IND AS 116 - Leases

June 2019

Overview

IND AS 116 at a glance

Topic	Description
Effective date	1 April 2019
Lessee accounting model	- Single Lease accounting model - No lease classification test - All leases on balance sheet : • Lessee recognizes ROU asset and lease liability • Treated as a purchase of an asset on financed basis
Lessor accounting model	- Dual lease accounting model for lessors - Lease classification test - Finance lease accounting model based on IAS 17 - Operating lease accounting model based on IAS 17 operating lease accounting
Practical expedients	- Optional lessee exemption for short term leases - Portfolio level accounting permitted if it does not differ materially from applying the requirements - Optional lessee exemption for leases of low value

Single lessee accounting model

All major leases on balance sheet

Balance sheet

Asset

= ‘Right-of-use’ (ROU) of underlying asset

Liability

= Obligation to make lease payments

P&L

Lease expense

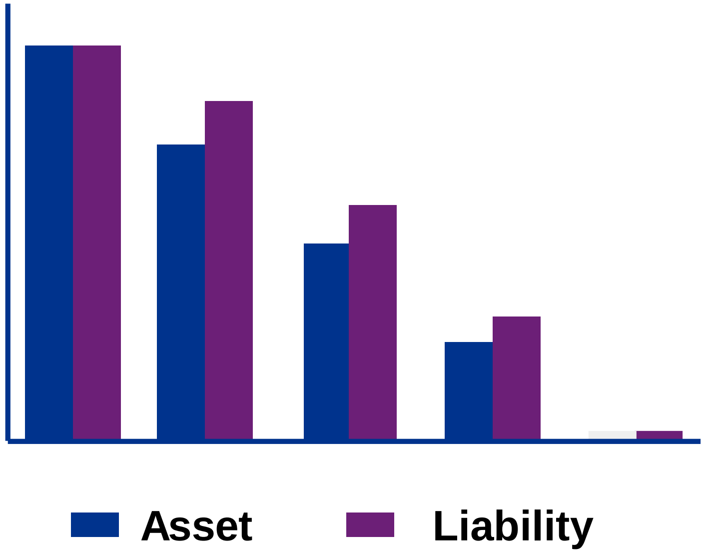
Depreciation

+ Interest

= Front-loaded total lease expense

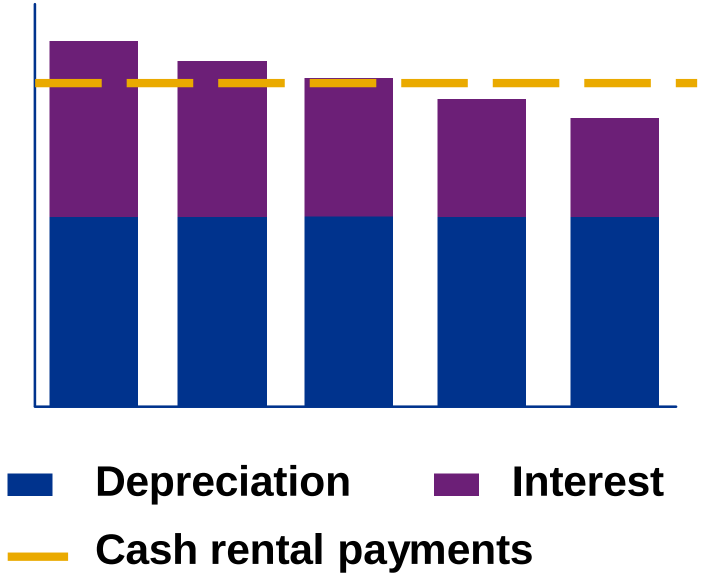
What's the impact?

Balance sheet



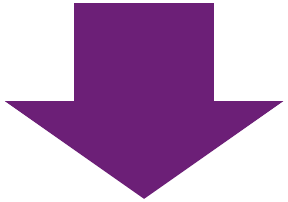
Lessees appear to be more ***asset-rich***, but also more ***heavily indebted.***

Profit/loss



Total lease expense is ***front-loaded*** even when cash rentals are constant.

Impact on financial ratios

	Profit/loss	Balance sheet	Ratios
	EBITDA	Total assets	Gearing
	EPS (in early years)	Net assets	Interest cover Asset turnover

