Changes to Lease accounting Highlights

Disclaimer

The definition/interpretation of terms used in this presentation are intended to provide better understanding of similar terms used in accounting standards and are not necessarily intended to be technical definitions of such terms/interpretations as per the relevant accounting standards.

If the definition/interpretation provided in this presentation are found to be different from what is described in the Company's financial statements, the definition/interpretation provided in the audited financial statements will prevail.

Examples provided are only for illustrative purposes.

Accounting for leases

- ‘Ind AS 17 / IAS 17 – Leases’ was applicable till March 31, 2019.
- Standard required lessee to classify a lease as an **operating** lease or a **finance** lease.
- Lessee accounted for an **operating** lease by recognizing the rental payout on a straight-line basis as an expense in the P&L.
- Lessee accounted for **finance** lease by recognizing an asset and a liability equal to the present value of the minimum lease payments.

Illustration of Ind AS 17 / IAS 17

Ind AS 17 / IAS 17			
Years	**Rent Payout**	**P&L Charge**	**Lease Liability**
1	1,000	1,130	130
2	1,000	1,130	260
3	1,100	1,130	290
4	1,100	1,130	320
5	1,100	1,130	350
6	1,200	1,130	280
7	1,200	1,130	210
8	1,200	1,130	140
9	1,200	1,130	70
10	1,200	1,130	-
	11,300	**11,300**	

Rationale for introduction of the new standard

- To bring off-Balance sheet financing provided through operating leases into the financial statements so that the reader can get view of all future commitments of the reporting entity.
- Ind AS 17 / IAS 17 allowed the lessee to record the straight-lined lease rental payout as operating cost. The future lease commitments were mere disclosures.
- Ind AS 116 / IFRS 16 records the present value of all future lease payments as liability in the books of lessee as also a corresponding Right-of-use (ROU) asset.
- As the liability is at present value there is an interest cost which builds the liability to match the actual payouts.
- The Right-of-use asset is depreciated over the lease term. Hence the rental cost now gets split into interest and depreciation.

Transition to Ind AS 116 / IFRS 16

Ind AS 116 : effective from April 1, 2019 ; IFRS 16 : effective from January 1, 2019

	Option 1	Option 2	
	Retrospective	Retrospective cumulative effect in the period of transition - A	Retrospective cumulative effect in the period of transition - B
Liability	Re-compute from lease start date with the rate prevailing on that day	Compute present value of future minimum lease payment	Compute present value of future minimum lease payment
ROU asset	Re-compute from lease start date with the rate prevailing on that day	Re-compute from lease start date with the rate prevailing on the date of transition	ROU asset* = Liability

****Adjusted for any lease liability or asset on the balance sheet as on the date of transition***

Illustration of Option 1 - Retrospective

Transition to Ind AS 116 / IFRS 16 is at the end of year 6

Asset Computation

Ind AS 116 / IFRS 16				
Years	**Rent**	***PV @ 6%**	**PV of asset**	**ROU Depreciation**
1	1,000	0.943	943	823
2	1,000	0.890	890	823
3	1,100	0.840	924	823
4	1,100	0.792	871	823
5	1,100	0.747	822	823
6	1,200	0.705	846	823
7	1,200	0.665	798	823
8	1,200	0.627	753	823
9	1,200	0.592	710	823
10	1,200	0.558	670	823
	11,300		**8,228**	**3,292**

Charge to P&L in Year 7	
Depreciation of ROU assets	823
Interest expense	249
Rent as per Ind AS 17 / IAS 17	1,130

Liability Computation

Liability present value table						
Years	***PV @ 6%**	**PV of Liability**	**Op Liability**	**Interest**	**Rent Paid**	**Cl Liability**
7	0.943	1,132	**4,158**	249	1,200	3,208
8	0.890	1,068	3,208	192	1,200	2,200
9	0.840	1,008	2,200	132	1,200	1,132
10	0.792	951	1,132	68	1,200	-
		4,158				

Transition accounting

Particulars	**Dr**	**Cr**
ROU assets	3,292	
Retained Earnings	866	
Lease Liability		4,158
Lease Liability (Ind AS 17 / IAS 17)	280	
Retained Earnings		280

**6% is the incremental borrowing rate at the inception of lease.*

Illustration of Option 2A

Transition to Ind AS 116 / IFRS 16 is at the end of year 6

Asset Computation

Ind AS 116 / IFRS 16				
Years	**Rent**	***PV @ 5%**	**PV of asset**	**ROU Depreciation**
1	1,000	0.952	952	865
2	1,000	0.907	907	865
3	1,100	0.864	950	865
4	1,100	0.823	905	865
5	1,100	0.784	862	865
6	1,200	0.746	895	865
7	1,200	0.711	853	865
8	1,200	0.677	812	865
9	1,200	0.645	774	865
10	1,200	0.614	737	865
	11,300		**8,647**	**3,460**

Charge to P&L in Year 7	
Depreciation of ROU assets	865
Interest expense	213
Rent as per Ind AS 17 / IAS 17	1,130

Liability Computation

Years	*PV @ 5%	PV of Liability	Op Liability	Interest	Rent Paid	Cl Liability
7	0.952	1,143	**4,255**	213	1,200	3,268
8	0.907	1,088	3,268	163	1,200	2,231
9	0.864	1,037	2,231	112	1,200	1,143
10	0.823	987	1,143	57	1,200	-
		4,255				

Transition accounting

Particulars	Dr	Cr
ROU assets	3,460	
Retained Earnings	795	
Lease Liability		4,255
Lease Liability (Ind AS 17 / IAS 17)	280	
Retained Earnings		280

**5% is the incremental borrowing rate on the date of transition.*

Illustration of Option 2B

Transition to Ind AS 116 / IFRS 16 is at the end of year 6

ROU Asset computation

Asset table			
Years	Op bal	Depreciation	Cl bal
7#	3,975	994	2,981
8	2,981	994	1,988
9	1,988	994	994
10	994	994	-

#ROU – 3975= (4255 – 280)

Liability computation

Years	*PV @ 5%	PV of Liability	Op Liability	Interest	Rent Paid	Cl Liability
7	0.952	1,143	**4,255**	213	1,200	3,268
8	0.907	1,088	3,268	163	1,200	2,231
9	0.864	1,037	2,231	112	1,200	1,143
10	0.823	987	1,143	57	1,200	-
		4,255				

Charge to P&L in Year 7	
Depreciation of ROU assets	994
Interest expense	213
Rent as per Ind AS 17 / IAS 17	1,130

Transition accounting

Particulars	Dr	Cr
ROU assets	4,255	
Lease Liability		4,255
Lease Liability (Ind AS 17 / IAS 17)	280	
ROU assets		280

**5% is the incremental borrowing rate on the date of transition.*

Rate to be used for discounting of Lease

Incremental borrowing rate is the rate at which lessee can borrow funds necessary to obtain an asset of a similar value to the right-of-use asset

- ✓ over a similar term,
- ✓ with a similar security
- ✓ in a similar economic environment.

Exemption from lease accounting for lessee

- IFRS 16 permits two exemptions where a lessee may elect not to apply the requirements of the standard:
  - short-term leases – lease term of less that 12 months
  - leases for which the underlying asset is of low value

- The lessee shall recognize the lease payments associated with those leases as an expense on a straight-line basis over the lease term

Thank You