



**Ind AS Implementation Committee
The Institute of Chartered Accountants of India**

Ind AS - 17

Leases

**By:-
CA Jatin Aggarwal**

“The material/presentation is prepared for use in educational programmes conducted by the Institute of Chartered Accountants of India. The views expressed herein do not necessarily represent the views of the Council of the Institute or any of its Committees.”

Agenda

- ❑ Objectives
- ❑ Scope and Key Definitions
- ❑ Classification
- ❑ Measurement
- ❑ Disclosures
- ❑ Sale and Leaseback Transactions
- ❑ Key Differences

Objectives

Objective of IAS 17 is to prescribe, for lessees and lessors, the appropriate accounting policies and disclosure to apply in relation to leases.

Scope

Out of scope for recognition

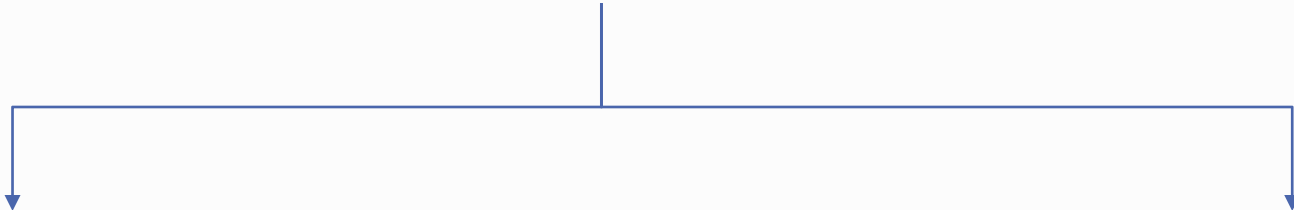
- Leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources
- Licensing agreements for such items as motion picture films, video recordings, plays, manuscripts, patents and copyrights

Out of scope for measurement

- Property held by lessees that is accounted for as investment property (see Ind AS 40 Investment Property)
- Investment property provided by lessors under operating leases (see Ind AS 40)
- Biological assets held by lessees under finance leases (see Ind AS 41 Agriculture)
- Biological assets provided by lessors under operating leases (see Ind AS 41)

Definitions

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**.



```
graph TD; A[ ] --- B[Finance lease]; A --- C[Operating lease];
```

Finance lease

A **finance lease** is a lease that transfers substantially all the risks and rewards incidental to ownership of an asset. Title may or may not eventually be transferred.

Operating lease

An **operating lease** is a lease other than a finance lease.

Classification of leases

Overriding Principle

Substance over form

Key Question

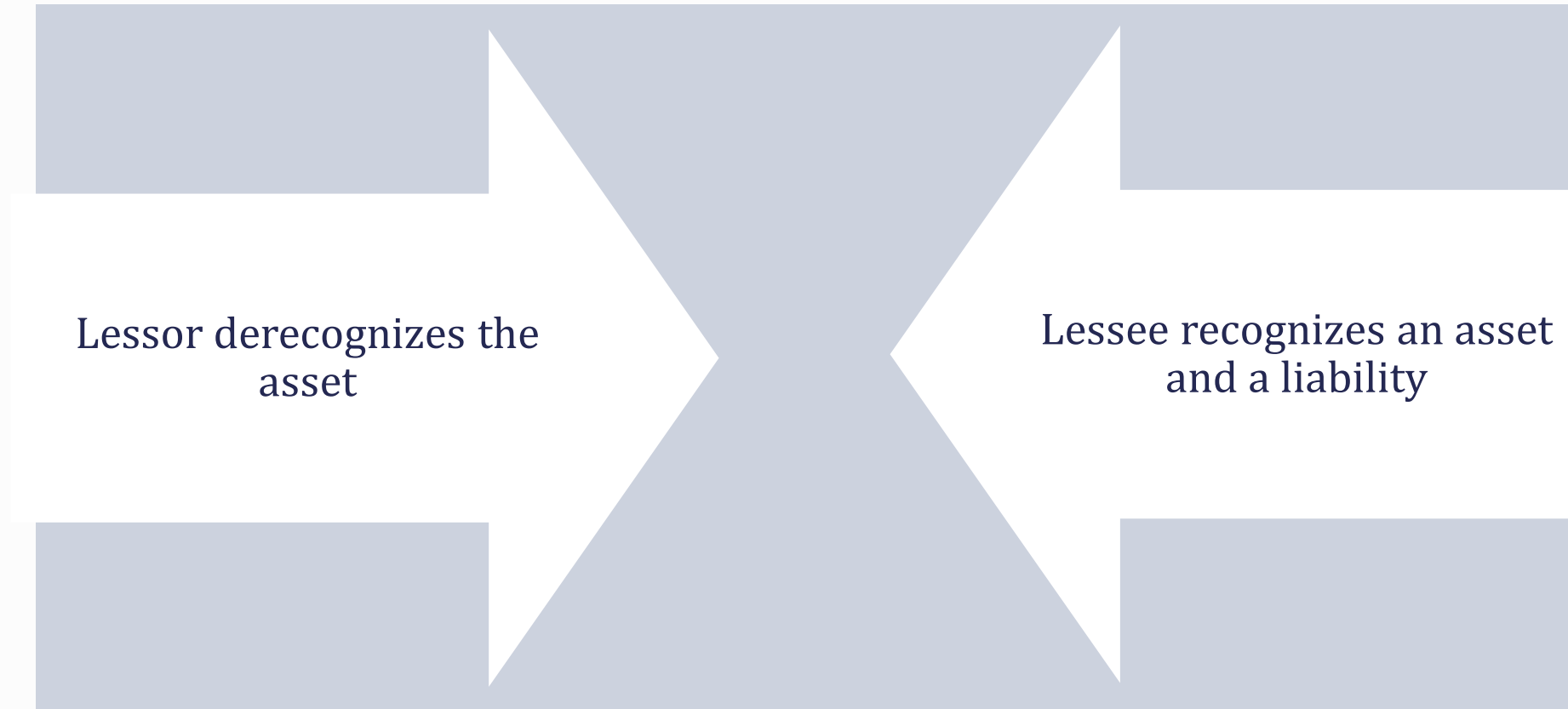
Have substantially all risks and rewards of ownership of the leased asset been transferred to the lessee?

