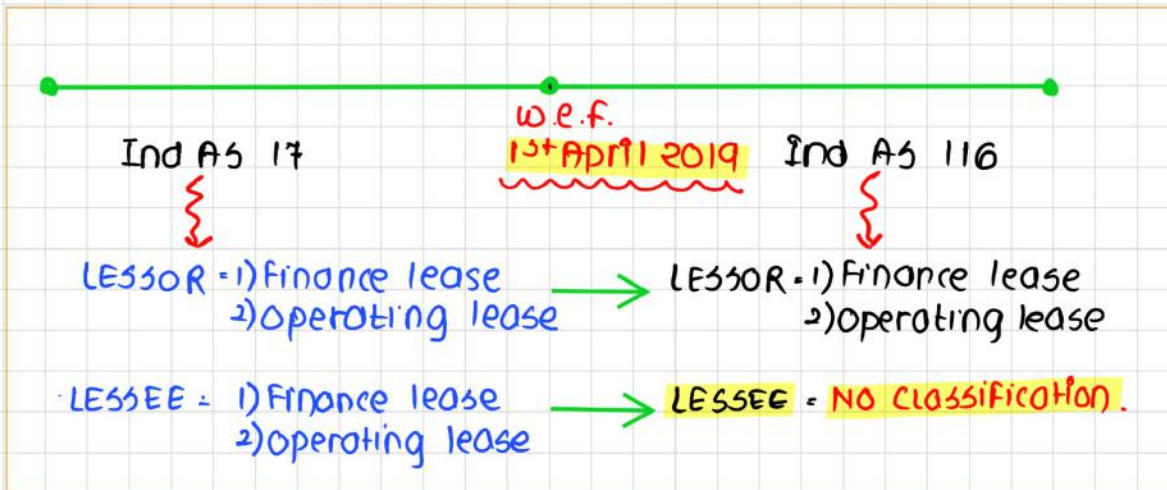


IND AS 116 : LEASES.

1.

1. HISTORY.:



2. APPLICABILITY:

Ind AS 116 shall be applied to ALL LEASES

EXCEPT :-

1. (Ind AS 38): Rights held by lessee under licensing agreements for such items as motion pictures, films, video recordings etc.
2. (Ind AS 41): Biological assets.
3. (Ind AS 106): Leases to explore for or use minerals, oil, natural gas & non-regenerative resources.
4. (Ind AS 115): Service concession arrangements.
5. (Ind AS 115): Licences of intellectual property rights

Ind AS 116

LEASES

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"One of my great ambitions before I die is to fly in an aircraft that is on an airline's balance sheet," Sir David Tweedie, Former Chairman of the IASB, revealed during a speech to the Empire Club of Canada on April 25, 2008. Sep 23, 2013



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: ROADMAP :

43 Illustrations
(+) 7 Test your knowledge
50 Questions (122 pages)

3. ANALYSIS OF STUDY MATERIAL:

- 1. Short term lease
Q1. exemption!
- 2. Identified Assets:
Q2.
Q3.
Q4.
Q5.
Q6.
Q7.
- 3. Right to Use & substantial benefits.
Q8.
Q9.
Q10.
Q11.
- 4. Lease and non-lease components.
Q12.
Q13.
Q14.
Q15.
- 5. Lease term & its Re-assessment.
Q16.
Q17.
Q18.
- 6. lease Payment.
Q19.
Q20.
Q21.
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Q23.

- Q24.
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Q28.
Q29.
Q30.
Q31.
Q32.
Q33.
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Q35.
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Q37.
- 8. Accounting the books of "LESSOR"
Q38.
- 9. Accounting for "SUB-LEASE"
Q39.
Q40.
Q41.
- 10. Accounting for "SALE & LEASE BACK"
Q42.
- 11. Accounting for "TRANSITION"
Q43.

