

**The George Washington University
Office of the Comptroller – Capital and Investing Reporting
Capital Projects for Leasehold Improvements**

The Purpose:

The purpose of this procedure is to ensure that future leasehold improvements in spaces leased by GWU from a third-party lessor/landlord are recorded in accordance with professional pronouncements of Generally Accepted Accounting Principles (GAAP).

Professional Pronouncements

FAS 13 *Accounting for Leases*

FTB 88-1 *Issues Relating to Accounting for Leases*

FAS 13 Paragraph 15

Normally, rental payments on an operating lease shall be charged to expense over the lease term as they becomes payable. If rental payments are not made on a straight-line basis, rental expenses nevertheless shall be recognized on a straight-line basis unless another systematic and rational basis is more representative of the time pattern in which use benefits are derived from the leased property, in which case that basis shall be used.

GWU has addressed the above pronouncement effective FYE 6/30/08 by recording an additional liability representing the difference between cash basis rent and straight line rental fees as of June 30 on a prospective basis.

Beginning in FY 2009 the current year's adjustment for FAS 13 purposes has been recorded quarterly. The liability for the FAS 13 adjustment has been recorded in funding source PA00005. The current year (2009 and beyond) adjustment for FAS 13 purposes is recorded to the rent expenditure account using the PA0005 funding source and a Net Asset Class of C for Capital to segregate these adjustments from the University's operating results.

FTB88-1 Paragraph 7

Payments made to or on behalf of the lessee represent incentives that should be considered reduction of rental expenses by the lessee and reduction of rental revenue by the lessor/landlord over the term of the new lease.... Incentives should be recognized on a straight line basis over the term of the new lease in accordance with paragraph 15 of FASB 13, Technical Bulletin 85-3 and paragraph 1-5 of FTB 88-1.

Other Professional Guidance (PwC) – A test to apply to the facts of an individuals lease.

There is significant diversity in practice as it relates to determining whether a lessor/landlord is paying a lease incentive to a lessee for the construction of a lessee asset or is reimbursing the lessee for the cost of a lessor/landlord asset. There are a number of models in use that consider a variety of factors to make the determination.

While other models used to distinguish between lessee assets and lessor/landlord assets may be acceptable, we believe that the following model is a good one because it closely follows the economics:

1. Where the lease does not explicitly require the lessee to make the improvement, the improvement should be considered an asset of the lessee.

2. In all situations not covered by (1) above, the uniqueness of the improvement to the lessee's intended use needs to be considered. Improvements that are fairly generic and for which it is probable that another tenant could utilize at the end of the lease term would likely be considered to be assets of the lessor/landlord.
3. Where factor (2) is not determinative, other factors include:
 - a. whether the improvements increase the fair value of the property from the standpoint of the lessor/landlord, and
 - b. the useful life of the improvements relative to the lease term.

The choice of model is an accounting policy decision. Once made, it should be applied consistently. Additionally, there should be adequate disclosure of the policy in the notes to the financial statements.

Applicability to GW Lease Transaction

Historically, GW has entered into operating leases for office and classroom space. In agreements where the lessor/landlord will pay the cost of improvements, the transaction can be handled two different ways. In a majority of the cases GWU representatives approved the plans and reviewed the invoices which are then forwarded to the lessor/landlord for payment. On rare occasions, in addition to reviewing the invoices, GWU has issued payments to the vendors and contractors and received reimbursement from the lessor/landlord.

The test outlined above, will be applied to the facts of the individual leases as they become available. Below please find examples of the accounting transactions

A) Where tenant improvements are considered to be the lessee's assets;

Example 1) the lessor/landlord pays the cost of the improvements

Example 2) the lessor/landlord reimburses GWU for cost incurred

In these examples the lessor/landlord's payment for these improvements or reimbursement of the cost of the improvements is considered an incentive for the University to enter into the lease. In these cases, the University will recognize a new asset (Capital Additions) and a deferred rental liability (Accrued Liabilities) in the amount of any funds expended by or reimbursed from the lessor/landlord.

