New Strategies Required for CRE Portfolios

IASB and FASB Update Notice
21 July 2011

At the conclusion of the July 2011 Lease Accounting Standards meeting, it was announced the entire August 2010 Exposure Draft would be re-exposed for public review and comment with a potential publishing of the new exposure document sometime after the Q3 2011 IASB & FASB deliberation meetings.

presented by

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Chartered Facilities Management Surveyor

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Will You Be Ready?

from the view point
of a Corporate Lessee

Forthcoming Changes to Accounting Procedures Will Affect
Leases of Real and Personal Property, Plant and Equipment

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Executive Summary.....from the view point of a Corporate Lessee

Accounting of Corporate Real Estate (CRE) leases is about to undergo massive changes that will dramatically alter how senior management view their real estate holdings; and how the CRE professionals in the future will be supporting their respective organizations.

On or about January 2012 a new IASB / FASB Lease Accounting Standard will go into effect, with the results affecting all corporations, large and small, public and private. With the resulting changes in accounting and reporting, leverage and capital ratios may be affected from the striking changes to the balance sheets.

These massive changes will affect not only leased commercial real property such as offices, retail facilities and industrial warehouses, but also leases of non-real or personal property. This includes such items as: furniture and fixtures, computers, copiers, automobiles, delivery trucks, manufacturing plant and equipment, as well as any material items that are leased by businesses.

> Beginning in 2012 the IASB / FASB will utilize a completely new model for lease accounting under which the lessee's rights and obligations under ALL leases, existing and new, would be capitalized on the balance sheet instead of the current methodology of utilizing off-balance sheet financing. [1]

When implemented as the new "Lease Accounting Standard," it will eliminate all current operating leases utilizing the existing off-balance sheet accounting rules. With the capitalization of all leases, the newly defined "right-to-use" leased assets and liabilities will be brought onto the balance sheet.

> Currently corporate real estate leasing accounts for roughly two-thirds of all leasing activity. This CRE leased property value is estimated by the U.S. Securities and Exchange Commission (SEC) as $1.0 to $1.3 trillion. Typically, real estate and related facilities expenses account for 20% of an organization's income statement, and for roughly 60% of all corporations, it is the 2nd or 3rd highest expense. [2]

A lease will be defined as:

> A contract in which the right to use a specified asset is conveyed, for a period of time, in exchange for consideration. Such a contract will apply to assets including property, plant and equipment. Additionally, the right to use an asset is conveyed if the contract conveys the right to use and to control the use of the underlying asset. [3]

There will be NO "grandfathering" of existing off-balance sheet leases. Any leases in place on the effective date will have to be re-accounted for the remaining lease term. The only exception will be those leases whose maximum possible lease term is less than12 months.

There are a few exceptions to this definition, including intangible assets, natural resources, biological assets, and contracts that represent the purchase or sale of the underlying assets. Leases for non-core assets or for long term leases of land are also not a part of the scope of exceptions.

Here is a quick example of the first year financial impact as a result of the new Lease Accounting Standard rule changes:

Let's assume a business unit has a 50,000 sf facility leased for 10 years at a flat "net" lease rate of $25 per sf per year equaling $1.25 million per year in rent expense. Incremental borrowing cost is 7%. Under current operating lease accounting rules the above lease has a P&L rent expense deduction in the amount of $1.25 million per year.

Under the new Lease Accounting Standard rules, this same lease would have a deduction for the "right-to-use" lease depreciation of $877,948 and an imputed interest expense of $614,563 for a total deduction of $1,492,501 the first year.

When compared to the current accounting rules, this results in a first year budget increase of over 19%. If there were any lease renewal options in the lease agreement, and are "likely" to be exercised, the first year's percentage increase will be much larger as a result of the implied longer lease term. *Are your forthcoming 2012 / 2013 budgets prepared for a 10% to 25% increase in first year lease expenses?*

As a result of the new Lease Accounting Standard being implemented, businesses will need to take a new fresh look at all the factors relating to their corporate real estate strategies. Economic conditions, operational issues, financing abilities, regulatory issues, tax apportioning considerations for international, federal and state facilities, governance and budgetary issues all play a factor in determining whether to lease or own real estate.

As the coming months and available time to gather the information slowly evaporates, anxiety, work overload and even outright panic will begin to develop. Suddenly realization will set in – "your" corporation just does not have the appropriate staff and talent to get the job done. Many corporations are not going to be able to comply by the anticipated January 2012 effective date. **Will you be ready? If not, now what are you going to do?**

A little history...

In March 2009, the International Accounting Standards Board, (IASB - www.iasb.org) based in London, England and the Financial Accounting Standards Board, (FASB - www.fasb.org) based in Norwalk, Connecticut began a process of soliciting comments on what was proposed as changes to how worldwide corporations accounted for all leased property. The stated project objective is:

> The objective is to create common lease accounting requirements to ensure that the assets and liabilities arising from lease contracts are recognized in the statement of financial position. [3]

Under current accounting rules, when a business enters into a lease agreement for any item: be it real estate, computers, land, copiers, vehicles, etc, management utilizes a rule called FAS 13 to first determine if the company essentially owns the item in question.

If the answer was "yes", the business capitalized the lease to simulate ownership and a loan, with the appropriate asset and liability entries on the Balance Sheet.

If the answer was "no", the business utilized "off-balance sheet" financing incorporating a simple accrual straight-line expense on the P & L Statements.

Then comes the IASB and FASB in March 2009 with their Discussion Paper proposing worldwide lease rule changes seeking comments from the public and industry on the principals of the proposal in order to assess impact and determine strategy. The comment period ended in July 2009, leading to deliberations between the principals of IASB and FASB which began October 2009. The result for far is the Project Update recently completed on 22 July 2010 and published on 29 July 2010.

It is anticipated the Project's Exposure Draft will be published in mid-August 2010. The next step in the project process will be for the public and industry to review the proposed details and submit comments on the details of the proposal which will establish policies and prepare financial results. This should take place in the fourth quarter 2010 into the first quarter 2011.

