CHAPTER – 7
INDAS 116 - LEASES

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BASICS

Q.INDAS116.SM.101:

Scenario A:

A lessee enters into a lease with a nine-month non-cancellable term with an option to extend the lease for four months. The lease does not have a purchase option. At the lease commencement date, the lessee is reasonably certain to exercise the extension option because the monthly lease payments during the extension period are significantly below market rates. Whether the lessee can take a short-term exemption in accordance with Ind AS 116?

Scenario B:

Assume the same facts as Scenario A except, at the lease commencement date, the lessee is not reasonably certain to exercise the extension option because the monthly lease payments during the optional extension period are at what the lessee expects to be market rates and there are no other factors that would make exercise of the renewal option reasonably certain. Will your answer be different in this case?

SOLUTION:

Scenario A:

As the lessee is reasonably certain to exercise the extension option (Refer section 3.2 lease term), the lease term is greater than 12 months (i.e., 13 months). Therefore, the lessee will not account for the lease as a short-term lease.

Scenario B:

In this case, the lease term is less than 12 months, i.e., nine months. Thus, the lessee may account for the said lease under the short-term lease exemption, i.e., it recognises lease payments as an expense on either a straight-line basis over the lease term or another systematic basis.

Q.INDAS116.SM.102:

Customer XYZ enters into a ten-year contract with Supplier ABC for the use of rolling stock specifically designed for Customer XYZ.

The rolling stock is designed to transport materials used in Customer XYZ's production process and is not suitable for use by other customers. The rolling stock is not explicitly specified in the contract but, Supplier ABC owns only one rolling stock that is suitable for Customer XYZ's use. If the rolling stock does not operate properly, the contract requires Supplier ABC to repair or replace the rolling stock.

Whether there is an identified asset?

SOLUTION:

Yes, the said rolling stock is an identified asset.

Though the rolling stock is not explicitly specified in the contract (e.g., by serial number), it is implicitly specified because Supplier ABC must use it to fulfil the contract.

Q.INDAS116.SM.103:

Customer XYZ enters into a ten-year contract with Supplier ABC for the use of a car. The specification of the car is specified in the contract (i.e., brand, type, colour, options, etc.). At inception of the contract, the car is not yet built.

Whether there is an identified asset?

SOLUTION:

Yes, the said car is an identified asset.

Though the car cannot be identified at inception of the contract, it is **explicitly specified** at the time the same will be made available to Customer XYZ.

Also, assuming that supplier does not have substantive substitution right.

Q.INDAS116.SM.104:

Scenario A:

An electronic data storage provider (supplier) provides services through a centralised data centre that involve the use of a specified server (Server No. 10). The supplier maintains many identical servers in a single accessible location and determines, at inception of the contract, that it is permitted to and can easily substitute another server without the customer's consent throughout the period of use.

Further, the supplier would benefit economically from substituting an alternative asset, because doing this would allow the supplier to optimise the performance of its network at only a nominal cost. In addition, the supplier has made clear that it has negotiated this right of substitution as an important right in the arrangement, and the substitution right affected the pricing of the arrangement.

Whether the substitution rights are substantive and whether there is an identified asset?

Scenario B:

Assume the same facts as in Scenario A except that Server No. 10 is customised, and the supplier does not have the practical ability to substitute the customised asset throughout the period of use. Additionally, it is unclear whether the supplier would benefit economically from sourcing a similar alternative asset.

Whether the substitution rights are substantive and whether there is an identified asset?

SOLUTION

Scenario A:

The customer does not have the right to use an identified asset because, at the inception of the contract, the supplier has the practical ability to substitute the server and would benefit economically from such a substitution. Thus, there is no identified asset.

However, if the customer could not readily determine whether the supplier had a substantive substitution right (**for e.g.**, there is insufficient transparency into the supplier's operations), the customer would **presume** the substitution right is not substantive and conclude that there is an identified asset.

Scenario B:

The substitution right is not substantive, and Server No. 10 would be an identified asset because the supplier does not have the practical ability to substitute the asset and there is no evidence of economic benefit to the supplier for substituting the asset. In this case, neither of the conditions of a substitution right is met (whereas both the conditions must be met for the supplier to have a substantive substitution right). Therefore, Server No 10 will be considered as an identified asset.

Q.INDAS116.SM.105:

Customer XYZ enters into a 15-year contract with Supplier ABC for the right to use five fibers within a fiber optic cable between Mumbai and Pune. The contract identifies five of the cable's 25 fibers for use by Customer XYZ. The five fibers are dedicated solely to Customer XYZ's data for the duration of the contract term. Assume that Supplier ABC does not have a substantive substitution right.

Whether there is an identified asset?

SOLUTION:

Yes, the said five fibers are identified assets because they are physically distinct and explicitly specified in the contract.

Q.INDAS116.SM.106:

Scenario A

Customer XYZ enters into a ten-year contract with Supplier ABC for the right to transport oil from India to Bangladesh through Supplier ABC's pipeline. The contract provides that Customer XYZ will have the right to use of 95% of the pipeline's capacity throughout the term of the arrangement.

Whether there is an identified asset?

Scenario B:

Assume the same facts as in Scenario A, except that Customer XYZ has the right to use 65% of the pipeline's capacity throughout the term of the arrangement.

Whether there Lease Contract?

SOLUTION:

Scenario A:

Yes, the capacity portion of the pipeline is an identified asset.

While 95% of the pipeline's capacity is not physically distinct from the remaining capacity of the pipeline, it represents **substantially all of the capacity** of the entire pipeline and thereby provides Customer XYZ with the **right to obtain substantially all of the economic benefits** from use of the pipeline.

Scenario B:

No, the capacity portion of the pipeline is **NOT** an identified asset.

Since 65% of the pipeline's capacity is **less than substantially all** of the capacity of the pipeline, Customer XYZ does **not have the right to obtain substantially all of the economic benefits** from use of the pipeline.

Q.INDAS116.SM.107:

ABC Ltd enters into a contract with XYZ Ltd, which grants ABC Ltd exclusive rights to use a specific grain storage facility over a five-year period in the months of May and June. During these months, ABC Ltd has the right to decide which crops are placed in storage and when to remove them. XYZ Ltd provides the loading and unloading services for the warehouse activities. During the other ten months each year, XYZ Ltd has the right to determine how the warehouse will be used.

Which party has the right to control the use of the identified asset during the period of use?

SOLUTION:

In the above case, ABC Ltd has the right to control the use of the identified asset during the period of use because they have the power to determine how the warehouse will be used during the contractually defined usage periods. The analysis should focus on the rights and economics of the use of the warehouse for the specified usage periods (May and June). During the period of use, ABC Ltd has the rights to determine how much of a crop to place in storage, and the timing of placing and removing it from storage. These rights are more significant to the economics of the use of the asset than the loading and unloading services performed by XYZ Ltd during the same period. ABC Ltd receives all of the economic benefit from use of the asset during those specified time periods. Therefore, contract contains a lease for the specified period of term.

Q.INDAS116.SM.108:

Company MNO enters into a 15-year contract with Power Company PQR to purchase all of the electricity produced by a new solar farm. PQR owns the solar farm and will receive tax credits relating to the construction and ownership of the solar farm, and MNO will receive renewable energy credits that accrue from use of the solar farm.).

Who has the right to substantial benefits from the solar farm?

SOLUTION:

Company MNO has the right to obtain substantially all of the economic benefits from use of the solar farm over the 15-year period because it obtains:

- The electricity produced by the farm over the lease term — i.e. the primary product from use of the asset; and
- The renewable energy credits — i.e. the by-product from use of the asset.

Although PQR receives economic benefits from the solar farm in the form of tax credits, these economic benefits relate to the ownership of the solar farm. The tax credits do not relate to use of the solar farm and therefore are not considered in this assessment.

Q.INDAS116.SM.109:

Customer X enters into a contract with Supplier Y to use a vehicle for a five-year period. The vehicle is identified in the contract. Supplier Y cannot substitute another vehicle unless the specified vehicle is not operational (for e.g., if it breaks down). Under the contract:

- *Customer X operates the vehicle (i.e., drives the vehicle) or directs others to operate the vehicle (for e.g., hires a driver).*
- *Customer X decides how to use the vehicle (within contractual limitations). For example, throughout the period of use, Customer X decides where the vehicle goes, as well as when or whether it is used and what it is used for. Customer X can also change these decisions throughout the period of use.*
- *Supplier Y prohibits certain uses of the vehicle (for e.g., moving it overseas) and modifications to the vehicle to protect its interest in the asset.*

Whether Customer X has the right to direct the use of the vehicle throughout the period of lease?

SOLUTION:

Yes, Customer X has the right to direct the use of the identified vehicle throughout the period of use because it has the **right to change** how the vehicle is used, when or whether the vehicle is used, where the vehicle goes and what the vehicle is used for.

Supplier Y's limits on certain uses for the vehicle and modifications to it are considered **protective rights** that define the scope of Customer X's use of the asset, but do not affect the assessment of whether Customer X directs the use of the asset.

Q.INDAS116.SM.110:

Entity A contracts with Supplier H to manufacture parts in a facility. Entity A designed the facility and provided its specifications. Supplier H owns the facility and the land. Entity A specifies how many parts it needs and when it needs the parts to be available. Supplier H operates the machinery and makes all operating decisions including how and when the parts are to be produced, as long as it meets the contractual requirements to deliver the specified number on the specified date. Assuming supplier H cannot substitute the facility and hence is an identified asset.

Which party has the right to control the use of the identified asset (i.e., equipment) during the period of use?

SOLUTION:

Entity A does not direct the use of the asset that most significantly drives the economic benefits because Supplier H determines how and when the equipment is operated once the contract is signed. Therefore, Supplier H has the right to control the use of the identified asset during the period of use. Although Entity A stipulates the product to be provided and has input into the initial decisions regarding the use of the asset through its involvement in the design of the asset, it does not have decision making rights over how and for what purpose the asset will be used over the asset during the period of use. This arrangement is a supply agreement, not a lease.

Q.INDAS116.SM.111:

Entity L enters into a five—year contract with Company A, a ship owner, for the use of an identified ship. Entity L decides whether and what cargo will be transported, and when and to which ports the ship will sail throughout the period of use, subject to restrictions specified in the contract. These restrictions prevent Entity L from sailing the ship into waters at a high risk of piracy or carrying explosive materials as cargo. Company A operates and maintains the ship, and is responsible for safe passage.

Who has the right to direct the use of the ship during the period of use?

SOLUTION:

Entity L has the right to direct the use of the ship. The contractual restrictions are protective rights. In the scope of its right of use, Entity L determines how and for what purpose the ship is used throughout the five — year period because it decides whether, where and when the ship sails, as well as the cargo that it will transport. Entity L has the right to change these decisions throughout the period of use. Therefore, the contract contains a lease.

Q.INDAS116.SM.112:

Entity M and Lessor A enter into a 10-year lease of an office building for fixed annual lease payments of Rs. 2,00,000. Per the terms of the lease agreement, annual fixed lease payments comprise Rs. 1,70,000 for rent and Rs. 30,000 for real estate taxes.
What are the fixed lease payments for purposes of classifying the lease?

SOLUTION:

The fixed lease payments are Rs. 2,00,000. Although real estate taxes are explicitly stated in the lease contract, they do not represent a separate non-lease component as they do not provide a separate good or service. The right to use the office building is the only component. The annual lease payments of Rs. 2,00,000 represent payments related to that single lease component.

Q.INDAS116.SM.113:

Entity Q enters into a seven-year lease for a piece of machinery. The contract sets out the lease payments as follows.

– *If Q uses the machinery within a given month, then an amount of 2,000 accrues for that month.*
– *If Q does not use the machinery within a given month, then an amount of 1,000 accrues for that month.*

What is considered as lease payment in this case?

SOLUTION:

Q considers the contract and notes that although the lease payments contain variability based on usage, and there is a realistic possibility that Q may not use the machinery in some months, a monthly payment of 1,000 is unavoidable. Accordingly, this is an in-substance fixed payment, and is included in the measurement of the lease liability.

Q.INDAS116.SM.114:

Entity P enters into a five-year lease for office space with Entity Q. The initial base rent is Rs. 1 lakh per month. Rents increase by the greater of 1% of Entity P's generated sales or 2% of the previous rental rate on each anniversary of the lease commencement date. What are the lease payments for purposes of measuring lease liability?

SOLUTION:

In the given case, the lease payments for purposes of classifying the lease are the fixed monthly payments of Rs1 lakh plus the minimum annual increase of 2% of the previous rental rate. Entity P is required to pay no less than a 2% increase regardless of the level of sales activity; therefore, this minimum level of increase is in substance fixed lease payment.

Q.INDAS116.SM.115:

Company N leases a production line. The lease payments depends on the number of operating hours of the production line – i.e., N has to pay Rs. 1,000 per hour of use. The annual minimum payment is Rs. 10,00,000. The expected usage per year is 1,500 hours.

SOLUTION:

The lease contains in substance fixed payments of Rs. 10,00,000 per year, which are included in the initial measurement of the lease liability. The additional ₹ 5,00,000 that Company N expects to pay per year are variable payments that do not depend on an index or a rate but usage.

Q.INDAS116.SM.116:

An entity enters into a 10-year lease of property. The lease payment for the first year is Rs. 1,000. The lease payments are linked to the consumer price index (CPI), i.e., not a floating interest rate. The CPI at the beginning of the first year is 100. Lease payments are updated at the end of every second year. At the end of year one, the CPI is 105. At the end of year two, the CPI is 108. What should be included in lease payments?

SOLUTION:

At the lease commencement date, the lease payments are Rs. 1,000 per year for 10 years. The entity does not take into consideration the potential future changes in the index. At the end of year one, the payments have not changed and hence, the liability is not updated.

At the end of year two, when the lease payments change, the entity updates the remaining eight lease payments to Rs. 1,080 per year (i.e., Rs. 1,000 / 100 x 108).

Q.INDAS116.SM.117:

Entity A enters into a five-year lease of an office building. The lease payments are Rs. 5,00,000 per year and the contract includes an additional water charge calculated as Rs. 0.50 per litre consumed. Payments are due at the end of year. Entity A elects to apply the practical expedient to combine lease and non-lease components

SOLUTION:

As stated above, payments are due at the end of the year. Entity A elects to apply the practical expedient not to separate lease and non-lease components.

At the commencement date, Entity A measures the lease liability as the present value of the fixed lease payments (i.e. five annual payments of 5,00,000). Although Entity A has elected to apply the practical expedient to combine non-lease components (i.e. water charges) with the lease component, Entity A excludes the non-lease component from its lease liability because they are variable payments that depend on usage. That is, the nature of the costs does not become fixed just because Entity A has elected not to separate them from the fixed lease payments. Entity A recognises the payments for water – as a variable lease payment – in profit or loss when they are incurred.

In contrast, if B does not elect to apply the practical expedient to combine lease and non-lease components, then it recognises the payments for water – as an operating expense – in profit or loss when they are incurred.

Q.INDAS116.SM.118:

Entity XYZ is a medical equipment manufacturer and a supplier of the related consumables. Customer ABC operates a medical centre. Under the agreement entered into by both parties, Entity XYZ grants Customer ABC the right to use a medical laboratory machine at no cost and Customer ABC purchases consumables for use in the equipment from Entity XYZ at Rs. 100 each.

The consumables can only be used for that equipment and Customer ABC cannot use other consumables as substitutes. There is no minimum purchase amount required in the contract.

Based on its historical experience, Customer ABC estimates that it is highly likely to purchase at least 8,000 units of consumables annually. Customer ABC has appropriately assessed that the arrangement contains a lease of medical equipment. There are no residual value guarantees or other forms of consideration included in the contract. Whether these payments affect the calculation of lease liability and ROU Asset? How does Entity XYZ and Customer ABC would allocate these lease payments?

SOLUTION:

There are two components in the arrangement, viz., a lease of equipment and the purchase of consumables. Even though Customer ABC may believe that it is highly unlikely to purchase lesser than 8,000 units of consumables every year, in this example, there are no lease payments for purposes of initial measurement (for Entity XYZ and Customer ABC) and lease classification (for Entity XYZ).

Entity XYZ and Customer ABC would allocate the payments associated with the future payments to the lease and consumables component of the contract (assuming Customer ABC does not elect to combine lease and non-lease components for this class of asset).

If Customer ABC elects the practical expedient not to separate the associated non-lease component from the lease component and instead accounts for the lease component and the non-lease component as a single lease component, the future payments for the consumables will still constitute genuine variability. Hence there will also be no lease payments for purposes of initial measurement.

Q.INDAS116.SM.119:

An entity (a lessee) enters into a lease and guarantees that the lessor will realise Rs. 20,000 from selling the asset to another party at the end of the lease. At lease commencement, based on the lessee's estimate of the residual value of the underlying asset, the lessee determines that it expects that it will owe Rs. 8,000 at the end of the lease. Whether the lessee should include the said payment of Rs. 8,000 as a lease payment?

SOLUTION:

The lessee should include the amount of Rs. 8,000 as a lease payment because it is expected that it will owe the same to the lessor under the residual value guarantee.

Q.INDAS116.SM.120:

Scenario A:

*A lessee enters a lease of an excavator and the related accessories (**for e.g.**, excavator attachments) that are used for mining purposes. The lessee is a local mining company that intends to use the excavator at a copper mine. How many lease and non-lease components are there?*

Scenario B:

*Assume the same facts as in Scenario A, except that the contract also conveys the right to use an additional loading truck. This loading truck could be deployed by the lessee for other uses (**for e.g.**, to transport iron ores at another mine).*

SOLUTION:

Scenario A:

The lessee would be unable to benefit from the use of the excavator without also using the accessories. Therefore, the excavator is dependent upon the accessories. Thus, from the perspective of the lessee, the contract contains one lease component.

Scenario B:

The lessee can benefit from the loading truck on its own or together with other readily available resources because the loading truck could be deployed for other uses independent of the excavator. The lessee can also benefit from the use of the excavator on its own or together with other readily available resources. Thus, from the perspective of the lessee, the contract contains two lease components, viz., a lease of the excavator (together with the accessories) and a lease of the loading truck.

Q.INDAS116.SM.121:

Entity L rents an office building from Landlord M for a term of 10 years. The rental contract stipulates that the office is fully furnished and has a newly installed and tailored HVAC system. It also requires Landlord M to perform all common area maintenance (CAM) during the term of the arrangement. Entity L makes single monthly rental payment and does not pay for the maintenance separately. The office building has a useful life of 40 years and the HVAC system and office furniture each has a life of 15 years.

What are the units of account in the lease?

SOLUTION:

There are three components in the arrangement – the building assets (office building and HVAC), the office furniture, and the maintenance agreement.

The office building and HVAC system are one lease component because they cannot function independently of each other. The HVAC system was designed and tailored specifically to be integrated into the office building and cannot be removed and used in another building without incurring substantial costs. These building assets are a lease component because they are identified assets for which Entity L directs the use.

