Chapter 2 Overview (AS19 Level)

Chapter Overview — AS19 leases

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7. Accounting for Operating lease
   a) Lessee Books
   b) Lessor Books
   c) Special Cases
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8. Sale & lease Back
9. Other Misc Points
   a) Contingent Rent
   b) Initial Direct Cost
   c) Lease Rent Beginning of the Year

As 19- Leases (v Imp)

1] Definition of lease

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

period of time → lease term

Eg: BB Sia gives studio on sent to Ak sie for 5 years @ 1 500,000 per annum

BB Sia → owner → festos → lessor

Ak sie → tenant → lessee

5 years → lease term

1 500,000 per annum → a lease Rentals (OR) lease payments (OR) Minimum lease Payments

Chapter overview

Chapter overview

two types of leases

- Operating lease (mode like a normal rental agreement)
- Finance lease

a] Operating Lease (mode like a Rental agreement) → (Jisne rent pediya uske liye Income & jisne asset rent pe liya uske liye expense)

a Operating lease mode like a Rental agreement

Journal Entries

Lessor (BB Sia) — owner	Lessee (Ak sia)
Day ① No entry	Day ① No entry
Yr end ClB/Alc Dr xx To lease Rent Income (P/L) xx	Yr end Lease Rent Exp (P/L) Dr TO ClB Alc
Asset BB Sia ke books mein he hai Yr end → Deprn (P/L) TO PPE	

(b) Finance lease (more like BBsia selling the asset to AK on loan/EMI Basis

Matlab BB Sid will not receive full money upfront He will receive in installment (lease Rentals)

Journal Entries

Lessor (BB Sid)	Lessee (AK Sid)
Say ① lease Reable All DQ xx To Asset studio Alc xx	Bad ① Asset Alc DR (studio) xx To Lease liability (payable) xx Payable
Yrend Lease Retable All Do TO Interest Income All	Yrend Interest Exp Alc DR To Lease liability
Yrend CIB Alc DS Alc TO Lease Retable Alc	Grend lease liability Alc DS TOCIB
OR	0120
Urend CIB Aec DS → lease Rentals TO Jut Income PII TO lease Retable Ale	Int Expense Alc DS lease liab Alc DS TOCIB
	Yred Asset is now in All Sid Books in case of Finance lease Depm xx TO PPE xx

2] Scope

This standard applies to all leases other than:

ⓐ lease agreements to explore or use natural resources such as oil, gas, metals, minerals etc.

ⓑ licensing agreements for items such as motion picture films, video recordings, plays, manuscripts, patents & copyright

ⓒ lease agreement to use Lands

3] Important definitions

ⓐ Lease Term

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

Day ① → Total lease Term

Eg: BB Sid (lessor) → AK Sid (lessee)

5yrs lease (non cancellable)

(+)

3yrs (option to renew)

- I am reasonably certain to exercise the option → 5yrs + 3yrs = 8yrs
- I am not reasonably certain to exercise the option → 5yrs

⑥ Lease Payments / Lease Rentals / Minimum lease Payments

Lessee	Lessee
① Fixed lease Rentals Eg1	① Fixed lease Rentals
② Guaranteed Residual value (GRV) Eg ② GRV given by lessee from 45 / 14 given by independent 3rd party Eg ③	② Guaranteed Residual value (GRV) GV given by lessee mom
③ Renewal option / Purchase option payment 440 / g Eg ⑤	③ Renewal option / Purchase option payment

Eg ① Fixed lease Rentals

BB Sid gave studio on lease to AkSis for 3yrs
Rentals every year were as follows

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

Fixed lease → Iska Amount Day ① se he pata hai
Rentals

Eg ② GRV

Alesia gives Ferrari Cad on lease to Manu Hd for 301 p.a for 3 years
lesson ifeng.gs

Guarantee for a Residual value → 15L @ the end of 3rd year

To ensure proper usage

Lease Rent

Yr	lease Rent
1	301
2	301
3	301 + 15L GRV

154

Day ① → BuyBack after (After 3yrs Flipkart will BuyBack @ ₹ 18k).

Eg: Iphone purchased by AK from Flipkart

BuyBack Iphone

AK gave Iphone on lease to Audit → L·R

(lessory) (lessee)

yr	lease Rentals
1	30k
2	30k
3	30k

No GRU promised by Audit (lessee)

Ak has received a GRV But from 3rd party flipkart & not from lessee

Lease Rentals

to Ak (lessor)

Yr	L·R
1	30k
2	30k
3	30k + GRU (3rd party) 18k

to Audit (lessee)

Yr	L·R
1	30k
2	30k
3	30k GRY

Eg: ④ BB Sir gave his studio on lease to All for 5yrs @ ₹51p.a.

