

7

ACCOUNTING STANDARD – 19

ACCOUNTING FOR LEASES

**"The higher you go, the more challenges you face.
Every New Levels Attract new devils"**

1. IMPORTANT DEFINITIONS

(1) What is Lease?

A Lease is

- A contract between lessor and lessee
- where lessor provides the **right to use** of an **asset**
- for a specified **period**
- in **exchange for consideration** (lease rent).

(2) Types of Leases?

- **Finance Lease:**

When **substantial risks and rewards** of ownership of asset are transferred to lessee.

- **Operating Lease:**

Any lease which is **not a Finance Lease**

(3) Indicators of Finance Lease:

AS 19 outlines some **situations** that would normally lead to a lease being classified as a **finance lease**:

1. **Ownership:** The **lessor transfers ownership** of the asset to the lessee by the end of the lease term. (Hire Purchase)
2. **Purchase Option:** The lessee **has the option to purchase the asset at a price** that is expected to be **sufficiently lower** than the fair value at the date of the option exercisability. It is reasonably certain, at the inception of the lease, that the option will be exercised
3. **Lease Term:** The **lease term is for the major part (at least 75%) of the economic life** of the asset even if the title is not transferred.
4. **PV of MLP:** At the inception of the lease the **present value of the minimum lease payments** amounts to at least substantially **(at least 90%)** all of **the fair value** of the leased asset.
5. **Specialized Asset:** The leased assets are of such a specialized nature that **only the lessee can use them without major modifications.** (i.e. customized asset for lessee's use)

(4) Important Dates under Leases -

Inception of the Lease	Commencement of the Lease
Date of Lease agreement or Date of Commitment by Parties whichever is earlier. As at this date, a lease is classified as either Finance or Operating lease. Also, Fair Value is determined on this date.	Date on which Asset is Available for Lessee As at this date, Lessee and Lessor starts accounting of leases.

(5) Other Important Terms

Initial direct costs (IDC)	Any Cost incurred at the commencement of lease by lessee or lessor for arranging the lease. Such as agreement cost, brokerage, Initial repairs and maintenance etc
Contingent Rent	It is a variable rent which may be paid by lessee only on fulfilment of certain conditions such as Additional rent (per Km) to be paid in case of excess running of Car taken on lease.
Residual Value	Value of Asset that can be realised at the end of useful life of Asset.

EXAMPLE 1: (Identification of Lease)

Asset is taken on Lease for 3 years; Economic Life is 6 Years.

Down Payment = 1,00,000/-; Annual Lease Payment = 3,00,000/-; Guaranteed Residual Value = 50,000/-

Fair Value of Asset at Inception = 8,50,000; Discount Rate = 10%

Identify the type of Lease?

SOLUTION:

If major Economic Life is covered under Lease term then it may be treated as Finance Lease

Here, it is difficult to conclude that it is a finance lease based on above condition, Since Economic life is 6 Years & Lease term is 3 Years.

If Sum of PV of Minimum Lease Payment is Equal to or subsequently covers initial Fair Value of Asset, then it may be treated as Finance Lease.

Year end	MLP	PV @10%
0	1,00,000	
1	3,00,000	
2	3,00,000	
3	3,50,000	
		8,83,621

Since, FV is 8,50,000, it can be seen from above Calculation that lessor is able to recover its entire Fair Value/Cost. Therefore, it is Finance Lease.

2. RECOGNITION AND MEASUREMENT OF FINANCE LEASE IN THE BOOKS OF LESSEE

Lessee shall measure and recognise the followings in the books:

- (a) Asset on Lease Account
- (b) Lease Liability Account

1. INITIAL RECOGNITION AND MEASUREMENT

Initial Recognition of Lease Liability and Asset on Lease	Lower of: Present Value (PV) of MLP or Fair Value of Asset Note 1: PV shall be calculated using following discounting rates: (a) Interest Rate implicit in lease (1st Priority); or (b) Lessee's incremental borrowing rate Note 2: When fair value is lower than PV of MLP, we have to re-calculate the Discount Rate by Trail & Error Method.
---	--

Minimum Lease Payment (MLP)	Initial Down Payment (+) Annual Lease Rents (+) Residual Value Guaranteed by Lessee (GRV)				
Initial Direct Cost (IDC) incurred by Lessee	IDC shall be capitalized to the cost of Asset				
Accounting Entry of Initial Recognition	Asset on Lease A/c Dr. (including IDC) To Bank A/c (IDC Payment & DP) To Lease Liability A/c (Balancing Fig.)				
Depreciation	Asset on Lease is subject to depreciation under AS 10 over the Lease Period or Life of Asset whichever is lower.				
Finance Charges (Interest Cost) on Lease Liability	Interest shall be calculated using the same discounting rate which was used earlier to calculate PV of MLP.				
	Interest shall be calculated on Opening Balance of Lease Liability as under:				
	Year	Opening	Interest	Payment	Closing
	(1)	(2)	(3) = (2) x Rate	(4)	(2+3-4)
Other Journal Entries					
	a) <u>For Charging Depreciation:</u> Depreciation A/c Dr. To Asset on Lease				
	b) <u>For Charging Finance Cost (Interest):</u> Finance Charges A/c Dr. To Lease Liability A/c				
	c) <u>For Payment of Lease Rent:</u> Lease Liability A/c Dr. To Bank A/c				
	d) <u>Transfer to Profit and Loss:</u> Profit and Loss A/c Dr. To Depreciation A/c To Finance Charges A/c				