- 1. HISTORY
- 2. APPLICABILITY
- 3. ANALYSIS OF SM.
- 4. DEFINITION OF LEASE
- 5. UNDERSTANDING OF TERM.
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 - 5.2) Commencement Date
 - 5.3) lease term 16
 - 5.4) Reassessment of lease term 17 18
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4. DEFINITION OF LEASE.

LEASE: It is defined as a contract or a part of contract that conveys right to control use of an identified asset for a period of time (lease term) in exchange for consideration (Lease Payment)

5. UNDERSTANDING OF TERMS:

5.1) Inception Date: Earlier of
 a) Date of lease agreement
 b) Date of commitment by parties to principal terms & conditions.
 This date is relevant for identification of lease in a contract.

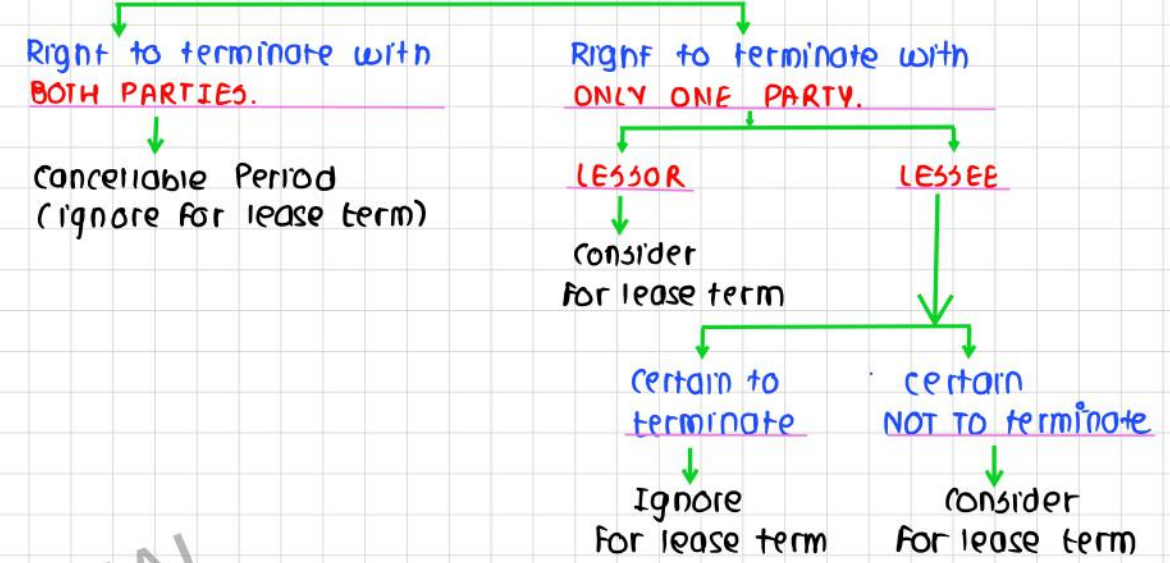
5.2) Commencement Date: It is the date on which right to control use of asset transferred.
 This date is relevant for accounting of lease in a contract.

5.3) Lease Term: Calculation of lease term:
 1. **N:** Non-cancellable period. x
 2. **E:** Extension period. x
 (If lessee is reasonably certain to exercise the option)
 3. **T:** Termination period. x
 (If lessee is reasonably certain NOT TO EXERCISE the option)

LEASE TERM xx

NOTE:

1. Lessee may enter into a lease contract for non-consecutive period
2. Lease term does not include cancellable period.
3. Termination period.



5.4) Reassessment of Lease Term: Lessee should assess the lease term at the end of each year. Following factors may affect lease term.

1. **I:** If lessee has made significant improvements in leasehold property
2. **M:** If lessee has carried significant modifications in the underlying asset.
3. **D:** If lessee has take business decision that is directly relevant to lessee's ability to exercise, or not exercise, an option.
4. **S:** If lessee has sub-leased the leased asset for beyond its non-cancellable period.

