

Query No. 27

Subject: Accounting treatment of perpetual lease in the books of Lessee.¹

A. Facts of the Case

1. A Company (hereinafter referred to as ‘the Company’) is a Central Public Sector Enterprise (CPSE) registered under the Companies Act, listed in Stock Exchanges and thereby governed under the relevant regulations. It is engaged in the business of refining and marketing of petroleum products, petrochemicals, gas and alternate energy.

2. The querist has stated that the Company has taken land on lease at various locations with perpetual lease time period, for which one-time upfront premium was paid at the time of commencement and rent is payable on periodic basis. The lease terms in almost all cases are such that any default in payment of periodic rent may lead to cancellation of lease agreement. Restrictions/ covenants are there on the use of land like office, fuel station only, etc. and there are restrictions/covenants also on change in the layout of the plan under these lease arrangements, which is not permitted. For example, in case of one of the perpetual land leases, there are restrictions like:

- i. Land is restricted to office use only,
- ii. Agreement gives blanket right to the lessor to remove any building paying only compensation,
- iii. Lessor can increase rent at its own discretion,
- iv. The Company needs the permission of lessor for alteration in layout, etc.

3. As the Company is a Government Company, its audited financial statements are subjected to supplementary audit u/s 143(6) of the Companies Act, 2013 by the Comptroller and Auditor General of India (C&AG). During supplementary audit by C&AG for the financial year (F.Y.) 2020-21, the accounting treatment followed for land taken on lease on perpetual basis came up for discussion and it was assured that an opinion will be sought from the Expert Advisory Committee (EAC) of the Institute of Chartered Accountants of India (ICAI).

Accounting treatment by the Company as per the requirements of Standards

4. Initial recognition of these leases:

As per paragraph 3 of Indian Accounting Standard (Ind AS) 116, ‘Leases’, an entity shall apply this Standard to all leases, including leases of right-of-use assets in a sublease, except for: (a) leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources; (b) leases of biological assets within the scope of Ind AS 41, *Agriculture*, held by a lessee; (c) service concession arrangements within the scope of Appendix D, *Service Concession Arrangements*, of Ind AS 115, *Revenue from Contracts with Customer*; (d) licences of intellectual property granted by a lessor within the scope of Ind AS 115, *Revenue from Contracts with Customers*; and (e) rights held by a lessee under licensing agreements within the scope of Ind AS 38, *Intangible Assets*, for such items as motion picture films, video recordings, plays, manuscripts, patents and copyrights.

¹ Opinion finalised by the Committee on 19.1.2022.

According to the querist, since perpetual lease is not covered in the exclusions given in Ind AS 116 above, leases of perpetual nature are also covered within the ambit of Ind AS 116. Further, the coverage of perpetual lease under Ind AS 116 is evidenced by FAQ No. 31 of Educational Material on Indian Accounting Standard (Ind AS) 116 *Leases*, issued by the Ind AS Implementation Committee of the ICAI and the same is also reproduced for reference:

“Question 31

Airline X (lessee) has entered into a lease arrangement with Entity Y (lessor) to take an aircraft on lease for which it pays monthly rental to Entity Y. There are no termination clauses for the contract, except in case of default in rental payment by the lessee.

What is the lease term?

Response

Ind AS 116 defines lease term as follows:

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

- (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.”

In the given case, since there is no defined period of time and no termination clause, the non-cancellable period for the lease can be said to be till perpetuity since lessee has the enforceable contractual right to use the underlying asset till perpetuity for exchange of consideration.

In this case, the lease term should be taken as the remaining economic life of the underlying asset, i.e., the aircraft, except if there are any legal or other economic factors due to which Entity X would not be able to use the aircraft for its entire remaining economic life.”

The underlying principle highlighted is that perpetual leases are leases with indefinite period and the said leases are covered within scope of Ind AS 116. Further in such cases, the lease term under Ind AS 116 is to be taken as the useful life of underlying asset. However, in the extant case, the underlying asset is land, which has indefinite life and hence, the perpetual leasehold land has been recognised as ‘Right of Use (ROU) Assets’ with indefinite life.

