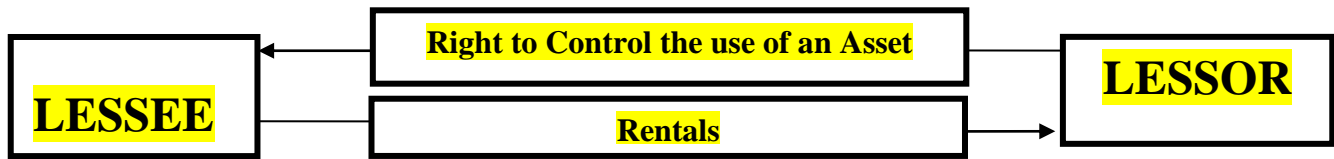


SLFRS 16 – Leases



Lessor - The party who transfers right to control the use of an asset in a lease contract

Lessee - The party who obtains the right to control the use of an asset in a lease contract

Accounting for Leases in the Books of Lessee

☞ **SLFRS 16 Do not apply for:**

- Short-term leases (a lease that, at the commencement date, has a lease term of 12 months or less)
- Leases for which the underlying asset is of low value.

Accounting treatment for above two situations:

Lease Rental	Dr	
Cash		Cr

Initial Recognition - Right of use Asset

☞ **Measure the right of use asset at cost at the commencement date**

☞ **The cost of the right of use asset comprises:**

- the amount of the initial measurement of the lease liability
- any lease payments made at or before the commencement date, less any lease incentives received.
- Any initial direct costs incurred by the lessee
- An estimate of costs to be incurred by the lessee in dismantling and removing the underlying asset, restoring the site on which it is located or restoring the underlying asset to the condition required by the terms and conditions of the lease, unless those costs are incurred to produce inventories.

Initial Recognition – Lease Liability

☞ **Measure the lease liability at the present value of the lease payments that are not paid at the commencement date.**

☞ **The lease payments are discounted using the interest rate implicit in the lease (If readily determinable)**

☞ **Lease payments included:**

- Fixed payments less any lease incentives receivable
- Variable lease payments that depend on an index or a rate.
- Amounts expected to be payable by the lessee under residual value guarantees.
- The exercise price of a purchase option of the lessee is reasonably certain to exercise that option.
- Payments of penalties for terminating the lease, if the lease term reflects the lessee exercising an option to terminate the lease.

Depreciation (finance Lease)

If Ownership is transferred at the end of lease period \Rightarrow Using useful life
If Ownership is not transferred at the end of lease period \Rightarrow lease period

The accounting for the lease in the books of the lessee.

- Initial deposit value / Down payment

Right of use asset	Dr	xxx	
Cash account		Cr	xxx

- Present value of minimum lease payment

Right of use asset	Dr	xxx	
Lease Liability account		Cr	xxx

- Interest on lease at the end of the period

Interest on lease account	Dr	xxx	
Lease Liability account		Cr	xxx

- Payment of installment

Lease Liability account	Dr	xxx	
Cash account		Cr	xxx

Classify Final Lease Liability as current and non current

Final Lease Liability \Rightarrow **Current Liability = Installment – Next year Interest**
 \Rightarrow **Non Current Liability = Final lease liability – Current portion**

Format of a Lease Liability account

Lease Liability			
		initial lease liability	xxx
		Interest	xxx
Installment	xxx		
BCD	xxx		
	xxx		xxx

Final Lease Liability

Example with workings

Supun PLC acquired a machine on lease basis on 01.04.2019. The following information is provided.

- ☞ Initial payment on 01.04.2019 - Rs. 500 000
- ☞ Annual installment - Rs. 200 000 (starting from 31.03.2020)
- ☞ Lease term - 4 years
- ☞ Initial direct cost incurred on 01.04.2019 by the lessee - Rs. 10 000
- ☞ The interest rate implicit the lease - 10%
- ☞ Discounting factors at 10% rate.
- ☞ Residual value - Rs. 143 800
- ☞ Useful life of the machine - 5 years
- ☞ The ownership of the machine will be transferred to Supun PLC at the end of 5th year.

Year	:	1	2	3	4
Discount factor	:	0.909	0.826	0.751	0.683

The ownership of the machine will be transferred to Supun PLC at the end of the lease term.

