Ind AS Technical Facilitation Group Clarification Bulletin 21

Ind AS Technical Facilitation Group (ITFG) of Ind AS Implementation Committee has been constituted for providing clarifications on timely basis on various issues related to the applicability and /or implementation of Ind AS under the Companies (Indian Accounting Standards) Rules, 2015, and other amendments finalised and notified till March 2019, raised by preparers, users and other stakeholders. Ind AS Technical Facilitation Group (ITFG) considered some issues received from members and decided to issue following clarifications[1] on September 17, 2019:

Issue 1: In year 2005, PQR Limited entered into a lease agreement to take on lease an office building from ABC Limited for a period of one year. Since 2005, the contract has been renewed every year for a further period of one year at a time. As per the past practice, it is likely that the contract will be renewed for another one year at the expiry of its current term.

The lease agreement does not provide any purchase option in respect of the leased asset to the lessee.

Whether the recognition exemption for short term leases as per paragraph 5 of Ind AS 116, *Leases,* is available to PQR Limited?

Response:

Paragraph 5 of Ind AS 116, *Leases,* states the following, inter alia:

"*A lessee may elect not to apply the requirements in paragraphs 22- 49 to:*

(a) short-term leases; and

(b) ...."

Ind AS 116 (or 'the standard') defines the terms 'lease term' and 'short-term lease' as follows:

Lease term

"*The non-cancellable period for which a lessee has the right to use an underlying asset, together with both:*

[1] Clarifications given or views expressed by the Ind AS Technical Facilitation Group (ITFG) represent the views of the ITFG and are not necessarily the views of the Ind AS Implementation Committee or the Council of the Institute. The clarifications/views are based on the accounting principles as on the date the Group finalises the particular clarification. The date of finalisation of this Bulletin is September 17, 2019. The clarification must, therefore, be read in the light of any amendments and/or other developments subsequent to the issuance of clarifications by the ITFG. The clarifications given are only for the accounting purpose. The commercial substance of the transaction and other legal and regulatory aspects has not been considered and may have to be evaluated on case to case basis.

(a) periods covered by an option to extend the lease if the lessee is reasonably certain to exercise that option; and

(b) periods covered by an option to terminate the lease if the lessee is reasonably certain not to exercise that option."

Short-term lease

"A lease that, at the commencement date, has a lease term of 12 months or less. A lease that contains a purchase option is not a short-term lease."

Paragraph B34 of Ind AS 116 states the following, inter alia:

"In determining the lease term and assessing the length of the non-cancellable period of a lease, an entity shall apply the definition of a contract and determine the period for which the contract is enforceable."

The term 'contract' is defined in the standard as follows:

"An agreement between two or more parties that creates enforceable rights and obligations."

As per a combined reading of the above, in determining the lease term (and therefore, in determining whether a lease is a short-term lease), only the enforceable rights of the lessee to renew or extend the lease beyond the non-cancellable period are taken into consideration. For example:

- Where a lease agreement grants the lessee a right (an option) to renew or extend the lessee beyond the non-cancellable period *without* the consent of the lessor, the lessee has the *right* to use the asset beyond the non-cancellable period. Accordingly, the period covered by the lessee's option to renew or extend the lease is included in the lease term if the lessee is reasonably certain to exercise that option.

- In contrast, where a lease agreement can be renewed or extended by the lessee beyond the non-cancellable period *only with* the consent of the lessor, the lessee does not have the *right* to use the asset beyond the non-cancellable period. By definition, there is no contract beyond the non-cancellable period if there are no enforceable rights and obligations existing between the lessee and lessor beyond that term.

In view of the above, where a lease agreement (including any addendum thereto or a side agreement) is entered into for a period of 12 months or less and does not grant a renewal or extension option to the lessee, it qualifies as a short-term lease within the meaning of the standard (provided it also does not grant a purchase option to the lessee). This is so even if there is a past practice of the lease being renewed upon expiry for a further one year at a time with the mutual consent of the lessee and the lessor.

