

## **Welcome to the Webinar on IND AS 116**

Session will start in 5 minutes....

Hope all of you and your family members are Safe and Healthy

#StayHome#StaySafe

### **Speakers:**

CA Ashish Mor

CA Praveen Kumar

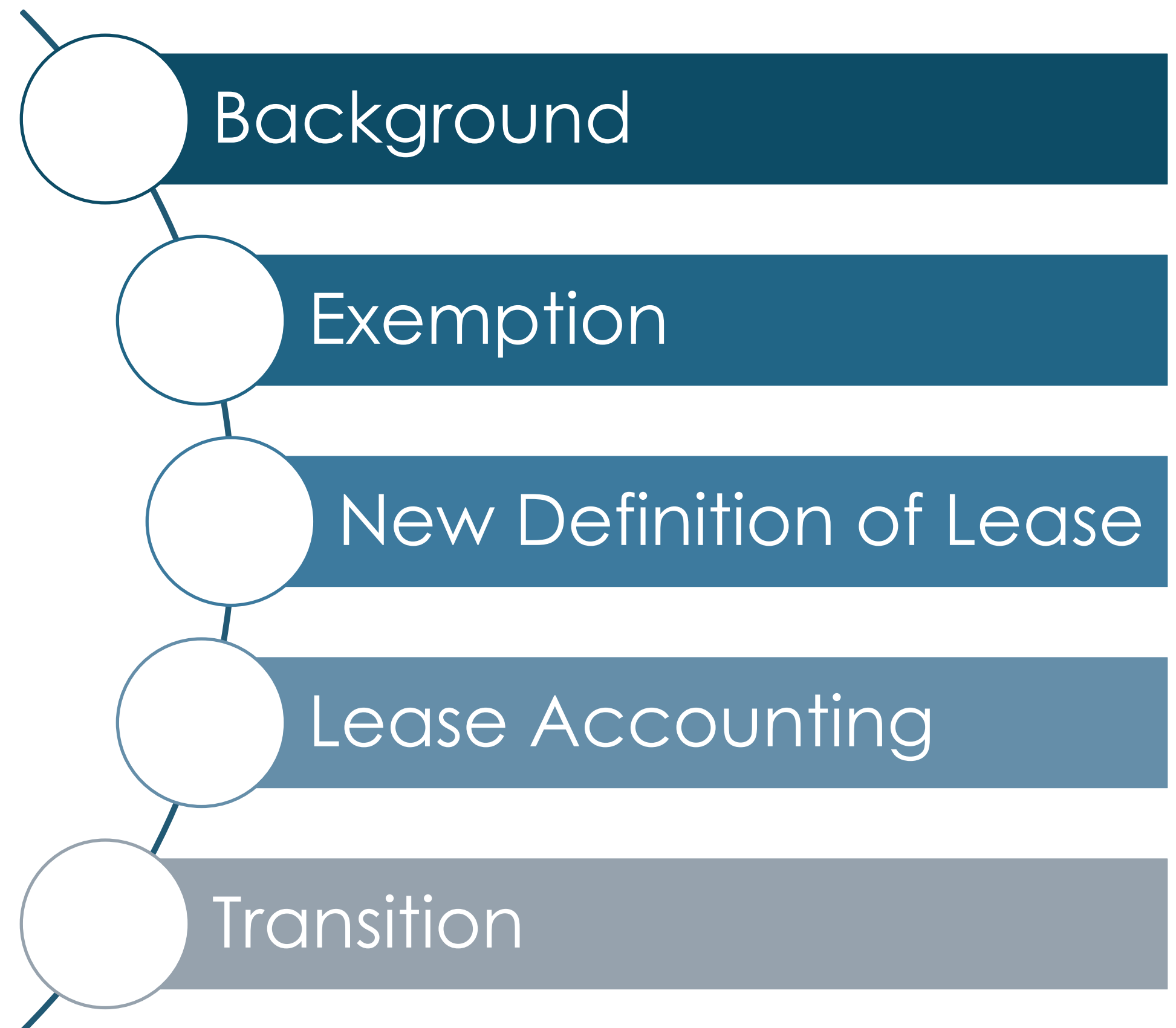
# Ind AS 116

## Leases

No More Off-Balance Sheet Treatment of Leases



# Session Take Away



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# Background

- Finally Ind AS 116 is here and it is changing the market for operating leasing.
- The need for development of a new leases standard goes back to 2008 when Sir David Tweedie, former Chairman of the International Accounting Standards Board ( IASB ) joked that "one of my great ambitions before I die is to fly in an aircraft that is on an airline's balance sheet"
- **Eliminates the accounting difference** between an **operating lease** and **finance lease**
- Lessee's with **operating leases will have a major impact** in accounting

