




JMC

SLFRS 16 Leases

Sandeepa Jayasekera

Co-ordinating office No. 136, Yakkala Road, Gampha.,
 Tel : 0332 229 122 | Mob : 0714 114 794 | Web : www.jmc.lk

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Sandeepa Jayasekera

- 11th in Sri Lanka in Advanced Level Commerce and 3rd in Colombo District
- First Class Degree in Accounting, Sri Jayewardenepura University and Gold Medal for Best Student
- Chartered Accountant (CA Sri Lanka)
- 1st in Sri Lanka for the second stage of Chartered Accountancy and the Advanced Financial Reporting Subject Prize in the final stage.
- Chartered Management Accountant in United Kingdom (CIMA-UK)
- Chartered Management Accountant (United Kingdom) 1st in Sri Lanka in Final Stage and 11th in the world



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- Member of the Institute of Accounting Technicians of Sri Lanka (AAT Sri Lanka)
- Member of the Institute of Certified Management Accountants of Sri Lanka (CMA Sri Lanka)
- Postgraduate Institute of Management (PIM-USJP) Final Stage of Postgraduate Degree in Management
- Chief Executive Officer of JMC Jayasekera Management Centre (Pvt) Ltd.
- Principal partner in the JMC International Schools Network
- Senior lecturer of JMC Professional Education Academy
- Author who wrote 'Awarjanayakata Awasarai'
- A motivational speaker and a trainer, conducted more than 100 sessions.



Sandeepa Jayasekera

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SLFRS 16 - Leases

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This is Shihan

Shihan wants a car

Car is worth of Rs. 5,000,000/-

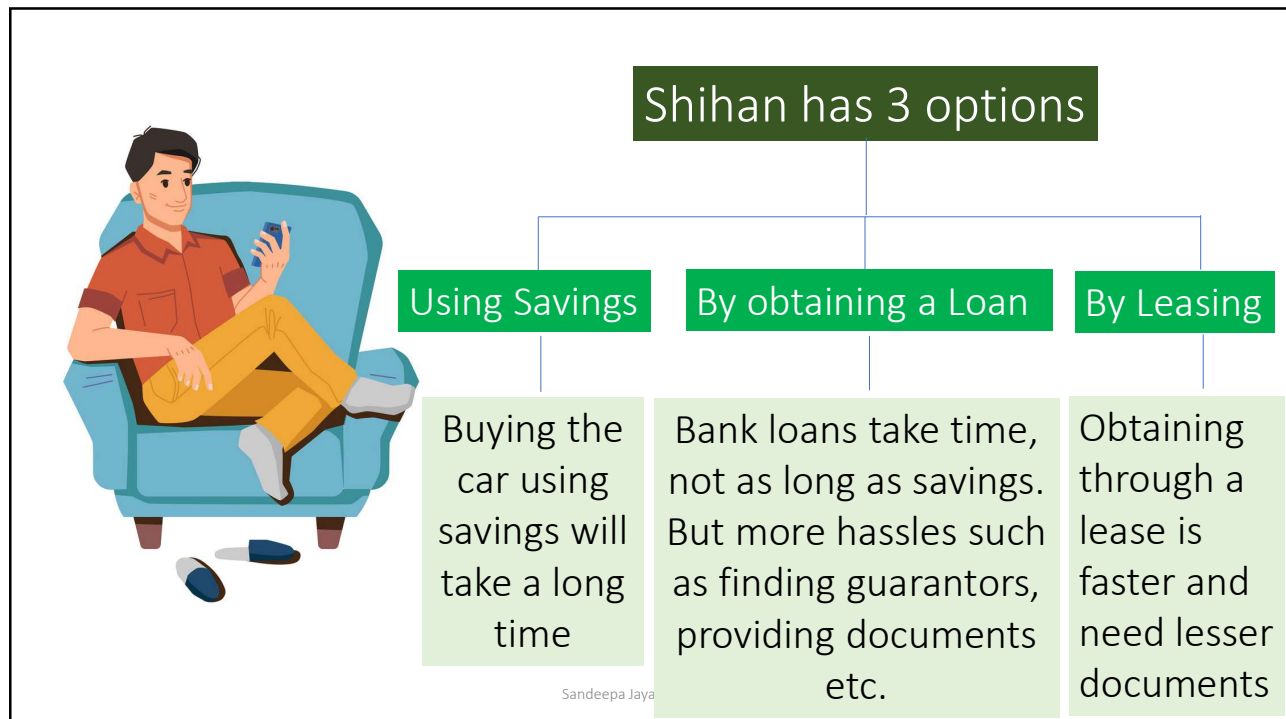
But Shihan has only Rs. 1,500,000/- in hand



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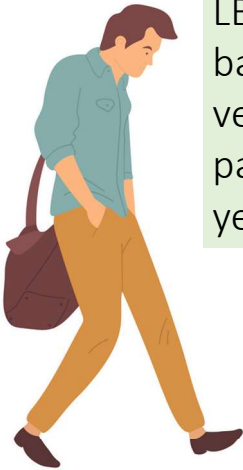
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Shihan went to LB Finance and asked for a vehicle lease facility

LB Finance said they will pay the balance Rs. 3,500,000/- to the vehicle seller. But asked him to pay the Rs. 3,500,000/- in 3 years with a 10% interest



Accordingly, this is also a Loan.
Paid for the vehicle, without giving cash.

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As hold over the loan, until the end of 3 years, the ownership of vehicle needs to be under the LB Finance. Shihan can use the vehicle, even though the ownership is with LB Finance. But if Shihan does not pay, LB Finance would come and takeover the vehicle, using the key they have.



When the total amount has been paid, Shihan can get the ownership of the vehicle, under his name.
Shihan got the vehicle, agreeing to these terms.

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At the end of 03 years, Shihan has paid Rs. 4,200,000/- for Loan

Excess Rs. 700,000/- paid was the Leasing Interest

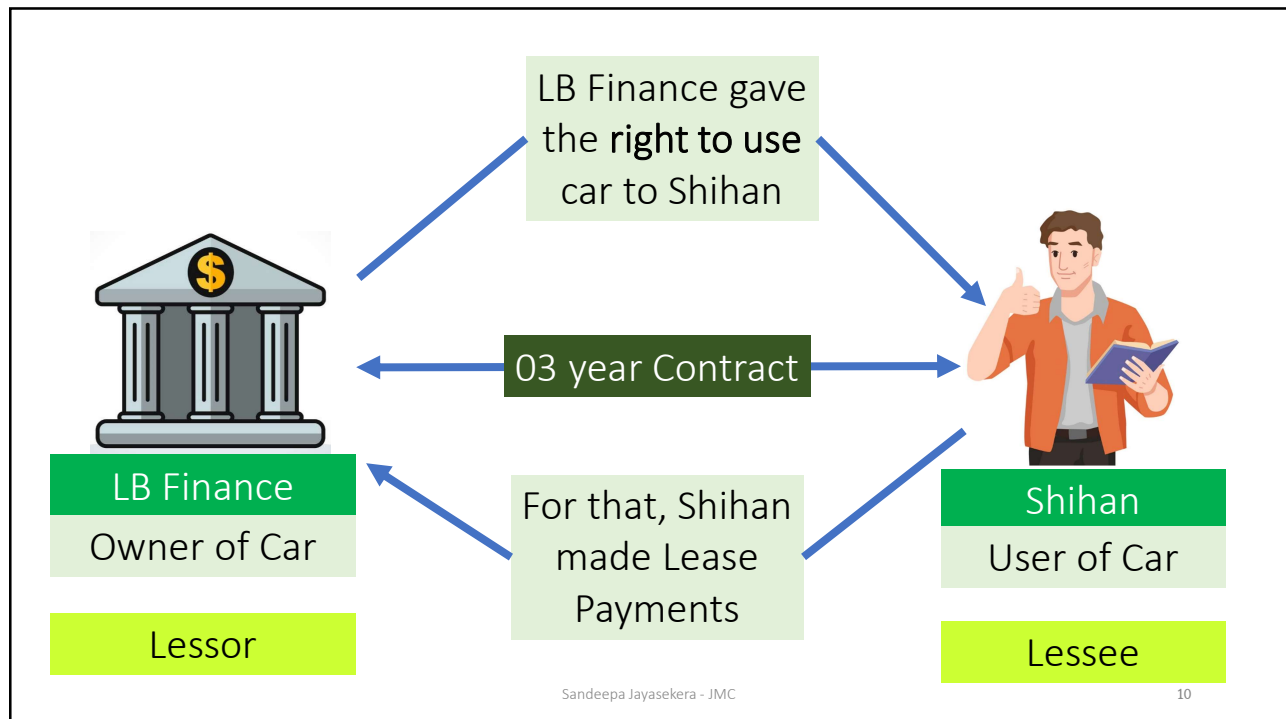


According to the contract, once the total amount has been paid, Shihan got the ownership of the car.

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This is Jennifer
She is looking for house on rent.



This is Akram
He is looking to give
the house on rent.

