

Ind AS 116: Leases

Converged with IFRS 16.

Replaced Ind AS 17 w.e.f FY beginning on or after 1 April 2019

Presented by-

CA Chandni Gupta
(AIR CA Final & IPCC)
(YouTube Channel & Blog:
IFRSworld)

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ORGANISED BY: CA Sangam Agarwal

What has changed and why?

- Accounting for lessee has changed significantly
 - Little change in accounting for lessor
 - Moving off-balance sheet financing to on-balance sheet for lessee.
 - Lessee will capitalize all the leases except for short term and low value leases.
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To bring transparency in financial reporting. This new standard will lead to a consistent, comparable and understandable financial information across industries.

Exemption to lessee:

Lessee can opt for exemption from all the above treatment for a class of underlying assets to which the right of use asset belongs and recognize the lease payments of SLM basis over the period of use or other systematic basis.

Short Term leases

- A lease that, at the commencement date, has a lease term of 12 months or less. A lease that contains a purchase option is not a short-term lease.

Leases of low value.

- Need to assess on the basis of its value when it's new. (a lease of a car can not be of low value because the value of a new car is high).
- The assessment will lead to same conclusion for different lessees because the asset has to be of low value in absolute terms.
- If lessee expects to sub lease an asset, the main lease cannot be classified as low value
- e.g: tablet, mobile phone, PCs, office items, furniture, etc

Scope of Ind AS 116:

This standard applies to all leases (including subleases), except for leases relating to:

- Minerals, oil, natural gas and similar nonregenerative resources within the scope of Ind AS 106
- Biological assets within the scope of Ind AS 41 Agriculture held by a lessee
- Service concession arrangements under Ind AS 115
- Licences of intellectual property granted by a lessor within the scope of Ind AS 115
- Motion picture films, video recordings, plays, manuscripts, patents and copyrights covered under Ind AS 38.
- Lessee has an option not to apply this standard on any Intangible asset.

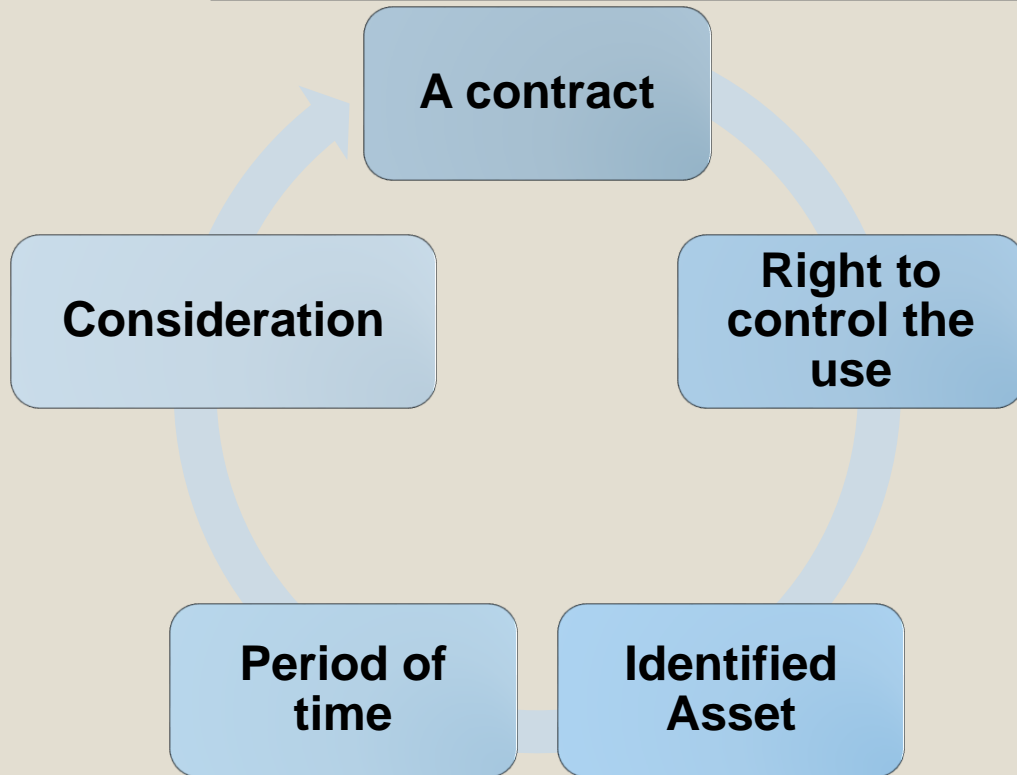
Inception date of lease

Inception date is the earlier of the date of a lease agreement and the date of commitment by the parties to the principal terms and conditions of the lease.