Timing of Classification

At the inception of the lease

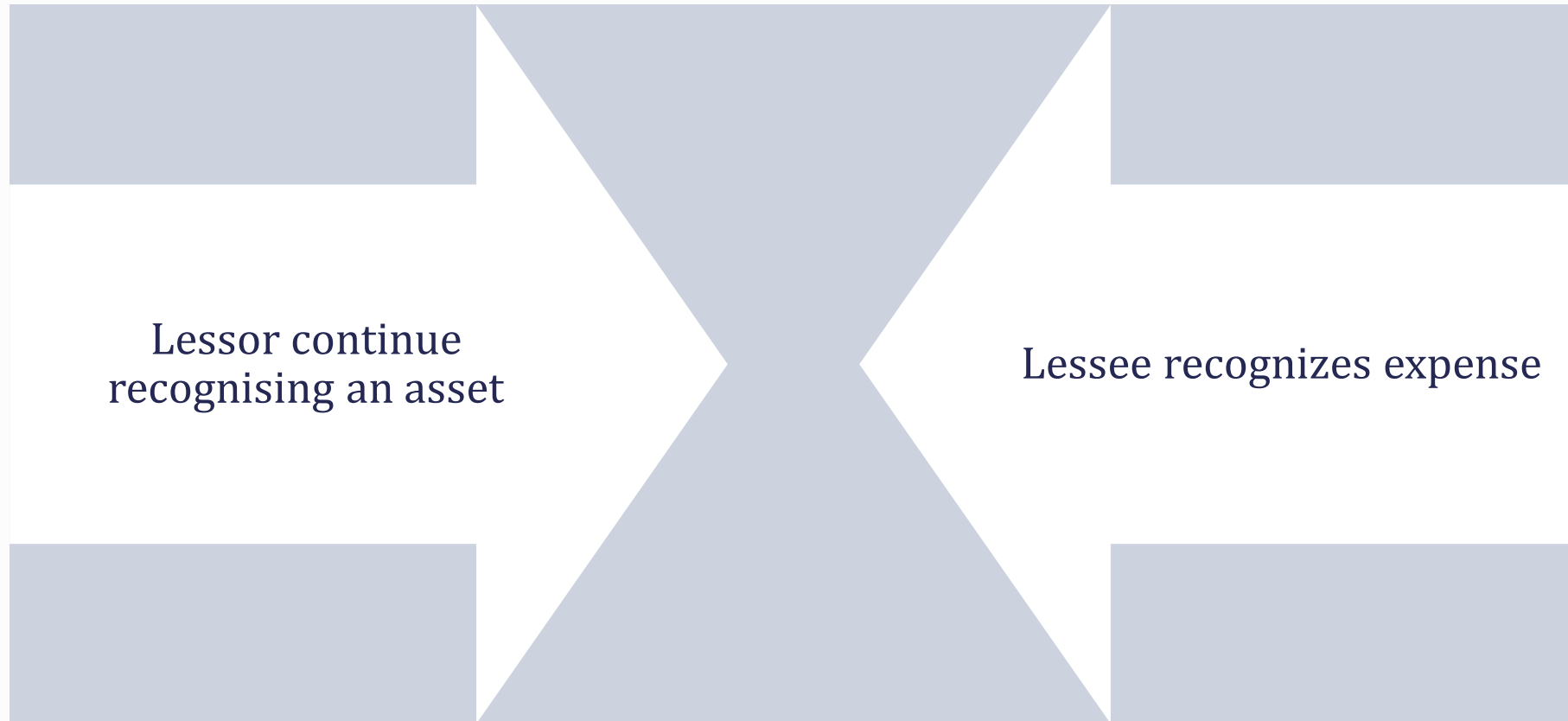
Finance lease

A lease that transfers substantially all the risks and rewards incidental to ownership of an asset.



