IND AS 116 - Leases
Overview
<table>
<thead>
<tr>
<th>Topic</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Effective date</td>
<td>1 April 2019</td>
</tr>
</tbody>
</table>
| 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
Lessees appear to be more *asset-rich*, but also more *heavily indebted*.

Total lease expense is *front-loaded* even when cash rentals are constant.
## Impact on financial ratios

<table>
<thead>
<tr>
<th>Profit/loss</th>
<th>Balance sheet</th>
<th>Ratios</th>
</tr>
</thead>
<tbody>
<tr>
<td>EBITDA</td>
<td>Total assets</td>
<td>Gearing</td>
</tr>
<tr>
<td>(in early years)</td>
<td>Net assets</td>
<td>Interest cover</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Asset turnover</td>
</tr>
</tbody>
</table>
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
Identify the population

Apply lease definition

Apply recognition exemptions?

Select transition option

Applying the standard

Full retrospective

Modifi,ed retrospective
Apply the definition to *all contracts*

OR

Grandfather existing contracts and apply the definition *only to new or changed contracts*
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.

### Is there a Lease?

- **Identified asset?**
  - Yes
  - No

- **Lessee obtains substantially all of the economic benefits?**
  - Yes
  - No

- **Lessee directs the use?**
  - Yes
  - No

- **Contract does not contain a lease**

- **Contract is or contains a lease**
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.

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

Apply the standard

Apply lease definition

Apply recognition exemptions?

Select transition option

Full retrospective

Modified retrospective
Recognition exemptions

Two major optional exemptions make the standard easier to apply.

- **Short term leases**: ≤ 12 months
- **Leases, of low value items**: ≤ USD 5,000 for example
Transition
nd AS17 to nd AS116- Transition models

Lessee

- Operating lease: Full retrospective
- Finance lease: Full retrospective

Lessor

- Operating lease: Modified retrospective with practical expedients
- Finance lease: No adjustment on transition except for subleases
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)
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
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

\[
\text{Lease liability} + \\
\text{Initial Direct cost} + \\
\text{Prepaid lease payments} + \\
\text{Estimate cost to dismantle, remove or restore} - \\
\text{Lease incentives received} = \\
\text{Right of use asset}
\]
Measurement of Right of use [ROU] asset on transition

- **Option 1**: Choose on a lease by lease basis
  - ROU asset = Measure retrospectively using transition discount rate

- **Option 2**: ROU asset = lease liability +/- prepaid/accrued payments

Apply Ind AS 36 at
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.
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 chooses 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:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Debit (INR)</th>
<th>Credit (INR)</th>
</tr>
</thead>
<tbody>
<tr>
<td>ROU asset</td>
<td>386</td>
<td></td>
</tr>
<tr>
<td>Retained earnings</td>
<td>47</td>
<td></td>
</tr>
<tr>
<td>Lease liability</td>
<td></td>
<td>433</td>
</tr>
</tbody>
</table>
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:

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<th>Debit (INR)</th>
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<td>ROU asset</td>
<td>433</td>
<td></td>
</tr>
<tr>
<td>Retained earnings</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>Lease liability</td>
<td></td>
<td>433</td>
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</table>

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: \( \frac{1}{5} \times \text{INR386} = \text{INR77} \)
- Option 2: \( \frac{1}{5} \times \text{INR433} = \text{INR87} \)

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 performing impairment review.

*Modified retrospective approach only!*
### 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 commencement but before the date of initial application.

### Presented views

- View A: Yes
- View B: No
7 year equipment lease from 1 Jan 2016

CU10,000 per annum in arrears

Initial direct costs: CU7,000

ROU asset depreciated on a straight-line basis.
**PE# 4- Transition options exam 2**

<table>
<thead>
<tr>
<th>Amount include in the ROU asset for the initial direct costs?</th>
<th>CU7,000</th>
<th>CU4000</th>
<th>Nil</th>
</tr>
</thead>
</table>

- **Examine:**
  - CU7,000 * 4/7
  - Unamortised amount of CU7,000 * 4/7

- **Mark:**
  - Cross
  - Green checkmark
  - Green checkmark

- **Note:** Exclude initial direct costs from ROU asset measurement.
Issue

- Retailer R leases 100 stores under leases classified as Ind 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 Ind AS 37 and concludes that 12 are onerous and 8 are not.
- R uses the modified retrospective transition method with a D/A of 1 April 2019. R plans to use the practical expedient to rely on its assessment of onerous contracts under Ind AS 37, instead of impairment review.

Question 1

What is the maximum number of leases to which R can apply the 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

<table>
<thead>
<tr>
<th>Lessee operating lease</th>
<th>Lessee finance lease</th>
<th>Lessor operating lease</th>
<th>Lessor finance lease</th>
</tr>
</thead>
<tbody>
<tr>
<td>Full retrospective</td>
<td>Full retrospective</td>
<td>No adjustment on transition except for subleases</td>
<td></td>
</tr>
<tr>
<td>Modified retrospective with practical expedients</td>
<td>Modified retrospective</td>
<td></td>
<td>Low</td>
</tr>
</tbody>
</table>

**Intensity Levels:**
- **High**
- **Medium**
- **Low**
Transition - Lessee Finance Lease

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*Ind AS 116 ROU asset and lease liability = Ind AS 17 carrying amounts*
Transition- Lessor
Lessee operating lease

Lessee finance lease

Full retrospective

Modified retrospective with practical expedients

Lessor operating lease

Lessor finance lease

Full retrospective

Modified retrospective

No adjustment on transition except for subleases

High

Medium

Low
Lease and non-lease components

A lessor uses IND AS 115 to allocate consideration between:

- **Lease components**
- **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: Lease component
- Cleaning and maintenance services: Non-lease component
- Property taxes and insurance: 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

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

IND AS 116 income
\[
\frac{90}{90+10} \times 105
\]

IND AS 115 revenue
\[
\frac{10}{90+10} \times 105
\]

Not a component

SSP = 90

SSP = 10

Cost = 5
Sub-lease
Sub-lease – IAS 17

Head lease: 30-year lease of land

Operating lease
— Recognise straight line expense

Bank (intermediate lessor)

Operating lease
— Recognise straight line income

Fast Retail Co (sub-lessee)
Sub-lease – IND AS 116

Head lease: 30-year lease of land

Sub lease: 30-year lease of land

Head lessor

Bank (intermediate lessor)

Fast Retail Co (sub-lessee)

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?