

K C Mehta & Co.

Chartered Accountants



kcmSpark

Audit & Assurance

Deciphering Amendment to
Ind AS 116 “Leases”

August 12, 2020

Snapshot

The Ministry of Corporate Affairs (MCA) in consultation with the National Financial Reporting Authority (NFRA), has amended the Companies (Indian Accounting Standards) Rules, 2015 on July 24, 2020.

The amendments are aimed to keep the Ind-AS converged with International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB).

The said amendments, inter alia, include amendment to Ind AS 116 - "Leases" in respect of rent concessions. Considering the significance of the rent concessions and intricacies involved in addressing various issues that may arise while dealing with the amendment, we will discuss about this amendment at length in this edition.

Overview

With the ongoing Covid-19 pandemic, with nationwide lockdown, a large number of lessees have obtained, or are expecting to obtain, some form of rent concessions from lessors.

According to the general principles enunciated in Ind-AS 116, whenever there is any modification which is not identified as separate lease, the lessee has to account for the lease modification by remeasuring the lease liability using a discount rate determined at the date of modification with a corresponding adjustment to the Right of Use (ROU) asset.

Considering the hardship that lessees would face in remeasurement of lease liabilities and consequent adjustment to ROU assets, the amendment aims to provide relief to the lessees from applying the Ind-AS 116 guidance on lease modification accounting, for rent concessions arising as a direct consequence of the Covid-19 pandemic.

Practical Expedient

As a practical expedient, a lessee may elect not to assess a rent concession that meets the conditions (discussed later) as a lease modification. In such a case, the lessee shall account for any change in lease payments resulting from the rent concession in the same way as if the change is not a lease modification i.e. not remeasuring the lease liability. The said change in form of rent concession is generally recognised as variable lease payment. The variable lease payments (not dependent on an index or a rate) are recognised in profit and loss and are not considered for measurement of ROU Assets and corresponding lease liabilities.

Deciphering Amendment to Ind AS 116 - "Leases"

This amendment is applicable for the annual reporting period beginning on or after April 1, 2020. However, in case a lessee has not yet approved the FY 2019-20 financial statements for issue before July 24, 2020 (date of this amendment notification) then the entity may apply the amendment for annual reporting period beginning on or after the April 1, 2019.

The amendment is to be applied retrospectively in accordance with Ind-AS 8 except the requirement of paragraph 28(f) i.e. restatement of prior period items.

The cumulative effect of initially applying this amendment should be recognised in the opening balance of retained earnings (or other component of equity, as appropriate) at the beginning of the annual reporting period.

The Ind AS-8 in such case would be applied to cover situations where rent concession is given with retrospective effect and portion of which relates to preceding year i.e. FY ending on March 31, 2020 or March 31, 2021 and where financial statements have already been approved for issue.

Ascertaining whether practical expedient would be available for election

To opt for the practical expedient, a lessee will have to ascertain whether the rent concession is occurring as a direct consequence of the Covid-19 pandemic and also, whether all of the following conditions are fulfilled:

- 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;
- any reduction in lease payments affects only payments originally due on or before the June 30, 2021; and
- there is no substantive change to other terms and conditions of the lease.

Deliberating on the conditions, some of the questions which may arise are addressed below:

Whether election and application of practical expedient is mandatory or optional?

The election and application of practical expedient is optional and discretionary. However, once applied, the entity needs to

apply the same consistently to all rent concessions related to the leases of similar characteristics and in similar circumstances.

Whether practical expedient applies to lessors also?

No. Practical expedient is meant for lessees only. It does not apply to lessors.

Whether the consideration should be substantially same or less, would mean that there can be no circumstances in which the consideration can increase?

The terminology used by the Standard is "substantially same or less", which would indicate that there can be an increase in the consideration subsequent to rent concession period. However, "substantially" has not been defined in the Standard and can be a matter of judgement.

It needs to be assessed whether subsequent increase in consideration is in form of compensation to the lessor reflecting the time value of money only. If it so, the increased consideration will still be considered as substantially the same, and therefore the rent concession would qualify for the practical expedient.

Deciphering Amendment to Ind AS 116 - "Leases"

Whether deferral of the lease payments for a few months of lockdown will be considered as lease modification?

