



# Ind AS - 17 Leases

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# Overview of session



1. Scope of application

2. Key concepts

3. Accounting for leases (lessee)

4. Disclosures

5. Next steps / Action planning

6. Questions





# Leases

## 1. Scope of application



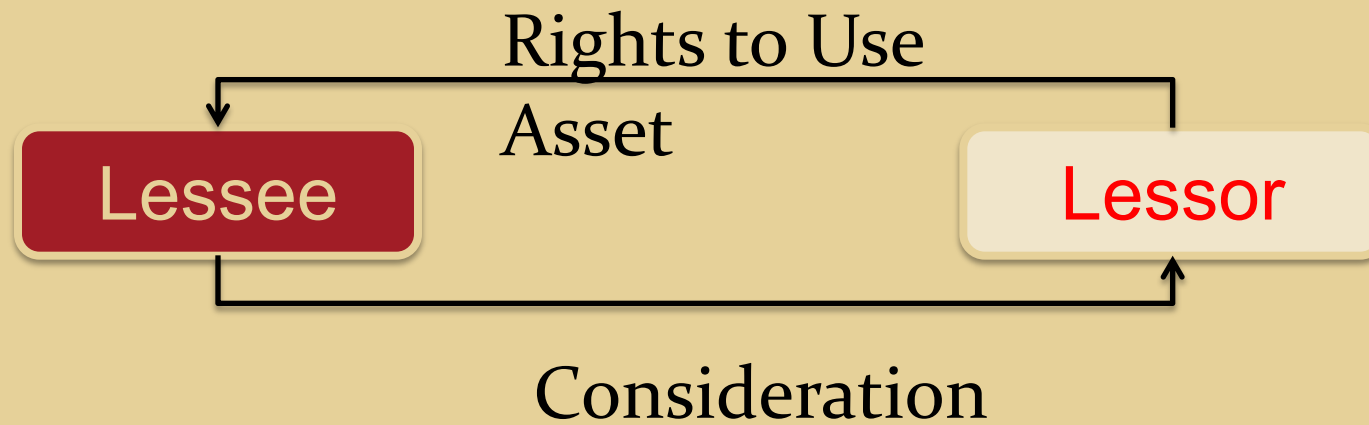
# Definition of a lease



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



# leases



# Scope of Ind AS - 17



- All leases other than
  - Leases to explore for or use natural resources, such as oil, natural gas, minerals and similar non regenerative natural resources.
  - Licensing agreements for items such as motion picture films, videos, plays, manuscripts, patents and copyrights
- For measurement of investment property leases ( see Ind AS 40, investment property )
- *Biological assets held under operating or finance lease.*

Investment property = property (land or a building - or part of a building - or both) held to earn rentals or for capital appreciation or both, rather than for use in the production or supply of goods or services or for administrative purposes; or for sale in the ordinary course of business





# Leases

## 2. Key concepts



# Definition of a lease



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

Finance lease

Operating lease





# Finance leases V Operating leases



## Finance Lease

A lease is a finance lease if it **transfers** substantially all the risks and rewards incident to ownership

## Operating Lease

A lease is an operating lease if it **does not transfer** substantially all the risks and rewards incident to ownership



# Risks and rewards incident to ownership



- Risks

- Losses from idle capacity
- Technological obsolescence
- Changes in value due to changing economic conditions
- Etc.

- Rewards

- Expectation of service potential or profitable operation over the asset's economic life
- Gain from appreciation in value
- Realisation of a residual value
- Etc.



# Finance lease or Operating lease?



- If substantially all of the risks and rewards incident to ownership are transferred from the lessor to the lessee, it is a finance lease. The lessee should recognise finance leases as assets and liabilities in the balance sheet at amounts equal at the inception of the lease to the fair value of the leased property or, if lower, at the present value of the minimum lease payments. The lessor should recognise assets held under a finance lease in its balance sheet and present it as a receivable at an amount equal to the net investment in the lease.



# Finance lease or Operating lease?



- If substantially all of the risks and rewards incident to ownership are not transferred from the lessor to the lessee, it is an operating lease: the financed assets remain on the lessor's balance sheet and the lease payments should be recognised in the income statement.



