

National Policy Bulletin

SEC Resolves Accounting for Contingent Rental Income

December 9, 1999

On December 3, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin No. 101 (the SAB), *Revenue Recognition in Financial Statements*, summarizing the staff's views in applying generally accepted accounting principles to revenue recognition in financial statements. Included in the SAB is the staff's resolution of the accounting for contingent rental income by lessors under operating leases. In its interpretive response to Question 8 of the SAB, the staff indicates 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." This view is consistent with the Financial Accounting Standards Board's Emerging Issues Task Force's (the Task Force) original May 22, 1998 conclusion (EITF 98-9).

Background

During the first half of 1998, the Task Force began a review of how to account for contingent rents, noting that "the [accounting] literature is unclear as to how contingent rent based on future specific targets should be accounted for in reporting periods prior to achievement of the target." At its May 1998 meeting, the Task Force discussed only the accounting during interim periods, and "reached a consensus that a lessor should defer recognition of contingent rental income in interim periods until the specific target that triggers the contingent rental income is achieved."

At its September 23-24, 1998 meeting, the Task Force discussed the lessor's accounting for contingent rental income in annual periods but was not asked to reach a consensus. In addition, the Task Force did not modify its prior consensus with respect to interim periods. At both the May and September 1998 meetings of the Task Force, the SEC observer commented that the SEC staff "has concerns about lessors' recognizing rental income prior to the resolution of the lease contingencies."

Between May and November 1998, NAREIT and its members strongly advocated the industry's position that accruing contingent rental income based on an evaluation of the probability that the lessor would satisfy the contingency was the most appropriate accounting. In addition, NAREIT challenged the process by which the May consensus was reached.

At its November 1998 meeting, the Task Force again discussed the consensus reached at its May meeting regarding the accounting for contingent rental income. As reported in EITF Abstracts with respect to EITF 98-9, "as a result of this [November] discussion and given that the SEC staff is considering issuing a Staff Accounting Bulletin on revenue recognition, the Task Force agreed to withdraw the consensus reached at the May 21, 1998 meeting regarding the lessor's accounting for contingent rental income in interim periods."



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After this November 1998 conclusion, lessors were to "follow an accounting policy that is consistent with either the policy that they followed in the prior fiscal year or the policy that they followed subsequent to the May 21, 1998 consensus." The SAB now clarifies the required accounting for contingent rental income.

Transition

Question 2 of the "Disclosures" section of the SAB discusses methods for a registrant to transition to the accounting described in the SAB. We have confirmed with the SEC staff that a change to reflect the staff's view of accounting for contingent rental income would be accounted for as a cumulative effect of a change in accounting principle pursuant to APB 20. This transition should be accounted for no later than the first fiscal quarter of the fiscal year beginning after December 15, 1999. The SAB can be found at <http://www.sec.gov/rules/acctreps/sab101.htm>.

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