IND AS 116 LEASES

IND AS CERTIFICATION COURSE

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Ind AS Certification Course Secretariat, Accounting Standards Board

The Institute of Chartered Accountants of India

New Delhi, India

1	Lease Recognition-Exception-Definition
2	Lease Term
3	Initial Recognition of ROU Asset – Lease Obligation
4	Subsequent Measurement of ROU Asset and Lease Obligation
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IND AS 116 LEASES

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- Ind AS 116 is effective from accounting period beginning on or after April 1,2019
- Lessees will have a single on-balance sheet accounting model for all leases, with exemptions for short-term leases and leases of low-value assets.
- Lessor accounting is substantially unchanged.
- Lessees and lessors will have additional disclosure requirements compared to current accounting.

SCOPE

This standard is applicable to all lease arrangements except for the following:

a) Leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources (Ind AS 106)

b) Leases of biological assets within the scope of Ind AS 41.

c) Service concession arrangements [Appendix D to Ind AS 115]

d) Licenses of intellectual property granted by lessor (Ind AS 115).

e) Rights held by a lessee under licensing agreements such items as motion picture films, video recordings, plays, manuscripts, patents and copyrights. (Ind AS 38).

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

RECOGNITION EXEMPTION

- A lessee may elect not to apply the requirements of this standard to:

(a) short-term leases;

(b) leases for which the underlying asset is of low value.

- The election for short-term leases shall be made by class of underlying asset to which the right of use relates.

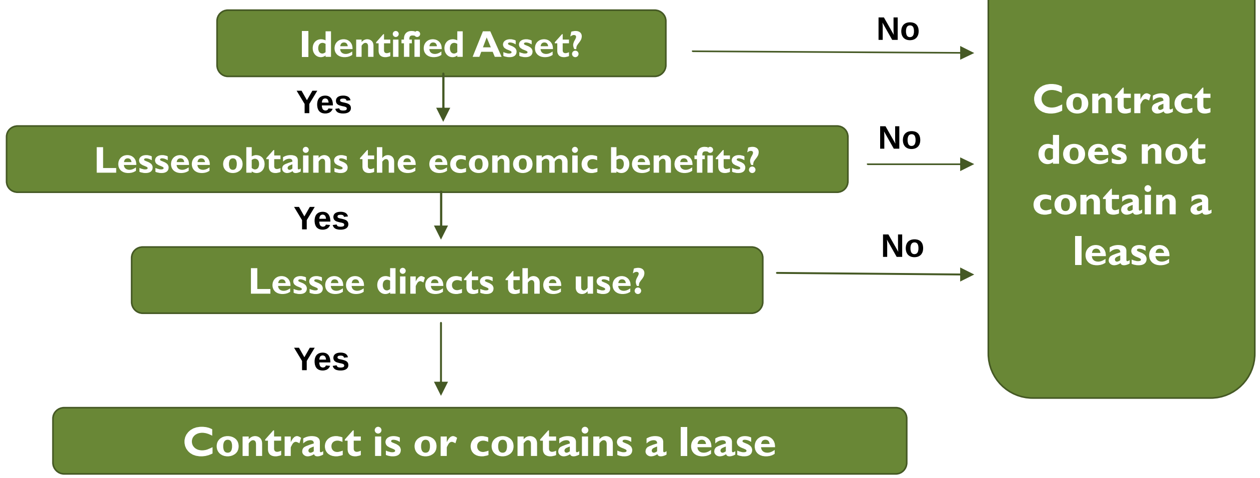
- The election for leases for which the underlying asset is of low value can be made on a lease-by-lease basis.

- Discussed in detail later

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.

Key Elements of Leases



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

IDENTIFIED ASSETS

- A contract contains a lease only if it relates to an **identified asset.**
- 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.

Substantive substitution right:

- An asset is not a identified asset if the lessor has a **substantive right to substitute the asset** for an alternative asset throughout the period of use.
- A lessor's substitution right is 'substantive' if the lessor:
  - has the practical ability to substitute the asset throughout the period of use; **and**
  - would benefit economically from exercising its right to substitute the asset.
- Evaluation of lessor's substitution right should be made at the inception of the contract.

RIGHT TO ECONOMIC BENEFITS

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- To control the use of an identified asset, a customer must have the right to obtain **substantially all of the economic benefits** from use of the asset **throughout the period of use**. e.g. by having exclusive use of the asset throughout that period.

- Economic benefits from use of an asset can be obtained by the customer in many ways e.g. by using, holding or sub-leasing the asset.

- Such economic benefits include the primary output and by-products generated from use of the asset, and other economic benefits from using the asset

- When assessing customer right to obtain substantially all of the economic benefits from the use of an assets, an entity considers the economic benefits that result from use of the asset within the defined scope of a customer's right to use the asset.

RIGHT TO DIRECT

- When assessing whether the customer has the right to direct the use of the identified asset, the key question is which party (customer or supplier) has **the right to direct how and for what purpose the identified asset is used** throughout the period of use.

- **The standard gives several illustrative examples of relevant decision-making rights:**
  - Right to change **what** type of output is produced.
  - Right to change **when** the output is produced.
  - Right to change **where** the output is produced.
  - Right to change **how** much of the output is produced.

- Relevance of each of the decision-making rights depends on the underlying asset being considered.

- Decision-making rights are relevant when they affect the economic benefits to be derived from the use of the asset.

- If both parties have decision-making rights, an entity considers the **rights that are most relevant to changing how and for what purpose the asset is used.**

