

# Problem-Solving Assignment 9 (P21-1; P21-2) Problems 1245

- (c) On January 1, 2017, McKane Corp. sold an airplane with an estimated useful life of 10 years. At the same time, McKane leased back the plane for 10 years. The sales price of the airplane was \$500,000, the carrying amount \$379,000, and the annual rental \$73,975.22. McKane Corp. intends to depreciate the leased asset using the sum-of-the-years'-digits depreciation method. Discuss how the gain on the sale should be reported at the end of 2017 in the financial statements.
- (d) On January 1, 2017, Sondgeroth Co. sold equipment with an estimated useful life of 5 years. At the same time, Sondgeroth leased back the equipment for 2 years under a lease classified as an operating lease. The sales price (fair value) of the equipment was \$212,700, the carrying amount is \$300,000, the monthly rental under the lease is \$6,000, and the present value of the rental payments is \$115,753. For the year ended December 31, 2017, determine which items would be reported on its income statement for the sale-leaseback transaction.

## PROBLEMS

**P21-1 (L02,4) (Lessee-Lessor Entries, Sales-Type Lease)** Glaus Leasing Company agrees to lease machinery to Jensen Corporation on January 1, 2017. The following information relates to the lease agreement.

1. The term of the lease is 7 years with no renewal option, and the machinery has an estimated economic life of 9 years.
2. The cost of the machinery is \$525,000, and the fair value of the asset on January 1, 2017, is \$700,000.
3. At the end of the lease term, the asset reverts to the lessor and has a guaranteed residual value of \$100,000. Jensen depreciates all of its equipment on a straight-line basis.
4. The lease agreement requires equal annual rental payments, beginning on January 1, 2017.
5. The collectibility of the lease payments is reasonably predictable, and there are no important uncertainties surrounding the amount of costs yet to be incurred by the lessor.
6. Glaus desires a 10% rate of return on its investments. Jensen's incremental borrowing rate is 11%, and the lessor's implicit rate is unknown.

### Instructions

(Assume the accounting period ends on December 31.)

- (a) Discuss the nature of this lease for both the lessee and the lessor.
- (b) Calculate the amount of the annual rental payment required.
- (c) Compute the present value of the minimum lease payments.
- (d) Prepare the journal entries Jensen would make in 2017 and 2018 related to the lease arrangement.
- (e) Prepare the journal entries Glaus would make in 2017 and 2018.

**P21-2 (L02,3) GROUPWORK (Lessee-Lessor Entries, Operating Lease)** Cleveland Inc. leased a new crane to Abriendo Construction under a 5-year noncancelable contract starting January 1, 2017. Terms of the lease require payments of \$33,000 each January 1, starting January 1, 2017. Cleveland will pay insurance, taxes, and maintenance charges on the crane, which has an estimated life of 12 years, a fair value of \$240,000, and a cost to Cleveland of \$240,000. The estimated fair value of the crane is expected to be \$45,000 at the end of the lease term. No bargain-purchase or -renewal options are included in the contract. Both Cleveland and Abriendo adjust and close books annually at December 31. Collectibility of the lease payments is reasonably certain, and no uncertainties exist relative to unreimbursable lessor costs. Abriendo's incremental borrowing rate is 10%, and Cleveland's implicit interest rate of 9% is known to Abriendo.

### Instructions

- (a) Identify the type of lease involved and give reasons for your classification. Discuss the accounting treatment that should be applied by both the lessee and the lessor.
- (b) Prepare all the entries related to the lease contract and leased asset for the year 2017 for the lessee and lessor, assuming the following amounts.
  - (1) Insurance \$500.
  - (2) Property taxes \$2,000.
  - (3) Maintenance and repairs \$650.
  - (4) Straight-line depreciation and salvage value \$15,000.
- (c) Discuss what should be presented in the balance sheet, the income statement, and the related notes of both the lessee and the lessor at December 31, 2017.

**P21-3 (L02,4) (Lessee-Lessor Entries, Balance Sheet Presentation, Sales-Type Lease)** Winston Industries and Ewing Inc. enter into an agreement that requires Ewing Inc. to build three diesel-electric engines to Winston's specifications. Upon completion of the engines, Winston has agreed to lease them for a period of 10 years and to assume all costs and risks of ownership. The lease is noncancelable, becomes effective on January 1, 2017, and requires annual rental payments of \$413,971 each January 1, starting January 1, 2017.