

# Ind AS 116 Leases: Accounting models

March 2019





# Lessee accounting - overview

# Single lease accounting model

## Balance sheet

### Asset

= 'Right-of-use' (ROU) of underlying asset

### Liability

= Obligation to make lease payments

## P&L

### Lease expense

Depreciation

+ Interest

= Front-loaded total lease expense

# Sir David Tweedie's aircraft



Five year  
lease of an  
aircraft



CU1,000,000  
per annum due  
at 31 Dec



No renewal  
no purchase  
option



Discount  
rate: 7%



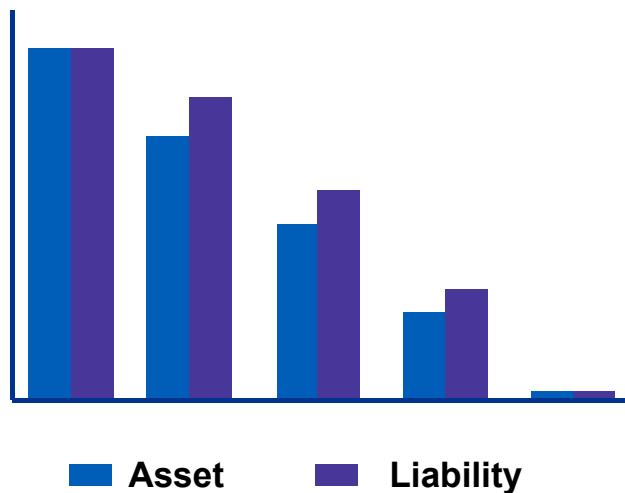
Aircraft  
useful life: 20  
years

# Journal entries

1 January 20X1	Debit (CU)	Credit (CU)
ROU asset (present value of 5 x CU1,000,000 @ 7%)	4,100,000	
Lease liability		4,100,000
31 December 20X1		
Depreciation expense (CU4,100,000/5)	820,000	
ROU asset		820,000
Interest expense (CU4,100,000 * 7%)	287,000	
<b>Total P&amp;L expense</b>	<b>1,107,000</b>	
Lease liability	713,000	
Cash		1,000,000

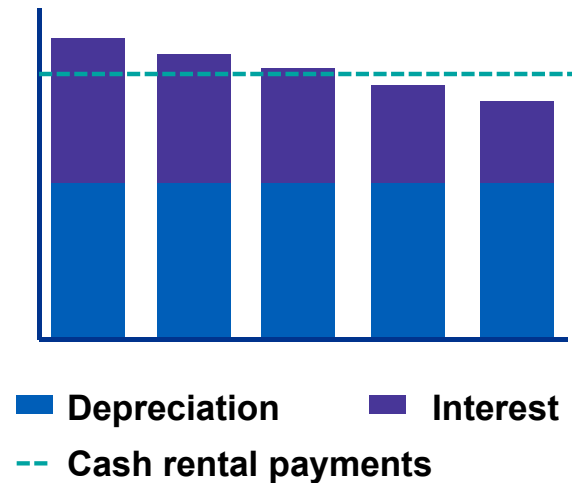
# What's the impact?

