

SREERAM COACHING POINT

AS 19

ACCOUNTING FOR LEASES

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Lease is an arrangement by which one person gives right to use an asset for given period of time to the another person on rent

Lease may be of two types: a) Finance Lease b) Operating Lease

The word lease includes “Hire Purchase”.

Finance Lease is a lease which transfers substantially all the risks and rewards incidental to ownership of an asset to the lessee by the lessor but not the legal ownership

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In the following situations, the lease transactions are called finance lease:

- a. The lessee will get the ownership of leased asset at the end of the lease term**
- b. The lessee has an option to buy the leased asset at the end of term at price, which is lower than the expected fair value on the date on which option will be exercised**
- c. The lease term covers the major part of the life of the asset**
- d. At the beginning of lease term, present value of minimum lease rental covers substantially the initial fair value of the leased asset**
- e. The asset given on lease to lessee is of specialized nature and can only be used by the lessee without major modification**

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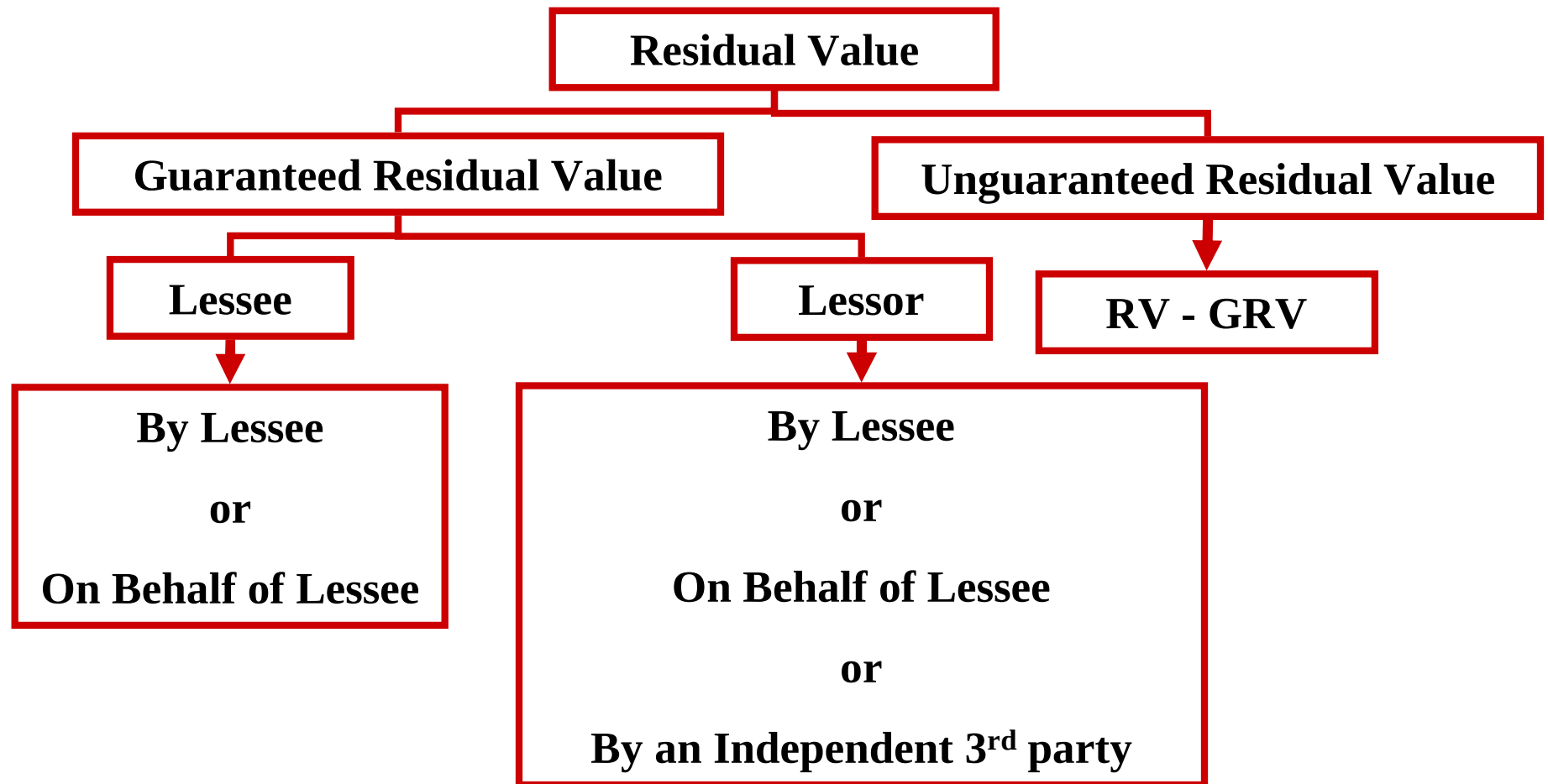
Operating lease is a lease which does not transfers substantially all the risks and rewards incidental to ownership. To be precise, it is a lease other than “Financial Lease”.

