

Building Lease with Revision for Reassessment of Contingent Rentals

****Disclaimer –** The exposure draft received nearly 700 letters of comment through the comment period ended December 15, 2010. There is some expectation that key features of the standard will be modified as a result of constituent response. As a result, these illustrative examples will not likely be accurate or appropriate to rely upon after issuance of the final standard. We have provided these as an educational tool only and do not represent these examples to be accurate under current or future final standards. Any templates used in the examples below are for internal use only and are not available for distribution.

Leasing Example – **Building Lease With Revision of Asset and Liability for Reassessment of Contingent Rentals**

Subject:

ABC Corporation has entered into a lease of a building to house its operations.

Details:

The lease terms are as follows:

Tenant:	ABC Corporation (ABC)
Lessor:	General Properties, LLC (GP, LLC)
Premises:	Suite 100 of the 9999 Building, totaling 20,000 rentable square feet
Term:	10 years
Lease Date	November 1, 2009
Commencement Date:	January 1, 2010
Base Rental:	\$22 per square foot for 2010 with a 5% increase annually on January 1
Contingent Rent:	Additional rent is payable annually if specified minimum sales level is achieved with amount based on percentage of various levels of sales achieved above the specified minimum level
Initial Direct Costs	ABC Corporation paid an attorney \$9,000 in general fees and \$1,000 for document preparation in conjunction with the lease process
Commissions	Commissions on the lease of \$50,000 are paid directly by the lessor
Security Deposit:	\$25,000
Free Rent Period:	No rent shall be due for January 1, 2010 through March 31, 2010
Option to Extend:	Lease may be extended for one (1) additional term of five (5) years with a significant termination penalty if not extended
% share Operating Costs:	Certain operating costs of the building will be allocated at \$25,000 annually for CAM
Subletting:	Not permitted
Build Out Allowance:	None at inception, \$50,000 build out allowance provided at the beginning of year 6 of the lease and at renewal, if extended
Residual Value Guarantees:	None
Purchase Option	None, but failure to renew does trigger a significant penalty in the contract

Other relevant assumptions:

Incremental borrowing:	The incremental borrowing rate of ABC Corporation is 7%
Rate charged by Lessor	This rate cannot be reliably determined by the lessee, but was computed at 8% for the lessor
Likelihood of extension:	More likely than not due to the term penalty
Reassessment:	Throughout the period, reassessment of contingent rentals occurs annually and no reassessment of impairment occurs

Amortization: The Right to Use Asset (lessee) and Lease Liability (lessor) will be amortized straight line over the life of the lease

The recorded lease liability includes a provision for contingent rentals based on estimated sales. At the end of 2014, the lessee determined that facts and circumstances indicated a significant change in the expected liability under the lease based on estimates of future sales since the previous reporting period. Accordingly, the lessee reassessed the expected amount of contingent rentals under paragraph 17 of the Exposure Draft (ED).

Following a probability-weighted approach using a reasonable number of expected outcomes, the lessee determined that the net present value of expected future lease payments had increased by \$325,000. Therefore, the lessee will make the following entry at December 31, 2014:

Right of use assets	\$325,000	
Lease liabilities		\$325,000

It is important to note that if a portion of the adjustment was related to sales of prior periods, that portion of the liability would be recorded in current income under paragraph 18 of the ED. In this scenario, since the increase in the liability is assumed to be related to future sales, the adjustment is recorded as an increase in right of use assets and will be amortized over the remaining lease term.

Entries to amortize the lease liability and right of use assets are revised to amortize the adjusted liability and right of use asset over the remaining lease term.