# Background...Continued

Lessee has to recognize a right-of use asset (ROU) and a lease liability for almost all lease contracts

Lessee has to present interest expense (on lease liability) and depreciation charge (for right of use of Assets) separately

Enhanced disclosure requirements including change in cash flow statement

Exemptions for short-term leases and leases of low value of Assets

Ind AS 116 Effective from April 1, 2019  
(IFRS 16 from January 1, 2019)

Lessor Accounting stays almost the same as under current guidance

Substance over form and Control Assessment

# Optional Exemptions

## I. Low Value Assets: (lease by lease basis)



Leases of low value items

### Examples of low value assets:

- Stand alone small furniture
- Computers/laptops
- Office equipment, telephones, tablets etc.

High in volume but low in value

## II. Short-term leases: (by class of underlying assets)



Short term leases  $\leq$  12 months

### Examples of Short term leases:

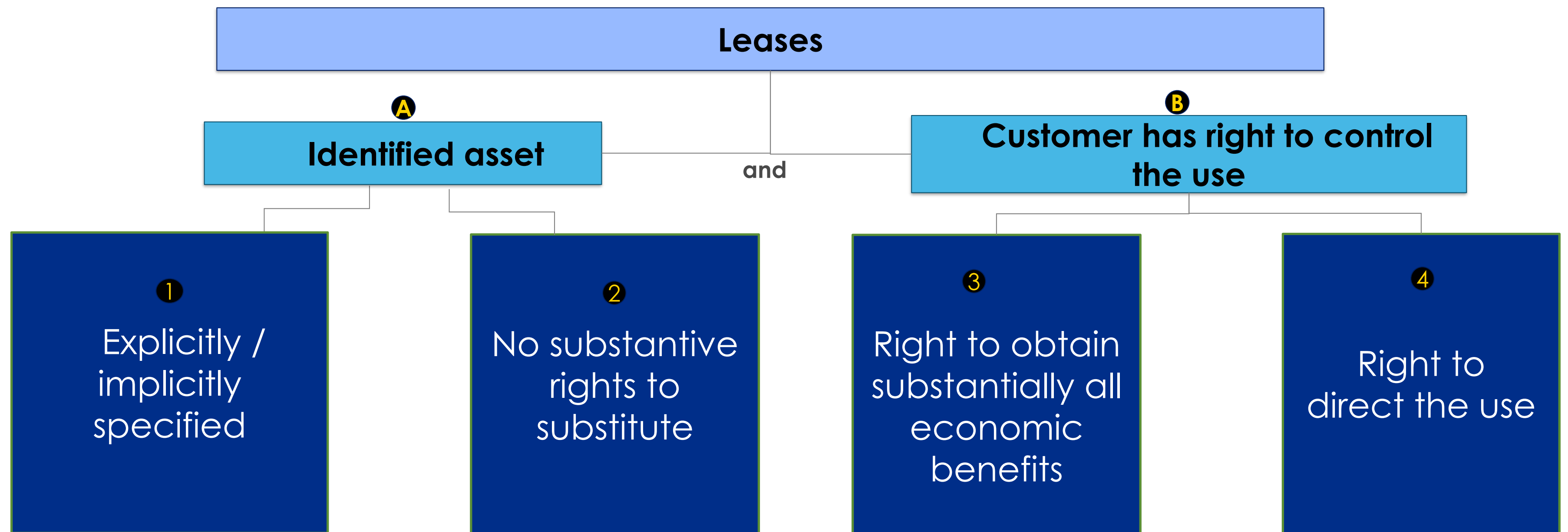
- Flat on rent for 11 months without renewal option
- Laptops on leases for 3 months in lockdown

Short term arrangements

Low value is not defined, its judgemental and depends on the Company's policy

# Lease definition

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 for consideration.

