IFRS 16
IND AS 116

Leases

What we will be discussing today?

- Why new standard?
- Effective date and Scoped out
- Key highlights
- Identifying a lease and Lease term
- Optional exemptions
- In the books of lessee
- In the books of lessor
- Transition
- Impact on Companies
- IFRS 16 Vs Ind AS 116
- Amendment in July 2020

Why new Standard?
IFRS 16/Ind AS 116

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Why new Standard?

- **Economically similar but accounted differently:** The existence of two different accounting models for leases, in which assets and liabilities associated with lease were not recognized for operating lease but were recognized for finance leases, meant that transactions that were economically similar could be accounted for very differently.

- **To Eliminate Balance sheet financing:** Information reported about operating leases lacked transparency and did not meet the needs of users of financial statement. Many users adjusted a lessee's financial statements to capitalize operating leases because, in their view, the financing and assets provided by leases should be reflected on the Balance Sheet.

- **Did not provide adequate information** about a lessor's exposure to credit risk

“One of my greatest ambitions before I die is to fly in an Aircraft that is on an Airline’s balance Sheet”

Sir David Tweedie, Former Chair to IASB
(Speech to the Empire Club in Toronto, April 2008)

Effective date

IFRS 16

Annual period beginning on or after January 1, 2019

Early application is permitted

Ind AS 116

Annual reporting period beginning on or after April 1, 2019

Scoped out

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Scoped out

An entity shall apply this Standard to all leases, including leases of right-of-use assets in a sublease, except for:

(a) leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources;

(b) leases of biological assets within the scope of IAS 41/Ind AS 41, Agriculture, held by a lessee;

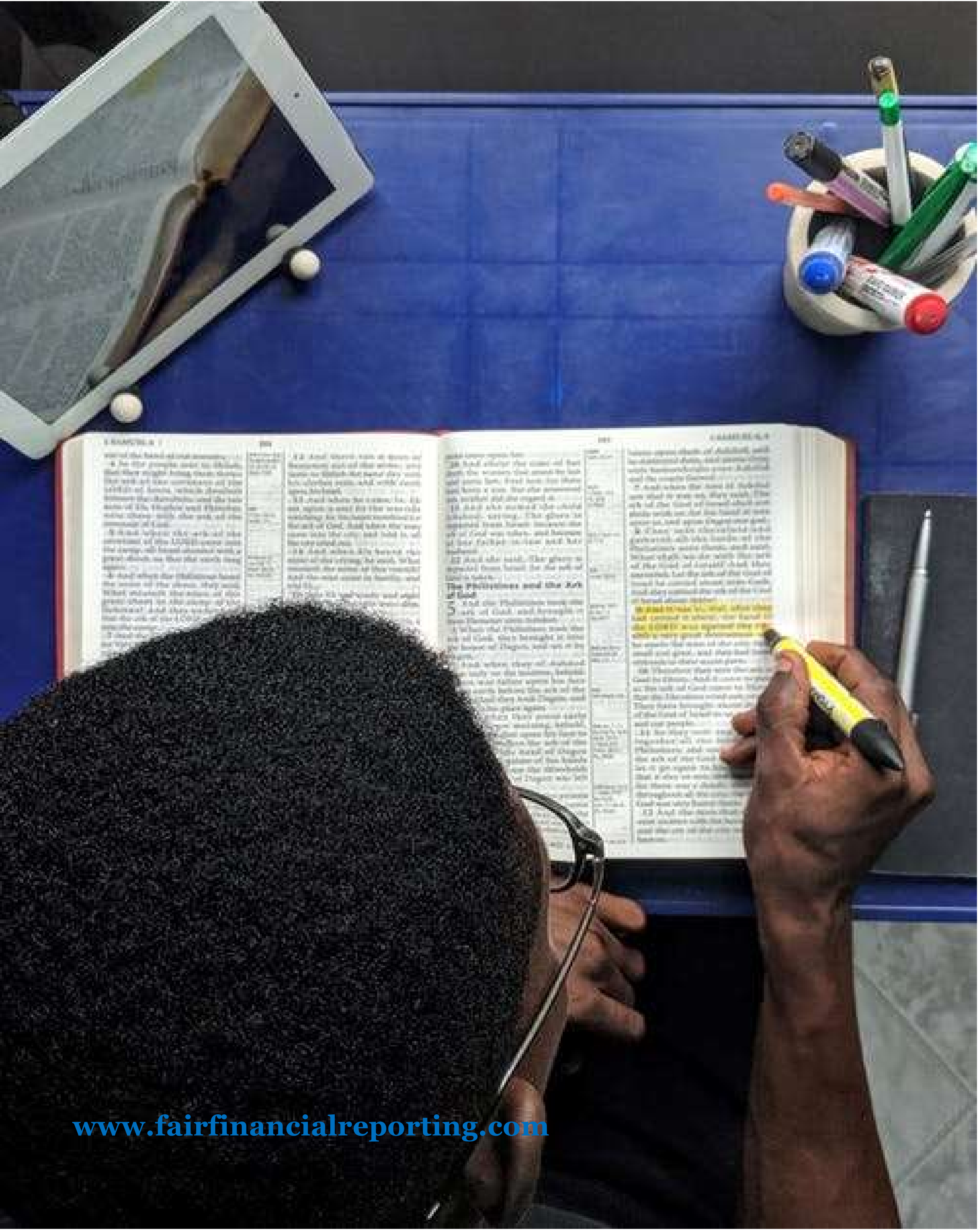
(c) service concession arrangements within the scope of IFRIC 12/Appendix C, Service Concession Arrangements, of Ind AS 115, Revenue from Contracts with Customer;