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Akram agrees to give the
house on rent to Jennifer



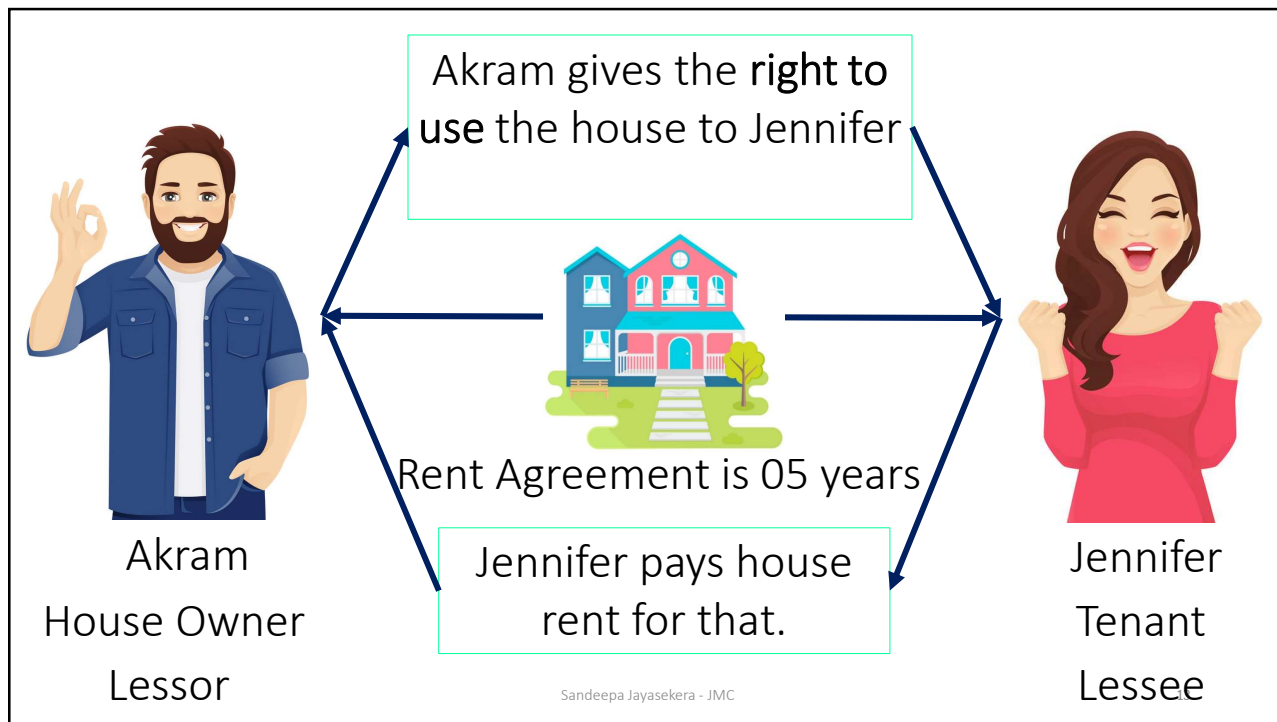
Akram and Jennifer
signs a House Rent
agreement!



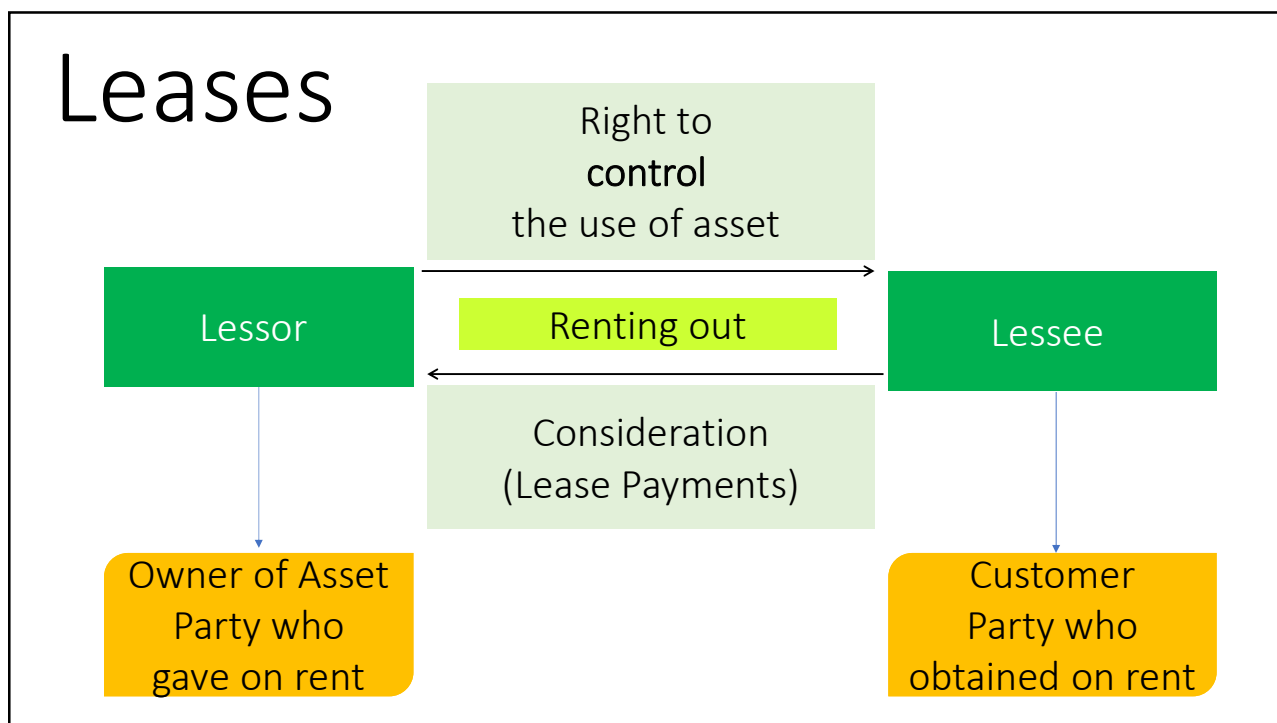
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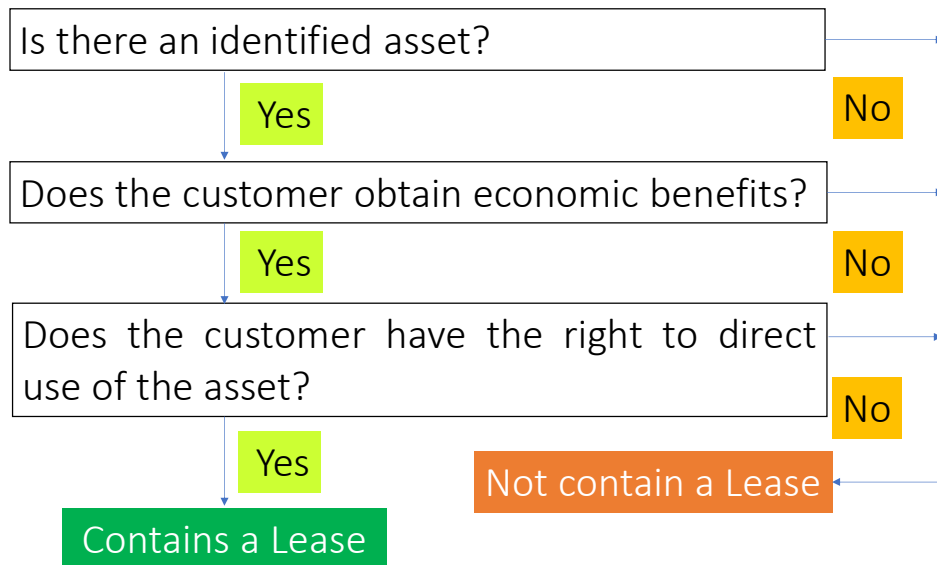
Accounting in Lessee's Books

15

Accounting for Leases Step 01 Determining whether a Contract contains a Lease

16

Determining whether a Contract contains a Lease



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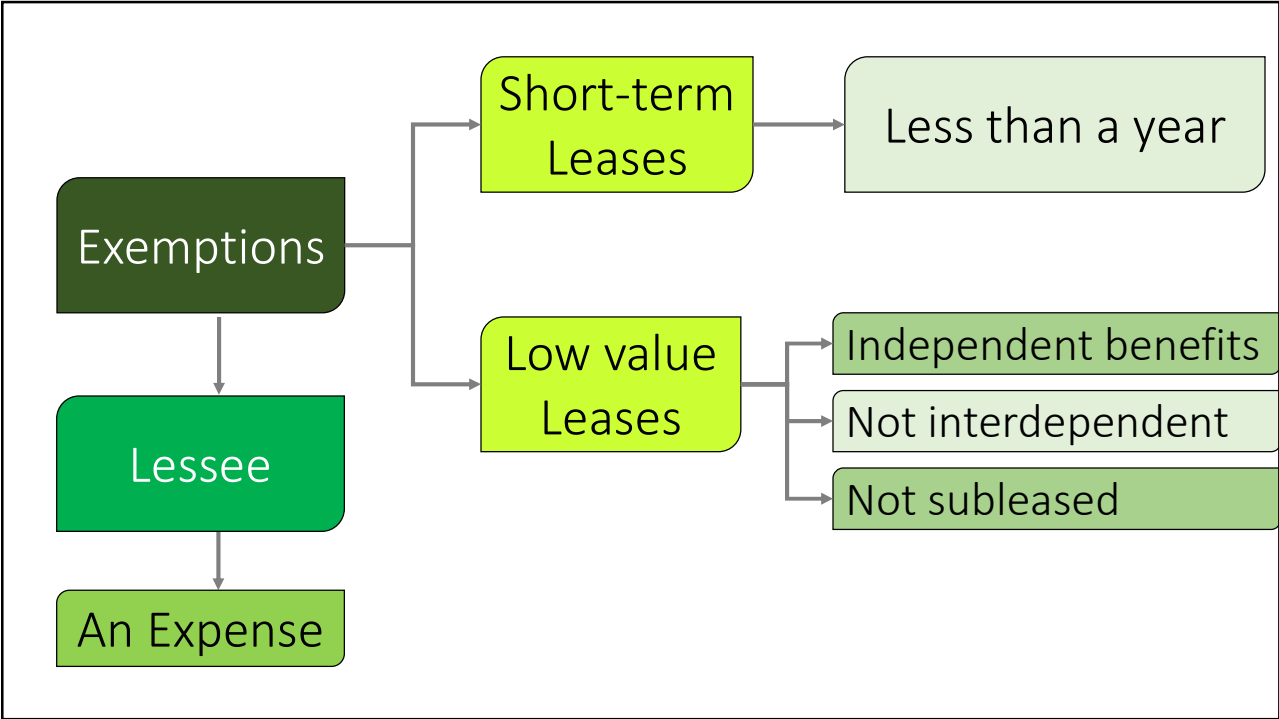
Accounting for Leases

Step 02

Exemptions -

Instances that can be excluded from
Accounting for Leases

18



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What is Subleasing?

20

Question 01

Namal PLC obtained a photocopy machine on 01/01/20X1 for an 08 month period based on a lease term.

Total lease expense of Rs. 80,000/- was fully paid on the date of entering the contract.

Show the accounting entries, assuming the accounting year ends on 31/03/20X1.