On this date, entities have certain tasks to do:

1. Identify a lease
2. Classification of lease by lessor into finance or operating lease

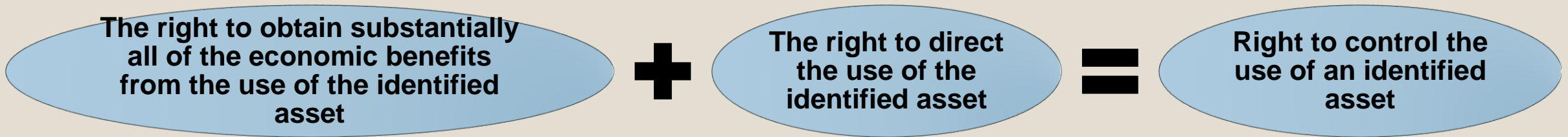
Identify a lease:



Lease is a contract, or part of a contract, that conveys **the right to control the use of an identified asset** for a period of time in exchange for consideration.

Underlying asset is an asset that is the subject of a lease, for which the right to use that asset has been provided by a lessor to a lessee.

Right to control the use of an asset:



These rights should remain “**throughout the period of use**”, if the customer has the right only for a portion of the term, then the contract contains lease for that limited term only.

Economic benefits may be derived by using, holding or sub leasing the asset. These include benefits from the use of its primary output as well as by-products and any other benefits that could be derived from the use of the asset.

In cases, wherein the customer is required to pay the supplier or another party a portion of the cash flows derived from the use of the asset as consideration, those cash flows are still counted as economic benefits derived by the customer from the use of the asset.

A customer has **the right to direct** the use of the identified asset, if he either:

- ✓ Has the **right to direct how and for what purpose** the asset is used, this right should remain valid throughout the period of use, or
- ✓ Relevant decisions about how and for what purpose the asset is used are **predetermined** and the customer has the **right to operate** in that manner throughout the period of use and the supplier does not have any right to change the **operating instructions**, or
- ✓ Has **designed** the asset in a manner that predetermines how and for what purpose the asset will be used throughout the period of use.

The supplier may have **Protective Rights** which typically define the scope of the customer’s right to use but does not prevent him from having right to control the use of the asset.

Identified Asset:

Explicitly identified/specified in the contract

Implicitly specified at the time when that asset is made available for the use by the customer

(e.g.: supplier has only one type of asset, or when the asset is under construction and will be made available for use)

Exception: Even if an asset is specified in a contract, the customer does not have a right to control the use of the asset if the supplier has a **substantive right to substitute** the asset throughout the period of use.

The rights are substantive only if **BOTH** the following conditions are fulfilled:

- ✓ He has the **practical ability** to substitute the alternative assets throughout the period of use, and
- ✓ He would **economically be benefitted** from doing so i.e. benefits exceeds the cost of substituting the asset

If his rights/obligation to substitute becomes exercisable only on occurrence or non-occurrence of an event, then his rights are not substantive.

Commencement date of lease

The date on which a lessor makes an underlying asset available for use by a lessee.

On this date, entities have certain tasks to do:

1. Determine the lease term
2. Initial recognition of lease

Lease term:

Non Cancellable Period

Commencement Date

Rent Free Period

Renewable Period
(*Certain to exercise*)

Period covered by an option to terminate
(*Certain not to exercise*)

Non-cancellable period is the period which is enforceable as per the contract.

- If **both the parties have a right to terminate** the lease without any major penalty, the term ends there and the contract remains no longer enforceable.
- If **only the lessee has an option** to terminate the contract, that right is considered to be an option to terminate the lease available to the lessee that an entity considers when determining the lease term.
- If **only the lessor has this right**, then the non-cancellable period includes the term covered by the option to terminate.

The **non-cancellable period** of a lease which **includes** the period beginning from **the commencement** of lease and includes the **rent-free period** provided by the lessor to the lessee, together with both:

- Periods covered by an option to **extend** the lease if the lessee is **reasonably certain to exercise** that option; and
- Periods covered by an option to **terminate** the lease if the lessee is **reasonably certain not to exercise** that option.

