Statement of Financial Accounting Standards No. 98

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FAS98 Summary

Accounting for Leases:

- Sale-Leaseback Transactions Involving Real Estate
- Sales-Type Leases of Real Estate
- Definition of the Lease Term
- Initial Direct Costs of Direct Financing Leases

an amendment of FASB Statements No. 13, 66, and 91 and a rescission of FASB Statement No. 26 and Technical Bulletin No. 79-11

May 1988

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

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FAS 98 Summary

This Statement specifies the accounting by a seller-lessee for a sale-leaseback transaction involving real estate, including real estate with equipment. In addition, this Statement modifies the provisions of FASB Statement No. 13, *Accounting for Leases,* that define the lease term, the accounting by a lessor for sales-type leases of real estate that provide for the transfer of title, and the accounting for initial direct costs of direct financing leases. This Statement provides that:

- A sale-leaseback transaction involving real estate, including real estate with equipment, must qualify as a sale under the provisions of FASB Statement No. 66, *Accounting for Sales of Real Estate,* as amended by this Statement, before it is appropriate for the seller-lessee to account for the transaction as a sale. If the transaction does not qualify as a sale under Statement 66, it should be accounted for by the deposit method or as a financing.
- A sale-leaseback transaction involving real estate, including real estate with equipment, that includes any continuing involvement other than a normal leaseback in which the seller-lessee intends to actively use the property during the lease should be accounted for by the deposit method or as a financing.
- The definition of lease term in paragraph 5(f) of Statement 13 is amended to include all

renewal periods during which there will be a loan outstanding from the lessee to the lessor. This Statement also defines the term *penalty* as used in the lease term provisions of paragraph 5(f) of Statement 13 and thereby may cause lease terms to be longer than previously contemplated. Those modifications of the lease term provisions of Statement 13 apply to *all* leases, not just to sale-leaseback transactions involving real estate.

- A lease involving real estate may not be classified as a sales-type lease unless the lease agreement provides for the transfer of title to the lessee at or shortly after the end of the lease term. Sales-type leases involving real estate should be accounted for under the provisions of Statement 66.

This Statement supersedes paragraph 40 of Statement 66 and rescinds FASB Statement No. 26, *Profit Recognition on Sales-Type Leases of Real Estate,* and FASB Technical Bulletin No. 79-11, *Effect of a Penalty on the Term of a Lease.* This Statement is effective for transactions entered into after June 30, 1988 with earlier application encouraged.

This Statement also amends paragraph 25 of FASB Statement No. 91, *Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases,* and amends Statement 13 to reflect the amendment intended by Statement 91. The effective date of that amendment is the effective date of Statement 91.

INTRODUCTION

1. The FASB has learned that practice varies in accounting by a seller-lessee for a sale-leaseback transaction involving real estate, including real estate with equipment (hereinafter referred to as a sale-leaseback transaction), such as manufacturing facilities, power plants, and office buildings with furniture and fixtures. Irrespective of the terms of the sale-leaseback agreement, some seller-lessees record the sale, remove all property and any related liabilities from the balance sheet, and recognize the profit in accordance with FASB Statement No. 13, *Accounting for Leases,* as amended by FASB Statement No. 28, *Accounting for Sales with Leasebacks.* That approach is hereinafter referred to as **sale-leaseback accounting.**[1] Others consider the provisions of the sale-leaseback agreement in evaluating compliance with the **sales recognition** criteria of FASB Statement No. 66, *Accounting for Sales of Real Estate.* In part, those differences result from differing interpretations of paragraph 40 of Statement 66. The FASB's Emerging Issues Task Force, the SEC staff, and others have asked the FASB to address the accounting for such transactions.

2. The FASB also has learned that diversity in practice exists in interpreting the definition of *lease term* in paragraph 5(f) of Statement 13. If the lessee provides financing to the lessor, some treat that loan the same as a guarantee by the lessee of the lessor's debt under paragraph 5(f) of Statement 13 and include all renewal periods during which the loan is expected to be in effect in the lease term. Others, however, do not include those periods in the lease term. This Statement amends paragraph 5(f) to address that circumstance.

3. Diversity also exists in interpreting the term economic penalty as used in FASB Technical Bulletin No. 79-11, *Effect of a Penalty on the Term of a Lease.* That Technical Bulletin clarifies that factors outside the lease agreement may be economic penalties. Some view an economic penalty as an agreement or other factor external to the lease that imposes a requirement on the lessee to pay a specified amount to a third party upon failure to renew the lease. Others view the loss of a future economic benefit, such as the loss of an enterprise's principal manufacturing or electric generating facility, as constituting an economic penalty and include the exercise of renewal rights related to that potential loss in determining the lease term. This Statement defines the term *penalty* to address those circumstances.

4. Statement 66 requires that a sale transaction be considered consummated before it is appropriate to recognize a sale. Consummation of a sale requires that (a) the parties are bound by the terms of a contract, (b) all consideration has been exchanged, (c) any permanent financing for which the seller is responsible has been arranged, and (d) all conditions precedent to closing have been performed. Statement 66 also requires that profit be recognized under other methods when a sale does not qualify for the full accrual method of profit recognition. The full accrual method of profit recognition requires that (i) the sale be consummated, (ii) the buyer's initial and continuing investments are adequate to demonstrate a commitment to pay for the property, (iii) the seller's receivable is not subject to future subordination, and (iv) the seller has transferred to the buyer the usual risks and rewards of ownership in a transaction that is in substance a sale and does not have a substantial continuing involvement with the property.

5. Consummation of a sale under Statement 66 would normally provide for the transfer of title to the buyer. Statement 13, on the other hand, allows a sale to be recognized in a sales-type lease of real estate even when title is *never* transferred provided that the transaction qualifies for the full accrual method of profit recognition. This Statement eliminates that inconsistency by requiring the transfer of title to the buyer for a transaction to qualify as a sales-type lease of real estate.

SCOPE

6. This Statement establishes standards of financial accounting and reporting with regard to the lease term for all leasing transactions (refer to paragraphs 22(a) and 22(b)), not just for sale-leaseback transactions involving real estate. In addition, this Statement establishes standards of financial accounting and reporting by a seller-lessee for sale-leaseback transactions involving real estate, including real estate with equipment, such as manufacturing facilities, power plants, and office buildings with furniture and fixtures. Under this Statement, a sale-leaseback transaction involving real estate with equipment includes any sale-leaseback transaction in which the equipment and the real estate are sold and leased back as a package, irrespective of the relative value of the equipment and the real estate. This Statement also

addresses sale-leaseback transactions in which the seller-lessee sells property improvements or integral equipment [2] to a buyer-lessor and leases them back while retaining the underlying land.[3] In addition, this Statement applies to sale-leaseback transactions involving real estate with equipment that include separate sale and leaseback agreements (a) with the same entity or related parties and (b) that are consummated at or near the same time, suggesting that they were negotiated as a package. Except as specified in this paragraph and paragraph 22, this Statement does not address sale-leaseback or other leasing transactions involving *only* equipment.

STANDARDS OF FINANCIAL ACCOUNTING AND REPORTING

Sale-Leaseback Transactions

Criteria for Sale-Leaseback Accounting

7. Sale-leaseback accounting shall be used by a seller-lessee only if a sale-leaseback transaction includes all of the following:

a. A normal leaseback as described in paragraph 8
b. Payment terms and provisions that adequately demonstrate the buyer-lessor's initial and continuing investment in the property (refer to paragraphs 8-16 of Statement 66)
c. Payment terms and provisions that transfer *all* of the other risks and rewards of ownership as demonstrated by the absence of *any* other continuing involvement by the seller-lessee described in paragraphs 11-13 of this Statement and paragraphs 25-39 and 41-43 of Statement 66.

8. A *normal leaseback* is a lessee-lessor relationship that involves the active use of the property by the seller-lessee in consideration for payment of rent, including contingent rentals that are based on the future operations of the seller-lessee,[4] and excludes other continuing involvement provisions or conditions described in paragraphs 11-13 of this Statement. The phrase *active use of the property by the seller-lessee* refers to the use of the property during the lease term [5] in the seller-lessee's trade or business, provided that subleasing of the leased back property is minor.[6] If the present value of a reasonable amount of rental for that portion of the leaseback that is subleased is not more than 10 percent of the fair value of the asset sold, the leased back property under sublease is considered minor. Active use of the property may involve the providing of services where the occupancy of the property is generally transient or short-term and is integral to the ancillary services being provided. Those ancillary services include, but are not limited to, housekeeping, inventory control, entertainment, bookkeeping, and food services. Thus, the use of property by a seller-lessee engaged in the hotel or bonded warehouse business or the operation of a golf course or a parking lot, for example, is considered

active use.

Terms of the Sale-Leaseback Transaction

9. Terms of the sale-leaseback transaction that are substantially different from terms that an independent third-party lessor or lessee would accept represent an exchange of some stated or unstated rights or privileges. Those rights or privileges shall be considered in evaluating the continuing involvement provisions in paragraphs 11-13 of this Statement. Those terms or conditions include, but are not limited to, the sales price, the interest rate, and other terms of any loan from the seller-lessee to the buyer-lessor. The fair value of the property used in making that evaluation shall be based on objective evidence, for example, an independent third-party appraisal or recent sales of comparable property.

Continuing Involvement

10. A sale-leaseback transaction that does not qualify for sale-leaseback accounting because of any form of continuing involvement by the seller-lessee other than a normal leaseback shall be accounted for by the deposit method or as a financing, whichever is appropriate under Statement 66. The provisions or conditions described in paragraphs 11-13 of this Statement are examples of continuing involvement for the purpose of applying this Statement.

