IND AS 116

LEASES

IND AS 116 LEASES SCOPE

An entity shall apply this Standard to all leases, except for:

- Leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources;
- Leases of biological assets within the scope of Ind AS 41 Agriculture held by a lessee;
- Service concession arrangements
- Licences of intellectual property granted by a lessor within the scope of Ind AS 115 Revenue from Contracts with Customers
- Rights held by a lessee under licensing agreements within the scope of Ind AS 38 Intangible Assets for such items as motion picture films, video recordings, plays, manuscripts, patents and copyrights.

IMPACT OF IND AS 116 LEASES

- Lessee to recognise most leases on their balance sheet
- Lessees will have single accounting model for all leases, with two exemptions (see next slide)
- Lessor accounting is substantially unchanged
- Additional disclosures requirement

IND AS 116 RECOGNITION EXEMPTION

Short-term leases and low value leases

Short-term leases

- Lease terms is 12 months or less
- No purchase option
- Factor in lessee options to terminate or extend lease if exercise is reasonably certain
- Apply consistently by class of underlying asset

Low value leases

- Assess based on value of an equivalent new asset;
- Not judged by reference to materiality
- Made on a lease by lease basis
- The lessee can benefit from the use of the asset on its own or together with other resources readily available to the lessee
- Underlying asset is not highly dependent/interrelated to other assets

FINANCIAL IMPACT BALANCE SHEET IMPACT

	Ind AS 17		Ind AS 116
	Finance Lease	Operating Lease	All Leases
Assets	@@	-	@@
Liabilities	$$	-	$$
Off Balance sheet- rights	-	@@	-
Obligations	-	$$	-

FINANCIAL IMPACT INCOME STATEMENT IMPACT

	Ind AS 17		Ind AS 116
	Finance Lease	Operating Lease	All Leases
Revenue	$$$	$$$	$$$
Operating cost (excluding depreciation and amortization cost)	-	Single lease expense	-
EBITDA			↑
Depreciation and amortization	Depreciation	-	Depreciation
Operating Profit			
Finance cost	Interest		Interest
Profit before tax			↔

IDENTIFYING ASSETS THAT ARE, OR CONTAIN, A LEASE

IND AS 116, *LEASES*
Definition of 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.'

IND AS 116, LEASES IDENTIFYING A LEASE

Identified asset

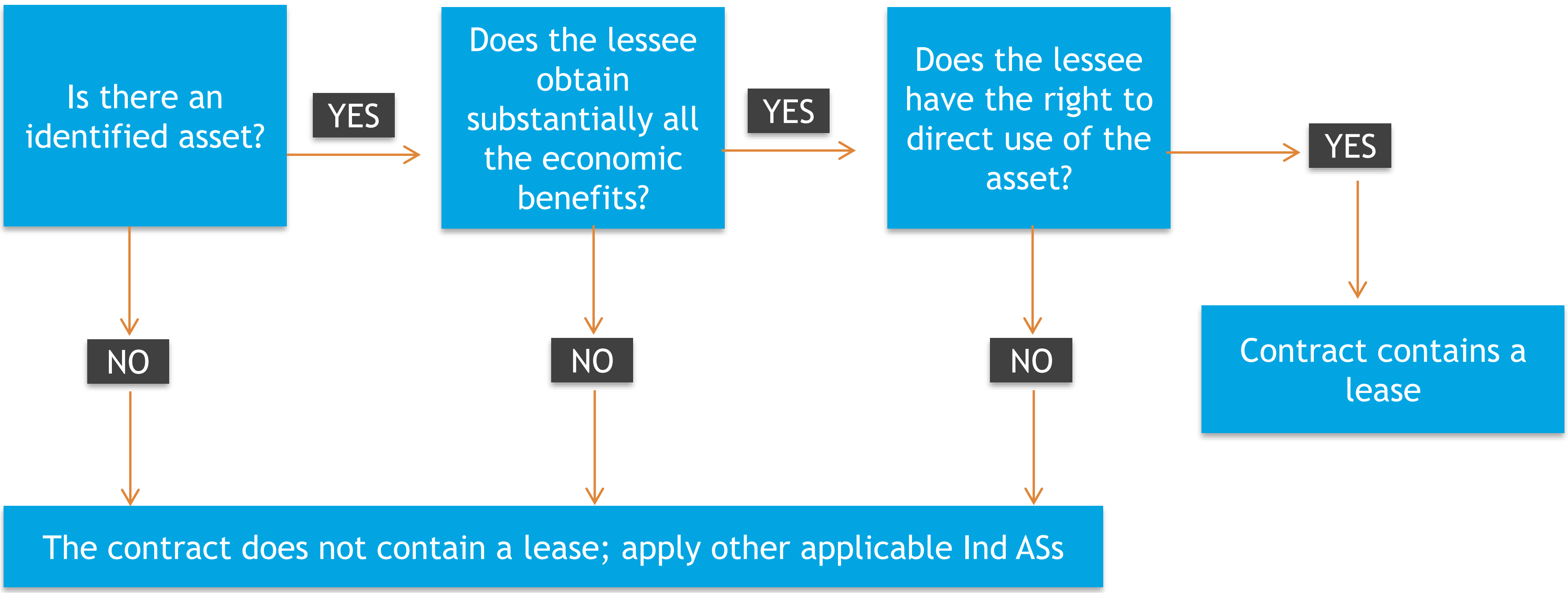
- No substantive right to substitute
- No benefit from substitution

