should be used by the lessee in determining the amount of a lease liability under a lease classified by the lessee as

   - ______ Either a Capital Lease or an Operating Lease
   - ______ A Capital Lease, but not as an Operating Lease
   - ______ Neither a Capital Lease, nor an Operating Lease
   - ______ An Operating Lease, but not as a Capital Lease

3. The methods of accounting for a lease by the lessee are

   - ______ Operating and capital lease methods.
   - ______ Operating, sales, and capital lease methods.
   - ______ Operating and leveraged lease methods.
   - ______ None of these.

4. Drawbacks to leasing include:

   - ______ The lessee may have to retain property no longer needed.
   - ______ Leasing allows the lessee under a capital lease, in effect, to depreciate land, which is not allowed if land is purchased.
   - ______ There are usually more financing restrictions placed on the lessee by the lessor than are imposed.
   - ______ The lessee can make improvements to the leased property without the lessor's permission.

5. Which of the following statements is correct?

   - ______ In a direct-financing lease, initial direct costs are added to the net investment in the lease.
   - ______ In a sales-type lease, initial direct costs are expensed in the year of incurrence.
   - ______ For operating leases, initial direct costs are deferred and allocated over the lease term.
   - ______ All of these.

6. Which of the following is a correct statement of one of the capitalization criteria?

   - ______ The lease transfers ownership of the property to the lessor.
   - ______ The lease contains a purchase option.
   - ______ The lease term is equal to or more than 75% of the estimated economic life of the leased property.
   - ______ The minimum lease payments (excluding executory costs) equal or exceed 90% of the fair value of the leased property.

7. One of the possible criteria for a capital lease is that the lease term be _________ equal to the estimated useful life of the property.

- ______ 75%
- ______ 50%
- ______ 51%
- ______ 95%

8. For a capital lease, the amount recorded initially by the lessee as a liability should normally

- ______ Exceed the total of the minimum lease payments.
- ______ Exceed the present value of the minimum lease payments at the beginning of the lease.
- ______ Equal the total of the minimum lease payments.
- ______ Equal the present value of the minimum lease payments at the beginning of the lease.

9. Executory costs include

- ______ Maintenance.
- ______ Property taxes.
- ______ Insurance.
- ______ All of these.

10. To avoid leased asset capitalization, companies can devise lease agreements that fail to satisfy any of the four leasing criteria. Which of the following is not one of the ways to accomplish this goal?

- ______ Lessee uses a higher interest rate than that used by lessor.
- ______ Set the lease term at something less than 75% of the estimated useful life of the property.
- ______ Write in a bargain purchase option.
- ______ Use a third party to guarantee the asset’s residual value.

11. The amount to be recorded as the cost of an asset under capital lease is equal to the

- ______ Present value of the minimum lease payments.
- ______ Present value of the minimum lease payments or the fair value of the asset, whichever is lower.
- ______ Present value of the minimum lease payments plus the present value of any unguaranteed residual value.
- ______ Carrying value of the asset on the lessor's books.

12. Minimum lease payments may include a

- ______ Penalty for failure to renew.
- ______ Bargain purchase option.
- ______ Guaranteed residual value.
- ______ Any of these.

13. On January 1, 2X10, JCK Co. signed a contract for an 8-year lease of its equipment with a 10-year life. The present value of the 16 equal semiannual payments in advance equaled 85% of the equipment's fair value. The contract had no provision for JCK, the lessor, to give up legal ownership of the equipment. Should JCK recognize rent or interest revenue in 2X12, and should

the revenue recognized in 2X12 be the same or smaller than the revenue recognized in 2X11?

- ______ Recognize Rent revenue in 2X12, and it should be the same compared to 2X11.
- ______ Recognize Rent revenue in 2X12, and it should be smaller compared to 2X11.
- ______ Recognize Interest revenue in 2X12, and it should be the same compared to 2X11.
- ______ Recognize Interest revenue in 2X12, and it should be smaller compared to 2X11.

