

Statement of Financial Accounting Standards No. 26

Note: This Statement has been completely superseded

[FAS26 Status Page](#)
[FAS26 Summary](#)

Profit Recognition on Sales-Type
Leases of Real Estate

(an amendment of FASB Statement No. 13)

April 1979



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

Copyright © 1979 by Financial Accounting Standards Board. All rights reserved. No part of this publication may be reproduced, stored in a retrieval system, or transmitted, in any form or by any means, electronic, mechanical, photocopying, recording, or otherwise, without the prior written permission of the Financial Accounting Standards Board.

Statement of Financial Accounting Standards No. 26
Profit Recognition on Sales-Type Leases of Real Estate
an amendment of FASB Statement No. 13
April 1979

CONTENTS

	Paragraph Numbers
Introduction and Background Information.....	1-6
Standards of Financial Accounting and Reporting:	
Amendment to FASB Statement No. 13	7
Effective Date and Transition.....	8

FAS 26: Profit Recognition on Sales-Type Leases of Real Estate an amendment of FASB Statement No. 13

FAS 26 Summary

This Statement specifies that a lease of real estate that would otherwise be classified as a sales-type lease under *FASB Statement No. 13, "Accounting for Leases,"* and that results in a "sales-type" profit shall be classified as an operating lease by the lessor unless at the beginning of the lease term it also meets the conditions for full and immediate profit recognition as described in the *AICPA Industry Accounting Guide, "Accounting for Profit Recognition on Sales of Real Estate."* This means that a lessor would be precluded from classifying a lease as a sales-type lease and recognizing a "sales-type" profit unless, for example, the lessor receives lease payments as of the beginning of the lease term in an amount at least equal to the minimum down payment requirement specified by the *AICPA Industry Accounting Guide*. The down payment requirements of the Guide range from 5 to 25 percent depending on the type of property.

The Statement does not affect the classification of a sales-type lease of real estate that results in a "sales-type" loss, nor does it affect the classification of a lease of real estate that would be classified as a direct financing lease.

INTRODUCTION AND BACKGROUND INFORMATION

1. The FASB has been asked by a committee of the American Institute of Certified Public Accountants to resolve a problem in the application of *FASB Statement No. 13, "Accounting for Leases,"* to leases involving real estate. The problem arises because the classification criteria of paragraph 8 of Statement No. 13 are different from and not as specific as those that relate to the recognition of profits on sales of real estate under the *AICPA Industry Accounting Guide, "Accounting for Profit Recognition on Sales of Real Estate"* (the AICPA Accounting Guide). The AICPA Accounting Guide addresses the timing of profit recognition on real estate sales and concludes that the buyer's investment in the property acquired and the seller's continuing involvement in the property sold are matters of significance in determining the recognition of profits from real estate sales.

2. Paragraph 6(b)(i) of FASB Statement No. 13 describes sales-type leases as:

Leases that give rise to manufacturer's or dealer's profit (or loss) to the lessor (i.e., the fair value of the leased property at the inception of the lease is greater or less than its cost or carrying amount, if different) and that meet one or more of the criteria in paragraph 7 and both of the criteria in paragraph 8. Normally, sales-type leases will arise when manufacturers or dealers use leasing as a means of marketing their products. Leases involving lessors that are primarily engaged in financing operations normally will not be sales-type leases if they qualify under paragraphs 7 and 8, but will most often be direct financing leases, described in paragraph 6(b)(ii) below. However, a lessor need not be a dealer to realize dealer's profit (or loss) on a transaction, e.g., if a lessor, not a dealer, leases an asset that at the inception of the lease has a fair value that is greater or less than its cost or carrying amount, if different, such a transaction is a sales-type lease, assuming the criteria referred to are met.

The criteria for lessors to classify leases are set forth in paragraphs 7 and 8 of Statement No. 13. A lease that meets any one of the criteria of paragraph 7 and both of the criteria of paragraph 8 is classified as a sales-type lease if at inception the fair value of the leased property is greater or less than its cost or carrying amount, if different.

3. Those making the request described in paragraph 1 indicated that sales transactions of real estate that would not meet the requirements of the AICPA Accounting Guide for full and immediate profit recognition might qualify for profit recognition if they were consummated, instead, as sales-type leases under *FASB Statement No. 13*. They believe that the collectibility criterion of paragraph 8(a) of Statement No. 13 for sales-type leases of real estate should be equivalent to the tests relating to the adequacy of the buyer's initial and continuing investment in the property acquired as described in paragraphs 15-37 of the AICPA Accounting Guide. Further, they believe that the cost uncertainty criterion of paragraph 8(b) of Statement No. 13 would not be met if the lessor continues to be involved with the leased property in any of the ways described in paragraphs 38-60 of the AICPA Accounting Guide because of uncertainties about the amount of unreimbursable costs yet to be incurred by the lessor.

4. An Exposure Draft of a proposed Statement on "Profit Recognition on Sales-Type Leases of Real Estate" was issued for public comment on December 22, 1978. The Board received 33 letters of comment in response to the Exposure Draft, a majority of which expressed general agreement.

5. Several respondents stated that the accounting requirements of the AICPA Accounting Guide should govern profit recognition on sales-type leases of real estate and not the classification of a lease. The Board considered the possibility of amending *FASB Statement No. 13* to adopt the accounting requirements prescribed in the AICPA Accounting Guide. However,

the Board concluded that that approach would involve significant implementation problems and require significant modifications to Statement No. 13. Accordingly, in the interest of resolving this problem, the Board decided to amend paragraph 8 of Statement No. 13 to adopt the requirements of the AICPA Accounting Guide for full and immediate profit recognition as a condition for classifying a lease of real estate as a sales-type lease if a "sales-type" profit would result from the transaction (i.e., the fair value of the leased property at inception is greater than its cost or carrying amount, if different). In concluding that those requirements should be adopted as a condition for classifying a lease of real estate as a sales-type lease, the Board determined that those requirements should be met as of the beginning of the lease term rather than as of the inception date. Those requirements concern the adequacy of the buyer's initial and continuing investment in the property acquired and the conditions relating to the seller's continued involvement with the property sold.

6. The Board has concluded that it can reach an informed decision on the basis of existing data without a public hearing and that the effective date and transition specified in paragraph 8 are advisable in the circumstances.

STANDARDS OF FINANCIAL ACCOUNTING AND REPORTING

Amendment to FASB Statement No. 13

7. Paragraph 8 of *FASB Statement No. 13* is amended by adding the following at the end of that paragraph:

However, a lease involving real estate that would otherwise be classified as of the inception date as a sales-type lease giving rise to a manufacturer's or dealer's profit as described in paragraph 6(b)(i) shall be classified as an operating lease unless at the beginning of the lease term it also meets the requirements that a sale of the same property would have to meet for full and immediate profit recognition under the *AICPA Industry Accounting Guide*, "Accounting for Profit Recognition on Sales of Real Estate." Those requirements relate to the adequacy of the buyer's initial and continuing investment in the property acquired and the conditions relating to the seller's continued involvement with the property sold.

Effective Date and Transition

8. The provisions of this amendment to *FASB Statement No. 13* shall be effective for leasing transactions recorded and lease agreement revisions (see paragraph 9 of Statement No. 13) recorded as of August 1, 1979 or thereafter. Earlier application is encouraged. In addition, except as provided in the next sentence, 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 annual 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 unanimous vote of the seven members of the Financial Accounting Standards Board:

Donald J. Kirk, *Chairman*
Frank E. Block
John W. March
Robert A. Morgan
David Mosso
Robert T. Sprouse
Ralph E. Walters