Important Terms	
1	Inception of Lease
2	Minimum Lease Payment
3	Residual Value
4	GIIL
5	NIIL
6	UFI
7	Interest Rate Implicit

Inception of the Lease

Earlier of the date of the lease and the date of a commitment by the parties to the principal provisions of the lease

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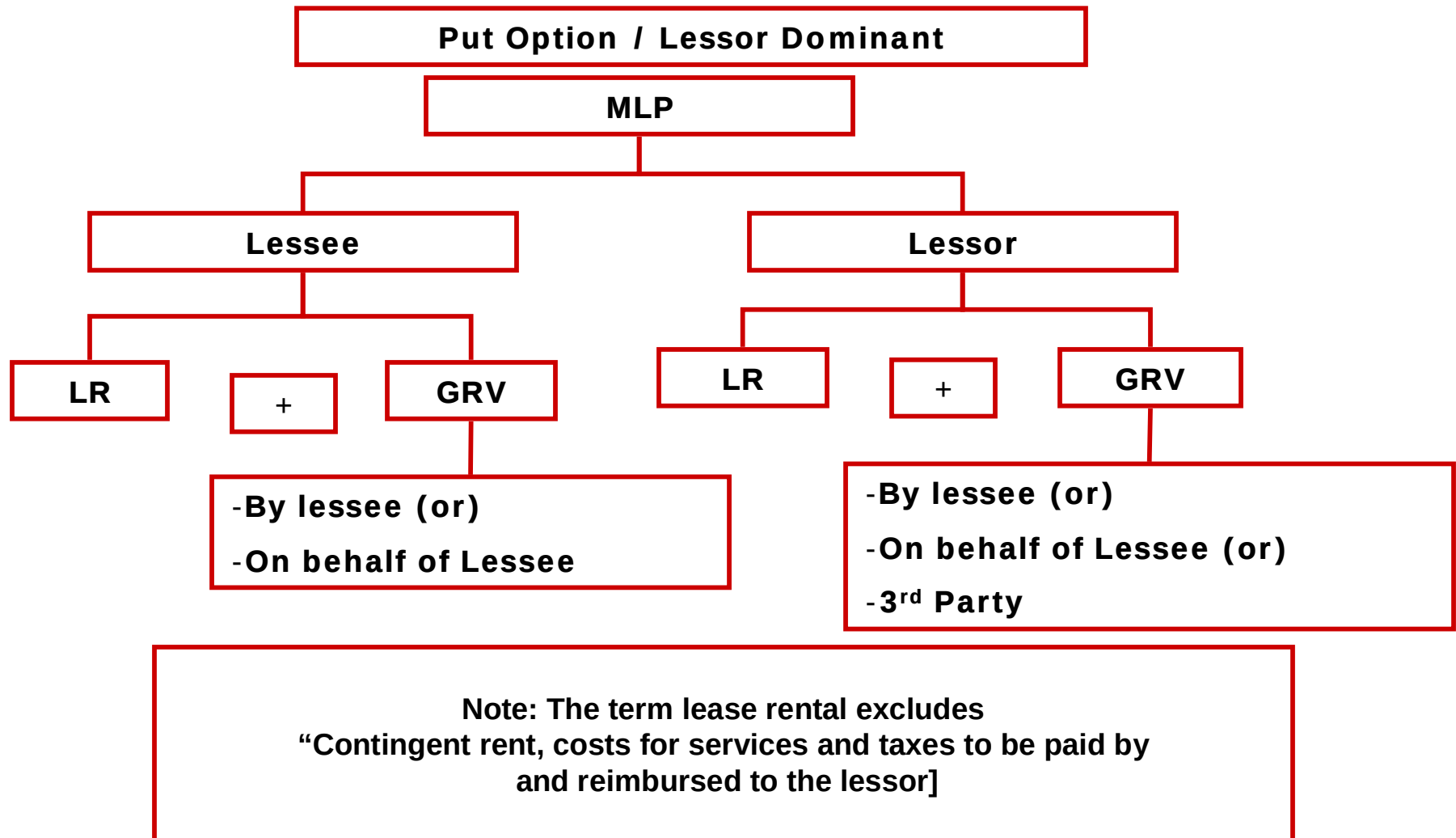


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Why Residual Value should be Guaranteed ?

