

Query No. 13

Subject: *Amortisation of land on lease under Ind AS 17, 'Leases'*.¹

A. Facts of the Case

1. A Public Sector Undertaking (PSU) (hereinafter referred to as 'the Company'), is domiciled and incorporated in India with equal equity participation of the Government of India and Government of Gujarat. The Company is executing phase I and phase II of Ahmedabad Metro and phase I of Surat metro which have been approved by the Government of India and Government of Gujarat. The Company carries on the business to set up, manage, operate and maintain a rail based mass rapid transport system in Gujarat to provide the general public with a fast reliable, convenient, efficient, modern and economic mode of public transport. There are two corridors under phase I of Ahmedabad metro rail project, viz., East-West corridor and North-South corridor.

2. For construction of station and viaduct, the Company prepares alignment route for identification of land parcel to be acquired. The Company needs to acquire land from private party, railway and the Government. The Company has got various permissions to use the railway land for construction of project and Right of Use (ROU). The value (net block) after amortisation till 31st March, 2019 including charges for current year is as under:

Sr. No.	Particulars	Amount in Rs. Lakhs
1	Net Block Value as at 01.04.2018	43,786.10
2	Additions during the year 2018-19 (Note 1)	3,519.12
3	Amortisation during the year 2018-19	1,333.98
4	Total Amortisation upto 31-Mar-2019	3,325.74
5	Net Block Value as at 31.03.2019 (1+2-4)	43,979.48

Note 1:

Additions during the financial year (F.Y.) 2018-19 relate to the acquisition of railway land in ADI yard - for construction of East-West Corridor. The details of the same are as under:

Sr. No.	Particulars	Amount in Rs.	Amount in Rs.
1	Leasing Charges Rs. 24,087 * 99%*12505		29,81,95,856
2	Nominal Charges For 35 Years – Rs. 1000 * 35 Years		35,000
3	Land on Rent for 4 Years		
3.1	4040 Sqm * Rs.24087 *6%	58,38,689	
3.2	4040 Sqm * Rs.25773 *6%	62,47,375	
3.3	4040 Sqm * Rs.27577 *6%	66,84,665	
3.4	4040 Sqm * Rs.29507 *6%	71,52,497	2,59,23,226
4	Underground Crossing of Track Changes 2 Nos * 3 Blocks * Rs.100,000 per Block * 10 Years (as per Para 6 of Railway Board Policy		62,61,232

¹ Opinion finalised by the Committee on 4.8.2020 and 5.8.2020.

	Circular No RB/L & A/090/2009 and 92/2010)		
	Sub Total		33,04,15,314
	GST		5,94,74,757
	Total		38,98,90,071

In respect of the above charges paid by the Company, the Railway Board Circular dated 03.06.2013 states as under:

“... it is re-iterated that the Railway land is leased to Government Departments (or undertaking) on long term lease basis for an initial period of 35 years against one time lump sum payment of lease charges equivalent to 99% of the current market value of land and a nominal licence fee of Rs.1000 p.a. plus service tax. The lease agreement can further be renewed for a period of 35 years on payment of nominal licence fee per annum to be decided at that time.”

Considering the above, the Company has adopted the accounting policy of treating leasing charges and nominal charges as right to use under the head ‘intangible assets’ as per Indian Accounting Standard (Ind AS) 38 ‘Intangible Assets’. The Company has amortised the amount of right to use over a period of 35 years. This policy has been consistently applied by the Company for the financial years 2016-17, 2017-18 and 2018-19.

3. The Office of Comptroller and Auditor General (C&AG) raised a paragraph on the above accounting treatment and issued the final POM as under:

“The paragraph 4 of Ind AS 17 mentions that if the lessee has contracted to lease the assets together with any further terms for which the lessee has the option to continue to lease the asset, with or without further payment and also when at the inception of the lease it is reasonably certain that the lessee will exercise the option, then such extendable period could also be considered as lease term.

The Company got the permission to use the Railway land for construction of project and the Right of Use (ROU) value (net block) i.e., after amortisation till 31st March 2019 was Rs. 439.79 crore. The Company amortises the assets on the basis of useful life i.e., life / period of validity of permission. The Railway Board Circular related to subject matter ‘Long term lease of Railway land to Government Department’ has re-iterated / clarified (03.06.2013) that the railway land is leased to Government Department (or undertaking) on long term lease basis for an initial period of 35 years against one time lump sum payment of lease charges equivalent to 99% of the current market value of the land and a nominal licence fee of Rs.1000 p.a. service tax. The lease agreement can be renewed for a period of 35 years on payment of nominal fee per annum to be decided at that time.

