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Sustainable Accounting through Ind AS 116 – An Investigation

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ABSTRACT*--Economic Reforms 1991 had a great impact on Indian economy, leading to more footage of foreign companies and foreign investors in India. According to FDI (Foreign direct investment) policy 2005 India permits 100 percent FDI in its ventures. India earns major inflow of foreign currency through its IT sector and is one among the top exporter of IT in the world. With these accolades India attracts more FDI. As the investors are from varied Nations, demand for uniform reporting of financial statements emerged, in order to facilitate understandability and* ***reliability*** *of the published reports of the companies. Hence, to establish harmonisation in financial reporting, India Adopted IFRS (International Financial Reporting Standards) with convergence of Indian Accounting Standards, named as Ind AS. Due to ICAI's (Institute of Chartered Accountant of India) membership in IASB (International Accounting Standard Board), until now 42 Accounting Standards were adopted in India. Among them Ind AS 116 'Leases' was the latest adopted standard through MCA (Ministry Of Corporate Affairs) with effect from 1st April 2019. The application of these accounting standards enhanced the reliability of financial statements and ensured sustainability in accounting. Hence, this present paper focus on the implication of Ind AS 116 on selected Indian IT companies namely, Infosys technologies, Wipro Technologies and Siffy Technologies. Lease accounting has a major impact on the financial statements of the companies as majority of companies do not prefer to block huge investments by purchasing own property. Further the paper also discusses the requisite to adopt this standard in India successfully. A detail note on the impact of this standard considering measurement metrics were reviewed and added to it the effect of lease (only) was shown in a projected consolidated financial statement and projected standalone financial statement of the stated companies, to get a clear representation.*

Keywords*--FDI, IASB, ICAI, harmonisation, MCA, reliability, sustainability.*

I. INTRODUCTION

International Accounting Standards Committee (IASC), a London based group responsible for developing International Accounting Standards (IAS), was established in 1973 comprising of various professional accountancy bodies of over 75 countries including Institute of Charted Accountant of India (ICAI) as its members. Between 1973 and 2001, IASC issued IAS. On 1st April 2001, IASC restructured their organisation and resulted in formation of International Accounting Standard Board (IASB). Henceforth, IASB started issuing IFRS (International Financial Reporting Standards) from 1stApril 2001. ICAI adopted these standards with certain carve-outs (deviations to make it applicable in Indian context) with effect from 2015-16, on voluntary basis and 2016-17 on mandatory basis. IFRS comprises of IAS issued by IASC, IFRS issued by IASB, Interpretations by SIC (Standard Interpretation Committee) and Interpretations by IFRIC (IFRS Interpretation Committee). The present study

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focuses on the recently introduced Ind AS 116 - 'Leases' issued by Ministry of Corporate Affairs (MCA) in India through ICAI on 30th march 2019 effectively applicable from 1st April 2019. This standard superseded Ind AS 17 'Leases'. As majority of the company opt lease contract for their business dealings in general, a detail study in this regard is of undue significance. Ind AS 17 was issued on September 1982, later amended and reissued on December 2003 with applicability effectively from 1st January 2005. This standard described the accounting treatment and related disclosure regarding leases for both Lessor and Lessee. According to this standard leases were classified into either finance lease or operating lease. The interpretation of this standard were published through IFRIC 4, SIC-15 and SIC-27.

II. REVIEW OF LITERATURE

Sacarin (2017) aimed to present, based on a comparative analysis of IFRS 16 and IAS 17, the main consequences that the application of IFRS 16 will arise, in respect of the financial statements and the financial indicators determined based on the information provided by these. Bail et al., (2016) and Senthil and Padma (2019) examined the determinants and economic consequences of classification shifting to manage operating cash flows. The study was based on a sample of firms that mandatorily adopt IFRS in Korea. The result showed that financially distressed firms, firms with high interest payments, and firms with high bank ownership, tend to shift their interest payments from operating to financing cash flows, thereby increasing the total amounts of operating cash flows. Meryem and Murat (2016) studied the statement of financial position of the lessee enterprise after the transition to the new financial reporting standard IFRS 16 and the impacts of the change in the basic ratios. For this purpose Gireeshan et al., (2015), the impacts possible to occur in the financial position of an airline company having activities in Turkey as a result of the application of the related standard have been examined. The results of the study showed that the reflection of the operating leases on the balance sheet shall cause to significant increases in the assets and liabilities and for this reason; there shall be a significant increase in the ratio of liability/asset and a significant decrease return on asset.

