



June 17, 2016

Memorandum

To: Members of the Board
From: Monica R. Valentine, Assistant Director
Wendy M. Payne
Through: Wendy M. Payne, Executive Director
Subj: Leases Project – **Tab H**¹

MEMBER ACTIONS REQUESTED:

- Approve the five staff recommendations in Attachment 1
- Provide feedback on draft exposure draft – Attachment 2
- Provide preliminary comments to staff by Thursday June 23, 2016

MEETING OBJECTIVES

The objective of this session is to

- ✓ review responses to seven specific questions staff posed to the lease task force (TF) related to issues in which the Board had requested additional information and
- ✓ review a draft Lease exposure draft.

BRIEFING MATERIAL

- **Staff Memo**
- **Attachment 1:** Summary of Lease TF Responses and Staff Analysis
- **Attachment 2:** Draft Lease Exposure Draft
- **Appendix A:** Full Text of Lease TF Responses
- **Appendix B:** History of Board Lease Discussions

UPDATE

Since the April meeting, staff has worked with the TF to address several specific lease accounting issues, continuing to follow the progress of the lease project from the Governmental Accounting Standards Board and further drafting the lease proposal.

¹ The staff prepares Board meeting materials to facilitate discussion of issues at the Board meeting. This material is presented for discussion purposes only; it is not intended to reflect authoritative views of FASAB or its staff. Official positions of FASAB are determined only after extensive due process and deliberations.

STAFF ANALYSIS

In late April, staff posed several questions to the lease TF related to issues in which the Board had requested additional information. Staff provided the TF with a discussion paper that included excerpts from the latest draft proposed lease standard, along with FASAB staff discussion, Board member comments, and specific TF questions. Staff received a total of eleven responses from the TF. The Board materials include a summary of TF responses with staff's recommendations based on the responses; the full text of TF responses; and a draft Lease exposure draft.

NEXT STEPS

Staff will revise the lease proposal as needed based on the Board discussion and continue to work with the TF to address any additional issues raised.

MEMBER FEEDBACK

Please contact staff as soon as possible to convey your questions or suggestions. Communication before the meeting will help make the meeting more productive. You can contact Monica by telephone at 202-512-7362 or by e-mail at ValentineM@fasab.gov with a cc to PayneW@fasab.gov

**SUMMARY OF FASAB LEASE TASK FORCE RESPONSES
AND STAFF ANALYSIS
(APRIL – MAY 2016)**

➤ **Probability Threshold (1)**

Excerpts from Draft FASAB Lease Standard:

LEASE TERM

The lease term is the period during which a lessee has a noncancelable right to use an underlying asset (referred to as the noncancelable period), plus the following periods, if applicable, covered by a lessee’s option to:

- a. **Extend** the lease if it is probable, based on all relevant factors, that the lessee will exercise that option
- b. **Terminate** the lease if it is probable, based on all relevant factors, that the lessee will not exercise that option.

Periods for which both the lessee and the lessor have an option to terminate the lease, or for which only the lessor has that option, are cancelable periods and are excluded from the lease term. Provisions that allow for termination of a lease due to (a) purchase of the underlying asset, (b) payment of all sums due, or (c) default on payments are not considered termination options.

A fiscal funding or cancellation clause (a clause that allows federal lessees to cancel a lease agreement, typically on an annual basis, if funds for the lease payments are not appropriated) should be considered in determining the lease term only when it is probable that the clause will be exercised.

FASAB Staff Discussion:

GASB and FASAB’s definitions of “probable” are different. GASB’s threshold of “probable” is higher than FASAB’s “probable” threshold. FASAB’s “probable” definition equates to “more likely than not.” (>50% probability). GASB’s “probable” definition equates to “likely to occur.” The FASAB previously agreed to not changing the definition of “probable” to be a higher threshold with respect to when certain lease payments should be included in the measurement of the lease.

The BFC of the GASB Lease ED (paragraph B.20) fully explains GASB’s rationale for using “reasonably certain” rather than probable. In short, “reasonably certain” has a higher threshold than “probable” and is less speculative. Also, “reasonably certain” is more consistent with “reasonably assured” used in their existing lease standards in GASB Stmt. 62.

Task Force (TF) Question 1: *Do you believe FASAB’s definition of probable (more likely than not - >50%) will make it easier or harder or neither for federal entities to assess the probability of the options as well as the funding clause? Please explain your reasoning.*

TF Responses:

Three TF members indicated that the options were either all the same level of difficulty or only slightly different. The slight difference noted was that “reasonably certain” would be slightly easier but in each case all facts and circumstances would need to be considered.

The four TF members supporting use of probable meaning “more likely than not,” said:

1. It provides more flexibility due to greater reliance on professional judgment.
2. Defining probable as “likely to occur” or “reasonably certain” would create inconsistencies as agencies may adopt disparate interpretations.
3. The risk of over/understatement of amounts may be mitigated by use of the lower threshold.
4. Having a single definition of probable is helpful. If the low threshold leads to more re-estimates, it should be clear that these are changes in estimates and that may alleviate cost concerns.
5. It is helpful that probable is quantified as greater than 50%.

The four TF members supporting use of “reasonably certain” said:

1. It is more definitive and concrete. “More likely than not” is more subjective and subject to greater speculation than “reasonably certain.” Using “more likely than not” will require increased professional judgment and in-depth knowledge.
2. Convergence would be supported by using GASB’s “reasonably certain.”
3. “More likely than not” is more susceptible to guessing.
4. More indicators can be identified for assessing a higher likelihood; this is based on experience with the higher threshold for probable for contingent liabilities.
5. More likely than not is harder to support, subject to inconsistencies in reaching determinations, and subject to more changes.

➤ **Probability Threshold (2)**

One Board member stated that GASB’s use of a higher threshold would shrink the pool of leases available for consideration and therefore affect the liability and asset recognition. It also may decrease the level of effort on the part of preparers because the threshold is so high.

TF Question 2: *Do you agree or disagree with this Board member’s thoughts? Please explain your reasoning.*

TF Responses:

A majority of the TF members agree with the Board member that that GASB’s use of a higher threshold would shrink the pool of leases available for consideration and therefore affect the liability and asset recognition; and also may decrease the level of effort on the part of preparers.

The following comments accompanied the TF member’s support of the Board member’s comment:

1. I also agree there is additional effort to assess and record the initial asset and liability entries; however, the subsequent activity should not take more effort.
2. Without being well-defined, the use of the definition of probable as “likely to occur” is so much more subjective than “more likely than not - >50%” that it obscures the actual probability.
3. Our goal should be to capture the non-intragovernmental leases that meet specific criteria that we believe are important to report. We should not be concerned with the volume of leases reported.
4. While we agree that the pool of leases could be smaller under a higher threshold, the reduction in level of effort to identify leases under the new definition could be offset by the higher level of rigor that would need to be applied to each lease to determine lease term and support the higher threshold through the gathering of statistical evidence.