NOTE: LESSOR will change his lease term according to lessee.

5.5) Lease Payments : **LESSEE:**

- Calculation of lease Payments.
- 1. **F**: Fixed Rentals x
In-substance fixed x
 - 2. **V**: Variable Rentals which depends upon CPI/RATES. x
 - 3. **G**: Guaranteed residual payments. x
 - 4. **E**: Exercise price of purchase option. x
 - 5. **T**: Termination penalty x
 - 6. **I**: Incentives by lessor (x)
- LEASE PAYMENTS (FOR LESSEE) x x**

FIXED RENTAL : a) It is the fixed payment made by lessee to lessor as per lease contract.
b) It may remain fixed during the agreed period or can increase over the time by fixed amount.

IN-SUBSTANCE: a) If there are multiple variables in the contract then we should go for that variable which seems to be real.
b) If there are more than one realistic variables then we should go for the variable with minimum increase (unavoidable)

VARIABLE LEASE PAYMENTS : a) If lease payments are based on consumer price index (CPI) rate of interest then following points shall be considered.

- On commencement date, lease payments shall be computed on prevailing rates.
- If relevant factors changes in future then lease payment shall be **remeasured** in relevant period.

VARIABLE LEASE PAYMENTS : b) If lease payment increases in future due to other factors (i.e. % change in sales/Profit) then such change shall be transferred to P/L in the same period. It will not affect the lease payments.

EXERCISE PRICE OF PURCHASE OPTION : a) It is part of lease payments only if lessee is certain to exercise purchase option.

TERMINATION PENALTIES : a) If it is certain that lessee will pay penalties due to termination of lease then it will also be included in lease payments

GUARANTEED RESIDUAL PAYMENTS : a) It is an expected amount which is payable by lessee at the end of the lease period due to decrease in value of asset.
b) COMPUTATION

Guaranteed value at the end of lease term : **x**
Expected value at the end of lease term : **(x)**
(only if positive) Consider in lease payment **x**

LESSOR.

Calculation of lease Payments.

Same as lessee (except point 3)

Guaranteed value at the end of lease term : **x**
(By lessee or 3rd party) **x**

xx

5.6) DISCOUNT RATE (FACTOR) : a) Implicit Rate of Return of LESSOR (IRR)
b) Incremental borrowing rate of LESSEE.

6. ACCOUNTING IN THE BOOKS OF "LESSEE"

6.1) INITIAL RECOGNITION:

(WN-1): Present Value of Lease Payments.

Years	Lease Payments	DF@%	Present Value.
x	x (Beg/end)	x	x

(WN-2): ROU asset (Right of use asset)

Particulars	Amount
1. L : Present value of lease payments.	x
2. I : Initial Direct Cost. (e.g. commission, stamp duty etc.)	x
3. C : Payment made before commencement.	x
4. D : Provision for dismantling & restoration cost (DRC)	x
ROU asset.	xx

JOURNAL ENTRY:

At commencement date,

ROU asset (1+2+3+4) x	
To Lease Liability (1) x	
To Bank (2+3) x	
To Provision for DRC (4) x	
(Being initial recognition made)	

6.2) SUBSEQUENT RECOGNITION:

(WN-3): Lease Liability Table

a) IF lease rentals (AT END)

Years	Opening Balance	+	Interest @ %	-	Lease Payments	=	Closing Balance.
	(A)	+	(B)	-	(C)	=	(D)
			(A x %)				
1	x		x		(x)		x
2	x		x		(x)		x

b) IF lease rentals (AT BEGINNING)

Years	Opening Balance (Before LP)	-	(LP) Lease Payment	=	Opening Balance (After LP)	+	Interest @ %	=	Closing Balance.
	(A)	-	(B)	=	(C)	+	(D)	=	(E)
					(A-B)		(C x %)		
1	x		(x)		x		x		x
2	x		(x)		x		x		x

(WN-4): ROU asset:

Years	Opening Balance	-	Depreciation	=	Closing Balance
1	x	-	(x)	=	x
2	x	-	(x)	=	x

JOURNAL ENTRIES:

- Interest x
To Lease Liability x
(Being interest accrued)
- Lease Liability x
To Bank x
(Being payment made)
- Depreciation x
To ROU asset x
(Being depreciation charged)
- Profit/Loss x
To Interest x
To Depreciation x
(Being expenses transferred to P/L)

Other points.

