Case 22-3c

Shuttered Inc.

Accounting for Lease Concessions Provided During an Economic Downturn

Shuttered Inc. (S) operates various types of retail stores across the United States, including grocery stores, pharmacies, electronics stores, and gaming equipment stores. While most of the stores are in stand-alone buildings, some are located in large shopping centers. All retail space is leased from public and private real estate companies (i.e., S is a lessee).

In early 20X2, an economic downturn began to negatively affect the retail industry in the United States. As a result, S decided to temporarily close some of its stores that experienced a sharp decrease in demand (e.g., electronics and gaming equipment stores) to curtail its costs while it assessed a longer term strategy. S's other stores (e.g., grocery stores and pharmacies) remained open but were adversely affected because of decreased customer discretionary spending in certain non-essential product categories.

To manage its costs, S requested and received the following rent concessions from its landlords in June 20X2[1]:

- *Electronics stores* — Abatement of three months' rent for the period beginning July 1, 20X2.
- *Gaming equipment stores* — Deferral of three months' rent for the period beginning July 1, 20X2, to be repaid in equal installments over the last six months of calendar year 20X4.
- *Grocery stores* — Abatement of three months' rent for the period beginning July 1, 20X2, along with an extension of the lease term by 12 months. The rent to be paid over the extended term will remain $10,000 per month.
- *Pharmacies* — No concessions.

Key Facts and Assumptions

- S has adopted ASC 842, *Leases*, before 20X2.
- All of S's leases are accounted for as operating leases both before and after the concessions.
- All of the leases began on January 1, 20X2, and required monthly lease payments of $10,000 through December 31, 20X4.
- The rate implicit in these leases is not readily determinable for S; accordingly, it used its own incremental borrowing rate (8 percent) as the discount rate for these leases at lease commencement.

[1] Assume that each of the leases described is with a different lessor.

- The right-of-use (ROU) asset and lease liability balances on July 1, 20X2, for each group of leases are as follows (refer to amortization schedule for more detail):
  - Lease liability — ($271,088).
  - ROU asset — $271,088.
  - S's incremental borrowing rate relevant to these leases upon the concessions in June 20X2 was 10 percent.
- There are no rent escalations under any of the lease contracts.
- None of the leases have an existing clause related to rent concessions in the event of an economic downturn or similar circumstance.
- There were no prior rent concessions with respect to any of the leases subject to the concessions described above.
- No other terms or conditions in the original lease agreements were modified along with the rent concessions.

Required:

1. How should S account for each of the rent concessions?

Reference:

Original amortization schedule for all leases. Handout 1