BB Sir also gave an option to renew for 3yrs @ ₹4tp.a for the renewal period.

It is reasonably certain that renewal option will be exercised

Calculate L·R for each year

a BB

Yr	lease Rentals
1	SL
2	SL
3	SL
4	SL
5	SL
6	4L
7	4L
8	4L

leafy

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

Egs BB Sid gave studio on lease to AK Sid for 5yrs @ 5Lp a.

BB Sid also gave an option to purchase the studio @ the end of 5yrs @ 181

to

AK Sid is reasonably certain to exercise the purchase option

Yr	L R
1	52
2	8
3	5
y	1
5	52 + 181

Purchase option payment

AK Sir is NOT reasonably certain to exercise the purchase option

98	1 R
1	52
2	82
3	52
4	51
5	5L

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④ Types of lease

- Operating lease
  - ① Does not trf the risk & reward of the asset
  - ② like a normal Rental agreement
- Finance lease
  - ① Transfer the risk & reward of the asset
  - ② like a loan agreement

⑤ Indicators of Finance lease

There are 5 conditions. If Any 1 is met, then it is a Finance lease

ⓐ Ownership

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

eg BB sir gave studio on rent for 5yrs @ the end of 5yrs ownership of asset will be transferred to AK sir → Fin lease

ⓑ 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

eg BB Sir gave studio on lease for 5yrs @ at the end of 5th yr AK sir has option to purchase the asset @ 18L (Fair value of which is 40L). It is reasonably certain that purchase option will be exercised → It is a Fin lease

ⓒ Lease Team

If lease team is for Inside of economic life of the asset (75%)

eg AK Sir gave Ferrari on lease to move for 8yrs (Total life of Ferrari is 10yrs)
lease Term covers 80% of life $\left(\frac{8\text{yrs}}{10\text{yy}} \times 100\right)$ → It is Fin lease

eg BB sir gave studio on lease for toys (Total life of studio is 40yrs)
lease Team covers 25% of life $\left(\frac{10\text{yrs}}{40\text{yrs}} \times 100\right)$ → It is not a Fin lease (as per 3rd condition)

ⓓ PV of Minimum Lease Payments

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

Eg Aksid Ferrari → lcr (Fair value)

COY (Owner / lessor)

Aksidgivesonleaseffiinouitdforf40hp.ae for 3 years

DF @ 10% (Given)

rend	lease Rent	DF 10%	PV
1	401	0909	36.36.000
2	401	0826	3304,000
3	401	0757	30 04,000
	PV of MLP	99,44000	approx
	Fair value	100,001000	

% of money recovered in rentals = 9944000 / 100,00000 × 100 = 99.44%

Eg Everything is same as above except lease Rentals is 301p.a for 3yrs.

301p.afor3yn.ht

104rendlease	Reut	DF 10%	PV
1	30.00.000	0909	27.27.000
2	30,00000	0826	2478,000
3	3000,000	0757	2253,000
	PV of MLP	74.58.000	
	Fair value	100,001000	

% of money recovered in rentals = 74,58000 / 100,00000 × 100 = 745 → 74.58%

∴ Not a Fin lease

Eg ③ AK —Ferrari 2yrs→ s Mau ltd (Fair value = ler)

LR = 301 p.a.

GRU = 251

DF @ 10% 101

Check whether PV of MLP substantially covers Fair value of Asset or not ?

Check whether PV of MLP substantially covers Fair value of Asset or not

Yrend	lease Rent	DF @ 10%	PV
1	30 00,000	0909	2727000
2	30,00 000	0826	2478000
3	30,00000	0757	41 30,500
	+ 25 00,000 ARV	PV of fat	93,35500
		Fair value	1,0000,000

% of money recovered in rentals = 9335,500 / 100,00000 × 100 = 93.35

PV of MLP substantially covers Fair value

∴ It is a Fin Lease

ⓔ 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 sty→ AK sir

Modifications

All within my audio

- King size Bed
- Swimming Pool
- waterproof fishes
- Multiplex for movies

Because asset is of specialised nature (only useful for lessee)

