

Ind AS 17

Leases

Agenda

- Scope and key definitions
- Classification
- Measurement
- Disclosures
- Sale and leaseback transactions
- Whether an arrangement contains a lease
- Key Differences

Scope and key definitions

Scope

Objective - To prescribe, for lessees and lessors, the appropriate accounting policies and disclosure to apply in relation to leases.

Out of scope

- leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources; and
- licensing agreements for such items as motion picture films, video recordings, plays, manuscripts, patents and copyrights.

Out of scope for measurement

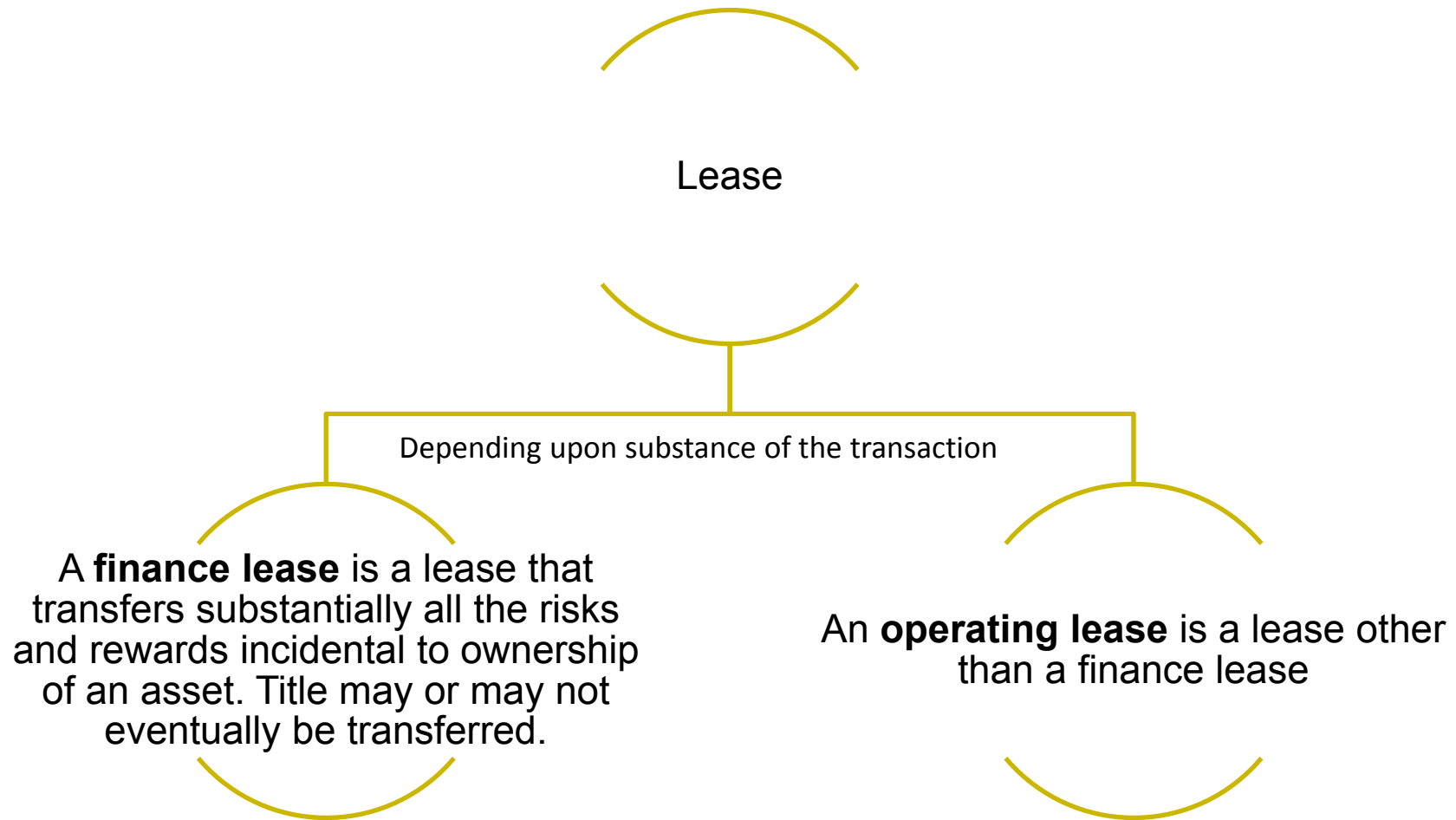
- property held by lessees that is accounted for as investment property (see Ind AS 40 Investment Property);
- investment property provided by lessors under operating leases (see Ind AS 40);
- biological assets held by lessees under finance leases (see Ind AS 41 Agriculture); or
- biological assets provided by lessors under operating leases (see Ind AS 41).

Key definitions

What is a lease?

