A Holistic Approach to IND AS 116 – Leases

Standard Impact

Effective from annual periods beginning on or after 1 April 2019, Ind AS 116 supersedes the existing Ind AS 17. The new standard requires entities to make more judgements and estimates (e.g., determining when a customer has the right to direct the use of an identified asset, estimating the incremental rate of borrowing) and make more disclosures (e.g., discount rate, weighted average lease term, other qualitative and quantitative information). In the capacity of a lessee, most companies will have a significant impact on their balance sheets along with ancillary impacts on their financial metrics.Vide Notification from MCA dated 30 March 2019, Ind AS 116 (corresponding to IFRS 16)has been made effective for accounting periods beginning on or after 1 April 2019.

IND AS 116

a) New standard is effective for annual reporting periods beginning on or after 1 April 2019
b) Lessees will have a single on-balance sheet accounting model for most leases, with a term of more than 12 months
c) Exemption from balance sheet recognition available for short-term leases and lease of low value assets

Initial application of IFRS 16/Ind AS 116

Details	Approach
Initial recognition and measurement	Initially measure right-of-use (ROU) asset and lease liability at present value of lease payments
Subsequent measurement of lease liability	Review the lease liability based on the interest method using a discount rate determined at lease commencement Reduce lease liability by payments made
Subsequent measurement of ROU asset	Depreciate the ROU asset, based on IND AS 16 Property, Plant and Equipment Other measurement models: under IND AS 16
Profit and loss	Recognise interest and depreciation Generally 'front-loaded' expense for individual leases [Expenses of rent will be reversed and amortisation will be accounted]
Term of lease	a) Non-cancellable period (which includes the period covered by the option to terminate the lease, if only a lessor has the right to terminate a lease) b) Periods covered by an option to extend the lease if the lessee is reasonably certain to exercise that option c) Periods covered by an option to terminate the lease if the lessee is reasonably certain not to exercise that option
Discount rate	Lessees use their incremental borrowing rate (IBR) when the interest rate implicit in the lease cannot be readily determined Lessee's IBR is the rate of interest that a lessee would

	have to pay to borrow over a similar term, and with a similar security, the funds necessary to obtain an asset of a similar value to the ROU asset in a similar economic environment
Reassessment of the lease liability and discount rate	a) After the commencement date, a lessee remeasures the lease liability to reflect changes to the lease payments b) A lessee is required to recognise the amount of the remeasurement of the lease liability as an adjustment to the ROU asset c) However, if the carrying amount of the ROU asset is reduced to zero and there is a further reduction in the measurement of the lease liability, a lessee recognises any remaining amount of the remeasurement in profit or loss d) In addition, IND AS116 provides specific guidance on lease modifications not accounted for as a separate lease

Lessee accounting

Lessees are required to initially recognize a lease liability for the obligation to make lease payments and a right of use asset for the right to use the underlying asset for the lease term. The lease liability is measured at the present value of the lease payments to be made over the lease term.

The right of use asset is initially measured at the amount of the lease liability, adjusted for lease prepayments, lease incentives received, the lessee's initial direct costs (e.g., commissions) and an estimate of restoration, removal and dismantling costs.

Lessees accrete the lease liability to reflect interest and reduce the liability to reflect lease payments made. The related right of use asset is depreciated in accordance with the depreciation requirements of Ind AS 16 Property, Plant and Equipment. For lessees that depreciate the right of use asset on a straight line basis, the aggregate of interest expense on the lease liability and depreciation of the right of use asset generally results in higher total periodic expense in the earlier periods of a lease.

Lessees re measure the lease liability upon the occurrence of certain events (e.g., change in the lease term, change in variable rents based on an index or rate), which is generally recognized as an adjustment to the right of use asset.

