Ind AS 116
The Standard on Lease

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Brief of Ind AS 116

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Brief of Ind AS 116

Objective

The objective of the Standard is to ensure that lessees and lessors provide relevant information in a manner that faithfully represents those transactions. To achieve this objective, the Standard sets out the principles for the recognition, measurement, presentation and disclosure of leases.

Applicability

IFRS 16 will be effective for annual periods beginning on or after 1 January 2019. In line with this, MCA wide notification dated 30th March, 2019, made Ind AS 116 effective for accounting periods beginning on or after 1 April 2019. Ind AS 116 supersedes the existing Ind AS 17. The new standard requires entities to make more judgements and estimates and make more disclosures.

Scope

Ind AS 116 covers Lease transactions for all the Assets with certain exclusions which are:

- leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources;
- leases of biological assets held by a lessee (Covered under Ind AS 41);
- service concession arrangements (Covered under Ind AS 115);
- licences of intellectual property granted by a lessor (Covered under Ind AS 115); and
- rights held by a lessee under licensing agreements (Covered under Ind AS 38, examples are motion picture films, video recordings, plays, manuscripts, patents, copyrights, etc.)

Brief of Ind AS 116 (Cont'd)

Identification of Lease

For a contract to qualify as a Lease, it shall convey the **right to control the use of an identified asset** to lessee for a period of time in exchange for consideration.

Right to control the use of an identified asset can be assessed by considering whether the customer has both of the following throughout the period of use:

- the **right to obtain substantially all of the economic benefits** from use of the identified asset; and
- the **right to direct the use of the identified asset**.

An entity shall **reassess** whether a contract is, or contains, a lease only if the terms and conditions of the contract are changed.

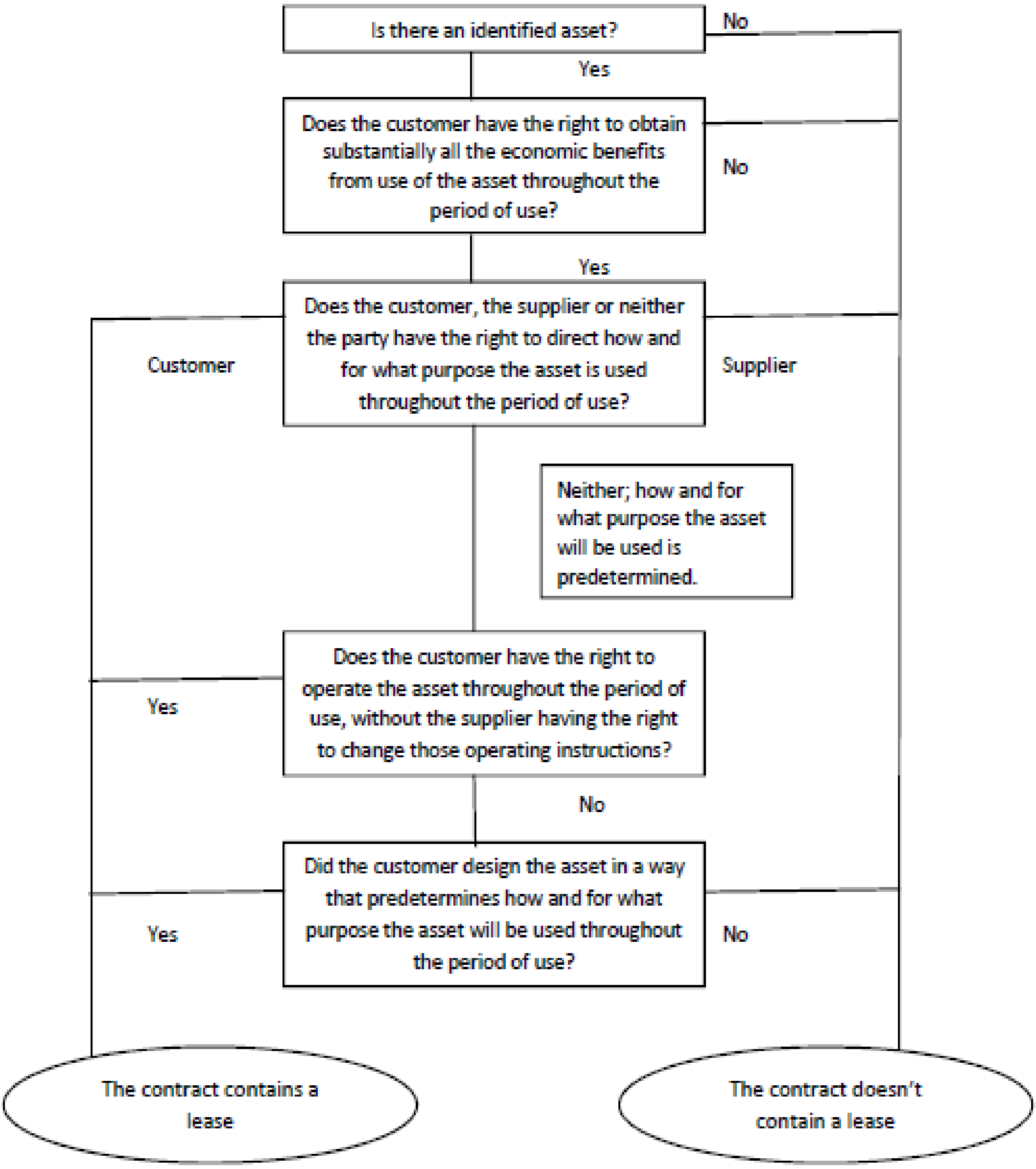
Contracts that contain the rights to use **multiple assets**, the right to use each asset is considered a separate lease component. The non-lease components of the contracts are identified and accounted for separately from the lease components.

