

University of Mississippi

eGrove

American Institute of Accountants

Deloitte Collection

1949

Disclosure of long-term leases in financial statements of lessees; Accounting Research Bulletin, no. 38

American Institute of Certified Public Accountants. Committee on Accounting Procedure

Follow this and additional works at: https://egrove.olemiss.edu/dl_aia



Part of the [Accounting Commons](#), and the [Taxation Commons](#)

Recommended Citation

American Institute of Certified Public Accountants. Committee on Accounting Procedure, "Disclosure of long-term leases in financial statements of lessees; Accounting Research Bulletin, no. 38" (1949).

American Institute of Accountants. 330.

https://egrove.olemiss.edu/dl_aia/330

This Article is brought to you for free and open access by the Deloitte Collection at eGrove. It has been accepted for inclusion in American Institute of Accountants by an authorized administrator of eGrove. For more information, please contact egrove@olemiss.edu.

Accounting Research BULLETINS

October, 1949

No. 38

★

Issued by the
Committee on Accounting Procedure,
American Institute of Accountants,
270 Madison Avenue, New York 16, N. Y.
Copyright 1949 by American Institute of Accountants

Disclosure of Long-Term Leases in Financial Statements of Lessees

1. The growth in recent years of the practice of using long-term leases as a method of financing has created problems of disclosure in financial statements. In buy-build-sell-and-lease transactions, the purchaser of land builds to his own specifications, sells the improved property, and simultaneously leases the property for a period of years. Similar transactions are the sale and lease of existing properties or the lease of properties to be constructed by the lessor to the specifications of the lessee. The lessee ordinarily assumes all the costs and obligations of ownership (such as taxes, insurance, maintenance and repairs) except for payment of any mortgage indebtedness on the property.

2. There are many variations in such types of transactions. For example, some leases contain an *option* for acquisition of the property by the lessee, while other leases contain a *requirement* that the lessee purchase the property upon expiration. In some the price to be paid upon repurchase is related to the fair value of the property or the depreciated book value; in others it is an arbitrary amount with little or no relation to the property's worth, or a nominal sum. Some leases provide for a high initial rental with declining payments thereafter or for renewal at substantially reduced rentals.

3. It has not been the usual practice for companies renting property to disclose in financial statements either the existence of leases or the annual rentals thereunder.¹ One of the effects of the long-term lease as a substitute for ownership and mortgage borrowing is that neither the asset nor any indebtedness in connection with it is shown on the balance-sheet. This has raised the question of disclosure in

¹ The Securities and Exchange Commission, however, in Note 5 to Rule 12-16 of Regulation S-X dealing with supplementary profit and loss information, requires disclosure in a schedule, if significant in amount, of ". . . the aggregate annual amount of the rentals upon all real property now leased to the person and its subsidiaries for terms expiring more than three years after the date of filing, and the number of such leases," and the minimum annual amount if the rentals are conditional.

Accounting Research Bulletins

financial statements of the fixed amounts payable annually thereunder.

4. Although the types of sell-and-lease arrangements referred to in paragraph 1 differ in many respects from the conventional long-term lease², the principles of disclosure stated herein are intended to apply to both. This bulletin does not apply to short-term leases, or to those customarily used for oil and gas properties.

5. The committee believes that material amounts of fixed rentals and other liabilities maturing in future years under long-term leases and possible related contingencies are material facts affecting judgments based on the financial statements of a corporation; and that those who rely upon financial statements are entitled to know of the existence of such leases and the extent of the obligations thereunder, irrespective of whether the leases are considered to be advantageous or otherwise. Accordingly, where the rentals or other obligations under long-term leases are material in the circumstances, the committee is of the opinion that:

- (a) disclosure should be made in financial statements or in notes thereto of
 - (1) the amounts of annual rentals to be paid under such leases with some indication of the periods for which they are payable, and
 - (2) any other important obligation assumed or guarantee made in connection therewith;
- (b) the above information should be given not only in the year in which the transaction originates but also as long thereafter as the amounts involved are material; and
- (c) in addition, in the year in which the transaction originates, there should be disclosure of the principal details of any important sale-and-lease transaction.

6. A lease arrangement is sometimes, in substance, no more than an installment purchase of the property. This may well be the case when the lease is made subject to purchase of the property for a nominal sum or for an amount substantially less than the prospective fair value of the property; or when the agreement stipulates that the rental payments may be applied in part as installments on the purchase price; or when the rentals obviously are so out of line with rentals for similar properties as to negate the representation that the rental payments are for current use of the property and to create

² The conventional lease, a straight tenure contract between the owner of property and a lessee, generally does not involve buying, building and selling of property by the lessee, or special repurchase arrangements.

Disclosure of Long-Term Leases in Financial Statements of Lessees

the presumption that portions of such rentals are partial payments under a purchase plan.

7. Since the lessee in such cases does not have legal title to the property and does not necessarily assume any direct mortgage obligation, it has been argued that any balance-sheet including the property as an asset and any related indebtedness as a liability would be incorrect. However, the committee is of the opinion that the facts relating to all such leases should be carefully considered and that, where it is clearly evident that the transaction involved is in substance a purchase, then the "leased" property should be included among the assets of the lessee with suitable accounting for the corresponding liabilities and for the related charges in the income statement.

The statement entitled "Disclosure of Long-Term Leases in Financial Statements of Lessees" was unanimously adopted by the twenty-one members of the committee.

NOTES

1. *Accounting Research Bulletins represent the considered opinion of at least two-thirds of the members of the committee on accounting procedure, reached on a formal vote after examination of the subject matter by the committee and the research department. Except in cases in which formal adoption by the Institute membership has been asked and secured, the authority of the bulletins rests upon the general acceptability of opinions so reached. (See Report of Committee on Accounting Procedure to Council, dated September 18, 1939.)*

2. *Recommendations of the committee are not intended to be retroactive, nor applicable to immaterial items. (See Bulletin No. 1, page 3.)*

3. *It is recognized also that any general rules may be subject to exception; it is felt, however, that the burden of justifying departure from accepted procedures must be assumed by those who adopt other treatment. (See Bulletin No. 1, page 3.)*

COMMITTEE ON ACCOUNTING PROCEDURE (1948-1949)

SAMUEL J. BROAD, *Chairman*
FREDERICK B. ANDREWS
WILLIAM H. BELL
FRANK S. CALKINS
THOMAS M. DICKERSON
JAMES L. DOHR
GEORGE P. ELLIS
J. P. FRIEDMAN

ANSON HERRICK
THOMAS G. HIGGINS
DAVID HIMMELBLAU
JOHN B. INGLIS
PAUL K. KNIGHT
JOHN A. LINDQUIST
EDWARD J. McDEVITT
WILLIAM A. PATON

MAURICE E. PELOUBET
WALTER L. SCHAEFFER
VIRGIL S. TILLY
C. OLIVER WELLINGTON
EDWARD B. WILCOX

CARMAN G. BLOUGH,
Director of Research