11. Paragraphs 25-39 and 41-43 of Statement 66 describe forms of continuing involvement by the seller-lessee with the leased property that result in the seller-lessee not transferring the risks or rewards of ownership to the buyer-lessor. Two examples of continuing involvement specified in those paragraphs that are frequently found in sale-leaseback transactions are provisions or conditions in which:

a. The seller-lessee has an obligation or an option [7] to repurchase the property or the buyer-lessor can compel the seller-lessee to repurchase the property.
b. The seller-lessee guarantees the buyer-lessor's investment or a return on that investment for a limited or extended period of time.

12. Other provisions or conditions that are guarantees and that do not transfer all of the risks of ownership shall constitute continuing involvement for the purpose of applying this Statement to sale-leaseback transactions and include, but are not limited to, the following:

a. The seller-lessee is required to pay the buyer-lessor at the end of the lease term for a decline in the fair value of the property below the estimated residual value on some basis other than excess wear and tear of the property levied on inspection of the property at the termination of the lease.
b. The seller-lessee provides **nonrecourse financing** to the buyer-lessor for any portion of the sales proceeds or provides recourse financing in which the only recourse is to the leased asset.
c. The seller-lessee is not relieved of the obligation under any existing debt related to the

property.

d. The seller-lessee provides collateral on behalf of the buyer-lessor other than the property directly involved in the sale-leaseback transaction, the seller-lessee or a related party to the seller-lessee guarantees the buyer-lessor's debt, or a related party to the seller-lessee guarantees a return of or on the buyer-lessor's investment.
e. The seller-lessee's rental payment is contingent on some predetermined or determinable level of future operations of the buyer-lessor.[8]

13. The following provisions or conditions also shall be considered examples of continuing involvement for the purpose of applying this Statement to sale-leaseback transactions:

a. The seller-lessee enters into a sale-leaseback transaction involving property improvements or integral equipment [9] without leasing the underlying land to the buyer-lessor.[10]
b. The buyer-lessor is obligated to share with the seller-lessee any portion of the appreciation of the property.
c. Any other provision or circumstance that allows the seller-lessee to participate in any future profits of the buyer-lessor or the appreciation of the leased property, for example, a situation in which the seller-lessee owns or has an option to acquire any interest in the buyer-lessor.

Sale-Leaseback Transactions by Regulated Enterprises

14. The provisions of this Statement apply to sale-leaseback transactions of a regulated enterprise subject to FASB Statement No. 71, *Accounting for the Effects of Certain Types of Regulation*, as amended. That accounting may result in a difference between the timing of income and expense recognition required by this Statement and the timing of income and expense recognition for rate-making purposes. That difference shall be accounted for as follows:

a. If the difference in timing of income and expense recognition constitutes all or a part of a phase-in plan, as defined in FASB Statement No. 92, *Regulated Enterprises— Accounting for Phase-in Plans,* it shall be accounted for in accordance with that Statement.
b. Otherwise, the timing of income and expense recognition related to the sale-leaseback transaction shall be modified as necessary to conform to Statement 71. That modification required for a transaction that is accounted for by the deposit method or as a financing is further described in paragraphs 15 and 16 of this Statement.

15. If a sale-leaseback transaction that is not part of a phase-in plan is accounted for by the deposit method but the sale is recognized for rate-making purposes, the amortization of the asset shall be modified to equal the total of the rental expense and the gain or loss allowable for rate-making purposes. Similarly, if the sale-leaseback transaction is accounted for as a financing and the sale is recognized for rate-making purposes, the total of interest imputed under the interest method for the financing and the amortization of the asset shall be modified to equal the total rental expense and the gain or loss allowable for rate-making purposes.

16. The difference between the amount of income or expense recognized for a transaction that is not part of a phase-in plan and that is accounted for by the deposit method or as a financing under this Statement and the amount of income or expense included in allowable cost for rate-making purposes shall be capitalized or accrued as a separate regulatory-created asset or liability, as appropriate, if that difference meets the criteria of Statement 71.

Financial Statement Presentation and Disclosure

17. In addition to the disclosure requirements of Statements 13 and 66, the financial statements of a seller-lessee shall include a description of the terms of the sale-leaseback transaction, including future commitments, obligations, provisions, or circumstances that require or result in the seller-lessee's continuing involvement.

18. The financial statements of a seller-lessee that has accounted for a sale-leaseback transaction by the deposit method or as a financing according to the provisions of this Statement also shall disclose:

a. The obligation for future minimum lease payments as of the date of the latest balance sheet presented in the aggregate and for each of the five succeeding fiscal years
b. The total of minimum sublease rentals, if any, to be received in the future under noncancelable subleases in the aggregate and for each of the five succeeding fiscal years.

Other

19. Appendix A provides additional discussion and illustrations of how the provisions of this Statement shall be applied to specific aspects of accounting for sale-leaseback transactions. Appendix A constitutes an integral part of the requirements of this Statement.

Other Changes to the Accounting for Leases

20. Paragraph 22(a) of this Statement revises the definition of *lease term* for all leasing transactions to (a) include all periods, if any, during which a loan from the lessee to the lessor directly or indirectly related to the leased property is expected to be outstanding and (b) insert a cross-reference to the definition of *penalty* in new paragraph 5(o). Paragraph 22(b) defines penalty for *all* leasing transactions. Paragraphs 22(h) and 22(i) amend Statement 13 to reflect the amendment to that Statement intended by FASB Statement No. 91, *Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases.* The remainder of paragraph 22 modifies lessors' accounting for sales-type leases of real estate that provide for the transfer of title at or shortly after the lease term. Paragraphs 22(k)-(n) also clarify that a lease involving land or land and buildings may be classified as a leveraged lease.

Amendments to Existing Pronouncements

21. This Statement rescinds FASB Statement No. 26, *Profit Recognition on Sales-Type Leases of Real Estate,* and FASB Technical Bulletin No. 79-11, *Effect of a Penalty on the Term of a Lease.* This Statement also amends paragraph 13 of FASB Statement No. 29, *Determining Contingent Rentals,* by deleting the reference to paragraph 18(b) of Statement 13 and deletes paragraphs 25(a)-(c) of Statement 91.

22. This Statement amends Statement 13 as follows:

a. The definition of lease term in paragraph 5(f) is superseded by the following:

> *Lease term.* The fixed noncancelable term of the lease plus (i) all periods, if any, covered by bargain renewal options (as defined in paragraph 5(e)), (ii) all periods, if any, for which failure to renew the lease imposes a penalty (as defined in paragraph 5(o)) on the lessee in such amount that a renewal appears, at the inception of the lease, to be reasonably assured, (iii) all periods, if any, covered by ordinary renewal options during which a guarantee by the lessee of the lessor's debt directly or indirectly related to the leased property* is expected to be in effect or a loan from the lessee to the lessor directly or indirectly related to the leased property is expected to be outstanding, (iv) all periods, if any, covered by ordinary renewal options preceding the date as of which a bargain purchase option (as defined in paragraph 5(d)) is exercisable, and (v) all periods, if any, representing renewals or extensions of the lease at the lessor's option; however, in no case shall the lease term be assumed to extend beyond the date a bargain purchase option becomes exercisable. A lease that is cancelable (a) only upon the occurrence of some remote contingency, (b) only with the permission of the lessor, (c) only if the lessee enters into a new lease with the same lessor, or (d) only if the lessee incurs a penalty in such amount that continuation of the lease appears, at inception, reasonably assured shall be considered "noncancelable" for purposes of this definition.
>
> *The phrase *indirectly related to the leased property* is used in this paragraph to describe provisions or conditions that in substance are guarantees of the lessor's debt or loans to the lessor by the lessee that are related to the leased property but are structured in such a manner that they do not represent a direct guarantee or loan. Examples include a party related to the lessee guaranteeing the lessor's debt on behalf of the lessee, or the lessee financing the lessor's purchase of the leased asset using collateral other than the leased property.

b. The definition of penalty is added in new paragraph 5(o) as follows:

> *Penalty.* Any requirement that is imposed or can be imposed on the lessee by the lease agreement or by factors outside the lease agreement to disburse cash, incur or assume a liability, perform services, surrender or transfer an asset or rights to an asset or

otherwise forego an economic benefit, or suffer an economic detriment. Factors to consider when determining if an economic detriment may be incurred include, but are not limited to, the uniqueness of purpose or location of the property, the availability of a comparable replacement property, the relative importance or significance of the property to the continuation of the lessee's line of business or service to its customers, the existence of leasehold improvements or other assets whose value would be impaired by the lessee vacating or discontinuing use of the leased property, adverse tax consequences, and the ability or willingness of the lessee to bear the cost associated with relocation or replacement of the leased property at market rental rates or to tolerate other parties using the leased property.

c. The first sentence of subparagraph 6(b)(i) is superseded by the following, thereby requiring that a lease involving real estate must transfer title by the end of the lease term for the lessor to classify the lease as a sales-type lease of real estate:

> *Sales-type leases.* 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, except as indicated in the following sentence. A lease involving real estate shall be classified as a sales-type lease only if it meets the criterion in paragraph 7(a), in which case the criteria in paragraph 8 do not apply.

d. Subparagraph 6(b)(iv) is superseded by the following:

> *Operating leases.* All other leases, including leases that involve real estate and give rise to manufacturer's or dealer's profit (or loss) to the lessor but do not meet the criterion in paragraph 7(a).