The office furniture functions independently and can be used on its own. It is also a lease component because it is a group of distinct assets for which Entity L directs the use.

The maintenance agreement is a non-lease component because it is a contract for service and not for the use of a specified asset.

Q.INDAS116.SM.122:

Scenario A:

Entity ABC enters into a lease for equipment that includes a non-cancellable term of six years and a two-year fixed-priced renewal option with future lease payments that are intended to approximate market rates at lease inception. There are no termination penalties or other factors indicating that Entity ABC is reasonably certain to exercise the renewal option. What is the lease term?

Scenario B:

Entity XYZ enters into a lease for a building that includes a non-cancellable term of eight years and a two-year, market-priced renewal option. Before it takes possession of the building, Entity XYZ pays for leasehold improvements. The leasehold improvements are expected to have significant value at the end of eight years, and that value can only be realised through continued occupancy of the leased property. What is the lease term?

Scenario C:

Entity PQR enters into a lease for an identified retail space in a shopping centre. The retail space will be available to Entity PQR for only the months of October, November and December during a non-cancellable term of seven years. The lessor agrees to provide the same retail space for each of the seven years. What is the lease term?

SOLUTION:

Scenario A:

At the lease commencement date, the lease term is six years (being the non-cancellable period). The renewal period of two years is not taken into consideration since it is mentioned that Entity ABC is not reasonably certain to exercise the option.

Scenario B:

At the lease commencement, Entity XYZ determines that it is reasonably certain to exercise the renewal option because it would suffer a significant economic penalty if it abandoned the leasehold improvements at the end of the initial non-cancellable period of eight years. Thus, at the lease commencement, Entity XYZ concludes that the lease term is ten years (being eight years of non-cancellable period plus the renewal period of two years where the lessee is reasonably certain to exercise the option).

Scenario C:

At the lease commencement date, the lease term is 21 months (three months per year over the seven annual periods as specified in the contract), i.e., the period over which Entity PQR controls the right to use the underlying asset.

Q.INDAS116.SM.123:

Retailer M enters into a five-year lease for a building floor, followed by two successive five-year renewal options. On the commencement date, Retailer M is not reasonably certain to exercise the extension option. At the end of third year, Retailer M extended to include another floor from year 4 due to a business acquisition. For this purpose, the lessee concludes a separate seven-year lease for an additional floor in the building already leased. Is Retailer M required to reassess the lease term in this case?

SOLUTION:

Ind AS 116 requires a lessee to reassess the lease term if there is change in business decision of the company which is directly relevant to exercising or not exercising an option to renew / extend the lease. In the given case, the Retailer M at the end of third year has extended to include another floor in the same building on account of acquiring another company. As Retailer M has entered into fresh lease of another floor for a seven-year term, it is reasonably certain to exercise the renewal option of original lease for a further five-year term. Hence Retailer M will have to reassess the lease term at the end of third year.

Author's View:

Alternatively, if acquisition of new business does not affect existing business or no synergy effect on existing business, lessee would not reassess the lease term of existing floor.

Q.INDAS116.SM.124:

Company N has taken 10 vehicles on lease for an initial period of 5 years with an extension option at the option of the lessee for a further period of 5 years at the same rental amount. The remaining useful life of the vehicles as on the commencement date of the lease is 15 years. Company N has determined at the commencement date that it is reasonably certain to exercise the extension option and hence it has taken a period of 10 years for the lease. At the end of 4th year, there is an announcement by the government that all the cars of this particular model have to be discontinued from the road within 1 year due to the change in the pollution norms in the country. Will the lease term be reassessed in this case?

SOLUTION:

In the given case, as per Ind AS 116, the announcement by the government to discontinue the use of the underlying asset will prohibit the lessee from exercising the extension option that was already included in the non-cancellable period by Company N and hence, Company N will reassess the non-cancellable period to exclude the extension option of 5 years.

Q.INDAS116.SM.125:

Scenario A:

A lessee enters into a five-year lease of equipment, with fixed annual payments of Rs. 10,000. The contract contains fixed annual payments as follows: Rs. 8,000 for rent, Rs. 1,500 for maintenance and Rs. 500 of administrative tasks. How the consideration would be allocated?

Scenario B:

Assume the fact pattern as in scenario A except that, in addition, the contract requires the lessee to pay for the restoration of the equipment to its original condition. How the consideration would be allocated?

SOLUTION:

Scenario A:

The contract contains two components, viz., a lease component (lease of equipment) and a non-lease component (maintenance). The amount paid for administrative tasks does not transfer a good or service to the lessee.

Assuming that the lessee does not elect to use the practical expedient as per para 15 of Ind AS 116, both the lessee and the lessor account for the lease of equipment and maintenance components separately and the administration charge is included in the total consideration to be allocated between those components. Therefore, the total consideration in the contract of Rs. 50,000 will be allocated to the lease component (equipment) and the non-lease component (maintenance).

Scenario B:

The contract still contains two components, viz., a lease component (lease of equipment) and a non-lease component (maintenance). Similar to the amount paid for administrative tasks, the restoration does not transfer a good or service to the lessee as it is only performed at the end of the lease term.

Therefore, the total consideration in the contract of Rs. 50,000 will be allocated to the lease component (equipment) and the non-lease component (maintenance).

Q.INDAS116.SM.126:

Entity L enters into a five—year contract with Company A, a ship owner, for the use of an identified ship. Entity L decides whether and what cargo will be transported, and when and to which ports the ship will sail throughout the period of use, subject to restrictions specified in the contract. These restrictions prevent Entity L from sailing the ship into waters at a high risk of piracy or carrying explosive materials as cargo. Company A operates and maintains the ship, and is responsible for safe passage.

Who has the right to direct the use of the ship during the period of use?

SOLUTION:

Entity L has the right to direct the use of the ship. The contractual restrictions are protective rights. In the scope of its right of use, Entity L determines how and for what purpose the ship is used throughout the five — year period because it decides whether, where and when the ship sails, as well as the cargo that it will transport. Entity L has the right to change these decisions throughout the period of use. Therefore, the contract contains a lease.

Q.INDAS116.SM.127:

Scenario A:

A lessee enters into a five-year lease of equipment, with fixed annual payments of Rs. 10,000. The contract contains fixed annual payments as follows: Rs. 8,000 for rent, Rs. 1,500 for maintenance and Rs500 of administrative tasks. How the consideration would be allocated?

Scenario B:

Assume the fact pattern as in scenario A except that, in addition, the contract requires the lessee to pay for the restoration of the equipment to its original condition. How the consideration would be allocated?

SOLUTION:

Scenario A:

The contract contains two components, viz., a lease component (lease of equipment) and a non-lease component (maintenance). The amount paid for administrative tasks does not transfer a good or service to the lessee.

Assuming that the lessee does not elect to use the practical expedient as per para 15 of Ind AS 116, both the lessee and the lessor account for the lease of equipment and maintenance components separately and the administration charge is included in the total consideration to be allocated between those components. Therefore, the total consideration in the contract of Rs. 50,000 will be allocated to the lease component (equipment) and the non-lease component (maintenance).

Scenario B:

The contract still contains two components, viz., a lease component (lease of equipment) and a non-lease component (maintenance). Similar to the amount paid for administrative tasks, the restoration does not transfer a good or service to the lessee as it is only performed at the end of the lease term.

Therefore, the total consideration in the contract of Rs. 50,000 will be allocated to the lease component (equipment) and the non-lease component (maintenance).

Q.INDAS116.SM.128:

Company N leases a production line. The lease payments depends on the number of operating hours of the production line – i.e., N has to pay Rs. 1,000 per hour of use. The annual minimum payment is Rs. 10,00,000. The expected usage per year is 1,500 hours.

SOLUTION:

The lease contains in substance fixed payments of Rs. 10,00,000 per year, which are included in the initial measurement of the lease liability. The additional ₹ 5,00,000 that Company N expects to pay per year are variable payments that do not depend on an index or a rate but usage. These variable payments should be directly transfer to P&L A/c.

Q.INDAS116.SM.129:

Entity A enters into a five-year lease of an office building. The lease payments are Rs. 5,00,000 per year and the contract includes an additional water charge calculated as Rs. 0.50 per litre consumed. Payments are due at the end of year. Entity A elects to apply the practical expedient to combine lease and non-lease components

SOLUTION:

As stated above, payments are due at the end of the year. Entity A elects to apply the practical expedient not to separate lease and non-lease components.

At the commencement date, Entity A measures the lease liability as the present value of the fixed lease payments (i.e. five annual payments of 5,00,000). Although Entity A has elected to apply the practical expedient to combine non-lease components (i.e. water charges) with the lease component, Entity A excludes the non-lease component from its lease liability because they are variable payments that depend on usage. That is, the nature of the costs does not become fixed just because Entity A has elected not to separate them from the fixed lease payments. Entity A recognises the payments for water – as a variable lease payment – in profit or loss when they are incurred.

In contrast, if B does not elect to apply the practical expedient to combine lease and non-lease components, then it recognises the payments for water – as an operating expense – in profit or loss when they are incurred.

Q.INDAS116.SM.130:
A lessee enters into a ten-year contract with a lessor (freight carrier) to transport a specified quantity of goods. Lessor uses rail wagons of a particular specification, and has a large pool of similar rail wagons that can be used to fulfil the requirements of the contract. The rail wagons and engines are stored at lessor's premises when they are not being used to transport goods. Costs associated with substituting the rail wagons are minimal for lessor.
Whether the lessor has substantive substitutions rights and whether the arrangement contains a lease?

ANSWER:
In this case, the rail wagons are stored at lessor's premises and it has a large pool of similar rail wagons and substitution costs to be incurred are minimal. Thus, the lessor has the practical ability to substitute the asset. If at any point, the same become economically beneficial for the lessor to substitute the wagons, he can do so and hence, the lessor's substitution rights are substantive and the arrangement does not contain a lease.

Q.INDAS116.SM.131:
Customer M enters into a 20-year contract with Energy Supplier S to install, operate and maintain a solar plant for M's energy supply. M designed the solar plant before it was constructed – M hired experts in solar energy to assist in determining the location of the plant and the engineering of the equipment to be used. M has the exclusive right to receive and the obligation to take any energy produced. Whether it can be established that M is having the right to control the use of identified asset?

ANSWER:
In this case, the nature of the solar plant is such that all of the decisions about how and for what purpose the asset is used are predetermined because:
- The type of output (i.e. energy) and the production location are predetermined in the agreement; and
- When, whether and how much energy is produced is influenced by the sunlight and the design of the solar plant.

Because M designed the solar plant and thereby predetermined any decisions about how and for what purpose it is used, M is considered to have the right to direct the use. Although regular maintenance of the solar plant may increase the efficiency of the solar panels, it does not give the supplier the right to direct how and for what purpose the solar plant is used. Hence, M is having a right to control the use of asset.

Q.INDAS116.SM.132:
A Customer enters into a ten-year contract with a Company (a ship owner) for the use of an identified ship. Customer decides whether and what cargo will be transported, and when and to which ports the ship will sail throughout the period of use, subject to restrictions specified in the contract. These restrictions prevent the company from sailing the ship into waters at a high risk of piracy or carrying explosive materials. The company operates and maintains the ship, and is responsible for safe passage.
Does the customer has the right to direct how and for what purpose the ship is to be used throughout the period of use and whether the arrangement contains a lease?

ANSWER:
The customer has the right to direct the use of the ship because the contractual restrictions are merely protective rights that protect the company's investment in the ship and its personnel. In the scope of its right of use, the customer determines how and for what purpose the ship is used throughout the ten-year period because it decides whether, where and when the ship sails, as well as the cargo that it will transport. The customer has the right to change these decisions throughout the period of use and hence, the contract contains a lease.

Q.INDAS116.SM.133:

A Lessee enters into a ten-year lease contract with a Lessor to use an equipment. The contract includes maintenance services (as provided by lessor). The Lessor obtains its own insurance for the equipment. Annual payments are ₹10,000 (₹ 1,000 relate to maintenance services and ₹ 500 to insurance costs).

The Lessee is able to determine that similar maintenance services and insurance costs are offered by third parties for ₹ 2,000 and ₹ 500 a year, respectively. The Lessee is unable to find an observable stand-alone rental amount for a similar equipment because none is leased without related maintenance services provided by the lessor.

How would the Lessee allocate the consideration to the lease component?

ANSWER:

The observable stand-alone price for maintenance services is ₹ 2,000. There is no observable stand-alone price for the lease. Further, the insurance cost does not transfer a good or service to the lessee and therefore, it is not a separate lease component.

Thus, the Lessee allocates ₹ 8,000 (₹ 10,000 – ₹ 2,000) to the lease component.

Q.INDAS116.SM.134:

A Lessee enters into a non-cancellable lease contract with a Lessor to lease a building. Initially, the lease is for five years, and the lessee has the option to extend the lease by another five years at the same rental.

To determine the lease term, the lessee considers the following factors:

- *Market rentals for a comparable building in the same area are expected to increase by 10% over the ten-year period covered by the lease. At inception of the lease, lease rentals are in accordance with current market rents.*
- *The lessee intends to stay in business in the same area for at least 20 years.*
- *The location of the building is ideal for relationships with suppliers and customers.*

What should be the lease term for lease accounting under Ind AS 116?

ANSWER:

After considering all the stated factors, the lessee concludes that it has a significant economic incentive to extend the lease.

Thus, for the purpose of lease accounting under Ind AS 116, the lessee uses a lease term of ten years.

Q.INDAS116.SM.135:

A Lessee enters into a lease of a five-year-old machine. The non-cancellable lease term is 15 years. The lessee has the option to extend the lease after the initial 15-year period for optional periods of 12 months each at market rents.

To determine the lease term, the lessee considers the following factors:

- *The machine is to be used in manufacturing parts for a type of plane that the lessee expects will remain popular with customers until development and testing of an improved model are completed in approximately 15 years.*
- *The cost to install the machine in lessee's manufacturing facility is significant.*
- *The non-cancellable term of lessee's manufacturing facility lease ends in 19 years, and the lessee has an option to renew that lease for another twelve years.*
- *Lessee does not expect to be able to use the machine in its manufacturing process for other types of planes without significant modifications.*
- *The total remaining life of the machine is 30 years.*

What should be the lease term for lease accounting under Ind AS 116?

ANSWER:

The lessee notes that the terms for the optional renewal provide no economic incentive and the cost to install is significant. The lessee has no incentive to make significant modifications to the machine after the initial 15-year period. Therefore, the lessee does not expect to have a business purpose for using the machine after the non-cancellable lease term of 15 years.

Thus, the lessee concludes that the lease term consists of the 15-year non-cancellable period only.

Q.INDAS116.SM.136:

A Company leases a manufacturing facility. The lease payments depend on the number of operating hours of the manufacturing facility, i.e., the lessee has to pay ₹ 2,000 per hour of use. The annual minimum payment is ₹ 2,00,00,000. The expected usage per year is 20,000 hours.
Whether the said payments be included in the calculation of lease liability under Ind AS 116?

ANSWER:

The said lease contains in-substance fixed payments of ₹ 2,00,00,000 per year, which are included in the initial measurement of the lease liability under Ind AS 116.
However, the additional ₹ 2,00,00,000 that the company expects to pay per year are variable payments that do not depend on an index or rate and, thus, are not included in the initial measurement of the lease liability but, are expensed when the over-use occurs.

Q.INDAS116.OM.137: (Singapore CA Institute)

Geylang Communications Ltd (GPL) enters into the following contracts in the year ended 31 December 20X7:

1. *A 24-month contract with Truckitt, a haulage firm, for the use of a specified delivery truck. Truckitt will operate and maintain the truck and can impose contractual restrictions on the use of the truck, e.g. prohibiting its use for the transportation of flammable materials. Beyond those restrictions, GPL decides what goods are transported on the truck and on what routes it operates and when.*
2. *A contract with VHL to obtain the use of a specified car for three years for the use of a director. Consideration is to be provided at $16,000 per annum. The contract restricts the use of the car, with a specified maximum mileage of 15,000 miles.*
3. *A contract with Advanced Telecommunications Ltd (ATL) to obtain the use of 15% of the capacity of ACL's fibre-optic cable network to enable GCL to deliver superfast broadband to its customers. The contract price is $1 million per annum for an initial term of eight years.*

Explain whether these arrangements are (or contain) a lease?

SOLUTION

LEASE CONTRACT

A contract is a lease if it conveys the right to control the use of an identified asset for a period of time in exchange for consideration

TRUCKITT

Right to control - GCL has the right to direct the use of the delivery truck for the contract term and no other party can use it during this time. Therefore, although Truckitt will operate and maintain the vehicle, GCL will obtain substantially all economic benefits from it.
Identified asset - The contract relates to an identified truck.
Period of time - Specified in the contract at 24 months.
Conclusion - The contract is a lease arrangement.

VHL

Right to control - The issue is whether GCL has the right to control the vehicle given the mileage restriction on usage. INDAS 116 states that when assessing control, only the economic benefits that are available within the defined scope of the customer's right to use an asset should be considered. Within the constraints of the maximum mileage, GCL may use the vehicle as it wishes and therefore the company has the right to control the vehicle.
Identified asset - The contract relates to a specified vehicle.
Period of time - Specified in the contract at three years
Conclusion - The contract is a lease arrangement.

ATL

Right to control - GCL has a right to use a proportion of the fibre-optic cable, however it is unlikely to obtain substantially all of the economic benefits available from the use of the cable and any decisions about the use of the cable are likely to be taken at an asset level i.e. GCL cannot direct the asset by virtue of being able to use 15% of its capacity.

Identified asset - The contract provides GCL with the right to use a portion of ACL's fibre-optic cable capacity; the asset is not, however physically distinct.
Period of time - Specified in the contract at eight years
Conclusion - The contract is not a lease arrangement.

Q.INDAS116.OM.138: (Singapore CA Institute)

Pacific Laundry Ltd, a commercial laundry, enters into a three-year lease contract to obtain use of a commercial washing machine and commercial dryer for use at its new premises within a hotel belonging to one of its main corporate customers. The terms of the contract provide for an annual service of the machines to be carried out by the manufacturer-lessor; an initial fee of $10,000 is payable and annual payments of $60,000 are required.
Pacific Laundry Ltd has established the following standalone prices for the lease of the washer, the lease of the dryer and their servicing:

	Leases ($)	***Servicing ($)***
Washer	*85,000*	*20,000*
Dryer	*75,000*	*15,000*
Total	***1,60,000***	***35,000***

Identify the components of the contract and explain how the contract consideration is allocated to them.

