Ind AS 116- LEASES

Part 1: Meaning of Leases	
Part 2: Lease inception date and Lease commencement date - meaning and relevance	
Part 3: Lease accounting in lessee books	
1	Initial accounting
	- Measurement of Lease liabillity
	- Measurement of ROU asset Qn
2	Subsequent measurement
	- Lease liability
	- Lease amortisation schedule (Payments at end of year or at beg of year)
	- ROU asset
3	Basic terms
	- Meaning of future lease payments Qn Qn
	- Meaning of lease term
	- Meaning of discount rate
4	Lease remeasurement
	- Change of estimates (index, GRV, etc.)
	- Change of reasonable certainty of exercising option (PO/ RO/ TO) Qn
5	Lease modification
	- Case A: Increase in scope with increase of rentals in line with market rent
	- Case B: Decrease of scope Qn
	- Case C: Any others Qn
	- What if decrease of lease term? Qn
6	Leases in foreign currency Qn
Part 4: Lease accounting in LESSOR books	
7	Classification of operating lease or finance lease
8	Financial lease accounting Qn Qn
9	Financial lease accounting - Mfr or dealor Qn
10	Operating lease accounting
Part 5: Others	
9	Recognition exemption
10	Sublease
	- in the books of ultimate lessor
	- in the books of ultimate lessee
	- in the books of intermediate lessor
11	Sale and leaseback
	- Sales price = Fair value Qn
	- Sales price > Fair value Qn
	- Sales price < Fair value Qn
12	Identification of lease contract
13	Separating lease and non lease components Qn
14	Separating multiple lease components
15	Treatment of initial direct costs

Priority of identifying arrear/adv

→ specified in Qn
→ Hint
→ Arrears

Ind AS 116: Leases

$$\text{Lessor} \xrightarrow{\text{Right of Use}} \text{Lessee}$$
$$\text{Lessor} \xleftarrow{\text{consideration}} \text{Lessee}$$

Lessor: Provides Right of Use

Lessee: obtains Right of Use

1) Lease
- Contract
- that conveys - Right of Use
- Identified asset
- Specified period of time
- in exch. of consideration.

2)

LEASE DATE	
LEASE INCEPTION DATE	**LEASE COMMENCEMENT DATE**
Earliar of: ☞ Date when contract is signed; or ☞ Date when parties commit to terms and conditions of lease.	☞ Date when the asset is made available to the lessee.
This is the date when it is assessed whether the contract is/ contains a Lease	This is the date when Lessee and Lessor starts accounting for the lease.

lease

lessee

Single lease accounting model

ROU Asset Dr
To Lease Liability

lessor

Operating lease

Recognise Rent income in PL over LT

Finance lease

lease Rec. Dr
To Asset
To Gain/loss on FL

LEASE TERM

LID LCD

Non-Cancellable period
+ RD/EO - if lessee is RC
+ TO - if Lessee is RC not to terminate

Assessment of REASONABLY CERTAINTY (RC)

At Lease commencement date, an entity is required to assess reasonably certainty of exercising / not exercising extension or termination option based on the factor that exercising the option creates an economic incentive or not for lessee.

Examples:

Location of underlying asset	Substantial costs incurred on leasehold improvements	Lease rentals in optional periods.

Re-assessment of REASONABLY CERTAINTY

Subsequent to lease commencement date, an entity is required to re-assess reasonable certainty of exercising/ not exercising extension or termination option. Changes in reasonable certainty will lead to changes in lease term and then lease re-measurement.

Termination option

Suppose the term of the contract is 10 years and the non-cancellable / lock in period is 6 years. The lease term shall be as follows:

	if for next 4 years:	
Termination option is with **LESSOR** only	Termination option is with **LESSEE** only	Termination option is with **BOTH**
Even after 6th year, lessee would be contractually bound until 10th year i.e., lessee cannot terminate the contract.	After 6th year, lessee would NOT be contractually bound until 10th year. Hence, lessee needs to assess reasonable certainty of exercising / not exercising termination option.	After 6th year, either of the parties can terminate the contract without the consent of other party and hence the contract is not enforceable.
Lease term is **10 years**.	Lease term is **10 years** assuming lessee is reasonably certain not to exercise termination option.	Lease term is **6 years**.