A lease modification occurs when there is a change in the scope of the lease, or the consideration of the lease, that was not part of the original terms and conditions of the lease. If there is merely change in the timing of cashflow and there is no change in the overall consideration of the lease, **the rent concession in form of deferral would not constitute a lease modification.**

What would be considered as substantive change in the terms and conditions of the lease?

The term substantive has not been defined in the Standard and needs to be assessed on case to case basis. Factors such as duration of the lease arrangement, the area under lease, the model of calculation of the lease payments (e.g. payments due during lockdown period changed from fixed payment to variable payment on the percentage of sales) etc. should be considered while coming to the conclusion that whether the changes are substantive or not.

Once it is settled that practical expedient would be available and lessee opts for it, the next most pertinent questions that arise are:

How has the same to be accounted for?

A reduction in the lease payment is to be recognised as gain directly to the statement of profit or loss in the period in which the same originally falls due. The lessee will carry out a corresponding reduction in the lease liability.

How should deferral of lease payments be accounted?

An alteration in the lease payments schedule, with overall lease payments remaining the same does not substantially change the consideration of the lease. It gives the benefit of time value of money to the lessee. This could include short term deferrals where additional interest is not charged for the period of the deferral. In this case, a lessee would continue to recognise interest expense against the lease liability.

Are there any disclosures required if the entity opts for practical expedient?

Yes. The amendment prescribes following disclosures:

- Whether an entity applied the practical expedient to all rent concessions that meet the conditions in the amendment and, if not, to disclose information about those exceptions; and
- Amount recognised in profit or loss for the reporting period to reflect changes in lease payments that arise from rent concessions to which the lessee has applied the practical expedient.

Apart from above disclosures, the following would also be required to be disclosed:

- If the practical expedient has been opted, the said fact needs to be stated in the financial statements;
- Information about the nature of contracts for which practical expedient has been applied; and
- The non-cash changes in lease liabilities.

Can the entity apply practical expedient in its interim financial statements/results?

Yes, an entity can apply the practical expedient in its interim financial statements / results.

Deciphering Amendment to Ind AS 116 - "Leases"

Illustration 1

A lessee operating a garments showroom at a shopping mall has a long-term lease contract with the lessor. The total duration of the contract is of 8 years, beginning on April 1, 2019, with 5 years of lock-in period. For easy understanding, let us consider the discount rate as 0% at the commencement date. The consideration includes ₹ 5 lakh monthly fixed lease payment and a variable lease payment of 2% of the sales per annum.

Scenario 1

Considering the nationwide lockdown, the lessor has waived off the lease payment originally due in the month of April, May & June 2020. Whether practical expedient can be applied? What will be accounting treatment for the same?

We will have to first assess whether the 4 conditions prescribed in the amendment to elect and apply the practical expedient are met.

Sr. No.	Conditions	Status
1	The rent concession is occurring as a direct consequence of the Covid-19 pandemic;	✓
2	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;	✓
3	Reduction in lease payments affects only payments originally due on or before the June 30, 2021; and	✓
4	There is no substantive change to other terms and conditions of the lease.	✓

Notes:

- Since all the conditions for election of practical expedient are met, the accounting treatment for rent concession would be as follows:

Lease Liability A/c Dr. ₹ 15 Lakhs

To Profit & Loss A/c ₹ 15 Lakhs

(Being fixed lease payments waived on account of Covid-19 pandemic)

- Only the fixed lease payments are required to be considered for the above accounting treatment since the variable lease payment would be recognised in Profit or Loss as the same is not dependent on an index or a rate in the given case.

Deciphering Amendment to Ind AS 116 - "Leases"

Scenario 2

Considering the nationwide lockdown and to make sure that the lessee does not vacant the premises, the lessor has waived off fixed lease payment for the month of April, May and June 2020 and the variable lease payment completely for the remaining duration. Whether practical expedient can be applied? What will be accounting treatment for the same?

Sr. No.	Conditions	Status
1	The rent concession is occurring as a direct consequence of the Covid-19 pandemic;	✓
2	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;	✓
3	Reduction in lease payments affects only payments originally due on or before the June 30, 2021; and	✓
4	There is no substantive change to other terms and conditions of the lease.	✓

Note:

The consideration for the lease has changed from a combination of fixed lease payments and variable lease payments to solely fixed lease payments. Though professional judgement would be required, but apparently the revised consideration would be considered as substantially the same or less than the original consideration as variable lease payments are not considered in measurement of ROU and lease liabilities. Therefore, the conditions to elect the practical expedient are met in this situation and hence, this will not be considered as a lease modification.

