AS 19 – Leases (4-6 marks)

1] Definition of Lease

A lease is an agreement whereby the lessor (legal owner) conveys to the lessee the right to use an asset for a period of time in return for a payment or series of payment

lease term

eg: BB Sir gives studio on rent to AK Sir for 5 years @ ₹ 5,00,000 per annum.

- BB Sir → lessor (owner)
- AK Sir → lessee (tenant)
- ₹ 5,00,000 per annum →
  - lease rentals /
  - lease payment
  - Minimum lease payment

Chapter Overview

Two types of lease → Operating lease, Finance lease

① **Operating lease** (It is like a rent agreement) → Jisne rent pe diya hai uske liye income & jisne asset rent pe liya hai uske liye exp.

Journal entries

Lessor (BB Sir)			Lessee (AK Sir)		
Day①	No entry		Day①	No entry	
4th Year	CIB A/c Dr	xx	4th Year	Lease Rent Exp A/c Dr	
	To Lease Rent Income (P/L)	xx		To CIB	
4th Year	Deprn (P/L) A/c Dr	xx			
	To PPE	xx			

Asset BB Sir ke books mein he hai

(b) Finance lease (It is more like BB Sir selling the asset to AK Sir on loan / EMI Basis. Matlab BB Sir will not receive full money upfront, He will receive in instalment)

Journal Entries

Lessor (BB Sir)			Lessee (AK Sir)		
Day①	Lease Receivable A/c Dr.		Day①	PPE A/c Dr	
	To PPE (Studio) A/c			To Lease Payable.	
4th Year	CIB A/c Dr. (lease Rentals.)		4th Year	Int Exp (P/L) A/c Dr.	
	To Int Inc (P/L)			Lease Payable Dr.	
	To Lease Rcable			To CIB	
	OR			OR	

4th end Lease Receivable A/c Dr To Int Inc (P/L)	4th end Int Exp A/c Dr To Lease Payable
4th end CIB A/c Dr To Lease Receivable	4th end Lease Payable A/c Dr To CIB.

4th end Asset is now in A/c's Books in case of Fin lease
Depr^n A/c Dr
To PPE A/c.

2] Scope

This standard applies to all leases other than:

(a) Lease agreement to explore or use of natural gas/resources eg: oil, gas, minerals etc.

(b) Licensing agreement for items such as motion picture films, video recordings, plays, manuscripts, patents & copyrights.

(c) lease agreement to use Lands.

3] Important terms

(a) Lease term

It includes non-cancellable period (+) Renewal period (if reasonably certain to exercise)

eg: BB Sir ——→ AK Sir
(lessor (lessee)

5 years (non-cancellable period)

(+)

3 years (option to renew)

Day ① lease Term

option ①
I am reasonably certain to exercise the option

Lease Term
↓
8 yrs

option ②
I am (NOT) reasonably Certain to exercise the option.

5 yrs.

⑥ Lease Payments / Lease Rentals / Minimum lease Payments

Lessor	lessee
1] Fixed lease Rentals — Eg①	1] Fixed lease Rentals
2] Guaranteed Residual Value (GRV) ↳ GRV given by lessee — Eg② ↳ GRV given by independent 3rd party ↳ Eg③	2] Guaranteed Residual Value (GRV) ↳ GRV given by lessee
3] Renewal option / Purchase option payment Eg④ Eg⑤	3] Renewal option / Purchase option payment

Eg ① Fixed lease Payments

BB Sir gave studio on lease to AK Sir for 3yrs. Rentals every year were as follows:

Yr	Lease Rent
1	10L
2	11L
3	13L

→ Fixed lease Rentals → Iska Amount Day① se pata hota hai.

Eg ② GRV

AK Sir (lessor) gives Ferrari (car) on lease to Msw ltd (lessee) for 30Lp.a. for 3years.

Guaranteed Residual value → 15L @ the end of 3rd year.
(To ensure proper usage)

Lease Rent	Yr	L.R
	1	30L
	2	30L
	3	30L + 15L ⇓ GRV.

Eg ③ Iphone purchased by AK from flipkart → Day① BuyBack offer from flipkart ⇓ (After 3years Flipkart will BuyBack iphone @ ₹18k).

AK gave iphone on lease to kushal
(lessor) (lessee).

No GRV promised by kushal.

Yr	L·R (Given)
1	30k
2	30k
3	30k

lessor

Yr	L·R
1	30k
2	30k
3	30k + 18K

GRV 3rd party

lessee

Yr	L·R
1	30k
2	30k
3	30k ~~+ 18K~~

Eg 4 BB sir gave his studio on lease to AK sir for 5 years @ ₹ 5L p.a. BB sir also gave an option to renew for another 3 years @ ₹ 4L p.a. for the renewal period. It is reasonably certain that renewal option will be exercised. Calculate L·R for each year.

Yr	L·R
1	5L
2	5L
3	5L
4	5L
5	5L
6	4L
7	4L
8	4L

} It is a part of lease Rentals only if it is reasonably certain to renew for 3 years.