The funding source used will be a PB fund established for the specific leased space. This accounting treatment differs from the FAS 13 recognition above because at the inception the University has no equity in the asset being created. The University's equity in the asset will develop over the life of the lease as the incentive liability is amortized as a reduction in the rental expense.

B) Where the tenant improvements are considered to be the lessor/landlord's assets

Example 3) the lessor/landlord pays the cost of the improvements

Example 4) the lessor/landlord reimburses GWU for cost incurred

**Capital Projects for Leasehold Improvements
September 2008**

Example 1: Assumes Landlord Pays Invoices Directly

Balance Sheet

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Income Statement

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- (1) Capitalize asset – Capital Additions, recognize Deferred Rent liability.
- (2) Rent school level
- (3) Rent – PA level
- (4) Record Depreciation Expense on Capital Additions

Capital Projects for Leasehold Improvements September 2008

Example 2

Assumptions:

A University entity is leasing the space.

GWU will pay the cost of the improvements and will be reimbursed by the Landlord.

The Assets are determined to assets of the University.

The University establishes a Capital Project (PN Funding Source) for the project.

The transaction process follows the same process as a standard Capital Project except that funding on this project will occur after the Landlord's reimbursement is paid.

The University would also establish a PB funding source specific to the property where the Capital Additions are being constructed.

1. DR UN.583xx.601101.PNxxxx.C.CAP.xx – CAPITAL EXPENDITURES ACCOUNTS
CR WC.11112.900001.C100001.G.ADM.FB – PNC CHECKING – GENERAL FUNDS
– ACCOUNTS PAYABLE
To record initial cost for leasehold improvements paid by GW via Procurement and Accounts Payable
2. DR UN.19125.601101.PNxxxxx.C.NIP.XX– CONSTRUCTION - IN - PROGRESS
CR UN.482xx.900636.PBxxxxx.C.NIP.xx – PLANT CAPITALIZATION ACCOUNTS
To transfer expenditures to CIP account
3. DR UN.19122.900636.PBxxxxx.C.NIP.xx – CAPITAL ADDITIONS - BUILDINGS
CR UN.19125.601101.PNxxxxx.C.NIP.xx – CONSTRUCTION – IN - PROGRESS
To capitalize the leasehold improvements at the completion of the project.

The lessor/landord/landlord's reimbursement will be recognized as follows:

4. DR UN.13649.900001.C100001.C.xxx.FB – MISCELLANEOUS RECEIVABLE
CR UN.21921.900636.PBxxxxx.C.ADM.FB – MISCELLANEOUS ACCRUED EXPENSES
To record amount due from the landlord for TI cost and recognizes the Deferred Rent liability to be amortized over the life of the lease.
5. DR UN.11111. 900001.C100001.G.ADM.FB – PNC BANK CHECKING – GENERAL FUNDS
CR UN.13649.900001.C100001.C.xxx.FB – MISCELLANEOUS RECEIVABLE
To record reimbursement from the landlord for TI cost.

The Project Funding entry appears below:

6. DR UN.58956.900636.PBxxxxx.C.xxx.xx - TO CAPITAL PROJECT –PLANT FUNDS
CR UN.58956.601101.PNxxxxx.C.Cap.xx – TO CAPITAL PROJECT –PLANT FUND
To record funding transfer to funds the PN Project after the Landlord's reimbursement is received.

The entry to record rental fees paid pursuant to the lease terms appears below4

7. DR UN.56311.xxxxxx.xxxxxxx.x.xxx.xx - BUILDING / ROOM / FACILITY RENTAL OCCUPANCY
CR WC.11112.900001.C100001.G.xxx.xx – PNC CHECKING – GENERAL FUNDS – ACCOUNTS PAYABLE
To record Rent expense at the school level

The entry to amortize the Deferred Rent Liability appears below.

