AS - 19 Leases

Parties to lease
- Lessor
- Lessee

Applicability
Not appl. to lease of:
→ Natural Resources (oil, gas etc.)
→ Licencig agreements of movies, video recordings, copyrights/patents
→ Use of land

Categories
- Operating
- Finance

I **Lessor :-**

Important terms

Accounting Treatment
- Op. lease
- Fin. lease

1. **Important terms :-**

a) Expected Residual Value.
a) Guaranteed Residual Value → to lessor, by lessee/third party
b) Unguaranteed Re. Value = Expected Re. Val. − Guaranteed RV
c) Gross Investment = Min. Lease Payments + Ung. Re. Value.
d) Min. Lease Payments = [Lease Rentals + Guaranteed Re. Val. + Res. value guaranteed by a third party]
(−) [Contingent Rent + Costs & taxes paid and reimbursed to Lessor]

e) Net Investment = Gross Investment − Unearned Fin. Income

f) Unearned fin. Income = Gross Invest. − PV of Gross Invest.
↳ [PV of MLP + PV of Ung. Res. Value]

g) Fair Value at the inception of lease = [PV of MLP + PV of Ung. Res. value] to the lessor.

2. Accounting Treatment

Op. Lease
- Asset − shown in the B/S
- Dep − as per Standard
- Lease Income − in P&L
- Other costs − exp. in P&L in the yr. they incurred.
- Initial costs − added to the CA of the leased asset.

Finance lease
Because of the Principle of Substance over form, the lessor is to treated as seller of the Leased Asset.

Net Invest. A/c Dr.
To Sale of Asset.

Recog. of Finance Income:
in proportion to o/s bal. receivable over lease period.

II Lessee

Important Terms

Accounting Treatment
- Op. Lease
- Fin. Lease

1. Important Terms:-

a. Guaranteed Res. Value
b) Min. Lease Payments = (Lease Rentals + Guaranteed Res. Value)
(−) (Contingent Rent + Costs & taxes reimb. to the lessor)

2. Accounting Treatment

a) Op. lease

lease Payments should be recog. as an expense in P&L A/c

Finance lease

According to substance over form Principle, the lessee becomes the buyer of the Asset.

b) Accounting treatment of finance lease:-

→ leased Asset and corresponding lease liability should be created. They should be recog. at lower of:

- ~~PV~~ Fair value of the asset at the inception of lease

(or)

- PV of MLP (from lessee point of view)

→ Depreciation should be charged in the books of lessee

→ lease liability should be w/o over the lease period.

→ fin. charge should be charged to P&L A/c

Entries:

Asset A/c Dr.
To lease Liability
(Asset & corresponding lease liab. being recog.)

Lease Rent A/c Dr.
To Bank A/c
(Being annual lease pyts made)

Depreciation A/c Dr.
To Fixed Asset A/c.

Fin. charge A/c Dr.
Lease Liability A/c Dr.
To Lease Rent A/c.
(Fin. charge and Principal amt. being charged)

P&L A/c Dr.
To Depreciation
To Fin. charge
(Dep. & fin. charge expensed in P&L)

Sale & Lease Back:-

- Lease Back is Fin. Lease
  - ~~Amortised over~~ Profit / Loss on sale
    - Deferred & Amortised over the lease period.
- Lease Back is Op. Lease
  - SP & FV
    - SP=FV
    - SP<FV
    - SP>FV
  - CA & FV
    - CA>FV
      - Impairme[nt]

NOTE: As per AS-19, lease will be classified as finance lease if at the inception of lease, Present value of MLP amounts to atleast substantially all the fair value of leased Asset.

I Sale Price & Fair Value:-

1) Sale Price = Fair Value
   Profit / Loss - recog. Immediately.

2) Sale Price < Fair Value
   - Sale results in Profit → Recognise immediately.
   - Sale results in Loss
     - Loss not compensated by future lease pyts → Recognise immediately.
     - Compensated → Amortise over the lease term.

