

FASB Interpretation No. 24

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Leases Involving Only Part of a Building

an interpretation of FASB Statement No. 13

September 1978



Financial Accounting Standards Board

of the Financial Accounting Foundation

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FIN 24: Leases Involving Only Part of a Building an interpretation of FASB Statement No. 13

FIN 24 Summary

This Interpretation concerns that portion of *FASB Statement No. 13*, "Accounting for Leases," stating that "when the leased property is part of a larger whole, its cost (or carrying amount) and fair value may not be objectively determinable, as for example, when an office or a floor of a building is leased."

This Interpretation recognizes that reasonable estimates of the leased property's fair value might be objectively determinable from other information if sales of property similar to the leased property do not exist.

INTRODUCTION AND BACKGROUND INFORMATION

1. Paragraph 28 of *FASB Statement No. 13*, "Accounting for Leases," states that "when the leased property is part of a larger whole, its cost (or carrying amount) and fair value may not be objectively determinable, as for example, when an office or floor of a building is leased. If the cost and fair value of the leased property are objectively determinable, both the lessee and the lessor shall classify and account for the lease according to the provisions of paragraph 26." Paragraph 28 goes on to state that "if the fair value of the leased property is not objectively determinable, the lessee shall classify the lease according to the criterion of paragraph 7(c) only...." Paragraph 5(c) of Statement No. 13 defines the fair value of leased property as "the price for which the property could be sold in an arm's-length transaction between unrelated parties."

2. The FASB has been asked if a fair value can be objectively determined for a lease involving only part of a building if there are no sales of property similar to the leased property to use as a basis for estimating the leased property's fair value for purposes of applying *FASB Statement No. 13*.

3. A draft of a proposed Interpretation on "Leases Involving Only Part of a Building" was issued on April 20, 1978. The Board received 29 letters of comment on the proposed Interpretation. The Board's consideration of certain of the respondents' comments is discussed in paragraphs 4 and 5 below.

4. A number of respondents questioned whether the proposed Interpretation would provide meaningful guidance. Some respondents noted that, in many cases, information providing a basis for a reasonable estimate of the leased property's fair value would not be available. Other respondents agreed that information providing a basis for a reasonable estimate of fair value might be obtained through an appraisal or other similar valuation. The Board does not intend to impose a requirement to obtain an appraisal or similar valuation as a general matter but does believe that kind of information should be obtained whenever possible if (a) classification as a capital lease seems likely and (b) the effects of capital lease classification would be significant to the financial statements of a lessee. Other respondents stated that the applicability of the Interpretation should be limited to lessees of a significant portion of a facility. Although that view was not adopted, the Board recognizes that a lessee's ability to make a reasonable estimate of the leased property's fair value will vary depending on the size of the leased property in relation to the entire facility. For example, obtaining a meaningful appraisal of an office or a floor of a multi-story building may not be possible whereas similar information may be readily obtainable if the leased property is a major part of that facility.

5. Some respondents stated that replacement cost measures costs of physical attributes but does not necessarily measure fair value. Two of those respondents stated that replacement cost would not reflect the value attributable to factors such as location of the leased property or traffic patterns of a larger complex. One respondent stated that a determination of replacement cost for only part of a building would require arbitrary cost allocations and subjective considerations. Paragraph 5(c)(ii) of *FASB Statement No. 13* states, in part, "when the lessor is not a manufacturer or dealer, the fair value of the property at the inception of the lease will ordinarily be its cost...." That paragraph further provides that if there is a significant lapse of time between construction or acquisition of the property and inception of the lease, the determination of fair value shall be made in light of the market conditions at inception. The Board recognizes that replacement cost will not reflect the fair value of the leased property in all cases. However, if the leased facility has been recently constructed or acquired, cost estimates may provide a reasonable basis for estimating the property's fair value for purposes of applying the recovery criterion of paragraph 7(d) of Statement No. 13.

INTERPRETATION

6. For purposes of applying paragraph 28 of *FASB Statement No. 13* to leases involving only part of a building, other evidence may provide a basis for an objective determination of fair value even if there are no sales of property similar to the leased property. For example,

reasonable estimates of the leased property's fair value might be objectively determined by referring to an independent appraisal of the leased property or to estimated replacement cost information.

EFFECTIVE DATE AND TRANSITION

7. 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.

Mr. Walters believes this is not a valid interpretation of *FASB Statement No. 13*. That Statement defines fair value as "the price for which the property could be sold in an arm's-length transaction between unrelated parties." Except for condominium or cooperative arrangements, fair value as defined does not exist for part of a building. Since it does not exist, it cannot be determined, objectively or otherwise. He believes this Interpretation contradicts the stated definition of fair value, and in effect selectively amends that definition as it relates to part of a building.

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