

FEBRUARY 2011 AP 5A FASB MEMO 129 - APPENDIX A - Application of Approaches (Variable Lease Payments)

A retailer in a 3-year store lease that includes a variable lease payment whereby the lessee pays a base amount of \$50,000 per year plus an additional \$10,000 of rent, paid at the end of the year, for each \$1 million of sales in the lease location up to a maximum of \$30,000. The lessee's incremental borrowing rate is 8%.

The lessee and lessor determine the probability of sales for the lease store generating each of the variable payments as follows. (Note: In most circumstances, the lessee and lessor will not determine the same probabilities. For simplicity in illustrating the approaches, the staff has assumed the same probably weighted expected outcome for the lessee and lessor.) At lease inception, the variable payment estimated is expected to stay the same for all three years.

At the end of Year 1, the variable payment estimated increases to \$8,500 for both Year 2 and Year 3. The actual cash flows in those years match this expectation.

*Note: The application of approaches to the derecognition approach to lessor accounting does not reflect changes to the

Incremental Borrowing Rate		8%			
Assumptions at Inception:					
Year	Base Rent	Cont Rent	Total Rent	PV of Rent	
1	50,000	7,650	57,650	53,380	<i>Estimated</i>
2	50,000	7,650	57,650	49,426	<i>Estimated</i>
3	50,000	7,650	57,650	45,764	<i>Estimated</i>
Assumptions at the End of Year 1:					
Year	Base Rent	Cont Rent	Total Rent	PV of Rent	
1	50,000	8,500	58,500	n/a	<i>Actual</i>
2	50,000	8,500	58,500	54,167	<i>Estimated</i>
3	50,000	8,500	58,500	50,154	<i>Estimated</i>

Actual rent equaled estimated rent in Years 2 & 3.

Exposure Draft (Approach A) - Lessee		
Lease Inception		
Right-of-Use Asset	148,570	
Lease Obligation		148,570
End of Year 1		
Amortization Expense	49,523	
Right-of-Use Asset		49,523
Interest Expense	11,886	
Lease Obligation	45,764	
Additional Lease Expense	850	
Cash		58,500
Right-of-Use Asset	1,516	
Lease Obligation		1,516
End of Year 2		
Amortization Expense	50,281	
Right-of-Use Asset		50,281
Interest Expense	8,346	
Lease Obligation	50,154	
Cash		58,500
End of Year 3		
Amortization Expense	50,281	
Right-of-Use Asset		50,281
Interest Expense	4,333	
Lease Obligation	54,167	
Cash		58,500
Check Figures:		
Total Cash	175,500	
Total Expense	175,500	
Ending Obligation	-	

Exposure Draft (Approach A) - Lessor PO		
Lease Inception		
Lease Receivable	148,570	
Lease Liability		148,570
End of Year 1		
Lease Liability	49,523	
Lease Income		49,523
Cash	58,500	
Interest Income		11,886
Lease Receivable		45,764
Additional Lease Income		850
Lease Receivable	1,516	
Lease Liability		1,516
End of Year 2		
Lease Liability	50,281	
Lease Income		50,281
Cash	58,500	
Interest Income		8,346
Lease Receivable		50,154
End of Year 3		
Lease Liability	50,281	
Lease Income		50,281
Cash	58,500	
Interest Income		4,333
Lease Receivable		54,167
Check Figures:		
Total Cash	175,500	
Total Income	175,500	
Ending Receivable	-	

Exposure Draft (Approach A) - Lessor Derec.		
Lease Inception		
Lease Receivable	148,570	
Lease Income		148,570
End of Year 1		
Cash	58,500	
Interest Income		11,886
Lease Receivable		45,764
Additional Lease Income		850
Lease Receivable	1,516	
Lease Income		1,516
End of Year 2		
Cash	58,500	
Interest Income		8,346
Lease Receivable		50,154
End of Year 3		
Cash	58,500	
Interest Income		4,333
Lease Receivable		54,167
Check Figures:		
Total Cash	175,500	
Total Income	175,500	
Ending Receivable	-	

Alternative View (Approach C) - Lessee

Lease Inception

Right-of-Use Asset	128,855	
Lease Obligation		128,855

End of Year 1

Amortization Expense	42,952	
Right-of-Use Asset		42,952
Interest Expense	10,308	
Lease Obligation	39,692	
Additional Lease Expense	8,500	
Cash		58,500

Right-of-Use Asset	n/a	
Lease Obligation		n/a

End of Year 2

Amortization Expense	42,952	
Right-of-Use Asset		42,952
Interest Expense	7,133	
Lease Obligation	42,867	
Additional Lease Expense	8,500	
Cash		58,500

End of Year 3

Amortization Expense	42,952	
Right-of-Use Asset		42,952
Interest Expense	3,704	
Lease Obligation	46,296	
Additional Lease Expense	8,500	
Cash		58,500

Liability Amortization Schedule

Year	Opening	Interest	Payment	Ending
1	128,855	10,308	(50,000)	89,163
2	89,163	7,133	(50,000)	46,296
3	46,296	3,704	(50,000)	0

Check Figures:

Total Cash	175,500
Total Expense	175,500
Ending Obligation	-

Alternative View (Approach C) - Lessor PO

Lease Inception

Lease Receivable	128,855	
Lease Liability		128,855

End of Year 1

Lease Liability	42,952	
Lease Income		42,952
Cash	58,500	
Interest Income	10,308	
Lease Receivable	39,692	
Additional Lease Income	8,500	

Lease Receivable	n/a	
Lease Liability		n/a

End of Year 2

Lease Liability	42,952	
Lease Income		42,952
Cash	58,500	
Interest Income	7,133	
Lease Receivable	42,867	
Additional Lease Income	8,500	

End of Year 3

Lease Liability	42,952	
Lease Income		42,952
Cash	58,500	
Interest Income	3,704	
Lease Receivable	46,296	
Additional Lease Income	8,500	

Receivable Amortization Schedule

Year	Opening	Interest	Payment	Ending
1	128,855	10,308	(50,000)	89,163
2	89,163	7,133	(50,000)	46,296
3	46,296	3,704	(50,000)	0

Check Figures:

Total Cash	175,500
Total Income	175,500
Ending Receivable	-

Alternative View (Approach C) - Lessor Derec.

Lease Inception

Lease Receivable	128,855	
Lease Income		128,855

End of Year 1

Cash	58,500	
Interest Income	10,308	
Lease Receivable	39,692	
Additional Lease Income	8,500	

Lease Receivable	n/a	
Lease Liability		n/a

End of Year 2

Cash	58,500	
Interest Income	7,133	
Lease Receivable	42,867	
Additional Lease Income	8,500	

End of Year 3

Cash	58,500	
Interest Income	3,704	
Lease Receivable	46,296	
Additional Lease Income	8,500	

Receivable Amortization Schedule

Year	Opening	Interest	Payment	Ending
1	128,855	10,308	(50,000)	89,163
2	89,163	7,133	(50,000)	46,296
3	46,296	3,704	(50,000)	0

Check Figures:

Total Cash	175,500
Total Income	175,500
Ending Receivable	-