14. A 6-year capital lease entered into on December 31, Year 4, specified equal minimum annual lease payments due on December 31 of each year. The first minimum annual lease payment, paid on December 31, Year 4, consists of which of the following?

- ______ Interest Expense and a Lease Liability
- ______ Interest Expense but not a Lease Liability
- ______ A Lease Liability but not Interest Expense
- ______ Neither Interest Expense nor a Lease Liability

15. In computing the present value of the minimum lease payments, the lessee should

- ______ Use its incremental borrowing rate in all cases.
- ______ Use either its incremental borrowing rate or the implicit rate of the lessor, whichever is higher, assuming that the implicit rate is known to the lessee.
- ______ Use either its incremental borrowing rate or the implicit rate of the lessor, whichever is lower, assuming that the implicit rate is known to the lessee.
- ______ None of these.

16. The rate that, at the inception of the lease, the lessee would have incurred to borrow the funds necessary to buy the leased asset on a secured loan with repayment terms similar to the payment schedule called for in the lease is called.

- ______ The lessee’s indexed borrowing rate
- ______ The lessee’s incremental borrowing rate
- ______ The lessee’s hypothetical borrowing rate
- ______ The lessee’s implicit borrowing rate

17. Moody, Inc. leased equipment from Walker Company under a four-year lease requiring equal annual payments of $20,000, with the first payment due at the end of the year. The lease does not transfer ownership, nor is there a bargain purchase option. The equipment has a 4-year useful life and no salvage value. If Moody, Inc.’s incremental borrowing rate is 10% and the rate implicit in the lease (which is known by Moody, Inc.) is 8%, what is the amount recorded for the leased asset at the lease inception? (Note the following present values: At 8% for 4 periods, the PV Annuity Due = 3.5771 and the PV Ordinary Annuity = 3.31213. At 10% for 4 periods, the PV Annuity Due = 3.48685 and the PV Ordinary Annuity = 3.16986.)

- ______ $71,542
- ______ $69,737
- ______ $66,243
- ______ $63,397

18. Pisa, Inc. leased equipment from Tower Company under a four-year lease requiring equal annual payments of $86,038, with the first payment due at lease inception. The lease does not transfer ownership, nor is there a bargain purchase option. The equipment has a 4-year useful life and no salvage value. If Pisa, Inc.’s incremental borrowing rate is 10% and the rate implicit in the lease (which is known by Pisa, Inc.) is 8%, what is the amount recorded for the leased asset at the lease inception? (Note the following present values: At 8% for 4 periods, the PV Annuity Due = 3.5771 and the PV Ordinary Annuity = 3.31213. At 10% for 4 periods, the PV Annuity Due = 3.48685 and the PV Ordinary Annuity = 3.16986.)

- ______ $307,767

______ $272,728

______ $284,969

______ $300,000

19. The Lease Liability account should be disclosed as

______ All current liabilities.

______ All noncurrent liabilities.

______ Current portions in current liabilities and the remainder in noncurrent liabilities.

______ Deferred credits.

20. In computing depreciation of a leased asset, the lessee should subtract

______ A guaranteed residual value and depreciate over the term of the lease.

______ An unguaranteed residual value and depreciate over the term of the lease.

______ A guaranteed residual value and depreciate over the life of the asset.

______ An unguaranteed residual value and depreciate over the life of the asset.

21. Andy, Inc. leased equipment from Tower Company under a four-year lease requiring equal annual payments of $86,038, with the first payment due at lease inception. The lease does not transfer ownership, nor is there a bargain purchase option. The equipment has a 4-year useful life and no salvage value. Andy, Inc.'s incremental borrowing rate is 10% and the rate implicit in the lease (which is known by Andy, Inc.) is 8%. Andy, Inc. uses the straight-line method to depreciate similar assets. What is the amount of depreciation expense recorded by Andy, Inc. in the first year of the asset's life? (Note the following present values: At 8% for 4 periods, the PV Annuity Due = 3.5771 and the PV Ordinary Annuity = 3.31213. At 10% for 4 periods, the PV Annuity Due = 3.48685 and the PV Ordinary Annuity = 3.16986.)