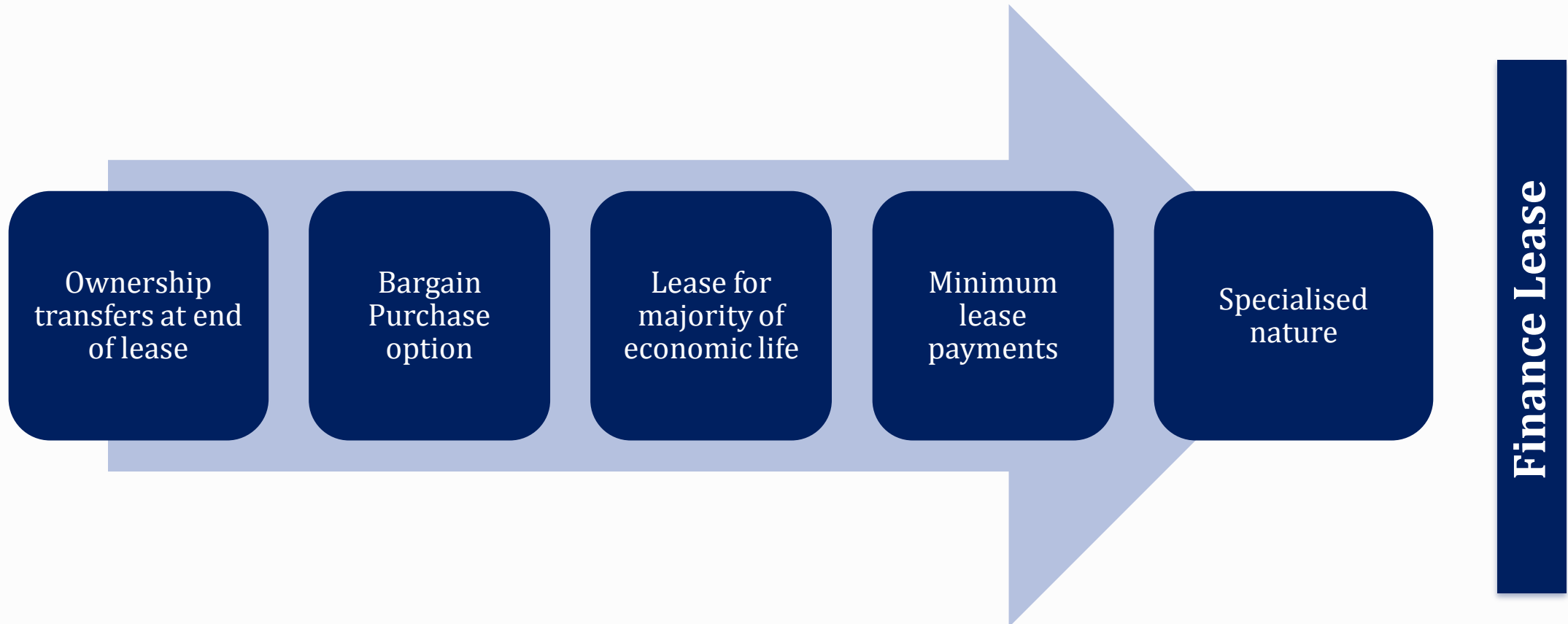
Operating lease

The risks and rewards incidental to ownership of an asset are not transferred.



Indicators of finance or operating 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:



Additional indicators of finance lease

Following are additional indicators which individually or in combination could lead to a lease being classified as finance lease, else it could be an operating lease:

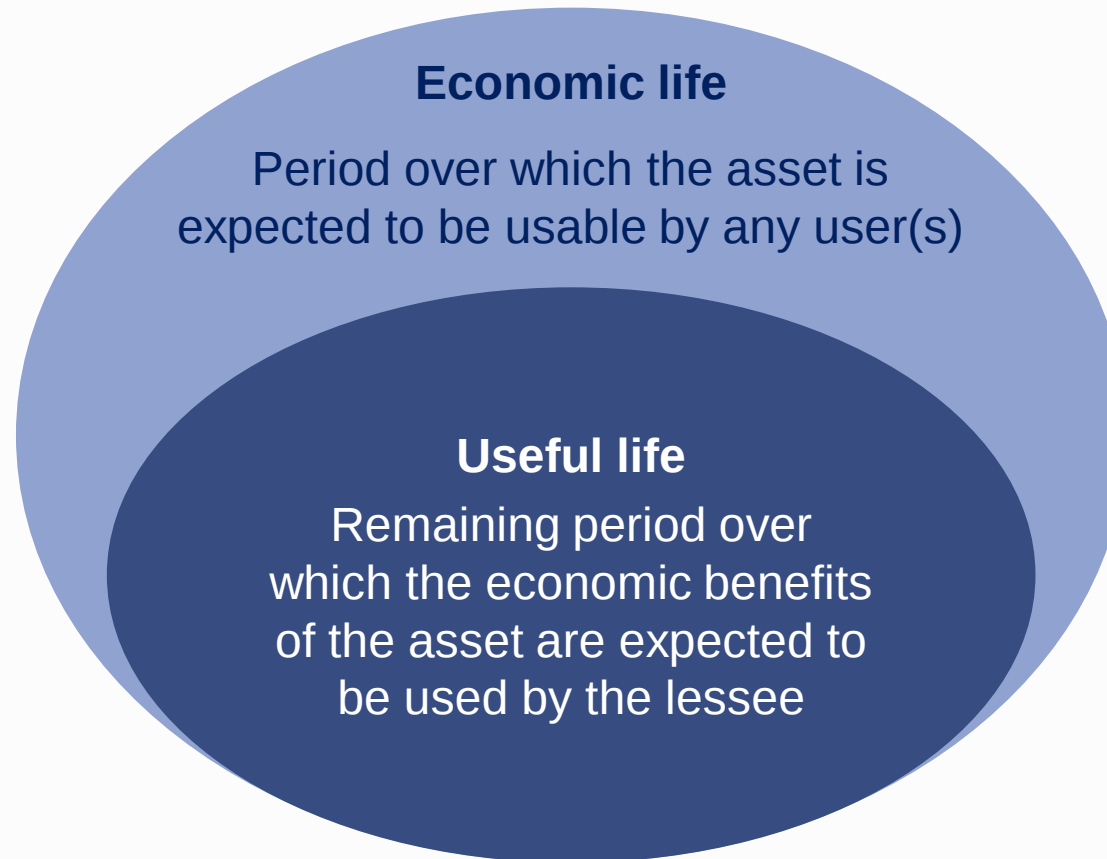
Lessor's cancellation losses borne by lessee

Changes in fair value of residual
borne by lessee

Bargain lease renewal option

Economic versus useful life

Lease for majority of economic life?



