

IND AS 116

Question 73: Remeasurement of a lease with variable lease payments (Modified)

Entity W entered into a contract for lease of retail store with Entity J on January 01/01/2017. The initial term of the lease is 5 years with a renewal option of further 3 years. The annual payments for initial term and renewal term is Rs. 100,000 and Rs. 110,000 respectively. The annual lease payment will increase based on the annual increase in the CPI at the end of the preceding year. For example, the payment due on 01/01/18 will be based on the CPI available at 31/12/17.

Entity W's incremental borrowing rate at the lease inception date and as at 01/01/2020 is 5% and 6% respectively and the CPI at lease commencement date and as at 01/01/2020 is 120 and 125 respectively.

At the lease commencement date, Entity W did not have a significant economic incentive to exercise the renewal option. In the first quarter of 2020, Entity W installed unique lease improvements into the retail store with an estimated five-year economic life. Entity W determined that it would only recover the cost of the improvements if it exercises the renewal option, creating a significant economic incentive to extend.

Is Entity W required to remeasure the lease in the first quarter of 2020?

Solution: Since Entity W is now reasonably certain that it will exercise its renewal option, it is required to remeasure the lease in the first quarter of 20X4.

The following table summarizes information pertinent to the lease remeasurement.

Remeasured lease term	5 years; 2 years remaining in the initial term plus 3 years in the renewal period
Entity W's incremental borrowing rate On the remeasurement date	6%
CPI available on the remeasurement date	125
Right-of-use asset immediately before the remeasurement	Rs. 1,81,840 (Refer note 1)
Lease liability immediately before the remeasurement	Rs. 1,95,244 (Refer note 1)

To remeasure the lease liability, Entity W would first calculate the present value of the future lease payments for the new lease term (using the updated discount rate of 6%). The following table shows the present value of the future lease payments based on an updated CPI of 125. Since the initial lease payments were based on a CPI of 120, the CPI has increased by 4.167% approx. As a result, Entity W would increase the future lease payments by 4%. As shown in the table, the revised lease liability is Rs. 4,91,376.

Year	4	5	6	7	8	Total
Lease payment	1,04,167	1,04,167	1,14,583	1,14,583	1,14,583	5,52,083
Discount	1	0.943	0.890	0.840	0.792	
Present value	1,04,000	98,230	1,01,979	96,250	90,750	4,91,376

To calculate the adjustment to the lease liability, Entity W would compare the recalculated and original lease liability balances on the remeasurement date.

Revised lease liability	4,91,376
Original lease liability	<u>(1,95,244)</u>
	<u>2,96,132</u>

Entity W would record the following journal entry to adjust the lease liability.

ROU Asset	Dr.	2,96,132	
To Lease liability			2,96,132
<i>Being lease liability and ROU asset adjusted on account of remeasurement.</i>			

Working Notes:

Calculation of ROU asset before the date of remeasurement

Year beginning	Lease Payment (A)	Present value factor @ 5% (B)	Present value of lease payments (A x B=C)
1	1,00,000	1.000	1,00,000
2	1,00,000	0.952	95,200
3	1,00,000	0.907	90,700
4	1,00,000	0.864	86,400
5	1,00,000	0.823	<u>82,300</u>
Lease liability as at commencement date			<u>4,54,600</u>

Calculation of Lease Liability and ROU asset at each year end

Year	Lease Liability				ROU asset		
	Initial value	Lease payments	Interest expense @ 5%	Closing balance	Initial Value	Depreciation for 5 years	Closing balance
1	4,54,600	1,00,000	17,730	3,72,330	4,54,600	90,920	3,63,680
2	3,72,330	1,00,000	13,617	2,85,947	3,63,680	90,920	2,72,760
3	2,85,947	1,00,000	9,297	1,95,244	2,72,760	90,920	1,81,840
4	1,95,244				1,81,840		

Question 75 Deferral of lease payments not a lease modification

Lessor L leases retail space to Lessee Z and classifies the lease as an operating lease. The lease includes fixed lease payments of Rs. 10,000 per month.

Due to the COVID-19 pandemic, L and Z agree on a rent concession that allows Z to pay no rent in the period from July, 2020 to September 2020 but to pay rent of 20,000 per month in the period from January 2021 to March 2021. There are no other changes to the lease.

How this will be accounted for by lessor?

