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# FAC2601 - STUDY UNIT 11 - IAS 17 Leases (lessees only)

## Contents




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# LEASES – CLASSIFICATION


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# LESSEE – FINANCE LEASE

## Journal entries

**1. Initial recognition**

| | | |
|---|---|---|
| Asset (SFP)(W1) | X | |
| VAT (SFP) | X | |
| Lease liability (SFP) | | X |

Asset = Lower of:

- Fair Value of asset
- Present value of Minimum Lease Payments (PV of MLP)

*W1) To calculate PV of MLP (use financial calculator):*
*FV = XX*
*Pmt = XX*
*Interest = X/ Y = X*
*N= X*
*Compute PV = ?*

**2. Capitalise initial direct costs (IDC)**

| | | |
|---|---|---|
| Asset (SFP) | X | |
| VAT (SFP) | X | |
| Bank (SFP) | | X |

Treat as a component of the asset. Costs may include legal costs & brokerage commissions


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**3. Instalments paid**

| | | |
|---|---|---|
| Lease liability (SFP)(W2) | X | |
| Interest expense (P/L)(W2) | X | |
| Bank (SFP) | | X |

*CalcAmort PRN = (refer W2 below)*
*CalcAmort INT = (refer W2 below)*
*= PMT from W1*

*W2) From W1, use the same inputs (FV, PMT, N, INT, Computed PV)*
*Now use the AMORT function (P1-P2)*
*Compute INT*
*Compute PRN*

**4. Depreciate asset**

| | | |
|---|---|---|
| Depreciation (P/L) | X | |
| Accumulated depreciation (SFP) | | X |

If ownership does not pass to the lessee at the end of the lease, use lease term not useful life of asset
Remember to include the IDC amount from journal 2 into the cost of the asset.

**5. Reflect current portion of lease liability**

| | | |
|---|---|---|
| Lease liability – non current | X | |
| Lease liability – current | | X |

Capital balance payable within next financial year.


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# Illustrative example – Finance Lease – Lessee with end payment

| | | | |
|---|---|---|---|
| COST INCLUSIVE VAT | 114,000 | VAT = 14,000 | |
| LEASE PERIOD | 3 | USEFUL LIFE | 3 YRS |
| INTEREST RATE | 15% | | |
| RESIDUAL PAYMENT *(Balloon payment)* | (10,000) | | |
| LEASE REPAYMENT | (47,050) | | |
| INITIAL DIRECT COSTS | 3,000 | *Ex VAT* | |

| AMORT TABLE | OPENING | INTEREST (INT) | INSTALMENT (PMT) | CAPITAL (PRN) | CLOSING |
|---|---|---|---|---|---|
| 31 December 20X0 | 114,000 | 17,100 | (47,050) | (29,950) | 84,050 |
| 31 December 20X1 | 84,050 | 12,608 | (47,050) | (34,442) | 49,608 |
| 31 December 20X2 | 49,608 | 7,442 | (47,050) | (39,608) | 10,000 |
| 31 December 20X2 | 10,000 | - | (10,000) | (10,000) | 0 |
| | (0) | 37,150 | 151,150 | 114,000 | |


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| ***Initial recognition*** | ***YEAR 1*** | ***YEAR 2*** | ***YEAR 3*** |
|---|---|---|---|
| ASSET (SFP) | 100,000 | | |
| VAT (SFP) | 14,000 | | |
| LEASE LIABILITY (SFP) | 114,000 | | |

*W1) TVM calculation(END)*
*PV = (114,000)*
*N = 3*
*Int = 15 (annually)*
*PMT = 47,050*
*Compute FV = 9998.63*
*FV Rounded = 10,000*

| ***Initial Direct Costs*** | ***YEAR 1*** | ***YEAR 2*** | ***YEAR 3*** |
|---|---|---|---|
| ASSET (SFP) | 3,000 | | |
| VAT (SFP) | 420 | | |
| BANK (SFP) | 3,420 | | |

*W2) CA of Asset =*
*100,000+3,000=103,000*


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| ***Lease Instalment Paid*** | ***YEAR 1*** | ***YEAR 2*** | ***YEAR 3*** |
|---|---|---|---|
| INTEREST EXPENSE (P/L) | 17,100 | 12,608 | 7,442 |
| LEASE LIABILITY (SFP) | 29,950 | 34,442 | 39,608 |
| BANK (SFP) | 47,050 | 47,050 | 47,050 |