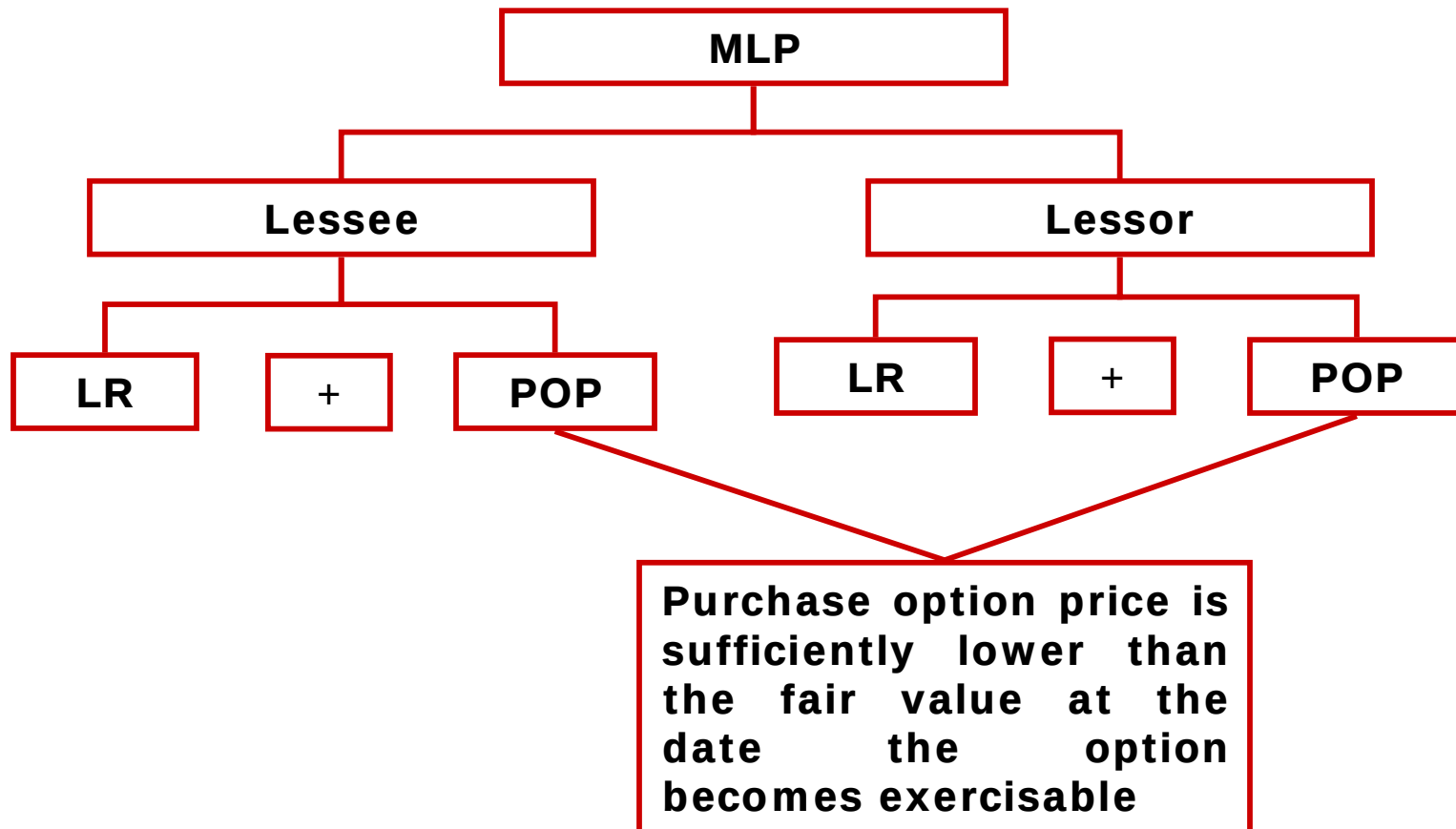
If the lessor retains the asset after the lease term, there is a risk that the lessee will not properly maintain the leased asset, in which case value of the asset at the end of the lease term [Residual value] may be reduced. That is why, lessee will be asked to guarantee either the full or part of the estimated residual value