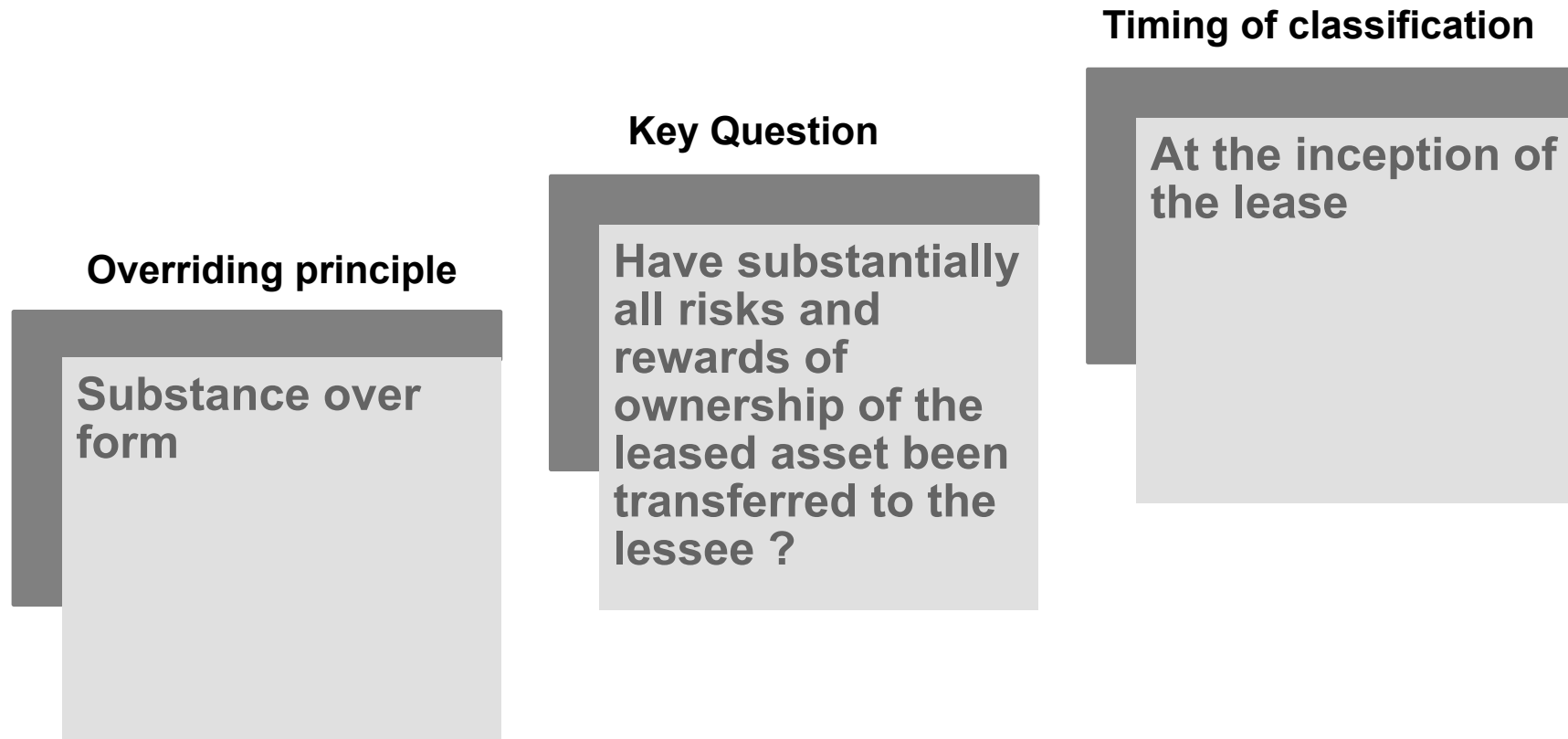
A **lease** is an agreement whereby the lessor conveys to the lessee in return for a payment or series of payments the right to use an asset for an agreed period of time

Types of lease



Classification

Classification of leases



If at any time the lessee and the lessor agree to change the provisions of the lease, except by renewing the lease, resulting in a different classification of the lease, if the changed terms were mentioned at the inception of the lease, the revised agreement is regarded as a new agreement over its term. Change in estimates do not give rise to a classification of the lease.

Indicators

If any of the indicators fulfil the conditions then lease shall be classified as finance lease else operating lease.