AND

Right to control the use of the identified asset

- Right to obtain substantially all economic benefits
- Right to direct the use

IDENTIFYING A LEASE



IDENTIFYING A LEASE

Identified Asset – Substitution Rights

A supplier's right would be substantive if both of the following conditions are met:

- The supplier has the practical ability to substitute alternative assets throughout the period of use;

AND

- The supplier would benefit economically from the exercise of its right to substitute the asset

In situations where it is not readily determinable whether a supplier has substantive substitution rights, a customer shall presume that any substitution right is not substantive.

IDENTIFYING A LEASE

Identified Asset – Substitution Rights

Scenario

Customer enters into a 10 year contract with a freight carrier (Supplier) to transport Customer's goods.

The contract requires the supplier to use rail cars of a particular specification and it will require 20 rail cars to transport the required quantity of goods over the 10 year term of the contract.

Supplier has a large pool of rail cars that can be used to fulfil the contract. All rail cars are stored at Supplier's premises when they are not being used to transport goods. Costs associated with substituting the rail cars are minimal for Supplier.

Are Supplier's substitution rights substantive?

IDENTIFYING A LEASE

Identified Asset – Substitution Rights

Discussion

In this case, the contract does not contain identified assets.

The supplier has a large pool of rail cars available, and it can use any of the pool to satisfy the contract.

If, in contrast, the rail cars were stored some distance away at, say, the customer’s premises, such that the supplier would have to incur significant costs to substitute those rail cars which would outweigh the potential benefits of substitution, then the substitution rights would not be substantive. It would then be necessary to consider the other guidance in Ind AS 116 in order to conclude whether the contract is, or contains, a lease.