Practical expedientsand accounting policies choices

a) Entities are permitted to make an election whether to reassess contracts to identify contracts containing a lease or apply practical expedient such that contracts that do not contain a lease under Ind AS 17 are not required to be reassessed
b) A lessee may elect, by class of underlying asset, not to separate non-lease components from lease components and instead account for both as a single lease component
c) For leases with a lease term of 12 months or less, lessees have an accounting policy election to not recognize lease assets or liabilities, by class of underlying asset. For leases with underlying asset of low value, lessees have an accounting policy election to not recognize lease assets or liabilities, on a lease by lease basis
d) A lessee has the option to, but is not required to, apply the standard to leases of intangible assets

e) The standard may be applied to a portfolio of leases with similar characteristics, provided that it is reasonably expected that the effects will not differ materially from applying the Standard to the individual leases within that portfolio

Transition:-

Based on the accounting options provided underInd AS 116, entities have three differentaccounting approaches at the time of transition. We have presented the impact of each approachon the balance sheet, statement of profit and loss and the statement of changes in equity in eachof the three approaches:

Full retrospective approach:

The transition impact based on the full retrospective transition approach will be as follows:

a) The lease liability is recognized on the lease commencement date using the interest rate implicit in the lease. If that rate cannot be readily determined, the incremental borrowing rate is used for discounting\
b) Comparative periods are restated as if Ind AS 116 is applied from the commencement of the lease, as such entities will present a third balance sheet as at the beginning of the preceding period in addition to the minimum comparative financial statements
c) The provisions of Ind AS 8 Accounting policies, changes in accounting estimates and errors" are applied. Accordingly, a third statement of financial position as at the beginning of the preceding period is presented, in addition to the minimum comparative financial statements

Modified retrospective approach:

The transition impact based on the modified retrospective transition approach will be as follows:

For the FY 2019 2020, the effective date of initial application will be 1 April 2019.

- The lease liability is recognized at the date of initial application. The lease liability is measured at the present value of the remaining lease payments discounted using lease incremental borrowing rate at the date of initial application
- Under the option given in para C8(b)(i) of Ind As 116 , the right of use asset is recognized at the date of initial application. The ROU asset is measured as if the Standard had been applied since the commencement date, but discounted using incremental borrowing rate at the date of initial application. Difference between ROU asset and lease liability is recognized in the opening retained earnings on initial application
- Under the option given in para C8(b)(ii) of Ind As 116, the right of use asset is recognized at the date of initial application . The ROU asset is measured at an amount equal to the lease liability, adjusted by the amount of any prepaid or accrued lease payments relating to that lease recognized in the balance sheet immediately before the date of initial application

Impact on FS due to IND AS 116

The anticipated amount of lease assets added to the balance sheet and the associated impacts on other financial statement captions is computed based on the following assumptions:

a) The present value of minimum lease payments is recognized as a right of use asset on day 1, with a corresponding recognition of lease liability of the same value.
b) The increase in EBITDA is on account of reduction of operating lease expenses. These expenses now take the form of depreciation and interest expense which improves EBITDA.
c) The differential rate at which depreciation and interest expense are recorded in the statement of profit and loss leads to an impact on profit and equity on a year to year basis. However, there is no impact on profit over the total lease term.
d) Finance costs are accreted on the financial liabilities at IBR.
e) Depreciation is computed on a straight line basis over the lease term.

Key disclosures

Areas	Impact
Balance sheet	► Carrying amount of right of use assets at the end of the reporting period by class of underlying asset ► Additions to right of use assets ► IND AS 12 impact of deferred tax due to difference between book base and tax base
Statement of profit and loss	► Depreciation charge for right of use assets by class of underlying asset ► Interest expense on lease liabilities ► Variable lease expense, i.e., for variable lease payment not included in the lease liability ► Short term lease expense for such leases with a lease term greater than one month [Lease contract qualifies for short term lease contract under IND AS 116] ► Low value asset lease expense (except for portions related to short term leases) ► IND AS 12 impact of deferred tax due to difference between book base and tax base
Statement of cash flow	Total cash out flow for leases
Other quantitative and qualitative information	Maturity analysis of lease liabilities ► Amount of its lease commitments for short term leases when short term lease commitments at the end of the reporting period are dissimilar to same period's short term lease expense ► The nature of the lessee's leasing activities ► Future cash outflows to which the lessee is potentially exposed that are not reflected in the measurement of lease liabilities: ► Variable lease payments ► Extension options and termination options ► Residual value guarantees ► Leases not yet commenced to which the lessee is committed ► Restrictions or covenants imposed by leases ► Facts of short term leases or leases of low value assets

