

Query No. 12

Subject: *Nature of Right-of-Use (RoU) Assets recognised in accordance with Ind AS 116, 'Leases'.¹*

A. Facts of the Case

1. A company (hereinafter referred to as 'the Company') is a Non-Banking Finance Company engaged in the business of providing financial services through its branch network spread across multiple states in India.

2. The Company has transitioned to the Indian Accounting Standards (Ind AS) and has been reporting its financials as per Ind AS norms from the financial year (F.Y.) 2018-19. Ind AS 116, 'Leases' prescribes recognition of Right-of-use (RoU) asset and lease liability for lease rentals payable across the tenure. RoU asset is recognised on the balance sheet at the commencement date of the lease, measured at the present value of lease payments, discounted using the lessee's incremental borrowing rate. A corresponding lease liability is also recognised, representing the lessee's obligation to make lease payments. RoU asset is depreciated over the lease term, with the depreciation expense recognised in the profit and loss statement. The lease liability is measured at amortised cost using the effective interest method. Interest expense on the lease liability is recognised in the profit and loss statement over the lease term. At the end of the lease term, the RoU asset and lease liability are settled in full, resulting in their simultaneous derecognition from the balance sheet.

3. The said RoU asset and lease liability have been recognised against lease of tangible premises from which the Company operates its branches. The lease agreements entered by the Company as of March 31, 2024, were long-term in nature and did not grant the lessor / the landlord the right to terminate the lease. The Company (the lessee) however had the right to terminate the lease agreement at any point with a notice of 90 days.

4. In this context, as per the querist, there is a lack of clarity on the nature / classification of the Right-of-Use assets. The query that the querist seeks to address is whether the RoU asset would be treated as a 'Tangible Asset' or as an 'Intangible Asset'.

5. The management of the Company has been of the view that RoU assets are tangible in nature for the following reasons:

- ❖ The erstwhile Ind AS Implementation Committee of the Institute of Chartered Accountants of India (the ICAI) has published an Educational Material on Indian Accounting Standard (Ind AS) 116, 'Leases'. Question No. 76 and its response from the said publication are being reproduced below:

“Question 76

How is the lease of a building (that does not qualify as investment property) classified in the balance sheet if an entity elects not to present right-of-use asset in a separate line item?

¹ Opinion finalised by the Committee on 12.9.2025.

Response

Paragraph 47 of Ind AS 116 provides that a lessee shall present a right-of use asset in the balance sheet either in a separate line item or in the same line item in which the corresponding underlying asset would have been presented if it had been owned, with a disclosure of which line item includes the right-of-use asset. Thus, *a right-of-use asset resulting from the lease of a building that is not presented in a separate line item on the balance sheet should be classified as property, plant and equipment.* The amount of right of use asset included in the line item of property, plant and equipment needs to be disclosed in the notes to the financial statements.” (Emphasis supplied by the querist.)

According to querist, the above Question clarifies that in the event an entity elects not to disclose or present RoU asset as a distinct line item in the balance sheet and so long as the same results from lease of a building, the RoU asset can be classified under property, plant and equipment which is a tangible asset. This indicates that RoU asset is tangible in nature when the underlying asset is tangible. If RoU assets were to be classified as intangible in nature, the above response would have warranted classification under ‘Intangible Assets’ and not under property, plant and equipment.

- ❖ Ind AS 116, ‘Leases’ is based on International Financial Reporting Standard (IFRS) 16, ‘Leases’. Global standards and practices treat RoU assets recognised against underlying tangible assets, as tangible assets. For instance, the Basel Committee while issuing responses to FAQs related to changes in lease accounting clarified that *“for regulatory capital purposes, an ROU Asset should not be deducted from regulatory capital so long as the underlying asset being leased is a tangible asset”* (Source- Press release dated April 6, 2017). In the absence of definitive guidance in the Indian Accounting Standards on whether RoU asset shall be treated as tangible or intangible, the aforesaid clarification can be relied upon. (Emphasis supplied by the querist.)