Note:

Interest Rate Implicit in the Lease (i.e. IRR) (Consider always from Lessor's point of view)	It is the rate at which- $PV \text{ of } (MLP + UGRV) = FV \text{ at Inception} + IDC$ (Refer Example 3)
Lessee's Incremental Borrowing Rate	It is the rate at which Lessee can Borrow additional funds over a similar term , security for the same amount of underlying asset.

Example 2: (Finance Lease - Books of Lessee)

Lease Term = 5 Years; Fair Value = 25,00,000; Down Payment = 3,00,000; Annual Lease Payment = 5,00,000;

Guaranteed Residual Value = 4,00,000 & Discount Rate is 12%. Show Accounting for Lessee.

Solution: -

(i) **Asset shall be recorded at lower of: -**

(a) Fair Value = 25,00,000

(or)

(b) PV of MLP = 23,29,358

Therefore, Asset = 23,29,358

Beginning of Lease

Asset on Lease A/c	Dr.	23,29,358	
To Bank A/c			3,00,000
To Lease Liability A/c			20,29,358
(Being Asset taken on 5 Years Lease)			

(ii) **Calculation of Interest: -**

Year	Opening O/s	Interest @12%	Payment	Closing
1	20,29,358	2,43,523	5,00,000	17,72,881
2	17,72,881	2,12,746	5,00,000	14,85,627
3	14,85,627	1,78,275	5,00,000	11,63,902
4	11,63,902	1,39,668	5,00,000	8,03,570
5	8,03,570	96,430	9,00,000	0

1st Year end:

Finance Charges (Interest) A/c	Dr.	2,43,523	
To Lease Liability A/c			2,43,523
(Being Interest @12% Charged)			
Lease Liability A/c	Dr.	5,00,000	
To Bank A/c			5,00,000
(Being Annual Lease rent discharged)			
Depreciation A/c	Dr.	3,85,872	
To Asset on Lease A/c			3,85,872
(Being Depreciation Charged)			
<u>2329358 - 400000</u>			
5			
Profit & Loss A/c	Dr.	6,29,395	
To Interest Expenses A/c			2,43,523
To Depreciation A/c			3,85,872
(Being Expenses Charged to P&L)			

3. PART 5 – RECOGNITION AND MEASUREMENT OF LEASE CONTRACT IN THE BOOKS OF LESSOR

KEY CONCEPTS FOR UNDERSTANDING LESSORS ACCOUNTING

'Gross investment in the lease' (GIL) = Initial Down Payment + Annual Lease Payments + GRV + UGRV	
'Net investment in the lease' (NIL)	(PV of GIL) PV of (DP + Lease Payments + UGRV) - Initial Direct Cost
'Unguaranteed residual value'	Total Estimated Residual Value (-) GRV

ACCOUNTING FOR FINANCE LEASE

Non-dealer Lessor	Dealer or Manufacturer Lessor
<u>Initial Recognition:</u> Lease Receivable A/c Dr. (Net Invst. in Lease) Bank A/c Dr. (Down Payment less IDC) To Asset (PPE) A/c (Carrying Amt.) Difference in above entry is transfer to P&L a/c <u>Initial Direct Cost (IDC):</u> IDC is part of Cash Flows and will be considered under Interest Rate Calculation and then it is deducted from lease receivable. <u>Year End:</u> Lease Receivable A/c Dr. To Finance Income (P&L) A/c Bank A/c Dr. To Lease Receivable A/c (Collection of Lease Rent)	<u>Initial Recognition:</u> Dealer Lessor shall record Sale at commencement of Lease: Lease Receivable A/c Dr. (Net Invst. in Lease) COGS A/c Dr. (Balancing Fig.) To Sale A/c (Lower of FV or PV of MLP) To Inventory A/c (Carrying Amt.) Sale (-) COGS = Profit on Outright Sale <u>Initial Direct Cost (IDC):</u> IDC is directly transferred to Profit and Loss account and not a part of Interest Rate Calculation. <u>Year End:</u> Same as Non-dealer Lessor's Accounting
<u>Calculation of Unearned Finance Income:</u> Disclose Unearned Finance Income every year: Gross Investment in Lease (-) Net Investment in Lease	
<u>Subsequent Measurement at Balance Sheet Date:</u> At every BS date, Lease Receivable shall be recognised at Current Net Investment in Lease (i.e. PV of Remaining Lease Payments + Re-estimated UGRV). UGRV shall be reviewed atleast once in a year and if there is any reduction in the estimated UGRV the reduced amount shall be considered, this will result in reduction of Finance Income of the lessor.	