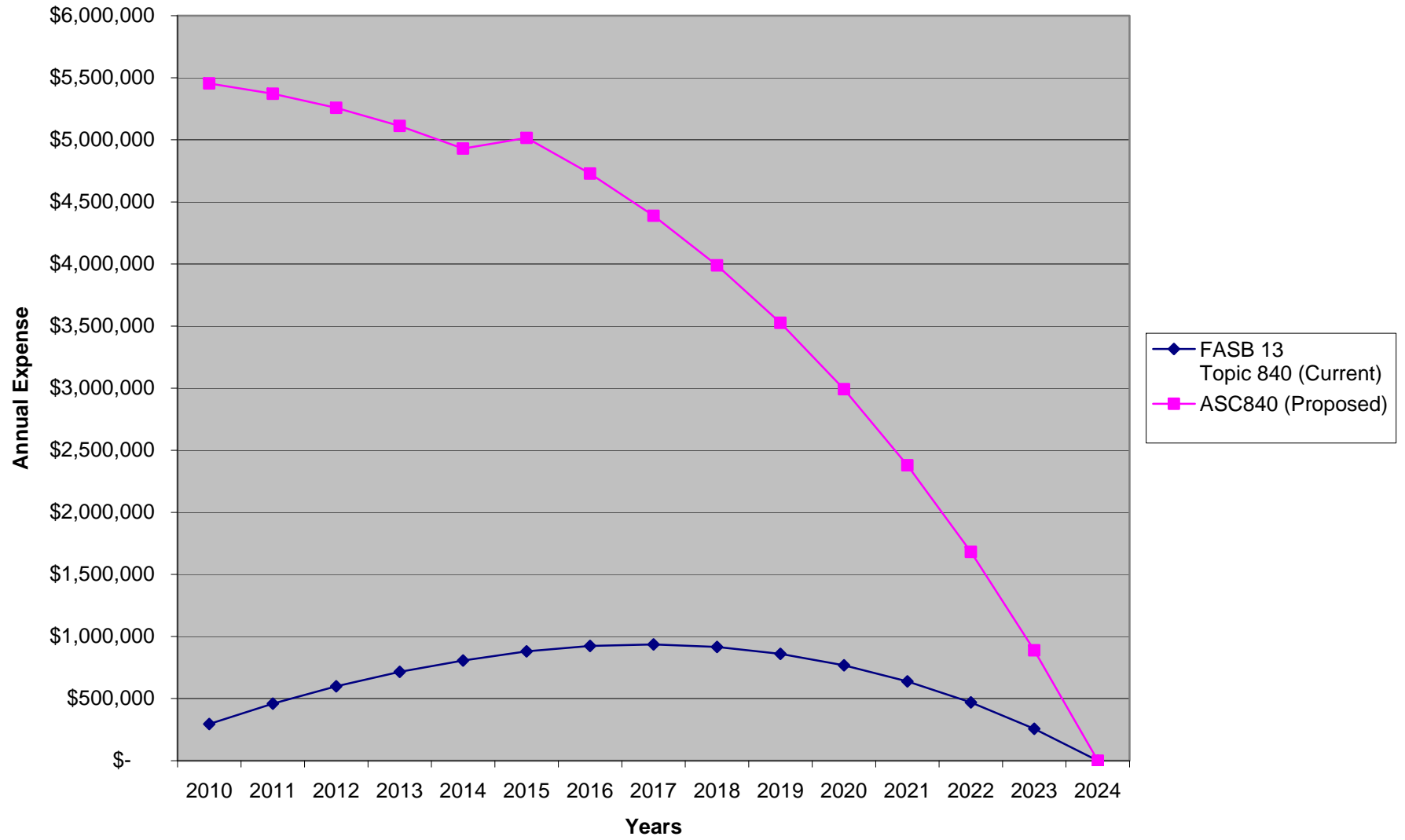
The tables following show the effect of this reassessment on the accounting for this lease under both the existing guidance in ASC 840 and under the ED.

