



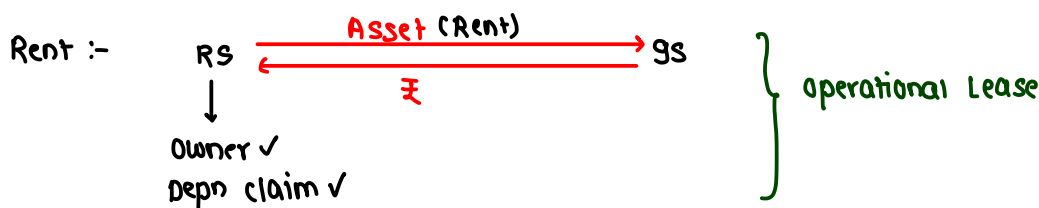
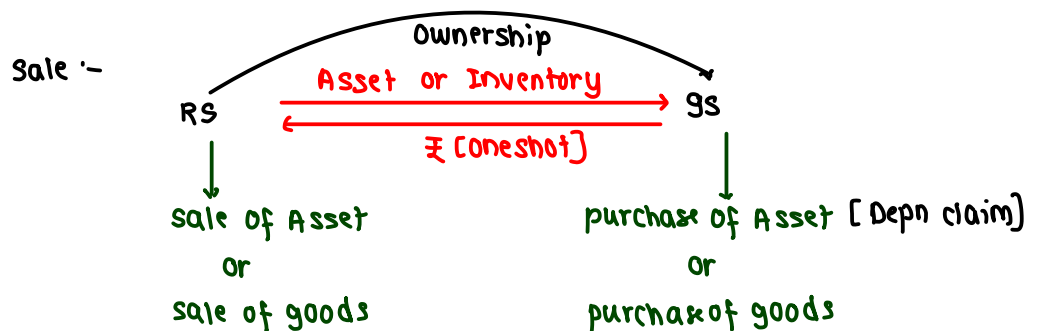
# AS-19: LEASES

## LEASE

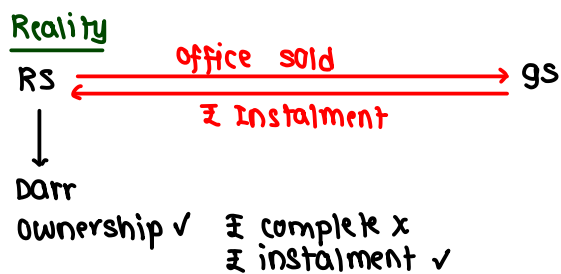
**Meaning:** Lease means transfer of right to use asset for specified period against consideration or series of considerations [Normal Scenario → Rent Agreement]

**Lessor:** The party who transfers the asset RS

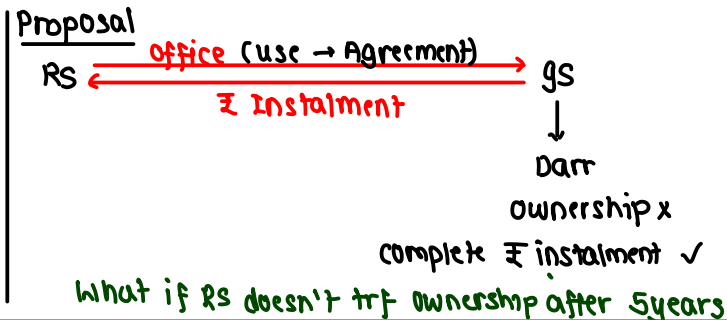
**Lessee:** The party to whom asset is transferred GS



**Sale** → Reality → but dikh raha Rent agreement

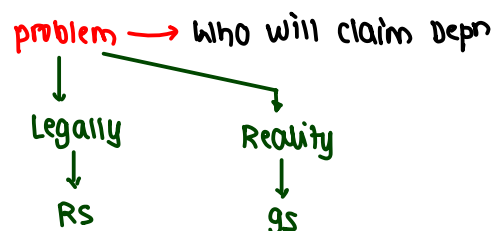
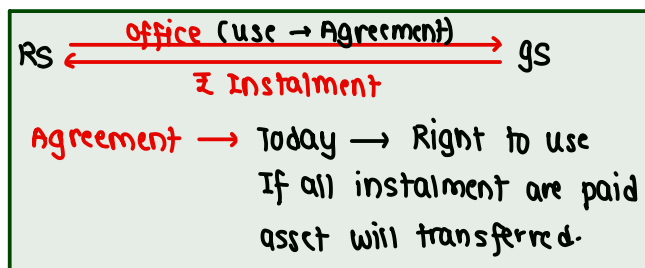