Thus, it is very much clear that the Company can renew the permission for a period for further 35 years on payment of nominal licence fee per annum only and lease charges are not required to be paid. This further implies that the lease charges component should be amortised over useful life of 70 years.

It was however observed that the Company has amortised the ‘lease charges’ considering its useful life as 35 years. This has resulted in overstatement of amortisation charges and understatement of ‘Intangible Assets- Right to Use’ by Rs. 12.85 crore (Current year – Rs. 6.62 crore, Prior period – Rs. 6.23 crore). Consequently, CWIP/Asset is also overstated by same extent.”

4. In response to the issue raised, the Company had given the following submission:

“As per Railway Board letter, the lease can be extended further by railway board after 35 years. The current lease period is for 35 years. The lease is extendable further at the end of 35 years. However, there is no surety of the extension as on the current date, as it will be done based on facts and circumstances at the end of the 35 years. There is no clarity at present about, whether it will be extended or not and hence Company has considered useful life as 35 years only, being the initial lease period, for amortisation of the lease charges.

As per paragraph 94 of Ind AS 38, ‘Intangible Asset’, useful life of an intangible asset that arises from contractual or other legal rights shall not exceed the period of the contractual or other legal rights, but may be shorter depending on the period over which the entity expects to use the asset. If the contractual or other legal rights are conveyed for a limited term that can be renewed, the useful life of the intangible asset shall include the renewal period(s) only if there is evidence to support renewal by the entity without significant cost.

In case of ambiguity, useful life of intangible asset is decided based on prudence. There is no evidence based on experience that the contractual or other legal rights will be renewed.

In view of the same, this para may please be treated as complied.”

5. With regard to whether the lease of Railway land in the query has been classified as operating lease or finance lease, the querist has separately confirmed that the lease of Railway land has been considered as finance lease in the books of the Company, i.e., lessee. The reasons for such classification are:

- (i) The leased assets are of such a specialized nature that only the lessee can use them without major modifications.
- (ii) Lease is perpetual lease where lessee will use assets for indefinite period for Metro Business.

It is further stated that once Metro corridor will be constructed on leased land, the Company cannot give back land to Indian Railways. Nature of the business of the Company is also such that the Company cannot construct again the same corridor. Though legal form of the transaction is executed through lease deed for 35 years and further extendable at the end of 35 years and there is no surety for extension as on the current date, it will be bound to be renewed based on the nature of business. So the lease is perpetual lease where lessee will use assets for indefinite period for Metro Business.

As per paragraph 10 of Ind AS 17, ‘Leases’ whether lease is a finance lease or operating lease depends upon substance of the transaction rather than form of the contract.

Further, paragraph 10 (e) of Ind AS 17 states that the leased assets are of specialized nature that only the lessee can use them without major modifications. In the extant case, leased lands are of specialized nature that once corridor will be constructed on leased land, the Company cannot give back such land to Indian Railway.

B. Query

6. Considering the above background, the querist has sought the opinion of the Expert Advisory Committee as to whether the amortisation should be done over a period of 35 years or 70 years under Ind AS 17, ‘Leases’.

C. Points considered by the Committee

7. The Committee notes that the basic issue raised in the query relates to amortisation period of right to use/lease of railway land for construction of metro project under Ind AS 17. The Committee has, therefore, considered only this issue and has not considered any other issue that may arise from the Facts of the Case, such as, measurement of right of use of/leased land, accounting for land on rent for 4 years, accounting for underground crossing of track charges, presentation of land under 'intangible assets', etc. Further, the opinion expressed hereinafter lays down the accounting principles to be followed and does not examine calculation of various amounts involved or from legal perspective. The Committee further wishes to point out that as the querist has referred the financial year 2018-19 for which Ind AS 17 was applicable and has also specifically referred Ind AS 17 in the query, the Committee has examined the issue from the perspective of Ind AS 17; and the opinion, expressed hereinafter does not examine the application of Ind AS 116, 'Leases', a new standard on leases which is effective for the accounting year beginning on or after 1st April, 2019. It may also be mentioned that Indian Accounting Standards (Ind ASs) cited hereinafter refer to Standards notified under the Companies (Indian Accounting Standards) Rules, 2015, as applicable for financial year 2018-19. The Committee also wishes to point out that the querist has informed that no lease agreement has been executed between the company and the Railways till date and as per the Railway Board Circular, the initial lease period is 35 years which can be renewed for a further period of 35 years only. No further renewal option is available as per the facts and circumstances available and thus, the Committee has proceeded on the said premise. In case, subsequently, the lease agreement is entered into and the renewal terms or other terms differ, the opinion may also differ substantially.