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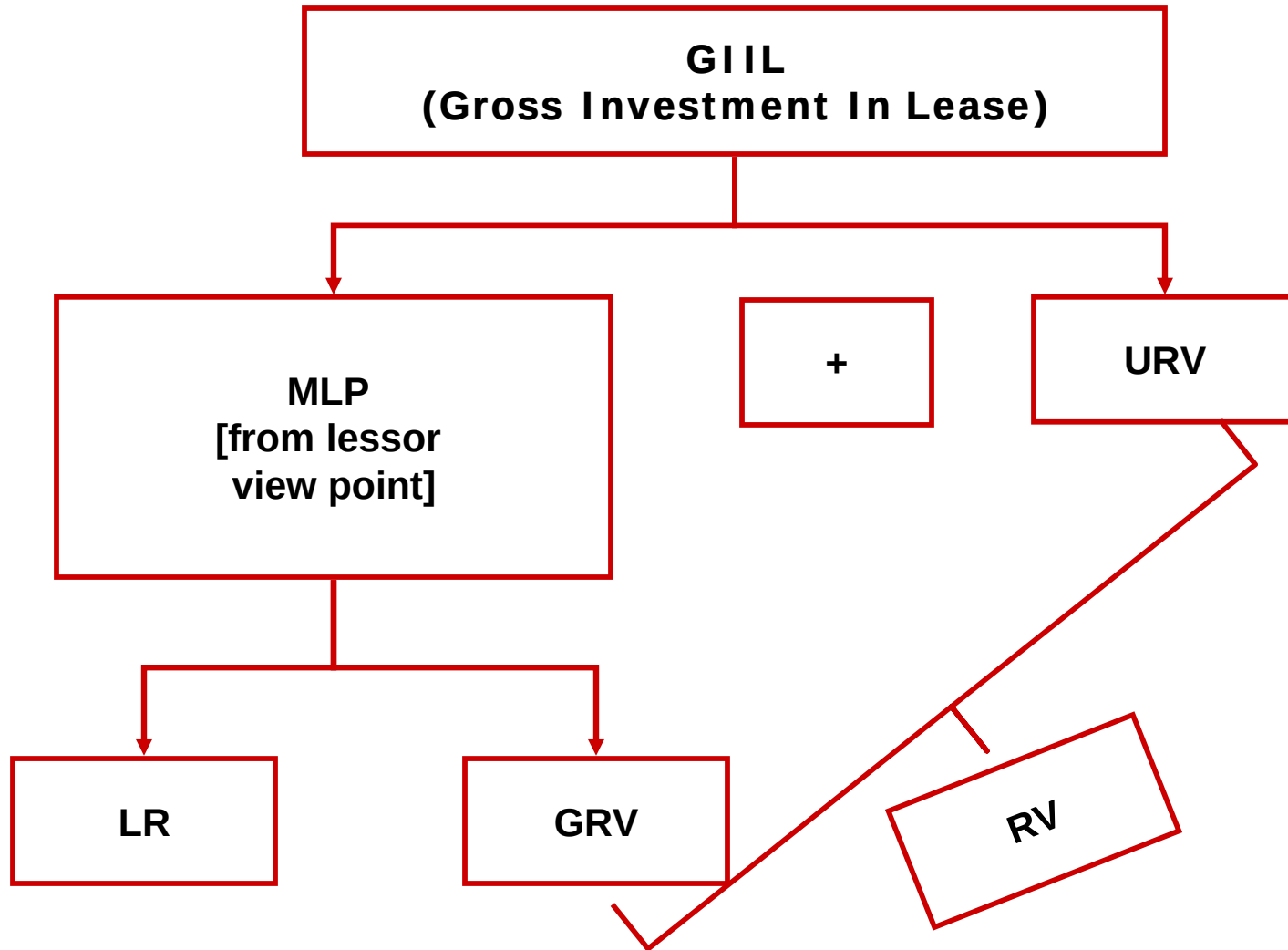