∴ It is a Fin lease

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

⑥ Accounting for Finance Lease
- Lessee Books
- Lessor Books / Lessed Books

ⓐ Lessee Books

Journal Entries

ⓑ Asset A/c Dr xx
To lease liab xx

lease Rent CRY

lower of
- fair value of asset → (Given in ques)
- ② PV of MLP (0120) → (Lease Rent CRY)

read

ⓑ Int Exp
To lease liab

ⓒ Lease liab
To AB

ⓓ Deprn
To PPE

Depreciation over the Lease team as useful life whichever is lower

ⓔ Extra Entry
P/L A/c Dr
To Depth A/c
To Int Exp A/c

Eg① Dhruv took an asset on lease from Rahul for 5yrs
(lessee) (lessor)

Asset Fair value is ₹ 10,00000

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 Dhruv ② also calculate Interest Finance charges for each year end. (Assume Fin lease)

Sol: In the Books of Davy ltd (lessee)

Day① Asset A/c Dr 978550
To lease liability 978550

WN①

1st Yrend IntExp/Fin charges A/c Dr 97855
To Lease liab A/c 97855

1st Yrend Lease liab A/c Dr 250000
To CIB 250000

1st Yrend Deprn 195710
To PPE 195710
(978550 / 5yd)

1st Yrend PL A/c Dr 293565
To Depth 195710
To Int Exp 97855

2nd Yrend Urdend IntExp/Fin charges A/c Dr 82641
To Lease liab A/c 82641

2nd Yrend Lease liab A/c Dr 250000
To CIB 250000

2nd Yrend Deprn 195710
To PPE 195710
(978550 / 5yd)

2nd Yrend PL A/c Dr 278351
To Depree 195710
To Int Exp 82641

WN① Calculation of Lease liability

lower of : Fair value = 10,00,000

PV of MLP = 978550

Yrend	Lease Rent	D.F @10%	PV
1	250000	0.909	227250
2	250000	0.826	206500
3	250000	0.757	187750
4	250000	0.683	170750
5	250000 + 50000 GRI	0.621	186300

PV of MLP 978550 approx

WN② Calculation of Interest (Finance charges) for each yr end (1 of 3 Repayment Table)

Jul 9 Repayment Table

Yrend	Opening of lease liab	Finance charges @ 10% (same as Disc. Factor)	Repayment / Installment / Lease Rent payment	closing Bal 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	(250000)	49691

only Lease Rent

Approx GR due to rounding off

this is not coming exact 50,000

6

Illus 1 In the Books of lessee

Calculation of lease liability : lower of Fair value 2000,000
or
PV of MLP 1855850

Year end	LR	DFC 15%	PV
1	625000	0.8696	543500
2	625000	0.7561	472563
3	625000	0.6575	410937
4	625000 + 125000	0.5718	428850
	TRY		18 55,850

Day 0 Journal Entry

Asset A/c DR 1855850
To lease liabt 1855850

Yr end Int Exp 278378
To lease liab 278378

Yr end Lease liab 625000
To CIB 625000

can also take 375000 as fv of ee given in ques

Yr end Depr 463963
To DDPE 463963

Cost 1855850 − 125000 / 4 yrs = 432713

0120 18 5 50 4918000 / 44ns

Yr end Depro
To DDPE
lume
1855850 aus

42341

To Int Exp 278378

WN Calculation of Interest/Finance charges for each trend. → lease Rent

Calculation of Interest/Finance charges for each trend

Trend	Opening	Finance charges @ 15%	Repayment	CL as
1	1855850	278378	(625000)	1509228
2	1509228	226384	(625000)	1110612
3	1110612	166592	(625000)	652204
4	652204	97831	(625000)	125035

H
GRV approx

Illus 10 (cont)

In the Books of lessee Ltd.

① Value of Machinery

Lower of fair value 700000

(or)

PV of MLP 699054

Trend	Lease Rent	D.F @ 15%	PV
1	300000	0.869	260700
2	300000	0.756	226800
3	300000 + 22000	0.657	211554
	H ARV		699054

Day ① J.E.