SOLUTION

The contract contains lease and non-lease components as well as an initial fee that is not a component of the contract.
The contract conveys the right to use two underlying assets – a washer and a dryer. These are two separate lease components because the washer and dryer are not highly dependent on one another. Although the dryer is used after items have been washed, it could be used in conjunction with any other washer, or after hand washing items. Equally the washer does not depend on the dryer as items could be hung to air-dry.
The contract also provides for the servicing of the washer and the servicing of the dryer. These are non-lease components and are therefore joined together to be a single non-lease component.
The contract therefore contains two lease components and a single non-lease component. The total contract consideration of $190,000 ($10,000 + ($60,000 X 3)) is allocated to these three components.
The total of the standalone prices is $195,000, meaning that a discount is provided in the contract. The $190,000 is allocated to the components of the contract as follows:

Lease of washer	= (85,000/195,000 X 1,90,000)	=	$82,821
Lease of dryer	= (75,000/195,000 X 1,90,000)	=	$73,077
Servicing	= (35,000/195,000 X 1,90,000)	=	$34,102

Q.INDAS116.OM.139: (Singapore CA Institute)

On 1 March 20X7 Sentosa Designs Ltd (SDL) leased a cutting machine with a fair value of $135,000 on a two year lease. Lease payments are $2,000 per calendar month, payable in advance. In addition SDL were required to pay fees of $5,000 at the start of the lease. SDL has an option to terminate the agreement after 12 months without penalty and management of SDL believe that they are likely to exercise this option.
Explain how the lease should be accounted for and calculate the amount to be recognised in the financial statements in the year ended 31 October 20X7.

SOLUTION

This lease is not for a low value asset; it is however a short-term lease.
A lease term is the non-cancellable period for which a lessee has the right to use the underlying asset, plus:

(a) Periods covered by an option to extend the lease if the lessee is reasonably certain to exercise the option; and
(b) Periods covered by an option to terminate the lease if the lessee is reasonably certain not to exercise the option.

The non-cancellable period is the initial 12 months of the lease. The remaining 12 months are covered by an option to terminate the lease. These form part of the lease term only if SDL is reasonably certain not to

exercise the option. This is not the case and therefore the additional 12 months are not part of the lease term. The lease is for 12 months and is therefore short-term.
SDL may elect to apply simplified accounting to this class of assets and assuming that it does, an expense of $19,333 in recognised in profit or loss for the year ended 31 October 20X7:
Total cost is $5,000 + (12 x $2,000) = $29,000
Therefore for 8 months: $29,000 x 8/12m = $19,333

Q.INDAS116.RMP.140: (RTP May22)

Case I

Scenario 1: The 'last mile' is a dedicated cable that connects Entity Y's network with the end customer's device. The use of this cable is at the discretion of the customer. Entity Y decides the location of end points and has right to replace the lines (dedicated cable), however it is not practical to replace the lines, since replacement would require additional costs to be incurred without any corresponding benefit. Whether the arrangement would be within the scope of Ind AS 116?
Scenario 2: If it is practical for the Entity Y to replace the lines and Entity Y would benefit from this replacement, would the answer be different?

Case II

Customer X enters into a 10-year contract with a utility company, Entity Y, for the right to use three specified, physically distinct fibers within a larger cable connecting Mumbai to Delhi. Customer makes the decisions about the use of the fibers by connecting each end of the fibers to its electronic equipment. Entity Y owns extra fibers but can substitute those for Customer's fibers only for reasons of repairs, maintenance or malfunction. The useful life of the fiber is 15 years. Whether this arrangement is covered under Ind AS 116?

Case III

Customer X enters into a 10-year contract with Entity Y for the right to use a specified amount of capacity within a cable connecting Mumbai to Delhi. The specified amount is equivalent to Customer X having the use of the full capacity of three fiber strands within the cable (the cable contains multiple fibers with similar capacities). Entity Y makes decisions about the transmission of data (i.e., Entity Y lights the fibers, makes decisions about which fibers are used to transmit Customer's traffic). The useful life of the fiber is 15 years. Whether this arrangement is covered under Ind AS 116?

SOLUTION

Paragraph 9, B9, B13 and B14 of Ind AS 116 state the following:
"9 At inception of a contract, an entity shall assess whether the contract is, or contains, a lease. A contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration."
"B9 to assess whether a contract conveys the right to control the use of an identified asset for a period of time, an entity shall assess whether, throughout the period of use, the customer has both of the following:
(a) The right to obtain substantially all of the economic benefits from use of the identified asset; and
(b) The right to direct the use of the identified asset."
"B13 an asset is typically identified by being explicitly specified in a contract. However, an asset can also be identified by being implicitly specified at the time that the asset is made available for use by the customer."
"B14 Even if an asset is specified, a customer does not have the right to use an identified asset if the supplier has the substantive right to substitute the asset throughout the period of use. A supplier's right to substitute an asset is substantive only if both of the following conditions exist:
(a) The supplier has the practical ability to substitute alternative assets throughout the period of use (for example, the customer cannot prevent the supplier from substituting the asset and alternative assets are readily available to the supplier or could be sourced by the supplier within a reasonable period of time); and
(b) The supplier would benefit economically from the exercise of its right to substitute the asset (i.e., the economic benefits associated with substituting the asset are expected to exceed the costs associated with substituting the asset)."
Paragraph B20 of Ind AS 116 which provides guidance regarding identified asset in case of portion of assets

states that a capacity portion of an asset is an identified asset if it is physically distinct (for example, a floor of a building). A capacity or other portion of an asset that is not physically distinct (for example, a capacity portion of a fibre optic cable) is not an identified asset, unless it represents substantially all of the capacity of the asset and thereby provides the customer with the right to obtain substantially all of the economic benefits from use of the asset.

Paragraph B21 of Ind AS 116, inter alia, states that to control the use of an identified asset, a customer is required to have the right to obtain substantially all of the economic benefits from use of the asset throughout the period of use (for example, by having exclusive use of the asset throughout that period). A customer can obtain economic benefits from use of an asset directly or indirectly in many ways, such as by using, holding or subleasing the asset.

Further, paragraph B24 of Ind AS 116 provides that a customer has the right to direct the use of an identified asset throughout the period of use if the customer has the right to direct how and for what purpose the asset is used throughout the period of use.

Paragraph B25 of Ind AS 116 states that a customer has the right to direct how and for what purpose the asset is used if, within the scope of its right of use defined in the contract, it can change how and for what purpose the asset is used throughout the period of use. In making this assessment, an entity considers the decision-making rights that are most relevant to changing how and for what purpose the asset is used throughout the period of use. Decision-making rights are relevant when they affect the economic benefits to be derived from use. The decision-making rights that are most relevant are likely to be different for different contracts, depending on the nature of the asset and the terms and conditions of the contract.

Case I

Scenario 1:

(i) As per paragraph B13 of Ind AS 116, 'Last mile' which is a dedicated cable is an identified asset since it is physically distinct.

(ii) There are no substantive substitution rights with Entity Y, as it does not have the practical ability to substitute alternative assets throughout the period of use.

Thus, this arrangement is within the scope of Ind AS 116.

Scenario 2:

If Entity Y has the practical ability to replace the lines and it would benefit from such replacement, Entity Y has substantive substitution rights. In such case, this arrangement for the 'last mile cable' will not be within the scope of Ind AS 116.

Case II

The fibers are specified in the contract and are physically distinct. Hence, in accordance with paragraph B13 and B20, the said three fibers are identified asset.

Paragraph B18, inter alia, states that the supplier's right or obligation to substitute the asset for repairs and maintenance, if the asset is not operating properly or if a technical upgrade becomes available does not preclude the customer from having the right to use an identified asset.

Further, paragraph B27 provides that although rights such as those to operate or maintain an asset are often essential to the efficient use of an asset, they are not rights to direct how and for what purpose the asset is used and can actually be dependent on the decisions about how and for what purpose the asset is used.

In accordance with the above, as Entity Y can substitute these three distinct fibers only for reasons of repairs, maintenance or malfunction, it does not preclude them from being an identified asset.

Further, the Customer X has right to control the use of the identified fibers for 10 year since it has –

(a) The right to obtain substantially all of the economic benefits from use of the identified fibers throughout the period of use, i.e., 10 years; and

(b) The right to direct the use of the fibers as it makes the decisions about the use of the fibers, i.e., it has right to direct how and for what purpose the fibers are used throughout the period of use.

Hence, this arrangement is within the scope of Ind AS 116.

Case III

Paragraph B20 specifically provides that a capacity or other portion of an asset that is not physically distinct (for example, a capacity portion of a fiber optic cable) is not an identified asset, unless it represents

substantially all of the capacity of the asset and thereby provides the customer with the right to obtain substantially all of the economic benefits from use of the asset. In the given case, the capacity portion that will be provided to Customer X is not physically distinct from the remaining capacity of the cable and does not represent substantially all of the capacity of the cable, thus, it is not an identified asset. Further, Entity Y makes all decisions about the transmission of data, (i.e., supplier lights the fibers, makes decisions about which fibers are used to transmit customer's traffic).
Thus, the contract does not contain a lease and is therefore not within the scope of Ind AS 116.

Q.INDAS116.RMP.141: (MTP May22)

The Company has taken a particular application software of a supplier namely, Crystal Systems Limited, which is available on a cloud infrastructure managed and controlled by the Crystal Systems Limited. The Company contracts to pay a fee of Rs. 5,00,000 per month in exchange for a right to receive access to the Crystal Systems Limited's application software for 2 years. The Company accesses the software on need basis over the internet. The contract does not convey any rights to New Age Technology Limited over the tangible assets of the Crystal Systems Limited. The Chief Accountant of New Age Technology Limited has sought your advice, whether the IT should account for this transaction for use of software with Crystal Systems Limited in terms of Ind AS 116 leases or an intangible asset in terms of Ind AS 38 'Intangible Assets'. Help him to understand your assessment.

SOLUTION

Assessment of applicability of Ind AS 38 in the given scenario
As per Ind AS 38, to be an intangible asset the asset should meet following criteria:

- Identifiability;
- Control over a Resource (Asset); and
- Existence of Future Economic Benefits.

Crystal Systems Limited manages and controls the application software available on a cloud infrastructure and New Age Technology Limited has limited rights to use the same. Merely right to access the application of Crystal Systems Limited, does not give New Age Technology Limited power to obtain future economic benefits flowing from the software itself. Hence, the application software should not be recognised as an asset under Ind AS 38.

Assessment of applicability of Ind AS 116 in the given scenario

At the inception of a contract, an entity shall assess whether the contract is or contains a lease. For the purpose, a lease is defined as a contract, or part of a contract that conveys the right to control the use of an identified asset for a period of time in exchange for consideration. This right to control the asset throughout the period of use is emphasized ONLY if the customer has both (i) right to obtain substantially all the economic benefits from the use of the identified asset, and (ii) the right to direct the use of the identified asset.
In the given case, the contract gives the New Age Technology Limited only the right to access the Crystal Systems Limited's application software over the contract term, and hence the contract is not a lease contract within the meaning of Ind AS 116.
Conclusion
The right to access the Crystal Systems Limited's application software for a price over a specified period is a service contract. If the Crystal Systems Limited pays amounts for which the services are yet to be received, then the advance payment is a prepayment and an asset for the Crystal Systems Limited.

LESSEE BOOKS

Q.INDAS116.SM.201:

Entity L enters into a lease for 10 years, with a single lease payment payable at the beginning of each year. The initial lease payment is Rs100,000. Lease payments will increase by the rate of LIBOR each year. At the date of commencement of the lease, LIBOR is 2 per cent.

Assume that the interest rate implicit in the lease is 5 per cent. How lease liability is initially measured?

SOLUTION:

In the given case, the lease payments depend on a rate (i.e., LIBOR) and hence is included in measuring lease liability, As per Ind AS 116, the lease payments should initially be measured using the rate (i.e. LIBOR) as at the commencement date. LIBOR at that date is 2 per cent; therefore, in measuring the lease liability, it is assumed that each year the payments will increase by 2 per cent, as follows

Year	Lease Payment	Discount factor @ 5%	PV of lease payments
1	1,00,000	1	100,000
2	1,02,000	0.952	97,102
3	1,04,040	0.907	94,364
4	1,06,121	0.864	91,689
5	1,08,243	0.823	89,084
6	1,10,408	0.784	86,560
7	1,12,616	0.746	84,012
8	1,14,869	0.711	81,672
9	1,17,166	0.677	79,321
10	1,19,509	0.645	77,083
			8,80,887

Therefore, the lease liability is initially measured at Rs. 8,80,887

Q.INDAS116.SM.202:

Entity Y and Entity Z execute a 12-year lease of a railcar with the following terms on January 1, 2016:

- *The lease commencement date is February 1, 2016.*
- *Entity Y must pay Entity Z the first monthly rental payment of Rs10,000 upon execution of the lease.*
- *Entity Z will pay Entity Y Rs. 50,000 cash incentive to enter into the lease payable upon lease execution.*

Entity Y incurred Rs. 1,000 of initial direct costs, which are payable on February 1, 2016. Entity Y calculated the initial lease liability as the present value of the lease payments discounted using its incremental borrowing rate because the rate implicit in the lease could not be readily determined; the initial lease liability is Rs. 8,50,000.

How would Lessee Company measure and record this lease?

SOLUTION:

Entity Y would calculate the right-of-use asset as follows: **Rs**

Initial measurement of lease liability	**8,50,000**
Lease payments made to Entity Z at or before the commencement date	10,000
Lease incentives received from Entity Z	(50,000)
Initial direct cost	1,000
Initial measurement of right-of-use asset	**8,11,000**

Q.INDAS116.SM.203:

Company H leases an aircraft for a period of 5 years. The aircraft must undergo a planned check after every 100,000 flight hours. At the end of the lease, company H must have a check performed (or refund the costs to the lessor), irrespective of the actual number of flight hours. What are the lease payments for purposes of calculating ROU asset?

SOLUTION:

In the given case, the legal requirement to perform a check after every 1,00,000 flight hours does not directly lead to an obligation as it depends on future circumstances. However, as the check must be carried out at the end of the lease irrespective of the actual number of flight hours gives rise to an obligation.

As a result, company H has to recognize a provision for the costs of the final check ("present value of the expected cost") at the beginning of the lease term. At the same time, these costs must be included in the cost of the right-of-use (ROU) asset pursuant to para 24 (d) of Ind AS 116.

Q.INDAS116.SM.204:

Entity ABC (lessee) enters into a three-year lease of equipment. Entity ABC agrees to make the following annual payments at the ***end*** *of each year:*
Rs20,000 in year one
Rs30,000 in year two
Rs50,000 in year three.
For simplicity purposes, there are no other elements to the lease payments (like purchase options, lease incentives from the lessor or initial direct costs). Assumed a discount rate of 12% (which is Entity ABC's incremental borrowing rate because the interest rate implicit in the lease cannot be readily determined). Entity ABC depreciates the ROU Asset on a straight-line basis over the lease term.
How would Entity ABC would account for the said lease under Ind AS 116?

SOLUTION:

At the commencement date, Entity ABC would initially recognise ROU Asset and the corresponding Lease Liability of **Rs. 77,364** which is calculated as follows:

Year	**Payments (Cash flows)**	**Discounting Factor @12%**	**Discounted Cash flows / Present Value**
1	20,000	0.8929	17,858
2	30,000	0.7972	23,916
3	50,000	0.7118	35,590
			77,364

Then, the next step would be to prepare a schedule for Lease Liability and ROU Asset as follows:
Lease Liability

Year	**Opening balance**	**Interest Expense**	**Payments**	**Closing balance**
1	77,364	9,284	(20,000)	66,648
2	66,648	7,998	(30,000)	44,646
3	44,646	5,354*	(50,000)	-

*Difference of Rs4 is due to approximation.
ROU Asset (assuming no lease incentives, no initial direct costs, etc.):

Year	**Opening balance**	**Depreciation**	**Closing balance**
1	77,364	(25,788)	51,576
2	51,576	(25,788)	25,788
3	25,788	(25,788)	-

At lease commencement, Entity ABC would recognise the Lease Liability and the corresponding ROU Asset as follows:

ROU Asset Dr.	77,364	
To Lease Liability		77,364
To initially recognise the Lease Liability and the corresponding ROU Asset		

The following journal entries would be recorded in the first year:

Interest Expenses Dr.	9,284	
To leases Liability		9,284
To record interest expenses and accrete the lease liability using the effective interest method (Rs 77,364 X12%)		
Depreciation Expense Dr.	25,788	
To ROU Asset		25,788
To record interest expense and accrete the lease liability using the straight line		

method (Rs 77,364 / 3years)		
Lease Liability Dr.	20,000	
To Cash / Bank		20,000
To record lease payment		

Following is the summary of the said lease contract's accounting (assuming no changes due to reassessment):

Particulars	Initially	Year 1	Year 2	Year 3
Cash lease payments		20,000	30,000	50,000
Lease Expense Recognised:				
Interest Expense		9,284	7,998	5,354
Depreciation Expense		25,788	25,788	25,788
Total Periodic Expense		35,072	33,786	31,142
Balance Sheet:				
ROU Asset	77,364	51,576	25,788	-
Lease Liability	(77,364)	(66,648)	(44,646)	-

Q.INDAS116.SM.205:

Company EFG enters into a property lease with Entity H. The initial term of the lease is 10 years with a 5- year renewal option. The economic life of the property is 40 years and the fair value of the leased property is Rs50 Lacs. Company EFG has an option to purchase the property at the end of the lease term for Rs30 lacs. The first annual payment is Rs5 lacs with an increase of 3% every year thereafter. The implicit rate of interest is 9.04%. Entity H gives Company EFG an incentive of Rs2 lacs (payable at the beginning of year 2), which is to be used for normal tenant improvement.

Company EFG is reasonably certain to exercise that purchase option. How would EFG measure the right-of-use asset and lease liability over the lease term?

SOLUTION:

As per Ind AS 116, Company EFG would first calculate the lease liability as the present value of the annual lease payments, less the lease incentive paid in year 2, plus the exercise price of the purchase option using the rate implicit in the lease of approximately 9.04%.

PV of lease payments, less lease incentive (W.N. 1)	Rs. 37,39,648
PV of purchase option at end of lease term (W.N. 2)	Rs. 12,60,000
Total lease liability	**Rs. 49,99,648 or Rs. 50,00,000 (approx)**

The right-of-use asset is equal to the lease liability because there is no adjustment required for initial direct costs incurred by Company EFG, lease payments made at or before the lease commencement date, or lease incentives received prior to the lease commencement date.

Entity EFG would record the following journal entry on the lease commencement date.

Right-of-use Asset Dr.	Rs 50,00,000	
To Lease Liability		Rs 50,00,000
To record ROU asset and lease liability at the commencement date.		

Since the purchase option is reasonably certain to be exercised, EFG would amortize the right-of-use asset over the economic life of the underlying asset (40 years). Annual amortization expense would be Rs. 1,25,000 (Rs. 50,00,000 / 40 years)

Interest expense on the lease liability would be calculated as shown in the following table. This table includes all expected cash flows during the lease term; including the lease incentive paid by Entity H and Company EFG's purchase option.