Eg ⑤ BB Sir gave studio on lease to AK Sir for 5yrs @ ₹5L p.a.
BB Sir also gave an option to purchase the studio @ the end of 5 years @ ₹19L

AK Sir is reasonably certain to exercise the purchase option

Yr	L·R
1	5L
2	5L
3	5L
4	5L
5	5L + 18L

AK Sir is NOT reasonably certain to exercise the purchase option

Yr	L·R
1	5L
2	5L
3	5L
4	5L
5	~~5L + 18L~~

4] Types of leases

→ Operating lease → Does not trf risks & rewards of the asset
It is like a normal rent agreement

→ Finance lease
↳ Trf of Risks & rewards
• It is like a purchase/sale of asset on loan/EMI Basis.

⑤ Indicators of Finance lease

(These are 5 conditions, if any 1 is met, then it is a Finance lease)

ⓐ Ownership

If lessor transfers the ownership of the asset to the lessee @ the end of lease term.

(eg: BB Sir gave classroom on rent for 5 yrs & at the end of 5 yrs ownership of asset will be transferred to AK Sir)

ⓑ Purchase option

If lessee has an option to purchase the asset at a price which is expected to be lower than fair value & it is reasonably certain that the option will be exercised. (Sasta purch option (+) certainty that it will be exercised)

Eg: BB Sir gave studio on lease for 5 yrs @ ₹5L and at the end of 5th yr AK Sir has option to purchase the asset @ ₹1L (Mkt value 50L). It is reasonably certain that purchase option will be exercised.

ⓒ Lease term

(75% or more) / 60% ← in icai ques

If lease term is for major part of economic life of the asset.

Eg: AK Sir gave Ferrari on lease to BB Sir for 8 yrs (Total life = 10 yrs)
Lease term covers 80% of life $\left(\frac{8\text{yrs}}{10\text{yrs}} \times 100\right)$ ⟶ It is fin lease.

Eg: Same as above except lease term is 4 yrs.

Lease term covers 40% of life $\left(\frac{4 yrs}{10 yrs} \times 100\right)$ ⟶ It is Not a fin lease

Present value

(D) PV of Minimum lease Payments (90% or more)

At inception of the lease, if present value of MLP substantially covers the fair value of asset, then it is Fin. lease.

Eg: AK Sir (lessor owner) gave ferrari on lease to BB Sir for ₹40L p.a for 3years.

Fair value of asset on Day ① = 1 cr.

D.F @ 10%.

Yr end	L.R (MLP)	D.F@10%	PV
1	40L	0.909	36.36L
2	40L	0.826	33.04L
3	40L	0.751	30.04L
		PV of MLP	99.44L approx

Fair value 1 cr (Given)

% of PV of MLP = $\frac{99.44L}{100L} \times 100$ = 99.44%. ∴ It is a Fin lease.

(Fair value)

Eg ② AK Ferrari, 3years. Maru Ltd (F.V = 1cr)

L.R = 30L p.a. GRV = 25L D.F @ 10%.

Calculate PV of MLP & check whether FL or Not.

Soln:	Yr	L.R	D.F @ 10%	PV
	1	30L	0.909	
	2	30L	0.826	
	3	30L + 25L	0.751	
				93.35L approx.

% of PV of MLP = $\frac{93.35L}{100L} \times 100 = 93.35\%$ approx

93.35L ← Fair value

It is a F.L.

(E) Specialised Nature

The leased asset is of a specialised nature such that only lessee can use it without major modifications being made.

eg: BB Sir — Studio → Modifications, AK Sir

- king size bed
- Swimming Pool
- Water proof fishes
- Multiplex for movies
- Rangeen light

Because asset is of Specialised nature (only useful for lessee)
∴ It is a Fin. lease.

Note: If none of the above 5 indicators are met, then it is an operating lease.

⑥ Accounting for finance lease → lessee Books / lessor Books.

(A) Lessee Books

Journal entries

Day ①

(a) Asset A/c Dr xx
To lease Payable / lease Liability xx

lower of:
PV of MLP
or
Fair value

(b) Year end

Int Exp A/c Dr
To lease Liability

Lease Liability A/c Dr
To CIB A/c.

(c) Deprn

Deprn A/c Dr
To Asset / PPE

→ If ownership trf to lessee after lease term → Depreciate over full useful life of asset

→ If ownership NOT trf after lease term → Depreciate over lease term or useful life (whichever is lower)

Extra Entry

P/L A/c Dr
To Int Exp
To Deprn.

Note: Initial Direct Cost (incurred by lessee) → Add to cost of Asset taken on lease → PPE xx / To CIB xx

lessee lessor

Eg ① Aditya ltd took an asset on lease from Harsh ltd for 5 years.
Asset Fair value = ₹10,00,000
lease Rentals are ₹ 250000 p.a. (payable @ the end of each year).
GRV @ the end of lease term promised by lessee is ₹ 50,000.
D.F @ 10%.
Calculate lease liability in the Books of Aditya ltd & also calculate Interest charges for each year end (Assume Fin lease)

Soln: In the Books of Aditya (lessee)

Yr 1

Day ① Asset A/c Dr 978550
To lease liability A/c 978550 } WN ①

Yr end Int Exp A/c Dr 97855
To lease liability 97855 } WN ②

lease liability 250000
To CIB 250000

Deprn 195710
To PPE 195710
(978550/5yrs)

Extra P/L 293565
To Deprn 195710
To Int 97855

WN① Calculation of lease liability

lower of: Fair value = 10,00,000
or
PV of MLP : 978550

Yr end	L.R.	D.F @ 10%	PV
1	250000	0.909	227250
2	250000	0.826	206500
3	250000	0.751	187750
4	250000	0.683	170750
5	250000 + 50000 (GRV)	0.621	186300
		PV	978550 approx

WN② Calculation of Interest & repayment.