5. Value for initial recognition:

As per paragraphs 22-24 of Ind AS 116, at the commencement date, a lessee shall recognise a right-of-use asset and a lease liability. A lessee shall measure the right-of-use asset at cost. The cost of the right-of-use asset shall comprise: (a) the amount of the initial measurement of the lease liability, as described in paragraph 26; (b) any lease payments made at or before the commencement date, less any lease incentives received; (c) any initial direct costs incurred by the lessee; and (d) an estimate of costs to be incurred by the lessee in dismantling and removing the underlying asset, restoring the site on which it is located or restoring the underlying asset to the condition required by the terms and conditions of the lease, unless those costs are incurred to produce inventories. The lessee incurs the obligation for those

costs either at the commencement date or as a consequence of having used the underlying asset during a particular period.

As per paragraph 26, at the commencement date, a lessee shall measure the lease liability at the present value (PV) 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.

In case of perpetual leases being discussed, both one-time upfront premium at the commencement of lease and fixed rent are being paid by the Company. The determination of discounted value for lease liability is being carried out considering time period as perpetual on the fixed rent. (PV of Perpetuity = Cash Flow/Interest Rate)

Thus, discounted value of lease rent for perpetuity is being recognised as lease liability. On the other hand, this lease liability along with upfront premium is being recognised as ROU asset.

6. Accounting in the subsequent periods:

- (a) The term of lease is perpetual, and the underlying asset is land, which does not have limited economic life (unlike example of aircraft in FAQ No. 31). Hence, at the end of each year, the lease term is still perpetual, and the calculation carried out during initial recognition remains valid. Therefore, no amortisation of ROU Asset is being carried out and no unwinding of lease liability is carried out.
- (b) As all the liability towards lease till perpetuity has already been provided by the Company, payment of fixed rent by the Company is being booked as finance cost in the financial statements.

7. Summary of accounting followed by the Company:

- (a) The lease liability is measured as the present value of lease payments using the Company's borrowing rate (based on the method of valuation of perpetuity) and no unwinding is done,
- (b) The ROU asset is measured and recognised at the amount equal to lease liability as computed in point (a) plus one time amount paid and no amortisation is made,
- (c) The finance cost is recognised on the outstanding lease liability equal to the lease rent as and when accrued.
- (d) Paragraphs B24-B30 of Ind AS 116 also justify the accounting treatment followed by the Company.

Accounting Policy in respect of ROU Assets:

8. The accounting policy of the Company states that "Right-of-use assets are measured at cost, less any accumulated depreciation and impairment losses, and adjusted for any remeasurement of lease liabilities". The word 'any' signifies that accumulated depreciation may be Nil in some cases.

Observation by Comptroller and Auditor General (CAG) during supplementary audit:

9. CAG during audit of financial statements raised the observation over treatment of perpetual leases as per Ind AS 116. The CAG observation is summarised below:

“In the perpetual leases, there is no defined period of time and no termination clause, and hence the Company has enforceable contractual right to use the underlying asset till perpetuity. Thus, perpetual arrangement is effectively a form of ownership interest. Ind AS 116 also states that if a contract is, or contains, a lease, the lease term needs to be determined whereas in the instant case of perpetual lease, the lease term of land cannot be determined and hence, the perpetual land cannot be classified as Right-of-use asset. Accordingly, these perpetual lease lands should have been recognised as freehold land under PPE on historical cost basis instead of Right of Use as per Ind AS 116.”

10. Justification towards Accounting by the Company:

1. Defining Characteristics of Freehold Land:

Freehold land has essential characteristics such as non-payment of rental amount, right to dispose-off the asset, using the land in a manner and purpose owner desires without any need of prior permission, among other things. The perpetual lease even though granting right to use the land on perpetuity does not provide these rights which are available on freehold land.

2. Control over Land:

It is pertinent to note that there are restrictions/covenants on the use of land like office or fuel station etc. and on change of the layout of the plan. Further, there exists periodic liability towards payment of rental amount, default in which might lead to termination of lease agreement. Thus, it is evident that total control over leasehold land does not exist in the hands of lessee.