DETERMINING WHETHER AN ARRANGEMENT CONTAINS A LEASE

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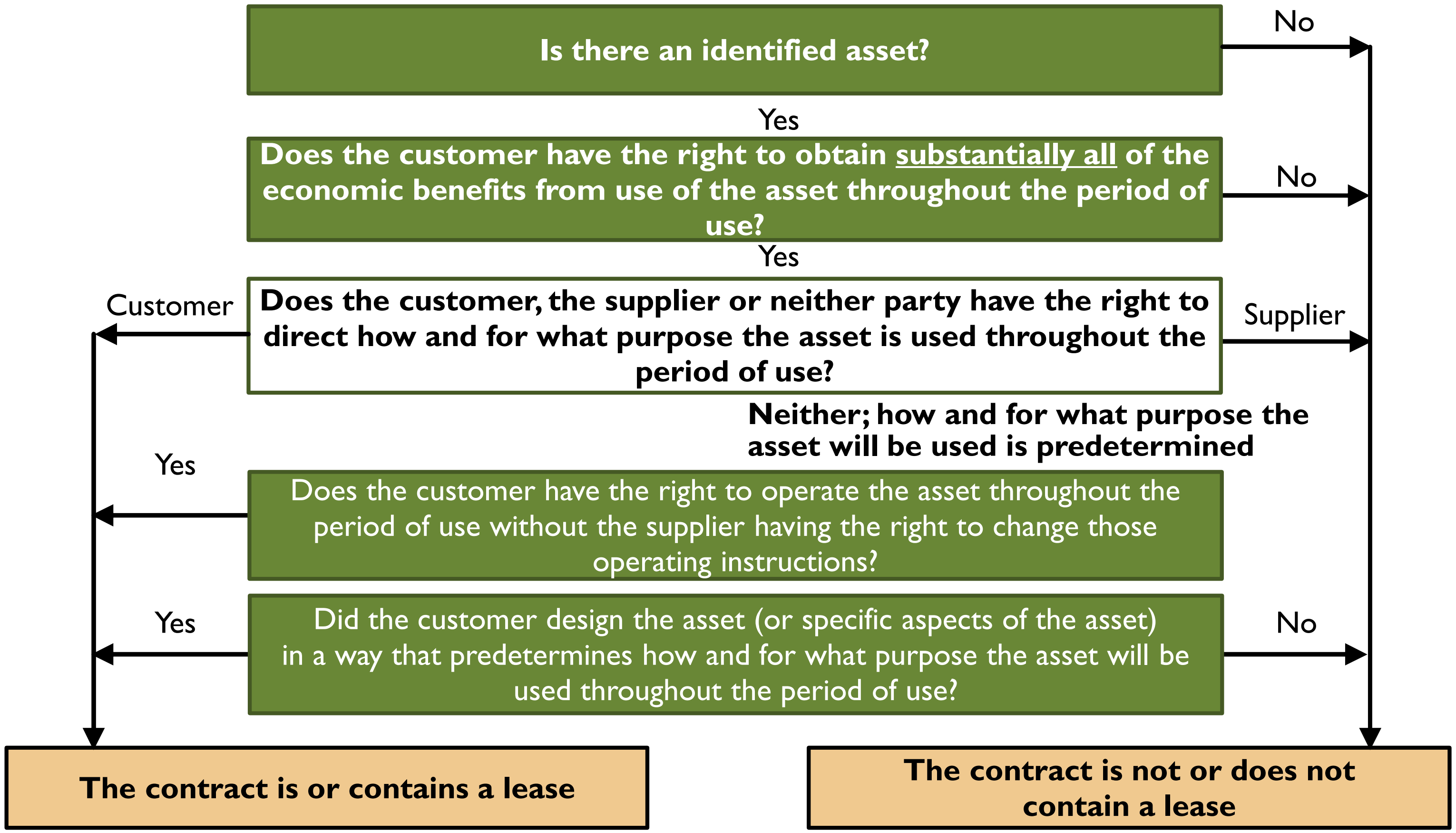

LEASE DEFINITION

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A contract is, or contains, a lease if the contract conveys the <u>right to control</u> the <u>use of an identified asset</u> for a <u>period of time</u> in exchange for consideration.

Leases

- **Identified asset**
  - **Explicitly / implicitly specified**
  - **No substantive rights to substitute**

and

- **Customer has right to control the use**
  - Right to obtain substantially all economic benefits
  - Right to direct the use

RECOGNITION AND MEASUREMENT

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

Balance sheet	Profit and Loss
Asset **= 'Right-of-use' of underlying asset** **Liability** **= Obligation to make lease payments**	**Lease expense** **= Depreciation + Interest**

IMPACT ON FINANCIALS

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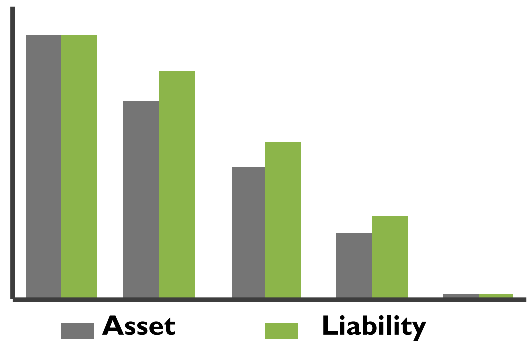
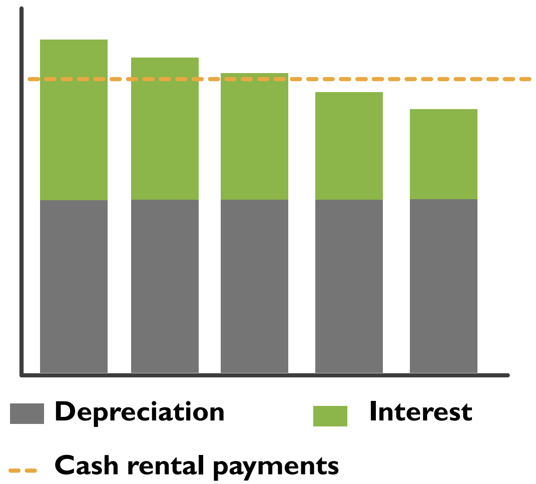
Impact on balance sheet

- **Companies with operating leases will appear to be more asset-rich, but also more heavily indebted**



Impact on statement of profit and loss

- **Total lease expense will be front-loaded even when cash rentals are constant**



IMPACT ON FINANCIALS RATIOS

	Profit/loss	Balance sheet	Ratios
↑	EBITDA	Total assets	Gearing
↓	EPS (in early years)	Net assets	Interest cover Asset turnover

RECOGNITION & MEASUREMENT EXEMPTION

RECOGNITION AND MEASUREMENT EXEMPTION

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Two optional exemptions make the standard easier to apply

Low value assets

- Lessees – can use 'low-value asset' exemption:
  - Not to recognise ROU assets or lease liabilities on the balance sheet.
  - Recognise lease expense on a straight-line basis over the lease term or another systematic basis.
- Standard does not specify the monetary amount,.
- Applies to assets that are not dependent on, or highly interrelated with, other assets
- Can be applied on a lease-by-lease basis.
- Examples of low-value underlying assets can include tablet and personal computers, small items of office furniture and telephones.

Leases of low value items

Short-term leases

- Lessees – can use 'short-term lease' exemption
  - Not to recognise ROU assets or lease liabilities on the balance sheet
  - Recognise lease expense on a straight-line basis over the lease term or another systematic basis.
- Applies to leases with a lease term of 12 months or less
- A lease that contains a purchase option does not qualify.
- To be applied by class of underlying assets.

Short term leases
$\leq$ 12 months

CASE STUDY - SHORT-TERM LEASES

Case study 1:

- An entity that has leased several items of office equipment – some for less than 12 months and some for longer than 12 months, with none containing purchase options. Items of office equipment are all considered to be of the same class.