Individual company's management decisions were analysed by Morales and Zamora (2018) on 1) alternative accounting treatments that IFRS 16 permits for certain aspects and 2) estimations, their effect on financial statements and how companies are expected to address them. The study emphasise that the companies are expected to make decisions that reduce the impact of IFRS 16 on their leverage level Gireeshan et al., (2020),. Rakesh and Shilpa (2013) studied the relationship between IFRS adoption and FDI and effect on Indian economy. The findings elucidated that there is significant relationship between IFRS adoption and FDI of the country. The study further revealed that the adoption of IFRS will promote companies' access to global capital markets thereby exposing them to cross border investments. However, the responses revealed that IFRS adoption has neither made much impact in making timely and accurate reports available nor has it made the financial statements more reliable.

III. OBJECTIVES OF THE STUDY

The present study was conducted with the following objectives

- To study the impact of lease on lessor on application of Ind AS 116
- To find out the effect of lease in the financial statement of the lessee on implementation of Ind AS 116.

- To examine the treatment of lease by lessor and lessee in the financial statement.

IV. IMPACT ON PARTIES TO LEASE

The parties involved in lease are termed as lessor, being owner of the leased property; and lessee, the person who uses the leased property (otherwise known as tenant). As per Ind AS 17, both the parties to lease, classifies the accounting treatment of leases into financial lease and operating lease. Though there is no significant difference in the accounting treatment of lease by lessor according to Ind AS 116, there is high significant difference considering the lessee's treatment of lease.

As per Ind AS 17 lessee treat the operating lease expense in Statement of Profit and Loss (SOPL) but according to Ind AS 116, operating lease has been divided into right of use Asset (which includes other Non-Financial asset like PPE) in the asset side of statement of balance sheet and Lease Liabilities (which includes financial liabilities and discounted Present Value of future lease payments), in the liabilities side of statement of balance sheet. Further interest obligation arising due to lease liabilities, were expensed in Profit and loss account (Finance cost). Likewise depreciation charges associated with right of use Asset (due to lease) will be transferred to depreciation and amortization expenses in SOPL. Moreover, IND AS 7 (statement of cash flow) insists that the lease liabilities should be classified into principal portion and interest portion separately. Adding to it the lessee records the discounted PV of future lease payments at incremental borrowing rate at the date of initial application of Ind AS 116 standard. At the same time, low value Assets (generally $5000) or assets held for less than 12 months, the lessee can recognise the payment made on such lease as expense on straight line basis and need not show it in the balance sheet throughout the lease term or through systematic allocation .However, lessor continues to classify lease into Financial lease and operational lease according to IND AS 116.

V. METHOD OF LEASE

IND AS 116 introduced single lease accounting model, which requires the lessee to identify Assets and liabilities for all the leases held by the lessee for more than 12 months. Implementation of this standard can be done through 2 ways, namely full retrospective approach and Simplified or modified retrospective approach. Lessee is permitted to choose any of the stated method. Former method demands the lessee to recast the revenue and expenses for all prior periods presented in the year of application of this standard; whereas the latter comprise of certain exceptions and does not require any such restatement of comparatives. Further in simplified approach, lessees are not required to revalue the lease at the date of initial application and instead carry forward cumulative adjustment value to Retained earnings.

VI. ANALYSIS OF IMPLEMENTATION OF IND AS 116 ON SELECTED IT COMPANIES

IND AS 116 affects almost all generally used financial ratios namely Liquidity ratios, gearing ratios, Earning per share (EPS), Earning Before Interest Tax Depreciation and Amortization (EBITDA), Interest coverage ratio, Earnings Before Interest and Tax (EBIT), Asset turnover ratio, Return on Capital Employed (ROCE), Return on equity ratio, Profitability ratios and operating cash flow ratio. Further there will be an increase in gearing ratio and a decrease in capital ratio.