The standard may be applied to a **portfolio of leases** with similar characteristics, provided that it is reasonably expected that the effects will not differ materially from applying the Standard to the individual leases within that portfolio.

Brief of Ind AS 116 (Cont'd)

Identification of Lease

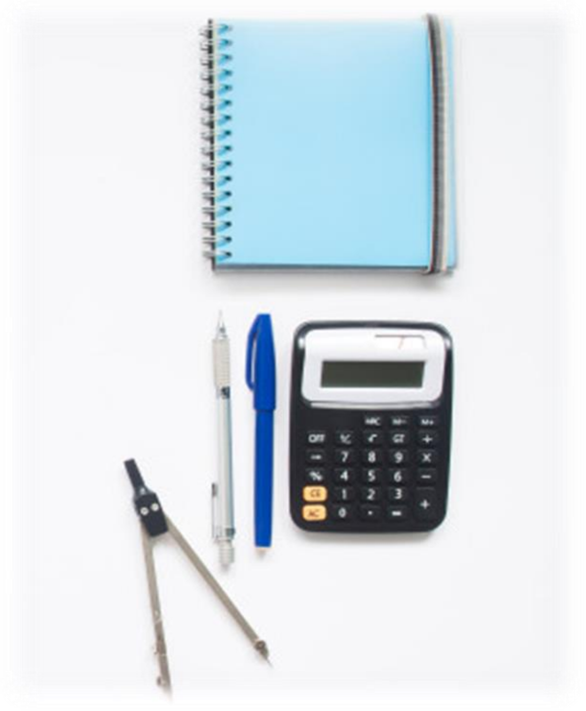
Flowchart



Brief of Ind AS 116 (Cont'd)

Accounting by Lessor

Under Ind AS 17, Lessor is required to classify Leases under two categories viz. Operating Lease and Finance Lease. Under Operating Lease, lessors recognize lease income on either a straight-line basis or another systematic basis that is more representative of the pattern in which benefit from the use of the underlying asset is obtained. Under Finance Lease, lessors derecognize the underlying asset and book profit or loss on such derecognition. Against this, Lessor recognises an assets held under a finance lease in their balance sheets and present them as a receivable at an amount equal to the net investment in the lease. Subsequently, Lessor recognises an interest income on such net investment in the lease and reduce that investment for payments received from lessee.



New Standard requires lessors to follow same recognition and measurement principles except in case of recognition of income from operating lease, under earlier standard, straight lining of Income was not required if payments to the lessor are structured to increase in line with expected general inflation whereas new Standard requires lessors to recognize lease income on either a straight-line basis or another systematic basis that is more representative irrespective of the fact that the lease escalations are in line with the inflation percentage in the economy.

Brief of Ind AS 116 (Cont'd)

Accounting by Lessee

Under Ind AS 17, Lessee is also required to classify Leases under two categories viz. Operating Lease and Finance Lease. Under Operating Lease, lessee recognises lease expense on either a straight-line basis or another systematic basis that is more representative of the pattern in which benefit from the use of the underlying asset is obtained. Under Finance Lease, at the commencement of the lease term, lessees shall recognise finance leases as assets and liabilities in their balance sheets at lower of an amount equal to the fair value of the leased property or the present value of the minimum lease payments, each determined at the inception of the lease.

