|  |
| --- |
| 1. **Why IFRS 16?** |
| 1. **Changes & Challenges** |
| 1. **Valuation of Leases** |
| 1. **Initial Measurement** |
| 1. **Subsequent Re-measurement** |
| 1. **Accounting Entries** |
| 1. **Financial Presentation** |
| 1. **Disclosures** |

**C. Valuation of Leases**

|  |
| --- |
| C1. **Importance of Valuation** |
| * The most important part of the new lease accounting standard is the “Valuation of leases”. * An accurate valuation of leases from inception reflects true and fair financial values in the financial statements of the lessee. * Lessee’s must drive to achieve accurate valuation of their leases from inception as any error in the valuation directly impacts the financial values in the financial statements and the financial ratios. * In this chapter, all key components and factors which are important for computation of valuation of leases are included and ensures lessee to have an accurate valuation in compliance with the new lease accounting standard. |

|  |
| --- |
| C2. **Lease Liability & Lease Asset** |
| * After identifying a contract contains a lease, where the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration, valuation of lease shall be carried out in accordance with the new lease accounting standard as set out in this chapter. * “Valuation of a Lease” involves: * Valuation of a lease liability; and * Valuation of a lease asset which is dependent on the valuation of a lease liability. * Valuation of a Lease shall be carried out both: * At the initial effective date of the new lease accounting standard or at initial recognition of a lease contract (start date of the lease contract); and * At any subsequent modification of lease terms between lessor and lessee or at any subsequent change in the lease discount rates. * In this chapter, we are focusing on the computation of the “Valuation of a Lease Liability”. * The “Valuation of a Lease Liability” both at the initial and subsequent recognition are calculated following the same valuation principles as set out in this chapter. * For the “Valuation of a Lease Asset” both at the Initial and subsequent recognition are discussed and covered in the next chapters. |

|  |
| --- |
| C3. **Excluded & Exempted Leases** |
| **Excluded Leases**   * The new lease accounting standard shall apply to all leases including subleases, except for below leases which are excluded: * Leases to explore for or use minerals, oil, natural gas, and similar non-regenerative resources; * Leases of Biological Assets; * Service Concession Arrangements; * Licenses of Intellectual Property Rights; * Intangible Assets under Licensing Arrangements; * A lessee may choose to apply the new lease accounting standard to leases of Intangible Assets (other than Intangible Assets under Licensing Arrangements as above). This option is available only once at the time of applying this standard and shall be followed consistently for all future reporting periods. * Leases of all above assets shall be required to comply with their respective accounting standard or expensed as and when incurred.   **Exempt Leases**   * A lessee may elect not to value the lease and recognize lease payments as an expense over the lease term in cases where: * Leases are of short-term with lease tenure of less than 12 months; and * Leases for which the underlying lease asset is of low value.   **Lease Duration Assessment**   * The lease duration shall be assessed at the time of initial application of the new lease accounting standard or at the initial recognition of a lease contract.  |  |  |  |  | | --- | --- | --- | --- | | Date of Application | Scenario | Lease Duration | Financial Treatment | | At Initial Application of this Standard  (Say January 01, 2019) | A Lease contract was signed in January 01, 2017 to end on December 31, 2019 | Short-term Lease Contract  (as on January 01, 2019) | Expense | | A Lease contract was signed in January 01, 2017 to end on December 31, 2020 | Long-term Lease Contract  (as on January 01, 2019) | Capitalize | | At Initial Recognition  (At Lease Start Date) | A Lease contract was signed on March 01, 2019 to end on February 28, 2020 | Short-term Lease Contract  (as on March 01, 2019) | Expense | | A Lease contract was signed on March 01, 2019 to end on February 28, 2021 | Long-term Lease Contract  (as on March 01, 2019) | Capitalize |   **Low-Value Lease Assessment**   * A low value shall be assessed by referring to the purchase value of the lease asset when it is new, regardless of the age of the asset being leased. * The assessment of whether an underlying asset is of low value is performed on an absolute basis. * The assessment is not affected by the size, nature or circumstances of the lessee. * An underlying asset can be of low value only if: * The lessee can benefit from the use of the underlying asset on its own or together with other resources that are readily available to the lessee; and * The underlying asset is not highly dependent on, or highly interrelated with, other assets. * **If a lessee subleases an asset, or expects to sublease an asset, the head lease does not qualify as a lease of a low-value asset**. |