8. At the outset, with regard to the applicable standard in the extant case, the Committee notes paragraph 3(c) of Ind AS 38, 'Intangible Assets', notified under the Rules, which states that:

“3. If another Standard prescribes the accounting for a specific type of intangible asset, an entity applies that Standard instead of this Standard. For Example, this Standard does not apply to:

...

(c) leases that are within the scope of Ind AS 17, *Leases*.”

The Committee also notes paragraph 3 of Ind AS 17, 'Leases', notified under the Rules, which states as follows:

“3. This Standard applies to agreements that transfer the right to use assets even though substantial services by the lessor may be called for in connection with the operation or maintenance of such assets. This Standard does not apply to agreements that are contracts for services that do not transfer the right to use assets from one contracting party to the other.”

As in the extant case, right to use the land has been transferred to the Company, the Committee is of the view that accounting for the same will be governed by Ind AS 17, 'Leases' and not Ind AS 38, 'Intangible Assets'.

9. The Committee notes paragraphs 10 and 11 of Ind AS 17, which states as follows:

“10 Whether a lease is a finance lease or an operating lease depends on the substance of the transaction rather than the form of the contract. Examples of situations that individually or in combination would normally lead to a lease being classified as a finance lease are:

- (a) the lease transfers ownership of the asset to the lessee by the end of the lease term;
 - (b) the lessee has the option to purchase the asset at a price that is expected to be sufficiently lower than the fair value at the date the option becomes exercisable for it to be reasonably certain, at the inception of the lease, that the option will be exercised;
 - (c) the lease term is for the major part of the economic life of the asset even if title is not transferred;
 - (d) 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 leased asset; and
 - (e) the leased assets are of such a specialised nature that only the lessee can use them without major modifications.
- 11 Indicators of situations that individually or in combination could also lead to a lease being classified as a finance lease are:
- (a) if the lessee can cancel the lease, the lessor's losses associated with the cancellation are borne by the lessee;
 - (b) gains or losses from the fluctuation in the fair value of the residual accrue to the lessee (for example, in the form of a rent rebate equalling most of the sales proceeds at the end of the lease); and
 - (c) the lessee has the ability to continue the lease for a secondary period at a rent that is substantially lower than market rent."

"15A When a lease includes both land and buildings elements, an entity assesses the classification of each element as a finance or an operating lease separately in accordance with paragraphs 7–13. In determining whether the land element is an operating or a finance lease, an important consideration is that land normally has an indefinite economic life."

In this context, the Committee notes from the facts of the case that the railway land is leased to Government Department (or undertaking) on long term lease basis for an initial period of 35 years against one time lump sum payment of lease charges equivalent to 99% of the current market value of the land and a nominal licence fee of Rs.1000 p.a. plus service tax and the lease agreement can be renewed for a period of 35 years on payment of nominal fee per annum to be decided at that time. Further, as specifically mentioned by the querist, once the metro corridor is constructed on the leased land, the leased land (together with the infrastructure constructed on such land) are of specialized nature so that only the lessee can use them without major modifications. Considering these factors/indicators, the Committee is of the view that the lease of Railway land in the extant query is a finance lease, which has also been separately confirmed by the querist.

10. With regard to amortisation of leased land, the Committee notes the following 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*.”

“The *lease term* is the non-cancellable period for which the lessee has contracted to lease the asset together with any further terms for which the lessee has the option to continue to lease the asset, with or without further payment, when at the inception of the lease it is reasonably certain that the lessee will exercise the option.”

“*Useful life* is the estimated remaining period, from the commencement of the lease term, without limitation by the lease term, over which the economic benefits embodied in the asset are expected to be consumed by the entity.”

“A *non-cancellable lease* is a lease that is cancellable only:

- (a) upon the occurrence of some remote contingency;**
- (b) with the permission of the lessor;**
- (c) if the lessee enters into a new lease for the same or an equivalent asset with the same lessor; or**
- (d) upon payment by the lessee of such an additional amount that, at inception of the lease, continuation of the lease is reasonably certain.”**

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 Railway Board letter for transfer of ownership of the land by the lessor to the Company and the Company has not entered into any lease agreement with Railways as on date. 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 leased 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'.

