AS-19: LEASES

LEASE

→ Tangible or Intangible

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

Rent

Lessor: The party who transfers the asset RS

Lessee: The party to whom asset is transferred gs

Sale :-

RS —(Ownership; Asset or Inventory)→ gs

gs —(₹ [oneshot])→ RS

RS ↓ sale of Asset or sale of goods

gs ↓ purchase of Asset [Depn claim] or purchase of goods

Rent :-

RS —(Asset (Rent))→ gs

gs —(₹)→ RS

RS ↓ Owner ✓, Depn claim ✓

} operational Lease

Sale → Reality → but dikh Raha Rent agreement

Reality

RS —(office sold)→ gs

gs —(₹ Instalment)→ RS

RS ↓ Darr

ownership ✓ ₹ complete ✗ ₹ instalment ✓

What if gs defaults the instalment

Proposal

RS —(office (use → Agreement))→ gs

gs —(₹ Instalment)→ RS

gs ↓ Darr

ownership ✗

complete ₹ instalment ✓

What if RS doesn't trf ownership after 5years

New proposal

RS —(office (use → Agreement))→ gs

gs —(₹ Instalment)→ RS

Agreement → Today → Right to use

If all instalment are paid asset will transferred.

↳ Finance Lease → AS 19 → sale purchase Transaction

∴ Depn claim → gs

problem → who will claim Depn

↓ Legally ↓ RS

↓ Reality ↓ 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* → Lessee POV
d) *Present value of minimum lease payments substantially covers Fair value of the asset*
e) *Asset is of specialized nature* Co. → Roll Royce [Pink Phantom Car] customised for Rs

RR ← car ₹ 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

[225000 x PVAF (10%, 6 years)]
225000 x 4.36

$\frac{1}{(1+r)}$ i.e

$\frac{1}{1.1}$ = mt, = mt, = mt, = mt, = mt, = mt

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 Lessor A/c [Liability]			
	To Bank A/c			
	Lessor A/c Dr. To Bank			
✓ 03	Depreciation A/c Dr.			
	To Asset on Lease A/c			
	→ period → lease term or Useful life			
04	Profit and Loss A/c Dr.	W.e.L		
	To Finance charges A/c ✓			
	To Depreciation A/c ✓			

Note 01: Lower of ✓ → ICAI module

a) Present value of Minimum Lease Payments from point of Lessee
[Lease Payments/Rentals + Guaranteed Residual Value by lessee or on his behalf]
225000 X 6 — OR — ₹200000

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 + guranteed RV by lessee

Lessor → Net Investment → Amt JE
PV of Lease Rent + guranteed RV + unguranteed RV
↓
Higher of
→ guarantee by Lessee
or
→ -11- by 3rd party

Example :- Cal. of IRR

FV of Lease Rental ⟶ @ inception ⟶ ₹4,00,000 i.e FV of Asset

Lease Rental ⟶ ₹1,00,000 for next 6 years

Discount Rate → IRR → FV = PV of cash flow

i.e 4L = PV of 100000 × 6

i.e 4L = PV of ₹6,00,000

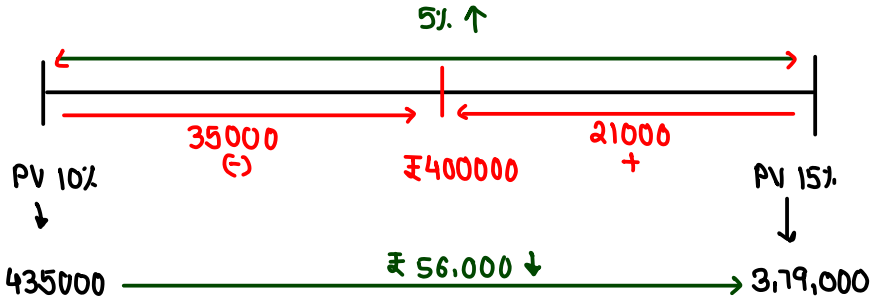
Year	Rental	PVF @ 10%	PV @ 15%
1	1,00,000	0.91	0.87
2	1,00,000	0.83	0.76
3	1,00,000	0.75	0.66
4	1,00,000	0.68	0.57
5	1,00,000	0.62	0.50
6	1,00,000	0.56	0.43
		4.35	3.79