Can entity avail the short term lease exemptions?

Responses:

- Yes, the entity can use the short-term lease exemption for all of the leases with terms of 12 months or less.

Case study 2:

- A lessee enters into a lease with a nine-month non-cancellable term with an option to extend the lease for four months.
- At the lease commencement lessee is reasonably certain to exercise the extension option because the monthly lease payments during the extension period are significantly below market rates.

Can entity avail all the lease exemptions?

Responses:

- No, The lease term is greater than 12 months i.e. 13 months. Lessee can not account for the lease as a short-term lease.

LESSEE ACCOUNTING – INITIAL MEASUREMENT

INITIAL MEASUREMENT – LEASE LIABILITY

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Initial measurement of lease liability :

- Lease liability shall be recognised at the PV of the outstanding lease payments*.
- Such lease payments shall be discounted using the interest rate implicit in the lease. If that rate cannot be readily determined, the lessee shall use its incremental borrowing rate.

Lease payments

Fixed payments, including in-substance fixed payments, less any lease incentives	Variable lease payments that depend on an index or rate	Payments for penalties for terminating the lease**	Exercise price of a purchase option	Residual value guarantees

- ***Any upfront deposits are not included in the lease payments.**
- ****Include unless reasonably certain that the lessee will not exercise an option to terminate the lease**

CASE STUDY

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1) <u>In substance fixed</u>

Company ABC leases a production line. The lease payments depend on the number of operating hours of the production line - i.e. ABC will pay 1,000 per hour of use. However, the annual minimum payment is 1,000,000.

The expected usage per year is 1,500 hours.

- Payments of 1,000,000 is in-substance fixed payment and hence will be considered as **a part of lease payments.**
- Additional 500,000 that ABC expect to pay are variable payment that do not depend upon index or rate (not part of lease payments). Since the payment is not dependent on any index, **hence not to be included in the lease liability and will be charged to PL.**

2) <u>Variable lease payment not depending on index</u>

Company ABC leases a store. The lease payments for the store amount to 1% of the store's revenues. There is no minimum rental payment.

- Not dependent on index and therefore such payment will be charged to PL.

CASE STUDY

3) **Variable lease payment depending on index**

Company ABC rents an office building. The initial annual rental payment is 2,500,000. The rent will be reviewed every year and increased by the change in the consumer price index (CPI).

- The annual rent payment is dependent on the consumer price index and therefore to be included in lease liability.
- Lessees generally recognise changes to index- and rate-based variable lease payments as an adjustment to the right of use asset and the lease liability in the period of the change.

4) **Residual value guarantee**

Lessee Z has entered into a lease with Lessor L to lease a car. The lease term is 5 years.

Z also agrees on a residual value guarantee – if the fair value of the car at the end of the lease term is below 400, then Z will pay to L an amount equal to the difference between 400 and the fair value of the car.

At inception of the lease, Z expects that the fair value of the car at the end of the lease term will be 300.

- 100 will be included in lease payments when calculating lease liability.

INITIAL MEASUREMENT – ROU

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Lease liability

+

Initial direct costs

+

Estimated costs to dismantle, remove or restore, measured
In accordance with Ind AS 37

+

Prepaid lease payments (eg. Deposit)

−

Lease incentives Received

=

Right-of-use-asset

LESSEE ACCOUNTING – SUBSEQUENT MEASUREMENT

SUBSEQUENT MEASUREMENT – LEASE LIABILITY

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- After initial recognition, the lease liability is increased by any interest on the outstanding liability (the so-called "unwinding of the discount") and decreased by the lease payments made.

For Example

- Lessee X has entered into a contract with Lessor L to lease a building for 7 years.
- The annual lease payments are 500, payable at the end of each year.
- X's incremental borrowing rate is 10%.

Calculate the value of lease liability ?

Response

- The calculated initial recognition of the obligation to make lease payments is ……….
- The carrying amount of the liability at the end of Year 1 is …………(……………….).
- Out of …………..is non current and ………. is current.

SUBSEQUENT MEASUREMENT – ROU

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Measurement basis :

Particulars	Amount
At Costs	XXX
Less : Accumulated Depreciation	XXX
Less : Accumulated Impairment Losses	XXX
WDV of ROU	**XXXX**

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

RE-MEASUREMENT

REASSESSMENT OF LEASE LIABILITY

Lessee re-measures lease liability when there is a change in ...

- the amount expected to be payable under the residual value guarantee changes;
- future lease payments change due to change in an index or rate used to determine the lease payments; or
- the variability of payments is resolved so that they become in-substance fixed payments.

Use unchanged discount rate

- the lease term changes due to change in non cancellable period; or
- the assessment of exercise of a purchase option changes.

Use revised discount rate

- **Any re-measurement of lease liability will be adjusted with the carrying amount of ROU asset.**
- **The ROU asset cant be reduced below zero. Any further adjustment of lease liability will is taken to PL**
- **What if the interest rates are floating?**

CASE STUDY

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Case study:

- A enter into a 7 year lease for office space.
- Lease rent for the first 2 years is 30,000 per annum, payable at the beginning of the each year.
- After 2 years rental will be reassessed using a retail price index, which at present is 126.
- Incremental cost of borrowing is 10%

- On day 1 accounting entry will be:

ROU asset	1,46,053
Lease liability {30,000*5.78 (annuity factor for 7 years)}	1,46,053

- Assume after 2 years the lease liability is 1,04,323 and
- ROU is 1,13,724.

3.7907 (5 year annuity factor @ 10%) *32,000	1,21,305
Lease liability (revised)	1,21,305

- **The lease liability is increased by 32,329 (1,46,053 – 1,13,724), the double entry is debit to ROU.**
- **Adjusted value of ROU 1,36,652 (1,04,323 + 32,329) will now be depreciated over the remaining 5 years.**