The goal of IASB and FASB will be to distill down the accumulated comments, thereafter coming to a mutual agreement between the two organizations, resulting in a unified new Lease Accounting Standard. The target date for this new Lease Accounting Standard to be issued is presently estimated to be mid-2011.

The actual effective date of the new Lease Accounting Standard is currently listed by the IASB and FASB as "to be determined". Knowledgeable industry personnel are indicating the **target effective date could be as early as January 2012, less than 18 months away**. Or, it could be delayed into 2013, or worst case into early 2014, depending on when the actual Lease Accounting Standard is published by the IASB and FASB.

Practical Applications of New Rules .....

Given that this new Lease Accounting Standard applies to all leased items of a material nature, a couple of questions may occur to you.

What is a material item you ask? So far that definition seems to be somewhat discretionary, but to paraphrase one commentary:

> "One leased computer may be immaterial, but 1,000 or 10,000 leased computers might be material depending on the size of the organization". [1]

Okay, how is this actually going to affect the accounting of my corporation's leased real estate?

Good question, below is a simplified example of how "present" Lease Accounting is handling the off-balance sheet lease financing as compared to what the "new" Lease Accounting Standard will look like.

Our simplified assumptions and example are as follows:

Length of Lease Term:	4 years
Net Rent per Year:	$12,000 per year
Incremental Borrowing Cost:	7% – (imputed interest rate)
Balance Sheet Numbers:	As at the beginning of the year

Financial Statements	Present Operating Lease Accounting					New Capitalized Lease Accounting				
	Year	1	2	3	4	Year	1	2	3	4
Cash Flow Stmt	Cash Flow	12,000	12,000	12,000	12,000	Cash Flow	12,000	12,000	12,000	12,000
P & L Statement	Rent	12,000	12,000	12,000	12,000	Right-to-Use Amortization	10,162	10,162	10,162	10,162
						Imputed Interest	2,845	2,204	1,518	785
P & L Statement	P & L Total	12,000	12,000	12,000	12,000	P & L Total	13,007	12,366	11,680	10,947
						% Increase	8.4%	3.1%	-2.7%	-8.8%
Balance Sheet	Asset	0	0	0	0	Right-to-Use Lse Asset	40,648	30,486	20,324	10,162
	Liability	0	0	0	0	Right-to-Use Lse Liability	40,648	31,493	21,697	11,215

NOTE: Lease expenses will be higher in the earlier lease years under the new Lease Accounting Standard.

See Exhibit A - Comparison of Existing and New Lease Accounting Standard Rules from the Lessee View Point

As a result of the new Lease Accounting Standard being proposed, the percentage of increase in P & L expenses the first year will range from roughly 2.7% for a two year lease up to as high as 23.0% for a 15 year lease. The exact percentage will depend on how long a lease term is remaining at the beginning of the effective date under the new Lease Accounting Standards. [2]

Another question may be, how long is my remaining lease term?

Under the new standards, the recognized lease term is defined as the <u>longest possible lease term that is more likely than not to occur</u>. If there is any uncertainty about a lease term, <u>one of the lease terms would be selected through recognition as the most likely to occur</u>, and the associated accounting would be based on that term. [3]

In addition, businesses will periodically need to reassess their requirements, and make adjustments as needed. Periodically could be quarterly, semi-annually or annually depending on the organization and the dynamics of their real estate requirements.

A few examples:

1. A business unit has a normal five year lease term, **PLUS** has three 5-year lease options or first rights to renew incorporated into the lease document. Based on their corporate strategy and past practices, facility locations are stable on a long term basis.

   For our purposes here, this business would account for this transaction based on a 20 year lease term.

2. A business unit has a normal three year lease term, **WITH** two 1-year lease options or first rights to renew incorporated into the lease document. Based on their corporate strategy and past practices, facility locations are stable on a mid-long term basis.

   For our purposes here, this business would account for this transaction based on a five year lease term.

3. A business unit has a normal five year lease term, **PLUS** has one 5-year lease option or first right to renew, **AND** has an early termination clause with the ability to terminate their lease with one year's notice anytime after completing three years of the original lease term incorporated into the lease document. This corporation strategically determines that based on the past practices and projected growth of the company, they will probably out grow their existing space late in the 3rd year or early 4th year, and need to substantially expand their facility in another location.

For our purposes here, this business would account for this transaction based on a four year lease term.

4. A business unit has a normal five year lease term, **PLUS** has three 5-year lease options or first rights to renew incorporated into the lease document. Based on their corporate strategy and past practices, facility locations are generally fixed for 10 years, then are relocated to newer facilities with an upgraded ambiance.

   For our purposes here, this business would account for this transaction based on a 10 year lease term.

Below is an example of a corporate portfolio with three leases currently in effect, and how on the effective date the new Lease Accounting Standard would be reflected.

Our simplified assumptions and example are as follows:

Corporate Lease Portfolio:	Three (3) existing leases in place, with one (1) additional facility planned on being added in the near future
Length of Original Lease Terms:	3, 5 and 10 years
Length of Remaining Lease Terms:	1, 4 and 6 years respectfully
Additional Facility Added:	Five year term lease added beginning of 2nd year after effective date
Net Rent per Year:	$12,000 per year (no annual rent increases shown)
Incremental Borrowing Cost:	7% – (imputed interest rate)
Renewal Assumptions:	Corporate strategy is to timely renew each lease for the same length as original lease term
Lease Renewal Options:	None provided for in the lease documents