Example 3: (Calculation of Interest Rate Implicit in Lease)

FV = 20,00,000, Annual Lease Rent = 4,50,000 p.a., Term = 5 years, GRV = 1,00,000, UGRV = 2,00,000. Calculate Interest Rate Implicit in Lease.

Solution

At 9%, PV of Inflows = 19,45,322

At 8%, PV of Inflows = 20,00,894

% Increase	1	X
Amount Decrease	55,572	894

$8\% + 894/55,572 = 8.016\%$

EXAMPLE 4: (Finance Lease - Non Dealer Lessor)

(Finance Lease-Books of Lessor)

Lease Term = 5 Years; DP = 1,00,000; Annual Lease Rent = 2,50,000 Per Annum; Guaranteed Residual Value = 80,000; ERV = 1,50,000 & Interest rate Implicit in lease = 9%

SOLUTION:

	Year	Amount	PvF @ 9%
Down Payment	0	1,00,000	
Lease Rent	1	2,50,000	
Lease Rent	2	2,50,000	
Lease Rent	3	2,50,000	
Lease Rent	4	2,50,000	
Lease Payment	5	2,50,000	
Guaranteed Residual Value	5	80,000	
UGRV	5	70,000	
	GIL	15,00,000	11,69,903

Unearned Finance Income = Gil - Nil
 = 15,00,000 - 11,69,903
 = 3,30,097/- (For 5 Years)

Beginning of Lease:

Beginning of Lease:			
Lease Receivable a/c	Dr.	11,69,903	
To Asset A/c			11,69,903
(Being lease Receivable recognised @ NIL)			
Down Payment Received:			
Bank A/c	Dr.	1,00,000	
To Lease Receivable A/c			1,00,000

Finance Income on (11,69,903 - 1,00,000) X 9% i.e., 96,291/-

Year end 1st

Lease Receivable a/c	Dr.	96,291	
----------------------	-----	--------	--

	To Finance Income A/c		96,291	
	Bank A/c	Dr.	2,50,000	
	To Lease Receivable A/c		2,50,000	

Example 5: (Finance Lease - Dealer lessor)

Fair Value of Asset given = 15,00,000, Lease Rent p.a. = 5,50,000, Term = 3 years, GRV = 1,00,000, UGRV = 50,000, IRI = 10%, Book Value of Inventory Which is Leased = 13,80,000. This is Finance Lease. Show Accounting as per AS 19.

Solution:**1) Net Investment in Lease:**

Years	Amounts	PV @10%
1	5,50,000	14,80,465/-
2	5,50,000	
3	5,50,000 + 1,50,000	

2) PV of MLP: -

Years	Amounts	PV @10%
1	5,50,000	14,42,900/-
2	5,50,000	
3	5,50,000 + 1,00,000	

3) Lease Receivable to be recognised at NIL i.e., 14,80,465/-

4) Sales shall be recognised at Lower of

(a) FV or (b) PV of MLP i.e., Sales = 14,42,900

5) Journal Entry: -

Lease Receivable A/c	Dr.	14,80,465	
COGS A/c	Dr.	13,42,435	
To Sales A/c			14,42,900
To Inventory A/c			13,80,000
Trading A/c	Dr.	13,42,435	
To COGS A/c			13,42,435
Sales A/c	Dr.	14,42,900	
To Trading A/c			14,42,900

Trading A/c

COGS	13,42,435	Sales	14,42,900
Profit on Outright Sale	1,00,465		

EXAMPLE 6: (Calculation of Annual Lease Rent)

Fair Value of Asset = 15,00,000; Lease Term = 4 Years; IRI 12%; Down Payment = 1,00,000; GRV = 0 & UGRV = 1,25,000

Annual Lease Rent = Not Known (But it is equal every year)

Calculate Annual Lease Rent

SOLUTION:

Let us Assume, Annual Lease Rent is X

Year	Amount	Pv	Amount
0	1,00,000	1	1,00,000
1	X	0.893	0.893X
2	X	0.797	0.797X
3	X	0.712	0.712X
4	X	0.636	0.636X
4	1,25,000	0.636	79,500
			15,00,000

$$1,00,000 + 3.038x + 79,500 = 15,00,000$$

$$X = 4,34,661$$

Therefore, Annual Lease Rent is 4,34,661/-

4. OPERATING LEASE

Treatment of Operating lease is same for Lessor and Lessee. Lessor shall recognise Lease income and lessee shall recognise lease expense on straight line basis (SLM) unless any other basis is more appropriate and reliable than SLM.