e. The following footnote is added to the end of paragraph 7(a):

> *This criterion is met in situations in which the lease agreement provides for the transfer of title at or shortly after the end of the lease term in exchange for the payment of a nominal fee, for example, the minimum required by statutory regulation to transfer title.

f. The first two sentences of paragraph 8 and paragraph 8(a) are superseded by the following:

> From the standpoint of the lessor, a lease involving real estate shall be classified as a sales-type lease only if it meets the criterion in paragraph 7(a) as appropriate under paragraph 6(b)(i). Otherwise, if the lease at inception meets any one of the four criteria in paragraph 7 and in addition meets both of the following criteria, it shall be classified as a sales-type lease, a direct financing lease, a leveraged lease, or an operating lease as

appropriate under paragraph 6(b). If the lease does not meet any of the criteria of paragraph 7 or both of the following criteria, the lease shall be classified as an operating lease.

a. Collectibility of the minimum lease payments is reasonably predictable. A lessor shall not be precluded from classifying a lease as a sales-type lease, a direct financing lease, or a leveraged lease simply because the receivable is subject to an estimate of uncollectibility based on experience with groups of similar receivables.

g. Paragraph 17(a) is amended by adding at the end of that paragraph the following sentence, which requires sales recognition in a sales-type lease of real estate in accordance with Statement 66:

However, if the sales-type lease involves real estate, the lessor shall account for the transaction under the provisions of *FASB Statement No. 66,* "Accounting for Sales of Real Estate," in the same manner as a seller of the same property.

h. Paragraph 18(a), as amended by FASB Statement No. 23, *Inception of the Lease,* and Statement 91, is superseded by the following to reflect the intent of the amendment made by Statement 91:

The sum of (i) the minimum lease payments (net of amounts, if any, included therein with respect to executory costs, such as maintenance, taxes, and insurance, to be paid by the lessor, together with any profit thereon) and (ii) the unguaranteed residual value accruing to the benefit of the lessor shall be recorded as the gross investment in the lease. The estimated residual value used to compute the unguaranteed residual value accruing to the benefit of the lessor shall not exceed the amount estimated at the inception of the lease.*

Footnote *, which was added to paragraph 18(a) by Statement 23, is unchanged by this Statement.

i. Paragraph 18(b), as amended by Statements 29 and 91, is superseded by the following to reflect the intent of the amendment by Statement 91:

The difference between the gross investment in the lease in (a) above and the cost or carrying amount, if different, of the leased property shall be recorded as unearned income. The net investment in the lease shall consist of the gross investment plus any unamortized initial direct costs less the unearned income. The unearned income and initial direct costs shall be amortized to income over the lease term so as to produce a constant periodic rate of return on the net investment in the lease.[21] However, other methods of income recognition may be used if the results obtained are not materially different from those that would result from the prescribed method in the preceding sentence. The net investment in the lease shall be subject to the same considerations as other assets in classification as current or noncurrent assets in a classified balance sheet. Contingent rentals shall be included in the determination of income as accruable.

Footnote 21 to paragraph 18(b) is unchanged by this Statement.

j. New paragraph 19(d) is added as follows:

If, at the inception of the lease, the fair value of the property in an operating lease involving real estate that would have been classified as a sales-type lease except that it did not meet the criterion in paragraph 7(a) is less than its cost or carrying amount, if different, then a loss equal to that difference shall be recognized at the inception of the lease.

k. The first two sentences of paragraph 25 are superseded by the following:

If land is the sole item of property leased and the criterion in either paragraph 7(a) or 7(b) is met, the lessee shall account for the lease as a capital lease, otherwise, as an operating lease. If the lease gives rise to manufacturer's or dealer's profit (or loss) and the criterion of paragraph 7(a) is met, the lessor shall classify the lease as a sales-type lease as appropriate under paragraph 6(b)(i) and account for the transaction under the provisions of Statement 66 in the same manner as a *seller* of the same property. If the lease does not give rise to manufacturer's or dealer's profit (or loss) and the criterion of paragraph 7(a) and both criteria of paragraph 8 are met, the lessor shall account for the lease as a direct financing lease or a leveraged lease as appropriate under paragraph 6(b). If the criterion of paragraph 7(b) and both criteria of paragraph 8 are met, the lessor shall account for the lease as a direct financing lease, a leveraged lease, or an operating lease as appropriate under paragraph 6(b). If the lease does not meet the criteria of paragraph 8, the lessor shall account for the lease as an operating lease.

l. Subparagraph 26(a)(ii) is superseded by the following two subparagraphs:

ii. Lessor's accounting if the lease meets criterion 7(a): If the lease gives rise to manufacturer's or dealer's profit (or loss), the lessor shall classify the lease as a sales-type lease as appropriate under paragraph 6(b)(i) and account for the lease as a single unit under the provisions of Statement 66 in the same manner as a *seller* of the same property. If the lease does not give rise to manufacturer's or dealer's profit (or loss) and meets both criteria of paragraph 8, the lessor shall account for the lease as a direct financing lease or a leveraged lease as appropriate under paragraph 6(b)(ii) or 6(b)(iii). If the lease does not give rise to manufacturer's or dealer's profit (or loss) and does not meet both criteria of paragraph 8, the lessor shall account for the lease as an operating lease.

iii. Lessor's accounting if the lease meets criterion 7(b): If the lease gives rise to manufacturer's or dealer's profit (or loss), the lessor shall classify the lease as an operating lease as appropriate under paragraph 6(b)(iv). If the lease does not give rise to manufacturer's or dealer's profit (or loss) and meets both criteria of paragraph 8, the lessor shall account for the lease as a direct financing lease or a leveraged lease as appropriate under paragraph 6(b)(ii) or 6(b)(iii). If the lease does not give rise to manufacturer's or dealer's profit (or loss) and does not meet both criteria of paragraph 8, the lessor shall account for the lease as an operating lease.

m. Subparagraph 26(b)(i)(b) is superseded by the following to remove the reference to *sales-type lease*:

Lessor's accounting: If either criterion (c) or (d) of paragraph 7 and both criteria of paragraph 8 are met, the lessor shall account for the lease as a single unit as a direct financing lease, a leveraged lease, or an operating lease as appropriate under paragraph 6(b). If the lease meets neither criterion (c) nor (d) of paragraph 7 or does not meet both criteria of paragraph 8, the lease shall be accounted for as an operating lease.

n. The first sentence in subparagraph 26(b)(ii)(b) is superseded by the following to remove the reference to *sales-type lease:*

Lessor's accounting: If the building element of the lease meets either criterion (c) or (d) of paragraph 7 and both criteria of paragraph 8, the building element shall be accounted for as a direct financing lease, a leveraged lease, or an operating lease as appropriate under paragraph 6(b).

23. Paragraph 40 of Statement 66 is superseded by the following:

The sale of the property is accompanied by a leaseback to the seller of all or any part of the property for all or part of its remaining economic life. Real estate sale-leaseback transactions shall be accounted for in accordance with FASB Statement No. 98, *Accounting for Leases: Sale-Leaseback Transactions Involving Real Estate, Sales-Type Leases of Real Estate, Definition of the Lease Term, and Initial Direct Costs of Direct Financing Leases.*

Effective Date and Transition

24. Except as provided in paragraph 25, the provisions of this Statement shall be effective for transactions entered into [11] after June 30, 1988. Earlier application to transactions occurring in periods for which annual financial statements have not been issued is encouraged.

25. The effective date and transition provisions for paragraphs 22(h) and 22(i), which amend

Statement 13 to reflect the amendments intended by Statement 91, shall be the same as the effective date and transition provisions of Statement 91.

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

This Statement was adopted by the affirmative vote of four members of the Financial Accounting Standards Board. Messrs. Beresford, Lauver, and Swieringa dissented.

Messrs. Beresford, Lauver, and Swieringa dissent because this Statement prescribes different accounting for certain sale-leaseback transactions based on a distinction between active (as defined) and other use of leased property by a seller-lessee. That distinction is without economic substance and is used to arbitrarily preclude sale-leaseback accounting when a seller-lessee subleases the leased property.

Paragraph 48 acknowledges that a leaseback is a form of continuing involvement with leased property but argues that the form of that involvement is different if the seller-lessee intends to sublease that property. In a sale-leaseback transaction, the seller-lessee has exchanged ownership rights for lease rights, and the rights to use the leased property and to benefit from that use are the same regardless of how that property is used. Moreover, any guarantee of the cash flows related to the leased property is lodged in the lease contract and is not altered by what the seller-lessee does with that property.

An objective of financial reporting is to achieve greater comparability of accounting information. Paragraph 119 of FASB Concepts Statement No. 2, *Qualitative Characteristics of Accounting Information,* states that this objective "is not to be attained by making unlike things look alike any more than by making like things look different. The moral is that in seeking comparability accountants must not disguise real differences nor create false differences."

Messrs. Beresford, Lauver, and Swieringa believe that this Statement makes like things look different by prescribing different accounting for certain sale-leaseback transactions based on the distinction between active and other use of leased property, a distinction not relevant to the accounting. Because that distinction arbitrarily limits the extent to which sale-leaseback accounting is permitted, the effects of accounting for identical sale-leaseback transactions will be different.