One TF member did not agree with the Board member’s comment and said:

1. It is not likely that the alternative GASB definition would substantially change the pool of leases that would require liability and asset recognition, but rather, the alternative definitions could significantly impact the calculation of amounts to be recognized.

➤ **Probability Threshold (3)**

Another Board member would like to be able to assess the cost-benefit factors of a higher-probability threshold versus a lower-probability threshold.

***TF Question 3:** What are your thoughts on the cost-benefit factors associated with a higher-probability threshold versus a lower-probability threshold?*

TF Responses:

A majority of the TF respondents are split between (1) agreeing that the cost/benefit factors favor a lower-probability threshold and (2) unable to assess the cost/benefit without more analysis.

TF members who agree that the cost/benefit factors favor a lower-probability threshold said:

1. I believe that the benefits of a lower probability is that there will be more consistency in financial reporting as more leases will be reported at the full lease term versus part of the lease term. I believe that such benefits outweigh the costs, although if I had more information on costs, my conclusion may change.
2. As stated in previously, one of the greatest benefits associated with a lower probability threshold is flexibility to the entities.
3. There should not be an increased cost for tracking lease costs and option years if a lower-probability threshold is chosen.
4. There would be a higher level of effort for the higher probability threshold than the lower probability threshold. The GASB definition, and FASAB's questions imply that the GASB standard is something greater than the FASAB standard of >50% but does not quantify the difference.

TF members who were unable to assess the cost/benefit factors associated with the probability thresholds without more analysis said:

1. We do not think an assessment of the cost-benefit factors of a higher-probability threshold versus a lower-probability threshold is required.
2. In order to assess the cost-benefits of a higher probability threshold versus a lower probability threshold, agencies will need to complete an analysis using both lower and higher thresholds.
3. While there would certainly be an impact on cost, depending on which threshold is selected (as discussed in question 2), the significance of the impact is not known, and would require piloting or similar modeling of processes required to implement the standard for any conclusions to be reached.

TF members who agree that the cost/benefit factors favor a higher-probability threshold said:

1. A higher threshold may achieve the benefits desired at a reasonable cost.
2. I think the higher probability threshold has a better cost-benefit factor for the accounting staff, and audit staff.

Staff Summary of TF Responses:

(1) The TF respondents are evenly split as to whether FASAB's definition of probable (more likely than not - >50%) will make it easier or harder or neither for federal entities to assess the probability of the options as well as the funding clause.

(2) A majority of the TF respondents agree with the Board member that that GASB's use of a higher threshold would shrink the pool of leases available for consideration and therefore affect the liability and asset recognition. It also may decrease the level of effort on the part of preparers because the threshold is so high.

(3) A majority of the TF respondents are split between agreeing that the cost/benefit factors favor a lower-probability threshold and unable to assess the cost/benefit without more analysis.

Staff Recommendations:

Staff recommends the Board continue using the FASAB definition of probable to assess the probability of the options as well as the funding clause. Staff also recommends that this question be added to exposure draft to get an even broader perspective from the community.

➤ **Lease Asset Classification**

Excerpts from Draft FASAB Lease Standard:

RECOGNITION and MEASUREMENT for LESSEES

At the beginning of the lease term, a lessee should recognize a lease liability and a right-to-use lease asset (hereinafter referred to as the lease asset), except as provided in paragraph 17 and paragraphs 59-61 (short-term leases).

FASAB Staff Discussion:

GASB specifically identifies the right-to-use lease asset as **an intangible asset**. In its basis for conclusions, GASB noted the following.

GASB Leases Exposure Draft – par. B17. –The Board considered whether amortization should be guided by a government’s depreciation policy for owned assets. That alternative was ultimately rejected, however, because the lease asset is an intangible asset that is distinct from the underlying asset being leased, and that lease asset may have a shorter useful life (lease term) than the useful life of the underlying asset.

SFFAS 6: Accounting for Property, Plant, and Equipment currently classifies capital leases as a PP&E asset. Although the GASB ED proposes that the underlying asset be recognized as an intangible asset, FASAB standards do not specifically require assets to be classified as tangible or intangible and there are currently no FASAB standards on intangibles.

Since the proposal includes both PP&E assets and intangible asset as lease assets, FASAB staff proposes that the lease asset not be classified as either an intangible or a PP&E asset but as a “leased asset” on the balance sheet if considered material.

TF Question 4: *Do you agree with FASAB staff’s proposal to not classify the lease asset as an intangible or a PP&E asset, but as a “leased asset” on the balance sheet? Please explain your reasoning.*

Staff Summary of TF Responses:

Five of the TF respondents agree with staff’s proposal to not classify the lease asset as an intangible or a PP&E asset, but as a “leased asset” on the balance sheet.

The TF members who agreed with staff’s proposal to not classify the lease asset as an intangible or a PP&E asset, but as a “leased asset” on the balance sheet said:

1. Our agency believes “leased asset” is a more appropriate term than “intangible asset” or “PP&E asset” as “leased asset” is more descriptive of the actual nature of the asset.
2. These assets have different characteristics than PP&E assets and should be reported separately.
3. The right-to-use is an intangible asset and amortization is over the lease term and not the useful life of the underlying asset. Therefore, leased assets should not be treated as PP&E. But since FASAB does not have any standards on intangible assets, it’s best to treat the assets as “leased assets” on the balance sheet.
4. Our agency agrees with FASAB staffs proposal to not classify the leased asset as an intangible or PP&E asset on the balance sheet because it avoids disparity with the definition of tangible versus intangible assets between federal agencies.

