



## Solution 120.2

<b>Component</b>	Retail and consumer
<b>Index</b>	Leases
<b>Short title</b>	Accounting for rent-free period – renewal options

**Attention:** This guidance is based on the revised standards and interpretations that are mandatory for accounting periods commencing 1 January 2005. A company may early adopt an individual revised standard, but only in its entirety. Guidance based on the previous version of the standards is included in the “Applying IFRS 2004” guidance.

### Issue

Lease payments under an operating lease are recognised as an expense in the income statement on a straight-line basis over the lease term unless the time pattern of the user’s benefit is better represented by another basis [IAS17R.33].

The lease term is the non-cancellable period for which the asset is leased, together with any further terms for which there is an option to continue to lease the asset, with or without further payment. That option should be reasonably certain to be exercised at the inception of the lease [IAS17R.3].

Should the intention to renew an agreement affect the allocation of the rental expenses?

### Background

A retailer enters into a lease agreement for a new store.

The agreement is for a period of five years and does not include an option to buy the property. The retailer will not have to make any payments during the first year of the lease term. The agreement grants the retailer an option to renew the lease for a further period of five years.

The retailer has made significant expenditure to tailor the premises to its required branding standards. Management is not reasonably certain at inception of the lease that it will exercise the option.

### Solution

Yes. Intention affects the allocation of the rental expenses.

Management should estimate and allocate the rental expenses on a straight-line basis over the five-year period. That is, management should allocate 20% of the total lease payments to each year.

The lease term is five years, because management is not reasonably certain at the inception of the lease to use the option.