Yr end	Opening lease liab	Int/Finance charges @ 10% (Disc. Factor)	Repayment/ Instalment/ lease Rent payment	Closing of lease liab.
1	978550	97855	(250000)	826405
2	826405	82641	(250000)	659046
3	659046	65905	(250000)	474951
4	474951	47495	(250000)	272446
5	272446	27245 (309) → approx adj	(250000) (50000)	NIL

Assumed that GRV was also paid.

4th

4th end Int Exp A/c Dr 82641
To lease liability 82641

lease liability 250000
To C/B 250000

Deprn 195710
To PPE 195710
(978550/5yrs)

Extra P/L 278351
To Deprn 195710
To Int 82641

Q1 → H.W

Q2 → In the books of lessee (S. Square)

i) Calculation of lease liability

4r end	L·R	D·f @ 15%	PV
1	625000	0·8696	543500
2	625000	0·7561	472563
3	625000	0·6575	410937
4	625000 + 125000 (GRV)	0·5718	428850
			18,55,850 approx

Journal entry

Day ① Asset A/c Dr 1855850

To lease Liab 1855850

Int Exp A/c Dr 278378

To lease Liability 278378

lease Liability 625000

To C/B 625000

Deprn 463963 (1855850 / 4yrs)

To PPE 463963

PL 742341

To Deprn 463963

To Int Exp 278378

WN 2 Calculation of Interest Expense & Repayment for each year.

Yr end	Opening lease Liab	Int/Finance charged @15% ↓ Disc. Factor	Repayment/ Instalment/ lease Rent payment	Closing of lease Liab.
1	1855850	278378	(625000)	1509228
2	1509228	226384	(625000)	1110612
3	1110612	166592	(625000)	652204
4	652204	97831	(625000)	NIL
		(35) approx adj	(125000)	

Assumed that GRV was also paid.

Ques 4 (LOR)

i) Calculation of lease liability

Yr end	Lease Rentals	D.F@ 10%	PV
1	350000	0.909	
2	350000	0.826	
3	350000	0.751	
4	350000 + 70000 = GRV	0.683	
		PV	11,56,960 approx

Journal entry

Day (1) Asset (Machine) A/c Dr 1150000

To lease liability 1150000

(lower of: Fair value = 11,50,000

or

PV of MLP 1156960

(B) Lessor Accounting

Hint: Its calculation is different from lessee. So dont mix it up.

Journal Entries (lessor Books, Finance lease)

Day ① Lease Receivable A/c Dr } @ Net Investment
To PPE A/c

Yr end Lease Receivable
To Int Income

Yr end CIB A/c Dr
To Lease Receivable A/c.

Yr end : Depn (Nahi aayega)

Extra J.E

Int Income A/c Dr
To P/L

Important terms

① Gross Investment = Minimum lease Payment (+) UGRV (Unguaranteed Res. value)

lease Rent + GRV

R.V = 100, GRV = 60
UGRV = 40 (Bif)

② Net Investment = PV of Gross Investment
= PV of MLP's + PV of UGRV

③ Unearned finance Income = Gross Investment (-) Net Investment

Eg Shlok took an asset on lease from Daksh ltd
↓ lessee ↓ lessor

Lease Rentals = 10L p.a. (excluding GRV)
Residual value = 1,00,000, GRV = 80,000, UGRV = 20,000
Lease Term = 5yrs, D.F@ 10%

Pass J.E on Day ① & 4th end in the Books of Daksh ltd (lessor)
(Assume Fin lease). Also calculate unearned finance income

Soln: In the Books of lessor

i) Gross Investment = MLP + UGRV
= 51,00,000

ii) Net Invst = PV of G.I
= 3852879

iii) Unearned finance Income = G.I (-) N.I
= 51,00,000 (-) 38,52,879
= 12,47,121

↳ this is upcoming 5yrs ka Int. This is Not Booked on Day①. This is computed for disclosure purpose.

WN1	Yr end	Lease Rentals	D.F@ 10%	PV
	1	10,00,000	0.909	
	2	10,00,000	0.826	
	3	10,00,000	0.751	
	4	10,00,000	0.683	
	5	10,00,000 + 80000 + 20000	0.621	
		⇓ GRV ⇓ UGRV		PV = 3852100 approx or 3852879 approx
		51,00,000 ⇓ Gross Invst		↓ Net Investment

J.E.