Members of the Financial Accounting Standards Board:

Dennis R. Beresford, *Chairman*
Victor H. Brown
Raymond C. Lauver
James J. Leisenring
C. Arthur Northrop
A. Clarence Sampson
Robert J. Swieringa

Appendix A

APPLICATIONS OF THE STANDARDS TO SPECIFIC ASPECTS OF ACCOUNTING FOR SALE-LEASEBACK TRANSACTIONS

CONTENTS

Paragraph Numbers

Appendix A: APPLICATIONS OF THE STANDARDS TO SPECIFIC ASPECTS OF ACCOUNTING FOR SALE-LEASEBACK TRANSACTIONS

Introduction

26. This appendix provides additional discussion and examples that illustrate applications of the standards to specific aspects of accounting for a sale-leaseback transaction. This appendix constitutes an integral part of the requirements of this Statement. A brief summary of the accounting guidance being demonstrated precedes each of the first three examples. All examples assume that the initial transaction occurs on the first day of the year and that subsequent transactions and payments are made on the last day of each year.

Sales Recognition

27. A sale-leaseback transaction that qualifies for sales recognition under the provisions of this Statement is accounted for using sale-leaseback accounting by the seller-lessee whether the leaseback is classified as a capital lease or an operating lease in accordance with Statement 13.[12] The proper approach is first to determine the gain that would be recognized under Statement 66 as if the transaction were a sale without a leaseback and then to allocate that gain as provided by Statement 13 over the remaining lease term. Under the provisions of footnote * to paragraph 33 of Statement 13, the gain to be deferred and amortized in proportion to the leaseback is the gain that would otherwise be recognized in that year under the provisions of Statement 66, except for the amount that can be recognized currently under paragraph 33 of Statement 13. The total gain is recognized immediately if the leaseback is considered minor under the context of paragraph 33(a) of Statement 13. The gain to be recognized currently under paragraph 33(b) of Statement 13 is the amount of gain in excess of (a) the present value of the minimum lease payments if the leaseback is classified as an operating lease or (b) the recorded amount of the leased asset if the leaseback is classified as a capital lease.

Example 1—Sale-Leaseback Transaction Accounted for as a Sale with Gain Recognized under the Installment Method and the Leaseback Classified as an Operating Lease

28. Company A (a seller-lessee) sells the building at its principal manufacturing facility with an estimated remaining life of 15 years and a cost less accumulated depreciation of $800,000 to a buyer-lessor for $950,000 (the fair value of the property as determined by an independent third-party appraisal) and enters into an agreement to lease back the building. In exchange for the building, the seller-lessee receives $50,000 and a 10-year $900,000 recourse note with a 10 percent annual interest rate with annual payments of $146,471. Under the terms of the agreement, the seller-lessee is required to lease the building back for $100,000 a year for an initial period of 5 years. In addition, the seller-lessee has the option to renew the lease for an

additional 5 years at $110,000 (estimated to be the then fair-market rental).

29. The sale-leaseback transaction does not include any form of continuing involvement that would preclude the seller-lessee from using sale-leaseback accounting. The initial down payment is inadequate for the seller-lessee to account for the transaction under the full accrual method described in Statement 66. Under the provisions of Statement 66, the seller-lessee elects to use the installment method to recognize the gain on the transaction. The property and any related debt would be removed from the seller-lessee's balance sheet and the note receivable net of unamortized deferred profit would be reported on the balance sheet. The renewal of the lease is included in the lease term for purposes of classifying the lease and amortizing income because the loss of the property at the end of the initial lease term is considered to be a penalty. The leaseback is classified as an operating lease because none of the criteria of paragraph 7 of Statement 13 is met.

Illustration 1—Recognition of the Gain on the Transaction

Calculation of the Gain

Sales price	$950,000
Cost less accumulated depreciation	800,000
Total gain to be recognized	$150,000

Gain Recognition under Section R10
(Installment Method Absent the Leaseback)

Day 1	$ 7,895
End of Year 1	8,916
Year 2	9,808
Year 3	123,381
Total	$150,000

Gain Recognition for the Sale-Leaseback under This Section

Period Recognized	Day 1 Gain	End of Year 1 Gain	Year 2 Gain	Year 3 Gain	Total Gain Recognized
	Allocation of Annual Gain under the Installment Method with the Leaseback				
Year 1	$ 789				$ 789
Year 2	789	$ 990			1,779
Year 3	789	990	$1,226		3,005
Year 4	789	990	1,226	$ 17,625	20,630
Year 5	789	991	1,226	17,626	20,632
Year 6	790	991	1,226	17,626	20,633
Year 7	790	991	1,226	17,626	20,633
Year 8	790	991	1,226	17,626	20,633
Year 9	790	991	1,226	17,626	20,633
Year 10	790	991	1,226	17,626	20,633
Total	$7,895	$8,916	$9,808	$123,381	$150,000

Note: The installment method as described in paragraph 56 of Statement 66 requires profit to be allocated to the down payment and subsequent collections on the buyer-lessor's note (principal portion only) by the percentage of profit inherent in the transaction (in this example, 15.79 percent). In addition, paragraph 61 of Statement 66 allows a seller to switch from the installment method to the full accrual method of recognizing profit when the transaction meets the requirements for the full accrual method on a cumulative basis. In this example, it is assumed that for the seller-lessee to recognize profit in year 3 under the full accrual method, the buyer-lessor must have an investment in the property of 20 percent of the sales price to meet the minimum investment requirement and that the seller-lessee elects to switch to the full accrual method in the first full year after the minimum initial and continuing investment criteria are met.

Deposit Method

30. Paragraphs 20-22, 28, and 32 of Statement 66 describe certain circumstances in which it is appropriate to account for a transaction using the deposit method (as described in paragraphs 65-67 of Statement 66). If a sale-leaseback transaction is accounted for by the deposit method, lease payments decrease and collections on the buyer-lessor's note, if any, increase the seller-lessee's deposit account. The property and any related debt continue to be included in the seller-lessee's balance sheet, and the seller-lessee continues to depreciate the property. Under the provisions of paragraph 21 of Statement 66, a seller-lessee that is accounting for any transaction by the deposit method according to the provisions of this Statement shall recognize a loss if at any time the net carrying amount of the property exceeds the sum of the balance in the deposit account, the fair value of the unrecorded note receivable, and any debt assumed by the buyer.

31. If a sale-leaseback transaction accounted for by the deposit method subsequently qualifies for sales recognition under this Statement and Statement 66, the transaction is accounted for using sale-leaseback accounting, and the gain or loss is recognized in accordance with the provisions of paragraph 27 of this Statement. In addition, the leaseback is classified and accounted for in accordance with Statement 13 as if the sale had been recognized at the inception of the lease. If the leaseback meets one of the criteria for classification as a capital lease, the asset and liability accounts related to the leaseback, including accumulated amortization, are recorded as of the date that the sale is recognized to reflect amortization that would have been charged to expense had the lease been recorded as a capital lease at its inception. The change in the related lease accounts that would have been recorded from the inception of the lease had the transaction initially qualified for sale-leaseback accounting is included in computing the gain or loss recognized in accordance with paragraph 27 of this Statement.

Example 2—Sale-Leaseback Transaction Accounted for by the Deposit Method with Subsequent Sales Recognition and the Leaseback Classified as a Capital Lease

32. Company B (a seller-lessee) sells the building at one of its manufacturing facilities to a buyer-lessor for $950,000 (the fair value of the property as determined by an independent third-party appraisal) and enters into an agreement to lease the building back for 10 years at $150,000 per year. The property has a historical cost of $1,300,000 and accumulated depreciation at the date of the transaction of $400,000. Depreciation expense is $80,000 per year. In exchange for the building, the seller-lessee receives $50,000 and a 10-year $900,000 recourse note with a 10 percent annual interest rate with annual payments of $146,471.

33. The sale-leaseback transaction does not include any continuing involvement provisions, but the buyer-lessor has a questionable credit rating. Based on the poor credit standing of the buyer-lessor and the inadequate initial investment, the seller-lessee elects to account for the transaction by the deposit method. The initial and continuing investment must equal 20 percent of the sales price before it is appropriate to recognize profit by the full accrual method. Based on the amortization schedule of the buyer-lessor's note and assuming an improved credit rating of the buyer-lessor, income recognition under the full accrual method will be appropriate for the transaction at the end of year 3. The leaseback meets the criteria for classification as a capital lease in accordance with the provisions of paragraphs 7(c) and 7(d) of Statement 13.

Illustration 2—Recognition of the Gain on the Transaction

Calculation of the Gain

Sales price (at inception)	$950,000
Cost less accumulated depreciation (end of year 3)	660,000
	290,000
Adjustments required by the deposit method or provisions of this Statement:	
Amortization of capital asset not recognized	(285,000)
Interest income credited to the deposit account in years 1-3 (credited to the deposit account as part of note payments received)	252,495
Interest expense charged to the deposit account in years 1-3 (charged to the deposit account as part of lease payments)	(247,363)
Total gain to be recognized	$ 10,132

Under the provisions of Statement 66 and absent the leaseback, a gain of $10,132 would be recognized at the end of year 3 under the full accrual method.