3) Sale Price > Fair Value.
   - CA = Fair Value → Profit → Amortise over lease Period.
   - CA < FV → Profit
     - SP - FV → Amortise over lease Period.
     - Bal → recog. Imm.
   - CA > FV
     - CA - FV → recog. Imm.
     - SP - FV → Amortise over lease term

II Carrying Amount & Fair Value:-

When CA is more than fair value it is Impairment of the Asset (AS-28) and the diff. is recog. in P&L as Impairment loss.

In case of sale & lease back, if
- SP = FV → No recog. since the diff is already recog. as Impairment loss.
- SP < FV
  - Loss not comp. by future lease pyts → recog. imm.
  - Compensated → Defer & Amortise
- SP > FV → Excess SP over FV → Defer & Amortise

AS-7 Construction Contract:-

% of Completion Method:

Profit / loss for the period:- [Contract Revenue − Contract Cost

Contract Price xxxx

$$\% \text{ of completion} = \frac{\text{Cost to date}}{\text{Cost to date} + \text{Further Cost}} \times 100.$$

Contract Revenue = Contract Cost × % of Completion. = xxx

(−) Contract Cost	(xxx)
Profit / loss	xxx
(−) Already Recog	(xxx)
Profit/loss for the period	xxx.

NOTE:-

If the Contract cost is more than the contract Price the entire loss is to be recog. in the current year, whether or not the contract was commenced and irrespective of the % of completion.

Contract Price:-

Includes: Price agreed
Esclation clause
Claims made additionally
Incentive Pyts to contractors

(Add)

Excludes: Penalties — ~~Sub~~ Deduct.

NOTE:-

Any uncertanity in collection of amounts already incl. in the Contract Revenue, in future years, to be recog. as an expense, rather than adj. to the Revenue.

Upto % completion → loss
Balance → Provision

Disclosures to be made:-

1) Contract Revenue Recog. in the period
2) Contract Cost till date
3) Profit / Loss recog. till date
4) Progressive Billings [Pyt. recd + Pyts to be recd.]
5) Amt. due from / to customers.

NOTE:-

Amt. due from / to customers =

$$\underbrace{(\text{Cost Incurred till date}) \pm (\text{Recog. Profit / Loss})}\ -\ (\text{Prog. Billings})$$

+ve ↓ Amts due from customers.

-ve ↓ Amts due to customers.

AS-26 - Intangible Asset

1) Recognition criteria:

Identifiable
Non-Monetary
No physical substance

+

Recog. Criteria of an Asset
Future Eco. Benefits
Measured reliably.

Controlled by the entp.
Result of Past Events
Future Eco. Bene

2) Three categories

Unidentifiable
Acq. & Identifiable
Internally generated & Identifiable.

3) Initial Measurement of Acquired

"At Cost"

Separate Acq
Purch. Price
Import Duties
Non-refundable taxes
Directly attributable exp

Exch. of Asset
FV of either of the Assets

Issue of S/D
FV of S/D
Or the Int. Asset

Whichever is more evidently available

Govt. Grant
as per AS-12

4) Internally Generated Brands & Goodwill → "NOT RECOGNISED"

5) Research & Development Expenditure

Research Exp. → Charged to P&L as and when incurred.

Development Exp → Charged to P&L unless it meets the recog. criteria.

Recog. Criteria of Development Exp:-

a) Asset Recog. criteria

+

b) The following also to be satisfied:-

i) Tech. feasibility of the product
ii) Availability of the product for use/ sale
iii) Identification of the cost incurred.
iv) Probability of the external Market
v) Realistic exp. that there will be sufficient future revenue to cover the cost.

6) Cost of internall generated Intangible:- a) Comprises of:

i) Exp. of services and materials used
ii) Salaries, wages, else costs of personnel engaged in development
iii) All directly attributable expenditure
iv) Overheads that are necessary for generation of Int Asset and can be allocated reasonably.

b) Cost doesnot Include:-

i) Selling & Admn. exp.
ii) Inefficiencies and initial operating Losses before recog. Criteria
iii) Exp. on Staff training.

c) Exp. incurred but no Intangible created → exp. as and when incurred.