Day① Lease Receivable A/c Dr 3852879 } Net Invst
To PPE A/c 3852879

Yr lend	Lease Receivable	385288		Extra
	To Int Income		385288	Int Inc 385288
				To PL 385288
Yr lend	CIB A/c Dr	10,00,000		
	To Lease Receivable		10,00,000	No Deprn

WN ② Calculation of Interest Income & Instalments

Year end	Opn Bal of lease Receivable	Int Income @ 10%	Repayment (lease Rent received)	Cls. Bal.
1	3852879	385288	(10,00,000)	3238167
2	3238167	323817	(10,00,000)	25,61,984
3	2561984	256198	(10,00,000)	18,18,182
4	18,18,182	181818	(10,00,000)	10,00,000
5	10,00,000	1,00,000	(10,00,000)	NIL
		1247121	(80000)	
			(20000)	

Unearned Fin Income

Assumed GRV & UGRV is recd

Ques (lessee) → Fin lease (Unearned Fin. Income was asked)

∴ It is a hint that Alc'ing in the Books of lessee is asked under Finance Lease.

(₹ in lakhs)

1] Gross Investment = Minimum lease Payments (+) UGRV (without PV)

= 43 lakhs

2] Net Investment = PV of Gross Investment

= 28.31 lakhs

3] Unearned Finance Income = Gross Invst (−) Net Invst

= 14.69 lakhs

WN①

Yr end	Lease Rent	D.F @ 15%	PV
1	8	0.8696	6.96
2	8	0.7561	6.05
3	8	0.6575	5.26
4	8	0.5718	4.57
5	8 + 1.6 + 1.4	0.4972	5.47
	⇓ GRV ⇓ UGRV		
	43		28.31 approx
	⇓ Gross Invst		⇓ Net Invst

7. Special Cases in lessee Accounting (Fin lease)

A] Annual lease Rent is missing?

whenever annual lease rent is missing we assume that cost of equipment will be recovered through PV of L.P & PV of UGRV

i.e. Cost of equipment = PV of lease Payments + PV of UGRV

Annual L.R = $\frac{\text{PV of L.P}}{\text{Annuity factor of lease Term}}$

Q6 (LDR)

Annual lease payments → Missing

Cost of equipment = PV of lease Payments + PV of UGRV

16,99,999.50 = PV of L.P + 100,300

(133500 x D.F of 3rd yr @ 10%)

16,99,999.50 − 100300 = PV of L.P

= 15,99,699.50

i) Annual lease Rent = $\frac{15,99,699.50}{\text{3 yrs } 2.486}$

Annual lease Rent = $\frac{\text{PV of L.R}}{\text{Annuity factor of 3 yrs}}$

Extra Past	Yr	L.R	(x) D.F @ 10%	= PV
	1		0.909	
	2		0.826	
	3		0.751	
			2.486	15,99,699.50

Annuity factor.

L·R × D·F = PV

L·R × 2.486 = 15,99,699.50

L·R = $\frac{1599699.50}{2.486}$

= 643483.

ii) Unearned finance Income = GI (-) NI

= 2063949 (-) 16,999,99.50

= 363949.5

CON	Yr	L·R	D·F @ 10%	PV
	1	643483	0.909	
	2	643483	0.826	
	3	643483 + 133500 (URV)	0.751	
		20,63,949 (GI.)		16,99,999.50

Hint:

Q7 (UDR) i) Annual L·R ii) Indicator's check iii) UFI.

i) Annual lease Rent

Cost /FV of equipment = PV of Lease Payments + PV of UGRV

10,00,000 = PV of L·P + 75130

PV of L·P = 924870 (1L × 0·7513)

$$\text{Annual L·R} = \frac{\text{PV of L·P}}{\text{Annuity factors of 3yrs}}$$

$$= \frac{924870}{2.4868}$$

$$= \boxed{371912}$$

ii) Check whether finance lease or Not (5 conditions, Any 1 to be met)

(a) Ownership Not getting trf @ the end of lease term

(b) There is NO purchase option @ the end of lease term

(c) lease term should cover major part of life = $\frac{\text{lease term}}{\text{life}} \times 100$ as per ICAI it's major

$= \frac{3yrs}{5yrs} \times 100 = 60\%$ → Not major

(d) PV of MLP should cover substantially (90%-) the fair value of asset.

$\frac{\text{PV of MLP}}{\text{Fair value}} \times 100 = \frac{924870}{1000000} \times 100 = 92.49\%$ approx → It is a fin lease.

(e) Asset is not of specialised nature.

Since 4th condition is met ∴ it is a finance lease.

iii) Unearned finance Income = Gross Invst (-) Net Invst

= 1215736 (-) 10,00,000

= 215736

Yr	L·R	DF@ 10%	PV
1	371912	0·909	
2	371912	0·826	
3	371912 + 1000000 (UGRV)	0·751	
	12,15,736 (GI.)		10,00,000 approx (NI)

(Interest Rate)

(B) Discounting factor is missing

In this case we find IRR (Internal rate of return). It is a rate where Day① Fair value = PV of future lease rentals (includes GRV) & PV of UGRV. Here, we do trial & error to find the rate & also follow interpolation technique.