In the given case, the lease agreement referred to in the query qualifies as a 'short-term lease'. Accordingly, PQR Limited can avail the exemption of not applying the lessee accounting model of the standard to the lease.

Issue 2:

ABC Limited is lessee in several long-term lease contracts for leases of office buildings, cars, etc. Under Ind AS 17, *Leases* these leases have been classified by ABC Ltd as operating leases and the company has been recognising the related lease rentals on a straight-line basis over the lease term of the respective leases (there is a 10% escalation in lease rentals every year in many leases). Because of straight-line recognition of escalating lease rentals, ABC Limited has a rent equalisation liability in its balance sheet as at 31 March 2019.

What would be the accounting treatment of rent equalisation liability appearing in the balance sheet of ABC Limited as at 31 March 2019 when the company applies Ind AS 116, *Leases*, with effect from 1 April 2019? It may be mentioned that none of the leases relates to a low-value item and all of the leases still have several years of lease term left as at 1 April 2019.

Response:

Paragraphs C5, C7 and C8 of Ind AS 116, *Leases,* state the following:

"*C5 A lessee shall apply this Standard to its leases either:*

(a) retrospectively to each prior reporting period presented applying Ind AS 8, Accounting Policies, Changes in Accounting Estimates and Errors; or

(b) retrospectively with the cumulative effect of initially applying the Standard recognised at the date of initial application in accordance with paragraphs C7–C13.

C7 If a lessee elects to apply this Standard in accordance with paragraph C5(b), the lessee shall not restate comparative information. Instead, the lessee shall recognise the cumulative effect of initially applying this Standard as an adjustment to the opening balance of retained earnings (or other component of equity, as appropriate) at the date of initial application.

C8 If a lessee elects to apply this Standard in accordance with paragraph C5(b), the lessee shall:

(a) recognise a lease liability at the date of initial application for leases previously classified as an operating lease applying Ind AS 17. The lessee shall measure that lease liability at the present value of the remaining lease payments, discounted using the lessee's incremental borrowing rate at the date of initial application.

(b) recognise a right-of-use asset at the date of initial application for leases previously classified as an operating lease applying Ind AS 17. The lessee shall choose, on a lease-by-lease basis, to measure that right-of-use asset at either:

(i) its carrying amount as if the Standard had been applied since the commencement date, but discounted using the lessee's incremental borrowing rate at the date of initial application; or

(ii) an amount equal to the lease liability, adjusted by the amount of any prepaid or accrued lease payments relating to that lease recognised in the balance sheet immediately before the date of initial application.

(c) apply Ind AS 36, Impairment of Assets, to right-of-use assets at the date of initial application, unless the lessee applies the practical expedient in paragraph C10(b)."

As per the above, the manner of dealing with the rent equalisation liability appearing in the balance sheet of ABC Limited as at 31 March 2019 depends on the choices it makes under paragraphs C5 and C8 of Ind AS 116, as explained in the following paragraphs.

(a) If Ind AS 116 is applied retrospectively as per paragraph C5(a)

As per paragraph C5(a) of Ind AS 116, a lessee can apply Ind AS 116 retrospectively to each prior reporting period presented applying Ind AS 8, *Accounting Policies, Changes in Accounting Estimates and Errors.*

Ind AS 8 states the following with regard to retrospective application of a change in an accounting policy.

22. Subject to paragraph 23, when a change in accounting policy is applied retrospectively in accordance with paragraph 19(a) or (b), the entity shall adjust the opening balance of each affected component of equity for the earliest prior period presented and the other comparative amounts disclosed for each prior period presented as if the new accounting policy had always been applied.

23 When retrospective application is required by paragraph 19(a) or (b), a change in accounting policy shall be applied retrospectively except to the extent that it is impracticable to determine either the period-specific effects or the cumulative effect of the change.

