TYPES OF LEASE ACCOUNTING

MULTIPLE CHOICE QUESTIONS

1. Under operating Lease the Lessor records-------------------
   
   a) Lease Revenue, Maintenance and depreciation expenses
   b) Lease rent paid
   c) None of the above

   Answer: a) Lease Revenue, Maintenance and depreciation expenses
   Lessor is the landlord and he records the rent received from the lessee. In Operating lease all the expenses pertaining to the maintenance of the asset need to be borne by the Lessor. Ownership being in the hands of the Lessor, he also charges depreciation.

2. Under operating Lease the Lessee records-------------------
   
   a) Lease Revenue, Maintenance and depreciation expenses
   b) Lease Rent / Minimum Rent
   c) None of the above

   Answer: b) Lease Rent – Lessee has borrowed the Asset from the Lessor and has to pay the Lease Rent. He records it as a revenue expenditure to utilize the asset in his books of accounts

3. Locate the wrong statement about a Finance Lease
   
   a) It is an arrangement of financing the Lessee
   b) Lessee charges depreciation in his books of accounts
   c) The Lessor records the leased item as an asset.

   Answer: c) The Lessor records the leased item as an asset is a wrong statement. In financial lease the Lessor acts as a financer, he intends to transfer the ownership of the asset towards the end of the useful life to the Lessee.
4. An agreement between the tenant and the flat owner is type of ------------ Lease

   a) Operating Lease
   b) Capital Lease
   c) Financial Lease

   **Answer:** a) Operating Lease –
   The intention of the Lessor is not to sell away the asset to the Lessee. It is only give the possession of the asset for the agreed period of time on mutually agreed terms and conditions.

5. If a company is using some assets but those are not visible in the balance sheet it is an indication of ------------ Lease

   a) Operating Lease
   b) Capital Lease
   c) Financial Lease

   **Answer:** a) Operating Lease –
   Under operating lease no long term liability of a long term loan is reflected nor is the value of the Asset shown on the Asset side of the balance sheet.

6. A Limited has leased 10 computers to B Ltd for four years. In the fifth year the computers are transferred to B Ltd on payment of a mutually agreed value. It is a case of------------

   a) Operating Lease
   b) Capital Lease
   c) None of the above

   **Answer:** b) Financial or Capital Lease –
   In Capital Lease the ownership is assumed to be transferred to the Lessee and the Lessor does not intend to Lease the Asset to any other Lessee. Lessor just acts as a financier.
7. If the present value of the Minimum Lease Payment (MLP) is at least 90% of the fair value of Asset it has to be termed as -------- Lease

   a) Operating Lease
   b) Capital Lease
   c) None of the above

Answer: b) Financial or Capital Lease –
In Capital lease the ownership is assumed to be transferred to the Lessee and the Lessor does not intend to Lease the Asset to any other Lessee. Lessor just acts as a financier.
If the total of the present value of the MLP is at least 90% of the fair value of the asset it is a case of financial lease.

8. Operating Lease is an agreement between the Lessee and the Lessor for a ------------ period of time

   a) Long period of time
   b) Short period of time
   c) None of the above

Answer: b) Short period of time
Operating lease can be for a very short period of time – may be a single day also. Capital Lease is for a long period of time almost nearing its estimated useful life.

9. Sale and lease back is a sub part of ------------ Lease

   a) Capital Lease
   b) Operating Lease
   c) Both a and b

Answer: a) Capital Lease
Sale and lease back is a sub part of capital lease. It is an arrangement in which a firm sells an asset to another party, who in turn leases it back to the firm.
10. In this type of lease the asset does not move from one party to another, but the transaction take place in the books of accounts.

a) Sale and Lease back
b) Operating Lease
c) Financial Lease

Answer: a) Sale and Lease back

It is an arrangement in which the firm having an asset sells to another party. The party makes the full payment in cash, so the ownership is transferred. The other party leases back the asset to the firm. Practically the asset remains with the firm only but the ownership has changed hands in the books of accounts. The lessor (other party) benefits by charging depreciation and maintenance expenses in his books due to this arrangement.

11. -------------- number of parties are involved in a Leveraged Lease

a) Three
b) Four
c) Two

Answer: a) Three parties are involved in leveraged lease – The Lessor, Lender and the Lessee. Lender is an additional party in such type of Lease

12. The following are the parties to a Leveraged Lease Agreement --------------

a) Lessor, Lessee, Lender
b) Lessor & Lessee
c) Lender, borrower, Lessor & Lessee.

Answer: a) Three parties are involved in leveraged lease – The Lessor, Lender and the Lessee. Lender is an additional party in such type of Lease
13. The company providing the leasing asset is situated in a foreign company and the Lessor and Lessee belong to the domestic country. It can be best termed as ____________ Lease

   a) Cross Border Lease
   b) International Lease
   c) Import Lease

Answer: c) Import Lease - It is an arrangement in which the lessee and lessor belong to the same country but the manufacturer from whom the asset is going to be leased out is in a foreign country.