7) Subsequent Expenditure :- Conditions for capitalizing:

i) Exp. increases the future economic benefits in excess of originally assessed ~~exp.~~ benefits.
ii) Exp. can be measured reliably and attributed to the asset.

8) Carrying Amount & Amortisation:-

Carrying Amount	Amortisation
Cost less Acc. Amortisation	$\frac{\text{Depreciable Amount}}{\text{useful life}}$

a) Depreciable Amount = Cost - Residual Value.
b) Residual value → Generally zero for an Intangible Asset unless: a) guaranteed by a third party (or) b) active market at the end of useful life.
c) Useful life → Generally not more than 10 yrs. However if there is reasonable evidence of more than 10 yrs, such life can be taken.

Goodwill as per AS-14 - only 5 yrs.

Amortisation Method:
a) Straight Line Method
b) Pattern of benefit and cost

NOTE:

Amortisation is generally recorded as an exp. However, it might be used in production of some other asset then amortisation exp. is added to such asset's cost.

d) Review of Method of Amortisation if:-

i) Expected useful life of the asset has significantly changed

(or)

ii) Patter of future economic benefit has changed.

9) Impairment:-

Carrying Amt ↓	>	Recoverable Amt ↓
Cost less Acc. Amortisation		Higher of: Net Selling Price, Value in use.

10) Disclosures:-

- Carrying Amt.
- Useful life
- Amortisation Method / Rate
- Reconciliation of Carrying Amt at the beginning and end of the period.

Addl:-

- If amortisation period is more than 10 yrs, reason
- Carrying Amt of Int. Assets which are pledged
- R&D exp, recog. as expense during the year.

NOTE:- a) Pattern of Benefit to Cost Method:-

$$\text{Cost of Asset} \times \frac{\text{Revenue for the year}}{\text{Total Revenue from the Asset}}$$

b) Cost of special equip. that can be used only ~~for~~ for a specific project / product → should be charged to P&L in the year of acquisition of such equip → irrespective of the life of asset. [Pg: 480]

AS-20 - Earnings Per Share

Basic → $\dfrac{\text{Net Profit for the year}}{\text{Wt. Avg. Eq. shares}}$

Diluted → $\dfrac{\text{NP} + \text{Inc. Income}}{\text{WAES} + \text{Inc. shares}}$

1) **Net Profit :-**

→ After tax Profit
→ Pref divd → Cumulative → deduct anyway
↳ Non-Cum → deduct only if provided.

2) **Wt. Avg. Equity shares :-**

→ Bonus - from the beginning of the year.
→ Rights - Right factor :

$$\text{Right factor} = \frac{\text{Market Price before Rights issue}}{\text{Theoretical Ex - Right factor}}$$

$$\text{Th. Ex-Right} = \frac{(\text{O/s shares} \times \text{CMP}) + (\text{Rights} \times \text{Issue Price})}{(\text{O/s} + \text{Rights})\ \text{shares}}$$

$$\text{EPS} = \frac{\text{Net Profit for the year}}{\left(\text{O/s shares} \times \text{Right factor} \times (12-n)/12\right) + \left(\text{O/s} + \text{Rights} \times n/12\right)}$$

n = no. of months in the year from the dt. of issue of Rights. ~~to the~~

→ All other cases → from the dt. to the year end.

Partly Paidup → $\dfrac{\text{Partly Paidup}}{\text{Face value}}$

Different face value. → Convert into same Nominal Value.

Diluted EPS:-

When there are Potential Equity shares in a company, the Diluted EPS is calc. to know their effect on the EPS.

Potential eq. sh. (any shares that reduce the EPS to eq. SH)

ESOPS	Conv. Pref. shares	Convertible Debentures

ESOPS:- There will be no incremental income from ESOPS.