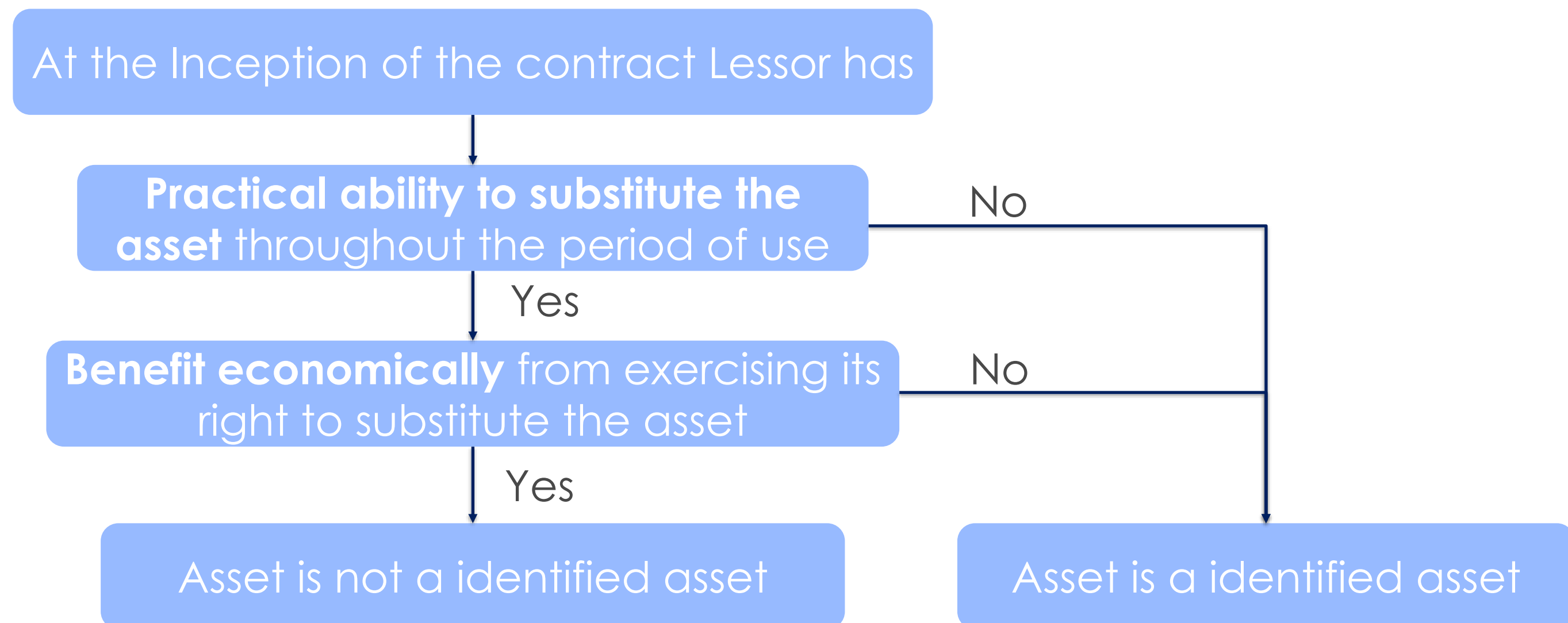


# A Identified assets

## 1 Explicitly or implicitly specified:

An asset can be either explicitly specified in a contract or implicitly specified at the time it is made available for use by the lessee.

## 2 Substantive rights to substitute:



**Note:** If the customer cannot readily determine whether the supplier has a substantive substitution right, the customer presumes that any substitution right is not substantive.



## B Right to control

**Control Assessment:** To assess whether a contract conveys the right to control the use of an identified asset for a period of time, an entity is required to assess whether, throughout the period of use, the customer has both of the following:

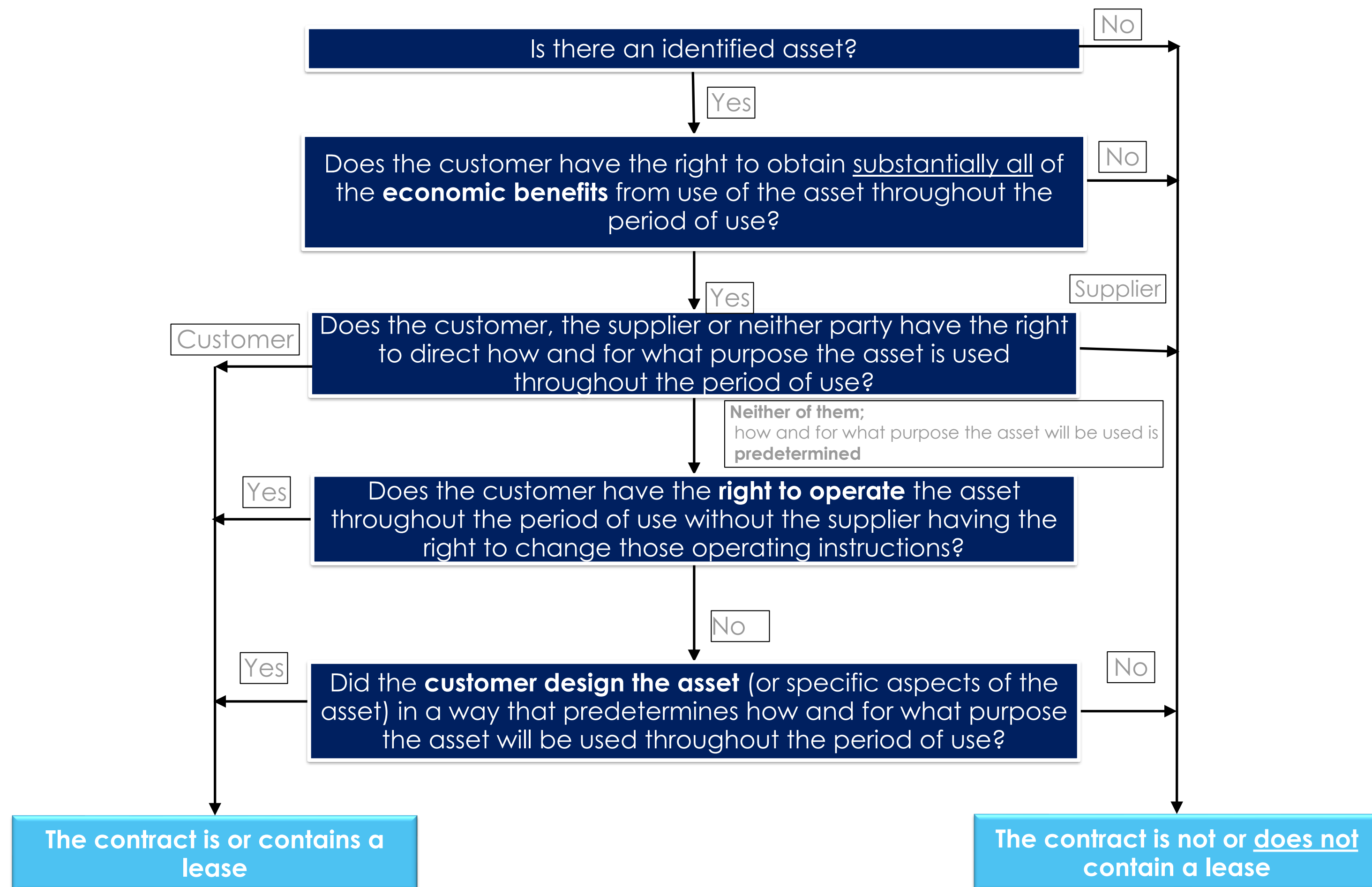
3  
Right to economic benefit  
(by using, holding or sub-leasing the asset.)

Economic benefits include Asset's primary outputs, any by products or benefits from using the asset

4  
Right to direct the use

Decisions about **How** and for **what** purpose of an asset will be used

# Determining whether an arrangement contains a lease



# Quiz: Ind AS 116 – Lease Definition and exemptions

1. Leasehold Land

- Yes

2. Building/ Office on Lease

- Yes

3. Stand alone Furniture amounting to Rs. 50k

- No, Low value exemption

4. Laptops on lease Total Rs. 10 lacs per month (each contract having a laptop of Rs. 20k)

- No, Low value exemption

5. Lease for 11 months but generally extended by 11 months but no renewal option in the contract

- No, Short-term exemption

6. Leases in which lessor have Substantive substitution right

- No, As it doesn't qualify identified asset definition

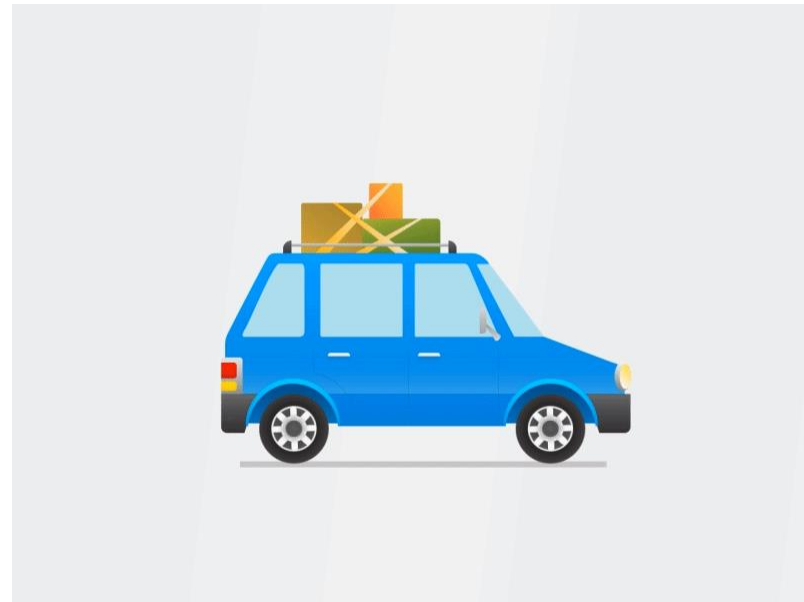
7. Specifically identified bus on Lease for long term, having company name on it, no other usage.