Solution: L determines that the reduction in lease payments in July 2020 to September 2020 and the proportional increase in January 2021 to March 2021 does not result in an overall change in the consideration for the lease.

L does not account for the change as a lease modification. L continues to recognise operating lease income on a straight-line basis, which is representative of the pattern in which Z's benefit from use of the underlying asset is diminished.

Question 76: Unamortised lease incentive: Lease modification

Lessor M enters into a 10-year lease of office space with Lessee K, which commences on 1 April 2015. The rental payments are 15,000 per month, payable in arrears. M classifies the lease as an operating lease. M reimburses K's relocation costs of K of 600,000, which M accounts for as a lease incentive. The lease incentive is recognised as a reduction in rental income over the lease term using the same basis as for the lease income – in this case, on a straight-line basis over 10 years.

On 1 April 2020, during the COVID-19 pandemic, M agrees to waive K's rental payments for May, June and July 2020.

This decrease in consideration is not included in the original terms and conditions of the lease and is therefore a lease modification.

How this will be accounted for by lessor?

Solution: M accounts for this modification as a new operating lease from its effective date – i.e. 1 April 2020. M recognises the impact of the waiver on a straight-line basis over the five-year term of the new lease. M also takes into account the carrying amount of the unamortised lease incentive on 1 April 2020 of Rs. 3,00,000. M amortises this balance on a straight-line basis over the five-year term of the new lease

Question 77 Modification that is not a separate lease and lease would have been classified as an operating lease

Lessor L enters into an eight-year lease of 40 lorries with Lessee M that commences on 1 January 2018. The lease term approximates the lorries' economic life and no other features indicate that

the lease transfer or does not transfer substantially all of the risks and rewards incidental to ownership of the lorries. Assuming that substantially all of the risks and rewards incidental to ownership of the lorries are transferred, L classifies the lease as a finance lease.

During the COVID-19 pandemic, M's business has contracted. In June 2020, L and M amend the contract so that it now terminates on 31 December 2020.

Early termination was not part of the original terms and conditions of the lease and this is therefore a lease modification. The modification does not grant M an additional right to use the underlying assets and therefore cannot be accounted for as a separate lease.

How this will be accounted for by lessor?

Solution: L determines that, had the modified terms been effective at the inception date, the lease term would not have been for the major part of the lorries' economic life. Furthermore, there are no other indicators that the lease would have transferred substantially all of the risks and rewards incidental to ownership of the lorries. Therefore, the lease would have been classified as an operating lease.

In June 2020, L accounts for the modified lease as a new operating lease. The lessor L:

- a) derecognises the finance lease receivable and recognises the underlying assets in its statement of financial position according to the nature of the underlying asset – i.e. as property, plant and equipment in this case; and
- b) measures the aggregate carrying amount of the underlying assets as the amount of the net investment in the lease immediately before the effective date of the lease modification.

Question 78 Revised consideration is substantially the same as or less than the original consideration

Retailer Q leases a store in a large retail mall. The rent payable is Rs. 1,00,000 per month. As a result of the COVID-19 pandemic, Q agrees with the lessor to defer the rent originally due in the months April, 2020 to June, 2020.

As part of this agreement, the rent for the period January, 2021 to March 2021 will be increased by Rs. 1,10,000 per month, which compensates the lessor for the deferred rent as adjusted for the time value of money.

Whether the rent deferral is eligible for the practical expedient if the other conditions are met?

Solution: The rent deferral satisfies the criteria to apply the practical expedient because:

- It is a rent concession occurring as a direct consequence of the pandemic;
- Increase in rentals during January, 2021 to March 2021 compensates for the time value of money;
- Rent deferral reduces lease payments originally due on or before 30 June 2021; and
- There is no substantive change to other terms and conditions of the lease. Hence, Q considers applying the practical expedient.

Question 79: Consider only payments that were originally due on or before 30 June, 2021

Lessee P operates a chain of restaurants and leases several outlets. As a result of COVID-19 pandemic, P agrees a rent deferral with the lessor.

Under the terms of the rent deferral, rent originally due in the period July 2020 to December 2020 will be added to the rent due in the period July 2021 to December 2021.

Whether the rent deferral is eligible for the practical expedient if the other conditions are met?

Solution: The rent deferral satisfies the criteria to apply the practical expedient because:

- It is a rent concession occurring as a direct consequence of the pandemic;
- Recovery of rentals during July, 2021 to December, 2021 is substantially the same as, or less than, the consideration for the lease immediately preceding the change;
- Rent deferral reduces lease payments originally due on or before 30 June 2021; and
- There is no substantive change to other terms and conditions of the lease.