Application

Applying IND AS 116

Determine when to apply standard

Identify the lease

Choose whether to apply the practical expedients

Separate lease and non lease components

Apply lease accounting models

Lessee

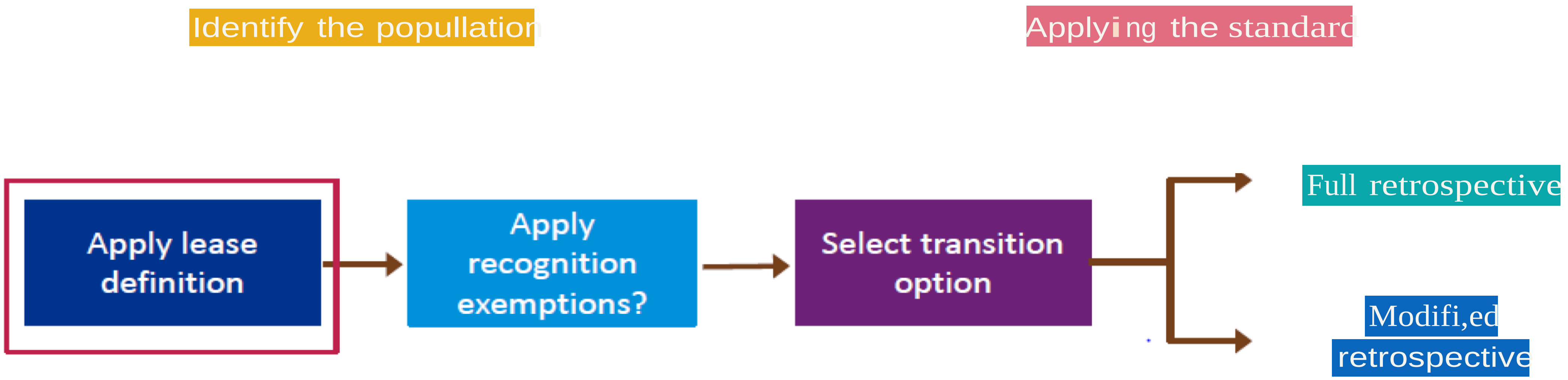
Lessee accounting model

Lessor

Lessor accounting model

Apply Other relevant guidance

ADO Ying NO AS 116

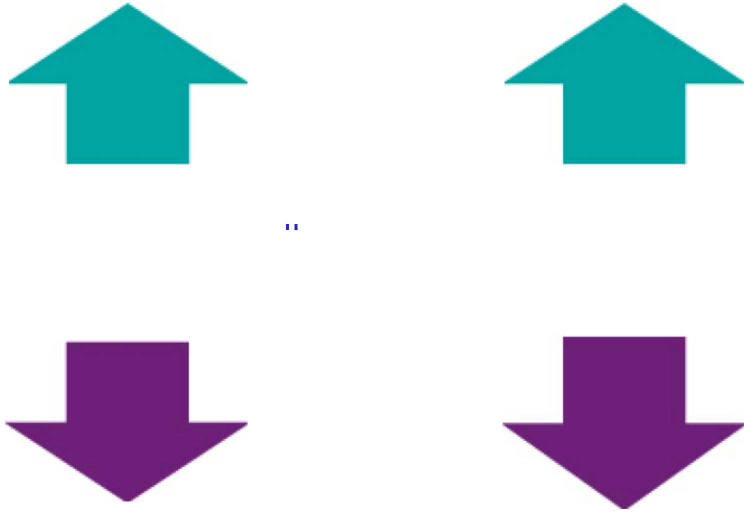


Aoo ying Lease definition

Cost

Comparability

Apply the definition to ***all contracts***



OR

PE

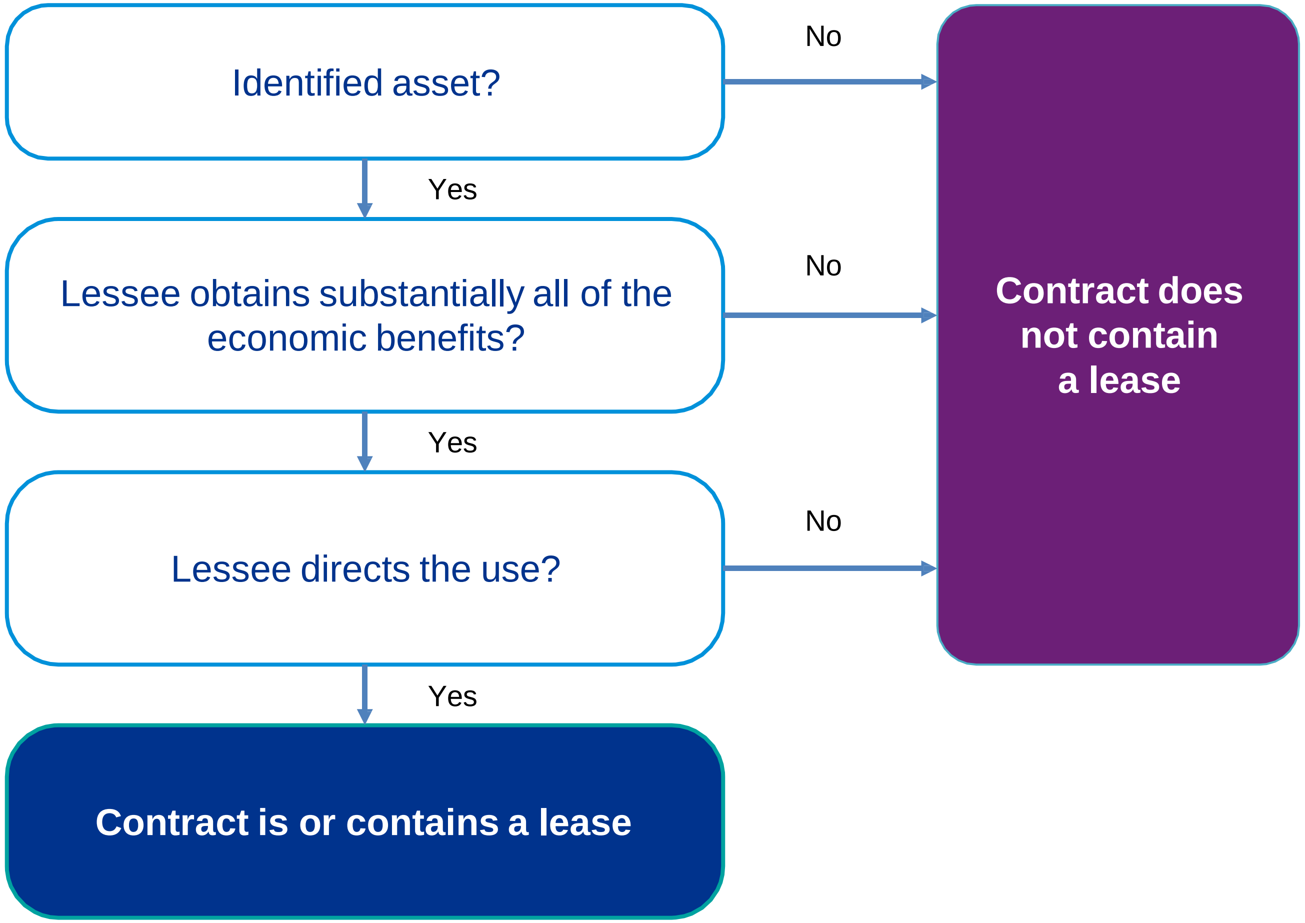
Grandfather existing contracts

and apply the definition ***only to new or changed contracts***

PE – practical expedient

Is there a Lease?

A contract is, or contains, a lease if the contract conveys the right to **control** the use of an **identified asset** for a **period of time** in exchange of **consideration**



How long is the lease -Lease term

Lease term

Non-cancellable period

Optional renewal periods
if lessee ***reasonably certain*** to exercise

Periods after optional termination date
if lessee ***reasonably certain not*** to exercise

Lease Components

If a contract contains lease then the company accounts for each lease component separately from non lease components

	Lessee	Lessor
