Quiz

1. Which one of the following definitions is correct?

A. A lease between a user and the manufacturer of the leased asset is a direct lease.
B. A leveraged lease is a sale and leaseback arrangement.
C. The lessor is the party which uses the leased asset.
D. A financial lease is an operating lease.
E. A sale and leaseback is the sale of an asset by Firm A to Firm B followed by the lease of that asset by Firm A.

A lease between a user and the manufacturer of the leased asset is a sales-type lease.

2. ABC Co. purchases a milling machine from The Mill Works and then leases the milling machine to Modern Tool. The lessor agrees to maintain and insure the milling machine. This is an example of which one of the following?

A. sale and leaseback
B. sales-type lease
C. direct lease
D. leveraged lease
E. financial lease

This is a direct operating lease.

3. Which one of these statements is correct concerning leasing arrangements?

A. The debt financing used to purchase the leased asset from the original manufacturer is debt of the lessee.
B. The manufacturer of the leased asset is sometimes also the lessee.
C. The lessee uses the asset but does not own the asset.
D. The manufacturer sells the asset to the lessee in a direct lease arrangement.
E. The lessee may issue stock to purchase the leased asset.

The manufacturer sells the asset to the lessor.

4. Which of the following are usually correct regarding operating leases?
I. The lessor will recoup the entire cost of the leased asset during the term of the original lease.
II. The leases are fully amortized.
III. The lessee has the right under the cancellation option to cancel the lease contract prior to the expiration date.
IV. The lessor is responsible for insuring the leased asset.

A. I and III only
B. II and IV only
C. III and IV only
D. II, III, and IV only
E. I, II, III, and IV

The lessor does not recoup the entire cost during the initial lease period.

5. Which of the following are normal characteristics of a financial lease?
I. Maintenance of the leased asset is the responsibility of the lessee.
II. The lease is generally cancellable by the lessee prior to the expiration date.
III. Financial leases are generally fully amortized.
IV. The lessee usually has the right to renew the lease at the end of the initial lease period.

A. I and III only

B. II, III, and IV only
C. I and II only
D. I, III, and IV only
E. I, II, III, and IV

Financial leases generally cannot be canceled.

6. A sale and leaseback arrangement does which one of the following?
A. allows the lessor to continue using the leased asset without any interruptions
B. allows the lessee to retain title of the asset
C. allows the lessee to generate cash while continuing to have use of the asset
D. provides the lessor with an immediate cash inflow equivalent to the market value of the leased asset
E. provides the lessee with an immediate cash inflow equivalent to the initial lease payment

The lessee continues to use the asset.

7. Which one of the following accurately describes an aspect of a leveraged lease?
A. The lenders own the leased asset.
B. The lessee pays all lease payments to the lenders.
C. The lessor has a first lien on the leased asset.
D. The lessor receives the tax benefits associated with ownership of the leased asset.
E. The lessee does not have to pay the remaining lease payments if the lessor defaults on the nonrecourse loan.

The lessee only pays the lease payments to the lender if the lessor defaults on the loan.

8. The general purposes of FAS 13 are to:
A. outline the accounting and tax aspects of a leveraged lease arrangement.
B. outline the accounting and tax aspects of a sale and leaseback arrangement.
C. set forth both the tax and legal responsibilities of lessors.
D. set forth the criteria of an operating lease and require that operating leases be recorded on the balance sheet.
E. set forth the criteria of a capital lease and require that capital leases be recorded on the balance sheet.

FAS 13 sets forth the criteria of a capital lease and requires the lease be recorded on the balance sheet.

9. Which of the following correctly state one of the criteria of a capital lease as set forth in FAS 13?
I. the lessee can purchase the asset at fair market value at the end of the lease term
II. the present value of the lease payments is at least 90 percent of the fair market value of the asset at the beginning of the lease term
III. the lease term is 60 percent or more of the estimated economic life of the asset
IV. the lease transfers ownership of the property to the lessee by the end of the lease term
A. I and III only
B. II and IV only
C. II and III only
D. III and IV only
E. I and II only

The lease term must be 75 percent or more of the estimated economic life of the asset.

10. Which one of these statements is correct?
A. Firms prefer to classify leases as capital leases rather than operating leases.

B. Neither operating nor capital leases are considered when determining the market value of a lessee's securities.
C. A bargain purchase price option is defined as applying a tax benefit such that the lease payments on an asset are lowered.
D. An asset leased under a capital lease is recorded as an asset on the financial statements of the lessee.
E. If a lease transfers ownership of the leased asset to the lessee at the end of the lease term, the lease is an operating lease.

If ownership is transferred to the lessee, the lease is a capital lease.