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Lease Expense paid in Advance

Cash Book

Lease Rental Expense Account

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Question 02

Dilki (Pvt) Ltd. has obtained the following assets under lease agreements. Identify the low value leases from the assets given below.

| Asset | Is it a low value lease? |
|---|--------------------------|
| Motor Vehicle | |
| Office Building | |
| Office Computer | |
| Photocopy machine that has been subleased to another office | |
| Mobile Phone | |

23

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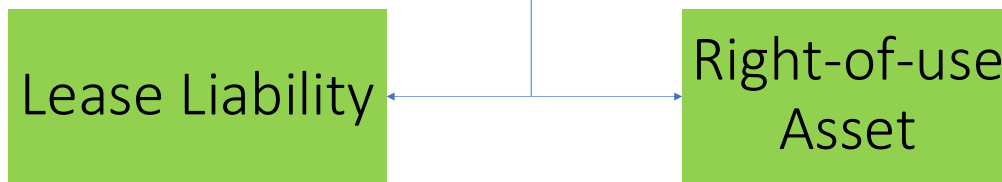
Accounting for Leases

Step 03

Lessee Accounting

24

Similar to acquiring an asset under a Long-term Loan



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Lease Liability is

Present Value of the

Amount obligated

To pay the Lease Creditor

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Let's understand the Time Value of Money

Do you like to receive Rs. 100/- today or in another one year's time?

You like to receive it today!

Reasons

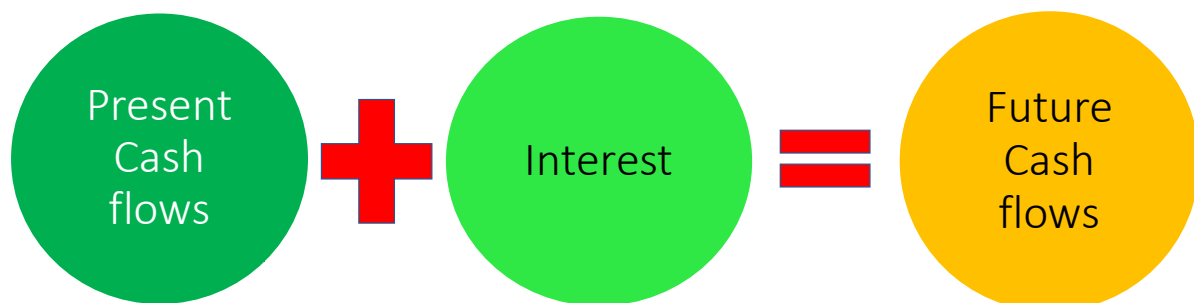
1. If you receive it today, you can **invest** it and earn an **income**.
2. **Goods and services** that can be purchased from Rs. 100/- today, cannot be purchased for the same price in another one year's time.
3. Money received today is certain. Receiving money in one year's time is **uncertain**.

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Therefore, if a sum of money is received in the future, for the Investment Income that will be lost - **Opportunity Cost**
Decline in Real Value - **Inflation**

Uncertainty

An **Interest** is expected as compensation



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Discounting is defined as the process of **eliminating the interest** included in future cash flows.



$$\text{Discounting Factor} = \frac{1}{1 + r^n}$$

r = Interest Rate

n = Time

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Question 03

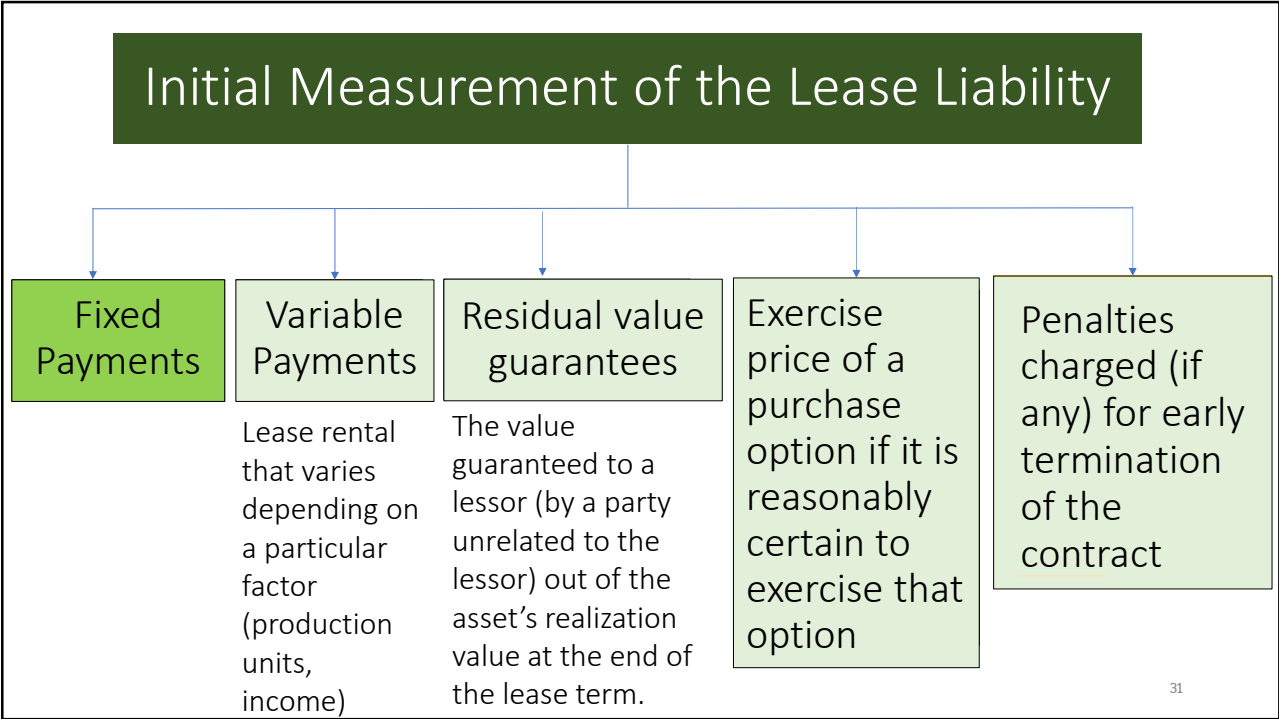
Calculate the Present Values of the cash flows given below.

(Assume the interest rate as 10%)

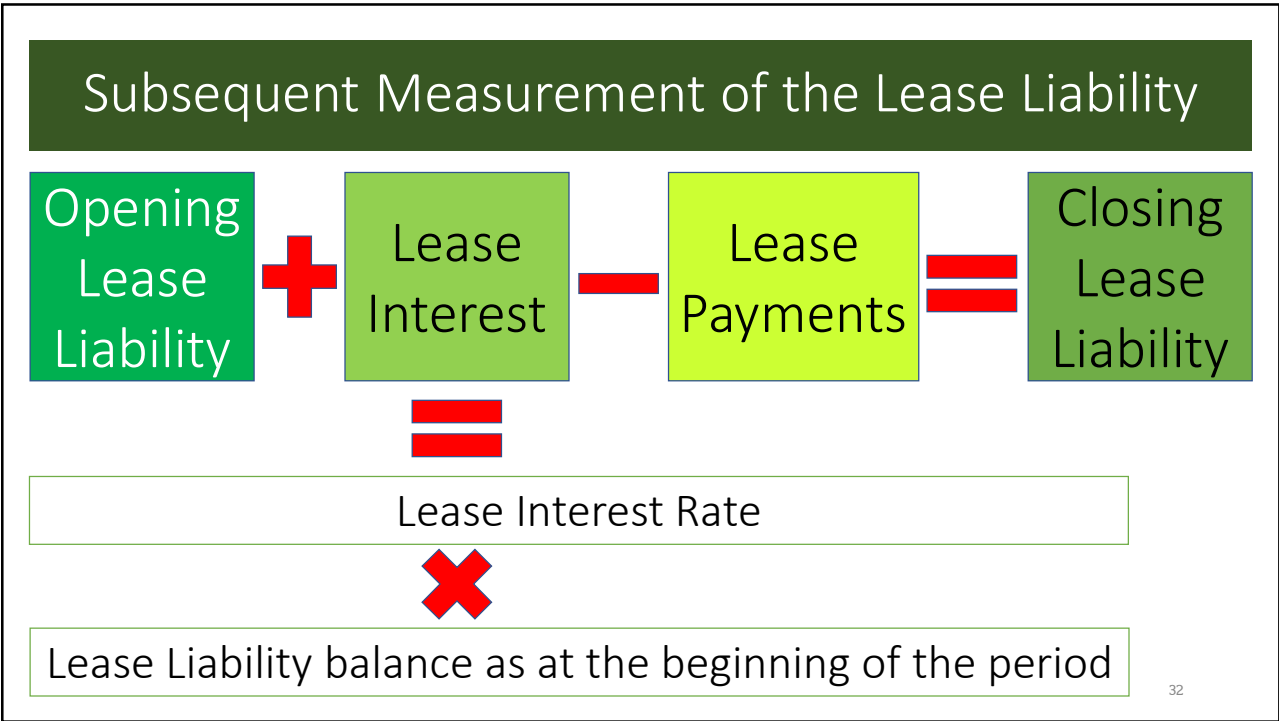
| Year | Future Cash Flow | Discounting Factor | Present Value | Interest |
|------|------------------|--------------------|---------------|-------------|
| | A | B | $C = A * B$ | $D = A - C$ |
| 0 | 100 | 1 | | |
| 1 | 110 | 0.91 | | |
| 2 | 121 | 0.83 | | |
| 3 | 133 | 0.76 | | |

