

Companies (Indian Accounting Standards) Amendment Rules, 2020, issued by MCA on 24th July 2020



**Amendment carried out in Ind AS – 116 on account of
Covid 19 situation:
Relaxation & its Implications**



Index	Page no.
Background	3
Objective	3
Amendment	4
Difference between both the scenarios	5
Accounting treatment before amendment	6
Accounting treatment as per amendment	6
Various scenarios	7
Effect on Lessor	8
Disclosure	8
Effective date with an example	9
Transition	9
Conclusion	9



(A) Background:

Covid-19 pandemic has shattered the entire globe in many ways. This pandemic is having a vast impact on the health of human beings (physical & mental health) and of the corporates (financial health). While we discuss about corporates, even accounting does not remain untouched, which is getting impacted due to it. Covid-19 is forcing the accounting bodies to make appropriate changes in accounting standards, in a rationale manner to deal with the real situation. As of now, though such modifications might be of short-term duration dealing with this specific situation, they are very much required.

One of the changes has recently been carried out is in Ind AS 116 - “Leases”. Ind AS 116 came into existence w.e.f. 1st April 2019, which is based on IFRS 16 - “Leases”, which is applicable from 1st January, 2019.

As we all know, due to this pandemic there has been lockdown situation in most of the places of this world including our country. Many organizations must be having leased premises to run their business operations. Lease transactions are higher for those who are in the business of retail, logistics, hospitality etc.. Due to lockdown situation, even though business activities were not being carried out, the organizations were bearing the cost of rentals. But this situation eventually compelled the lessees to negotiate the rental cost to be paid by them to the lessor of such assets.

Changes in lease terms at large scale across the business houses have initiated the trigger point for International Accounting Standards Board (IASB) to carry out an amendment to IFRS 16 to make it easier for lessees to account for covid-19 related rent concessions such as rent holidays and temporary rent reductions. Eventually, on 28th May 2020, it has issued an amendment to IFRS 16.

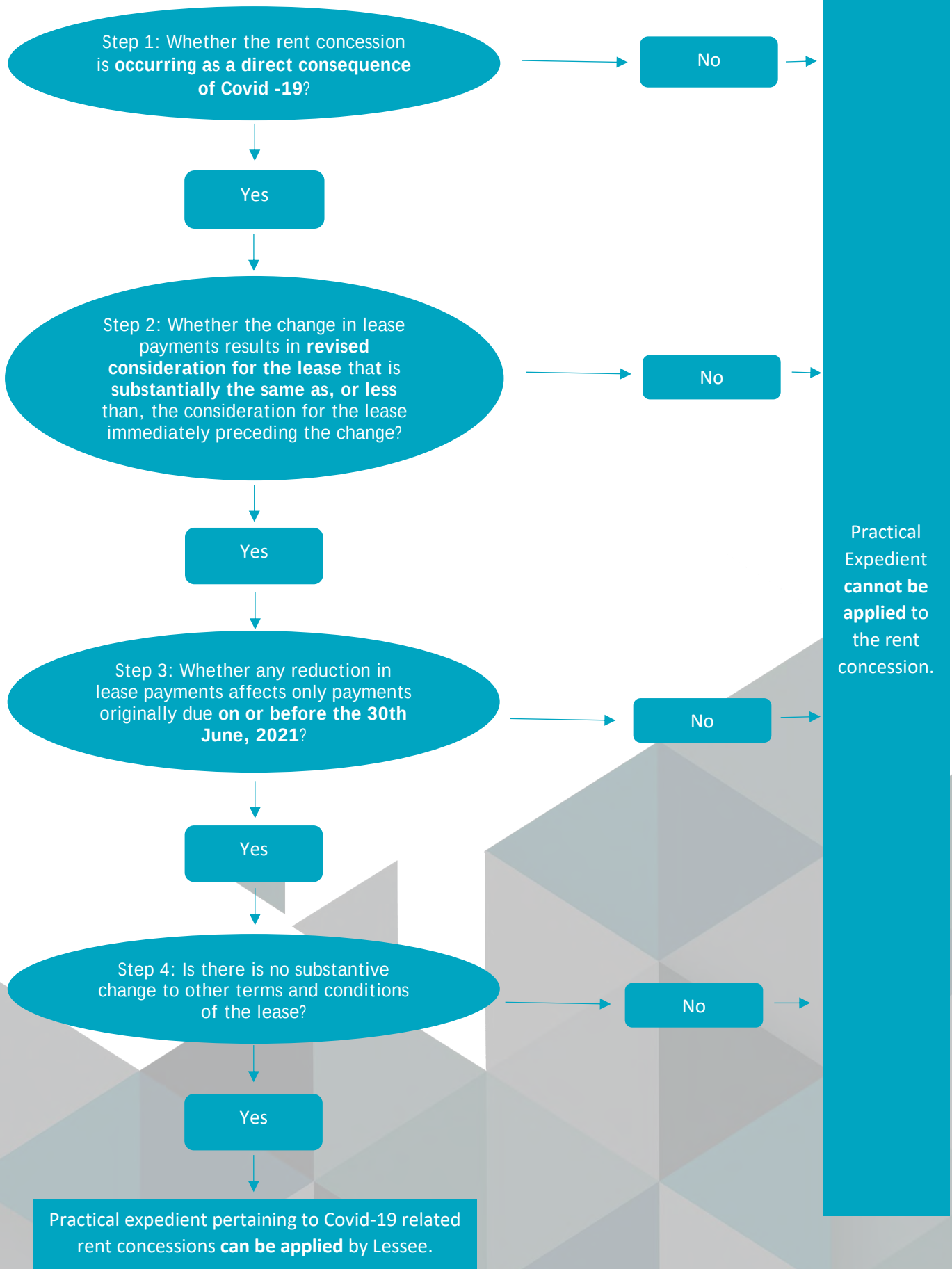
Consequent to that, **MCA has carried out an amendment in Ind AS 116 by virtue of a notification dated 24th July, 2020.**