*W3) TVM amort 1-3*

*AMRT 1-1*
*INT=* 17,100
*PRN=* 29,950

*AMRT 2-2*
*INT=* 12,608
*PRN=* 34,442

*AMRT 3-3*
*INT=* 7,442
*PRN=* 39,608

| ***Final residualpayment*** | ***YEAR 1*** | ***YEAR 2*** | ***YEAR 3*** |
|---|---|---|---|
| LEASE LIABILITY (SFP) | | | 10,000 |
| BANK (SFP) | | | 10,000 |

| ***Depreciation- leased asset*** | ***YEAR 1*** | ***YEAR 2*** | ***YEAR 3*** |
|---|---|---|---|
| DEPRECIATION (P/L) | 34,333 | 34,333 | 34,334 |
| ACC. DEPR. (SFP) | 34,333 | 34,333 | 34,334 |

*W4) 103,000 X 1/3 years*


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| ***Classify current portion*** | ***YEAR 1*** | ***YEAR 2*** | ***YEAR 3*** |
|---|---|---|---|
| Lease liability – non current | 34,442 | 49,608 | 0 |
| Lease liability – current | 34,442 | 49,608 | 0 |

*Refer W3 for next year PRN* *39,608+10,000*

**An extract from the disclosures that students find tricky…..**

**Reconciliation of minimum lease payments (Assume for year 1 AFS)**

| | Next 1 year | Next 2-5 years | Thereafter | Total |
|---|---|---|---|---|
| Minimum lease payments | 47,050 | 57,050 | 0 | 104,100 |
| Interest | (12,608) | (7,442) | 0 | (20,050) |
| Present value | 34,442 | 49,608 | 0 | 84,050 |

**Reconciliation of minimum lease payments (Assume for year 2 AFS)**

| | Next 1 year | Next 2-5 years | Thereafter | Total |
|---|---|---|---|---|
| Minimum lease payments | 57,050 | 0 | 0 | 57,050 |
| Interest | (7,442) | 0 | 0 | (7,442) |
| Present value | 49,608 | 0 | 0 | 49,608 |


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# Disclosure (year 1 AFS)

## Notes to SOCI

1. **Profit before tax:**

   Expenses

| | |
|---|---|
| Finance charges | 17,100 |
| Depreciation – leased assets | 34,333 |

## Notes to SOFP

2. **Property plant and equipment – leased**

   Asset is encumbered……

3. **Finance lease liability**

   **General description of leasing arrangement:**

   - Asset description
   - Secured by asset in note …
   - Period
   - Instalments
   - Frequency
   - Residual (balloon) payments
   - Effective interest rate.
   - Renewal option
   - Purchase option
   - Contingent rentals


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**IFRS 7 disclosure**

| | |
|---|---|
| Current portion | 34,442 |
| Non-current portion | 49,608 |
| Total | 84,050 |

Concentration of interest rate risk
Concentration of liquidity risk

**Reconciliation of minimum lease payments (Assume for year 1 AFS)**

| | Next 1 year | Next 2-5 years | Thereafter | Total |
|---|---|---|---|---|
| Minimum lease payments | 47,050 | 57,050 | 0 | 104,100 |
| Interest | (12,608) | (7,442) | 0 | (20,050) |
| Present value | 34,442 | 49,608 | 0 | 84,050 |


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# Illustrative example – Finance Lease – Lessee with advance payment

| | |
|---|---|
| COST INCLUSIVE VAT | 114,000 |
| PERIOD | 3 |
| INTEREST RATE | 15% |
| RESIDUAL (BALLOON) PAYMENT | (10,000) |
| LEASE REPAYMENT | (40,913) |
| INITIAL DIRECT COSTS (LEGAL FEES) | 3,000 |

| **AMORT TABLE** | **OPENING** | **INTEREST** | **INSTALMENT** | **CAPITAL** | **CLOSING** |
|---|---|---|---|---|---|
| 01 January 20X0 | 114,000 | - | (40,913) | (40,913) | 73,087 |
| 01 January 20X1 | 73,087 | 10,963 | (40,913) | (29,950) | 43,138 |
| 01 January 20X2 | 43,138 | 6,471 | (40,913) | (34,442) | 8696 |
| 31 December 20X3 | 8,696 | 1,304 | (10,000) | (8,696) | 0 |
| | (0) | 18,738 | 132,739 | 114,00 | |