Scoped out

(d) licenses of intellectual property granted by a lessor within the scope of IFRS 15/Ind AS 115, Revenue from Contracts with Customers; and

(e) rights held by a lessee under licensing agreements within the scope of IAS 38/Ind AS 38, Intangible Assets, for such items as motion picture films, video recordings, plays, manuscripts, patents and copyrights.

A lessee may, but is not required to, apply this Standard to leases of intangible assets other than those described in (e) above



Key Highlights

Key highlights

- Lessees will use a single accounting model for all leases, with limited exemptions. No classification of operating and finance lease.

- The new standard require lessees to recognize most leases on their balance sheets. On assets side as "Right for use" and on liability side as "Lease liability" for the present value of obligations.

- In place of "rent" in Profit & loss, it will be "depreciation" on right for use and "Interest exp" on lease liability.

- Foreign currency leases will increase P&L volatility due to a restatement of foreign currency liability.

Key highlights

- Change in definition of lease ***from***

  "A lease is an agreement whereby the lessor conveys to the lessee in return for a payment or series of payments the right to use an asset for an agreed period of time." Specific guidance in Appendix C to determine the lease.

  to

  "A contract, or part of a contract, that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration." Specific guidance withdrawn.

- **Lessor accounting** is substantially **unchanged**. Ind AS 17 had a carve out which stated that no straight lining should be done when the rentals are increased based on inflations. No such express provision is there in Ind AS 116 so straight lining will be done.

- The new lease standard also refers to Ind AS 115.

