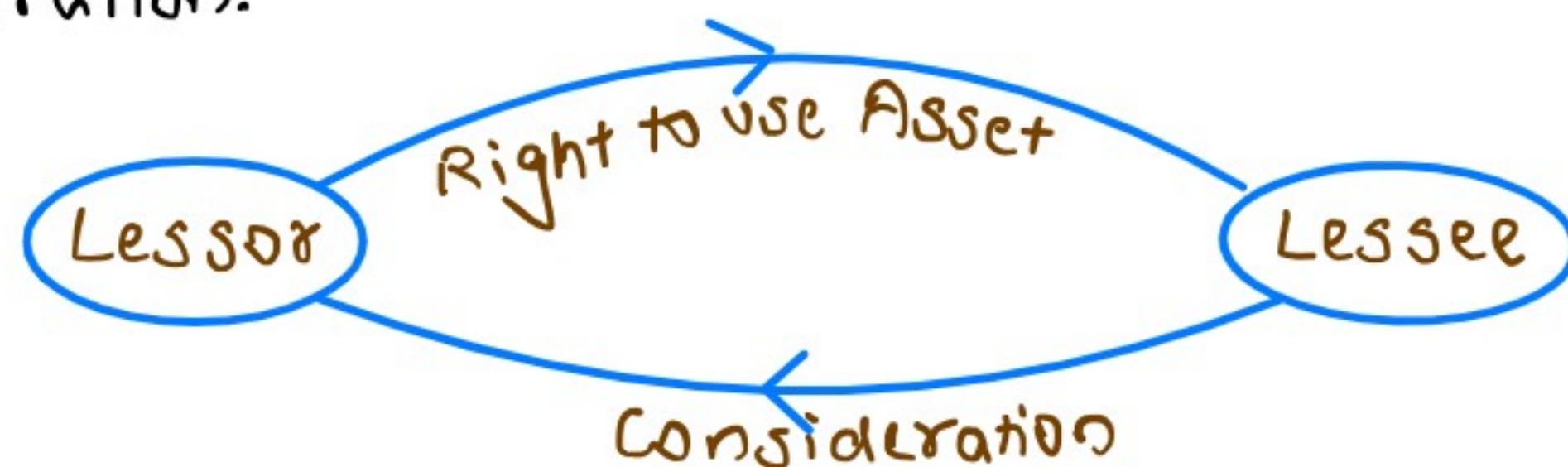


AS 19: LEASES

Lease means transfer of right to use asset for specified period against consideration / series of consideration.



Types of Lease

1) Finance Lease

2) Operating Lease

Finance Lease: If it transfers substantially all risks & rewards incident to ownership.

Conditions of Finance Lease (Deterministic Conditions): Any one to be satisfied

- Transfer of ownership at the end of Lease term
- Lessee has purchase option at reduced rate & lessee is certain to opt at inception
- Lease period covers substantial period of economic life of asset.
- Present value of Minimum Lease payments substantially covers fair value of asset.
- Asset is of specialised nature such that only lessee can use it without major modifications

Operating Lease: Lease other than Finance Lease

Finance Lease (Books of Lessee)

Journal Entries

Year 1 (Day 1) 1) Asset on Lease A/c - Dr (Lower of: Present value of MLP^{*} Lessee (or) Fair value of Asset)
To Lessor A/c

* MLP_{Lessee} ie. Minimum Lease Payments from Stand point of Lessee

⇒ Lease Payments/Rentals + Guaranteed Residual value (GRV) by Lessee or on his behalf

Year End (Each Year) 2) Finance charges (Interest) A/c - Dr
To Lessor A/c

Table

Year (A)	opening o/s (B)	Interest (C) = (B) × Discount Rate	Instalment Lease Payment (D)	Closing o/s (E) = (B) + (C) - (D)
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3) Lessor A/c - Dr
To Bank A/c
(Payment of Lease Instalment)

4) Depreciation A/c - Dr
To Asset on Lease A/c

If Asset will be retained at the end : $\frac{\text{Period}}{\text{Useful Life}}$
If Asset will be returned : Useful life or Lease Period w.e. is shorter

5) P&L A/c - Dr
To Finance charges A/c
To Depreciation A/c

Notes:

- ★ Rate of Interest (ie. Discount Rate) would be Interest rate implicit on Lease (IRR) → Given directly
(Rate at which Net Investment = Fair value)
- ★ If Interest rate implicit on Lease cannot be computed, use lessee's incremental borrowing rate of interest
- ★ If Fair value of Asset < Present value of MLP_{Lessee}, IRR would be recomputed