Indicators to classify

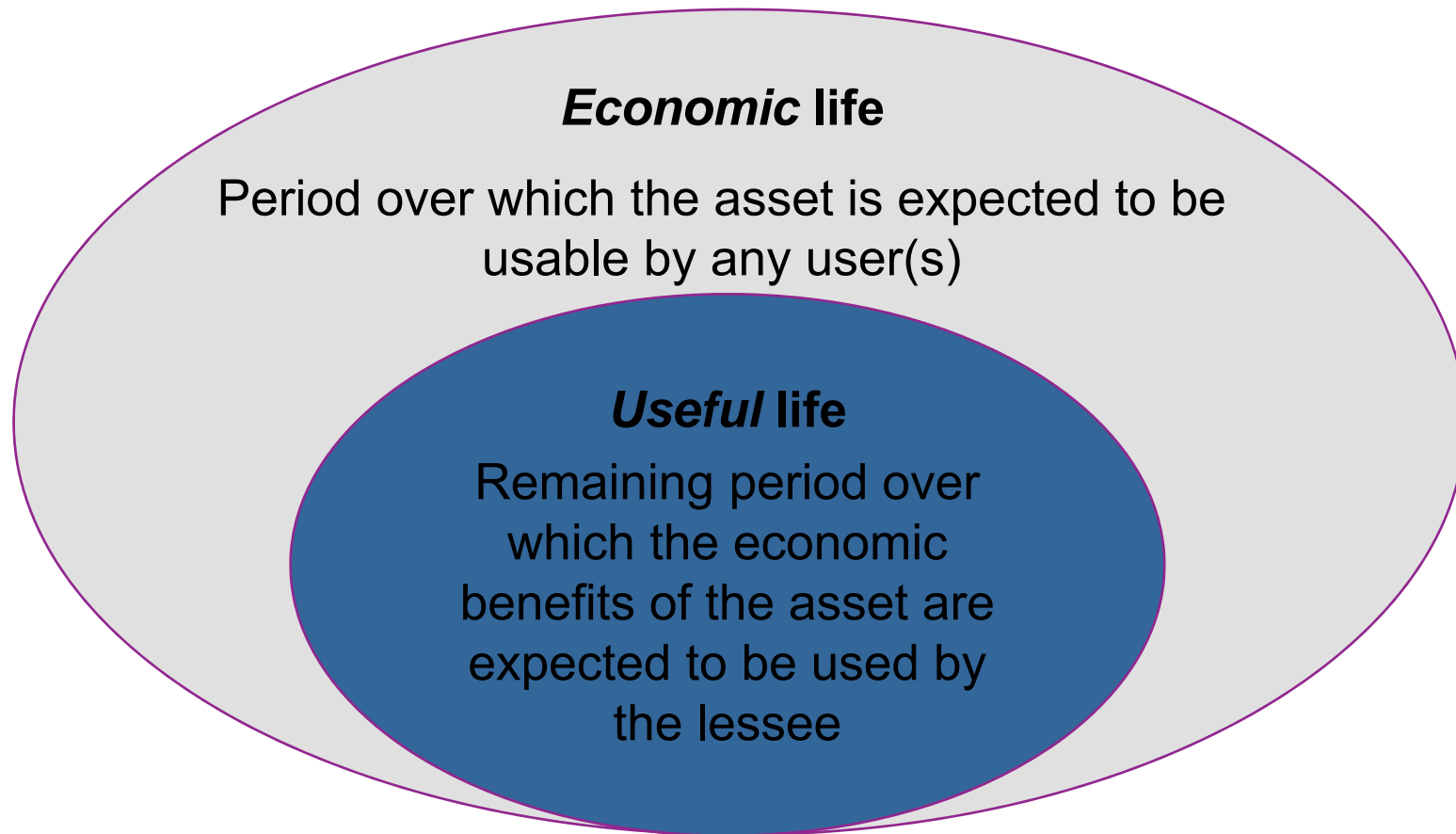


Additional indicators:

- If the lessee cancels the lease, cancellation losses are borne by the lessee.
- Gains or losses from the fluctuation in the fair value of the residual accrue to the lessee
- The lessee has the ability to continue the lease for a secondary period at a rent that is substantially lower than market rent.

Economic versus useful life

Lease for majority of *economic life* ?



Minimum lease payments



Include

- Non-cancellable lease payments
- Lease payments under bargain renewal option
- Purchase option if reasonable certainty of exercise
- Guaranteed residual value

Exclude

- Cost for services
- Taxes if paid by and reimbursed to the lessor
- Contingent rent

Guaranteed residual value

▶ Lessee

- ▶ Lessee (or related party) guarantees value of asset at the end of the lease term
- ▶ Lessee is at risk for residual value
- ▶ Include amount of residual value guaranteed in the minimum lease payments

▶ Lessor

- ▶ Amount of residual value guaranteed by lessee (or party related to lessee or third party)
- ▶ Means lessor is not at risk for residual value
- ▶ Include amount of residual value guarantee in minimum lease payments

Discount rates for PV calculations

- ▶ Lessor
 - ▶ Interest rate implicit in the lease

- ▶ Lessee
 - ▶ Interest rate implicit in the lease
 - ▶ If not possible to determine: incremental borrowing rate for acquiring such an asset