Machinery A/c Dr	699054	
To lease liab		699054

(ii) Calculation of Finance charges for each Yrend

Yrend	Opening	Finance charges @ 15%	Repayment	CB
1	699054	104858	(300000)	503912
2	503912	75587	(300000)	279499
3	279499	41925	(300000)	21424

ftp.v approx

Ques 4 → lessee – Finance lease (HW) done

HW QOTD

Ques 5 → lessee Finance lease (Refer QB)

Refer QB

(b) Lessor Accounting

Hint: Its calculation is different from lessee so don't try to mix it up

Journal Entries (In the Books of lessor) Finance lease

Day 1 Lease Receivable A/c Dr xx
To PPE xxx
@ net Investment

Yrend No Deprn (Asset bahar chala gaya)

Yrend Lease Receivable xx
To Interest Income xx

Yrend CB A/c Dr xx
To Lease Receivable xx

Unrealised Int Income xx } Income being t of to PL
read Int Income xx
TO PL xx

Important terms

1) Gross Investment = Minimum lease Payments (+) UGRV (Unguaranteed Residual Value)
(without Present value) — least + GRV — Real — Residual = GRV + UGRV

2) Net Investment = PV of Minimum lease Payments (+) PV of UGRI
PV of Gross Investment

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

Eg① Aadit took an asset on lease from Maman
(lessee) (lessor)

lease Rentals = 10L p.a excluding GRV
Residual value = 1,001000, GRV = 80000, UGRV = 20,000
lease Team = 5 years, D F @ 10%

Pass J E on Day ① & Yrend in the Books of Maman assuming it is a Fin lease
Also calculate the amount of unearned Finance Income

100 = 20 + 80

Soln: Lessor Books

Day ① Lease Receivable A/c Dr 3852100 } @ net Investment
same area
To PPE 3852100

1] Gross Investment = Minimum lease Payment (+) UGRV
(without Present value) = lefuelRem.FR
= 5100,000

2] Net Investment = PV of Gross Investment
= 3852100

3] Unearned Finance Income = Gross Investment (-) Net Investment
= 5100.000 (-) 3852100
= 1247900

upcoming 5 years ka Interest
This is Not Booked on 1st day
This is computed for disclosure purpose.

Trend Journal Entries

Lease Receivable 3852,0
To Interest Income 385210

CIB A/C Dr 10,001000
To Lease Receivable 10,00000

Int Income 385210
To PL 385210

wn①

Yrend	Lease Rentals	D.F @ 10%	PV
1	10,00000	0.909	909000
2	10100,000	0.826	826000
3	10,00000	0751	751000
4	10100,000	0.683	683000
5	10,00000 + 80000 + 20000	0.621	683100
	51100.000		3852100

Hpv virus

Chose Investment

Met Investment

wn② Calculation of Finance charges (Interest Income) & Installment received

Yrend	Opn Bal of lease Reable	Interest Income @ 10%	Disc factor	Repayment (Installment / lease receive)	closing Bal
1	3852100	385210		10,00000	3237310
2	3237310	323731		1000,000	2561041
3	2561,041	256104		10.00000	1817145
4	1817145	181715		10.00.000	998860
5	998860	99886		1000,000	98746
		1246646			

Interest for 5 years

GRU + UCRV approx.

app

Illus 2 (lessee → Fin lease) (Unearned Fin Income was asked)

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

(₹ in lakhs)

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

= 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
	43 (GRV + UGH)		28.31 approx
	↓ Gross Invst		↓ Net Invst

DMI Lease Receivable 28.31 } @ Net Invst
TO PPE 28.3

Calculation of Finance charges for each Yr

Yr end	Opn	Int income @ 15% DF	Repayment	Closing
1	28.31	4.25	(8)	24.56
2	24.56	3.68	(8)	20.24
3	20.24	3.04	(8)	15.28
4	15.28	2.29	(8)	9.57
5	9.57	1.44	(8)	3.01 approx.

GRAVARI

* Special cases is lessor Accounting (Fin lease)

J Annual lease Rent is Not given in the ques?

84 CPR

whenever lease Rentals are missing we assume that we want to recover the Fair value of asset through PV of MLP & PV of UGRY

If Fairvalue/CostofAsset = PV of MLP + PV of UGRY

16,99,99950 = PV of MLP + 100258.5
(133500 × 3rd year Disfactor @ 10%)
(0.757)

16,99,999.5057 100258.5 = PV of MLP

P of Mlp = 1599741

i) Annual lease Rent = 1599741 / 3yrs = Pyot MU / Annuity factor of 3yrs (10%) = 1599741 / 2.486 = 643500.6