## Balance sheet



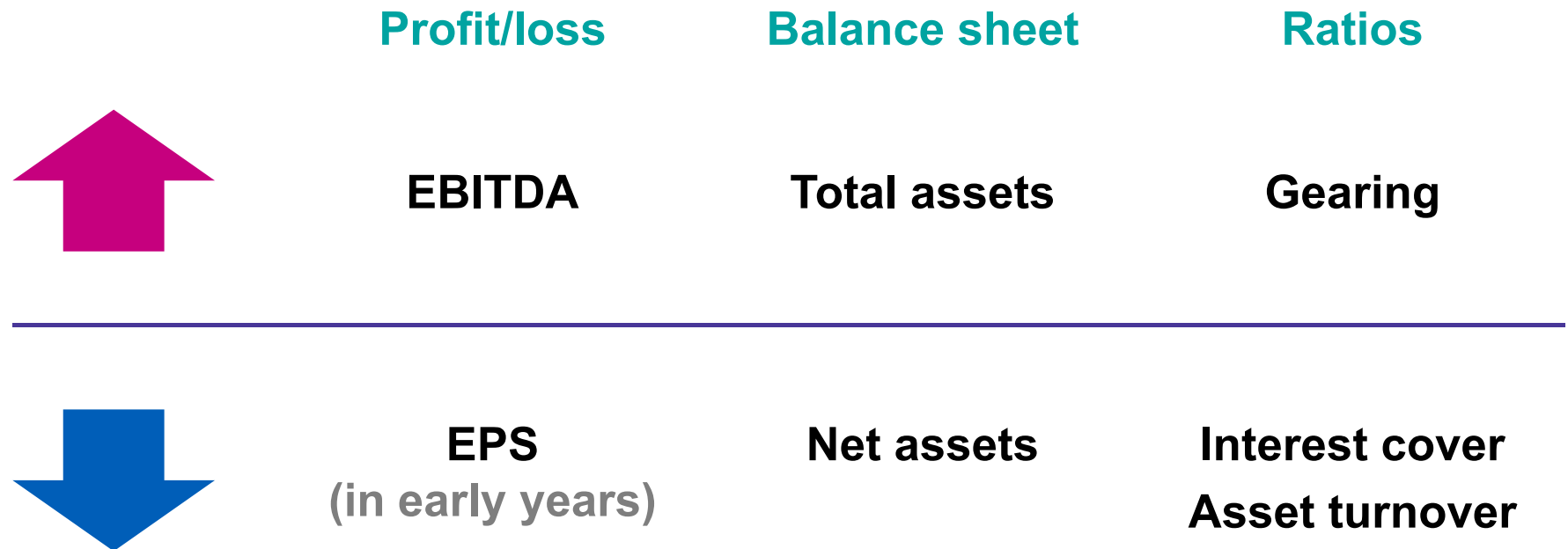
- Airline appears to be more ***asset-rich***, but also more ***heavily indebted***.

## Profit/loss



- Total lease expense is ***front-loaded*** even when cash rentals are constant.