New Standard requires Lessees to initially recognize a lease liability for the obligation to make lease payments and a right of use asset for the right to use the underlying asset for the lease term. The lease liability is measured at the present value of the lease payments to be made over the lease term. The right of use asset is initially measured at the amount of the lease liability, adjusted for lease prepayments, lease incentives received, the lessee's initial direct costs such as commissions and an estimate cost of restoration, removal and dismantling of an asset. Lessee increases the lease liability to reflect interest cost and reduce the same to reflect lease payments made over a period. The corresponding right of use asset is depreciated in accordance with the depreciation requirements of Ind AS 16 Property, Plant and Equipment over a tenure of lease.

Recognition Exemption:
Lessee may elect not to apply above recognition principles in case of **short-term leases** (12 months or less) and leases for which the underlying **asset is of low value** (such as tablets, computers, small items of office furniture, etc). In such case, the lessee shall recognise the lease payments as an expense on either a straight-line basis over the lease term or another systematic basis which is more representative of the pattern of the lessee's benefit.
The election for short-term leases shall be made by class of underlying asset to which the right of use relates whereas the election for leases for which the underlying asset is of low value can be made on a lease-by-lease basis.

Other Key Features

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Other Key Features

Lease Modification

Change in Scope / Consideration / Terms & Conditions of Lease contract

Account for a modification as a separate lease if:

•Modification increases the scope by adding the right to use one or more underlying assets and

•Consideration for the lease increases by an amount commensurate with the stand-alone price for the increase in scope.

If not accounted as a separate lease then lessee shall remeasure the lease liability by discounting the revised lease payments using a revised discount rate and recognize any gain or loss relating to the partial / full termination of the lease by reducing the carrying amount of right of use asset.

If not accounted as a separate lease then lessor shall revise the classification of lease and recognize the underlying asset (if classification is revised to operating lease) or apply requirements of Ind AS 109.

Other Key Features (Cont'd.)

Sale and Lease back Transaction

- To determine whether a sale has occurred in a sale and leaseback transaction, one need to apply the requirements of Ind AS 115.
- lessee shall measure the right-of-use asset arising from the leaseback at the proportion of the previous carrying amount of the asset that relates to the right of use retained by the seller lessee and recognizes only the amount of any gain or loss that relates to the rights transferred to the lessor.

- If the fair value of the consideration for the sale of an asset does not equal the fair value of the asset then an entity is required to measure the sale proceeds at fair value with corresponding adjustment as a prepayment of lease payments
- If the payments for the lease are not at market rates then also an entity is required to measure the sale proceeds at fair value with corresponding adjustment as additional financing by lessor.

Transition Provisions

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Transition Provision

Full Retrospective:

- As if Ind AS was applied since commencement of Lease (Use incremental rate on commencement of lease).
- Restate previous periods.

Modified Retrospective:

- Recognise difference between asset and liability in opening retained earnings.
- Recognise lease liability at present value of future lease payments using incremental borrowing rate at the date of initial application.
- For recognising right-to-use asset, lessee has two options.

Recognise right-to-use asset as if Ind AS was applied since commencement of Lease (Use incremental rate at the date of initial application.

Recognise right-to-use asset at same value at which liability is recognised.

Appendix C to Ind AS 116 allows Lessees to choose between two transition approaches, full retrospective approach or the modified retrospective approach which needs to be applied consistently to all leases.

Transition Provision (Cont'd.)

Full Retrospective Approach

Under the full retrospective transition approach, Lessees are required to apply this standard retrospectively to each prior reporting period presented. The lease liability is recognized on the lease commencement date using the interest rate implicit in the lease. Under this approach, Comparative periods are required to be restated as if Ind AS 116 is applied from the commencement of the lease. Further, considering the provisions of Ind AS 8, an opening balance sheet as at the beginning of the preceding period is required to be presented, in addition to the minimum comparative financial statements.