IDENTIFYING A LEASE

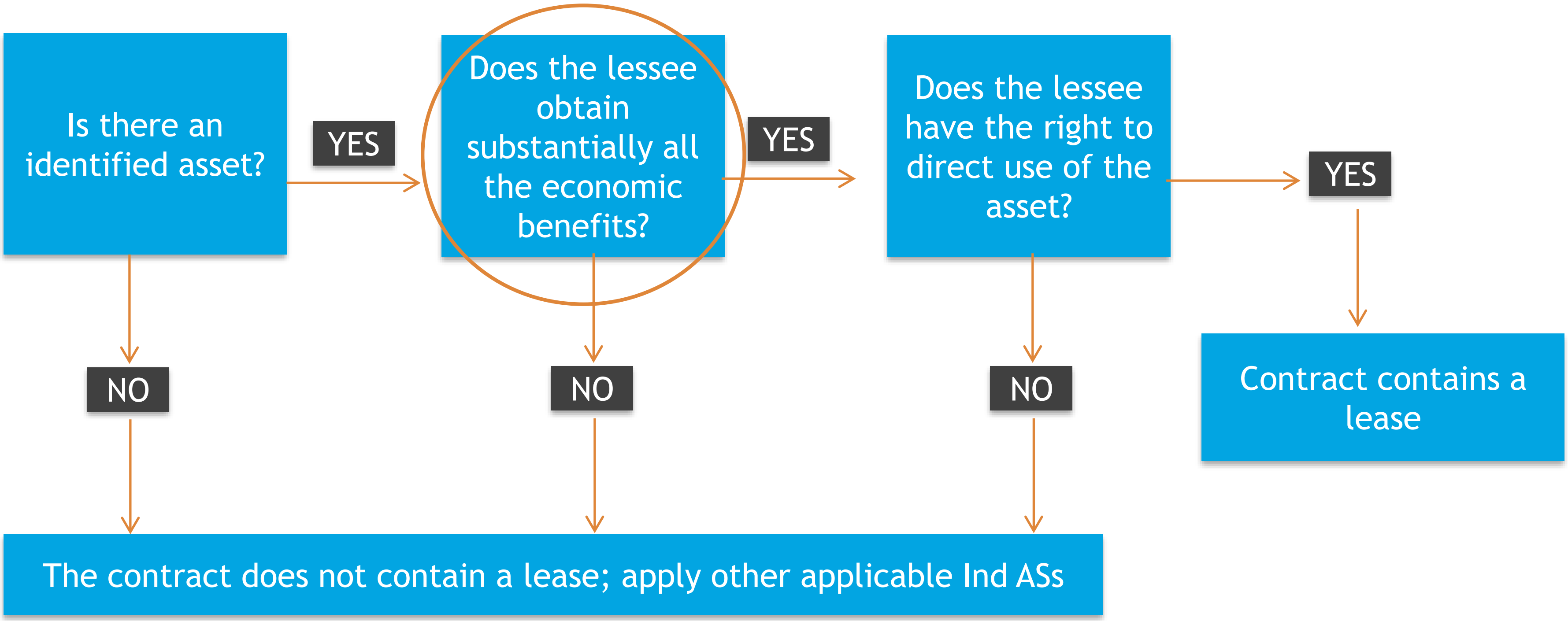
- Is the portion of an asset physically distinct?

✓ Yes. Then it is an identified asset.

? No. It might be a lease if it represents substantially all of the capacity of the asset.

IDENTIFYING A LEASE

Right to control the use of an asset



IDENTIFYING A LEASE

Economic Benefits

Scenario I

A retailer enters into a contract with a lessor for the lease of retail space in a shopping centre for 5 years. The lease payments are equal to 20% of the gross sales revenue of the store. The lessee has the right to determine which products are to be sold and the design of the store.

Who has the right to obtain substantially all of the economic benefits from use of the asset throughout the period of use?

IDENTIFYING A LEASE

Economic Benefits

Discussion

In this case, it is the customer's control and use of the property which generates all of the sales revenue. The lessee has a right to 100% of the sales revenue generated from the store.

This represents all of the economic benefits that will be generated by the store over the period of use, even though it has negotiated a contract which results in rental payments being a percentage of sales revenue.

This type of contractual term is common in leases of retail real estate.

IDENTIFYING A LEASE

Economic Benefits

Scenario II

Customer enters into a 10-year contract with Power Company Supplier to purchase all of the electricity produced by a new solar farm.

Supplier owns the solar farm and will receive tax credits relating to the construction and ownership of the solar farm, and the customer will receive renewable energy credits that accrue from use of the solar farm.

Who has the right to obtain substantially all of the economic benefits from use of the asset throughout the period of use?