Applying the above requirements of Ind AS 8 (and assuming that retrospective application is not subject to limitation of impracticability as described in paragraph 23 of Ind AS 8), the accounting treatment of transition from Ind AS 17 to Ind AS 116 by ABC Limited would be as follows.

1. For each lease, the amount of the lease liability and the related right of use asset *as at the beginning of the preceding period* (i.e., 1 April 2018) would be determined as if Ind AS 116 had always been applied.

2. The difference, *as at the beginning of the preceding period* (i.e., 1 April 2018), between

   (i) the amount at which right of use asset is measured, together with the rent equalisation liability, and

   (ii) the amount at which lease liability is measured

   would be recognised in retained earnings (or other component of equity, as appropriate).

   For example, assume that retrospective application of Ind AS 116 results in the entity recognising a lease liability of Rs 110 and right-of-use asset of Rs 98 in respect of a lease as at the beginning of the preceding period, i.e., 1 April 2018. Assume further that the entity's balance sheet as at 31 March 2018 has a 'rent equalisation liability' of Rs 5 in respect of the lease. In such a case, it would give effect to the transition as of 1 April 2018 as follows.

Dr	Right-of-use asset	98	
Dr	Rent equalisation liability	5	
Dr	Retained earnings/other appropriate component of equity (balancing figure)	7	
Cr	Lease liability		110

3. The comparative amounts presented in the financial statements for the year ended March 31, 2020 would be restated.

Paragraph 40A of Ind AS 1 requires that:

An entity shall present a third balance sheet as at the beginning of the preceding period in addition to the minimum comparative financial statements required in paragraph 38A if:

(a) it applies an accounting policy retrospectively, makes a retrospective restatement of items in its financial statements or reclassifies items in its financial statements; and

(b) the retrospective application, retrospective restatement or the reclassification has a material effect on the information in the balance sheet at the beginning of the preceding period.

Accordingly, if the retrospective application of Ind AS 116 has a material effect on the information in the balance sheet at the beginning of the preceding period (i.e., 1 April 2018), a third balance sheet as at the aforesaid date will also need to be presented.

(b) If Ind AS 116 is applied retrospectively as per paragraph C5(b) and the right of use asset is measured by applying paragraph C8(b)(i)

In this case, the difference, *as at the date of initial application of Ind AS 116* (i.e. 1 April 2019), between

(i) the amount at which right of use asset is measured, together with the amount of rent equalisation liability, and

(ii) the amount at which lease liability is measured

would be recognised in retained earnings (or other component of equity, as appropriate).

For example, assume that the entity recognises lease liability of Rs 100 (as per paragraph C8(a)) and right-of-use asset of Rs 85 (as per paragraph C8(b)(i)) in respect of a lease as at 1 April 2019. Assume further that the entity's balance sheet as at 31 March 2019 has a 'rent equalisation liability' of Rs 10 in respect of the lease. In such a case, it would give effect to the transition by passing the following journal entry as at 1 April 2019.

Dr	Right-of-use asset	85	
Dr	Rent equalisation liability	10	
Dr	Retained earnings/other appropriate component of equity (balancing figure)	5	
Cr	Lease liability		100

Comparatives would not be restated, nor would a third balance sheet as at the beginning of the preceding period be required to be presented.

(c) If Ind AS 116 is applied retrospectively as per paragraph C5(b) and the right of use asset is measured by applying paragraph C8(b)(ii)

In this case, the rent equalisation liability would be regarded as 'accrued lease payments' and the amount of right of use asset would be determined by deducting the said liability from the amount of 'lease liability' determined in accordance with paragraph C8(a).

For example, assume that an entity recognises lease liability of Rs 100 (as per paragraph C8(a)) in respect of a lease as at 1 April 2019. Assume further that the entity's balance sheet as at 31 March 2019 has a 'rent equalisation liability' of Rs 10 in respect of the lease. In this case, as per paragraph C8(b)(ii), the right of use asset would be measured at Rs 90 (Rs 100 minus Rs 10 of accrued lease payments) as at 1 April 2019. Accordingly, the entity would give effect to the transition by passing the following journal entry as at 1 April 2019.