Measurement

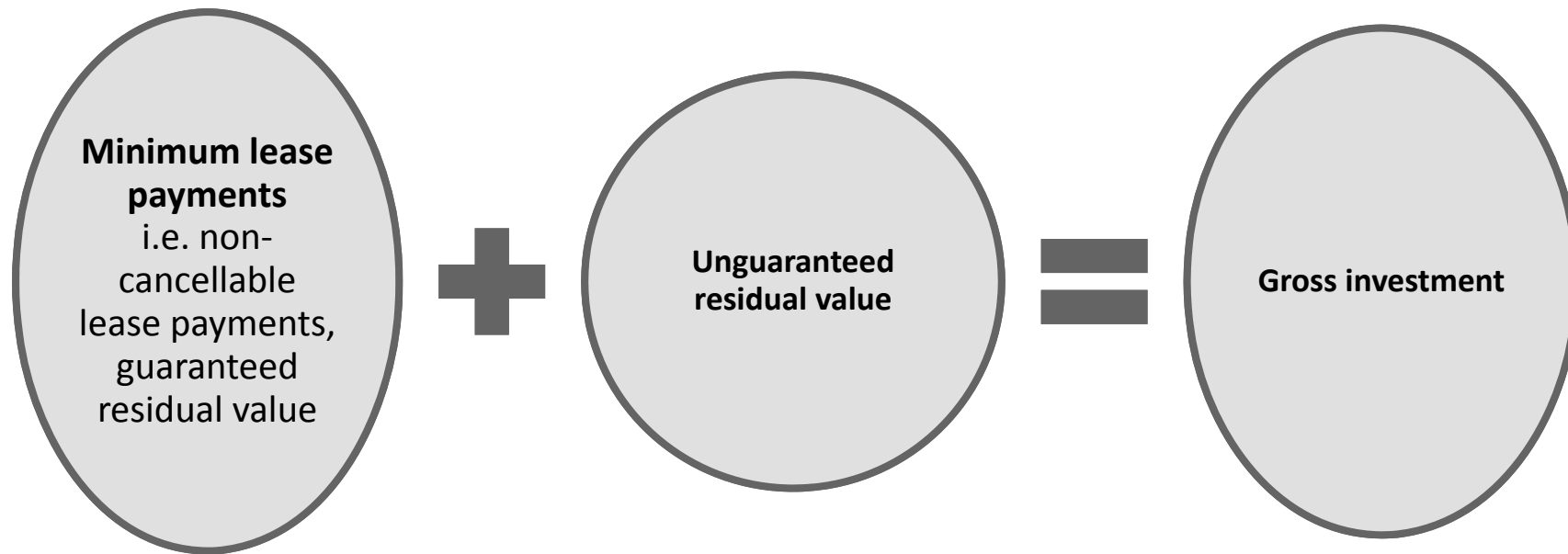
Operating lease

	Lessee	Lessor
Balance sheet	<ul style="list-style-type: none"> ▶ Prepaid/accrued lease rental payable 	<ul style="list-style-type: none"> ▶ Leased asset ▶ Accrued/deferred lease rental receivable
Income statement	<ul style="list-style-type: none"> ▶ Straight-line lease rentals expense over the lease term unless: ▶ another systematic basis is more representative of the time pattern of the user's benefit or ▶ increase in the payments to lessor are in line with expected general inflation to compensate for the lessor's inflationary cost increases 	<ul style="list-style-type: none"> ▶ Depreciation expense ▶ Lease rental income on a straight-line basis

Finance lease

	Lessee	Lessor
Balance sheet	<ul style="list-style-type: none"> ▶ Leased asset Includes direct costs ▶ Liability (offset by subsequent MLPs) Initially at higher of fair value or PV of minimum lease payments 	<ul style="list-style-type: none"> ▶ Receivable (At net investment in the lease, which is the gross investment in the lease discounted at the interest rate implicit in the lease.)
Income statement	<ul style="list-style-type: none"> ▶ Depreciation ▶ Finance expense (portion of MLPs) ▶ Contingent rents shall be expensed 	<ul style="list-style-type: none"> ▶ Profit on sale ▶ Finance income

Understanding the balance sheet terminology for lessors



Finance lease – Important considerations

- ▶ Lessee:
 - ▶ initially records leased asset and corresponding liability at lower of:
 - ▶ PV of minimum lease payments, and
 - ▶ fair value
 - ▶ depreciates asset over the shorter of:
 - ▶ lease term, or
 - ▶ useful life
 - ▶ unless reasonable certainty that lessee will obtain ownership by the end of the lease term
 - ▶ Lessee / Lessor:
 - ▶ Finance income or expense is calculated using effective interest rate method (using rate implicit in lease)
-

An example – Lease classification and measurement

- ▶ Entity A takes a machinery on lease for a period of 3 years (useful life 4 years)
- ▶ The fair value of the asset at the date of contract inception is INR 100,000 and the present value of minimum lease payments is INR 90,000. The MLPs are payable as INR 40,000 p.a. for 3 yrs.
- ▶ The interest rate implicit in the lease is 10%
- ▶ Post lease period the asset will be transferred to the lessee
- ▶ How would the lease be classified and accounted?

An example – Lease classification and measurement (cont.)

- ▶ The lease is taken for 75% of the useful life of the asset and the PV of minimum lease payments amount to 90% of the fair value of the asset. Hence, the lease shall be classified as a finance lease.
- ▶ On the date of commencement of the lease term, the asset and liability would be recorded at the lower of the fair value/ PV of MLPs at the date of inception of the lease (contract date) i.e., at INR 90,000.
- ▶ The asset would be depreciated over a period of 4 years and the lease payments would be offset between finance charge and outstanding liability.

An example – Lease classification and measurement (cont.)