# Impact on financial ratios





# Lessee accounting - initial measurement



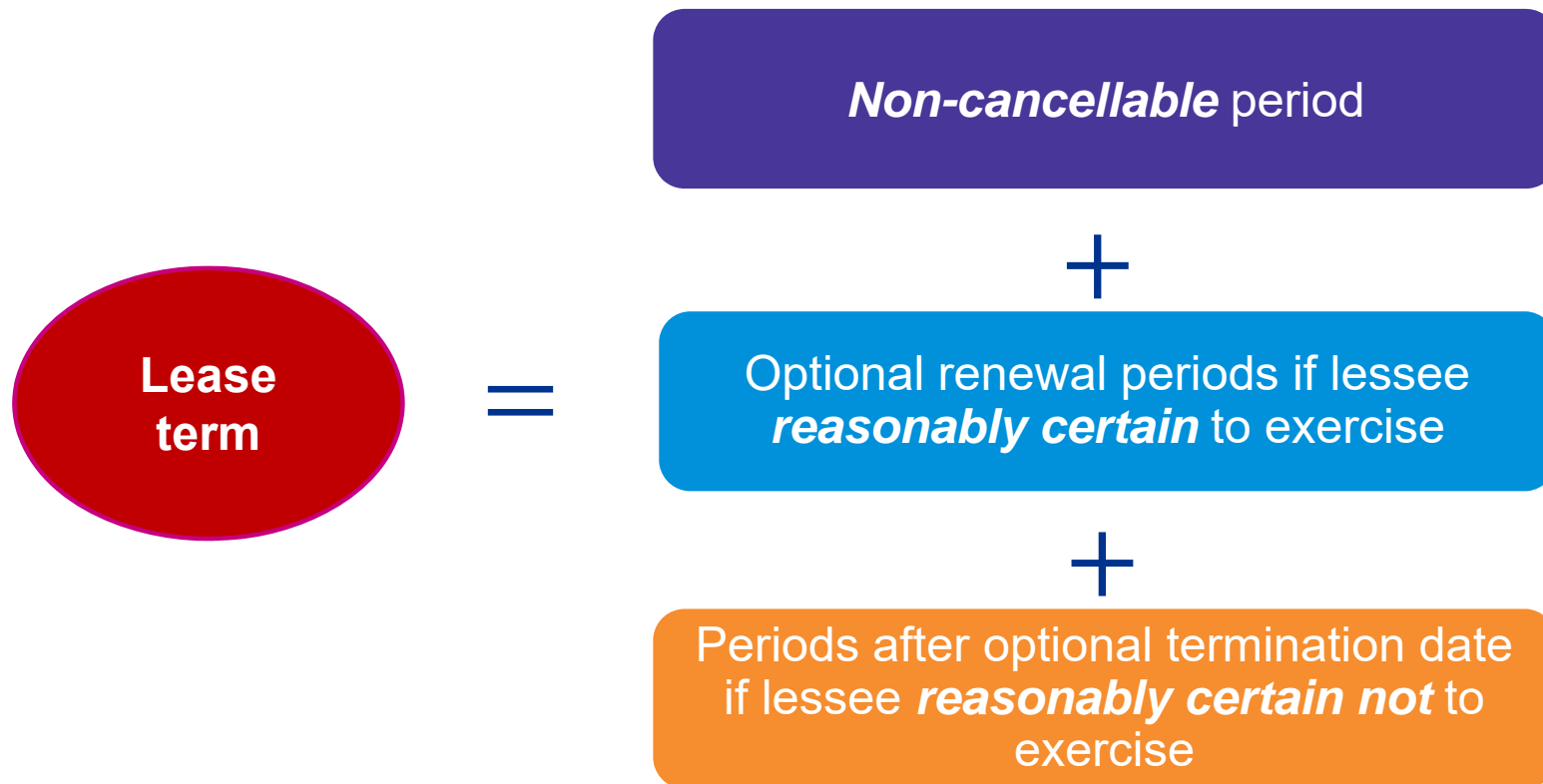
# Measuring the lease liability



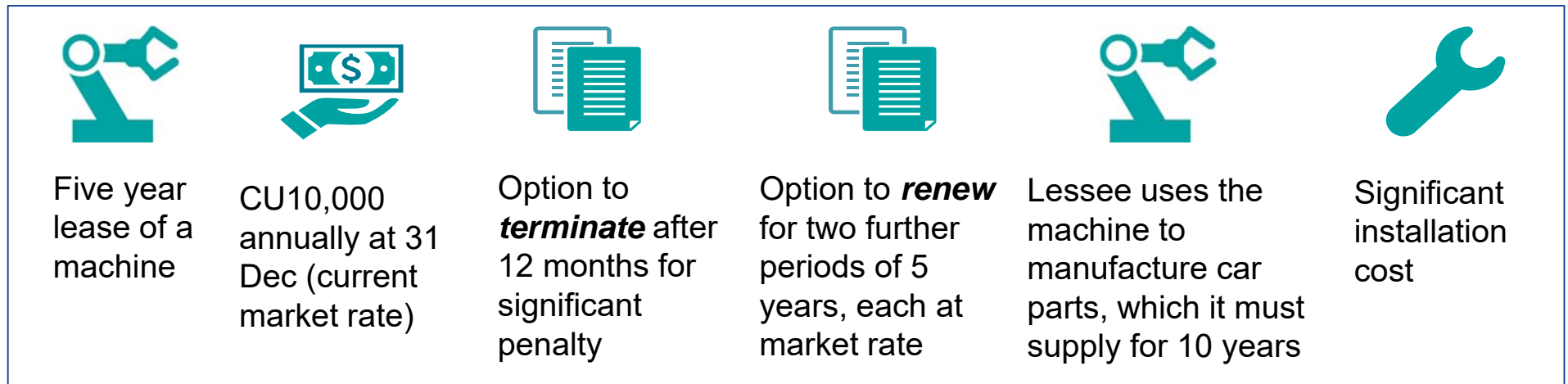
**Key inputs**



# Lease term



# Lease term - example









**“Why is the lease term important?”**

Lease term?	Lease liability*
1 year	CU9,000
5 years	CU41,000
10 years	CU70,000
15 years	CU91,000

\* Based on 7% discount rate

# Lease term - example

					
Five year lease of a machine	CU10,000 annually at 31 Dec (current market rate)	Option to <b>terminate</b> after 12 months for significant penalty	Option to <b>renew</b> for two further periods of 5 years, each at market rate	Lessee uses the machine to manufacture car parts, which it must supply for 10 years	Significant installation cost

Incentive to terminate / renew the lease?



