EXHIBIT 3
Illustration: Accounting for Incentives Received from a Landlord

On January 1, 2006, Regent Corporation (lessee) signed a 10-year operating lease for office space owned by Barker Development, Inc. (lessor). The lease requires fixed monthly rent payments of $20,000 throughout the term and does not include a renewal option or rent holiday. Regent expects to make significant improvements to the space to satisfy its business needs. As an incentive to sign the lease, Barker agrees to reimburse Regent for 25% of the first $1 million of improvements. During the six-month period from January 1 through June 30, 2006, Regent makes $1,500,000 of improvements and receives the $250,000 cash reimbursement from Barker. The improvements have an estimated useful life of 15 years. Regent occupies the new space on July 1, 2006, and commences operations.

Proper Accounting Treatment

Per FTB 88-1 and the SEC staff, Regent would account for the $250,000 incentive as a credit to deferred rent. The credit would be amortized on a straight-line basis over the lease term as an annual reduction in rent expense of $25,000 ($250,000 ÷ 10 years). For 2006, net rent expense would be $215,000 ($240,000 paid – $25,000). Leasehold improvements would be reported at the total cost of $1,500,000 and amortized as $150,000 per year over the lease term of 10 years. For the six months of 2006, amortization expense would be $75,000. Regent's statement of cash flows would include expenditures of $1,500,000 in investing activities. Cash flows from operations would reflect rent paid of $240,000 and the $250,000 incentive from the landlord (net inflow of $10,000).

Past Accounting Errors

Using the above facts, assume that Regent incorrectly netted the $250,000 incentive against the cost of the leasehold improvements. Accordingly, amortization expense of $62,500 for 2006 ($1,250,000 ÷ 10 years x 6/12) would be understated by $12,500 ($75,000 – $62,500). Similarly, rent expense would be overstated by $25,000, representing the required annual decrease in deferred rent ($250,000 ÷ 10 years) from the incentive. If Regent discovered this error in 2007, the pertinent financial statement effects (pretax) resulting from the restatement of 2006 results would be as follows:

Summary Financial Impact: 2006

	As Originally Reported	Adjustment Dr. (Cr.)	As Restated
Balance Sheet			
Leasehold improvements	$1,250,000	$ 250,000	$ 1,500,000
Less: accumulated amortization	($62,500)	($12,500)	($75,000)
	$1,187,500	$ 237,500	$ 1,425,000
Deferred rent liability	$0	($225,000)*	($225,000)
Income Statement			
Rent expense	$ 240,000	($25,000)	$ 215,000
Amortization expense	$ 62,500	$ 12,500	$ 75,000
Statement of Cash Flows		**Inflow (Outflow)**	
Net cash flow from operating activities	($240,000)	$ 250,000	$ 10,000
Net cash flow from investing activities	($1,250,000)	($250,000)	($1,500,000)

**Represents the incentive ($250,000) less the $25,000 reduction in rent expense for 2006.*