When there is an observable standalone price for each component	Unless the practical expedient is elected (see below) separate and allocate based on the relative standalone price of components Example:	Always separate and allocate on a relative standalone selling price basis
When there is not an observable standalone price for some or all components	Maximise the use of observable information	
Taxes, insurance on property and administrative costs	Activities (or cost of lessor) that do not transfer a good or service to the lessee are not components in a contract	
Practical expedient: Accounting policy election by class of underlying	Combine Lease and any non lease components and account for them as lease components	NA

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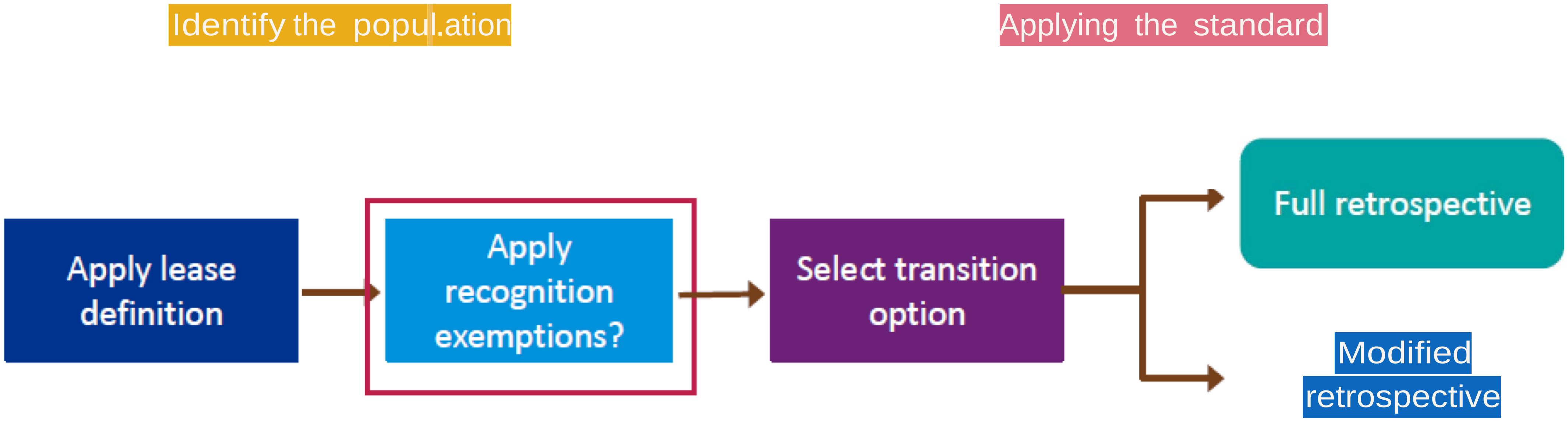


Recognition exemotions

Two major opt-onal exemptions make the standard easier to apply

Short term leases

:S 12 months

Leases, of low value items

:S USD 5,000 for example

Transition

Ind AS 17 to Ind AS 116- Transition impact

lessee operating lease	lessee finance lease	lessor operating lease	lessor finance lease
Full retrospective	Full retrospective	No adjustment on transition except for subleases	
Modified retrospective with practical expedients	Modified retrospective		
High	Medium	Low	