Incremental shares:

$$\left(\text{No. of opt.} \times \text{shares/opt.}\right) \times \left(\frac{\text{Market Price} - \text{Exercise Price}}{\text{Market Price}}\right)$$

Issued @ ≥ FMP → Anti-Dilutive

Dilutive ← Issued @ < FMP

Pref. shares: Incr. Income = Pref. Dividend + DDT

Inc. shares = Conversion Ratio.

Debentures: Inc. Income = Deb. Int. − Tax Rate

Inc. share = Conversion Ratio

Only those PES which have dilutive effect on the EPS should be considered for calc. of Diluted EPS.

Those which increase the EPS are to be ignore.

To know the dilutive effect ~~of~~ on EPS, the PES are to ranked ~~them~~ (in ascending order of EPS) based on Ratio of Incremental Income to Incremental shares Ratio.

Instrument	Inc. Income	Inc. Shares	EPS	Rank.
ESOPS	—	50,000	—	1
Pref. sh.	12,00,000	1,00,000	12	3.
Deb.	9,60,000	~~1,00,000~~ 1,20,000	8	2

Calc. of Dilutive EPS:- WAES

Instrument	NP+ Incr. Inc.	+ Incr. sh	EPS	Dilutive / Not
NP	10,00,000	1,00,000	10	—
ESOP	10,00,000	1,50,000	6.67	D
Deb.	19,60,000	2,70,000	7.25	ND
Pref. shares	31,60,000	3,70,000	8.5	ND.

∴ Diluted EPS = $\frac{10,00,000}{1,50,000}$ = 6.67.

Since the effect of ~~EPS~~ Deb. & Pref. shares on the EPS is increasing the EPS, they are Anti- Dilutive and to be ignored in calc. of Diluted EPS.

NOTES:-

1. Whenever the shares/securities are issued in the middle of the year, the wt. for such shares/sec. and their income (in case of Diluted EPS) should be calc. for such no. of months.
   Exception - Bonus shares

2. Incase of ESOPS if the Exercise Price is more than the average Market Price, they are Anti- Dilutive and to be ignored in calc. of Dilutive EPS.

~~3. When the Bonus is issued, they co. should~~

3. When Bonus is declared, Bonus shares should be given also on the existing convertible Debentures.
   (SEBI guidelines)

   (pg. 355)

4. Always see if Pref. dvd. is ded. from the NP given
   (St) If not → deduct, before calc. of EPS.

Disclosures:-

→ Numerator in calc. of Basic & Diluted EPS and its reconciliation with the Net Profit or loss for the period
→ Denominators and its reconciliation.
→ Nominal value along with EPS.
→ Basic Earnings Per share calc. excluding Extra ordinary items (net of tax) and also Diluted EPS.

AS-28 - Impairment of Assets

1) When the Carrying Amount of the Asset is less than the Recoverable Amount, the asset is said to be impaired.

Carrying Amount (CA) = Historical Cost / Revalued Amount less Acc. Depreciation.

Recoverable Amount (RA) = Higher of the following:
- NSP (or)
- VIU

Historical Cost - Cost at which the asset was acquired.
Revalued Amt - Any Revaluations of the Asset
Acc. Dep - Depreciation on the Asset till date

NSP => Net Selling Price
ie, Selling Price - any exp. for selling

VIU => Value in Use
ie, Present Value of the (future cash flows from the Asset + any Residual Value)

Impairment Loss (IL) = CA - RA.

2) Indicators of Impairment:-

External	Internal
MV of Asset ↓	Obsolescence
change in Tech.	Change in use of Asset
Market Cap < Net Assets etc.	Continued losses from Asset.

3. Effect of Impairment on Dep:-

$$\text{Depreciation} = \frac{CA - IL}{\text{Bal. life / New life.}}$$

4. Recog. of Impairment Loss

If the Asset carried at Historical Cost
↓
IL will be debited to P&L

If the Asset is carried at Revalued Price.
↓
IL equal to cts & Rev. Reserve will be set off against Rev. Surplus

Balance and

5. Cash Generating Unit:- (CCGU)

Means

Assets that cannot generate C/f separately.

