IND AS 116 Leases

(Proposed to be applicable from 1.4.2019)

21 Feb 2019

BAUVA & Co. Chartered Accountants

IND AS 116 Overview

- Standard is proposed to be effective from annual periods beginning on or after 1 April 2019 (MCA notification is pending).
- The proposed standard for lessee eliminates the accounting difference between an operating lease and an finance lease.
- Lessee's with operating leases will have a major impact in accounting under the proposed standard.
- For lessor the accounting and classification is done based on existing operating/finance lease model.

Definitions

Lease

- Identified asset.
- Lessee obtains substantially all of the economic benefits.
- Lessee directs the use.

If all the above conditions are fulfilled the Contract will classify as lease.

Lessee Accounting

Initial Recognition

- A Lessee will recognise assets and liabilities for all leases for a term of more than 12 months, unless the underlying asset is of low value.
- A Lessee is required to recognise a right of use asset representing its right to use the underlying leased asset and a lease liability representing its obligations to make lease payments.
- A lessee will measure right-of-use assets similarly to other non-financial assets (such as property, plant and equipment) and lease liabilities similarly to other financial liabilities.
- A lessee will recognise depreciation of the right-of-use asset and interest on the lease liability (as per IND AS 17 the same was classified as rent in case of operating lease on a straight-line basis).
- A Lessee will recognise interest cost as finance cost.

Lessee Accounting (contd..)

Initial Recognition (contd..)

- Lease liability = Present value of lease rentals + present value of expected payments at the end of lease. The lease liability will be amortised using the effective interest rate method.
- Lease term = non-cancellable period + renewable period if lessee reasonably certain to exercise.
- Right to use asset = Lease liability + lease payments (advance)- lease incentives to be received if any initial + initial direct costs + cost of dismantling/ restoring etc. The asset will be depreciated as per IND AS 16 Property plant and equipment.

Case study

- Rent of Rs. 10 lakhs per annum.
- Discount rate – 7%.
- Lease tenure – 5 years.

* We have ignored other conditions for ease of understanding.

Case Study

- Right of use asset will be recognised at Rs. 41,00,197 (Present value of 5 installments of Rs 10 lakhs each) and will be depreciated over a period of 5 years.
- Lease liability Computation is as below:

Year	Opening	Interest	Payment	Closing
1	41,00,200	2,87,014	(10,00,000)	33,87,214
2	33,87,214	2,37,105	(10,00,000)	26,24,319
3	26,24,319	1,83,702	(10,00,000)	18,08,021
4	18,08,021	1,26,561	(10,00,000)	9,34,582
5	9,34,582	65,418	(10,00,000)	-

Case Study

- Impact on Profit & Loss as per Old and Proposed accounting standard.

As per IND AS 116				As per IND AS 17	Difference
Year	Depreciation	Interest	Total	Amount	Amount
1	8,20,040	2,87,014	11,07,054	10,00,000	(1,07,054)
2	8,20,040	2,37,105	10,57,145	10,00,000	(57,145)
3	8,20,040	1,83,702	10,03,742	10,00,000	(3,742)
4	8,20,040	1,26,561	9,46,601	10,00,000	53,399
5	8,20,040	65,418	8,85,458	10,00,000	1,14,542

- On account of change in Accounting standard, the impact on profit & loss is higher in the initial years and in the later years there is a gain.

Disclosures

Proposed Ind AS 116 has additional disclosures, few of them are listed below:

Balance sheet:

- Right of use asset
- Lease liability

Profit & Loss:

- Finance cost (Interest)
- Depreciation

Cash Flow:

- Financing activity – Lease liability

Potential impact areas

Depending on the agreements and case to case basis following contacts may have an impact on account of proposed Ind AS 116:

- Property leases
- Printer leases
- Parking leases
- Car/Vehicle leases
- Airline sector – Operating lease for aircraft and engines etc.

Transition to IND AS 116

On Transition to IND AS 116 following two options are available :

- retrospectively to each prior reporting period presented applying IND AS 8 i.e. 1 April 2018.
- retrospectively with the cumulative effect of initially applying the standard on application date i.e. 1 April 2019.

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