Modified Retrospective Approach

Under Modified retrospective approach, the lessee shall recognise a lease liability on initial application (i.e. April 1, 2019) at the present value of the remaining lease payments, discounted using the lessee's incremental borrowing rate at the date of initial application. To recognise a right-of-use asset at the date of initial application, the lessee shall choose, on a lease-by-lease basis, to measure that right-of-use asset at either:

- its carrying amount as if the Standard had been applied since the commencement date, but discounted using the lessee's incremental borrowing rate at the date of initial application (i.e. 1st April, 2019); or
- an amount equal to the lease liability, adjusted by the amount of any prepaid or accrued lease payments relating to that lease recognised in the balance sheet immediately before the date of initial application.

Transition Provision (Cont'd.)

Modified Retrospective Approach (Cont'd.)

Here, the lessee shall not restate comparative information. Instead, the lessee shall recognise the cumulative effect of initially applying this Standard as an adjustment to the opening balance of retained earnings (or other component of equity, as appropriate) at the date of initial application.

Transition Provision in case of Business combination

Any asset or liability created by lessee relating to favourable or unfavourable terms of an operating lease which is subsequently acquired as part of a business combination by an acquirer needs to be derecognised on the date of initial application. The acquirer is required to measure the right of use asset at the same amount at which lease liability created.

Presentation Requirements for Lessee & Practical Expedients

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Presentation requirement for Lessee

In Balance Sheet lessee shall:

Present right-of-use assets separately from other assets.

If a lessee does not present right-of-use assets separately in the balance sheet, the lessee shall include right-of-use assets within the same line item as that within which the corresponding underlying assets would be presented if they were owned and disclose which line items in the balance sheet include those right-of-use assets.

Note: The aforesaid requirement does not apply to right-of-use assets that meet the definition of investment property, which shall be presented in the balance sheet as investment property.

Present lease liabilities separately from other liabilities.

If a lessee does not present lease liabilities separately in the balance sheet, the lessee shall disclose which line items in the balance sheet include those liabilities.

In Statement of P&L lessee shall:

Present interest expense on the lease liability separately under finance cost and the depreciation charge for the right-of-use asset under depreciation and amortisation expense.

In Statement of Cash Flow lessee shall classify:

Cash payments for the principal portion of the lease liability within financing activities;

Cash payments for the interest portion of the lease liability within financing activities; and

Short-term lease payments, payments for leases of low-value assets and variable lease payments not included in the measurement of the lease liability within operating activities.

Practical Expedients

1. Practical expedient is given in Ind AS 116 for Lease identification under which an entity is not required to reassess whether a contract is, or contains, a lease at the date of initial application. Instead, the entity is permitted:
   - to apply this Standard to contracts that were previously identified as leases applying Ind AS 17, Leases.
   - not to apply this Standard to contracts that were not previously identified as containing a lease applying Ind AS 17.
2. lessee may apply single discount rate to a portfolio of leases with reasonably similar characteristics.
3. Reliance can be places upon lessee's assessment of onerous lease applying Ind AS 37 before the date of initial application as an alternative to performing an impairment review. lessee shall adjust the right-of-use asset at the date of initial application by the amount of any provision for onerous leases recognised before the date of initial application.
4. Lessee may choose not to apply transition provision to short-term leases and leases for which the underlying asset is of low value.
5. Lessee may exclude initial direct costs from the measurement of the right-of-use asset at the date of initial application.

Illustrations

1. Accounting of Operating Lease in the Books of Lessor

Assumptions:

Monthly Rental for letting out a commercial property: INR 1,00,000/-

Lease Tenure: 3 years

Escalation in Rental: 5% p.a. from second year

Inflation rate in economy: 4.8% p.a.

Accounting:

Lessor needs to equalise Lease income over the tenure of lease and recognise lease income of INR 12,61,000/- p.a.

Impact on Statement of P&L:

	Year 1	Year 2	Year 3
Ind AS 17	12,00,000	12,60,000	13,23,000
Ind AS 116	12,61,000	12,61,000	12,61,000
Difference - Profit / (Loss)	(61,000)	(1,000)	62,000

Illustrations (Cont'd.)

2. Accounting in the Books of Lessee

Assumptions:

Monthly Rental for on commercial property: INR 1,00,000/-

Lease Tenure: 3 years

Escalation in Rental: 5% p.a. from second year

Lessee's incremental borrowing rate: 10% p.a.