Identifying a lease

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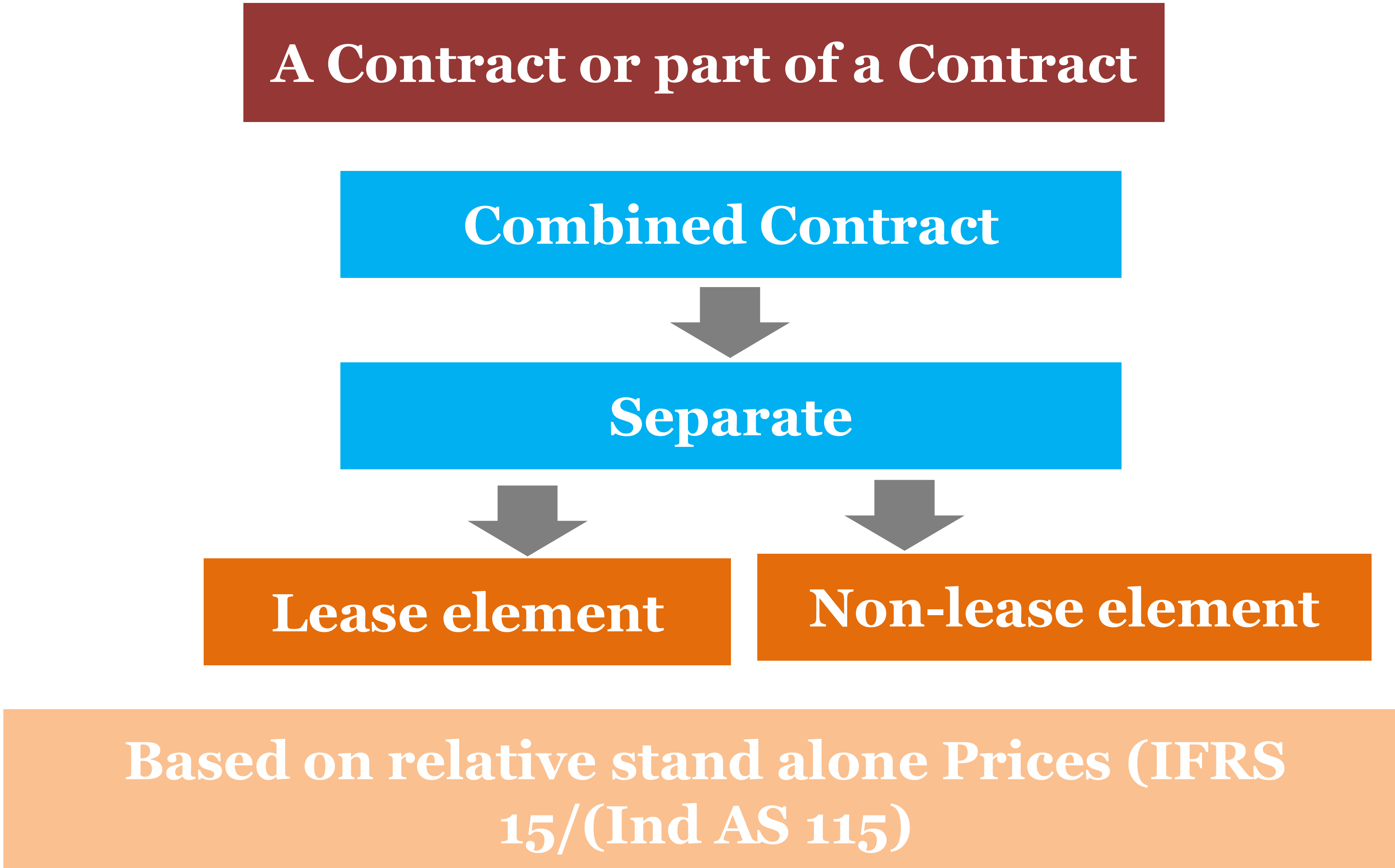
What is a lease?

A contract, or part of a contract, that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration.

- A **Contract or part of a contract** – lease contract; service contract
- The **right (control) to use** of

  - **Asset (identified)**

  - For a period of time
- Exchange for consideration


A Contract or part of a Contract
Combined Contract
Separate
Lease element
Non-lease element
Based on relative stand alone Prices (IFRS 15/(Ind AS 115)

Under IFRS 16/Ind AS-116, you need to assess whether these contracts contain lease as defined in IFRS 16/Ind AS-116.

The first thing you would look at is

Whether an underlying asset can be identified?

Yes	**No**
Lease	**No lease**

Case study 1

Let’s say you took a godown space and to pay Rs. 100,000 per year for 3 years period. This payment includes the payment of rental of unit no. 13 and its cleaning once per week.
You find out that you would be able to rent out similar unit in the warehouse next door for Rs. 90,000 per year without cleaning service and you would need to pay Rs. 15,000 per year for its cleaning.