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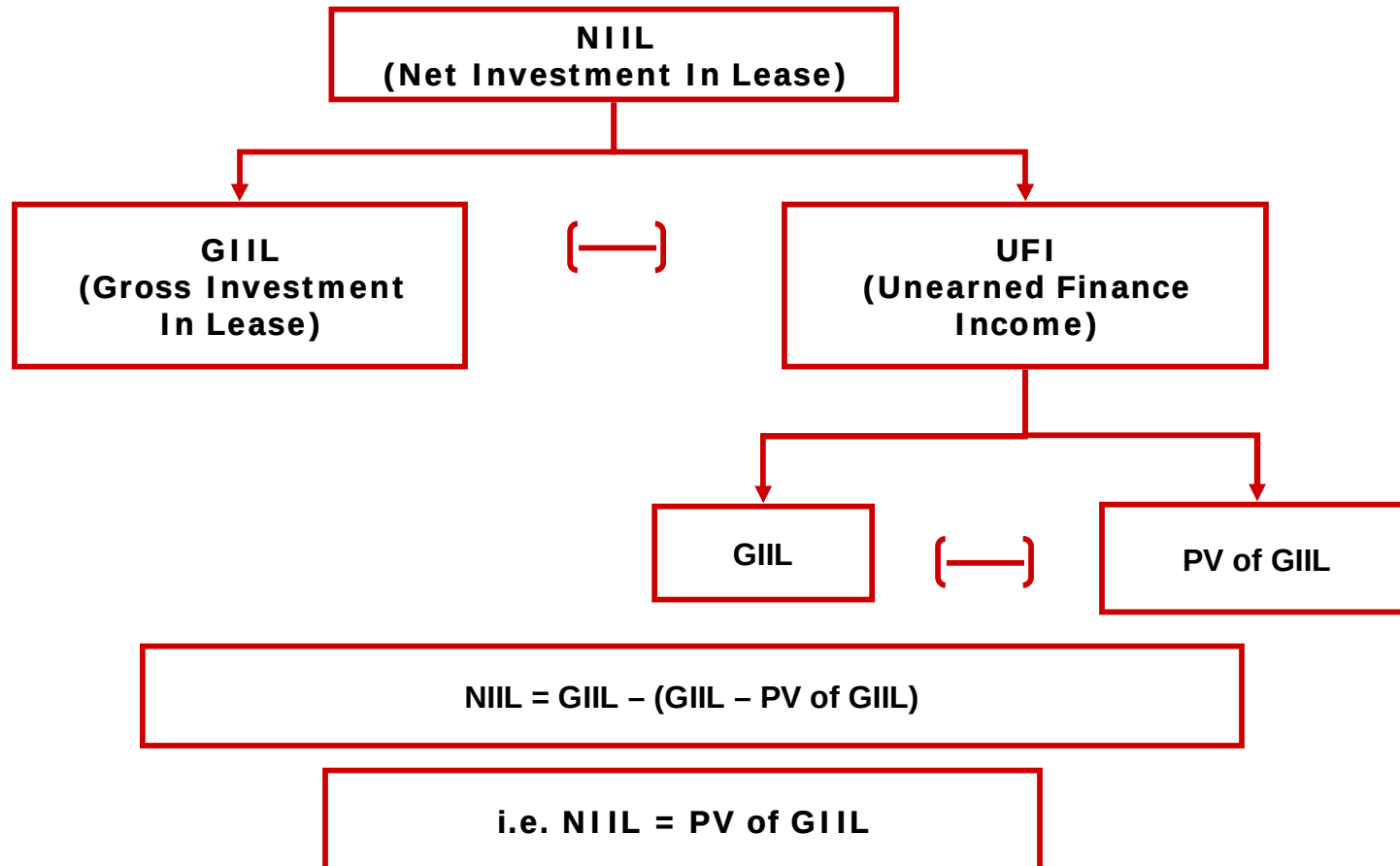
Call Option / Lessee Dominant



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Therefore, Fair Value = NIIL = PV of (MLP & URV)

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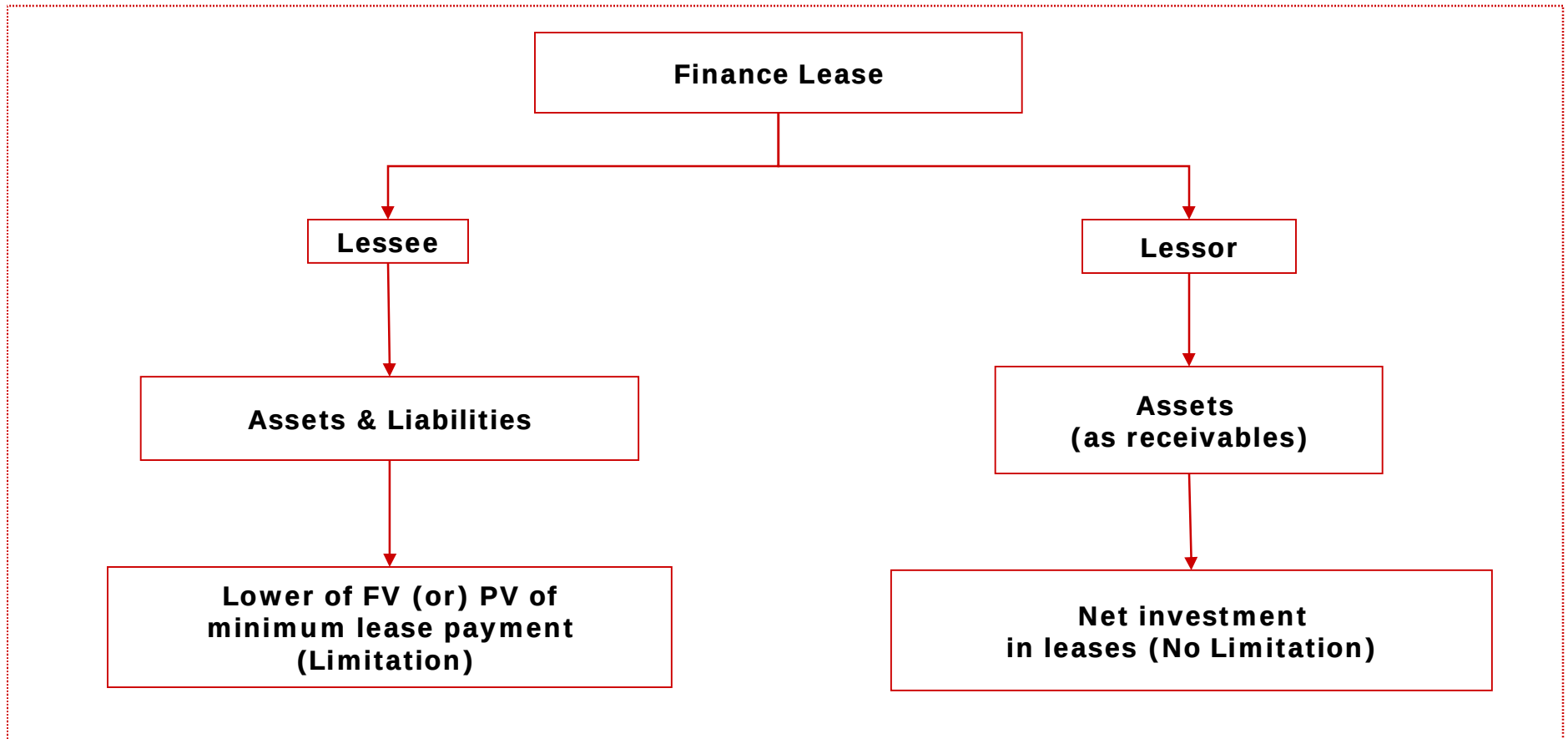
Interest Rate implicit is the “The discount rate that, at the inception of lease, causes