What if GS defaults the instalment



What if RS doesn't trf ownership after 5 years

**New proposal**



KAISE HOH RAJA ! ALL WELL & SET

1

↳ Finance Lease → AS 19 → sale purchase Transaction  
∴ Depn claim → GS



## TYPES OF LEASES

Lease can be of two types:

- a) **Finance Lease** [Rent Agreement, but has taste of transfer of ownership]
- b) **Operating Lease** [Normal: Rent Agreement]

## CONDITIONS FOR FINANCE LEASE

**Finance Lease:** A lease is classified as a finance lease if it transfers substantially all the risks and rewards incident to ownership. Title may or may not eventually be transferred.

Atleast one of the following conditions must be satisfied to recognize the lease as Finance Lease:

- ✓ a) *Transfer of ownership at the end of lease term* →
- b) *Lessee has purchase option at reduced rate and lessee is certain to opt it*
- c) *Lease period substantially covers economic life of the asset*
- d) *Present value of minimum lease payments substantially covers Fair value of the asset*
- e) *Asset is of specialized nature*

→ Lessee POV

CO. → Roll Royce [Pink Phantom car] customised for Rs

RR ← ₹ instalment → RS

→ (c) machine → Lease Agreement → 8 years

→ useful life 10 years

(b) RS → machine purchase → COA ₹10L → Lease Agreement → mm

→ ₹ 225000 p.a for next 6 years

DCF 10%.

Asset COA / FV → ₹10,00,000

PV of Lease Rental → ₹9,81,000

$$\frac{[225000 \times PVAF(10\%, 6 \text{ years})]}{225000 \times 4.36}$$

$$\frac{1}{(1+r)}$$

i.e

$$\frac{1}{1.1} = m + \frac{1}{1.1} = m + \frac{1}{1.1} = m + \frac{1}{1.1} = m + \frac{1}{1.1} = m + \frac{1}{1.1}$$



## FINANCE LEASE JOURNAL ENTRIES

In the books of **Lessee:** ← mil raha hai  
Asset

### Journal Entries

| Date | Particulars                                  | L/F | Dr.      | Cr.      |
|------|----------------------------------------------|-----|----------|----------|
| ✓ 01 | Asset on lease A/c Dr.                       |     | (Note-1) |          |
|      | To Lessor A/c [Liability] → loan             |     |          | (Note-1) |
| 02   | Lessor A/c Dr.                               |     |          |          |
|      | Finance Charges A/c Dr. ← Finance charge Dr. |     |          |          |
|      | To Bank A/c                                  |     |          |          |
|      |                                              |     |          |          |
|      |                                              |     |          |          |
| ✓ 03 | Depreciation A/c Dr.                         |     |          |          |
|      | To Asset on Lease A/c                        |     |          |          |
|      |                                              |     |          |          |
| 04   | Profit and Loss A/c Dr.                      |     |          |          |
|      | To Finance charges A/c ✓                     |     |          |          |
|      | To Depreciation A/c ✓                        |     |          |          |

Note 01: Lower of ↘

a) Present value of Minimum Lease Payments from point of Lessee

$$\frac{[\text{Lease Payments/Rentals} + \text{Guaranteed Residual Value by lessee or on his behalf}]}{225000 \times 6} \quad \text{OR} \quad ₹200000$$

ILLI  
ICAI  
module

b) Fair Value of Asset

### Additional Notes:

- ✓ Rate of interest would be incremental rate of return (IRR)
- ✓ Whenever IRR is given, Follow given IRR
- ✓ If fair value of asset < Present value of Minimum lease payments from Lessee point, then IRR would be recomputed

Lessee → minimum Lease payment → or Fv of Asset → w.e.L → Amt JE  
 PV of Lease Rent + guaranteed RV by lessee

Lessor → Net Investment → Amt JE  
 PV of Lease Rent + guaranteed RV + unguaranteed RV

