

**ACCOUNTANCY 422
SUPPLEMENTAL LEASE PROBLEMS**

FIRST PROBLEM

Henri Retail Stores is negotiating three leases for store locations. Henri's incremental borrowing rate is 14%. Each store will have an economic life of 30 years. Lease payments will be made at the **end** of each year. The property will be returned to the lessor at the end of the lease term. Each lease has an implicit interest rate of 12%. Additional data are given below. The purchase price is given as an alternative to leasing.

	<u>Lease Term</u>	<u>Lease Payment</u>	<u>Guaranteed Residual Value</u>	<u>Unguaranteed Residual Value</u>	<u>Purchase Price</u>
Location A	26 years	\$1,500,000	\$120,000	-	\$12,000,000
Location B	20 years	\$1,300,000	-	150,000	\$10,000,000
Location C	20 years	\$1,400,000	200,000	-	\$15,000,000

Required:

Test each lease against all the lease classification criteria to determine if it is a capital or an operating lease. You must clearly indicate the result of each test in order to receive full credit. You must also clearly state whether the lease is a capital lease or an operating lease.

SECOND PROBLEM

On September 30, 2008, the Sting Company entered into a lease agreement for the purpose of leasing a crane to be used in the business. The following information is available concerning the lease agreement:

- a. The term of the noncancelable lease is four years. The crane must be returned to the lessor at the end of the lease. Payments of \$75,000 are due on September 30 of each year, beginning on September 30, 2008, the date the lease is signed.
- b. Sting Company uses straight line depreciation. The crane's estimated residual value on June 30, 2012 is \$85,000. This residual value is guaranteed to the lessor.
- c. Sting Company's incremental borrowing rate is 6 percent. The implicit interest rate used by the lessor is 8 percent.
- d. As of July 1, 2008, the crane has a remaining economic life of six years. The crane's salvage value on September 30, 2014 is \$2,800.
- e. The fair market value of the crane on September 30, 2008 is determined to be \$300,000.

Required:

1. What type of lease contract has Sting Company signed. If it is a capital lease, be sure to note **all** of the lease classification criteria that it has met?
2. Prepare the journal entry made at the lease signing.
3. Prepare the journal entries at year end 2008.
4. Prepare journal entries relating to the lease on September 30, **2010**.

THIRD LEASE PROBLEM

Silas Corp. is a manufacturer of truck trailers. On July 1, 2007, Silas Corp. leases ten trailers to Polley Company under a six-year noncancelable lease agreement. Silas had paid attorneys \$2,000 to prepare the lease document on June 15, 2007. The following information about the lease and the trailers is provided:

1. Equal annual payments of \$129,786 that are due on June 30 each year, beginning on June 30, 2008, provide Silas Corp. with an 8% return on net investment.
2. At the end of the lease Polly may purchase the ten trailers for \$1,000 **each**. This price is expected to be well below the market value of the trailers.
3. The list price of each trailer is \$65,000. The cost of each trailer to Silas Corp. is \$54,000. Each trailer has an expected useful life of nine years.
4. Collectibility of the lease payments is reasonably predictable and there are no important uncertainties surrounding the amount of costs yet to be incurred by Silas Corp.

Required:

- A. Prepare the journal entries for the lessor on July 1, 2007 (assume the use of a perpetual inventory method and round all amounts to the nearest dollar). Use the gross method (the method demonstrated in class).
- B. Prepare the journal entry for the lessor on December 31, 2007. You may ignore depreciation.
- C. Prepare the journal entry for the lessor on June 30, 2008.
- D. Prepare the journal entry for the lessor on June 30, 2009.