LEASE MODIFICATION - LESSEE

LEASE MODIFICATION - LESSEE

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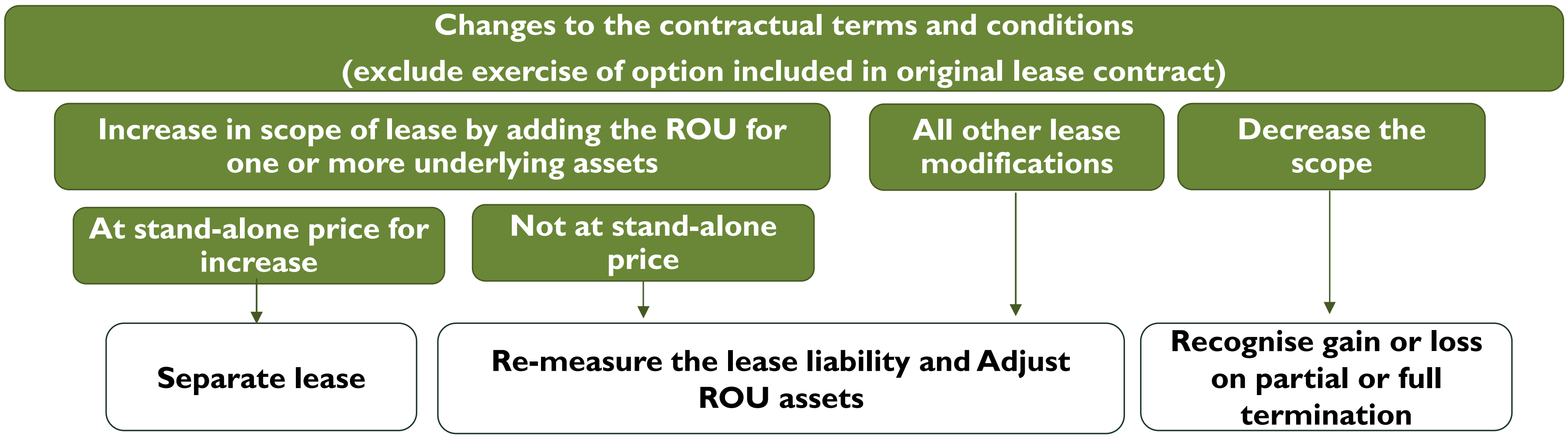
- A lease modification is a <u>change in the scope</u> of a lease, or the consideration for a lease, <u>that was not part of the original terms and conditions</u> of the lease - e.g. adding or terminating the right to use one or more underlying assets.
- Lease modification can result in:
  - A separate lease or
  - Change in the accounting for the existing lease
- A lease modification that grants the lessee the right to use the existing leased asset for an additional period of time does not result in a separate contract.
- Following diagram represents the guidance to account for lease modification for lessee:



EXAMPLE – MODIFICATION – DECREASE IN SCOPE

Original lease :

- A enters into a 10 year lease for 5,000 sq. meters of office space
- Lease payments are 50,000 payable at end of each year.
- Lessee incremental borrowing rate is 6 % and the asset will be depreciated over a period of 10 years.
- **Carrying value of lease liability immediately before the lease modification (beginning of 6th year) is 210,618 and ROU is 184,002**

Modification:

- At the beginning of 6th year lessee and lessor amend the lease to reduce the space to only 2,500 sq. meters. Amended lease rentals are 30,000 from 6th year and there is no change Incr. borrowing rate.
- **The lease liability and ROU are reduced by 50% to reflect the new lease term and the difference will be taken to PL**

Lease liability (210,618 / 2)	105,309
To ROU (184,002 / 2)	92,001
To PL	13,308

- Lessee will re-measure the lease liability for a 5 year remaining lease term which is equal to 126,370
- **The difference in the new liability of 21,062 (126,370 - 105,309) is added to the ROU to reflect the change in the revised discount rates.**

SUB-LEASE
SALE AND LEASE BACK

LESSOR ACCOUNTING – SALE AND LEASE BACK

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- **In a sale-and-leaseback transaction, two transactions are involved :**
  (1) Sale of an asset and
  (2) Leaseback of the same asset to the seller.
- **Accounting treatment are as mentioned below :-**

Particulars	Lessee (seller)	Lessor (buyer)
Transfer is a sale	▪ Derecognise the underlying asset ▪ Apply the lessee accounting model to the leaseback asset. ▪ Measure the ROU asset at the retained portion of the previous carrying amount (i.e. at cost). ▪ Recognise a gain or loss related to the rights transferred to the lessor ▪ Recognise a lease liability	▪ Recognise the underlying asset ▪ Apply the lessor accounting model to the leaseback asset.
Transfer is a not sale	▪ Continue to recognise the underlying asset ▪ Recognise a financial liability under Ind AS 109 for any amount received from the buyer-lessor.	▪ Do not recognise the underlying asset. ▪ Recognise a financial asset under Ind AS 109 for any amount paid to the seller lessee

LESSOR ACCOUNTING – SUB LEASES

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A sub-lease is a transaction in which a lessee (or 'intermediate lessor') grants a right to use the underlying asset to a third party, and the lease (or 'head lease') between the original lessor and lessee remains in effect.

Head lessor

Original lessee or intermediate lessor

↓

Sub - lessee

- An intermediate lessor classifies the sub-lease as a finance lease or as an operating lease with reference to the right-of-use asset arising from the head lease.

- However, if the head lease is a short term lease then intermediate lessor shall classify the sub lease as operating lease.

LESSOR ACCOUNTING

LESSOR ACCOUNTING - OVERVIEW

- Lessor accounting remains similar to current practice.
- Lease classification test is essentially unchanged from Ind AS 17 (5 indicators + 3 additional indicators)

Lease classification test ✓

Finance leases and operating leases ✓

A lessor classifies a lease as either a finance lease or an operating lease, as follows:

Operating lease ← No — Does the lease transfer **substantially all the risks and rewards** incidental to ownership of an underlying asset ? — Yes → Finance lease

- For a lease of land and buildings in which the amount of the land element is immaterial to the lease, a lessor may treat the land and buildings as a single unit.
- Lease classification is reassessed only if there is a lease modification.
- Changes in estimates do not give rise to the reassessment of lease classification.

INDICATORS OF FINANCE LEASE

Following indicators individually or in combination would normally lead to a lease being classified as finance lease, else it would be an operating lease:

- Ownership transfers at end of lease
- Purchase option
- Lease for majority of economic life
- Minimum lease payments
- Specialised nature

Additional indicators for Finance lease:

1) Gains or losses from the fluctuation in the fair value of the residual fall to the lessee
2) Lessee has the ability to continue the lease for a secondary period at a rent that is substantially lower than market rent.
3) Lessee can cancel the lease and Lessor’s losses of cancellation borne by lessee.

AN EXAMPLE – LEASE CLASSIFICATION AND MEASUREMENT

- Entity A transferred a machinery on lease for a period of 3 years (useful life 4 years)
- The fair value of the asset at the date of contract inception is INR 100,000 and the present value of minimum lease payments is INR 90,000. The MLPs are payable (at year end) as INR 37,500 p.a. for 3 yrs.
- The interest rate implicit in the lease is 10%
- Post lease period the asset will be transferred to the lessee
- How would the lease be classified and accounted?

