

Ind AS 116

Leases



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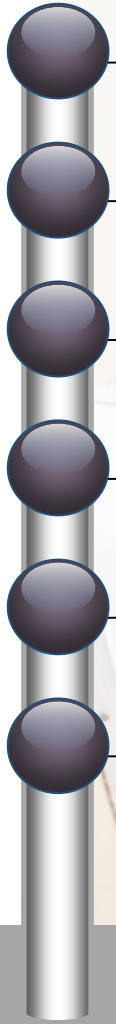
“The more you learn, you
learn that you still have lot
to learn”

Why a new leasing standards ?

Currently analyst adjust financial statements for off - balance sheet leases

Under Ind AS 116, companies will bring these leases on balance sheet, using a common methodology

Agenda Points



New Definition

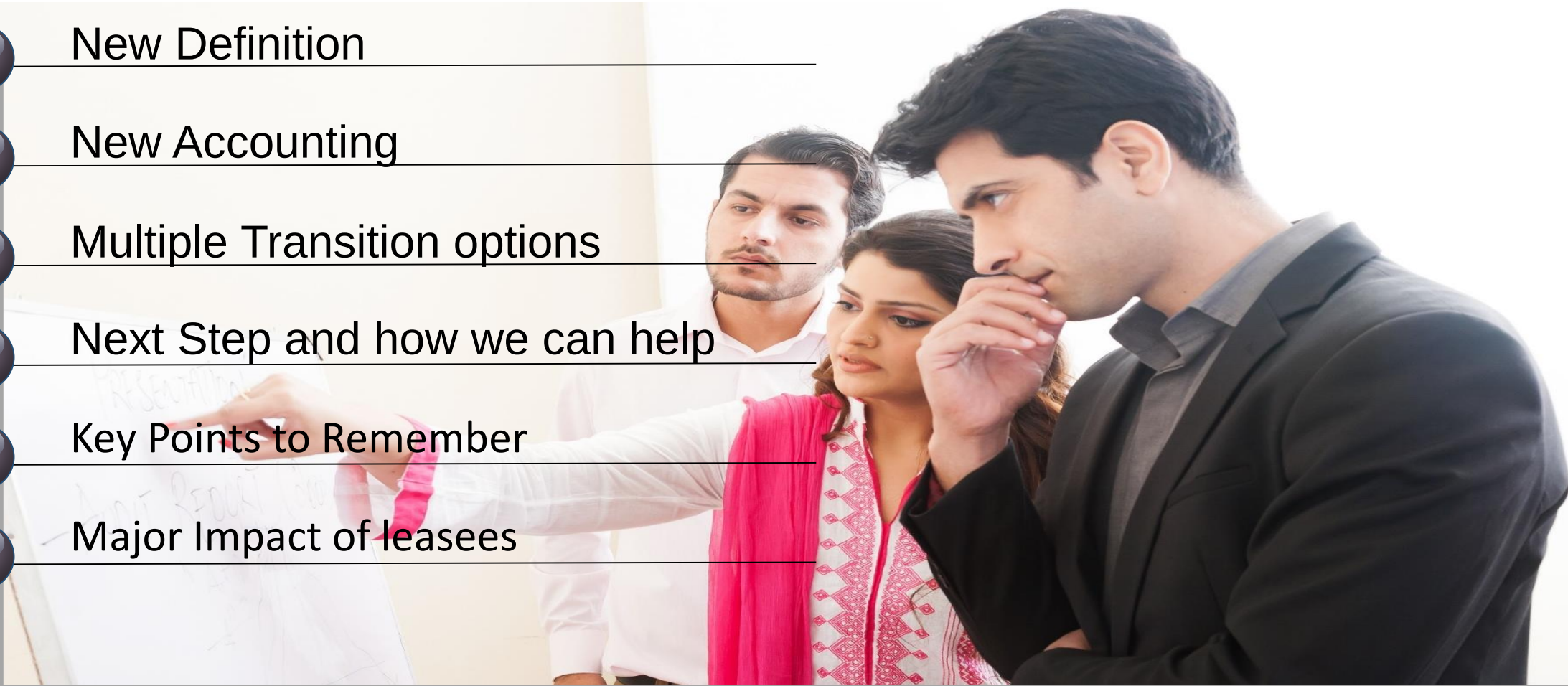