- Depreciation on ROU asset as per Ind AS:16 PPE.
(If question silent, SLM method)
- Period of Depreciation:

- a) Lessee is certain to exercise Purchase option "OR"
- b) Automatic transfer of ownership at the end of lease term.

- | | |
|--------------------------------------|-----------------------------|
| YES | NO |
| Depreciate over useful life of Asset | Depreciate over lease term. |

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6.3) REMEASUREMENT:

FACTORS FOR REMEASUREMENT

case 1): significant change (Revised Discount Rate)

- a) change in decision of
 - Extension option.
 - Termination option.
 - Purchase option.

case 2): insignificant change (old Discount Rate)

- a) change in Guaranteed Residual Payment.
- b) change in lease rentals due to CPI.

ACCOUNTING FOR REMEASUREMENT.

(STEP 1): carrying amount of Lease Liability on remeasurement date (original terms).

- a) Initial recognition
- b) subsequent recognition

(STEP 2): Present value of Lease Liability on remeasurement date (new terms)

Years	Lease Payments	Df _t x	PV.
significant change		Revised	
insignificant change		Old.	

(STEP 3): Re-measurement.

STEP 2	x
STEP 1	(x)
Liability Increase / (decrease)	x/(x)

ROU asset	x	To Lease Liability	x
Lease Liability	x	To ROU asset	x

6.4) MODIFICATIONS:

TREATED AS SEPARATE CONTRACT.

We can consider modification as a separate contract only if following two conditions are satisfied. (BOTH)

a) Modification should be in relation to increase in scope (eg. area) of lease.

&
b) Lease payments for such increase should be at its standalone price.

If BOTH conditions satisfied then
→ No change in existing contract.
→ Increase in scope shall be accounted as separate contract.

ROU Asset (new) x
To Lease Liability x
(Being Initial recognition made for separate contract.)

REMEASUREMENT
changes in lease liability due to pre-existing conditions.

TREATED AS MODIFICATION TO EXISTING CONTRACTS.

FACTORS

Increase in scope (area).
(not at standalone price)
Increase in lease term.
change in lease payments.

ACCOUNTING FOR INCREASE

(STEP 1): carrying amount of Lease Liability on MODIFICATION date (original terms).

- a) Initial recognition
- b) subsequent recognition

(STEP 2): Present value of Lease Liability on MODIFICATION date (new terms)

Years	Lease Payments	Df _t x	PV.
significant change		Revised	
insignificant change		Old.	

(STEP 3): MODIFICATION.

STEP 2	x
STEP 1	(x)
Liability Increase / (decrease)	x/(x)

ROU asset	x	To Lease Liability	x
Lease Liability	x	To ROU asset	x

MODIFICATION.
changes in lease liability due to new terms which were not earlier in contract.

Decrease in Scope (area)
Decrease in Lease term

ACCOUNTING FOR DECREASE

(STEP 1): carrying amount of Lease Liability on MODIFICATION date (original terms).

- a) Initial recognition
- b) subsequent recognition
- c) Proportionate decrease in carrying amount. (decrease entry)

Lease Liability x
P/L x / x
To ROU asset x

(STEP 2): Present value of Lease Liability on MODIFICATION date (new terms)

Years	Lease Payments	Df _t x	PV.
significant change		Revised	
insignificant change		Old.	

(STEP 3): MODIFICATION.

