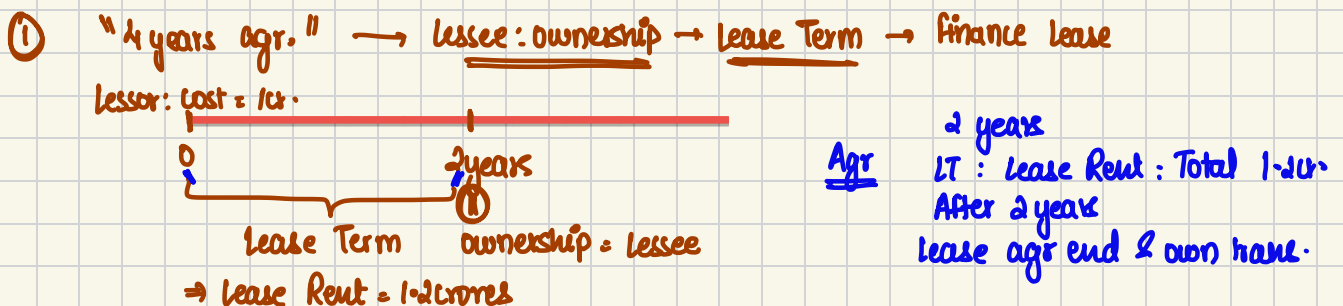
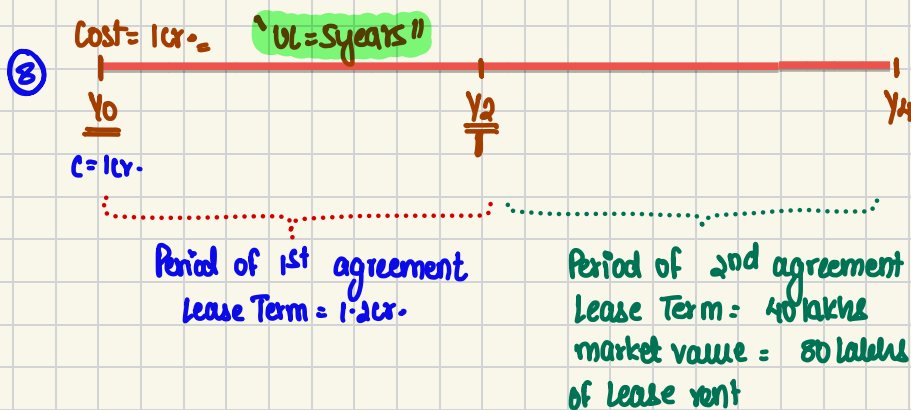
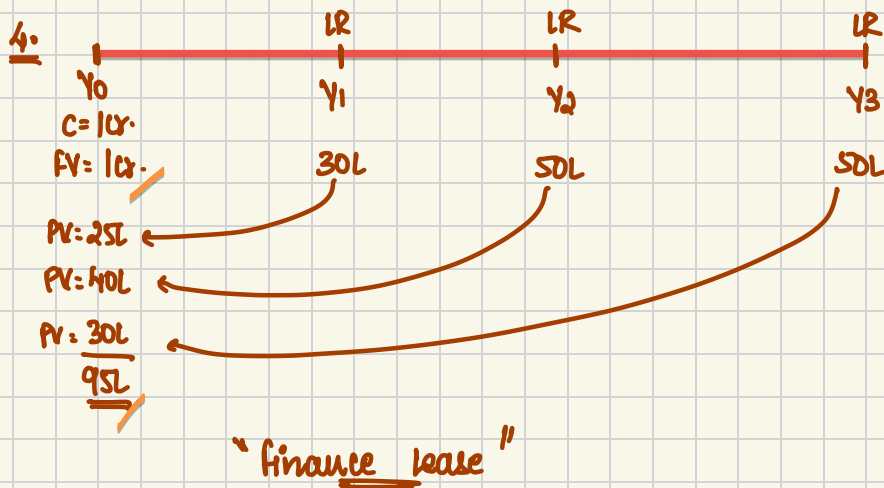
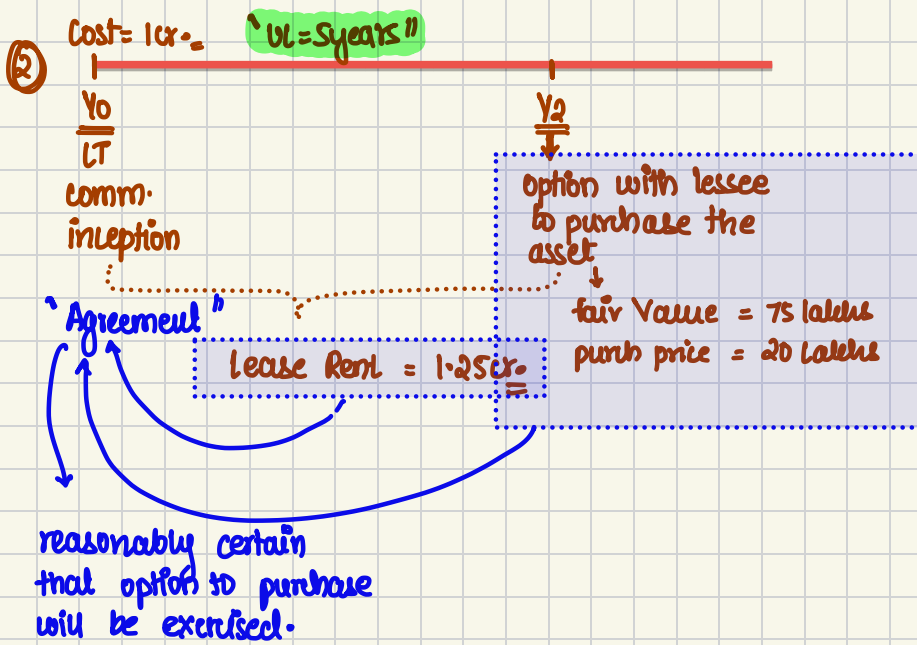