- Yes

8. Purchase all of the electricity from supplier

- Yes, as Company has right to obtain substantially all of the economic benefits

# Quiz: Ind AS 116 applicability on Different lease Agreement- Some issues



Car on lease

## **Leasehold Land : Non refundable lease premium amount equaling market value**

ITFG 21 clarifies that lease Deed qualifies as a lease within the meaning of IND AS 116 even though almost all of the consideration has been paid upfront.

## **Contract Manufacturing arrangement/Tooling arrangement contain an embedded lease?**

(A thorough understanding of a arrangement from a commercial and economic perspective will be required to determine whether or not such arrangement contains an embedded lease.)

Points to ponder upon for conclusions are- Dedicated manufacturing line, Take or pay arrangement, economic penalties for reduction in production, Fixed and Variable pay arrangement, guarantee of substantially take off,

# Case Study

| Particulars   | (A)<br>Identified Asset  |   | (B)<br>Customer has right to control the use of the identified asset?  |  | Lease?     |
|---|--|---|--|--|------------|
|   | 1<br>Explicit/implicitly mentioned in contract?  | 2<br>Whether Lessor has substitution right?                                       | 3<br>Right to economic benefits (Substantially All)  | 4<br>Right to direct the use (How and what)  |            |
| 1. Contract entered between customer and a freight carrier (Supplier), to provides customer with the use of 10 rail cars of a particular type for five years. Lessor cannot provide alternative rail car. | <b>Yes</b><br>Specific rails cars identified in contract.                                  | <b>NO</b>   | <b>Yes</b>   | <b>Yes</b><br>Customer has a right to direct when and where the cars are used, and which goods are transported i.e. he is having a right to change how and for what purpose the railcars are used. | <b>Yes</b> |
| 2. Coffee company (Customer) enters into a contract with an airport operator (Supplier) to use a space (for movable shops) in the airport to sell its goods for a 3 years period.                         | <b>No</b><br>Many areas are available for Customer and none are specified in the contract. | <b>Yes</b><br>Supplier has Alternative to use its space in most efficient manner. | <b>Depends/Not relevant as there is no identified Asset</b><br>Supplier selects which space is allocated to Customer and obtains substantially all of the economic benefits from use of the concession space ( He may makes changes basis beneficial to him) |  | <b>No</b>  |



# Recognition and measurement

A lessee applies a single lease accounting model under which it recognises all major leases on-balance sheet