Solution:

- The PV of minimum lease payments amount to more than 90% of the fair value of the asset. Also, ownership of the asset will be transferred to the lessee by the end of the lease term. Hence, the lease shall be classified as a finance lease.
- On the date of commencement of the lease term, the asset would be derecognized and lease receivable would be recorded at the PV of MLPs at the date of inception of the lease (contract date) i.e., at INR 90,000.

LESSOR ACCOUNTING – FINANCE LEASE: LESSOR ACCOUNTING CONCEPTS UNDER FINANCE LEASE

Gross investment in the lease (GIL)

=

Lease payments receivable by a lessor under finance lease

Unguaranteed residual value* accruing to the lessor

Discounted at the interest rate implicit in the lease

Net investment in the lease (NIL)

* **Unguaranteed residual value** is that portion of the residual value of the underlying asset, realisation of which by a lessor is not assured or is guaranteed solely by a party related to the lessor.

LESSOR ACCOUNTING – FINANCE LEASE

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Lessors
❖ Lessor will derecognise the asset
❖ Lessor will recognize the net investment in the lease (Recognizes lease receivables at present value of future lease payments)
❖ Lessor will book interest income on the lease receivable
❖ Lease receivable will be reduced by the amount received. (Payments receipts in subsequent years would be bifurcated into two parts: Interest income and repayment of lease obligations)

OPERATING LEASE

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Lessor
Does not de-recognise Fixed Assets
Every year recognises rental income
If leased assets is land or building or land and building – Ind AS 40 Applies

PRESENTATION

PRESENTATION - LESSEE

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Balance sheet	Income statement	Statement of cash flows
ROU asset:		
► Separately from other assets (e.g. owned assets), or with corresponding underlying assets and disclose line items containing ROU assets	► Depreciation expense (separate from interest expense)	
Lease liability:		
► Separately from other liabilities, or together with other liabilities and disclose line items containing lease liabilities	► Interest expense (separate from depreciation expense)	► Principal payments within financing activities ► Interest payments consistent with policy election in Ind AS 7 ***Statement of Cash Flows*** ► Lease payments for low-value assets, short-term leases and variable lease payments (not included in the lease liability) within operating activities

PRESENTATION - LESSOR

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Balance sheet	Income statement	Statement of cash flows
Operating lease:	**Operating lease:**	**Both lease types:**
- Continue to present the underlying asset.	- Recognise lease income over the lease terms, typically on a straight-line basis. - Expense costs related to underlying asset e.g. depreciation.	- Cash lease payments received presented in accordance with Ind AS 7, generally within operating activities
Finance lease:	**Finance lease:**	
- Derecognize the underlying asset. - Recognise a finance lease receivable (i.e., net investment in the lease – present value of lease payments and unguaranteed residual value)	- Recognize finance income on the receivable based on the effective interest method.	

PRESENTATION IN CASH FLOW STATEMENT

In the statement of cash flows, a lessee shall classify:

(a) cash payments for the principal portion of the lease liability within financing activities;

(b) cash payments for the interest portion of the lease liability within financing activities applying the requirements in Ind AS 7, *Statement of Cash Flows*, for interest paid; and

(c) 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.

CASE STUDY

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Date of transition	:	April 1, 2016
Date of Deposit	:	April 1, 2014
Tenure	:	10 years.
Amount of Deposit given	:	Rs. 10,00,000

The above deposit is refundable.

How would you deal with this deposit on the date of transition ?

IMPACT ON FINANCIALS

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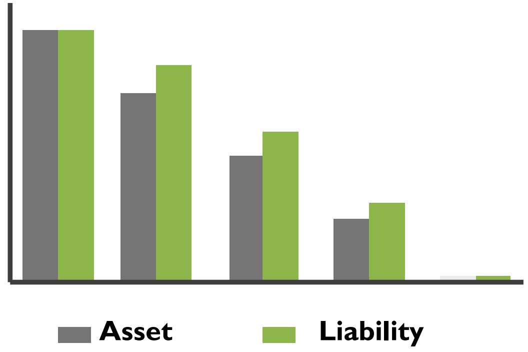
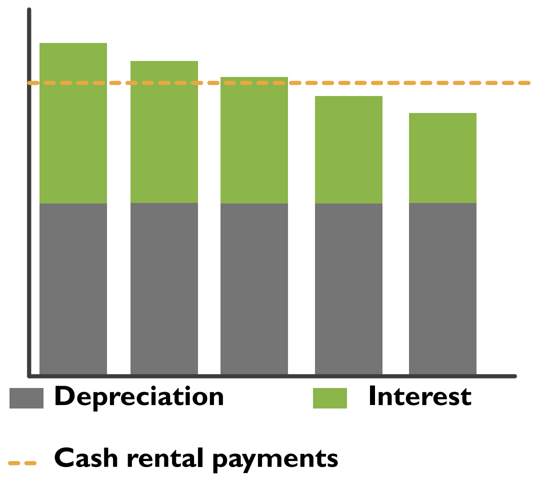
Impact on balance sheet

- Companies with operating leases will appear to be more asset-rich, but also more heavily indebted



Impact on statement of profit and loss

- Total lease expense will be front-loaded even when cash rentals are constant



TRANSITION IMPACT – LESSEE

TRANSITION DATE – RETROSPECTIVE VS MODIFIED APPROACH OPTION

A lessee can choose to apply the standard :

Retrospectively to all accounting periods **OR**

Modified retrospective approach at the date of initial application

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
- Calculate present value of remaining lease payments for existing operating leases using incremental borrowing rate at date of transition
- Choose how to measure 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)

LEASES PREVIOUSLY CLASSIFIED AS FINANCE LEASES

If a lessee elects to apply modified retrospective approach for leases that were classified as finance leases applying Ind AS 17, then :

- the carrying amount of the right-of-use asset and the lease liability at the date of initial application shall be the carrying amount of the lease asset and lease liability immediately before that date measured applying Ind AS 17.

TRANSITION DATE – RETROSPECTIVE VS MODIFIED APPROACH

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Insights

- This is single choice and must be applied to all lease
- Under the modified retrospective approach, lessee chooses on a lease-by-lease basis how to measure the ROU asset on transition i.e. Apply Ind As116 using incremental borrowing rate on initial application or amount equal to the lease liability.

Practical expedients for operating leases

- Apply a single discount rate to a portfolio of leases with reasonably similar characteristics.
- Account for leases for which the lease term ends within 12 months of the date of initial application as short-term leases.
- Exclude initial direct costs from the measurement of the right-of-use asset at the date of initial application.
- Use hindsight, such as in determining the lease term if the contract contains options to extend or terminate the lease.