Therefore, P concludes that the rent deferral meets the 'payments due' eligibility criterion.

Question 80- Reduction in rent payments that extends beyond 30 June 2021

Lessee T leases office buildings from a lessor. As a result of the COVID-19 pandemic, in September 2020, T agrees a rent concession with the lessor, under which the monthly rent will be reduced by 50% per month for the 12 months commencing 1 October 2020.

Whether the rent deferral is eligible for the practical expedient if the other conditions are met?

Solution: The rent deferral does not satisfies the criteria to apply the practical expedient because out of the listed eligibility criteria given in para 46B of Ind AS 116, rent deferral reduces lease payments starting from October, 2020 and reduction will continue till September, 2021 which is beyond 30 June 2021.

Therefore, T is not permitted to apply the practical expedient.

Question 81- Deferral of rent payments by extending the lease term

A lessee is granted a rent concession by the lessor whereby the lease payments for the period April 2020 to June 2020 are deferred. Three months are added to the end of the lease term at the same monthly rent, and the lessee repays the deferred rent during those additional months. The rent concession is a direct consequence of COVID-19.

Whether the rent deferral is eligible for the practical expedient?

Solution: The lessee considers applying the practical expedient. In considering whether this rent concession is eligible for the practical expedient, the lessee notes the following.

Firstly, the revised consideration in the lease is substantially the same as the original – i.e. the condition in paragraph 46B(a) of Ind AS 116 is met.

Secondly, the rent concession only reduces lease payments originally due in 2020 – i.e. before 30 June 2021 – so the condition in paragraph 46B(b) of Ind AS 116 is met.

Thirdly, there is a change in the lease term – an extension by three months.

There is no explicit guidance on what is considered ‘substantive’. Judgement will need to be applied, considering both qualitative and quantitative factors. The lessee assesses that three-month extension at the end of the lease term with substantially the same lease payments, would not constitute a substantive change.

Hence, the condition in paragraph 46B(c) of Ind AS 116 is met. Since, the rent concession is a direct consequence of COVID-19 and all three conditions in paragraph 46B of Ind AS 116 are met, the lessee concludes that the rent concession is eligible for application of practical expedient.

Question 82- Forgiveness of lease payments

Lessee Z entered into a lease contract with Lessor L to lease 1,500 sqm of retail space for five years. The lease commenced on 1 April 2018 and the rental payments are 100,000 payable quarterly in advance on 1 April, 1 July, 1 October and 1 January. Z’s incremental borrowing rate at commencement of the lease is 5% (assume that the interest rate implicit in the lease cannot be readily determined). There are no initial direct costs, lease incentives or dismantling costs.

Z’s business is severely impacted by the COVID-19 pandemic and L and Z negotiate a rent concession. On 1 June 2020, L agrees to provide Z with an unconditional rent concession that allows Z to forego payment of its rent due on 1 July – i.e. L forgives Z the rent payment of 100,000 due on 1 July.

What will be the accounting treatment in the books of lessee for rent concessions assuming that it is eligible for practical expedient?

Solution: Z determines that the rent concession is eligible for the practical expedient.

Applying the practical expedient, Z should account for the forgiveness of rent as a negative variable lease payment. The rent concession is unconditional, so the event that triggers the variable lease payment is the agreement between Z and L for the rent concession on 1 June 2020.

Therefore, Z accounts for the rent concession as a negative variable lease payment on 1 June.

Assuming that there are no other changes to the lease, Z continues to use the retail space and the right-of-use asset is not impaired. The lease accounting entries will be as follows:

- recognise the rent concession as a variable lease payment in profit or loss (i.e. record a debit to the lease liability and a corresponding credit in the income statement); and
- continue to accrue interest on the lease liability at the unchanged incremental borrowing rate of 5% (i.e. record a debit to interest expense and a corresponding credit to the lease liability).

After accounting for the impact of the rent concession, Z's lease liability represents the present value of all future lease payments owing to L, discounted at the unchanged incremental borrowing rate. Z has effectively derecognised the portion of the lease liability that has been extinguished by the forgiveness of the quarterly lease payment due on 1 July 2020.

In addition, Z continues to depreciate the carrying amount of the right-of-use asset, which is unchanged as a result of the rent concession.