Intermediate Accounting 2

Chapter 18 – Leases

Question Sheet

1. Jay from Millers Corporation had negotiated a lease agreement with his friend Steve from KLC Corporation. The lease agreement was made for a heavy duty machine with a fair value of $36,000 that has an economic life of 7 years. The lease term for the machinery was for 5 years, beginning November 1st 2011. Lease payments of $7,500 are to paid at the beginning of each year. The lessee can negotiate a buyout for the machinery, if a buyout doesn’t take place the ownership remains with the lessor. The borrowing rate is 8% and Millers Corporation uses straight line method of depreciation, nearest to the whole month. Millers Corporations year end is December 31st.

**Required**

a. State who is the lessee and the lessor
b. Is this a finance lease or an operating lease?
c. Prepare an amortization table
d. Prepare journal entries for the year 2011 and 2012

2. Access Ltd has decided to lease office equipment with a fair market value of $580,000. This lease is with imperial Leasing Corporation. The terms of the lease are:

- The initial lease term is 5 years and commences on Jan 1st 2011
- For the initial lease term, the payments are $105,000 annually, made at the beginning of each lease year. Each payment includes $5,000 of insurance.
- There is a renewal term of the lease for 3 years at the lessee’s option. Payments during the lease term are $43,000, including $3,000 for insurance.
- Access Ltd guarantees a residual value of $150,000 at the end of the first term if the renewal term is not exercised. If he does renew, there will be no requirement to guarantee a residual
- The incremental borrowing rate is 8%

**Required**

a. Is this a finance lease or an operating lease?
b. Prepare an amortization table until 2016.
c. Prepare journal entries for Access Ltd for the first year assuming that Dec 31st is the year end and uses straight line depreciation
d. Prepare journal entries for Access Ltd for the first year assuming that March 31st is the year end and uses straight line depreciation

Prepared by: Charanjit Singh