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 finance lease: [Any 1]

a) Is there certainty that the lessee will obtain ownership of the property at the end?

b) Will the lessee receive substantially all of the economic benefits of the leased property? [75%]

c) Will the lessor be assured of recovering substantially all of the investment in the leased property? [90%]

d) Is the leased asset so specialized that only the lessee can obtain the benefit without substantial modification?

a) Guaranteed Residual → 2 options: [Calculate PV of both options]

Option 1 [Guaranteed Residual]

FV = 110,000

D_y = 7

Pmt = 85,000 - 5,000 = 80,000

N = 4

D_y - D_y = 1

PV = 87,864 [Beginning Mode]

Prepared by: Charanjit Singh
Option 2 → Renewal of lease [Beginning Mode]

\[ \begin{align*}
4 \text{ years} & \quad 7 \text{ years} \\
\text{PV} = 7 & \quad \text{Pmt} = 85,000 \\
\text{Pmt} = 32,000 & \quad \text{FV} = 0
\end{align*} \]

\[ \begin{align*}
- 5,000 & \quad - 2,000 \\
\text{Net} & \quad \text{Net}
\end{align*} \]

\[ \begin{align*}
80,000 & \quad 30,000
\end{align*} \]

\[ \begin{align*}
\text{FV} = 0 & \quad \text{FV} = 84,240.55
\end{align*} \]

\[ \begin{align*}
\text{Ily} = 7 & \quad \text{Ily} = 7
\end{align*} \]

\[ \begin{align*}
\text{Pmt} = 32,000 & \quad \text{Pmt} = 80,000
\end{align*} \]

\[ \begin{align*}
N = 3 & \quad N = 4
\end{align*} \]

\[ \begin{align*}
\text{Ily-cy} = 1 & \quad \text{Ily-cy} = 1
\end{align*} \]

\[ \begin{align*}
\text{PV} = 84,240.55 & \quad \text{PV} = 354,212
\end{align*} \]

* Select option 2, since PV is lower!

If the PV is 90% or more of the fair value of the leased asset, it is considered as finance lease.

\[ \frac{354,212}{400,000} = 88.55\% \text{ close to } 90\% \]

Finance lease

b) 2011
Jan 1st - Asset under lease 354,212
Lease liability 354,212

- Lease liability 80,000
- Insurance expense 5,000
- Cash 85,000

Prepared by: Charanjit Singh
Dec 31st
- Interest expense 19,195
- Lease liability 19,195
- Depreciation expense 57,143
- Accumulated Depreciation - equipment 57,143

\[
\frac{400,000}{7\text{ yrs}} = 57,143
\]

2. The criterion of recognizing the future benefit as an asset is simply a matter of probability. If it is probable that the carry forward will be realized, then the benefit is recognized.

Evidence of Probability:
- The company has earnings history that indicates future taxable profits.
- The taxable loss was the result of an unusual event not likely to recur.
- The company has enough accumulated taxable temporary differences to absorb the unrealized loss as the temporary difference.
- The company has tax planning opportunities that will create taxable profits in the carry forward period.

a) Pre-tax Income | Rate | Post-tax Income
--- | --- | ---
2012 | 200,000 | 30% | 60,000
2013 | 160,000 | 30% | 48,000
2014 | 270,000 | 34% | 91,800

\[
630,000 = 199,800
\]

Prepared by: Charanjit Singh
Loss Carry-forward = $990,000 - 630,000 = 360,000

Deferred Income Tax Asset = $100,000 x 34%
= 34,000

2015:
Income Tax Receivable 199,800
DIT - Asset 34,000
Income Tax Recovery 233,800

2016:
* Income Tax Expense 38,500
DIT - Asset 34,000
Income Tax Recovery 4500
* [110,000 x 35%]

DIT Asset 87,500
Income Tax Recovery 87,500
[360,000 - 110,000] 35%

2017:
Income Tax Expense [200,000 x 37%] 74,000
DIT - Asset 55,500
Income Tax Recovery 18,500
[360,000 - 110,000 - 200,000]
= 50,000 x 37% = 18,500

Prepared by: Chovaajit Singh
(A) Net Defined Liability, Dec 31st 2012 $120,000 (Cr)
Less: Pension Plan Assets, Dec 31st 2012 70,000 (Dr)
Net Defined Benefit Liability $50,000 (Cr)

(B) Defined Benefit Obligation, Jan 1st 2013 $120,000
Add: Current Service Cost 7,000
Add: Past Service Cost 3,500
Add: Interest @ 7% [(20,000 - (20,000 x 6/12)] 7,700
Less: Actuarial Revaluation (4,000)
Less: Benefits Paid (20,000)
$114,200 (Cr)