Year	Payment	Principal paid at the beginning of the year	Interest paid	Interest expense	Lease Liability (end of the year
	A	b= a-c	c = (d of pvs. Year)	d = [(e of pvs. year- a) x 9.04%]	e = (e of pvs. Year + d – a)
Commencement					50,00,000
Year 1	5,00,000	5,00,000	-	4,06,800	49,06,800
Year 2	3,15,000*	(91,800)	4,06,800	4,15,099	50,06,899
Year 3	5,30,450	1,15,351	4,15,099	4,04,671	48,81,120
Year 4	5,46,364	1,41,693	4,04,671	3,91,862	47,26,618
Year 5	5,62,754	1,70,892	3,91,862	3,76,413	45,40,277
Year 6	5,79,637	2,03,224	3,76,413	3,58,042	43,18,682
Year 7	5,97,026	2,38,984	3,58,042	3,36,438	40,58,094
Year 8	6,14,937	2,78,499	3,36,438	3,11,261	37,54,418
Year 9	6,33,385	3,22,124	3,11,261	2,82,141	34,03,174
Year 10	6,52,387	3,70,246	2,82,141	2,49,213*	30,00,000
Year 10	30,00,000	27,50,787	2,49,213*	-	-
Total	**85,31,940**	**50,00,000**	**35,31,940**	**35,31,940**	

*(5,00,000 + increased by 3% - lease incentive paid amounting to 2,00,000)

Although the lease was for 10 years, the asset had an economic life of 40 years. When Company EFG exercises its purchase option at the end of the 10-year lease, it would have fully extinguished its lease liability but continue depreciating the asset over the remaining useful life.

Working Notes

1. **Calculating PV of lease payments, less lease incentive:**

Year	Lease Payment (A)	Present value factor @ 9.04% (B)	Present value of lease payments (A*B=C)
Year 1	5,00,000	1	5,00,000
Year 2	3,15,000	0.92	2,89,800
Year 3	5,30,450	0.84	4,45,578
Year 4	5,46,364	0.77	4,20,700
Year 5	5,62,754	0.71	3,99,555
Year 6	5,79,637	0.65	3,76,764
Year 7	5,97,026	0.59	3,52,245
Year 8	6,14,937	0.55	3,38,215
Year 9	6,33,385	0.50	3,16,693
Year 10	6,52,387	0.46	3,00,098
Total			**37,39,648**

2. Calculating PV of purchase option at end of lease term:

Year	Payment on purchase option (A)	Present value factor @ 9.04%(B)	Present value of purchase option (A*B=C)
Year 10	30,00,000	0.42	12,60,000
Total			**12,60,000**

The discount rate for year 10 is different in the above calculations because in the earlier one its beginning of year 10 and in the later one its end of the year 10.

Q.INDAS116.SM.206:

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 isRs100,000 and Rs110,000 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:

ICAI Suggested as per Module:

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 2020.
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 4.167%. As shown in the table, the revised lease liability is Rs. 4,91,376.

Year	**4**	**5**	**6**	**7**	**8**	**Total**
Lease payment	104,167	104,167	114,583	114,583	114,583	552,083
Discount	1	0.943	0.890	0.840	0.792	
Present value	104,167	98,230	101,979	96,250	90,750	491,376

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	491,376
Original lease liability	(1,95,244)
	2,96,132

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
Being lease liability and ROU asset adjusted on account of remeasurement.		

Working Notes:

1. Calculation of ROU asset before the date of remeasurement

Year beginning	**Lease Payment(A)**	**Present value factor @ 5%(B)**	**Present value of lease payments(AxB=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	82,300
Lease liability as at commencement date			**4,54,600**

2. Calculation of Lease Liability and ROU asset at each year end

Year	**Lease Liability**				**ROU asset**		
	Initial value	**Lease payments**	**Interest expense**	**Closing balance**	**Initial Value**	**Depreciation**	**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		

Q.INDAS116.SM.207:

A lessee enters into a lease of an equipment. The contract stipulates the less or will perform maintenance of the leased equipment and receive consideration for that maintenance service. The contract includes the following fixed prices for the lease and non-lease component:

Lease	*Rs 80,000*
Maintenance	*Rs 10,000*
Total	***Rs 90,000***
Assume the stand-alone prices cannot be readily observed, so the lessee makes estimates, maximising the use of observable information, of the lease and non-lease components, as follows:	
Lease	*Rs 85,000*
Maintenance	*Rs 15,000*
Total	***Rs 1,00,000***

In the given scenario, assuming lessee has not opted the practical expedient, how will the lessee allocate the consideration to lease and non-lease component?

SOLUTION:

The stand-alone price for the lease component represents 85% (i.e., Rs. 85,000/Rs. 1,00,000) of total estimated stand-alone prices. The lessee allocates the consideration in the contract (i.e., Rs. 90,000), as follows:

Lease	* Rs. 76,500
Maintenance	** Rs. 13,500
Total	**Rs. 90,000**

* Rs 90,000 x 85%
** Rs 90,000 x 15%

Q.INDAS116.SM.208: (SIMILAR TO RTP Nov20)

Entity X (lessee) entered into a lease agreement ('lease agreement') with Entity Y (lessor) to lease an entire floor of a shopping mall for a period of 9 years. The annual lease rent of ₹ 70,000 is payable at year end. To carry out its operations smoothly, Entity X simultaneously entered into another agreement ('facilities agreement') with Entity Y for using certain other facilities owned by Entity Y such as passenger lifts, DG sets, power supply infrastructure, parking space etc., which are specifically mentioned in the agreement, for annual service charges amounting to ₹ 1,00,000. As per the agreement, the ownership of the facilities shall remain with Entity Y. Lessee's incremental borrowing rate is 10%.

The facilities agreement clearly specifies that it shall be co-existent and coterminous with 'lease agreement'. The facility agreement shall stand terminated automatically on termination or expiry of 'lease agreement'.

Entity X has assessed that the stand-alone price of 'lease agreement' is ₹ 1,20,000 per year and stand-alone price of the 'facilities agreement' is ₹ 80,000 per year. Entity X has not elected to apply the practical expedient in paragraph 15 of Ind AS 116 of not to separate non-lease component(s) from lease component(s) and accordingly it separates non-lease components from lease components.

How will Entity X account for lease liability as at the commencement date?

ANSWER:

Entity X identifies that the contract contains lease of premises and non-lease component of facilities availed. As Entity X has not elected to apply the practical expedient as provided in paragraph 15, it will separate the lease and non-lease components and allocate the total consideration of ₹ 1,70,000 to the lease and non-lease components in the ratio of their relative stand-alone selling prices as follows:

Particulars	Stand-alone Prices	% of total Stand -alone Price	Allocation of consideration
	₹		₹
Building rent	1,20,000	60%	1,02,000
Service charge	80,000	40%	68,000
Total	**2,00,000**	**100%**	**1,70,000**

As Entity X's incremental borrowing rate is 10%, it discounts lease payments using this rate and the lease liability at the commencement date is calculated as follows:

Year	Lease Payment (A)	Present value factor @ 10% (B)	Present value of lease payments (A x B = C)
Year 1	1,02,000	0.909	92,718
Year 2	1,02,000	0.826	84,252
Year 3	1,02,000	0.751	76,602
Year 4	1,02,000	0.683	69,666
Year 5	1,02,000	0.621	63,342
Year 6	1,02,000	0.564	57,528
Year 7	1,02,000	0.513	52,326
Year 8	1,02,000	0.467	47,634
Year 9	1,02,000	0.424	43,248
Lease Liability at commencement date			**5,87,316**

Further, ₹ 68,000 allocated to the non-lease component of facility used will be recognised in profit or loss as and when incurred.

Q.INDAS116.SM.209: (SIMILAR TO RTP May21 & MTP May23))

Entity X is an Indian entity whose functional currency is Indian Rupee. It has taken a plant on lease from Entity Y for 5 years to use in its manufacturing process for which it has to pay annual rentals in arrears of USD 10,000 every year. On the commencement date, exchange rate was USD = Rs. 68. The average rate for Year 1 was Rs. 69 and at the end of year 1, the exchange rate was Rs. 70. The incremental borrowing rate of Entity X on commencement of the lease for a USD borrowing was 5% p.a.

How will entity X measure the right of use (ROU) asset and lease liability initially and at the end of Year 1?

ANSWER:

On initial measurement, Entity X will measure the lease liability and ROU asset as under:

Year	Lease Payments (USD)	Present Value factor @ 5%	Present Value of Lease Payment	Conversion rate (spot rate)	INR value
1	10,000	0.952	9,520	68	6,47,360
2	10,000	0.907	9,070	68	6,16,760
3	10,000	0.864	8,640	68	5,87,520
4	10,000	0.823	8,230	68	5,59,640
5	10,000	0.784	7,840	68	5,33,120
Total			**43,300**		**29,44,400**

As per Ind AS 21, the Effects of Changes in Foreign Exchange Rates, monetary assets and liabilities are restated at each reporting date at the closing rate and the difference due to foreign exchange movement is recognised in profit and loss whereas non-monetary assets and liabilities carried measured in terms of historical cost in foreign currency are not restated.

Accordingly, the ROU asset in the given case being a non-monetary asset measured in terms of historical cost in foreign currency will not be restated but the lease liability being a monetary liability will be restated at each reporting date with the resultant difference being taken to profit and loss.

At the end of Year 1, the lease liability will be measured in terms of USD as under:

Lease Liability:

Year	Initial Value (USD) (a)	Lease Payment (b)	Interest @ 5% (c) = (a x 5%)	Closing Value (USD) (d = a + c - b)
1	43,300	10,000	2,165	35,465

Interest at the rate of 5% will be accounted for in profit and loss at average rate of ₹ 69
(i.e., USD 2,165 x 69) = ₹ 1,49,385.

Particulars		Dr. (₹)	Cr. (₹)
Interest Expense	Dr.	1,49,385	
To Lease liability			1,49,385

Lease payment would be accounted for at the reporting date exchange rate, i.e. ₹ 70 at the end of year 1

Particulars		Dr. (₹)	Cr. (₹)
Lease liability	Dr.	7,00,000	
To Cash			7,00,000

As per the guidance above under Ind AS 21, the lease liability will be restated using the reporting date exchange rate i.e., ₹ 70 at the end of Year 1. Accordingly, the lease liability will be measured at ₹ 24,82,550 (35,465 x ₹ 70) with the corresponding impact due to exchange rate movement of ₹ 88,765 (24,82,550 – (29,44,400 + 1,49,385 – 700,000) taken to profit and loss.

At the end of year 1, the ROU asset will be measured as under:

Year	Opening Balance (₹)	Depreciation (₹)	Closing Balance (₹)
1	29,44,400	5,88,880	23,55,520

Q.INDAS116.OM.210: (Singapore CA Institute)

Rainbow Botanic Ltd (RBL) enters into a lease contract to obtain the use of a potting machine for use in its nurseries for four years. The terms of the contract require a payment at the start of the lease on 1 August 20X5 and subsequent payments in advance on 1 August 20X6, 20X7 and 20X8. The first payment is $15,000 and subsequent payments increase by the rate of SIBOR. At 1 August 20X5 SIBOR is 1%. The interest rate implicit in the lease is 5%. How the lease liability is initially measured?

SOLUTION

At the commencement of the lease the liability is measured based on the current SIBOR of 1% i.e. each annual payment is expected to increase by 1%. Payments at discounted at the 5% implicit interest rate:

Date	Payment	Discount Factor	Present Value
1.08.X5	15000	1	15000
1.08.X6	15150	0.9524	14429
1.08.X7	15302	0.9070	13879
1.08.X8	15455	0.8638	13350
LEASE LIABILITY			**56658**

Q.INDAS116.OM.211: (Singapore CA Institute)

Noon Consumables Ltd (NCL) leased a manufacturing machine on 1 June 20X6 for a period of five years. The terms of the lease contract required NCL to pay a fixed annual amount of $50,000, in advance, and an additional payment at the end of each year based on the output of the machine. The additional payment is calculated as $10 for each unit of output produced, with a minimum annual additional payment of $10,000. On average NCL's expected output is 1,100 units per annum. NCL's incremental borrowing rate is 4%. Explain how the lease liability is initially measured.

SOLUTION

The lease liability is initially measured at the present value of the future lease payments discounted at the lessee's incremental borrowing rate.

This lease includes fixed payments in advance of $50,000 and variable payments in arrears based on output. Variable payments are included in the calculation of the lease liability only if they are based on a rate or index or if they are in substance fixed. In this case there is an in-substance fixed payment of $10,000 per annum, being the minimum additional payment.

Therefore the lease liability is initially measured at:

	Fixed Payment	In-substance Fixed Paymt.	Total	Dis. Factor	PV
1/06/X6	50000	-	50000	1	50000
1/06/X7	50000	10000	60000	0.9615	57692
1/06/X8	50000	10000	60000	0.9246	55473
1/06/X9	50000	10000	60000	0.8890	53340
1/06/Y0	50000	10000	60000	0.8548	51288
1/06/Y1	-	10000	10000	0.8219	8219

					276012

The additional expected variable payment of $1,000 per annum ((1,100 x $10) – $10,000) will be expensed when incurred.

Q.INDAS116.OM.212: (Singapore CA Institute)

In arranging the lease contract for the manufacturing machine (see Q.INDAS116.OM.211), NCL paid the lessor a $5,000 arrangement fee on 25 May 20X6. The company also paid its legal advisers $3,000 to review the lease contract and provide advice on its terms. At the end of the lease term NCL is contractually obliged to dismantle the machine and transport it back to the lessor. The estimated present value of the cost of meeting this obligation on 31 May 20Y1 is $46,000. What journal entries are required to recognise the right-of-use asset at 1 June 20X6?

SOLUTION

The ROU Asset is initially measured at:

Initial measurement of lease liability (11.3)	276012
Lease payments made by lessee before commencement of lease	5000
Estimated dismantling and restoration costs at the end of the lease term (payable by lessee)	3000
Cost of right-of-use asset	**330012**

Journal Entry will be:

Right of Use Asset A/c Dr. 330012
To Lease Liability A/c 276012
To Bank A/c 8000
To Provision for Dismantling A/c 46000

Q.INDAS116.OM.213: (Singapore CA Institute)

Orchard Ornamental Fish Ltd (OOF) enters into a 5 year contract on 1 May 20X6 to acquire the use of a water aeration system. The terms of the lease contract require annual payments in advance of $6,000. Lease payments will increase every year on the basis of the increase in the Singapore Consumer Price Index (CPI) in the previous 12 months. The CPI at the commencement date is 99. The interest rate implicit in the lease is not readily determinable; OOF's incremental borrowing rate is 6%. How the lease liability is initially measured? The CPI at 30 April 20X7 was 102. Explain how the lease liability is remeasured at this date?

SOLUTION

At the commencement of the lease the liability is measured based on the current CPI i.e. it is measured based on 6 annual payments of $6,000.

Therefore, Orchard Ornamental Fish Ltd (OOF) initially recognised a lease liability of $26,791 on 1 May 20X6, based on annual lease payments in advance of $6,000, which were due to increase each year on the basis of the increase in the Singapore Consumer Price Index (CPI) in the previous 12 months. The CPI at the commencement date was 99 and OOF's incremental borrowing rate 6%.

The lease liability at 30 April 20X7 is measured at $22,038:

	b/f	**Payment**	**c/f**	**Interest @ 6%**	**c/f**
30/04/X7	26791	-6000	20791	1247	22038

Future lease payments will be $6,182 ($6,000 □ 102/99), and the lease liability is therefore re-measured:

Date	**Payment**	**Discount Factor**	**Present Value**
1/05/X7	6182	1	6182
1/05/X8	6182	0.9434	5832
1/05/X9	6182	0.8901	5502
1/05/Y0	6182	0.8396	5191
Lease Liability			**22707**

The lease liability (and therefore the right-of-use asset) both increase by $669 (22,707 – 22,038). This is achieved by ($):

Right of Use Asset A/c Dr. 669
To Lease Liability A/c 669

Q.INDAS116.OM.214: (Singapore CA Institute)

Porcheron Property Ltd (PPL) entered into a five-year lease agreement on 1 July 20X6 to obtain the use of a construction vehicle with a useful life of seven years. The lease required payments in arrears of $7,000 per annum plus an additional $1,000 if a 4,000 miles per annum limit was exceeded. The implicit interest rate in the lease was 6%. PPL paid a $4,000 arrangement fee. The mileage limit was exceeded in the year ended 30 June 20X7 and PPL expected to exceed it in the year ended 30 June 20X8.
What journal entries are required in respect of the year ended 30 June 20X7?

HINT ANSWER

The variable payments are not part of the measurement of the lease liability as they are not fixed in substance and are not related to a rate or index.

Lease Liability Initially measured at – 29484/-
ROU Asset – 29484 + 4000 = 33484/-
Depreciation per annum – 6697 (33484 / 5)

Variable lease payment if paid will be transfer to P&L directly.

Q.INDAS116.OM.215: (Singapore CA Institute)

Barlow Wholesale Ltd (BWL) sells a packaging machine for its fair value of $300,000 to Frost Solutions Ltd (FSL) on 1 August 20X7. On this date the machine had a carrying amount of $260,000. On the same date BWL entered into an arrangement to lease back the machine for 6 years in an arrangement determined by FSL to be an operating lease. Annual lease payments are $35,000 in arrears and the implicit interest rate is 7%. The present value of the lease payments at 1 August 20X7 is $178,507.
The transfer qualifies as a sale. Explain how BWL and FSL should account for the transfer.

SOLUTION

BOOKS OF BWL

Both the carrying amount of the machine ($260,000) and the profit on transfer of $40,000 ($300,000 – $260,000) must be split into the portion that relates to the retained rights and the portion that relates to the transferred rights.
This split is based on fair values; the fair value of the machine in its entirety is $300,000; the fair value of the retained right-of-use asset is $178,507 (the lease liability).
Therefore:

	Retained	**Transferred**
Underlying Asset $ 260000	260000 x 178507/300000 = $154706	$260000 - $154706 =$105294
Gain $40000	40000x 178507/300000 = $23801	$40000 - $23801 = $16199

In respect of Retained Rights:

Right of Use Asset A/c	Dr.	154706	
To Underlying Asset A/c			154706

In respect of Transferred Rights:

Bank A/c	Dr.	300000	
To Underlying Asset A/c			105294
To Lease Liability A/c			178507
To Gain on Transfer A/c			16199

BOOKS OF FSL

FSL should recognise the machine at cost of $300,000 by ($):

Machine A/c	Dr.	300000	
To Bank A/c			300000

This is an operating lease arrangement and therefore FSL recognise income in each year of the lease of $35,000.