Eg: (Find Interest rate / IRR) → Internal Rate of Return

Annual lease Rent = 1,00,000 @ the end of the year

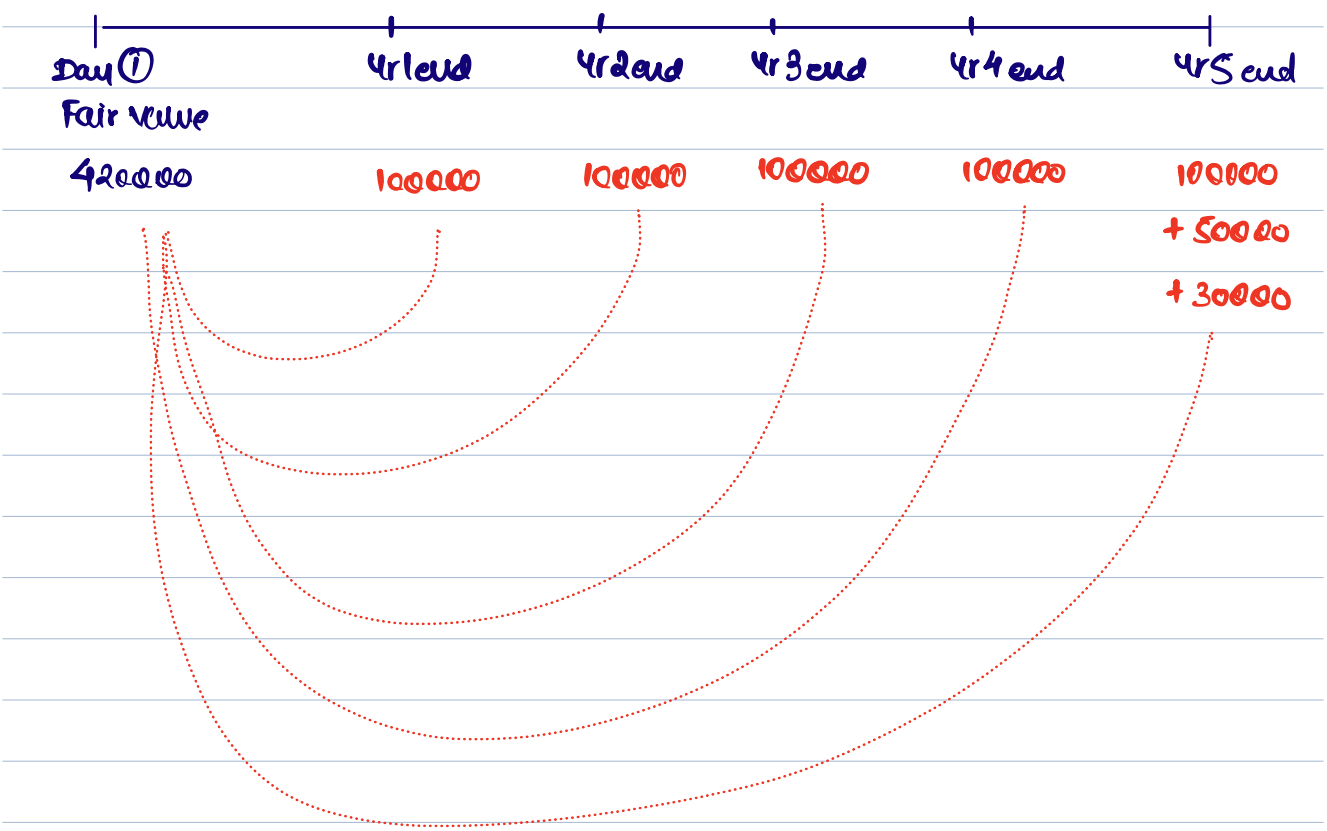
lease term = 5 yrs

GRV = 50,000

UGRV = 30,000

Fair value @ the Beg = 4,20,000

Find Interest Rate / IRR



Discount the cash flows of 5 years @ such rate that PV should be equal Day ① FV i.e. 420000

↓

Now we will start trial & error

Assume D.F @ 10%.

Yr	C.F	D.F @ 10%	PV
1	100000	0.909	90900
2	100000	0.826	82600
3	100000	0.751	75700
4	100000	0.683	68300
5	100000 + 50000 + 30000	0.621	111780
			428680 ☹

Assume DF@12%.

Yr	C.F	DF@12%	PV
1	100000	0.893	
2	100000	0.797	
3	100000	0.712	
4	100000	0.636	
5	100000 + 50000 + 30000	0.567	
			405872 approx.

10% → PV 428680
12% → PV 405872
} inke beech mein hai 420000

By using Interpolation = $10\% + \frac{428680 - 420000}{428680 - 405872} \times (12\% - 10\%)$

BODMAS
Bracket open Divide Multiply Add Subs.

$= 10\% + \frac{8680}{22808} \times 2\%$ — 1st Divide

$= 10\% + 0.38 \times 2\%$ — 2nd Multiply

$= 10\% + 0.76$ — 3rd Add.

$= \boxed{10.76\%}$ → Disc factor / IRR / Int Rate.

Q.10 (LDR)

Discount lease Rent, GRV, UGRV @ such rate that present value should come to ₹2,00,000 (Fair value)

Assume 10%.

Yr	L.R	D.F @ 10%	PV
1	50k		
2	50k		
3	50k		
4	50k		
5	50k + 25k + 15k		
			214376 approx

Assume 12%.

Yr	L.R	D.F @ 12%	PV
1	50k		
2	50k		
3	50k		
4	50k		
5	50k + 25k + 15k		
			202936 approx

Assume 14%.