Allocation of Gain Recognition under Statement 13 and This Statement

Period Recognized	Year 3 Gain
Year 4	$ 1,447
Year 5	1,447
Year 6	1,447
Year 7	1,447
Year 8	1,448
Year 9	1,448
Year 10	1,448
Total	$10,132

Illustration 3—Journal Entries

At inception:

Cash	50,000	
Deposit		50,000
To record the receipt of the down payment on the property		

Recurring journal entries in years 1-3:

Cash	146,471	
Deposit		146,471
To record the receipt of collections on the buyer-lessor's note (the annual payment required for a 10-year $900,000 note)		
Deposit	150,000	
Cash		150,000
To record the lease payments		
Depreciation expense	80,000	
Accumulated depreciation		80,000
To record the depreciation expense		

When the sale is recognized at end of year 3:

Deposit	39,413	
Capital asset	950,000	
Note receivable	713,082	
Accumulated depreciation	640,000	
Property, plant, and equipment		1,300,000
Capital lease obligation		747,363
Accumulated amortization of the capital asset		285,000
Deferred gain		10,132
To recognize the sale and to record the capitalization of the leased asset		

Illustration 4—Annual Balances in Related Balance Sheet Accounts

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)
					Memo entries only in years 1-3							
Period	**Deposit Account**	**Property Plant, and Equipment**	**Accum. Depr.**	**Deferred Gain**	**Deferred Interest Income**	**Gross Note Receiv.**	**Net Note Receiv.**	**Deferred Interest Expense**	**Gross Lease Oblig.**	**Net Lease Oblig.**	**Capital Lease Asset**	**Accum. Amort. Capital Lease**
At inception	$50,000	$1,300,000	$400,000	$ 0	$564,710	$1,464,719	$900,000	$550,000	$1,500,000	$950,000	$950,000	$ 0
Year 1	46,471	1,300,000	480,000	0	474,710	1,318,239	843,529	461,635	1,350,000	888,365	950,000	95,000
Year 2	42,942	1,300,000	560,000	0	390,357	1,171,768	781,411	379,003	1,200,000	820,997	950,000	190,000
Year 3	39,413	1,300,000	640,000	0	312,215	1,025,297	713,082	302,637	1,050,000	747,363	950,000	285,000
After sale is recognized	0	0	0	10,132	312,215	1,025,297	713,082	302,637	1,050,000	747,363	950,000	285,000
Year 4	0	0	0	8,685	240,907	878,826	637,919	233,120	900,000	666,880	950,000	380,000
Year 5	0	0	0	7,238	177,115	732,355	555,240	171,090	750,000	578,910	950,000	475,000
Year 6	0	0	0	5,791	121,591	585,884	464,293	117,242	600,000	482,758	950,000	570,000
Year 7	0	0	0	4,344	75,162	439,413	364,251	72,337	450,000	377,663	950,000	665,000
Year 8	0	0	0	2,896	38,736	292,942	254,206	37,209	300,000	262,791	950,000	760,000
Year 9	0	0	0	1,448	13,316	146,471	133,155	12,765	150,000	137,235	950,000	855,000
Year 10	0	0	0	0	0	0	0	0	0	0	950,000	950,000

Computations:

Column (2)	Original deposit plus collections on the buyer-lessor's note net of payments on the lease.
Column (3)	Plant balance at inception of lease.
Column (4)	Accumulated depreciation at inception of lease plus annual depreciation expense.
Column (5)	Deferred gain account less amount recognized annually per Exhibit 160B.
Column (6)	Column 7 less column 8.
Column (7)	Balance of remaining payments on the buyer-lessor's note.
Column (8)	The present value of the remaining note payments discounted at 10 percent.
Column (9)	Column 10 less column 11.
Column (10)	Accumulated balance of the remaining payments on the lesser- lessee's lease obligation.
Column (11)	The present value of the remaining lease payments discounted at 9.301595 percent (assumed to be the buyer-lessor's incremental borrowing rate).
Column (12)	Balance of the capital lease asset.
Column (13)	Accumulated balance of annual amortization of $95,000.

Financing Method

34. This Statement and paragraphs 25-39 and 41-43 of Statement 66 describe some common forms of continuing involvement with the property by the seller that preclude a sale-leaseback transaction from sale-leaseback accounting. Depending on the nature and duration of the continuing involvement with the property, those provisions may require a sale-leaseback transaction to be accounted for as a financing. If a sale-leaseback transaction is reported as a financing, lease payments, exclusive of an interest portion, decrease and collections on the buyer-lessor's note increase the seller-lessee's liability account with a portion of the lease payments being recognized under the interest method. The seller-lessee reports the sales proceeds as a liability, continues to report the real estate or the real estate and equipment as an asset, and continues to depreciate the property.

35. If a sale-leaseback transaction accounted for as a financing subsequently qualifies for sales recognition under this Statement and Statement 66, the transaction is then recorded using sale-leaseback accounting, and the cumulative change in the related balance sheet accounts is included in the computation of the gain recognized in accordance with the provisions of paragraph 27 of this Statement. In addition, the leaseback is classified and accounted for in accordance with paragraph 7 of Statement 13 as if the sale had been recognized at the inception of the lease. If the leaseback meets one of the criteria for classification as a capital lease, the related lease accounts, including accumulated amortization, are established as of the date the sale is recognized to reflect accumulated amortization and interest that would have been charged to expense had the lease been recorded at its inception. The change in the related lease accounts from the inception of the lease to the date the sale is recognized is included in the gain recognized in accordance with paragraph 27 of this Statement.

Example 3—Sale-Leaseback Transaction (with Seller-Lessee Providing Financing) Accounted for as a Financing with Subsequent Sales Recognition and the Leaseback Classified as an Operating Lease

36. Company C (a seller-lessee) sells one of its older special-purpose buildings at its principal manufacturing facility to a buyer-lessor for $950,000 (the fair value of the property as determined by an independent third-party appraisal) and enters into an agreement to lease the building back for 5 years at $100,000 per year. In addition, the agreement includes an option that allows the seller-lessee to renew the lease for an additional 5 years at $100,000 per year (estimated to be the then fair-market rental). The lease agreement also includes a fair value repurchase option during the initial lease term, and the seller-lessee guarantees that the residual value of the property will be no less than $920,000 at the end of the initial lease period. The special-purpose building has a historical cost of $3,510,000 and accumulated depreciation at the date of the transaction of $2,660,000. Depreciation expense is $70,000 per year. In exchange for the building, the seller-lessee receives $50,000 and a 10-year $900,000 recourse note with a 10 percent annual interest rate.

37. The seller-lessee accounts for this transaction as a financing because of the continuing involvement associated with the guarantee and the repurchase option. At the end of year 5, the seller-lessee exercises the renewal option, and the continuing involvement with the property is no longer at issue because the repurchase option and the guarantee no longer exist. The seller-lessee recognizes the transaction as a sale and classifies the leaseback as an operating lease because none of the criteria of paragraph 7 of Statement 13 is met.

Illustration 5—Recognition of the Gain on the Transaction

Calculation of the Gain

Sales price (at inception)	$ 950,000
Cost less accumulated depreciation (end of year 5)	500,000
	450,000
Adjustments required by the provisions of this Statement:	
Rent charged to the finance obligation account in years 1-5	(500,000)
Interest expense charged to income during years 1-5	82,405
Interest income credited to the finance obligation account in years 1-5	387,595
Total gain to be recognized	$ 420,000

Under the provisions of Statement 66 and absent the leaseback, a gain of $420,000 would be recognized at the end of year 5 under the full accrual method.

Allocation of Gain Recognition under Statement 13 and This Statement

Period Recognized	Year 5 Gain
Year 5	$ 34,060*
Year 6	77,188
Year 7	77,188
Year 8	77,188
Year 9	77,188
Year 10	77,188
Total	$420,000

*Represents the amount by which the total gain to be recognized exceeds the present value of the future minimum lease payments discounted at the seller-lessee's incremental borrowing rate, assumed to be 9.301595 percent ($420,000 - $385,940 = $34,060).

Illustration 6—Journal Entries

At inception:

Cash	50,000	
Finance obligation		50,000

To record the receipt of the down payment on the property

Recurring journal entries in years 1-5:

Cash	146,471	
Finance obligation		146,471

To record the receipt of collections on the buyer-lessor's note (the annual payment required for a 10-year $900,000 note)

Depreciation expense	70,000	
Accumulated depreciation		70,000

To record the depreciation expense

Nonrecurring journal entries:

Year 1

Finance obligation	94,972	
Interest expense	5,028	
Cash		100,000

To record the lease payments (Interest expense is calculated under the interest method using an effective yield of 10.0562 percent and the guaranteed residual value as the last payment.)

Year 2

Finance obligation	89,793	
Interest expense	10,207	
Cash		100,000

To record the lease payments

Year 3

Finance obligation	84,093	
Interest expense	15,907	
Cash		100,000

To record the lease payments

Year 4		
Finance obligation	77,820	
Interest expense	22,180	
Cash		100,000
To record the lease payments		
Year 5		
Finance obligation	70,917	
Interest expense	29,083	
Cash		100,000
To record the lease payments		

When the sale is recognized:

Finance obligation	364,760	
Note receivable	555,240	
Accumulated depreciation	3,010,000	
Property, plant, and equipment		3,510,000
Deferred gain		385,940
Gain on sale		34,060
To record the transaction as a sale		

Illustration 7—Annual Balances in the Related Balance Sheet Accounts

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
					Memo entires only in years 1-5		
Period	**Finance Obligation**	**Property, Plant, and Equipment**	**Accumulated Depreciation**	**Deferred Gain**	**Deferred Interest Income**	**Gross Note Receivable**	**Net Note Receivable**
At inception	$50,000	$3,510,000	$2,660,00	$ 0	$564,710	$1,464,710	$900,000
Year 1	101,499	3,510,000	2,730,000	0	474,710	1,318,239	843,529
Year 2	158,177	3,510,000	2,800,000	0	390,357	1,171,768	781,411
Year 3	220,555	3,510,000	2,870,000	0	312,215	1,025,297	713,082
Year 4	289,206	3,510,000	2,940,000	0	240,907	878,826	637,919
Year 5	364,760	3,510,000	3,010,000	0	177,115	732,355	555,240
After sale is recognized	0	0	0	385,940	177,115	732,355	555,240
Year 6	0	0	0	308,752	121,591	585,884	464,293
Year 7	0	0	0	231,564	75,162	439,413	364,251
Year 8	0	0	0	154,376	38,736	292,942	254,206
Year 9	0	0	0	77,188	13,316	146,471	133,155
Year 10	0	0	0	0	0	0	0

Computations:

Column (2)	Collections on the buyer-lessor's note net of payments on the lease applied to the finance obligation account.
Column (3)	Plant balance at inception of lease.
Column (4)	Accumulated depreciation at inception of lease plus annual depreciation expense.
Column (5)	Deferred gain less amounts recognized annually per Exhibit 160E.
Column (6)	Column 7 less column 8.
Column (7)	Balance of remaining payments on the buyer-lessor's note.
Column (8)	The present value of the remaining note payments discounted at 10 percent.