# Lease term - economic factors

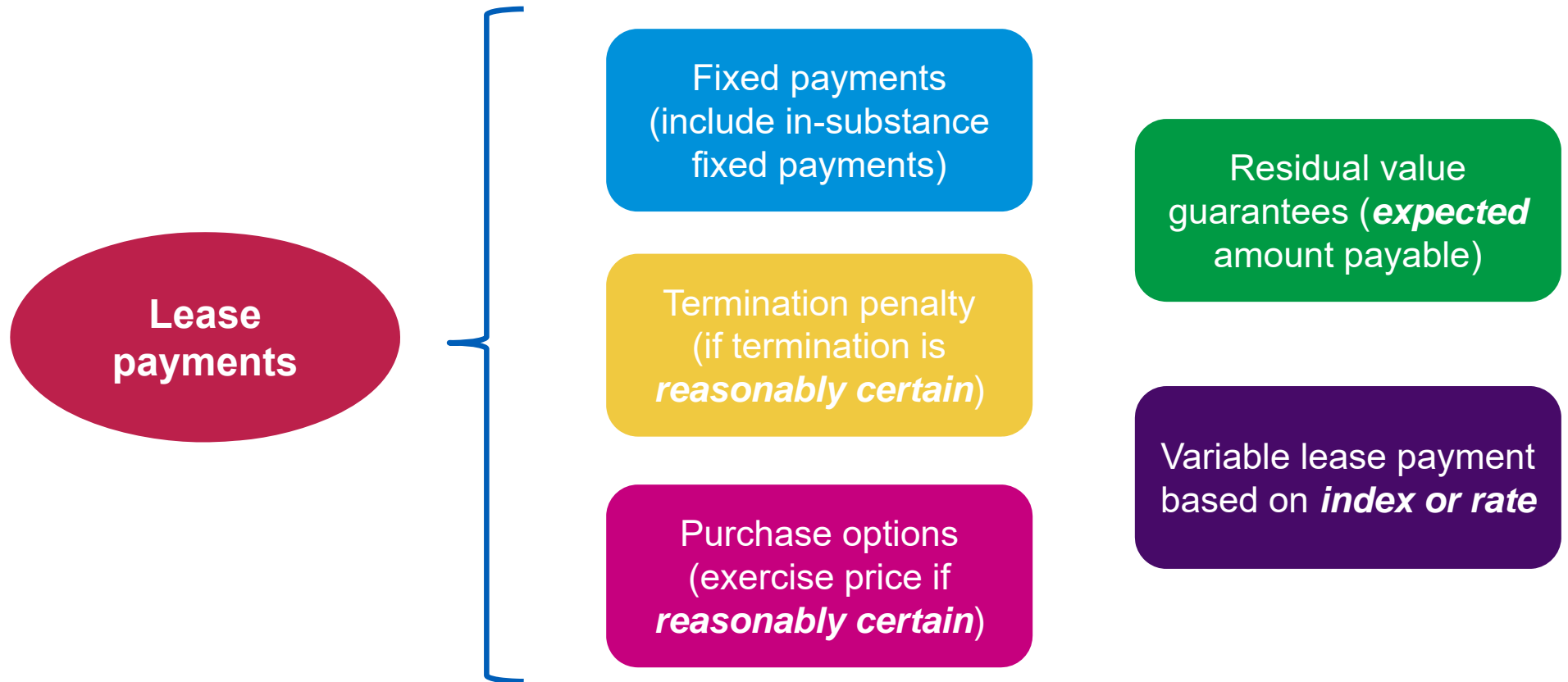
## Contractual/market

- Level of rentals in secondary period compared to market rates.
- Contingent payments.
- Renewal and purchase options.
- Costs relating to the termination of the lease and the signing of a new replacement lease.
- Returning costs of the underlying asset.

## Asset

- Nature of item (specialised).
- Location.
- Availability of suitable alternatives.
- Existence of significant leasehold improvements.

# Lease payments



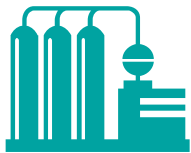
# Lease payments - include in lease liability?



Termination penalties



Based on assessment of lease term



Exercise price of purchase option



If reasonably certain to exercise



Variable payments based on sales or usage



Variable payments based on an index or rate



Based on current value of index or rate



Residual value guarantee



Based on expected payment

# Lease payments - example



15 year lease  
of a wind  
farm



Usage payments  
for expected case  
of CU1,000,000  
per annum



Usage payments  
for extreme low  
case of  
CU700,000 per  
annum\*



Maintenance  
costs of  
CU10,000 per  
annum



Restoration  
costs of  
CU100,000 at  
end of lease

\*based on 20 years of climate data: wind has never blown at less than 70% of the wind farm's capacity.



# Lease payments - example



15 year lease  
of a wind  
farm



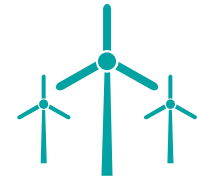
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Restoration  
costs of  
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end of lease

\*based on 20 years of climate data: wind has never blown at less than 70% of the wind farm's capacity.

Include in  
lease  
liability?



(But still a liability  
under Ind AS 37!)