3. Basis for Conclusions (BC) for International Financial Reporting Standard (IFRS) 16, ‘Leases’, issued by the International Accounting Standards Board:

As per BC 78 for IFRS 16, “A long-term lease of land is sometimes regarded as being economically similar to the purchase of the land. Consequently, some stakeholders suggested that long-term leases of land should be excluded from the scope of IFRS 16. However, the IASB decided not to specifically exclude such leases from the scope of IFRS 16 because:

- (a) there is no conceptual basis for differentiating long-term leases of land from other leases. If the contract does not transfer control of the land to the lessee, but gives the lessee the right to control the use of the land throughout the lease term, the contract is a lease and should be accounted for as such.
- (b) for a long-term lease of land (for example, a 99-year lease), the present value of the lease payments is likely to represent substantially all of the fair value of the land. In this case, the accounting applied by the lessee will be similar to accounting for the purchase of the land. If the lessee obtains control of the land, it will account for the contract as the purchase of the land by applying IAS 16 *Property, Plant and Equipment*, rather than by applying IFRS 16.”

According to the querist, control is an important aspect to be considered in determining whether a long-term lease constitutes an ROU asset under Ind AS 116 or a freehold land under Ind AS 16. Since in the case of perpetual leases being discussed, control is not transferred to the lessee, it cannot be treated as freehold land and hence, it is being recognised as ROU Asset.

11. The querist has also submitted the following details with regard to the present value of the lease payments and the fair value/market value of land:

Particulars	Amount (₹ in crore)
Market Value as per Report by Government approved Valuer	21.92
-	-
Upfront Premium	11.95
PV of Future Rental Cash Outflows	2.22
Total	14.17

Further, the querist has informed that the present lease is perpetual and there is no expressed clause under lease deed/terms of allotment for purchase of land by the Company. Also, as conveyed by the lessor, at present, there is no policy for freehold conversion.

B. Query

12. In view of the above, the querist has sought the opinion of the Expert Advisory Committee (EAC) on the following issues:

- (i) Whether accounting treatment and disclosure by the Company of recognising ROU assets, lease liability and finance cost is in order.
- (ii) Whether the ROU asset should be amortised, and unwinding entry posted for lease liability. If yes, then what should be the period considered for the purpose when life term is perpetuity?
- (iii) Whether all perpetual lease of land, irrespective of whether there is restriction over usage like change in layout, disposal of land, etc. should be treated as freehold land.
- (iv) If the perpetual lease is to be recognised as freehold land, how the same is to be valued when there are upfront charges and periodic payment of lease rent?

C. Points considered by the Committee

13. The Committee notes that the basic issue raised in the query relates to accounting treatment of land taken on lease for perpetuity. 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, accounting for any other expenditure incurred in relation to the land, appropriateness of the discount rate used, etc. Further, the Committee has expressed its opinion purely from the accounting perspective and not from the perspective of legal interpretation of lease agreement etc. Further, the Committee has examined only one lease agreement as confirmed by the querist in the context of the query and not the other lease agreements as submitted by the querist. The Committee also notes that the querist has provided some details regarding market value as per Report by Government approved valuer and PV of future rental cash outflows. However, since such market value may not be comparable with the fair value of land or the right of use of land as per the requirements of Ind AS 113, 'Fair Value Measurement', the Committee has not taken the same into consideration while expressing its opinion.