TRANSITION DATE – RETROSPECTIVE VS MODIFIED APPROACH

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Example

Illustration of the accounting impact on statement of profit and loss under both the approaches over the remaining lease terms:

- Lessee enters into a 20-year lease agreement on **April 01, 2008**.
- The lease requires annual payments of Rs. 60,000 at the end of each year.
- The interest rate implicit in the lease cannot be readily determined.
- The lessee's incremental borrowing rate is 11%.
- **Assume, Company opt for Ind As 116 on April 01, 2016**

Depreciation impact on income statement in both the approaches:

Approach	Depreciation expense	Other factors to be considered
I – Retrospective	2,86,680	• Rate implicit in the lease agreement will be used for discounting. If there is no implicit rate in the agreement then Incremental borrowing rate applicable on the lease start date will be used. • Evaluate and adjust the initial direct cost in ROU asset. • Restate comparative information.
II - Modified Approach		
ROU = Lease liability	2,86,680	• Incremental borrowing rate on the initial application of Ind AS 116 will be used for discounting. • No need to evaluate and adjust the initial direct cost in ROU asset. • No need to restate comparative information. • Any difference between asset and liability, is recognised in opening retained earnings at transition.
ROU = Lease liability	3,89,541	• Incremental borrowing rate on the initial application of Ind AS 116 will be used for discounting. • No need to evaluate and adjust the initial direct cost in ROU asset. • No need to restate comparative information.

TRANSITION IMPACT – LESSOR

LESSOR AND INTERMEDIATE LESSOR

Except in cases of intermediate lessor where the entity lessor it is not required to make any adjustments on transition for leases in which it is a lessor and shall account for those leases applying this Standard from the date of initial application.

An intermediate lessor shall for subleases that were classified as operating leases applying Ind AS 17 but finance leases applying Ind AS 116 , account for the sublease as a new finance lease entered into at the date of initial application.

SALE AND LEASEBACK TRANSACTIONS BEFORE THE DATE OF INITIAL APPLICATION

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- An entity shall not reassess sale and leaseback transactions entered into before the date of initial application to determine whether the transfer of the underlying asset satisfies the requirements in Ind AS 115 to be accounted for as a sale.

- If a sale and leaseback transaction was accounted for as a sale and a finance lease applying Ind AS 17, the seller-lessee shall:
  (a) account for the leaseback in the same way as it accounts for any other finance lease that exists at the date of initial application; and
  (b) continue to amortise any gain on sale over the lease term.

- If a sale and leaseback transaction was accounted for as a sale and operating lease applying Ind AS 17, the seller-lessee shall:
  (a) account for the leaseback in the same way as it accounts for any other operating lease that exists at the date of initial application; and
  (b) adjust the leaseback right-of-use asset for any deferred gains or losses that relate to off-market terms recognised in the balance sheet immediately before the date of initial application.

SALE AND LEASEBACK (ON MARKET TERMS)

Sale and Leaseback:

- An entity shall apply the requirements for determining when a performance obligation is satisfied in Ind AS 115 to determine whether the transfer of an asset is accounted for as a sale of that asset

- If control of an underlying asset passes to the buyer-lessor, the transaction is accounted for as a sale or purchase of the asset and a lease. If not, both the seller-lessee and the buyer-lessor account for the transaction as a financing transaction

Transfer is a sale:

- The lessee measures the ROU arising from the leaseback at the proportion of the previous carrying amount that relates to the right of use retained by the lessee. This is calculated as:

  - Carrying amount x present value of lease payments / fair value

Only the gain / loss on the sale that relates to the rights transferred to the buyer are recognised.

SALE AND LEASEBACK: EXAMPLE

Sale and Leaseback:

On 1st April 02, Co X bought a machine for INR 600,000. The carrying amount of the machine as at 31st March 03 was INR 500,000. On the same date, Co X sold the machine to Co Y for INR 740,000 (fair value). Co X took the machine immediately back on lease for 5 years (remaining useful life), at INR 160,000 per annum (in arrears). The present value of the lease payments is INR 700,000 and the transaction qualifies as sale.

Solution:

Total Gain on Sale: INR 740,000 – INR 500,000 = INR 240,000

Gain relating to rights retained: Gain x PV of lease payment / fair value

= INR 240,000 x 700,000 / 740,000 = INR 227,027

Gain relating to rights transferred: Total Gain – Gain relating to rights retained

= INR 240,000 – INR 227,027 = INR 12,973

SALE AND LEASEBACK (NOT ON MARKET TERMS)

Sale at other than fair value

Any **below-market terms** should be recognised for as a pre-payment of lease payments

Any **above-market terms** are accounted for as additional financing provided by the lessor

Example:

On 1st April 02, Co X bought a machine for INR 800,000. The carrying amount of the machine as at 31st March 03 was INR 600,000. On the same date, Co X sold the machine to Co Y for INR 800,000 (fair value is INR 750,000). Co X took the machine immediately back on lease for 5 years (remaining useful life), at INR 120,000 per annum (in arrears). The present value of the lease payments is INR 526,800 and the transaction qualifies as sale.

Solution:

Additional amount (over and above fair value) = INR 50,000 (financing provided by Lessor)

Right of Use	= Carrying amount x PV of lease payments / fair value
	= INR 600,000 x INR 476,800 / INR 750,000
	= INR 381,440

SALE AND LEASEBACK (NOT ON MARKET TERMS)

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Gain on Sale:

Total Gain = INR 750,000 – INR 600,000 = INR 150,000

Gain relating to rights retained: Gain x PV of lease payments / Fair Value

= INR 150,000 x 476,800 / 750,000

= INR 95,360

Gain relating to rights transferred: Total gain – gain relating to rights retained

= INR 150,000 – INR 95,360 = INR 54,640

Accounting impact:

Dr Bank	INR 800,000	
Dr Right of Use	INR 381,440	
Cr Machine		INR 600,000
Cr Lease Liability(INCL 50000)		INR 526,800
Cr Gain on Sale		INR 54,640

DISCLOSURES

DISCLOSURES - LESSEE

Related to statement of financial position

- Additions to right-of-use assets;
- Year-end carrying amount of right-of-use assets by class of underlying asset;
- Amount of Lease liabilities
- Maturity analysis for lease liabilities.
- If a lessee measures right-of-use assets at revalued amounts applying Ind AS 16, the lessee shall disclose the information required by paragraph 77 of Ind AS 16 for those right-of-use assets

Related to statement of profit & loss and other comprehensive income

- **Depreciation charge** for right-of-use assets by class of underlying asset;
- **Interest expense** on lease liabilities;
- **Expense relating to short-term leases** for which the recognition exemption is applied (leases with a lease term of up to one month can be excluded);
- **Expense of low-value lease items** for which the recognition exemption is applied;
- Expense relating to variable lease payments not included in lease liabilities;
- Income from sub-leasing right-of-use assets;
- Gains or losses arising from sale-and-leaseback transactions.