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Right-of-use Asset is

The Right

Received by the Lessee

To direct the use of an underlying asset

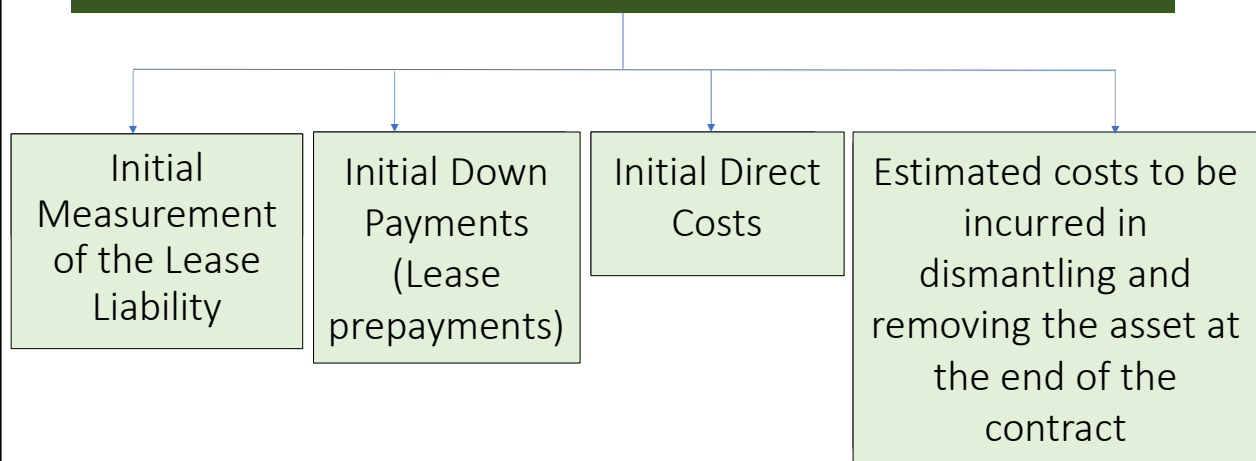
Over the lease term

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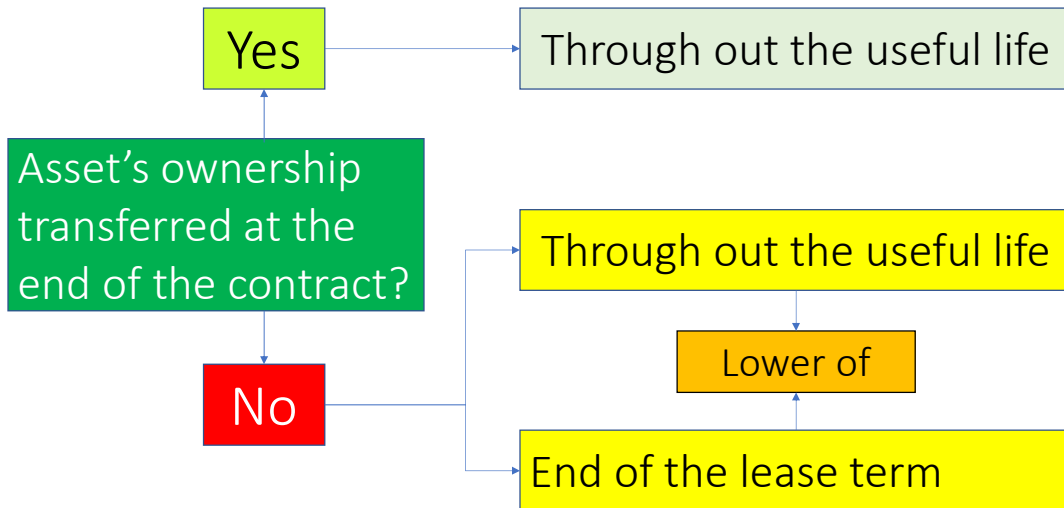
Initial Measurement of the Right-of-use Asset



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Rule on Depreciating the Right-of-use Asset



35

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Subsequent Measurement of the Right-of-use Asset

| Cost Model | | Revaluation Model | |
|-----------------------------------|-----|--|-----|
| Cost | XX | Revalued Amount | XX |
| (-) Accumulated Depreciation | (X) | (-) Subsequent Accumulated Depreciation | (X) |
| (-) Accumulated Impairment Losses | (X) | (-) Subsequent Accumulated Impairment Losses | (X) |
| Net Book Value | XX | Net Book Value | XX |

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Lessee Accounting

| Description | Double Entry |
|---|--------------|
| Initial Payment | |
| Right-of-use the Asset account | Dr |
| Cash book | Cr |
| Amount recognized as the Lease Liability | |
| Right-of-use the Asset account | Dr |
| Lease Liability account | Cr |

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Lessee Accounting

| Description | Double Entry |
|--|--------------|
| Payment made as Initial Direct Cost | |
| Right-of-use the Asset account | Dr |
| Cash book | Cr |
| Annual Interest on lease | |
| Interest Expense account | Dr |
| Lease Liability account | Cr |

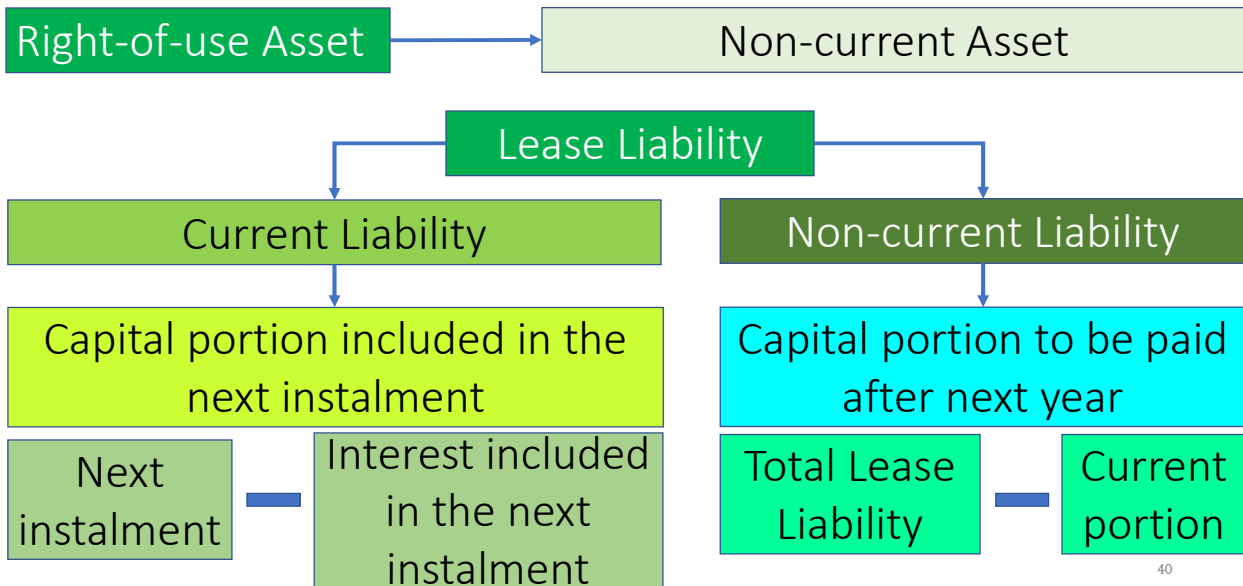
38

Lessee Accounting

| Description | Double Entry |
|----------------------------------|--------------|
| Payment of Lease Rental | |
| Lease Liability account | Dr |
| Cash book | Cr |
| Depreciation of Asset | |
| Depreciation account | Dr |
| Accumulated Depreciation account | Cr |

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Presentation in the Statement of Financial Position



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Presentation in the Statement of Profit or Loss

Depreciation

Lease Interest

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Question 04

Shihan obtained a motor vehicle on 01.04.20X7, under lease agreement with LB Finance PLC. According to the agreement,

Lease period - 03 years Down payment - Rs. 1,500,000/-

The remaining amount is to be paid in 03 equal installments of Rs. 1,400,000/- annually. All installments are to be paid in arrears (At the end of the year). The useful life is 05 years.

The present value of unpaid lease payments was Rs. 3,475,500/-.

Interest rate - 10%

The interest included in the 1st installment and 2nd installment is Rs. 350,000/- and Rs. 245,000/- respectively. The ownership of the asset transfers at the end of the lease term.

You are required to,

Show the accounting entries for the year ended 31.03.20X8 and the extracts of Statement of Financial Position and Statement of Profit or Loss for that date. ⁴²

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Answer 04

Let's understand the information given.

| Year | Down Payment | Lease Installments | Interest @ 20% | Loan Capital portion |
|-------|--------------|--------------------|----------------|----------------------|
| 0 | 1,500,000 | | 0 | |
| 1 | | 1,400,000 | 350,000 | 1,050,000 |
| 2 | | 1,400,000 | 245,000 | 1,155,000 |
| 3 | | 1,400,000 | | |
| Total | 1,500,000 | 4,200,000 | 700,000 | 3,500,000 |

Ignore decimal differences if any

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Double Entries

| Description | Debit | Credit |
|--|-----------|-----------|
| Down Payment | | |
| Right-of-use the Asset | 1,500,000 | |
| Cash | | 1,500,000 |
| Lease Liability (Loan capital portion) | | |
| Right-of-use the Asset | 3,500,000 | |
| Lease Liability | | 3,800,000 |
| Interest included in the 1st Installment | | |
| Lease Interest | 350,000 | |
| Lease Liability | | 350,000 |

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Double Entries

| Description | Debit | Credit |
|---|-----------|-----------|
| Payment of 1st Lease Instalment | | |
| Lease Liability | 1,400,000 | |
| Cash | | 1,400,000 |
| Depreciation of 1st Year | | |
| Depreciation | 1,000,000 | |
| Accumulated Depreciation | | 1,000,000 |

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Computation of Depreciation

The ownership of asset transfers at the end of the agreement. Therefore, it should be depreciated over the useful life of 05 years.

