Ind AS-116 → Leases

Accounting Principles | Application Guidelines

ICAI has merged above two in its module

Key changes incorporated by Ind AS 116:

→ Scrapped off the concept of Operating & finance Lease.
→ Applicable for Statutory Audits for the year ended 31.03.2020.
→ Significantly changes the "Lessee" Accounting

OBJECTIVE:- Set out principles for recognition, measurement, p & d of leases.

This standard to be applied to all the "contracts" & all the relevant facts & circumstances are to be the consideration.

Scope: All leases & Subleases except

- Leases to explore for or use of NON REGENERATIVE Resources.
- Leases of Biological Assets
- Service concession agreements.
- Licensing of IPR
- Rights held by Lessee under licensing agreements within scope of Ind AS 38 for films, videos, plays etc.

★ Recognition exemptions:

- SHORT TERM LEASES
- LOW VALUE ASSETS.

- If recognition exemptions are opted, lease payments are to be recorded as an EXPENSE
    - either on straight line basis. or
    - another systematic basis.

Short term Leases:
↳ a lease that
↳ at the commencement date
↳ has a lease term of 12 months or less (P)
↳ does not include an option of purchasing the asset.

• Exemption to be availed for a (CLASS OF UNDERLYING ASSETS.)

Low Value Assets:
↳ Conditions for treating an asset as a low value asset

Lessee can benefit from the asset either on its own or with other readily available resources	(P) The underlying asset is not highly dependent or related with other asset.

• ~~Exan~~ Exemption of low value assets can be made on lease to lease basis.

- Low value assets are exempted even if they are material to the assessee.
- Assessment of low value assets is not dependent upon size, nature & circumstances of lessee.
- Assessment to be done on the basis of the value of new asset.

What is a $\boxed{\text{LEASE?}}$

↓

A contract that conveys

RIGHT TO CONTROL	THE USE OF AN IDENTIFIED ASSET	FOR A PERIOD OF TIME	IN EXCH. OF CONSIDE-RATION

CONTRACT + Relevant facts & Circumstances.

Ind AS 116 to be Applied to assess whether it is a Lease.

Assessment to be done at the inception date 'or' Earlier:

- Date of Agreement
- Date of commitment by the parties to the principle terms & conditions of lease

LEASE

RIGHT TO CONTROL

Entity should, throughout the period of use, have

① The right to obtain substantially all the economic benefits from the use of identified asset

Economic benefits may be direct/indirect.

- If there are such terms in a contract that defines the scope of use of asset, it does not, in itself, prevent the customer from ①
- If the customer has to pay some portion of output to the supplier it also will not prevent ①

② The right to direct the use of asset

- Decision reg "how & for what purpose asset will be used"

Ⓐ

Contⁿ to a page next to next page

Ⓐ THROUGOUT THE PERIOD OF USE

Strict interpretation

IDENTIFIED ASSET.

- Asset explicitly/implicitly specified in the contract
- Asset is physically distinct.

may be entire asset/portion of asset

not identified asset if not physically distinct unless it represents substantially all the capacity of asset thereby providing the customer ability to get substantially all benefits.

- Supplier must not have Substantive Substitution Rights over the asset. Right to substitute is substantive when

Supplier has a PRACTICAL ABILITY TO substitute the asset + He would BENEFIT ECONOMICALLY BY DOING SO

• The absense of SSR gives the customer the control of the asset.

• Entity shall evaluate SSR on the basis of facts & circumstances on the inception of contract & shall not consider future events that are not likely to occur.

• Entity should presume that the right of substitution is not substansive if customer cannot readily determine the SSR.

(A)

⇒ Relevant decisions to assess the right to direct the use of asset, this is because such rights determine the economic benefits

Decisions reg. where & when the asset can be used are not that relevant.

For eg. outsourcing of operations does not prevent right to direct the use of asset.

(Para B24–B30) Right to Direct the Use

Customer has right to direct how & for what purpose asset can be used

If it has power to change how & for what purpose asset is used throughout the period

OR

These decisions are predetermined & 1) customer has right to operate the asset or 2) asset is designed as per customer specifications.

Consider decision making rights that are most relevant for changing how & for what purpose asset is used

Decisions are relevant when they affect the economic benefits.

· Standard provides examples of such relevant decisions.

Protective Rights:

↳ Does not in itself prevent the customer from having the right to direct the use of asset.

Seperation of Lease & Non Lease Components:

Lease components

The right to use of an asset is considered as a seperate lease component only if

The lessee can benefit from the asset either on its own or ~~fro~~ with resources readily available with him

AND

The underlying asset is niether highly dependent on, nor highly interrelated with the other underlying assets.

If the above criteria are not met, the right to use of multiple assets shall be considered as a SINGLE LEASE COMPONENT.

Seperation'

CONTRACT

Lease
service
purchase

=> ONLY ITEMS THAT CONTRIBUTE TO SECURE THE OUTPUT OF ASSET CAN BE CONSIDERED AS Lease Components.

Other components are seperated & accounted seperately.