Depreciation: SLM Basis

Accounting:

Lessee shall recognise right-of-use asset and lease liability at INR 31,26,221/-

Impact on Balance Sheet:

Balance at the end of	Year 1	Year 2	Year 3
Right-of-use Asset	20,84,147	10,42,074	-
Lease Liability	22,38,843	12,02,727	-

Impact on Statement of P&L:

	Year 1	Year 2	Year 3
Finance cost	3,12,622	2,23,884	1,20,273
Amortisation	10,42,074	10,42,074	10,42,074
Total P&L Charge – Ind AS 116	13,54,696	12,65,958	11,62,346
Ind AS 17	12,00,000	12,60,000	13,23,000
Difference Profit / (Loss)	(1,54,696)	(5,958)	1,60,654

Illustrations (Cont'd.)

3. Transition – Full Retrospective Approach

<u>Assumptions:</u>

Lease Rental of INR 50,00,000/- p.a.

No escalation in Lease rentals

Lease Tenure: 15 years

Balance life of Lease as at 01-04-2019: 3 Years

Depreciation: SLM Basis

Lessee's incremental borrowing rate: 8% p.a. (at the commencement of lease)

<u>Accounting:</u>

Under full retrospective approach, an entity needs to restate the previous period figures and adjust difference in Opening Reserve (01-04-2018).

Continued on next page…

Illustrations (Cont'd.)

3. Transition – Full Retrospective Approach (Cont'd.)

Sr. No.	Particulars	Debit	Credit
1	**As at April 01, 2018**		
	Right-of-use Assets A/c	1,14,12,638	
	Retained Earnings A/c	51,47,996	
	Lease Liability A/c		1,65,60,634
2	**For the Year 2018-19**		
	Finance Cost A/c	13,24,851	
	Depreciation and Amortisation Exp A/c	28,53,160	
	Lease Liability A/c		13,24,851
	Right-of-use Assets A/c		28,53,160
	Lease Liability A/c	50,00,000	
	Bank A/c		50,00,000
3	**For the Year 2019-20**		
	Finance Cost A/c	10,30,839	
	Depreciation and Amortisation Exp A/c	28,53,160	
	Lease Liability A/c		10,30,839
	Right-of-use Assets A/c		28,53,160
	Lease Liability A/c	50,00,000	
	Bank A/c		50,00,000

Illustrations (Cont'd.)

4. Transition – Modified Retrospective Approach (Option I)

Assumptions:

Lease Rental of INR 50,00,000/- p.a.

No escalation in Lease rentals

Lease Tenure: 15 years

Balance life of Lease as at 01-04-2019: 3 Years

Depreciation: SLM Basis

Lessee's incremental borrowing rate: 10% p.a. (as at April 1, 2019)

Accounting:

Under first modified approach, an entity needs to compute lease liability and right of use asset using discounting rate as at date of initial application and adjust difference in Opening Reserve (01-04-2018).

Continued on next page…

Illustrations (Cont'd.)

4. Transition – Modified Retrospective Approach (Option I) (Cont'd.)

Sr. No.	Particulars	Debit	Credit
1	**As at April 01, 2019**		
	Right-of-use Assets A/c	76,06,080	
	Retained Earnings A/c	48,28,180	
	Lease Liability A/c		1,24,34,260
2	**For the Year 2019-20**		
	Finance Cost A/c	12,43,426	
	Depreciation and Amortisation Exp A/c	25,35,360	
	Lease Liability A/c		12,43,426
	Right-of-use Assets A/c		25,35,360
	Lease Liability A/c	50,00,000	
	Bank A/c		50,00,000

Illustrations (Cont'd.)

5. Transition – Modified Retrospective Approach (Option II)

Assumptions:

Lease Rental of INR 50,00,000/- p.a.

No escalation in Lease rentals

Lease Tenure: 15 years

Balance life of Lease as at 01-04-2019: 3 Years

Depreciation: SLM Basis

Lessee's incremental borrowing rate: 10% p.a. (as at April 1, 2019)

Accounting:

Under second modified approach, an entity needs to compute lease liability using discounting rate as at date of initial application and at same value right of use asset is recognised.

Sr. No.	Particulars	Debit	Credit
1	**As at April 01, 2019**		
	Right-of-use Assets A/c	1,24,34,260	
	Lease Liability A/c		1,24,34,260
2	**For the Year 2019-20**		
	Finance Cost A/c	12,43,426	
	Depreciation and Amortisation Exp A/c	41,44,753	
	Lease Liability A/c		12,43,426
	Right-of-use Assets A/c		41,44,753
	Lease Liability A/c	50,00,000	
	Bank A/c		50,00,000

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