## Balance sheet

**Asset = 'Right-of-use' of underlying asset (ROU)**

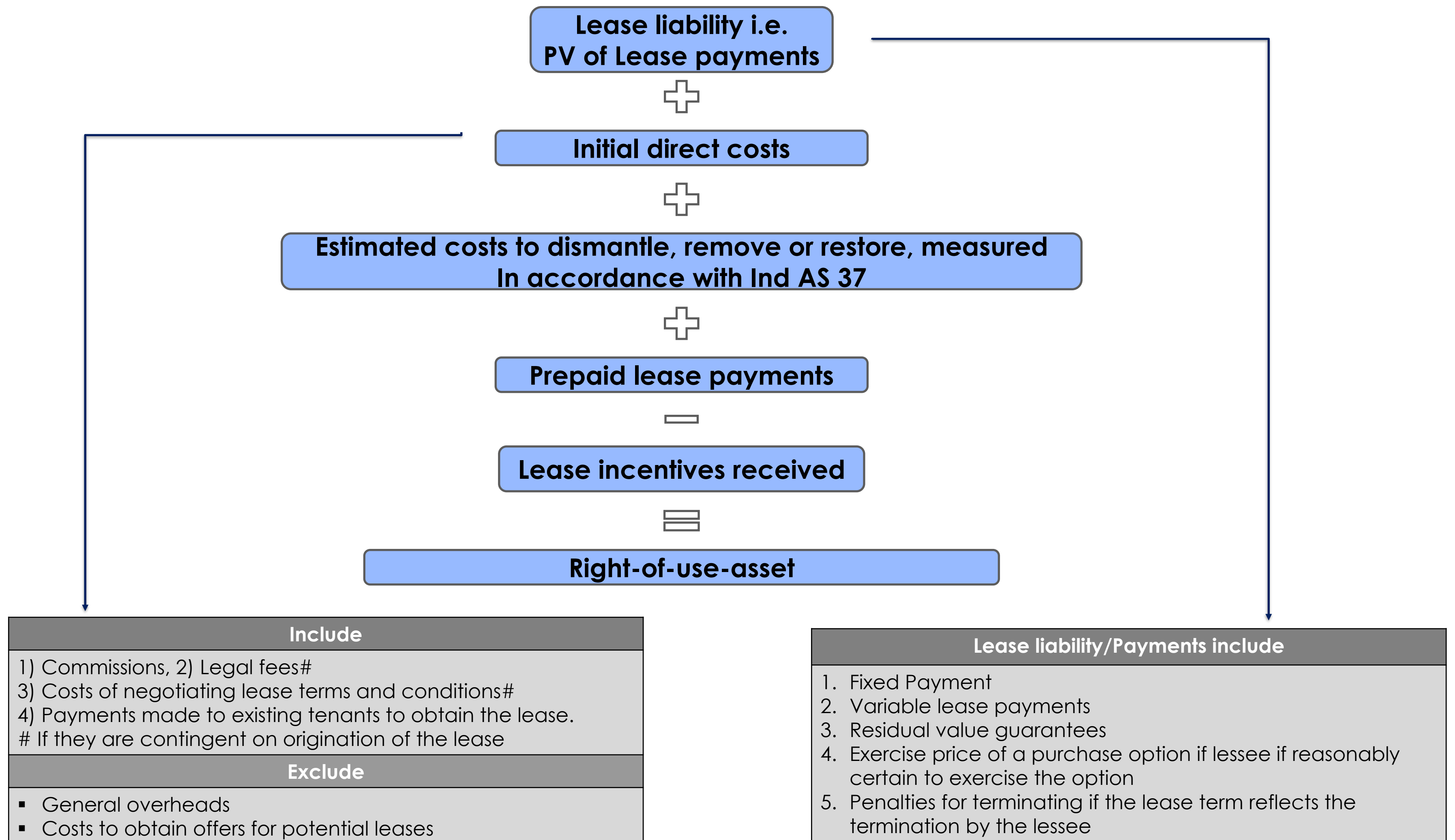
**Liability = Obligation to make lease payments**

## Profit and Loss

**Depreciation on ROU+  
Interest on lease liability**

**Discount Rate:** Interest rate implicit in the lease  
If not available or readily determined then incremental borrowing rate at commencement date

# Initial measurement – ROU



# Subsequent measurement

## ROU:

The ROU is subsequently measured using the cost model. However, it may be revalued if it belongs to a class of assets that are revalued.

| Particulars                                      | Amount      |
|--|-------------|
| At Costs (ROU at initial recognition)            | XXX         |
| Less : Accumulated Depreciation                  | XXX         |
| Less : Accumulated impairment losses             | XXX         |
| Add/Less: Re-measurements of the lease liability | XXX         |
| <b>WDV of ROU</b>                                | <b>XXXX</b> |

## Lease liability:

| Particulars   | Amount      |
|---|-------------|
| Lease liability (initial recognition)   | XXX         |
| Add : Accrued interest on outstanding liability   | XXX         |
| Less: Actual lease payments to lessor   | XXX         |
| Add/Less: Remeasuring the carrying amount to reflect any reassessment or lease modification | XXX         |
| <b>Closing lease liability (to be bifurcated into current and non current)</b>              | <b>XXXX</b> |

## Depreciation (Useful life)

If lessee is reasonably certain **not to obtain ownership**, ROU will be depreciated over (whichever is shorter)

- ✓ The lease term
- ✓ Its useful life

If lessee is reasonably certain to **obtain the ownership**, ROU will be depreciated over the **useful life**.



# Lease term

The assessment of the lease term is **a critical estimate and a key input** to the amount of the lease liability.

The lease term can be defined as :

| Particulars   | Years       |
|---|-------------|
| 1. Non-cancellable period   | XXX         |
| 2. Optional renewable periods (where lessee is reasonably certain to extend the lease)                          | XXX         |
| 3. Periods covered by option to terminate the lease (where lessee is reasonably certain not to terminate early) | XXX         |
| <b>Total Lease terms</b>  | <b>XXXX</b> |

- Lease term begins at the commencement date and include any rent free period.
- Termination options held by the lessor are not considered when determining the lease term.

