Welcome

01 Series of knowledge sharing calls

02 Covering current and emerging reporting issues

03 Scheduled towards the end of each month

04 Look out for our Accounting and Auditing Update, First Notes and Voices on Reporting publications
Speaker for the call

Ruchi Rastogi
Partner
Assurance
KPMG in India
Ind AS 116, Leases
**Accounting by lessee**

**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/loss**

**Lease expense**

Depreciation + Interest

= Front-loaded total lease expense
Impact on financial statements

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

*Balance sheet to be significantly grossed up*

**Profit/loss**

- **Depreciation**
- **Interest**

---

Total lease expense is *front-loaded* even when cash rentals are constant.

*EBITDA* will improve

(*EBITDA - Earnings Before Interest, Tax, Depreciation and Amortisation*)
Impact on financial ratios

Profit/loss
- EBITDA

Balance sheet
- Total assets

Ratios
- Gearing

PAT#/EPS*
(in early years)

Net assets

Interest cover
- Asset turnover

("PAT - Profit After Tax

*EPS - Earnings Per Share")
The new on/off-balance sheet test for lessees – a key judgement area

Lease definition

New standard

Old standard

ON

OFF

Lease classification test

Lease

Finance lease

Operating lease

Service
Lease definition (cont.)

Identified asset?}

Yes

Lessee obtains substantially all of the economic benefits?

Yes

Lessee directs the use?

Yes

Contract is or contains a lease

No

Contract does not contain a lease
Substantive substitution rights

- Practical ability of lessor to substitute an asset *throughout* the period of use?
  - Yes → Lessor benefits economically from substitution?
  - No

- Lessor benefits economically from substitution?
  - Yes → Could be identified as an asset
  - No → No identified asset
The new definition increases focus on who controls the asset and may change which contracts are leases.

Think about…

- Contract Manufacturing Operation (CMO)
- Supply of medical equipment
- Future supply of consumables.
Directing the right to use

Who takes the *how and what purpose* decisions throughout the period of use?

<table>
<thead>
<tr>
<th>Predetermined</th>
<th>Supplier</th>
</tr>
</thead>
<tbody>
<tr>
<td>Customer <em>operates asset</em> or directs others to do so</td>
<td>Other</td>
</tr>
<tr>
<td>Customer designed asset</td>
<td></td>
</tr>
</tbody>
</table>

**Contract is or contains a lease**

**Contract does not contain a lease**

*Protective rights* of the supplier
Example: Supply contract

Manufacturer S \rightarrow 5\text{-year contract} \rightarrow \text{Company B}

Contract specifies using manufacturing unit M to supply components.

S will operate the plant and charge a cost plus price to B.

There is no prohibition to sell to other customers and it is remote that other customers will take any of the production.
Example: Supply contract solution

Contract + Specific asset + Right to use = Lease

Contract + Identified asset + Substantially all of the economic benefits + Directing right to use = Lease

Think about…

- Contract manufacturing contracts
Two major optional exemptions make the standard easier to apply

Lease definition - Exemptions

Short-term leases

- 12 months

Leases of low value items

- ≤ USD5,000 for example

Think about…

- Short term equipment financing for medical equipment
- Supply of dispensers for medicine delivery.
Measuring the lease liability

Lease liability

= 

Present value of lease rentals + Present value of expected payments at end of lease
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
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: ✗
## Transition options

<table>
<thead>
<tr>
<th>Approach</th>
<th>31 March 2019</th>
<th>31 March 2020</th>
<th>Date of equity adjustment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Full retrospective (no practical</td>
<td>Ind AS 116*</td>
<td>Ind AS 116</td>
<td>1 April 2018</td>
</tr>
<tr>
<td>expedients)</td>
<td>Ind AS 17*</td>
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<tr>
<td>Modified retrospective (with</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>practical expedients)</td>
<td>Ind AS 17</td>
<td>Ind AS 116</td>
<td>1 April 2019</td>
</tr>
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<td></td>
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</tbody>
</table>

(*The company will apply Ind AS 17 when preparing its financial statements for 31 March 2019. It will then apply Ind AS 116 to prepare comparative financial information to be included in its 2019-20 financial statements.*)
Have you evaluated which option to consider while transitioning to a new standard?

**Retrospective**

- Apply the standard to all leases in which the entity is a lessee
- Restate prior period financial information
- Recognise an adjustment in equity at the beginning of the earliest period presented
- Make the disclosure as per Ind AS 8, *Accounting Policies, Changes in Accounting Estimates and Errors.*

**Modified retrospective**

- Lease liability is recognised at the date of initial application using the incremental borrowing rate at that date
- Does not restate its prior-period financial information
- Recognises an adjustment in equity at the beginning of the current period
- Make additional disclosures as per the standard.