Q.INDAS116.RMP.216: (RTP Nov21 & MTP Nov22)

The Company has entered into a lease agreement for its retail store as on 1st April, 20X1 for a period of 10 years. A lease rental of Rs. 56,000 per annum is payable in arrears. The Company recognized a lease liability of Rs. 3,51,613 at inception using an incremental borrowing rate of 9.5% p.a. as at 1st April 20X1. As per the terms of lease agreement, the lease rental shall be adjusted every 2 years to give effect of inflation. Inflation cost index as notified by the Income tax department shall be used to derive the lease payments. Inflation cost index was 280 for financial year 20X1-20X2 and 301 for financial year 20X3-20X4. The current incremental borrowing rate is 8% p.a. Show the Journal entry at the beginning of year 3, to account for change in lease.

SOLUTION

As per para 27 (b) of Ind AS 116, variable lease payments that depend on an index or a rate, are initially measured using the index or rate as at the commencement date.

At the beginning of the third year, Lessee remeasures the lease liability at the present value of eight payments of Rs. 60,200 discounted at an original discount rate of 9.5% per annum as per para 43 of Ind AS 116.

Year	Revised lease rental	Discount factor @ 9.5%	Present value
3	[(56,000 / 280) x 301] = 60,200	0.913	54,963
4	60,200	0.834	50,207
5	60,200	0.762	45,872
6	60,200	0.696	41,899
7	60,200	0.635	38,277
8	60,200	0.580	34,916
9	60,200	0.530	31,906
10	60,200	0.484	29,137
			3,27,127

Table showing amortised cost of lease liability

Year	Opening balance	Interest @ 9.5%	Rental paid	Closing balance
1	3,51,613	33,403	56,000	3,29,016
2	3,29,016	31,257	56,000	3,04,273

Difference of Rs. 22,854 (3,27,127 – 3,04,273) will increase the lease liability with corresponding increase in ROU Asset as per para 39 of Ind AS 116.

Journal entry at the beginning of year 3 would be:

Right-of-use asset Dr. Rs. 22,854
To Lease liability Rs. 22,854

Q.INDAS116.RMP.217: (MTP Nov22)

Feel Fresh Limited (the Company) is into manufacturing and retailing of FMCG products listed on stock exchanges in India. One of its products is bathing soap which the Company sells under the brand name 'Feel Fresh'. The Company does not have its own manufacturing facilities for soap and therefore it enters into arrangements with a third party to procure the soaps. The Company entered into a long-term purchase contract of 10 years with M/s. Radhey. Following are the relevant terms of the contract with M/s. Radhey.

(i) M/s. Radhey has to purchase a machine costing Rs. 10,00,000 from the supplier as specified by the Company. The machine will be customized to produce the soaps as designed by the Company. This machine cannot be used by M/s. Radhey to produce the soaps for buyers other than the Company due to the design specifications. The machine has a useful life of 10 years and the straight-line method of depreciation is best suited considering the use of the machine.

(ii) The Company will pay Rs. 4.75 per soap for the first year of contract. This is calculated based on the budgeted annual purchase of 7,00,000 soaps as follows:

Particulars	Per soap price
Variable cost of manufacturing	4.00
Cost of machine (Rs. 1,74,015 / 7,00,000 soaps)	0.25
M/s. Radhey's margin	0.50
Per soap cost to the Company	4.75

In case the Company purchases more than 7,00,000 (i.e. budgeted number of soaps) soaps in the first year then the cost of the machine (i.e. 0.25 per soap) will not be paid for soaps procured in excess of 7,00,000 units. However, in case Company procures less than budgeted number of soaps, then the Company will pay the differential unabsorbed cost of the machine, at the end of the year. For example, if the Company purchases only 6,00,000 soaps in first year then the differential amount of Rs. 24,015 (1,74,015 - (6,00,000 x 0.25)) will be paid by the Company to M/s. Radhey at the end of the year. Variable cost will be actualized at the end of the year.

(iii) The cost per soap will be calculated for each year in advance based on the budgeted number of soaps to be produced each year. An amount of Rs. 1,74,015 shall be considered each year for the cost of machine for year 1 to year 8 while calculating the cost per soap. Any differential under absorbed amount shall be paid by the Company to M/s. Radhey at the end of that year. A charge of Rs. 1,74,015 per annum for the machine is derived using borrowing cost of 8% p.a. For year 9 and year 10, only variable cost and margins will be paid.

(iv) M/s. Radhey does not have any right to terminate the contract but the Company has the right to terminate the contract at the end of each year. However, if the Company terminates the contract, it has to compensate M/s. Radhey for any unabsorbed cost of Machine. For example, if the Company terminates the contract at the end of second year then it has to pay Rs. 10,44,090 (i.e. 1,74,015 per year x 6 remaining years). If it terminates the contract after the 8th year then the Company does not have to pay the compensation since the cost of the machine would have been absorbed.

(v) In the first year, the Company purchases 5,50,000 soaps at Rs. 4.75 per soap.

Evaluate the contract of the Company with M/s. Radhey and provide necessary accounting entries for first year in accordance with Ind AS with working notes. Assume all cash flows occur at the end of the year.

SOLUTION

Identification of the contract (by applying para 9 of Ind AS 116)

(a) **Identified asset**

Feel Fresh Ltd. (a customer company) enters into a long-term purchase contract with M/s Radhey (a manufacturer) to purchase a particular type and quality of soaps for 10 year period.

Since for the purpose of the contract M/s Radhey has to buy a customized machine as per the directions of Feel Fresh Ltd. and also the machine cannot be used for any other type of soap, the machine is an identified asset.

(b) **Right to obtain substantially all of the economic benefits from use of the asset throughout the period of use**

Since the machine cannot be used for manufacture of soap for any other buyer, Feel Fresh Ltd. will obtain substantially all the economic benefits from the use of the asset throughout the period of use.

(c) **Right to direct the use**

Feel Fresh Ltd. controls the use of machine and directs the terms and conditions of the contract with respect to recovery of fixed expenses related to machine.

Hence the contract contains a lease.

Lease term

The lease term shall be 10 years assuming reasonable certainty. Though the lessee is not contractually bound till 10th year, i.e., the lessee can refuse to make payment anytime without lessor's permission but, it is assumed that the lessee is reasonably certain that it will not exercise this option to terminate.

Identification of lease payment

Lease payments are defined as payments made by a lessee to a lessor relating to the right to use an underlying asset during the lease term, comprising the following:

(a) fixed payments (including in-substance fixed payments), less any lease incentives
(b) variable lease paym
(c) ents that depend on an index or a rate
(d) the exercise price of a purchase option if the lessee is reasonably certain to exercise that option
(e) payments of penalties for terminating the lease, if the lease term reflects the lessee exercising an option to terminate the lease

Here in-substance fixed payments in the given lease contract are Rs. 1,74,015 p.a. The present value of lease payment which would be recovered in 8 years @ 8% would be Rs. 10,00,000 (approx.)
Variable lease payments that do not depend on an index or rate and are not, in substance, fixed are not included as lease payments. Instead, they are recognised in profit or loss in the period in which the event that triggers the payment occurs (unless they are included in the carrying amount of another asset in accordance with other Ind AS).
Hence, lease liability will be recognized by Rs. 10,00,000 in the books of Feel Fresh Ltd. Since there are no payments made to lessor before commencement date less lease incentives received from lessor or initial direct costs incurred by lessee or estimate of costs for restoration / dismantling of underlying asset, the right of use asset is equal to lease liability.

Journal Entries

On initial recognition

ROU Asset	Dr.	10,00,000	
To Lease Liability			10,00,000
To initially recognise the Lease Liability and the corresponding ROU Asset			

At the end of the first year

Interest Expense	Dr.	80,000	
To Lease Liability			80,000
To record interest expense and accrete the lease liability using the effective interest method (Rs. 10,00,000 x 8%)			
Depreciation Expense (10,00,000 / 10 years)	Dr.	1,00,000	
To ROU Asset			1,00,000
To record depreciation on ROU using the straight-line method (Rs. 10,00,000 / 10 years)			
Lease Liability	Dr.	1,74,015	
To Bank / M/s. Radhey			1,74,015
To record lease payment			
Cost of soap	Dr.	24,75,000	
To Bank / M/s. Radhey {5,50,000 x (4 + 0.5)}			24,75,000
To record variable expenses paid as cost of the goods purchased			

LEASE MODIFICATION (LESSEE)

Q.INDAS116.SM.301:

Lessee enters into a 10-year lease for 2,000 square metres of office space. At the beginning of Year 6, Lessee and Lessor agree to amend the original lease for the remaining five years to include an additional 3,000 square metres of office space in the same building. The additional space is made available for use by Lessee at the end of the second quarter of Year 6. The increase in total consideration for the lease is commensurate with the current market rate for the new 3,000 square metres of office space, adjusted for the discount that Lessee receives reflecting that Lessor does not incur costs that it would otherwise have incurred if leasing the same space to a new tenant (for example, marketing costs).

How should the said modification be accounted for?

SOLUTION:

Lessee accounts for the modification as a separate lease, separate from the original 10-year lease because the modification grants Lessee an additional right to use an underlying asset, and the increase in consideration for the lease is commensurate with the stand-alone price of the additional right-of-use adjusted to reflect the circumstances of the contract. In this example, the additional underlying asset is the new 3,000 square metres of office space. Accordingly, at the commencement date of the new lease (at the end of the second quarter of Year 6), Lessee recognises a ROU Asset and a lease liability relating to the lease of the additional 3,000 square metres of office space. Lessee does not make any adjustments to the accounting for the original lease of 2,000 square metres of office space as a result of this modification.

Q.INDAS116.SM.302: (SIMILAR TO MTP May22 & MTP May21)

Lessee enters into a 10-year lease for 5,000 square metres of office space. The annual lease payments are Rs1,00,000 payable at the end of each year. The interest rate implicit in the lease cannot be readily determined. Lessee's incremental borrowing rate at the commencement date is 6% p.a. At the beginning of Year 7, Lessee and Lessor agree to amend the original lease by extending the contractual lease term by four years. The annual lease payments are unchanged (i.e., Rs1,00,000 payable at the end of each year from Year 7 to Year 14). Lessee's incremental borrowing rate at the beginning of Year 7 is 7% p.a.

How should the said modification be accounted for?

SOLUTION:

At the effective date of the modification (at the beginning of Year 7), Lessee remeasures the lease liability based on:

(a) An eight-year remaining lease term

(b) Annual payments of Rs1,00,000 and

(c) Lessee's incremental borrowing rate of 7% p.a.

The modified lease liability equals Rs5,97,100 (W.N.1). The lease liability immediately before the modification (including the recognition of the interest expense until the end of Year 6) is Rs3,46,355 (W.N.3). Lessee recognises the difference between the carrying amount of the modified lease liability and the carrying amount of the lease liability immediately before the modification (i.e., Rs2,50,745) (W.N. 4) as an adjustment to the ROU Asset.

Working Notes:

1. Calculation of modified lease liability:

Year	Lease Payment (A)	Present value factor @ 7% (B)	Present value of lease payments (A*B=C)
7	100,000	0.935	93,500
8	100,000	0.873	87,300
9	100,000	0.816	81,600
10	100,000	0.763	76,300
11	100,000	0.713	71,300
12	100,000	0.666	66,600
13	100,000	0.623	62,300
14	100,000	0.582	58,200
Modified lease liability			**5,97,100**

2. Calculation of Lease liability as at commencement date:

Year	Lease Payment (A)	Present value factor @ 6% (B)	Present value of lease payments (A x B = C)
1	100,000	0.943	94,300
2	100,000	0.890	89,000
3	100,000	0.840	84,000
4	100,000	0.792	79,200
5	100,000	0.747	74,700
6	100,000	0.705	70,500
7	100,000	0.665	66,500
8	100,000	0.627	62,700
9	100,000	0.592	59,200
10	100,000	0.558	55,800
Lease liability as at modification date			**7,35,900**

3. Calculation of Lease liability immediately before modification date:

Year	Opening lease liability (A)	Interest @6% (B) = [A x 6%]	Lease payments (C)	Closing liability (D) = [A+B-C]
1	7,35,900	44,154	100,000	6,80,054
2	6,80,054	40,803	100,000	6,20,857
3	6,20,857	37,251	100,000	5,58,108
4	5,58,108	33,486	100,000	4,91,594
5	4,91,594	29,496	100,000	4,21,090
6	4,21,090	25,265	100,000	3,46,355
	Lease liability as at modification date			3,46,355

4. Adjustment to ROU asset:

Modified Lease liability	5,97,100
Original Lease liability as at modification date	(3,46,355)
Adjustment to ROU asset	**2,50,745**

The ROU asset will be increased by Rs2,50,745 on the date of modification.

Q.INDAS116.SM.303: (SIMILAR To MTP May21, May22)

Lessee enters into a 10-year lease for 5,000 square meters of office space. The annual lease payments are Rs. 50,000 payable at the end of each year. The interest rate implicit in the lease cannot be readily determined. Lessee's incremental borrowing rate at the commencement date is 6% p.a. At the beginning of Year 6, Lessee and Lessor agree to amend the original lease to reduce the space to only 2,500 square meters of the original space starting from the end of the first quarter of Year 6. The annual fixed lease payments (from Year 6 to Year 10) are Rs. 30,000. Lessee's incremental borrowing rate at the beginning of Year 6 is 5% p.a.

How should the said modification be accounted for?

SOLUTION:

In the given case, Lessee calculates the ROU asset and the lease liabilities before modification as follows:

	Lease Liability				ROU asset		
Year	**Initial value**	**Lease payments**	**Interest expense @ 6%**	**Closing balance**	**Initial Value**	**Depreciation**	**Closing balance**
	A	**B**	**c = a x 6%**	**d = a-b + c**	**e**	**f**	**g**
1	3,67,950*	50,000	22,077	3,40,027	3,67,950	36,795	3,31,155
2	3,40,027	50,000	20,402	3,10,429	3,31,155	36,795	2,94,360
3	3,10,429	50,000	18,626	2,79,055	2,94,360	36,795	2,57,565
4	2,79,055	50,000	16,743	2,45,798	2,57,565	36,795	2,20,770
5	2,45,798	50,000	14,748	2,10,546	2,20,770	36,795	1,83,975
6	2,10,546				1,83,975		

*(refer note 1)

At the effective date of the modification (at the beginning of Year 6), Lessee remeasures the lease liability based on:

(a) a five-year remaining lease term,

(b) annual payments of Rs. 30,000 and

(c) Lessee's incremental borrowing rate of 5% p.a.

Year	Lease Payment(A)	Present value factor @ 5% (B)	Present value of lease payments (A x B = C)
6	30,000	0.952	28,560
7	30,000	0.907	27,210
8	30,000	0.864	25,920
9	30,000	0.823	24,690
10	30,000	0.784	23,520
Total			**1,29,900**

Lessee determines the proportionate decrease in the carrying amount of the ROU Asset on the basis of the remaining ROU Asset (i.e., 2,500 square meters corresponding to 50% of the original ROU Asset).

50% of the pre-modification ROU Asset (Rs. 1,83,975) is Rs. 91,987.50.
50% of the pre-modification lease liability (Rs. 2,10,546) is Rs. 1,05,273.

Consequently, Lessee reduces the carrying amount of the ROU Asset by Rs. 91,987.50 and the carrying amount of the lease liability by Rs. 1,05,273. Lessee recognises the difference between the decrease in the lease liability and the decrease in the ROU Asset (Rs. 1,05,273 – Rs. 91,987.50 = Rs. 13,285.50) as a gain in profit or loss at the effective date of the modification (at the beginning of Year 6).
Lessee recognises the difference between the remaining lease liability of Rs. 1,05,273 and the modified lease liability of Rs. 1,29,900 (which equals Rs. 24,627) as an adjustment to the ROU Asset reflecting the change in the consideration paid for the lease and the revised discount rate.

Working Note:
Calculation of Initial value of ROU asset and lease liability:

Year	Lease Payment(A)	Present value factor @ 6% (B)	Present value of lease payments (A x B = C)
1	50,000	0.943	47,150
2	50,000	0.890	44,500
3	50,000	0.840	42,000
4	50,000	0.792	39,600
5	50,000	0.747	37,350
6	50,000	0.705	35,250
7	50,000	0.665	33,250
8	50,000	0.627	31,350
9	50,000	0.592	29,600
10	50,000	0.558	27,900
			3,67,950

Q.INDAS116.SM.304:

Lessee enters into a 10-year lease for 5,000 square metres of office space. At the beginning of Year 6, Lessee and Lessor agree to amend the original lease for the remaining five years to reduce the lease payments from Rs1,00,000 per year to Rs95,000 per year. The interest rate implicit in the lease cannot be readily determined. Lessee's incremental borrowing rate at the commencement date is 6% p.a. Lessee's incremental borrowing rate at the beginning of Year 6 is 7% p.a. The annual lease payments are payable at the end of each year.
How should the said modification be accounted for?

SOLUTION:

In the given case, Lessee calculates the ROU asset and the lease liabilities before modification as follows:

Year	Opening lease liability (A)	Interest @6% (B) = [A x 6%]	Lease payments (C)	Closing liability (D) = [A+B-C]
1	7,35,900	44,154	100,000	6,80,054
2	6,80,054	40,803	100,000	6,20,857
3	6,20,857	37,251	100,000	5,58,108
4	5,58,108	33,486	100,000	4,91,594
5	4,91,594	29,496	100,000	4,21,090
6	4,21,090			

At the effective date of the modification (at the beginning of Year 6), Lessee remeasures the lease liability based on:

(a) a five-year remaining lease term,

(b) annual payments of Rs95,000, and

(c) Lessee's incremental borrowing rate of 7% p.a.

Year	Lease Payments (A)	Present value @ 7% (B)	Present value of lease payments (A x B = C)
1	95,000	0.935	88,825
2	95,000	0.873	82,935
3	95,000	0.816	77,520
4	95,000	0.763	72,485
5	95,000	0.713	67,735
			3,89,500

Lessee recognises the difference between the carrying amount of the modified liability (Rs3,89,500) and the lease liability immediately before the modification (Rs4,21,090) of Rs31,590 as an adjustment to the ROU Asset.

Working Note:

Calculation of Initial value of ROU asset and lease liability:

Year	Lease Payment (A)	Present value factor @ 6% (B)	Present value of lease payments (A x B = C)
1	100,000	0.943	94,300
2	100,000	0.890	89,000
3	100,000	0.840	84,000
4	100,000	0.792	79,200
5	100,000	0.747	74,700
6	100,000	0.705	70,500
7	100,000	0.665	66,500
8	100,000	0.627	62,700
9	100,000	0.592	59,200
10	100,000	0.558	55,800
Lease liability as at modification date			**7,35,900**

Q.INDAS116.SM.305:

Lessee enters into a 10-year lease for 2,000 square metres of office space. The annual lease payments are Rs1,00,000 payable at the end of each year. The interest rate implicit in the lease cannot be readily determined. Lessee's incremental borrowing rate at the commencement date is 6% p.a.