|  |
| --- |
| C4. **Valuation Period** |
| * Valuation period here refers to the “Lease Term” for which valuation of a lease shall be carried out. * The lease term refers to as the “Non-Cancellable Period” of a lease under the lease contract, including the period under below options:  |  |  |  | | --- | --- | --- | | 1. | Termination Option | Periods covered by an option to terminate the lease if the lessee is reasonably certain not to exercise that option. | | 2. | Renewal Option | Periods covered by an option to extend the lease if the lessee is reasonably certain to exercise that option; and | | 3. | Purchase Option | Periods covered by an option to purchase the lease. |  * The lease term begins at the lease start date and includes any lease-free period provided to the lessee by the lessor. * At the lease start date, the lessee shall assess whether there is any reasonable certainty to exercise an option to extend the lease or to purchase the underlying asset, or not to exercise an option to terminate the lease. * At subsequent, the lessee shall revise the lease term if there is a change in the non-cancellable period of a lease or by exercising an option to extend or purchase or terminate the lease. * It is important to note that the valuation period in case of “Valuation of a Lease Liability” shall starts from the date of initial application of the new lease accounting standard or the lease start date whichever is later. This is discussed more under chapter initial measurement. * Hence, the valuation period starts from the lease start date or date of initial application (whichever is later) and ends on the lease end date or end of renewal period (if any) or lease termination date (if any) or lease purchase date (if any).  |  | | --- | | **Important Note:**  The “Valuation of a Lease Liability” shall be computed and recognized in the financial statements of the Lessee only to the extent of the lease payments payable in future including outstanding lease payable as on date of the initial application of the new lease accounting standard or initial recognition of a lease contract whichever is later.  For example: a lease started on January 01,2017 and ends on December 31, 2025. The date of initial application of the new lease accounting standard is January 01, 2019.  The date of initial recognition of lease was January 01, 2017  Date of initial application of new lease accounting standard is January 01, 2019  Valuation of a Lease Liability shall be computed as on January 01, 2019 for all lease payments payable in future including any outstanding lease payments as on January 01, 2019. (the date of initial application of new lease accounting standard – the later date). |   Valuation-Period%20(1).jpg |

|  |
| --- |
| C5. **Lease Payments to Consider for Valuation** |
| * For the purpose of the “Valuation of a Lease” at initial application or initial recognition and subsequent recognition, lease payments that are payable in the future shall only be considered. * Lease payments to consider for “Valuation of a Lease” shall include only: * Fixed lease payments; * Variable lease payments only to the extent determinable at the initial measurement and that depend on an index or a rate; * Amounts expected to be payable by the lessee under residual value guarantees; * The exercise price of a purchase option if the lessee is reasonably certain to exercise the option; * Payments of penalties for terminating the lease, if the lease term reflects the lessee exercising an option to terminate the lease. * The above lease payments do not include payments allocated to “Non-Lease Components” of a contract, unless the lessee elects to combine “Non-Lease Components” with a “Lease Component” and to account for them as a single lease component. * Hence, the above lease payments which are allocable to below components shall only be considered for the “Valuation of a Lease”: * Lease Components; and * Single Lease Component (Lease & Non-Lease Components Combined). |

|  |
| --- |
| A4. **IFRS 16 Impact in the Financial Statements of Lessee** |
| * Let us understand the impact of IFRS 16 by referring to the pre-IFRS 16 position. Continuing with the same scenario as in illustrative example 1 above with some additional information as below:  |  |  |  | | --- | --- | --- | | Illustrative Example 2 | Scenario | ABC Company is in the business of generation of Solar Energy for which the company has taken a land on lease for 50 years on January 01, 2017 with a quarterly lease payment of USD 100,000.  The land shall be used for the installation of solar panels for the generation of solar energy.  To best analyze, let us also assume ABC has earned a revenue of USD 1.5 Million during the year 2017 and made equity investment of USD 10 million for purchase of Solar Panels.  The incremental borrowing rate existing is 3%. | | Lease classification | The lease was classified as operating lease prior to January 01, 2019. | | Accounting Treatment | The lessee expensed the lease payment on a quarterly basis as and when incurred until December 31, 2018 and applied IFRS 16 effective from January 01, 2019. | | Financial Presentation | Let us examine the financial presentation under Pre-IFRS 16 and Post IFRS 16 in the below infographic presentation: |  * Hence, you will notice that under IFRS 16, a lease liability with the right of use asset is recognized in the balance sheet of the lessee and the lease expense is divided into two (2) components – interest on lease liability and depreciation on lease asset in the income statement of the lessee. Whereas the lease payment |