Lessee Accounting

Lease liability- measurement

Lease liability

-

Present value of remaining rentals

+

Present value of expected payments at end of lease

Discount rate = lessee's incremental borrowing rate at *initial application (transition discount rate)*

Lease payments

Lessee includes the following payments for use of underlying asset in measurement of the liability:

- Fixed payments (less any incentive receivable and including in-substance fixed payments structured as variable lease payments)

- Variable payments that depend on index or a rate

- Amounts expected to be payable by the lessee under residual value guarantees

- Exercise price of purchase option , lessee is reasonably certain to exercise

- Payments to terminate the lease if the lease term reflects early termination

Lease payments

Which variable lease payments are included in the lease liability?

✓

Fixed and in-substance fixed payments

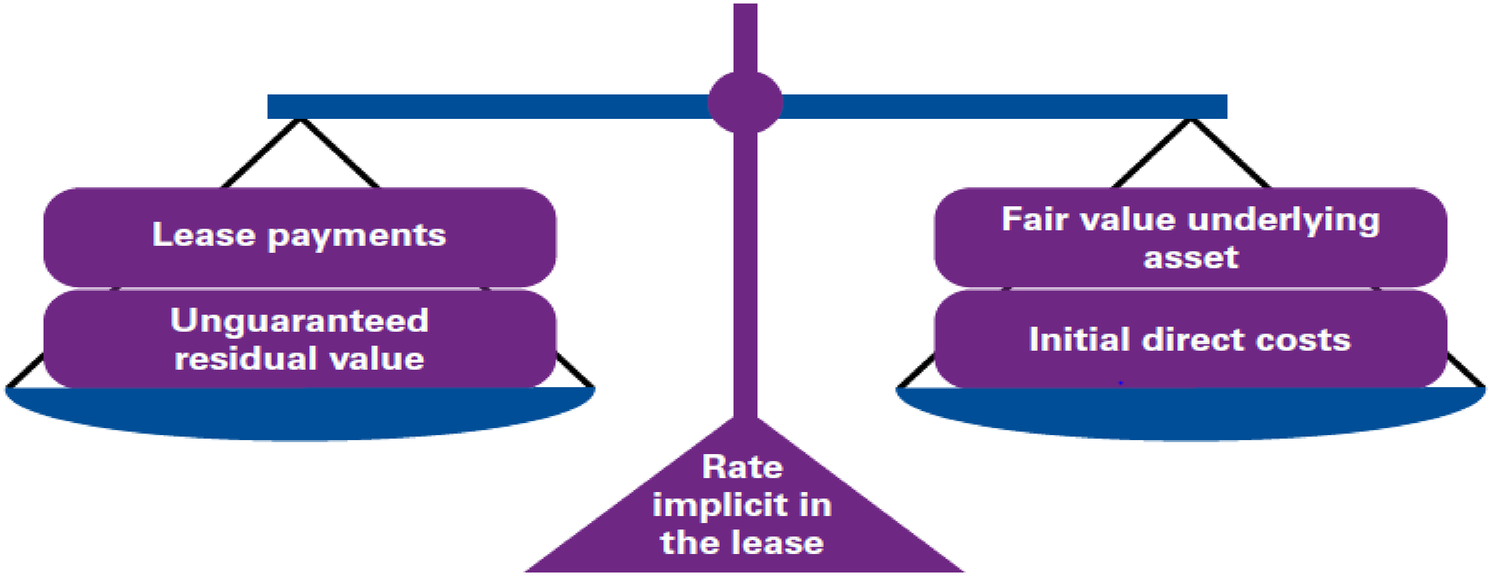
Payments based on an index or rate (based on current value)

✗

Payments based on turnover or usage

Discount Rate

Lessee calculates the present value of the lease payments using the interest rate implicit in the lease.

