


AS 19 — Leases

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Agenda


What We Will Cover Today

01	02
Core of the Standard Objective, scope, key definitions, and classification criteria for finance vs. operating leases	Accounting Treatment Recognition, measurement, and disclosure requirements for lessees and lessors
03	04
Practical Issues Complexities in real-world application — sale and leaseback, variable rentals, lease modifications, and more	Indian Case Studies High-level summaries of how Indian companies have applied (and sometimes misapplied) AS 19 in practice

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Crux of the Standard

Objective, Scope & Key Definitions



Objective

AS 19 prescribes the accounting policies and disclosures applicable to finance and operating leases for both lessees and lessors, ensuring transparent reflection of lease obligations and assets in financial statements.

Scope — What is Excluded

- Lease agreements to explore or use natural resources (oil, gas, minerals)
- Licensing agreements for films, plays, patents, and copyrights
- Lease agreements to use lands (covered by other standards)

Key Definition

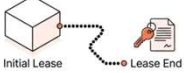
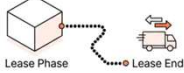
A lease is an agreement whereby the lessor conveys to the lessee, in return for a payment or series of payments, the right to use an asset for an agreed period of time.

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Crux of the Standard

Classification: Finance Lease vs. Operating Lease

Classification hinges on the substance of the transaction rather than its legal form. A lease is classified as a finance lease if it transfers substantially all risks and rewards incidental to ownership of an asset.

<p>Finance Lease</p>  <p>Ownership Transfers or Bargain Purchase Option exists. Term is Major Part of useful life.</p>	<p>Operating Lease</p>  <p>Risks & Rewards Remain with Lessor. Asset Returned at end. Rentals Expensed straight-line.</p>
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The classification is made at the inception of the lease and is not changed during the lease term, unless the lessee and lessor agree to change the provisions of the lease (other than renewals)

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Crux of the Standard

Accounting by Lessees

<p>Finance Lease — Lessee</p> <ul style="list-style-type: none"> Recognise asset and liability at lower of fair value or present value of minimum lease payments (MLP) at inception Depreciate the asset over its useful life (or lease term if ownership transfer is not certain) Apportion lease payments into finance charge and reduction of liability using the effective interest method Disclose net carrying amount, reconciliation of MLP to PV, contingent rents, and general lease terms 	<p>Operating Lease — Lessee</p> <ul style="list-style-type: none"> Lease payments recognised as expense on a straight-line basis over the lease term Any deviation from straight-line must reflect the time pattern of benefit — but straight-line is the default Disclose future MLP for <1 year, 1–5 years, and >5 years Disclose total lease and sublease payments recognised in P&L for the period
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Crux of the Standard

Accounting by Lessors

<p>Finance Lease — Lessor</p> <p>Recognise receivable equal to net investment in the lease. Allocate finance income over the lease term using the effective interest method, reflecting a constant periodic rate of return on the net investment.</p>	<p>Manufacturer / Dealer Lessor</p> <p>Recognise selling profit or loss at inception of a finance lease, equivalent to an outright sale. Finance income is earned over the lease term; selling profit is not inflated by artificially low discount rates.</p>	<p>Operating Lease — Lessor</p> <p>Continue to present the leased asset on the balance sheet. Recognise lease income on a straight-line basis. Depreciate as per AS 6/AS 10 policy. Initial direct costs are added to the carrying amount of the leased asset.</p>
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PRACTICAL ISSUES

Issue 1: Determining the Lease Term

The Challenge

AS 19 defines the lease term as the **non-cancellable period** plus 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.

In practice, most Indian commercial and retail leases have a base period with renewal options and escalation clauses. Determining "reasonable certainty" requires professional judgement and is frequently contested.

Key Judgement Factors

- Significant leasehold improvements made by the lessee
- Below-market renewal rents (economic compulsion to renew)
- Location-specific assets or retail locations with high foot traffic
- History of renewals by the entity in similar arrangements
- Cost and business disruption of relocating operations

⚠️ A shorter lease term can convert a finance lease into an operating lease — classification risk is significant here.

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PRACTICAL ISSUES

Issue 2: Escalation Clauses & Straight-Line Expense

The Problem

Many Indian leases have annual rent escalation clauses (e.g., 5% or 15% every 3 years). AS 19 requires operating lease payments to be recognised on a **straight-line basis** over the lease term, unless another systematic basis is more representative of the time pattern of the user's benefit.

This means the total lease rentals payable over the entire lease term must be averaged and charged uniformly to the P&L — even though actual cash outflows differ year to year. A **deferred rent liability** (or prepaid rent asset) is created in the balance sheet.

Illustration

Year	Actual Rent (₹ Lakh)	Straight-Line (₹ Lakh)
Year 1	10	12.5
Year 2	10	12.5
Year 3	15	12.5
Year 4	15	12.5

☐ Total charge = ₹50 Lakh in both cases. Straight-line simply smooths the recognition pattern.

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PRACTICAL ISSUES

Issue 3: Sale and Leaseback Transactions

A sale and leaseback involves selling an asset and immediately leasing it back. The accounting treatment depends on whether the leaseback is a finance lease or an operating lease.

Finance Leaseback	Operating Leaseback at Fair Value	Operating Leaseback Below Fair Value
Any excess of sale proceeds over the carrying amount is deferred and amortised over the lease term. The transaction is in substance a financing arrangement — the seller retains risks and rewards of ownership.	Any profit or loss is recognised immediately in the P&L. The sale is a genuine disposal and the leaseback is an independent operating arrangement at market terms.	If the sale price is below fair value, profit/loss is recognised immediately — except that if the loss is compensated by below-market future rentals, it is deferred and amortised in proportion to the lease payments over the period of use.

