Overview of Ind AS 116 – Leases

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Why is this important?

- Most companies lease assets
- Under Ind AS 116, leases will be recognised on the balance sheet
- Changes many financial ratios
- Your stakeholders/investors will want to understand the impact on your business
- Changes in the system may be required

Contents

Major impact for lessees

Significant change in lessee accounting

All leases will be recognised on balance sheet, with few exceptions

Balance sheet

Asset

Right-of-use asset

Liability

Present value of future lease payments

Profit and loss

Lease expense

Depreciation

+ Interest

May result into front-loaded expenditure

Impact on Balance sheet

	Ind AS 17		Ind AS 116
	Finance leases	**Operating leases**	**All leases**
Assets		------------	
Liabilities	INR	------------	INR
Off balance sheet rights/ obligations	------------	 INR	------------

Impact on profit and loss

	Ind AS 17		Ind AS 116
	Finance leases	**Operating leases**	**All leases**
Revenue	INR	INR	INR
Operating costs (excluding depreciation and amorisation)	------------	Single lease expense	------------
EBITDA		------------	▲▲
Depreciation and amortisation	Depreciation	------------	Depreciation
Operating profit			▲
Finance costs	Interest		Interest
Profit before tax			⬌ *

* Over the lease term

Impact on key financial ratios

Metric	What is measures	Common method of calculation	Expected effect
EBITDA	Profitability	Profit before interest, tax, depreciation and amortisation	Increase
Operating cash flow	Profitability	Direct / Indirect method – Does not include depreciation and interest	Increase
Leverage (gearing)	Long-term solvency	Liabilities / Equity	Increase
Current ratio	Liquidity	Current assets / Current liabilities	Decrease
Asset turnover	Profitability	Sales / Total assets	Decrease

Definition of lease and lease accounting

Lease definition

Contract, or a part of a contract, that conveys the right to use an asset for a period of time in exchange of consideration

Is it a lease ?

- **Identified asset**
  - No substantive rights to substitute
- **Customer controls use**
  - Substantially all of economic benefits
  - Directs the use of asset

Lease definition – Exemptions

A lessee may elect not to apply the lessee accounting model to

Short-term leases

≤ 12 months

No purchase option

OR

Leases of low value when asset is new

Measuring the lease liability

Lease liability

=

Present value of lease rentals and other expected payments at the end of lease term

Lease payments

Fixed payments	includes in-substance fixed payments / incentives
+	
Variable lease payments	only for index or market rate (Payments based on turnover or usage are excluded)
+	
Residual value guarantees	at amount lessee expects to pay
+	
Purchase option exercise price	if lessee reasonably certain to exercise
+	
Payments for terminating	If lease term reflects termination by lessee

Measuring the right-of-use asset

Right-of-use asset = **Lease liability** + **Initial direct costs** + **Prepayments** + **Restore/ dismantle** - **Incentives received**

Lessor accounting and other changes

- **Lessor accounting substantially remains similar to current practice (Asymmetrical model to lessee accounting)**
- **Changes in sub-lease and sale and leaseback accounting**
- **Enhanced quantitative and qualitative disclosures**

Transition options

Applying the new lease definition

Apply the new definition to all contracts

OR

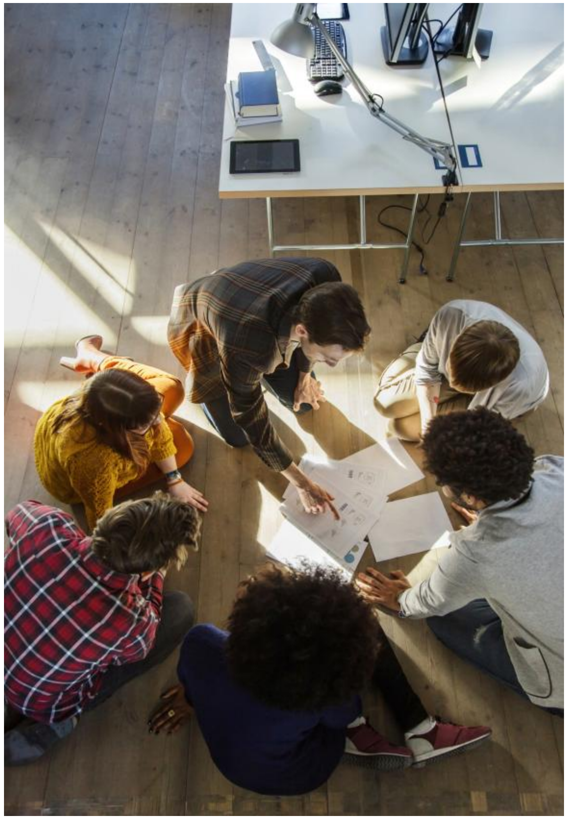
Grandfather existing contracts and apply the new definition only to new contracts or modified after date of transition

Transition approach

Retrospective	Modified retrospective
Date of equity adjustment 1 April 2018	Date of equity adjustment 1 April 2019
Restate comparatives as if Ind AS 116 was always applied	Do not restate comparatives
Practical expedients not available	Difference between asset and liability is recognised in opening retained earnings
	Practical expedients available

Practical challenges

Practical challenges



- Determination of lease term
- Determination of discount rate
- Challenges relating to working in MS Excel
- Co-ordination with lease administration team and finance team
- Changes in ERP systems

Illustration

Illustration (1/2)

Lessee ABC enters into a contract with Lessor XYZ for the right to use office space for a 10-year term. The right to use the office space is a lease and there are no other components of the contract. The following facts are relevant at the lease commencement date.

Lease payments:	Fixed payments of INR 14,527 per year in arrears, with a 3% increase every year after Year 1
Renewal options:	5-year extension; payments during that period are INR 19,523 per year in arrears, with a 3% increase every year after Year 1 of the extended period
Lessee's incremental borrowing rate	10% (the rate implicit in the lease cannot be readily determined)
Initial direct costs of lessee	IN 5,000

Determine the amount of right to use asset. (Assume: At the commencement date lessee is not reasonable certain to avail extension option.)

Illustration (2/2)

Contractual payments are set below:

Non-cancellable period (INR)

Yr. 1	Yr. 2	Yr. 3	Yr. 4	Yr. 5	Yr. 6	Yr. 7	Yr. 8	Yr. 9	Yr. 10	Total
14,527	14,963	15,412	15,874	16,350	16,841	17,346	17,866	18,402	18,954	166,535

Extension period

Yr. 1	Yr. 2	Yr. 3	Yr. 4	Yr. 5	Total
19,523	20,109	20,712	21,333	21,973	103,650

Lease liability = INR 1,00,000 (10 lease payments discounted @ 10% p.a.)

Right-of-use asset = INR 1,05,000 (INR 1,00,000 + INR 5,000 initial direct cost)

Interest expense @ 10% shall be recognised on lease liability and right-of-use asset shall be depreciated on appropriate basis.

Q & A session

Thank You

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