Example 4—Sale-Leaseback Transaction (All Cash) Accounted for as a Financing with Subsequent Sales Recognition

38. Company D (a seller-lessee) sells the building at one of its manufacturing facilities to a buyer-lessor for $950,000 (the fair value of the property as determined by an independent third-party appraisal) and enters into an agreement to lease the building back for 5 years at $100,000 per year. In addition, the seller-lessee has an option to renew the lease for an additional 5 years at $110,000 (estimated to be the then fair-market rental). The lease agreement also includes a fair value repurchase option, and the seller-lessee guarantees that the residual value of the property will be no less than $950,000 at the end of the initial lease period. The property has a historical cost of $1,200,000 and accumulated depreciation at the date of the transaction of $400,000. Depreciation expense is $80,000 per year.

39. Because of the continuing involvement associated with the guarantee and the repurchase option, the seller-lessee accounts for this transaction as a financing in accordance with the

provisions of this Statement. At the inception of the lease, it is known that the seller-lessee is developing a new manufacturing process that will require a different manufacturing facility. The new technology becomes available at the end of the initial lease term, and the seller-lessee vacates the property. The fair value of the property (as determined by an independent third-party appraisal) at that time is $915,000. The seller-lessee honors the $950,000 guarantee of the property by paying the buyer-lessor $35,000 and recognizes the sale of the property.

Illustration 8—Recognition of the Gain on the Transaction

Calculation of the Gain before the Effect of the Guarantee

Sales price (at inception)	$950,000
Cost less accumulated depreciation (end of year 5)	400,000
Total gain to be recognized	$550,000

Illustration 9—Journal Entries

At inception:

Cash	950,000	
Finance obligation		950,000

To record the receipt of the proceeds from the sale of the property

Recurring journal entries in years 1-5:

Depreciation expense	80,000	
Accumulated depreciation		80,000

To record the depreciation expense

Interest expense	100,000	
Cash		100,000

To record the lease payments (Interest expense is calculated under the interest method using an effective yield of 10.5263 percent and the guaranteed residual as the last payment.)

When the sale is recognized:

Accumulated depreciation	800,000	
Finance lease obligation	950,000	
Property, plant, and equipment		1,200,000
Cash		35,000
Gain on sale of property		515,000

To record the transaction as a sale

Under the provisions of this Statement, gain deferral is not required because the seller-lessee no longer occupies or otherwise benefits from the property and no longer has any guarantee or other continuing involvement.

Illustration 10—Annual Balances in the Related Balance Sheet Accounts

(1) Period	(2) Finance Obligation	(3) Property, Plant, and Equipment	(4) Accumulated Depreciation
At inception	$950,000	$1,200,000	$400,000
Year 1	950,000	1,200,000	480,000
Year 2	950,000	1,200,000	560,000
Year 3	950,000	1,200,000	640,000
Year 4	950,000	1,200,000	720,000
Year 5	950,000	1,200,000	800,000
When property is vacated	0	0	0

Appendix B

BASIS FOR CONCLUSIONS

CONTENTS

Paragraph Numbers

Appendix B: BASIS FOR CONCLUSIONS

Introduction

40. This appendix summarizes considerations that were deemed significant by members of the Board in reaching the conclusions in this Statement. It includes reasons for accepting certain views and rejecting others. Individual Board members gave greater weight to some factors than to others. The Board concluded that it could reach an informed decision on the basis of existing information without a public hearing.

General

41. An FASB Exposure Draft, *Sale and Leaseback Transactions Involving Real Estate, Sales-Type Leases of Real Estate, Definition of the Lease Term, and Initial Direct Costs of Direct Financing Leases,* was issued for public comment on August 31, 1987. The Board received 72 letters of comment in response to the Exposure Draft.

42. The provisions of this Statement that address sale-leaseback transactions are based on the view that those transactions should qualify for sales recognition before it is appropriate for the seller-lessee to use sale-leaseback accounting. Statement 66 establishes standards for profit recognition for sales of real estate. It also precludes sales recognition in certain circumstances and prescribes other methods to account for those transactions (paragraphs 20, 26-29, 32, and 38 of Statement 66). This Statement requires that a sale-leaseback transaction qualify for sales recognition under the provisions of Statement 66 before it is appropriate for the seller-lessee to use sale-leaseback accounting.

Scope

43. Real estate sales transactions may be accounted for differently than sales of other assets. This Statement does not address a sale-leaseback transaction involving no real estate except for (a) modifying the definition of the lease term and the definition of a penalty and (b) precluding sale-leaseback accounting because of the continuing involvement in the circumstance in which the seller-lessee enters into a sale-leaseback transaction involving property improvements or integral equipment without leasing the underlying land to the buyer-lessor. However, this Statement does apply to a sale-leaseback transaction involving real estate with equipment. Paragraph 107 of Statement 13 states:

> The Board noted that most sale-leasebacks are entered into as a means of financing, for tax reasons, or both and that the terms of the sale and the terms of

> the leaseback are usually negotiated as a package. Because of this interdependence of terms, no means could be identified for separating the sale and the leaseback that would be both practicable and objective.

Similarly, because of the interdependence of terms in a sale-leaseback transaction involving real estate with equipment, no objective means could be identified for separating the real estate portion of the sale-leaseback transaction from that portion of the transaction relating to equipment. Therefore, the provisions of this Statement apply equally to a sale-leaseback transaction involving real estate with equipment or equipment integral to real estate and to a sale-leaseback transaction involving *only* real estate.

44. Some respondents to the Exposure Draft noted that separate accounting for the real estate and equipment portions of a transaction is required for income tax purposes and by paragraph 27 of Statement 13 and that objective methods to separate those portions of a transaction have been developed. Other respondents suggested that the Board develop a materiality test to exclude transactions that involve insignificant portions of real estate from the scope of this Statement.

45. The Board acknowledges that separate accounting for real estate and equipment portions of sales and leases of real estate with equipment are being made on the basis of applicable tax law or by whatever means is considered appropriate in the circumstance. While separate accounting for those portions may be appropriate for a transaction involving real estate with equipment structured either as a sale or as a lease, the Board believes separate accounting for those portions is not appropriate for determining profit recognition for a sale-leaseback transaction. That conclusion is based on (a) the interdependence of the contractual terms of the sale and the leaseback, (b) the physical interrelationship of the values associated with the equipment and the real estate, and (c) the significance of the values of some types of property, for example, power plants and refineries, in relation to the value of the underlying real estate.

Continuing Involvement

46. The Board believes that a leaseback in conjunction with a sale could be considered as constituting a form of continuing involvement that precludes a seller-lessee from using sale-leaseback accounting. Paragraph 28 of Statement 66 suggests the leaseback serves as a guarantee of the buyer-lessor's investment. That paragraph states:

> *The seller guarantees the return of the buyer's investment or a return on that investment for a limited or extended period.* For example, the seller guarantees cash flows, subsidies, or net tax benefits. If the seller guarantees return of the buyer's investment or if the seller guarantees a return on the investment for an extended period, the transaction shall be accounted for as a financing, leasing, or profit-sharing arrangement. If the guarantee of a return on the investment is for a limited period, the deposit method shall be used until operations of the property cover all operating expenses, debt service, and contractual payments. At that

> time, profit shall be recognized on the basis of performance of the services required. . . . [Footnote reference omitted.]

However, others have observed that paragraph 40 of Statement 66 clearly provides for sale-leaseback accounting and does not preclude sales recognition. That paragraph states:

> *The sale of the property is accompanied by a leaseback to the seller of all or any part of the property for all or part of its remaining economic life.* Real estate sale and leaseback transactions shall be accounted for in accordance with the provisions of this Statement and FASB Statements No. 13, *Accounting for Leases,* and 28, *Accounting for Sales with Leasebacks*. . . . Regardless of whether the leaseback is a capital lease or an operating lease, a sale shall be recorded, and the property sold and any related debt assumed by the buyer shall be removed from the seller-lessee's balance sheet.

47. The principal objective of this Statement is to reconcile the inconsistency between Statements 13 and 66 described in the preceding paragraph without reconsidering the underlying principles of either document. To satisfy that objective, the Board considered whether there were any circumstances in which sale-leaseback accounting for real estate, including real estate with equipment, would be acceptable. The Exposure Draft proposed that sale-leaseback accounting be prescribed for a normal leaseback in which the seller-lessee intends to occupy the property. In adopting that approach, the Board accepted the continuing involvement and the form of guarantee that is inherent in a normal leaseback but limited that involvement to instances in which the seller-lessee intended to occupy the property. The Exposure Draft would have precluded sale-leaseback accounting for a sale-leaseback transaction in which the seller-lessee did not intend to occupy the property from the inception of the lease.