STEP 2	x
STEP 1	(x)
Liability Increase / (decrease)	x/(x)

ROU asset	x	To Lease Liability	x
Lease Liability	x	To ROU asset	x

7. ACCOUNTING IN THE BOOK'S OF "LESSOR"

7.1) FINANCE LEASE:

It is a lease that transfers substantially all risk and rewards incidental to ownership of an underlying asset.

Following INDICATORS should be considered (At inception date)

- OWNERSHIP:** The lease transfers ownership of the asset to the lessee at the end of lease term.
- OPTION TO PURCHASE:** The lessee has the option to purchase the asset at a price that is expected to be sufficiently lower than fair value.
- LEASE TERM:** Lease term is for major part of economic life.
- PV OF MINIMUM LEASE PAYMENTS:** Present value lease payments amounts to at least substantially all of the fair value of leased asset.
- SPECIALISED NATURE:** Leased assets are of such a specialised nature that only lessee can use it without major modifications.

ADDITIONAL INDICATORS:

- If lessee can cancel the lease, the lessor's losses associated with cancellation are borne by LESSEE.
- Lessee has the ability to continue lease for a secondary period at a rent that is substantially lower than market rate.

ACCOUNTING for Finance lease.

(At commencement date)

INITIAL RECOGNITION:

(WN-1): Present value of Gross Investment.

Years	Particulars	Df @ %	Present Value
1	Lease Payment	x	x
2	Unguaranteed Residual Value	x	x
(a) GROSS INVESTMENT			
(b) NET INVESTMENT			

(a-b)
Unearned
Finance
Income

JOURNAL ENTRY:

At commencement date.

Lease receivable (net investment) x
 Profit/loss x/x
 To Asset sale x

(Being initial recognition made)

7.2] OPERATION LEASE.

MEANING: If any lease is not classified as finance then it is operating lease.

INITIAL & SUBSEQUENT RECOGNITION: Lessor recognises collection from lessee as RENTAL INCOME in PIL on SLM basis. If actual collection differs from SLM rent then difference will be recognised as advance rent / outstanding rent.

MODIFICATION: If modification is made in operating lease contract then it will be considered as new contract from such date & SLM rate will be revised from such date.

SUBSEQUENT RECOGNITION:

(WN-2): Lease receivable

Years	Opening Balance (A)	+	Interest @ % (B) (A x %)	-	Lease Payments (C)	=	Closing Balance (D)
x	x		x		x		x
x	x		x		x		x

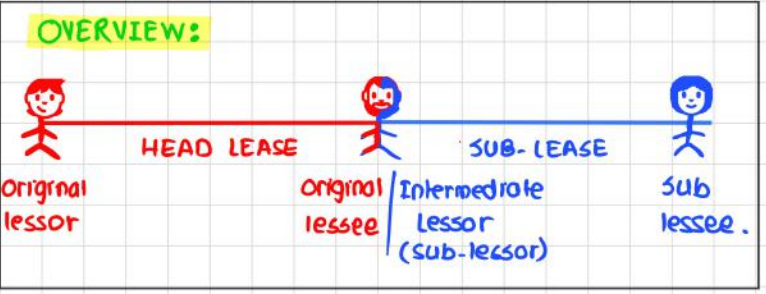
JOURNAL ENTRIES:

- Lease receivable x
 To Interest (income) x
 (Being interest accrued)
- Bank x
 To lease receivable x
 (Being lease payment received)
- Interest (Income) x
 To Profit/loss x
 (Being interest income transferred to PIL)

MODIFICATIONS:

Lease receivable is a financial asset & therefore, any modification in lease contract shall be accounted as per Ind AS 109

8. ACCOUNTING FOR SUB-LEASE.



Accounting for sub-lease contracts will be based on nature of head-lease contracts.

NATURE OF HEAD LEASE : EXPECTED LEASE

NATURE OF SUB-LEASE : SUB-LEASE shall be considered as OPERATING LEASE.