After the commencement date, a lessee reassesses the lease term upon the **occurrence of a significant event** or a **significant change in circumstances** that is within the control of the lessee and affects whether the lessee is reasonably certain:

- to exercise an option not previously included in its determination of the lease term, or
- not to exercise an option previously included in its determination of the lease term

Future lease payments

Future lease payments for the lessor

Future lease payments for the lessee

Fixed payments (including in-substance fixed payments)**, less any lease incentives

Variable lease payments that depend on an index or a rate, measured using a prevailing rate at measurement date**

Exercise price of a purchase option if the lessee is reasonably certain to exercise that option

Penalties for terminating the lease, if the lease term reflects the lessee exercising an option to terminate the lease

Residual value guarantees by the lessee

Residual value guarantees to the lessor by a party related to the lessee or a third party unrelated to the lessor that is financially capable of discharging the obligations under the guarantee

****Variable lease payments that do not depend on any index or rate are not in substance, fixed, and hence are not included in lease payments. In some cases, it may so happen that variability is resolved during the lease term, so that the payments become fixed for the remainder of the lease term, then these payments will be used to remeasure the lease liability (with an offset to ROU Asset).**

Meaning of terms:

Interest Rate Implicit in the lease is the rate at which*

** If that rate cannot be readily determined, the lessee shall use the **lessee's incremental borrowing rate.***

(Net Investment in lease):

PV of lease payments accruing to the lessor

+

PV of Unguaranteed Residual Value


Fair Value of the underlying asset


+

Initial Direct cost to the lessor (not being manufacturer/dealer lessor)

Net Investment = PV of Lease payments accruing to lessor + PV of Unguaranteed Residual Value

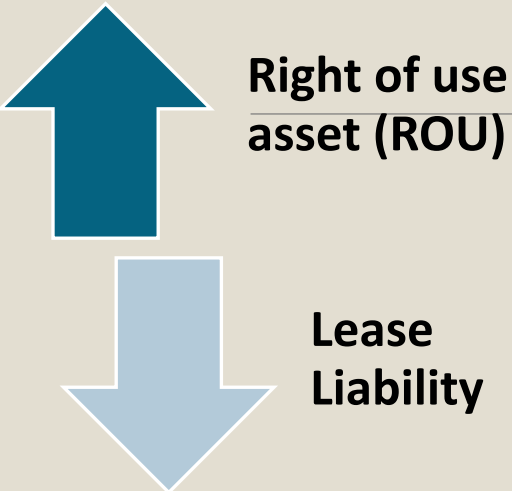
Initial Direct Costs: Incremental costs of obtaining a lease that would not have been incurred if the lease had not been obtained, except for such costs incurred by a manufacturer or dealer lessor in connection with a finance lease.

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1. Commission (including to employees acting as selling agents)
 2. Legal fees
 3. Lease document preparation costs
 4. Payments to existing tenants to move out
 5. Consideration for a guarantee to an unrelated third party for residual value.

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1. Employee Salaries
 2. Legal fees for services rendered before the execution of the lease
 3. Negotiating lease terms and conditions
 4. Advertising
 5. Depreciation and amortisation

Treatment in the books of lessee:

Initial Recognition:

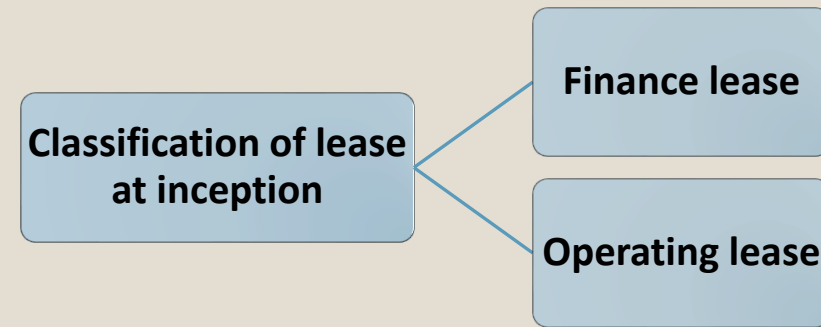


ROU Asset	Dr.	Sum total of all below
Lease Liability	Cr.	PV of future lease payments to lessee using interest rate implicit in lease*
Lessor/Supplier	Cr.	Any lease payment made on or before the commencement date (less lease incentives received)
Bank/Creditor	Cr.	Initial Direct Costs incurred by lessee
Provision for dismantling/removing the underlying cost	Cr.	Estimate of costs to be recognized only when lessee incurs an obligation for these costs (IAS 37)

Subsequent Measurement:

- **ROU Asset:**
 - **Cost model** i.e. (Cost less Accumulated Dep less Accumulated Impairment) and adjusted for any remeasurement of lease liability.
 - Depreciation period= Useful life of the asset {if lessee intends to purchase it} or the earlier of useful life or period of use.
 - Dep on SLM basis.
 - Apply Ind AS 16.
 - **Revaluation model**, in case right of use asset belongs to the class of PPE to which lessee chooses to apply RV model under Ind AS 16
- **Lease liability:**
 - Increased by : Interest charge in P&L at rate used for discounting, on the balance of lease liability
 - Decreased by: Actual lease payments

Treatment in the books of lessor:



Finance Lease: If it transfers substantially all the risks and rewards incidental to the ownership of an underlying asset. If the lessor does not transfer substantially all the risks and rewards incidental to the ownership of the asset, then the lessor shall classify the lease as an **Operating lease**.

