

## Illustrative Example 1- Existing Lease Transition

Specialty contractor enters into a three-year contract effective January 1, 2021 for the use of four bulldozers and agrees to make the following annual escalating payments.

**Year one: \$ 80,000**

**Year two: \$ 140,000**

**Year three: \$ 180,000**

The transition amount of the right-of-use (ROU) asset and liability to make lease payments is \$244,144 at a discount rate of 4.8% starting the effective date of the second year of lease.

### Journal Entry Year One: (before effective date)

	Dr.	Cr.
Operating rent expense	\$ 133,333	
Deferred rent liability		\$ 53,333
Cash operating rent payment		\$ 80,000
<i>Operating lease rent payment</i>		

### Journal Entry Year Two: (January 1, 2022 effective date)

Operating right-of-use asset	\$ 244,144	
Deferred rent liability	\$ 53,333	
Operating current liability		\$ 125,721
Operating long term liability		\$ 171,755
<i>Capitalization of operating lease for transition year</i>		

Operating current liability	\$ 125,721	
Operating lease cost	\$ 133,333	
Operating accumulated depreciation		\$ 119,054
Cash operating rent payment		\$ 140,000
<i>Operating expense accrual and payment</i>		

Operating long term liability	\$ 171,756	
Operating current liability		\$ 171,756
<i>Reclassification of operating liability from long term to current</i>		

### Journal Entry Year Three:

Operating current liability	\$ 171,756	
Operating lease cost	\$ 133,333	
Operating accumulated depreciation		\$ 125,089
Cash operating rent payment		\$ 180,000
<i>Operating expense accrual and payment</i>		

Operating accumulated depreciation	\$ 244,144	
Operating right-of-use asset		\$ 244,144
<i>Normal termination of operating lease at end of lease term.</i>		