1. Right to use the asset.
2. Substantially all risks & rewards related to the ownership of that asset vest with the lessee.

Indicators





- Finance Lease : meaning ✓
- Finance lease : indicators ✓
- Finance lease : Accounting : lessor ✓
- Minimum lease Payment : Pending (MLP)
- A: Lease Rec: Net Investment in Lease Lessee ✓
- A: mach. acq: MLP : Pending ✓

Minimum Lease Payments

Lessee POV

- Lease Rentals
- Guaranteed Residual Value
 - : by lessee himself
 - : by third party on behalf of lessee.

Lessor POV

- Lease Rentals
- Guaranteed Residual Value
 - : by lessee himself
 - : by third party on behalf of lessee.
 - : by an independent third party.

Contingent rent (lease payment)

not included in MLP.

same

Gross Investment in Lease (Lessor POV)

+ Unguaranteed Residual Value

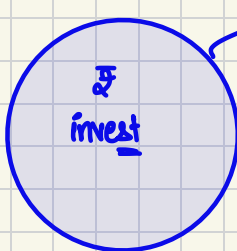
i.e.

MLP (Lessor POV) → FV

+ Unguaranteed R.V. → FV

- Interest (Unearned Finance Income)

Net Investment in Lease (PV)



Recover

→ Gr.I. Lease (Lessor POV)

→ LR

→ GRV : lessee & third party

→ UGRV :

} MLP

(1-5)
(5)

(5)

Gross Inv. in Lease
(Recovery - Lessor: FV)

LR	1	50000
	2	50000
	3	50000
	4	50000
	5	50000
GRV	5	20000
UGRV	5	10000
		<u>280000</u>

→ F.V.