Accounting Treatment:

Lease Liability A/c Dr. ₹ 15 Lakhs

To Profit or Loss A/c ₹ 15 Lakhs

(Being fixed lease payments waived on account of Covid-19 pandemic)

Deciphering Amendment to Ind AS 116 - "Leases"

Scenario 3

The lessor has deferred the lease payment originally pertaining to April, May, and June 2020 to March 2021. Whether practical expedient can be applied? What will be accounting treatment for the same?

Sr. No.	Conditions	Status
1	The rent concession is occurring as a direct consequence of the Covid-19 pandemic;	✓
2	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;	✓
3	Reduction in lease payments affects only payments originally due on or before the June 30, 2021; and	✓
4	There is no substantive change to other terms and conditions of the lease.	✓

Note:

Since there is merely deferral of the payment for upto 12 months, the benefit arising to the lesser is only deferral of cashflow and the time value of money. As the discount rate is considered as 0%, there will not be any accounting impact.

Scenario 4

The lessor has reduced the fixed lease payment by ₹ 1 Lakh per month and variable lease payment by 1% on sales p.a., for the duration April 2020 to October 2021. Whether practical expedient can be applied? What will be accounting treatment for the same?

Sr. No.	Conditions	Status	Note:
1	The rent concession is occurring as a direct consequence of the Covid-19 pandemic;	✓	The reduction of the consideration is going to have its effect till October 2021. It is noteworthy that the lessee cannot opt to exercise the practical expedient partially upto June 2021 and recognise lease modification impact for the period from July 2021 to October 2021, as mentioned in the scenario. Hence, this entire scenario will have to be treated as lease modification only and the following accounting treatment will have to be given: <i>Lease Liability A/c Dr. ₹ 19 Lakhs</i> <i>To Right-of-use-Asset A/c ₹ 19 Lakhs</i> <i>(Being fixed lease payments reduced by ₹ 1 lakh per month for 19 months, considered as lease modification)</i>
2	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;	✓	
3	Reduction in lease payments affects only payments originally due on or before the June 30, 2021; and	✗	
4	There is no substantive change to other terms and conditions of the lease.	✓	

Deciphering Amendment to Ind AS 116 - "Leases"

Scenario 5

The lessor has reduced the fixed lease payment by ₹ 1 Lakh per month and variable lease payment by 1% on sales p.a., for the duration April 2020 to June 2021, which is then increased by the same amount for the next 15 months. Whether practical expedient can be applied? What will be accounting treatment for the same?

Sr. No.	Conditions	Status	Note:
1	The rent concession is occurring as a direct consequence of the Covid-19 pandemic;	✓	This is similar to the scenario explained above with the difference being that the lease payment reduction is till June 2021 and thereafter the lease payments will increase. As far as the conditions to fulfil the practical expedient are concerned, they stand fulfilled since the reduction in lease payment is now till June 2021 and not beyond that. Further, increased consideration is substantially same. Such situation will be considered as eligible to be accounted for using practical expedient and the following entries will have to be passed: <i>Lease Liability A/c Dr. ₹ 15 Lakhs</i> <i>To Profit or Loss A/c ₹ 15 Lakhs</i> <i>(Being fixed lease payments waived on account of Covid-19 pandemic for 15 months)</i>
2	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;	✓	
3	Reduction in lease payments affects only payments originally due on or before the June 30, 2021; and	✓	
4	There is no substantive change to other terms and conditions of the lease.	✓	

Scenario 6

The lessor has waived off the lease payment originally due in the month of April & May 2020. However, this waiver was given after the interim financial results for quarter ended June 30, 2020 were already approved. Assuming the conditions to the practical expedient are fulfilled, what will be accounting treatment for the same?

Note:

The amendment to this standard is to be applied retrospectively, and on the transition date the cumulative effect of initially applying this amendment is to be adjusted to the opening balance of retained earnings (or other component of equity, as appropriate) at the beginning of the annual reporting period in which the lessee first applies the amendment. Since, the

Deciphering Amendment to Ind AS 116 - "Leases"

concession is conveyed during the current year and affects current year's lease accounting, the following treatment should be given.