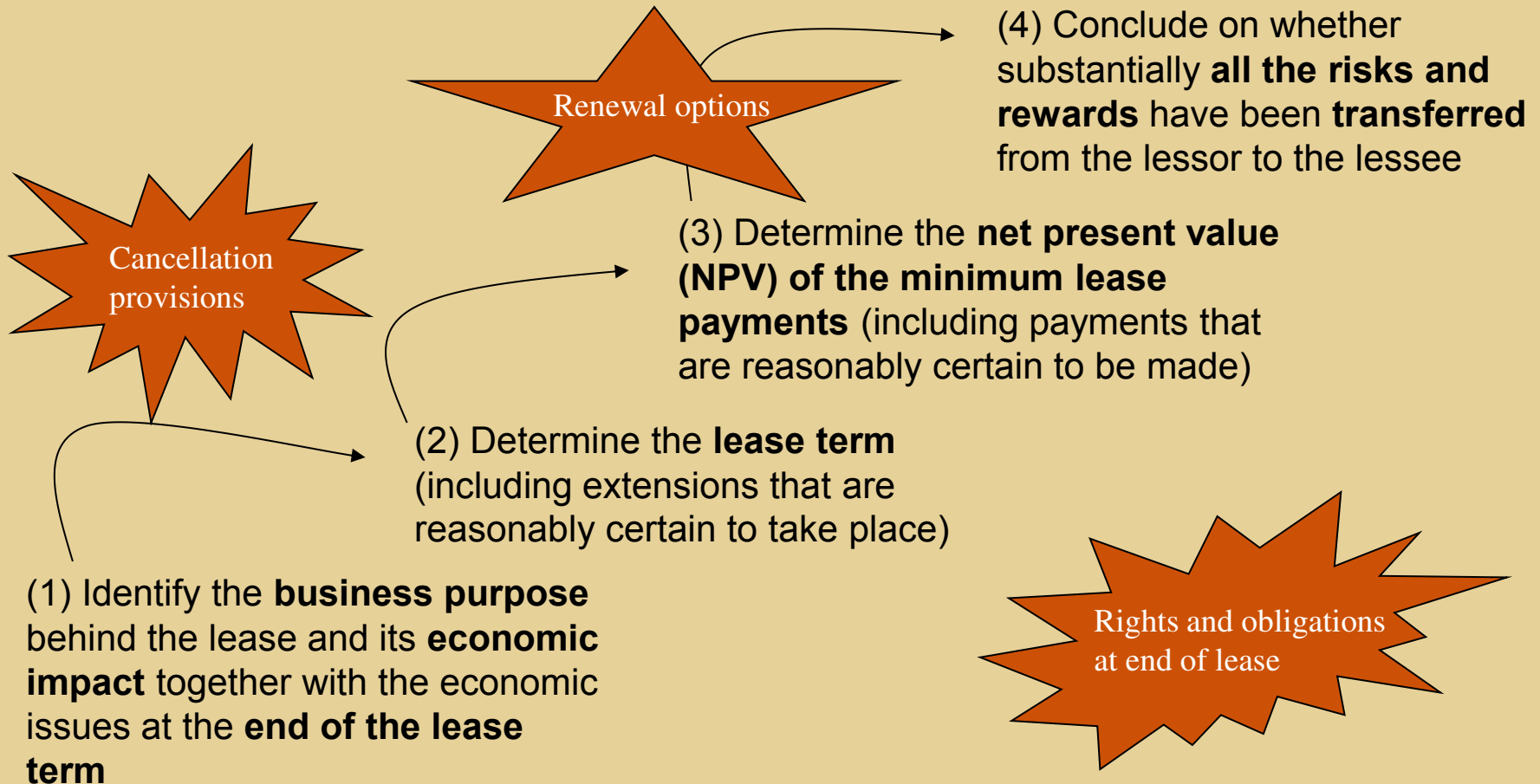
# Finance lease or Operating lease?



- No mathematical thresholds are used to determine whether a lease should be classified as a finance or as an operating lease. An overall analysis of the transaction needs to be performed, at inception of the contract, to determine whether substantially all of the risks and rewards are transferred from the lessor to the lessee.