Minimum lease payments

MLP are the payments over the lease term that the lessee is or can be required to make

Include

- ☐ Non-cancellable lease payments
- ☐ Lease payments under bargain renewal option
- ☐ Purchase option if reasonable certainty of exercise
- ☐ **Guaranteed residual value**

For a lessee,
any amounts guaranteed by the lessee or by a party related to the lessee;

Exclude

- ☐ Cost for services
- ☐ Taxes if paid by and reimbursed to the lessor
- ☐ Contingent rent

For a lessor,
any residual value guaranteed to the lessor by: (i) the lessee; (ii) a party related to the lessee; or (iii) a third party unrelated to the lessor that is financially capable of discharging the obligations under the guarantee.

Minimum lease payments – Case study

A , a bank, leases an asset as follows:

<i>Lessee</i>	<i>Terms</i>	<i>Comments</i>
B	5 years in arrears at \$10,000 pa	A manufacturing company
C	Year 6 and 8 in arrears at \$8,000 pa	A subsidiary of B
D	Year 9 and 10 in arrears at \$5,000 pa	An unrelated company

The scrap value at year 10 is estimated at \$2,000.

Which flows should be included in:

- (a) the lessee's minimum lease payments
- (b) the lessor's minimum lease payments?

Minimum lease payments – Case study

<i>Time</i>	<i>Lessee's</i>	<i>Lessor's</i>
1-5	10,000	10,000
6-8	8,000	8,000
9-10	5,000	5,000
10	2,000	2,000

Discount rates for calculating PV of MLP

Lessor

Interest rate implicit in the lease

Lessee

Interest rate implicit in the lease

(If not possible to determine)
Incremental borrowing rate of interest

An example – classification of lease

ABC Ltd. entered into a finance lease on July 1, 2015. The terms of the lease were six payments of \$200 payable annually in arrears. The cash price of the asset was \$870.

The interest rate implicit in the lease is 10%.

- ☐ Show the interest allocation
- ☐ Show how the lease would be carried in the financial statements of ABC Ltd. As at June 30, 2016.

INTEREST ALLOCATION

Total Finance Charge:

Rentals	(6*\$200)	\$1200
---------	-----------	--------

Cash price of the asset	<u>\$(870)</u>
-------------------------	----------------

	<u>\$330</u>
--	--------------

An example – classification of lease

Allocation of Interest

Period	Amount owed at the start of the period	Interest @10%	Rental	Amount owed at the end of the period
1	870	87	(200)	757
2	757	76	(200)	633
3	633	63	(200)	496
4	496	50	(200)	346
5	346	35	(200)	181
6	181	19	(200)	0
		330		

Example

Holly entered into a finance lease on 1 July 2015. The terms of the lease were six payments of \$200 payable annually in advance. The cash price of the asset was \$870.

The interest rate implicit in the lease is 15%.

Required:

Show the interest allocation using the actuarial method.

Solution

a) Interest allocation

W1 Total finance charge

Rentals (6 × \$200)	\$ 1,200
Cash price of the asset	<u>(870)</u>
	330

W2 Allocation of interest – Actuarial method

Period	Amount owed at the start of the period	Rental	Interest @ 15%	Amount owed at the end of the period
1	870	(200) = 670	101	771
2	771	(200) = 571	86	657
3	657	(200) = 457	69	526
4	526	(200) = 326	49	375
5	375	(200) = 175	25	200
6	200	(200) = 0	<u>330</u>	

Example

Ivy leased an asset to Holly under a finance lease arrangement on 1 July 2015. The terms of the lease were six payments of \$200 payable annually in arrears. The cash price of the asset was \$870.

The interest rate implicit in the lease is 10%.

Required:

Show how the transaction would be accounted for in Ivy's financial statements for the year ended 30 June 2016.

Solution

Sale of asset

As the transaction is a finance lease the physical asset should be derecognized through a sale transaction, with any profit or loss on sale included in profit or loss for the period.

A receivable asset should be recognized instead of the physical asset sold; the receivable recognized at lease inception would be based on the cash price of the asset, \$870.

Annual rent

The \$200 rent needs to be split into the interest element and the repayment of capital. In this example the interest income for year ended 30 June 2016 would be \$87 (see previous example) and the receivable would be reduced to \$757.

Classification of real estate leases

Land and buildings elements should be considered separately:

- ❑ **Land:** Usually operating lease (indefinite economic life), unless title passes by the end of the lease term
- ❑ **Buildings:** Apply criteria as described

Minimum lease payments are allocated to land and buildings based on relative fair values of leasehold interests in land and buildings elements

If reliable allocation is not possible, **treat both as finance lease** unless it is clear that **both elements are operating leases**.

