FEBRUARY 14, 2002

# Financial Accounting Series

EXPOSURE DRAFT (Revised)

# Proposed Statement of Financial Accounting Standards

## Rescission of FASB Statements No. 4, 44, and 64 and Technical Corrections—Amendment of FASB Statement No. 13

Limited revision of Exposure Draft
issued November 15, 2001

This Exposure Draft of a proposed Statement of Financial Accounting Standards is issued by the Board for public comment. Written comments should be addressed to:

Director of Research and Technical Activities
File Reference No. 1031-001R

Comment Deadline: March 18, 2002

Financial Accounting Standards Board
of the Financial Accounting Foundation

Responses from interested parties wishing to comment on the revised limited Exposure Draft must be *received* in writing by March 18, 2002. Responses received after that date will be distributed to Board members but will *not* be considered in the staff's analysis of comments that will be the basis for the Board's redeliberations. Interested parties should submit their comments by email to director@fasb.org File Reference 1031-001R. Those without email may send their comments to the "RTA Director–File Reference 1031-001R" at the address at the bottom of this page. Responses should *not* be sent by fax.



Financial Accounting Standards Board
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**Notice for Recipients**
**of This Exposure Draft**

As the result of comments received on the November 2001 FASB Exposure Draft, *Rescission of FASB Statements No. 4, 44, and 64 and Technical Corrections,* the Board decided to amend paragraph 14(a) of FASB Statement No. 13, *Accounting for Leases*. This limited revised Exposure Draft (proposed Statement) addresses that proposed amendment of Statement 13, which the Board plans to include in the final Statement that rescinds Statements 4, 44, and 64 and makes technical corrections.

*Issue:* This proposed Statement would amend the accounting for modifications of capital leases provided in paragraph 14(a) of Statement 13. Certain transactions described in that paragraph have economic effects that are similar to sale-leaseback transactions, but the current wording in paragraph 14(a) provides that the transactions be accounted for differently. This proposed Statement would require that the accounting for certain lease modifications that have economic effects that are similar to sale-leaseback transactions be accounted for under the provisions for sale-leaseback transactions in FASB Statement, No. 98, *Accounting for Leases,* or paragraphs 2 and 3 of FASB Statement No. 28, *Accounting for Sales with Leasebacks*, as applicable. If a capital lease is modified so that it would be reclassified as an operating lease, is the proposed requirement to account for that modification in the same manner as a sale-leaseback transaction under the provisions of Statements 28 and 98 appropriate? If not, why not?

## Summary

This proposed Statement would amend FASB Statement No. 13, *Accounting for Leases,* to eliminate an inconsistency between the required accounting for sale-leaseback transactions and the required accounting for certain lease modifications that have economic effects that are similar to sale-leaseback transactions.

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## STANDARDS OF FINANCIAL ACCOUNTING AND REPORTING

### Introduction

1. Paragraph 14(a) of FASB Statement No. 13, *Accounting for Leases,* describes the accounting by a lessee for certain lease modifications. If a capital lease is modified in such a way that the change in the lease provisions gives rise to a new agreement classified as an operating lease, paragraph 14(a) requires that the asset and obligation under the lease be removed, a gain or loss be recognized for the difference, and the new lease agreement thereafter be accounted for as any other operating lease. Several constituents have advised the Board that, in their view, if a capital lease is modified as described above, the modification has economic effects that are similar to a sale-leaseback transaction. However, Statement 13 does not require the accounting for the lease modification as a sale-leaseback transaction. This Statement requires that capital leases that are modified so that the resulting lease agreement is classified as an operating lease be accounted for under the sale-leaseback provisions of FASB Statement No. 98, *Accounting for Leases,* or paragraphs 2 and 3 of FASB Statement No. 28, *Accounting for Sales with Leasebacks,* as applicable.

### Amendment of Statement 13

2. The last sentence of paragraph 14(a) of FASB Statement No. 13, *Accounting for Leases,* is replaced by the following:

> If the change in the lease provisions gives rise to a new agreement classified as an operating lease, the transaction shall be accounted for under the sale-leaseback requirements of FASB Statement No. 98, *Accounting for Leases,* or paragraphs 2 and 3 of FASB Statement No. 28, *Accounting for Sales with Leasebacks,* as applicable.

## Effective Date and Transition

The provisions of this Statement shall be effective for transactions occurring after May 15, 2002, with early adoption encouraged.

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

**Appendix**

**BACKGROUND INFORMATION AND BASIS FOR CONCLUSIONS**

A1. This appendix summarizes considerations that Board members deemed significant in reaching the conclusions in this Statement. It includes reasons for accepting certain approaches and rejecting others. Individual Board members gave greater weight to some factors than to others.

A2. In August 2001, the Board undertook a project to rescind FASB Statement No. 4, *Reporting Gains and Losses from Extinguishment of Debt*. As part of the project, the Board decided to take the opportunity to make various technical corrections to other pronouncements. In November 2001, the Board issued the Exposure Draft, *Rescission of FASB Statements No. 4, 44, and 64 and Technical Corrections.* The Board received 30 comment letters in response to that Exposure Draft.

A3. Several respondents to the Exposure Draft suggested that Statement 13 be amended to eliminate an inconsistency between the accounting by lessees for certain lease modification transactions that would require reclassification of a capital lease as an operating lease and the accounting for sale-leaseback transactions required by Statement 28 or Statement 98. The Board concluded that the former transactions have economic effects that are similar to sale-leaseback transactions and that it would be appropriate to amend paragraph 14(a) of Statement 13 to eliminate that inconsistency. However, the Board concluded that that particular amendment is not a technical correction because it is substantive in nature. Because a substantive amendment must be subjected to the Board's due process, the Board decided to issue a revised limited Exposure Draft that would amend paragraph 14(a) of Statement 13.

A4. The amendment of Statement 13 affects the accounting by the lessee for certain lease modifications that have economic effects similar to sale-leaseback transactions. The Board believes that the changes made by this Statement improve financial accounting because similar transactions should be accounted for in a similar manner. However, those lease modification transactions affected by this Statement might have been structured differently if the provisions of this Statement had been in effect at the time. Therefore, the Board decided that this Statement should be effective for transactions occurring after its issuance, with early adoption encouraged.

A5. The Board's mission statement charges the Board to determine that a standard will fill a significant need and that the costs it imposes will be justified in relation to the overall benefits. The amendment of Statement 13 will eliminate an inconsistency in the accounting treatment of transactions that have similar economic effects, the benefit of which is improved financial reporting. The Board believes that the amendment is consistent with its goal to consider promptly any significant areas of deficiency in financial reporting that might be improved through the standard-setting process and its goal to improve the usefulness of financial reporting by focusing on the primary characteristics of relevance and reliability and on the qualities of comparability and consistency.