Required to Calculate:

1. The amount of the lease liability
2. The amount to be recognized as right of use asset
3. Prepare lease liability account for the year ended 31.03.2020
4. Prepare financial statement extracts for the year ended 31.03.2020

Answer

1.	Year	:	1	2	3	4
	Discount factor	:	0.909	0.826	0.751	0.683
	Lease installment	:	200,000	200,000	200,000	200,000
	Present value	:	181,800	165,200	150,200	136,600
	Initial lease liability	:	633,800			

2. Right of use asset

Initial payment	500,000
(+) present value	633,800
(+) Initial Direct cost	10,000
	1,143,800

3.			Lease Liability	
			initial lease liability	633,800
	Installment	200,000	Interest	63,380
	BCD	497,180		
		<u>697,180</u>		<u>697,180</u>

Final Lease Liability

4. I/S extract

Distribution expense	
Right of use asset depreciation	200,000
Finance expense	
Interest	63,380

SOFP extract	Non Current Assets	
	Right of use asset	943,800
	Non Current liability	
	Lease Liability	346,898
	Current liability	
	Lease Liability	150,282

- Final Lease Liability**
- | | |
|--|--|
| Current Liability = Installment – Next year Interest | |
| 150,282 = 200,000 - 49,718 | |
| Non Current Liability = Final lease liability – Current portion | |
| 346,898 = 497,180 - 150,282 | |

Exercise 01

Following information has been provided by Chethanee PLC for a machine acquired under Finance lease agreement from ABC Leasing Limited.

Cash price (Initial cost)	Rs.3,000,000
Down payment made on 01.04.2018	Rs.1,000 000
Agreement period	4 years
Value of an annual installment due on 31" March	Rs.700 000
Depreciation rate	10% on straight line method
Date of first annual installment made	31.03.2019
Lease interest : For the year ended 31.03.2019	Rs.320 000
For the year ended 31.03.2020	RS.240 000
For the year ended 31.03.2021	Rs.160 000
For the year ended 31.03.2022	Rs.80 000

Required:

With regards to above leasing transaction, prepare the following accounts in the books Chethanee PLC for the year ended 31.03.2019, 2020, 2021 and 2022 together with the extracts of comprehensive income statements, statements of financial positions and cash flow statements for each year.

- (i) Machineries account
- (ii) ABC leasing Limited's account
- (iii) Lease interest account
- (iv) Machinery depreciation account
- (v) Provision for depreciation on machinery account

Exercise 02

On 01.04.2019 Sahan Ltd acquired a motor vehicle on finance leased terms.

Following details are provided.

Fair value of the motor vehicle	- Rs. 2 300 000
Lease period	- 5 years
Annual installment	- Rs. 606 800
(paid at the end of each year)	
Annual interest	- 10%
Useful life of the motor vehicle	- 5 years
Residual value	- Rs. 300 000

Relevant journal entries and ledger accounts of Sahan Ltd for the year ended 31.03.2020

ADVANCE LEVEL – 2013

The cost of the motor vehicle acquired on 01.04.2012 under a finance lease was 2400 000. The lease term of the motor vehicle is 4 years and its expected useful life is 5 years. The ownership of the motor vehicle is passed to the company at the end of the lease term. The annual lease installment is Rs.930 000.

The installment paid during the year has been debited to a lease installment account. The lease interest for the period is as follows.

Year	Interest (Rs. '000)
2012/13	480
2013/14	390
2014/15	290
2015/16	160

Required: Financial Statements extracts for the year ended 31.03.2013.

☛ ADVANCE LEVEL – 2014

The motor vehicle was acquired on 01.04.2013 under finance lease (The cost of Motor vehicle was 4 000 000) for a period of 4 years. The useful life of this asset is 6 years. The ownership of the motor vehicle is not passed to the lessee at the end of the lease period. Under the lease agreement, a down payment of Rs. 960 000 has to be paid. Further, an annual lease installment of Rs. 960 000 is to be paid at the end of every year starting from 31.03.2014. The lease interest for the 4 year period is as follows.

Year	Interest (Rs. '000)
2013/14	304
2014/15	238
2015/16	166
2016/17	92

Required: Financial Statements extracts for the year ended 31.03.2014.

☛ ADVANCE LEVEL – 2015

Information extracted from the trial balance of Sagara PLC as at 31.03.2015 was as follows.