The six TF members who disagreed with staff's proposal to classify the lease asset as a "leased asset" on the balance sheet did not all support the same option. Four supported classification as PP&E while two supported options other than PP&E. These TF members said:

1. I believe it would be better to present the PP&E leased assets with PP&E and the intangible assets with the intangible categories that they would normally be reported under on the balance sheet because this is more consistent and the term "lease asset" is not sufficiently meaningful because it does not provide information on what type of assets are leased.
2. While it is agreed that lease costs will include both tangible and intangible assets, I would recommend classifying leased assets as PP&E and the costs associated with leased assets as a separate major category of PP&E. Considering substance over form concept, although the costs are related to a legal agreement, the costs are associated with the use of an underlying asset.
3. Recommend that FASAB remain silent. The document should state that the asset should be capitalized. Agencies should be allowed to figure out how to disclose it. We don't think there is value added in raising the tangible / intangible discussion.
4. We believe leased assets, in theory, should be classified as intangibles since the leased asset may have a shorter useful life (lease term) than the useful life of the underlying asset. However, since FASAB does not have an "intangible" standard, the next most similar type of classification, we believe, is utilizing PP&E because it is grouping like transactions together
5. Our agency DOES NOT concur with the FASAB Staff Proposal. An intangible asset is defined as a "non-physical asset having a useful life greater than one year. These assets are generally recognized as part of an acquisition, where the acquirer is allowed to assign some portion of the purchase price to acquired intangible assets." It is our agency's position that a lease agreement that provides a 'right to use' an asset, and that 'right to use' meets the definition of an intangible asset with its own useful life separate from the useful life of the leased asset itself.
6. The proposal doesn't help entities where the balances are not material but are significant enough for asset recognition. For amounts that do not meet the threshold of being material, such assets would then need to be presented within an existing Balance Sheet line, which FASAB should define to either be PP&E or another categorization (such as Other Assets on a Balance Sheet).

Staff Recommendations:

Staff recommends the Board propose that the lease asset not be classified as either an intangible or a PP&E asset but as a "leased asset" on the balance sheet if considered material. Staff also recommends that this question be added to exposure draft to get an even broader perspective from the community.

➤ **Lease Asset Meets the Definition of an Investment**

Excerpts from Draft FASAB Lease Standard:

LEASES OF ASSETS THAT ARE INVESTMENTS

If the underlying asset in a lease meets the definition of an investment, the lessor should account for that asset as an investment and should not apply the recognition and measurement provisions of this Statement.

FASAB Staff Discussion:

The Board instructed FASAB staff to include a definition of “investment” in the proposed Lease standard if the above section [Leases of Assets that are Investments] is to be included in the proposal.

***TF Question 5:** Before developing a specific definition for “investments” in the Lease proposal, we want to query the task force about the prevalence of non-intragovernmental federal lessors involved in leases of assets that are investments. If your federal entity is a federal lessor of leased assets that are considered investment assets please provide us a description of the asset and the nature of the non-intragovernmental lease.*

Staff Summary of TF Responses:

All TF respondents noted that they are not aware of any non-intragovernmental federal lessors involved in leases of assets that are investments.

The following are some of the TF comments:

1. I am not aware of federal entities having investment leases.
2. We do not have any leased assets that are investments; hence, we defer this question to those agencies that have such arrangements and can provide an informative response.
3. Accordingly no significant examples were identified for this response.
4. Several other TF representatives stated that they were not aware of any leased assets that are considered investment assets.

Staff Recommendations:

Staff recommends that this topic not be included in the standards section of the Lease ED, but include a brief discussion in the BFC.

➤ **Rent Holidays**

Excerpts from Draft FASAB Lease Standard:

LESSEE TREATMENT OF SHORT-TERM LEASES

A lessee should recognize short-term lease payments as expense based on the payment provisions of the contract/agreement. The lessee should not apply the recognition and measurement requirements of paragraphs 16–31 but should recognize an asset if payments are made in advance of the period to which they relate, or a liability for rent due if payments are made subsequent to that period. The lessee should recognize any rent holiday period (for example, one or more months free) as reductions of lease rental expense on a straight-line basis over the lease term.

LESSOR TREATMENT OF SHORT-TERM LEASES

A lessor should recognize short-term lease payments as revenue based on the payment provisions of the contract/agreement. The lessor should not apply the recognition and measurement requirements of paragraphs 33–47 but should recognize a liability if payments are received in advance of the period to which they relate, or an asset for rent due if payments are received subsequent to that period. The lessor should recognize any rent holiday period (for example, one or more months free) as reductions of lease rental income on a straight-line basis over the lease term

FASAB Staff Discussion:

The GASB Lease exposure draft proposes not to straight-line rent holidays. However, the FASAB has tentatively agreed to recognize rent holidays on a straight-line basis over the lease term. The Board would like to be able to assess the cost-benefit factors associated with the straight-line recognition of rent holidays versus as rent holiday payments are made/received.

TF Question 6: *What are your thoughts on the cost-benefit factors associated with the straight-line recognition of rent holidays versus recognition of rent holiday payments as they are made/received? Please explain your reasoning.*

Staff Summary of TF Responses:

A slight majority of the TF respondents agree that the cost-benefit factors favor the straight-line recognition of rent holidays versus recognition of rent holiday payments as they are made/received.

The six TF members supporting straight-line recognition of rent holidays, said:

1. I agree with the straight-line recognition of rent holidays as the alternative is more costly to assess and track.
2. Straight-lining a rent holiday can provide users of the financial statements the true cost of leasing arrangements overall and not just in the current fiscal year.
3. There is little cost incurred to straight-line expenses because the total annual rent payments are added to an Excel spreadsheet as each lease is signed or amended and then rolled forward and updated, as needed, in each subsequent reporting period.
4. We believe that the minimal cost of calculating and recognizing rent holidays over the term of the lease on a straight-line basis is more than offset by the benefit of accurate financial reporting.
5. We believe any rental holiday, applicable for short-term leases, should be amortized over the length of the lease contract, as it would smooth out any fluctuations on a month-to-month basis, which is the basis of accrual accounting.
6. While the tracking and straight-line recording of rent holidays does place additional cost and resource burden, while automation techniques have been found to help reduce monthly transaction recording. The benefit achieved provides for timely recognition of hundreds of millions of dollars of value being assigned to the periods cost was applicable to rather than an absence of cost (if cash-basis were used) for extended periods of time, in some instances up to a year or more. Conceptually, matching cost to the periods services are received is always preferable to cash basis accounting.

The four TF members supporting “as payments are made/received” recognition of rent holidays, said:

1. Recognition of rent holiday payments as they are made/received would cost less than straight-line recognition. Rent holidays may not be material.
2. Straight-lining the rent holiday will create a burden on the accounting staff. A straight-line calculation for the financial statements will not affect the availability of resources for the appropriation, or change which appropriation is used to pay the rent that is actually due.
3. Since under the FASAB lease standard the leases will be treated as assets and liabilities, rent holidays should be recognized as they are made/received as the payment/receipt reduces future liabilities.
4. We do not generally benefit from rent holidays. However, it is our opinion that since rent holidays are not guaranteed and can not necessarily be planned for, it makes sense to recognize and record them as what they are: single events with benefit limited to one accounting period.

Staff Recommendations:

Staff recommends that the Board propose that the lessee/lessor of short-term leases should recognize any rent holiday period as reductions of lease rental expense/ reductions of lease rental income on a straight-line basis over the lease term.