Operating lease

- ☐ Rentals are charged to the statement of profit and loss on a systematic basis over the period of the lease
- ☐ No balances appear in the balance sheet other than accruals and prepayments on rented rather than owned assets

Note :- As per Ind AS 17 straight-lining not allowed where the escalation of lease rentals is in line with general inflation

Operating lease

	Lessee	Lessor
Statement of Profit and Loss	❑ Straight-line lease rentals expense over the lease term unless another systematic basis is more representative	❑ Depreciation expense ❑ Lease rental income on a straight-line basis unless another basis is more representative
Balance sheet	❑ Prepaid/accrued lease rental payable	❑ Leased asset ❑ Accrued/deferred lease rental receivable

Straight-lining not allowed where the escalation of lease rentals is in line with general inflation

An example – operating lease

Under a lease agreement ABC Ltd. pays a non returnable deposit of \$100,000 and then three years rental of \$100,000 pa on the first day of each year. The asset has a life of 6 years.

Calculate the charge to the statement of profit or loss each year and any balance in the Balance sheet at the end of the first year.

Statement of Profit and Loss

(\$100,000) + (\$300,000) = \$ 133,333

3 years

Balance Sheet

At the end of first year	= \$ 200,000	paid
	<u>\$ (133,333)</u>	charged
	<u>\$ 66,667</u>	prepayment

Example

Under a lease agreement Cartright receives a non-returnable deposit of \$100,000 and then three years rental income of \$100,000 paid on the first day of each year. The asset has a life of 10 years.

Required:

Calculate the credit to the statement of profit or loss each year and any balance in the statement of financial position at the end of the first year.

Solution

Statement of profit or loss

$$((\$100,000) + (\$300,000)) / 3 \text{ years} = \$133,333$$

Statement of financial position

At end of 1st year	\$	
	200,000	received
	(133,333)	credited

	66,667	unearned income

Finance lease

	Lessee	Lessor
Balance sheet	❑ Leased asset ❑ Includes direct costs ❑ Liability (offset by subsequent MLPs) Initially at lower of fair value or PV of minimum lease payments	❑ Receivable (At net investment in the lease, which is the gross investment in the lease discounted at the interest rate implicit in the lease)
Income statement	❑ Depreciation ❑ Finance expense (portion of MLPs) ❑ Contingent rents shall be expensed	❑ Profit on sale ❑ Finance income

An example – classification of lease

Entity A acquires a transferable land-use right by making a single upfront payment of \$160, with the intention of holding it to earn rentals and for capital appreciation. The lease term is 150 years. At the end of the reporting period, the fair value of the long-term land-use right is \$165. The entity assesses the classification of the lease in accordance with Ind AS 17 Leases and determines it is a finance lease.

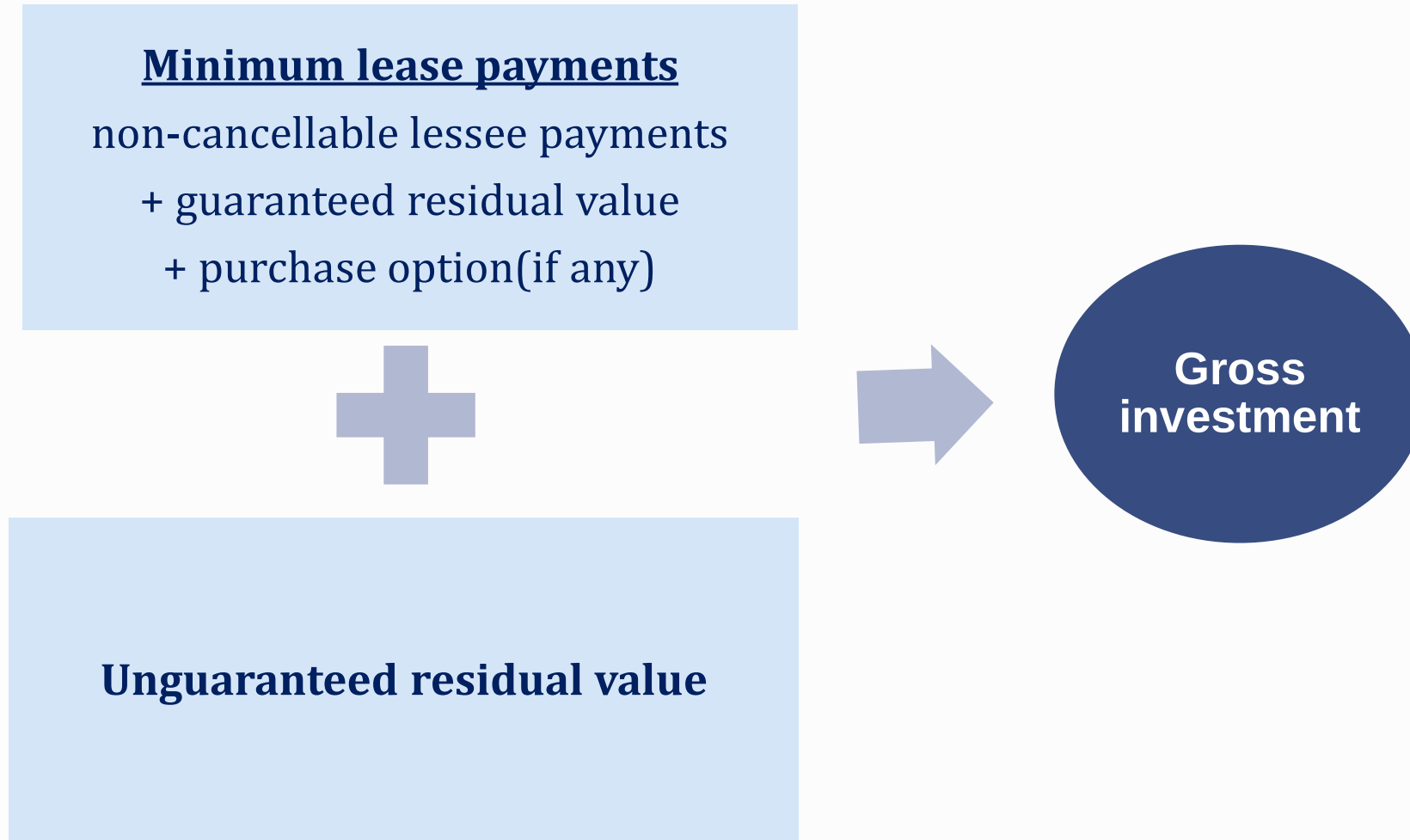
Solution:

Entity A has determined the lease is a finance lease.

It is recognised in the financial statements as a leased asset under a finance lease that is initially measured at the fair value of the leased property, or if lower, the present value of the minimum lease payments

In this scenario this means the leased asset is measured \$160. Subsequently, it is depreciated over 150 years and measured at its cost less any accumulated depreciation and any accumulated impairment in accordance with Ind AS 17

Understanding the balance sheet terminology for lessors



Understanding the balance sheet amounts for lessors



Unearned finance income:

Calculate as difference between gross investment and net investment

(net investment = PV of minimum lease payments + unguaranteed residual value, discounted using the interest rate implicit in lease)

Finance lease – important considerations

Lessee:

- ☐ Initially records leased asset and corresponding liability at lower of:
 - ☐ PV of minimum lease payments, and
 - ☐ Fair value

- ☐ Depreciates asset over the shorter of:
 - ☐ Lease term, or
 - ☐ Useful life

Unless reasonable certainty that lessee will obtain ownership by the end of the lease term.

Lessee / Lessor:

- ☐ Finance income or expense is calculated using effective interest rate method (using rate implicit in lease)

An example – lease classification and measurement

Entity A takes 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 93,257. 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?

An example – lease classification and measurement (cont.)

- ❑ 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 and liability would be recorded at the lower of the fair value/ PV of MLPs at the date of inception of the lease (contract date) i.e., at INR 93,257.
- ❑ The asset would be depreciated over a period of 4 years and the lease payments would be offset between finance charge and outstanding liability.

An example – lease classification and measurement (cont.)

Classification as finance lease (Year 1)

Statement of profit and loss	'000
Depreciation of machinery (assuming no residual value)	(22.5)
Finance charge (90,000 *10%)	(9)

An example – lease classification and measurement (cont.)

Classification as finance lease (Year 1)

Balance Sheet

Tangible non-current assets

Property (90-22.5)	67.5
--------------------	------

Non-current liabilities:

Deferred lease liability (90-(40-9))	(59)
--------------------------------------	------

(MLP split between finance charge and outstanding liability)