Effective Date

			New Lease Accounting Standard Applications										
Lease Term	RLT	Present Acct'g	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	Year 11
3 Yr Lse	1	12,000	11,214	12,701	12,016	11,283	12,701	12,016	11,283	12,701	12,016	11,283	12,701
			1 Yr Remain	3 Year Lease Renewal			3 Year Lease Renewal			3 Year Lease Renewal			3 Yr Lse first yr
5 Yr Lse	4	12,000	13,007	12,366	11,680	10,947	13,284	12,685	12,044	11,359	10,625	13,284	12,685
			4 Years Remaining Lease Term				5 year Lease Renewal					5 Year Renewal 2 Yrs Shown	
New 5 Yr Lse		12,000	NA	13,284	12,685	12,044	11,359	10,625	13,284	12,685	12,044	11,359	10,625
				New 5 Year Lease Term					5 Year Lease Renewal				
10 Yr Lse	6	12,000	13,537	12,977	12,378	11,737	11,052	10,319	14,328	13,902	13,444	12,955	12,432
			6 Years Remaining Lease Term						10 Year Lease Renewal only 5 years shown				
Yearly Totals		48,000	37,758	51,328	48,760	45,971	48,396	45,644	50,939	50,646	48,129	48,881	48,443
% Increase over Present Acct'g			4.9%	6.9%	1.6%	-4.2%	0.1%	-4.9%	6.1%	5.5%	0.3%	1.8%	0.9%

RLT = Remaining Lease Term

NOTE: 1st Year yearly cash flow total is only $36,000, with new lease addition in 2nd year, cash flow increases to the $48,000 as shown; 1st Year percentage based on $36,000

On the effective date, leases accounted for as if they were new leases over the remaining existing lease term.

The biggest increases in P & L expenses may not occur until leases are renewed.

For many Corporate Real Estate portfolios, depending on the timing of renewals, the new Lease Accounting Standard will increase lease expenses, semi-permanently.

Interestingly, the new Lease Accounting Standard will have a positive effect on EBITDA (Earnings Before Interest Taxes Depreciation and Amortization), which many companies use as an important measure of profitability. EBITDA will improve because the interest and depreciation that will replace today's rent expenses are; by definition, not included in the EBITDA calculation. [2]

New Strategies to Consider .....

As a result of the new Lease Accounting Standard being implemented, businesses will need to take a new fresh look at all the factors relating to their corporate real estate strategies. Economic conditions, operational issues, financing abilities, regulatory issues, tax apportioning considerations for international, federal and state facilities, governance and budgetary issues all play a factor in determining whether to lease or own real estate.

As a direct result of the upcoming lease accounting changes on the financial statements, the down stream effect of those changes could change how:

1. A corporation's budgets are generated;
2. Inter-company facility charge-backs are handled;
3. Existing and new debt covenants are viewed by lenders;
4. Third party cost plus contracts are priced;
5. Income and associated taxes are apportioned for international, federal and state operations; and
6. Performance metrics are calculated which in turn could affect corporate bonuses at all levels.

For many companies, the driving decisions to lease a particular asset versus buying it are no longer going to be relevant. Will it be cheaper to own a real estate asset using the corporation's potentially cheaper cost of funds? Or will the operational flexibility associated with short to long term leasing continue to be the desirable method used?

Both have strong debating points. When a corporation's long term property needs are unclear, leasing appears to be the stronger position to be in. But when corporate stability is apparent, property ownership may prove to be a better solution.

In many cases, the actual method used may be a combination of both short term leasing and long term ownership. For example: A stable corporate headquarters along with a stable distribution warehousing system, combined with numerous flexible short term leased product sales or service outlets. Each short term leased facility subject to change depending on the associated demographics of the individual metropolitan area.

Secondly, many desirable locations may not be generally available to purchase, i.e. retail malls or regional power centers, mid-size to large high rise multi-tenant, multi-floor office buildings, or any property that can not be functionally independent.

While it may be feasible for a business to buy their own suburban single tenant headquarters office building, it is doubtful that an existing landlord of a major metropolitan multi-tenant, multi-floor office building would consider selling only a portion of the building consisting of one or more floors to one corporate entity.

With our current economic disruption anticipated to continue for quite some time, opportunities to negotiate existing lease rental rates to lower levels certainly exist. In addition, opportunities to purchase real estate that has been foreclosed on, or is in financial difficulties also exist in many metropolitan areas.

Corporate Real Estate Department personnel will be very active in the coming months re-analyzing lease vs own situations for their entire portfolios. A company's credit quality and it's desired operational flexibility will help determine which directions are better suited for each respective company.

Depending on the size of the organization, existing CRE departments may be very hard pressed in the next few months to gather and verify all the lease information out of where ever they have been stored to determine:

1. What actually has been leased, both domestically and internationally;
2. Confirming accuracy of the lease terms and forthcoming rental increases;
3. The structure of the associated CAM and other lease expenses - gross, modified gross or net leases;
4. What documented renewal or termination options may be available;
5. What are the anticipated physical space requirements in the coming years;
6. What CRE strategy will be in creating, documenting and maintaining written policies about lease renewals, rental terms, lease structures, contingencies and other related items;
7. How to seamlessly interface the massive accumulated CRE information with the accounting department for further input into the financial statements; and
8. What automated technology applications are available to assist the entire process.

All of this will be necessary in order to properly evaluate what financial impact any one and collectively all the corporate real estate leases will have when off-balance sheet financing is eliminated.

Any processes created or revised to account for leases must comply with provisions of the Sarbanes-Oxley Act (SOX). In order to become SOX compliant, processes must be documented and tested prior to implementation within the business.

Author's Note: Above paragraph only applies if your company is required to comply with SOX.

The lease accounting process can be broken down into five sub-processes:

Sub-process #1: Collect and record lease information

The goal of this sub-process is to create a complete inventory of leases and verify that all required lease information is accurately recorded for use by other sub-processes.

Sub-process #2: Account for capital and impaired leases

Present accounting for capital leases and impaired leases that are already on the balance sheet will need to be collated with the lease inventory from sub-process #1 to make sure that these leases are not double-counted.

Sub-process #3: Make necessary lease assumptions

Determining lease assumptions may require the involvement of different groups within the company beyond the real estate and finance groups. For example, business managers may be integral to make sound assumptions about the likelihood of exercising renewal rights for a given lease.