∴ PV @ 10% = 4.35 × 100000

= 4,35,000

∴ PV @ 15% = 3.79 × 100000

= 3,79,000



Option A ⟶ 5% ↑ 56000 ↓

x ↑ 35000 ↓

∴ $x = \frac{35000 \times 5}{56000}$

= 3.125 ↑

∴ IRR = 10 + 3.125

= 13.125%

Option B ⟶ 5% ↓ 56000 ↑

x ↓ 21000 ↑

∴ $x = \frac{21000 \times 5}{56000}$

= 1.875 ↓

∴ IRR = 15 (-) 1.875

= 13.125%

Q12

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
			6,99,054

Cal. of Finance charge

Year	Op. OIS	Int. @ 15%	Total	Paid	Cl. OIS
1	6,99,054	✓ 104858.1	8,03,912.1	3,00,000	5,03,912.1
2	5,03,912.1	75586.82	5,79,498.82	3,00,000	2,79,498.92
3	2,79,498.92	41924.84	3,21,423.76	3,00,000	21,423.76

↓

GRV

(1) Machine A/c Dr. 699054

To Lessor A/c 699054

Lessee ⟶ Lessor

↓ ↓

GRV ₹22000 Estimate

RV 15000

(2) Year end Finance charges A/c Dr. 104858.1

To Lessor A/c 104858.1

Lessor A/c Dr. 300000

To Bank A/c 300000

Depn A/c Dr. 233018

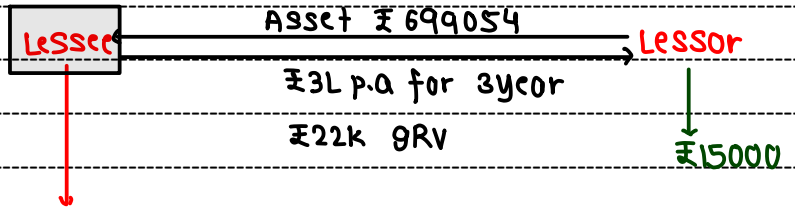
To machine A/c 233018

[699054 | 3]

PL A/c Dr. 337876.1

To FC A/c 104858.1

To Depn A/c 233018



after 3 years ⟶ Asset sold ..... ₹ kitna milenga ... ₹0 (assume)
SV, RV for Depn
↳ No Info

Example

Mr.A ⟶ COA → ₹10L
SV → ₹2L → kisseh milengi Mr.A
Life → 4year 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 → 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 ↳ PV of gross investment			(Note-1)
02 ✓	Bank A/c Dr.			
✓	To Lease Receivable / Lessee A/c ← To finance charges 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

₹981000 ₹13,50,000

Net Investment = Present value of Gross Investment

Gross Investment = Asset → Residual value 2.25.000

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

225000 x 6 ↳ ₹1350000 ₹2.00.000 ₹25000

Guaranteed residual value of lessor = Higher of

a) Guaranteed residual value of lessee ₹200000

OR (Rahul Sir)

b) Guaranteed residual value of Third Party ₹175000

₹369000 ₹1350000 ₹981000

Unearned Financial Income = Gross Investment – Net Investment

RS → purchase → Leased to mm @ ₹2,25,000 → with guranteed RV ₹2L

↓ COA ₹10,00,000 for 6 years ↳ i.e 225000 x 6 = ₹13,50,000

DCF 10%. useful life 8years PV of FV → ₹981000

Finance → Asset sold → RS

(1) mm A/c Dr. 9,81,000 + PV of Residual value

P&L A/c Dr. 19,000

To PPE 10,00,000

(2) Bank A/c Dr. 2,25,000

To P&L A/c 98,100

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

Year	Op. O/S	Int @10%	Tot O/S	paid	Cl. O/S
1	981000	98100	1079100	225000	854100
2	854100	85410	939510	225000	714510
3	714510	71451	785961	225000	560961
4	560961	56096.1	617057.1	225000	392057.1
5	392057.1	39205.71	431262.81	225000	206262.81
6	206262.81	18737.19	225000	225000	0

PQ13

Cal. of unearned finance income

Year	gross investment	PVF @10%		Net Investment	%
2009	371912	0.9091			unearned
2010	371912	0.8264	PVAF	9,24,870	Finance income
2011	371912	PVF ← 0.7513	2.4868		= 1215736 (-)
2011	100000	PVF ← 0.7513		75,130	100000
	12,15,736			10,00,000	= 215736