# Discount rate

The rate implicit in the lease, if readily available

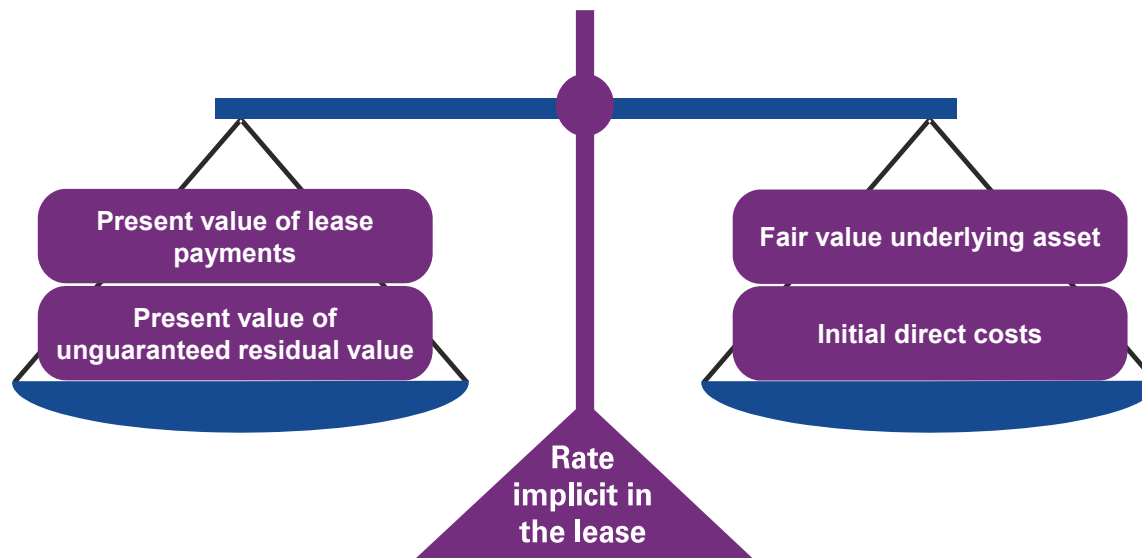
OR

The lessee's incremental borrowing rate

**“Why is the discount rate important?”**

Discount rate	Lease liability (5 year lease @ CU10,000 per annum)
3%	CU46,000
5%	CU43,000
7%	CU41,000
10%	CU38,000

# Discount rate - rate implicit in the lease



# Measuring the right-of-use (ROU) asset

**ROU asset**

=

**Lease liability**

+

**Initial direct costs**

+

**Prepaid lease payments**

+

**Costs to dismantle or restore  
(Ind AS 37)**

-

**Lease incentives**

# Lessee accounting - subsequent measurement

# Subsequent measurement

## Lease liability

- Amortised cost using the effective interest method.

## ROU asset (cost model)

- Depreciated in accordance with Ind AS 16 *Property, Plant & Equipment*.
- Depreciation period is the shorter of lease term/useful life.
- Impairment testing under Ind AS 36 *Impairment*.

## ROU asset (alternative models)

- Revaluation model under Ind AS 16.
- Fair value model under Ind AS 40 *Investment Property*.

# Re-measurement of lease liability

Re-measure to reflect reassessment of any changes in:

- |  |          |
|--|----------|
| <ul style="list-style-type: none"><li>▪ Expected amount payable on the residual value guarantee</li><li>▪ Index or rates</li><li>▪ In-substance fixed payments</li></ul> | <b>A</b> |
| <ul style="list-style-type: none"><li>▪ Lease term</li><li>▪ Floating interest rates</li><li>▪ Assessment of purchase options</li></ul>                                  | <b>B</b> |