Classification as finance lease (Year 1)

Statement of profit and loss	‘000
Depreciation of machinery (assuming no residual value)	(22.5)
Finance charge (90,000 *10%)	(9)

Balance Sheet

Tangible non-current assets	
Property (90-22.5)	67.5
Non-current liabilities:	
Deferred lease liability (90-(40-9))	(59)
(MLP split between finance charge and outstanding liability)	

Balance sheet impact – Summary

	Operating lease	Finance lease
Lessee	Off balance sheet	Leased asset Lease liability (PV of minimum lease payments)
Lessor	Leased asset	Lease receivable (PV of gross investment)

Land leases

- ▶ AS 19 scopes out lease of land from its scope.
- ▶ As per the recent EAC opinion, lease of land for longer period (say, 99 years) is treated as finance lease.
- ▶ Ind AS 17 deals with lease of land.
- ▶ Since land normally has an indefinite economic life, lease of land is normally operating lease unless the title passes on to the lessee by the end of the lease term.
- ▶ In case of composite leases, land lease need to be separated from building.

Land and buildings

- ▶ The land and buildings elements of a lease of land and buildings are considered separately for the purposes of lease classification under Ind AS 17.15
- ▶ **Composite lease of land and buildings :**
 - Minimum lease payments are allocated among them in proportion to the relative fair values at the inception of the lease. If the lease payments cannot be allocated reliably between these two elements, the entire lease is classified as a finance lease, unless it is clear that both elements are operating leases.
 - Amount that would initially be recognised for the land element is immaterial, the land and buildings may be treated as a single unit and classified as a finance or operating lease in accordance usual criteria and the economic life of the buildings is regarded as the economic life of the entire leased asset.
- ▶ Land element under Ind AS 17:
 - *“When a lease includes both land and buildings elements, an entity assesses the classification of each element as a finance or an operating lease separately. In determining whether the land element is an operating or a finance lease, an important consideration is that land normally has an indefinite economic life.”*
- ▶ Buildings element:
 - Classified as either finance or operating lease, using the usual criteria

Sale and leaseback transactions

Sale and leaseback transactions

A sale and leaseback transaction involves the sale of an asset and the leasing back of the same asset.

Resulting in finance lease- any excess of sales proceeds over the carrying amount shall not be immediately recognised as income by a seller-lessee. Instead, it shall be deferred and amortised over the lease term.

Resulting in operating lease-

-If at fair value, any profit or loss shall be recognised immediately.

-If the sale price is below fair value, any profit or loss shall be recognised immediately except that, if the loss is compensated for by future lease payments at below market price, it shall be deferred and amortised in proportion to the lease payments over the period for which the asset is expected to be used.

-If the sale price is above fair value, the excess over fair value shall be deferred and amortised over the period for which the asset is expected to be used.

Sale and leaseback transactions may trigger the separate disclosure criteria in Ind AS 1 Presentation of Financial Statements.

Sale and leaseback transactions - Example

- ▶ An asset that has a carrying value of ₹ 7,000 and a remaining useful life of 7 years is sold for ₹ 12,000 and leased back on a finance lease. This is accounted for as a disposal of the original asset and the acquisition of an asset under a finance lease for ₹ 12,000. The excess of sales proceeds of ₹ 5,000 over the original carrying value should be deferred and amortised (i.e. credited to profit and loss) over the lease term.
- ▶ The net impact on income of the charge for depreciation based on the carrying value of the asset held under the finance lease of ₹ 1,715 (₹ 12,000 over 7 years) and the amortisation of the deferred income of ₹ 715 (₹ 5,000 over 7 years) is the same as the annual depreciation of ₹ 1,000 based on the original carrying amount

Disclosures

Disclosures – Operating Lease

Disclosures

By lessees- operating lease

- ▶ Future minimum lease payments (< 1 yr, 1–5 yrs, >5 yrs)
- ▶ Total of future minimum sublease payments expected to be received under non cancellable subleases
- ▶ Lease and sublease payments recognised as an expense in the period, with separate amounts for minimum lease payments, contingent rents, and sublease payments.
- ▶ General description of material leasing arrangements.

By Lessors- operating leases

- ▶ Future minimum lease payments (< 1 yr, 1–5 yrs, >5 yrs)
- ▶ contingent rents recognised as income in the period.
- ▶ a general description of the lessor's material leasing arrangements

Disclosures- Finance Lease

Disclosures

By lessees- finance lease

- ▶ for each class of asset, the net carrying amount at the end of the reporting period
- ▶ reconciliation between the total of future MLPs at the end of the reporting period, and their PV for (< 1 yr, 1–5 yrs, >5 yrs)
- ▶ contingent rents recognised as an expense in the period
- ▶ Total of future minimum sublease payments expected to be received under non cancellable subleases
- ▶ General description of material leasing arrangements.