WN1:- Cal. of Lease Rental

FV of Asset = PV of Lease Rent + PV of (GRV + UGRV)

10,00,000 = Lease Rent x PVAF (3yr, 10%) + PVF (3rd yr, 10%) x UGRV

10,00,000 = Lease Rent x 2.4868 + 0.7513 x 100000

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

∴ Lease Rent p.a = 3,71,912 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 (5) is part of lease term (3) ⟶ Yes

(d) PV of MLP cover substancial amount of FV of Asset ⟶ Yes

↳ Lessee POV ⟶ ₹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
	7,00,000

Ratio of Benefit derived → Case A Not available i.e 700000/4 = ₹175000 p.a

→ Case B Available 2:2:2:1

Case A

RS Books	Year 1	Year 2	Year 3	Year 4
	100000	150000	200000	250000
Bank A/c Dr.	75000	25000	-	-
Lease Equilisation A/c Dr.				
To Lease Income	175000	175000	175000	175000
To Lease Equilisation A/c	-	-	25000	75000

Case B

RS Books	Year 1	Year 2	Year 3	Year 4
	100000	150000	200000	250000
Bank A/c Dr.	100000	50000	-	-
Lease Equilisation A/c Dr.				
To Lease Income	200000	200000	200000	100000
To Lease Equilisation A/c	-	-	-	150000

CQ.11

Machine cost ⟶ ₹2,25,000

↓

Kamai 30%.

∴ Tot Amt in 5years = 225000 + (225000 × 30%)

= ₹2,92,500

Tot unit to be produced ⟶

Year	Unit
1	60,000
2	75,000
3	90,000
4	1,20,000
5	1,05,000
	4,50,000

✗ option A = $\frac{292500}{5}$ × 3 ⟶ ₹1,75,500 for 3yr
i.e ₹58500 p.a

✓ option B = $\frac{292500}{450000}$ × 225000 (preferred)
i.e ₹146250 for 3years
i.e ₹48,750 p.a

∴ Depreciable amount = COA (-) SV

= 225000 (-) 0

= 225000

∴

Year	Unit	Depn	
1	60,000	₹30,000	[225000/450000 × 60000]
2	75,000	₹37,500	[225000/450000 × 75000]
3	90,000	₹45,000	[225000/450000 × 90000]
4	1,20,000		
5	1,05,000		
	4,50,000		

In Books of Lessor

	Year 1	Year 2	Year 3	Total
Bank A/c (Receipt) Dr.	48,750	48,750	48,750	₹146250
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	48750	58500	₹146250
	$\left[\frac{146250}{225000} \times 60000\right]$	$\left[\frac{146250}{225000} \times 75000\right]$	$\left[\frac{146250}{225000} \times 90000\right]$	

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

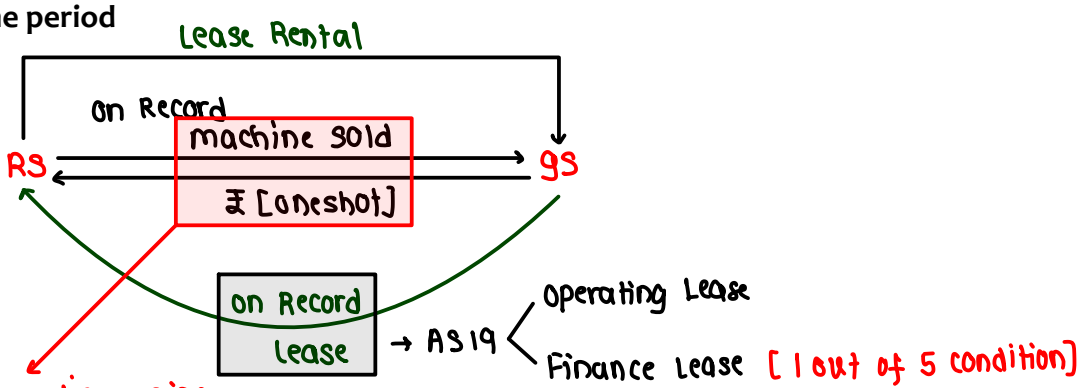
[Carrying amount – Fair Value]

