

5b: leases e-mail memo



**ASSIGN
BUSTER**

Jan Waters, Controller [insert here] Re: [insert the of the assignment here]
[insert the here]

Calliope faces many challenges as it undergoes a transformational strategic process of expanding into offering online courses. The results during the first quarter of offering online courses has been spectacular and opened the eyes of the decision makers at Calliope's. In order for this small educational institution with limited resources to expand it must find innovative ways to obtain the resources in needs to comply with the demand for educational services. The organization needs to acquire need equipment and materials to be able to enroll more online students to take college courses.

A way for the institution to acquire the needed assets is by utilizing a leasing mechanism. There are two types of leasing structure the company can used to acquire equipment. The two leasing structures are capital leases and operating leases. An operating lease is one that allows the use of an asset, but does not convey rights similar to ownership. Under an operating lease the acquisition is not capitalized and the lease in itself behaves like an account similar to a rental expense. Since the lease acts as an expense it affects the results in the financial statements of the company. The operating leases increases the amount of expenses in the income statement which has the effect of increasing costs, thus the overall net income of the organization decreases. In the balance sheet the outflows of lease payment end up reducing the cash account of the company which reduces the current assets of Calliope. The new assets are not entered into the balance sheet under an operating lease since the company is the rightful owner of the asset. The cash flow statement is affected by an outflow of cash related to operating

activity. A second possibility is to enter into a capital agreement to acquire the equipment.

A capital lease is much different than an operating lease because this arrangement has the characteristics of a transaction in which a company purchased equipment. A capital lease has the possibility of purchasing the asset at the end of the contract by paying a residual value. The income statement of Calliope is not affected by this transaction. In the balance sheet of the company the new equipment becomes an asset of the company illustrated in fixed asset and the balance of debt becomes a liability which acts as accrual. The company payments lower the debt of acquiring the asset. At the end of the contract the company can either pay the residual value and keep the asset or not spend the money and give back the asset eliminated the value of the asset and the debt from the books of the company and the balance sheet. The statement of cash flow of the company is affected by an outflow related to financing activity. Both options are good alternatives, but the company must decide which type of lease arrangement to use depending on how fast the asset depreciates. If an asset does not depreciate too fast then a capital lease is a viable alternative.

Which accounts are affected by the lease payment for a lease that is classified as an operating lease? Assume even lease payments over the term of the lease.

Account affected

Increase or decrease?

Cash

Decrease

Operating expense

Increase

How is the balance sheet affected by the lease payment for a lease that is classified as an operating lease? Assume even lease payments over the term of the lease.

Account affected

Increase or decrease?

Cash

Decrease

How is the income statement affected by the lease payment for a lease that is classified as an operating lease? Assume even lease payments over the term of the lease.

Account affected

Increase, decrease, or no change?

Expenses

Increase

How is the statement of cash flows using the direct method affected by the lease payment for a lease that is classified as an operating lease? Assume even lease payments over the term of the lease.

Operating Activities – list event

Cash inflow, cash outflow, or no change?

Cash

Cash outflow

Which accounts are affected by the entry to record a lease that is classified as a capital lease? Discuss the original entry to record the lease on the books of the lessee.

Account affected

Increase or decrease?

Cash

Decrease

Debt

Increase

How is the balance sheet affected by the entry to record a lease that is classified as a capital lease? Discuss the original entry to record the lease on the books of the lessee.

Account affected

Increase or decrease?

Debt

Increase

How is the income statement affected by the entry to record a lease that is classified as a capital lease? Discuss the original entry to record the lease on the books of the lessee.

Account affected

Increase, decrease, or no change?

N/A

No change

How is the statement of cash flows affected by the entry to record a lease that is classified as a capital lease? Discuss the original entry to record the lease on the books of the lessee.

Financing activities – list event

Cash inflow, cash outflow, or no change?

Cash

No change

What accounts are affected by the entry to record a lease that is classified as a capital lease? Discuss the first lease payment paid by the lessee.

Account affected

Increase or decrease?

Equipment

Increase

Debt

Decrease

How is the balance sheet affected by the entry to record a lease that is classified as a capital lease? Discuss the first lease payment paid by the lessee.

Account affected

Increase or decrease?

Cash

Decrease

Debt

Decrease

How is the income statement affected by the entry to record a lease that is classified as a capital lease? Discuss the first lease payment paid by the lessee.

Account affected

Increase, decrease or no affect?

N/A

No change

How is the statement of cash flows affected by the entry to record a lease that is classified as a capital lease? Discuss the first lease payment paid by

the lessee.

Financing activities – list event

Cash inflow, cash outflow, or no affect?

Cash

Cash Outflow

Which accounts are affected by the entry to record a lease that is classified as a capital lease? Discuss the second through the final lease payment paid by the lessee.

Account affected

Increase or decrease?

Cash

Increase

Debt

Decrease

How is the balance sheet affected by the entry to record a lease that is classified as a capital lease? Discuss the second through the final lease payment paid by the lessee.

Account affected

Increase or decrease?

Debt

Decrease

Cash

Decrease

How is the income statement affected by the entry to record a lease that is classified as a capital lease? Discuss the second through the final lease payment paid by the lessee.

Account affected

Increase, decrease or no affect?

None

How is the statement of cash flows affected by the entry to record a lease that is classified as a capital lease? Discuss the second through the final lease payment paid by the lessee.

Operating activities – list event

Cash inflow, cash outflow, or no affect?

None

No effect

Financing activities – list event

Cash

Outflow

Which accounts are affected by the entry to record a lease that is classified as a capital lease? Discuss the entry to record amortization expense on the leased asset.

Account affected

Increase or decrease?

Amortization expense

Increase

Accumulated amortization

Increase

How is the balance sheet affected by the entry to record a lease that is classified as a capital lease? Discuss the entry to record amortization expense on the leased asset.

Account affected

Increase or decrease?

Amortization expense

Increase

Accumulated amortization

Increase

How is the income statement affected by the entry to record a lease that is classified as a capital lease? Discuss the entry to record amortization expense on the leased asset.

Account affected

Increase, decrease or no affect?

n/a

No effect

How is the statement of cash flows affected by the entry to record a lease that is classified as a capital lease? Discuss the entry to record amortization expense on the leased asset.

Operating activities – list event

Cash inflow, cash outflow, or no change?

n/a

No effect