New Accounting

Multiple Transition options

Next Step and how we can help

Key Points to Remember

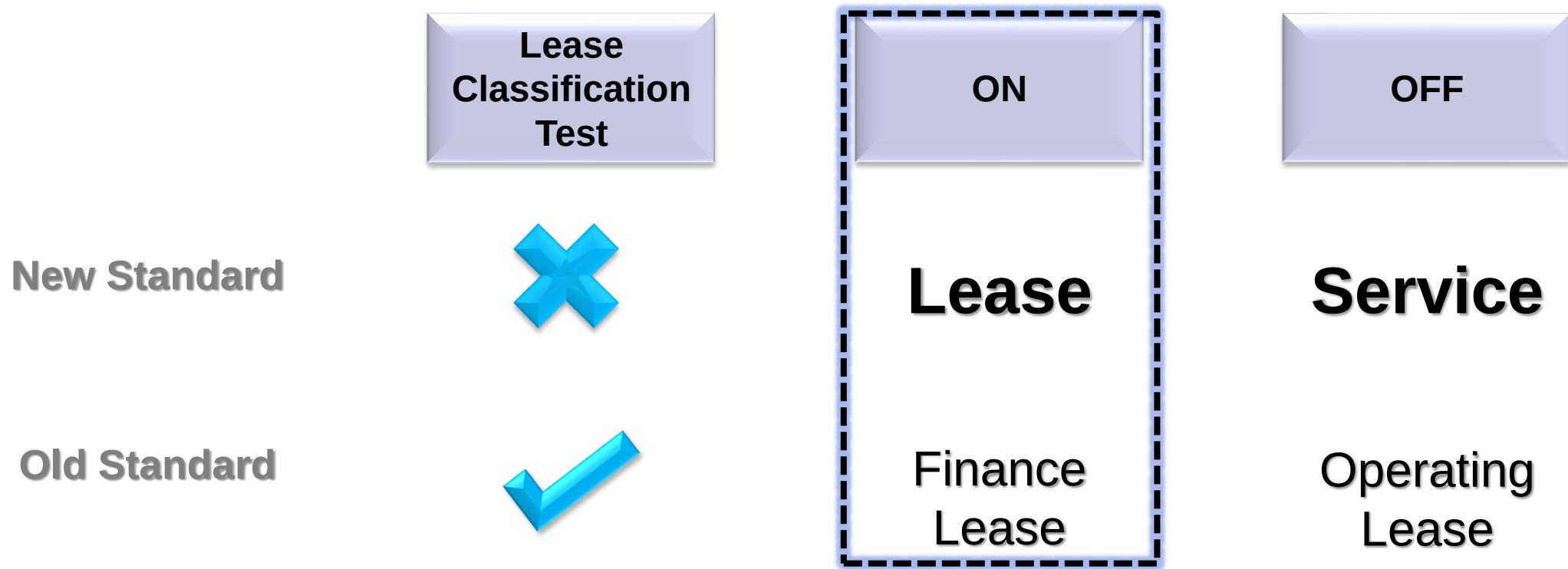
Major Impact of leasees



New definition

Lease Definition

The new on/off- balance sheet test for lessees – a key judgement area



Lease Definition

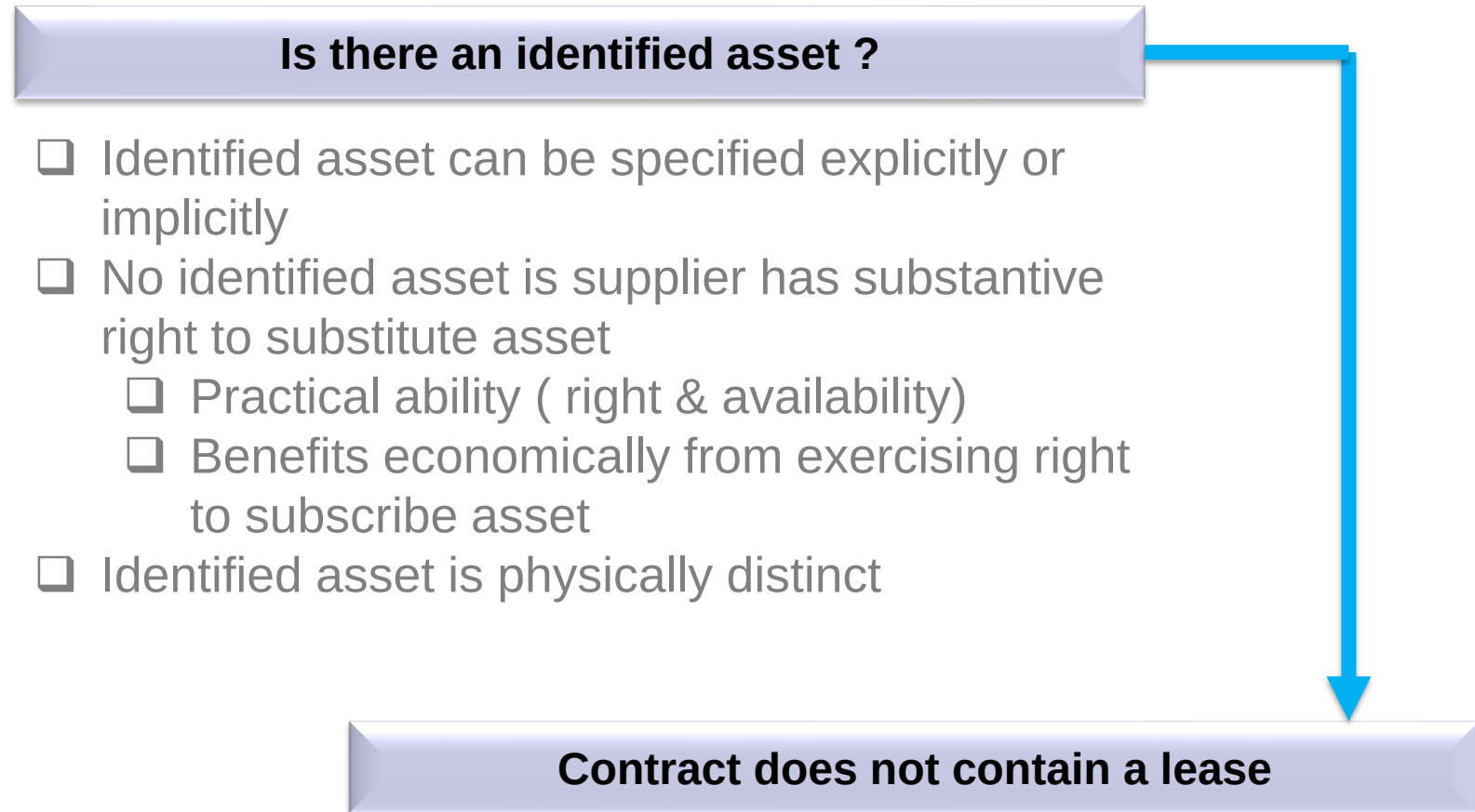
Contract, or part of a contract, that conveys the **right to use an asset** for a **period of time** in exchange of **consideration**