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| ***Initial Recognition*** | **YEAR 1** | | **YEAR 2** | **YEAR 3** |
|---|---|---|---|---|
| ASSET (SFP) | 100,000 | | | |
| VAT (SFP) | 14,000 | | | |
| LEASE LIABILITY (SFP) | | 114,000 | | |

*W1) TVM calculation (BEGIN)*
*PV = (114,000)*
*N = 3*
*Int = 15 (annually)*
*PMT = 40,913*
*Compute FV = 9998.79*
*FV Rounded = 10,000*

| ***Initial Direct Costs*** | **YEAR 1** | | **YEAR 2** | **YEAR 3** |
|---|---|---|---|---|
| ASSET (SFP) | 3,000 | | | |
| VAT (SFP) | 420 | | | |
| BANK (SFP) | | 3,420 | | |

*W2) CA of Asset*
*100,000+3,000=103,000*


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***Lease Instalment Paid***

| | | | |
|---|---|---|---|
| INTEREST EXPENSE (P/L) | - | 10,963 | 6,471 |
| LEASE LIABILITY (SFP) | 40,913 | 29,950 | 34,442 |
| BANK (SFP) | 40,913 | 40,913 | 40,913 |

*W3) TVM Amort 1-3*

*AMRT 1-1* BEGIN
*INT=* 0
*PRN=* 40,913

*AMRT 2-2* BEGIN
*INT=* 10,963
*PRN=* 29,950

*AMRT 3-3* BEGIN
*INT=* 6,471
*PRN=* 34,442

***Interest Accrual Current Year***

| | ***YEAR 1*** | ***YEAR 2*** | ***YEAR 3*** |
|---|---|---|---|
| INTEREST EXPENSE (P/L) | 10,963 | 6,471 | 1,304 |
| ACCRUED INTEREST (SFP) | 10,963 | 6,471 | 1,304 |

*W4) Interest accrued for the year but not yet paid (paid 1st day of next period)*

*Int for Amort 2-2*

*Int for Amort 3-3*

CBal 3-3 = 8,696
(FV to unwind)
x Int 15% = 1,304

***Reverse Prior Year Accrual***

| | **YEAR 1** | **YEAR 2** | **YEAR 3** |
|---|---|---|---|
| ACCRUED INTEREST (SFP) | - | 10,963 | 6,471 |
| INTEREST EXPENSE (P/L) | - | 10,963 | 6,471 |


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***Final Residual / Balloon Payment***

| ***Interest and PRN*** | **YEAR 1** | **YEAR 2** | **YEAR 3** |
|---|---|---|---|
| INTEREST EXPENSE (P/L) | | | 1,304 |
| LEASE LIABILITY (SFP) | | | 8,696 |
| BANK (SFP) | | | 10,000 |

| ***Depreciation Expense*** | **YEAR 1** | **YEAR 2** | **YEAR 3** |
|---|---|---|---|
| DEPRECIATION (P/L) | 34,333 | 34,333 | 34,333 |
| ACC. DEPRECIATION (SFP) | 34,333 | 34,333 | 34,333 |

103,000 X 1/3

| ***Classify Current Portion*** | **YEAR 1** | **YEAR 2** | **YEAR 3** |
|---|---|---|---|
| Lease liability – non current | 29,950 | 43,138 | - |
| Lease liability – current | 29,950 | 43,138 | - |

*W5) Amort PRN repaid in next year:*

*Amort 2-2* BEGIN
*PRN* 29,950

*Amort 3-3* BEGIN
*PRN* 34,442
*+*
*CBAL* 8,696


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# ILLUSTRATIONS USING FINANCIAL CALCULATOR - MONTHLY IN ARREARS

| | | |
|---|---|---|
| PV | 228,000 | VAT inclusive |
| n | 120 | months |
| i | 1 | per month |
| FV | 11,304 | end of the lease |
| PMT | 3,222 | per month |

| | |
|---|---|
| Commence date | 01 January 20X6 |
| **Year end** | **31 March 20X6** |

| | | | |
|---|---|---|---|
| Interest expense | 6,812 | | Per 1-3 int |
| Balance on liability - non current | | 212,837 | Bal after 15 |
| Balance on liability - current | | 12,309 | Per 4-15 cap |

| **Lease note** | **Next year Per 4-15** | **2 -5 years Per 16-63** | **Thereafter Per 64-120** |
|---|---|---|---|
| Minimum lease payment | 38,664 | 154,656 | 194,958 |
| Interest | 26,355 | 87,701 | 49,076 |
| Capital | 12,309 | 66,955 | 145,882 |