- Interest

- Interest

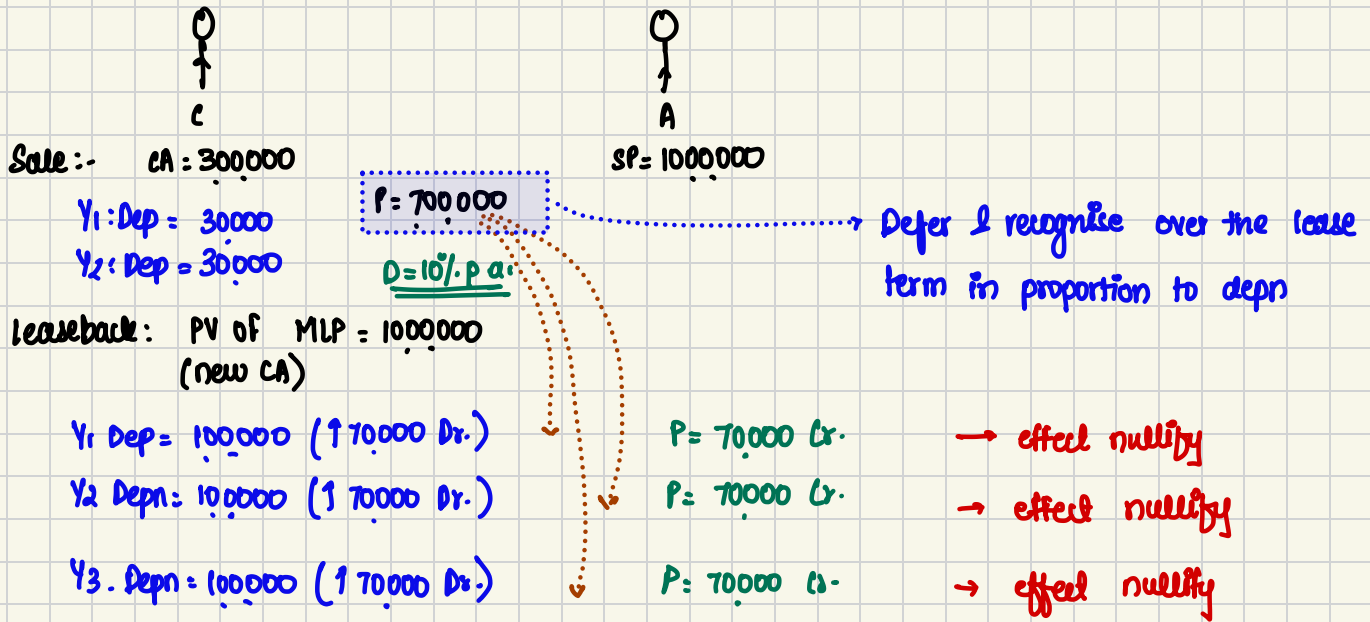
Unearned Finance Income

Net Investment in Lease
(Recovery - Lessor @ PV)

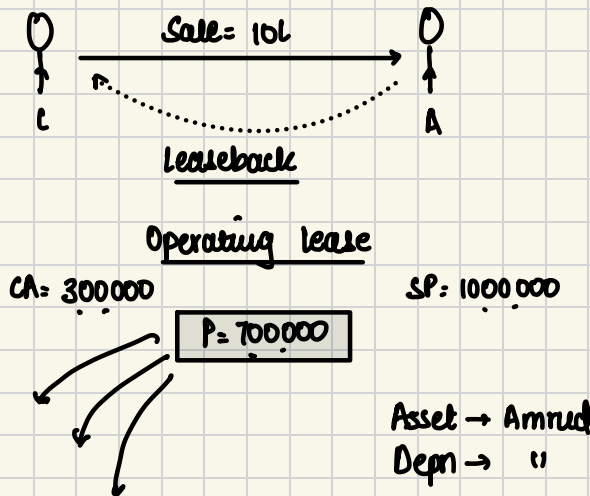
0	45000
0	43000
0	42000
0	40000
0	35000
0	18000
0	6000
	<u>229000</u>

→ P.V.