Lease Liability / Receivable

from Lessor A/c Dr. ₹ 10 Lakhs

To Profit and Loss A/c ₹ 10 Lakhs

(Being reversal of lease liability payable/paid for April & May 2020 which got waived)

Illustration 2

The lessee has got multiple lease arrangements consisting of:

- 2 lease arrangements for warehouses,
- 4 lease arrangements for shops in shopping malls across all metro cities in India,
- 16 lease arrangements for machineries used for maintenance of stores; and
- 24 lease arrangements for vehicles used for employee commuting.

All the warehouses & shops lease arrangements are similar in nature having similar characteristics and circumstances, while the terms of machinery & vehicle lease arrangements and their characteristics differ from case-to-case. Due to Covid-19, there has been either reduction or deferral in lease payments in all of the leases mentioned above and let us assume that all the 4 conditions for exercising the practical expedient are fulfilled. Now, the lessee is intending to opt for practical expedient in the

arrangements in which the rent reduction is more than 10%. This would cover the following lease arrangements:

- both the warehouses;
- 2 shops;
- 12 machineries; and
- 20 vehicle leases.

Whether practical expedient can be applied in such selective manner? What could be acceptable practice as per the standard?

Sr. No.	Conditions	Status
1	The rent concession is occurring as a direct consequence of the Covid-19 pandemic;	✓
2	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;	✓
3	Reduction in lease payments affects only payments originally due on or before the June 30, 2021; and	✓
4	There is no substantive change to other terms and conditions of the lease.	✓

Note:

It is to be noted that the practical expedient is not required to be applied to all rent concessions. It can be observed from above table that all the

Deciphering Amendment to Ind AS 116 - "Leases"

conditions are fulfilled. However, the practical expedient should be applied consistently to all the leases with similar characteristics and in similar circumstances. In the scenario given above, it could be applied to all warehouses & shops' lease arrangements as they belong to the same class, having similar arrangement, nature, characteristics, and circumstances.

However, what is intended by the lessee to apply practical expedient to only a few selective arrangements would not be permissible as it would result into picking and choosing out of the leases which are similar in nature as described above. But when it comes to machinery & vehicles lease arrangement, election of practical expedient could be considered as possible since all the lease arrangements are having different terms & the same are not similar in characteristics and circumstances.

Should you need more information, kindly reach out to



Shripal Shah

Director

shripal.shah@kcmehta.com
+91 265 2440425 (Direct)
+91 98251 06674 (Handheld)



Ashish Mrug

Deputy Manager

ashish.mrug@kcmehta.com
+91 265 2440443 (Direct)
+91 89769 47543 (Handheld)

Deciphering Amendment to Ind AS 116 - "Leases"

About **kcm**Spark

kcmSpark is a periodic, highly research-oriented publication which covers research and analysis on specific topics by our subject matter experts. As the name suggests, our endeavour is to present to you, interesting and thought-provoking aspects about a particular topic, in each edition of **kcm**Spark.

This publication is prepared exclusively for the benefit and use of the clients of K. C. Mehta & Co. This should not be used as a substitute for professional advice. Reasonable care has been taken for ensuring the accuracy and the authenticity of the contents of this publication. However, we do not take any responsibility for any error or omission contained therein on any account. It is recommended that the readers should take professional advice before acting on the same. No part of this document may be reproduced in whole or in part in any manner without prior written permission from K. C. Mehta & Co.

Locations

Ahmedabad

Arpit Jain

Level 11, Tower B,
Ratnaakar Nine Square,
Vastrapur,
Ahmedabad - 380 015

+ 91 79 4910 2200

arpit.jain@kcmehta.com

Bengaluru

Payal Shah

19/4, Between 7th & 8th Cross,
Malleswaram,
Bengaluru - 560 003

+91 80 2356 1880

payal.shah@kcmehta.com

Mumbai

Vishal Doshi

508, The Summit Business Bay,
Nr. WEH Metro Station,
Gundavali, Andheri East,
Mumbai - 400 069

+91 22 2612 5834

vishal.doshi@kcmehta.com

Vadodara

Milin Mehta

Meghdhanush,
Race Course,
Vadodara - 390 007

+91 265 2440400

milin.mehta@kcmehta.com

Independent Member of