8. DR UN.21921.900636.PBxxxxx.C.ADM.FB – MISCELLANEOUS ACCRUED EXPENSES
CR UN.56311.900636.PBxxxxx.C.ADM.FB - BUILDING / ROOM / FACILITY RENTAL OCCUPANCY
To record amortization of Landlord’s payments for TI cost over the life of the lease or the life of the asset (whichever is shorter)

The entry to recognize Depreciation Expense for the Capital Addition asset appears below

- 9 DR UN.56511.900636.PBxxxxx.C.NIP.FB – DEPRECIATION EXPENSE
CR UN.19131.900636.PBxxxxx.C.NIP.FB - ACCUMULATED DEPRECIATION
To record depreciation expense on Capital Addition – LI.

**Capital Projects for Leasehold Improvements
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Example 2: Assumes GWU Pays Expenses and receives reimbursement from the Landlord

Balance Sheet

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- (1) Record expenditure
- (2) Transfer to CIP
- (3) Capitalize leasehold improvements
- (4) Record amount due from LL
- (5) Record reimbursement from Landlord
- (6) Record Funding transfer to PN fund to fund the project
- (7) Rent at school level
- (8) Amortization of Deferred Rent liability

**Capital Projects for Leasehold Improvements
September 2008**

Example 3

Assumptions:

The University entity is leasing the space

The Landlord will pay the cost of the improvements directly.

The Assets are determined to assets of the Landlord

1. DR UN.56311.xxxxxx.C100001.x.xxx.FB - BUILDING / ROOM / FACILITY RENTAL OCCUPANCY
CR WC.11112.xxxxxx.xxxxxxx.C.xxx.FB – PNC CHECKING – GENERAL FUNDS – ACCOUNTS PAYABLE
To record Rent expense at the school level

The cost of the tenant improvements become the asset of the Landlord. Therefore there is no asset recognition on the University’s general ledger. Accordingly, there is no recognition of the reduction in rental liability as described in examples 1 and 2.

Balance Sheet	Income Statement
<div style="border-top: 1px solid black; margin-bottom: 5px;">11112.</div> <div style="display: flex; justify-content: center; align-items: center;"> <div style="border-left: 1px solid black; border-right: 1px solid black; padding: 0 10px;">50,000</div> <div style="margin-left: 10px;">(1)</div> </div>	<div style="border-top: 1px solid black; margin-bottom: 5px;">56311 Rent.School</div> <div style="display: flex; justify-content: center; align-items: center;"> <div style="margin-right: 10px;">(1)</div> <div style="border-left: 1px solid black; border-right: 1px solid black; padding: 0 10px;">50,000</div> </div>

(1)Rent school level

Capital Projects for Leasehold Improvements September 2008

Example 4

Assumptions:

The University entity is leasing the space

GWU will pay the cost of the improvements and will be reimbursed by the Landlord

The Assets are determined to assets of the Landlord

GWU will establish a Capital Project funding source for this project

The accounting for the expenditures will follow the standard operating procedures for Capital Projects. The Project Owner (Facilities or Office of Real Estate) will submit PO's and Invoices for the project using the established PN funding code.

Rather than capitalizing these expenditures to CIP, the Office of the Comptroller (CIR) will record a Receivable from the lessor/landlord. Note the transfer entry offsets the expenditure balance in the PN funding source.

There is no funding entry required for this type of project.

1. DR UN.583xx.601101.PNxxxx.C.CAP.xx – CAPITAL EXPENDITURES ACCOUNTS
CR WC.11112.900001.C100001.C.xxx.xx – PNC CHECKING – GENERAL FUNDS –
ACCOUNTS PAYABLE
To record initial cost for leasehold improvements paid by GWU via Procurement
and Accounts Payable
2. DR UN.13649.xxxxxx.Cxxxxxx.C.ADM.FB – MISCELLANEOUS RECEIVABLE
CR UN.482xx.900636.PNxxxxx.C.CAP.xx – PLANT CAPITALIZATION ACCOUNTS
To transfer expenditures to an Accounts Receivable account
3. DR UN.11111.900001.C100001.G.ADM.FB – PNC BANK CHECKING – GENERAL
FUNDS
CR UN.13649.900001.C100001.C.xxx.FB – MISCELLANEOUS RECEIVABLE
To record reimbursement from the landlord for TI cost.
4. DR UN.56311.xxxxxx.C100001.x.xxx.FB - BUILDING / ROOM / FACILITY RENTAL
OCCUPANCY
CR WC.11112.xxxxxx.xxxxxxx.C.xxx.FB – PNC CHECKING – GENERAL FUNDS –
ACCOUNTS PAYABLE
To record Rent expense at the school level