Lease transactions for all assets are covered under Ind AS 116, except:

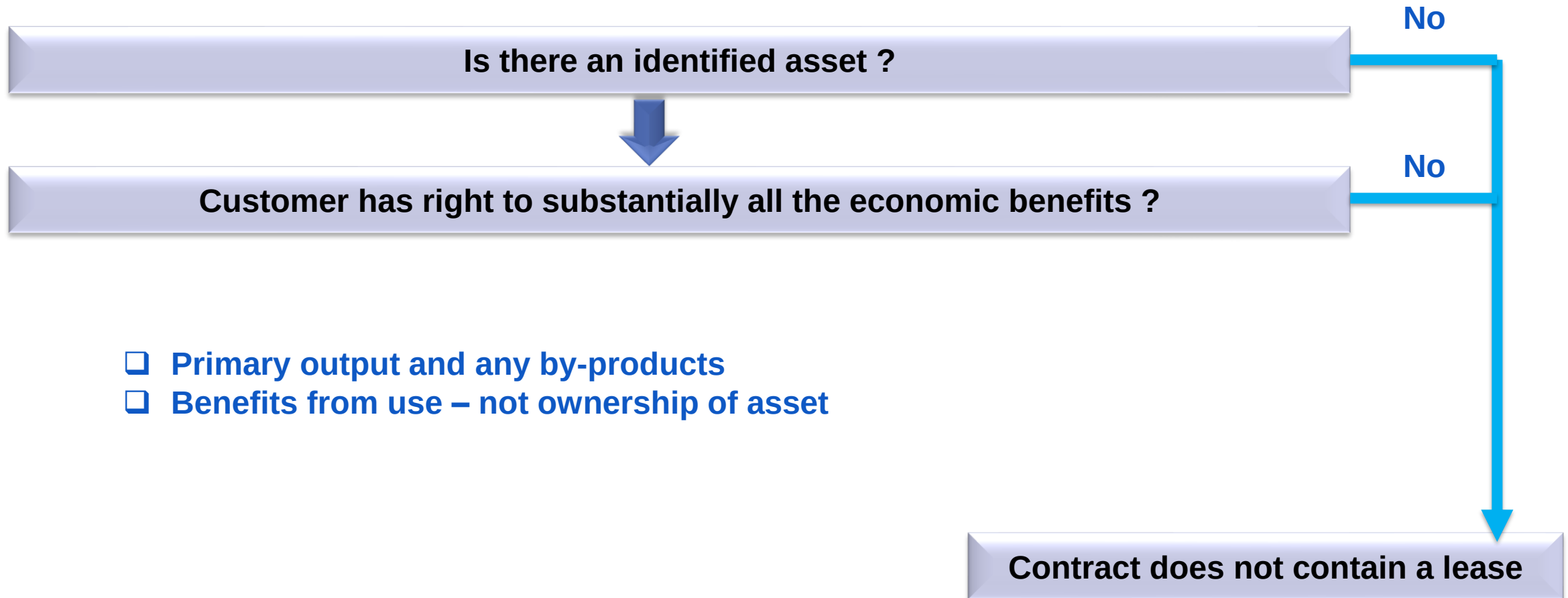
- ☐ Leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources
- ☐ Leases of biological assets
- ☐ Service concession arrangements
- ☐ Licences of intellectual property granted by lessor
- ☐ Rights held by a lessee under certain licensing agreements (e.g. films)