Lease term for Non-consecutive periods

EXAMPLE: ABC Limited enters into contract with XYZ to use grain storage faciity for a 5 year period in the months of May and June only. ABC has all the rights for these two months on how and for what purpose this asset will be used.

ANSWER: Lease term will be 2 months per year for 5 years = 10 months.

3) Lease accounting in LESSEE's books

Initial accounting (ICD)

ROU Asset Dr
To Lease Liability

Lease Liability

PV of FLP

- Fixed LP ;
- Insubstance fixed LP ;
- Variable LP linked to index or a rate ; E
- Guaranteed Residual value ; E
- Penalties, if TO is RC
- Purchase price, if PO exists + RC

ROU Asset

- Lease liab
- + upfront LP
- + Initial direct costs
- + P/DRRC

Subsequent Measurement

LCD

ROU Asset Dr

To LL

To Bank (up LP + IDC)

To P/DRRC

Note :

i) Variable lease payments
ii) Variable component of in-substance fixed LP

} PL - as and when incurred on actual basis.
Rent exp.

Discount rate :

Priority 1 : Implicit rate of interest
Priority 2 : Incremental Borrowing rate of Lessee

In exam, use whichever is given. If BOTH given - use implicit rate of interest.

Note :

Rate at which OF = IF [Lessor point of view]

FV of asset + Initial direct costs = PV of (FLP + UGRV)

FLP includes GRV

EXAMPLE:

On 1 April 20X1, A Limited obtained a machine on lease for 3 years. Lease payments are Rs. 100,000 or 20% of cash flow generated from the use of the asset, whichever is higher.

Actual cashflows generated from use over next three years are as follows:

Year 1	Rs. 480,000	96000
Year 2	Rs. 650,000	
Year 3	Rs. 900,000	

Assuming incremental borrowing rate of A Ltd. Is 10% p.a., suggest accounting treatment on lease commencement date and over lease term.

I

100000 100000 100000

LL@10%

248685

ROU Dr 248685 → depreciate over 3years

To LL 248685 → amortise over 3years

	Actual CF	CF in LL	Variable
Y1	100000	100 000	– ✓
Y2	113000	100 000	13000
Y3	180000	100 000	80 000

PL

ROU

	−82895	−82895	−82895
248685	165790	82895	–

	Y1	Y2	Y3
Depn exp Dr	82895	82895	82895
To ROU Asset			

LL

	FC 24868	FC 17355	9091
248685	−100000	−100000	−100000
	= 173553	= 90909	= NIL

Finance costs Dr	24868	17355	9091
To Lease Liability			
Lease Liability Dr	(100000)	(100000)	(100000)
To Bank			

4) Subsequent Measurement

Lease liability

Amortise as per Ind AS 109

Closing lease liability = Opening lease liability + Finance costs using discount rate - Actual lease payments

F. Costs Dr {PL}
To LL

LL Dr
To Bank

Right of use asset - Cost model

Depreciate in accordance with Ind AS 16/ 40.

- Lease term
- Useful life

PO exists + Lessee is reasonably certain

Earliar

Remaining useful life

ALERT

Note: Be careful and check if lease payments are made at:

→ End of Year; or

→ Begining of Year.

Mistakes

If Paid at end of Year (Arrears)

Op LL + F. Costs on Op LL − LP = Cl. LL

If Paid at beg of Year

Op LL − LP + FC on (Op − LP) = Cl. LL

FC = OPLL

OPLL

(LP)

= CLL

FC = OP − LP

(OP LL

− LP)

= CLL

5. LEASE REMEASUREMENT

(Change of estimates)

→ Calculate CA of LL and ROU Asset;

→ Calculate Revised LL
- Revised lease payments
- Applicable discount rate

→ Change in lease liability

→ Make a corresponding change to ROU Asset.

change of index, change of GRV, etc.

Use Original discount rate LCD

change of Reasonable certainty of PO/RO/TO

Use Revised discount rate

Note : If both the above changes - Use Revised discount rate

6. LEASE MODIFICATION

A. Increase in scope + Increased Rentals in line with market

Separate contract

B. ~~De~~crease in scope and ~~De~~crease in LT

C. All others

(Same as Lease Remeas) New Dis. rate

→ CA of LL & ROU

→ Remeasure LL using
- Revised LP ; and
- Revised rate

→ Change in LL

→ Corresponding change to ROU.