For the present study 2018-19 Annual report of Infosys Ltd., Wipro Ltd., and Siffy Technologies Ltd., were taken. Since IND AS 116 application was notified by MCA on 30th March 2019, the exact figures of implication can be retrieved only after the release of annual report of the companies for the year ended 2019-2020. Hence projected figures of lease implication of the selected IT companies were retrieved from their annual report for the year ended 2018-19. Table 1 represents the projected Group Financial Statement of Infosys Ltd., Wipro Ltd., and Siffy Technologies Ltd.,

TABLE-1: Projected effect of Ind AS 116 on Group Financial Statement (Consolidated) of selected IT companies (Rs. in Crores)

		INFOSYS	SIFFY	WIPRO
ASSETS				
Increase in Right to Use Asset		2,300	81	13,266
Right to Use Asset (Reclassified)				
i. Lease Payments	135			
ii. Indefeasible Right of Use (IRU)	49	—	184	—
Net Investment in Sub Lease		440	—	—
EQUITY AND LIABILITY				
Increase in Lease Liability		3,050	96	15,867

Source: Annual Report of Infosys, Siffy and Wipro, 2018-19

From the Table 1, it is clear that there is significant increase in Right to Use Asset in the books of all the IT companies as an effect of Ind AS 116. Whereas Right to Use Asset under Reclassified which includes Indefeasible rights of use viz., leases which are of permanent contractual agreement that cannot be void due to any clause had an effect only in the accounting statement of Siffy Technologies Ltd., which implies such Leases will not have an impact due to Ind AS 116. Likewise, Infosys Ltd., has considerable increase in the assets due to increase in Net investment in Sub Lease category, which other companies do not possess. Net effect of Liabilities in Infosys Ltd., and Wipro Ltd., had increased as a result of financial liabilities and discounted Present Value of future lease payments, which were not considered in Ind AS 17. But net effect of Siffy Technologies Ltd., with reference to Assets does not show an increase in the corresponding liability as it is using Indefeasible Right of Use Asset.

Projected implications of Ind AS 116 on Stand Alone Financial Statements of Infosys Ltd., Siffy Technologies Ltd., and Wipro Ltd., were projected in Table 2.

TABLE-2: Projected effect of Ind AS 116 on Stand Alone Financial Statement of selected IT companies (Rs. in Crores)

	INFOSYS	SIFFY	WIPRO
ASSETS			
Increase in Right To Use Asset	1,300	80	5579

Right To Use Asset (Reclassified)				
i. Lease Payments	112			
ii. Indefeasible Right of Use (IRU)	49	—	161	—
Net Investment in Sub Lease		550	—	—
EQUITY AND LIABILITY				
Increase in Lease Liability		2,000	95	6,799

Source: Annual Report 2018-19 of Infosys, Siffy and Wipro

Table 2 shows that among the group companies Parent/Holding companies of Infosys and Siffy contributes to 56.5 per cent and 98.76 per cent, increase in assets due to increase in Right to Use Asset. Whereas holding company of Wipro group contributes to 42.05 per cent increase in Right to Use Asset. Similarly other leases appearing in the assets of the Balance sheet under the sub head Right to Use Asset are through the Parent company of Siffy (87.5 per cent). Increase in Lease Liabilities, therefore were contributed by the Parent companies of Infosys, Siffy and Wipro at 66%, 99% and 43% respectively.

VII. FINDINGS OF THE STUDY

With a note of harmonization, IFRS was introduced to Indian Accounting system in a converged form with the already prevailing standards. The recent adoption of Ind AS 116, brought down various changes in the domain of Lease accounting considering Lessee. Hence the balance sheet of the selected IT companies as a Lessee shows considerable increase in the assets and financial liability. As an impact of lease, Debt equity ratio gets affected due to increase in assets and financial liability, leading to increase in cost contributed by depreciation due to recognition of Right To Use Asset; and interest associated with lease liability. At the same time, in comprehensive income there will be a positive impact on EBIT and EBITDA on account of removal of operating lease; and addition of depreciation and interest. Moreover entities leasing high value Non-Current assets will affect widely. The selected companies invariably adopt Simplified or modified retrospective approach, which does not require any restatement of comparatives and revaluation of lease at the date of initial application. Hence these companies carry forward cumulative adjustment value to Retained earnings.

VIII. Suggestions to the Study

The Study led to the following suggestions

- To adopt Ind AS 116 effectively, the companies should be equipped with proper internal accounting and auditing team.
- Interested groups of the company should be informed well in advance before implementing the standard in order to avoid misinterpretations.
- To implement this standard as per the complete requirement more fund need to be allocated as it incurs huge expenses during initial implementation
- The entities after analysing the pros cons of lease from their financial position can decide whether to lease or buy decision.

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IX. CONCLUSION

This catalyst approach in Lease accounting leads way to fair representation of accounting statements by removing all possible loop holes of window dressing done to accounting statements prior to implementation of harmonization of accounting standards. Such transformation leads to sustainability in accounting practice which facilitates the stake holders of the company to increase their trust in the financial statements and increase the value of the company.

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