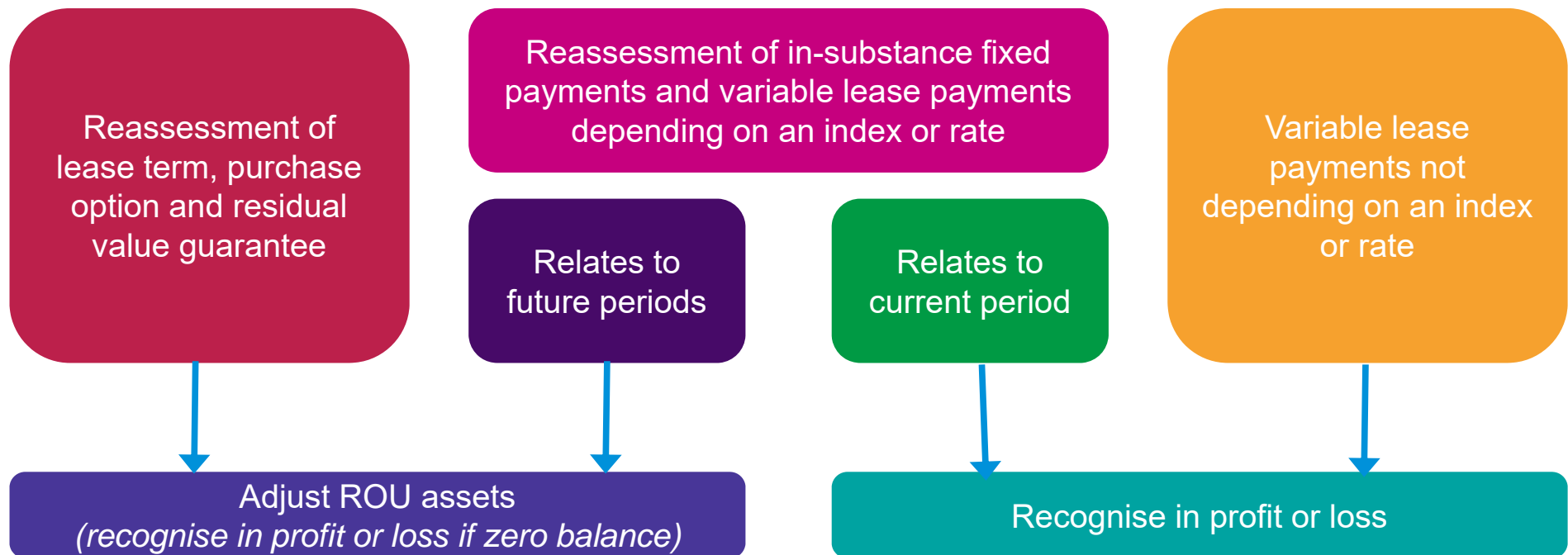
For each trigger:  
Which discount rate ?

A. Unchanged discount rate ?

B. Revised discount rate ?

# Re-measurement of ROU asset

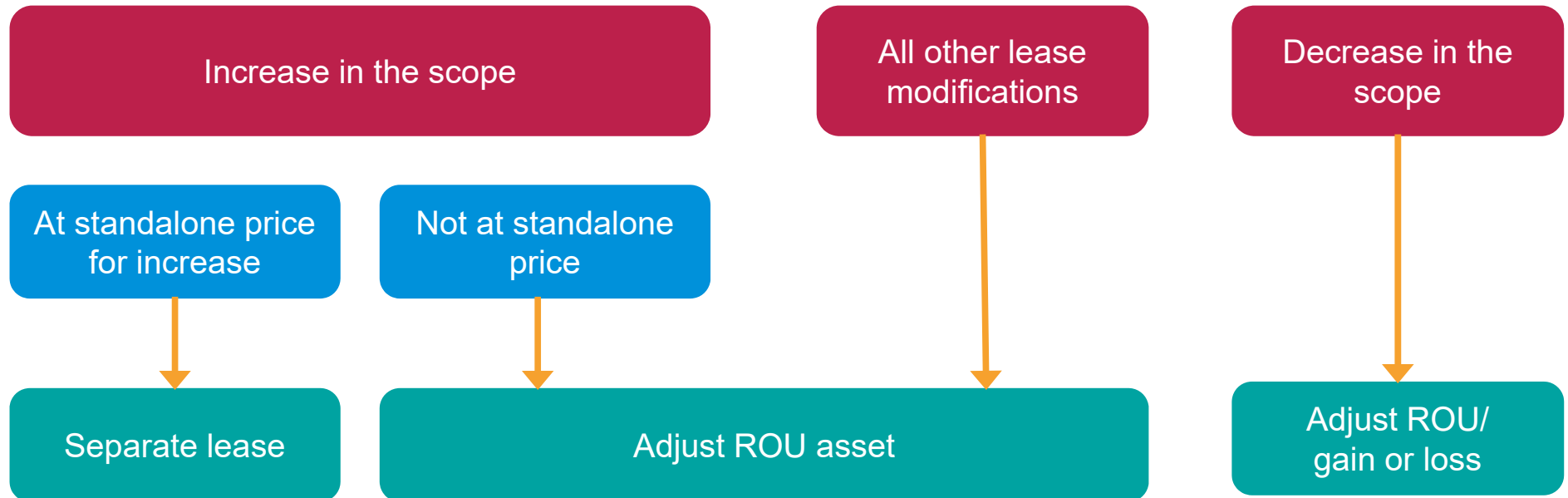
Changes in carrying amount of lease liability due to:





# Lease modifications

Change to the contractual terms and conditions  
(excludes exercise of option included in original lease contract)






