Compiled Interpretation **Interpretation 115**

Operating Leases – Incentives

This compiled UIG Interpretation applies to annual reporting periods beginning on or after 1 January 2014. Early application is not permitted. It incorporates relevant amendments made up to and including 20 December 2013.

Prepared on 30 July 2014 by the staff of the Australian Accounting Standards Board.

Australian Government

Australian Accounting Standards Board

Obtaining Copies of Interpretations

Compiled versions of Interpretations, original Interpretations and amending pronouncements (see Compilation Details) are available on the AASB website: www.aasb.gov.au.

Printed copies of original Interpretations and amending pronouncements are available for purchase by contacting:

The Customer Service Officer
Australian Accounting Standards Board
Level 7
600 Bourke Street
Melbourne Victoria
AUSTRALIA

Postal address:
PO Box 204
Collins Street West Victoria 8007
AUSTRALIA

Phone: (03) 9617 7637
Fax: (03) 9617 7608
E-mail: publications@aasb.gov.au
Website: www.aasb.gov.au

Other Enquiries

Phone: (03) 9617 7600
Fax: (03) 9617 7608
E-mail: standard@aasb.gov.au

COMPILATION DETAILS

UIG Interpretation 115 *Operating Leases – Incentives* as amended

This compiled Interpretation applies to annual reporting periods beginning on or after 1 January 2014. It takes into account amendments up to and including 20 December 2013 and was prepared on 30 July 2014 by the staff of the Australian Accounting Standards Board (AASB).

This compilation is not a separate Interpretation issued by the AASB. Instead, it is a representation of Interpretation 115 (July 2004) as amended by other pronouncements, which are listed in the Table below.

Table of Pronouncements

Pronouncement	**Month issued**	**Application date** ***(annual reporting periods … on or after …)***	**Application, saving or transitional provisions**
Interpretation 115	Jul 2004	*(beginning)* 1 Jan 2005	
AASB 2007-8	Sep 2007	*(beginning)* 1 Jan 2009	see (a) below
AASB 2009-6	Jun 2009	*(beginning)* 1 Jan 2009 and *(ending)* 30 Jun 2009	see (b) below
AASB 2010-5	Oct 2010	*(beginning)* 1 Jan 2011	see (c) below
AASB 2013-9	Dec 2013	Pt A *(ending)* 20 Dec 2013 Pt B *(beginning)* 1 Jan 2014	see (d) below see (e) below

(a) Entities may elect to apply this Standard to annual reporting periods beginning on or after 1 January 2005 but before 1 January 2009, provided that AASB 101 *Presentation of Financial Statements* (September 2007) is also applied to such periods.

(b) Entities may elect to apply this Standard to annual reporting periods beginning on or after 1 January 2005 but before 1 January 2009, provided that AASB 101 *Presentation of Financial Statements* (September 2007) is also applied to such periods, and to annual reporting periods beginning on or after 1 January 2009 that end before 30 June 2009.

(c) Entities may elect to apply this Standard to annual reporting periods beginning on or after 1 January 2005 but before 1 January 2011.

(d) Entities may elect to apply this Standard to annual reporting periods beginning on or after 1 January 2005 that end before 20 December 2013, provided that AASB CF 2013-1 *Amendments to the Australian Conceptual Framework* and AASB 1048 *Interpretation of Standards* (December 2013) are also applied to the such periods.

(e) Early application of Part B of this Standard is not permitted.

