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**Audit & Assurance**

**Deciphering Amendment to  
Ind AS 116 "Leases"**

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## 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.

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.

## 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.

## 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.

## Scenario 2

Considering the nationwide lockdown and to make sure that the lessee does not vacate 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)*





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

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.

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