At the beginning of Year 6, Lessee and Lessor agree to amend the original lease to:

(a) Include an additional 1,500 square metres of space in the same building starting from the beginning of Year 6 and

(b) Reduce the lease term from 10 years to eight years. The annual fixed payment for the 3,500 square metres is Rs1,50,000 payable at the end of each year (from Year 6 to Year 8). Lessee's incremental borrowing rate at the beginning of Year 6 is 7% p.a.

The consideration for the increase in scope of 1,500 square metres of space is not commensurate with the stand-alone price for that increase adjusted to reflect the circumstances of the contract. Consequently, Lessee does not account for the increase in scope that adds the right to use an additional 1,500 square metres of space as a separate lease.
How should the said modification be accounted for?

SOLUTION:

The pre-modification ROU Asset and the pre-modification lease liability in relation to the lease are as follows:

Year	Lease liability				ROU Asset		
	Opening balance	**Interest expense @ 6%**	**Lease payment**	**Closing balance**	**Opening balance**	**Depreciation charge**	**Closing balance**
1	7,35,900*	44,154	(1,00,000)	6,80,054	7,35,900	(73,590)	6,62,310
2	6,80,054	40,803	(1,00,000)	6,20,857	6,62,310	(73,590)	5,88,720
3	6,20,857	37,251	(1,00,000)	5,58,108	5,88,720	(73,590)	5,15,130
4	5,58,108	33,486	(1,00,000)	4,91,594	5,15,130	(73,590)	4,41,540
5	4,91,594	29,496	(1,00,000)	4,21,090	4,41,540	(73,590)	3,67,950
6	4,21,090				3,67,950		

*Refer Note 4.

At the effective date of the modification (at the beginning of Year 6), Lessee remeasures the lease liability on the basis of:

(a) A three-year remaining lease term (i.e. till 8th year),
(b) Annual payments of Rs150,000 and
(c) Lessee's incremental borrowing rate of 7% p.a.

Year	Lease Payments (A)	Present value @ 7% (B)	Present value of lease payments (A x B = C)
1	1,50,000	0.935	1,40,250
2	1,50,000	0.873	1,30,950
3	1,50,000	0.816	1,22,400
Modified lease liability			**3,93,600**

The modified liability equals Rs3,93,600, of which (a) Rs1,31,200 relates to the increase of Rs50,000 in the annual lease payments from Year 6 to Year 8 and (refer note 1) (b) Rs2,62,400 relates to the remaining three annual lease payments of Rs1,00,000 from Year 6 to Year 8 with reduction of lease term (Refer Note 3)

Decrease in the lease term:

At the effective date of the modification (at the beginning of Year 6), the pre-modification ROU Asset is Rs. 3,67,950. Lessee determines the proportionate decrease in the carrying amount of the ROU Asset based on the remaining ROU Asset for the original 2,000 square metres of office space (i.e., a remaining three-year lease term rather than the original five-year lease term). The remaining ROU Asset for the original 2,000 square metres of office space is Rs. 2,20,770 [i.e., Rs. (3,67,950 / 5) x 3 years].

At the effective date of the modification (at the beginning of Year 6), the pre-modification lease liability is Rs. 4,21,090. The remaining lease liability for the original 2,000 square metres of office space is Rs. 2,67,300 (i.e., present value of three annual lease payments of Rs. 1,00,000, discounted at the original discount rate of 6% p.a.) (refer note 2).

Consequently, Lessee reduces the carrying amount of the ROU Asset by Rs. 1,47,180 (Rs. 3,67,950 – Rs. 2,20,770), and the carrying amount of the lease liability by Rs. 1,53,790 (Rs. 4,21,090 – Rs. 2,67,300). Lessee recognises the difference between the decrease in the lease liability and the decrease in the ROU Asset (Rs. 1,53,790 – Rs. 1,47,180 = Rs. 6,610) as a gain in profit or loss at the effective date of the modification (at the beginning of Year 6).

Lease Liability	Dr.	1,53,790	
To ROU Asset			1,47,180
To Gain			6,610

At the effective date of the modification (at the beginning of Year 6), Lessee recognises the effect of the remeasurement of the remaining lease liability reflecting the revised discount rate of 7% p.a., which is Rs4,900 (Rs2,67,300 – Rs2,62,400*), as an adjustment to the ROU Asset.
*(Refer note 3)

Lease Liability Dr.	4,900	
To ROU Asset		4,900

Increase in the leased space:
At the commencement date of the lease for the additional 1,500 square metres of space (at the beginning of Year 6), Lessee recognises the increase in the lease liability related to the increase in leased space of Rs1,31,200 (i.e., present value of three annual lease payments of Rs50,000, discounted at the revised interest rate of 7% p.a.) as an adjustment to the ROU Asset.

ROU Asset Dr.	1,31,200	
To Lease Liability		1,31,200

The modified ROU Asset and the modified lease liability in relation to the modified lease are as follows:

Year	Lease liability				ROU Asset		
	Opening balance	**Interest expense @ 7%**	**Lease payment**	**Closing balance**	**Opening balance**	**Depreciation charge**	**Closing balance**
6	3,93,600	27,552	(1,50,000)	2,71,152	3,47,100**	(1,15,700)	2,31,400
7	2,71,152	18,981	(1,50,000)	1,40,133	2,31,400	(1,15,700)	1,15,700
8	1,40,133	9,867*	(1,50,000)	-	1,15,700	(1,15,700)	-

*Difference is due to approximation.
**Refer Note 5

Working Notes:

1. **Calculation of lease liability on increased consideration:**

Year	Lease Payments (A)	Present value @7% (B)	Present value of lease payments (A x B = C)
1	50,000	0.935	46,750
2	50,000	0.873	43,650
3	50,000	0.816	40,800
Modified lease liability			**1,31,200**

2. **Calculation of remaining lease liability for the original contract of 2000 square meters at Original discount rate:**

Year	Lease Payments (A)	Present value factor @ 6% (B)	Present value of lease payments (A x B = C)
1	1,00,000	0.943	94,300
2	1,00,000	0.890	89,000
3	1,00,000	0.840	84,000
Remaining lease liability			**2,67,300**

3. **Calculation of remaining lease liability for the original contract of 2000 square meters at revised discount rate:**

Year	Lease Payments (A)	Present value factor @ 7%(B)	Present value of lease payments (A x B = C)
1	1,00,000	0.935	93,500
2	1,00,000	0.873	87,300
3	1,00,000	0.816	81,600
Remaining lease liability			**2,62,400**

4. Calculation of Initial value of ROU asset and lease liability:

Year	Lease Payment (A)	Present value factor @ 6%(B)	Present value of lease payments (A x B = C)
1	100,000	0.943	94,300
2	100,000	0.890	89,000
3	100,000	0.840	84,000
4	100,000	0.792	79,200
5	100,000	0.747	74,700
6	100,000	0.705	70,500
7	100,000	0.665	66,500

5. Calculation of opening balance of Modified ROU Asset at the beginning of 6th year:

The remaining ROU Asset for the original 2,000 square metres of office space after decrease in term	2,20,770
Less: Adjustment for increase in interest rate from 6% to 7%	(4,870)
Add: Adjustment for increase in leased space	1,31,200
	3,47,100

COVID IMPACT (LESSEE)

Q.INDAS116.OM.401:

Lease Term – 2 years from 1st Jan, 20 onwards. Lease Rent 50000 pm in arrears. Discount Rate is 12% pa. On 1st Jan, 20. Lessor agreed to provide Rent Concession to lessee due to Covid-19 as under:

***Case A** – Unconditional Waiver of Lease payment from April 20 to Sep 20*

***Case B** – Waiver of Monthly Lease Rent of 50000 from April 20 to Sep 20 with 50% recovery thereof from Oct. 20 onwards*

***Case C** – Waiver of Lease Rent on monthly basis from April 20 to the date when lockdown will be lifted. (Assume lockdown lifted on 1st Oct 20)*

SOLUTION:

CASE A

1. PV of Lease Payments at 1% PM discounting at 1st Jan 20 = 50000 x 21.2432 = 1062160/-

   ROU Asset A/c Dr. 1062160

   To Lease Liability A/c 1062160

2. Lease Liability and Interest schedule :

Month	Opening Bal.	Interest@ 1% pm	Lease payment	Closing Bal.
Jan. 20	1062160	10622	50000	1022782
Feb. 20	1022782	10228	50000	983010
Mar. 20	983010	9830	50000	942840
Apr. 20	942840	9428	Not paid	**952268**

3. Carrying Amount of Lease Liability on 30th April 20 = 952268
4. Revised Lease Liability is 659595/- to be determined as under:

Month	Lease Payment	PVF @ 1%	Amount.
May20	Nil	0.9901	0
June 20	Nil	0.9803	0
July 20	Nil	0.9706	0
Aug. 20	Nil	0.9610	0
Sep. 20	Nil	0.9515	0
Oct. 20	50000	0.9420	47100
Nov. 20	50000	0.9327	46635
Dec. 20	50000	0.9235	46175
Jan.21	50000	0.9143	45715
Feb. 21	50000	0.9053	45265
Mar. 21	50000	0.8963	44815
Apr. 21	50000	0.8874	44370
May21	50000	0.8787	43935
June 21	50000	0.8700	43500
July 21	50000	0.8613	43065
Aug. 21	50000	0.8528	42640
Sep. 21	50000	0.8444	42220
Oct. 21	50000	0.8360	41800
Nov. 21	50000	0.8277	41385
Dec. 21	50000	0.8195	40975
Revised Lease Liability @ Org. Dis. Rate			**659595/-**

5. Adjusting Entry as on 30/04/20 in case Practical Expedient Taken:

   Lease Liability A/c Dr. 292673 **(952268 – 659595)**

   To Profit and Loss A/c 292673

6. Revised Carrying Amount of Lease Liability will be Rs. 659595/- on which Finance charges for the further periods to be calculated.

7. Amortisation Schedule:

Month	Opening Bal.	Interest@ 1% pm	Lease payment	Closing Bal.
May 20	**659595**	6596	-	666191
June 20	666191	6662	-	672853
July 20	672853	6729	-	679582
Aug. 20	679582	6796	-	686378
Sep. 20	686378	6864	-	693242
Oct. 20	693242	6932	(50000)	650174

and so on……

Students Note:

CASE B

1. PV of Lease Payments at 1% PM discounting at 1st Jan 20 = 50000 x 21.2432 = 1062160/-

ROU Asset A/c Dr. 1062160

To Lease Liability A/c 1062160

2. Lease Liability and Interest schedule Table :

Month	Opening Bal.	Interest@ 1% pm	Lease payment	Closing Bal.
Jan. 20	1062160	10622	50000	1022782
Feb. 20	1022782	10228	50000	983010
Mar. 20	983010	9830	50000	942840
Apr. 20	942840	9428	Not paid	**952268**

3. Carrying Amount of Lease Liability on 30th April 20 = 952268

4. Revised Lease Liability is 797450/- to be determined as under:

Month	Lease Payment	PVF	Amount.
May20	Nil	0.9901	0
June 20	Nil	0.9803	0
July 20	Nil	0.9706	0
Aug. 20	Nil	0.9610	0
Sep. 20	Nil	0.9515	0
Oct. 20	75000	0.9420	70650
Nov. 20	75000	0.9327	69953
Dec. 20	75000	0.9235	69263
Jan.21	75000	0.9143	68573
Feb. 21	75000	0.9053	67898
Mar. 21	75000	0.8963	67223
Apr. 21	50000	0.8874	66555
May21	50000	0.8787	43935
June 21	50000	0.8700	43500

July 21	50000	0.8613	43065
Aug. 21	50000	0.8528	42640
Sep. 21	50000	0.8444	42220
Oct. 21	50000	0.8360	41800
Nov. 21	50000	0.8277	41385
Dec. 21	50000	0.8195	40975
			797450

5. Adjusting Entry as on 31/04/20 in case Practical Expedient Taken:

Lease Liability A/c Dr. 154818 **(952268 – 797450)**
To Profit and Loss A/c 154818

6. Revised Carrying Amount of Lease Liability will be Rs. 787450/- on which Finance charges for the further periods to be calculated.

7. Amortisation Schedule:

Month	Opening Bal.	Interest@ 1% pm	Lease payment	Closing Bal.
May 20	**797450**	7975	-	805425
June 20	805425	8054	-	813479
July 20	813479	8135	-	821614
Aug. 20	821614	8216	-	829830
Sep. 20	829830	8298	-	838128
Oct. 20	838128	8381	-75000	771509

and so on……

Student Note:

CASE C

1. The liability for April 20 is waived, but the outcome of Future Lease payments will be assessed monthly and cannot be considered to accrue on 30/04/20. Therefore, the adjusting entries need to be passed monthly till the time rent concessions continue.

2. Adjusting Entry as on 30/04/20 in case Practical Expedient Taken:

Lease Liability A/c Dr. 50000
To P&L A/c 50000

3. Amortisation Schedule:

Month	Opening Bal.	Interest@ 1% pm	Lease payment	Covid-19 Rent Concession	Closing Bal.
Apr. 20	942840	9428	0	50000	902268
May. 20	902268	9023	0	50000	861291
June 20	861291	8613	0	50000	819904
July 20	819904	8199	0	50000	778103
Aug. 20	778103	7781	0	50000	735884

Sep. 20	735884	7359	0	50000	693243
Oct. 20	693243	6932	50000	-	650175

and so on……

Student Note:

Q.INDAS116.SM.402:

Retailer Q leases a store in a large retail mall. The rent payable is ₹ 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 ₹ 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:

(1) It is a rent concession occurring as a direct consequence of the pandemic;

(2) Increase in rentals during January, 2021 to March 2021 compensates for the time value of money;

(3) Rent deferral reduces lease payments originally due on or before 30 June 2021; and

(4) There is no substantive change to other terms and condition of the lease. Hence,

Q considers applying the practical expedient.

Q.INDAS116.SM.403:

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:

(1) It is a rent concession occurring as a direct consequence of the pandemic;

(2) 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;

(3) Rent deferral reduces lease payments originally due on or before 30 June 2021; and

(4) 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.

Q.INDAS116.SM.404:

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.

Q.INDAS116.SM.405:

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:

(Author's Note: The below suggested answer is subject in nature, there may consist of alternate opinion.)

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.

Q.INDAS116.SM.406:

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 de-recognised 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.

Q.INDAS116.SM.407:

Lessor L leases retail space to Lessee Z and classifies the lease as an operating lease. The lease includes fixed lease payments of ₹ 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.

Q.INDAS116.RMP.408: (JULY. 21 EXAM)

Ted entered into a lease contract with lessor to lease 2,000 sqm of retail space for 5 years. The rentals are payable monthly in advance. The lease commenced on 1st April 2019. In the year 2020, as a direct consequence of Covid 19 pandemic, Ted has negotiated with the lessor which may results in the following situations:

- *Lessor agrees a rent concession under which the monthly rent will be reduced by 30% per month for the 12 months commencing 1st October 2020.*
- *Ted is granted a rent concession by the lessor whereby the lease payments for the period October 2020*

to December 2020 are deferred. Three months are added to the end of the lease term at same monthly rent.

- *Lessor offers to reduce monthly rent by 50% for the months October 2020 to March 2021 on the condition that its space is reduced from 2,000 sqm to 1,500 sqm.*

Analyze the given situations in the light of Ind AS 116 and comment on whether rent concession/ deferral is eligible for practical expedient?

SOLUTION

Applicability of practical expedient:

The practical expedient applies only to rent concessions occurring as a direct consequence of the covid-19 pandemic.

As a practical expedient, a lessee may elect not to assess a rent concession as a lease modification only if all of the following conditions are met:

(a) The change in lease payments results in revised consideration for the lease that is substantially the same as, or less than, the consideration for the lease immediately preceding the change;

(b) Any reduction in lease payments affects only payments originally due on or before the 30th June, 2021; and

(c) There is no substantive change to other terms and conditions of the contract

Analysis:

Based on above guidance, answer to the given situations with the lessor would be as follows:

1. Lessor agrees a rent concession under which the monthly rent will be reduced by 30% per month for the 12 months commencing 1st October 2020:
   The rent deferral does not satisfy the criteria to apply the practical expedient because out of the listed eligibility criteria given in Ind AS 116, rent concession reduces lease payments starting from October, 2020 and reduction will continue till September, 2021 which is beyond 30th June 2021. Therefore, Ted is not permitted to apply the practical expedient.
2. Ted is granted a rent concession by the lessor whereby the lease payments for the period October 2020 to December 2020 are deferred. Three months are added to the end of the lease term at same monthly rent:
   (a) Condition is met since revised consideration in the lease is substantially the same as the original
   (b) Condition is met since the rent concession only reduces lease payments originally due in 2020 – i.e. before 30th June 2021.
   (c) Condition is met since the lessee assesses that three-month extension at the end of the lease term is with substantially the same lease payments. Hence, it would not constitute a substantive change.
   Since, the rent concession is a direct consequence of COVID-19 and all three conditions are met, rent concession is eligible for application of practical expedient in this case.

3. Lessor offers to reduce monthly rent by 50% for the months October 2020 to March 2021 on the condition that its space is reduced from 2,000 sqm to 1,500 sqm:
   The rent concession does not satisfy the criteria to apply the practical expedient because out of the listed eligibility criteria given in Ind AS 116, there is a substantive change to the terms and conditions of the lease as there is a change in the scope of lease by reducing the space from 2,000 sqm to 1,500 sqm. Therefore, Ted is not permitted to apply the practical expedient.

LESSORS' BOOK (FINANCE LEASE)

Q.INDAS116.SM.501:

A Lessor enters into a 10-year lease of equipment with Lessee. The equipment is not specialised in nature and is expected to have alternative use to Lessor at the end of the 10-year lease term. Under the lease:

- *Lessor receives annual lease payments of Rs15,000, payable at the end of the year*
- *Lessor expects the residual value of the equipment to be Rs50,000 at the end of the 10-year lease term*
- *Lessee provides a residual value guarantee that protects Lessor from the first Rs30,000 of loss for a sale at a price below the estimated residual value at the end of the lease term (i.e., Rs50,000)*
- *The equipment has an estimated remaining economic life of 15 years, a carrying amount of Rs1,00,000 and a fair value of Rs1,11,000*
- *The lease does not transfer ownership of the underlying asset to Lessee at the end of the lease term or contain an option to purchase the underlying asset*
- *The interest rate implicit in the lease is 10.078%.*

How should the Lessor account for the same in its books of accounts?

SOLUTION:

Lessor shall classify the lease as a **FINANCE LEASE** because the sum of the present value of lease payments amounts to **substantially all** of the fair value of the underlying asset.

At lease commencement, Lessor accounts for the finance lease, as follows:

Net investment in the lease	Rs 1,11,000(a)	
Cost of goods sold	Rs 92,340(b)	
Revenue		Rs 1,03,340(c)
Property held for lease		Rs 1,00,000(d)

To record the net investment in the finance lease and derecognise the underlying asset.