Lease Definition – Identified asset

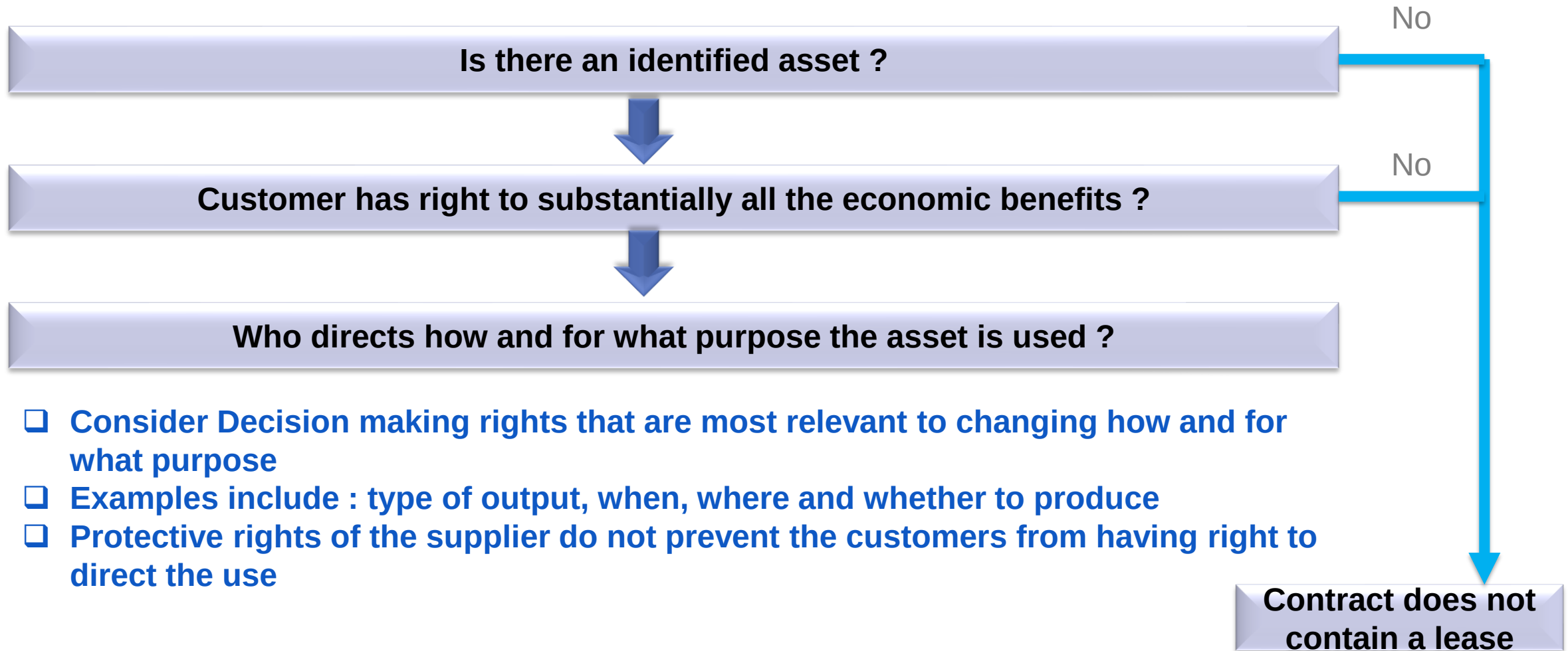
The new definition increases focus on **who controls the asset** and may change which contracts are leases



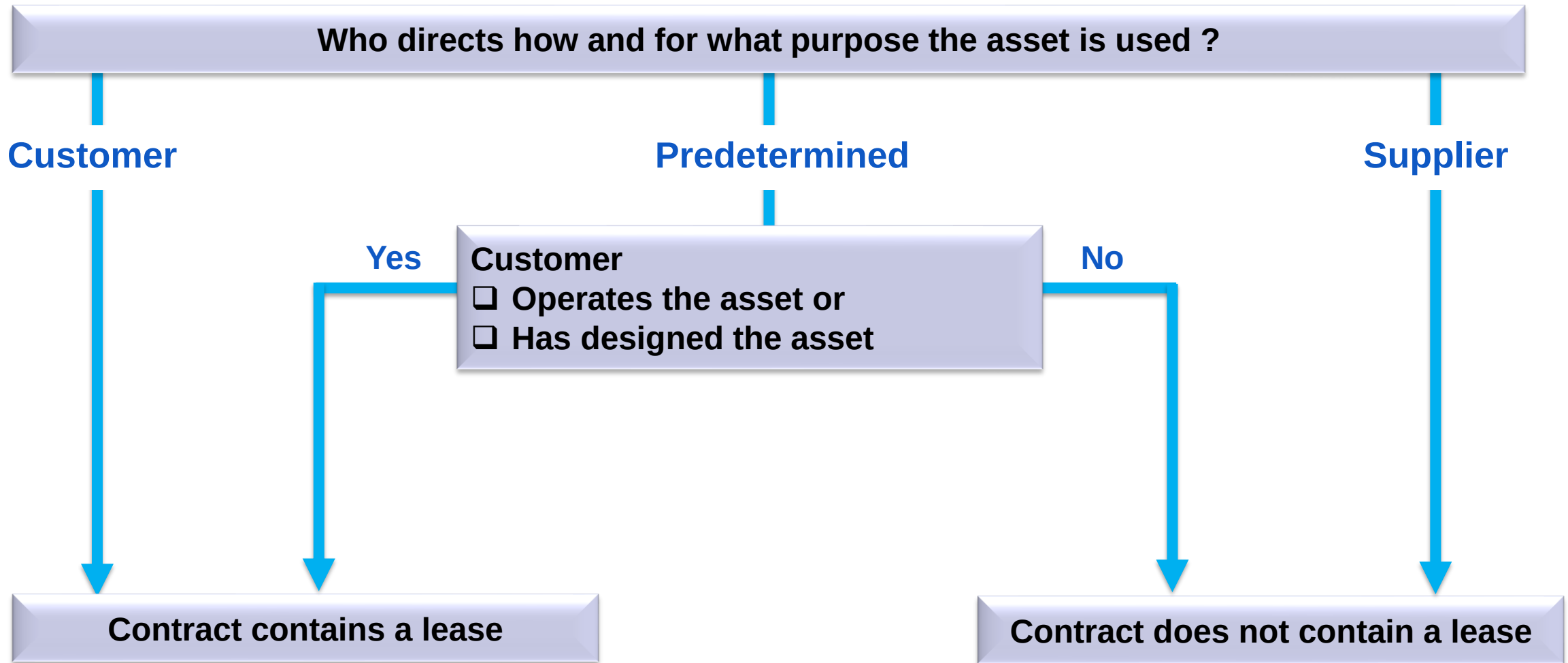
Lease definition – Control



Lease definition – Control



Lease definition – Control



Lease definition – Control

The new definition increases focus on **who controls the asset** and may change which contracts are leases



