SIC Interpretation 15

Operating Leases—Incentives

This version includes amendments resulting from IFRSs issued up to 31 December 2010.

SIC-15 *Operating Leases—Incentives* was developed by the Standing Interpretations Committee and issued in December 1998.

In April 2001 the International Accounting Standards Board resolved that all Standards and Interpretations issued under previous Constitutions continued to be applicable unless and until they were amended or withdrawn.

Since then, SIC-15 has been amended by the following IFRSs:

- IAS 17 *Leases* (as revised in December 2003)
- IAS 1 *Presentation of Financial Statements* (as revised in September 2007).[*]

[*] effective date 1 January 2009

SIC Interpretation 15 *Operating Leases—Incentives* (SIC-15) is set out in paragraphs 3–6. SIC-15 is accompanied by a Basis for Conclusions and illustrative examples. The scope and authority of Interpretations are set out in paragraphs 2 and 7–16 of the *Preface to International Financial Reporting Standards*.

SIC Interpretation 15
Operating Leases—Incentives

References

- IAS 1 *Presentation of Financial Statements* (as revised in 2007)
- IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*
- IAS 17 *Leases* (as revised in 2003)

Issue

1 In negotiating a new or renewed operating lease, the lessor may provide incentives for the lessee to enter into the agreement. Examples of such incentives are an up-front cash payment to the lessee or the reimbursement or assumption by the lessor of costs of the lessee (such as relocation costs, leasehold improvements and costs associated with a pre-existing lease commitment of the lessee). Alternatively, initial periods of the lease term may be agreed to be rent-free or at a reduced rent.

2 The issue is how incentives in an operating lease should be recognised in the financial statements of both the lessee and the lessor.

Consensus

3 All incentives for the agreement of a new or renewed operating lease shall be recognised as an integral part of the net consideration agreed for the use of the leased asset, irrespective of the incentive's nature or form or the timing of payments.

4 The lessor shall recognise the aggregate cost of incentives as a reduction of rental income over the lease term, on a straight-line basis unless another systematic basis is representative of the time pattern over which the benefit of the leased asset is diminished.

5 The lessee shall recognise the aggregate benefit of incentives as a reduction of rental expense over the lease term, on a straight-line basis unless another systematic basis is representative of the time pattern of the lessee's benefit from the use of the leased asset.

6 Costs incurred by the lessee, including costs in connection with a pre-existing lease (for example costs for termination, relocation or leasehold improvements), shall be accounted for by the lessee in accordance with the Standards applicable to those costs, including costs which are effectively reimbursed through an incentive arrangement.

Date of consensus

June 1998

Effective date

This Interpretation becomes effective for lease terms beginning on or after 1 January 1999.

Basis for Conclusions on SIC Interpretation 15 *Operating Leases—Incentives*

This Basis for Conclusions accompanies, but is not part of, SIC-15.

[The original text has been marked up to reflect the revision of IASs 8 and 17 in 2003 and of IAS 1 in 2007: new text is underlined and deleted text is struck through. References to the Framework *are to IASC's* Framework for the Preparation and Presentation of Financial Statements, *adopted by the IASB in 2001. In September 2010 the IASB replaced the* Framework *with the* Conceptual Framework for Financial Reporting.*]*

7 Paragraph 35 of the *Framework*[*] explains that if information is to represent faithfully the transactions and events that it purports to represent, it is necessary that transactions and events are accounted for and presented in accordance with their substance and economic reality and not merely their legal form. IAS ~~1.20(b)(ii)~~ 8.10(b)(ii) also requires the application of accounting policies which reflect economic substance.

8 Paragraph 22 of the *Framework*[†] and IAS 1.~~25~~27 require the preparation of financial statements under the accrual basis of accounting. IAS 17.33~~25~~ and IAS 17.50~~42~~ specify the basis on which lessees and lessors respectively should recognise amounts payable or receivable under operating leases.

9 The underlying substance of operating lease arrangements is that the lessor and lessee exchange the use of an asset for a specified period for the consideration of a net amount of money. The accounting periods in which this net amount is recognised by either the lessor or the lessee is not affected by the form of the agreement or the timing of payments. Payments made by a lessor to or on behalf of a lessee, or allowances in rental cost made by a lessor, as incentives for the agreement of a new or renewed lease are an inseparable part of the net amount receivable or payable under the operating lease.

10 Costs incurred by the lessor as incentives for the agreement of new or renewed operating leases are not considered to be part of those initial costs which ~~may be recognised as an expense in the income statements in the period in which they are incurre~~d are added to the carrying amount of the leased asset and recognised as an expense over the lease term on the same basis as the lease income in accordance with ~~under~~ IAS 17.52~~44~~. Initial costs, such as direct costs for administration, advertising and consulting or legal fees, are incurred by a lessor to arrange a contract, whereas incentives in an operating lease are, in substance, related to the consideration for the use of the leased asset.

11 Costs incurred by the lessee on its own behalf are accounted for using the applicable recognition requirements. For example, relocation costs are recognised as an expense in profit or loss ~~the income statement~~ in the period in which they are incurred. The accounting for such costs does not depend on whether or not they are effectively reimbursed through an incentive arrangement as they are not related to the consideration for the use of the leased asset.

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* Paragraph 35 was superseded by Chapter 3 of the *Conceptual Framework*.

† Paragraph 22 was not carried forward into the *Conceptual Framework*.

Illustrative examples

These examples accompany, but are not part of, SIC-15.

Example application of SIC-15

Example 1

An entity agrees to enter into a new lease arrangement with a new lessor. The lessor agrees to pay the lessee's relocation costs as an incentive to the lessee for entering into the new lease. The lessee's moving costs are 1,000. The new lease has a term of 10 years, at a fixed rate of 2,000 per year.

The accounting is:

The lessee recognises relocation costs of 1,000 as an expense in Year 1. Net consideration of 19,000 consists of 2,000 for each of the 10 years in the lease term, less a 1,000 incentive for relocation costs. Both the lessor and lessee would recognise the net rental consideration of 19,000 over the 10 year lease term using a single amortisation method in accordance with paragraphs 4 and 5 of this Interpretation.

Example 2

An entity agrees to enter into a new lease arrangement with a new lessor. The lessor agrees to a rent-free period for the first three years as incentive to the lessee for entering into the new lease. The new lease has a term of 20 years, at a fixed rate of 5,000 per year for years 4 through 20.

The accounting is:

Net consideration of 85,000 consists of 5,000 for each of 17 years in the lease term. Both the lessor and lessee would recognise the net consideration of 85,000 over the 20 year lease term using a single amortisation method in accordance with paragraphs 4 and 5 of this Interpretation.