Q-1. Assume U.S. GAAP applies unless otherwise noted. At the beginning of the year, a lessee company enters into a new lease agreement that is correctly classified as a finance lease, with the following terms:

Annual lease payments due at the end of the year	$100,000
Lease term	5 years
Appropriate discount rate	12%
Depreciation method	straight-line basis
Estimated salvage value	$0

With respect to the effect of the lease on the company’s financial statements in the first year of the lease, which of the following is most accurate? The reduction in the company’s:

A. pretax income is $72,096.

B. cash flow from financing is $56,742.

C. cash flow from operations is $72,096.

Q-2. Compared with classifying a lease as a financing lease, if a lessee reports the lease as an operating lease, it will most likely result in:

A. a higher debt-to-equity ratio.

B. a lower return on assets.

C. lower cash from operations.

Q-3. Under U.S. GAAP, a lessor's reported revenues at lease inception will be highest if the lease is classified as a(n):

A. sales-type lease.

B. operating lease.

C. direct financing lease.

Q-4. Compared to using a finance lease, a lessee that makes use of an operating lease will most likely report higher:

A. debt.

B. rent expense.

C. cash flow from operating activity.

Q-5. The quality of earnings is most likely compromised by which of the following misconducts of a reported company?

A. reported an account called deferred customer acquisition costs for the very first time as an asset.

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B. Reduced the expected useful life of a machine from 12 years to 7 years.

C. Reported an equipment as long-term capital lease instead of purchasing it as an asset.

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