↓  
 Higher of  
 → guarantee by Lessee  
 or  
 → -1- by 3rd party



### Example :- Cal. of IRR

FV of Lease Rental  $\longrightarrow$  @ inception  $\longrightarrow$  ₹4,00,000 i.e. FV of Asset

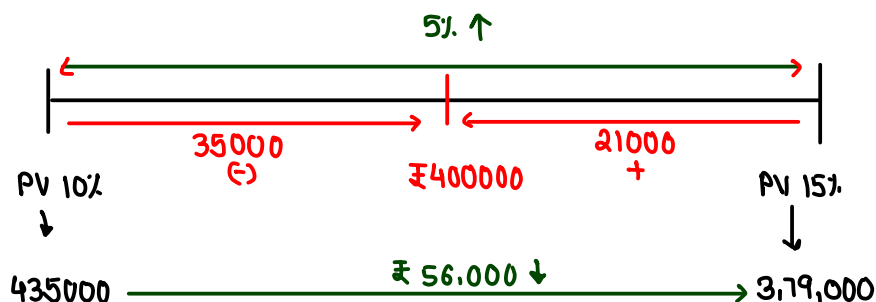
Lease Rental  $\longrightarrow$  ₹1,00,000 for next 6 years

Discount Rate  $\rightarrow$  IRR  $\rightarrow$  FV = PV of cash flow  
 i.e. 4L = PV of 100000 X 6  
 i.e. 4L = PV of ₹6,00,000

| Year | Rental   | PVFC @ 10%  | PV @ 15%    |
|------|----------|-------------|-------------|
| 1    | 1,00,000 | 0.91        | 0.87        |
| 2    | 1,00,000 | 0.83        | 0.76        |
| 3    | 1,00,000 | 0.75        | 0.66        |
| 4    | 1,00,000 | 0.68        | 0.57        |
| 5    | 1,00,000 | 0.62        | 0.50        |
| 6    | 1,00,000 | 0.56        | 0.43        |
|      |          | <u>4.35</u> | <u>3.79</u> |

$$\therefore \text{PV @ 10\%} = 4.35 \times 1,00,000 = 4,35,000$$

$$\therefore \text{PV @ 15\%} = 3.79 \times 1,00,000 = 3,79,000$$



Option A  $\rightarrow$  5% ↑ 56000 ↓  
 $x$  ↑ 35000 ↓

$$\therefore x = \frac{35000 \times 5}{56000} = 3.125 \uparrow$$

$$\therefore \text{IRR} = 10 + 3.125 = 13.125\%$$

Option B  $\rightarrow$  5% ↓ 56000 ↑  
 $x$  ↓ 21000 ↑

$$\therefore x = \frac{21000 \times 5}{56000} = 1.875 \downarrow$$

$$\therefore \text{IRR} = 15 - 1.875 = 13.125\%$$



Pg 12

Lessee Accounting done at

Lower of

FV of Asset ₹700000

or

PV of MLP ₹699054 → Loan

Cal. of PV of MLP

| Year | Lease    | PVF @ 15% | PV              |
|------|----------|-----------|-----------------|
| 1    | 3,00,000 | 0.869     | 2,60,700        |
| 2    | 3,00,000 | 0.756     | 2,26,800        |
| 3    | 3,00,000 | 0.657     | 1,97,100        |
| 3    | 22,000   | 0.657     | 14,454          |
|      |          |           | <u>6,99,054</u> |

Cal. of Finance charge

| Year | Op. Dis     | Int. @ 15%   | Total       | Paid     | Cl. Dis          |
|------|-------------|--------------|-------------|----------|------------------|
| 1    | 6,99,054    | ✓ 1,04,858.1 | 8,03,912.1  | 3,00,000 | 5,03,912.1       |
| 2    | 5,03,912.1  | 75,586.82    | 5,79,498.92 | 3,00,000 | 2,79,498.92      |
| 3    | 2,79,498.92 | 41,924.84    | 3,21,423.76 | 3,00,000 | <u>21,423.76</u> |