IDENTIFYING A LEASE

Economic Benefits

Discussion

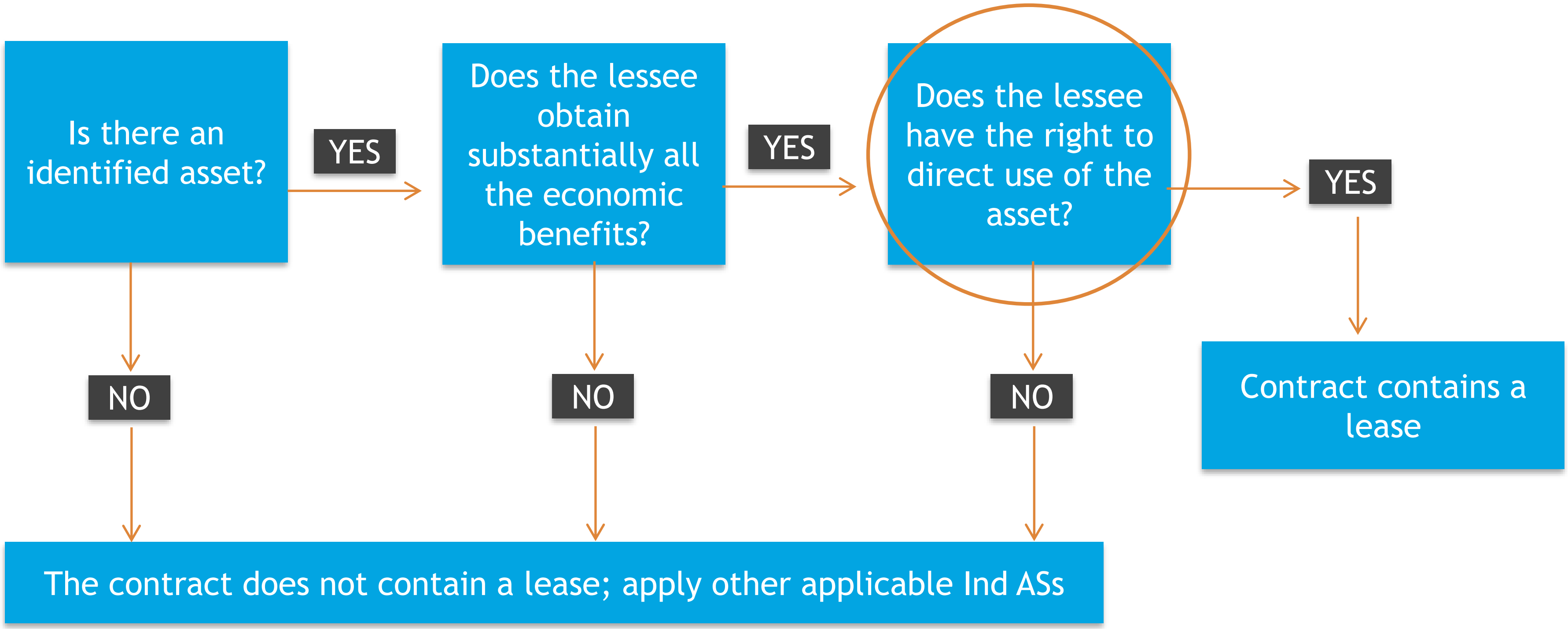
The customer has the right to obtain substantially all of the economic benefits from use of the solar farm over the 10-year period because it obtains:

- The electricity produced by the farm over the lease term – i.e. the primary output from use of the asset; and
- The renewable energy credits, which are a by-product from use of the asset.

Although the lessor receives economic benefits from the solar farm in the form of tax credits, these economic benefits relate to the legal ownership of the solar farm. They are not derived from the use of the solar farm and therefore are not relevant to the assessment of economic benefits that is required by Ind AS 116.