Dr	Right-of-use asset (balancing figure)	90
Dr	Rent equalisation liability	10
Cr	Lease liability	100

Comparatives would not be restated, nor would a third balance sheet as at the beginning of the preceding period be required to be presented.

Issue 3:

XYZ Limited is engaged in manufacturing activities and is required to apply Ind ASs. For its business purposes, XYZ Limited acquired a plot of land several years back on 99 year lease from industrial development corporation of the State Government. XYZ Limited paid the lease premium at the time of execution of lease deed. The lease premium amount was equal to market value of the land at that time. In addition to the lease premium, the company is required to pay lease rent on annual basis over the 99 year period. The lease rent is a nominal amount, say Re. 1 per square metre per year.

The lease premium is non-refundable. However, XYZ Limited can transfer the leased land to a third party after prior consent of the industrial development corporation.

There is no specific clause in the lease deed on renewability of lease on completion of 99 years. However, the website of the industrial development corporation mentions that lease would be renewable after the expiry of 99 years; there is no mention on the website regarding any further lease premium payment to be made on completion of 99 years to obtain the renewal.

(a) On application of Ind AS 116, what would be the treatment of the lease in the books of XYZ Limited, if company classified the lease as a finance lease under Ind AS 17? In particular, how should the right of use asset and lease liability be measured when lease payments except upfront payment (which was equal to market value of the land at that time and is nor refundable) are negligible?

(b) Should the right-of-use asset be amortised over 99 years or over 198 years or not amortised at all?

Response:

The first issue that merits consideration is whether the transaction described in the query is a 'lease' within the meaning of this term under Ind AS 116 when the payment for the same made upfront accounts for almost all of the present value of the payments to be made over the lease term.

Ind AS 116 defines the term 'lease' as follows:

> *"A contract, or part of a contract, that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration."*

The term 'contract' is defined in Ind AS 116 as follows:

> *"An agreement between two or more parties that creates enforceable rights and obligations."*

As per the above definition, for a contract (or a part of a contract) to qualify as a 'lease', exchange of consideration for the right of use of the underlying asset is essential. However, the timing or pattern of flow of such consideration is not relevant in determining whether or not an arrangement is a lease. In the present case, the 'lease deed' executed between the company and the state industrial development corporation creates enforceable rights and obligations between the two parties and thus constitutes a 'contract'. The contract conveys the right of use of a specified parcel of land (the underlying asset) to the company for 99 years in exchange for upfront payment of lease premium and annual payment of lease rent (consideration). The lease deed therefore qualifies as a 'lease' within the meaning of Ind AS 116, notwithstanding that almost all of the consideration has been paid by the company upfront.

While not relevant in view of the above, it may be mentioned that as a practical expedient, Ind AS 116 allows an entity not to reassess whether a contract is, or contains, a lease at the date of initial application. Instead, the entity is permitted:

(a) to apply Ind AS 116 to contracts that were previously identified as leases applying Ind AS 17, *Leases*.

(b) not to apply Ind AS 116 to contracts that were not previously identified as containing a lease applying Ind AS 17.

Appendix C to Ind AS 116 contains transitional provisions. For measuring the amount of lease liability and right of use at the time of transition to Ind AS 116, the following extracts from the said Appendix are particularly relevant in the present case.

C5 A lessee shall apply this Standard to its leases either:

(a) retrospectively to each prior reporting period presented applying Ind AS 8, Accounting Policies, Changes in Accounting Estimates and Errors; or

(b) retrospectively with the cumulative effect of initially applying the Standard recognised at the date of initial application in accordance with paragraphs C7–C13.

C6 A lessee shall apply the election described in paragraph C5 consistently to all of its leases in which it is a lessee.

