

Interpretation of the Emerging Accounting Issues Working Group

INT 00-27: EITF 98-9: Accounting for Contingent Rent

ISSUE NULLIFIED BY SSAP NO. 22

INT 00-27 Dates Discussed

June 12, 2000; September 11, 2000

INT 00-27 References

SSAP No. 22—Leases (SSAP No. 22)

INT 00-27 Issue

1. Some rental agreements provide for minimum rental payments plus contingent rents based on the lessee's operations, such as a future specified sales target. The literature is unclear as to how contingent rent based on future specified targets should be accounted for in reporting periods prior to achievement of the target.

2. Paragraph 19.b. of FASB Statement No. 13, *Accounting for Leases* (FAS 13) provides guidance on how the lessor should account for an operating lease and states that "rent shall be reported as income over the lease term as it becomes receivable according to the provisions of the lease". Paragraph 15 of FAS 13 provides guidance on how the lessee should account for an operating lease and states that "normally, rental on an operating lease shall be charged to expense over the lease term as it becomes payable" (emphasis added). In addition, paragraph 13 of FASB Statement No. 29, *Determining Contingent Rentals an amendment of FASB Statement No. 13* states that "contingent rentals shall be included in the determination of income as accruable".

3. With regard to interim period financial statements, paragraph 11 of APB Opinion No. 28, *Interim Financial Reporting* (APB No. 28) states that "revenue from products sold or services rendered should be recognized as earned during an interim period on the same basis as followed for the full year." In addition, paragraph 17 of APB No. 28 states that "the amounts of certain costs and expenses are frequently subjected to year-end adjustments even though they can be reasonably approximated at interim dates. To the extent possible such adjustments should be estimated and the estimated costs and expenses assigned to interim periods so that the interim periods bear a reasonable portion of the anticipated annual amount."

4. The issues are:

- a. How a lessor should account for contingent rental income that is based on future specified targets.
- b. How a lessee should account for contingent rental expense that is based on future specified targets.

INT 00-27 Discussion

5. The working group reached a consensus to adopt the final conclusions reached in EITF 98-9, *Accounting for Contingent Rent* (EITF 98-9) with modification. The conclusions of EITF 98-9 are adopted as follows:

6. With respect to lessors' accounting for contingent rent, entities shall follow the revenue guidelines outlined in Question 8 of SEC Staff Accounting Bulletin No. 101, *Revenue*

Recognition in Financial Statements (SAB No. 101). The working group will expect entities that have not applied this accounting to report a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors* by no later than the first fiscal quarter of the fiscal year beginning January 1, 2001.

7. The applicable provision of SAB No. 101 is as follows: (Question 8 excerpted from full text of SAB No. 101):

Question 8

Facts: Company A owns and leases retail space to retailers. Company A (lessor) renews a lease with a customer (lessee) that is classified as an operating lease. The lease term is one year and provides that the lease payments are \$1.2 million, payable in equal monthly installments on the first day of each month, plus one percent of the lessee's net sales in excess of \$25 million if the net sales exceed \$25 million during the lease term (*i.e.*, contingent rental). The lessee has historically experienced annual net sales in excess of \$25 million in the particular space being leased, and it is probable that the lessee will generate in excess of \$25 million net sales during the term of the lease.

Question: Should the lessor recognize any rental income attributable to the one percent of the lessee's net sales exceeding \$25 million before the lessee actually achieves the \$25 million net sales threshold?

Interpretive Response: No. The working group believes that contingent rental income "accrues" (*i.e.*, it should be recognized as revenue) when the changes in the factor(s) on which the contingent lease payments is (are) based actually occur.

8. With respect to lessees' accounting for contingent rent, the EITF reached a consensus that a lessee should recognize contingent rental expense (in annual periods as well as in interim periods) prior to the achievement of the specified target that triggers the contingent rental expense, provided that achievement of that target is considered probable. Previously recorded rental expense should be reversed into income at such time that it is probable that the specified target will not be met.

INT 00-27 Status

9. No further discussion is planned.