Related to cash flow statement

- Total cash outflow for leases

DISCLOSURES - LESSOR

For Finance lease

- Reconciliation between the gross investment in the lease at the end of the reporting period, and the present value of MLPs (≤ 1 year, > 1 year and ≤ 5 years, > 5 years)
- Unearned finance income
- Unguaranteed residual values accruing to the benefit of the lessor
- The accumulated allowance for uncollectible minimum lease payments receivable

For Operating leases

- Future minimum lease payments (≤ 1 year, > 1 year and ≤ 5 years, > 5 years)

General Disclosures

- Contingent rents recognised as income in the period.
- A general description of the lessor's material leasing arrangements.

CASE STUDY - 1

ABC Pvt. Ltd. Co. enters into a contract with an airport operator to use some space in the airport to sell its goods from portable kiosks for a three-year period. ABC Pvt. Ltd. Co. owns the portable kiosks. The contract stipulates the amount of space and states that the space may be located at any one of several departure areas within the airport. The airport operator can change the location of the space allocated to ABC Pvt. Ltd. Co. at any time during the period of use, and the costs that the airport operator would incur to do this would be minimal. There are many areas in the airport that are suitable for the portable kiosks.

Required:

Does the contract contain a lease?

ANSWER TO CASE STUDY - 1

The contract does not contain a lease because there is no identified asset.

The contract is for space in the airport, and the airport operator has the practical right to substitute this during the period of use because:

- There are many areas available in the airport that would meet the contract terms, providing the operator with a practical ability to substitute
- The airport operator would benefit economically from substituting the space because there would be minimal cost associated with it. This would allow the operator to make the most effective use of its available space, thus maximizing profits.

CASE STUDY - 2

On 1 January 2018, XYZ Pvt. Ltd. Co. entered into a two year lease for a lorry. The contract contains an option to extend the lease term for a further year. XYZ Pvt. Ltd. Co. believes that it is reasonably certain to exercise this option. Lorries have a useful economic life of ten years.

Lease payments are Rs. 10,000 per year for the initial term and Rs. 15,000 per year for the option period. All payments are due at the end of the year. To obtain the lease, XYZ Pvt. Ltd. Co. incurs initial direct costs of Rs. 3,000. The lessor immediately reimburses Rs. 1,000 of these costs.

The interest rate within the lease is not readily determinable. XYZ Pvt. Ltd. Co. incremental rate of borrowing is 5%.

Required:

Calculate the initial carrying amount of the lease liability and the right-of-use asset and provide the double entries needed to record these amounts in XYZ Pvt. Ltd. Co.'s financial records.

ANSWER TO CASE STUDY - 2

The lease term is three years. This is because the option to extend the lease is reasonably certain to be exercised.

The lease liability calculated as follows:

Date	Cash Flow (Rs.)	Discount Rate	Present Value (Rs.)
31/12/2018	10,000	1/1.05	9,524
31/12/2019	10,000	1/1.05^2	9,070
31/12/2020	15,000	1/1.05^3	12,958
			31,552

ANSWER TO CASE STUDY – 2 (CONTD.)

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The initial cost of the right-of-use asset is calculated as follows:

Particulars	Rs.
Initial liability value	31,552
Direct costs	3,000
Reimbursement	(1,000)
	33,552

The double entries to record this are as follows:

Dr Right-of-use asset	Rs. 31,552	
Cr Lease liability		Rs. 31,552
Dr Right-of-use asset	Rs. 3,000	
Cr Cash		Rs. 3,000
Dr Cash	Rs. 1,000	
Cr Right-of-use asset		Rs. 1,000

CASE STUDY - 3

Ind AS Course
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On 1 January 2018 PQR Pvt. Ltd. Co. entered into a contract to lease a crane for three years. The lessor agrees to maintain the crane during the three year period. The total contract cost is Rs. 180,000. PQR Pvt. Ltd. Co. must pay Rs. 60,000 each year with the payments commencing on 31 December 2018. PQR Pvt. Ltd. Co. accounts for non-lease components separately from leases.

If contracted separately it has been determined that the standalone price for the lease of the crane is Rs. 160,000 and the standalone price for the maintenance services is Rs. 40,000.

PQR Pvt. Ltd. Co. can borrow at a rate of 5% a year.

Required:

Explain how the above will be accounted for by PQR Pvt. Ltd. Co. in the year ended 31 December 2018.

ANSWER TO CASE STUDY - 3

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Allocation of payments

The annual payments of Rs. 60,000 should be allocated between the lease and non-lease components of the contract based on their standalone selling prices:

Lease of Crane: (Rs. 160/[Rs. 160 + Rs. 40]) x Rs. 60,000 = Rs. 48,000

Maintenance (Rs. 40/[Rs. 160 + Rs. 40]) x Rs. 60,000 = Rs. 12,000

Lease of Crane

The lease liability is calculated as the present value of the lease payments, as follows:

Date	Cash flow (Rs.)	Discount rate	Present value (Rs.)
31/12/18	48,000	1/1.05	45,714
31/12/19	48,000	1/1.05^2	43,537
31/12/20	48,000	1/1.05^3	41,464
Total Value			130,715

ANSWER TO CASE STUDY – 3 (CONTD.)

There are no direct costs so the right-of-use asset is recognised at the same amount:

Dr Right-of-use asset	Rs. 130,715	
Cr Lease liability		Rs. 130,715

Interest of Rs. 6,536 (W1) is charged on the lease liability.

Dr Finance costs (P/L)	Rs. 6,536	
Cr Lease liability		Rs. 6,536

The cash payment reduces the liability.

Dr Lease liability	Rs. 48,000	
Cr Cash		Rs. 48,000

ANSWER TO CASE STUDY – 3 (CONTD.)

The liability has a carrying amount of Rs. 89,251 at the reporting date.

The right-of-use asset is depreciated over the three year lease term. This gives a charge of Rs. 43,572 (Rs. 130,715/3 years).

Dr Depreciation (P/L) Rs. 43,572

Cr Right-of-use asset Rs. 43,572

The carrying amount of the right-of-use asset will be reduced to Rs. 87,143 (Rs. 130,715 - Rs. 43,572).

(W1) Lease liability table

Year-ended	Opening Rs.	Interest (5%) Rs.	Payments Rs.	Closing Rs.
31/12/18	1,30,715	6,536	(48,000)	89,251

ANSWER TO CASE STUDY – 3 (CONTD.)