Yr	L.R	D.F @ 12%	PV
1	50k		
2	50k		
3	50k		
4	50k		
5	50k + 25k + 15k		192429 approx.

10% ⟶ 214376 ✗

12% ⟶ 202936 } → inke Beech mein hai 200000

14% ⟶ 192426 }

By using interpolation, $12\% + \frac{202936 - 200000}{202936 - 192426} \times (14\% - 12\%)$

$= 12\% + \frac{2936}{10510} \times 2\%$

$= 12\% + 0.28 \times 2\%$

$= 12\% + 0.56$

$= \boxed{12.56\%}$ approx

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8. Accounting for operating lease → lessee Books
→ lessor Books

Lessee	Lessor
Day ① No entry	Day ① No entry
Yrend Lease Rent Exp A/c Dr	Yrend CIB A/c Dr
	Lease Equilisation Dr (BIF)
To CIB	To Lease Rent income
	To lease Equ (BIF)

[AS 19 suggests to Book lease rent income/exp on SLM Basis unless any other method is more appropriate]

SLM ⇓ Straight line method.

Yrend Depr
TO PPE
} uselife
life.
cost

(lessee) (lessor)

Eg: AK sir took studio on lease from BB sir for 5 years. It is an operating lease

Lease Rent

Yr	L.R.
1	100000
2	110000
3	120000
4	130000
5	140000
	600000

Soln: In the Books of BB sir (lessor)

Avg Rent p.a. (SLM Basis) = $\frac{600000}{5 \text{ years}}$ = 120000 p.a.

Journal entries

Yr 1end C/B A/c Dr 1,00,000
lease Equilisation A/c Dr. 20000
BS current asset
To lease Rent income (P/L) 120000

Yr 2end C/B A/c Dr 110000
lease Equivilisation A/c 10000
To lease Rent income (P/L) 120000

Yr 3 end CIB A/c Dr 120000

To lease Rent income (P/L) 120000

Yr 4 end CIB A/c Dr 130000

To lease Rent income (P/L) 120000
To lease Equilisation A/c. 10000

Yr 5 end CIB A/c Dr 140000

To lease Rent income (P/L) 120000
To lease Equilisation A/c. 20000

Lessee Books (In the Books of AK Sir)

Yr 1 end lease Rent Exp 120000
To CIB 100000
To lease Equilisatn 20000 → B/s Current liab

Yr 2 end lease Rent Exp 120000
To CIB 110000
To lease Equilisatn 10000

Yr 3 end lease Rent Exp 120000

To CIB 120000

Yr 4 end Lease Rent Exp 120000
Lease Equilisatn 10000
To CIB 130000

Yr 5 end Lease Rent Exp 120000
Lease Equilisatn 20000
To CIB 140000

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* Special case in operating lease

Sometimes we have to book lease Rent not in the ratio of SLM But in the ratio of output that is expected to be derived from leased asset.

Eg: Suppose a machine is taken on lease by AK Ltd (lessee) for 3 yrs. The output estimated from the machine is 10000 units in Yr 1, 20000 units in Yr 2, 30000 units in Yr 3. Annual lease Rentals is ₹40000 per annum. Calculate Lease Rent Exp & Pass J.E.

Lessee / Op. lease.

Soln: Total lease Rent for 3 years = 40000 x 3 years

= 120000

~~SLM~~

Book in ratio of output.

Total Rent = 120000

	Yr 1	Yr 2	Yr 3
output	10000 units	20000 units	30000 units
Lease Rent to be Booked in PL	20000	40000	60000
	$\left(120000 \times \frac{10000}{60000}\right)$	$\left(120000 \times \frac{20000}{60000}\right)$	$\left(120000 \times \frac{30000}{60000}\right)$

Yr 1 end (lessee Book)

Lease Rent Exp A/c Dr 20000

Lease Equilisation A/c Dr 20000

To CIB A/c 40000

Yr 2 end Lease Rent Exp A/c Dr 40000

To CIB A/c 40000

Yr 3 end Lease Rent Exp A/c Dr 60000

To CIB A/c 40000

To Lease Equilisation A/c 20000

2 Dues

CIB every year kitna

PL every year kitna

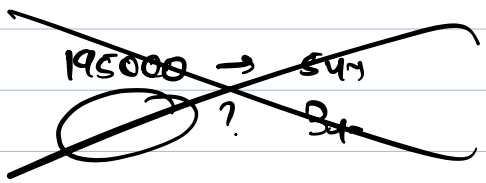
Q11 (10K)

Op lease (3years) life of Asset (5yrs)

(a) Calculation of Annual Lease Rent

Cost of Machine	150000
(+) Profit Margin (30%)	45000
	195000

The life of asset is 5 years but we are giving on lease only for 3yrs.
∴ Proportionate rent will be recovered in the ratio of output & not in the ratio of years.



Yr	output
1	40000
2	50000
3	60000
4	80000
5	70000
	3,00,000 units

Total Lease Period output = 150000 units.

Total lease Rent for 3years = 195000 × (output of 3yrs / Total output)

= 195000 × (150000 units / 300000 unit)

= 97500

Annual lease Rent = $\frac{97500}{3 \text{ year}}$

= 32500 → Yeh CB ka amount nai every year.