Finance Lease (Books of Lessor)

Journal Entries

Year 1 (Day 1) 1) Lease Receivable/Lessee A/c - Dr
To Asset A/c/Sale A/c (Amount = Net Investment)

Where Net Investment = Present value of Gross Investment

$$\text{Gross Investment} = \text{Lease Rentals} + \overbrace{\text{Guaranteed Residual value (GRV Lessor)}}^{\text{MLP Lessor}} + \text{Unguaranteed Residual value (UGRV)}$$

Residual value

$$\text{GRV Lessor} = \text{Higher of } \text{GRV Lessee} \text{ or } \text{GRV 3rd Party}$$

Year End (Each Year) 2) Lease Receivable/Lessee A/c - Dr
To Finance Income (Interest) A/c

3) Bank A/c - Dr
To Lease Receivable/Lessee A/c

4) Finance Income A/c - Dr
To P&L A/c

$$\text{Unearned Finance Income} = \text{Gross Investment} - \text{Net Investment}$$

Operating Lease

Lessor

Rental Income

Lessee

Rental Expense

To be recognised in P&L in ratio of benefit derived
If not available, then SLM is used

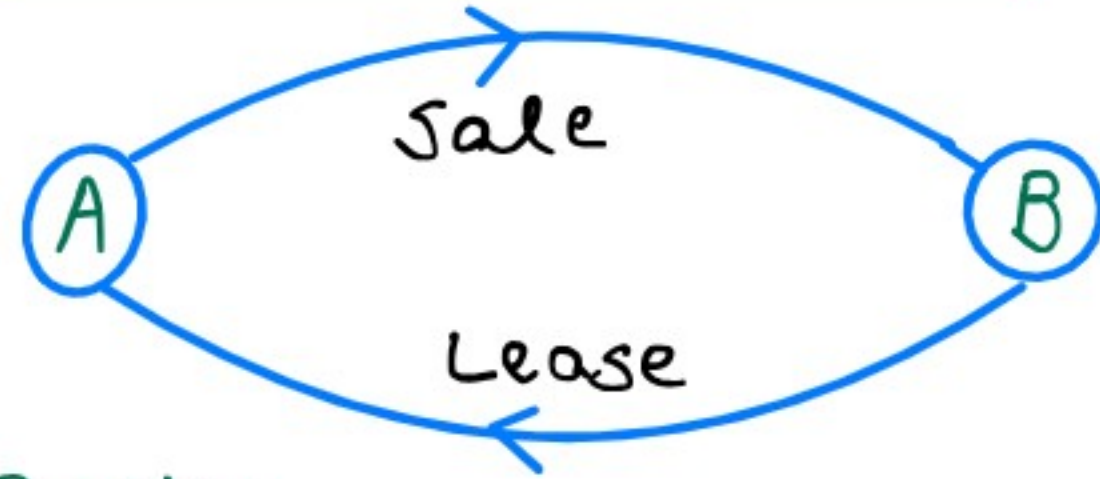
Lessor

- 1) Lessee A/c - Dr
Lease Rent Adj. A/c - Dr (Accrued)
 To Lease Rental Income A/c
 To Lease Rent Adj. A/c (Pre Received)
- 2) Bank A/c - Dr
 To Lessee A/c
- 3) Lease Rental Income A/c - Dr
 To P&L A/c
- 4) Depreciation A/c - Dr
 To Asset A/c
- 5) P&L A/c - Dr
 To Depreciation A/c

Lessee

- 1) Lease Rental Expense A/c - Dr
Lease Rent Adj. A/c - Dr (Prepaid)
 To Lessor A/c
 To Lease Rent Adj. A/c (O/S)
- 2) Lessor A/c - Dr
 To Bank A/c
- 3) P&L A/c - Dr
 To Lease Rental Expense A/c

Sale and Lease Back



Sale & Finance Lease Back:

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

Sale & Operating Lease Back:



1) Calculate Impairment Loss : Carrying Amount - Fair Value (A - B)
To be recognised immediately

2) Calculate Deferred Income : Sale Price - Fair value (C - B)
To be recognised over lease period

3) Calculate Difference : Sale Price - Carrying Amount (C - A) [+ve or -ve]
Remaining after (1) & (2)
To be recognised immediately

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