

Query No. 8

Subject: Accounting treatment of leasehold land.¹

A. Facts of the Case

1. A company is a public limited company (hereinafter referred to as the 'company'), fully owned by the Ministry of Railways (MOR), Government of India (GoI) incorporated in India under the provisions of Companies Act, 1956 with the objective of fast track implementation of rail infrastructure projects and raising extra budgetary resources for project execution. The company is implementing various types of rail infrastructure projects assigned by the Ministry of Railways including doubling (including 3rd/4th lines), gauge conversion, new lines, railway electrification, major bridges, workshops, production units and extension of the Kolkata Metro Rail System.

2. The company is covered under phase-I of roadmap for implementation of Indian Accounting Standards (Ind ASs), issued by the Ministry of Corporate Affairs (MCA) and prepared its first Ind AS financials for the financial year 2016-17 and the balance sheet as on 31.03.2016 for comparative period as per Indian Accounting Standard (Ind AS) 101, 'First-time Adoption of Indian Accounting Standards'.

3. The company entered into a lease deed on 4th December 2017 to take on lease, a plot of land for setting up of premises for its official purpose under the 'Noida Open-ended Scheme for institutional plots-2015(02)' (copy of Noida Open-ended Scheme has been supplied by the querist for the perusal of the Committee). Lease deed contains the followings clauses:

- i. As per clause 2 of the lease deed, the lessee was given the demised premises for a period of 90 years commencing from the due date or actual date of execution of lease deed whichever is earlier.
- ii. As per clause 7 of the lease deed, the lessee will at their own cost construct a building on the demised plot as per the floor area ratio (FAR) provided under this Scheme and in accordance with the prescribed bye laws, plan and building regulations.
- iii. As per clause 13 of the lease deed, the company can transfer plot after 5 years with consideration after payment of transfer charges as fixed from time to time.
- iv. As per clause 14, the lessee may with the permission of the lessor (NOIDA authority) mortgage the demised plot to any government organisation or any institution recognized by the government and/or the Reserve Bank of India (RBI) for raising loans for purposes of construction of the building/functioning of the project subject to such charges & terms and conditions as decided by the lessor at the time of granting the permission.

4. The company has paid an amount of Rs. 23,548.36 lakhs for leasehold land which also includes one-time lease rent, stamp duty charges and GST payment; and capitalised the same under the property, plant and equipment (Note No. 3) in the financial statements. Leasehold land has been allotted to the company on 2nd May 2017, however title deed is dated 4th December 2017. During the year ended 31st March 2018, the company has not amortised the leasehold land in the financial statements and has disclosed it as leasehold land under 'Property, Plant & Equipment'.

5. The Comptroller and Auditor General of India (C&AG) while auditing the accounts of the company has raised an objection as follows:

¹ Opinion finalised by the Committee on 7.8.2019.

“A finance lease gives rise to depreciation expense for depreciable assets as well as finance expense for each accounting period. The depreciation policy for depreciable leased assets shall be consistent with that for depreciable assets that are owned, and the depreciation recognised shall be calculated in accordance with Ind AS 16, ‘Property, Plant and Equipment’ and Ind AS 38, ‘Intangible Assets’. If there is no reasonable certainty that the lessee will obtain the ownership by the end of the lease term, the asset shall be fully depreciated over the shorter of lease term and its useful life. Further, as per Significant Accounting Policy No. 2.15: Leases (a)(v) of the company, finance lease is depreciated over the useful life of the asset. However, if there is no reasonable certainty to obtain ownership by the end of the lease term, the asset is depreciated over the shorter of the estimated useful life of the asset and the lease term.

The company entered a lease deed on 4th December 2017 to take on lease a plot of land for setting up of office. As per clause 2 of the lease deed, the lessee was given the demised premises for a period of 90 years commencing from the due date or actual date of execution of lease deed whichever is earlier. The company has shown the leasehold land under the property, plant and equipment (Note No. 3) with an amount of Rs. 23,548.36 lakhs which also includes the one-time leasehold rent, stamp duty charges and GST payment in accordance with Ind AS 17, ‘Leases’. During the audit scrutiny of the lease deed, the audit did not find any clause which could establish that the lessee would obtain the ownership by the end of the lease term. Therefore, the company is required to amortise the capitalised value of the leasehold land in accordance with paragraph 97 of Ind AS 38. Thus, non-amortisation of the leasehold land resulted in overstatement of profit by Rs. 87.22 lakh and overstatement of Property, Plant and Equipment by the same amount.”