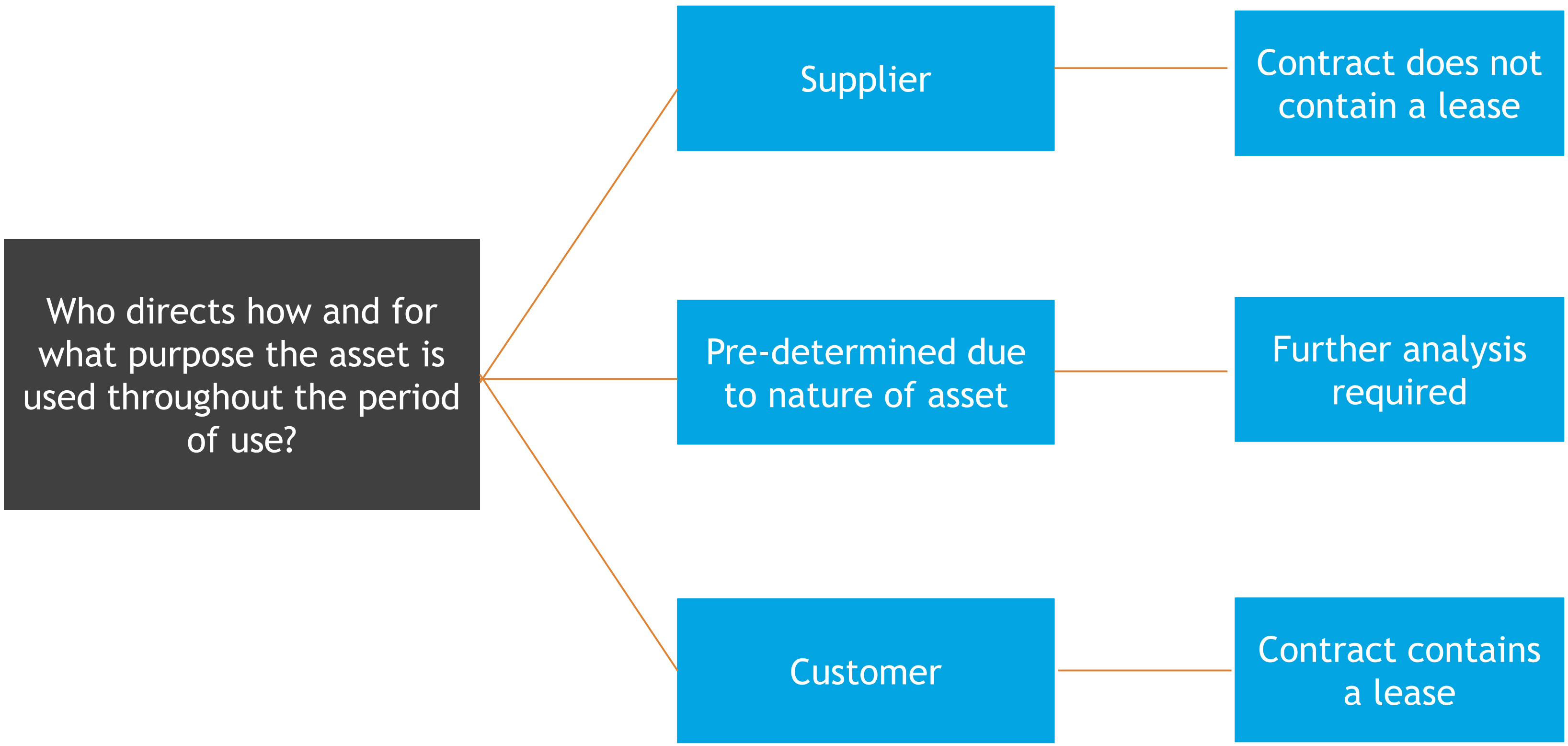
IDENTIFYING A LEASE

Right to control the use of an asset



IDENTIFYING A LEASE

Right to direct use



IDENTIFYING A LEASE

Who directs use?

Scenario

A customer enters into a contract with a supplier where the customer will purchase at least 80% of the energy produced by a bio-mass facility.

The contract specifies that the energy must be produced from this particular facility. The supplier is responsible for building, operating, and maintaining the facility to the customer's specification.

The customer designed the bio-mass facility before it was constructed and hired experts to assist in determining the location of the facility and the engineering of the equipment to be used.

There are no decisions to be made about whether, when or how much electricity will be produced because the design of the asset has predetermined those decisions.

IDENTIFYING A LEASE

Economic Benefits

Discussion

Neither the customer nor the supplier has the right to direct the use of the asset during the period of its use, because the functionality of the facility is predetermined based on its design.

However, the customer's design of the bio mass facility gives it the right to direct how and for what purpose the asset is used.

The customer's control over the design is equivalent to the customer having control over those decisions.

In addition, as the biomass facility is clearly identified and, through the purchase of 100% of the energy produced the customer obtains substantially all of the economic benefits from the facility, the contract contains a lease.

IDENTIFYING A LEASE

Separating lease and non – lease components

Lease and Non-lease components bundled (e.g. leased asset and regular maintenance)

ACCOUNTING POLICY CHOICE BY CLASS OF UNDERLYING ASSET

Allocate consideration to each lease component based on relative stand-alone price for lease components and non-lease components separately

OR

Account for lease component and associated non-lease component as a single lease

THE LEASE TERM

DETERMINING THE LEASE TERM

Non-cancellable period of the lease + Extension options if reasonably certain to exercise + Termination options if reasonably certain not to exercise = Lease Term