➤ **Certain Regulated Leases**

Excerpts from Draft FASAB Lease Standard:

(Par. 39) For leases for which external laws, regulations, or legal rulings (a) establish the cost that may be recovered through lease payments and (b) significantly limit the ability of the lessor to set rates in excess of those costs, the lessor should not apply the general recognition and measurement provisions of this Statement. For example, U.S. Department of Transportation regulates aviation leases between airports and airlines. For such leases, the lessor should recognize revenue based on the payment provisions of the contract/agreement and provide the disclosures in paragraph 53.

(Par. 53) A lessor with one or more regulated leases as described in paragraph 39 should disclose the following about those lease activities (which may be grouped for purposes of disclosure), other than short-term leases:

- a. A general description of its agreements
- b. The carrying amount of assets subject to exclusive use by one counterparty under agreements, by major class of assets, and the amount of accumulated depreciation
- c. The total amount of revenue (for example, lease revenue, interest revenue, and any other lease-related revenue) recognized in the reporting period from agreements, if the total is not displayed on the face of the financial statements
- d. A schedule of future minimum payments under the agreement for each of the subsequent five years and in five-year increments thereafter
- e. The amount of lease revenue recognized in the reporting period for variable payments not included in the future minimum payments
- f. The existence, terms, and conditions of options by the lessee to terminate the lease, if the lessor federal entity has issued debt for which the principal and interest payments are secured by the lease payments.

FASAB Staff Discussion:

According to GASB this provision arises because there are higher jurisdictions (state for local and federal for state) which can impose laws, regulations, and legal rulings. However, for the federal government, there may be no external laws, regulations or legal rulings imposed. FASAB staff believes this provision may be confusing to federal entities because they may think any laws are external. Therefore FASAB staff questions the need for this provision and would like to seek input from the task force as to the need for this provision in the proposed lease accounting standards.

TF Question 7: *Based on your entity’s leasing activities, would there be a need for any “Certain Regulated Leases” provisions in the proposed federal lease accounting standards? If so, please provide us a description of your entity’s “regulated” leasing activities.*

Staff Summary of TF Responses:

A majority of the TF respondents noted that they were not aware of federal entities with regulated leases.

One of the TF respondents, said, yes, there is a need for clarity in this regard, as silence in the FASAB standard in this regard then leaves open for interpretation of other authoritative guidance by the audit and financial communities, and potentially result in differing interpretations and application of unintended guidance. The existing wording was unclear whether it was intended to include laws, regulations, and legal rules directly applicable to Federal activities.

Staff Recommendations:

Staff recommends that this topic not be included in the standards section of the Lease ED, but include a brief discussion in the BFC.



Federal Accounting Standards Advisory Board

ACCOUNTING FOR LEASES:

AN AMENDMENT OF SFFAS 5, ACCOUNTING FOR LIABILITIES OF THE FEDERAL GOVERNMENT AND SFFAS 6, ACCOUNTING FOR PROPERTY, PLANT, AND EQUIPMENT

Statement of Federal Financial Accounting Standards

Exposure Draft

Written comments are requested by [date 90 days after issuance]

Month day, year

Working Draft – Comments Are Not Requested on This Draft

THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General, established the Federal Accounting Standards Advisory Board (FASAB or “the Board”) in October 1990. FASAB is responsible for promulgating accounting standards for the United States Government. These standards are recognized as generally accepted accounting principles (GAAP) for the federal government.

An accounting standard is typically formulated initially as a proposal after considering the financial and budgetary information needs of citizens (including the news media, state and local legislators, analysts from private firms, academe, and elsewhere), Congress, federal executives, federal program managers, and other users of federal financial information. The proposed standards are published in an Exposure Draft for public comment. In some cases, a discussion memorandum, invitation for comment, or preliminary views document may be published before an exposure draft is published on a specific topic. A public hearing is sometimes held to receive oral comments in addition to written comments. The Board considers comments and decides whether to adopt the proposed standard with or without modification. After review by the three officials who sponsor FASAB, the Board publishes adopted standards in a Statement of Federal Financial Accounting Standards. The Board follows a similar process for Statements of Federal Financial Accounting Concepts, which guide the Board in developing accounting standards and formulating the framework for federal accounting and reporting.

Additional background information is available from the FASAB or its website:

- [“Memorandum of Understanding among the Government Accountability Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board.”](#)
- [“Mission Statement: Federal Accounting Standards Advisory Board”](#), [exposure drafts](#), [Statements of Federal Financial Accounting Standards and Concepts](#), [FASAB newsletters](#), and other items of interest are posted on FASAB’s website at: www.fasab.gov.

Copyright Information

This is a work of the U. S. government and is not subject to copyright protection in the United States. It may be reproduced and distributed in its entirety without further permission from FASAB. However, because this work may contain copyrighted images or other material, permission from the copyright holder may be necessary if you wish to reproduce this material separately.

Contact us:

Federal Accounting Standards Advisory Board
441 G Street, NW, Suite 6814
Mailstop 6H19
Washington, DC 20548
Telephone 202-512-7350
FAX – 202-512-7366
www.fasab.gov



Federal Accounting Standards Advisory Board

ISSUE DATE

TO: ALL WHO USE, PREPARE, AND AUDIT FEDERAL FINANCIAL INFORMATION

Your comments on the exposure draft of a proposed Statement of Federal Financial Accounting Standards, entitled *Accounting for Leases: An Amendment of SFFAS 5, Accounting for Liabilities of the Federal Government and SFFAS 6, Accounting for Property, Plant, and Equipment*, are requested. Specific questions for your consideration appear on page 6 but you are welcome to comment on any aspect of this proposal. If you do not agree with the proposed approach, your response would be more helpful to the Board if you explain the reasons for your position and any alternative you propose. Responses are requested by **DUE DATE**.

All comments received by the FASAB are considered public information. Those comments may be posted to the FASAB's website and will be included in the project's public record.

Mail delivery is delayed by screening procedures. Therefore, please provide your comments in electronic form by e-mail to fasab@fasab.gov. If you are unable to e-mail your responses, we encourage you to fax the comments to (202) 512-7366. Alternatively, you may mail your comments to:

Wendy M. Payne, Executive Director
Federal Accounting Standards Advisory Board
Mailstop H19
441 G Street, NW, Suite 6814
Washington, DC 20548

We will confirm receipt of your comments. If you do not receive confirmation, please contact our office at 202.512.7350 to determine if your comments were received.

The Board's rules of procedure provide that it may hold one or more public hearings on any exposure draft. No hearing has yet been scheduled for this exposure draft. **or** A public hearing has been scheduled at 9:00 AM on Month Day, Year, in Room 7C13 at the GAO Building, 441 G Street, NW, Washington, D.C.