(Copy of C&AG comments has been supplied separately by the querist for the perusal of the Committee.)

6. The company has given reply to the Comptroller and Auditor General of India for their objection that, as per Ind AS 17, if there is reasonable certainty that at the end of the lease term, the company will obtain the ownership of the land then there is no requirement of any depreciation. Further, in Indian conditions generally, the leasehold property gets converted into a freehold as per the different schemes launched by the authority from time to time. Also as per the past practices of industry in most of the cases, the leasehold property gets converted to the freehold on payment of freehold charges. The land taken on lease of 90 years has reasonable certainty of getting freehold during the life time of the lease period. Accordingly, depreciation has not been charged on land.

7. Lease deed in opening para states “And lessor has agreed to demise”; meaning of demise is to convey or grant (an estate) by will or lease. Paragraph 13 of the Lease Agreement allows that after 5 years, the company can transfer plot with consideration after payment of transfer charges as fixed from time to time. Land in India in general, appreciates in value; therefore, this plot has reasonable certainty of appreciation and not depreciation.

8. According to the querist, when interpreting lease under section 105 of the Transfer of Property Act, 1882, Supreme Court in case of Chapsibhai V. Purshottam AIR 1971 SC 1878 has held “that where a land is held on lease for building residential houses the lease may be presumed to be permanent one.” In case of the company, building of offices/ training centre makes the lease permanent in nature.

9. The querist has separately clarified the following with regard to various indicators/situations mentioned in paragraphs 10 and 11 of Indian Accounting Standard (Ind AS) 17, ‘Leases’:

(a) With regard to whether there is any possibility of transfer of ownership of leasehold land to the lessee, i.e., the company by the end of the lease term or has there been any past instances of such transfer in the area where the leasehold land is situated or with respect to the same lessor, the querist has mentioned that transfer of ownership is not clearly mentioned in the lease deed, however following clauses of the lease deed give a reference of transfer of ownership:

- i. As per clause 2 of the lease deed, the lessee was given the demised premises for period of 90 years commencing from the due date or actual date of execution of lease deed whichever is earlier.
- ii. As per clause 7 of the lease deed, the lessee will at their own cost construct a building on the demised plot as per the floor area ratio (FAR) provided under this Scheme and in accordance with the prescribed bye laws, plan and building regulations.
- iii. As per clause 13 of the lease deed, the company can transfer plot after 5 years with consideration after payment of transfer charges as fixed from time to time.
- iv. As per clause 14, the lessee may with the permission of the NOIDA, mortgage the demised plot to any government organisation or any institution recognized by the government and /or RBI for raising loans for purposes of construction of the building/functioning of the project subject to such charges & terms and conditions as decided by the lessor at the time of granting the permission.

With regard to any past case/ instances where leasehold property has been converted into freehold, the querist has provided an inter-departmental communication dated May 10, 1995 for the State in which the land is situated, containing the procedure for such conversion. The querist has also informed that Noida authority is in the process of implementing of scheme of conversion of leasehold property into freehold and therefore, scheme document is not available.

(b) With regard to whether any option is available with the company to purchase the land, if yes, at what price (viz., at fair value or at a price lower than fair value) and what is the possibility that the said option would be exercised, the querist has stated that the option to purchase the land is not specifically given under the lease deed, however following the clauses of the lease deed as given above and further since leasehold property generally gets converted into freehold, the question of purchase of land does not arise.

(c) With regard to whether at the inception of the lease, the present value of the minimum lease payments amounts to at least substantially all of the fair value of the land, the querist has mentioned that the total consideration of the land is Rs. 169,54,68,030/- which is calculated at the circle rate of Rs. 73,600.80 per sq. mtr in Noida, if the present value of the same to be considered it will be substantially of the fair value of land. On further request to provide the basis for such calculation, the querist has informed that total consideration of the land has been calculated at the circle rate in the Noida i.e. Rs. 73,600.80 per sq. mtr.

(d) With regard to whether lease is cancellable and in case of cancellation of lease, who will bear the lessor's losses, the querist has informed that as per clause 23(b) of the lease deed, if the lessee does not abide by the terms and conditions of the lease and building bye laws or any other rules framed or directions issued by the lessor, the lease

may be cancelled by the lessor and the possession of the demised premises may be taken over by the lessor followed by forfeiture of the deposits as per the prevailing policy. Further as per clause 24(iii) of the lease deed, any loss suffered by the lessor on account of the fresh lease may be recoverable by the lessor. Therefore, lease may be cancelled by the lessor and in case of cancellation, the cancellation charges shall be borne by the lessee.