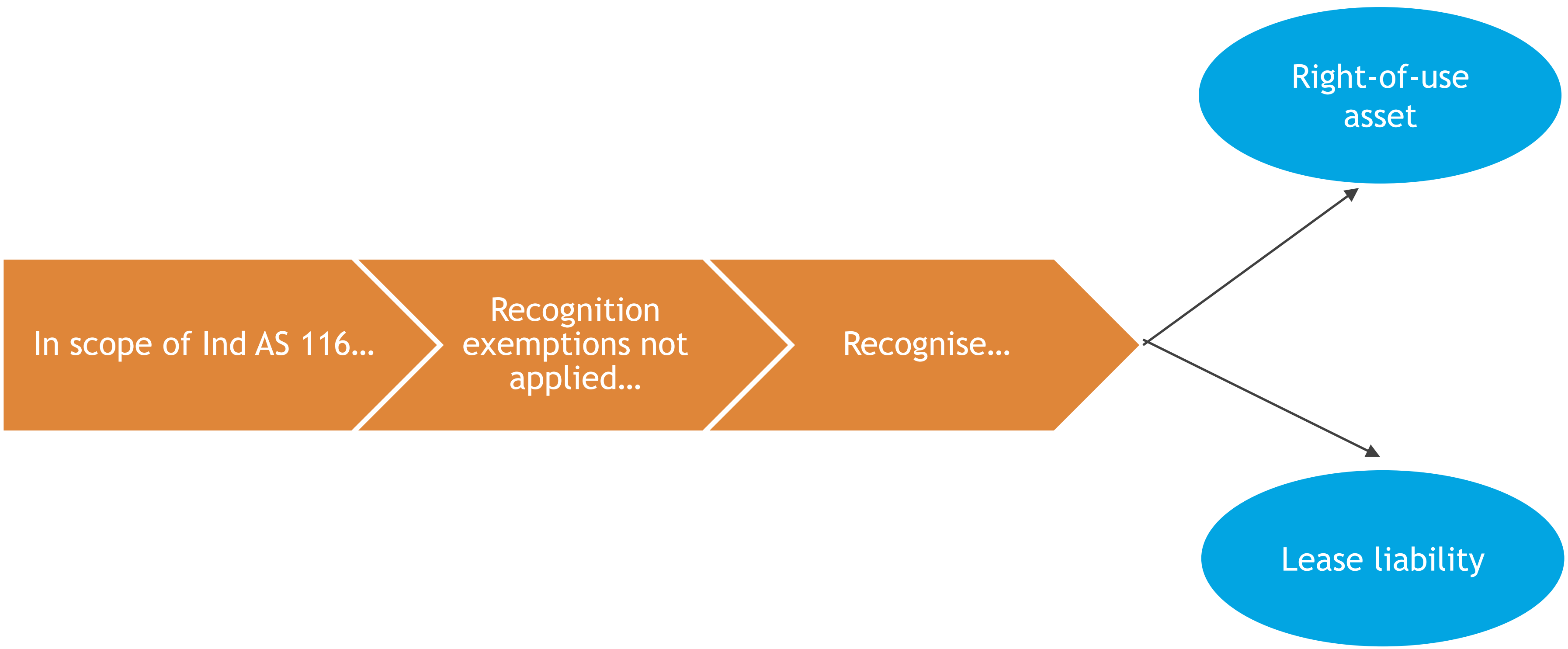
The lease term begins at the commencement date

(i.e. the date on which the lessor makes the underlying asset(s) available for use by the lessee) and <u>includes</u> any rent-free or reduced rent periods provided to the lessee by the lessor.

ACCOUNTING BY LESSEE

RECOGNITION AND MEASUREMENT

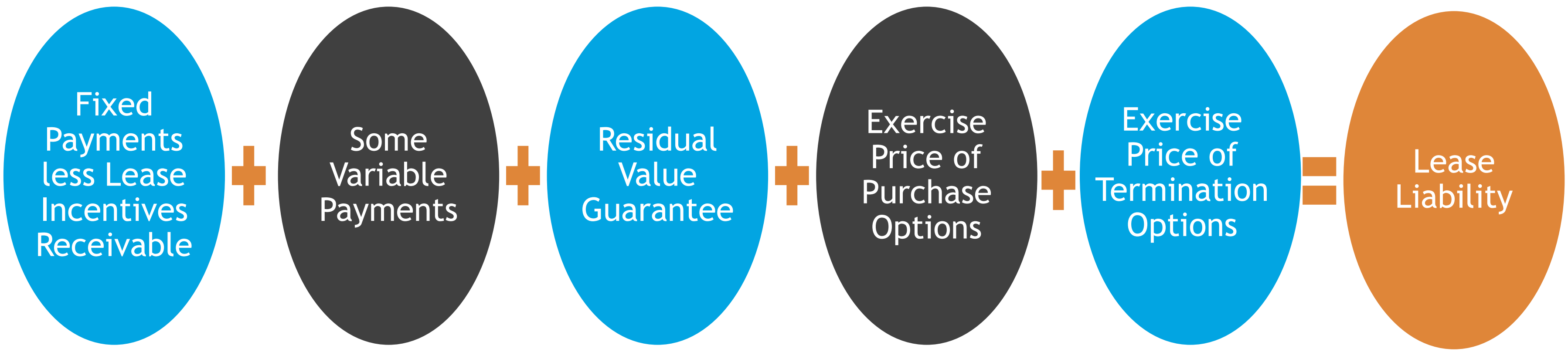
Overview



RECOGNITION AND MEASUREMENT

Lease Liability

- Measurement of the lease liability consists of the present value of the following components that have not been paid at the commencement date:



RECOGNITION AND MEASUREMENT

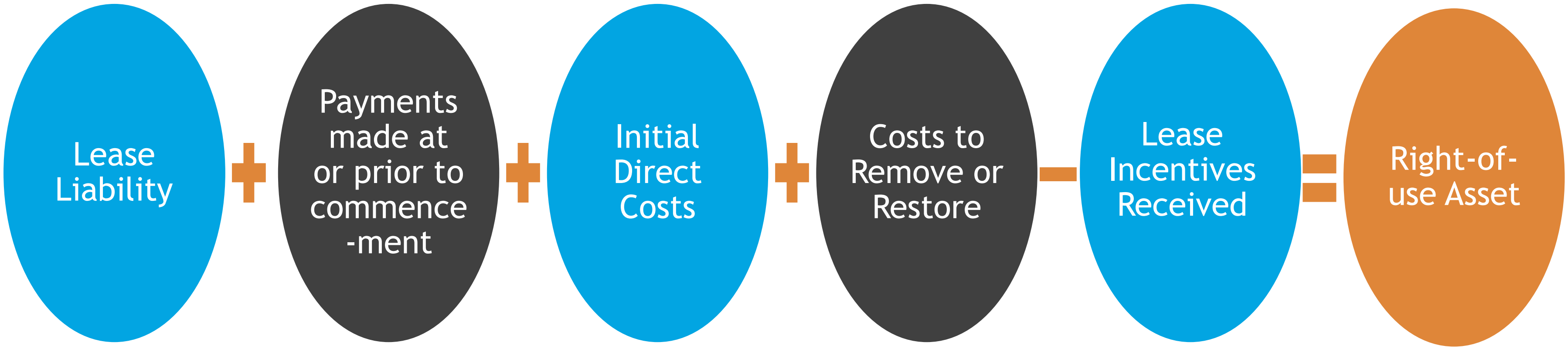
Discount Rate

- Interest rate implicit in the lease should be used unless it is not readily determinable.
- Implicit rate is often difficult to determine in practice, therefore, incremental rate of borrowing may be used
  - Similar security to right-of-use asset
  - Borrowing of similar term to lease term
  - Same currency as the lease payments
- Inappropriate to use WACC

RECOGNITION AND MEASUREMENT

Right-of-use Asset

- Right-of-use asset on initial recognition is measured at cost, comprising:



RECOGNITION AND MEASUREMENT

Calculating lease liability and ROU asset

Example	(Amount is in ‘000)

Entity Z (the lessee) enters into a 5-year lease of a floor of a building, with a 5 year extension option. Lease payments are INR 50,000 per annum (including the extension period), all payable at the beginning of each year. To obtain the lease, lessee incurs initial direct costs of INR 20,000 (INR15,000 paid to the former tenant occupying the floor and INR 5,000 for real estate commissions).

The terms of the lease also require Entity Z annually to pay the lessor 2% of the gross sales revenue generated from the space being rented.

Entity Z concludes that it is reasonably certain that it will exercise the extension option

The rate implicit in the lease is not readily determinable. The lessee has determined that its incremental rate of borrowing is estimated at 5% per annum.

RECOGNITION AND MEASUREMENT

Example - Lease Liability

Fixed Payments less Lease Incentives Receivable	+	Some Variable Payments	+	Residual Value Guarantee	+	Exercise Price of Purchase Options	+	Exercise Price of Termination Options	=	Lease Liability
355,391 Less Nil	+	Nil	+	Nil	+	Nil	+	Nil	=	355,391
9 payments of INR 50,000, discounted at 5%		Exclude variable payments that do not depend on a rate/index		N/A		N/A		N/A		