Sale & leaseback : Finance lease



Sale & leaseback : Operating lease



THUMB RULE

- Compare Carrying Amount with fair Value.

100	←	150	→ nothing to be done
200	7	150	

Recognise loss and calculate RCA:

- Compare Revised Carrying with selling Price.

RCA = 150

FV = 150

SP = 250

Calculate Profit/Loss on sale.

Recognise profit/loss immediately except when $SP > FV$ or $SP < FV$.
In such a case defer the profit/loss over lease term.

CASE I :-

1. Compare CA with FV

$$CA = SD \quad FV = SD$$

No loss recognised.
 $RCA = SD$

2. Compare RCA with SP

$$RCA = SD \quad SP = SD$$

No P/L

CASE II :-

1. Compare CA with FV.

$$CA = SS \quad FV = SD$$

$$\text{Loss} = 5 \text{ (P&L Dr.)}$$

$$RCA = SD$$

2. Compare RCA with SP.

$$RCA = SD \quad SP = SD$$

No P/L

CASE IV :-

$$CA = SD \quad FV = SD$$

No loss
 $RCA = SD$

$$RCA = SD \quad SP = SS \quad (FV = SD)$$

$$P = 5$$

Defer & amortise over lease term.

CASE VII :-

$$CA = SD \quad FV = SD$$

No loss

$$RCA = SD$$

$$RCA = SD \quad SP = 45 \quad (FV = SD)$$

$L = 5$
either
Imm. recog. to P&L. Defer & amortise

If going ahead the lease rents are charged at a lower rate than the market rate.

CASE V :-

$$CA = SS \quad FV = SD$$

loss = 5 (P&L Dr.)
 $RCA = SD$

$$RCA = SD \quad SP = SS \quad (FV = SD)$$

$$P = 5$$

Defer & amortise over lease term.

CASE VIII :-

$$CA = SS \quad FV = SD$$

$L = 5$ (P&L Dr.)

$$RCA = SD$$

$$RCA = SD \quad SP = 45 \quad (FV = SD)$$

$L = 5$
either
Imm. recog. to P&L. Defer & amortise

If going ahead the lease rents are charged at a lower rate than the market rate.

CASE III :-

1. Compare CA with FV.

$$CA = 45 \quad FV = SD$$

No loss.
 $RCA = 45$.

2. Compare RCA with SP

$$RCA = 45 \quad SP = SD \quad (FV = SD)$$

$$P = 5$$

Immediately recogn. (P&L Cr.)

CASE VI :-

$$CA = 45 \quad FV = SD$$

No loss
 $RCA = 45$

$$RCA = 45 \quad SP = SS \quad (FV = SD)$$

$$P = 10$$

$P = 5$ $P = 5$
Imm. recog. to P&L Cr. Defer & amortise

CASE IX :-

$$CA = 45 \quad FV = SD$$

$L = 0$

$$RCA = 45$$

$$RCA = 45 \quad SP = 45$$

$$L = 0$$

FV SD

SP=SS

L33

Chinku

P=5 Cr.

LR= 1st Dr.

1st Dr.

1st Dr.

1st Dr.

1st Dr.