(e) With regard to whether the lease is renewable or can be continued for a secondary period and in case of renewability, the terms including the details of lease term, rentals, etc., the querist has informed that original period of the lease is 90 years and as explained above that the 90 years lease property is generally converted from leasehold to freehold, therefore, the question of renewal to secondary period does not arise.

B. Query

10. The opinion of the Expert Advisory Committee of the ICAI has been sought in respect of the accounting treatment of the leasehold land as per the requirements of Ind AS 17, 'Leases' and other Indian Accounting Standards, if applicable in this particular case on the following issues:

- (i) Whether the leasehold land taken on the lease for a period of 90 years has been correctly disclosed in the financial statements or land on lease needs to be amortised.
- (ii) If the land is to be amortised, how much would be the period for amortisation?

C. Points considered by the Committee

11. At the outset, based on the comments of the C&AG auditor and the contentions of the querist/management of the company, the Committee notes that the basic issue raised relates to amortisation of land obtained on leasehold basis for a period of 90 years and disclosure of the same as leasehold land under 'Property, Plant & Equipment'; and the issue relating to classification of lease into operating or finance lease has not been raised. The Committee further notes that, since the land has been presented in the extant case as an item of 'Property, plant and equipment', the company has apparently determined the lease of the nature of 'finance lease'. Therefore, the Committee has not examined the appropriateness of classification of lease as 'finance lease' in the extant case. Further, the Committee has not considered any other issue that may arise from the Facts of the Case, such as, accounting for the building constructed on leasehold land, commencement of the lease, etc. Also, the Committee has examined the query only from accounting perspective and not from any other perspective, such as, legal interpretation of Transfer of Property Act, 1882 or interpretation of judgements of Supreme Court, as referred to by the querist. The Committee further wishes to mention that Indian Accounting Standards cited hereinafter refer to Standards notified under the Companies (Indian Accounting Standards) Rules, 2015. The Committee also wishes to point out that since the querist has referred to financial year 2017-18 and Ind AS 17 in the Facts of the Case, the opinion, expressed hereinafter does not examine the application of Ind AS 116, 'Leases', which is applicable from the accounting periods beginning on or after April 1, 2019.

12. With regard to amortisation, the Committee further notes the requirements of Ind AS 17, 'Leases' and Ind AS 16, 'Property Plant and Equipment', as follows:

Ind AS 17

"27 A finance lease gives rise to depreciation expense for depreciable assets as well as finance expense for each accounting period. The depreciation policy

for depreciable leased assets shall be consistent with that for depreciable assets that are owned, and the depreciation recognised shall be calculated in accordance with Ind AS 16, *Property, Plant and Equipment* and Ind AS 38, *Intangible Assets*. If there is no reasonable certainty that the lessee will obtain ownership by the end of the lease term, the asset shall be fully depreciated over the shorter of the lease term and its useful life.

28 The depreciable amount of a leased asset is allocated to each accounting period during the period of expected use on a systematic basis consistent with the depreciation policy the lessee adopts for depreciable assets that are owned. If there is reasonable certainty that the lessee will obtain ownership by the end of the lease term, the period of expected use is the useful life of the asset; otherwise the asset is depreciated over the shorter of the lease term and its useful life.”

“30 To determine whether a leased asset has become impaired, an entity applies Ind AS 36, *Impairment of Assets*.”

Ind AS 16

“50 The depreciable amount of an asset shall be allocated on a systematic basis over its useful life.”

“58 Land and buildings are separable assets and are accounted for separately, even when they are acquired together. With some exceptions, such as quarries and sites used for landfill, land has an unlimited useful life and therefore is not depreciated. Buildings have a limited useful life and therefore are depreciable assets. An increase in the value of the land on which a building stands does not affect the determination of the depreciable amount of the building.”