Comparison of Financial Statement Impact for Life of the Lease

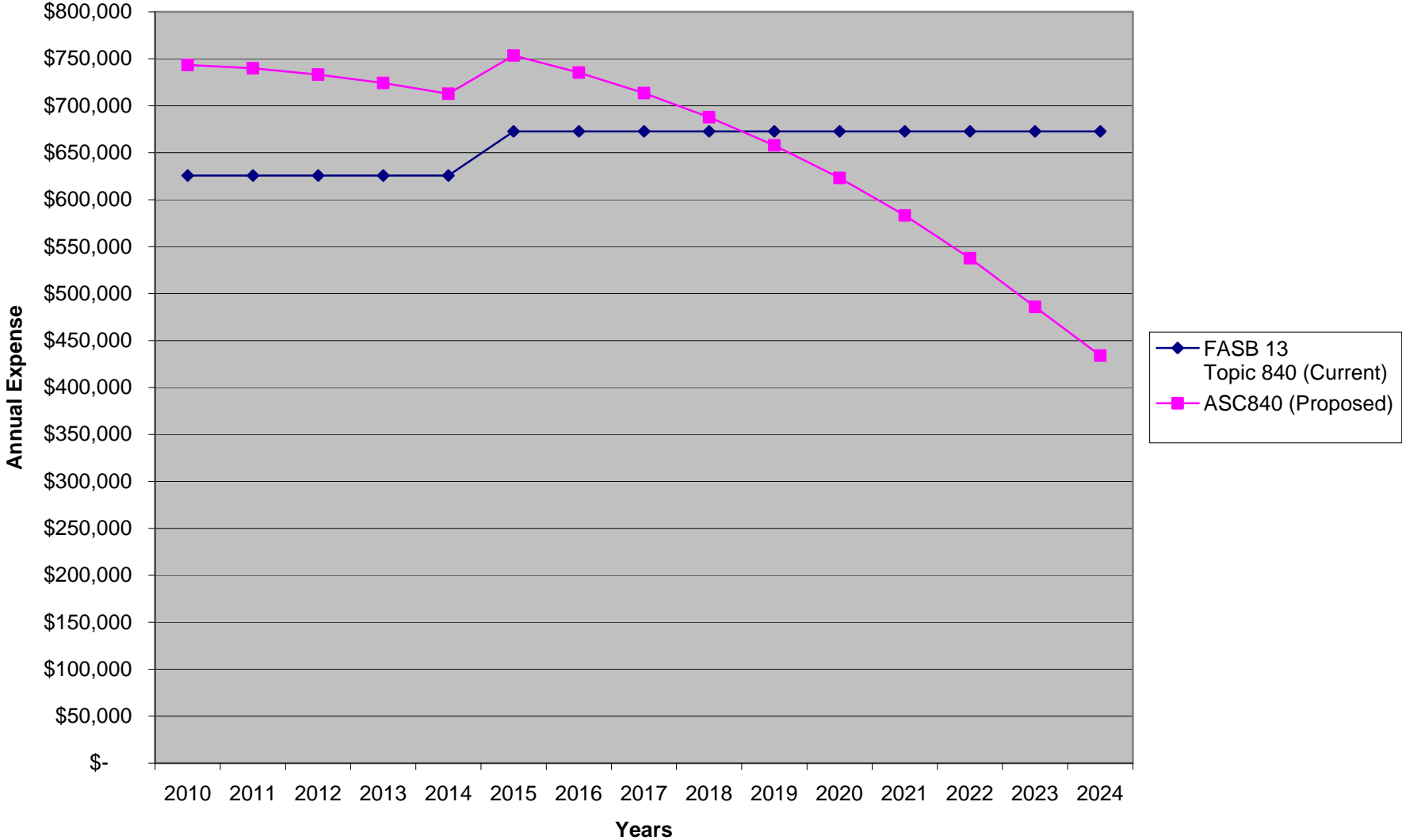
Detailed balance sheet comparisons follow, but the summary impact of key elements are listed below:

Year	Lease Expense vs. Amortization and Interest Expense		Right To Use Asset (Not Recorded under Current Accounting)		Straight Line Liability vs. Lease Liability	
	FASB 13 Topic 840 (Current)	ASC840 (Proposed)	FASB 13 Topic 840 (Current)	ASC840 (Proposed)	FASB 13 Topic 840 (Current)	ASC840 (Proposed)
2009	\$ 10,000	\$ -				
2010	\$ 625,653	\$ 743,398		\$ 5,050,477	\$ 295,653	\$ 5,453,874
2011	\$ 625,653	\$ 739,895		\$ 4,689,729	\$ 459,307	\$ 5,371,021
2012	\$ 625,653	\$ 733,146		\$ 4,328,980	\$ 599,760	\$ 5,258,219
2013	\$ 625,653	\$ 724,200		\$ 3,968,232	\$ 716,013	\$ 5,112,271
2014	\$ 625,653	\$ 712,819		\$ 3,932,368	\$ 806,867	\$ 4,929,541
2015	\$ 672,693	\$ 753,483		\$ 3,539,131	\$ 880,560	\$ 5,015,672
2016	\$ 672,693	\$ 735,242		\$ 3,145,895	\$ 924,254	\$ 4,728,677
2017	\$ 672,693	\$ 713,468		\$ 2,752,658	\$ 936,547	\$ 4,388,509
2018	\$ 672,693	\$ 687,798		\$ 2,359,421	\$ 915,840	\$ 3,989,669
2019	\$ 672,693	\$ 657,834		\$ 1,966,184	\$ 860,534	\$ 3,526,266
2020	\$ 672,693	\$ 623,143		\$ 1,572,947	\$ 768,827	\$ 2,991,772
2021	\$ 672,693	\$ 583,255		\$ 1,179,710	\$ 638,920	\$ 2,379,190
2022	\$ 672,693	\$ 537,656		\$ 786,473	\$ 468,814	\$ 1,680,810
2023	\$ 672,693	\$ 485,790		\$ 393,236	\$ 256,507	\$ 888,362
2024	\$ 672,693	\$ 434,075		\$ (1)	\$ 0	\$ (0)
2025	\$ -	\$ -		\$ -	\$ -	\$ (0)
2026	\$ -	\$ -		\$ -	\$ -	\$ (0)
2027	\$ -	\$ -		\$ -	\$ -	\$ (0)
2028	\$ -	\$ -		\$ -	\$ -	\$ (0)
2029	\$ -	\$ -		\$ -	\$ -	\$ (0)
2030	\$ -	\$ -		\$ -	\$ -	\$ (0)
2031	\$ -	\$ -		\$ -	\$ -	\$ (0)
2032	\$ -	\$ -		\$ -	\$ -	\$ (0)
2033	\$ -	\$ -		\$ -	\$ -	\$ (0)
2034	\$ -	\$ -		\$ -	\$ -	\$ (0)
2035	\$ -	\$ -		\$ -	\$ -	\$ (0)
2036	\$ -	\$ -		\$ -	\$ -	\$ (0)
2037	\$ -	\$ -		\$ -	\$ -	\$ (0)
2038	\$ -	\$ -		\$ -	\$ -	\$ (0)
2039	\$ -	\$ -		\$ -	\$ -	\$ (0)
Totals	\$ 9,865,200	\$ 9,865,201				

Impact on Lease Liability



Impact on Net Income



The table below shows the income statement effects of the reassessment on both the proposed accounting under the Exposure Draft and the current provisions of ASC 840. It is important to note that the effects of the reassessment on the years 2015-2024 in total are the same under both the proposed accounting and current GAAP.

Amortization and Interest Under Exposure Draft Provisions			
Year	Before Reassessment	After Reassessment	Effect of Reassessment
2015	\$ 698,732	\$ 753,483	\$ 54,751
2016	681,651	735,242	53,591
2017	661,265	713,468	52,203
2018	637,228	687,798	50,570
2019	609,159	657,834	48,675
2020	576,653	623,143	46,490
2021	539,272	583,255	43,983
2022	496,542	537,656	41,114
2023	447,940	485,790	37,850
2024	392,902	434,075	41,173
	\$ 5,741,344	\$ 6,211,744	\$ 470,400

Accounting Under Current Provisions of ASC 840			
Year	Before Reassessment	After Reassessment	Effect of Reassessment
2015	\$ 625,653	\$ 672,693	\$ 47,040
2016	625,653	672,693	47,040
2017	625,653	672,693	47,040
2018	625,653	672,693	47,040
2019	625,653	672,693	47,040
2020	625,653	672,693	47,040
2021	625,653	672,693	47,040
2022	625,653	672,693	47,040
2023	625,653	672,693	47,040
2024	625,653	672,693	47,040
	\$ 6,256,530	\$ 6,726,930	\$ 470,400