C7 If a lessee elects to apply this Standard in accordance with paragraph C5(b), the lessee shall not restate comparative information. Instead, the lessee shall recognise the cumulative effect of initially applying this Standard as an adjustment to the opening balance of retained earnings (or other component of equity, as appropriate) at the date of initial application.

C11 If a lessee elects to apply this Standard in accordance with paragraph C5(b), for leases that were classified as finance leases applying Ind AS 17, the carrying amount of the right-of-use asset and the lease liability at the date of initial application shall be the carrying amount of the lease asset and lease liability immediately before that date *measured applying Ind AS 17. For those leases, a lessee shall account for the right-of-use asset and the lease liability applying this Standard from the date of initial application.*

The requirements of Ind AS 116 relating to measurement of lease liability by a lessee at commencement date are substantially unchanged from those applicable for initial measurement of finance lease payable by a lessee under Ind AS 17. Besides, in the present case, the upfront lease premium paid at the time of execution of the lease deed accounted for almost all of the present value of total lease payments. Given this position, it seems that the amount of lease liability immediately upon transition to Ind AS 116 would be similar regardless of whether the company applies paragraph C5(a) or paragraph C5(b) to account for the transition.

As regards the right-of-use asset, it seems that the amount of right of use asset immediately upon transition to Ind AS 116 would be similar regardless of whether the company applies paragraph C5(a) or C5(b) to account for the transition. This is because in the context of their application in the present case, the requirements of both Ind AS 116 and Ind AS 17 as to the period over which, and the manner in which, the right of use asset (under Ind AS 116) or the asset arising from the finance lease (under Ind AS 17) should be depreciated are similar. In this regard, it is specifically noted that both Ind AS 116 and Ind AS 17 have essentially the same requirements as to determination of leas term, in particular when a period covered by a renewal option should be included in lease term. Therefore, assuming that the lease term (whether 99 years or 198 years) was correctly determined by the company under Ind AS 17, the same assessment of lease term would be acceptable under Ind AS 116 also (though it may be mentioned that as per the transitional provisions of Ind AS 116, a lessee may (but is not required to) use hindsight, such as in determining the lease term if the contract contains options to extend or terminate the lease).

It may be clarified that unless the title transfer to the lessee at the end of the lease term or the lessee has a purchase option that is reasonably certain to be exercised, a leasehold land is a depreciable asset even if the lease term is very long (e.g. 99 years or 198 years).

Issue 4:

Entity A is required to apply Ind ASs for the first time when it prepares its financial statements for the accounting period beginning on April 1, 2019.

Entity A had acquired a subsidiary (an Indian company) in the year 2014. At the date of its acquisition by Entity A, the acquired subsidiary was a lessee in certain operating leases which Entity A did not capitalise in its consolidated financial statements prepared under previous GAAP.

From the perspective of Entity A, the acquisition of the aforesaid subsidiary qualifies as a 'business combination' within the meaning of this term under Ind AS 103, *Business Combinations.*

Ind AS 116, *Leases*, which has superseded Ind AS 17, *Leases,* is applicable for accounting periods beginning on or after April 1, 2019.

In its first Ind AS consolidated financial statements, whether Entity A is required to apply Ind AS 116 in respect of leases acquired in the aforesaid business combination from -

(i) the date of acquisition of the subsidiary, or

(ii) the date of transition, i.e., 1 April 2018.

Response:

As a first-time adopter of Ind ASs, Entity A is required to apply Ind AS 101, *First-time Adoption of Indian Accounting Standards*, in preparing its first Ind AS financial statements which would include, *inter alia*, an opening Ind AS balance sheet as at the date of transition to Ind ASs, i.e., 1 April 2018.

Paragraph 7 of Ind AS 101 states the following:

> *"An entity shall use the same accounting policies in its opening Ind AS Balance Sheet and throughout all periods presented in its first Ind AS financial statements. Those accounting policies shall comply with each Ind AS effective at the end of its first Ind AS reporting period, except as specified in paragraphs 13–19 and Appendices B–D."*

As per the above, the general requirement of Ind AS 101 is retrospective application of the standards in force at the end of an entity's first Ind AS reporting period. There are, however, certain optional exemptions from, and some mandatory exceptions to, this general requirement.