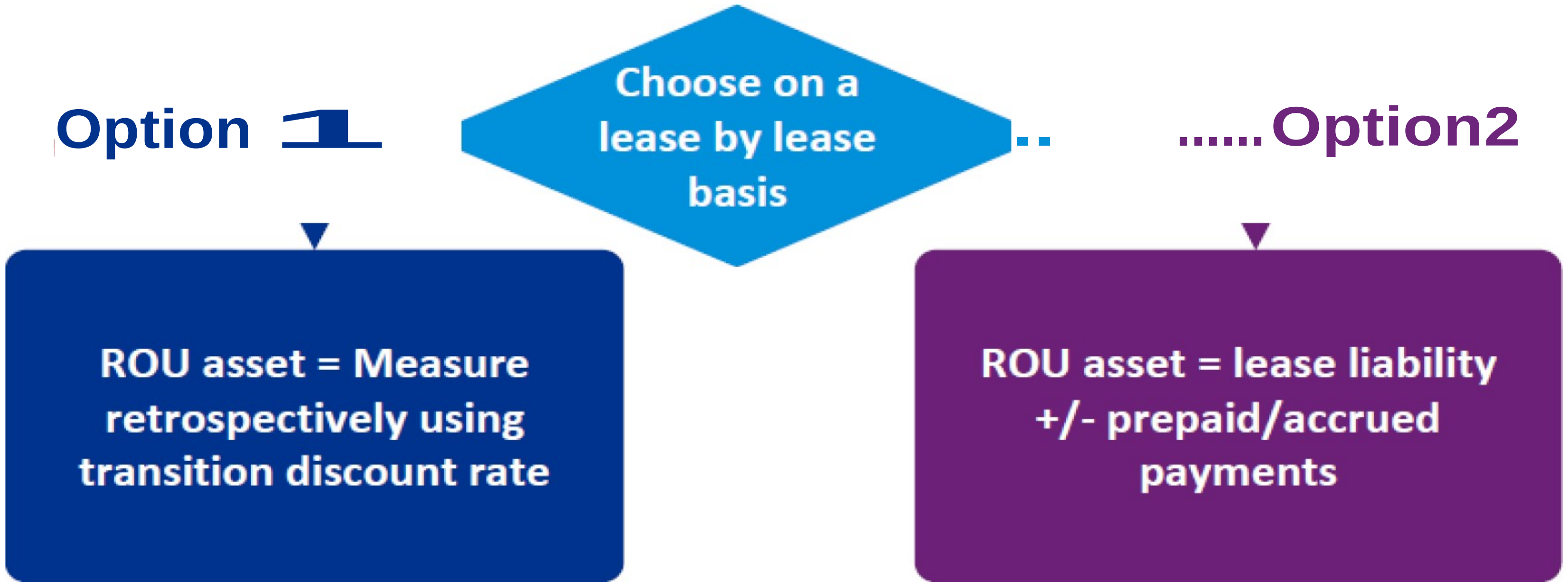


If implicit rate is not determinable then lessee uses its incremental borrowing rate i.e this is the rate that lessee would pay on the commencement date of lease for a loan of a similar term and security to obtain similar value to the right of use asset in similar economic environment

Initial measurement of Right of use (ROU) asset

Lease liability
+
Initial Direct cost
+
Prepaid lease payments
+
Estimate cost to dismantle, remove or restore
–
Lease incentives received
=
Right of use asset

Measurement of Right of use [ROU] asset on transition



Apply Ind AS 36 at

Transition approach - Illustration

Measuring the lease liability: Modified retrospective approach

For leases previously classified as operating leases, a lessee measures the lease liability at the date of initial application as the present value of the remaining lease payments. The discount rate is the lessee's incremental borrowing rate at that date.

Lease commences on 1 April 2014.

- Non-cancellable lease period: 10 years
- Option to renew for further five years.

Fixed rental of INR100 per annum

Incremental borrowing rate on:

- Transition date: 5% p.a.
- Commencement of lease: 7% p.a.

At the time of lease commencement:

It is not reasonably certain to exercise renewal options

Remaining term of lease is five years

Analysis: Lease liability on transition is calculated based on the lease payments over the remaining lease term (five years at INR100 per annum) discounted at its incremental borrowing rate at that date-5% – giving a lease liability of INR433.

Transition approach – Illustration (cont.)

Measuring ROU asset

Option 1: Measure retrospectively using transition discounting rate

Option 2: Lease liability +/ - prepaid/accrued payments

Apply this option on a lease-by-lease basis

Option 1: Retrospective but using the incremental borrowing rate on transition date

Analysis: Assuming there are no initial direct costs, ROU asset is calculated on lease commencement (1 April 2014) as the present value of the lease payments over the 10-year term (10 years at INR100 per annum) discounted at ABC's incremental borrowing rate on transition of 5% – giving an amount of INR772.

Considering that company choses to depreciate ROU assets on a straight-line basis over the lease term, the carrying amount of the ROU asset on transition date is 5 / 10 x INR772 = INR386.

Journal entry on initial recognition of this lease on date of transition is:

Particulars	Debit (INR)	Credit (INR)
ROU asset	386	
Retained earnings	47	
Lease liability		433

Transition approach – Illustration (cont.)

Option 2: ROU asset equal to the lease liability

Analysis: Under option 2, on the date of transition, the ROU asset is equal to the lease liability of INR433.

Journal entry on initial recognition of this lease on date of transition is:

Particulars	Debit (INR)	Credit (INR)
ROU asset	433	
Retained earnings	-	
Lease liability		433

Overall transition choice: Option 1 typically results in a lower depreciation charge and lower risk of impairment. In the above example, the depreciation charge under both options is:
Option 1: 1/5 x INR386 = INR77
Option 2: 1/5 x INR433 = INR87

Full retrospective approach: Requires companies to determine the carrying amount of all leases in existence at the earliest comparative period as if those leases had always been accounted for under IFRS 16 using incremental borrowing rate at the inception of the contract.

Practical Expedients

Practica Exoadiants

Account for leases expiring within 12 months as short term leases.

Lease liability

Apply single discount rate to leases with similar characteristics.

Use of hindsight e.g. determining lease term.

ROU asset

Exclude initial direct costs from ROU asset measurement.

Onerous contracts – alternative to pe1forming impairment review.