Particulars	Treatment
Initial Measurement	Not Required
Recognition of Lease Income for Lessor	Bank A/c Dr. To Lease Rent Income A/c (Difference is transferred to Lease Equalisation Account) Recognise Income on SLM basis unless another basis is more appropriate.
Recognition of Lease Expense for Lessee	Lease Rent Expenses A/c Dr. To Bank A/c Dr. (Difference is transferred to Lease Equalisation Account) Recognise Income on SLM basis unless another systematic basis is more representative.
Depreciation on Asset	Depreciation shall be charged by Lessor Only because Asset is show under Lessor's Balance Sheet: Depreciation A/c Dr. To Asset A/c
Initial Direct Cost incurred by Lessor	IDC shall be deferred and Amortised by lessor and lessee over the lease term on either SLM basis or any other appropriate basis.

EXAMPLE 7: (Operating Lease)

Suppose outputs from a machine taken on a 3-year operating lease are estimated as 10,000 units in year 1; 20,000 units in year 2 and 50,000 units in year 3. The agreed annual lease payments are Rs. 25,000, Rs. 45,000 and Rs. 50,000 respectively. The total lease payment Rs. 1,20,000 in this example should be recognised in proportion of output as Rs. 15,000 in year 1, Rs. 30,000 in year 2 and Rs. 75,000 in year 3. The difference between lease rent due and lease rent recognised can be debited / credited to Lease Equalization A/c. The accounting entries for year 1 in books of lessee are suggested below

Lease Rent A/c Dr.	15,000	
Lease Equalization A/c Dr.	10,000	
To Lessor A/c		25,000
Lessor A/c Dr.	25,000	
To Bank A/c		25,000
Profit and Loss A/c Dr.	15,000	
To Lease Rent A/c		15,000

Since total lease rent due and recognised must be same, the Lease Equalisation A/c will close in the terminal year. Till then, the balance of Lease Equalisation A/c can be shown in the balance sheet under "Current Assets" or Current Liabilities" depending on the nature of balance.

5. PART 7 – SALE & LEASE BACK

A **sale and leaseback transaction** involves the sale of an asset and the leasing the same asset back. In this situation, a seller becomes a lessee, and a buyer becomes a lessor.

SALES AND LEASE BACK involves two transactions-

1. Sale of Asset by Seller Lessee to Buyer Lessor.
2. Lease Transaction (Finance Lease or Operating Lease)

Note: Here we have to understand the treatment of gain or loss on sale of Asset in the books of lessee (seller):

(A) Sale and Leaseback with Finance Lease

If the resulting lease is a **finance lease**, then in fact, the transaction is a loan securitized by the leased asset and seller / lessee keeps recognizing the asset. Any excess of proceeds over the carrying amount of the leased asset is deferred and amortized over the lease term in proportion of depreciation to be charged. (i.e. **Gain/Loss is to be deferred and amortised**)

Transaction 1: Sale of Asset

Bank A/c	Dr.
To Asset A/c	

To Gain on Sale A/c*

*This Gain Shall be Deferred & Amortised over the Lease term in proportion of Depreciation to be Charged by Seller Lessee

Transaction 2: Finance Lease

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

Lower of (a) FV or (b) PV of MLP

(B) Sale and Leaseback with Operating Lease

If the resulting lease is an operating lease, then a seller/lessee **derecognizes the asset**, and a **buyer/lessor recognizes the asset**. Further accounting treatment is as follow:

1. Important Information: -

SP means Actual Sale price of Asset (Agreed Contract Value)

CA Means Carrying Amt. (Book Value) of Asset

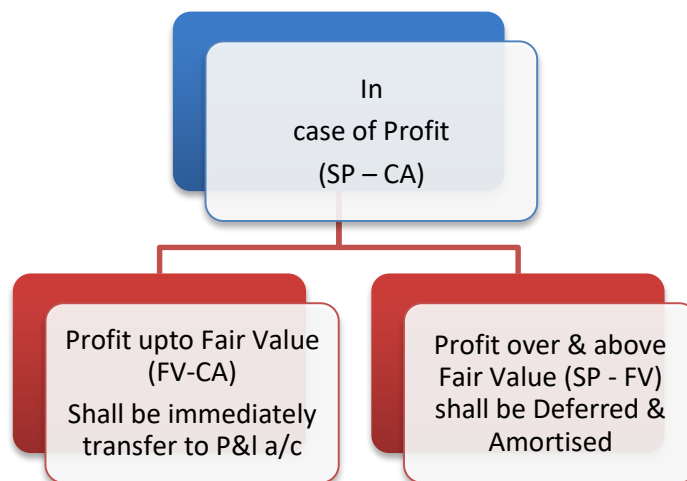
FV mean Fair Value of Asset (Market Value)

2. Important Rules: -

Rule - 1: If there is a Loss ($CA - SP$) then transfer it immediately to P&L.

Exceptions:- If Loss is to be Compensated with Future Lower Lease Rent. $\Rightarrow$ then Loss is to be Deferred & Amortized over the Lease Term.