1 Cr.

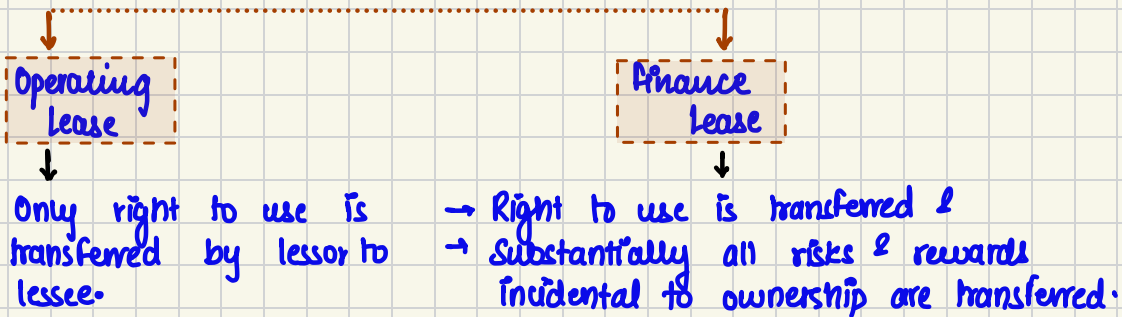
1 Cr.

1 Cr.

Lease :- Lessor conveys to the lessee :-

- the right to use the asset
- in exchange :- a payment series of payments.

Leases can be of two types :-



Indicators of Finance Lease

- 1) Lessor transfer the ownership to lessee at the end of lease term.
- 2) Lessor gives the lessee the right to purchase the asset at the end of lease term at a price which is substantially lower than the fair market value, such that at the inception of lease it becomes reasonably certain that the lessee will exercise the option.
- 3) Lease Term is for the major part of economic life of asset.
- 4) PV of MLP is approximately equal to fair value at the inception.
- 5) The asset is of such specialised nature that only the lessee can use it without major modifications being made.
- 6) If on cancellation of lease, the losses accruing to lessor are borne by lessee.
- 7) Fluctuations to Residual Value → Gain/Loss → accruing to lessee.
- 8) Lease rent for secondary term is substantially lower.

Accounting for Finance Lease

Lessee Books

Assets :- Leased Asset + Initial Direct cost
Expense :- Depreciation, Interest (Finance Ch.)
Liability :- Lease Rental payable

Lessee will record the asset in NB books at lower of :-

- 1) Present Value of MLP
- 2) Fair Value.

Lessor Books

Asset :- Lease Rent receivable.
Income :- Interest Income
Initial Direct cost will be charged to P&L.

Important Terminologies for practical questions

Minimum Lease Payment

Lessee POV

- Lease Rentals
- Guaranteed residual value : by lessee : on behalf of lessee

Lessor POV

- Lease Rentals
- Guaranteed residual value : by lessee : on behalf of lessee : by independent third party.

* contingent rent is not included in MLP.

+ Unguaranteed Residual Value

= Gross Investment in lease (MLP + UGRV)

- Interest Unearned finance income

= Net Investment in lease (PV of MLP + PV of UGRV)

Accounting for operating lease

Lessee Books

Asset :- x
Expense :- Lease Rentals + Initial Direct cost
Liability :- Lease Rental pay.

Lessor Books

Asset :- Leased Asset + IDC
Expense :- Depreciation
Income :- Lease Rental

Sale & Leaseback Transactions

Finance Lease

- Profit/loss on sale will be deferred and amortised over the lease term.

Operating Lease

THUMB RULE

- Compare CA with FV.
- Compare RCA with SP.

Sale & Leaseback : Operating lease

(imp. points)

- 1) IF $CA > FV$: recognise loss immediately & bring down CA to FV.
IF $CA < FV$: no treatment required.

We will arrive at RCA.

- 2) $RCA < SP$: Profit

$SP > FV$

Profit will be deferred & amortised over lease term.

$SP = FV$

Profit will be recognised immediately.

$RCA > SP$: Loss

$SP < FV$

loss is compensated by future lower lease rentals

Defer and amortise over lease term.

Loss does not have an impact on future lease rentals.

Recognise loss immediately.

Recognise loss immediately

Question 4:- As per AS-19: Leases, in case of a finance lease the lessee will record the asset in his books at the lower of the following:-

1. PV of Minimum lease Payment = 10,07,020
2. Fair Value = 10,00,000

L32

Calculation of Present Value of minimum lease payment

Year	Cashflows	Discounting factor @ 16%/-	Discounted Cash Flows
1	350000	0.8621	301735
2	350000	0.7432	260120
3	350000	0.6407	224245
4	350000	0.5523	193305
4	50000	0.5523	27615
MLP = 1450000			1007020 ⇒ PV of MLP

Hence, the asset will be recorded at ₹ 10,00,000.