Sub-process #4: Financial projections and calculations

Based on the information and assumptions made available in the previous three sub-processes, the next step in the lease accounting process is to calculate the present value of each lease obligation and create the amortization schedule necessary to account for the lease liability.

Sub-process #5: Make accounting entries

The final step in the lease accounting process is to enter data into the financial accounting system. Companies will need to invest a significant amount of manpower and talent to design a lease accounting process. Companies will be challenged to design a process that will allow information to move accurately and efficiently from one sub-process to the next.

The effort required to design the process will be large. While some sub-processes might be outsourced, selecting an outsourced provider should be done carefully. Any outsourced provider selected will need internal processes that comply with Sarbanes-Oxley. [2]

Many CEO's and COO's have not always viewed their real estate departments as a material element contributing to the success of the corporation. As a result, the previous role of a CRE director or vice president may not have been as operationally effective as they potentially could have been, or has been viewed as a necessary, but largely an administrative function. This view point will change as a result of the accounting rule changes. Additionally, this is not just an accounting department problem to be solved.

CRE personnel along with other stakeholder representatives of the organization, including, but not limited to: CFO / Accounting Department, Legal and Regulatory Departments, COO / Operational divisions, Human Resources, IT / Information Systems will all need to gather together, possibly by forming a steering committee, to evaluate the impact of the new Lease Accounting Standard will have in affecting the organization's future financial and operational status.

CRE personnel are the experts in how their respective corporations utilize and maintain existing facilities, as well as making recommendations to add or reduce the overall exposure of the corporate real estate portfolio. CRE personnel will need to become more active in their corporate real estate decision making process.

As a result of the new lease accounting rule changes, senior management will need to target their real estate strategies and operations for a major renovation and update in order to be able to comply with the new accounting requirements, as well as being more flexible in the current economic climate.

CRE departments will require new technology, additional personnel and tools to create new processes of managing the existing real estate information, as well as obtaining new volumes of information going forward. All the CRE information will need to be seamlessly integrated with the accounting functions.

With better information available from the CRE departments, senior management will be better informed and able to make the correct lease versus own decisions going forward.

Last point .....

DON"T WAIT, January 2012 is less than 18 months away. Many corporate real estate operations, large and small, are going to be hard pressed to comply with the new Lease Accounting Standard, and many organizations are still in denial or think that this does not affect them.

And remember, this new Lease Accounting Standard affects not only leased real estate, but also affects ALL items leased by a corporation, including manufacturing plant and equipment, furniture and fixtures, vehicles and delivery trucks, just to name a few. <u>Anything that is of a material nature and is leased will be affected</u>.

As indicated above, as the coming months and available time to gather the information slowly evaporates, anxiety, work overload and even outright panic will begin to develop. Suddenly realization will set in – "your" corporation just does not have the appropriate staff and talent to get the job done. Many corporations are not going to be able to comply by the anticipated January 2012 effective date.

Will you be ready? If not, now what are you going to do?

As a result of not being ready, the negative financial results of non-compliance will be ..... Well, I will leave that to your individual imaginations to determine your own cataclysmic scenario.

Author's Note: James T. Saint is a CCIM, (Certified Commercial Investment Member), one of a network of 9,000 professionals across North America and 30 international countries holding one of the most coveted and respected designations in the industry, and often referred to as the "Ph.D of commercial real estate". In addition, Mr Saint holds a MRICS designation and is a Chartered Facilities Management Surveyor, as conveyed by the London, England based Royal Institute of Chartered Surveyors (RICS).

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References

The following references have been used in the above article:

[1] – PriceWaterhouseCoopers (www.pwc.com) white paper, dtd May 2010
entitled - *"The overhaul of lease accounting: Catalyst for change in corporate real estate"*

[2] – Bob Cook, Real Estate Consultant, Cook & Associates webinars, dtd June 2010, held on behalf of Tririga, Inc (www.tririga.com) and associated white paper, dtd July 2010
both entitled - *"The New Lease Accounting and You"*

[3] – IASB / FASB Project Update , dtd 29 July 2010
entitled - *"Leases - Joint Projects of the IASB and FASB"*

Encl 1 Exhibit A - Comparison of Existing and New Lease Accounting Standard Rules from the Lessee View Point

EXHIBIT A

COMPARISON OF EXISTING AND NEW LEASE ACCOUNTING STANDARD RULES from the LESSEE VIEW POINT

FINANCIAL STATEMENT ASSUMPTIONS

The following simplistic assumptions have been used in the enclosed example:

1. The Corporation has leased a commercial real estate facility for the corporate use consisting of 10,000 rentable square feet.

2. The lease term is for four (4) years with a lease start date of 1 January, Year 1. The corporate real estate strategy is to move to a new more modern facility every four years.

3. The lease is a net lease with annual rent of $12,000.00, and common area maintenance (CAM) charges of $6,000.00 per year.

4. The Corporation has two (2) types of annual income being generated: 1) Income Type 1 consisting of $90,000.00; and 2) Income Type 2 consisting of $10,000.00. The Corporation has a total of $70,000.00 in other corporate expenses.

5. The Corporation has a 35% tax rate; and a 7% corporate cost of debt.

6. The Corporation has purchased $10,000.00 worth of new PP&E with 100% financing at 7% annual interest with a P&I payment of $1,855.00 per year. Purchase date, based on a 1 January, Year 1 acquisition date, uses a 7-year MACRS depreciation scheduled based on a 1st mid-quarter convention as follows:

Year 1 - 25.00% - $2,500.00	Year 2 - 21.43% - $2,143.00	Year 2 - 15.31% - $1,531.00	Year 4 - 10.93% - $1,093.00
Year 5 - 8.75% - $ 875.00	Year 6 - 8.74% - $ 874.00	Year 7 - 8.75% - $ 875.00	Year 8 - 1.09% - $ 109.00