14. At the outset, the Committee notes the following relevant clauses from the lease agreement:

“... NOW THIS INDENTURE WITNESSETH that in consideration of the amount of Rs... paid towards premium before the execution of these presents (the receipt where of the Lessor hereby acknowledges) and of the rent hereinafter reserved and of the covenants on the part of the Lessee hereinafter contained, the Lessor doth hereby demise unto the Lessee, all the plot of land being the Commercial Plot No. ...at ... admeasuring an area of... situated at ... and to be used only as **Commercial Space** purposes ... TOGETHER with all rights, easements and appurtenances whatsoever to the said Commercial plot to be used only as Commercial Space purpose belonging or appertaining TO HOLD the premises unto the lessee in perpetuity from **11th day of June Two Thousand and Nineteen** YIELDING and PAYING therefore the yearly rent payable in advance of **Rs. 5/- (Rupees Five Only) till 10th day of June Two Thousand and Twenty Four** thereafter at the rate of **two and a half percent** of the premium (the sums already paid and such other sums or sums hereafter to be paid towards under the covenants and the conditions hereinafter contained) or such other enhanced rent as may hereafter be assessed under covenants and conditions hereinafter contained clear of all deductions by equal half yearly payments on the **fifteenth day of January and the fifteenth day of July in each year** at the STATE BANK OF INDIA/SYNDICATE BANK ...

(Emphasis supplied by the Committee.)

- (II) (6) (a) (i) The Lessee shall not sell, transfer, assign or otherwise part with the possession of the whole or any part of the Commercial Plot except with the previous consent in writing of the Lessor which he shall be entitled to refuse in his absolute discretion.

PROVIDED that in the event of the consent being given, the Lessor may impose such terms and conditions as he thinks fit and the Lessor shall be entitled to claim and recover and portion of the unearned increase in the value (i.e., the difference between the premium paid and the market value) of the Commercial Plot at the time of sale, transfer, assignment or parting with the possession, the amount to recovered being fifty percent of the unearned increase and the decision of the Lessor in respect of the market value shall be final and binding.

PROVIDED FURTHER that the Lessor shall have the pre-emptive right to purchase the whole property or any part thereof that may be subject of sale, transfer, assignment or otherwise parting with possession as the case may be, after deducting fifty percent of the unearned increase as aforesaid.

PROVIDED FURTHER that notwithstanding the limitations and conditions as mentioned in sub-clause 6(a), The lessee may sell or transfer the floor space constructed on the plot subject to the permission of the Lessor in writing on payment of Rs. 100/- for each flat floor space for the first sale/transfer. For subsequent sale/transfer the Lessor may on payment of proportionate 50% of the unearned increase ... grant permission to the sub-lessee/transferor for such subsequent sale/transfer of the floor space to be transferred. ...”

- (8) Whenever the title of the Lessee in Commercial Plot or any part thereof is transferred in any manner whatsoever, the transferee shall be bound by all the covenants and conditions contained herein and be answerable in all respects thereof.

- (9) Whenever the title of the lessee in the Commercial Plot or any part thereof is transferred in any manner, whatsoever the transferor and the transferee shall, within three months of the transfer give notice of such transfer in writing to the Lessor.

...

- (14) The plot and building thereon or any part thereof shall not be used for the purpose other than as specified in the Control Conditions. ...

- (IV) If the sum or sums payable towards the premium or the yearly rent hereby reserved or any part thereof shall at any time be in arrear and unpaid for one calendar month next after any of the days whereon the same shall have become due, ...it shall be lawful for the Lessor, (notwithstanding) the waiver of any previous cause or right of re-entry upon, the Commercial plot hereby demised and the building thereon to re-enter upon and take possession of the Commercial plot and the buildings and fixtures and thereupon his lease and everything herein contained shall cease and determine and the Lessee shall not be entitled to any compensation whatsoever nor to the return of any premium paid by him.

...

- (VI) The rent hereby reserved shall be enhanced from the **first day of January Two Thousand and Fifty** thereafter at the end of each successive period of thirty years, provided that increase in the rent fixed at each enhancement shall not each such time exceed hundred percent of that immediately before the enhancement value of the site without building at the date on which the enhancement is due and such letting value shall be assessed by the Collector or Additional Collector of Delhi as may be appointed by the Lessor.

...”