# Example

## Example

Lessee enters into a 4 years lease with option to renew of equipment. The arrangement provides the following:

|                                      |                                      |
|--------------------------------------|--------------------------------------|
| Lease term                           | Five years ( <i>See below note</i> ) |
| Annual payments                      | Rs.10 Lakh per annum                 |
| Discount rate                        | 10%                                  |
| Present value (PV) of lease payments | Rs. 37,90,986                        |

Right of use asset will be recognised at Rs. 37,90,986 (Present value of 5 instalments of Rs. 10 lakhs each) and will be depreciated over a period of 5 years.

### Lease term:

3.5 years (non cancellable period) + 1.0 years (option to renew and it is certain they will renew) + 0.5 years (notice period/termination period) = 5 years

# Response

## Lease Liability:

| Year         | Opening   | Subsequent Measurement |                    | Closing   |
|--------------|-----------|------------------------|--------------------|-----------|
|              |           | Interest               | Payment            |           |
| 1            | 3,790,787 | 379,079                | (1,000,000)        | 3,169,865 |
| 2            | 3,169,865 | 316,987                | (1,000,000)        | 2,486,852 |
| 3            | 2,486,852 | 248,685                | (1,000,000)        | 1,735,537 |
| 4            | 1,735,537 | 173,554                | (1,000,000)        | 909,091   |
| 5            | 909,091   | 90,909                 | (1,000,000)        | -         |
| <b>Total</b> |           | <b>1,209,215</b>       | <b>(5,000,000)</b> |           |

## ROU Amortisation:

| Year         | Opening   | Subsequent Measurement               |  | Closing   |
|--------------|-----------|--------------------------------------|--|-----------|
|              |           | Depreciation<br>(basis lease period) |  |           |
| 1            | 3,790,787 | 758,157                              |  | 3,032,630 |
| 2            | 3,032,630 | 758,157                              |  | 2,274,472 |
| 3            | 2,274,472 | 758,157                              |  | 1,516,315 |
| 4            | 1,516,315 | 758,157                              |  | 758,157   |
| 5            | 758,157   | 758,157                              |  | -         |
| <b>Total</b> |           | <b>3,790,785</b>                     |  |           |

# Response

## Summary:

| Year                                   | 1                | 2                | 3                | 4                | 5                | Total            |
|--|------------------|------------------|------------------|------------------|------------------|------------------|
| <b>Balance Sheet:</b>                  |                  |                  |                  |                  |                  |                  |
| Lease Liability                        | 3,169,865        | 2,486,852        | 1,735,537        | 909,091          | -                |                  |
| ROU (Asset)                            | 3,032,630        | 2,274,472        | 1,516,315        | 758,157          | -                |                  |
| <b>Profit &amp; Loss:</b>              |                  |                  |                  |                  |                  |                  |
| Interest Expense                       | 379,079          | 316,987          | 248,685          | 173,554          | 90,908           | <b>1,209,213</b> |
| Depreciation                           | 758,157          | 758,157          | 758,157          | 758,157          | 758,157          | <b>3,790,787</b> |
| <b>Total Expense as per Ind AS 116</b> | <b>1,137,236</b> | <b>1,075,144</b> | <b>1,006,842</b> | <b>931,711</b>   | <b>849,065</b>   | <b>5,000,000</b> |
| <b>Total Expense as per Ind As17</b>   | <b>1,000,000</b> | <b>1,000,000</b> | <b>1,000,000</b> | <b>1,000,000</b> | <b>1,000,000</b> | <b>5,000,000</b> |
| <b>Variation</b>                       | <b>137,236</b>   | <b>75,144</b>    | <b>6,842</b>     | <b>(68,289)</b>  | <b>(150,935)</b> | <b>-</b>         |



**In the initial years higher impact on profits and working capital ratio**

# Response

| Example   |                      | Debit     | Credit    |
|---|----------------------|-----------|-----------|
| <b>A At lease commencement</b>  |                      |           |           |
| 1   | ROU asset            | 3,790,787 |           |
|   | Lease liability      |           | 3,790,787 |
| <i>To initially recognise the ROU asset and lease liability</i>   |                      |           |           |
| <b>B Year 1 journal entries</b>   |                      |           |           |
| 1   | Interest expense     | 379,079   |           |
|   | Lease liability      |           | 379,079   |
| <i>To record interest expense and accrete the lease liability using the interest method (3,790,787 x 10%)</i> |                      |           |           |
| 2   | Amortisation expense | 758,157   |           |
|   | ROU asset            |           | 758,157   |
| <i>To record amortisation expense on the ROU asset (3,790,787 ÷ 5 years)</i>                                  |                      |           |           |
| 3   | Lease liability      | 1,000,000 |           |
|   | Cash                 |           | 1,000,000 |
| <i>To record lease payment</i>  |                      |           |           |

# Transition date – Retrospective Vs Modified approach option

Lease definition exemption – option available either apply to all contracts **or** only the new one.