Calculation of finance charges

Year	Opening o/s	+ Interest (16%/-)	= Total o/s	- Instalment	= Closing o/s
1	1000000	160000	= 1160000	- 350000	= 810000
2	810000	129600	= 939600	- 350000	= 589600
3	589600	94336	= 683936	- 350000	= 333936
4	333936	66064 (bal.)	= 400000	- 400000 (?)	= 0

Question 5b) CASE I :-

134

$$CA = 40L \quad FV = 45 \quad SP = 38$$

1) Compare CA with FV.

$$CA = 40L \quad FV = 45L$$

$$\text{Loss} = 0$$

$$RCA = 40L$$

2) Compare RCA with SP.

$$RCA = 40L \quad SP = 38L \quad (FV = 45L)$$

$$\text{Loss} = 2L$$

Loss of 2L will be charged to P&L a/c if such loss is not compensated by future lower lease rentals.

However, if such loss is compensated by future lower lease rentals then such loss will be deferred & amortised over the lease term.

CASE II :-

$$CA = 40L \quad FV = 40L \quad SP = 50L$$

1) Compare CA with FV.

$$CA = 40L \quad FV = 40L$$

$$\text{No Loss}$$

$$RCA = 40L$$

2) Compare RCA with SP.

$$RCA = 40L \quad SP = 50L \quad (FV = 40L)$$

$$\text{Profit} = 10L$$

Since the SP exceeds the FV the profit of ₹ 10 lakhs will be deferred and amortised over the lease term.

CASE III :-

$$CA = 40L \quad FV = 46L \quad SP = 50L$$

1) Compare CA with FV.

$$CA = 40L \quad FV = 46L$$

$$\text{Loss} = 0$$

$$RCA = 40L$$

2) Compare RCA with SP.

$$RCA = 40L \quad SP = 50L \quad (FV = 46L)$$

$$P = 10L$$



P= GL
↓
Credited to
P&L.

P= AL
↓
Defer & amortise
over lease term.

Answer 6:- As per AS-19: Leases, a lease will be classified as a finance lease if

1. PV of MLP is subs. equal to the FV at inception
2. Lease Term is for major part of economic life of the asset.

In the given case, $CT = 3$ years
 $EL = 14$ years

PV of MLP $\neq$ FV

Hence the given lease agreement signifies OL and the lease rentals should be charged to P&L a/c.

Question 10: Indicator of finance lease

133

PV of MLP "almost = " fair value at the inception
652190 almost = 700000

Calculation of PV of MLP

At inception ; fair value = Net investment in lease

$$\begin{aligned} \text{Net Investment in lease} &= \text{PV of MLP} + \text{PV of UGRV} \\ 700000 &= x + (70000 \times 0.683) \\ 700000 &= x + 47810 \\ 652190 &= x \end{aligned}$$

Since the PV of MLP is almost equal to the fair value at the inception of lease, the lease constitutes finance lease.

Calculation of Unearned finance income

$$\begin{aligned} &= \text{Gross Investment in lease} - \text{Net Investment in lease} \\ &= 893212 - 700000 \\ &= 193212 \end{aligned}$$