ACCOUNTING : Rentals from sub-lease shall be recognised on SLM basis.

NOTE :

- a) The original lessee (Intermediate lessor) will pay rentals for Head lease and will collect rentals in sub-lease contract.
- b) we can not off-set lease rentals under original contract & sub-lease contract in the books of original lessee (Intermediate lessor).

NATURE OF HEAD LEASE : NOT EXPECTED LEASE.

Original lessee

ROU asset x
To Lease Liability x

NATURE OF SUB-LEASE : a) Finance / operating lease.
b) It depends upon facts in sub-lease contracts.

NATURE OF SUB-LEASE : OPERATING LEASE.

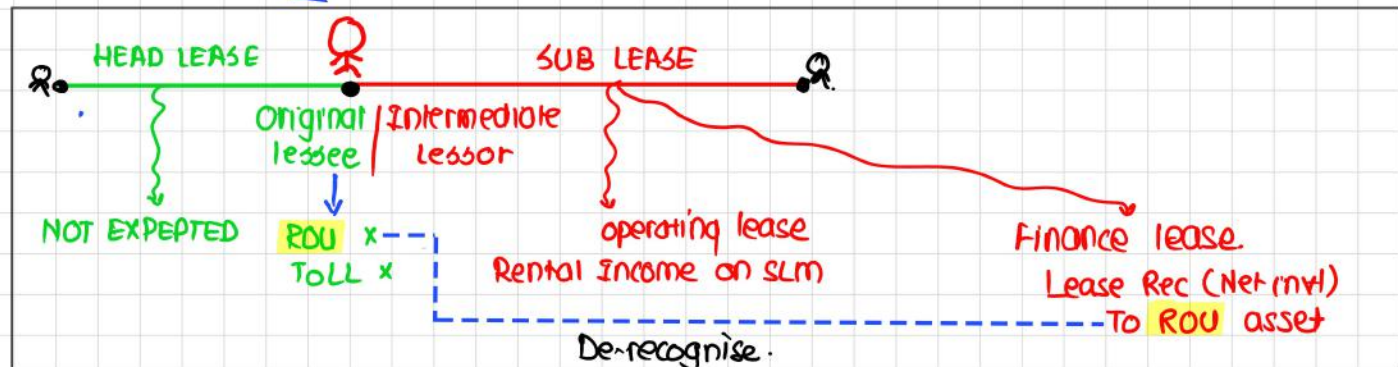
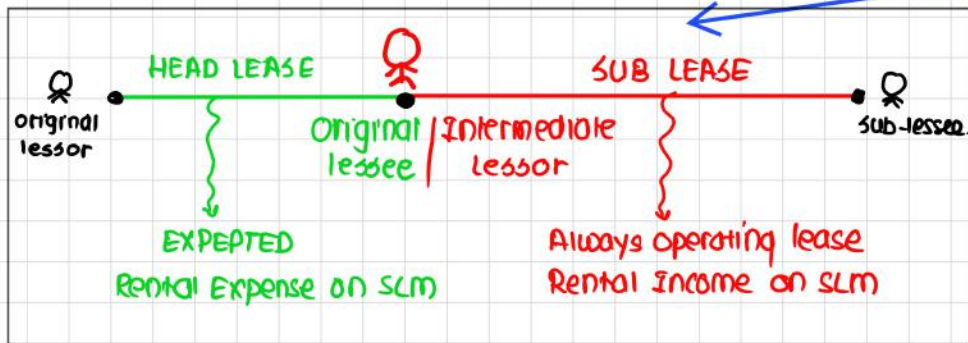
ACCOUNTING : Rentals from sub-lease shall be recognised on SLM basis.
Do not derecognize ROU asset recorded under head lease.

NATURE OF SUB-LEASE : FINANCE LEASE.

ACCOUNTING : De-recognised ROU asset & recognise net investment as follows.