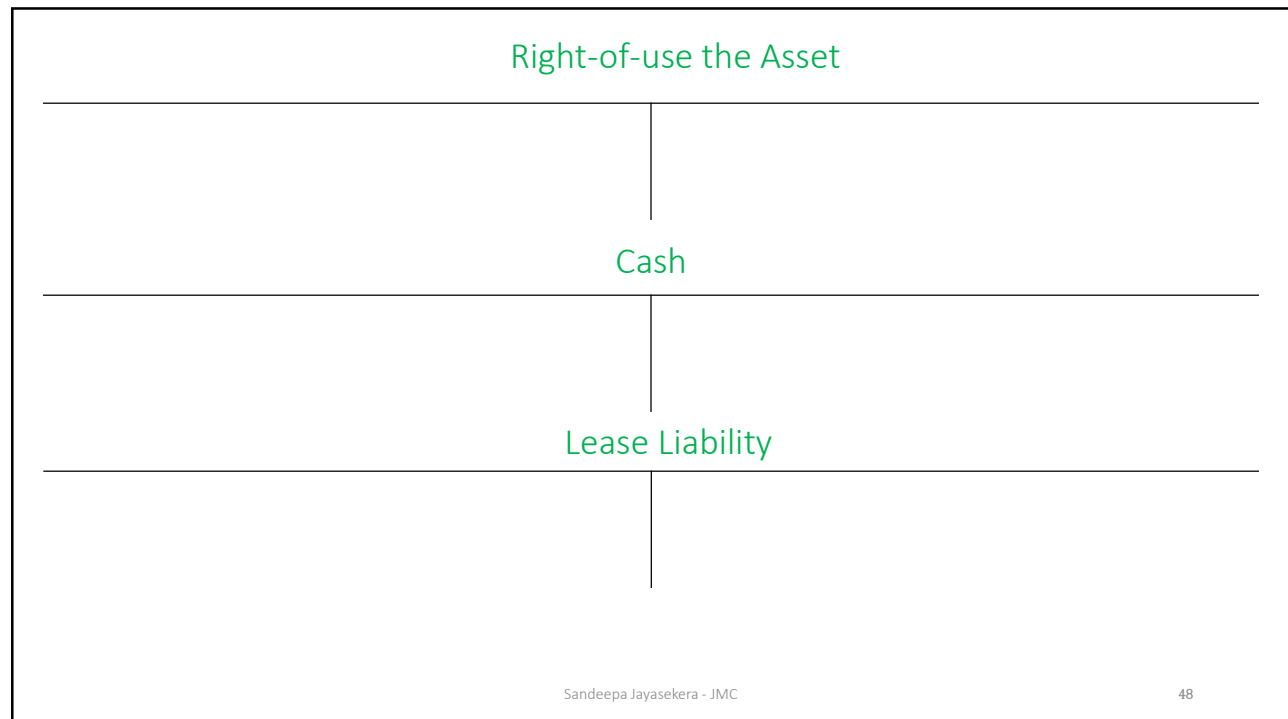
$$\text{Depreciation} = (\text{Depreciable Amount}/\text{Useful life})$$

$$\text{Depreciation} = [(\text{Cost} - \text{Residual Value})/\text{Useful life}]$$

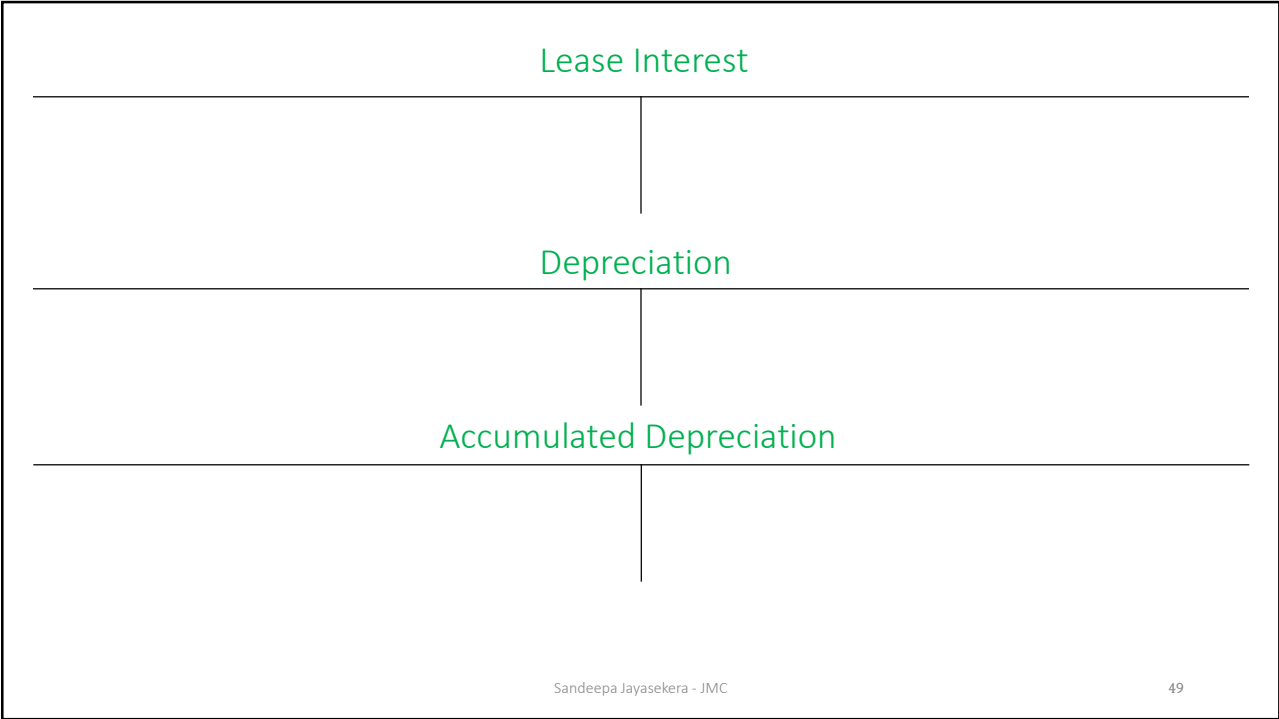
$$\text{Depreciation} = [(5,000,000 - 0)/5]$$

$$\text{Depreciation} = 1,000,000$$

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Presentation

| Extract of Statement of Financial Position | Rs. |
|--|-----|
| Non-current Assets | |
| Right-of-use the Asset | |
| Non-current Liabilities | |
| Lease Liability | |
| Current Liabilities | |
| Lease Liability | |

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Presentation

| Extract of Statement of Profit or Loss and Other Comprehensive Income | Rs. |
|---|-----|
| Depreciation | |
| Lease Interest | |

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Question 05

Luckyland PLC obtained a machine from People's Leasing PLC under a lease agreement on 01.04.20X1. The present value of unpaid lease payments was Rs. 1,000,000/-. According to the lease agreement, Rs. 100,000/- has to be paid on 01.04.20X1. The balance has to be settled in 03 equal installments of Rs. 400,000/- annually. Installments have to be paid in arrears. Interest on lease is 10% per annum, calculated based on the opening loan value.

On 01.04.20X1 a cost of Rs. 100,000/- was incurred to transport and install the machine. The ownership of the asset does not transfer at the end of the lease term. The useful life of the machine is 4 years.

You are required to,

Show the accounting entries of Luckyland PLC for the year 20X1/20X2 and extracts of Statement of Financial Position as at 31.03.20X2 and Statement of Profit or Loss.

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Answer 05

Let's understand the information given.

| Year | Down Payment | Lease Installments | Interest @ 10% | Loan capital portion |
|-------|--------------|--------------------|---|--------------------------------|
| 0 | 100,000 | | | |
| 1 | | 400,000 | $1,000,000 \times 10\%$ 100,000 | $400,000 - 100,000$ 300,000 |
| 2 | | 400,000 | $(1,000,000 - 300,000) \times 10\%$ 70,000 | $400,000 - 70,000$ 330,000 |
| 3 | | 400,000 | | |
| Total | 100,000 | 1,200,000 | 200,000 | 1,000,000 |

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Double Entries

| Description | Debit | Credit |
|---|-----------|-----------|
| Down Payment | | |
| Right-of-use the Asset | 100,000 | |
| Cash | | 100,000 |
| Initial Direct Costs | | |
| Right-of-use the Asset | 100,000 | |
| Cash | | 100,000 |
| Lease Liability (Loan Capital portion) | | |
| Right-of-use the Asset | 1,000,000 | |
| Lease Liability | | 1,000,000 |

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Double Entries

| Description | Debit | Credit |
|---|---------|---------|
| Interest included in the 1st Instalment | | |
| Lease Interest | 100,000 | |
| Lease Liability | | 100,000 |
| Payment of 1st Lease Instalment | | |
| Lease Liability | 400,000 | |
| Cash | | 400,000 |
| Depreciation of 1st year | | |
| Depreciation | 400,000 | |
| Accumulated Depreciation | | 400,000 |

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Computation of Depreciation

The ownership of asset does not transfer at the end of the agreement. Therefore, it should be depreciated over the lease term, which is the lower of between the asset's useful life of 04 years and lease term of 03 years.

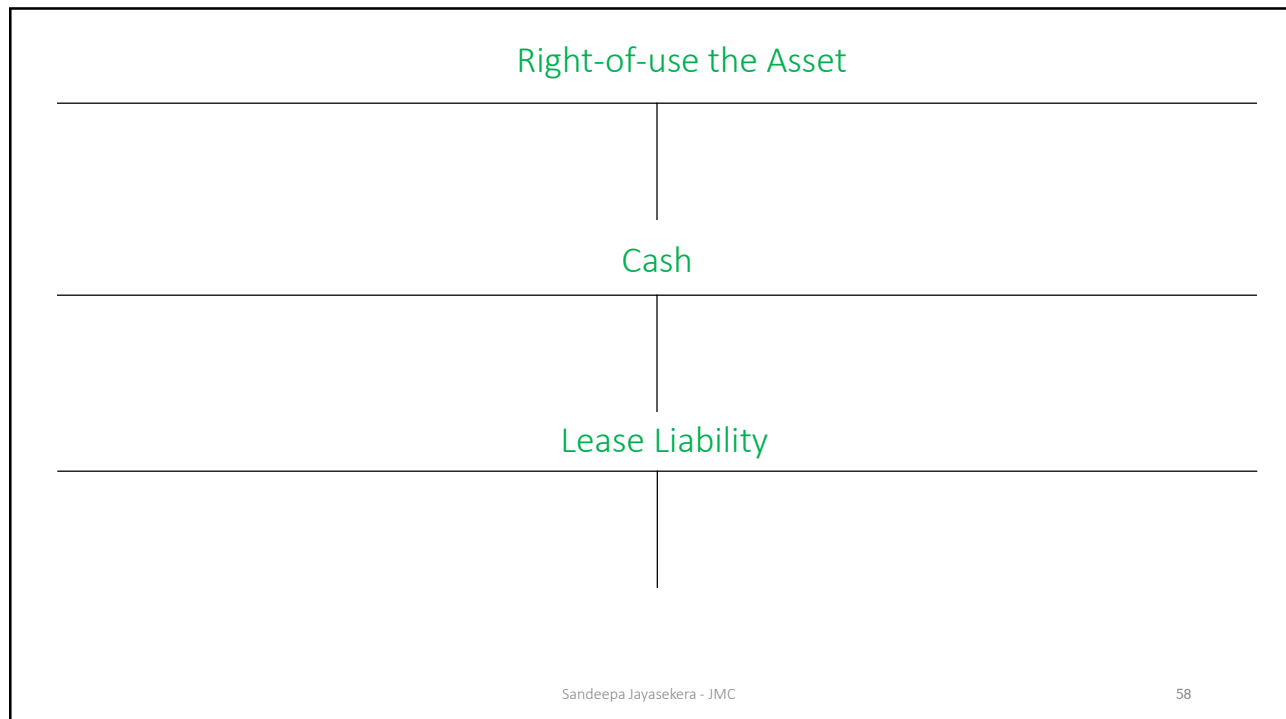
$$\text{Depreciation} = (\text{Depreciable Amount}/\text{Lease term})$$