15. In the context of the issue raised, the Committee notes paragraph BC78 of Basis for Conclusions for IFRS 16, ‘Leases’, which states as follows:

“Long-term leases of land

BC78 A long-term lease of land is sometimes regarded as being economically similar to the purchase of the land. Consequently, some stakeholders suggested that long-term leases of land should be excluded from the scope of IFRS 16. However, the IASB decided not to specifically exclude such leases from the scope of IFRS 16 because:

- (a) there is no conceptual basis for differentiating long-term leases of land from other leases. If the contract does not transfer control of the land to the lessee, but gives the lessee the right to control the use of the land throughout the lease term, the contract is a lease and should be accounted for as such.
- (b) for a long-term lease of land (for example, a 99-year lease), the present value of the lease payments is likely to represent substantially all of the fair value of the land. In this case, the accounting applied by the lessee will be similar to accounting for the purchase of the land. If the lessee obtains control of the

land, it will account for the contract as the purchase of the land by applying IAS 16 *Property, Plant and Equipment*, rather than by applying IFRS 16.”

From the above, the Committee notes that in case of long-term leases or right of use arrangements, an important aspect to be examined is whether the arrangement or contract transfers control of the underlying asset or only right to control the use of the asset throughout the arrangement/contract is being transferred. If former is the case, viz., the transferee obtains control of the asset, the same should be accounted for as per Ind AS 16, ‘Property, Plant and Equipment’.

The Committee further notes that Ind AS 16 does not provide guidance with respect to control; therefore, considering the hierarchy as per paragraph 10 of Ind AS 8, ‘Accounting Policies, Changes in Accounting Estimates and Errors’, the Committee notes the requirements relating to ‘control’ from the Conceptual Framework for Financial Reporting under Indian Accounting Standards (Ind AS), issued by the ICAI as follows:

“Control

- 4.19 Control links an economic resource to an entity. Assessing whether control exists helps to identify the economic resource for which the entity accounts. For example, an entity may control a proportionate share in a property without controlling the rights arising from ownership of the entire property. In such cases, the entity’s asset is the share in the property, which it controls, not the rights arising from ownership of the entire property, which it does not control.
- 4.20 An entity controls an economic resource if it has the present ability to direct the use of the economic resource and obtain the economic benefits that may flow from it. Control includes the present ability to prevent other parties from directing the use of the economic resource and from obtaining the economic benefits that may flow from it. It follows that, if one party controls an economic resource, no other party controls that resource.
- 4.21 An entity has the present ability to direct the use of an economic resource if it has the right to deploy that economic resource in its activities, or to allow another party to deploy the economic resource in that other party’s activities.
- 4.22 Control of an economic resource usually arises from an ability to enforce legal rights. However, control can also arise if an entity has other means of ensuring that it, and no other party, has the present ability to direct the use of the economic resource and obtain the benefits that may flow from it. For example, an entity could control a right to use know-how that is not in the public domain if the entity has access to the know-how and the present ability to keep the know-how secret, even if that know-how is not protected by a registered patent.
- 4.23 For an entity to control an economic resource, the future economic benefits from that resource must flow to the entity either directly or indirectly rather than to another party. This aspect of control does not imply that the entity can ensure that the resource will produce economic benefits in all circumstances. Instead, it means that if the resource produces economic benefits, the entity is the party that will obtain them either directly or indirectly.
- 4.24 Having exposure to significant variations in the amount of the economic benefits produced by an economic resource may indicate that the entity controls

the resource. However, it is only one factor to consider in the overall assessment of whether control exists.”

From the above requirements of Conceptual Framework, the Committee notes that for an entity to control an economic resource, the future economic benefits from that resource must flow to the entity either directly or indirectly rather than to another party. In the extant case, the Committee notes that if lessee wants to sell, transfer, assign or otherwise part with the possession of the land (the underlying asset), prior consent of lessor is required. Further, in the event of consent being given, lessor may impose such terms and conditions as he thinks fit; and the lessor is also entitled to recover fifty percent of the unearned increase in the value (i.e., the difference between the premium paid and the market value) of the land at the time of sale, transfer, assignment or parting with the possession and the market value shall also be finalised by the lessor. Further, the lessor retains the title to the asset and the lessee cannot use the plot of land and building thereon or any part thereof for the purpose other than as specified in the lease documents. Thus, it cannot be considered that the future economic benefits (existing and potential) from the resource, viz., the land shall entirely flow to the Company and therefore, it cannot be considered that the lessee obtains control of the leased asset, viz., land. Accordingly, the Committee is of the view that land cannot be recognised as a property, plant and equipment by the Company.

