Reading 36

TOPICS IN LONG-TERM LIABILITIES & EQUITY

1. (C) **Describe how defined benefit plans affect amounts, timings, and uncertainties relating to future net income.**

   Explanation

   While defined benefit plans do have an impact on future net income, the objective set out in IAS 19 is to describe how defined benefit plans affect amounts, timings, and uncertainties relating to future cash flows (not net income). The other two options are objectives of IAS 19.

   (Module 36.2, LOS 36.c)

2. (A) **benefit from appreciation in the asset's value.**

   Explanation

   A lessee would not be concerned with the value of the asset at the end of the lease unless the lease included an option to buy the asset. Typically, leases require a small, if any, payment at lease inception. Because a lease is secured by an asset, financing costs may be lower than the rate on a loan to purchase the asset.

   (Module 36.1, LOS 36.a)

3. (B) **record a right-of-use asset on the balance sheet.**

   Explanation

   The company will report a finance lease because the lease is in effect for the asset's useful life. With a finance lease, the company will recognize the present value of the lease payments on the balance sheet as a right-of-use asset, and amortize this asset straight ine over the lease term.

   (Module 36.1, LOS 36.a)

4. (B) **record a profit.**

   Explanation

   A lessor will recognize a profit or loss on entering a finance lease only if the lease value is greater than its net book value asset on the lessor's balance sheet. At inception, a lessor adds a lease receivable to her balance sheet and amortizes it over the term of the lease.

   (Module 36.1, LOS 36.a)

5. (B) **on the balance sheet as a net pension asset or liability.**

Explanation

A net pension asset or net pension liability defined benefit plan is the difference between the fair value of the plan's assets and the estimated benefit obligation. A plan with a net pension asset is said to be overfunded, and a plan with a net pension liability is said to be underfunded.

(Module 36.2, LOS 36.b)

6. (B) **impairments of the leased asset.**

Explanation

Because the leased asset remains on the lessor's balance sheet for an operating lease, the lessor must disclose impairments of the asset. The other choices refer to lessor disclosures for finance leases.

(Module 36.2, LOS 36.c)

7. (B) **the lessor.**

Explanation

With an operating lease, the actual leased asset remains on the lessor's balance sheet and the lessor recognizes depreciation expense on the asset. The lessee is required to recognize an asset and a liability equal to the present value of the promised lease payments.

(Module 36.1, LOS 36.a)

8. (B) **the asset and liability are equal.**

Explanation

At the initiation of a lease, the lessee records an asset and a liability that are both equal to the present value of the promised lease payments.

(Module 36.1, LOS 36.a)

9. (C) **regardless of whether the lease is a finance or operating lease.**

Explanation

For both finance and operating leases, both IFRS and U.S. GAAP require an asset and a liability to be recorded on the lessee's balance sheet, unless the lease is short-term or (under IFRS) for a low-value asset.

(Module 36.1, LOS 36.a)

10. (C) **Reasons for changes in employer contributions for defined contribution plans.**

Explanation

Minimum disclosure requirements for defined benefit plans include expected future employer contributions. The only disclosure required for defined contribution plans is the separate disclosure of the employer's contribution expensed in the income statement. No further disclosure regarding changes in employer contributions is required.

(Module 36.2, LOS 36.c)

11. (A) **the defined benefit plan.**

Explanation

Only a defined benefit plan has a funded status that would appear on the balance sheet as an asset or liability. Employer payments into a defined contribution plan are recognized as expenses in the period incurred.

(Module 36.2, LOS 36.b)

12. (B) **ownership of the leased asset transfers to the lessee.**

Explanation

A lease is reported as a finance lease when ownership of the leased asset transfers to the lessee. Among the other conditions for a finance lease are that the present value of the lease payments is greater than or equal to the asset's fair value, and that the lessor has no other use for the asset.

(Module 36.1, LOS 36.a)

13. (C) **Both IFRS and U.S. GAAP.**

Explanation

Both IFRS and U.S. GAAP require companies to estimate the fair value of share-based compensation at the grant date and to expense it to the income statement oveer the vesting period.

(Module 36.2, LOS 36.b)

14. (A) **Share price at the reporting date.**

Explanation

The required disclosures are the nature of the plan as well as key details such as grant date, vesting date, service period, and settlement characteristics; how the fair value at the grant date was determined; and the effect on earnings and the financial position (i.e., income statement and balance sheet). Share price at the reporting date is not a required disclosure, although it may be helpful for the users' understanding.

(Module 36.2, LOS 36.c)

15. (A) **The lessor recognizes the lease payments as income.**

Explanation

For an operating lease, the lessor reports the lease payments as income. The lessor does not remove the leased asset from the balance sheet and continues to record the depreciation expense over the life of the asset.

(Module 36.1, LOS 36.a)

16. (B) **an operating lease.**

Explanation

Both the lessee and lessor report a lease as an operating lease when the risks of ownership are not substantially transferred to the lessee.

(Module 36.1, LOS 36.a)

17. (C) a finance lease.

Explanation

Under IFRS and U.S. GAAP, a lessor will classify a lease as either an operating lease or a finance lease. If it is classified as a finance lease, the leased asset is removed from the lessor's balance sheet and interest income is recognized over the life of the lease. A sale type lease is a classification under U.S. GAAP that does not affect the accounting treatment.

(Module 36.1, LOS 36.a)

18. (C) the lessor has no other use for the asset.

Explanation

A lessee is required to classify a lease as a finance lease if the lessor has no other use for the asset. Long-term leases can be either operating or finance leases. A lease must be classified as a finance lease if the present value of the lease payments is equal to or greater than the value of the leased asset.

(Module 36.1, LOS 36.a)

19. (C) operating leases, but not finance leases.

Explanation

For an operating lease, the lessor retains the leased asset on its balance sheet and recognizes depreciation expense over its life. For a finance lease, the lessor removes the leased asset from its balance sheet and recognizes a lease receivable.

(Module 36.1, LOS 36.a)

20. (B) financing.

Explanation

The principal portion of a lease payment is a financing outflow on the lessee's cash flow statement. The interest portion is an operating cash outflow under U.S. GAAP and may be treated as an operating or financing outflow under IFRS.

(Module 36.1, LOS 36.a)

21. (A) the present value of the lease payments.

Explanation

With a finance lease, both an asset and liability are reported on the lessee's balance sheet, equal to the present value of the promised lease payments.

(Module 36.1, LOS 36.a)

22. (C) Maturity analysis of future payments.

Explanation

Both the lessee and lessor are required to disclose a maturity analysis of the lease liabilities (lessee) and lease payments receivable (lessor). Only the lessee must disclose the restrictions and covenants imposed by the lease. The lessee will disclose the interest expense resulting from the lease; the lessor will disclose the interest income.

(Module 36.2, LOS 36.c)