New Accounting

Lease recognition – Exemptions

Two major optional exemptions make the standard easier to apply



**Short term
leases**

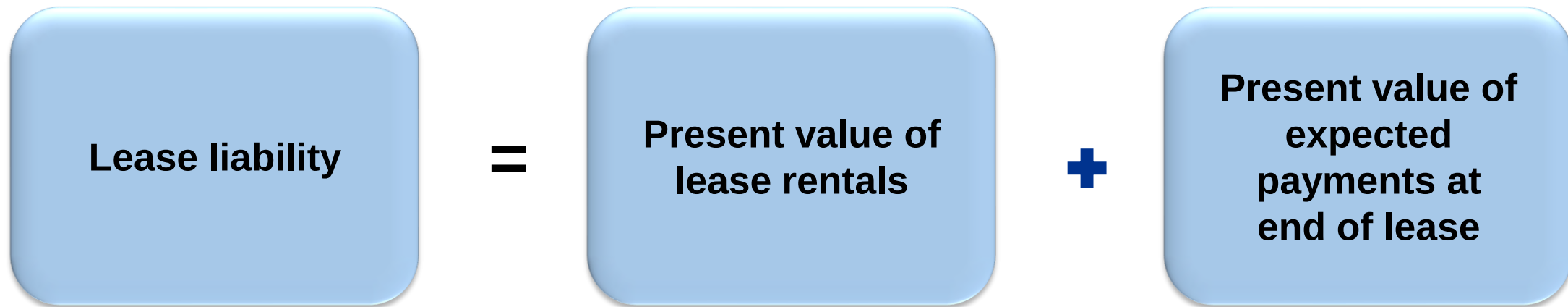
≤ 12 months



**Leases of low
value items**

≤ INR 5,000
for example

Measuring the lease liability



Lease payments

Fixed Payments



Variable Lease Payments



Residual Value guarantees



Purchase option exercise price



Payments for terminating

includes in substance fixe payments / incentives

only for index or rate/rate of commencement

at amounts lessee expects to pay

if lessee reasonably certain to exercise

if lease term reflects termination by lessee

Variable lease payments

Which variable lease payments are included in the lease liability?

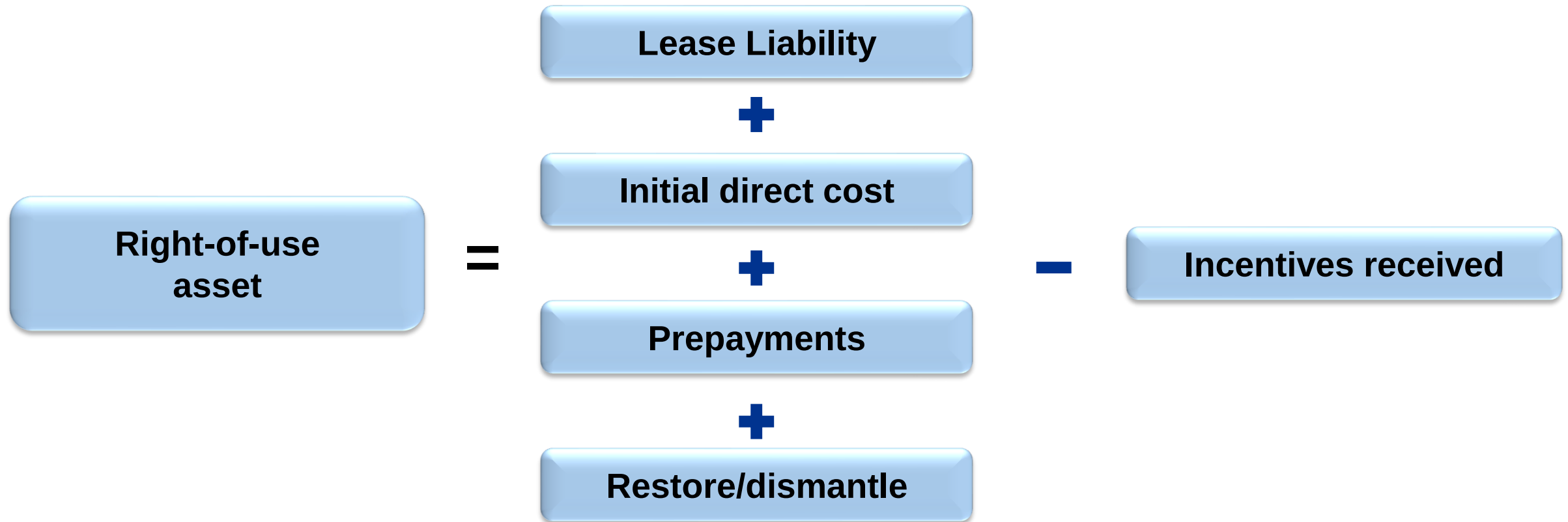


Payments based on an index or rate



Payments based on turnover or usage

Lease payments



Lessor accounting

Lessor accounting
remains similar to
current practice...