Lease receivable (net investment) x
Profit/Loss x/x
To ROU asset x

SUMMARY



9. ACCOUNTING FOR SALE & LEASE BACK.

APPLY IND AS 115.

TRANSACTION: SALE
[Control Transferred]

TRANSACTION: NOT SALE
[Control not transferred]

SALE: Market terms

SALE: off market terms.

Carrying amount : 80
Fair Value : 100
Selling Price : 100
PV of lease Payment : 60

REFER NEXT PAGE.

SELLER/LESSEE

BUYER/LESSOR

Bank x
To loan Payable x
(Being loan taken)

loan Receivable x
To Bank x
(Being loan given)

SELLER/LESSEE

BUYER/LESSOR

(WN-1): Calculation of PV of Lease Liability (ROU)

Years	Lease Payments	DF of	PV
1	x	x	x
Present value of lease Liability			60

(+/-): off market adjustment

Fair Value	100	
(-) Selling Price	(100)	
Lease Liability (ROU)		NEL 60

Asset 100
To Bank 100
(Being asset purchased)

Accounting for asset given on lease will depend upon the fact whether lease is operating or financing lease.

(WN-2): Calculation of Profit/Loss on sale.

Particulars	Fair Value	Carrying amt.
Total	100	80
(-) Retained (ROU)	(60)	?
Transferred.	40	32
Profit = (40 - 32) = 8		

Journal Entry:

Bank	100	
ROU Asset	48	
To Asset		80
To Profit on Sale		8
To lease liability		60

(Being sale & lease back recorded)

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SALE : off market terms.

SALES : BELOW MARKET TERMS

Carrying amount	: 80
Fair Value	: 100
Selling Price	: 95
PV of lease payment	: 55

SELLER/LESSEE

(WN-1): Calculation of PV of Lease Liability (ROU)

Years	Lease Payments	DF@%	PV
1	x	x	x
Present value of lease liability			<u>55</u>

(H-): Off market adjustment

Fair Value	100	
(-) Selling Price	(95)	
Lease Liability (ROU)		<u>5</u>
		60

(WN-2): Calculation of Profit/Loss on sale.

Particulars	Fair Value	Carrying amt.
Total	100	80
(-) Retained (ROU)	(60)	(?) (48)
Transferred.	<u>40</u>	<u>32</u>
Profit = (40 - 32) - 8		

Journal Entry:

Lease Prepayment	5	
Bank	95	
ROU Asset	48	
To Asset		80
To Profit on Sale		8
To Lease Liability		60

(Being sale, lease back & lease prepayment recorded)

BUYER/LESSOR

Asset	100
To Bank	95
To lease Pre. recd	5

(Being asset purchased)

Accounting for asset given on lease will depend upon the fact whether lease is operating or financing lease.

SALES : ABOVE MARKET TERMS

Carrying amount	: 80
Fair Value	: 100
Selling Price	: 104
PV of lease payment	: 64

SELLER/LESSEE

(WN-1): Calculation of PV of Lease Liability (ROU)

Years	Lease Payments	DF@%	PV
1	x	x	x
Present value of lease liability			<u>64</u>

(H-): Off market adjustment

Fair Value	100	
(-) Selling Price	(104)	
Lease Liability (ROU)		<u>(4)</u>
		60

(WN-2): Calculation of Profit/Loss on sale.

Particulars	Fair Value	Carrying amt.
Total	100	80
(-) Retained (ROU)	(60)	(?) (48)
Transferred.	<u>40</u>	<u>32</u>
Profit = (40 - 32) - 8		

Journal Entry:

Bank	104	
ROU Asset	48	
To Asset		80
To Profit on Sale		8
To Lease Liability		60
To Additional Liability		4

(Being sale, lease back and additional liability recorded)

BUYER/LESSOR

Loan Asset	4
Asset	100
To Bank	104

(Being asset purchased)

Accounting for asset given on lease will depend upon the fact whether lease is operating or financing lease.

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