Financial Statements

Cash Flow Statement

Financial Statements					
Calendar Year of All Leases	0	1	2	3	4
Cash Flow Statement		**4 Year Existing Accounting Rules Example**			
Lease Term Year	0	1	2	3	4
Income		Initial 4-Year Lease Term			
Corporate Income Type 1		$90,000	$90,000	$90,000	$90,000
Corporate Income Type 2		$10,000	$10,000	$10,000	$10,000
Total Income		$100,000	$100,000	$100,000	$100,000
Expenses					
Corp - Lease Rental Expenses		($12,000)	($12,000)	($12,000)	($12,000)
Corp - Lease CAM Expenses		($6,000)	($6,000)	($6,000)	($6,000)
Corp - PP&E Debt Interest Exp		($700)	($619)	($532)	($440)
Corp - PP&E Principal Expense		($1,155)	($1,236)	($1,323)	($1,415)
Corp - Other Expenses		($70,000)	($70,000)	($70,000)	($70,000)
Total Expenses		($89,855)	($89,855)	($89,855)	($89,855)
Total Cash Flow Before Tax		$10,145	$10,145	$10,145	$10,145
Est. Corporate Tax Rate	35.00%	($3,080)	($3,233)	($3,478)	($3,663)
After Tax Cash Flow		$7,065	$6,912	$6,667	$6,482

Financial Statements					
Calendar Year of All Leases	0	1	2	3	4
Cash Flow Statement		**4 Year New Lease Accounting Standard Example**			
Year of Lease	0	1	2	3	4
Income		Initial 4-Year Lease Term			
Corporate Income Type 1		$90,000	$90,000	$90,000	$90,000
Corporate Income Type 2		$10,000	$10,000	$10,000	$10,000
Total Income		$100,000	$100,000	$100,000	$100,000
Expenses					
Corp - Lease Rental Expenses		($12,000)	($12,000)	($12,000)	($12,000)
Corp - Lease CAM Expenses		($6,000)	($6,000)	($6,000)	($6,000)
Corp - PP&E Debt Interest Exp		($700)	($619)	($533)	($440)
Corp - PP&E Principal Expense		($1,156)	($1,236)	($1,323)	($1,416)
Corp - Other Expenses		($70,000)	($70,000)	($70,000)	($70,000)
Total Expenses		($89,856)	($89,855)	($89,856)	($89,856)
Total Cash Flow Before Tax		$10,144	$10,145	$10,144	$10,144
Est. Corporate Tax Rate	35.00%	($2,728)	($3,105)	($3,590)	($4,032)
After Tax Cash Flow		$7,416	$7,040	$6,554	$6,112

NOTE: No real differences between the two different accounting rules for the Cash Flow Statement.

The only notable change is the different amounts in the corporate tax, which is calculated on the below EBITDA P & L Statement; and the resulting difference in the "After Tax Cash Flow" number.

Financial Statements

EBITDA P & L Statement

Calendar Year of All Leases	0	1	2	3	4
EBITDA P & L Statement		**4 Year Existing Accounting Rules Example**			
Lease Term Year	0	1	2	3	4
Income		Initial 4-Year Lease Term			
Corporate Income Type 1		$90,000	$90,000	$90,000	$90,000
Corporate Income Type 2		$10,000	$10,000	$10,000	$10,000
Total Income		$100,000	$100,000	$100,000	$100,000
Expenses					
Corp - Lease Rental Expenses		($12,000)	($12,000)	($12,000)	($12,000)
Corp - Lease CAM Expenses		($6,000)	($6,000)	($6,000)	($6,000)
Corp - Other Expenses		($70,000)	($70,000)	($70,000)	($70,000)
Total Expenses		($88,000)	($88,000)	($88,000)	($88,000)
Total EBITDA		$12,000	$12,000	$12,000	$12,000
Corp - PP&E Debt Interest Exp		($700)	($619)	($532)	($440)
Corp - PP&E Depreciation		($2,500)	($2,143)	($1,531)	($1,093)
Sub-Total Before Tax Expenses		($3,200)	($2,762)	($2,063)	($1,533)
Before Tax Net Income		$8,800	$9,238	$9,937	$10,467
Est. Corporate Tax Rate	35.00%	($3,080)	($3,233)	($3,478)	($3,663)
Current Yr - Earnings (After Tax)		$5,720	$6,005	$6,459	$6,804

Calendar Year of All Leases	0	1	2	3	4
EBITDA P & L Statement		**4 Year New Lease Accounting Standard Example**			
Year of Lease	0	1	2	3	4
Income		Initial 4-Year Lease Term			
Corporate Income Type 1		$90,000	$90,000	$90,000	$90,000
Corporate Income Type 2		$10,000	$10,000	$10,000	$10,000
Total Income		$100,000	$100,000	$100,000	$100,000
Expenses					
Corp - Lease Rental Expenses	**NA**				
Corp - Lease CAM Expenses		($6,000)	($6,000)	($6,000)	($6,000)
Corp - Other Expenses		($70,000)	($70,000)	($70,000)	($70,000)
Total Expenses		($76,000)	($76,000)	($76,000)	($76,000)
Total EBITDA		$24,000	$24,000	$24,000	$24,000
	4-Yr Lse NPV @ 7%	Straight-Line Amortization Method			
Corp - Right-To-Use Lse Deprec	**$40,648.00**	($10,162)	($10,162)	($10,162)	($10,162)
Corp - R-T-U Lse Imputed Interest		($2,845)	($2,204)	($1,518)	($785)
Corp - PP&E Debt Interest Exp		($700)	($619)	($533)	($440)
Corp - PP&E Depreciation		($2,500)	($2,143)	($1,531)	($1,093)
Sub-Total Before Tax Expenses		($16,207)	($15,128)	($13,744)	($12,480)
Before Tax Net Income		$7,793	$8,872	$10,256	$11,520
Est. Corporate Tax Rate	35.00%	($2,728)	($3,105)	($3,590)	($4,032)
Current Yr - Earnings (After Tax)		$5,065	$5,767	$6,666	$7,488

NOTE: Areas circled in red indicate new requirements from the IASB / FASB under the forthcoming new Lease Accounting Standard rule changes.