but lacks consistency
with new lessee
accounting model

Lease classification
test



Finance leases and
operating leases



Consistent
accounting model for
lessors and lessees



Lessor accounting

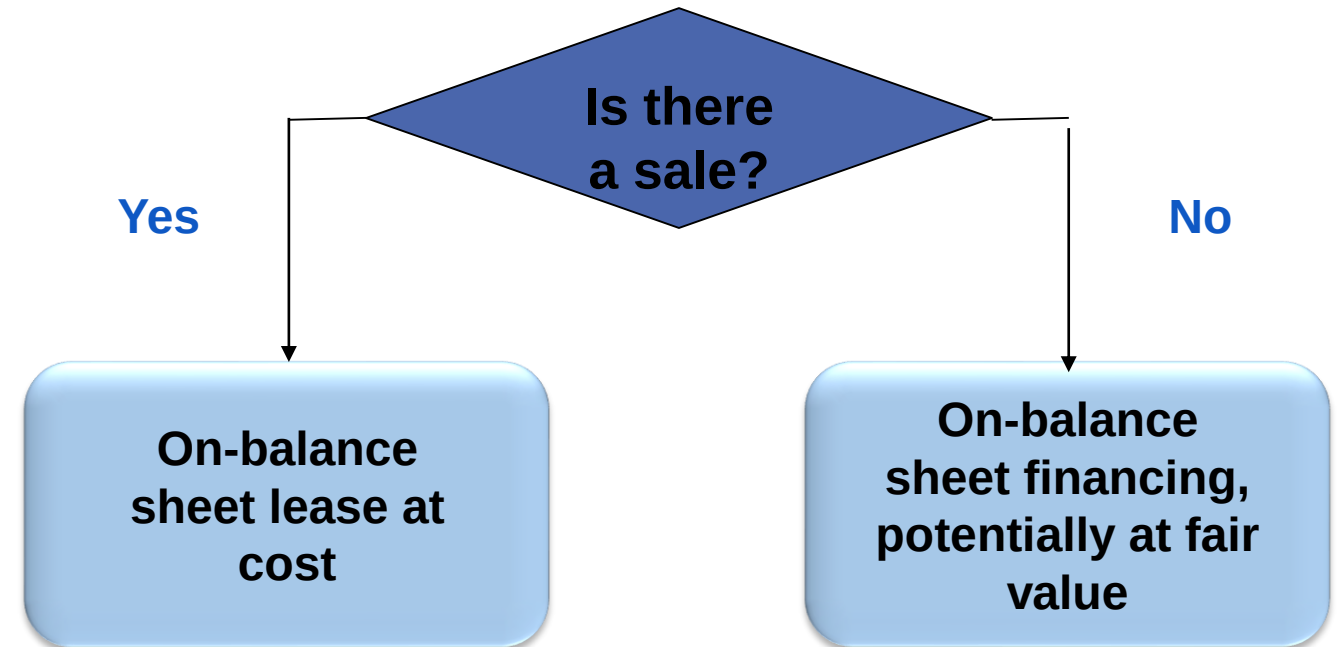
Wider changes have an impact

- ☐ Definition of lease
- ☐ Lease payment guidance
- ☐ Sale and lease back guidance
- ☐ Sub-lease guidance
- ☐ Modification Accounting
- ☐ Disclosure requirements

Changes in contract term and business practices

Sale-and-leaseback

Ind AS 16 essentially **kills sale-and-leaseback** as an off-balance sheet financing structure



Multiple transition options

Applying the new standard

A lessee can choose to apply the standard...

Retrospectively to all accounting periods

OR

As a 'big bang' at the date of initial application

Cost



Comparability



Examples

Things to think about now

Some questions to assess the impact on your company's financial statements



Which contracts are leases?



Which transition options to choose?



Database of all leases?



Systems and processes in place?



What about ratios and covenants?



Commercial Opportunities



Impact Assessment

MAJOR IMPACT FOR LESSEES

Broader Business Impacts



Sector-wise potential impact - Airlines sector



Most airline companies finance aircrafts through off-balance sheet lease models, as a common practice in the aviation industry. In addition, other assets such as check-in kiosks, boarding gates, which are taken on lease from respective airport owners are also classified as operating leases.

Another key change for this sector will be the treatment of sale and leaseback transactions, wherein determining whether a sale has occurred in the context of a sale and leaseback transaction is already a judgmental area under the new revenue recognition standard (Ind AS 115).

The changes under Ind AS 116 will bring all these arrangements on the balance sheet of airline companies, having a significant increase in lease assets and liabilities on day 1.

Sector-wise potential impact - Transport and logistics sector

Arrangements in the transportation and logistics sector usually contain multiple components typically termed as a "wet leases". For example, the lease of a ship would include the lease payments for the ship, the crew and maintenance services which are currently classified as one lease arrangement and charged as "operating lease expense". Under the new guidance, arrangements are required to be allocated between lease and non lease components. Segregation of arrangement may have significant impact on accounting under new guidance, depending upon the value of lease and non-lease components.



Sector-wise potential impact - Retail and consumer sector



Most rental contracts for retail outlets whether for individual outlets or high street stores are likely to qualify as leases, as such contracts will meet the key criteria for lease, which is having the right to control the asset and obtaining the related economic benefits from the use. Under the retail sector, leases with variable payments, for example where lease payments that are dependent on the consumer price index or rate, will need to be assessed as the lease liabilities associated with variable payments are required to be re-measured at each date of change of the future contractual cash flows. This recurring re-measurement will introduce volatility in the balance sheet.