16. The Committee now examines whether the lease or right of use of land in the extant case can be considered as a ‘lease’ within the scope of Ind AS 116, ‘Leases’. In this context, the Committee notes the following paragraphs from Ind AS 116:

“Lease 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.”

“9 At inception of a contract, an entity shall assess whether the contract is, or contains, a lease. A contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset *for a period of time* in exchange for consideration. Paragraphs B9–B31 set out guidance on the assessment of whether a contract is, or contains, a lease.

10 A period of time may be described in terms of the amount of use of an identified asset (for example, the number of production units that an item of equipment will be used to produce).”

(Emphasis supplied by the Committee.)

From the above, the Committee notes that a contract contains lease only if it conveys the right to control the use of an identified asset for ‘*a period of time*’, which may also be described in terms of amount of use of the leased asset. In the extant case, the lease arrangement is for perpetuity, which may also be considered as a period of time. Further, in the extant case, the contract conveys the right to control the use of land for perpetuity in exchange for initial premium and periodic rentals. Therefore, the Committee is of the view that though a specific period has not been defined in the extant case, the arrangement, in substance, is in the nature of lease within the scope of Ind AS 116. .

17. With regard to the accounting for right of use of land and the liability in respect of the same, the Committee notes the following requirements of Ind AS 116, ‘Leases’:

“23 At the commencement date, a lessee shall measure the right-of-use asset at cost.

- 24 The cost of the right-of-use asset shall comprise:
- (a) the amount of the initial measurement of the lease liability, as described in paragraph 26;
 - (b) any lease payments made at or before the commencement date, less any *lease incentives* received;
 - (c) any *initial direct costs* incurred by the lessee; and
 - (d) an estimate of costs to be incurred by the lessee in dismantling and removing the underlying asset, restoring the site on which it is located or restoring the underlying asset to the condition required by the terms and conditions of the lease, unless those costs are incurred to produce inventories. The lessee incurs the obligation for those costs either at the commencement date or as a consequence of having used the underlying asset during a particular period.”

“26 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*.”

“Subsequent measurement

Subsequent measurement of the right-of-use asset

29 After the commencement date, a lessee shall measure the right-of-use asset applying a cost model, unless it applies the measurement model described in paragraph 35.

Cost model

- 30 To apply a cost model, a lessee shall measure the right-of-use asset at cost:
- (a) less any accumulated depreciation and any accumulated impairment losses; and
 - (b) adjusted for any remeasurement of the lease liability specified in paragraph 36(c).
- 31 A lessee shall apply the depreciation requirements in Ind AS 16, *Property, Plant and Equipment*, in depreciating the right-of-use asset, subject to the requirements in paragraph 32.
- 32 If the lease transfers ownership of the underlying asset to the lessee by the end of the lease term or if the cost of the right-of-use asset reflects that the lessee will exercise a purchase option, the lessee shall depreciate the right-of-use asset from the commencement date to the end of the *useful life* of the underlying asset. Otherwise, the lessee shall depreciate the right-of-use asset from the commencement date to the earlier of the end of the *useful life* of the right-of-use asset or the end of the lease term.

33 A lessee shall apply Ind AS 36, *Impairment of Assets*, to determine whether the right-of-use asset is impaired and to account for any impairment loss identified.”

“35 If right-of-use assets relate to a class of property, plant and equipment to which the lessee applies the revaluation model in Ind AS 16, a lessee may elect to apply that revaluation model to all of the right-of-use assets that relate to that class of property, plant and equipment.