Financial Statements

Balance Sheet

Existing Lease Accounting Rule Example
4-Year Lease Term

Calendar Year of All Leases	0	1	2	3	4
Balance Sheet		**4 Year Existing Accounting Rules Example**			
Lease Term Year	0	1	2	3	4
Assets		Initial 4-Year Lease Term			
Current YR - After Tax Cash	$0.00	$7,065	$6,912	$6,667	$6,482
Accumulated MMF Savings	$0.00	$0	$7,065	$13,977	$20,644
Sub-Total Cash	$0.00	$7,065	$13,977	$20,644	$27,126
Corp - PP&E	$10,000.00	$10,000	$10,000	$10,000	$10,000
Current Yr - PP&E Depreciation	$0.00	($2,500)	($2,143)	($1,531)	($1,093)
Accumulated PP&E Depreciation	$0.00	$0	($2,500)	($4,643)	($6,174)
Sub-Total PP&G	$10,000.00	$7,500	$5,357	$3,826	$2,733
Total Assets	$10,000.00	$14,565	$19,334	$24,470	$29,859
Liabilities & Capital					
Corp - PP&E Loan	$10,000.00	$10,000	$10,000	$10,000	$10,000
Current Yr - Loan Principal Payment	$0.00	($1,155)	($1,236)	($1,323)	($1,415)
Accumulated Loan Prin Payments	$0.00	$0	($1,155)	($2,391)	($3,714)
Sub-Total PP&E Loan Liabilities	$10,000.00	$8,845	$7,609	$6,286	$4,871
Total Liabilities	$10,000.00	$8,845	$7,609	$6,286	$4,871
Initial Capitial	$0.00	$0	$0	$0	$0
Current Yr - Earnings	$0.00	$5,720	$6,005	$6,459	$6,804
Retained Earnings	$0.00	$0	$5,720	$11,725	$18,184
Total Capital	$0.00	$5,720	$11,725	$18,184	$24,988
Total Liabilities & Capital	$10,000.00	$14,565	$19,334	$24,470	$29,859

NOTE: Areas circled in red indicate new requirements from the IASB / FASB under the forthcoming new Lease Accounting Standard rule changes.

New Lease Accounting Standard Example
4-Year Lease Term

Calendar Year of All Leases	0	1	2	3	4
Balance Sheet		**4 Year New Lease Accounting Standard Example**			
Year of Lease	0	1	2	3	4
Assets		Initial 4-Year Lease Term			
Current YR - After Tax Cash	$0.00	$7,416	$7,040	$6,554	$6,112
Accumulated MMF Savings	$0.00	$0	$7,416	$14,456	$21,010
Sub-Total Cash	$0.00	$7,416	$14,456	$21,010	$27,122
	4-Yr Lse NPV @ 7%	Straight-Line Amortization Method			
Corp - Right-to-Use Lse Asset	$40,648.00	$40,648	$40,648	$40,648	$40,648
Current Yr - R-T-U Depreciation	$0.00	($10,162)	($10,162)	($10,162)	($10,162)
Accumulated R-T-L Depreciation	$0.00	$0	($10,162)	($20,324)	($30,486)
Sub-Total Right-to-Use Asset	$40,648.00	$30,486	$20,324	$10,162	$0
Corp - PP&E	$10,000.00	$10,000	$10,000	$10,000	$10,000
Current Yr - PP&E Depreciation	$0.00	($2,500)	($2,143)	($1,531)	($1,093)
Accumulated PP&E Depreciation	$0.00	$0	($2,500)	($4,643)	($6,174)
Sub-Total PP&G	$10,000.00	$7,500	$5,357	$3,826	$2,733
Total Assets	$50,648.00	$45,402	$40,137	$34,998	$29,855
Liabilities & Capital					
Corp - PP&E Loan	$10,000.00	$10,000	$10,000	$10,000	$10,000
Current Yr - Loan Principal Payment	$0.00	($1,156)	($1,236)	($1,323)	($1,416)
Accumulated Loan Prin Payments	$0.00	$0	($1,156)	($2,392)	($3,715)
Sub-Total PP&E Loan Liabilities	$10,000.00	$8,844	$7,608	$6,285	$4,869
	4-Yr Lse NPV @ 7%	Effective Interest Amortization Method			
Corp - Right-to-Use Lse Liability	$40,648.00	$40,648	$40,648	$40,648	$40,648
Current Yr - R-T-U Amortization	$0.00	($9,155)	($9,796)	($10,482)	($11,215)
Accumulated R-T-U Amortization	$0.00	$0	($9,155)	($18,951)	($29,433)
Sub-Total Right-to-Use Liability	$40,648.00	$31,493	$21,697	$11,215	$0
Total Liabilities	$50,648.00	$40,337	$29,305	$17,500	$4,869
Initial Capitial	$0.00	$0	$0	$0	$0
Current Yr - Earnings	$0.00	$5,065	$5,767	$6,666	$7,488
Retained Earnings	$0.00	$0	$5,065	$10,832	$17,498
Total Capital	$0.00	$5,065	$10,832	$17,498	$24,986
Total Liabilities & Capital	$50,648.00	$45,402	$40,137	$34,998	$29,855

EXHIBIT B

MEETING SUMMARY

IASB / FASB February 2011
[excerpts]

The IASB and FASB discussed the definition of a lease, types of leases, definition of 'specified asset', assets that are incidental to the delivery of specified services, a portion of a larger asset, right to control the use of a specified asset, variable lease payments, residual value guarantees, and term option penalties.

The IASB and the FASB tentatively decided that the lease term should be defined, for both lessees and lessors, as follows:

> The lease term is the non cancellable period for which the lessee has contracted with the lessor to lease the underlying asset, together with any options to extend or terminate the lease when there is a significant economic incentive for an entity to exercise an option to extend the lease, or for an entity not to exercise an option to terminate the lease.