~~Inc~~ in scope + LP ~~(Market)~~

~~Inc~~. of LT

~~Inc~~/Dec of LP

			Mkt rent	
3rd	Rent	90000	100000	(c)
		90000	95000	Sep. lease a/c
		-5000		

B. Decrease in scope

→ CA of LL and ROU on date of mod.

→ Decrease LL and ROU proportionately

Impact goes to PL

JE: LL Dr

To ROU Asset

To PL

$$\frac{\text{Decrease in scope}}{\text{Original scope}}$$

→ Remeasure LL using
- Revised LP
- Revised discount rate

→ Calculate change of lease liability

→ Make a corresponding change to ROU

JE: ROU Asset Dr

To LL

c. Decrease in Lease term

→ CA of LL and ROU on date of mod.

→ Decrease

- ROU Asset proportionately
- Lease Liability: Remeasure Original LP for Rem. LT @ Original discount rate

Impact goes to PL

JE:

LL Dr

To ROU Asset

To PL

→ Remeasure LL using
- Revised LP
- Revised discount rate

→ Calculate change of lease liability

→ Make a corresponding change to ROU

JE: ROU Asset Dr

To LL

7. Leases in foreign currency

STEP 1: On **LEASE COMMENCEMENT DATE**, calculate Lease liability in foreign currency and convert to functional currency using spot rate on such date.

STEP 2: Prepare lease amortization schedule in foreign currency

STEP 3: **At each REPORTING DATES:**

i. Convert Finance cost to functional currency using average rate

ii. Convert Lease payments to functional currency using payment date rate

iii. Calculate Lease liability in functional currency (Step 1 + Step 3(i) – Step 3 (ii))

iv. Restate closing lease liability (being a foreign currency monetary item) in foreign currency and any difference is to be considered as exchange gain or loss in accordance with Ind AS 21.

v. ROU asset (not a foreign currency monetary item) is carried at its historic cost and depreciated over the lease term. It remains unaffected by changes in exchange rates.

LEASE ACCOUNTING - LESSOR'S BOOKS

Lease classification

At lease **INCEPTION DATE**

Transfer of substantially all risks and rewards incidental to ownership of underlying asset to lessee

Finance Lease **Operating Lease**

Indicators of FINANCE LEASE:

- Transfer of ownership at end of lease term;
- Purchase option with lessee at nominal price;
- At inception date, PV of FLP covers substantial portion (90% for exam) of FV of asset;
- Lease term covers major part (75% for exam) of economic life of asset;
- Asset is of specialised nature that only lessee can use.

LESSOR'S BOOKS - FINANCE LEASE ACCOUNTING

i) Initial Lease accounting - Finance Lease

Lease receivables	Debit	PV of (FLP + Unguaranteed residual value)
To Asset	Credit	Carrying amount of asset
To P&L	Credit	(Difference, if any)

ii) Initial Lease accounting - Finance Lease (Dealor/ Manufacturer) ALERT

Lease receivables	Debit	PV of future lease payments
To Revenue	Credit	
Lease receivables	Debit	PV of Unguaranteed residual value
Cost of Sales	Debit	Balancing amount
To Asset	Credit	Carrying Amount

iii) Subsequent Lease accounting - Finance Lease

No depreciation, as the asset gets derecognised on Lease commencement date.

Amortise Lease receivable as per Ind AS 109.

Closing Lease Receivable = Opening lease rec. + Finance income - Lease receipts

Lease receivable	Debit	Bank	Debit
To Finance Income	Credit	To Lease receivable	Credit

Note: Variable lease payments not considered in calculating lease receivables will be recognised in P&L as Rent income.

Asset
CA = 200000 | 1L | 1L | 1L

PV @ 10%
248685

JE : LR Dr 248685
To Asset 200000
To P/L 48685 (PL Imm.)

UEFI = Gross Inv − Net Inv
= 3L − 248685
= 51315

FI 24868 | FI 17355 | FI 9091

248685 | −1L | −1L | −1L
| LR 173553 | 90909 | —

FL

	Gain on FL 48685

Mfr/Dealer

Revenue	248685
COS	(200000)
	48685

KEY TERMS - Finance Lease

Gross Investment: Lease payments receivable + Unguaranteed residual value
Net Investment: Present value of Gross investment = Lease receivables
Unearned Finance Income: Gross investment - Net investment
Unguaranteed Residual Value (RV): Expected RV - Guranteed RV

LESSOR'S BOOKS - OPERATING LEASE ACCOUNTING

Lease accounting - Operating Lease

Recognise lease payments as income on either:

- Straight line basis over lease term; or
- another systematic basis which is more representative of the lessor's benefit.