Rule - 2:



Rule - 3: Before Applying above 2 Rules, always Check if FV is lower than CA, if Yes then Impairment loss ($CA - FV$) shall be recognized First in P&L & then we can apply above Rule 1 & 2.

EXAMPLE 8: -

Ajay owns a Building having FV of 25,00,000/-. To arrange the Funds for Business Ajay sold its Building to Jai for ₹ 25 Lacs & at the same time Jai leases the same Building Back to Ajay. Book value of Building in the book of Ajay is 23,00,000. This is a Finance Lease back by Jai to Ajay.

SOLUTION:

- (1) Who is Ajay = Seller Lessee
- (2) Who is Jai = Buyer Lesser
- (3) Who will Received the profit = Seller Lessee.

Under AS 19 we will discuss the A/c of profit in the book of Seller Lessee

Normally when PPE/Asset is sold, any gain or loss as sale shall be transfer to Profit and loss a/c of seller (AS 10). But this rule shall not be applied for "Sale & Lease Back Transaction". AS 19 has set specific rules for this transaction:

Sale & Finance Lease Back:

- a) Who was the owner before sale of Asset?
Ajay (seller Lessee)
- b) Who has got Substantial Risk & Rewards after sales lease?
Ajay (seller Lessee)

Conclusion: Any gain/Loss accrue to seller Lessee shall be deferred & Amortize over the lease Term in proportion of Depreciation.

(1)

Books of Seller Lessee

Bank A/c	Dr.	25,00,000	
To Asset			23,00,000
To Deferred Gain			2,00,000

(2)

Lease Back

Asset as Lease A/c	Dr.	
To Lease Liabilities A/c		

After 1 Year, Amortize the Deferred gain in Proportion of Depreciation, assuming Depreciation is 12%
WDV Method = $2,00,000 \times 12\% = 24,000$

Deferred gain A/c	Dr.	24,000
To Profit & Loss		24,000

Note: Unamortized Deferred gain of 1,76,000 to be shown on Liabilities side of B/S

Example 9: (Sale and Operating Lease Back)

Journalise in each of the following cases assuming transaction is of sale and operating lease back:

Cases	Fair Value	Book Value	Sale Price
1	100000	100000	100000
2	100000	80000	100000
3	100000	120000	100000
4	100000	100000	120000
5	100000	80000	120000

6	100000	120000	120000
7	100000	100000	90000
8	100000	90000	80000
9	100000	70000	80000
10	100000	110000	80000

Answer:

- 1) No Profit/Loss
- 2) Gain 20000 => P & L immediately
- 3) Loss 20000
General Rule - Immediately transfer to P&L
Exception - If loss is compensated with future lease payments then Deferred & Amortised.
- 4) Gain = 20000 D&A
- 5) Gain = 40000 20K P & L
 20K D&A
- 6) Rule-3 => Imp. Loss = 20000 P & L
Rule-2 => Profit = 20000 D&A
- 7) Loss = 10000 Generally P & L
 If compensated with rent then D&A
- 8) Loss = 10000 (same as 7)
- 9) Gain = 10000 P & L (Rule 2)
- 10) Rule - 3 => Imp. Loss 10000 P & L
Rule - 1 => Loss = 20000

6. MCQ's from ICAI Resources

1. A Ltd. sold machinery having WDV of ₹ 40 lakhs to B Ltd. for ₹ 50 lakhs (Fair value ₹ 50 lakhs) and same machinery was leased back by B Ltd. to A Ltd. The lease back is in nature of operating lease. The treatment will be
 - (a) A Ltd. should amortise the profit of ₹ 10 lakhs over lease term.
 - (b) A Ltd. should recognise the profit of ₹ 10 lakhs immediately.
 - (c) A Ltd. should defer the profit of ₹ 10 lakhs.
 - (d) B Ltd. should recognise the profit of ₹ 10 lakhs immediately.

2. In case of an operating lease - identify which statement is correct:
 - (a) The lessor continues to show the leased asset in its books of accounts.
 - (b) The lessor de-recognises the asset from its Balance Sheet.
 - (c) The lessor discontinues to claim depreciation in its books.
 - (d) The lessee recognises the asset in its Balance Sheet.

3. In case of finance lease, if the asset is returned back to the lessor at the end of the lease term - the lessee always claims depreciation based on which of the following:
 - (a) Useful life.
 - (b) Lease term.
 - (c) Useful life or lease term whichever is less.
 - (d) Useful life or lease term whichever is higher.

4. AS 19 lays down 5 deterministic conditions to classify the lease as a finance lease. To classify the lease as an operating lease - which statement is correct?
 - (a) Any 1 condition fails.
 - (b) Majority of the 5 conditions fail.
 - (c) All 5 conditions fail.
 - (d) Any 2 conditions fails.

