FASB Interpretation No. 23

Leases of Certain Property Owned by a Governmental Unit or Authority

an interpretation of FASB Statement No. 13
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SUMMARY

This Interpretation clarifies that portion of paragraph 28 of FASB Statement No. 13, "Accounting for Leases," stating that leases of certain property owned by a governmental unit or authority shall be classified as operating leases.

The Interpretation describes six conditions that must be met for a lease of government owned property to be automatically classified as an operating lease. If all of the six conditions are not met, the criteria for classifying leases under Statement No. 13 that are applicable to leases generally are also applicable to leases involving government owned property.
INTRODUCTION AND BACKGROUND 
INFORMATION

1. The FASB has been asked to clarify that portion of paragraph 28 of FASB Statement No. 13, "Accounting for Leases," stating that leases of certain property owned by a governmental unit or authority shall be classified as operating leases. That portion of paragraph 28 is as follows:

   Because of special provisions normally present in leases involving terminal space and other airport facilities owned by a governmental unit or authority, the economic life of such facilities for purposes of classifying the lease is essentially indeterminate. Likewise, the concept of fair value is not applicable to such leases. Since such leases also do not provide for a transfer of ownership or a bargain purchase option, they shall be classified as operating leases. Leases of other facilities owned by a governmental unit or authority wherein the rights of the parties are essentially the same as in a lease of airport facilities described above shall also be classified as operating leases. Examples of such leases may be those involving facilities at ports and bus terminals.

2. That provision of paragraph 28 was further explained in paragraph 106 of FASB Statement No. 13 as follows:

   A number of respondents pointed out that leases of facilities such as airport and bus terminals and port facilities from governmental units or authorities contain features that render the criteria of paragraph 7 inappropriate for classifying such leases. Leases of such facilities do not transfer ownership or contain bargain purchase options. By virtue of its power to abandon a facility during the term of a lease, the governmental body can effectively control the lessee's continued use of the property for its intended purpose, thus making its economic life essentially indeterminate. Finally, since neither the leased property nor equivalent property is available for sale, a meaningful fair value cannot be determined, thereby invalidating the 90 percent recovery criterion. For those reasons, the Board concluded that such leases shall be classified as operating leases by both the lessee and lessor.

3. The Board has been asked to clarify the conditions that shall cause leases of certain property owned by a governmental unit or authority to be classified as operating leases.

4. A draft of a proposed Interpretation on "Leases of Certain Property Owned by a Governmental Unit or Authority" was issued on April 7, 1978. The Board received 43 letters of comment in response to the proposed Interpretation. Some respondents disagreed with the proposed Interpretation because they believe that a lessee's classification of leases of government owned property should be determined by the same criteria as those applied to leases generally. A few respondents expressed neither overall agreement nor disagreement but offered comments or suggestions about specific matters. The remainder of the respondents expressed general agreement with the proposed Interpretation.

5. The Board also considered the possibility of amending FASB Statement No. 13 to delete that portion of paragraph 28 that applies to leases of certain
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As stated in the proposed Interpretation that was released for comment, some Board members believe that a lessee’s classification of leases of government owned property should be determined by the same criteria as those applied to leases generally. However, in the interest of a timely resolution of the matter, the Board concluded that further consideration of amending the applicable portion of paragraph 28 of Statement No. 13 should not delay the issuance of this Interpretation.

6. A number of respondents recommended that the Board clarify subparagraph 8(d) with respect to the lessor’s right to terminate the lease during the lease term. Some of those respondents stated that the existence of the termination right was the significant issue and that such a right can exist even though explicit reference to the right is not contained in the lease agreement. The Board did not intend that leases of government owned property would be classified as operating leases merely because sovereign rights, such as the right of eminent domain, exist. Accordingly, the Board has modified subparagraph 8(d) to clarify its intent.

7. Some respondents suggested that the Board define the term “equivalent property in the same service area” as that term is used in subparagraph 8(f), and a footnote has been added to that subparagraph to provide additional guidance.

INTERPRETATION

8. The provisions of paragraph 28 of FASB Statement No. 13 stating that certain leases shall be classified as operating leases are intended to apply to leases only if all of the following conditions are met:

a. The leased property is owned by a governmental unit or authority.

b. The leased property is part of a larger facility, such as an airport, operated by or on behalf of the lessor.

c. The leased property is a permanent structure or a part of a permanent structure, such as a building, that normally could not be moved to a new location.

d. The lessor, or in some cases a higher governmental authority, has the explicit right under the lease agreement or existing statutes or regulations applicable to the leased property to terminate the lease at any time during the lease term, such as by closing the facility containing the leased property or by taking possession of the facility.

e. The lease neither transfers ownership of the leased property to the lessee nor allows the lessee to purchase or otherwise acquire ownership of the leased property.

f. The leased property or equivalent property in the same service area cannot be purchased nor can such property be leased from a nongovernmental unit or authority.

9. Leases of property not meeting all of the conditions of paragraph 8 of this Interpretation are subject to the same criteria for classifying leases under FASB Statement No. 13 that are applicable to leases not involving government owned property.

EFFECTIVE DATE AND TRANSITION

10. The provisions of this Interpretation shall be effective for leasing transactions recorded and lease agreement revisions (see paragraph 9 of FASB Statement No. 13) 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 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 affirmative votes of six members of the Financial Accounting Standards Board following submission to the members of the Financial Accounting Standards Advisory Council and the Screening Committee on Emerging Problems. Mr. Walters dissented.

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1As used in this Interpretation, equivalent property in the same service area is property that would allow continuation of essentially the same service or activity as afforded by the leased property without any appreciable difference in economic results to the lessee.
Mr. Walters cannot support further efforts to apply different capitalization criteria for leases of government owned property, and he believes that this Interpretation shows the futility of attempting to rationalize that position. Among the conditions cited in paragraph 8 of this Interpretation, the only one that is relatively unique to leases of government property is the unilateral right to terminate the lease. Special consideration of this condition if termination is a remote contingency, in his view, denies the definition of “lease term” in paragraph 5(f) of FASB Statement No. 13.

Members of the Financial Accounting Standards Board:

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