(a) The net investment in the lease consists of:

(1) The present value of 10 annual payments of Rs15,000 plus the guaranteed residual value of Rs30,000, both discounted at the interest rate implicit in the lease, which equals Rs1,03,340 (i.e., the lease payment) (Refer note 1) **AND**

(2) The present value of unguaranteed residual asset of Rs20,000, which equals Rs7,660 (Refer note 2).Note that the net investment in the lease is subject to the same considerations as other assets in classification as current or non-current assets in a classified balance sheet.

(b) Cost of goods sold is the carrying amount of the equipment of Rs1,00,000 (less) the present value of the unguaranteed residual asset of Rs7,660.

(c) Revenue equals the lease receivable.

(d) The carrying amount of the underlying asset.

At lease commencement, Lessor recognises selling profit of Rs11,000 which is calculated as = lease payment of Rs1,03,340 – [carrying amount of the asset (Rs1,00,000) – net of any unguaranteed residual asset (Rs7,660) i.e. which equals Rs92,340]

Cash	Rs 15,000(e)	
Net investment in the lease		Rs 3,813(f)
Interest income		Rs 11,187(g)

(e) Receipt of annual lease payments at the end of the year.

(f) Reduction of the net investment in the lease for lease payments received of Rs15,000, net of interest income of Rs11,187

(g) Interest income is the amount that produces a constant periodic discount rate on the remaining balance of the net investment in the lease. Please refer the computation below:

The following table summarises the interest income from this lease and the related amortisation of the net investment over the lease term:

Year	Annual Rental Payment	Annual Interest Income(h)	Net investment at the end of the year
Initial net investment	-	-	1,11,000
1	15,000	11,187	1,07,187
2	15,000	10,802	1,02,989
3	15,000	10,379	98,368
4	15,000	9,914	93,282
5	15,000	9,401	87,683
6	15,000	8,837	81,520
7	15,000	8,216	74,736
8	15,000	7,532	67,268
9	15,000	6,779	59,047
10	15,000	5,953	50,000(i)

(h) Interest income equals 10.078% of the net investment in the lease at the beginning of each year. For e.g., Year 1 annual interest income is calculated as Rs1,11,000 (initial net investment) x 10.078%.

(i) The estimated residual value of the equipment at the end of the lease term.

Working Notes:

1. Calculation of net investment in lease:

Year	Lease Payment (A)	Present value factor @ 10.078% (B)	Present value of lease payments (A x B = C)
1	15,000	0.908	13,620
2	15,000	0.825	12,375
3	15,000	0.750	11,250
4	15,000	0.681	10,215
5	15,000	0.619	9,285
6	15,000	0.562	8,430
7	15,000	0.511	7,665
8	15,000	0.464	6,960
9	15,000	0.421	6,315
10	15,000	0.383	5,745
10	30,000	0.383	11,480*
			1,03,340

* Figure has been rounded off for equalization of journal entry.

2. Calculation of present value of unguaranteed residual asset

Year	Lease Payment (A)	Present value factor @ 10.078% (B)	Present value of lease payments (A x B = C)
10	20,000	0.383	7,660

Q.INDAS116.SM.502: (SIMILAR TO Jan21 EXAM)

B&P Ltd. availed a lease from N&L Ltd. The conditions of the lease terms are as under:

(a) Lease period is 3 years, in the beginning of the year 20X1, for equipment costing Rs 10,00,000 and has an expected useful life of 5 years.

(b) The Fair market value is also Rs 10,00,000.

(c) The property reverts back to the lessor on termination of the lease.

(d) The unguaranteed residual value is estimated at Rs 1,00,000 at the end of the year 20X1.

(e) 3 equal annual payments are made at the end of each year.

(f) Consider IRR = 10%

(g) The present value of Rs. 1 due at the end of 3rd year at 10% rate of interest is Rs. 0.7513.

(h) The present value of annuity of Rs. 1 due at the end of 3rd at 10% IRR is Rs 2.4868.

State whether the lease constitute finance lease for Lessor.

SOLUTION:

Computation of annual lease payment to the lessor

Particulars	Amount (Rs.)
Cost of equipment	10,00,000
Unguaranteed residual value	1,00,000
Present value of residual value after third year @ 10% (1,00,000 × 0.7513)	75,130
Fair value to be recovered from lease payments (Rs 10,00,000 – Rs 75,130)	9,24,870
Present value of annuity for three years	2.4868
Annual lease payment = ₹ 9,24,870/2.4868	3,71,912

The present value of lease payment i.e., Rs 9,24,870 equals 92.48% of the fair market value, i.e., Rs 10,00,000. As the present value of minimum lease payments substantially covers the initial fair value of the leased asset and lease term covers the major part of the life of asset, it constitutes a finance lease.

Computation of Unearned Finance Income

Particulars	Amount (Rs.)
Total lease payments (Rs 3,71,912 × 3)	11,15,736
Add: Unguaranteed residual value	1,00,000
Gross investment in the lease	12,15,736
Less: Net Investment, i.e., Present value of gross investment (lease payments and residual value) (₹ 75,130 + Rs 9,24,870)	10,00,000

Q.INDAS116.RMP.503: (RTP Nov18)

A Ltd. prepares its financial statements for the period ending on 31st March each year. The financial statement for the year ended 2017-2018 is under preparation. The following events are relevant to these financial statements:

On 1stApril, 2016, A Ltd. purchased an asset for Rs. 2,00,00,000. The estimated useful life of the asset was 10 years, with an estimated residual value of zero. A Ltd. immediately leased the asset to B Ltd. The lease term was 10 years and the annual rental, payable in advance by B Ltd., was Rs. 27,87,000. A Ltd. incurred direct costs of Rs. 2,00,000 in arranging the lease. The lease contained no early termination clauses and responsibility for repairs and maintenance of the asset rest with B Ltd. for the duration of the lease. The annual rate of interest implicit in the lease is 8%. At an annual discount rate of 8% the present value of Rs. 1 receivable at the start of years 1–10 is Rs. 7·247.

Examine and show how the above event would be reported in the financial statements of A Ltd. for the year ended 31stMarch, 2018 as per Ind AS.

SOLUTION

The lease of the asset by A Ltd. to B Ltd. would be regarded as a finance lease because the risks and rewards of ownership have been transferred to B Ltd. Evidence of this includes the lease is for the whole of the life of the asset and B Ltd. being responsible for repairs and maintenance.

As per para 36 of Ind AS 17, since the lease is a finance lease and A Ltd. is the lessor, A Ltd. will recognise a financial asset i.e. as a receivable at an amount equal to the 'net investment in finance leases. The amount recognised will be the present value of the minimum lease payments which will be 20,197.39 i.e. 2,787 x 7.247.

The impact of the lease on the financial statements for the year ended 31st March, 2018 can best be seen by preparing a profile of the net investment in the lease for the first three years of the lease and shown below:

(All Fig. in Rs. '000)

Year Ending	Opening Balance	Finance income	Rental	Closing Balance
2017	20,197.39	1392.831	(2,787)	18803.22
2018	18803.22	1281.298	(2,787)	17297.518
2019	17297.518	1160.84	(2,787)	15671.359

During the year ended 31st March, 2018, A Ltd. will recognise income from finance leases of 1,281.298

The net investment on 31st March, 2018 will be 17,297.518.

Of the closing net investment of 17,761.27, current asset will be shown for 2,787 and 14,510.518 as a non-current asset.

Note: In Suggested Answer, rental is being assumed as paid at the end but in question it is clearly given that it is being paid in advance

Q.INDAS116.RMP.504: (RTP Nov22)

A company manufactures specialised machinery. The company offers customers the choice of either buying or leasing the machinery. A customer chooses to lease the machinery. Details of the arrangement are as follows:

(i) The lease commences on 1st April, 20X1 and lasts for three years.
(ii) The lessee is required to make three annual rentals payable in arrears of Rs. 57,500.
(iii) The leased machinery is returned to the lessor at the end of the lease.
(iv) The fair value of the machinery is Rs. 1,50,000, which is equivalent to the selling price of the machinery
(v) The machinery cost Rs. 1,00,000 to manufacture.
(vi) The lessor incurred costs of Rs. 2,500 to negotiate and arrange the lease
(vii) The expected useful life of the machinery is 3 years. The machinery has an expected residual value of Rs. 10,000 at the end of year three. The estimated residual value does not change over the term of the lease.
(viii) The interest rate implicit in the lease is 10.19%. The lessor classifies the lease as a finance lease.
How should the Lessor account for the same in its books of accounts? Pass necessary journal entries.

SOLUTION

The cost to the lessor for providing the machinery on lease consists of the book value of the machinery (Rs. 1,00,000), plus the initial direct costs associated with entering into the lease (Rs. 2,500), less the future income expected from disposing of the machinery at the end of the lease (the present value of the unguaranteed residual value of Rs. 10,000 discounted @ 10.19%, being Rs. 7,470). This gives a cost of sale of Rs. 95,030.

The lessor records the following entries at the commencement of the lease:

	Rs.	Rs.
Lease receivable Dr.	1,50,000	
Cost of sales Dr.	95,030	
To Inventory		1,00,000
To Revenue		1,42,530
To Creditors/Cash		2,500

The sales profit recognised by the lessor at the commencement of the lease is therefore Rs. 47,500 (Rs. 1,42,530 - Rs. 95,030). This is equal to the fair value of the machinery of Rs. 1,50,000, less the book value of the machinery (Rs. 1,00,000) and the initial direct costs of entering into the lease (Rs. 2,500). Revenue is equal to the lease receivable (Rs. 1,50,000), less the present value of the unguaranteed residual value (Rs. 7,470).

Year	Lease receivable at the beginning of year (Rs.) (a)	Lease payments (Rs.) (b)	Interest Income (10.19% per annum) (Rs.) (c)	Decrease In lease receivable (Rs.) (d)=(b)-(c)	Lease receivable at the end of year (Rs.) (e)=(a)-(d)
1	1,50,000	57,500	15,285	42,215	1,07,785
2	1,07,785	57,500	10,983	46,517	61,268
3	61,268	57,500	6,232*	51,268	10,000

*Difference is due to approximation

The lessor will record the following entries:

		Rs.	Rs.
Year 1	Cash/Bank Dr.	57,500	
	To Lease receivable		42,215
	To Interest income		15,285
Year 2	Cash/Bank Dr.	57,500	
	To Lease receivable		46,517
	To Interest income		10,983
Year 3	Cash/Bank Dr.	57,500	
	To Lease receivable		51,268
	To Interest income		6,232

At the end of the three-year lease term, the leased machinery will be returned to the lessor, who will record the following entries:

		Rs.	Rs.
Inventory	Dr.	10,000	
To Lease receivable			10,000

LESSORS' BOOK (OPERATING LEASE)

Q.INDAS116.SM.601:

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?

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 ₹ 3,00,000. M amortises this balance on a straight-line basis over the five-year term of the new lease.

Q.INDAS116.SM.602:

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.

Q.INDAS116.SM.603: (SIMILAR TO MTP Apr19)

On 1 April 2017, Jupiter ltd began to lease a property on a 20-year lease. Jupiter ltd paid a lease premium of Rs. 30,00,000 (One Time payment) on 1 April 2017. The terms of the lease required Jupiter ltd to make annual payments of Rs. 500,000 in arrears, the first of which was made on 31 March 2018.

On 1 April 2017 the fair values of the leasehold interests in the leased property were as follows:

– Land Rs. 30,00,000.

– Buildings Rs. 45,00,000.

There is no opportunity to extend the lease term beyond 31 March 2037. On 1 April 2017, the estimated useful economic life of the buildings was 20 years.

The annual rate of interest implicit in finance leases can be taken to be 9·2%. The present value of 20 payments of Rs. 1 in arrears at a discount rate of 9·2% is Rs. 9.

Required:

Explain the accounting treatment for the above property lease and produce appropriate extracts from the financial statements of Jupiter ltd for the year ended 31 March 2018.

SOLUTION:

1) The **land lease is an operating lease** because land has an indefinite useful economic life and the lease term is 20 years.

The lease premium and annual rentals are apportioned 40% (3/7·5) to the land element.

Therefore the premium for the land element is Rs. 12,00,000 (Rs. 30,00,000 X 40%) and the annual rentals for the land element Rs. 200,000 (Rs 500,000 X 40%). This makes the total lease payments Rs. 52,00,000 (Rs. 12,00,000 + 20 X Rs. 200,000).

The rental expense for the current period is Rs. 2,60,000 (Rs. 52,00,000 X 1/20).

The amount paid in the current period re: the land element is Rs. 14,00,000 (Rs. 12,00,000 + Rs. 200,000).

Therefore there is a prepayment of Rs. 1,140,000 (Rs. 14,00,000 – Rs. 2,60,000) at the year end.

In the next 19 periods, the rental expense will be Rs. 260,000 and the rental payment will be Rs. 200,000. Therefore Rs. 60,000 of the rental prepayment will reverse in each period. This means that Rs. 60,000 of the prepayment will be a current asset, and the balance a non-current asset.

2) The **buildings element of the lease will be a finance lease** because the lease term is for substantially all of the useful life of the buildings.

The premium apportioned to the buildings element is Rs. 18,00,000 (Rs. 30,00,000 X 60%) and the annual rental apportioned to the buildings is Rs. 300,000 (Rs. 500,000 X 60%).

The initial carrying value of the leased asset in PPE is Rs. 45,00,000 (Rs. 18,00,000 + Rs. 300,000 X 9).

Therefore the annual depreciation charge is Rs. 2,25,000 (Rs. 45,00,000 X 1/20) and the closing PPE (Rs. 45,00,000 – Rs. 2,25,000). The finance cost in respect of the finance lease and the closing non-current liability is shown in the working below. The closing current liability is Rs. 56,300 (Rs. 26,48,400 – Rs. 25,92,100).

Lease liability profile – working

Year ended 31st March	Bal b/f Rs.'000	Finance Cost @ 9.2% Rs. '000	Lease rental payment Rs. '000	Bal c/f Rs. '000
2018	*2,700	248·4	(300)	2,648·4
2019	2,648·4	243·7	(300)	2,592·1

* Balance brought forward is equal to net of lease premium of Rs. 18,00,000 i.e. Rs. 45,00,000 – Rs. 18,00,000 = Rs. 27,00,000.

Q.INDAS116.SM.604:

On April 1, 2012 ABC Ltd. leases equipment for 4 years to XYZ Ltd. The Cost of the equipment is Rs. 15,00,000 and has a useful life of 10 years (assume straight line method of depreciation). The lease payments to be made are as follows:

Year	*Amount*
1	*1,00,000*
2	*1,50,000*
3	*1,75,000*
4	*2,00,000*

The lease is classified as an operating lease. How would this lease be accounted for in the books of accounts of the Lessee and the Lessor?

(Hint: 156250/- LEASE RENT to be recognised)

Q.INDAS116.RMP.605: (RTP Nov19)

Jeevan India Limited is in the business of development of smart city. For development of smart city, Jeevan India Limited allots its land to customer on 99 years of lease. The customer is required to pay lease premium at the time of execution of lease deed and lease rent on annual basis over a period of 99 years.

The lease premium amount is the market value of land and lease rent is nominal amount say Rs. 1 per square metre per year. The lease premium is non-refundable. As per the lease terms, on completion of 99 years, the lease is renewable at mutual consent of lessor and lessee.

How would income in respect of lease premium collected by Jeevan India Limited (which is the market value of land and is not refundable) at the time of execution of lease deed be recognised as per Ind AS, if for subsequent years, only nominal lease rent is collected.

SOLUTION

Paragraph 5 of Ind AS 115 scopes out revenue arising from lease agreements. Principles enunciated under Ind AS 116, Leases would be applicable for revenue arising from leasing agreements.

Recognition of income in respect of lease would depend on its classification as per Ind AS 116, Leases.

(a) If the lease of land is an operating lease, then it will be accounted for as given below:

- **(i)** Lessors shall present assets subject to operating leases in their balance sheet according to the nature of the asset.
- **(ii)** Lease income from operating leases shall be recognised in income on a straight- line basis over the lease term, unless another systematic basis is more representative of the time pattern in which use benefit derived from the leased asset is diminished, even if the payments to the lessors are not on that basis;

(b) The long lease term may be an indication that the lease is classified as a finance lease. If it is a finance lease then lessor Jeevan India Ltd. shall recognise assets held under a finance lease in their balance sheets and present them as a receivable at an amount equal to the net investment in the lease. The recognition of finance income shall be based on a pattern reflecting a constant periodic rate of return on the lessor's net investment in the finance lease.

Q.INDAS116.RMP.606: (RTP May23)

How will Entity Y account for the incentive in the following scenarios:

Scenario A:

Entity Y (lessor) enters into an operating lease of property with Entity X (lessee) for a five-year term at a monthly rental of ₹ 1,10,000. In order to induce Entity X to enter into the lease, Entity Y provides ₹ 6,00,000 to Entity X at lease commencement for lessee improvements (i.e., lessee's assets).

Scenario B:

Entity Y (lessor) enters into an operating lease of property with Entity X (lessee) for a five-year term at a monthly rental of ₹ 1,10,000. At lease commencement, Entity Y provides ₹ 6,00,000 to Entity X for leasehold improvements which will be owned by Entity Y (i.e., lessor's assets). The estimated useful life of leasehold improvements is 5 years

SOLUTION:

Para 70 of Ind AS 116 state that at the commencement date, the lease payments included in the measurement of the net investment in the lease comprise the following payments for the right to use the underlying asset during the lease term that are not received at the commencement date:

(a) fixed payments (including in-substance fixed payments as described in para B42), less any lease incentives payable;
(b) variable lease payments that depend on an index or a rate, initially measured using the index or rate as at the commencement date;
(c) any residual value guarantees provided to the lessor by the lessee, a party related to the lessee or a third party unrelated to the lessor that is financially capable of discharging the obligations under the guarantee;
(d) the exercise price of a purchase option if the lessee is reasonably certain to exercise that option (assessed considering the factors described in para B37); and
(e) payments of penalties for terminating the lease, if the lease term reflects the lessee exercising an option to terminate the lease.

Further para 71 of the standard states that a lessor shall recognise lease payments from operating leases as income on either a straight-line basis or another systematic basis. The lessor shall apply another systematic basis if that basis is more representative of the pattern in which benefit from the use of the underlying asset is diminished."

Scenario A

In accordance with above, in the given case, at lease commencement, Entity Y accounts for the incentive as follows:

To account for the lease incentive Deferred lease incentive A/c Dr. To Cash A/c	₹ 6,00,000	₹ 6,00,000

Recurring monthly journal entries in Years 1 – 5

To record cash received on account of lease rental and amortisation of lease incentive over the lease term Cash Dr. To Lease income To Deferred lease incentive	₹ 1,10,000	₹ 1,00,000 ₹ 10,000*

* This is calculated as ₹ 6,00,000 ÷ 60 months.

Scenario B

Entity Y has provided lease incentive amounting to ₹ 6,00,000 to Entity X for leasehold improvements in the premises. As Entity Y has the ownership of the leasehold improvements carried out by the lessee, it shall account for the same as property, plant and equipment and shall depreciate the same over its useful life.