Extra

Yr	L.R	(x) DF@10%	= PV
1		0.909	
2		0.826	
3		0.751	
		2.486	1599741

20486
total of Byears
Discount factor
Petrame Annuity factor

LR	(x) DF	= PV
?	(x) 2.486	= 1599741

L.R = PV / DF of 3yrs (Annuity factor)
= 1599741 / 2.486
= 643500.6

ii) Unearned Finance Income

a) Gross Investment = MLPS + UGRV = 2064001.8
(without PV)

b) Net Investment = PV of GI = 1700000.9

c) Unearned Finance Income = GI (-) NI = 364000.8

WE

Yr	LR	D.F @ 10%	PV
1	643500.6	0.909	584942
2	6435006	0.826	531531.5
3	6435006 + 133500	0.751	583527.4
	2064001.8		1700,000.9 → approx

Gross Invest
Net Invest

Illustration 11 (USR)

① LRpa ② Check ③ conditions ④ OFF (Fin - Op) GI MI steps to solve

Assumption (i)

Fair value of Asset = PV of MLP + PV of UGRV

10,00,000 = PV of MLP + 75130

(100,000 × 0.7543)

PV of MLP = 10,00,000 (-) 75130

= 924870

Annual lease Rent = PV of MLP / Annuity factor of (3yr, 10%) = 924870 / 2.4869 = 371911.7

(ii) Check whether Finance lease as Operating lease

5 conditions (Any 1 is to be met)

(i) Ownership transferred @ the end of lease term → No

(ii) Purchase option @ the end of lease team → No

(iii) lease team covers major part of life = lease term (3yr) / Life (5yr) × 100 = 60% (75%) → No

Art of life is 60 to be major part

I consider's 75% for the major part for this ques

(iv) PV of MLP covers substantial (90%) Fair value of Asset → YES

PV of MLP 924870, Fair value 10,00,000, 924870 / 10,00,000 × 100 = 92.48%

(v) Specialised Nature Asset → No

4th condition not met ∴ It is a Finance lease

(iii) Unearned Finance Income

Unearned Finance Income

Gross Invst = 1215,735.1

Net Invst = 10100,000

Unearned Fin Income : 2,15,735.1

IN	Us	LR	DF@10%	PV
	y	3719117	0.909	
	2	3719117	0.826	
	3	3719117 + 100000 = 108899	0757	
		1215,735		10100,000

Ques 3 → GOTD

(i) Annual LR (ii) Check 5 conditions (iii) UFI GI NI

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2 Special case 2

Interest Rate is missing

will be discussed in detail in FM subject along with logics

In this case we will find Internal Rate of Return (IRR) - Interest Rate for lease

It is a rate where your Cost/Fair of Asset on Day ① = PV of Future lease Rentals U

PV of UGRY

Eg TO calculate IRR

Annual lease Rentals ₹1.00.000

thoendofeachyear.leaseterm

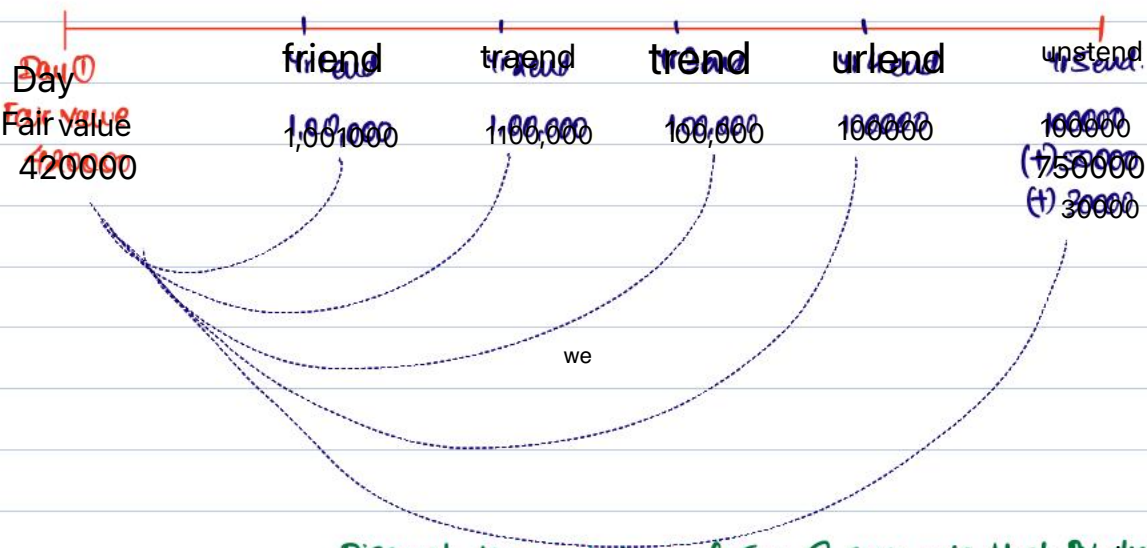
Syrs

GRU = 50,000

UGRY = 30,000

air valve @ Beginning of lease 4.20.000

Find Interestrate internalrate of return /InterestRate implicit in lease



Discount the cashflows of Syrs @ such rate that PV should come to Day Fair value ie 420000