RECOGNITION EXEMPTIONS - LESSEE

This exemption is available with **LESSEE only**. Exemption is available only to:

- Short term leases; OR (upto 12m + No PO)
- Lease of Low value item (example - Laptop, Tablet, Computer, Mobile, etc.)

If lessee opts for this exemption, then lease payments are to be recorded as **EXPENSE in statement of profit or loss** on either straight line method or another systematic basis that is more respresentative of lessee's benefits.

PL - Rent exp

1) Variable LP (actual)
2) Variable comp of in-subs fixed LP (actual)
3) Recog exemp (PL - SLM basis)

		Rent
Y1	5	10
Y2	10	10
Y3	15	10
	30/3	

SALE & LEASE BACK

Indigo —sold→ State Bank of India

leaseback

Sale should qualify transfer of **CONTROL** *criterion as per Ind AS 115.*

Yes → Sale and lease back accounting

No → Financing arrangement

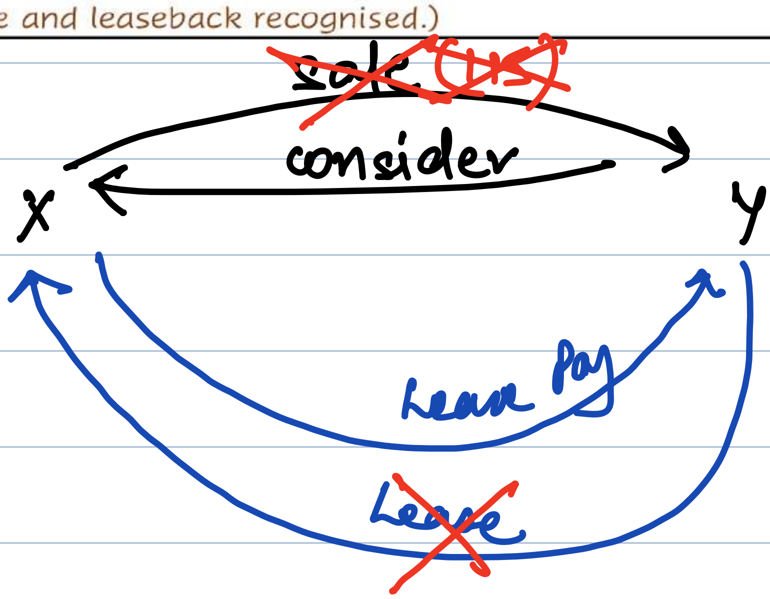
09

Accounting Treatment – SELLER LESSEE

Case A: Sold at Fair value	Case B: Sale proceeds > Fair value	Case B: Sale proceeds < Fair value
Step 1: Lease liability = Present value of future lease payments	**Step 1**: Lease liability = Present value of future lease payments – Excess of SP over Fair value	**Step 1**: Lease liability = Present value of future lease payments
Step 2: ROU asset = CA of Asset X (Lease Liability / Fair Value) contro	**Step 2**: ROU asset = CA of Asset X (Lease Liability / Fair Value)	**Step 2**: ROU asset = CA of Asset X (Lease Liability / Fair Value) + Excess of Fair value over SP
Step 3: Gain on SLB = Gain on sale (~~SP~~ FV – CA) x (1 – Lease liability / Fair value	**Step 3**: Gain on SLB = Gain on sale (FV – CA) x (1 – Lease liability / Fair value	**Step 3**: Gain on SLB = Gain on sale (FV – CA) x (1 – Lease liability / Fair value

Journal Entry in books of Seller Lessee:

Bank	Debit	Sale proceeds
ROU asset	Debit	Refer Step 2
To Lease liability	Credit	Refer Step 1
To Asset	Credit	Carrying amount on date of SLB
To Finance liability	Credit	Excess of SP over FV in Case 2
To Gain/loss on SLB	Credit	Balancing figure (Refer Step 3)
(Being Sale and leaseback recognised.)		



