

IASB/FASB Joint Meeting - Week Commencing 16 May 2011
IASB/FASB Education Sessions - Week Commencing 9 May 2011
Agenada Paper 2H/FASB Memo 175 - Appendix B
Illustration of Approaches - Reassessing the Discount Rate When Lease Payments Change

A lessee enters into 10-year lease with a 5-year extension option, with the following terms:

Initial Lease Term	10 years
Initial Lease Term Payment	50,000
Optional Lease Term	5 years
Option Lease Term Payment	55,000
Rate at lease commencement	6.00%
Rate at end of Year 3 (spot rate)	8.00%
Rate at end of Year 10 (forward rate at end of Year 3)	7.00%

At the end of Year 3, the lessee determines that it has made large investments in the leased asset (leasehold improvements) that create a significant economic incentive to exercise the extension option. The examples below illustrate the difference between the two approaches presented in the memo for accounting for a change in the discount rate resulting from a change in the estimate of lease payments. Assume all leases are other-than-finance.

Accounting for the Initial Lease Term:

Year	Payment	Right-of-Use Asset	Lease Obligation	Amortization Expense	Interest Expense	Lease Expense
		368,004	368,004			
1	50,000	340,085	340,085	27,920	22,080	50,000
2	50,000	310,490	310,490	29,595	20,405	50,000
3	50,000	279,119	279,119	31,371	18,629	50,000
4	50,000	245,866	245,866	33,253	16,747	50,000
5	50,000	210,618	210,618	35,248	14,752	50,000
6	50,000	173,255	173,255	37,363	12,637	50,000
7	50,000	133,651	133,651	39,605	10,395	50,000
8	50,000	91,670	91,670	41,981	8,019	50,000
9	50,000	47,170	47,170	44,500	5,500	50,000
10	50,000	(0)	(0)	47,170	2,830	50,000
TOTAL	500,000			368,004	131,996	500,000

EXAMPLE 1: Use the spot rate at the end of Year 3 and apply to all remaining lease payments (years 4 through 15)

Right-of-Use Asset 109,333
Lease Obligation 109,333

End of Year 3: Reassessment journal entry to account for optional lease term at updated discount rate.

Current and extended lease term at 8%

Year	Payment	Right-of-Use Asset	Lease Obligation	Amortization Expense	Interest Expense	Lease Expense
3		388,452	388,452			
4	50,000	367,445	369,529	21,007	31,076	52,083
5	50,000	344,924	349,091	22,521	29,562	52,083
6	50,000	320,768	327,018	24,156	27,927	52,083
7	50,000	294,846	303,180	25,922	26,161	52,083
8	50,000	267,017	277,434	27,829	24,254	52,083
9	50,000	237,129	249,629	29,889	22,195	52,083
10	50,000	205,016	219,599	32,113	19,970	52,083
11	55,000	170,500	182,167	34,515	17,568	52,083
12	55,000	132,990	141,740	37,510	14,573	52,083
13	55,000	92,246	98,080	40,744	11,339	52,083
14	55,000	48,009	50,926	44,237	7,846	52,083
15	55,000	(0)	(0)	48,009	4,074	52,083
TOTAL	625,000			388,452	236,548	625,000

EXAMPLE 2: Use the forward rate at the end of Year 3 and apply to only the additional lease payments (years 11 through 15)

Right-of-Use Asset 140,437
Lease Obligation 140,437

End of Year 3: Reassessment journal entry to account for optional lease term at updated discount rate.

Current lease term @6%

Year	Payment	Right-of-Use Asset	Lease Obligation	Amortization Expense	Interest Expense	Lease Expense
3		279,119	279,119			
4	50,000	251,449	251,449	27,670	22,330	50,000
5	50,000	221,564	221,564	29,884	20,116	50,000
6	50,000	189,290	189,290	32,275	17,725	50,000
7	50,000	154,433	154,433	34,857	15,143	50,000
8	50,000	116,787	116,787	37,645	12,355	50,000
9	50,000	76,130	76,130	40,657	9,343	50,000
10	50,000	32,221	32,221	43,910	6,090	50,000
11	-	-	-	-	-	-
12	-	-	-	-	-	-
13	-	-	-	-	-	-
14	-	-	-	-	-	-
15	-	-	-	-	-	-
TOTAL	350,000			246,898	103,102	350,000

Extended lease term @7%

Year	Payment	Right-of-Use Asset	Lease Obligation	Amortization Expense	Interest Expense	Lease Expense
		140,437	140,437			
4	0	150,267	150,267	(9,831)	9,831	-
5	0	160,786	160,786	(10,519)	10,519	-
6	0	172,041	172,041	(11,255)	11,255	-
7	0	184,084	184,084	(12,043)	12,043	-
8	0	196,970	196,970	(12,886)	12,886	-
9	0	210,758	210,758	(13,788)	13,788	-
10	0	225,511	225,511	(14,753)	14,753	-
11	55,000	186,297	186,297	39,214	15,786	55,000
12	55,000	144,337	144,337	41,959	13,041	55,000
13	55,000	99,441	99,441	44,896	10,104	55,000
14	55,000	51,402	51,402	48,039	6,961	55,000
15	55,000	(0)	(0)	51,402	3,598	55,000
TOTAL	350,000			275,000	140,437	275,000

Current and extended lease term:

Year	Payment	Right-of-Use Asset	Lease Obligation	Amortization Expense	Interest Expense	Lease Expense
3		419,556	419,556			
4	50,000	401,716	401,716	17,840	32,160	50,000
5	50,000	382,351	382,351	19,365	30,635	50,000
6	50,000	361,331	361,331	21,020	28,980	50,000
7	50,000	338,517	338,517	22,814	27,186	50,000
8	50,000	313,757	313,757	24,759	25,241	50,000
9	50,000	286,888	286,888	26,869	23,131	50,000
10	50,000	257,732	257,732	29,157	20,843	50,000
11	55,000	186,297	186,297	39,214	15,786	55,000
12	55,000	144,337	144,337	41,959	13,041	55,000
13	55,000	99,441	99,441	44,896	10,104	55,000
14	55,000	51,402	51,402	48,039	6,961	55,000
15	55,000	(0)	(0)	51,402	3,598	55,000
TOTAL	625,000			387,335	237,665	625,000