48. Some respondents to the Exposure Draft noted that the nature of the continuing involvement associated with a normal leaseback does not change because of the seller-lessee's intent to occupy the property. The Board acknowledges that the leaseback is a form of continuing involvement with the property that serves as support for the buyer-lessor's investment. Accordingly, the Board believes that transactions accounted for as sales should be limited when a sale-leaseback of property exists; otherwise, the effectiveness of paragraph 28 of Statement 66 would be compromised. Occupancy of the property by the seller-lessee provides a basis for distinguishing among sale-leaseback transactions involving real estate, including real estate with equipment. The Board believes that the intent to sublease the property represents a different form of continuing involvement than does the intent to occupy and use the property in the seller-lessee's trade or business. When the property is subleased, the form and consequences of the seller-lessee's continuing involvement are equivalent to those of a real estate investor or developer whose ultimate source, timing, and amount of cash flows from the use of the property are different from those realized by a tenant. Based on those differences, the Board decided to reaffirm the Exposure Draft's provision to allow sale-leaseback accounting when the seller-lessee occupies the leased property.

49. Some respondents suggested that sale-leaseback accounting also be allowed for certain sale-leaseback transactions involving property, such as hotels, whose subsequent use by the seller-lessee involves some amount of subleasing integral to other ancillary services provided. The Board agreed and concluded that such transactions involve the active use of leased property in the seller-lessee's business in a manner similar to occupancy by the seller-lessee. The same reasoning should apply to other businesses in which the seller-lessee actively uses the property in its operations, as is the case with warehouse, golf course, and parking lot enterprises. Therefore, the Board revised the occupancy requirement of the Exposure Draft to one that prescribes sale-leaseback accounting when the leased back property is actively used by the seller-lessee.

50. The Exposure Draft precluded sale-leaseback accounting when any portion of the leaseback property was not occupied by the seller-lessee. Statement 28 provides for full profit recognition by the seller-lessee if the present value of a reasonable amount of rental for the leaseback represents 10 percent or less of the fair value of the property sold at the date of the transaction. Some respondents stated that it was inconsistent with that provision of Statement 28 to preclude sale-leaseback accounting for a leaseback that is minor, irrespective of whether the seller-lessee occupies the property. The Board agreed with those respondents. This Statement allows sale-leaseback accounting for a leaseback that is minor as defined by paragraph 33(a) of Statement 13.

51. Other respondents noted that some subleasing may be necessary to provide for the seller-lessee's future growth. Those respondents questioned whether some minor amount of subleasing should preclude a transaction from sale-leaseback accounting in situations in which the seller-lessee initially intends to occupy less than the entire leased property. The Board decided to allow sale-leaseback accounting for such transactions, provided that the portion of the leaseback that the seller-lessee intends to sublease is minor in relation to the fair value of the property sold at the date of the transaction. The term *minor* is used here in the context of its use in paragraph 33(a) of Statement 13.

52. The Board considered whether a normal leaseback should be considered in conjunction with the other continuing involvement provisions or conditions of the sale-leaseback transaction in analyzing the level of continuing involvement with the property. As mentioned in paragraphs 48-51, the Board decided to allow sale-leaseback accounting in certain limited circumstances involving a normal leaseback or a leaseback with a minor sublease. The Board concluded that any additional continuing involvement should preclude sale-leaseback accounting.

53. Many respondents noted that the Exposure Draft would preclude sales recognition for sale-leaseback transactions in which nonrecourse financing is provided by the seller-lessee to the buyer-lessor for the sales proceeds. They commented that this is inconsistent with Statement 66, which allows profit to be recognized on a sale involving seller financing. The Board considered those comments but decided to retain the nonrecourse provision in paragraph 12(b). The Board

believes that because nonrecourse financing provided by the seller-lessee in a sale-leaseback transaction limits the buyer-lessor's risk of loss to the original investment, it is tantamount to a guarantee by the seller-lessee.

54. Several respondents to the Exposure Draft objected to precluding sale-leaseback accounting for a sale-leaseback transaction in which the seller-lessee provides additional collateral for or on behalf of the buyer-lessor or a party related to the seller-lessee guarantees a return of or on the buyer-lessor's investment. Those respondents suggested that such a provision should not apply to situations in which additional collateral or guarantees are provided solely in support of the leaseback payments and not to the leased asset's residual value. However, the Board believes that even in that circumstance the fair value of the additional collateral or the amount of the guarantee reduces the buyer-lessor's risk of loss and is substantially the same as a guarantee of some portion of the buyer-lessor's investment by the seller-lessee. Therefore, the Board decided to retain that requirement in paragraph 12(d).

55. Paragraph 43 of Statement 66 includes the following as an example of continuing involvement permitted by the seller:

> *The seller will participate in future profit from the property without risk of loss (such as participation in operating profits or residual values without further obligation).* If the transaction otherwise qualifies for recognition of profit by the full accrual method, the transfer of risks and rewards of ownership and absence of continuing involvement criterion shall be considered met. The contingent future profits shall be recognized when they are realized. All the costs of the sale shall be recognized at the time of sale; none shall be deferred to periods when the contingent profits are recognized. [Footnote reference omitted.]

Many respondents stated that the provision of the Exposure Draft that precluded the participation in future profits by the seller-lessee was inconsistent with the provisions of paragraph 43 of Statement 66 that allow the seller to participate in future profits if there is no risk of loss. The Board considered those comments and whether to allow sale-leaseback accounting when the seller-lessee retains an interest in the residual value of the property or will receive future profits from the residual value of the property. The Board decided that the practice permitted by paragraph 43 of Statement 66 should not apply to a sale-leaseback transaction because the continuing involvement inherent in the normal leaseback could represent sufficient continuing involvement to disqualify profit recognition by the seller-lessee. Therefore, the Board concluded that if the seller-lessee retains any portion of future profits or ownership interest in the residual value of the leased asset, retention of that interest represents continuing involvement with the property sufficient to preclude sales recognition.

56. The Board accepted the continuing involvement of a leaseback under certain circumstances, in part because that continuing involvement could be measured by the payment terms of the lease agreement. Some respondents also suggested allowing minor continuing

involvement and requested that the Board develop a test to measure minor continuing involvement. The Board considered allowing sale-leaseback accounting for a sale-leaseback transaction that provides for minor continuing involvement other than the leaseback. However, the Board rejected that notion because it believes that many continuing involvement provisions are not measurable, so that there is no objective way to determine the amount of involvement.

57. Many respondents questioned why a fair value repurchase option should preclude a seller-lessee from using sale-leaseback accounting. Other respondents commented that Statement 66 precludes a seller from recognizing a sale if the agreement includes a repurchase option at any value and suggested that the Board reconsider the accounting for repurchase options under paragraph 26 of Statement 66. The Board currently has on its agenda a project addressing many issues relating to financial instruments and off-balance-sheet financing. The Board believes that it is inappropriate to reconsider the accounting for repurchase options until that project has proceeded further.

Sale-Leaseback Transactions by Regulated Enterprises

58. Paragraph 41 of Statement 71 states:

> For financial reporting purposes, the classification of the lease is not affected by the regulator's actions. The regulator cannot eliminate an obligation that was not imposed by the regulator. Also, by including the lease payments as allowable costs, the regulator sets rates that will provide revenue approximately equal to the combined amount of the capitalized leased asset and interest on the lease obligation over the term of the lease and, thus, provides reasonable assurance of the existence of an asset. Accordingly, regulated enterprises would classify leases in accordance with Statement 13 as amended. [Paragraph references omitted.]

Similarly, the financial reporting of a sale-leaseback transaction may be considered to be of less consequence to the regulator. The regulator may continue to focus on the leaseback payments as allowable costs and continue to provide reasonable assurance of the existence of an asset.

59. Paragraph 42 of Statement 71 states:

> The nature of the expense elements related to a capitalized lease (amortization of the leased asset and interest on the lease obligation) is not changed by the regulator's action; however, the timing of expense recognition related to the lease would be modified to conform to the rate treatment. Thus, amortization of the leased asset would be modified so that the total of interest on the lease obligation and amortization of the leased asset would equal the rental expense that was allowed for rate-making purposes.

Similarly, the timing of expense recognition related to a sale-leaseback transaction accounted for by the deposit method (amortization of the asset) or as a financing (amortization of the asset and imputed interest on the financing) under the provisions of this Statement would be modified to conform to the rate treatment. Amortization of the asset would be modified so that the total of interest (if accounted for as a financing) and amortization of the asset would equal the rental expense net of the amortization of any gain allowable for rate-making purposes. Statement 92 addresses the accounting by regulated enterprises for phase-in plans. A regulator's treatment of a sale with leaseback for regulatory purposes may meet the definition of a phase-in plan under that Statement. In that case, Statement 92 may require different income and expense recognition for financial reporting purposes than that indicated above.