By Lessors- Finance Lease

- ▶ reconciliation between the gross investment in the lease at the end of the reporting period, and the present value of MLPs (< 1 yr, 1–5 yrs, >5 yrs)
- ▶ unearned finance income
- ▶ the unguaranteed residual values accruing to the benefit of the lessor.
- ▶ the accumulated allowance for uncollectible minimum lease payments receivable.
- ▶ contingent rents recognised as income in the period.
- ▶ a general description of the lessor's material leasing arrangements

Arrangement containing a lease

Arrangement containing a lease

Introduction

- ▶ Entities often enter into agreements such as outsourcing agreements
 - ▶ Such agreements require/ entitle other company to acquire substantially all of output of an asset/ group of assets
 - ▶ Purchaser normally makes specified payments regardless of whether it takes delivery of goods/ services or not
 - ▶ Price generally does not vary in the same proportion as number of units purchased/ supplied.
- ▶ Typical examples
 - ▶ Outsourcing of data processing function of an entity
 - ▶ Arrangements in telecommunications industry, in which suppliers of network capacity enter into contracts to provide purchasers with rights to capacity
 - ▶ Power purchase agreements
- ▶ Assessment will be required to determine whether such arrangement is or contains a lease.
- ▶ Such assessment/ determination shall be made as per Ind AS 17.

Arrangement containing a lease

Whether an arrangement contains a lease

- ▶ Determination based on substance of the arrangement in terms of :
 - ▶ Whether fulfilment of arrangement is dependent on the use of specific asset or assets; and
 - ▶ Whether it conveys a right to use the asset

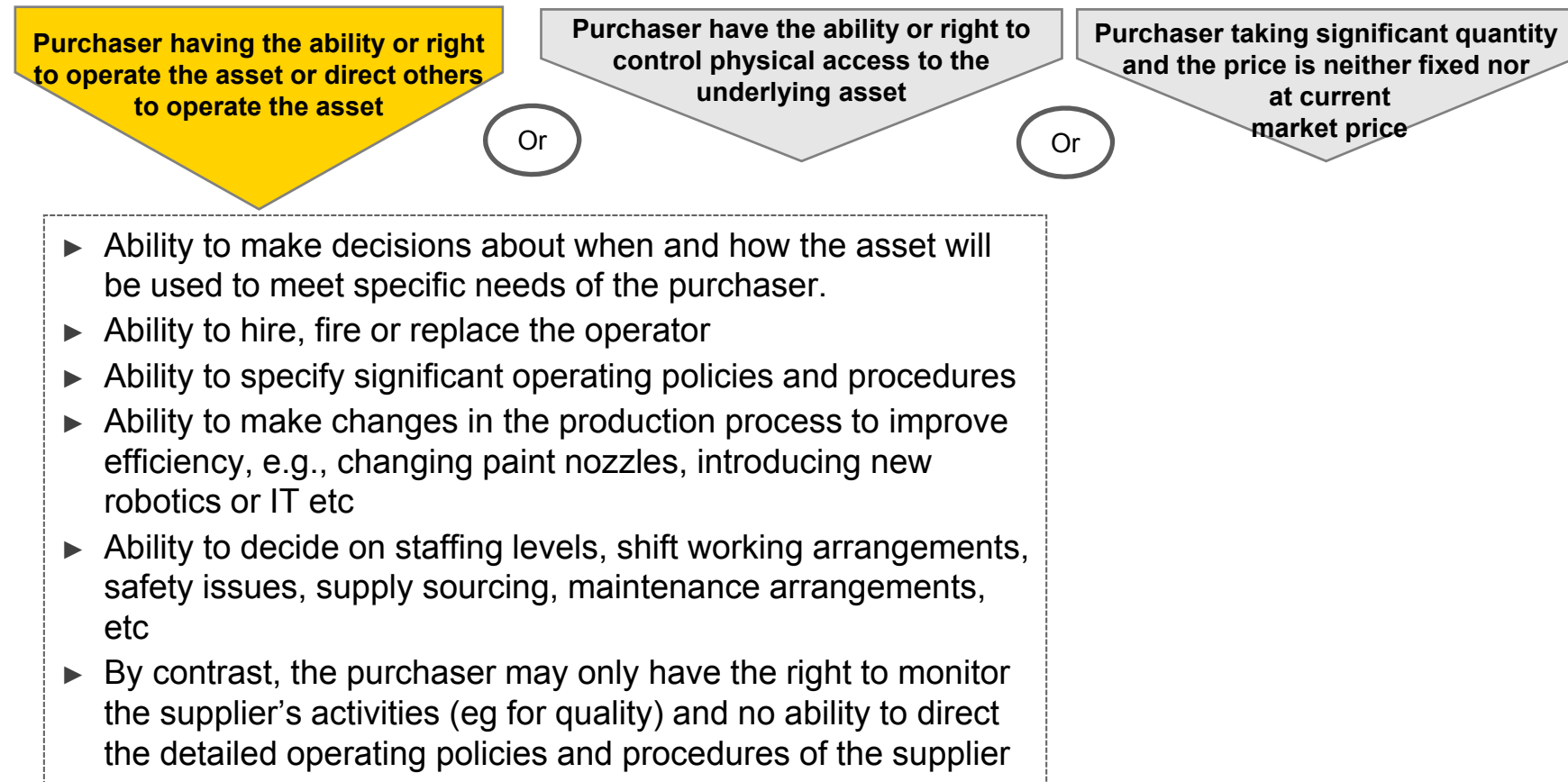
Dependence on use of specific asset

- ▶ Fulfilment of the arrangement is dependent on use of specific asset (s)
 - ▶ Although an asset may be explicitly identified in an arrangement, it is not the subject of a lease if fulfilment of arrangement is not dependent on its use.
 - ▶ For example, if the supplier is obliged to deliver a specified quantity of goods or services and has the right and ability to provide those goods or services using other assets not specified in the arrangement, then fulfilment of the arrangement is not dependent on the asset.
- ▶ Asset could be implicitly specified
 - ▶ For example, the supplier owns or leases only one asset and it is not economically feasible or practicable to perform its obligation through alternative assets.