Subsequent measurement of the lease liability

36 After the commencement date, a lessee shall measure the lease liability by:

(a) increasing the carrying amount to reflect interest on the lease liability;

(b) reducing the carrying amount to reflect the lease payments made; and

(c) remeasuring the carrying amount to reflect any reassessment or lease modifications specified in paragraphs 39–46, or to reflect revised in-substance fixed lease payments (see paragraph B42).

37 Interest on the lease liability in each period during the lease term shall be the amount that produces a constant periodic rate of interest on the remaining balance of the lease liability. The periodic rate of interest is the discount rate described in paragraph 26, or if applicable the revised discount rate described in paragraph 41, paragraph 43 or paragraph 45(c).

38 After the commencement date, a lessee shall recognise in profit or loss, unless the costs are included in the carrying amount of another asset applying other applicable Standards, both:

(a) interest on the lease liability; and

(b) variable lease payments not included in the measurement of the lease liability in the period in which the event or condition that triggers those payments occurs.”

“49 In the statement of profit and loss, a lessee shall present interest expense on the lease liability separately from the depreciation charge for the right-of-use asset. Interest expense on the lease liability is a component of finance costs, which paragraph 82(b) of Ind AS 1, *Presentation of Financial Statements*, requires to be presented separately in the statement of profit and loss.”

From the above, the Committee is of the view that at the commencement date, the Company should recognise a right-of-use asset in respect of the land and a lease liability. At the commencement date, the Company should measure right-of-use asset at cost, which shall comprise the initial measurement of lease liability, lease payments made at or before the commencement date less any lease incentives received, any initial direct costs incurred by the lessee and an estimate of costs to be incurred by the lessee in dismantling/removing and restoring the asset as per the terms and conditions of the lease. The Company should also recognise a lease liability at the commencement date at the present value of the lease payments that are not paid at that date considering lease payments over perpetuity. The lease payments shall be discounted using the interest rate implicit in the lease or using the lessee’s incremental borrowing rate (if the interest rate implicit in the lease cannot be readily determined). Further, the Company should present in the Statement of Profit and Loss, an

interest expense on the lease liability separately from the depreciation charge for the right-of-use asset as per the above-reproduced requirements of Ind AS 116.

18. As far as depreciation charge for right of use of land is concerned, the Committee notes that in the extant case, there is no purchase option and the lease does not transfer the ownership of land to the Company and therefore, as per the requirements of paragraph 32 of Ind AS 116, as reproduced above, the Company shall depreciate the right-of-use asset from the commencement date to the earlier of the end of the useful life of the right-of-use asset or the end of the lease term. Further, paragraph 31 of Ind AS 116 states that the lessee should apply the depreciation requirements in Ind AS 16, 'Property, Plant and Equipment', in depreciating the right-of-use asset. Therefore, the Committee notes the following requirements of Ind AS 16, 'Property Plant and Equipment':

“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 depreciable amount of an asset shall be allocated on a systematic basis over its useful life. Further, as the land has unlimited useful life, it is not depreciated. Accordingly, the Committee is of the view that in the extant case, since the underlying asset under ROU, being land has unlimited useful life and the lease term is also unlimited, the right of use of land should not be depreciated/amortised. However, the Company should apply Ind AS 36, 'Impairment of Assets', to determine whether the right-of-use asset is impaired and to account for any impairment loss identified.

D. Opinion

19. On the basis of the above, the Committee is of the following opinion on the issues raised in paragraph 12 above:

- (i) The arrangement in the extant case is, in substance, in the nature of lease and recognition and measurement principles of Ind AS 116 should be applied. Therefore, a right-of-use asset, lease liability and finance cost should be recognised as per the requirements of Ind AS 116, as discussed in paragraph 17 above.
- (ii) In the extant case, since the underlying asset under ROU, being land has unlimited useful life and the lease term is also unlimited, the right of use of land should not be depreciated/amortised. However, the Company should apply Ind AS 36, 'Impairment of Assets', to determine whether the right-of-use asset is impaired and to account for any impairment loss identified, as discussed in paragraph 18 above.
- (iii) This is a general question, which cannot be answered by the Committee.
- (iv) In view of (i) and (ii) above, the question does not arise.