

Sen Finance ACC201, Accounting-II, Practice Questions - III
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Question 107: I) In an Capital Lease the lease is treated as if the Lessee has purchased the asset.

II) In an Operating Lease the Asset enters the left side of the B/S and the present value of future payments to be made for the lease enter the right side of the B/S as a Liability.

I&II are: A) TT B) TF C) FT D) FF

Question 108: I) A sufficient condition for a lease to be treated as a Capital Lease is : At the end of the lease the Lessee becomes the owner of the asset

II) A sufficient condition for a lease to be treated as a Capital Lease is : The lease contract includes a “bargain purchase option”, that is the asset can be purchased by the Lessee at a lower price.

I&II are: A) TT B) TF C) FT D) FF

Question 109: I) The PV of the payments to be made to the Lessor by the Lessee exceeds 90% of Fair Market Value of the asset is not a sufficient condition for a lease to be treated as a Capital Lease.

II) If the length of time for which the asset is leased is greater than 75% of the useful life of the asset is not a sufficient condition for a lease to be treated as a Capital Lease .

I&II are: A) TT B) TF C) FT D) FF

Question 110: I) An equipment with a useful life of 12 years is leased to a Lessee for a period of 8 years. This is sufficient information for it to be treated as a Capital Lease.

II) An equipment with a market price (FMV) of \$410,000 is leased, with the lease payments are \$80,000 a year for 6 years. The borrowing rate for the firm is 9%, and the rate implicit in the lease is 7%. This is sufficient information for it to be treated as a Capital Lease.

I&II are: A) TT B) TF C) FT D) FF

Information for questions 111 to 118: A firm leases an equipment with lease payments of \$55,000 for 5 years. The borrowing rate for the firm is 8%, and the rate implicit in the lease is 6.25%. The FMV of the equipment is \$250,000.

Question 111: The lease will cause assets and liabilities to increase by:

- A) \$0**
- B) \$55**
- C) \$220**
- D) \$230**

Question 112: Interest Expense for the first year of the lease will be:

- A) \$0.00**

- B) \$14.38
- C) \$17.57
- D) \$55.00

Question 113: Depreciation Expense for the first year of the lease will be:

- A) \$0
- B) \$43.92
- C) \$46.02
- D) \$50.00

Question 114: Due to the lease increase (decrease -ve sign) in CFF for the first year will be:

- A) -\$55
- B) -\$40.62
- C) -\$37.43
- D) \$0

Question 115: Due to the lease increase (decrease -ve sign) in CFI for the first year will be:

- A) -\$55
- B) -\$40.62
- C) -\$37.43
- D) \$0

Question 116: Due to the lease increase (decrease -ve sign) in CFO for the first year will be:

- A) \$0.00
- B) \$14.38
- C) \$17.57
- D) \$55.00

Question 117: At the beginning of the second year, the Asset/Liability in the B/S due to the lease will be:

- A) \$175
- B) \$182
- C) \$189
- D) \$195

Question 118: Due to the lease increase (decrease -ve sign) in CFO for the second year will be:

- A) \$0
- B) \$11.84
- C) \$14.01
- D) \$20.00

Question 119: I) In a Capitalized Lease (compared to Operating Lease) the asset is treated as being financed by a borrowing, so CFF lower.

II) Assets and Liabilities are both lower in a Capitalized Lease compared to an Operating Lease.

I&II are: A) TT B) TF C) FT D) FF

Question 120: I) In the early years of a lease, CL provides tax advantages

II) Firms with higher effective tax rates have greater incentive to use CL.

I&II are: A) TT B) TF C) FT D) FF

Question 121: I) A CL will result in a lower D/E ratio compared to a OL.

II) An OL results in higher NI in earlier years.

I&II are: A) TT B) TF C) FT D) FF

Question 122: I) Operating Lease (compared to Capitalized Lease) results in higher leverage.

II) Capitalized Lease (compared to Operating Lease) results in higher ROA and Turnover ratios.

I&II are: A) TT B) TF C) FT D) FF

Question 123: I) In the early years of a lease, a CL (compared to an OL) will result in lower NI.

II) In the later years of a lease, a CL (compared to an OL) will result in higher NI.

I&II are: A) TT B) TF C) FT D) FF

Information for questions 124 and 125: A firm has taken a capital lease with an implicit rate of 9.5%. The obligation entered in the balance sheet is \$500,000. For the first year, the amortization of the lease obligation is \$70,000.

Question 124: The amount of cash flow (ignore sign) in CFF applicable to the lease is:

- A) \$0**
- B) \$47,500**
- C) \$70,000**
- D) \$117,500**

Question 125: The amount of cash flow in CFO (ignore sign) applicable to the lease is:

- A) \$0**
- B) \$47,500**
- C) \$70,000**
- D) \$117,500**

107) B 117) C

108) A 118) B

109) D 119) B

110) C 120) A

111) D 121) C
112) B 122) D
113) C 123) A*
114) B 124) C
115) D 125) B
116) B

Answer 123: In the early years of a lease, if we have a CL then interest expense plus depreciation exceeds lease payments, resulting in lower NI (compared to OL).

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