Now we will start trial & error

Assume D.F @ 10%

Yr	Lease Rent	D.F 10%	PV
1	100000	0.909	90900
2	100000	0.826	82600
3	100000	0.757	75700
4	100000	0.683	68300
5	100000 + 50000 + 30000	0.621	111780
	9890	39882	428680 → 488.84

Assume D.F 12%

yr	Lease Rent	D.F @ 12%	PV
1	100000	0.893	89300
2	100000	0.797	79700
3	100000	0.712	71200
4	100000	0.636	63600
5	100000 + 50000 + 30000	0.567	102060
			405860

GRV UGA

420000 428 aaaya

By using interpolation

ek PV 420000 se zyada aaya

1 PV 420000 se kum aaya

$$= 10\% + \frac{428680 - 420000}{428680 - 405860} \times (12\% - 10\%)$$

$$= 10\% + \frac{8680}{22820} \times 2\%$$

$$= 10\% + 0.380 \times 2\%$$

$$= 10\% + 0.76$$

$$= 10.76\% \approx 10761 \text{ IRR}$$

1st divide

2nd multiply 0.380 by 2 (Don't press %)

3rd then add 10% (Don't press %)

10761

Eg 2 Annual lease Rentals 25000

lease Term 5 yrs

GRV 12500

UGRV 7500

Fair value 100,000

Compute IRR.

Sol: Discount all Rentals, CRY & UCRI such that its P.V should come to 100,000

Trial & Error

2Esaodssu meD.F

Assume D.F @ 12%

Yr	C.F	D.F @ 12%	P.V
1	25000	0.893	
2	25000	0.797	
3	25000	0.712	
4	25000	0.636	
5	25000 + 12500 + 7500	0.567	

P.V 101465 — Maniaaya 100000

D.F @ 14%

Yr	C.F	D.F @ 14%
1	25000	0.877
2	25000	0.769
3	25000	0.675
4	25000	0.592
5	25000 + 12500 + 7500	0.519

P.V 96180 approx — Maniaaya 100000

By using interpolation

nePV should be more than 1L

nepv in less than 1L

$$= 12\% + \frac{101465 - 100000}{101465 - 96180} \times (14\% - 12\%)$$

$$= 12\% + \frac{1465}{5285} \times 2\%$$

$$= 12\% + 0.277 \times 2\%$$

$$= 12\% + 0.554$$

IRR = 12.55% approx

101 → 12.768%

9 → Mt

Solved Example 1

Discount Lease Rent GRV 9 AGRI such hate that present value should come to 2.00.000 (Fair value)

Assume 10%

Yr	LR	DF @ 10%	PV
1	50000		
2	50000		
3	50000		
y	80000		
5	50000 + 25000 + 15000		

PV = 214340 → nahi aaya 200000

Assume 12%

Ur	LR	DF @ 12%	PV
1	50000	0.893	
2	50000	0.797	
3	50000	0.712	
y	80000	0.636	
5	50000 + 25000 + 15000	0.567	

PV 202780 → nahi aaya 200000

Interpolation nahi chalega → Kyu? ek 21 se upar } value dona 21 se
ek 22 se niche } upar hai

Assume 14%

Ur	LR	DF @ 14%	P
1	50000	0.877	
2	50000	0.769	
3	50000	0.675	
y	80000	0.592	
5	50000 + 25000 + 15000	0.519	

PV = 192360

101 → 21340 → Ignore

121 - 202780 6

141 - 192360 6

By using interpolation 12 + 202780 (-) 200000 / 241970 × (14% - 12%) 119

= 12% + (0.267 × 2%)

= 12% + 0.533

= 12.53% approx

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7. Accounting for operating lease