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| **Year end** | **31 March 20X7** | |
|---|---|---|
| Interest expense | 26,355 | Per 4-15 int |
| Balance on liability - non current | 198,967 | Bal after 27 |
| Balance on liability - current | 13,870 | Per 16-27 cap |

| **Lease note** | **Next year Per 16-27** | **2 -5 years Per 28-75** | **Thereafter 76-120** |
|---|---|---|---|
| Minimum lease payment | 38,664 | 154,656 | 156,294 |
| Interest | 24,794 | 79,209 | 32,773 |
| Capital | 13,870 | 75,447 | 123,521 |
| | 12.00 | 48.00 | 45.00 |


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## Lessee - Operating lease

### Journal entries

**1. Lease instalment**

| | | |
|---|---|---|
| Expense (P/L) | X | |
| VAT (SFP) | X | |
| Bank (SFP) | | X |

**2. Initial direct costs**

| | | |
|---|---|---|
| IDC – prepaid exp (SFP) | X | |
| VAT (SFP) | X | |
| Bank (SFP) | | X |

*Results in prepaid expense asset to be amortised over lease term*

**3. Equalise lease instalments**

| | | |
|---|---|---|
| Expense (P/L) | X | |
| Equalisation adj (L) (SFP) | | X |

*Equalised rental > paid (Lease accrual = liability)*

OR

| | | |
|---|---|---|
| Equalisation adj (A) (SFP) | X | |
| Expense (P/L) | | X |

*Equalised rental < paid (Lease Prepayment = Asset)*


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| | | | |
|---|---|---|---|
| **4. Amortise IDC (prepaid expense) asset** | IDC amortised (PL) | X | *Amortise IDC prepaid expense asset over the lease term.* |
| | IDC asset (SFP) | X | |
| **5. Classify current portion of IDC (prepaid expense) asset** | IDC asset – Current A | X | *The portion to be amortised in the next year is current.* |
| | IDC asset – Non Current A | X | |
| **6. A – If Equalisation Adj = Lease Accrual (Liability)** ***Classify current portion:*** | Lease Accrual – Non Curr L | X | *The portion of the lease accrual expected to reverse next year* |
| | Lease Accrual – Curr | X | |
| **6. A – If Equalisation Adj = Lease Prepayment (Asset)** ***Classify current portion:*** | Lease prepmt – Current A | X | *The portion of the lease asset expected to realise next year* |
| | Lease prepmt – Non Curr A | X | |


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## Disclosure

## Accounting policy note

## Notes to SOCI

1. **Profit before tax:**

Expenses

| | |
|---|---|
| Operating lease expense | X |
| Amount paid | X |
| Equalisation adjustment | X /(X) |
| Initial direct cost amortised | X |


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## Notes to SOFP

### 2. Operating lease

***General description of leasing arrangement:***

- Asset
- Period
- Instalments
- Frequency
- Residual
- Renewal option
- Purchase option
- Contingent rentals
- Restrictions

***Reconciliation of minimum lease payments***

| | Next 1 year | Next 2-5 years | Thereafter | Total |
|---|---|---|---|---|
| Minimum lease payments | X | X | X | X |


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***Equalisation asset (Lease Prepayment) / liability (Lease Accrual)***

| | | |
|---|---|---|
| Opening balance | x | |
| Current year adjustment | x | |
| Closing balance | x | |
| Amount expected to reverse in next year | (x) | Current |
| Amount expected to reverse beyond next year | x | Non Current |

***Initial direct cost asset = Prepaid Expense Asset***

| | | |
|---|---|---|
| Opening balance | x | |
| Current year adjustment | x | |
| Closing balance | x | |
| Amount expected to reverse in next year | (x) | Current |
| Amount expected to reverse beyond next year | x | Non Current |


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