This definition was supported by the IASB (13 members supporting with 2 disagreeing) and the FASB (4 members supporting with 1 disagreeing).

The boards tentatively decided that a lessee and a lessor should reassess the lease term only when there is a significant change in relevant factors such that the lessee would then either have, or no longer have, a significant economic incentive to exercise any options to extend or terminate the lease. This decision was supported by 14 members of the IASB and all members of the FASB.

Definition of a lease

A lease is defined as a contract in which the right to use a specified asset is conveyed, for a period of time, in exchange for consideration. The Leases exposure draft included two principles relating to that definition to help to assess whether a contract contains a lease:

a. the fulfilment of the contract depends on providing a specified asset or assets; and

b. the contract conveys the right to control the use of a specified asset for an agreed period of time.

At this meeting, the boards discussed how those principles might be clarified to address comments received from respondents to the exposure draft and through other outreach activities.

Types of leases

The FASB and the IASB tentatively decided to identify a principle for identifying two types of leases for both lessees and lessors, with different profit and loss effects, as follows:

- a finance lease with a profit or loss recognition pattern that is consistent with the proposals in the exposure draft, and
- an other-than-finance lease with a profit or loss recognition pattern that is consistent with an operating lease under existing IFRSs/US GAAP.

The boards directed the staff to seek input through targeted outreach on the approaches detailed below. The purpose of the outreach is to:

- obtain a better understanding of the implications of any proposed changes to the Leases exposure draft;
- understand whether a principle for identifying two types of leases for both lessees and lessors would provide more useful information; and
- test whether the proposed changes would provide a better basis on which to determine whether a contract contains a lease.

The feedback received will provide the boards with input to help make final decisions at a future meeting about the definition of a lease and about types of lease.

Location: **London UK**

Date: **16/02/2011**

EXHIBIT C

PRESS RELEASE

IASB and FASB announce intention to re-expose leasing proposals

21 July 2011

The International Accounting Standards Board (IASB) and the US-based Financial Accounting Standards Board (FASB) announced today their intention to re-expose their revised proposals for a common leasing standard. Re-exposing the revised proposals will provide interested parties with an opportunity to comment on revisions the boards have undertaken since the publication of an exposure draft on leasing in August 2010.

Even through the boards have not completed all of their deliberations, the decisions taken to date were sufficiently different from those published in the exposure draft to warrant reexposure of the revised proposals. The boards intend to complete their deliberations, including consideration of the comment period, during Q3 2011 with a view to publishing a revised exposure draft shortly afterwards.

Commenting on the decision, Hans Hoogervorst, Chairman of the IASB said:

> Although we have yet to conclude our deliberations on this project, the direction of travel indicates that there are aspects of our revised proposals that would benefit from additional input from interested parties.

Leslie F Seidman, Chairman of the FASB, said:

> During our discussions of the extensive comments we received on the exposure draft, the boards have reaffirmed the major change to lease accounting, which is to report lease obligations and the related right-to-use on the balance sheet.
>
> However, the boards decided to make many other changes to address the comments made by stakeholders. The boards decided that, while we still have other matters to discuss, stakeholders would appreciate the opportunity to comment on the revised package of conclusions.

Further details will be available shortly from the leases project sections of the IASB and FASB websites.

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EXHIBIT D

MEETING SUMMARY

IASB / FASB July 2011

The IASB and the FASB discussed re-exposure of the proposed standard, lessor accounting, the accounting for lease payments that depend on an index or a rate, the accounting for embedded derivatives in lease contracts, lessee presentation and disclosure, presentation: lessee statement of financial position and lessee statement of cash flows.

Re-exposure of the proposed standard

The boards agreed unanimously to re-expose their revised proposals for a common leasing standard. Re-exposing the revised proposals will provide interested parties with an opportunity to comment on revisions that the boards have undertaken since the publication of an exposure draft on leasing in August 2010.

The boards made this decision earlier in the process than normal to give interested parties some certainty about the project plan. The boards have still to consider some aspects of the leases project and expect to conclude their discussions in September. At that time the boards will confirm the comment period for the revised exposure draft and will be in a better position to provide more information about the timing of the project.

Lessor accounting

The boards tentatively decided that a lessor should apply a 'receivable and residual' accounting approach as follows:

1. The lessor would recognized a right to receive lease payments and a residual asset at the date of the commencement of the lease.

2. The lessor would initially measure the right to receive lease payments at the sum of the present value of the lease payments, discounted using the rate that the lessor charges the lessee.

3. The lessor would initially measure the residual asset as an allocation of the carrying amount of the underlying asset and would subsequently measure the residual asset by accreting it over the lease term using the rate that the lessor charges the lessee.

4. If profit on the right-of-use asset transferred to the lessee is reasonably assured, the lessor would recognise that profit at the date of the commencement of the lease. The profit would be measured as the difference between (a) the carrying amount of the underlying asset and (b) the sum of the initial measurement of the right to receive lease payments and the residual asset.

5. If profit on the right-of-use asset transferred to the lessee is not reasonably assured, the lessor would recognise that profit over the lease term. In that case, the lessor would initially measure the residual asset as the difference between the carrying amount of the underlying asset and the right to receive lease payments. The lessor would subsequently accrete the residual asset, using a constant rate of return, to an amount equivalent to the underlying asset's carrying amount at the end of the lease term as if the underlying asset had been subject to depreciation.

6. If the right to receive lease payments is greater than the carrying amount of the underlying asset at the date of the commencement of the lease, the lessor would recognise, as a minimum, the difference between those two amounts as profit at that date. Nine IASB members and five FASB members agreed.

The boards also tentatively decided that the following should be excluded from the scope of the 'receivable and residual' approach to lessor accounting:

7. Leases of investment property measured at fair value (all IASB and FASB members agreed)

8. Short-term leases (all IASB members and six FASB members agreed).

For those excluded leases, a lessor should (1) continue to recognise and depreciate the underlying asset and (2) recognise lease income over the lease term on a systematic basis.