Notice of the date and location of any public hearing on this document will be published in the Federal Register and in the FASAB's newsletter.

Sincerely,

D. Scott Showalter
Chairman

EXECUTIVE SUMMARY

WHAT IS THE BOARD PROPOSING?

The Board is proposing revisions to the existing federal lease accounting standards. The proposal provides a comprehensive set of lease accounting standards to ensure federal lease activities are recognized in the reporting entity's general purpose federal financial reports (GPFRRs) and appropriate disclosures are included.

The Board is proposing that federal lessees recognize a lease liability and a leased asset at the beginning of the lease, unless it is an intragovernmental lease or a short-term lease. A federal lessor would recognize a lease receivable and deferred revenue, unless it is an intragovernmental lease or a short-term lease.

HOW WOULD THIS PROPOSAL IMPROVE FEDERAL FINANCIAL REPORTING AND CONTRIBUTE TO MEETING THE FEDERAL FINANCIAL REPORTING OBJECTIVES?

Lease accounting was first addressed by the Board during the development of SFFAS 5 and 6. At that time the Board decided to use the high level language on lease accounting from Financial Accounting Standards Board's (FASB) *SFAS 13 Accounting for Leases* as a placeholder until the Board was prepared to add lease accounting to its agenda as a separate project. The standards in SFFAS 5 and 6 are minimal and only address the definition of a capital lease, the criteria for capital leases, and the measurement of a capital lease asset and liability.

The current lease accounting standards have been criticized as not making meaningful distinctions between types of leases and not providing sufficient guidance to the federal community. Additionally, the current federal standards are based on FASB lease accounting standards which have been revised.

This lease proposal will improve the existing lease accounting standards in SFFAS 5 and SFFAS 6 by

- providing relevant and meaningful financial information needed by federal financial statement users and
- ensuring comprehensive lease standards appropriately address the various lease transactions/activities of the federal community.

TABLE OF CONTENTS

Executive Summary.....	4
What is the Board proposing?	4
How would this proposal improve federal financial reporting and contribute to meeting the federal financial reporting objectives?.....	4
Questions for Respondents.....	6
Introduction.....	9
Purpose	9
Materiality	9
Proposed Standards.....	10
Scope	10
Definitions	10
Amendments to SFFAS 5, <i>Accounting for Liabilities of the Federal Government</i> and SFFAS 6, <i>Accounting for Property, Plant, and Equipment</i>	11
Standards for Non-Intragovernmental Leases	11
Lease Term	11
Recognition and Measurement For Lessees.....	12
Disclosure Requirements for lessees.....	15
Recognition and Measurement for Lessors	16
Disclosures for Lessors	18
Contract/Agreements with Multiple Components.....	18
Contract/Agreement Combinations	19
Short-Term Leases.....	20
Lease Terminations and Modifications	20
Subleases	21
Sale-Leaseback Transactions	22
Lease-Leaseback Transactions	23
Standards for Intragovernmental Leases.....	24
Appendix A: Basis for Conclusions	29
Project history.....	29
Key Areas of Improvement.....	30
Scope	30
Definitions	31
Lease Term -- Renewal and Termination Options.....	32
Non-Intragovernmental Leases.....	33
Intragovernmental Leases	35
Appendix B: Illustration	37
Appendix C: Abbreviations.....	38
Appendix D: Glossary	39

QUESTIONS FOR RESPONDENTS

The Board encourages you to become familiar with all proposals in the Statement before responding to the questions in this section. In addition to the questions below, the Board also would welcome your comments on other aspects of the proposed Statement. Because the proposals may be modified before a final Statement is issued, it is important that you comment on proposals that you favor as well as any that you do not favor. Comments that include the reasons for your views will be especially appreciated.

The Board believes that this proposal would improve federal financial reporting and contribute to meeting the Federal financial reporting objectives. The Board has considered the perceived costs associated with this proposal. In responding, please consider the expected benefits and perceived costs and communicate any concerns that you may have in regard to implementing this proposal.

The questions in this section are available in a Word file for your use at www.fasab.gov/exposure.html. Your responses should be sent by e-mail to fasab@fasab.gov. If you are unable to respond by e-mail, please fax your responses to (202) 512-7366. Alternatively, you may mail your responses to:

Wendy M. Payne, Executive Director
Federal Accounting Standards Advisory Board
Mailstop 6H19
441 G Street, NW, Suite 6814
Washington, DC 20548

All responses are requested by [insert date].

- Q1. The Board is proposing to define a **lease** as a contract or agreement that conveys the right to use a nonfinancial asset (the underlying asset) for a period of time in an exchange transaction. The current lease standards, Statement of Federal Financial Accounting Standards (SFFAS) 5, *Accounting for Liabilities of the Federal Government* and SFFAS 6, *Accounting for Property, Plant, and Equipment (PP&E)*, do not specifically define a lease. SFFAS 5 and 6 only define a capital lease as a “lease that transfers substantially all the benefits and risks of ownership to the lessee.” The Board believes that the more concise definition being proposed is broad enough to capture the diversity of federal leasing activities. The proposed lease definition is presented in paragraph 9.

Do you agree or disagree with the proposed definition of lease? Please provide the rationale for your answer.

- Q2. The Board is proposing to define **lease term** as the period during which a lessee has a noncancelable right to use an underlying asset (referred to as the noncancelable period), plus the following periods, if applicable, covered by a lessee’s option to (a) extend the lease if it is probable, based on all relevant factors, that the lessee will

exercise that option and (b) terminate the lease if it is probable, based on all relevant factors, that the lessee will not exercise that option. The lease term proposal also provides guidance on fiscal funding/cancellation clauses, month-to-month lease holdovers, relevant factors when assessing the lease term, and reassessing the lease term. The proposed lease term requirements are presented in paragraphs 16 – 20.

Do you agree or disagree with the proposed definition of lease term? Please provide the rationale for your answer.

- Q3. The Board is proposing that at the beginning of the lease term, a lessee should recognize a lease liability and a right-to-use lease asset (the lease asset), except for short-term leases. The proposed lease recognition requirements are presented in paragraph 21.

Do you agree or disagree with the proposed lessee recognition of a lease at the beginning of the lease term? Please provide the rationale for your answer.

- Q4. The Board is proposing that a lessee should measure the **lease liability** initially at the present value of payments to be made for the lease term. In addition the measurement of the lease liability should include the several types of payments that might be required by a lease. The proposed lease liability measurement and recognition requirements are presented in paragraphs 23 – 31.

Do you agree or disagree with the proposed lessee recognition of the lease liability? Please provide the rationale for your answer.