Based on this, **you need to:**

- **Allocate** Rs. 85,710 [(Rs. 90,000/(Rs. 90,000+Rs 15,000)] to the lease element and account for that **as for the lease**; and
- Allocate Rs. 14,290 [(Rs. 15,000/Rs. 90,000+Rs. 15,000)] to the service element and in this case, probably recognise it in profit or loss as an expense for cleaning.

Case study 2

(a) You will occupy a certain area of XY cubic meters, but the specific place will be determined by the owner of the warehouse, based on actual usage of the warehouse and free storage.
(b) You will occupy Unit no. 13 of XY cubic meters in the sector A of that warehouse. This place is assigned to you and no one can change it during the duration of the contract.

Both contracts looks like lease contracts?
Indeed, **As per old standard** on lease-In both cases, you would book the rental payments an expenses in profit or loss.

Under **IFRS 16/Ind AS-116**, you need to assess whether these contracts contain lease as defined in IFRS 16/Ind AS-116.

The first thing you would look at is-

Whether an underlying asset can be identified?

Yes	No
Lease	No lease

Substantive right to substitute:

You will occupy a certain area of XY cubic meters for a 3 year period, but the specific place will be determined by the owner of the warehouse, based on actual usage of the warehouse and free storage during the period of use. There are minimal costs to supplier associated with changing the space of the customer. customer uses a kiosk (that it owns) that can be moved easily to sell goods.

The contract does not contain a lease :

Supplier has the substantive right to substitute the space Customer uses because Supplier has the practical ability to change the space used by customer throughout the period of use. Supplier would benefit economically from substituting the space.

Right to obtain economic benefit from use

To **control the use** of an identified asset, a customer is required to have the right to obtain **substantially all** of the **economic benefits** from use of the asset **throughout** the **period of use**.

Right to direct the use :

Either

The customer has the right to direct how and for what purpose the asset is used throughout the period of use.

Or

The relevant decision about how and for what purpose the asset is used are predetermined

Protective rights

- A contract may include terms and conditions designed to protect the supplier's interest in the asset or other assets, to protect its personnel, or to ensure the supplier's compliance with laws or regulations.

- Protective rights **typically *define the scope*** *of the customer's right of use* but ***do not***, in isolation, ***prevent the customer from having the right to direct the use of an asset***.

- Example-A Contract may
    i. Specify the maximum amount of use of an asset or limit when the customer can use the asset
    ii. Require a customer to follow particular operating policies
    iii. Require a customer to inform the supplier of change in how an asset will be used.

Lease term

Lease term

- In determining the lease term and assessing the length of the non-cancellable period of a lease, an entity shall **apply the definition of a contract and determine the period for which the contract is enforceable**.

- A lease is no longer enforceable when the lessee and the lessor each has the right to terminate the lease without permission from the other party with no more than an insignificant penalty.

- The lease term begins at the commencement date and includes any rent-free periods provided to the lessee by the lessor

- If only a lessee has the right to terminate a lease, that right is considered to be an option to terminate the lease available to the lessee.

- If only a lessor has the right to terminate a lease, the non-cancellable period of the lease includes the period covered by the option to terminate the lease

Lease term

- At the commencement date, an entity assesses whether the lessee is reasonably certain to exercise an option to extend the lease or not to exercise an option to terminate the lease.

- A Lessee's past practice regarding the period over which it has typically used particular type of assets and its economic reason for doing so may provide useful information.

Lease payments

Lease payments include any in-substance fixed lease payments. In-substance fixed lease payments are payments that may, in form, contain variability but that, in substance, are unavoidable.

The following payment for the right to use the underlying asset during the lease term that are not paid at the commencement date:
•**Fixed payment** (including in-substance fixed payments), less any lease incentive receivables;
•**Variable lease payment** that depends on an index or a rate, initially measured using the index or rate as at the commencement date;
•Amounts expected to be payable by the lessee under **residual value guarantees**;
•The exercise prices of a **purchase option** if the lessee is reasonably certain to exercise that option; and
•Payment of **penalties for terminating** the lease, if the lease term reflects the lessee exercising an option to terminate the lease.