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



we are now discussing profit or loss treatment on sale of Asset

Scenario 1 → Profit or Loss on sale of Asset shall be immediately recognised

FV of Asset = Sale value

Scenario 2 → Profit or Loss on sale of Asset shall be immediately recognised

FV of Asset > Sale value

Exception → In case of Loss, if the same is compensated by Reduced Lease Rental, then till Loss shall be amortised over Lease term

Scenario 3 → Profit or Loss upto FV of asset → immediately recognised

FV of Asset < Sale value

Bal. → 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&L A/c — FV (-) CA
FV zyada → over the term of Lease — SP (-) FV

PQ14

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 ⟶ Relavance ⟶ Depn, PV, sale and Lease Back

Rs —Asset→ gs
[lessor] ←Lease— [lesse

⟶ Agreed period ⟶ 5year
+
option with gs ⟶ After 5year Lease period further renew for 4year

For cal. purpose ⟶ Lease Term

- 5year
- 9year ⟶ If their is reasonable certainity that gs will exercise the option
  - NO ⟶ 5year

* Lease Rent ⟶ Dependent on future prospect / project
  % on sales or % of cost incurred or % of gp
  - ⟶ operating Lease ⟶ Rent ⟶ Income / Expense ⟶ P&L A/c
    =
    Receipt / Payment
    - Recd. + Receivable
    - paid + payable

* Lease Agreement ⟶ Before start of Agreement
Their are some expense incurred
↳ Ex:- Lawyer Expense
Stamp paper
Stamp duty / Registration

↓

Treatment

↓

Depend on who paid

- lessor [generally pay] → P&L A/c
- lessee
  - Finance lease → Asset cost ↑
  - Operating lease → P&L A/c

* 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	PVF @ 15%
1	0.8696
2	0.7561
3	0.6575
4	0.5718
5	0.4972

∴ PVAF = 3.3522

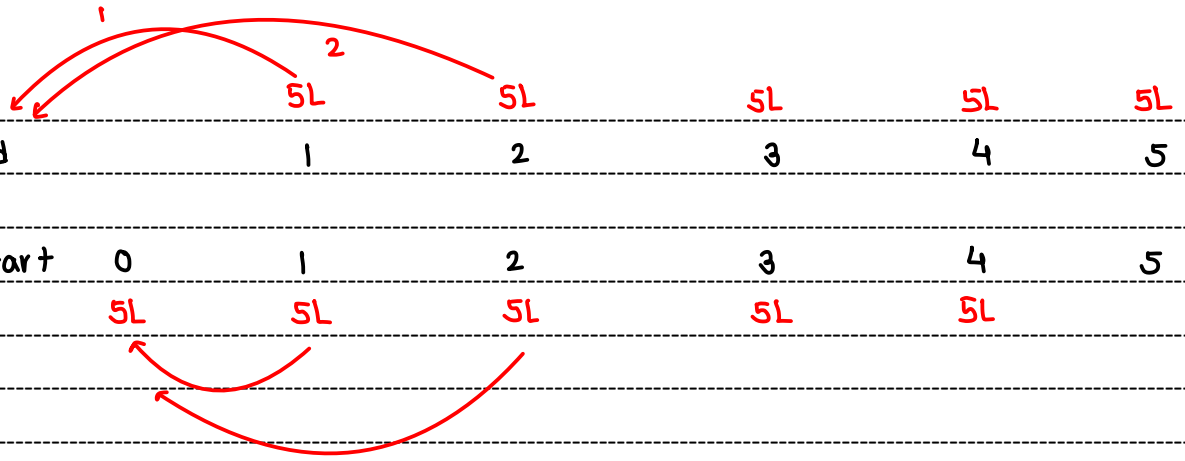
∴ PV of LR = 3.3522 × 500000 = ₹ 16,76,100

Option B

Year Start	PVF @ 15%
1	1
2	0.8696
3	0.7561
4	0.6575
5	0.5718

∴ PVAF 3.855

∴ PV of LR = 500000 × 3.855 = ₹ 19,27,500


1
2
SL
SL
SL
SL
SL
Year end
1
2
3
4
5
Year start
0
1
2
3
4
5
SL
SL
SL
SL
SL