Modified retrospective approach *only!*

PE # 3 use of hindsight

Issue

- Entity A leases a building with a lease commencement date of 1 September 2006.
- Lease payments are based on CPI.
- Entity A intends to use the modified retrospective approach with the ROU asset measured as if Ind AS 116 had been applied since 1 September 2006 (Ind AS 116.C8(b)(i)).

Question

Can hindsight be used for the changes in CPI that occur after lease commenoement but before the date of initial application.

Presented views

- View A: Yes
- View B: No

PE# 4- Transition ootions- examo e 2

7-years equipment lease from 1 Jan 20.16

CUlO,OOO per annum 1n arrears

Initial direct costs: CU7,000

ROU asset depreciated on a straight-line basis

PE# 4- Transition ootions examo e 2

Amount include in the ROU asset for the initial direct costs?	CU7,000	CU4,000	Nil
	✗	✓	✓
		Unamortised amount of CU7,000*4/7	Exclude initial direct costs from ROU asset measurement.

PE# 5- onerous contracts

Issue

- Retailer R leases 100 stores under leases classified as lnd AS 17 operating leases. R has ceased trading at 20 stores and is seeking to sublet these.
- In March 2018, R assesses whether the leases on the vacant 20 stores are onerous under lnd AS 37 and conclludes that 12 are onerous and 8 are not.
- Ruses the modified retrospective transition method with a DIA of 1 April 2019. R plans to use the practical exped;ent to rely on its assessment of onerous contracts under lnd AS 37, instead of impairment review..

Question 1

What is the maximum nUimber of leases to which R can applythe practical expedient?

Presented views

- View 1: 100 leases.
- View 2: 20 leases-i.e. those that were assessed to determine if they were onerous.
- View 3: 12 leases- i.e. those for which a provision was recognised.

Lessee Finance Lease

Lessee operating lease	Lessee finance lease	Lessor operating lease	Lessor finance lease
Full retrospective	Full retrospective	No adjustment on transition except for subleases	
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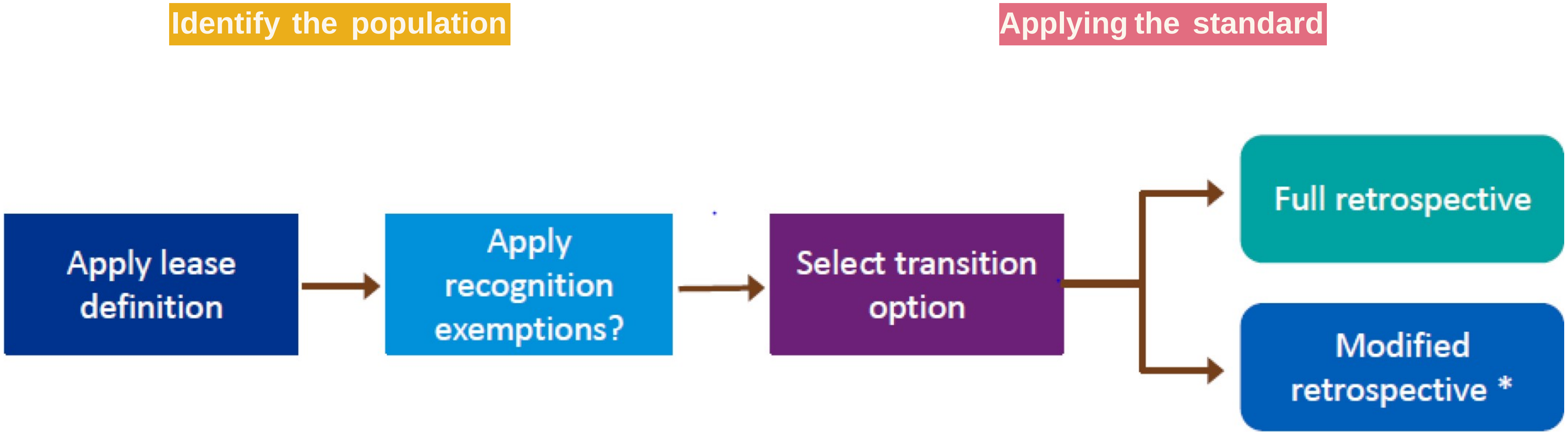
High	Medium	Low	

what's THE IMPACT ?

Transition- Lessee Finance Lease



*Ind AS 116 ROU asset and lease liability = Ind AS 17 carrying amounts

Transition- Lessor

Transition- Lessor

Lessee operating lease	Lessee finance lease	Lessor operating lease	Lessor finance lease
Full retrospective	Full retrospective	No adjustment on transition except for subleases	
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Lease and non-lease components

A lessor uses IND AS 115 to allocate consideration between:

Lease components and **Non-lease components**

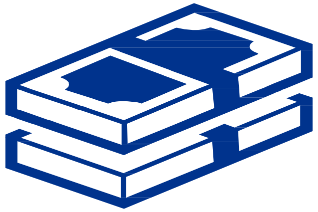
Items that do not transfer a good or service to the lessee are not components