GRV

(1) Machine A/c Dr. 699054  
To Lessor A/c 699054

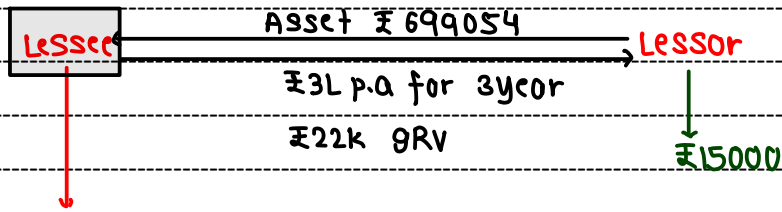
Lessee → Lessor

(2) Year end Finance charges A/c Dr. 1,04,858.1  
To Lessor A/c 1,04,858.1

↓ GRV ₹22000      ↓ Estimate RV 15000

Lessor A/c Dr. 300000  
To Bank A/c 300000

Depn A/c Dr. 233018      PL A/c Dr. 337876.1  
To Machine A/c 233018      To PC A/c 1,04,858.1  
[699054 / 3]      To Depn A/c 233018



after 3 years → Asset sold ..... ₹ kitna milenga ... ₹ 0 [assume]  
 SV, RV for Depn                      ↳ No Info

### Example 1

Mr. A → COA → ₹ 10L

SV → ₹ 2L → kisseh milengi Mr. A

Life → 4 year i.e. After 4 year asset will be sold for ₹ 2L

∴ Depn p.a → ₹ 2L p.a  $[(10-2)/4]$



In the books of **Lessor:** Asset  $\xrightarrow{\text{transfer}}$

### Journal Entries

| Date | Particulars                                                  | L/F | Dr.                   | Cr.      |
|------|--------------------------------------------------------------|-----|-----------------------|----------|
| 01   | Lease receivable / Lessee A/c Dr. [loan diya]                |     | (Note-1)              |          |
|      | To Sale / Asset A/c $\hookrightarrow$ PV of gross investment |     |                       | (Note-1) |
| 02   | Bank A/c Dr.                                                 |     | Lessee A/c Dr.        |          |
|      | To Lease Receivable / Lessee A/c                             |     | To Finance charge A/c |          |
|      | To Finance Income A/c                                        |     |                       |          |
|      |                                                              |     | Bank A/c Dr.          |          |
| 03   | Finance Income A/c Dr.                                       |     | To Lessee             |          |
|      | To Profit and Loss A/c                                       |     |                       |          |

### Note 01: Net Investment

Net Investment = Present value of Gross Investment

Gross Investment = Asset  $\xrightarrow{\text{transfer}}$  Residual value 2.25.000

Lease rentals + Guaranteed residual value of lessor + Unguaranteed Residual Value

225000  $\times$  6  $\hookrightarrow$  ₹1350000      ₹2.00.000      ₹25000

Guaranteed residual value of lessor = Higher of

a) Guaranteed residual value of lessee ₹200000

(Rahul Sir) OR  
b) Guaranteed residual value of Third Party ₹175000

Unearned Financial Income = Gross Investment - Net Investment

RS  $\xrightarrow{\text{purchase}}$   $\xrightarrow{\text{COA ₹10,00,000}}$  Leased to mm @ ₹2,25,000  $\rightarrow$  with guaranteed RV ₹2L  
 $\downarrow$  DCF 10%      useful life 8 years      for 6 years       $\hookrightarrow$  i.e. 225000  $\times$  6 = ₹13,50,000  
 PV of FV  $\rightarrow$  ₹981000

| Finance $\rightarrow$ Asset sold $\rightarrow$ RS | Year | Op. 01s   | Int @ 10% | Tot 01s   | paid   | Cl-01s    |
|---------------------------------------------------|------|-----------|-----------|-----------|--------|-----------|
| (1) mm A/c Dr. 9,81,000 + PV of Residual value    | 1 +  | 981000    | 98100     | 1079100   | 225000 | 854100    |
| P&L A/c Dr. 19,000                                | 2    | 854100    | 85410     | 939510    | 225000 | 714510    |
| To PPE 10,00,000                                  | 3    | 714510    | 71451     | 785961    | 225000 | 560961    |
|                                                   | 4    | 560961    | 56096.1   | 617057.1  | 225000 | 392057.1  |
| (2) Bank A/c Dr. 2,25,000                         | 5    | 392057.1  | 39205.71  | 431262.81 | 225000 | 206262.81 |
| To P&L A/c 98,100                                 | 6    | 206262.81 | 18737.19  | 225000    | 225000 | 0         |
| To mm A/c 1,26,900                                |      |           |           |           |        |           |
| (3) Bank A/c Dr. 2,25,000                         |      |           |           |           |        |           |
| To P&L A/c 85,410                                 |      |           |           |           |        |           |
| To mm A/c 1,39,590                                |      |           |           |           |        |           |



