

APPENDIX A - Application of Approaches

A retailer in a 3-year store lease that includes a contingent rental arrangement whereby the lessee pays a base amount of \$50,000 per year plus an additional \$10,000 of rent 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 determines the probability of sales for the lease store generating each of the various contingent rental amounts 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 contingent rental amount estimated is expected to stay the same for all three years.

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

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)			Alternative View (Approach C)		
Lease Inception			Lease Inception		
Right-of-Use Asset	148,570		Right-of-Use Asset	128,855	
Lease Obligation		148,570	Lease Obligation		128,855
End of Year 1			End of Year 1		
Amortization Expense	49,523		Amortization Expense	42,952	
Right-of-Use Asset		49,523	Right-of-Use Asset		42,952
Interest Expense	11,886		Interest Expense	10,308	
Lease Obligation	45,764		Lease Obligation	39,692	
Additional Lease Expense	850		Additional Lease Expense	8,500	
Cash		58,500	Cash		58,500
Right-of-Use Asset	1,516		Right-of-Use Asset	n/a	
Lease Obligation		1,516	Lease Obligation		n/a
End of Year 2			End of Year 2		
Amortization Expense	50,281		Amortization Expense	42,952	
Right-of-Use Asset		50,281	Right-of-Use Asset		42,952
Interest Expense	8,346		Interest Expense	7,133	
Lease Obligation	50,154		Lease Obligation	42,867	
Cash		58,500	Additional Lease Expense	8,500	
			Cash		58,500
End of Year 3			End of Year 3		
Amortization Expense	50,281		Amortization Expense	42,952	
Right-of-Use Asset		50,281	Right-of-Use Asset		42,952
Interest Expense	4,333		Interest Expense	3,704	
Lease Obligation	54,167		Lease Obligation	46,296	
Cash		58,500	Additional Lease Expense	8,500	
			Cash		58,500