(b) Lease Rent income to be booked each year

Total Rent = 97500 (for 3yrs)

	Yr 1	Yr 2	Yr 3
output	40000 units	50000 units	60000 units
Lease Rent income to be booked in PIL	26000	32500	39000

Extra Yr 1 CB 32500

TO lease income 26000

TO lease Eq. 6500

(c) Depreciation for 3years

Deprn is always charged on the cost of Machine (i.e. ₹ 150000) over useful life of asset is 5 yrs. & not 3yrs.

In qves deprn method is suggested in ratio of output.

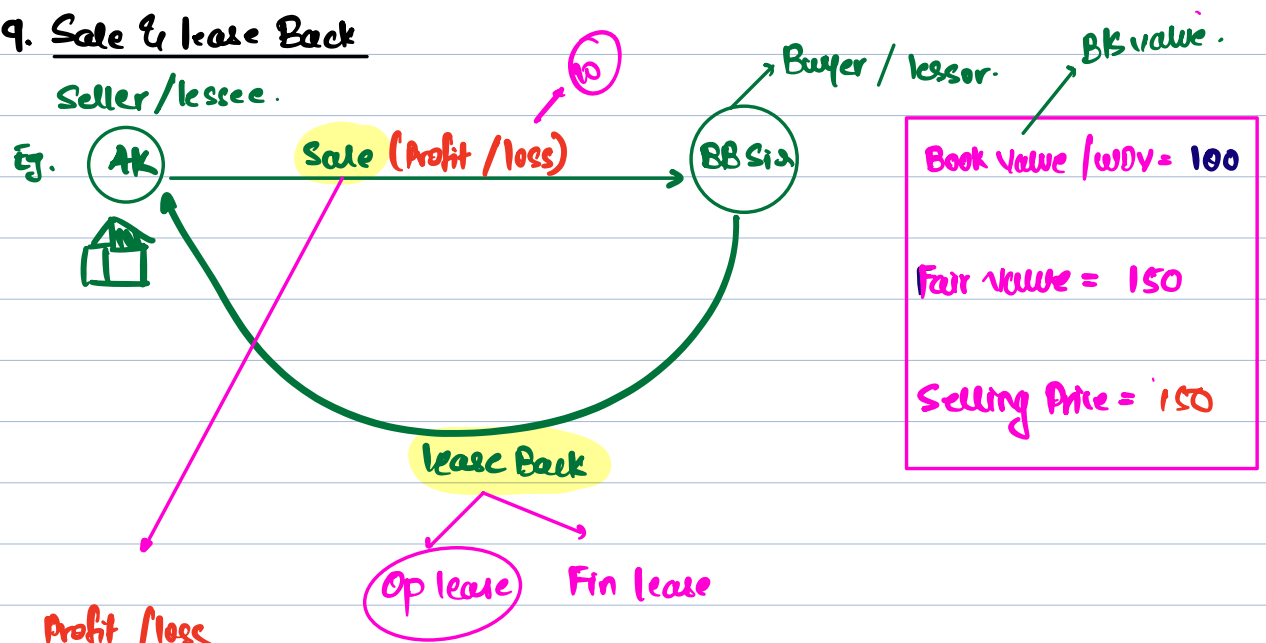
Yr	Depn
1	20000
2	25000
3	30000
4	40000
5	35000
	150000

Ex 150

$\left(150000 \times \frac{40000}{200000}\right)$

$\left(150000 \times 50000/200000\right)$

9. Sale & lease Back



A] Sale Done & lease back results in Finance lease

Profit / loss on sale is to be amortised & booked over the lease term in the proportion of deprn.

B] Sale Done & lease back results in Operating lease

↓

We will discuss how to treat profit/loss on sale

Case ① Sale Price = Fair value	Case ② Sale Price is less than Fair value	Case ③ Sale Price is more than Fair value
Profit/loss on sale can be recognised immediately	ⓐ If there is profit, Book immediately. ⓑ If there is loss & such loss is compensated by future lease payments @ Below market rate, Then such loss should be deferred & Booked in proportion of future lease payment. (If loss But no compensation of less rentals, then Book loss immediately)	• Profit/loss upto Fair value can be booked immediately. • Excess profit (i.e. Selling price over Fair value) should be deferred & Booked over the period for which asset is expected to be used

In case 1 & 2, Compare S.P & W.D.V to calculate profit

Hint:
- F.V(-)WDV/BV = xx → Profit/loss Book immediately.
- S.P(→) F.V = Profit → Defer.

Eg: Asset WDV / BV = 100

i) S.P = 120, FV = 120

→ Case ① FV = S.P

→ Profit = 20 ⟶ Book immediately

ii) S.P = 120, FV = 130

⟶ Case ②⑥ S.P less than F.V

Profit = 20 ⟶ Book immediately

(S.P - WDV)

iii) SP = 90, FV = 110

→ Case ② SP less than FV

Loss = 10 (S.P - WDV)

→ If loss compensated by future lease payment or Below mkt rate, then defer loss

→ Otherwise trf loss immediately to P/L.

iv) S.P = 150, FV = 130

Case 3

↳ FV - WDV (130 - 100) → 30 → Book immediately

↳ S.P - FV (150 - 130) = 20 → Defer

v) S.P = 140, FV = 90

→ Case ③

i) (10 loss) ⟶ Book immediately

(FV - WDV)

90 100

ii) SO Profit → Defer.