5. The basis of classification of a lease is:
 - (a) Control Test.
 - (b) Risk and reward Test.
 - (c) Both control test and risk and reward test.
 - (d) Only reward Test

6. N Limited has entered into lease agreement for machinery from S Limited for 10 years for Rs. 1 lakh per year. Guaranteed scrap value of machinery after 15 years is Rs. 0.5 lakh unguaranteed scrap value is Rs. 0.2 lakh. Present Value of Rs. 1 lakh for 10 years is Rs. 7 lakh, Present value of Rs. 0.5 lakh after 15th year is 0.18 lakh & of Rs. 0.2 lakh is 0.07 lakh. Calculate Unearned Finance Income for S Limited.
- Rs. 3.45 Lakh
 - Rs. 3 Lakh
 - Rs. 3.32 Lakh
 - Rs. 3.13 Lakh
7. N Limited has taken a lease of land from S Limited for 15 years. Following are the terms of lease agreement: - N Limited to make payment of Rs. 1 lakh for 15 years. - N Limited to reimburse Rs. 10,000 tax to S limited every year. - If N Limited makes petrol pump on the land, then it has to pay Rs. 50,000 extra every year. N Limited is not sure about the receipt of approval for making petrol pump. - N Limited has option to purchase land for extra Rs. 10 lakh after end of lease. However, N Limited is not sure about purchase of land. Present Value of Rs. 1 lakh for 15 years is Rs. 12 lakh, Present value of Rs. 10 lakh after 15th year is 5.5 lakh. Calculate Minimum Lease Payment for N Limited.
- Rs. 15 Lakh
 - Rs. 12 Lakh
 - Rs. 34 Lakh
 - Rs. 24.7 Lakh
8. Which of the following would not lead to lease being classified as Finance lease?
- Title of the asset is not transferred but the lease term is for the major part of the economic life of the asset.
 - The lessee has the option to purchase the asset at a price which is expected to be sufficiently lower than the fair value at the date the option becomes exercisable.
 - The lease does not transfer substantially all the risks and rewards incident to ownership.
 - At the inception of the lease the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset.

9. Which of the following would not lead to lease being classified as Finance lease?
- Title of the asset is not transferred but the lease term is for the major part of the economic life of the asset.
 - The lessee has the option to
 - purchase the asset at a price which is expected to be sufficiently lower than the fair value at the date the option becomes exercisable.
 - The lease does not transfer substantially all the risks and rewards incident to ownership. At the inception of the lease the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset.
10. N Limited has taken a lease of land from S Limited for 15 years. Following are the terms of lease agreement: - N Limited to make payment of Rs. 1 lakh for 15 years. - N Limited to reimburse Rs. 10,000 taxes to S limited every year.
- If N Limited makes petrol pump on the land, then it has to pay Rs. 50,000 extra every year. N Limited is not sure about the receipt of approval for making petrol pump. - N Limited has option to purchase land for extra Rs. 10 lakh after end of lease. It is beneficial for N Limited to purchase land. Present Value of Rs. 1 lakh for 15 years is Rs. 12 lakh, Present value of Rs. 10 lakh after 15th year is 5.5 lakh. Calculate Minimum Lease Payment for N Limited.
- Rs. 25 Lakh
 - Rs. 17.5 Lakh
 - Rs. 34 Lakh
 - Rs. 24.7 Lakh

ANSWERS	1	2	3	4	5	6	7	8	9	10
	b	a	c	c	b	a	a	c	b	a

7. MCQ's Created by Jai Sir & Team

11. At the commencement of the lease term, lessor should recognize Lease Receivable in his statement of financial position of amount equal to:
- Net Investment in the lease.
 - Gross Investment in the lease.
 - MLP + any UGRV.
 - All of the above.
12. Which lease transfer substantially all risk & rewards incident to ownership of an asset?
- Operating lease
 - Finance Lease
 - Both
 - None
13. A portion of the lease payments that is not fixed in amount but is based on a factor other than just the passage of the time is termed as:
- House rent
 - Contingent rent
 - Outstanding rent
 - Incremental rent
14. In which type of lease, expenses like maintenance, repair and taxes are borne by the lessor:
- Operating lease
 - Finance lease
 - Both
 - None of the above
15. X Ltd sold machinery having WDV of Rs. 80 Lakhs to Y Ltd. for Rs. 90 Lakhs and the same machinery was leased back by Y Ltd. To X Ltd. The lease back is operating lease. What if Fair market value of machinery is Rs. 80 Lakhs and sale price is Rs. 90 lakhs
- Profit of Rs. 10 lakhs shall be transferred to P&L
 - Profit of Rs. 10 lakhs shall be deferred & amortized over the lease period
 - Profit of Rs. 5 Lakhs shall be transferred to P&L and Rest Rs. 5 Lakhs shall be deferred & Amortized over the lease term
 - As fair value is equal to WDV nothing to be done.
16. Annual lease rent = Rs. 80,000
 Lease period = 3 years
 Fair value at inception of lease = 3,00,000
 Guaranteed residual value = Rs. 28,000

Interest rate implicit = 12%

Calculate amount at which asset should be recorded in the books of lessee.

