Loans

Loans: Accounting Analysis

a) Type of lease for Pippin and Why?

Considering the case of Pippin, the most suitable lease for Pippin are either capital lease or finance lease as it is meeting condition of the present value of the minimum lease payment. This minimum payment should exceed 90% of the fair value of the leased assets. According to lease theories in order to be a capital lease, assets agreement must meet any of the stated requirements i.e. four conditions to be a capital lease (Jennings, 2012). The following calculation will show that Pippin fair value of the leased assets is more than 90%.

= ($ 85,549.75 / $ 92, 625 x 100)

= 92.36%

Present value of Minimum Lease Payments = $ 10, 000 x 8.514 =$ 85, 140

Add: Residual Present Value = $ 2, 750 x 0.149: $ 409.75

Total present Value = $ 409.75 + $ 85, 140

= $ 85, 549.75

Asset Fair market value: **$ 92, 625**

From the above calculation it is clear that minimum lease payment present value is more than 90% of the asset fair value.

b)

No matter what is the nature of the business, each transaction of lease will have direct impact on the financial statements of the company. Financial statements that are impacted by these lease transactions are as followed:

Income Statement: Future cash flow present value will be posted as revenues and expenses. For this question as Future cash flow present value is $ 85, 549.75.

Balance Sheet: In balance sheet the amount of lease receivable would be $ 85, 549.75 and this will be under assets and interest revenue worth of $ 8, 555 for the first year with $5,319 as unearned.

Cash flow statement: Investing activities will increase by $10,000 as a rental lease (Schroeder, Clark, Cathey, 2012).

c.

Lessor is not liable to record depreciation expense. Regardless of this, if lessor desire to record depreciation expense then the depreciation expense mount would be posted and recorded under the heading of operating expense in Income statement. This value will be deducted from total assets book value in the Balance sheet. As far as cash flow is concern, Depreciation amount is added back to the net income since it is non-cash expense for company. In order words, cash is not going out from the company. This will increase overall net cash flow for 2011 (Jennings, 2012).

d.

Grant will record the future cash flows present value as revenue in income statement. Furthermore, lease receivable as Grant will receive amount as it will be paid will be shows in balance sheet on assets side and interest revenue would be recognized over the term of the lease (Jennings, 2012).

e.

Of Grant treats the lease as sales-type lease then financial statements that will be affected on January 2, 2011 would be Income statement and balance sheet. Lessor would recognize profit on sale and interest revenue in income statement while Equipment amount and Unearned Interest on balance sheet (Jennings, 2012).

f.

If Grant records the lease as an operating lease and uses straight-line depreciation, then in income statement yearly depreciation expense will be part of operating expenses while, Accumulated Expense will be deducted from book value of assets in balance sheet and in cash flow statement, this yearly depreciation will be added back to the net income as it is non-cash expense for company (Schroeder, Clark, Cathey, 2012).

References

Jennings R., (2012), *Financial Accounting, Cengage Learning EMEA*, Retrieved from: <*http://books.google.com/books?id=-838UAXYMUAC&pg=PA131&dq=lease+accounting&hl=en&sa=X&ei=hj2UUs_CIYSnhAf614GwAw&ved=0CDkQ6AEwAg#v=onepage&q=lease%20accounting&f=false*>, Dated: 26th November, 2013

Schroeder G., Clark W., Cathey M., (2012) *Financial Accounting Theory and Analysis: Text and Cases*, John Wiley and Sons, Retrieved from: <*http://books.google.com/books?id=HTXzc5VjT4QC&pg=PA449&lpg=PA449&dq=Case+13-2+Lessee+and+Lessor+Accounting+for+leases&source=bl&ots=71ROei3t-P&sig=vcM_TaGhRF3Ic8O7luoCmsrsc3g&hl=en&sa=X&ei=nyiUUprdFIOe0QWB0YGIBQ&ved=0CDcQ6AEwAg#v=onepage&q=Case%2013-2%20Lessee%20and%20Lessor%20Accounting%20for%20leases&f=false*>, Dated: 26th November, 2013