As far as lease term is concerned, the Committee is of the view that the lease term is the non-cancellable period for which the lease has been contracted plus further period(s) for which the lessee has the option to continue the lease provided such option at the inception of the lease it is reasonably certain that the lessee will exercise. In this context, the Committee is of the view that when a lease agreement is entered into for a certain initial period, that initial period can be construed as the period for which the lease of the asset is reasonably certain to continue at the inception of the lease. For any extension of the initial lease term to be treated as the 'lease term', the Committee is of the view that the reasonable certainty of renewal of the lease agreement by the lessee at the inception of the lease should be considered. The same should be determined on the basis of facts and circumstances considering various factors, e.g., intent of the lessee to continue with the lease, the expectation that the rentals during the period of renewal are expected to be considerably lower than the fair market value of the rentals at the date the option by the lessee becomes exercisable, the lessee has made substantial expenditure which have useful life much in excess of the initial lease period, importance of the lease to the business, or the fact that the lessee has entered into business commitments, the fulfilment of which would require renewing the lease of the premises beyond the initial lease term, uniqueness of purpose or location of the property, the availability of a comparable replacement property, ability or willingness of the lessee to bear the cost associated with relocation or replacement of the leased property at market rental rates, any past practice in this regard in comparable circumstances, etc.

In this context, the Committee notes that the Railway Board Circular dated June 3, 2013, inter alia, states as under:

“... the Railway land is leased to Government Departments (or undertaking) on long term lease basis for an initial period of 35 years against one time lump sum payment of lease charges equivalent to 99% of the current market value of land and a nominal licence fee of Rs.1000 p.a. plus service tax. The lease agreement can further be renewed for a period of 35 years on payment of nominal licence fee per annum to be decided at that time.”

From the above, the Committee notes that the Circular gives an option to the Company to renew the lease for a further period of 35 years, however, the Company has not considered the renewal period(s) in the lease term as there is no surety for extension as on current date. The Committee also notes that while determining the classification of lease as finance lease in the extant case, the Company has considered lease as perpetual lease where lessee will use the asset (land) for indefinite period for metro business. Further, in the extant case, considering that (i) lease charges of 99% of current market value of land has been paid by the Company, (ii) the lease agreement can be renewed for a period of 35 years on payment of nominal fee indicating that the lessee has the ability to continue the lease for a secondary period at a rent that is substantially lower than market rent, (iii) long-term usage of the infrastructure and assets constructed on leased land and (iv) specialized nature of leased asset together with infrastructure created that only the lessee can use them without major modifications, the Committee is of the view that there is an economic sense for the company to continue the lease for its renewal period. Therefore, the lease term in the extant case should be determined to be 70 years, i.e., after considering the renewal period of 35 years unless it can be proved otherwise by the company as determination of lease term is subject matter of judgement depending on the facts and circumstances of the case.

Accordingly, the Committee is of the view that in the extant case, the leased land should be amortised over shorter of lease term (determined in accordance with the above-mentioned discussion) and its useful life (which is generally unlimited in case of land).

D. Opinion

11. On the basis of above, the Committee is of the opinion that the leased land in the extant case should be amortised over shorter of lease term and its useful life (which is generally unlimited in case of land). Further, with regard to determination of lease term, the Company should evaluate in its own facts and circumstances that whether at the inception of lease, it is reasonably certain that the Company will exercise the option to renew the lease, considering the factors, as discussed in paragraph 10 above. However, considering that (i) lease charges of 99% of current market value of land has been paid by the Company, (ii) the lease agreement can be renewed for a period of 35 years on payment of nominal fee indicating that the lessee has the ability to continue the lease for a secondary period at a rent that is substantially lower than market rent, (iii) long-term usage of the infrastructure and assets constructed on leased land, and (iv) specialized nature of leased asset together with infrastructure created that only the lessee can use them without major modifications, the Committee is of the view that there is an economic sense for the company to continue the lease for its renewal period. Therefore, the lease term in the extant case should be determined to be 70 years, i.e., after considering the renewal period of 35 years unless it can be proved otherwise by the company as determination of lease term is subject matter of judgement depending on the facts and circumstances of the case.
