

FASB Interpretation No. 26

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Accounting for Purchase of a Leased Asset by the Lessee during the Term of the Lease

an interpretation of FASB Statement No. 13

September 1978



Financial Accounting Standards Board
of the Financial Accounting Foundation
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FIN 26: Accounting for Purchase of a Leased Asset by the Lessee during the Term of the Lease

an interpretation of FASB Statement No. 13

FIN 26 Summary

This Interpretation clarifies the application of paragraph 14 of *FASB Statement No. 13*, "Accounting for Leases," to a termination of a capital lease that results from the purchase of a leased asset by the lessee.

The purchase by the lessee of property under a capital lease and the related lease termination are accounted for as a single transaction. The difference, if any, between the purchase price and the carrying amount of the lease obligation is recorded as an adjustment of the carrying amount of the asset. The Board also noted that Statement No. 13 does not prohibit recognition of a loss if a loss has been incurred.

INTRODUCTION AND BACKGROUND INFORMATION

1. The FASB has been asked to clarify whether a termination of a capital lease that results from the purchase of a leased asset by the lessee is the type of transaction contemplated by paragraph 14(c) of *FASB Statement No. 13*, "Accounting for Leases." That paragraph states that "a termination of a capital lease shall be accounted for by removing the asset and obligation, with gain or loss recognized for the difference."
2. A draft of a proposed Interpretation on "Accounting for Purchase of a Leased Asset by the Lessee during the Term of the Lease" was issued on April 28, 1978. The Board received 27 letters of comment in response to the proposed Interpretation. Certain of the comments received and the Board's consideration of them are discussed in paragraphs 3 and 4 below.
3. A number of respondents stated that the purchase of a leased asset by the lessee during the term of a capital lease gives rise to an early extinguishment of debt for which the accounting is prescribed in *APB Opinion No. 26*, "Early Extinguishment of Debt." The Board concluded that it

should look to *FASB Statement No. 13* to clarify the accounting for the termination of a lease instead of Opinion No. 26. Statement No. 13 specifies different accounting for the termination of a capital lease for which the leased asset ceases to be carried on the enterprise's balance sheet and for a renewal or extension for which the leased asset continues to be carried on the enterprise's balance sheet. The Board views the purchase of the leased asset by the lessee during the term of the lease as a transaction for which similar rights for the same asset continue to be carried on the enterprise's balance sheet. The Board is aware that some extensions of capital leases and purchases of leased assets could be viewed as similar to early extinguishments of debt. Other extensions of capital leases and purchases of leased assets could be viewed as nonmonetary transactions with an amount of monetary consideration of the type (exchanges of rights to productive assets not held for sale in the ordinary course of business) for which *APB Opinion No. 29*, "Accounting for Nonmonetary Transactions," does not permit recognition of gain. The Board considered the possible applicability of both Opinion No. 26 and Opinion No. 29 during its deliberations on the provisions of Statement No. 13 that address accounting for extensions and other terminations of capital leases. The subjectivity of an allocation of the purchase price between retirement of the lease obligation and acquisition of additional property rights was also a consideration in the determination that recognition of gain or loss should not be required if the asset continued to be carried on the enterprise's balance sheet.

4. Some respondents stated that this Interpretation should require recognition of a loss if a loss is indicated by the terms of the transaction. The Board noted that *FASB Statement No. 13* does not include a requirement for loss recognition on an extension of a capital lease. Therefore, an Interpretation of Statement No. 13 could not include such a requirement. However, the Board also noted that Statement No. 13 does not prohibit recognition of a loss if a loss has been incurred.

INTERPRETATION

5. The termination of a capital lease that results from the purchase of a leased asset by the lessee is not the type of transaction contemplated by paragraph 14(c) of *FASB Statement No. 13* but rather is an integral part of the purchase of the leased asset. The purchase by the lessee of property under a capital lease shall be accounted for like a renewal or extension of a capital lease that, in turn, is classified as a capital lease,¹ that is, any difference between the purchase price and the carrying amount of the lease obligation shall be recorded as an adjustment of the carrying amount of the asset.

EFFECTIVE DATE AND TRANSITION

6. The provisions of this Interpretation shall be effective for purchases of leased property recorded as of December 1, 1978 or thereafter. Earlier application is encouraged. In addition,

except as provided in the next sentence, the provisions of this Interpretation shall be applied retroactively at the same time and in the same manner as the provisions of *FASB Statement No. 13* are applied retroactively (see paragraphs 49 and 51 of Statement No. 13). Enterprises that have already applied the provisions of Statement No. 13 retroactively and have published annual financial statements based on the retroactively adjusted accounts before the effective date of this Interpretation may, but are not required to, apply the provisions of this Interpretation retroactively.

This Interpretation was adopted by the unanimous vote of the seven members of the Financial Accounting Standards Board following submission to the Financial Accounting Standards Advisory Council and the Screening Committee on Emerging Problems.

Members of the Financial Accounting Standards Board:

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

Footnotes

FIN26, Footnote 1--Paragraph 14(b)(i) of *FASB Statement No. 13* refers to paragraph 14(a) of the Statement for the accounting for a renewal or an extension of a capital lease that is also classified as a capital lease.