$$\text{Depreciation} = [(\text{Cost} - \text{Residual Value})/\text{Lease term}]$$

$$\text{Depreciation} = [(1,200,000 - 0)/3]$$

$$\text{Depreciation} = 400,000$$

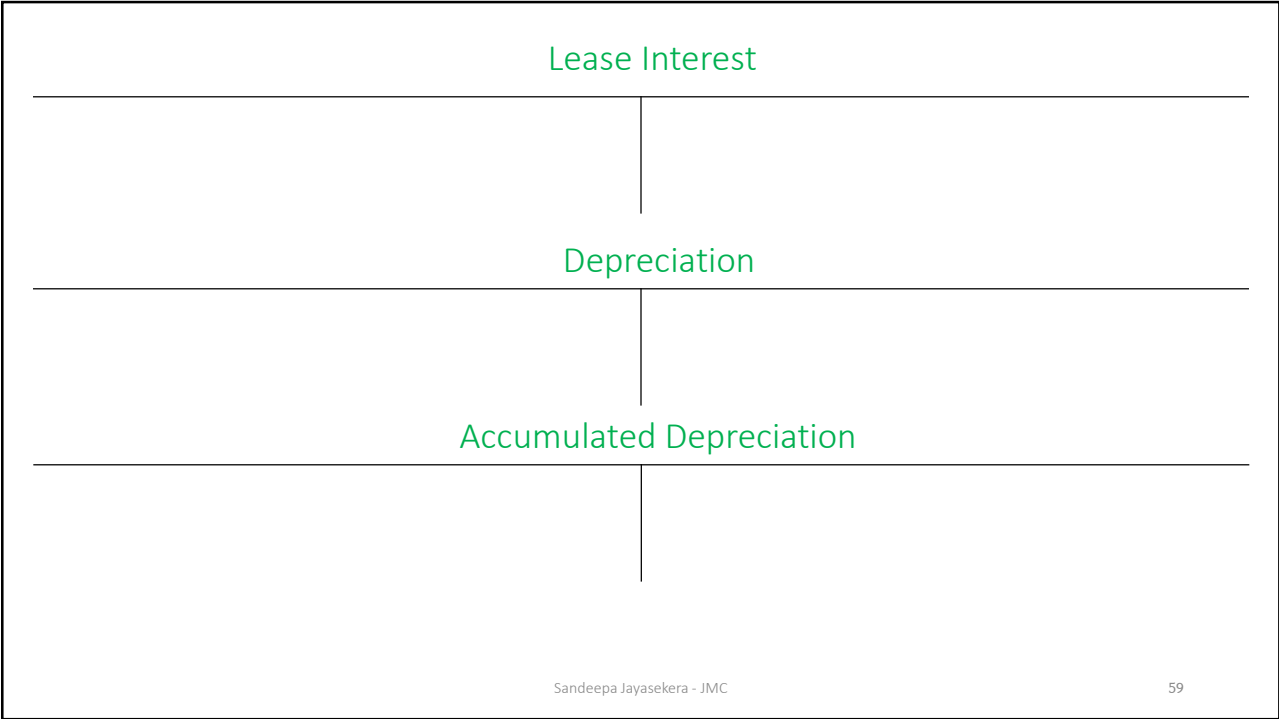
57



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Presentation

| Extract of the Statement of Financial Position | Rs. |
|--|-----|
| Non-current Assets | |
| Right-of-use the Asset | |
| Non-current Liabilities | |
| Lease Liability | |
| Current Liabilities | |
| Lease Liability | |

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Presentation

| Extract of the Statement of Profit or Loss and Other Comprehensive Income | Rs. |
|---|-----|
| Depreciation | |
| Lease Interest | |

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Question 06

Kesara PLC leased a machine from Sampath Leasing Ltd. On 01.04.20X1 Rs. 200,000/- was made as a down payment. The balance was agreed to be settled in 03 equal installments of Rs. 400,000/-. Interest rate is 10%.

Discounting factors are as follows:

Year 01 0.91

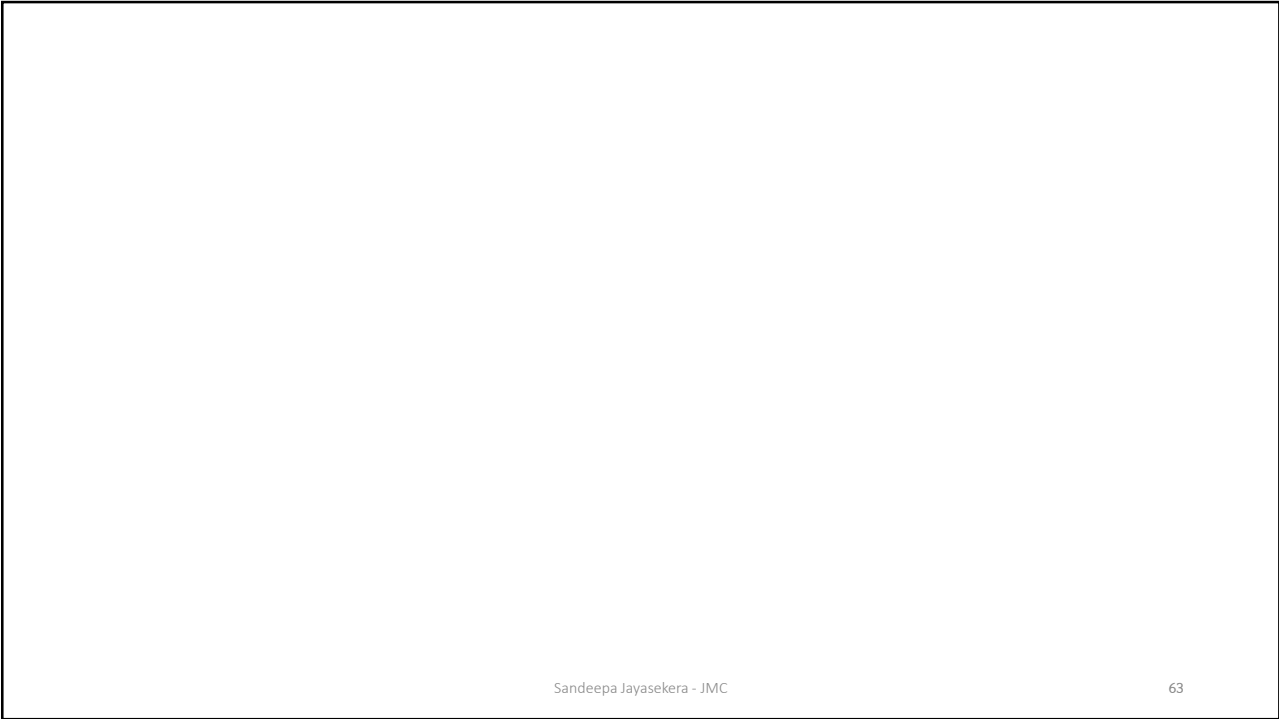
Year 02 0.83

Year 03 0.76

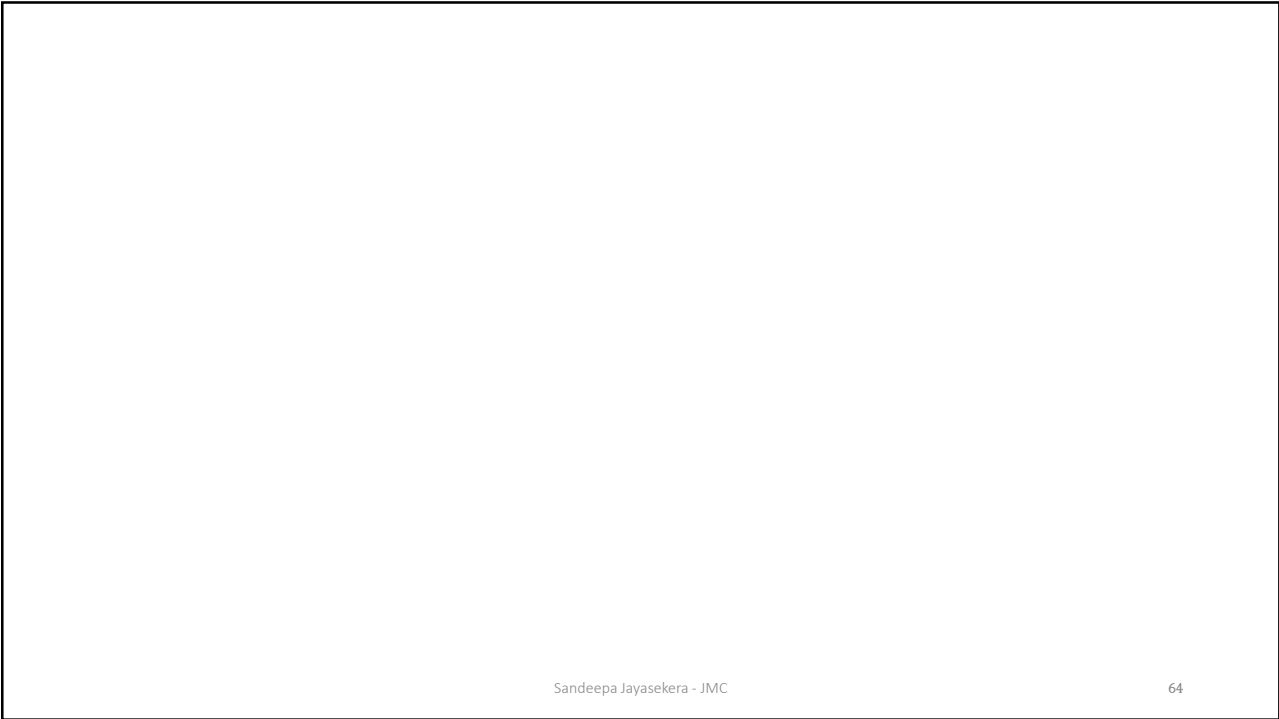
The useful time of the machine is 02 years. The ownership of the machine does not transfer at the end of the contract. The company uses the revaluation model for the machine. The machine was revalued as at 31.03.20X2, where the revalued amount was Rs. 800,000/-.