**Capital Projects for Leasehold Improvements
September 2008**

Example 4 – GWU pays for the cost of the improvements on the lessor/landlord’s behalf and is reimbursed by the lessor/landlord.

Balance Sheet

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Income Statement

58956.PNxxxx		58956.C
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(1) 100,000	100,000 (2)	(4) 10,000

- (1) GWU records expenditure for TI work
- (2) GWU transfers these expenditures to an Accounts Receivable account.
- (3) Landlord reimburses GW
- (4) Rent at school level

The cost of the tenant improvements become the asset of the Landlord. Therefore there is no asset recognition on the University’s general ledger. Accordingly, there is no recognition of the reduction in rental liability as described in examples 1 and 2.

Office of the Comptroller – Capital and Investing Reporting
2033 K Street – Test - Leasehold Improvements
October 2008

1. Where the lease does not explicitly require the lessee to make the improvement, the improvement should be considered an asset of the lessee.

The lease (the sixth amendment to an existing lease) does not explicitly require the lessee to make the improvements. The improvements should be considered an asset of the lessee (GWU).

2. In all situations not covered by (1) above, the uniqueness of the improvement to the lessee's intended use needs to be considered. Improvements that are fairly generic and for which it is probable that another tenant could utilize at the end of the lease term would likely be considered to be assets of the lessor/landlord.

The improvements involve the construction of office space. The space is considered generic "for which it is probable that another tenant could utilize at the end of the term". The improvements should be considered an asset of the lessor/landlord.

3. Where factor (2) is not determinative, other factors include:

- a. whether the improvements increase the fair value of the property from the standpoint of the lessor/landlord, and
- b. the useful life of the improvements relative to the lease term.

The improvements are being made to space previously occupied. Accordingly, the improvements are not considered to "increase the fair value of the property from the standpoint of the lessor/landlord". The lease term is 5-6 years. The useful life of the improvements (10 years) is considered longer than the lease term.

The lessor/landlord has paid all of the costs (up to the allowance amount) to a contractor selected by the lessor/landlord. A full accounting has been provided and is attached. Example 1 of the procedure above will be used to record this transaction

**Office of the Comptroller – Capital and Investing Reporting
1925 Ballenger Drive – Test - Leasehold Improvements
October 2008**

1. Where the lease does not explicitly require the lessee to make the improvement, the improvement should be considered an asset of the lessee.

The lease does not explicitly require the lessee to make the improvements. The improvements should be considered an asset of the lessee (GWU).

2. In all situations not covered by (1) above, the uniqueness of the improvement to the lessee's intended use needs to be considered. Improvements that are fairly generic and for which it is probable that another tenant could utilize at the end of the lease term would likely be considered to be assets of the lessor/landlord.

The improvements involve the construction of large classroom space. These spaces are not considered generic "for which it is probable that another tenant could utilize at the end of the term". The improvements should be considered an asset of the lessee (GWU).

3. Where factor (2) is not determinative, other factors include:

- a. whether the improvements increase the fair value of the property from the standpoint of the lessor/landlord, and
- b. the useful life of the improvements relative to the lease term.

The improvements are being made to "shell" space not previously occupied. Accordingly, the improvements are considered to "increase the fair value of the property from the standpoint of the lessor/landlord". However, the original lease term is 16 years and provides for additional improvement allowance in year 10. Accordingly, the useful life of the improvements (10 years) is considered less than original lease term.

Under the Ballenger lease, GWU is paying the construction costs and requesting reimbursement from the lessor/landlord. Example 2 of the procedures above will be used to record this transaction.