**Think about…**

- As each option has significant differences, this may change the numbers significantly.
Things to think about now

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

- Database of all leases?
- Which transition options to choose?
- Which contracts are leases?
- Systems and processes in place?
- What about ratios and covenants?
Uncertainty over income tax treatments
Overview

Key highlights

- Ind AS 12, *Income Taxes* provides guidance on recognition of income taxes and liabilities.
- Interpreting areas of uncertainty in tax law can be complex and result in diversity in practice for the recognition and measurement of tax liability.
- Appendix C, *Uncertainty over Income Tax Treatments* to Ind AS 12 clarifies the accounting for income tax treatments that have yet to be accepted by tax authorities and reflect it in measurement of current and deferred taxes.
- The clarification provided by Appendix C would provide tax transparency in the financial statements.
The key test

Will tax authorities accept treatment in tax returns?

Yes/Probable

Financial statements = Tax return

No/Not probable

Financial statements ≠ Tax return

Assume that the tax authority would have full knowledge of all relevant information.
Measurement of uncertainties

In case it is not probable that the tax authority would accept the treatment…

Reflect the uncertainty using…

The most likely amount

or

The expected value

… whichever provides a better prediction
Recognition of uncertainty

Uncertainty is reflected in the overall measurement of tax

Separate provision is not allowed
**Subsequent adjustments**

Update the amount in the financial statements if facts and circumstances change or new information becomes available.

- Examination or action by the tax authority
- Changes in tax rules
- Time limit for tax inspections
- Any other new facts and circumstances
Depending on your current accounting and jurisdiction…

• You may need to increase your tax liability or recognise an asset

• Timing of derecognition may also change.
Key challenges

• A tax inspection report may not break down amounts due if various taxes are assessed together.

• Estimating the amount of income tax may be more complex.
Disclosure requirements

Companies need to provide disclosures, under existing disclosure requirements, about...

- Judgements made
- Assumptions and other estimates used
- Potential impact of uncertainties not reflected.
Companies can apply Appendix C either….

- Retrospectively under Ind AS 8, if possible without hindsight
- By adjusting equity on initial application, without adjusting comparatives

1 April 2018
Start of comparative period

1 April 2019
Start of year of initial application
## Links to previous recordings of VOR

<table>
<thead>
<tr>
<th>Month</th>
<th>Topics</th>
<th>Link</th>
</tr>
</thead>
<tbody>
<tr>
<td>November 2018 (special session)</td>
<td>• Impact of Ind AS 103 and Ind AS 115 on technology sector</td>
<td>Click <a href="#">here</a></td>
</tr>
<tr>
<td>December 2018 (special session)</td>
<td>• Ind AS 115 and IFRS 16 - Impact on Transport, leisure and sports sector</td>
<td>Click <a href="#">here</a></td>
</tr>
<tr>
<td>January 2019</td>
<td>• Ind AS Transition Facilitation Group (ITFG) clarification - Bulletin 17</td>
<td>Click <a href="#">here</a></td>
</tr>
<tr>
<td></td>
<td>• Amendments to the Companies Act, 2013 and key clarifications</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Framework for fund raising by issue of debt securities by large corporates</td>
<td></td>
</tr>
<tr>
<td>February 2019 (special session)</td>
<td>• Impact of Ind AS 115 and IFRS 16 on healthcare sector</td>
<td>Click <a href="#">here</a></td>
</tr>
<tr>
<td>February 2019 (special session)</td>
<td>• Key Audit Matters and new standard on leases - Impact on technology sector</td>
<td>Click <a href="#">here</a></td>
</tr>
<tr>
<td>April 2019</td>
<td>• Key updates relating to the Companies Act, 2013 issued by MCA</td>
<td>Click <a href="#">here</a></td>
</tr>
<tr>
<td></td>
<td>• Supreme Court ruling on applicability of Provident Fund (PF) contribution on allowances</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• SEBI amendments pursuant to Kotak Committee applicable from 1 April 2019</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Ind AS 116, <em>Leases</em> and amendments to other Ind ASs</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• New/revised Standards on Auditing (SAs).</td>
<td></td>
</tr>
</tbody>
</table>

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Our publications

Accounting and Auditing Update

First Notes

Coming up next

New issue of:
- Accounting and Auditing Update
- First Notes
- Voices on Reporting - publication

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