Calculation of Gross Investment in lease

⇒ Lease Rent

Guaranteed Residual Value

Unguaranteed Residual Value

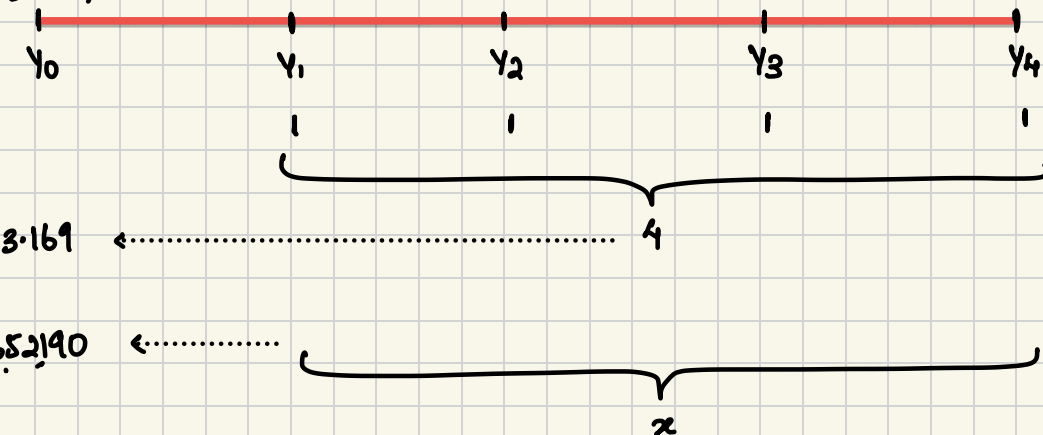
→ 823212

→ 0 → because instalments are equal.

→ 70000

893212

DR = 10%.



$$x = 652190 \times \frac{4}{3.169}$$

$$x = 823212$$

Minimum lease Payment

L22

$$\begin{array}{lcl} 1. \text{ lessee (Bau)} :- & \text{LR} & = 25000 \times 32 = 800000 \\ & \text{GRV} & = \underline{55000} \\ & \text{MLP} & = \underline{855000} \\ & & \uparrow \\ & & \text{Same from Lessor POV} \end{array}$$

$$\begin{array}{lcl} 2. \text{ lessee (Bau)} : & \text{LR} & = 15000 \times 48 : 720000 \\ & \text{GRV} & = \underline{10000} \\ & & \underline{730000} \\ & & \uparrow \\ & & \text{same from lessor POV} \end{array}$$

* contingent rent not included in MLP.

Answer 12 :- Calculation of Gross Investment & Net Investment in Lease

L3a

Year	CashFlow (GIL)	Discounting factor @15%	Discounted cash flows (NIL)
1	800000	0.8696	695680
2	800000	0.7561	604880
3	800000	0.6575	526000
4	800000	0.5718	457440
5	800000	0.4972	397760
5	160000	0.4972	79552
5	140000	0.4972	69608
GIL = <u>4300000</u>			NIL → <u>2830920</u>

$$\begin{aligned}\text{Unearned finance income} &= \text{GIL} - \text{NIL} \\ &= 1469080 \text{/-}\end{aligned}$$

Quote :- GIL
 NIL
 MLP }

Question 15 :-

132

GILL LR
RV

$$\begin{aligned}
 &= 500000 \times 3.3522 = 1676100 \\
 &= 200000 \times 0.4972 = 99440 \\
 \text{GILL} &= \underline{2100000} \quad \text{NIL} = \underline{1775540} \\
 &\downarrow \quad \downarrow \\
 &\text{lessor} \quad \text{lessor} \\
 &\quad \text{VFI} = \underline{924460} \\
 &\quad \downarrow \\
 &\quad \text{lessor}
 \end{aligned}$$

$$\begin{aligned}
 &SL \times (Y_1F + Y_2F + Y_3F) \\
 &SL \times \text{PVAF}
 \end{aligned}$$

lessee books → PV of MLP
FV } lower → Amount : Recog.

133

$$\begin{aligned}
 \text{i) PV of MLP} &\rightarrow \text{lease Rent} \rightarrow 500000 \times 3.3522 = 1676100 \\
 &\quad \text{GRV} \rightarrow 100000 \times 0.4972 = \underline{49720} \\
 &\quad \quad \quad \underline{1725820} \\
 \text{2) FV} &= \underline{2000000} \quad \left. \begin{array}{l} \\ \\ \end{array} \right\} \text{Lower}
 \end{aligned}$$

Cost of asset in lessee books → 1725820.

lessee Books → Asset record
Depreciation
lease Rental
Interest } homogenous class
↳ calculation table.