You are required to demonstrate how the above transaction should be reflected in the Financial Statement as at 31/03/20X2 and Statement of Profit or Loss for the year 20X1/X2.

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Answer 06

Let's compute present value of the unpaid lease payments

| Year | Future Cash Flows | Discounting Factor | Present Value |
|--------------|-------------------|--------------------|------------------|
| 1 | 400,000 | 0.91 | 364,000 |
| 2 | 400,000 | 0.83 | 332,000 |
| 3 | 400,000 | 0.76 | 304,000 |
| Total | 1,200,000 | | 1,000,000 |

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Answer 06

Let's understand the information given.

| Year | Down Payment | Lease Installments | Interest @ 10% | Loan capital portion |
|--------------|----------------|--------------------|---------------------------------------|----------------------------|
| 0 | 200,000 | | | |
| 1 | | 400,000 | 1,000,000×10% 100,000 | 400,000-100,000 300,000 |
| 2 | | 400,000 | (1,000,000- 300,000)×10% 70,000 | 400,000-70,000 330,000 |
| 3 | | 400,000 | | |
| Total | 200,000 | 1,200,000 | 200,000 | 1,000,000 |

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Double Entries

| Description | Debit | Credit |
|--|-----------|-----------|
| Down Payment | | |
| Right-of-use the Asset | 200,000 | |
| Cash | | 200,000 |
| Lease Liability (Loan capital portion) | | |
| Right-of-use the Asset | 1,000,000 | |
| Lease Liability | | 1,000,000 |
| Interest included on the 1st Installment | | |
| Lease Interest | 100,000 | |
| Lease Liability | | 100,000 |

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Double Entries

| Description | Debit | Credit |
|---|---------|---------|
| Payment of 1st Lease Instalment | | |
| Lease Liability | 400,000 | |
| Cash | | 400,000 |
| Depreciation of 1st Year | | |
| Depreciation | 600,000 | |
| Accumulated Depreciation | | 600,000 |
| Transferring accumulated depreciation of revalued asset to Asset account | | |
| Accumulated Depreciation | 600,000 | |
| Right-of-use the Asset | | 600,000 |

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Double Entries

| Description | Debit | Credit |
|---|---------|---------|
| Accounting the Revaluation Gain | | |
| Right-of-use the Asset | 200,000 | |
| Revaluation Reserve account (through Other Comprehensive Income) | | 200,000 |

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Computation of Depreciation

The ownership of the asset does not transfer at the end of the agreement.

Accordingly, it is depreciated over the useful life, which is the lower of between the asset's useful life of 02 years and lease term of 03 years.

Depreciation = (Depreciable Amount/Useful life)

Depreciation = [(Cost - Residual Value)/Useful life]

Depreciation = [(1,200,000 - 0)/2]

Depreciation = 600,000

70

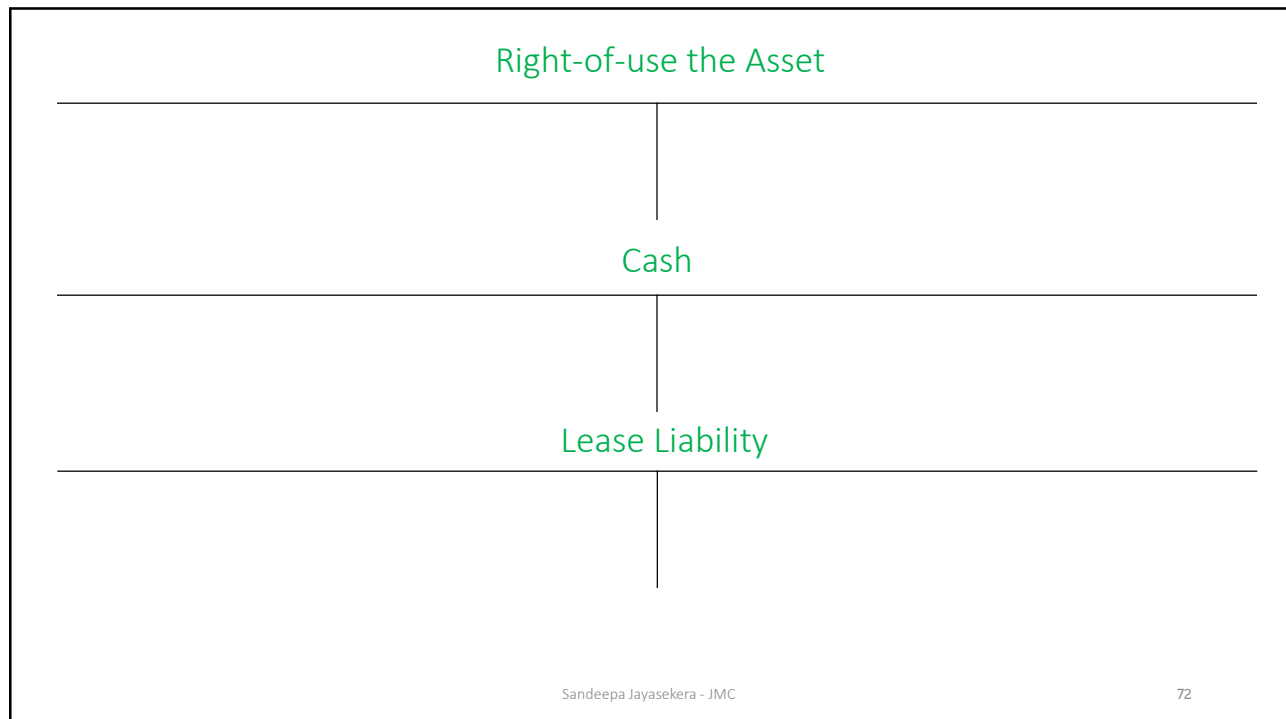
Computation of Revaluation Gain or Loss

| | | |
|---|-----------|-----------|
| Revalued Amount | | 800,000 |
| (-) Carrying amount of the asset as at 31.03.20X2 | | |
| Cost of Right-of-use the Asset | 1,200,000 | |
| (-) Accumulated Depreciation | (600,000) | (600,000) |
| Revaluation Gain | | 200,000 |

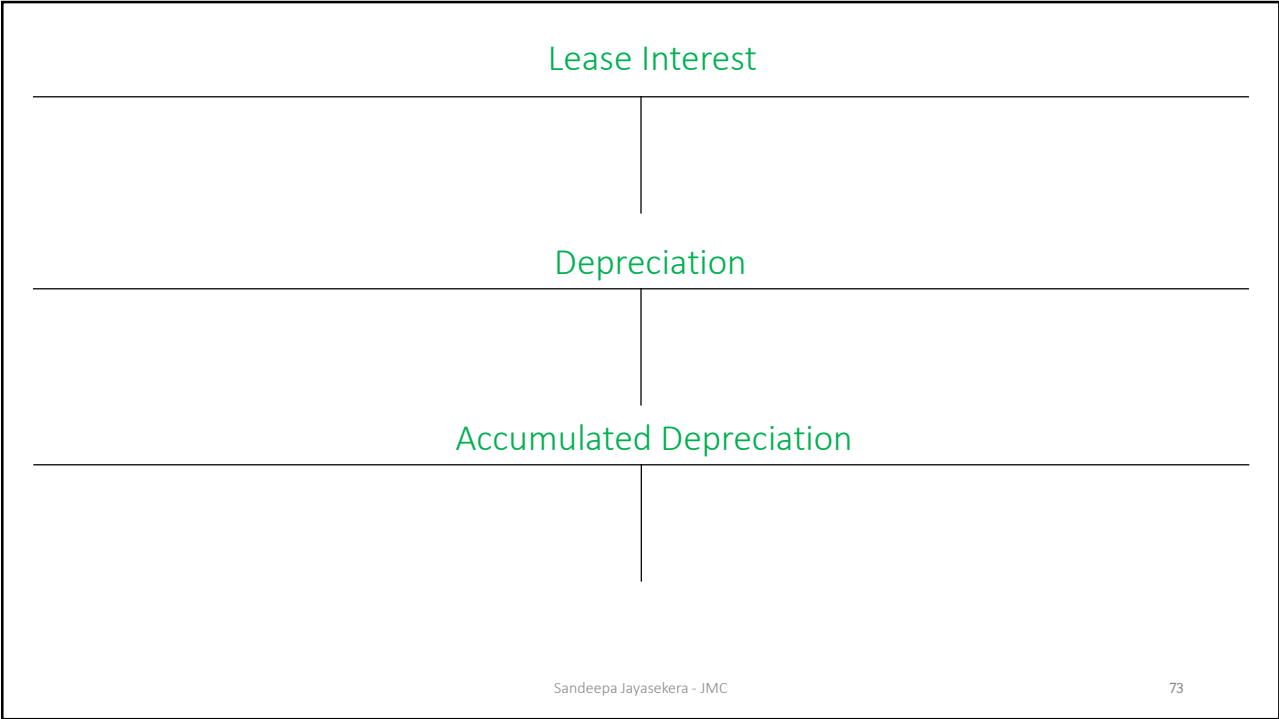
Accounting for Revaluation Gain

As there are no prior year revaluation losses in relation to this asset, the total gain can be recognized in the Revaluation Reserve through the Statement of Other Comprehensive Income.

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Presentation

| Extract of Statement of Financial Position | Rs. |
|--|-----|
| Non-current Assets | |
| Right-of-use the Asset | |
| | |
| Equity | |
| Revaluation Reserve | |
| | |
| Non-current Liabilities | |
| Lease Liability | |
| | |
| Current Liabilities | |
| Lease Liability | |

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Presentation

| Extract of Statement of Profit or Loss and Other Comprehensive Income | Rs. |
|---|-----|
| Profit or Loss account | |
| Depreciation | |
| Lease Interest | |
| | |
| Statement of Other Comprehensive Income | |
| Revaluation Gain | |

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Question 04 - 2020 Question 01(vii)

The company entered into a lease agreement on 01.03.2020 to obtain the right-of-use of a building for a period of 4 years. However, this building was available for use from 31.03.2020 after spending Rs.500,000 for renovation. This renovation is expected to generate benefits to the company over the entire lease period. However, this amount has been accounted in the other administrative expenses.