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PRACTICAL ISSUES

Issue 4: Land and Building Leases

The Core Complexity

AS 19 specifically excludes lease agreements for the use of **lands**. However, a lease that covers both land and a building must be **split into two components** — the land element (excluded from AS 19) and the building element (covered by AS 19).

In practice, this requires allocation of lease payments between land and building based on relative fair values at inception, which is often difficult in Indian urban markets where land values dominate.

Practical Guidance

- Obtain a valuation report to split fair values of land vs. building at inception
- If the land element is immaterial, treat the entire lease as a building lease under AS 19
- Long-term land leases (99-year leases common in India) often have economic characteristics of ownership — evaluate substance carefully
- SEB-listed entities have faced scrutiny from auditors on long-term land lease classification under AS 19

⚠️ This split is one of the most frequently misapplied aspects of AS 19 in India.

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PRACTICAL ISSUES

Issue 5: Contingent Rents & Variable Lease Payments

What Are Contingent Rents?

AS 19 defines **contingent rent** as that portion of lease payments which is not fixed in amount but is based on a factor other than the passage of time — for example, percentage of sales, usage, index, or market interest rates.

Contingent rents are **excluded from minimum lease payments** (MLPs) and are recognised as expense or income in the period incurred. This significantly affects the classification of a lease and the PV computation.

Indian Context

- Mall operators frequently charge retail tenants a base rent plus a percentage of monthly revenue (revenue-sharing model)
- The revenue-linked component is a contingent rent — not to be capitalised or included in MLPs
- Only the fixed base rent component is included in computing PV of MLPs for classification
- Disclosure of contingent rents recognised in P&L is mandatory under AS 19 para 37(c)

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INDIAN CASE STUDY

Shopper's Stop Ltd. — Retail Operating Leases

Background

Shopper's Stop operates large-format department stores across India, predominantly in leased premises within malls. Lease terms typically range from 9 to 15 years with renewal options and periodic rent escalations.

AS 19 Issue Identified

The company entered into multiple operating leases with **15–25% escalation clauses** every 3 years. Early financial statements recognised rent expense on a cash basis (i.e., actual rentals paid), not on the straight-line basis required by AS 19.

Resolution & Impact

- On transition and subsequent audit scrutiny, deferred rent liabilities were recognised to reflect the straight-line adjustment
- Profit for early years was reduced; profit for later years (when higher actual rents were payable) was higher than previously reported
- The adjustment created a significant balance sheet item — **deferred rent liability** — previously absent from reported financials

📌 This case illustrates how cash-basis rent recognition, while intuitive, is non-compliant with AS 19 for operating leases with escalation clauses.

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INDIAN CASE STUDY 2

Infosys Ltd. — Operating Leases & Disclosure Quality

Context

Infosys, as a large listed company applying AS (pre-Ind AS transition), provided detailed AS 19 disclosures for its extensive portfolio of office space and equipment operating leases across India and internationally. Their approach is widely regarded as a benchmark for disclosure quality under AS 19.

Key Disclosure Practices

- Future MLP obligations disclosed in three maturity buckets (<1 year, 1–5 years, >5 years) as required
- Contingent rents (utility-linked charges) separately identified and disclosed
- Lease renewal options and escalation terms described in notes to accounts
- Sub-lease income disclosed separately, with corresponding future income schedule

Infosys's disclosures demonstrate that a robust operating lease note goes well beyond the minimum required — enhancing investor confidence and audit defensibility.

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INDIAN CASE STUDY 3

DLF Ltd. — Sale and Leaseback of Commercial Properties

Transaction Structure

DLF, India's largest listed real estate developer, has entered into sale and leaseback structures involving commercial office assets — selling completed buildings to institutional investors (including its own REIT vehicle) and leasing them back for continued occupation by tenants.

AS 19 Application Issues

- Determining whether the leaseback qualifies as a finance or operating leaseback is critical — it determines whether the gain on sale is deferred or immediately recognised
- Where the leaseback was structured as an operating lease at fair value, gains were recognised immediately in P&L — boosting reported profitability
- Auditors scrutinised whether the "fair value" used was genuinely arms-length, particularly in related-party structures
- The ICAI and SEBI have flagged such structures as requiring enhanced scrutiny to prevent premature profit recognition

⚠️ Sale and leaseback transactions in real estate remain a high-risk area for misapplication of AS 19 gain recognition principles.

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Summary & Key Takeaways

Applying AS 19 with Professional Rigour

Substance Over Form

Classification always depends on economic substance — who bears the risks and rewards of ownership — not the legal label attached to the arrangement.

Straight-Line is Non-Negotiable

For operating leases, straight-line recognition of lease expense is the mandatory default. Escalation clauses create deferred rent balances — these must appear on the balance sheet.

Disclosure is a Compliance Act

The AS 19 disclosure requirements are detailed and specific. Inadequate disclosure — even if recognition is correct — is a compliance failure and an audit risk.

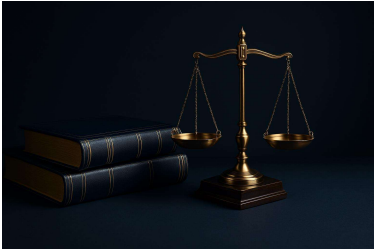
High-Risk Areas to Watch

Sale-leaseback gain recognition, land-building splits, lease term determination with renewals, and contingent rent exclusions from MLP are the most frequent audit and regulatory flashpoints.

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Thank you

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