$\boxed{OR}$

Assets that can generate c/f separately but cannot be disposed off separately.

I Steps for Recog. of IL of a CGU:-

i) Identification of CGU & its CA
ii) Determination of RA (Higher of NSP or VIU)
iii) G/W & Corporate Assets related to the CGU and their CA that can be allocated to CGU on a reasonable basis. (Bottom up Test)
iv) CA of CGU = CA of [Asset + G/W + Corp. Assets]
v) Determine ~~for~~ IL, if any.

vi) Allocation of IL:-

- First to G/w
- Then to other Assets of the CGU incl. Corp. Assets on a Pro-rata Basis based on CA of Assets.

viii) Ensure that after allocation of IL, the CA of CGU should not fall below, highest of:

a) NSP
b) VIU
c) zero

II Recog. of IL if any/ all of G/w and Corp. Asset are not allocable:-

(i) – (vii) - Same

viii) A "Top Down Test" to be conducted

ix) Calc. the CA & RA of the larger CGU which includes CGU under review. and to which G/w and/or Corp. Asset can be allocated on a reasonable basis.

x) Calc. the IL.

xi) Allocate IL to G/w then to Corp. Asset.

xii) Any remaining amt should be shown as liab. if other standards require.

6) Impairment of Discontinuing Operations:

Disposed off entirely	Piecemeal / Abandonment
↓	↓
RA determined as a whole & IL if any allocated among assets	RA is determined for ind. assets

NOTE:-

If any asset of the CGU is impaired, it should not be recog. ~~note~~ if the CGU is not Impaired.

7. Reversal of Impairment Loss:-

The entp. should, on each B/s date, assess if the IL previously recog., has decreased.

External sources | Internal sources.

Reversal of IL of Individual Asset.

Asset being Carried at Historical cost
↓
Asset A/C Dr.
To Reversal of IL

Reversal of IL
To P&L A/C.

Asset being carried at Revalued Amount.
↓
To the extent the IL debited to Rev. Res. should be credited to Rev. Res. A/C
Bal^{on} which was debited to P&L A/C, should be shown in P&L.

However after Reversal, increased CA should not exceed the CA (net of Dep./Amort.) that would have been determined, had no Impairment loss was prev. recog.
Any excess is Revaluation Profit. (Pg: 517)

Reversal of ~~CGU~~ IL

of CGU | of Goodwill.

AS-22- Acc. for Taxes

Tax Exp.

↓

Current Tax

+

Deferred Tax

Current Tax

↓

Income Tax payable @ appl. on the Taxable Income

↓

$\boxed{\text{@ Current Rates}}$

Deferred Tax.

↓

Diff. b/w Tax Exp. and Current Tax

↓

that arises only out of Timing Differe

↓

Diff. due to Perma differences are to be ignored.

↓

@ future enacted Ra

2) Tax Effect of Timing Differences:-

a) Acc. Income > Tax Income — Deferred Tax Liability
b) Acc. Income < Tax Income — Deferred Tax Asset
c) Acc. loss & Tax Income — Deferred Tax Asset
[Subject to recoverability from future incomes]
d) Acc. Profit & Tax loss – MAT Payable — Deferred Tax Liability
e) Acc. Exp. > Tax Exp. — Deferred Tax Asset.
f) Acc. Exp. < Tax Exp. — Deferred Tax Liability
g) Acc. Exp – Nil & Tax Exp. ✓ — Deferred Tax Liability
h) Acc. Exp. – ✓ & Tax Exp – X (Disallowed) — Deferred Tax Asset.

NOTE:- The effect of exp. are to be considered only if they are Timing diff.
Permanent Diff. are to be ignored in calc. of DT A/L

3) Timing Diff. & Permanent Diff.:-

Timing Diff.:
Originate in one period
&
Capable of Reversal in one/more subsequent periods.
↓
Eg: Depreciation, Deferred Inc./exp. etc.