Contract:

Lease	xx	→ Ind AS 116
Service	xx	→ Ind AS 115
	xxx	
GST	xx	
Total.	xxx	

ALLOCATE

- Payments for
  - maintainance
  - materials
  - operations

not termed as a lease components

Practical Expedient:

Determining & Allocating Consideration

Lessor

Apply Para 73-90 of Ind AS 115.

Lessee

- Allocate the consideration in the contract to the Lease & Non Lease components on Relative Stand Alone Price Basis.
- Lessees are required to use the prices at which a customer would purch. the component seperately & if such price is not available, entity needs to estimate such price.

Combination of Contracts:

- 2 or more contracts
- entered into at or near the same time
- with same counterparty
- to be considered as a single contract if

The contracts are negotiated as a package with a commercial objective that CANNOT be understood w/o combining

OR

The amount of consideration to be paid depends upon the price/performance of other contract

OR

The right to use the underlying assets conveyed in the contracts are a single lease component

Portfolio Application:

Where there are large number of leases of similiar assets where lease by lease application becomes practically tough, Ind AS 116 permits portfolio application.

Condition:

The entity should reasonably expect that the effects on the financial statements would not materially differ had the application was done on lease to lease basis.

Inception Date :: Agreement
Commitment

Commencement Date

↳ the date on which the lessor makes an underlying asset
↳ available for use

If commencement date is before the inception date., the lease term is deemed to be commenced even if no rent is to be paid.

Lease Term:

- Non Cancellable Period +
- Period covered by option to extend if the ~~lessee~~ is reasonably certain that it will exercise the option +
- Period covered by option to terminate the lease if the lessee is reasonable certain that it will not exercise the option.

- Assessment to be done on the commencement date.
- Detailed discussion in module.

• Lease term begins at the commencement date.

Cancellable Leases:

Lease Term → Non cancellable term → Apply Defn of CONTRACT

To determine for what period the contract is enforcable.

An arrangement is not enforceable if

Both the parties have right to terminate w/o permission of each other & with no more than an insignificant penalty.

Right to terminate.

Lessor → Option to terminate → NON CANCELLABLE PERIOD.

Lessee → Option to terminate → Assess the option

⇒ Reassessment of Lease term & Purchase option

· Lessees are required to monitor the leases for significant changes that can change the lease term

Reassessment

↓ If

Significant event/change

- that is within the control of lessee.
- & that affects the certainity to exercise/not to exercise renewal/termi-nation/purch.

Examples: (Pg 7.99 of module)

* Changes in market based factors that are not under control of the lessee does not, in itself, trigger a reassessment.

"LEASE PAYMENTS"

→ Payments made by lessee relating to the right to use the Asset

- Fixed Payments (-) Incentives ① +
- Variable Lease payments that depends upon any index or rate +
- the exercise price of option to extend +
- Amounts expected to be paid under Residual Value Guarantees (Lessee)
- Penalties for termination

Exclusion from Lease payments:

Lease payments allocated to Non Lease Components unless the Lessee combines the components & treat as a single contract.

&

Variable payments that do not depend upon any index or rate

① FIXED PAYMENTS:

→ Either a fixed amount paid at fixed intervals [₹10,000 for 3 years annually]
→ or payments that change over time [₹10,000 in 1st year, ₹15000 in 2nd year & so on]

"In substance" fixed payments:
→ Payments that are in form variable but in substance unavoidable. [Pg 7.102 contains examples]

Incentives: [Evaluate the Nature of Incentive & Determine whether it is an Asset]

Payments made by Lessor → Lessee

↓

Reimbursement | Discount | Assumption of cost of Lessee

Lessee

↓

Deductible from Lease payments & reduce initial measurement of ROU Asset

Lessor

↓

Deducted from Lease payments & if

- Finance Lease → Reduce the Net Investment
- Operating Lease → Reduce the Lease Income over the lease term

Variable Lease Payments: [That Depend upon an Index or Rate]

→ Payments that vary because of changes in facts & circumstances occuring after the commencement date.
→ for eg., payments linked to consumer price index (CPI) or such other indices, interest benchmarks like LIBOR/MIBOR (London Interbank Offer Rate).

→ Such payments are INCLUDED in the lease payments & measured using the prevailing rates)
[Refer Illustration 23 (Pg 7.105) for clarity]

→ If a lease contract stipulates such payments, it becomes "unavoidable" & they also do not depend upon future activity of Lessee" & hence it meets the defn of Lease Liability

Lease payments that do not depend upon index or rate:

- Variable lease payments that are not substance as fixed.
  for eg., payments based on performance, usage or results of the asset
- These are NOT INCLUDED in the lease payments & recognised in P&L.
  [Refer example 25]

→ Residual Value Guarantees:

- Lessee
  - ~~RG~~ RVG
    - Payable by LESSEE only
- Lessor
  - RVG that may be paid by
    - Lessee
    - Party related to Lessee
    - Other person

Lease Payments

- Fixed & In substance fixed
  - Fixed in nature & accrue over Period
- Variable
  - Depend upon any index or rate
    - Include
  - Does not depend upon any index or rate
    - Exclude
- Exercise price (Option) &/or penalties (Termination)
  - Exercise price
    - Include
  - Termination penalty
    - Exclude
  - Only if entity is reasonably certain
- RGVs
  - Include

Diversity and inclusion matters