(B) Objective:

Generally, changes carried out in lease terms falls under the category of lease modifications. To identify, whether the respective carried out change falls under the category of lease modifications or not sometimes becomes quite cumbersome. Further, to reidentify the incremental rate of borrowing or implicit rate of interest adds up huge amount of task. Specifically, for those business organizations who has large number of lease transactions.

To deal with this situation in a better manner in times of Covid-19, MCA has brought practical expedient which provides relief to lessees from carrying out accounting in the nature of lease modification for lease rent concessions.

(C) Amendment to Ind AS 16 - para 46 B:



(D) Difference between accounting treatment before amendment and accounting treatment after amendment:

Sr. no.	Effects in Financial Statement	Practical expedient not applied - accounting will be as per lease modification	Practical expedient applied - accounting will be as per the nature of variable lease payment
1	On discount rate	Use a revised discount rate identifiable on the date of modification.	Discount rate is not revised.
2	On lease liability	Lease liability is reduced to give effect to the revised consideration.	Lease liability is reduced to give effect to the revised consideration.
3	On right of use asset	Adjustment is made to right of use asset.	No adjustment is made.
4	On P&L account	No effect on P&L. Modification will affect interest cost and depreciation in the subsequent period.	Adjustment is recognized in P&L.

(E) Example:

On 1st April, 2019, Mumbai Indians Ltd. takes office premises on lease from Chennai Express Ltd. for a period of 4 years. Lease rental will be paid at the end of every year. Yearly rentals are of Rs. 24,00,000. As on 1st April 2019 Mumbai Indians incremental borrowing rate is of 10%.

On 1st April, 2020 due to Covid-19, Mumbai Indians negotiate the rental cost for FY 20-21 and is successful in getting the reduction in yearly rent payment for FY 20-21 to Rs. 18,00,000. Incremental borrowing rate as on 1st April, 2020 is of 9% (it got reduced due to reduction in rates brought in by RBI for easing the liquidity).

Balances arising due to accounting treatment:

Outstanding balance as on 31st March, 2020 of Lease Liability and ROU asset:

Balance of Lease Liability:	Rs. 59,68,722
Balance of ROU asset:	Rs. 57,05,640

Accounting treatment before amendment (if practical expedient is not applied):

1. Remeasurement of lease liability using lessee's revised incremental borrowing rate existing as at 1st April, 2020 i.e. 9% p.a. (revised payments discounted at revised rate):

Sr. no.	Date	Lease rental	Discounted IBR	NPV
1	31/03/2021	18,00,000	0.9174	16,51,376
2	31/03/2022	24,00,000	0.8417	20,20,080
3	31/03/2023	24,00,000	0.7722	18,53,280
Total		66,00,000		55,24,736

2. Accounting entry:

Difference arising between remeasured lease liability and the earlier lease liability of Rs. 4,43,536 (Rs. 59,68,722 - Rs. 55,24,736) will be adjusted between Lease liability and ROU. Accounting entry will be as mentioned hereunder:

Lease Liability a/c Dr.	4,43,536	-
To, Right of Use Asset a/c	-	4,43,536

3. Revised figures for respective item will be as stated herein:

Particulars	Lease Liability	ROU
Balance as at 1 st April, 2020	59,68,272	57,05,640
less: adjustment	4,43,536	4,43,536
Revised Balance	55,24,736	52,62,104
Revised IBR	9% p.a.	
Revised ROU amortization for balance period of lease		17,54,035

Accounting Treatment after amendment (if practical expedient is applied):

1. Remeasurement of lease liability using lessee's original incremental borrowing rate i.e. 10% p.a. (revised payments discounted at original rate):

Sr. no.	Date	Lease rental	Discounted IBR	NPV
1	31/03/2021	18,00,000	0.9091	16,36,380
2	31/03/2022	24,00,000	0.8264	19,83,360
3	31/03/2023	24,00,000	0.7513	18,03,120
Total		66,00,000		54,22,860