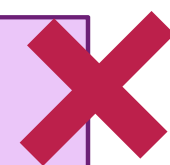
# Lessor accounting

# Lessor accounting

## Same as Ind AS 17

- Lease classification test.
  - Finance lease model.
  - Operating lease model.
- 

## Different to Ind AS 17

- Definition of a lease.
  - Sale-and-leaseback guidance.
  - Sub-lease guidance.
  - Accounting for lease modifications.
  - Disclosure requirements.
- 

**No symmetry between lessee and lessor accounting!**



# Lessor accounting - example



Five year  
lease of a  
machine



CU10,000 per  
annum due at  
31 Dec



No renewal  
nor purchase  
option



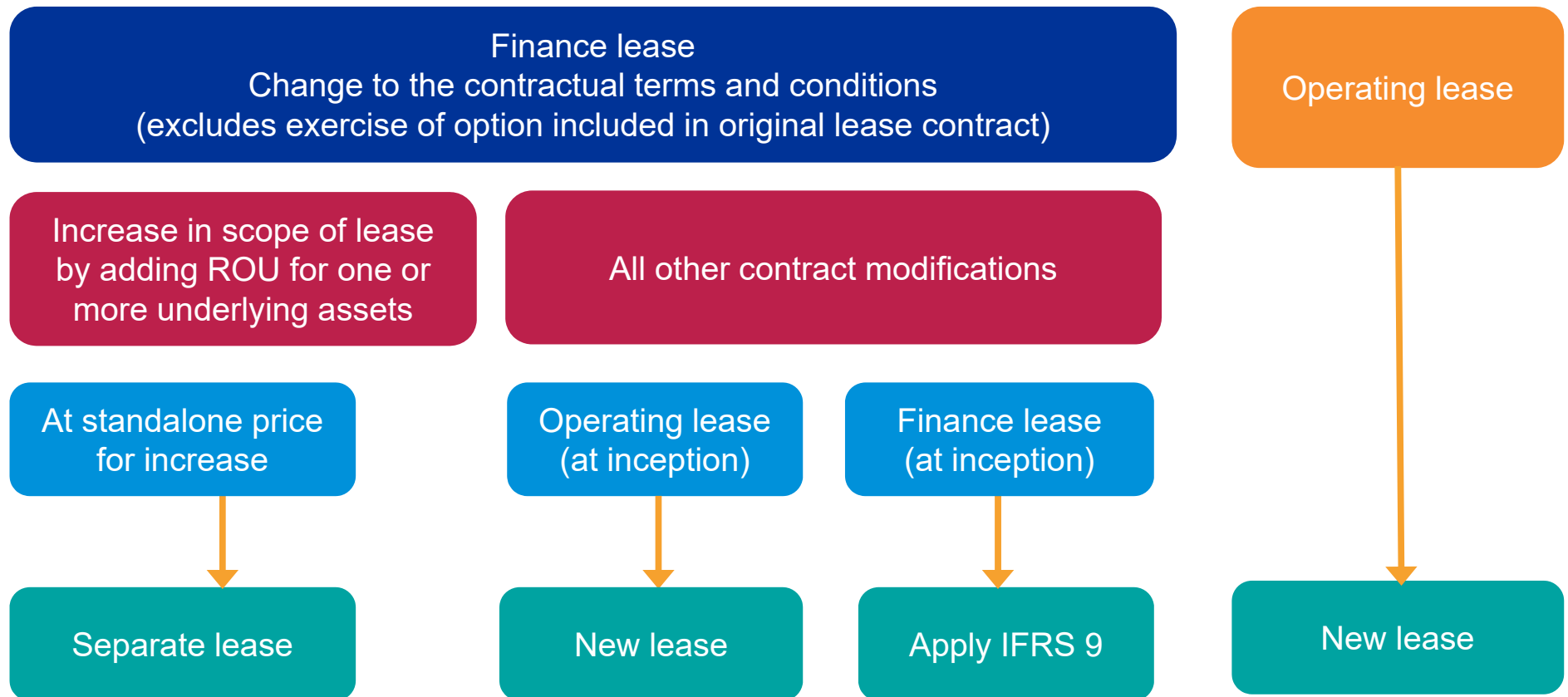
Discount  
rate: 7%



Machine  
useful life: 10  
years

Lessee A ROU asset on initial measurement = CU41,000

# Lessor accounting - lease modifications

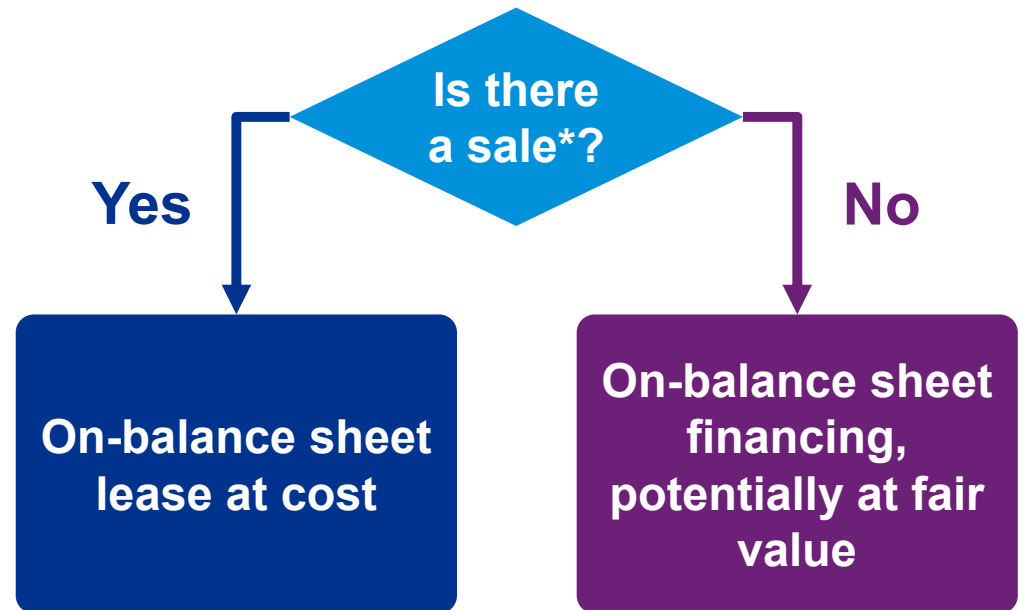




# Other lease accounting topics

# Sale-and-leaseback

Ind AS 116 essentially ***kills sale-and-leaseback*** as an off-balance sheet financing structure.



\*Apply IFRS 15 *Revenue from Contracts with Customers* to assess whether there is a sale

# Investment property

A lessee applies Ind AS 40 for subsequent measurement of a right-of-use asset if the underlying asset is investment property.