PQ13

### Cal. of unearned finance income

| Year | gross investment | PVF @ 10%    |                  | Net Investment   | %              |
|------|------------------|--------------|------------------|------------------|----------------|
| 2009 | 371912           | 0.9091       | } PVAF<br>2.4868 | 9,24,810         | unearned       |
| 2010 | 371912           | 0.8264       |                  |                  | Finance income |
| 2011 | 371912           | PVF ← 0.7513 |                  |                  | = 1215736 (-)  |
| 2011 | 100000           | PVF ← 0.7513 |                  | 75,130           | 100000         |
|      | <u>12,15,736</u> |              |                  | <u>10,00,000</u> | = 215736       |

WNI:- Cal. of Lease Rental

$$FV \text{ of Asset} = PV \text{ of Lease Rent} + PV \text{ of } (GRV + UGRV)$$

$$10,00,000 = \text{Lease Rent} \times PVAF(3\text{yr}, 10\%) + PVF(3\text{rd yr}, 10\%) \times UGRV$$

$$10,00,000 = \text{Lease Rent} \times 2.4868 + 0.7513 \times 100000$$

$$\therefore \text{Lease Rent} = \frac{10,00,000 (-) 75,130}{2.4868}$$

$$\therefore \text{Lease Rent p.a} = 3,71,912 \text{ or } 3,11,911.69$$

### Is the Lease Finance Lease

(a) At the end of Lease term is Asset transferred to lessee → NO

(b) At the end of Lease term, lessee has option to take this asset at price lower than FV, lessee is certain to opt → NO

(c) Substantial Economic Life is part of Lease term → Yes  
(5) (3)(d) PV of MLP cover substantial amount of FV of Asset → Yes  
↳ Lessee PV → ₹9,24L ₹10L

(e) Asset under Lease customised → NO



## OPERATING LEASE

**Operating Lease:** A lease is classified as an operating lease if it does not transfer substantially all the risks and rewards incident to ownership.

→ **claims Depn**

**For Lessor:** Rental Income to be recognized in Statement of Profit and Loss

**For Lessee:** Rental Expenses to be recognized in Statement of Profit and Loss

**How to Recognise?** [Income or Expense]

- Recognise in the ratio of benefit derived. → Also Refer CQ11
- ✓ • However, use SLM if the ratio of benefit derived is not available

JE

| BOOKS of LESSOR        |                           | BOOKS to LESSEE        |                           |
|------------------------|---------------------------|------------------------|---------------------------|
| Bank A/c               | Dr.                       | Lease / Rental Exp A/c | Dr.                       |
| Lease Equilisation A/c | Dr.                       | Lease Equilisation A/c | Dr.                       |
|                        | To Lease / Rental Income  |                        | To Bank A/c               |
|                        | To Lease Equilisation A/c |                        | To Lease Equilisation A/c |

RS ← Office → GS

Lease Rent

| Year | Rent            |
|------|-----------------|
| 1    | 1,00,000        |
| 2    | 1,50,000        |
| 3    | 2,00,000        |
| 4    | 2,50,000        |
|      | <u>7,00,000</u> |

Ratio of Benefit derived

Case A

Not available i.e.  $700000/4 = ₹175000 \text{ p.a.}$

Case B

Available 2:2:2:1

**CASE A**

RS Books

Bank A/c Dr.

Lease Equilisation A/c Dr.

To Lease Income

To Lease Equilisation A/c

Year 1

100000

75000

175000

-

Year 2

150000

25000

175000

-

Year 3

200000

-

175000

25000

Year 4

250000

-

175000

75000

**CASE B**

RS Books

Bank A/c Dr.

Lease Equilisation A/c Dr.