2. Accounting entry:

Difference arising between remeasured lease liability and the earlier lease liability of Rs. 5,45,412 (Rs. 59,68,722 - Rs. 54,22,860) will be adjusted in Lease liability and another adjustment will be made in statement of P&L. Accounting entry will be as mentioned hereunder:

Lease Liability a/c Dr.	5,45,412	-
To, Profit on lease rent concession a/c	-	5,45,412

3. Revised figures for respective item will be as stated herein:

Particulars	Lease Liability	ROU
Balance as at 1 st April, 2020	59,68,272	57,05,640
less: adjustment	5,45,412	-
Revised Balance	54,22,860	57,05,640
IBR	10% p.a.	
ROU amortization for balance period of lease		19,01,880

(F) Various scenarios to understand when practical expedient (PE) can be applied:

- (i) Lease duration is from 1st April, 2018 till 31st March, 2022. Lease rental got reduced at the end of September 2019 for a period of 6 months. Whether PE can be applied?

Answer: No, as the reduction is not on account of Covid-19 situation.

- (ii) Lease duration is from 1st April, 2018 till 31st March, 2022. Lease rental is of Rs. 50,000 p.m. with an escalation of 10% at the beginning of every year. However, due to pandemic, lessee negotiated the rentals and is able to get complete waiver of rent from April 2020 for a period of 6 months. Another condition is that from 1st April, 2021 the lease rentals will increase by 12.5% in place of 10% for FY 21-22. Whether PE can be applied?

Answer: Yes, as the lease rental is reduced within the prescribed period and there is no substantive change to other terms and conditions of the lease.

- (iii) Lease duration is from 1st April, 2018 till 31st March, 2022. It is Rs. 50,000 p.m. with an escalation of 10% at the beginning of every year. Due to Covid-19 lease rentals were reduced by 50% from 1st April 2020 till 31st July 2021. Whether PE can be applied?

Answer: No, as the lease rental reduction is beyond 30th June 2021.

- (iv) India Ltd. has a subsidiary in Wuhan named as Wuhan Ltd. Wuhan Ltd. has taken a premise on lease from 1st January 2019 till 31st December 2021. Its annual reporting period is from 1st April till 31st March. Wuhan Ltd. is able to negotiate its lease rentals in January 2020 and get its lease rental reduced by 25% for a period of 24 months from 1st July 2019 till 30th June

2021 and thereafter till December 21 it will pay rentals as per the original agreement. Whether PE can be applied?

Answer: Yes, as Wuhan city got caught into Covid 19 much earlier and lockdown situation prevailed during January 2020, it is presumed that this reduction happened on account of covid-19 situation. If the financial statements are not approved before the issuance of this amendment, the amendment permits PE's application from 1st April 2019 till 30th June 2021.

(v) What if in question (iv) above, the annual reporting period is from 1st January 2019 till 31st December 2019? All other facts remain the same. Whether PE can be applied?

Answer: No, as the earlier application of the amendment can be done if the financial year begins on or after 1st April 2019.

(vi) Dharma Ltd. (lessor) offers to YRF Ltd. (lessee) to reduce the monthly rent by 10% on the condition that its space is reduced from 20,000 sq. ft. to 15,000 sq. ft. Whether PE can be applied?

Answer: PE cannot be applied as there is substantive change to other terms and conditions of the lease.

(G) Effect on Lessor:

- This amendment will have no separate effect in the books of lessor.
- However, lessor is required to carry out the impairment testing of the assets appearing in its books of accounts as earnings and cash flows from such assets have reduced on account of covid-19. Similarly, longer-term effects of the covid-19 pandemic could affect the expected ongoing economic performance of right-of-use assets.
- Lessor will also require to look further into the requirement of ECL provisioning towards such lease rental receivables as per IND AS 109 "Financial Instruments", as there may be delay in payment of lease rentals on account of cash flow crunch arising at lessee's end due to Covid - 19.

(H) Disclosure:

Lessee shall disclose:

- that it has applied the practical expedient to all rent concessions that meet the specified conditions or,
- if not applied to all such rent concessions, information about the nature of the contracts to which it has applied the practical expedient; and

- the amount recognized 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

(I) Effective date:

- This amendment applies to annual reporting periods beginning on or after 1st April, 2020.
- However, in case lessee has not yet approved its financial statements for issue before the issuance of this amendment, then it can be applied for annual reporting periods beginning on or after 1st April, 2019. Refer example (iv) above.

(J) Transition:

- A lessee shall apply Covid-19-related rent concessions retrospectively, recognizing the cumulative effect of initially applying that amendment as an adjustment 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.
- In the reporting period in which a lessee first applies Covid-19-related rent concessions, a lessee is not required to disclose the information required by paragraph 28(f) of Ind AS 8 “Accounting Policies, Changes in Accounting Estimates & Errors”.

(K) Conclusion:

This amendment provides relief to lessees for rent concession accounting arising on account of Covid-19 and enables them to continue providing information about their leases that is useful to investors. Application of this amendment is voluntary, which remains at the choice of the lessee. It requires critical evaluation and identification of the implications at the lessee’s end, which can enable it to decide whether it should opt for this amendment or not.