- Q5. The Board is proposing that the future lease payments should be discounted using **the rate the lessor charges the lessee**, which may be the interest rate implicit in the lease. If the rate cannot be reasonably estimated by the lessee, the **lessee's incremental borrowing rate**¹ (the estimated rate that would be charged for borrowing the lease payment amounts for the lease term) should be used. The specific proposed requirement is presented in paragraph 25.

Do you agree or disagree that the rate the lessor charges the lessee, which may be the interest rate implicit in the lease, should be used to measure the future lease payments? Do you agree or disagree that the lessee's incremental borrowing rate should be used to measure the future lease payments when the lessor rate cannot be reasonably estimated by the lessee? Please provide the rationale for your answers.

- Q6. The Board is proposing that a lessee should measure the **lease asset** initially as the sum of (1) the amount of the initial measurement of the lease liability, (2) lease payments made to the lessor at or before the beginning of the lease, less any lease incentives received from the lessor, and (3) initial direct costs that are ancillary charges necessary to place the lease asset into service. The proposed lessee lease asset measurement and recognition requirements are presented in paragraphs 32 – 36.

¹ SFFAS 5: "The Treasury borrowing rate for securities of similar maturity to the term of the lease."

Do you agree or disagree with the proposed lessee measurement and recognition of the lease asset? Please provide the rationale for your answer.

- Q7. The Board is proposing that at the beginning of the lease term, a lessor should recognize a **lease receivable and deferred revenue**, except for short-term leases. The proposed requirements for the measurement and recognition of the lessor lease receivable and deferred revenue are presented in paragraphs 38 – 50.

Do you agree or disagree with the proposed lessor measurement and recognition of the lease receivable and deferred revenue? Please provide the rationale for your answer.

- Q8. The Board is proposing to define a **short-term lease** as a lease that, at the beginning of the lease, has a maximum possible term under the contract/agreement of 24 months or less, including any options to extend, regardless of its probability of being exercised. The proposed requirements for the measurement and recognition of a short-term lease are presented in paragraphs 61 – 63.

Do you agree or disagree with the proposed definition and measurement and recognition of a short-term lease? Please provide the rationale for your answer.

- Q9. The Board is proposing to establish distinct standards for **intragovernmental leases**. An intragovernmental lease is a contract or agreement that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration occurring within a consolidation entity or between two or more consolidation entities as defined under SFFAS 47, *Reporting Entity*. The proposed requirements for the measurement, recognition, and disclosure of intragovernmental leases are presented in paragraphs 77 – 97.

Do you agree or disagree with the proposed definition, measurement, recognition, and disclosures of intragovernmental leases? Please provide the rationale for your answer.

INTRODUCTION

PURPOSE

1. This project was undertaken primarily because
 - a. the current lease accounting standards, Statement of Federal Financial Accounting Standards (SFFAS) 5 and 6, have been criticized as ineffective because they do not make meaningful distinctions between capital and operating leases based on the substance of lease transactions, and
 - b. the lease accounting standards in SFFAS 5 and 6 are based on Financial Accounting Standards Board (FASB) lease accounting standards which have been amended. In addition existing FASAB standards are not comprehensive and do not provide meaningful information on federal leasing activities.
2. SFFAC 5, *Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements*, defines both an asset and liability. In that concept statement an asset is defined as “a resource that embodies economic benefits or services that the federal government controls.” Liability is defined as “a present obligation of the federal government to provide assets or service to another entity at a determinable date, when a specific event occurs, or on demand.” The SFFAC 5 definitions only address whether the asset or liability exists and not how it should be measured or whether or when it should be recognized. The current leasing activities/transactions of federal entities should be evaluated against these definitions to ensure proper measurement and recognition. This proposal seeks to adopt the most current concepts so that the accounting principles for leases provide comprehensive guidance for consistent reporting.
3. This Statement is intended to improve federal financial reporting for leases by requiring concise, meaningful, and transparent information about the cost and related asset and liability in order to understand the operating performance.

MATERIALITY

4. The provisions of this Statement need not be applied to immaterial items. The determination of whether an item is material depends on the degree to which omitting or misstating information about the item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement.

PROPOSED STANDARDS

SCOPE

5. This Statement applies to federal entities that present general purpose federal financial reports, including the consolidated financial report of the U.S. Government (CFR), in conformance with generally accepted accounting principles, as defined by paragraphs 5 through 8 of Statement of Federal Financial Accounting Standards (SFFAS) 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*.
6. For purposes of applying this Statement, a **lease** is defined as a contract or agreement that conveys the right to use a nonfinancial asset² (the underlying asset) for a period of time in an exchange transaction. Leases include contracts or agreements that, although not explicitly identified as leases, meet the definition of a lease. This definition does not include contracts or agreements for services unless that contract or agreement also conveys the right to use a nonfinancial asset (the underlying asset) for a period of time in an exchange transaction.
7. This Statement amends the lease accounting standards in *SFFAS 5, Accounting for Liabilities of the Federal Government* and *SFFAS 6, Accounting for Property, Plant, and Equipment*. This Statement also establishes distinct standards for intragovernmental leases.
8. This Statement does not apply to leases of federal natural resources as defined in Technical Bulletin (TB) 2011-1: *Accounting for Federal Natural Resources Other than Oil* and leases of federal oil and gas resources as defined in *SFFAS 38: Accounting for Federal Oil and Gas Resources*.

DEFINITIONS

9. **Lease** – A lease is a contract or agreement that conveys the right to use a nonfinancial asset (the underlying asset) for a period of time in an exchange transaction.
10. **Intragovernmental Lease** – A lease occurring within a consolidation entity or between two or more consolidation entities as defined under *SFFAS 47, Reporting Entity*.³
11. **Lease Term** – The period during which a lessee has a noncancelable right to use an underlying asset (referred to as the noncancelable period), plus the following periods, if applicable, covered by a lessee's option to:
 - a. **Extend** the lease if it is probable⁴, based on all relevant factors, that the lessee will exercise that option

² Examples of nonfinancial assets include land, buildings, vehicles, equipment, internal use software, and intangible assets. Examples of financial assets include cash, investments, and receivables.

³ *SFFAS 47, Reporting Entity*, outlines the characteristics as a whole that an organization would have to be considered a consolidated entity (see *SFFAS 47 par. 38-42*).

- b. Terminate the lease if it is probable, based on all relevant factors, that the lessee will not exercise that option.

Periods for which both the lessee and the lessor have an option to terminate the lease, or for which only the lessor has that option, are cancelable periods and are excluded from the lease term. Provisions that allow for termination of a lease due to (a) purchase of the underlying asset, (b) payment of all sums due, or (c) default on payments are not considered options to terminate.