From the above, the Committee notes that in case of leased assets, if there is no reasonable certainty that the lessee will obtain ownership by the end of the lease term, the asset shall be fully depreciated over the shorter of the lease term and its useful life. In this context, the Committee notes that in the extant case, there is no specific clause in the lease agreement for transfer of ownership of the land by the lessor to the company; however, the querist has claimed that leasehold land will be converted into freehold property as per the laws and regulations prevailing in the State in which the land is situated and in this context, has provided an inter-departmental communication dated May 10, 1995 for the State in which the land is situated, containing the procedure for such conversion. The Committee also notes that the querist has also informed that Noida authority is in the process of implementing a scheme of conversion of leasehold property into freehold, however, scheme document is not available. Thus, the Committee notes that at present, the land given to the company is a leasehold land and there are no documents or evidence (e.g. approved schemes) etc. to substantiate that the land will be converted into freehold. Therefore, considering the requirements of Ind AS 17, the Committee is of the view that although normally useful life of land is unlimited and is not depreciated; however, in case of leasehold land in the extant case (classified as finance lease), it needs to be depreciated over shorter of lease term or its useful life. Further, the leased land shall be tested for impairment as per the requirements of Ind AS 36, ‘Impairment of Assets’.

13. With regard to disclosure of leasehold land under ‘property plant and equipment’ as raised by the querist in the extant case, the Committee notes paragraphs 31 and 32 of Ind AS 17 and paragraph 74 of Ind AS 16 as follows:

Ind AS 17

“31 Lessees shall, in addition to meeting the requirements of Ind AS 107, *Financial Instruments: Disclosures*, make the following disclosures for finance leases:

- (a) for each class of asset, the net carrying amount at the end of the reporting period.**
- (b) a reconciliation between the total of future minimum lease payments at the end of the reporting period, and their present value. In addition, an entity shall disclose the total of future minimum lease payments at the end of the reporting period, and their present value, for each of the following periods:**
 - (i) not later than one year;**
 - (ii) later than one year and not later than five years;**
 - (iii) later than five years.**
- (c) contingent rents recognised as an expense in the period.**
- (d) the total of future minimum sublease payments expected to be received under non-cancellable subleases at the end of the reporting period.**
- (e) a general description of the lessee’s material leasing arrangements including, but not limited to, the following:**
 - (i) the basis on which contingent rent payable is determined;**
 - (ii) the existence and terms of renewal or purchase options and escalation clauses; and**
 - (iii) restrictions imposed by lease arrangements, such as those concerning dividends, additional debt, and further leasing.**

32 In addition, the requirements for disclosure in accordance with Ind AS 16, Ind AS 36, Ind AS 38, Ind AS 40 and Ind AS 41 apply to lessees for assets leased under finance leases.”

Ind AS 16

“74 The financial statements shall also disclose:

- (a) the existence and amounts of restrictions on title, and property, plant and equipment pledged as security for liabilities;**

...”

The Committee also notes the requirements of General Instructions for Preparation of Balance Sheet in Part I of Division II - Ind AS Schedule III to the Companies Act, 2013 as follows:

Part I of Division II - Ind AS Schedule III to the Companies Act, 2013:

“6. A company shall disclose the following in the Notes:

A. Non-Current Assets

I. Property, Plant and Equipment:

(i) Classification shall be given as:

- (a) Land

- (b) Buildings
- (c) Plant and Equipment
- (d) Furniture and Fixtures
- (e) Vehicles
- (f) Office equipment
- (g) Bearer Plants
- (h) Others (specify nature)

(ii) Assets under lease shall be separately specified under each class of assets.”

From the above, the Committee is of the view that the company can classify the leased land in the extant case under ‘Property Plant and Equipment’, however, it should be specified as ‘under lease’ as per the requirements of the Schedule III to the Companies Act, 2013 and should also disclose the existence of restrictions on title, as per the requirements of Ind AS 16 apart from complying with other disclosure requirements as per the relevant applicable Standards, for example, Ind AS 17, Ind AS 16, Ind AS 36, etc.

D. Opinion

14. On the basis of the above, the Committee is of the following opinion on the issues raised in paragraph 10 above:

- (i) and (ii) At present, the land given to the company is a leasehold land and there are no documents or evidence (e.g. approved schemes) etc. to substantiate that the land will be converted into freehold. Therefore, considering the requirements of Ind AS 17, although normally useful life of land is unlimited and is not depreciated; however, in case of leasehold land in the extant case (classified as finance lease), it needs to be depreciated over shorter of lease term or its useful life, as discussed in paragraph 12 above. Further, with regard to disclosure of the leased land, the Committee is of the view that the company can classify the leased land in the extant case under ‘Property Plant and Equipment’, however, it should be specified as ‘under lease’ as per the requirements of the Schedule III to the Companies Act, 2013 and should also disclose the existence of restrictions on title, as per the requirements of Ind AS 16 apart from complying with other disclosure requirements as per the relevant applicable Standards, for example, Ind AS 17, Ind AS 16, Ind AS 36, etc., as discussed in paragraph 13 above.