

OPERATING LEASES — INCENTIVES: SIC 15

In a lease arrangement a lessor can provide the following incentives:

- **up-front cash payment** to the lessee
- 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)
- **Free rent** for a certain period (i.e. first month free)
- **Reduced rent**

Accounting for lease incentives in an operating lease

In the lessor's books

- The lessor recognises the total cost of incentives as a reduction of rental income over the lease term, on a straight-line basis

In the lessee's books

- The lessee recognises the total benefit of incentives as a reduction of rental expense over the lease term, on a straight-line basis

Example

- Bob leases office space from Tom for 5 years at \$12,000 per year; Tom provides the first year rent free
- Rent expense/income per year = $(4 \times 12,000) / 5 = \$9,600$
- **In the books of the lessee (Bob):**
 - Year 1:

Dr. Rent Expense.....	9,600
Cr. Rent Liability.....	9,600
 - Years 2 - Year 5:

Dr. Rent Expense.....	9,600
Dr. Rent Liability.....	2,400
Cr. Cash.....	12,000
- **In the books of the lessor (Tom):**
 - Year 1:

Dr. Rent Asset.....	9,600
Cr. Rent Revenue.....	9,600
 - Years 2 - Year 5:

Dr. Cash.....	12,000
Cr. Rent Asset.....	2,400
Cr. Rent Revenue.....	9,600