14. The maximum period for which a lease agreement can take place between a Lessor and a Lessee can take place is ---------------------

   a) 11 Months
   b) 11 years
   c) 99 years

Answer: c) 99 years – In India the maximum term for which a lease can take place is 99 years. Usually immovable properties like land, buildings, mines, quarries, oil fields.

15. ____________ is the owner of the asset in a lease agreement

   a) Lessee
   b) Tenant
   c) Lessor

Answer: c) Lessor – In lease agreement the person who lends the asset is the Lessor or Landlord
16. Hire Purchase provisions are covered under Hire Purchase Act of 1--------.

   a) 1972
   b) 1982
   c) 1962

   Answer: a) 1972 – Hire Purchase Act of 1972 regulates the provisions of Hire Purchase Agreements

17. In Hire Purchase, the person who sells the goods to the buyer is known as 1--------.

   a) Hire Purchaser
   b) Buyer
   c) Hire Vendor

   Answer: c) Hire Vendor- The persons who sells the goods to the buyers under hire purchase agreement are known as hire vendors.

18. Royalty Account is 1--------- type of Account

   a) Nominal Account
   b) Personal Account
   c) Real Account

   Answer: a) Nominal Account – Royalty is a regular payment done by the Lessee to the Lessor for using the property of the Lessor and hence it is considered as revenue expenditure.

19. In Hire Purchase System the amount which has to be paid on entering into the agreement is known as 1---------.

   a) First Payment
   b) First Installment
   c) Down Payment
Answer: c) Down Payment – The amount that is paid while entering into a hire purchase agreement is known as down payment.

20. In---------------- Ownership is transferred on the payment of the last installment.
   a) Installment Sale
   b) Royalty Agreement
   c) Hire Purchase

   Answer: c) Hire Purchase - As per the provisions of the hire purchase Act, the hire purchaser is allowed to take the possession of the goods on payment of down payment amount, but he becomes the rightful owner only on payment of the last installment. The Hire vendor has the rights to take away the goods if the purchaser is not able to pay the installments.

21. The installments paid by the hire purchaser, are treated as---------------- by the hire vendor on nonpayment of all the installments--.
   a) Amount paid towards the purchase price of the Asset
   b) Interest
   c) Rent, for the use of the Asset.

   Answer: c) Rent – If the Hire purchaser is not able to pay the balance installments the asset is taken away by the hire vendor and the amount paid as installments is treated as rent received for the use of the asset.

22. The Price which is paid for purchasing the asset on cash basis is known as
   a) Cash Price
   b) Hire Purchase Price
   c) Down payment

   Answer: a) Cash Price – It refers to the original amount which needs to be paid without any additional charges (Interest). The difference between the hire purchase price and the cash price is the interest for the facility given to pay amount of the asset in installment for a specified period of time.
23. The contract to purchase an asset on an hire purchase basis, takes place between the following parties:

a) Buyer and Seller  
b) Borrower and Lender  
c) **Hire Purchaser and Hire Vendor**

**Answer:** c) **Hire Purchaser and Hire Vendor** – The two parties involved in hire purchase are the person who sells the goods on hire purchase system is known as the hire vendor and the buyer is known as the hire purchaser.

24. In a lease agreement, a clause may be included to direct the Lessee to pay _________ whether the Lessee benefits or not in the stipulated period of time.

a) Royalty  
b) Down Payment  
c) **Minimum Rent**

**Answer:** c) **F3 is the inbuilt shortcut key to be used in Tally, to select a company.**

25. The difference between Minimum Rent and Royalty is known as _________.

a) Lease Rent  
b) Interest  
c) **Short Workings**

**Answer:** c) **Short workings** – If the amount of royalty payable is less than the minimum rent, the difference is the loss for the Lessee and is known as the short workings.
26. The main difference between hire purchase and installment system is---------.

a) Transfer of ownership 

b) Number of Installments 

c) Amount of first installment 

Answer: a) Transfer of Ownership – In case of installment sale the buyer becomes the owner as soon as the invoiced is raised by the seller. But in case of a hire purchase agreement the hire purchaser becomes the owner of the asset only on paying the last installment.

27. If the Clause includes in the Lease Agreement, the Lessee can ------------- the Losses of Previous years within the stipulated term as agreed and included in the Agreement.

a) Recover or Recoup the Short Workings 

b) Increase 

c) Decrease 

Answer: a) Recover or recoup the short workings – As per the terms of the lease agreement between the Lessor and the Lessee, the loss incurred due to payment of minimum rent over and above the royalty amount can the recovered in future by deducting and paying the balance royalty.