- 12. **Lease Option Periods** – Lease option periods are additional lease periods beyond the initial lease term – the options may be included in the initial lease or may be agreed to later in the lease term.
- 13. **Initial Direct Costs** – Initial direct costs are costs that are directly attributable to negotiating and arranging a lease or portfolio of leases and would not have been incurred without entering into the lease.
- 14. **Short-Term Lease** – A short-term lease is a lease that, at the beginning of the lease, has a maximum possible term under the contract or arrangement of 24 months or less, including any options to extend, regardless of their probability of being exercised.

AMENDMENTS TO SFFAS 5, ACCOUNTING FOR LIABILITIES OF THE FEDERAL GOVERNMENT AND SFFAS 6, ACCOUNTING FOR PROPERTY, PLANT, AND EQUIPMENT

- 15. This Statement rescinds paragraphs XX – XX of SFFAS 5 and paragraphs XX – XX of SFFAS 6.

[Specific references will be included in the next draft of the exposure draft]

STANDARDS FOR NON-INTRAGOVERNMENTAL LEASES

LEASE TERM

- 16. The lease term is the period during which a lessee has a noncancelable right to use an underlying asset (referred to as the noncancelable period), plus the following periods, if applicable, covered by a lessee's option to:
 - a. Extend the lease if it is probable, based on all relevant factors, that the lessee will exercise that option
 - b. Terminate the lease if it is probable, based on all relevant factors, that the lessee will not exercise that option.

⁴ That which can reasonably be expected or believed to be more likely than not on the basis of available evidence or logic but which is neither certain nor proven. *[FASAB Handbook – Appendix E: Consolidated Glossary]*

Periods for which both the lessee and the lessor have an option to terminate the lease, or for which only the lessor has that option, are cancelable periods and are excluded from the lease term. Provisions that allow for termination of a lease due to (a) purchase of the underlying asset, (b) payment of all sums due, or (c) default on payments are not considered options to terminate.

17. A fiscal funding or cancellation clause (a clause that allows federal lessees to cancel a lease agreement, typically on an annual basis, if funds for the lease payments are not appropriated) should be considered in determining the lease term only when it is probable that the clause will be exercised.
18. Month-to-month lease holdovers, or rolling lease extensions, or any lease that continues into a holdover period until a new contract or agreement is signed would be considered cancelable because either the lessee or lessor could cancel the lease at any time. These holdover periods should be excluded from the lessee's lease liability and the lessor's lease receivable.
19. At the beginning of a lease, lessors and lessees should assess all factors relevant to the likelihood that the lessee will exercise options, whether these factors are contract/agreement based, underlying asset based, market based, or federal specific. The assessment often will require the consideration of a combination of these interrelated factors. Examples of factors to consider include, but are not limited to, the following:
 - a. A significant economic incentive, such as contractual terms and conditions for the optional periods that are favorable compared with current market rates
 - b. A significant economic disincentive, such as costs to terminate the lease and sign a new lease (for example, negotiation costs, relocation costs, abandonment of significant leasehold improvements, costs of identifying another suitable underlying asset, costs associated with returning the underlying asset in a contractually specified condition or to a contractually specified location, or a substantial cancellation penalty)
 - c. The lessee's history of exercising renewal or termination options
 - d. The extent to which the lease is essential to the provision of federal services.
20. Lessors and lessees should reassess the lease term only if the lessee does either of the following:
 - a. Elects to exercise an option even though the lessor or lessee had previously determined that it was probable that the lessee would not exercise that option.
 - b. Does not elect to exercise an option even though the lessor or lessee had previously determined that it was probable that the lessee would exercise that option.

RECOGNITION AND MEASUREMENT FOR LESSEES

21. At the beginning of the lease term, a lessee should recognize a lease liability and a right-to-use lease asset (hereinafter referred to as the lease asset), except as provided in paragraph 22 and paragraphs 61-63 (short-term leases).

LEASES THAT TRANSFER OWNERSHIP

22. A lease contract/agreement that transfers ownership of the underlying asset to the lessee at or before the end of the lease, and does not contain termination options (see paragraph 16), should be reported as a financed purchase of that asset.

LEASE LIABILITY

23. A lessee should measure the lease liability initially at the present value of payments to be made for the lease term. Measurement of the lease liability should include the following types of payments that might be required by a lease:
- a. Fixed payments, less any lease incentives (such as a cash payment or reimbursement of moving costs) receivable from the lessor
 - b. Variable lease payments that depend on an index or a rate (such as the Consumer Price Index or a market interest rate), initially measured using the index or rate as of the beginning of the lease
 - c. Variable lease payments that are fixed in-substance as described in paragraph 24
 - d. Amounts that are probable of being required to be paid by the lessee under residual value guarantees
 - e. The exercise price of a purchase option if it is probable that the lessee will exercise that option
 - f. Payments for penalties for terminating the lease, if the lease term reflects the lessee exercising an option to terminate the lease or a fiscal funding or cancellation clause
 - g. Any other payments that are probable of being required based on an assessment of all relevant factors.
24. Variable payments based on future performance of the lessee or usage of the underlying asset should not be included. Rather, these variable payments should be recognized as an expense in the statement of net cost in the period in which those payments are incurred. However, any component of these variable payments that is fixed in-substance should be included in the lease liability. An example would be a lease payment based on a percentage of sales or usage but with a required minimum amount to be paid. That required minimum payment is fixed in-substance.
25. The future lease payments should be discounted using the rate the lessor charges the lessee, which may be the interest rate implicit in the lease. If the rate cannot be reasonably

estimated by the lessee, the **lessee's incremental borrowing rate**⁵ (the estimated rate that would be charged for borrowing the lease payment amounts for the lease term) should be used.

26. At subsequent financial reporting dates, the lessee should calculate the amortization of the discount on the lease liability and recognize that amount as interest expense for the period. Any payments made should be allocated first to the accrued interest liability and then to the lease liability.
27. The lessee should remeasure the lease liability at subsequent financial reporting dates if any of the following changes have occurred and are expected to significantly affect the amount of the lease liability:
 - a. There is a change in the lease term due to a reassessment (see par.20), a modification (see par. 68), or a termination (see par. 66).
 - b. An assessment of all relevant factors indicates that the likelihood of a residual value guarantee being paid has changed from probable to not probable, or vice versa.
 - c. An assessment of all relevant factors indicates that the likelihood of a purchase option being exercised has changed from probable to not probable, or vice versa.
 - d. There is a change in the estimated amounts for payments already included in the liability.
 - e. There is a change in the rate the lessor charges the lessee, if used as the initial **discount rate**.
28. If a lease liability is remeasured for any of the changes in paragraph 27, the liability also should be remeasured for any change in an index or rate used to determine variable lease payments if that change in the index or rate is expected to significantly affect the amount of the liability. A lease liability is not required to be remeasured solely for a change in an index or rate used to determine variable lease payments.
29. The lessee also should update the discount rate as part of the remeasurement if any of the following changes have occurred and are expected to significantly affect the amount of the lease liability:
 - a. There is a change in the lease term due to a reassessment (see par.20), a modification (see par. 68), or a termination (see par. 66).
 - b. An assessment of all relevant factors indicates that the likelihood of a purchase option being exercised has changed from probable to not probable, or vice versa.
30. A lease liability is not required to be remeasured, nor is the discount rate required to be reassessed solely for a change in the lessee's incremental borrowing rate.
31. If the discount rate is required to be updated based on the provisions in paragraph 29, the discount rate should be based on the revised rate the lessor charges the lessee at the time the discount rate is updated. If that rate cannot be readily determined, the lessee's estimated incremental borrowing rate should be used.