	Debit (Rs. '000)	Credit (Rs. '000)
Lease interest	720	-
Lease creditors	-	1 788
Motor vehicle	3 000	-

The motor vehicle was acquired on 01.04.2013 under a finance lease for a 4 year period for delivery of goods. The annual lease installment payable is Rs. 720 000. The current year's lease installment has been paid and debited to the lease interest account. The lease interest applicable for the current year and the next two years is as follows. (Depreciation 20% per annum)

Year	Interest (Rs. '000)
2014/15	179
2015/16	125
2016/17	68

Required: Financial Statements extracts for the year ended 31.03.2015.

☛ ADVANCE LEVEL – 2016

Information extracted from the trial balance of Sumeda PLC as at 31.03.2016 was as follows.

	Debit (Rs. '000)	Credit (Rs. '000)
Lease creditors	-	2353
Motor vehicle	6000	2400

(useful life 5 years)

Motor vehicles are used for the delivery of goods and their lease term is 5 years. The annual lease installment is Rs.1 583 000. The current year lease installment has been paid and debited fully to the lease creditor's account. No other entry has been made in this respect. The lease interest is as follows.

Year	Interest(Rs.'000)
2013/14	600
2014/15	502
2015/16	394
2016/17	275
2017/18	144

Required: Financial Statements extracts for the year ended 31.03.2016.

☛ ADVANCE LEVEL – 2017

A lorry was acquired on 01.04.2016 on finance lease basis for 5 years. It's fair value was Rs.5000 000. The ownership of this Asset will be transferred to the company at the end of the lease term. The lease interest relevant for the first year and the second year are Rs.500 000 and Rs.418 000 respectively and the total lease interest for the remaining three years amount to Rs.682 000. Annual lease installment is Rs.1 320 000. It has been paid at the year end and recorded as a distribution cost. No other entry has been made in relation to this transaction.

Property plant and equipment are depreciated at 10% per annum on straight line basis.

Required: Financial Statements extracts for the year ended 31.03.2017.

☛ ADVANCE LEVEL – 2018

Gamage PLC purchased a motor vehicle on 01.04.2017 on a finance lease. On this date, the fair value of the motor vehicle was Rs. 5 400 000 and a down payment of Rs. 1 400 000 was paid on the same day. A lease installment of Rs. 1 262 00 is payable on 31st March of each year over the lease term of 4 years. The first installment was paid on 31.03.2018. The interest rate implicit in the lease is 10% per annum.

The lease liability presented as a current liability and non-current liability in the Statement of Financial Position as at 31.03.2018 as per LKAS 17 (Leases)

	Current Liability (Rs.)	Non-current Liability (Rs.)
(1)	862 000	2 189 800
(2)	862 000	3 138 000
(3)	948 200	2 189 800
(4)	948 200	3 138 000
(5)	1 262 000	1 876 000

(.....)

☛ ADVANCE LEVEL – 2019

The company entered into a lease agreement on 01.04.2018 and obtained the right of use of a motor vehicle for a period of 5 years. As at 01.04.2018 the cost of right to use the motor vehicle and its useful life were estimated as Rs. 5 960 000 and 5 years respectively. According to the lease agreement, Rs. 2 500 000 was paid as the down payment on 01.04.2018 and the first annual installment of Rs. 1 250 000 was paid on 31.03.2019. The initial measurement of the lease liability was Rs. 3 460 000. The lease interests for the years ending 31.03.2019 and 31.03.2020 are Rs. 346 000 and Rs. 256 000 respectively. Only the down payment and first lease installment paid by the company have been recorded in the lease payments account. No other entry has been made in this respect.

Required: Financial Statements extracts for the year ended 31.03.2019.

Exercise 03

The company acquired a motor vehicle on 01.04.2019 under a finance lease for use in the business. Lease period and useful life time of the motor vehicle is 4 years and 5 years respectively. The following information is also available.

Description	Lease Installment (Rs)	Present value of Lease Installment (Rs)	Lease Interest (Rs.)
Down Payment	1 000 000	1 000 000	-
1 st Year	1 000 000	900 000	400 000
2 nd Year	1 000 000	800 000	300 000
3 rd Year	1 000 000	700 000	200 000
4 th Year	1 000 000	600 000	100 000

Initial down payment and installment paid to lease creditors during the year ending 31.03.2020 has been included in finance cost. No other entries have been made in this respect. Depreciation for the Motor Vehicle has to be provided on straight line method. Ownership of the asset may transfer to lessee at the end of the lease period.

Required: Financial Statements extracts for the year ended 31.03.2020.