**Measure at cost or  
fair value  
(accounting policy choice  
for all investment property)**

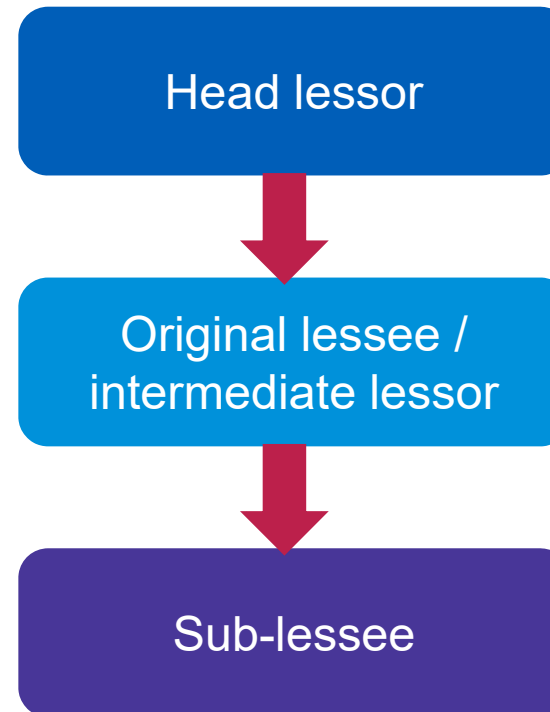
**Fair value disclosures  
under Ind AS 40 and Ind AS  
113**



# Sub-lease

## Intermediate lessor:

- Accounts for head lease and sublease as two separate contracts.
- Classifies the sublease **based on the ROU asset** arising from the head lease.
- Recognises lease assets and lease liabilities gross – unless offset criteria met.
- Recognises lease income and lease expense gross – unless acting as agent.



# Sub-lease - example

## Head lease:

- 50-year lease of investment property, commenced 1 January 1996.
- As at 1 January 2016:
  - Fair value of ROU asset CU30 million.
  - Lease liability of CU15 million.

Government  
(head lessor)

Prop Co  
(intermediate lessor)

Fast Retail Co  
(sub-lessee)

## Sub lease:

- 30-year sub-lease, commenced 1 January 2016.
  - Initial direct costs of CU1 million.
  - Present value of fixed lease payments CU20 million.
  - Present value of expected turnover rents CU10 million.

What  
questions  
do you  
have?



Thank you