NIIL = FAIR VALUE OF THE ASSET”

The rate of interest the lessee would have to pay on a similar lease or, if that is not determinable, the rate that, at the inception of the lease, the lessee would incur to borrow over a similar term, and with a similar security, the funds necessary to purchase the asset

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Accounting



Finance Lease –
In the books of lessee

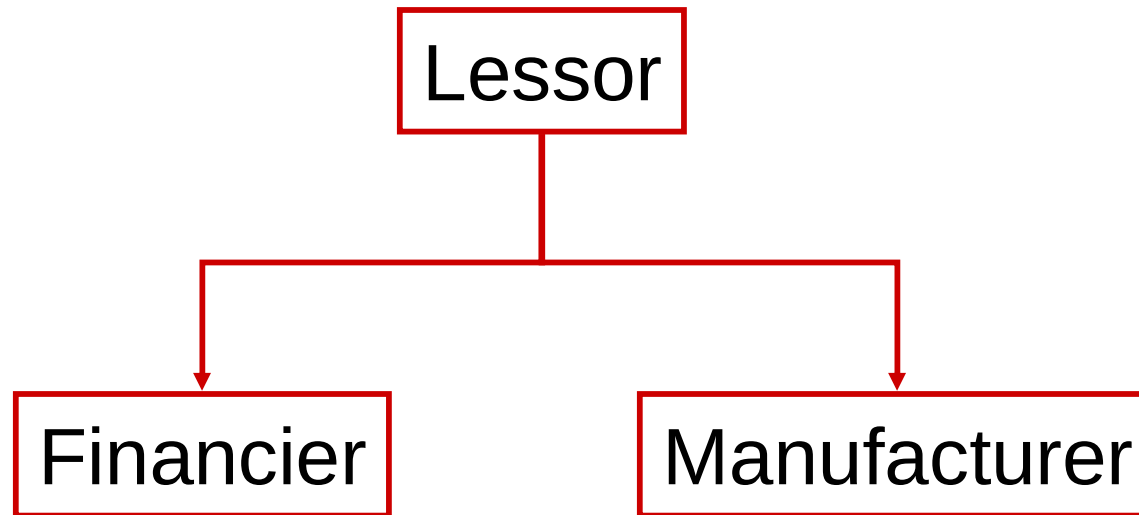
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S.N	Details	Journal	Debit	Credit
1	At the inception of the lease			
		Leased asset a/c dr.		
		To Lease Payable a/c		
2	At the end of the year	Interest a/c Dr.		
		To lease Payable a/c		
3	At the time of payment of lease rental	Lease payable a/c dr.		
		To Cash a/c		
4	Depreciation	Depreciation a/c Dr.		
		To leased Asset		
5	Transfer of Depreciation and Interest to P & L a/c	P & L a/c Dr.		
		To Interest a/c		
		To Depreciation a/c		

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Finance Lease –
In the books of lessor
- Financier

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S.N	Details	Journal	Debit	Credit
1	At the inception of the lease			
		Lease Receivable a/c dr.		
		To Asset sold a/c		
2	At the end of the year	Lease Receivable a/c Dr.		
		To interest income a/c		
3	At the time of receipt of lease rental	Cash a/c Dr.		
		To Lease Receivable a/c		
4	Transfer of Interest Income to P & L a/c	Interest income a/c Dr.		
		To P & L a/c		

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**Entries in the books of Lessor
If he is a Manufacturer/Dealer**

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S.N	Details	Journal	Debit	Credit
1	Manufacturing goods			
		Cost of Mfg		
		To Cash		
2	At the inception of lease	Lease Receivable a/c Dr.		
		To Sales		
3	At the end of the year	Lease Receivable a/c Dr.		
		To Interest Income a/c		
4	Receipt of lease rent	Cash a/c Dr.		
		To Lease receivable		

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Change in Estimated Unguaranteed Residual Value

Estimated unguaranteed residual values used in computing the lessor's gross investment in a lease are reviewed regularly. If there has been a reduction in the estimated unguaranteed residual value, the income allocation over the remaining lease term is revised and any reduction in respect of amounts already accrued is recognised immediately. An upward adjustment of the estimated residual value is not made.