# Finance lease or Operating lease?



# Finance lease or Operating lease?



- Examples of situations which would normally lead to a lease being classified as a finance lease:
  - The lessor transfers ownership of the asset to the lessee at the end of the lease term
  - The lessee has the option to purchase the asset at a price, which is expected to be sufficiently lower than the fair value at the date the option becomes exercisable such that, at the inception of the lease, it is reasonably certain that the option will be exercised (“bargain” purchase option)



# Finance lease or Operating lease?



- Examples of situations which would normally lead to a lease being classified as a finance lease (cont'd):
  - The lease term is for the major part of the economic life of the asset even if title is not transferred (cfr. US GAAP: 75%)
  - The leased assets are of a specialised nature such that only the lessee can use them without major modifications being made
  - The leased assets cannot be easily replaced
  - At the inception of the lease, the present value of the minimum lease payments (MLP) amounts to at least substantially all of the fair value of the leased asset (cfr. US and UK GAAP: 90%)





# Finance lease or Operating lease?



- Other indicators which individually or in combination could also lead to a lease being classified as a finance lease:
  - If the lessee can cancel the lease, the lessor's losses associated with the cancellation are borne by the lessee
  - The lessee bears gains/losses from changes in the fair value of the residual
  - The lessee has the ability to continue the lease for a secondary period at a rate which is substantially lower than market rate



# Minimum lease payments



MLPs comprise the total payments by the lessee plus:

- payment required to exercise the lessee's bargain purchase option if it is reasonably certain that the lessee will exercise the option
- any amounts guaranteed by the lessee or by a party related to the lessee (e.g. the parent)
- any residual value guaranteed to the lessor by the lessee, by a party related to the lessee or by an independent third party

The minimum lease payments are discounted to their present value.



# Implicit discount rate



The implicit discount rate is the rate that, at the inception of the lease, causes the

present value of the sum of the minimum lease payments

+ plus the unguaranteed residual value

to equal the fair value of the leased asset.

The portion of the residual value on which the lessor is at risk – its realisation by the lessor is not assured



# Leases Involving Land and Buildings



Analyse land and buildings individually

Land → indefinite  
life → always  
operating lease  
(unless title  
passes at the end  
of the lease term)

Buildings → To  
decide whether  
finance or  
operating lease





# Leases

## 3. Accounting for leases (lessee)



# Operating lessee accounting



- Rental expense is recognised on a straight-line basis in the economic outturn account over the lease term
- Irrespective of the form or timing, the cost is recognised on a straight-line basis (e.g. free rent for a certain period at the beginning of the lease contract)
- Cut-off:
  - Accrue if service rendered but invoice not received at year-end
  - Defer if invoice received in advance of the service (to be rendered in the next accounting period)



# Finance lessee accounting – value at inception



Recognises the **asset** and the lease obligation on balance sheet

at the lower of the **present value of the minimum lease payments** and the fair value of the asset

Including initial direct costs incurred by the lessee in securing the lease (e.g. commission and legal fees)

Use interest rate **implicit** in the lease if this is practicable to determine; if not, use lessee's **incremental borrowing rate** – i.e. the rate at which the lessee would borrow to purchase a similar item

→ This corresponds to the **explicit** (facial) interest rate in simple, linear cases



# Finance lessee accounting

## - Worked example



**Lessee's PV of MLPs**

**Each lease payment is paying off a proportion of capital and an element of interest charge**

**Implicit interest rate**

Start of Period (ten 6-month periods)	Opening Obligation	Lease Payments in Advance (MLPs = 10 x 12,000)	In-Year Obligation	Finance charge at 4.3535%	Capital repayment	Closing Obligation
1/1/2001	99,804	(12,000)	87,804	3,823	8,177	91,627
1/7/2001	91,627	(12,000)	79,627	3,467	8,533	83,094
1/1/2002	83,094	(12,000)	71,094	3,095	8,905	74,189
1/7/2005	12,000	(12,000)	nil	nil	12,000	nil

**Asset and Liability in B/S**

**Closing/Opening Liability in B/S**

**Apportion between current/long term**





# Finance lessee accounting

## – Subsequent measurement



- Depreciate assets with finite lives over their useful life
  - If it is **not** reasonably certain that ownership will be transferred to the lessee at the end of the lease term, the asset should be depreciated over the shorter of the lease term or its useful life
- Subsequent expenditures – refer to P,P & E
- Impairment – refer to P,P & E