28. Minimum Rent is also known as----------.

a) Rock Rent 

b) Dead Rent 

c) Both a and b 

Answer: c) both a and b – minimum rent is also known as fixed rent or rock rent or dead rent.
29. Following is the disadvantage of Lease Agreement to the Lessee.

a) Has to bear the costs of repairs and maintenance
b) Total cost is more than on taking the asset on loan
c) **Both a and b**

Answer: c) Both a and b – The Lease amount (royalty) which the Lessee has to pay to the Lessor is the mutually agreed fixed percentage in the profit or revenue which the Lessee generates due to production or sale. It is certainly more than the interest to be paid for taking the asset on loan basis. While the Asset is possession of the Lessee all the incidental costs need to be incurred by the lessee.

30. If the Lessor and Lessee are situated in two different countries, the type of lease is known as--------

a) **Cross Border Lease**
b) Financial Lease
c) Operating Lease

Answer a) Cross Border Lease - It the two parties among whom the lease agreement takes place are not in the same country and situated in two different countries, it is known as cross border lease.

31. In this type of Lease the final intention of the Lessor is to transfer and sell of the asset to the Lessee.

a) Operating Lease
b) Leveraged Lease.
c) **Financial Lease**

Answer: c) Financial Lease – It is an arrangement where the Lessor buys and leases the asset to the Lessee, to be finally sold to the Lessee.
32. The following is disadvantage of Lease arrangement to the Lessor

a) Loss due to negligence in taking due care of the asset, by the Lessee
b) Defaults and irregular Lease Payments by the Lessee.
c) Both a and b

Answer: c) Both a and b – In Lease the limitation to the Lessor is that there is no assurance of the Lessee making all the payments regularly and taking due care of the asset.

33. The following is advantage of Lease arrangement to the Lessee

a) Can make use of the Asset without investing in the asset.
b) Can dispose or change the Asset whenever desired.
c) Both a and b

Answer: c) both a and b – The Lessee is free to take the decision of replacing the asset at any time if the asset is outdated or not performing well it has been taken on lease. There is wide choice for the Lessee. Lessee on paying the proportionate rent uses the highly productive asset up to the time it is profitable to him.

34. The following is advantage of Lease arrangement to the Lessor

a) Regular income and earnings.
b) Income Tax Benefits
c) Both a and b

Answer: c) Both a and b – Lessor is the landlord or the owner of the Asset who has leased out the Asset to the Lessee for a fixed period of time and hence will earn regular income. Though the asset is used by the Lessee, being the owner can take the benefit of deducting the depreciation from such revenue and thereby reducing the income tax liability.
35. Under this type of Lease the Lessor can Lease the Asset to more than one person.

a) Financial Lease
b) Leveraged Lease
c) Operating Lease

Answer c) Operating Lease – Under this type of Lease the, the Lessor has the opportunity to Lease out the Asset to more than one person, since the asset need not be leased out for almost the entire estimated useful life of the asset.

36. As Lessor is to Lessee; Hire Vendor is to----------.

a) Hire Purchaser
b) Lender
c) Seller

Answer c) Hire Purchaser - Just as Lessor and Lessee are the two parties involved in the Lease Agreement. In Hire Purchase agreement Hire Purchaser is the person who intends to buy an asset by paying down payment and installments and the Hire Vendor who sell the asset on credit basis agreeing to accept payments in installments.

37. To record the royalty received from the Lessee, the amount has to be debited in -------- ----------- Account in the books of the Lessor.

a) Lessee Account
b) Cash or Bank Account
c) Lessor Account

Answer b) Cash or Bank Account -
38. When the Royalty is less than the Minimum Rent, the amount needs to be credited in the------------ Account in the books of the Landlord.

a) Royalty Receivable Account
b) Royalty Suspense Account
c) Lessee’s Account

Answer b) Royalty Suspense Account – The Short working is the loss for the Lessee and may be recovered in the future years, therefore it needs to be credited to the Royalty Suspense Account.

39. When the Royalty is more than the Minimum Rent, Short working Account needs to be---------- in the books of the Lessee.

a) Debited
b) Credited
c) None of the above

Answer b) Credited – Short working Account will be credited if the Royalty amount is more than the minimum rent, only to the extent of debit balance of the short working and a provision of the same in the Lease Agreement.

40. Royalty will be considered as --------------- for the Lessee.

a) Direct Expenses
b) Indirect Expenses
c) Indirect Incomes

Answer a) Direct Expenses- Royalty is the major and main cost for hiring the Asset, It forms the integral part of the cost in manufacturing and hence it is considered as the direct expense.
41. Every year Royalties has to be transferred to the __________ Account.

   a) Profit and Loss Account
   b) Minimum Rent Account
   c) None of the above

   Answer a) Profit and Loss Account – Royalty being the income for the Landlord needs to be transferred to the profit and loss account.

42. The unrecovered amount of the short working which is to be written off is debited to __________ Account, in the books of the Lessee.

   a) Profit and Loss Account
   b) Minimum Rent Account
   c) None of the above

   Answer a) Profit and Loss Account – Short working which is not recoverable is loss to the Lessee and hence is debited to Profit and Loss account.