# Statement of Financial Accounting Standards No. 17

Note: This Statement has been completely superseded

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FAS17 Summary

## Accounting for Leases—Initial Direct Costs

(an amendment of FASB Statement No. 13)

November 1977

Financial Accounting Standards Board
of the Financial Accounting Foundation
401 MERRITT 7, P.O. BOX 5116, NORWALK, CONNECTICUT 06856-5116

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## INTRODUCTION AND BACKGROUND INFORMATION

1. *FASB Statement No. 13,* "Accounting for Leases," issued by the Board in November 1976, defined *initial direct* costs in paragraph 5(m) as follows:

> Those incremental direct costs incurred by the lessor in negotiating and consummating leasing transactions (e.g., commissions and legal fees).

2. Since issuance of *FASB Statement No. 13* the Board has received a number of requests to interpret the definition of *initial direct costs*, specifically to clarify the meaning of "incremental direct costs." On April 7, 1977, the Board submitted a proposed Interpretation of the definition to the members of the Financial Accounting Standards Advisory Council for comment. The proposed Interpretation stated that *direct* referred to those costs that are incurred in connection with specific leasing transactions and *incremental* limited such costs to those that vary directly with the number or dollar amount of leasing transactions, as distinct from ongoing, recurring expenses that ordinarily do not vary with the number or dollar amount of leasing transactions. Twenty-five letters of comment were received from Council members and from others representing businesses that would be affected by the Interpretation. Many respondents to the proposed Interpretation urged the Board to include in the definition of initial direct costs sales salaries and other costs that do not vary directly with specific leasing transactions but that do vary with the general level of leasing business acquired. The Board concluded that it should amend the definition of initial direct costs to encompass costs that are directly related to consummated leasing transactions and that vary either with specific leasing transactions or with the general level of leasing business acquired.

3. An Exposure Draft of a proposed Statement on "Accounting for Leases — Initial Direct Costs" was issued on August 8, 1977. The Board received 42 letters of comment in response to the Exposure Draft. Certain of those comments and the Board's consideration of them are discussed in paragraphs 4-6 below.

4. Some respondents recommended that the Board conform the accounting for initial direct costs of leases to the existing practices for other financing activities of finance companies; other respondents recommended that the Board conform the accounting for initial direct costs of leases to the existing practices for other financing

activities of banks. The *AICPA Industry Audit Guide*, "Audits of Finance Companies," permits the use of any of three overall methods of recognizing finance income. All of the methods require that direct and indirect acquisition costs applicable to loans be charged to operations when incurred. Two of the methods require that an amount of deferred finance income equal to estimated acquisition costs be transferred to operations in the same period; such a transfer is prohibited under the other permitted method. Banks often charge all loan origination costs to expense without offsetting revenue recognition. Conforming the accounting for initial direct costs of leases to the accounting for initial direct costs of other financing activities of various types of enterprises would require alternative methods of accounting for similar leasing transactions. Still other respondents recommended that the Board permit the option of charging initial direct costs to expense without offsetting revenue recognition. The Board concluded that it should not prescribe alternative methods of accounting for similar leasing transactions.

5. Some respondents to the Exposure Draft stated that the cost of identifying the portion of salespersons' salaries that relates to specific completed leasing transactions would be excessive. The Board believes that salespersons can estimate the portion of their time that results in completed leases and the portion spent in negotiations for leases that were not consummated and in other activities and that reasonable allocations of other costs can be made based on similar estimates. In some enterprises, the determinations can be made by periodic statistical samples. The Board believes that enterprises can perform the required allocations without excessive cost.

6. Some respondents to the Exposure Draft asked if the Board intended that a provision for bad debts be included in initial direct costs. The Board does not intend that initial direct costs, as defined, include a provision for bad debts. Accounting for bad debts that are expected to result from leases and other financing activities is a pervasive issue that the Board did not address in *FASB Statement No. 13.* The Board has not studied that question and did not intend that Statement No. 13 would change existing practices in accounting for bad debts.

7. The Board concluded that on the basis of existing data it could make an informed decision on the matter addressed in this Statement without a public hearing and that the effective date and transition prescribed in paragraph 9 are advisable.

## STANDARDS OF FINANCIAL ACCOUNTING AND REPORTING

### Amendment to FASB Statement No. 13

8. Paragraph 5(m) of *FASB Statement No. 13* is superseded by the following:

> *Initial direct costs.* Those costs incurred by the lessor that are directly associated with negotiating and consummating completed leasing transactions. Those costs include, but are not necessarily limited to, commissions, legal fees, costs of credit investigations, and costs of

preparing and processing documents for new leases acquired. In addition, that portion of salespersons' compensation, other than commissions, and the compensation of other employees that is applicable to the time spent in the activities described above with respect to completed leasing transactions shall also be included in initial direct costs. That portion of salespersons' compensation and the compensation of other employees that is applicable to the time spent in negotiating leases that are not consummated shall not be included in initial direct costs. No portion of supervisory and administrative expenses or other indirect expenses, such as rent and facilities costs, shall be included in initial direct costs.

## Effective Date and Transition

9. The provisions of this amendment to FASB Statement No. 13 shall be effective for leasing transactions and lease agreement revisions (see paragraph 9 of Statement No. 13) entered into on or after January 1, 1978. Earlier application is encouraged. In addition, the provisions of this Statement shall be applied retroactively at the same time and in the same manner as the provisions of Statement No. 13 are applied retroactively (see paragraphs 49 and 51 of Statement No. 13). Enterprises that have already applied the provisions of Statement No. 13 retroactively and have published financial statements based on the retroactively adjusted accounts before the effective date of this Statement may, but are not required to, apply the provisions of this Statement retroactively.

**The provisions of this Statement need not be applied to immaterial items.**

*This Statement was adopted by the affirmative votes of five members of the Financial Accounting Standards Board. Messrs. Gellein and Kirk dissented.*

Messrs. Gellein and Kirk dissent because the Statement proliferates further, and therefore adds confusion to, the accounting for costs of acquiring business. As indicated in paragraph 4 of the Statement, financial-type enterprises, including banks, finance companies, leasing companies, and insurance companies, follow various methods of accounting for acquisition costs. Messrs. Gellein and Kirk object to piecemeal consideration of the accounting for such acquisition costs, particularly if the result is to establish a method followed by few, if any, companies, without offering the rationale for the method. Understanding of financial statements of companies in industries with similar operating circumstances is not enhanced by specifying a new accounting method based on a new meaning of terms for certain transactions of an enterprise while similar transactions are accounted for under different methods.

Messrs. Gellein and Kirk believe that the revenue of a period is not determined by the expenses of the period and therefore they can accept a transfer to revenue of an amount equivalent to certain expenses of the period only as an expedient, pending further consideration of the accounting for business acquisition costs. In the meantime they would limit the extent of that kind of transfer to additional costs incurred to obtain the business, as was the intention in *FASB Statement No. 13* and the proposed Interpretation referred to in paragraph 2 of this Statement.

*Members of the Financial Accounting Standards Board:*

Marshall S. Armstrong, *Chairman*
Oscar S. Gellein
Donald J. Kirk
Arthur L. Litke
Robert E. Mays
Robert T. Sprouse
Ralph E. Walters