Case 15-4
All-In

All-In operates casinos across the United States. The company has experienced tremendous success at its existing casino locations and would like to expand its operations by opening a new casino in Asia in the next few years. Off-Book is in the business of (1) acquiring land to develop buildings that meet its customer specifications and (2) subsequently leasing the buildings to the customer.

On January 1, 2012, All-In and Off-Book entered into an arrangement in which Off-Book will purchase land in a specific location and build a casino according to All-In's specifications. Once the construction is complete (expected by January 1, 2014), Off-Book will lease the casino to All-In. Although All-In provided the overall design and layout of the casino, Off-Book is responsible for all construction activities. The budgeted cost of constructing the casino is $60 million. Off-Book will pay all construction costs up to the budgeted amount and $40 million to purchase the land.

In order to minimize Off-Book's construction risk — which in turn allows Off-Book to charge lower rental payments — All-In has agreed to directly pay for all construction cost overruns. All-In believes its responsibility to pay construction cost overruns is not a significant risk given Off-Book's history of successfully constructing large buildings (including casinos) close to budget. While some variability in the total cost of constructing the casino is expected, All-In considers it remote that the total construction costs of the building will exceed $65 million.

On the basis of the estimated construction costs and the purchase price of the land, Off-Book and All-In jointly entered into a lease for the casino with the following key terms:

- The lease has a 20-year term beginning on the date construction of the casino is completed. The expected life of the casino is 40 years.
- All-In will make annual lease payments to Off-Book in the amount of $5 million, beginning on the date construction is completed.
- The lease does not transfer title and does not contain any renewal options or purchase options.
- All-In's incremental borrowing rate is 6 percent.

On the basis of the terms above, All-In believes that the lease will qualify for operating lease accounting.

Required:

1. How should All-In account for the lease on January 1, 2012 (the date All-In and Off-Book entered into the lease)?
2. Assume that construction of the casino was completed as scheduled on January 1, 2014. Would All-In need to reevaluate the transaction upon completion of construction?