Accounting for operating lease → lessee Books / lessor Books

Normal Rental agreement

Lessor Books	lessee Books
Day ① No entry	Day ① No entry
Yrend CIB A/c Dr To Lease Rent Income (PL) TO lease Equilisation Blf	Yrend lease Rent Exp (PL) lease Equilisation Blf TO CIB to lease Equilisation Blf
IAS 19 suggests to Book lease rent on Slid Basis unless any other Basis is more appropriate	[same]
Yrend Depr^n (PL) TO PPE	Yrend No Deprn

Eg Ak sie took studio on lease (lessee) from BB sie (lessor) for 5yrs. It is an operating lease

Lease Rent	yr	LR
	1	100000
	2	110000
	3	120000
	4	130000
	5	140000
		600000

Avg Rent p.a (Sum Basis) = 600000 / 5yrs = 120000 p.a

In the Books of BB Sid (lessor)

Yr end				
	CIB	A/c	Dr	100,000
	Lease Equilisation	A/c	Dr	20,000
	TO Lease Rent			120000

Current Asset(s) BIs

Yr end				
	CIB	A/c	Dr	110000
	Lease Equilisation	A/c	DR	10000
	TO Lease Rent (PL)			120000

Yr end				
	CIB	A/c	Dr	120000
	TO Lease Rent (PL)			120000

484yd CIB A/c Dr 130000

To lease Rent (P/L) 120000

To lease Equilisation 10000

Yrsed CIB A/c Dr 140000

To lease Rent (P/L) 120000

To lease Equilisation 20000

Lessee Books (AK sir) Aug Rent Exp 1.24 p.a.

Urlend Lease Rent Exp (P/L) 120000

To UB 100000

To lease Equilisation 20000 → current liab

Yrlend Lease Rent Exp (P/L) 120000

To UB 110000

To lease Equilisation 10000

Urlend Lease Rent Exp (P/L) 120000

To UB 120000

Urlend Lease Rent Exp (P/L) 120000

lease Equilisation Dr 10000

To UB 130000

Lease Rent Exp (P/L) 120000

Lease Equilisation A/c 20000

140000

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* Special case in operating lease

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 Akild (lessee) for 3yrs (Op lease). The output estimated from the machine is 10000 units in Year 1, 20000 units in Yr 2 30000 units in Year 3. The annual agreed lease Rentals is ₹ 40,000 per annum. Calculate lease Rent Exp each Yr & Pass J.E.

Total lease Rent for 3 years = 40000 × 3yrs = 120000

Book in ratio of output

	Yr 1	Yr 2	Yr 3
output	10000 units	20000 units	30000 units
L R to be Booked in P/L	120000 × 10000/60000 = 20000	120000 × 20000/60000 = 40000	120000 × 30000/60000 = 60000

In the Books of lessee

Year				
Year 1	lease Rent Exp	PL	20000	
	Lease Equilisation A/c		20000	
	TO CIB			40000
Year 2	lease Rent Exp	CPIC	40000	
	TO CIB			40000
Year 3	lease Rent Exp	PL	60000	
	To CIB			40000
	TO lease Equilisation			20000

Hint: lessee Books

6 8 Fries

f

Illus 9

Op lease (3yrs) life of Asset (5yrs) Airing in the Books of lessee

a) Annual lease Rent

cost of machine		150000
(+) Profit margin	30%	45000
		195000

the life of Asset is 5yrs But we are giving on lease only for 3yrs ∴ Proportionate Rent will be recovered Output of each year is also given ∴ we will use the output to calculate Annual lease Rentals

Yr	Output	
1	40000	lease Period
2	50000	
3	60000	
4	80000	
5	70000	

768 mi's

Total Lease Rent = 195000 × output of 3yr / Total output

= 195000 × 150000 units / 300000 units

= 97500

Annual lease Rent (Equal) = 97500 / 3 = 32500 → Itna har saal paisa aayega.

Itnaharsaalpaisaaayega.by's

(b) Lease Rent Income to be Booked each Yr (CSMXRatio of output)

Total lease Rent 32500 × 3yr

= 97500

	Yr 1	982	Yr 3
output	40000 units	50000 units	60000 units
Lease Rent	₹ 26000	₹ 32500	₹ 39000
Income (Tr to PL)	(97500 × 40000/150000) 48	(97500 × 50000/150000) 98	(97500 × 60000/150000) 998

Journal Entries lessor → Not asked

Year1

CIB All Dr 32500

To lease Reelt Income 26000

To lease Equilisation 6500

Year2

CIB Alc Dr 32500

To lease Rent PIL 32500

Year3

CIB Alc Dr 32500

lease Equilisation 6500

to lease Rent Pll 390

(c) Depreciation for 3 years

Depreciation is always charged on the cost of machine (ie ₹ 150000) over useful life ie 5yrs By lessee. It should be allocated in ratio of output.