Paragraph 9 of Ind AS 101 states the following:

> *"The transitional provisions in other Ind ASs apply to changes in accounting policies made by an entity that already uses Ind ASs; they do not apply to a first-time adopter's transition to Ind ASs, except as specified in Appendices B–D."*

It is clear from the above that being a first-time adopter, Entity A can apply the transitional provisions contained in Ind AS 116 only to the extent required or allowed to do so under Appendices B-D of Ind AS 101.

The following optional exemptions available under Ind AS 101 are relevant in the present case:

- Exemption from restating past business combinations
- Exemption from retrospective application of Ind AS 116, Leases

Exemption from restating past business combinations

Under Appendix C to Ind AS 101, a first-time adopter has a choice not to apply Ind AS 103 retrospectively to past business combinations (i.e., business combinations that occurred before the date of transition to Ind ASs).

Alternatively, a first-time adopter may apply Ind AS 103 retrospectively to business combinations that occurred on after a date selected by it.

Exemption from retrospective application of Ind AS 116, Leases.

Paragraphs D9-D11 of Ind AS 101 contain provisions dealing with application of Ind AS 116 by a first-time adopter and *inter alia* state the following:

> *"D9B When a first-time adopter that is a lessee recognises lease liabilities and right-of-use assets, it may apply the following approach to all of its leases (subject to the practical expedients described in paragraph D9D):-*
>
> *(a) measure a lease liability at the date of transition to Ind AS. A lessee following this approach shall measure that lease liability at the present value of the remaining lease payments (see paragraph D9E), discounted using the lessee's incremental borrowing rate (see paragraph D9E) at the date of transition to Ind AS.;*
>
> *(b) measure a right-of-use asset at the date of transition to Ind AS. The lessee shall choose, on a lease-by-lease basis, to measure that right-of-use asset at either:-*
>
> *(i) its carrying amount as if Ind AS 116 had been applied since the commencement date of the lease (see paragraph D9E), but discounted using the lessee's incremental borrowing rate at the date of transition to Ind AS; or*
>
> *(ii) an amount equal to the lease liability, adjusted by the amount of any prepaid or accrued lease payments relating to that lease recognised in the Balance Sheet immediately before the date of transition to Ind AS.*
>
> *(c) apply Ind AS 36 to right-of-use assets at the date of transition to Ind AS.*"

Depending on the elections that Entity A makes in respect of the above optional exemptions, in the first Ind AS consolidated financial statements of Entity A, accounting treatment of leases acquired in the business combination would be as follows.

Scenario I: The business combination referred to in the query is restated

In such a case, Entity A is required to account for the business combination retrospectively from the acquisition date of the business combination. As required by paragraph 7 of Ind AS 101, the business combination would be accounted for as per Ind AS 103 effective at the end of its first Ind AS reporting period (the 'current version of Ind AS 103').

The current version of Ind AS 103 states the following with regard to recognition of leases acquired in a business combination.

> *"28A The acquirer shall recognise right-of-use assets and lease liabilities for leases identified in accordance with Ind AS 116 in which the acquiree is the lessee. The acquirer is not required to recognise right-of-use assets and lease liabilities for:*
>
> *(a) leases for which the lease term (as defined in Ind AS 116) ends within 12 months of the acquisition date; or*
>
> *(b) leases for which the underlying asset is of low value (as described in paragraphs B3–B8 of Ind AS 116).*
>
> *28B The acquirer shall measure the lease liability at the present value of the remaining lease payments (as defined in Ind AS 116) as if the acquired lease were a new lease at the acquisition date. The acquirer shall measure the right-of-use asset at the same amount as the lease liability, adjusted to reflect favourable or unfavourable terms of the lease when compared with market terms."*