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Manufacturer or dealer lessors sometimes quote artificially low rates of interest in order to attract customers. The use of such a rate would result in an excessive portion of the total income from the transaction being recognised at the time of sale. If artificially low rates of interest are quoted, selling profit would be restricted to that which would apply if a commercial rate of interest were charged.

The sales revenue recorded at the commencement of a finance lease term by a manufacturer or dealer lessor is the fair value of the asset. However, if the present value of the minimum lease payments accruing to the lessor computed at a commercial rate of interest is lower than the fair value, the amount recorded as sales revenue is the present value so computed. The cost of sale recognised at the commencement of the lease term is the cost, or carrying amount if different, of the leased asset less the present value of the unguaranteed residual value. The difference between the sales revenue and the cost of sale is the selling profit, which is recognised in accordance with the policy followed by the enterprise for sales.

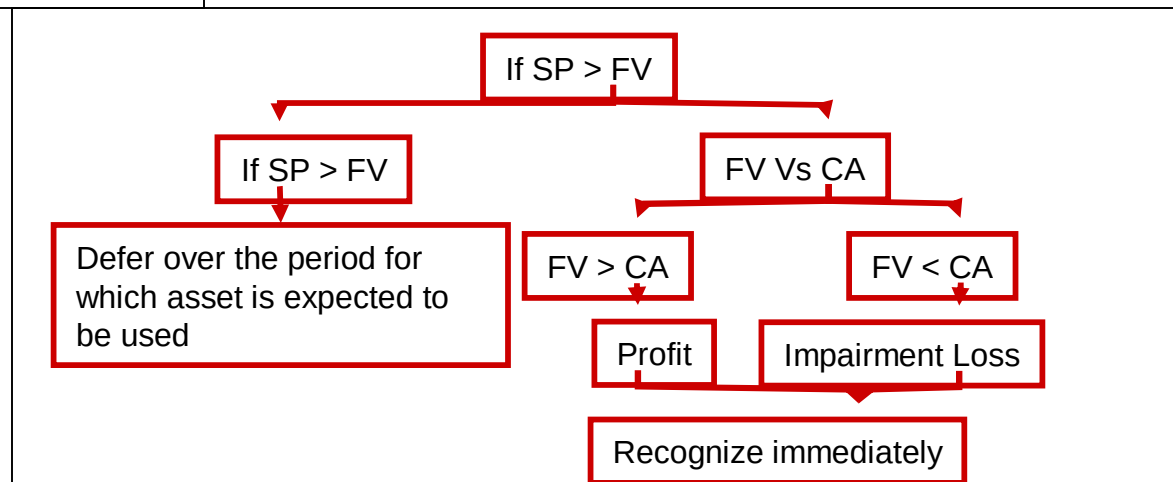
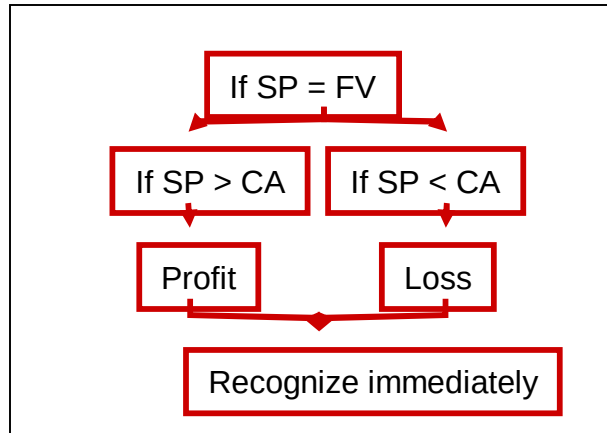
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SALE AND LEASE BACK