# Lease accounting summary



	Balance Sheet	Profit & loss statement
Finance Lease - Lessee	Asset Lease Obligation Accumulated Depreciation Reduction in Lease Obligation	Finance Charge Depreciation Expense
Operating Lease - Lessee		Rental Expense





# Leases

## 4. Disclosures



# Key Disclosures – Finance leases (lessees)



- For each class of asset, net carrying amount at the reporting date
- A reconciliation between the total of MLPs at the reporting date and their present value, including disclosure for each of the following periods: no later than 1 year; later than 1 year and not later than 5 years; and later than 5 years
- A general description of significant leasing arrangements



# Key Disclosures – Operating leases (lessees)



- The total of future MLPs under non-cancelable operating leases for each of the following periods: no later than 1 year; later than 1 year and not later than 5 years; and later than 5 years
- A general description of the lessee's significant leasing arrangements





# Leases

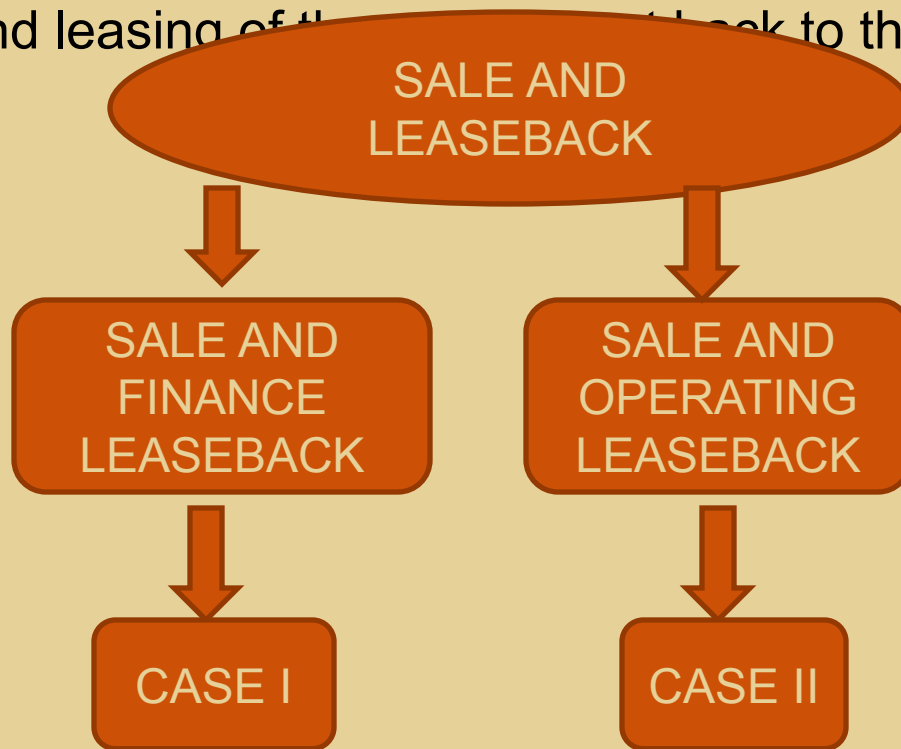
## 5. Sale & lease back



# SALE AND LEASEBACK TRANSACTIONS



A sale and leaseback transaction involves the sale of an asset by the vendor and leasing of the asset back to the vendor.





## CASE I

Whenever SLB is of financial nature, any gain/loss on sale should be deferred and amortized over the lease term in proportion to the depreciation of the leased asset.

## CASE II

Whenever SLB is of operating nature, any profit/loss arising out of sale transaction is recognized immediately when sale price is equal to fair value.







- If sale price is above fair value-
- $\text{Deferred income} = \text{Sale proceeds} - \text{Fair value of asset}$
- If the sale price is below fair value, any profit or loss should be recognized immediately except that, if the loss is compensated by future lease payments at below market price, it should be deferred and amortized in proportion to the lease payments over the period for which the asset is expected to be used.





# Leases

## 6. Questions