- a) 2,12,076
- b) 3,00,000
- c) 3,04,270
- d) 2,88,382

17. Unearned finance income is difference between:

- a) Gross Investment & Present value of MLP
- b) Net Investment & Present value of MLP
- c) Gross Investment & Present value of (MPL+UGRV)
- d) Gross Investment & Net Investment

18. In case of sale & lease back, if there is profit on sale, which is correct out of following:

- a) Profit over & above fair value shall be transferred to P&L immediately.
- b) Profit upto fair value shall be deferred & amortised over the lease period.
- c) Both (a) & (b)
- d) None of the above.

19. In the books of seller-lessee, if a sale and leaseback transactions results in an operating lease, and it is clear that the transaction is established at fair value, then:

- a) Any profit or loss should be recognised immediately.
- b) Any profit or loss should be deferred and amortised over the period for which the asset is expected to be used.
- c) If there is loss, then immediately recognised in P&L statement and if there is gain then amortised over the lease term.
- d) Either A or B

20. Classification of lease as Operating or Financing is done on following date:

- a) The date of the lease agreement
- b) The date of commitment by the parties to the principle provisions of the lease.
- c) At earlier of A & B
- d) The date when assets are available for use

21. What is the accounting treatment for all Initial Direct cost incurred by lessor to earn revenues from an operating lease?

- a) Deferred and allocated to income over the lease term in proportion to the recognition of the rent income.
- b) Recognised as an expense in the statement of profit and loss in the period in which they are incurred.
- c) Added in the cost of the asset
- d) Either A or B

22. On which date lessee should recognise Lease assets & Liability?
- a) The date of the lease agreement
 - b) The date of a commitment by the parties to the principle provision of the lease.
 - c) At the earlier of A & B
 - d) The date when asset is available for use.
23. If Sale and Leaseback transaction results in an operating lease and sale price is more than fair value, the excess amount is
- a) Credited to P&L statement.
 - b) Deferred and amortise over expected period of use of the asset.
 - c) Deferred and amortise over period of five years.
 - d) Amortised in proportion to lease payments.
24. X limited has taken machinery on Operating lease for 3 years. Initial yearly rent is Rs. 10,000. Rent is subject to 5% escalation every year. General inflation rate in the country is also 5% per year. What amount will be charged in the statement of P&L in the first year? Present value of total rent payment over 3 years is Rs. 26,051.
- a) Rs. 10,508.33
 - b) Rs. 10,000
 - c) Rs. 26,051
 - d) Rs. 11,302.33
25. According to AS 19, if a lease agreement is signed on January 15, but the parties committed to the principal provisions of the lease on December 31 of the previous year, when should the inception of the lease be recognized?
- a) January 15
 - b) December 31
 - c) The average of January 15 and December 31
 - d) The later of January 15 and December 31
26. A lessee enters into a lease agreement with a lessor. The lease term is 5 years, and the minimum lease payments are ₹10,000 per year, contingent rent estimated ₹5,000. Additionally, the lessee guarantees a residual value of ₹5,000 at the end of the lease term. What is the total minimum lease payment for the lessee? ₹
- a) ₹50,000
 - b) ₹45,000
 - c) ₹55,000
 - d) ₹10,000

27. In a lease arrangement of 3 years, the lessor receives annual lease payments of ₹20,000, guarantees a residual value of ₹5,000, and expects an undiscounted unguaranteed residual value (UGRV) of ₹2,000. What is the Net Investment (GI) for the lessor if discounting rate is 10%?
- a) ₹55,000
 - b) ₹67,000
 - c) ₹53,494
 - d) ₹25,000
28. What is unearned finance income for a lessor in a finance lease?
- a) Gross investment divided by lease term.
 - b) Total of lease payments and residual value less present value of gross investment.
 - c) Gross investment less residual value.
 - d) Gross investment less unguaranteed residual value.
29. What does the lessee's incremental borrowing rate of interest represent in lease accounting?
- a) The lessor's desired profit margin.
 - b) The interest rate implicit in the lease.
 - c) Revised interest rate implicit in the lease to get extra income through lease.
 - d) The rate of interest the lessee would incur to borrow funds to purchase a similar asset over a similar term and with similar security.
30. ABC Leasing, a lessor, has incurred initial direct costs, including commissions and legal fees, while negotiating and arranging a finance lease. How should ABC Leasing account for these initial direct costs?
- a) Allocate them against the finance income over the lease term.
 - b) Capitalize them as part of the leased asset and amortize over the lease term.
 - c) (a) and (b) both
 - d) (a) or (b)
31. ABC Leasing enters into a finance lease with a lessee. The lease term is 10 years, and the interest rate implicit in the lease is 8%. How should ABC Leasing recognize unearned finance income over the lease term according to AS 19?
- a) Recognize unearned finance income immediately in the first year.
 - b) Allocate unearned
 - c) finance income evenly over the lease term.
 - d) Systematically and rationally recognize unearned finance income based on a constant periodic return using the implicit interest rate.
 - e) Base unearned finance income recognition on the lessee's payment schedule.
32. ABC Leasing has leased specialized equipment to a lessee under a finance lease. The lease term is 8 years, and the estimated unguaranteed residual value is \$20,000. According to

AS 19, if ABC Leasing identifies a reduction in the estimated unguaranteed residual value during a regular review, what action should be taken regarding income allocation?