Financial Statement Presentation and Disclosure

60. The Board considered disclosure requirements for a sale-leaseback transaction accounted for by the deposit method, as a financing, or using sale-leaseback accounting under the provisions of this Statement and concluded that the significant terms and provisions of the transactions should be disclosed. The Board concluded that the amount charged to expense during the period for the transaction and the amount of the commitment or obligation to make future rental payments under the leaseback are relevant information irrespective of whether the sale-leaseback transaction is accounted for as a lease under Statement 13 or by the deposit method or as a financing under the provisions of this Statement and Statement 66. In the Board's view, those disclosures are consistent with the information required to be disclosed for owned property and long-term obligations in general. The Board concluded that the disclosure of a sale-leaseback transaction accounted for by the deposit method or as a financing under the provisions of this Statement should be similar to the disclosure that would have been required by Statements 13 and 66 had those transactions qualified for sale-leaseback accounting.

Lease Term Provisions

61. Subparagraph 5(f)(ii) of Statement 13 requires that the lease term include "all periods, if any, for which failure to renew the lease imposes a penalty on the lessee in an amount such that renewal appears, at the inception of the lease, to be reasonably assured." In addition, paragraph 3 of Technical Bulletin 79-11 states:

> The "penalty" referred to in paragraph 5(f) of Statement 13 is not limited to a penalty imposed by the lease agreement. Accordingly, the lease term would also include any periods for which failure to renew the lease would result in an *economic* penalty as a result of factors external to the lease so long as (a) the existence of the penalty were known at the inception of the lease and (b) the nature and estimated amount of the penalty at the inception of the lease were such that renewal would appear to be reasonably assured. [Emphasis added.]

62. Paragraph 22(b) of this Statement requires that the loss of a present or future economic benefit should be considered an economic penalty in the context of Technical Bulletin 79-11 and

paragraph 5(f) of Statement 13. That loss is an economic penalty similar to a requirement to make a payment to the lessor at the end of the lease. Several respondents suggested that requiring an economic penalty to be considered in determining the lease term is too subjective and should not be required. However, the Board concluded that such penalties do affect the lessee's decision to renew the lease and any renewal period for which those penalties are present should be included in the lease term under paragraph 5(f) of Statement 13.

63. Several respondents questioned why a loan from the lessee under usual terms and prevailing interest rates should affect the determination of the lease term. Subparagraph 5(f)(iii) of Statement 13 includes in the lease term "all periods, if any, covered by ordinary renewal options during which a guarantee by the lessee of the lessor's debt related to the leased property is expected to be in effect." The Board believes that a note from the buyer-lessor to the seller-lessee creates risks similar to a guarantee by the seller-lessee of the buyer-lessor's debt and concluded that the lease term should include all periods during which a loan from the seller-lessee to the buyer-lessor is outstanding.

Amendments to Other Pronouncements

64. Statement 66 precludes a sale of real estate from being recognized as a sale if the transaction gives the seller an option to repurchase the property. However, Statement 13, as amended by Statement 26, would allow a lessor (seller) to recognize *profit* under the full accrual method in a sales-type lease of real estate while retaining ownership of the property, provided that the transaction otherwise meets the requirements for full and immediate profit recognition under the full accrual method as described by Statement 66. This Statement amends Statement 13 to prohibit a lease involving real estate from being classified as a sales-type lease unless the lease transfers ownership of the property to the lessee by the end of the lease term.

65. Statement 13 also requires that a lessor recognize immediately a manufacturer's or dealer's loss in a sales-type lease. Statement 26 did not amend that requirement for sales-type leases involving real estate because it only applied to manufacturer's or dealer's *profit,* not loss. The Exposure Draft did not address recognition of a loss in a lease involving real estate that does not qualify as a sales-type lease because the title has not been transferred to the lessee by the end of the lease term. The Board did not intend to amend Statement 13 to allow the deferral of a loss in a sales-type lease in any circumstance. Therefore, this Statement clarifies that intent and requires that any applicable loss be recognized immediately in a lease involving real estate that would otherwise qualify as a sales-type lease but does not because of the requirements of this Statement.

66. Several respondents noted that some leases of real estate include provisions that transfer title at or shortly after the end of the lease term upon payment of some nominal or trifling amount, usually based on the minimum statutory amount necessary to transfer title. Those respondents suggested that such a provision be considered as meeting the criterion as a transfer of title during the lease term. The Board agreed with those respondents and added a footnote to

paragraph 7(a) of Statement 13 to that effect.

67. Statement 66 recognizes that a sale of real estate may not qualify for full and immediate profit recognition under the full accrual method at inception. Thus, that Statement describes other profit recognition methods for such sales and allows for later qualification under the full accrual method. However, Statement 13, as amended by Statement 26, prohibits a lessor (seller) from recognizing profit under any of those other methods on a transaction involving real estate that would otherwise be classified at the inception of the transaction as a sales-type lease if that transaction does not qualify for profit recognition under the full accrual method and requires that the transaction be accounted for as an operating lease. This Statement amends Statement 13 to provide that a lessor should account for any sales-type lease of real estate under the provisions of Statement 66 in the same manner as a *seller* of the same property.

68. The objective of amending Statement 13 in Statement 91 was to achieve consistency between direct financing leases and loans for the capitalization of origination costs and recognition of income. In Statement 91, the Board concluded that the practice of recognizing a portion of loan origination fees as revenue in the period of origination to offset all or part of the cost of origination would no longer be acceptable. Prior to this amendment, Statement 91 required that initial direct costs of origination be included as part of the gross investment in a direct financing lease. Although this is consistent with the approach for a loan, the mechanics of lease accounting under Statement 13 are such that the effect of adding initial direct costs to the gross investment before calculating unearned income would cause overstatement of unearned income. This Statement corrects the amendment of Statement 13 by Statement 91 to reflect the Board's intent when Statement 91 was issued. Initial direct costs are capitalized separately from the gross investment.

Effective Date and Transition

69. The Board considered whether this Statement should be applied only to future transactions or retroactively to all transactions. The Board recognized that applying this Statement only to future transactions would diminish both comparability of the resulting financial statements among enterprises and consistency within an enterprise that had entered into similar transactions both before and after the effective date of this Statement. While sale-leaseback and leasing transactions tend to have a long-term effect on the financial statements of an enterprise, the Board believes that transactions previously entered into might have been structured differently if the provisions of this Statement had been known at the time. Therefore, the Board concluded that this Statement should be applied prospectively except for the amendment to Statement 13 to reflect the intended amendment of that Statement by Statement 91, which should have an effective date and transition consistent with that of Statement 91.

Appendix C: GLOSSARY

70.	This appendix defines certain terms as they are used in this Statement.

Nonrecourse financing

Lending or borrowing activities in which the creditor does not have general recourse to the debtor but rather has recourse only to the property used for collateral in the transaction or other specific property.

Sale-leaseback accounting

For purposes of this Statement, a method of accounting for a sale-leaseback transaction in which the seller-lessee records the sale, removes all property and related liabilities from its balance sheet, recognizes gain or loss from the sale in accordance with Statement 13 as amended by Statements 28 and 66 and this Statement, and classifies the leaseback in accordance with Statement 13, as amended by Statement 28.

Sales recognition

Any method that is described in Statement 66 as a method to record a transaction involving real estate, other than the deposit method, or the methods to record transactions accounted for as financing, leasing, or profit-sharing arrangements. Profit recognition methods described in Statement 66 commonly used to record transactions involving real estate include, but are not limited to, the full accrual method, the installment method, the cost recovery method, and the reduced profit method.

Footnotes

FAS98, Footnote 1--Terms defined in the glossary (Appendix C) are in **boldface type** the first time they appear in this Statement.

FAS98, Footnote 2--The terms *property improvements or integral equipment* as used in this Statement refer to any physical structure or equipment attached to the real estate, or other parts thereof, that cannot be removed and used separately without incurring significant cost. Examples include an office building, a manufacturing facility, a power plant, and a refinery.

FAS98, Footnote 3--Paragraphs 38 and 39 of Statement 66 address transactions in which the seller sells property improvements to a buyer and leases the underlying land to the buyer of the improvements. Under certain circumstances, paragraph 38 of Statement 66 precludes sales recognition for such transactions and requires that they be accounted for as leases of both the land and improvements. It is not the intent of this Statement to modify paragraph 38; thus, it does not address a sale-leaseback transaction that does not qualify for sales recognition under the provisions of paragraph 38. However, this Statement does address a sale-leaseback transaction that qualifies for sales recognition under the provisions of paragraph 39 of Statement 66.

FAS98, Footnote 4--This Statement distinguishes between contingent rentals that are based on the future operations of the seller-lessee and those that are based on some predetermined or determinable level of future operations of the buyer-lessor. The latter type of contingent rental is addressed in paragraph 12(e) of this Statement.

FAS98, Footnote 5--*Lease term* is used in this Statement in the context of the definition in paragraph 5(f) of Statement 13, as amended by this Statement.

FAS98, Footnote 6--*Minor* is used in this Statement in the context of the definition in paragraph 33(a) of Statement 13, as amended by Statements 28 and 66 (hereinafter referred to collectively as Statement 13).

FAS98, Footnote 7--A right of first refusal based on a bona fide offer by a third party ordinarily is not an obligation or an option to repurchase. An agreement that allows the seller-lessee to repurchase the asset in the event no third-party offer is made is an option to repurchase.

FAS98, Footnote 8--Refer to footnote 4.

FAS98, Footnote 9--Refer to footnote 2.

FAS98, Footnote 10--Refer to footnote 3.

FAS98, Footnote 11--For the purpose of applying the provisions of this Statement, *entered into* is used in the context of the term *inception of the lease* as defined in paragraph 5(b) of Statement 13, as amended by Statement 23.

FAS98, Appendix A, Footnote 12--Statement 13, as used in this appendix, refers to Statement 13 as amended by Statement 28.