1. On 1 April 2007, Fino increased the operating capacity of its plant. Due to a lack of liquid funds it was unable to buy the required plant which had a cost of Ksh.350,000. On the recommendation of the finance director, Fino entered into an agreement to lease the plant from the manufacturer. The lease required four annual payments in advance of Ksh.100,000 each commencing on 1 April 2007. The plant would have a useful life of four years and would be scrapped at the end of this period. The finance director, believing the lease to be an operating lease, commented that the agreement would improve the company’s return on capital employed (compared to outright purchase of the plant).

**Required:**

**(i) Discuss the validity of the finance director’s comment and describe how IAS 17 *Leases* ensures that leases such as the above are faithfully represented in an entity’s financial statements.** (4 marks)

**(ii) Prepare extracts of Fino’s income statement and balance sheet for the year ended 30 September 2007 in espect of the rental agreement assuming:**

1. **It is an operating lease** (2 marks)
2. **It is a finance lease assuming an implicit interest rate of 10% (4 mks)**
3. J. Mining Company is engaged in working a coal mine. On January 1, 2008 it entered into an agreement with the owner of the land which provided for;
   * 1. A royalty of Ksh.20 per ton of coal raised
     2. A minimum rent of Ksh.50,000 per annum
     3. The recovery of short workings within a period of first 3 years

The output during the First 5 years was;

|  |  |
| --- | --- |
| **Years** | **Output (Tons)** |
| 2008 | 2000 Tons |
| 2009 | 2250 Tons |
| 2010 | 3,000 Tons |
| 2011 | 38000 Tons |
| 2012 | 5000 Tons |

The amounts due to landlord in respect of each year were paid at the end of the year.

* Journalize the transactions and prepare (a) Royalties A/c (b) Short working A/c. and (c) Land A/c. in the books of the J. Mining Company
* Post the transactions in the books of J. Mining company.