To Lease Income

To Lease Equilisation A/c

Year 1

100000

100000

200000

-

Year 2

150000

50000

200000

-

Year 3

200000

-

200000

-

Year 4

250000

-

100000

150000

Q.11machine cost  $\longrightarrow$  ₹ 2,25,000

Scrap 30%.

$$\therefore \text{Tot Amt in 5 years} = 225000 + (225000 \times 30\%)$$

$$= ₹ 2,92,500$$

Tot unit to be produced  $\longrightarrow$  X Option A =  $\frac{292500}{5} \times 3 \longrightarrow ₹ 1,75,500$  for 3yr  
 ie ₹ 58500 p.a

| Year | Unit            |
|------|-----------------|
| 1    | 60,000          |
| 2    | 75,000          |
| 3    | 90,000          |
| 4    | 1,20,000        |
| 5    | 1,05,000        |
|      | <u>4,50,000</u> |

✓ Option B =  $\frac{292500}{450000} \times 225000$   
 (preferred)

ie ₹ 146250 for 3 years

ie ₹ 48,750 p.a

$$\therefore \text{Depreciable amount} = \text{COA} (-) \text{SV}$$

$$= 225000 (-) 0$$

$$= 225000$$

| Year | Unit            | Depn     |                                  |
|------|-----------------|----------|----------------------------------|
| 1    | 60,000          | ₹ 30,000 | $[225000 / 450000 \times 60000]$ |
| 2    | 75,000          | ₹ 37,500 | $[225000 / 450000 \times 75000]$ |
| 3    | 90,000          | ₹ 45,000 | $[225000 / 450000 \times 90000]$ |
| 4    | 1,20,000        |          |                                  |
| 5    | 1,05,000        |          |                                  |
|      | <u>4,50,000</u> |          |                                  |



### In Books of Lessor

|                                  | Year 1                                              | Year 2                                              | Year 3                                              | Total    |
|----------------------------------|-----------------------------------------------------|-----------------------------------------------------|-----------------------------------------------------|----------|
| Bank A/c (Receipt) Dr.           | 48,750                                              | 48,750                                              | 48,750                                              | £146,250 |
| Lease Equilisation A/c Dr. (B.f) | -                                                   | -                                                   | 9,750                                               | -        |
| To Lease equilisation A/c (B.f)  | 9,750                                               | -                                                   | -                                                   | -        |
| To Lease income A/c              | 39,000                                              | 48,750                                              | 58,500                                              | £146,250 |
|                                  | $\left[ \frac{146250 \times 60000}{225000} \right]$ | $\left[ \frac{146250 \times 75000}{225000} \right]$ | $\left[ \frac{146250 \times 90000}{225000} \right]$ |          |



## SALE AND LEASE BACK

**Meaning:** A sale and leaseback transaction involves the sale of an asset by the vendor and the leasing of the same asset back to the vendor.

### Sale and Finance Lease Back

Any Profit or Loss is to be deferred in the ratio of depreciation over lease period