B. Query

6. In view of above, the querist has sought the opinion of EAC as to whether Right-of-Use (RoU) asset recognised in accordance with Ind AS 116, ‘Leases’ against underlying leased premises, shall be considered as ‘Tangible Assets’ or ‘Intangible Assets’.

C. Points considered by the Committee

7. The Committee notes that the basic issue raised by the querist relates to classification of right-of-use (RoU) asset recognised in accordance with Ind AS 116, ‘Leases’ against underlying leased premises. The Committee has, therefore, considered only this issue and has not examined any other issue that may arise from the Facts of the Case, such as, recognition, measurement and derecognition of RoU asset, accounting for lease liability, depreciation/amortisation of RoU asset, accounting for interest expense on lease liability, etc. The opinion expressed hereinafter is in the context of Indian Accounting Standards (Ind AS), notified under the Companies (Indian Accounting Standards) Rules, 2015 as amended or revised from time to time.

At the outset, the Committee wishes to point out that the Committee has examined the issue purely from accounting perspective only and not from any other perspective including for regulatory capital purposes, such as under RBI regulations or Basel norms. In this regard, the Committee notes that Ind AS 116 lays down accounting treatment of RoU asset, which includes requirements for recognition, measurement, presentation and disclosure. For recognition and measurement, the Standard does not make any distinction based on the nature of underlying asset of the RoU asset (for example, on the basis of tangible or intangible asset); however, for presentation and disclosure purposes, the Standard considers the nature of underlying asset, viz., tangible or intangible – where an entity decides to follow Ind AS 116 for intangible assets as per paragraph 4 thereof (as discussed in paragraphs below). Therefore, from accounting perspective, the issue raised in regard to classification of RoU asset has been examined in the context of presentation and disclosure of RoU asset in the financial statements (Balance Sheet). Therefore, the opinion expressed hereinafter is in this context only.

8. With regard to presentation and disclosure in the financial statements, the Committee notes from the requirements of Ind AS 116 (as reproduced below) that in case the Company elects not to present RoU asset separately from other assets, it would be presented in the same line item as that of the *owned* underlying asset and if the owned underlying asset meets the definition of PPE² (as is the situation for leased office premises/buildings in the extant case), the same will be presented under PPE, i.e., the presentation takes into consideration the nature of underlying asset including physical substance, viz., tangible or intangible:

- “47 A lessee shall either present in the balance sheet, or disclose in the notes:
- (a) right-of-use assets separately from other assets. If a lessee does not present right-of-use assets separately in the balance sheet, the lessee shall:
 - (i) include right-of-use assets within the same line item as that within which the corresponding underlying assets would be presented if they were owned; and
 - (ii) disclose which line items in the balance sheet include those right-of-use assets.
- ...”

Further, in case the Company elects to present the RoU asset separately from other assets, in that case also, considering the requirements of paragraph 30A of Ind AS 1, ‘Presentation of Financial Statements’, that “An entity shall not reduce understandability of its financial statements by.... aggregating material items that have different natures ...”, the nature of the asset (including physical substance, viz., tangible or intangible) is to be considered for presentation/disclosure purposes. In nutshell, for presentation and disclosure purposes in financial statements, the nature of RoU assets, viz., tangible or intangible, is determined on the basis of the nature of the underlying item.

² *Property, plant and equipment* are tangible items that:

- (a) are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and
- (b) are expected to be used during more than one period.

D. Opinion

9. On the basis of the above and for the reasons stated in paragraph 8 above, the Committee is of the opinion that for presentation and disclosure purposes in financial statements, the nature of RoU assets, viz., tangible or intangible, is determined on the basis of the nature of the underlying item. Accordingly, in the extant case, for presentation and disclosure purposes, if the RoU asset is not presented as a separate line item in the balance sheet, the nature of RoU asset will be determined on the basis of underlying tangible leased premises.