Another impact area will be the treatment of initial direct costs, such as commissions, as some costs might need to be included as part of the right of use asset and amortized over the anticipated lease term. A third significant impact on the retail and consumer sector will be the arrangements with non-lease components such as property management, maintenance, security distribution and power services which in some cases may have been clubbed together as “operating lease” expense.

Sector-wise potential impact - Information technology sector

Leasing has long been an attractive option in IT and IT enabled services sector. Real estate leases are common in IT sector for setting up development and delivery centres, along with leases of IT equipment and services. The arrangements for "co-location" hosting and even some "cloud" services usually contain multiple elements of hardware support along with personnel assistance. Under the new standard, these will now need to be evaluated and accordingly allocated.



Sector-wise potential impact - Power and utilities



In the power sector, “pole attach” agreements whereby a utility allows a third party to attach equipment, such as a telephone or cable, to its utility pole for a monthly fee, are a common occurrence. Such agreements will have to be assessed for “substitution fee”. In case they can be substituted and the supplier would economically benefit from such substitution, the right to use the underlying asset may have to be considered non-substantive.

In addition, power purchase agreements (PPA) will also need to be evaluated for substitution rights and lease and non-lease components, if they are not classified as “service concession agreements” under IndAS 115, “Revenue from contracts with customers”. The new lease standard requires the assessment of whether a contract gives the customer the right to control the use of a specified asset. If not, the PPA would have to be segregated into lease and non-lease components and accounted for accordingly.

Sector-wise potential impact - Telecom

Contracts involving direct cable that is a part of a larger infrastructure (such as unbundled network element arrangements for the “last mile” to a customer location, “special access” arrangements for a dedicated connection between two locations) may fall in the definition of an identified asset and will therefore be required to be accounted for on-balance sheet.

Another key feature of the telecom sector are the mobile tower-sharing arrangements. Such arrangements between operators will need to be assessed for lease and non-lease components and accordingly be accounted for on-balance sheet.



Sector-wise potential impact - Healthcare and pharmaceutical sector



Hospitals enter into arrangements for leasing medical device equipment, many of which are currently accounted for as operating leases. These assets, if falling under the definition of an identified asset, will have to be accounted for on-balance sheet.

Sector-wise potential impact - Engineering and construction

The new lease standard will require engineering and construction companies to recognize construction equipment and office space, currently accounted for as operating leases, as on-balance sheet leases. Further, wherever these arrangements contain substitution rights, these will need to be analyzed to determine whether the supplier would economically benefit from exercising these rights, in order to be considered substantive.

Additionally, components of arrangements such as maintenance service for construction equipment or service contracts will have to be bifurcated for lease and non-lease components for separate treatment of both.



Sector-wise potential impact - Mining and minerals



Most of the equipment used in exploration and evaluation (E&E) and other mining activities which are currently accounted for as operating leases will have to be evaluated under the new standard.

Additionally, mining services arrangements containing drilling and blasting services, smelting and transportation services will have to be bifurcated into lease and non-lease components for separate treatment of both.

Sector-wise potential impact - Oil and gas

The assessment of whether there is an identified asset in companies in the oil and gas sector, will be straightforward in most arrangements, but judgment will be required in certain arrangements. A physically distinct portion of a larger asset (e.g., segment of a pipeline that connects a single customer to a larger pipeline) can be an identified asset.

Further assessing the lease and non-lease components in processing, transportation and storage contracts, outsourced oil and gas service contracts and drilling contracts, which typically include operation services, etc. will be an additional point of judgement.

In addition, because the current accounting for operating leases and service contracts is similar, entities may not have always focused on determining whether an arrangement is a lease or a service contract.

Depending on the significance of these arrangements, the new standard will impact the financial statements and the key financial metrics used to report results.