Yr	Deprn
1	20000
2	25000
3	30000
4	40000
5	35000

(150000 × 40000/300000 units)

150000 × 50000/300000

150000 × 60000/300000

150000 × 80000/300000

150000 × 70000/300000

19

IE Extra

Yr Deprn 20000

To PPE (machine) 20000

OR

8 Sale & lease Back

Sale a lease Back

Treatment of Profit loss on this sale Transaction is also discussed in AS 19

1] Sale Done & lease back deserts in Finance lease

Profit loss on sale → It is to be amortised over the lease team in the proportion of Deprn

2) Sale Done & leaseback results in Operating lease / operating lease

How to treat Profit/loss on sale

[BV/CA/WDV] ① selling Price ② Fair value ③

Case ① Sale Price = Fair value	case ② Sale Price is less than Fair value (Sp < FV)	case ③ Sale Price is more than Fair value (Sp > FV)
Profit/loss on sale can be recognised immediately	Profit/loss on sale can be recognised immediately However if there loss & such loss is compensated by future lease payments Below market Rate, then Such loss should be deferred & Booked in proportion of future lease payments	• Profit/loss upto Fair value can be Booked immediately • Excess selling price over Fair valu should be deferred & Booked over the period for which asset is expected to be used

Hint/shortcut:

F.V (-) B.V/WDV = +ve (Profit) -ve loss → Book immediately

S.P (-) F.V = +ve (profit) → Defer

ftp:tigefe cheating

Incase 14 2 Compare S Pawad to calculate Profit

written Downe Book value Ant caddying

Assist W Bu/cat = 100

i) SP 120, FV 120

Ans: Case ① FV = SP, Profit = S.P - B.V = 20 → Book immediately

ii) SP 120 FV 130

Ans: case ① SP < FV, Profit S.P - B.V = 20 → Book immediately

iii) SP 90, FY 110

Ans: Case ② SP<FV, Profit s.pt BV = 10 loss → Book immediately

90 ↓ 100

However, uparwaa.lagyan

iv) SP 150, FY 130

Ans: Case ③ FV(-)WDV = 20 → Profit Book immediately

as Case FUCWDV 130 ↓ 100 130ft

total profit 50

Cheating → SP(-)FV = 20 Profit → Defer

150 ↓ 130

150Cl

804 in futyrmof over lease

Asset

Illus 3 (CDR)

(i) Case ① (FY=SP) SP=BV(WDV) = 50 lakh (-) 40 lakhs

= 10 lakhs profit, Book immediately

(ii) Case ② (SP<FV) SP=BV(WDV) = 50 lakh (-) 40 lakh

= 10 lakhs profit → Book immediately

(iii) Case ② (SP<FV) SP=BV(WDV) = 38 lakh (-) 40 lakh

= 2 lakh loss → Book immediate

However if loss is compensated by Below market future lease payments then defer & amortise

(iv) Case ③ (SP>FV) FV(-)WDV = 40 (-) 40 = 0 → Book immediately

SP(-)FV = 50 (-) 40 = 10 Profit Defer over the lease period

sp

(v) Case ③ FV < BV (won) → 464740 − 6 lakh Profit Book immediately

SP > FV S.PH FV → 50 (−) 46 = 4 lakhs Profit Defer over the lease period

cheating

(vi) Case ④ FV < BV → 35 (−) 40 = (5) loss Book immediately

SP > FV SP 77 → 39 (−) 35 = 4 Profit Defer over the lease period

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9 Other Miscellaneous Points

(a) Contingent Rent

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

(b) Initial Direct Cost

Cost which are incurred for entering into lease. Generally they are incurred by lessee in most of the cases.

Accounting treatment → If incurred by lessor → Generally to PIL (all other cases)

→ Rare: If incurred by lessee (under Finance lease) → capitalise to the cost of Asset

(c) Normally lease Rentals are paid @ the end of the Year

eg: LR = 1L, LT = 3yrs, DF @ 10%

Yr	Lease Rent	D.F 10%	PV
1	100000	0.909	
2	100000	0826	
3	100000	0.751	

If Rentals are paid @ the Beginning of the year

Yr	Begn lease Rent	D.F 10%	PV
1	100000	0909 1	
2	100000	0.909	
3	100000	0826	