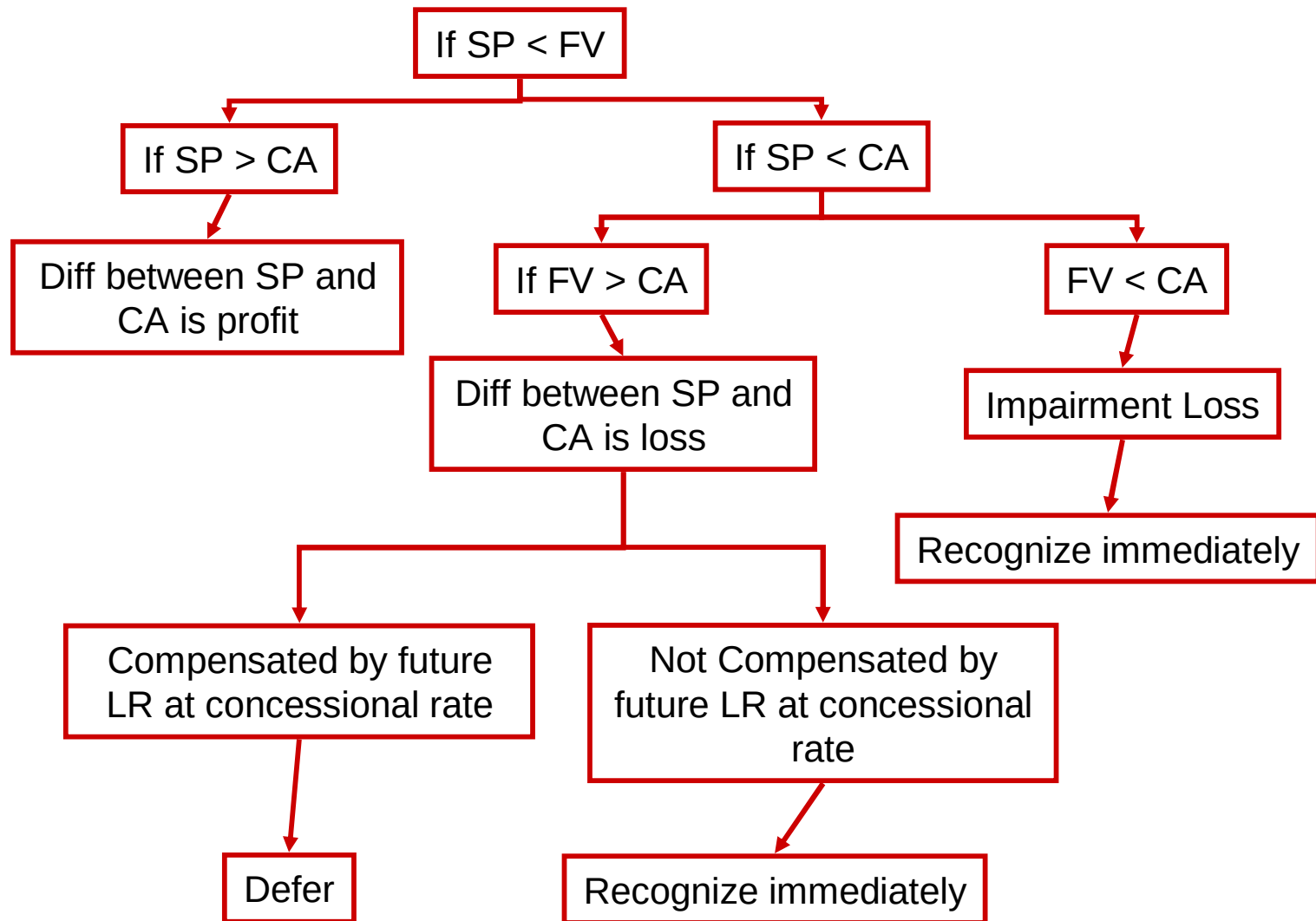
If a sale and leaseback transaction results in a finance lease, any excess or deficiency of sales proceeds over the carrying amount should not be immediately recognised as income or loss in the financial statements of a seller-lessee. Instead, it should be deferred and amortized over the lease term in proportion to the depreciation of the leased asset.

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If a sale and leaseback transaction results in a operating lease,



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Disclosure Requirements – Operating Lease

The lessee/lessor should make the following disclosures for operating leases:

The total of future minimum lease payments under non-cancellable operating leases for each of the following periods:

- (i) not later than one year;***
- (ii) later than one year and not later than five years;***
- (iii) later than five years;***

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Disclosure Requirements – Finance Lease

Lessee

A reconciliation between the total of minimum lease payments at the balance sheet date and their present value. In addition, an enterprise should disclose the total of minimum lease payments at the balance sheet date, and their present value, for each of the following periods:

- (i) not later than one year;
- (ii) (ii) later than one year and not later than five years;
- (iii)(iii) later than five years;

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Disclosure Requirements – Finance Lease

Lessor

A reconciliation between the total gross investment in the lease at the balance sheet date, and the present value of minimum lease payments receivable at the balance sheet date. In addition, an enterprise should disclose the total gross investment in the lease and the present value of minimum lease payments receivable at the balance sheet date, for each of the following periods:

- (i) not later than one year;
- (ii) later than one year and not later than five years;
- (iii) later than five years;