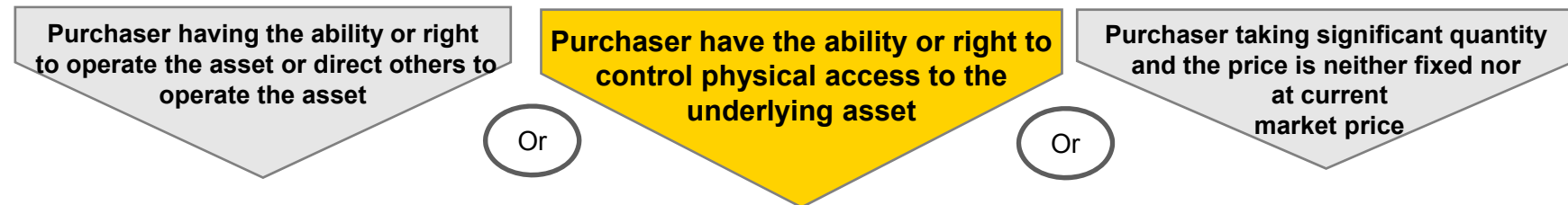
Conveyance of right to use

- ▶ An arrangement conveys right to use the asset if any one of the following conditions is met:
 - ▶ Purchaser has the ability or right to operate the asset or direct others to operate the asset in a manner it determines while obtaining or controlling more than an insignificant amount of the output or other utility of the asset;
 - ▶ Purchaser has the ability or right to control physical access to the underlying asset while obtaining or controlling more than an insignificant amount of the output or other utility of the asset;
 - ▶ Facts and circumstances indicate that it is remote that one or more parties other than the purchaser will take more than an insignificant amount of the output during the term of the arrangement, and the price is
 - ▶ Neither contractually fixed per unit of output;
 - ▶ Nor is equal to the current market price per unit

Right to use the asset



Right to use the asset



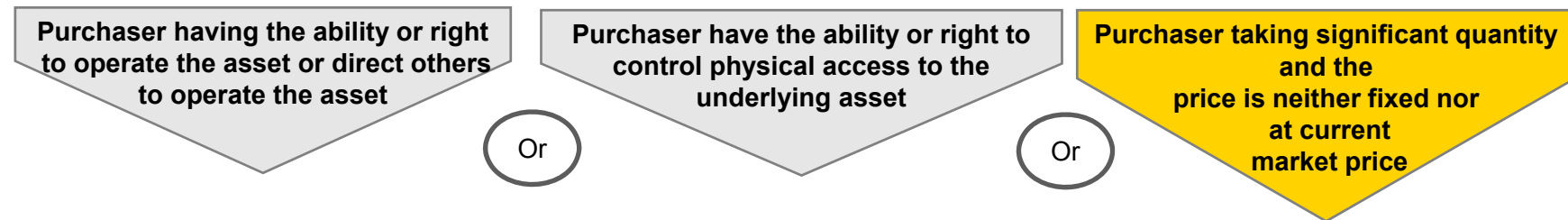
- ▶ Ability to prevent others from using or accessing the asset for their needs or restricting the ability of the supplier to move or use the asset as it desires.
- ▶ Where the specific asset is stated in the agreement this right will often exist.

Example:

- ▶ Entity A has outsourced its storage of confidential data.
- ▶ Data storage controlled by a computer system owned by a supplier and located at its premises
- ▶ Developed specifically to meet A's requirements
- ▶ A takes 50% of the capacity and remaining to other entities
- ▶ A has the right to approve or reject new customers

The arrangement contains a lease within the scope of Ind AS 17 since A has the right to control physical access due to its right to approve or reject new customers.

Right to use the asset



- ▶ To assess whether the purchaser takes substantially all of the output it is necessary to compare the contracted arrangement with the asset's capacity and to assess the feasibility of other parties taking some of the output.
- ▶ When purchaser takes all or substantially all of the output from a specific asset, then whether the purchaser is essentially paying an arm's length price for the output or for right to use the specific asset.
- ▶ Fixed price criterion means absolutely fixed, with no variance per unit based on underlying costs or volumes (either discount or stepped pricing)

Arrangement containing a lease

Separating lease and other payments

- ▶ Ind AS 17 is applied only to the lease element:
- ▶ Consideration for the arrangement is separated at the inception between lease payments and payments for other elements (e.g. services) based on relative fair values.
- ▶ It may require estimation
- ▶ If not practicable:
 - ▶ For finance lease, recognise an asset and liability at FV of the asset
 - ▶ For operating lease, all payments are lease payments for disclosure

Arrangement containing a lease

Examples 1 – Dependence on use of specific asset

- ▶ X Limited located in Gurgaon enters into an arrangement with Y Limited (supplier) for supply of a minimum quantity of power needed in its production process for a specified period of time.
- ▶ Y designs and builds a power plant near X Limited's plant to produce the power.
- ▶ Y maintains ownership and control over all the significant aspects of operating the facility.
- ▶ The power plant is explicitly identified in the arrangement and Y has the contractual right to supply power from other sources as well which are located in other cities. However, this is not economically feasible or practicable.
- ▶ Y has the right to provide power from the facility to other customers and to remove and replace the power plant's equipment and modify or expand the facility to enable it to do so.
- ▶ At inception of the arrangement, Y has no plans to modify or expand the power plant.