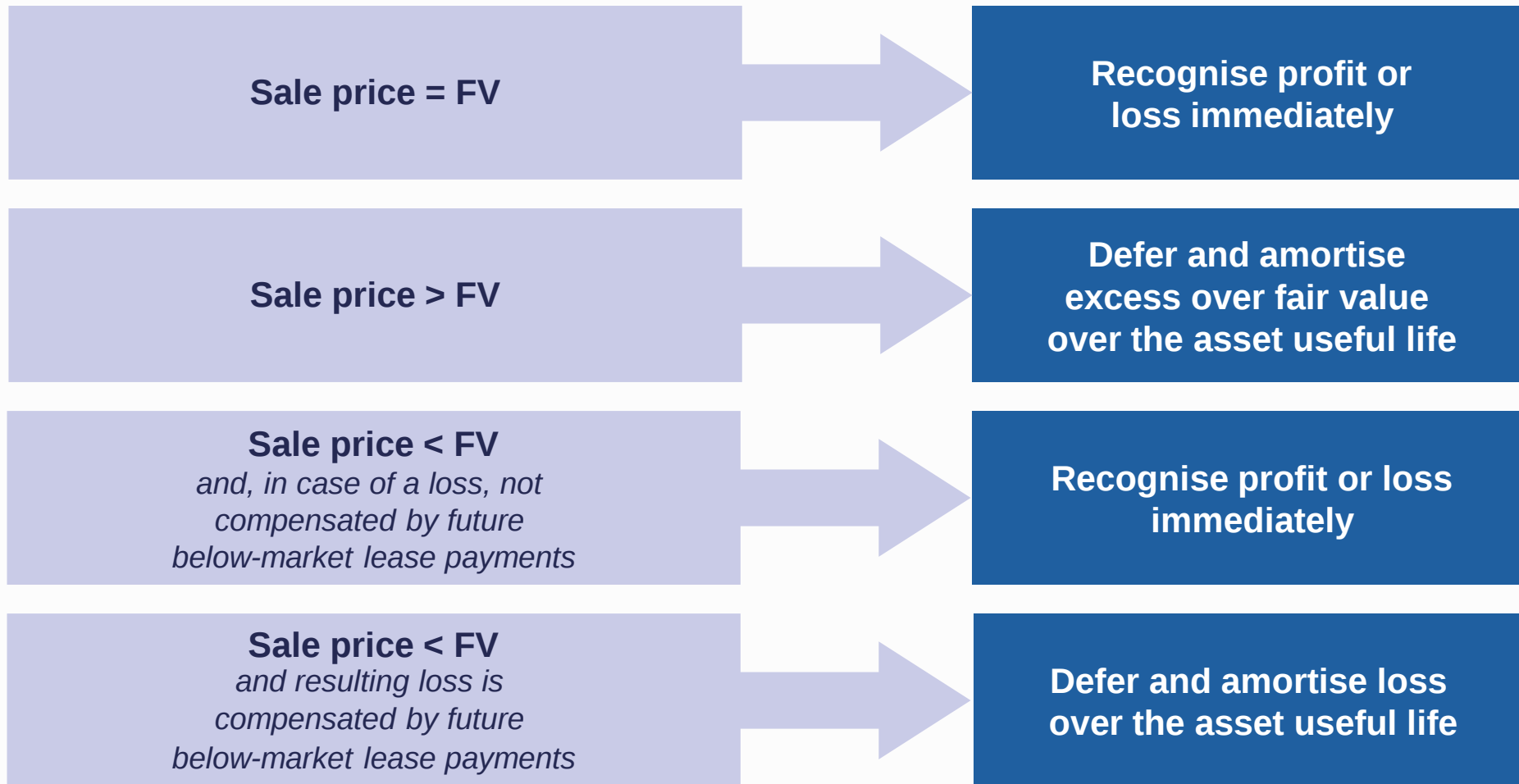
Balance sheet impact – summary

	Operating Lease	Finance Lease
Lessee	Off balance sheet	Leased asset Lease liability (PV of minimum lease payments)
Lessor	Leased asset	Lease receivable (PV of gross investment)

Sale and leaseback transactions

- ☐ Sale and leaseback involves:
 - ☐ Sale of an asset
 - ☐ Leaseback of the same asset to the seller.
- ☐ Leaseback can be classified as:
 - ☐ Finance; or
 - ☐ Operating

Operating leaseback



Example

Friends has an asset with a carrying amount of \$70,000. The fair value is \$100,000. It would like to enter into a sale and operating leaseback agreement and it has been offered the following from three different banks.

	Sale price	Annual rental for 5 years
(a)	\$100,000	\$28,000
(b)	\$120,000	\$28,000
(c)	\$80,000	\$20,000 (i.e. below market price)
(d)	As (c) but assuming that the carrying amount was \$95,000.	

Required:

Record the transaction in each case. Assuming the transaction occurs at the start of Year 1 show the effect on profit or loss for Year 1 of the transaction in each case.

Solution

Operating leaseback

Sale at fair value (\$100,000)

Recording of transaction

	\$	\$
Dr Cash	100,000	
Cr Asset		70,000
Cr Profit or loss		30,000

Effect on profit or loss in year 1

	\$
Profit on disposal	30,000
Rental	(28,000)
	<u>2,000</u>

Solution

Operating leaseback

Sale (\$120,000) > fair value

Recording of transaction

	\$	\$
Dr Cash	1,20,000	
Cr Asset		70,000
Cr Profit or loss		30,000
Cr Deferred income		20,000

Effect on profit or loss in year 1

	\$
Profit on disposal	
-immediate	30,000
-deferred (20,000 / 5)	4,000
Rental	(28000)

	6,000

Solution

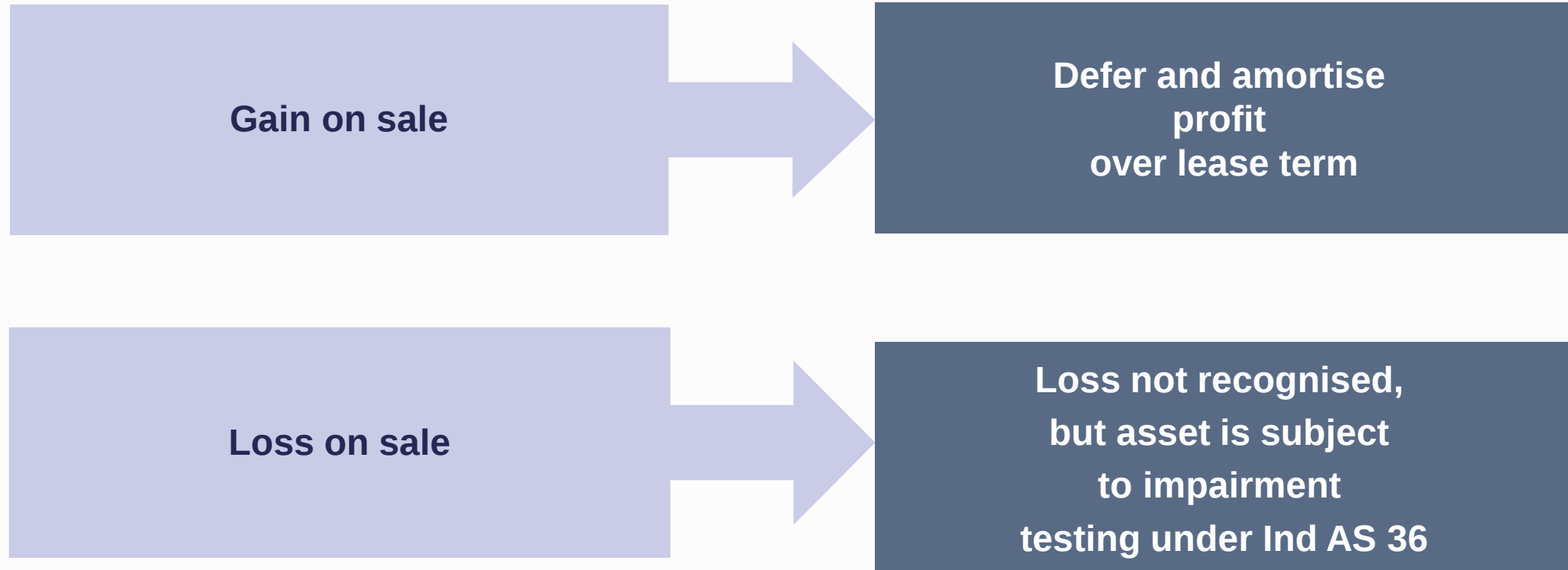
Sale (\$80,000) < fair value with profit on sale