Ind AS Course
ICAI

Maintenance

The cost of one year's maintenance will be expensed to profit or loss:

Dr P/L	Rs. 12,000	
Cr Cash		Rs. 12,000

CASE STUDY - 4

MNO Pvt. Ltd. Co. hires out industrial plant on long-term operating leases. On 1 January 2018, it entered into a seven-year lease on a mobile crane. The terms of the lease are Rs. 175,000 payable on 1 January 2018, followed by six rentals of Rs. 70,000 payable on 1 January 2019 — 2027. The crane will be returned to MNO Pvt. Ltd. Co. on 31 December 2027. The crane originally cost Rs. 880,000 and has a 25-year useful life with no residual value.

Required:

Discuss the accounting treatment of the above in the year ended 31 December 2018.

ANSWER TO CASE STUDY - 4

MNO Pvt. Ltd. holds the crane in its statement of financial position and depreciates it over its useful life. The annual depreciation charge is Rs. 35,200 (Rs. 880,000/25 years).

Rental income must be recognised in profit or loss on a straight line basis.

Total lease receipts are Rs. 595,000 (Rs. 175,000 + (Rs. 70,000 x 6 years)). Annual rental income is therefore Rs. 85,000 (Rs. 595,000/7 years). The statement of financial position includes a liability for deferred income of Rs. 90,000 (Rs. 175,000 — Rs. 85,000).

CASE STUDY - 5

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January 2018, A Pvt. Ltd. Co. sells an item of machinery to B Pvt. Ltd. Co. for its fair value of Rs. 3,00,000. The asset had a carrying amount of Rs. 1,20,000 prior to the sale. This sale represents the satisfaction of a performance obligation, in accordance with Ind AS 115 Revenue from Contracts with Customers. A Pvt. Ltd. Co. enters into a contract with B Pvt. Ltd. Co. for the right to use the asset for the next five years. Annual payments of Rs. 50,000 are due at the end of each year. The interest rate implicit in the lease is 10%.

The present value of the annual lease payments is Rs. 1,90,000. The remaining useful economic life of the machine is much greater than the lease term.

Required:

Explain how the transaction will be accounted for on 1 January 2018 by both A Pvt. Ltd. Co. and B Pvt. Ltd. Co.

ANSWER TO CASE STUDY - 5

A Pvt. Ltd.

A Pvt. Ltd. must remove the carrying amount of the machine from its statement of financial position. It should instead recognise a right-of-use asset. This right-of-use asset will be measured as the proportion of the previous carrying amount that relates to the rights retained by A Pvt. Ltd.:

(1,90,000/3,00,000) x Rs. 1,20,000 = Rs. 76,000. The entry required is as follows:

Dr Cash	Rs. 3,00,000	
Dr Right-of-use asset	Rs. 76,000	
Cr Machine		Rs. 1,20,000
Cr Lease liability		Rs. 1,90,000
Cr Profit or loss (bal. fig.)		Rs. 66,000

ANSWER TO CASE STUDY – 5 (CONTD.)

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Note: The gain in profit or loss is the proportion of the over Rs. 1,80,000 million gain on disposal (Rs. 3,00,000 — Rs. 1,20,000) that relates to the rights transferred to Collage. This can be calculated as follows:

((3,00,000 —1,90,000)/3,00,000) x Rs. 1,80,000 = Rs. 66,000.

The right of use asset and the lease liability will then be accounted for using normal lessee accounting rules.

B Pvt. Ltd.

B Pvt. Ltd. will post the following:

Dr Machine	Rs. 3,00,000	
Cr Cash		Rs. 3,00,000

Normal lessor accounting rules apply. The lease is an operating lease because the present value of the lease payments is not substantially the same as the asset's fair value, and the lease term is not for the majority of the asset's useful life. B Pvt. Ltd. will record rental income in profit or loss on a straight line basis.

CASE STUDY - 6

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On 1 January 2018, M Ltd. sells an item of machinery to C Ltd. for Rs. 3,00,000. Its fair value was Rs. 2,80,000. The asset had a carrying amount of Rs. 1,20,000 prior to the sale. This sale represents the satisfaction of performance obligation, in accordance with Ind AS 115 Revenue from Contracts with Customers.

M Ltd. enters into a contract with C Ltd. for the right to use the asset for the next five years. Annual payments of Rs. 50,000 are due at the end of each year. The interest rate implicit in the lease is 10%. The present value of the annual lease payments is Rs. 1,90,000.

Required:

Explain how the transaction will be accounted for on 1 January 2018 by both M Ltd. and C Ltd.

ANSWER TO CASE STUDY - 6

The excess sales proceeds are Rs. 20,000 (Rs. 3,00,000 — Rs. 2,80,000). This is treated as additional financing.

The present value of the lease payments was Rs. 1,90,000. It is assumed that Rs. 20,000 relates to the additional financing that M Ltd. has been given. The remaining Rs. 1,70,000 relates to the lease.

M Ltd.

M Ltd. must remove the carrying amount of the machine from its statement of financial position. It should instead recognise a right-of-use asset. This right-of-use asset will be measured as the proportion of the previous carrying amount that relates to the rights retained by M Ltd.:

(1,70,000/2,80,000) x Rs. 1,20,000 = Rs. 0.73 Lakhs

ANSWER TO CASE STUDY – 6 (CONTD.)

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The entry required is as follows:

Dr Cash	Rs. 3,00,000
Dr Right-of-use asset	Rs. 73,000
Cr Machine	Rs. 1,20,000
Cr Lease liability	Rs. 1,70,000
Cr Financial liability	Rs. 20,000
Cr Profit or loss (bal. fig.)	Rs. 63,000

Note: The gain in profit or loss is the proportion of the overall Rs. 1,60,000 gain on disposal (Rs. 2,80,000 — Rs. 1,20,000) that relates to the rights transferred to C Ltd. This can be calculated as follows:

((2,80,000 — 1,70,000)/2,80,000) x Rs. 1,60,000 = Rs. 0.63 Lakhs .

The right of use asset and the lease liability will then be accounted for using normal lessee accounting rules. The financial liability is accounted for in accordance with Ind AS 109 Financial Instruments.

ANSWER TO CASE STUDY – 6 (CONTD.)

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C Ltd.

C Ltd. will post the following:

Dr Machine	Rs. 2,80,000
Dr Financial asset	Rs. 20,000
Cr Cash	Rs. 3,00,000

It will then account for the lease using normal lessor accounting rules.

Note

The payments/receipts will be allocated between the lease and the additional finance. This is based on the proportion of the total present value of the payments that they represent:

- The payment/receipt allocated to the lease will be Rs. 447,368 ((1.7/1.9) x Rs. 500,000).
- The payment/receipt allocated to the additional finance will be Rs. 52,632 ((0.2/1.9) x Rs. 500,000).

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Thank You

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