Whether the arrangement is dependent upon use of specific asset?

Response:

- ▶ Yes, the fulfillment of the arrangement is dependent upon use of the specific asset.
- ▶ Though Y has contractual right to supply power from other sources as well which are located in other cities, it is not economically feasible or practicable.

Arrangement containing a lease

Examples 2 – Dependence on use of specific asset

- ▶ The facts given in example 1 are same except the following:
 - ▶ Y has other power plants located at the same location.
 - ▶ It can use those plants to supply power from those plants without any extra cost.

Response:

- ▶ Fulfillment of the arrangement is not dependent upon use of the specific asset.
- ▶ Though power plant is explicitly identified in the arrangement, Y can supply power using alternate resources as well.

Arrangement containing a lease

Examples 3 – Dependence on use of specific asset

- ▶ Entity A outsources its product delivery department to entity S.
- ▶ Entity S is obliged to make available a certain number of delivery vehicles of standard specification on need basis.
- ▶ Entity S is a delivery organisation with many other vehicles available.
- ▶ Entity S is free to provide alternate vehicles on availability basis to entity A.

Response:

- ▶ Delivery vehicles are neither explicitly nor implicitly identified in the arrangement.
- ▶ Thus, fulfillment of the arrangement is not dependent upon use of the specific asset.
- ▶ However, if the supplier has to supply and maintain a specified number of specialist vehicles in the purchaser's livery, then this arrangement is more likely to contain a lease.

Arrangement containing a lease

Examples 4 – Conveyance of right to use the asset

- ▶ Entity A has outsourced its storage of confidential data.
- ▶ The data storage is controlled by means of a computer system owned by the supplier and located at its premises.
- ▶ System was developed specifically to meet A's requirements and to meet specific criteria for interfacing with A's own systems.
- ▶ Contract with A takes 50% of the capacity with the other 50% being used to supply services to two other entities.
- ▶ A has the right to approve or reject new customers for services that involve the use of the computer system.

Whether arrangement conveys right to use the asset?

Arrangement containing a lease

Examples 4 – Conveyance of right to use the asset (Contd.)

Response:

- ▶ Evaluation of arrangement on various conditions is as under:
 - ▶ Is it remote that one or more parties other than the purchaser will take more than an insignificant amount of the output?
No. Other purchasers take 50% of the capacity of the computer.
 - ▶ Does the purchaser obtain or control more than an insignificant amount of the output or other utility of the asset?
Yes, A takes 50% of the capacity.
 - ▶ Does the purchaser have the ability or right to operate the asset or direct others to operate the asset in a manner it determines?
No, A does not have, for example, the ability to hire, fire or replace the operator of the asset.
 - ▶ Does the purchaser have the ability or right to control physical access to the underlying asset?
Yes. Entity A has the right to control physical access as a result of its right to approve or reject new customers.
- ▶ Thus, arrangement meets one criterion for conveyance of right to use the asset.
- ▶ It also meets the criteria for dependence on use of specific asset.
- ▶ Thus, arrangement contains a lease.

Key Differences

Key Differences

Issue	Ind AS 17	Indian GAAP
Leasehold land	Recognized as operating or finance lease as per definition and classification criteria except that a property interest in an operating lease cannot be accounted for as investment under Ind AS 40	Recorded and classified as fixed assets
Finance Leases- Initial direct costs for lessors	For other than manufacturer/ dealer lessors, initial direct costs are included in measurement of finance lease receivable and reduce the amount of income recognized over lease term.	For other than manufacturer/ dealer lessors, initial direct costs are either recognized as expense immediately in the statement of profit and loss or allocated against finance income over the lease term.

Key Differences

Issue	Ind AS 17	Indian GAAP
Operating leases- Initial direct costs for lessors	Added to carrying amount of leased asset and recognized as expense over the lease term on the same basis as lease income	Either deferred or allocated to income over the lease term in proportion to the recognition of lease income or recognized as expense in the statement of profit and loss in the period in which incurred
Operating leases- incentives	Recognized as a reduction of lease income and expense by the lessors and lessees, respectively, over the lease term on a straight-line basis unless another basis is more appropriate	No specific guidance

Key Differences

Issue	Ind AS 17	Indian GAAP
Determining whether an arrangement contains a lease	Arrangements that do not take the legal form of a lease but fulfilment of which is dependent on the use of specific assets and which convey the right to use the assets	No specific guidance

Thank You!