In accordance with the above, in case Entity A elects to restate the business combination, it is required to apply Ind AS 116 to acquired leases (except those for which exemption is available under paragraph 28A of Ind AS 103) as if each of those leases were a new lease at the acquisition date. In measuring the lease liability in respect of a lease at the acquisition date, Entity A would be required to apply paragraph 26 of Ind AS 116 which states the following:

> *"At the commencement date, a lessee shall measure the lease liability at the present value of the lease payments that are not paid at that date. The lease payments shall be discounted using the interest rate implicit in the lease, if that rate can be readily determined. If that rate cannot be readily determined, the lessee shall use the lessee's incremental borrowing rate."*

It may be clarified that the incremental borrowing rate would be determined with reference to the acquisition date which represents the 'commencement date' within the meaning of Ind AS 116 in respect of leases acquired in a business combination.

Scenario II: The business combination referred to in the query is not restated

In such a case, the accounting treatment of the acquired leases in the first Ind AS consolidated financial statements would be as follows.

- In case Entity A elects not to avail of the exemption provided by Ind AS 101 in respect of leases, it would measure the lease liability and right-of-use asset in respect of the acquired leases at the date of transition to Ind ASs by applying Ind AS 116 retrospectively from the acquisition date. This implies, *inter-alia* that the lease payments would be discounted using the interest rate implicit in the lease, if that rate can be readily determined. If that rate cannot be readily determined, the lessee's incremental borrowing rate determined with reference to the acquisition date would be used.

- In case Entity A elects to avail of the exemption provided by Ind AS 101 in respect of leases, it would measure the lease liability and right-of-use asset in respect of the acquired leases at the date of transition to Ind ASs by applying paragraph D9B of Ind AS 101. This implies, inter alia, that the incremental borrowing rate to be applied for measuring the lease liability would be determined with reference to the date of transition to Ind ASs.

Issue 5:

Ind AS 116, *Leases*, which applies in respect of accounting years commencing on or after 1 April 2019 requires (subject to limited exemptions) a lessee to recognise a lease liability and a right of use asset in respect every lease.

Applying the requirements of Ind AS 116, a company has recognised a lease liability and a right-of-use asset as at 1 April 2019 in respect of a long-term lease that was entered into before the beginning of its first Ind AS financial reporting period and was classified as an operating lease under the previous GAAP (i.e., under AS 19). The lease payments are denominated in a foreign currency. Also, as per Ind AS 116 the lessee must recognise lease asset and lease liability in the books of accounts w.e.f. 1 April 2019.

Whether, the foreign exchange differences relating to the lease liability recognised by the company are covered by the exemption provided by paragraph D13AA of Ind AS 101 or whether the same should be expensed off immediately as they arise?.

Response:

Paragraph D13AA of Ind AS 101, *First-time Adoption of Indian Accounting Standards*, states the following:

> "*A first-time adopter may continue the policy adopted for accounting for exchange differences arising from translation of long-term foreign currency monetary items recognised in the financial statements for the period ending immediately before the beginning of the first Ind AS financial reporting period as per the previous GAAP*."

Further, paragraph 18 of Ind AS 101 specifically states that an "*entity shall not apply the exemptions contained in Appendices C-D by analogy to other items.*"

The exemption provided by paragraph D13AA of Ind AS 101 is available only in respect of "long-term foreign currency monetary items recognised in the financial statements for the period ending immediately before the beginning of the first Ind AS financial reporting period as per the previous GAAP." The way paragraph D13AA is worded, the exemption is not available in respect of a lease liability recognised by a lessee as a result of application of Ind AS 116 since this liability was not "recognised in the financial statements for the period ending immediately before the beginning of the first Ind AS financial reporting period as per the previous GAAP."

Paragraph 18 of Ind AS 101 specifically states that an “entity shall not apply the exemptions contained in Appendices C-D by analogy to other items.”

In accordance with the above, foreign exchange differences relating to the lease liability recognised by the company should be expensed off immediately as they arise.

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