No practical expedient to combine lease and non-lease components

Example – identifying components

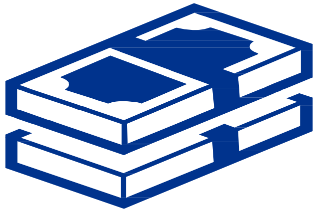
Right to use an office building

Cleaning and maintenance services



Property taxes and insurance

Example – identifying components



Right to use an office building

Cleaning and maintenance services

Property taxes and insurance

Lease component

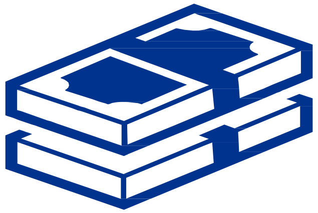
Non-lease component

Not a component

Example – allocating consideration

SSP = 90

SSP = 10



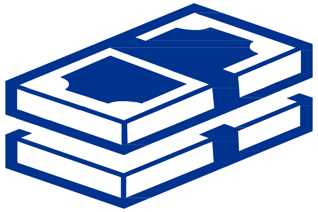
Cost = 5

Assume annual rental charge by the lessor to the lessee is 105

Example – allocating consideration

SSP = 90

SSP = 10



Cost = 5

Assume annual rental charge by the lessor to the lessee is 105

IND AS 116 income

90/(90+10) x 105

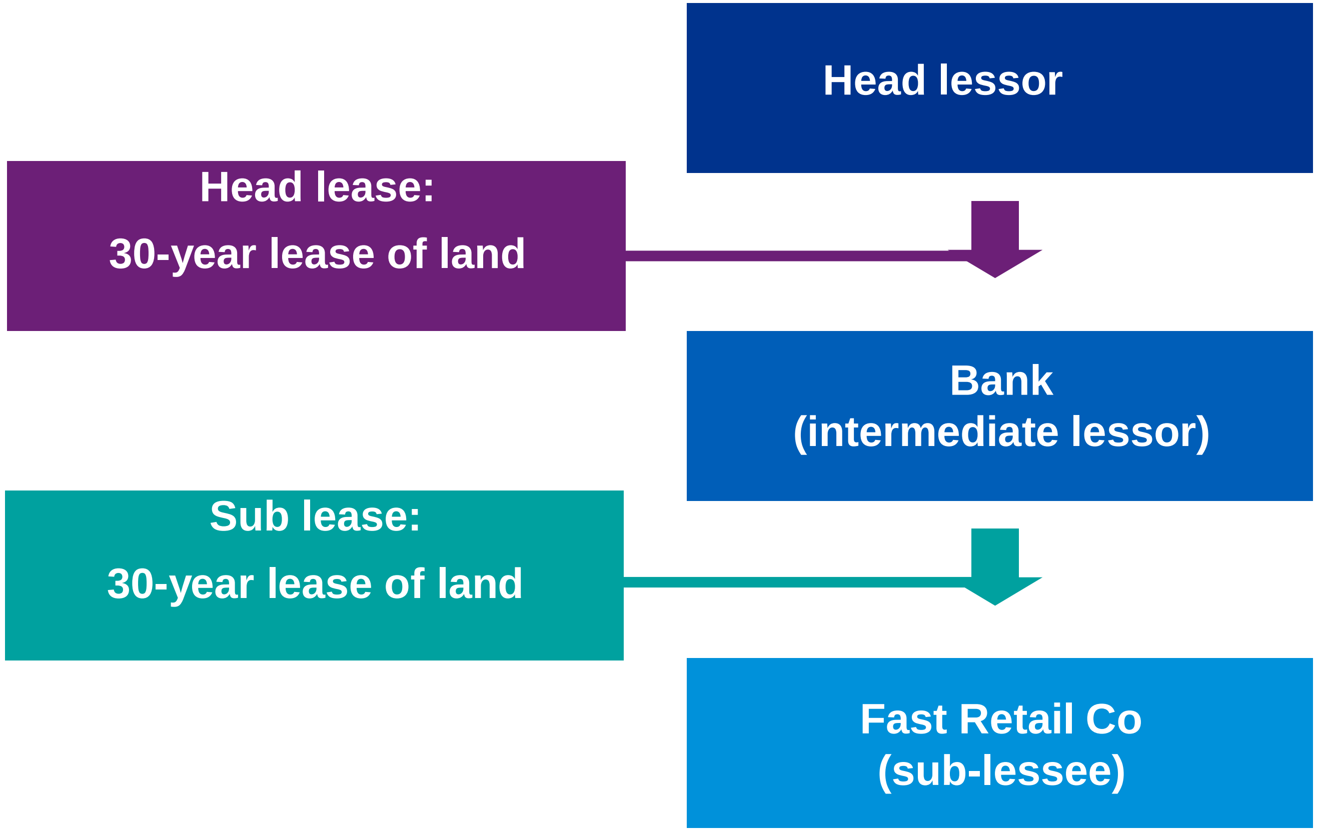
IND AS 115 revenue

10/(90+10) x 105

Not a component

Sub-lease

Sub-lease – IAS 17



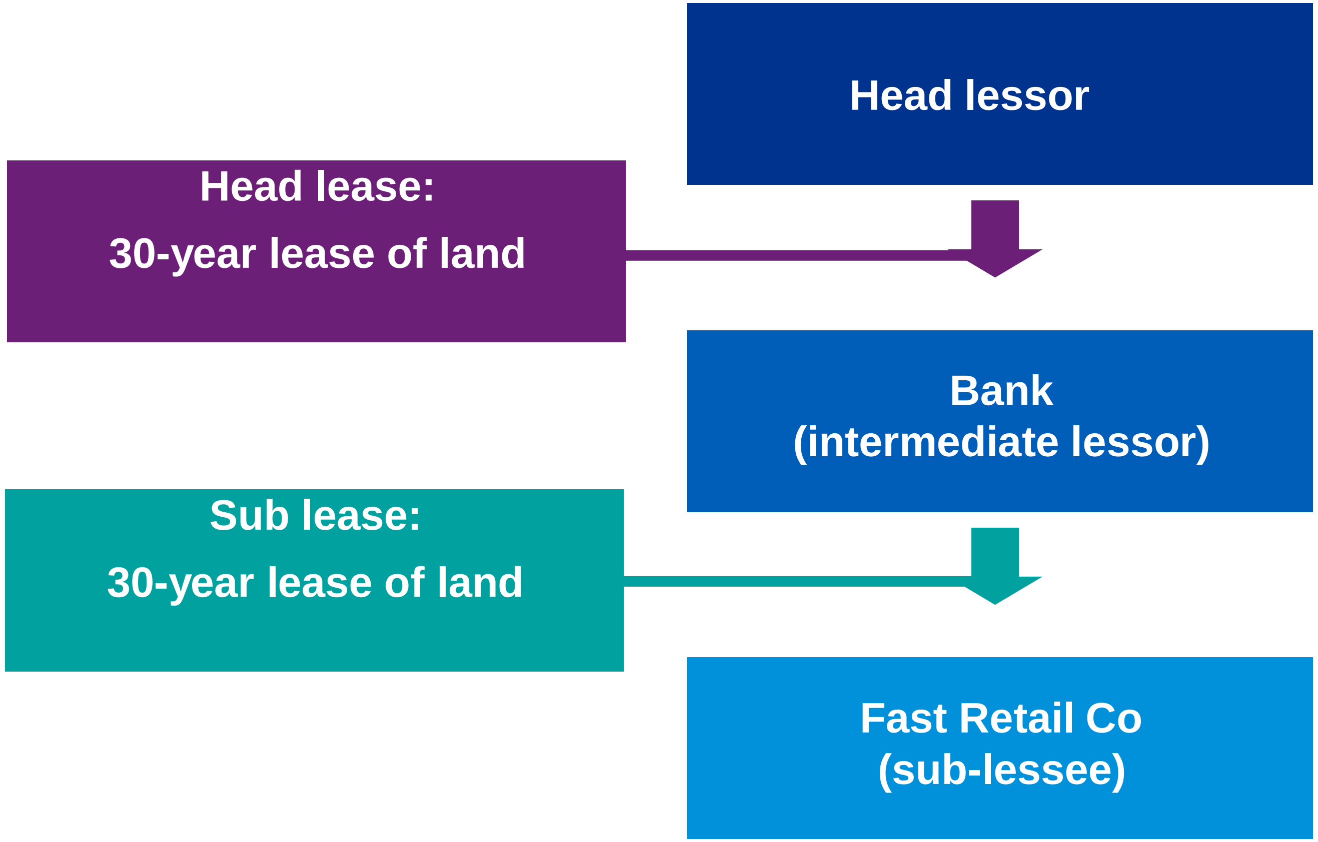
Operating lease

— Recognise straight line expense

Operating lease

— Recognise straight line income

Sub-lease – IND AS 116



ROU model

— Dr ROU asset

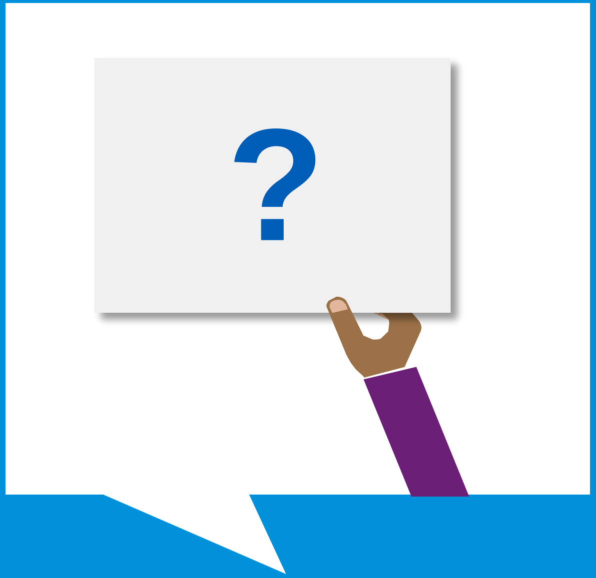
— Cr Lease liability

Finance lease

— Dr Lease receivable

— Cr ROU asset

Wrap Up



Wrap Up

- IND AS 116 impact
- Lease definition
- Lessee- operating lease accounting
- Lessee- Finance lease accounting
- Lessor – accounting
- Sub leases
- Intercompany leases
- Disclosures

What questions do you have?