Lease payments that depend on an index or a rate

The boards discussed the measurement of lease payments that depend on an index or on a rate that is included in the lessee's liability to make lease payments and the lessor's right to receive lease payments and tentatively decided that:

1. Lease payments that depend on an index or a rate should be measured initially using the index or rate that exists at the date of commencement of the lease. Twelve IASB members and five FASB members agreed.

2. Lease payments that depend on an index or a rate should be reassessed using the index or rate that exists at the end of each reporting period. Thirteen IASB members and five FASB members agreed.

3. Lessees should reflect changes in the measurement of lease payments that depend on an index or a rate (a) in net income to the extent that those changes relate to the current reporting period and (b) as an adjustment to the right-of-use asset to the extent that those changes relate to future reporting periods. All IASB and FASB members agreed.

The boards will discuss at a future meeting how a lessor should reflect changes in the measurement of lease payments that depend on an index or a rate.

Embedded derivatives in lease contracts

The boards tentatively decided that an entity should assess whether a lease contract includes embedded derivatives that should be bifurcated and accounted for in accordance with applicable US GAAP and IFRS requirements on derivatives. Fourteen IASB members and all FASB members agreed.

Lessee presentation and disclosure

The boards discussed lessee disclosures and tentatively decided that a lessee should disclose the following:

1. A reconciliation of the opening and closing balance of right-of-use assets, disaggregated by class of underlying asset. Fourteen IASB members and all FASB members agreed.

2. A reconciliation of the opening and closing balance of the liability to make lease payments (unlike the proposal in the exposure draft, a lessee would not be required to disaggregate the reconciliation by class of underlying asset). Fourteen IASB members and all FASB members agreed.

3. A maturity analysis of the undiscounted cash flows that are included in the liability to make lease payments. The maturity analysis should show, at a minimum, the undiscounted cash flows to be paid in each of the first five years after the reporting date and a total of the amounts for the years thereafter. The analysis should reconcile to the liability to make lease payments. All IASB and FASB members agreed.

4. Information about the principal terms of any lease that has not yet commenced, if the lease creates significant rights and obligations for the lessee. Thirteen IASB members and four FASB members agreed.

5. Information required in paragraphs 73(a)(ii)-73(a)(iii) of the exposure draft (the boards will provide guidance, illustrations, or both about those requirements). All IASB and FASB members agreed.

6. All expenses relating to leases recognised in the reporting period, in a tabular format, disaggregated into (a) amortisation expense, (b) interest expense, (c) expense relating to variable lease payments not included in the liability to make lease payments, and (d) expense for those leases for which the short-term practical expedient is elected, to be followed by the principal and interest paid on the liability to make lease payments. Ten IASB members and all FASB members agreed.

7. Qualitative information to indicate whether circumstances or expectations about short-term lease arrangements are present that would result in a material change to the expense in the next reporting period as compared with the current reporting period. Ten IASB members and five FASB members agreed.

The boards also tentatively decided that a lessee should:

1. Present or disclose separately interest expense and interest paid relating to leases. All IASB and FASB members agreed.

2. Not combine interest expense and amortisation expense and present it as lease or rent expense. All IASB and FASB members agreed.

In addition, the boards tentatively decided that a lessee is not required to disclose the following:

1. The discount rate used to calculate the liability to make lease payments. Thirteen IASB members and six FASB members agreed.

2. The range of discount rates used to calculate the liability to make lease payments. Thirteen IASB members and all FASB members agreed.

3. The fair value of the liability to make lease payments. Eleven IASB members and all FASB members agreed.

4. The existence and principal terms of any options for the lessee to purchase the underlying asset, or initial direct costs incurred on a lease. Eight IASB and five FASB members agreed.

5. Information about arrangements that are no longer determined to contain a lease. Fourteen IASB members and all FASB members agreed.

With regard to future contractual commitments:

1. The IASB tentatively decided that a lessee is not required to disclose the future contractual commitments associated with services and other non-lease components that are separated from a lease contract. Ten IASB members agreed.

2. The FASB tentatively decided that a lessee should disclose the future contractual commitments associated with services and other non-lease components that are separated from a lease contract. Four FASB members agreed.

Presentation: lessee statement of financial position

The boards discussed presentation in the lessee statement of financial position and tentatively decided that a lessee should:

1. Separately present in the statement of financial position, or disclose in the notes to the financial statements, right-of-use assets and liabilities to make lease payments. If right-of-use assets and liabilities to make lease payments are not separately presented in the statement of financial position, the disclosures should indicate in which line item in the statement of financial position the right-of-use assets and liabilities to make lease payments are included. Ten IASB members and five FASB members agreed.

2. Present the right-of-use asset as if the underlying asset were owned. All IASB and FASB members agreed. The boards also decided that it is not necessary to clarify whether the right-of-use asset is a tangible or an intangible asset. Thirteen IASB and six FASB members agreed.

Presentation: lessee statement of cash flows

The boards discussed the lessee's statement of cash flows and tentatively decided that a lessee should:

1. Classify cash paid for lease payments relating to the principal within financing activities. Thirteen IASB members and five FASB members agreed.

2. Classify or disclose cash paid for lease payments relating to interest in the statement of cash flows in accordance with applicable IFRSs or US GAAP. Thirteen IASB members and five FASB members agreed.

3. Classify as operating activities cash paid for variable lease payments that are not included in the measurement of the liability to make lease payments. Thirteen IASB members and four FASB members agreed.

4. Classify as operating activities cash paid for short-term leases that are not included in the liability to make lease payments. All IASB members and six FASB members agreed.

The boards tentatively decided that a lessee should disclose:

1. The expense recognised in the reporting period for variable lease payments that are not included in the liability to make lease payments. All IASB and FASB members agreed.

2. The acquisition of a right-of-use asset in exchange for a liability to make lease payments as a supplementary non cash transaction disclosure. All IASB and FASB members agreed.

Location: **London UK**

Date: **20/07/2011**