Intermediate Accounting 2
Chapter 18: Leases
Answer Key

**Finance Lease**: It gives the lessee (the renter) substantially all of the benefits of ownership. The lessee also has to bear most of the risk of ownership. For example, he will be committed to the contract even if he has no particular use of it.

**Classification of a Finance Lease**

- Is there certainty that the lessee will obtain ownership of the property at the end?
- At the end will he receive all of the economic benefits of the leased property?
- Will the lessor be assured of recovering substantially all of the investment in the leased property?
- The leased asset is so specialized that only the lessee can obtain the benefit without substantial modification?

1. **A** - Lessee: Jay (Millers Corporation), Lessor: Steve (KLL Corporation)

2. If the lease term of the asset is 75% of the economic life of the asset, then it is a finance lease.

\[
\frac{5 \text{ yrs}}{7 \text{ yrs}} = 71.43\% 
\]
If the PV of the asset is 90% of the asset, then it is a finance lease.

\[ PV = 0, \; PMT = 7500, \; I/Y = 8, \; N = 5 \text{ yrs}, \; P/Y, \; C/Y = 1 \]

\[ PV = 32341 \text{ ( Rounded) } \]

\[ \frac{32341}{36000} = 90\% \quad \text{[It is a finance lease]} \]

Amortization Table:

<table>
<thead>
<tr>
<th>Years</th>
<th>PMT's</th>
<th>InterestExp</th>
<th>Difference</th>
<th>Ending Bal.</th>
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<td>555</td>
<td>6945</td>
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D. 2011
Nov 1st - Asset - Machinery: 32341
   - Lease Liability: 32341
   - Lease Liability: 7500
   - Cash: 7500

Dec 31st - Interest expense (Lease Liability): 231
   - Depreciation expense: 1078
   - Accumulated Depreciation - Machine: 1078

\[ \left( \frac{24841 \times 8\%}{12} \right) \times \frac{2}{12} \]

Prepared by: [Name] 8/9/16
2012 Nov 1st  - Lease Liability
- 7500
- Interest Expense
- Lease Liability
- 1656
- $2484 \times \frac{8\% \times 10}{12}$
- Dec 31st
- Interest Expense
- Lease Liability
- 258
- $19328 \times \frac{8\% \times 2}{12}$
- Depreciation Expense
- 6468
- Accumulated Depreciation - Machinery
- $\frac{32341}{5\text{ yrs}}$

Guaranteed Residual ⇒ 2 Options:

Option 1:
- \( PMT = 105000 - 5000 = 100000 \)
- \( Iy = 8\% \)
- \( N = 5\text{ yrs} \)
- \( \text{PVdy} = 1 \)
- \( FV = 150000 \)
- PV = 533300 ⇒ Option 1

Option 2:
- \( PMT = 43000 - 3000 = 40000 \)
- \( Iy = 8\% \)
- \( N = 3\text{ yrs} \)
- \( \text{PVdy} = 1 \)
- \( FV = 0 \)
- PV = $111300$

Option 2 = $75700 + 431213 = 50693$

Prepared by: Charanjit Singh (3)
$$\frac{506913}{580000} = 87\% \quad [\text{Finance Lease}]$$

<table>
<thead>
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<th>Difference</th>
<th>Ending BAL</th>
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Jan 1st, 2011
- Asset - Equipment: 506982
- Lease Liability: 506982
- Cash: 105000

Dec 31st - Interest Expense: 32559
- Depreciation Exp: 72500
- Accumulated Depri - Equip: 72500

2011 Do
- Asset - Equip: 506982
- Lease Liability: 506982
- Cash: 105000

Prepared by: Cheerupit 89
2011
March 31st

Interest Expense 8140
[406982 x 8.1% x \( \frac{3}{12} \)]

Lease Liability 8140

Depreciation Expense 18125

Accumulated Depreciation - Equip 18125

\[ \frac{580000}{8 \text{ yrs}} x \frac{3}{12} \]

Prepared by: Aseja Singh