Optional Exemptions

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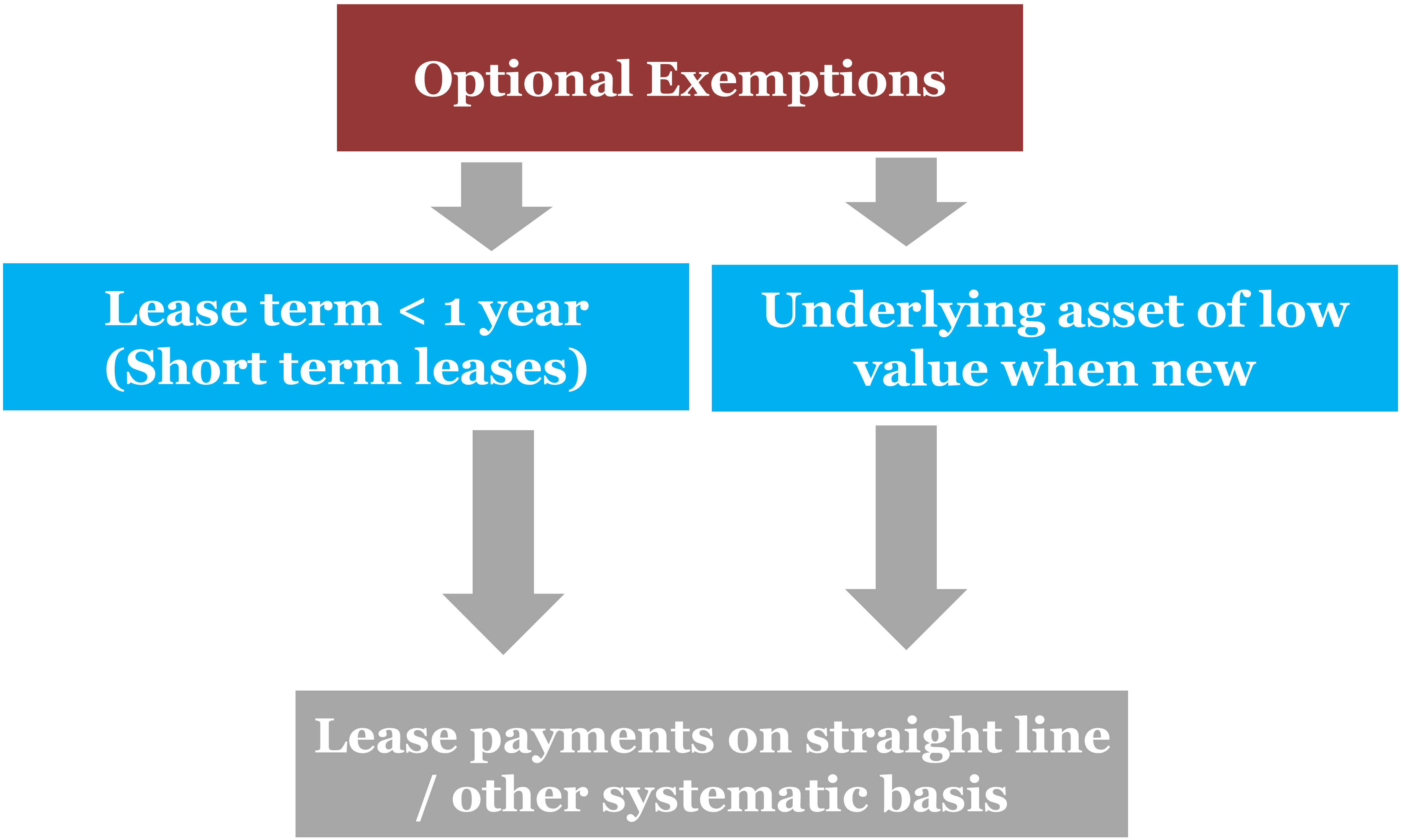
Optional Exemptions
Lease term < 1 year (Short term leases)
Underlying asset of low value when new
Lease payments on straight line / other systematic basis

Low value assets

- The IASB intended the exemption to apply to lease for which the underlying asset, **when new**, is of low value. Examples: Leases of tablet and personal computers, small items of office furniture and telephones.