### Sale and Operating Lease Back

**Step 1:** Calculate impairment Loss to be recognized immediately

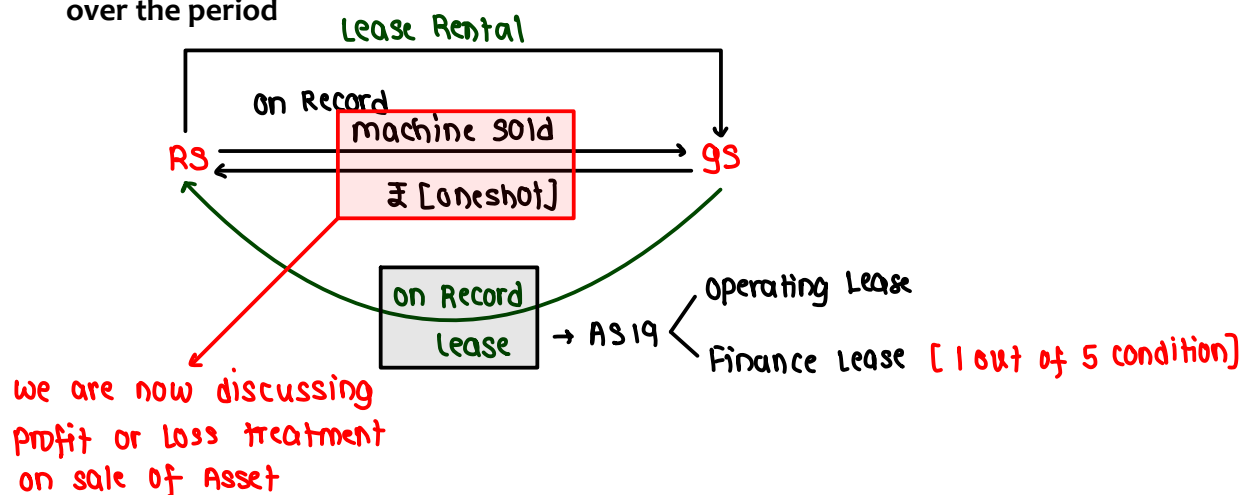
*[Carrying amount – Fair Value]*

**Step 2:** Calculate Deferred Income to be recognized over Lease Period

*[Sale Price – Fair value]*

**Step 3:** Calculate Difference to be recognized immediately

**Exception:** If loss is compensated by future lease payments then it should be amortised over the period



Scenario 1  $\longrightarrow$  Profit or Loss on sale of Asset shall be immediately recognised  
 $FV \text{ of Asset} = \text{Sale value}$

Scenario 2  $\longrightarrow$  Profit or Loss on sale of Asset shall be immediately recognised  
 $FV \text{ of Asset} > \text{Sale value}$   
 Exception  $\longrightarrow$  In case of Loss, if the same is compensated by Reduced Lease Rental, then till Loss shall be amortised over Lease term

Scenario 3  $\longrightarrow$  Profit or Loss upto  $FV \text{ of asset}$   $\longrightarrow$  immediately recognised  
 $FV \text{ of Asset} < \text{sale value}$   
 Bal.  $\longrightarrow$  Recognised over Lease term



- 1 FV = SP
- 2 FV > SP
- 3 FV < SP

ILL3

CA → BS value

| Case     | Asset sold WDV | Sold for | Fair Value | Profit / Loss [CA vis Sale] | Scenario 1, 2, 3 | Immediately P&L A/c | Over the Lease term |
|----------|----------------|----------|------------|-----------------------------|------------------|---------------------|---------------------|
| (a)      | 40L            | 50L      | 50L        | ₹10L profit                 | 1                | ₹10L                | -                   |
| (b)      | 40L            | 50L      | 60L        | ₹10L profit                 | 2                | ₹10L                | -                   |
| (c)      | 40L            | 38L      | 45L        | ₹2L loss                    | 2                | (₹2L)               | -                   |
| (d)      | 40L            | 50L      | 40L        | ₹10L profit                 | 3                | -                   | ₹10L                |
| (e)      | 40L            | 50L      | 46L        | ₹10L profit                 | 3                | ₹6L                 | ₹4L                 |
| Imp. (f) | 40L            | 39L      | 35L        | ₹1L loss                    | 3                | (₹5L)               | ₹4L                 |

Scenario 3 → FV tak → P&amp;L A/c

FV (-) CA

FV zyada → Over the term of Lease

SP (-) FV

Q14

CA → BS value

| Case  | Asset sold WDV | Sold for | Fair Value | Profit / Loss [CA vis Sale] | Scenario 1, 2, 3 | Immediately P&L A/c | Over the Lease term |
|-------|----------------|----------|------------|-----------------------------|------------------|---------------------|---------------------|
| (i)   | 300L           | 400L     | 400L       | ₹100L profit                | 1                | ₹100L               | -                   |
| (ii)  | 300L           | 400L     | 450L       | ₹100L profit                | 2                | ₹100L               | -                   |
| (iii) | 300L           | 250L     | 350L       | ₹50L loss                   | 2                | (₹50L)              | -                   |
| (iv)  | 300L           | 400L     | 300L       | ₹100L profit                | 3                | -                   | ₹100L               |
| (v)   | 360L           | 290L     | 250L       | ₹10L loss                   | 3                | (₹50L)              | ₹40L                |



### Misc. Points

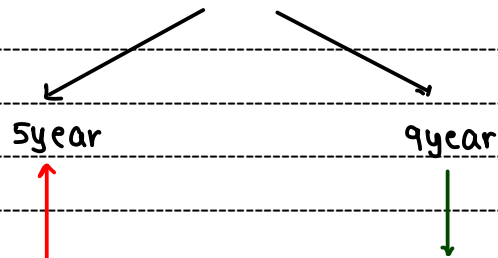
\* Lease Term  $\longrightarrow$  Relavance  $\longrightarrow$  Depn, PV, sale and Lease Back