## Retrospective application or modified approach?

### Option 1 – Retrospective

- Restate comparatives as if Ind AS 116 always applied.

### Option 2 – Modified (Do not change comparative FS)

- Difference between asset and liability recognised in opening RE at transition date.
- **Lease liability** = Present value of remaining lease payments (incremental borrowing rate) on date of transition.
- Choose 2A or 2B for measuring ROU asset on **lease-by-lease basis**:

#### Option 2A –

- Measure asset as if Ind AS 116 had been applied from lease commencement (but using incremental borrowing rate at date of transition)

#### Option 2B –

- Measure asset at amount equal to liability (adjusted for accruals and prepayments)

Entries to pass on date of transition:

Right of use asset **(Debit)** (As calculated above)

Rent equalization reserve **(Debit)** (Amount appearing in books on date of transition)

Lease Liability **(Credit)** (As calculated above)

Security Deposits (SD) **(Credit)** (Actual SD (-) PV of SD)



# Transition impact for Indigo and Spice Jet

## Comparison as per results at QE Sep 30, 2019

| Rs. In Million  | Spice Jet         | Indigo            |
|---|-------------------|-------------------|
| <b><u>Balance Sheet Position</u></b>                                    |                   |                   |
| Right of Use of Assets – Disclosed after PP&E                           | 68,921.77         | 132,823.10        |
| Lease liabilities (Total) – Disclosed under Finance liabilities         | (78,757.90)       | (192,195.43)      |
| <b>% Increase in finance liabilities</b>                                | <b>366.86%</b>    | <b>200.74%</b>    |
|   |                   |                   |
| <b><u>Impact Profit and Loss</u></b>                                    |                   |                   |
| Lease Payments reversed (charged as per earlier Ind AS 17)              | 4,791.00          | 10,095.61         |
| Depreciation  | (3,721.00)        | (8,172.62)        |
| Interest Expenses   | (1,074.60)        | (2,657.49)        |
| Foreign gain/loss   | (1,797.30)        | (4,281.62)        |
| <b>Net impact increase/(decrease) in profit before tax</b>              | <b>(1,802.80)</b> | <b>(5,016.12)</b> |
| <b>% of change in Profit/Loss increase/(decrease) due to Ind AS 116</b> | <b>(63.86%)</b>   | <b>(89.51%)</b>   |
| <b>EBIDTA Change to turnover – Improved/(Declined)</b>                  | <b>10.84%</b>     | <b>7.55%</b>      |

\* Source: Results published by the entity


# What to Expect

- Affect primarily the accounting by lessees and will result in the recognition of almost all leases on balance sheet
- The statement of profit and loss will also be affected because the total expense is typically higher in the earlier years of a lease and lower in later years
- Internal Financial controls and MIS Reporting

  
Accounting  
Change

  
Impact

- Operating cash flows will be higher as repayments of the lease liability and related interest are classified within financing activities.
- Additional Disclosure requirements
- Impact on ICDS and MAT calculation
- Change in Deferred tax calculation
- Application of Judgements
- Working capital Impact and distorted
- Working capital ratio for Lessee
- Impact on EBITDA

  
Impact due  
to COVID  
19

  
Points to  
pounder

- Modification of Leases: if any concession for lease payments or rent free holidays etc.
- Variable lease payments may be significantly impacted,
- Discount rate -incorporate any risk associated with COVID-19.
- Government Assistance Ind As 12 : Any compensation is given/declared by the Government to the lessor for providing concession to the lessee
- Whether any lease arrangement became onerous

- An optional exemption exists for short-term and low-value leases.
- On transition, lessees can choose between full retrospective application or a simplified approach that includes certain reliefs and does not require a restatement of comparatives.
- Review contracts for possible impacts



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# Q&A...



# Contact Us

You will no doubt appreciate that a firm profile of this nature is unlikely to contain every aspect of our approach, methodology and work plan. Whilst we have made sincere attempts, through this profile, to communicate all the relevant matters, we will be pleased to have an opportunity to discuss with you to resolve any queries, which you may have.

Should you have any queries, please feel free to contact us

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We look forward to hearing from you!



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# Thank you

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