______ $0 because the asset is depreciated by Tower Company.

______ $71,242

______ $76,942

______ $75,000

22. If the residual value of a leased asset is guaranteed by a third party

______ It is treated by the lessee as no residual value.

______ The third party is also liable for any lease payments not paid by the lessee.

______ The net investment to be recovered by the lessor is reduced.

______ It is treated as executory costs. As such, they are not included in computing the minimum lease payments.

23. Based solely upon the following sets of circumstances indicated below, which set gives rise to a sales-type or direct-financing lease of a lessor?

______ Transfer of Ownership by End of Lease = NO, Contains Bargain Purchase Option = YES, Collectibility of Lease Payments Assured = YES, and Any Important Uncertainties = NO.

______ Transfer of Ownership by End of Lease = YES, Contains Bargain Purchase Option = NO, Collectibility of Lease Payments Assured = NO, and Any Important Uncertainties = NO.

______ Transfer of Ownership by End of Lease = YES, Contains Bargain Purchase Option = NO, Collectibility of Lease Payments Assured = NO, and Any Important Uncertainties = YES.

______ Transfer of Ownership by End of Lease = NO, Contains Bargain Purchase Option = YES, Collectibility of Lease Payments Assured = YES, and Any Important

Uncertainties = YES.

24. The initial direct costs of leasing

- ______ Are generally borne by the lessee.
- ______ Include incremental costs related to internal activities of leasing, and internal costs related to costs paid to external third parties for originating a lease arrangement.
- ______ Are expensed in the period of the sale under a sales-type lease.
- ______ All of the above are true with regard to the initial direct costs of leasing.

25. The primary difference between a direct-financing lease and a sales-type lease is the

- ______ Manner in which rental receipts are recorded as rental income.
- ______ Amount of the depreciation recorded each year by the lessor.
- ______ Recognition of the manufacturer's or dealer's profit at the inception of the lease.
- ______ Allocation of initial direct costs by the lessor to periods benefited by the lease arrangements.

26. In a sale-leaseback transaction, the seller-lessee has retained the property. The gain on the sale should be recognized at the time of the sale-leaseback when the lease is classified as a (n)

- ______ Both a Capital Lease and an Operating Lease
- ______ Neither a Capital Lease nor an Operating Lease
- ______ An Operating Lease, but not a Capital Lease
- ______ A Capital Lease, but not an Operating Lease

27. When a company sells property and then leases it back, any gain on the sale should usually be

- ______ Recognized in the current year.
- ______ Recognized as a prior period adjustment.
- ______ Recognized at the end of the lease.
- ______ Deferred and recognized as income over the term of the lease.

28. For a sales-type lease,

- ______ The sales price includes the present value of the unguaranteed residual value.
- ______ The present value of the guaranteed residual value is deducted to determine the cost of goods sold.
- ______ The gross profit will be the same whether the residual value is guaranteed or unguaranteed.
- ______ None of these.

29. Which one of the following statements is true?

- ______ Equipment values, if material, can be commingled with real estate values in leases.
- ______ Minimum lease payments attributable to equipment should not be estimated appropriately and stated separately.
- ______ Equipment values, if material, should be estimated and accounted for separately.
- ______ GAAP does not address the issue of the criteria for the classification of leases being applied separately to the equipment to determine proper accountability.

30. Which of the following statements is true when comparing the accounting for leasing transactions under U.S. GAAP with IFRS?

- ______ IFRS requires that companies provide a year-by-year breakout of future noncancelable lease payments due in years 1 through 5.

- ______ IFRS for leases is more “rules-based” than U.S. GAAP and includes many bright-line criteria to determine ownership.
- ______ The IFRS leasing standard is the subject of over 30 interpretations since its issuance in 1982.
- ______ IFRS does not provide detailed guidance for leases of natural resources, sale-leasebacks, and leveraged leases.

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