- A lease will not qualify for exemption if the nature of the underlying asset is such that , when new, its value is typically not low.

In the books of lessee

Lease accounting by lessee: No classification of leases

At the commencement

Right for use	Lease liability
▪ Amount for lease liability ▪ Lease payments before/on commencement date-lease incentives ▪ Initial direct costs ▪ Estimate of dismantling cost	▪ Fixed payments ▪ Variable payments (index) ▪ Residual value guarantees ▪ Exercise price of purchase option ▪ Penalties for terminating **Payments not paid at the commencement date** **Discounted using Interest rate implicit in the lease/Incremental borrowing rate**

Lease accounting by lessee: No classification of leases

After commencement

Right for use	Lease liability
Depreciation xxx To Acc. Depreciation xxx ▪ Cost model (Ind AS-16 and 40) ▪ Impairment tests (IAS 36/Ind AS-36)	Interest xxx To lease liability xxx (Constant periodic interest rate) Lease liability xxx To Cash/bank xxx

In the books of lessor

Lease accounting by lessor: No change other than enhanced disclosure requirements

Risks and Rewards transferred to lessee?

Yes — **Finance lease**

- Ownership transferred
- Option to purchase the asset at price < fair value
- Lease term => major part of the economic life of asset
- Leased asset are of specialized nature

No — **Operating lease**

Lease accounting by lessor: No change other than enhanced disclosure requirements

Accounting by lessor

Finance lease	Operating lease
At commencement: Lease receivable xxx To PPE xxx Lease receivable=Net investment in the lease **Subsequent measurement:** Bank/Cash xxx To Lease receivable xxx To Interest Income xxx Constant periodic rate of return	**Will keep recognizing the asset** Revenue-Rental income on straight line basis/other systematic basis

Transition

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Transitional provision

Retrospective approach:

Retrospectively to each prior reporting period presented applying Ind AS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*;

Cumulative catch-up approach:

Retrospectively with the cumulative effect of initially applying the Standard recognized at the date of initial application in retained earnings

Single choice that must be applied to all leases

Option 1- Retrospective

Restate comparatives as if Ind AS-116 always applied

Option 2- Cumulative Catch-up

- Leave comparative as previously reported
- Carry forward existing finance lease liabilities
- Any difference between asset and liability recognized in opening retained earnings at transition
- Calculate outstanding liability for existing operating leases using implicit rate or incremental borrowing rate at date of transition
- Choose how to measure 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) present value of remaining lease payments.

Case study 5

- 5 Years lease, entered into on April 1, 2017;
- Rs. 100 payable on second day of each year;
- 8% discount rate at lease commencement
- 12% incremental borrowing rate at date of transition; and
- Straight-line depreciation of the right-of use asset is appropriate.

Option 1

Date	Asset	Liability	Total Expenses
Lease Commencement April 1, 2017	431	431	
Year ended March 31, 2018	345	358	113
Amounts recognized on April 1, 2018	**345**	**358**	
Year ended March 31, 2019	259	278	107
Year ended March 31, 2020	172	193	101
Year ended March 31, 2021	86	100	94
Year ended March 31, 2022	0	0	86
Total Expenses post-transition			**280**

Option 2A

Date	Asset	Liability	Total Expenses
Lease Commencement April 1, 2017	404	404	
Year ended March 31, 2018	323	340	
Year ended March 31, 2019	242	269	
Amounts recognized at transition on April 1, 2019	**242**	**269**	
Year ended March 31, 2020	161	189	101
Year ended March 31, 2021	81	100	91
Year ended March 31, 2022	0	0	81
Total Expenses post-transition			**273**

Option 2B

Date	Asset	Liability	Total Expenses
Amounts recognized at transition on April 1, 2019	**269**	**269**	
Year ended March 31, 2020	179	189	110
Year ended March 31, 2021	90	100	100
Year ended March 31, 2022	0	0	90
Total Expenses post- transition			**300**

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Impact on Companies

Impact on Companies

Infosys:

Adoption of new accounting standard on Leases - Ind AS 116

- Modified retrospective method
- Recognition of Right-of-Use asset (ROU) of Rs. 2,907 crore,
- Net investment in sublease of ROU asset of Rs.430 crore and
- A lease liability of Rs. 3,598 crore.
- The cumulative effect of applying the standard resulted in Rs. 40 crore being debited to retained earnings, net of taxes.
- The effect of this adoption is *insignificant on the profit for the period* and earnings per share.