- a) Revise the income allocation for the remaining lease term, but only if the reduction is significant.
- b) Ignore the reduction in unguaranteed residual value for income allocation purposes.
- c) Revise the income allocation over the remaining lease term immediately, irrespective of the magnitude of the reduction.
- d) Continue with the existing income allocation, and only adjust for the reduction in unguaranteed residual value at the end of the lease term.

33. ABC Manufacturing, acting as a lessor, sells machinery to a lessee under a finance lease arrangement. According to AS 19, if artificially low rates of interest are quoted in the lease agreement, how should ABC Manufacturing recognize the profit on the sale in its statement of profit and loss?

- a) Recognize the entire profit on the sale immediately, irrespective of the quoted interest rates.
- b) Restrict the profit on the sale to that which would apply if a commercial rate of interest were charged.
- c) Recognize profit on the sale over the lease term, even if artificially low rates of interest are quoted.
- d) Adjust the profit on the sale based on the prevailing market interest rates at the inception of the lease.

34. XYZ Ltd, a lessee, has entered into an operating lease for specialized manufacturing equipment. The lease term is 10 years. According to AS 19, under what circumstances can XYZ Ltd deviate from recognizing lease payments on a straight-line basis?

- a) If the fair value of the leased equipment fluctuates during the lease term.
- b) If XYZ Ltd anticipates changes in its financial position during the lease term.
- c) If another systematic basis is more representative of the time pattern of the user's benefit.
- d) If the lessor offers variable lease payments based on market conditions.

35. Mr. Johnson, a lessee, enters into an operating lease agreement for a commercial property with Realty Leasing. The lease term is 12 years. According to AS 19, what is the primary consideration for Mr. Johnson in determining the recognition of lease payments?

- a) The lessor's accounting policies for operating leases.
- b) The fair value of the leased property.
- c) The time pattern of user's benefit.
- d) Mr. Johnson's preferred method of accounting.

36. ABC Leasing, as a lessor, leases machinery to XYZ Corporation. According to AS 19, how should ABC Leasing recognize depreciation in its books for the leased machinery if it leases the machine on finance lease?
- a) Depreciate the leased machinery based on the lessee's depreciation policy.
 - b) Recognize depreciation on a straight-line basis over the lease term, irrespective of the lessor's normal depreciation policy.
 - c) Apply the lessor's normal depreciation policy for similar assets consistently, as stated in AS 10.
 - d) Lessor cannot book depreciation in his books in case of leased asset.
37. ABC Corporation, as a seller-lessee, enters into a sale and leaseback transaction resulting in a finance lease. The excess of sales proceeds over the carrying amount of the asset should be deferred. According to AS 19, how should ABC Corporation amortize this excess over the lease term?
- a) Amortize the excess evenly over the entire lease term.
 - b) Amortize the excess in proportion to the depreciation of the leased asset.
 - c) Amortize the excess based on the fair value of the asset.
 - d) Amortize the excess only if the lease payments exceed market rates.
38. Lease Term is 5 Years. Initial Direct Cost incurred by lessor is 50,000. Fair Value of Leased Asset is 14,50,000. Annual lease rent is Equal in every year. GRV is 1,00,000 and UGRV is 60,000. Interest Rate Implicit in lease is 10%. Calculate Annual Lease Rent Amount.
- (a) 3,50,000
 - (b) 3,69,560
 - (c) 3,95,778
 - (d) 3,79,393
39. Lease Term is 3 years. Annual Lease Rent is 5,00,000. GRV is 2,00,000 and UGRV is 1,00,000. Fair Value of Lease Asset is 15,00,00 and initial direct cost is 50,000. What should be the approx interest rate implicit in lease?
- (a) 8.23%
 - (b) 10%
 - (c) 7.63%
 - (d) 7.23%

Correct Answer											
Q11	Q12	Q13	Q14	Q15	Q16	Q17	Q18	Q19	Q20	Q21	Q22
a	b	b	a	b	a	c	d	a	c	d	d
Q23	Q24	Q25	Q26	Q27	Q28	Q29	Q30	Q31	Q32	Q33	Q34
b	a	b	c	a	b	d	a	c	a	b	C
Q35	Q36	Q37	Q38	Q39							
c	d	b	b	d							



Student Notes:-