Agreed period  $\longrightarrow$  5 year  
 +

option with gs  $\longrightarrow$  After 5 year Lease period  
 further renew for 4 year

For cal. purpose  $\longrightarrow$  Lease Term



NO

If there is reasonable certainty  
 that gs will exercise the option

\* Lease Rent  $\longrightarrow$  Dependent on future prospect / project

% on sales or % of cost incurred or % of gp

$\longrightarrow$  operating

Lease  $\longrightarrow$  Rent  $\longrightarrow$  Income / Expense  $\longrightarrow$  P&L A/c

=

Receipt / Payment

Recd.

paid

+ Receivable

+ payable



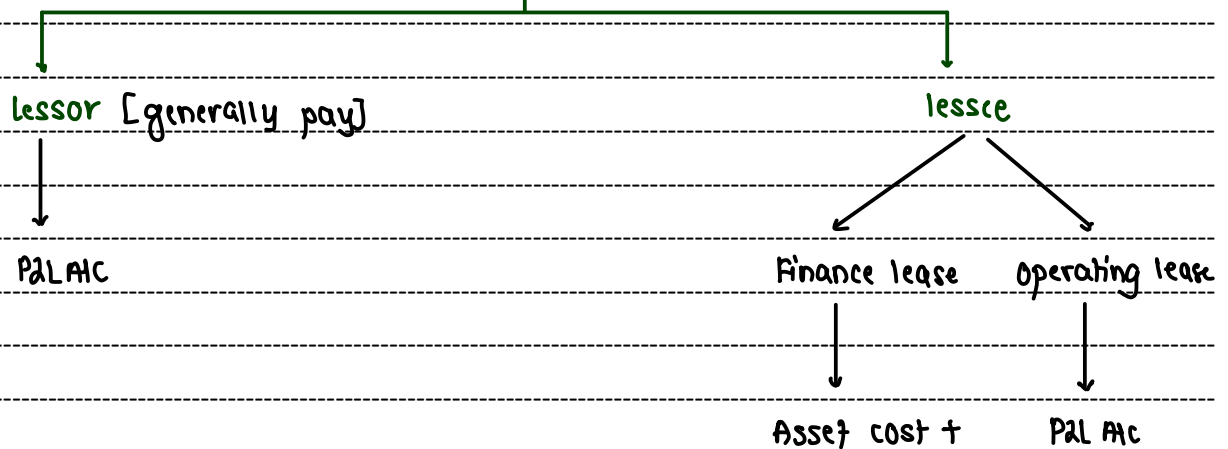
\* Lease Agreement —————> Before start of Agreement  
There are some expense incurred

↳ Ex:- Lawyer Expense  
Stamp paper  
Stamp duty / Registration

Treatment



Depend on who paid



\* Common sense

Lease Rent ₹ 5,00,000 p.a for 5 years DF @ 15%.

(a) paid at end of each year [Q. silent we assume this]

(b) paid at start of each year

Cal- PV of Lease Rent

Option a

| Year | PV F @ 15% |                                                                                                                                                           |
|------|------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------|
| 1    | 0.8696     | $\left. \begin{array}{l} \therefore \text{PVAF} = 3.3522 \\ \therefore \text{PV of LR} \\ = 3.3522 \times 5,00,000 \\ = ₹ 16,76,100 \end{array} \right\}$ |
| 2    | 0.7561     |                                                                                                                                                           |
| 3    | 0.6575     |                                                                                                                                                           |
| 4    | 0.5718     |                                                                                                                                                           |
| 5    | 0.4972     |                                                                                                                                                           |

Option B

| Year start | PV F @ 15% |                                                                                                                                                         |
|------------|------------|---------------------------------------------------------------------------------------------------------------------------------------------------------|
| 1          | 1          | $\left. \begin{array}{l} \therefore \text{PVAF} = 3.855 \\ \therefore \text{PV of LR} \\ = 5,00,000 \times 3.855 \\ = ₹ 19,27,500 \end{array} \right\}$ |
| 2          | 0.8696     |                                                                                                                                                         |
| 3          | 0.7561     |                                                                                                                                                         |
| 4          | 0.6575     |                                                                                                                                                         |
| 5          | 0.5718     |                                                                                                                                                         |