Lessees face major changes

All major leases on balance sheet

Balance Sheet

Asset

= 'Right-of-use' of underlying asset

Liability

= Obligation to make lease payments

Profit and Loss

Lease Expenses

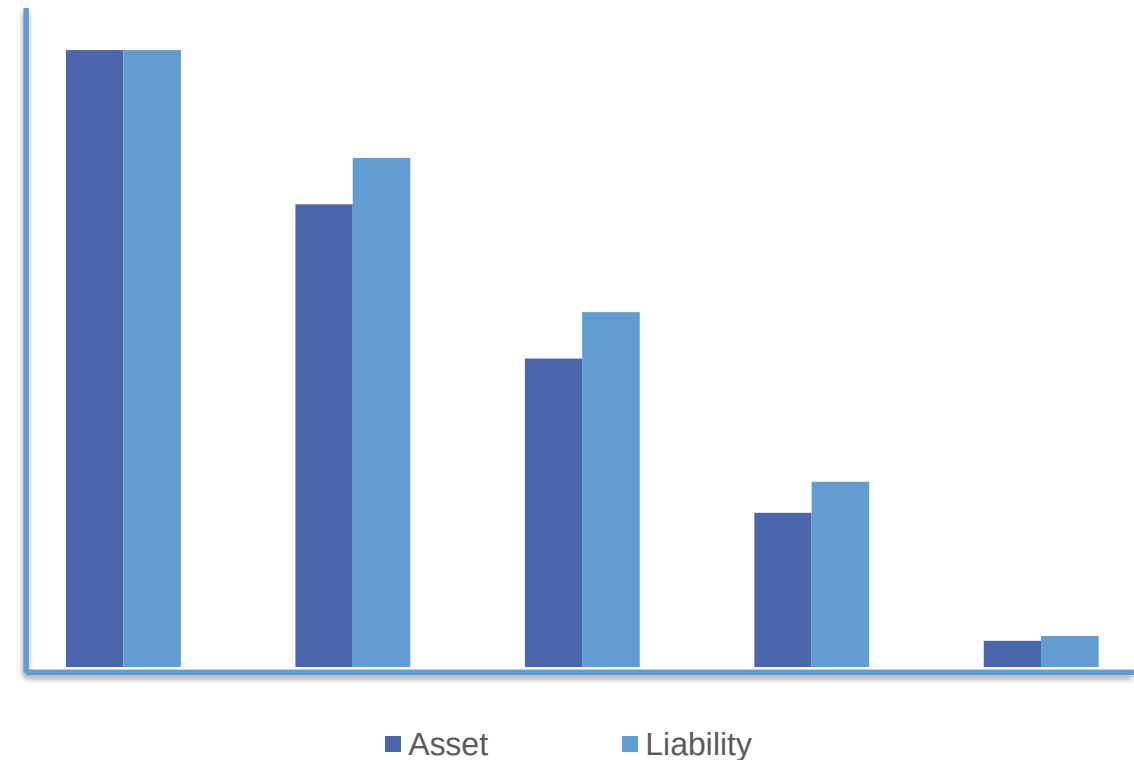
Depreciation

+ Interest

= Front-Loaded total lease expense

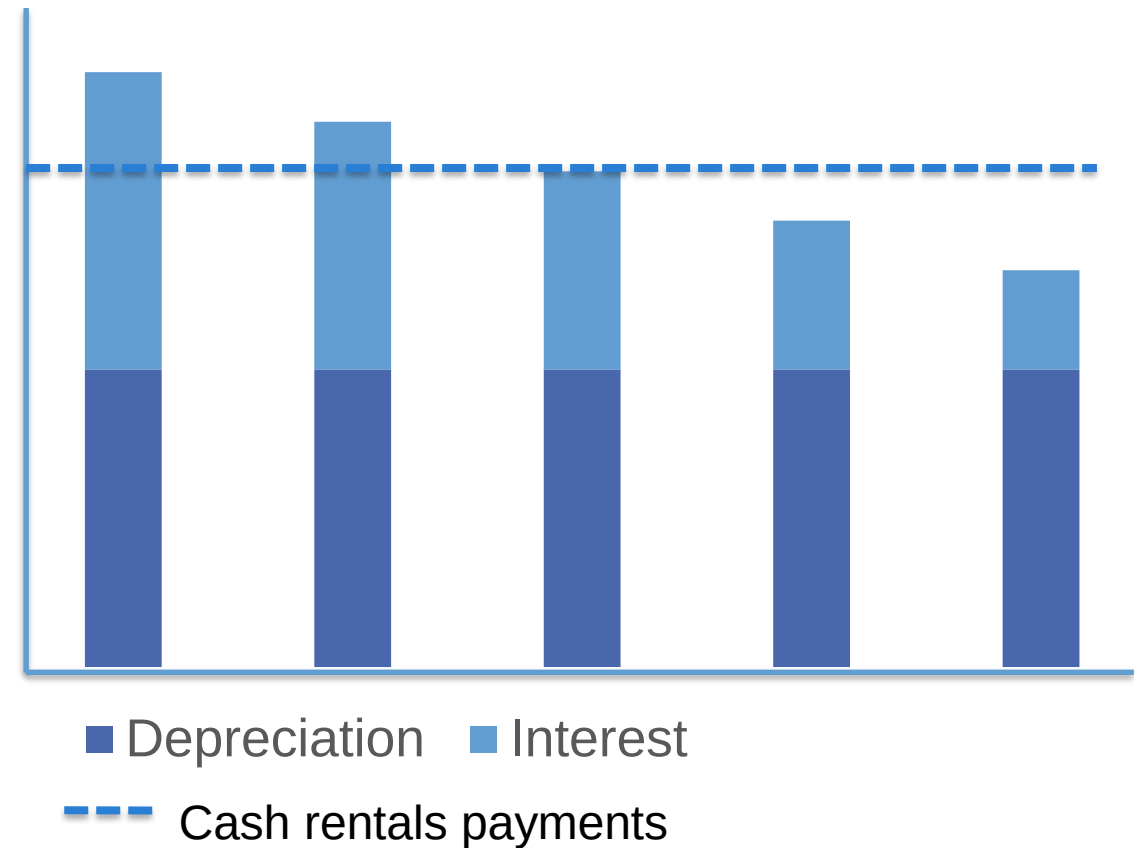
Impact of Balance Sheet

Companies with operating leases will appear to be more **asset-rich**, but also more **heavily indebted**



Impact of Profit and Loss

Total lease expenses will be **front-loaded** even when cash rentals are constant



Impact of financial ratios



Profit/loss

Balance Sheet

Ratios

EBIDTA

Total Assets

Gearing



EPS
(In early years)

Net Assets

Interest Cover
Asset Turnover



Questions & Answers

THANK YOU

*For further information please
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