Initial Recognition:

Finance Lease:

Finance Lease Receivable	Dr.	Net Investment
Underlying Asset	Cr.	Carrying Amount

(Balancing figure: profit/loss)

Operating Lease: no entry on initial recognition

Subsequent Measurement:

Finance lease receivable:

- Increased by : Interest income in P&L at rate used for discounting, on the balance of receivable
- Decreased by: Receipt of actual lease payments

Operating lease:

- Lease income recorded in P&L on SLM basis or another systematic basis {SLM means total lease payments divided by lease term}

Lease modification:

- A change in the scope of a lease, **or**
- A change in the consideration for a lease,

that was not part of the original terms and conditions of the lease.

(for example, adding or terminating the right to use one or more underlying assets, or extending or shortening the contractual lease term).

Account for as a separate lease, only if:

- Increase in **scope** of the lease by adding the right to use one or more underlying assets, **and**
- Increase in **consideration** by an amount commensurate with the stand-alone price for the increase in scope

Reassessment:

IN THE BOOKS OF LESSEE:

Lease modification not accounted for as a separate lease.

- **Decrease in scope (either in lease term or underlying asset):** Remeasure the lease liability using revised discount rate and decrease the ROU asset by its relative scope compared to the original lease, and the difference will be recognized in P&L.
- **Other lease modification:** Discount revised lease payments at revised discount rate over revised lease term (Reassess lease liability and adjust ROU Asset):

Discount revised lease payments using original discount rate:

- **Not a lease modification but:**
 - Change in guaranteed residual value
 - Change in index or rate on which lease payments were dependent
 - Variability of lease payments resolved that they become in-substance fixed

If, the value of ROU is NIL, the adjustment will be made in P&L

Reassessment:

IN THE BOOKS OF LESSOR:

Finance lease: lease modification which has not been accounted for as a separate lease:

- Lessor will assess, if the lease would have been classified as an operating lease had the modification been in effect at the inception date, the lessor shall:
 - account for the lease modification as a new lease from the effective date of the modification; and
 - measure the carrying amount of the underlying asset as the net investment in the lease immediately before the effective date of the lease modification.
- Otherwise, the lessor shall apply the requirements of IFRS 9.

Operating lease: Account for as a new lease from the effective date of lease modification, considering any prepaid lease or accrual as part of lease payments of new lease.

Lease of land and building:

- The classification into finance or operating lease will be done for land and building separately, as the land has an indefinite useful life it will be classified as an operating lease.
- The consideration will be apportioned between the two in proportion of their fair values at the inception date.
- If the amount of land is immaterial, lessor may consider it as a single unit and will classify the lease with regards to the economic life of building.

Covid Impact and Proposed amendment:

During these times, lessees are invoking “force majeure” where they are not going to pay lease for a specified period of time, and there are some cases where lessees are getting rent concessions by way of waiver or reduction in lease payments.

IASB has already amended IFRS 16 in the month of May 2020 and ASB has issued exposure draft for proposed amendment

As a practical expedient, a lessee may elect not to assess whether a rent concession that meets the conditions for practical expedient, is a lease modification. A lessee that makes this election shall account for any change in lease payments resulting from the rent concession the same way it would account for the change applying this Standard if the change were not a lease modification.

Conditions for applying practical expedient: It applies only to rent concessions that occur as a direct consequence of the covid-19 pandemic and:

- ✓ the change in lease payments results in revised consideration for the lease that is substantially the same as, or less than, the consideration for the lease immediately preceding the change;
- ✓ any reduction in lease payments affects only payments originally due on or before 30 June 2021 (for example, a rent concession would meet this condition if it results in reduced lease payments on or before 30 June 2021 and increased lease payments that extend beyond 30 June 2021); and
- ✓ there is no substantive change to other terms and conditions of the lease (exception: a three-month rent holiday before 30 June 2021 followed by three additional months of substantially equivalent payments at the end of the lease would not constitute a substantive change to other terms and conditions of the lease).

Thanks for watching!

CA Chandni Gupta
Visit my YouTube channel @IFRSworld
and blog @ifrs-world

Contact details:
+91 9958108075
chandni@ifrsworld.in