In accordance with above, in the given case, at lease commencement, Entity Y accounts for the incentive as follows:

To record the lease incentive Property, Plant & Equipment A/c Dr. To Cash A/c	₹ 6,00,000	₹ 6,00,000

Recurring monthly journal entries in Years 1 – 5

To record cash received on account of lease rental over the lease term Cash Dr. To Lease income	₹ 1,10,000	₹ 1,10,000
To record depreciation on PPE over the lease term using straight line method Depreciation A/c Dr. To Accumulated Depreciation	₹ 10,000	₹ 10,000

SUB LEASE

Q.INDAS116.SM.701:

Entity ABC (original lessee/intermediate lessor) leases a building for five years. The building has an economic life of 40 years. Entity ABC subleases the building for four years.

How should the said sublease be classified by Entity ABC?

SOLUTION:

The sublease is classified with reference to the 'ROU Asset' in the head lease (and **NOT** the 'underlying building' of the head lease). Hence, when assessing the useful life criterion, the sublease term of four years is compared with five-year ROU Asset in the head lease (**NOT** compared with 40-year economic life of the building) and accordingly may result in the sublease being classified as a finance lease.

Q.INDAS116.SM.702:

Head lease:

An intermediate lessor enters into a five-year lease for 10,000 square metres of office space (the head lease) with Entity XYZ (the head lessor).

Sublease:

At the beginning of Year 3, the intermediate lessor subleases the 10,000 square metres of office space for the remaining lease term i.e. three years of the head lease to a sub-lessee.

How should the said sublease be classified and accounted for by the Intermediate Lessor?

SOLUTION:

The intermediate lessor classifies the sublease by reference to the ROU Asset arising from the head lease (i.e., in this case, comparing the three-year sublease with the five-year ROU Asset in the head lease). The intermediate lessor classifies the sublease as a finance lease, having considered the requirements of Ind AS 116 (i.e., one of the criteria of 'useful life' for a lease to be classified as a finance lease).

When the intermediate lessor **enters into** a sublease, the intermediate lessor:

(i) Derecognises the ROU asset relating to the head lease that it transfers to the sublessee and recognises the net investment in the sublease;

(ii) Recognises any difference between the ROU asset and the net investment in the sublease in profit or loss; AND

(iii) Retains the lease liability relating to the head lease in its balance sheet, which represents the lease payments owed to the head lessor.

During the term of the sublease, the intermediate lessor recognises both

- Finance income on the sublease **AND**
- Interest expense on the head lease.

Q.INDAS116.SM.703:

Head lease:

An intermediate lessor enters into a five-year lease for 10,000 square metres of office space (the head lease) with Entity XYZ (the head lessor).

Sublease:

At the commencement of the head lease, the intermediate lessor subleases the 10,000 square metres of office space for two years to a sub-lessee.

How should the said sublease be classified and accounted for by the Intermediate Lessor?

SOLUTION:

The intermediate lessor classifies the sublease by reference to the ROU Asset arising from the head lease (i.e., in this case, comparing the two-year sublease with the five-year ROU Asset in the head lease). The intermediate lessor classifies the sublease as an operating lease, having considered the requirements of Ind AS 116 (i.e., one of the criteria of 'useful life' for a lease to be classified as a finance lease and since, it is not satisfied, classified the same as an operating lease).

When the intermediate lessor **enters into** the sublease, the intermediate lessor retains:

- The lease liability **AND**
- The ROU asset

Both relating to the head lease in its balance sheet.

During the term of the sublease, the intermediate lessor:
(a) Recognises a depreciation charge for the ROU asset and interest on the lease liability; **AND**
(b) Recognises lease income from the sublease.

Sub-lessee Accounting:
A sub-lessee accounts for its lease in the same manner as any other lease (i.e., as a new lease subject to Ind AS 116's recognition and measurement provisions).

SALE & LEASE BACK

Q.INDAS116.SM.801: (SIMILAR TO Nov20 EXAM)

An entity (Seller-lessee) sells a building to another entity (Buyer-lessor) for cash of Rs. 30,00,000. Immediately before the transaction, the building is carried at a cost of Rs. 15,00,000. At the same time, Seller-lessee enters into a contract with Buyer-lessor for the right to use the building for 20 years, with annual payments of Rs. 2,00,000 payable at the end of each year.

The terms and conditions of the transaction are such that the transfer of the building by Seller-lessee satisfies the requirements for determining when a performance obligation is satisfied in Ind AS 115 Revenue from Contracts with Customers.

The fair value of the building at the date of sale is Rs. 27,00,000. Initial direct costs, if any, are to be ignored.

The interest rate implicit in the lease is 12% p.a., which is readily determinable by Seller-lessee.

Buyer-lessor classifies the lease of the building as an operating lease.

How should the said transaction be accounted by the Seller-lessee and the Buyer-lessor?

SOLUTION:

Considering facts of the case, Seller-lessee and buyer-lessor account for the transaction as a sale and leaseback.

Firstly, since the consideration for the sale of the building is not at fair value, Seller-lessee and Buyer - lessor make adjustments to measure the sale proceeds at fair value. Thus, the amount of the excess sale price of Rs3,00,000 (as calculated below) is recognised as additional financing provided by Buyer-lessor to Seller-lessee.

Sale Price:	30,00,000
Less: Fair Value (at the date of sale):	(27,00,000)
Additional financing provided by Buyer-lessor to Seller-lessee	**3,00,000**

Next step would be to calculate the present value of the annual payments which amounts to Rs14,94,000 (calculated considering 20 payments of Rs2,00,000 each, discounted at 12% p.a.) of which Rs3,00,000 relates to the additional financing (as calculated above) and balance Rs11,94,000 relates to the lease — corresponding to 20 annual payments of Rs40,164 and Rs1,59,836, respectively (refer calculations below).

Proportion of annual lease payments:

Present value of lease payments (as calculated above)	(A)	14,94,000
Additional financing provided (as calculated above)	(B)	3,00,000
Relating to the Additional financeing provided	(C) = (E x B /A)	40,160
Relating to the Lease	(D) = (E –C)	1,59,840
Annual payments (at the end of each year)	(E)	2,00,000

Seller-Lessee:

At the commencement date, Seller-lessee measures the ROU asset arising from the leaseback of the building at the proportion of the previous carrying amount of the building that relates to the right-of-use retained by Seller-lessee, calculated as follows:

Carrying Amount	(A)	15,00,000
Fair Value (at the date of sale)	(B)	27,00,000
Discounted lease payments for the 20-year ROU asset	(C)	11,94,000
ROU Asset	**[(A / B) xC]**	**6,63,333**

Seller-lessee recognises only the amount of the gain that relates to the rights transferred to Buyer-lessor, calculated as follows:

Fair Value (at the date of sale)	(A)	27,00,000
Carrying Amount	(B)	15,00,000
Discounted lease payments for the 20-year ROU asset	(C)	11,94,000
Gain on sale of building	**(D) = (A -B)**	**12,00,000**
Relating to the right to use the building retained by Seller-lessee(E) = [(D / A) x C]		5,30,667

Relating to the rights transferred to Buyer-lessor	(D -E)	6,69,333

At the commencement date, Seller-lessee accounts for the transaction, as follows:

Cash	Dr.	30,00,000	
ROUAsset	Dr.	6,63,333	
To Building			15,00,000
To Financial Liability			14,94,000
To Gain on rights transferred			6,69,333

Buyer-Lessor:

At the commencement date, Buyer-lessor accounts for the transaction, as follows:

Building	Dr.	27,00,000	
Financial Asset (20 payments of Rs40,160 discounted @ 12% p.a.) (approx.)	Dr.	3,00,000	
To Cash			30,00,000

After the commencement date, Buyer-lessor accounts for the lease by treating Rs1,59,840 of the annual payments of Rs2,00,000 as lease payments. The remaining Rs40,160 of annual payments received from Seller-lessee are accounted for as:

(a) payments received to settle the financial asset of Rs3,00,000 **AND**

(b) Interest revenue.

TRANSITION APPROACH

Q.INDAS116.SM.901: (SIMILAR TO MTP Nov21)

A retailer (lessee) entered into 3-year lease of retail space beginning at 1 April 2017 with three annual lease payments of Rs. 2,00,000 due on 31 March 2018, 2019 and 2020, respectively. The lease is classified as an operating lease under Ind AS 17. The retailer initially applies Ind AS 116 for the first time in the annual period beginning at 1 April 2019. The incremental borrowing rate at the date of the initial application (i.e., 1 April 2019) is 10% p.a. and at the commencement of the lease (i.e., 1 April 2017) was 12% p.a. The ROU asset is subject to straight-line depreciation over the lease term. Assume that no practical expedients are elected, the lessee did not incur initial direct costs, there were no lease incentives and there were no requirements for the lessee to dismantle and remove the underlying asset, restore the site on which it is located or restore the underlying asset to the condition under the terms and conditions of the lease.

What would be the impact for the lessee using all the following transition approaches?

Full Retrospective Approach

Modified Retrospective Approach

- *Alternative 1*
- *Alternative 2*

SOLUTION:

Full Retrospective Approach:

Under the full retrospective approach, the lease liability and the ROU asset are measured on the commencement date (i.e., 1 April 2017 in this case) using the incremental borrowing rate **at lease commencement date** (i.e., 12% p.a. in this case). The lease liability is accounted for by the interest method subsequently and the ROU asset is subject to depreciation on the straight-line basis over the lease term of three years. Let us first calculate the Lease Liability and ROU Asset as follows:

Year	Payments (Cash flows)	Present Value Factor @12%	Discounted Cash flows/ Present Value
31 Mar 2018	2,00,000	0.8929	1,78,580
31 Mar 2019	2,00,000	0.7972	1,59,440
31 Mar 2020	2,00,000	0.7118	1,42,360
	6,00,000		**4,80,380**

Lease Liability Schedule:

Year	Opening	Interest Expense @ 12%	Payments	Closing
31 Mar 2018	4,80,380	57,646	(2,00,000)	3,38,026
31 Mar 2019	3,38,026	40,563	(2,00,000)	1,78,589
31 Mar 2020	1,78,589	21,411*	(2,00,000)	-

*Difference is due to approximation

ROU Asset Schedule:

Year	Opening	Depreciation	Closing
31 Mar 2018	4,80,380	(1,60,126)	3,20,254
31 Mar 2019	3,20,254	(1,60,127)	1,60,127
31 Mar 2020	1,60,127	(1,60,127)	-

The following table shows account balances under this method beginning at lease commencement:

Date	ROU Asset	Lease Liability	Interest Expense	Depreciation Expense	Retained Earnings
01 Apr 2017	4,80,380	4,80,380	-	-	-
31 Mar 2018	3,20,254	3,38,026	-	-	-
01 Apr 2018	3,20,254	3,38,026			(17,772)
31 Mar 2019	1,60,127	1,78,589	40,563	1,60,127	-
01 Apr 2019	1,60,127	1,78,589	-	-	-

31 Mar 2020	-	-	21,411	1,60,127	-

Ind AS 116 is applicable for the financial year beginning from 1st April 2019. Hence, 2019-20 is the first year of adoption and using Full retrospective method the comparative for 2018-19 needs to be restated and 1st April 2018 (i.e. the opening of the comparative) is taken as transition date for adoption of this standard. At adoption, the lessee would record the ROU asset and lease liability at the 1 April 2018 by taking values from the above table, with the difference between the ROU asset and lease liability going to retained earnings as of 1 April 2018 (assuming that only the 2018-19 financial information is included as comparatives).

ROU Asset	Dr.	3,20,254	
Retained Earnings	Dr.	17,772	
To Lease Liability			3,38,026
To initially recognise the lease-related asset and liability as of 1 April 2018.			

The following journal entries would be recorded during 2018-19:

Interest expense	Dr.	40,563	
To Lease Liability			40,563
To record interest expense and accrete the lease liability using the interest method.			
Depreciation expense	Dr.	1,60,127	
To ROU Asset			1,60,127
To record depreciation expense on the ROU asset.			
Lease Liability	Dr.	2,00,000	
To Cash			2,00,000
To record lease payment.			

The following journal entries would be recorded during 2019-20:

Interest expense	Dr.	21,411	
To Lease Liability			21,411
To record interest expense and accrete the lease liability using the interest method.			

Depreciation expense	Dr.	1,60,127	
To ROU Asset			1,60,127
To record depreciation expense on the ROU asset.			

Lease Liability	Dr.	2,00,000	
To Cash			2,00,000
To record lease payment.			

Modified Retrospective Approach (Alternative 1):

Under the modified retrospective approach (Alternative 1), the lease liability is measured based on the remaining lease payments (i.e., from the date of transition to the lease end date, viz., 01 April 2019 to 31 March 2020 in this case) discounted using the incremental borrowing rate as of the date of initial **application being 01 April 2019** (i.e. 10% p.a. in this case). The ROU asset is at its carrying amount as if Ind AS 116 had been applied since the commencement date (i.e., 01 April 2017 in this case) by using incremental borrowing rate as at transition date. Let us first calculate the Lease Liability and ROU Asset as follows:

Year	Payments (Cash flows)	Discounting Factor @10%	Discounted Cash flows/ Present Value
31 Mar 2020	2,00,000	0.9091	1,81,820
	2,00,000		**1,81,820**

Lease Liability Schedule:

Year	Opening Balance	Interest Expense @ 10%	Payments	Closing Balance
31 Mar 2020	1,81,820	18,182	(2,00,000)	-

ROU Asset Schedule:

Year	Opening Balance	Depreciation	Closing Balance

31 Mar 2020	1,65,790***	(1,65,790)	-

***(Refer note no 3)

The following table shows account balances under this method beginning at lease commencement:

Date	ROU Asset	Lease Liability	Interest Expense	Depreciation Expense	Retained Earnings
01 Apr 2017	4,97,360*	4,97,360**	-	-	-
31 Mar 2018	3,31,574	3,47,096	49,737	1,65,786	-
31 Mar 2019	1,65,787	1,81,806	34,710	1,65,787	(16,019)
01 Apr 2019	1,65,787	1,81,806	-	-	-
31 Mar 2020	-	-	18,194	1,65,787	-

*(Refer note no 1)
**(Refer note no 2)

At adoption, the lessee would record the ROU asset and lease liability at the 1 April 2019 by taking values from the above table, with the difference between the ROU asset and lease liability going to retained earnings as of 1 April 2019.

ROU Asset	Dr.	1,65,787	
Retained Earnings	Dr.	16,019	
To Lease Liability			1,81,806
To initially recognise the lease-related asset and liability as of 1 April 2019.			

The following journal entries would be recorded during 2019-20:

Interest expense	Dr.	18,182	
To Lease Liability			18,182
To record interest expense and accrete the lease liability using the interest method.			
Depreciation expense	Dr.	1,65,787	
To ROU Asset			1,65,787
To record depreciation expense on the ROU asset.			
Lease Liability	Dr.	2,00,000	
To Cash			2,00,000
To record lease payment.			

Note 1:

Calculation of Present value of lease payments as at commencement date i.e., 01/04/2017

Year	Payments (Cash flows)	Discounting Factor @10%	Discounted Cash flows/ Present Value
31 Mar 2018	2,00,000	0.9091	1,81,820
31 Mar 2019	2,00,000	0.8264	1,65,280
31 Mar 2020	2,00,000	0.7513	1,50,260
	6,00,000		**4,97,360**

Lease Liability Schedule:

Year	Opening	Interest Expense @ 10%	Payments	Closing
31 Mar 2018	4,97,360	49,736	(2,00,000)	3,47,096
31 Mar 2019	3,47,096	34,710	(2,00,000)	1,81,806
31 Mar 2020	1,81,806	18,194*	(2,00,000)	-

*Difference is due to approximation

Calculation of ROU asset as at transition date i.e., April 01, 2019

Year	Opening	Depreciation	Closing
31 Mar 2018	4,97,360	(1,65,786)	3,31,574
31 Mar 2019	3,31,574	(1,65,787)	1,65,787
31 Mar 2020	1,65,787	(1,65,787)	-

Modified Retrospective Approach (Alternative 2):

Under the modified retrospective approach (Alternative 2), the lease liability is also measured based on the remaining lease payments (i.e., from the date of transition to the lease end date, viz., 01 April 2019 to 31

March 2020 in this case) discounted using the incremental borrowing rate as of the date of initial **application being 01 April 2019** (i.e. 10% p.a. in this case). The carrying amount of the ROU asset is an amount equal to the carrying amount of the lease liability on the date of initial application as there are no prepayments or accrual items and hence, no impact on retained earnings as on the transition date. Let us first calculate the Lease Liability and ROU Asset as follows:

Year	Payments (Cash flows)	Discounting Factor @ 10%	Discounted Cash flows / Present Value
31 Mar 2020	2,00,000	0.9091	1,81,820
	2,00,000		**1,81,820**

Lease Liability Schedule:

Year	Opening	Interest Expense	Payments	Closing
31 Mar 2020	1,81,820	18,182	(2,00,000)	-

ROU Asset Schedule:

Year	Opening	Depreciation	Closing
31 Mar 2020	1,81,820	(1,81,820)	-

The following table shows account balances under this method beginning at lease commencement:

Date	ROUAsset	Lease Liability	Interest Expense	Depreciation Expense	Retained Earnings
01 Apr 2019	1,81,820	1,81,820	-	-	-
31 Mar 2020	-	-	18,182	1,81,820	-

At adoption, the lessee would record the ROU asset and lease liability at the 1 April 2019 by taking values from the above table and there will be no impact on retained earnings on the transition date being 1 April 2019 since under this alternative, ROU Asset is equal to the Lease Liability.

ROU Asset	Dr.	1,81,820	
To Lease Liability			1,81,820
To initially recognise the lease-related asset and liability as of 1 April 2019.			

The following journal entries would be recorded during 2019-20:

Interest expense	Dr.	18,182	
To Lease Liability			18,182
To record interest expense and accrete the lease liability using the interest method.			
Depreciation expense	Dr.	1,81,820	
To ROU Asset			1,81,820
To record depreciation expense on the ROU asset.			
Lease Liability	Dr.	2,00,000	
To Cash			2,00,000
To record lease payment.			

A summary of the lease contract's accounting (assuming there are no changes due to reassessments) is, as follows:

Particulars	Full Retrospective Approach	Modified Retrospective Approach (Alternative 1)	Modified Retrospective Approach (Alternative 2)
Opening balance sheet impact as on 1 April 2019:			
ROU Asset	1,60,126	1,65,787	1,81,820
Lease Liability	1,78,589	1,81,806	1,81,820
Period ended 31 March 2020 activity:			
Cash lease payments	2,00,000	2,00,000	2,00,000
Lease payments recognised:			
Interest expense	21,411	18,194	18,182
Depreciation expense	1,60,127	1,65,787	1,81,820
Total periodic expense	1,81,538	1,83,981	2,00,002