Fair Value of Plan Assets, Jan 1st 2013 70,000
Add: Actual Earnings on Plan Assets 5,000
Add: Fundings / Contributions 6,000
Less: Benefits Paid (20,000)
61,000 (Dr)

(C) Service Cost:
Pension Expense [7,000 + 3,500] 10,500
Net Defined Benefit Liability 10,500

Net Interest:
Interest Expense 3,500
Net Defined Benefit Liability 3,500

7% [(20,000 - (20,000 x 6/12)] = 7,700 (Interest Expense)
7% [(70,000 - (20,000 x 6/12)] = 4,200 (Interest Income)
7,700 - 4,200 = 3,500

Prepared by: Charanjit Singh
Contribution:
Net Defined Benefit Liability 6,000
Cash 6,000

Remeasurements:
- Net Defined Benefits Liability 800
  Accumulated OCI 800
  $[10,000 - (20,000 \times 6\%) \times 7\% - 5000$
- Net Defined Benefit Liability 4000
  OCI 4000

(D) Net Defined Benefit Liability $53,200
  $[114,200 - 61,000$}

Prepared by: Aravind Singh
a) Basic EPS: 

\[
\text{Basic EPS} = \frac{\text{Earnings} - \text{Preferred dividends}}{\text{Weighted Average Shares Outstanding}}
\]

\[
\text{Net Earnings} = 2,500,000
\]

\[
\text{less: Preferred dividends} = (250,000) \\
150,000 \times 5
\]

\[
\text{Total Dividend} = 2,250,000
\]

- Weighted Average:

<table>
<thead>
<tr>
<th>Date</th>
<th>Shares</th>
<th>Fraction</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jan 1st</td>
<td>450</td>
<td>9/12</td>
</tr>
<tr>
<td>Sept 20th</td>
<td>550</td>
<td>3/4</td>
</tr>
<tr>
<td>Sept 30th</td>
<td>550</td>
<td>7/12</td>
</tr>
</tbody>
</table>

\[
\text{Weighted Average Shares} = 137,500
\]

\[
\text{Basic EPS} = \frac{2,250,000}{137,500} = 4.074
\]

b) Dilutive EPS tells us the worst case scenario.

- Options: A stock option gives the holder the right to acquire shares at a stated price. Options include: stock rights, warrants and employee stock options. Options are considered "in the money" when the exercise price is lower than the market value; we assume the proceeds would be used to retire more common shares.

Prepared by: Chananjit Singh
| Earnings Weighted Average EPS |
| Data from Basic $2,250,000 475,000 4.74 |
| Options: |
| Shares issued 50,000 |
| Less: Shares Retired (12,500) |
| Proceeds / Average Market Value |
| (50,000 x $5) / $20 |
| Subtotal $2,250,000 512,500 4.39 |
| Convertible Bonds |
| Shares converted 65,000 |
| (1000 x 65) |
| Interest avoided after tax: 48,000 |
| [1,000,000 x 8% (1-.40)] |
| Subtotal 2,298,000 577,500 3.098 |

Lessors Perspective (Net Method)

2014:
Jan 1st: - Lease Receivable 7,000
- Equipment 7,000
- Cash 1,700

Dec 31st:
- Lease Receivable 583
- Finance Revenue 583

(7,000 - 1,700) x (11%)

Prepared by: Charanjit Singh 8
b) Lessee's Perspective (Gross Method)

Jan 1st 2014:
- Gross Lease Receivable $8,300
- Unearned finance revenue $1,300
- Equipment $7,000
- Cash $1,700
- Lease Receivable $1,700

Dec 31st 2014:
- Unearned finance revenue $726
- Finance revenue $726

\[ (8,300 - 1,700) \times 4 \]

6) This is change in accounting policy and should be accounted for retrospectively.

a) Jan 1st 2015:
- Inventory \([90,000 - 50,000]\) $40,000
- Deferred tax liability \([40,000 \times 30]\) $12,000
- Retained Earnings \([40,000 \times 70]\) $28,000

b) Statement of Changes in Equity

\[
\begin{align*}
\text{Beginning Balance} & \quad 190,000 \\
(155,000 + 105,000 - 60,000) & \\
\text{Increase in retained earnings due to charge} & \quad 28,000 \\
\text{Less: Dividends Paid} & \quad 75,000 \\
\text{Add: Net Income} & \quad 105,000 \\
\text{Ending Balance} & \quad 248,000
\end{align*}
\]

prepared by: Charanjit Singh