Table of Amendments to Interpretation

Paragraph affected	How affected	By … [paragraph]
Aus6.4	amended deleted	AASB 2007-8 [8] AASB 2013-9B [37, 38]
7	amended	AASB 2013-9A [32]
8	amended amended	AASB 2009-6 [119] AASB 2013-9A [33]
11	amended amended	AASB 2007-8 [6] AASB 2009-6 [120]

Table of Amendments to Illustrative Examples

Paragraph affected	How affected	By … [paragraph]
Title, rubric, heading	renamed and amended	AASB 2010-5 [70, 71]
Example 2	amended	AASB 2009-6 [121]

COMPARISON WITH SIC-15

UIG Interpretation 115 *Operating Leases – Incentives* as amended incorporates Standing Interpretations Committee Interpretation SIC-15 *Operating Leases – Incentives*, issued by the International Accounting Standards Board. Paragraphs that have been added to this Interpretation (and do not appear in the text of SIC-15) are identified with the prefix "Aus", followed by the number of the preceding SIC paragraph and decimal numbering.

Entities that comply with Interpretation 115 as amended will simultaneously be in compliance with SIC-15 as amended.

INTERPRETATION 115

UIG Interpretation 115 was issued in July 2004.

This compiled version of Interpretation 115 applies to annual reporting periods beginning on or after 1 January 2014. It incorporates relevant amendments contained in other AASB pronouncements up to and including 20 December 2013 (see Compilation Details).

URGENT ISSUES GROUP

INTERPRETATION 115

OPERATING LEASES – INCENTIVES

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 Australian Accounting Standards applicable to those costs, including costs which are effectively reimbursed through an incentive arrangement.**

Application

Aus6.1 This Interpretation applies when Accounting Standard AASB 117 *Leases* applies.

Aus6.2 This Interpretation applies to annual reporting periods beginning on or after 1 January 2005.
[Note: For application dates of paragraphs changed or added by an amending pronouncement, see Compilation Details.]

Aus6.3 This Interpretation shall not be applied to annual reporting periods beginning before 1 January 2005.

Aus6.4 [Deleted by the AASB]

Aus6.5 When applicable, this Interpretation supersedes Abstract 3 *Lessee Accounting for Lease Incentives Under a Non-Cancellable Operating Lease*, as issued in August 1995.

Aus6.6 Abstract 3 remains applicable until superseded by this Interpretation.

Discussion

7 Paragraph 35 of the *Framework for the Preparation and Presentation of Financial Statements*[1] 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. AASB 108 *Accounting Policies, Changes in*

1 In December 2013 the AASB amended the *Framework*. Paragraph 35 was superseded by Chapter 3 of the *Framework*. References to the *Framework* in this Interpretation are to the *Framework for the Preparation and Presentation of Financial Statements* (as identified in AASB 1048 *Interpretation of Standards*).

Accounting Estimates and Errors, paragraph 10(b)(ii), also requires the application of accounting policies which reflect economic substance.

8 Paragraph 22 of the *Framework*[2] and AASB 101 *Presentation of Financial Statements*, paragraph 27, require the preparation of financial statements under the accrual basis of accounting. AASB 117.33 and 117.50 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 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 AASB 117.52. 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 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.

Date of SIC's Consensus: [Deleted by the UIG]

Effective Date of SIC-15: [Deleted by the UIG]

---

2 In December 2013 the AASB amended the *Framework*. Paragraph 22 was deleted.

ILLUSTRATIVE EXAMPLES

These examples accompany, but are not part of, Interpretation 115.

Example Application of Interpretation 115

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.

REFERENCES

Australia

The Urgent Issues Group discussed Issues Paper UIG/SIC 04/1 “Adoption of Various SIC Interpretations in Australia” in relation to this Interpretation at its meeting on 4 May 2004.

Accounting Standard AASB 101 *Presentation of Financial Statements*

Accounting Standard AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors*

Accounting Standard AASB 117 *Leases*

Framework for the Preparation and Presentation of Financial Statements

International Accounting Standards Board

International Accounting Standard IAS 17 *Leases*

Standing Interpretations Committee Interpretation SIC-15 *Operating Leases – Incentives*

IFAC Public Sector Committee

International Public Sector Accounting Standard IPSAS 13 *Leases*

DELETED SIC-15 TEXT

Deleted SIC-15 text is not part of UIG Interpretation 115.

Date of SIC's Consensus

June 1998

Effective Date of SIC-15

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