In the books of lessee

Journal Entry : Cash Price Method

Year 1

Beginning Asset
To, lessor

Dr. 1725820 ✓
1725820

End Depreciation
To, Asset

Dr. 172582 ✓
172582

Interest
To, lessor Dr. 258873
258873 ✓

lessor
To, Bank Dr. 500000
500000 ✓

P&L
To, Interest Dr. 431455
To, Depreciation 258873
172582

Opening o/s	+	Interest	=	Total o/s	-	Installment	=	Closing o/s
<u>1725820</u> ✓	+	<u>258873</u>	=	1984693	-	<u>500000</u>	=	1484693
1484693	+	222704	=	1707397	-	500000	=	1207397
1207397	+	181110	=	1388507	-	500000	=	888507
888507	+	133276	=	1021783	-	500000	=	521783
521783	+	78217	=	600000	-	600000	=	0
		(bal.)		<u>874180</u>				

Journal Entries by Interest Suspense Method

Y₀ Asset
To, lessor Dr. 1725820
1725820

Y₀ Interest Suspense Dr. 874180
To, lessor 874180

Y₁ Interest Dr. 258873
To, Interest Suspense 258873

Y₁ lessor Dr. 500000
To, Bank 500000

Y₁ Depreciation Dr. 172582
To, Asset 172582

Y₁ P&L Dr. 431455
To, Interest 258873
To, Depreciation 172582

Interest Suspense presentation B/s → Y₁

lessor	1725820
	874180
- Int sus.	(615307)
	<u>1984693</u>

Question 17:-

134

CASE I :- CA = 50L FV = 60L SP = 60L

1) Compare Carrying Amt. with Fair Value

CA = 50L FV = 60L

No loss.
RCA = 50L

2) Compare RCA with Selling Price

RCA = 50L SP = 60L
P = 10L (FV = 60L)
↓
Credit to P&L

CASE II :-

CA = 50L FV = 50L SP = 45L

1) Compare CA = 50L with FV = 50L

CA = 50L FV = 50L
L = 0
RCA = 50L

2) Compare RCA = 50L with SP = 45L

RCA = 50L SP = 45L
L = 5L (FV = 50L)

If such loss is compensated by future lower lease rentals then defer and amortise the loss over the lease term.

If such loss is not compensated by future lower lease rentals then immediately charge it to P&L a/c.

CASE III :-

CA = 50L FV = 55L SP = 62L

1) Compare CA with FV.

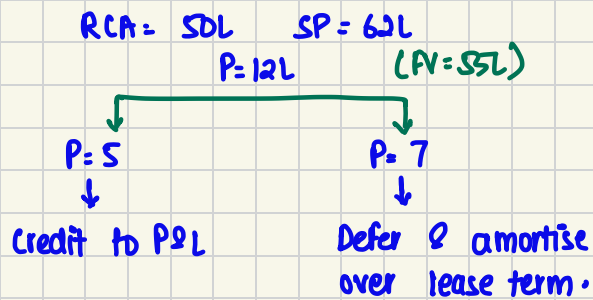
CA = 50L FV = 55L

$$L = 0$$

$$RCA = SDL$$

L34

2) Compare RCA with SP.



CASE IV :- $CA = SDL$ $FV = 45L$ $SP = 48L$

i) Compare CA with FV

$CA = SDL$ $FV = 45L$
 $L = 5L \rightarrow$ immediately Dr. to P&L.
 $RCA = 45L$

2) Compare RCA with SP

$RCA = 45L$ $SP = 48L$
 $P = 3L$ $(FV = 45L)$
 $\downarrow$
 Defer & amortise
 over lease term