Recording of transaction			Effect on profit or loss in year 1	
	\$	\$		\$
Dr Cash	80,000		Profit on disposal	10,000
Cr Asset		70,000	Rental	(20,000)
Cr Profit or loss		10,000		<u>(10,000)</u>

Sale < fair value (\$80,000) with loss on sale and future rentals at < market price

Recording of transaction			Effect on profit or loss in year 1	
	\$	\$		\$
Dr Cash	80,000		Deferred loss (15000 / 5)	(3,000)
Dr Deferred loss	15,000		Rental	(20,000)
Cr Asset		95,000		<u>(23,000)</u>

Finance leaseback



Case study

ABC Ltd. disposes of an asset by way of a finance lease. The carrying amount is \$70,000, the sale proceeds are at fair value of \$120,000 and the useful life is five years. There are five annual rentals of \$28,000.

Required:

Set out the journal entries on disposal and calculate the total profit effect of the lease each year, assuming the allocation of finance charges and depreciation on a straight line basis

Case study - solution

Journal entries on disposal:

	Dr.	Cr.
Cash	120,000	
Non current asset		70,000
Deferred profit		50,000
Non-current asset	120,000	
Lease creditor		120,000

Case study - solution

Statement of profit or loss		(\$)
Depreciation	$(120,000/5)$	24,000
Interest	$\frac{(5 \times 28,000) - (120,000)}{5}$	4,000
Release of deferred profit	$(50,000/5)$	(10,000)
		<u>18,000</u>

Disclosures

By lessees- finance lease

- ▶ For each class of asset, the net carrying amount at the end of the reporting period
- ▶ Reconciliation between the total of future minimum lease payments at the end of the reporting period, and their present value (≤ 1 year, > 1 year and ≤ 5 years, > 5 years)
- ▶ Contingent rents recognised as an expense in the period

By lessees- operating lease

- ▶ Future minimum lease payments (≤ 1 year, > 1 year and ≤ 5 years, > 5 years)
- ▶ Lease and sublease payments recognised as an expense in the period, with separate amounts for minimum lease payments, contingent rents, and sublease payments

Disclosures

By lessees- general

- ▶ Description of significant leasing arrangements
- ▶ The total of future minimum sublease payments expected to be received under non-cancellable subleases at the end of the reporting period

Disclosures

By Lessors- 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
- ❑ The unguaranteed residual values accruing to the benefit of the lessor
- ❑ The accumulated allowance for uncollectible minimum lease payments receivable

By Lessors- operating leases

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

Disclosures

By Lessors- general

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

Key differences

Issue	IAS 17	Ind AS 17
Lease rentals in line with expected general inflation	Straight-lining of lease rentals will apply.	No straight-lining of lease rentals if the payments to the lessor are structured to increase in line with expected general inflation to compensate for the lessor's expected inflationary cost increases.

Key differences

Issue	IAS 17	Indian GAAP
Finance Leases- Initial direct costs for lessors	For other than manufacturer/ dealer lessors, initial direct costs are included in measurement of finance lease receivable and reduce the amount of income recognized over lease term.	For other than manufacturer/ dealer lessors, initial direct costs are either recognised as expense immediately in the statement of profit and loss or allocated against finance income over the lease term.

Key differences

Issue	IAS 17	Indian GAAP
Operating leases- Initial direct costs for lessors	Added to carrying amount of leased asset and recognised as expense over the lease term on the same basis as lease income	Either deferred or allocated to income over the lease term in proportion to the recognition of lease income or recognised as expense in the statement of profit and loss in the period in which incurred
Operating leases- incentives	Recognized as a reduction of lease income and expense by the lessors and lessees, respectively, over the lease term on a straight-line basis unless another basis is more appropriate	No specific guidance

Thank You

CA Jatin Aggarwal

Email - ca.jatin132@gmail.com

Mobile - +91 9811708064

“The material/presentation is prepared for use in educational programmes conducted by the Institute of Chartered Accountants of India. The views expressed herein do not necessarily represent the views of the Council of the Institute or any of its Committees.”