Permanent Diff.:
Originate in one period
&
Donot reverse in subsequent Periods.
↓
Eg: Disallowed exp., Exempted Income etc.
Permanent Diff

4) Origination & Reversal:-

Origination means the diff. arises in one period and its reversal will be done in subsequent periods.

Same in case of DTL & its Reversal

NOTE:- When DTA was originated in a year, the effect of its reversal in subsequent years will have same effect as origination of DTL in such year. However, while solving the prob. a clear differentiation b/w Reversal of DTA & origination of DTL should be made.

When a diff of inc./exp. arises in a period it is said to be originated in such period.

The DTA/L that was created due to such difference will be reversed in one/more subsequent periods.

Timing Diff. which originate first are to be reversed first.

5) Entries:-

DTL

Yr:1

Profit & Loss xxx
  To Current Tax xxx

P&L A/c xxx
  To Deferred Tax ~~Liab.~~ xxx
[DTL being created]

Yr:2

P&L xxx
  To Current Tax xxx

Deferred Tax xxx
  To P&L xxx
[Reversal of DTL created in Prev. Year]

Year:3

P&L A/c xxx
  To Current Tax xxx

Deferred Tax xxx
  To P&L xxx
[Reversal of DTL created in PY's.]

Deferred Tax Asset :-

Yr:1 P&L A/c xxx
 TO Current Tax xxx

Deferred Tax xxx
 TO P&L xxx
[Being DT Asset Created]

Yr:2 P&L A/c xxx
 TO Current Tax xxx

P&L xxx
 TO Deferred Tax xxx
[Reversal of Deferred Tax Asset created in PY]

6. Recog. of DTA&L :-

a) Deferred Tax Liab:- recog. for timing differences that would result in higher taxable Income in future

b) Deferred Tax Asset :- recog. only if there is evidence that there would be sufficient future income to recover the same.

7) Unabsorbed Dep. & B/f Losses :- (DTA)
Recog. only if there is sufficient evidence that there will be future income to recover the DTA created because of B/f losses & Unab. Dep.

8) The DTA recog. or unrecog. should be re-assessed at every B/s date. If there is any change in the condition the DTA should be ~~unrecog~~ w/o or recog. respectively.

9) DTA & DTL should be set off if permissable under tax laws.

10. **NOTES:-**

a. DT that originate during the Tax holiday period and

Reverse DURING Tax holiday period → should not be Recog.

Reverse AFTER Tax holiday period → should be recog. → In the years in which Timing Diff. originate

b. AS-22 & MAT:-

- DTA/L to be measured at normal tax rate and not MAT Rate.
- Calc. of DTA/L & Current Tax (When MAT appl.)

(Pg:392)

Current Tax = MAT % × Book Profit

DTA/L = (Acc. Inc − Tax Inc.) × Tax %

Tax Exp = Current Tax ± DTL/A.

- Current tax is always the tax we paid to Govt. ie, either MAT / Income Tax - which ever paid
- DTA/L is always diff. b/w Acc. & Tax Inc. irrespective of the Current Tax. [@ Income Tax]

c. Impairment loss: Not allowed as per IT Act. Hence Create DTA due to timing difference. Recog. the DTA subject to Prudence.

d. When the question gives unab. Dep & B/f Losses, they include CY Dep & CY losses. (Pg: 394)

e. ~~DTL~~ Elements of DTL

-

-

-

Total (A)

Elements of DTA.

-

-

-

Total (B)

Net (A-B) DTA/L

f. Extract from P&L:-

Profit Before Tax		xxxx
(-) Tax Exp:		
- Current Tax (IT/MAT)	xxx	
- Deferred Tax A/L	xxx	(xxx)
Profit After Tax		xxxx

g. When no particular details are given, give a note of your assumptions in the solution. (Pg: 398)