(SP - FV)

140 - 90

Ques 12 (UOR)

Hint: Case kaunsa hai uske liye compare S.P & FV
Profit / loss ke liye compare (S.P & WDV)

ⓐ Case① : Profit (S.P - W.D.V) = SO lakhs - 40L
(SP = FV) ∴ 10 lakhs (Book immediately)

ⓑ Case②ⓐ → Profit (S.P - WDV) = SOL - 40L
(Selling price less than Fair value) = 10L Profit (Book immediately)

ⓒ Case 2ⓑ → loss (S.P - WDV) = 38L - 40L
= (2L) loss
(If loss compensated by future lease payment at below mkt rate, then defer, otherwise book immediately in PIL.

ⓓ Case 3 : → Profit (FV - WDV) = 40 (-) 40 = 0 → Book immediately
(Selling price more than FV)
→ Profit (S.P - FV) = SO - 40 = 10 Profit (Defer)

(e) Case (3) (Selling price more than FV) → Profit (FV - WDV) = 46L - 40 = 6 → Book immediately

→ Profit (S.P - FV) = 50L - 46L = 4 → Profit Defer

(f) Case (3) (Selling price more than FV) → loss (FV - WDV) = 35L - 40L = 5 (Loss) Book immediately

→ Profit (S.P - FV) = 39L - 35L = 4 profit (Defer)

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10. Other Misc Points

(a) Contingent Rent

If lease rent is based on future sales / future profits etc, then such rentals will be booked in PIL as & when received / paid.

(b) Initial Direct Cost

Cost which are incurred for entering into lease. (eg: Brokerage, legal fees, etc.)

Accounting treatment

→ If incurred by lessee (under Fin lease) → Add to cost of Asset taken on lease.

→ All other cases → Trf to PIL

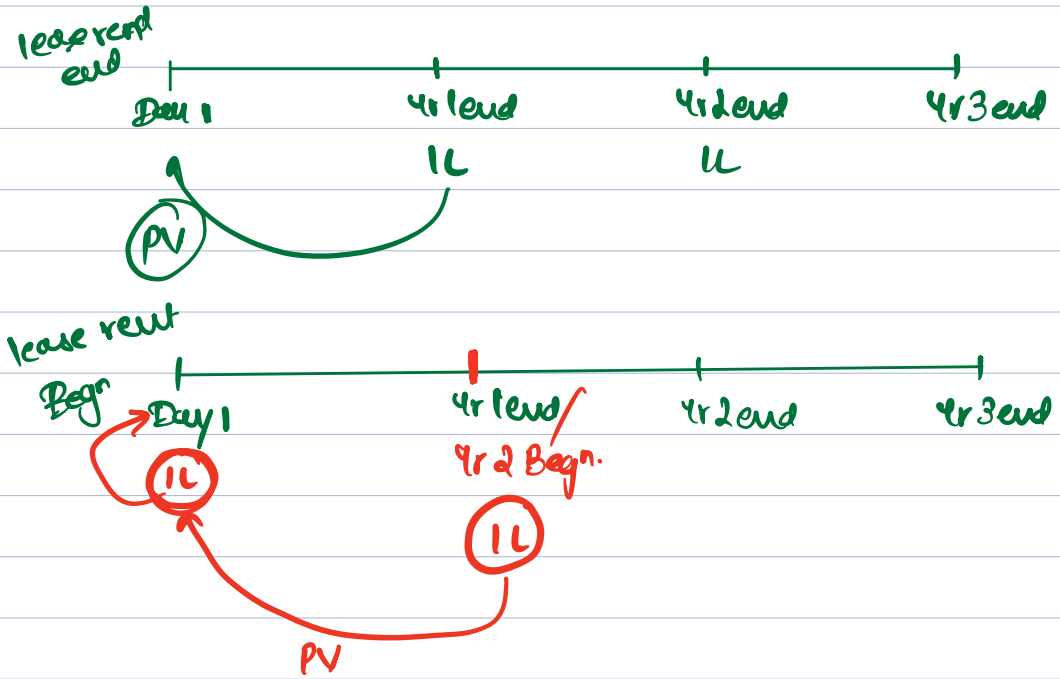
(c) Normally lease Rentals are paid @ the end of the year (eg: L.R = 1L, L.T = 3yrs, D.F@10%)

Yr	Lease Rent	D.F@10%	PV
1	1L	0.909	
2	1L	0.826	

→ If rentals are paid @ the Begn of the year.

Yr Begn	L.R	D.F@10%
1	1L	~~0.909~~ 1
2	1L	0.909
3	1L	0.826

3 IL @ 7%


lease rent end
Day 1
Yr 1 end
Yr 2 end
Yr 3 end
IL
IL
PV
lease rent Beg
Day 1
Yr 1 end / Yr 2 Beg.
Yr 2 end
Yr 3 end
IL
IL
PV