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Lease interest is not charged during the renovation period

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Question 04 - 2020 Question 01(vii)

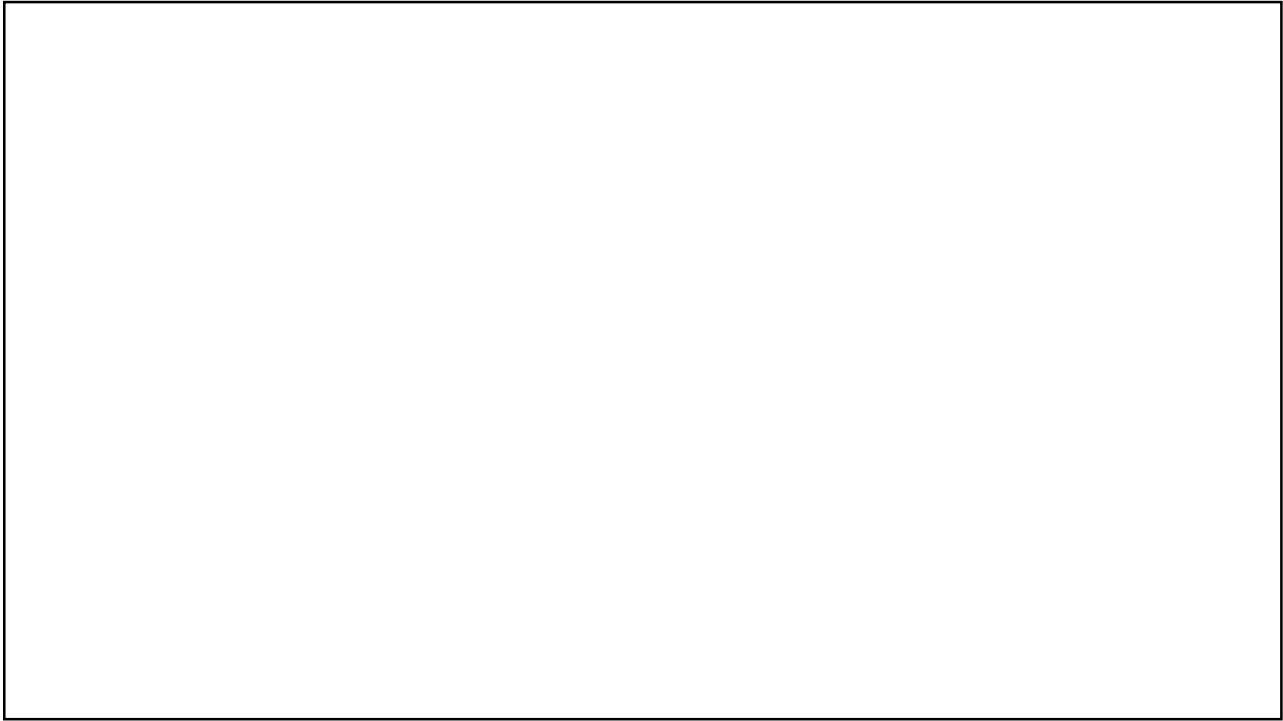
According to the agreement, an annual lease rental of Rs. 4,413,000 is payable from 31.03.2021. The lease interest applicable for the year ending 31.03.2021 is Rs.1,890,000.

The lease liability in the books and administrative expenses in the books were Rs.12,600,000/- and Rs.6,462,000/- respectively.

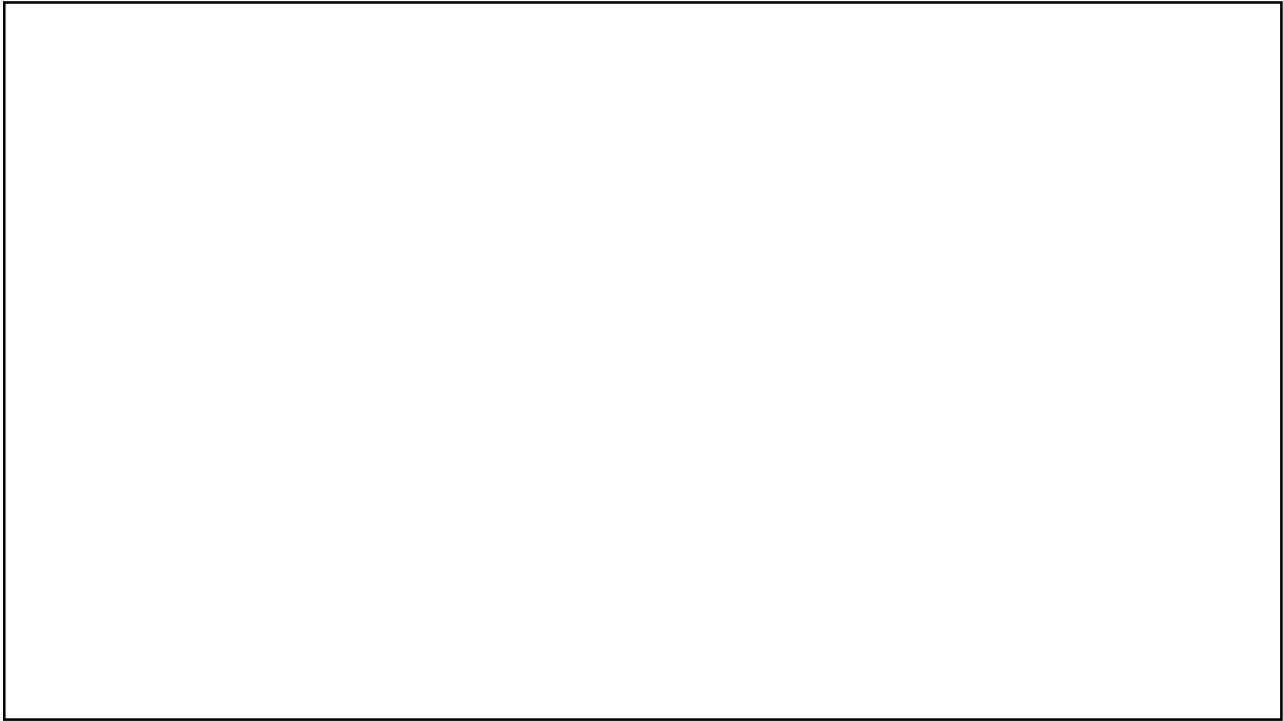
Show the Financial Statement extracts for the year ended 31.03.202.

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Question 05 – 2019 Question 01(iv)

The company entered into a lease agreement on 01.04.2018 to purchase a motor vehicle under a finance lease. The lease term is 5 years. As at 01.04.2018, the fair value of 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.

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Question 05 – 2019 Question 01(iv)

The lease interest 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.

Show the Financial Statement extracts for the year ended 31.03.2019.

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Question 06 – 2017 Question 01(vii)

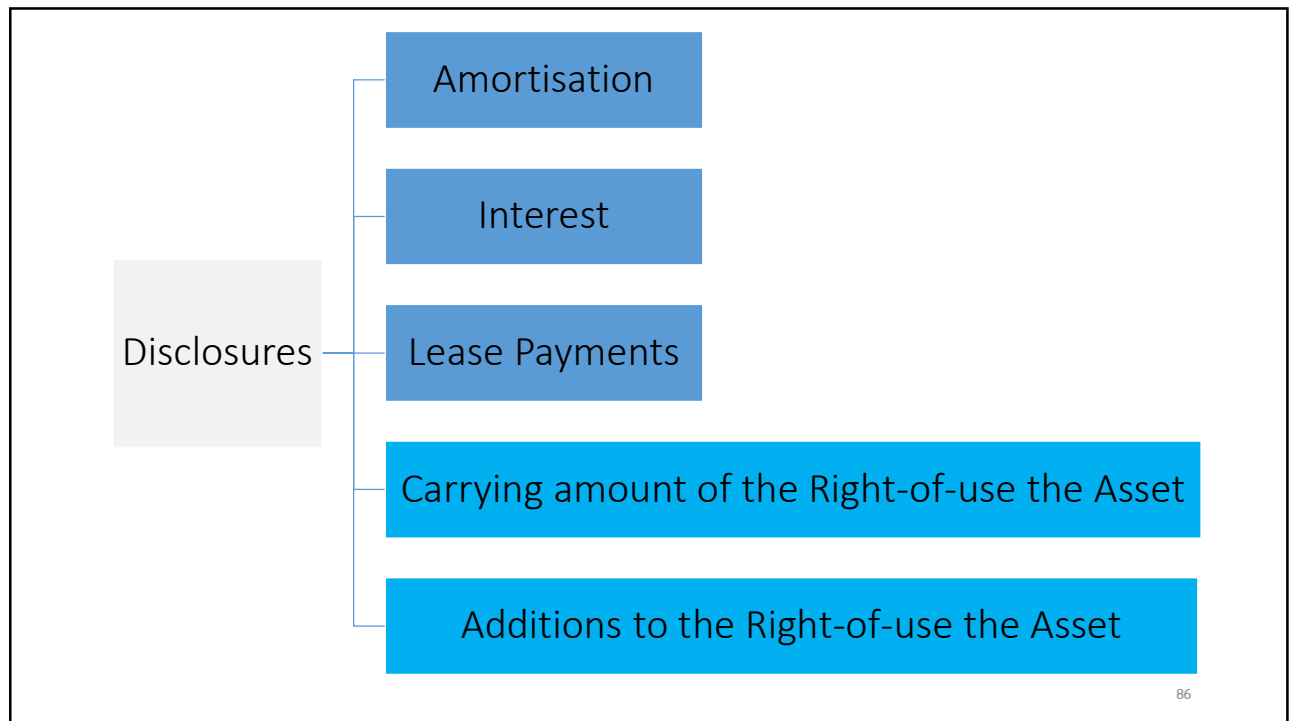
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On 01.04.2016 a lorry was acquired on a lease basis for a period of 5 years. Its fair value was Rs.5,000,000. Ownership of the lorry will transfer to the Company at the end of the lease term. The lease interest for the first and second years is Rs.500,000 and Rs.418,000 respectively and the total lease interest for the remaining three years is Rs.682,000. The annual lease payment is Rs.1,320,000. It is paid at the end of the year and is recorded as a distribution cost. No other adjustments have been made regarding this transaction.

Show the Financial Statement extracts for the year ended 31.03.2017

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