Accounting Treatment - BUYER LESSOR		
Case A: Sold at Fair value	**Case B: Sale proceeds > Fair value**	**Case B: Sale proceeds < Fair value**
Recognise purchase of asset @ Fair value on date of SLB		
Apply Ind AS 116 for Lessor accounting.	Apply Ind AS 116 for Lessor accounting.	Apply Ind AS 116 for Lessor accounting.
	Recognise a Financial asset for excess of SP over FV	Recognise a liability for excess of FV over SP

Journal Entry in books of Buyer Lessor:

Asset	Debit	Fair value
Financial asset	Debit	Excess of SP over FV in Case 2
To Liability	Credit	Excess of FV over SP in Case 3
To Cash	Credit	Amount paid
(Being Sale and leaseback recognised.)		

SUBLEASE

Tail lease

A → B → C

A: Head Lease — **Apply Lessor accounting**

B: **Intermediate Lessor**

- Apply lease accounting in the capacity of lessee.
- Apply lessor accounting in capacity of lessor:

Operating lease	**Finance lease***
Record rental income in SPL on straight line basis.	De-recognise ROU asset and recognise lease receivables.

C: Sublease — **Apply Lessee accounting**

Note:

- An intermediate lessor, while assessing classification of lease (in capacity of being a lessor) - shall compare lease term of sublease with that of Headlease. (Compare original lease terms).

- If an intermediate lessor subleases an asset, or expects to sublease an asset, the head lease does not qualify as a lease of a low-value asset.

Sublease (LT) forms sig part of HL (LT) - FL

else - OL

Identification of LEASE

Identified Asset

→ Explicit / Implicit

→ No SSR to Lessor

- Practical ability;
- Benefits

→ Physically distinct (subs cap. i.e more than 90%)

and

Right to economic benefits from USE

→ Substantially all from USE

→ Direct / indirect

and

Right to direct the USE

→ How / Purpose and Where / When

Predetermined

Right to direct the use exists, if:

Customer has right to operate the asset	OR	Customer designed the asset.

<u>Note</u> : PROTECTIVE RIGHTS doesn't impact classif. of contract as lease contract.

SEPARATING MULTIPLE LEASE COMPONENTS

Sometimes, there are contracts that contain right to use multiple assets. The right to use each such asset is considered as a separate lease component only if both conditions are satisfied:

Lessee can benefit from the use of the asset either on its own or together with any other resources that are readily available to the lessee	***AND***	The underlying asset is neither highly dependent or highly interrelated with other underlying assets in the contract

Note:

- If one or both criteria are not met then, the right to use multiple assets is considered as a single lease component, i.e., not a separate lease component.
- If both the above conditions are satisfied, then entity should mandatorily separate the multiple lease components in one contract.

SEPARATING LEASE & NON LEASE COMPONENTS

Sometimes, there are contracts that contain right to use an asset along with an agreement to purchase or sell other goods or services (non-lease components). **For example**: Lease of a building along with common area maintenance, etc.

Separating lease and non-lease components

Separating lease and non-lease components	Practical expedient (OPTIONAL)
Lease component – Apply Ind AS 116 **Non-lease component** – Under respective standards	Do not separate lease and non-lease component and account for them under Ind AS 116.

Accounting Treatment:

Lessee's that do not apply practical expedient, are required to allocate the consideration in the contract to lease and non-lease components on a relative standalone price basis. If observable standalone prices are not readily available, consider Fair value as the standalone prices.

Note: Costs that do not involve transfer of either lease or non-lease components (for example – property taxes and insurance, etc.), should be allocated between the lease and non-lease components, if lessee does not apply practical expedient.

L/NL

sep

Not sep

Treatment of Initial direct costs

incremental cost to obtain lease.

Initial direct costs

Lessee	Lessor	
	Finance lease	Operating lease
Added to Right of use asset.	Interest rate implicit in lease factors in itself the impact of initial direct costs. No separate treatment.	Added to carrying amount of the underlying asset and recognise these as expense over the lease term on the same basis as lease income.

Note: In case of Finance lease – Lessor is a manufacturer or dealer, any initial direct costs is to be expensed off to SPL immediately at lease commencement date.

FV of asset + IDC = PV (FLP + UGRV)

Use of disc. rates (Lessee)

- Lease Remeas
  - GRV / Index — Old disc rate
  - RC of PO / TO / RO — New disc rate
- Lease mod
  - New disc rate
  - Dec in LT for calc. dec. of LL use old disc rate

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