RECOGNITION AND MEASUREMENT

Example – Right – Of – Use Asset

Lease Liability	+	Payments made at or prior to commence -ment	+	Initial Direct Costs	+	Costs to Remove or Restore	+	Lease Incentives Received	=	Right-of-use Asset
355,391	+	50,000	+	20,000	+	Nil	+	Nil	=	425,391
Amount calculated for lease liability		First lease payment made in advance		Former tenant costs and commissions		N/A		N/A		

RECOGNITION AND MEASUREMENT

Solution

- To record the initial value of the lease asset and liability:

			Amount is in '000
Dr	Right-of-use asset	425,391[1]	
Cr	Lease liability		355,391[2]
Cr	Cash		70,000[3]

1: PV of 9 payments at INR 50,000, discounted at 5% + INR 50,000 (initial payment made up front) + INR 20,000 initial direct costs
2: PV of 9 payments at INR 50,000, discounted at 5%
3: INR 50,000 first period rent + INR 20,000 direct costs

SUBSEQUENT MEASUREMENT AND RE-MEASUREMENTS OF LEASE LIABILITIES AND RIGHT-OF-USE ASSETS

SUBSEQUENT MEASUREMENT

Lease Liability

- Subsequent accounting is similar to other interest bearing liabilities, except for more specific guidance on remeasurements.

SUBSEQUENT MEASUREMENT

Right-of-use Asset

- Measurement Models
  - Cost Model (Ind AS 16)
  - Revaluation Model (Ind AS 16)

LEASE MODIFICATIONS

LEASE MODIFICATIONS

Separate lease

Does the modification give rise to a separate lease?

The modification increases the scope of the lease by adding the right to use one or more underlying assets (e.g. additional vehicles, an extra floor of a building, etc.)

+

The consideration for the lease increases by an amount commensurate with the standalone price for the increase in scope (e.g. a market rate for the vehicle)

Assessed using the criteria to determine whether a contract is, or contains, a lease (e.g. identified asset, obtain economic benefit, right to direct use)

PRESENTATION - LESSEE

Primary financial statements

Balance sheet

- Right-of-use asset: present in its own line item separately from other assets with separate disclosure.
- If ROU assets meet the definition of investment property, it shall be presented in the balance sheet as investment property.
- Lease liabilities: present separately from other liabilities

Statement of profit and loss

- Interest expense with other finance costs
- Amortisation of right-of-use assets

Statement of Cash Flows

- Cash payments for lease liabilities as financing activities
- Cash payments for interest in accordance with Ind AS 7's requirements for interest paid.
- Short-term, low-value and variable lease payments within operating activities.

DISCLOSURE – LESSEE

Balance sheet	Statement of profit and loss	Statement of Cash Flows
• Additions to right-of-use assets. • Carrying value of right-of-use assets at the end of the reporting period by class. • Maturity analysis of lease liabilities separately from other liabilities based on Ind AS 107 requirements.	▪ Depreciation for assets by class. ▪ Interest expense on lease liabilities. ▪ Short-term leases expensed.* ▪ Low-value leases expensed.* ▪ Variable lease payments expensed. ▪ Income from subleasing. ▪ Gains or losses arising from sale and leaseback transactions.	▪ Cash payments for lease liabilities as financing activities ▪ Cash payments for interest in accordance with Ind AS 7's requirements for interest paid ▪ Short-term, low-value and variable lease payments within operating activities

* These disclosures need not include leases with lease terms of one month or less.

DISCLOSURE - LESSEE

Qualitative Disclosure Requirements

- A summary of the nature of the entity’s leasing activities;
- Potential cash outflows the entity is exposed to that are not included in the lease liability, including:
  - Variable lease payments;
  - Extension options and termination options;
  - Residual value guarantees; and
  - Leases not yet commenced to which the lessee is committed.
  - Restrictions or covenants imposed by leases; and
  - Information about sale and leaseback transactions

* The above disclosures include the major disclosures requirements. Additional disclosures might be required based on particular facts and circumstances of each case.

DISCLOSURE - LESSOR

Qualitative Disclosure Requirements

- A summary of the nature of the entity's leasing activities;
- This disclosure would include the nature of the lessor's leasing activities and how the lessee manages risks associated with those activities, including risk management on rights retained in underlying assets and risk management strategies including:
  - Buy-back agreements;
  - Residual value guarantees;
  - Variable lease payments for excess use; and
  - Any other risk management strategies

* The above disclosures include the major disclosures requirements. Additional disclosures might be required based on particular facts and circumstances of each case.

Thank you