Audit risk and sample controls

Risk	Control
Invoices processed wrongly and disclosed wrongly	a) Invoices are mapped vendor wise and PO wise. b) Invoices are reviewed for nature of expenses by payables team.
Risk of all records not captured fully	**Finance lease assets** a) Loan is mapped by the management to assets accounted in books. **Lease prepayment:-** All deposits are reviewed by FRG team and assessed for IND AS 109 accounting and IND AS 116 accounting. **Office rentals:-** All rental expenses are reviewed and a rental with initial lease term > 1 year is considered. All rental cost is considered with inflation and discounted at IBR. Data is captured as and when incurred by admin team in an excel. **Entry:-** All lease is present valued as at reporting date at IBR and accounted for as IBR with lease liability.
Term of lease captured wrongly	Based on the agreements period is captured by operations team and are reviewed on sample basis by finance team.
Period of working is not appropriate	Finance team considers period of agreement as lease term and calculates ROU value after considering escalation as per agreement.
Inappropriate amortisation/interest accounting	All cost is amortised as per lease term and interest is accrued on initial liability at IBR.
Duplication of invoice processing	AP team reviews invoice with PO/Agreement and ensures invoices are accounted only once.
Invoices not processed and data not considered	All pending POs are reviewed and considered for assessment. Also charges not accounted are considered as provision in line with IND AS 37 by management as at reporting date.
Change in terms are not considered	All changes in terms are updated in finance lease agreement tracked by treasury team and in excel sheet tracked by Admin/operations team which is considered by finance team for re-assessment at every quarter end for IND AS 116.
Disclosures are not made appropriately	Management ensures FS is prepared in line with Schedule III and IND AS. The same is reviewed by CFO and adopted by BOD.

Audit approach

<table>
<tr><th>Details</th><th>Approach</th></tr>
<tr><td>Completeness/valuation</td><td><u>Finance lease:-</u>
a) Meeting with treasury team happens during every quarter and update for lease is obtained
b) Treasury tracker is reviewed for new lease
c) Existing lease is continued from earlier period
d) Agreements are reviewed for amount & period, nature of asset
e) Confirmation from bank/lessor is considered
f) BRS is reviewed for any reconciling items of lease not there in above a to e
<u>Operating lease:-</u>
a) Rental expenses are considered and reviewed whether all agreements are considered and for not considered ones reasons are obtained.
b) The reasons are obtained on sample basis [Above threshold limit]
<u>Lease prepayment:-</u>
All security deposits and leased assets are considered based on payments

Agreements are reviewed for value and period of discounting</td></tr>
<tr><td>Occurrence</td><td>Charge from P&L is considered

All cost are rationalised and ensured cost in P&L is appropriate

<u>Amortisation and interest:-</u>
All ROU assets are amortised as per lease term and interest is charged over lease period on closing balance of earlier period at IBR
<u>Overall mapping:-</u>
Impact as per old and new standard is reviewed to ensure cost in P&L is not over or understated as there are no contractual differences between 2018-19 and 2019-20.</td></tr>
<tr><td>Estimate</td><td>Discount rate is reviewed with loan average rate and ensure is approximate</td></tr>
<tr><td>Presentation & disclosure</td><td>Balance sheet has been reviewed for disclosure of Right of use assets, lease liability, lease straight lining adjustment and repayments

P&L has been reviewed for Reclass and depreciation

Cash flow has been reviewed for ensuring all new lease assets, deposits are considered as investing activity and contractual payments are considered as financing activity</td></tr>
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Advantages of ASA

ASA has a software for calculation of lease accounting and disclosure by name – “Leasa”

a) It is a tool (with Excel spread sheet for input and upload to the tool) in which database of rental contracts can be updated
b) End of the period accounting entry will be available for the financial statement
c) Working sheet , Master data and Journal will be available for download
d) It allows usage of tool for monthly, quarterly, half yearly and yearly as per the book close process followed by the Company

It saves time and becomes a database which allows evaluation of IND AS 116 to be completed. The same can be used for periodical review by management. The accuracy of output and processing of data is high.