The Indian Hotels Company Limited :

Adoption of new accounting standard on Leases - Ind AS 116

- Retrospective approach with the cumulative effect at the date of initial application
- Recognition of Right-of-Use asset (ROU) of Rs, 83,181 Lacs and A lease liability of Rs. 90,135 Lacs
- The cumulative effect of applying the standard resulted in adjusting the retained earnings as at April 1, 2019 with Rs. 10,145 Lacs (net of taxes).
- Profit before tax for the first quarter is lower by Rs. 480 Lacs

Impact on Companies

Indigo-InterGlobe Aviation Limited:

- Retrospectively with the cumulative effect of initially applying the standard, recognized as an adjustment to the opening balance of retained earnings as on the date of initial application
- Recognizing a right-of-use asset of Rs. 132,823 million and
- A corresponding lease liability of Rs. 192,195 million
- Net impact on profit before tax for the half year amounts to a loss of Rs. 4838 million.

Aditya Birla Fashion Retail Limited:

- Modified retrospective method
- Recognized Rs. 130 Crores (net of taxes) as an adjustment to the opening balance of retained earnings as on the date of initial application
- Recognizing a right-of-use asset of Rs. 1,816 Crores
- A corresponding lease liability of Rs. 2,110 Crores

IFRS 16
Vs
Ind AS 116

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IFRS 16 Vs Ind AS 116

IFRS 16	Ind AS 116
Para 34 of IFRS 16: If lessee applies fair value model in IAS 40 to its Investment Property, it shall apply the fair value model to the right-of-use assets that meet the definition of Investment Property.	Ind AS 40 does not allow the use of fair value model hence this para has been deleted in Ind AS 116.
Para 50(b) of IFRS 16 requires to classify cash payments for interest on lease liability applying requirements of IAS 7, Statement of cash flows. IAS 7 provides option of treating interest paid as operating or financing activity.	Ind AS 7 requires interest paid to be treated as finance activity only.

Amendment in July 2020

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Amendments in July 2020

Covid 19 related rent concessions

- Rent concessions often meet the definition of lease modification and its accounting can be complex.

- To address this challenge and in line with the amendments made to IFRS, on 24 July 2020, the Ministry of Corporate Affairs (MCA) has issued amendment to Ind AS 116.

- The amendment permits lessee, **as a Practical expedient**, not to assess whether **rent concessions** that occur as a direct consequence of Covid 19 pandemic and meet specified conditions are lease modifications and instead to **account for those rent concessions as if they were not lease modifications.**

- The amendments are effective from annual reporting periods beginning on or after 1 April 1, 2020. However, in case a lessee has not yet approved the financial statements for issue before the issuance of the amendments, then the same may be applied for annual reporting periods beginning on or after 1 April 2019.

Amendments in July 2020

Conditions to avail the practical expedient:

- Rent concessions is a direct consequence of Covid 19 pandemic
- Revised consideration should be same or less than the consideration before the change
- Rent concession should affect only lease payments originally due on or before June 30, 2021.
- No substantive change in other terms and conditions

All conditions should be satisfied to avail the practical expedient

Amendments in July 2020

	Practial expedient not applied - lease modification accounting (IFRS 16.39-43)	Practical expedient is applied - variable lease payment accounting (IFRS 16.38(b))
Effect on lease liability	Reduced to reflect the revised consideration	Reduced to reflect the revised consideration
Effect on discount rate	The total revised, remaining consideration is remeasured using an updated discount rate as at the effective date of the lease modification	No change in discount rate
Effect on right-of-use asset	The offsetting adjustment is recorded against the carrying value of the right-of-use asset	No effect
Effect on profit or loss	None as at the time of modification; will result in modified finance expense and depreciation in subsequent periods	The offsetting adjustment is recorded in profit or loss

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