⁵ SFFAS 5: "The Treasury borrowing rate for securities of similar maturity to the term of the lease."

LEASE ASSET

32. A lessee should initially measure the lease asset as the sum of the following:
- a. The amount of the initial measurement of the lease liability (see paragraph 23)
 - b. Lease payments made to the lessor at or before the beginning of the lease, less any lease incentives received from the lessor
 - c. Initial direct costs that are ancillary charges necessary to place the lease asset into service.
33. The lease asset should be amortized in a systematic and rational manner over the shorter of the lease term or the useful life of the underlying asset, except as provided in paragraph 34. The amortization of the lease asset should be reported amortization expense.
34. If the lease contains a purchase option that the lessee has determined is probable of being exercised, the lease asset should be amortized over the useful life of the underlying asset. In this circumstance, if the underlying asset is non-depreciable, such as land, then the lease asset should not be amortized.
35. The lease asset generally should be adjusted by the same amount when the corresponding lease liability is remeasured based on paragraphs 27–31. However, if this change reduces the carrying value of the lease asset to zero, any remaining amount should be reported in the flows statement as a gain.
36. The presence of impairment indicators (described in paragraph 12 of Statement 44) with respect to the underlying asset may result in a change in the manner or duration of use of the lease asset. The change in the manner or duration of use of the lease asset is an indicator that the lease asset may be impaired. The period for which the underlying asset has less usable capacity should be the relevant factor(s) in determining the magnitude of the decline in service utility of the lease asset. If a lease asset is impaired, it should be reduced first for any change in the corresponding lease liability. Any remaining amount should be recognized as an impairment.

DISCLOSURE REQUIREMENTS FOR LESSEES

37. A lessee should disclose the following about its lease activities (which may be grouped for purposes of disclosure), other than short-term leases:
- a. A general description of its leasing arrangements, including:
 - i. The basis, terms, and conditions on which variable lease payments not included in the lease liability are determined
 - ii. The existence, terms, and conditions of residual value guarantees provided by the lessee
 - b. The total amount of lease assets, and the related accumulated amortization, to be disclosed separately from other capital assets

- c. The amount of lease expense recognized for the period for variable lease payments not previously included in the lease liability
- d. Principal and interest requirements to maturity, presented separately, for the lease liability for each of the five subsequent years and in five-year increments thereafter
- e. The amount of the annual lease expense and the discount rate used to calculate the lease liability

RECOGNITION AND MEASUREMENT FOR LESSORS

38. At the beginning of the lease term, a lessor should recognize a lease receivable and a deferred revenue, except as provided in paragraph 39 and paragraphs 61–63 (short-term leases). Any initial direct costs incurred by the lessor should be reported as an expense of the period.

LEASES THAT TRANSFER OWNERSHIP

39. A lease contract/agreement that transfers ownership of the underlying asset to the lessee at or before the end of the lease, and does not contain termination options (see paragraph 16), should be reported as a financed sale of that asset.

LEASE RECEIVABLE

40. A lessor should measure the lease receivable initially at the present value of lease payments to be received for the lease term, reduced by any provision for uncollectible amounts. Measurement of the lease receivable should include the following types of payments that might be required by a lease:
- a. Fixed payments
 - b. Variable payments that depend on an index or a rate (such as the Consumer Price Index or a market interest rate), initially measured using the index or rate as of the beginning of the lease
 - c. Portions of variable payments that are fixed in substance (as described in paragraph 41)
 - d. Residual value guarantees that are fixed payments in substance (as described in paragraph 42).
41. Variable payments based on future performance of the lessee or usage of the underlying asset should not be included in the receivable. Those payments should be recognized as revenue in the period to which those payments relate. However, any component of those variable payments that is fixed in substance should be included in the lease receivable. For example, if a lease payment is based on a percentage of sales but has a required minimum payment, that required minimum is a fixed payment in substance. Similarly, a residual value guarantee is an in-substance fixed payment if it stipulates the underlying asset will be sold

at the end of the lease term, with the lessee assuming a liability for any shortfall if the sales price is less than an agreed-upon minimum amount.

42. Amounts to be received under residual value guarantees (that are not fixed in substance) should be recognized as a receivable and revenue when (a) a guarantee payment is required (as agreed to by the lessee and lessor) and (b) the amount can be reasonably estimated. Amounts to be received for the exercise price of a purchase option or penalties for lease termination should be recognized as a receivable and revenue when those options are exercised.
43. The future lease payments to be received should be discounted using the rate the lessor charges the lessee, which may be the interest rate implicit in the lease. Lessors are not required to apply imputed interest, but may do so as a means of determining the rate implicit in the lease.
44. At subsequent financial reporting dates, the lessor should calculate the amortization of the discount on the receivable and report that amount as interest revenue for the period. It should be calculated so as to produce a constant periodic rate of return on the receivable. Any payments received should be allocated first to the accrued interest receivable and then to the lease receivable.
45. The lessor should remeasure the lease receivable and update the discount rate at subsequent financial reporting dates if either of the following changes have occurred and are expected to significantly affect the amount of the receivable:
 - a. There is a change in the lease term.
 - b. There is a change in the rate the lessor charges the lessee.
46. If a lease receivable is remeasured for either of the changes in paragraph 45, the receivable also should be remeasured for any change in an index or rate used to determine variable lease payments if that change in the index or rate is expected to significantly affect the amount of the receivable. A lease receivable is not required to be remeasured solely for a change in an index or rate used to determine variable lease payments.
47. If the discount rate is updated based on the provisions in paragraph 49, the receivable should be discounted using the revised rate.

DEFERRED REVENUE

48. A lessor should measure the deferred revenue at the initial value of the lease receivable, less any provision for uncollectible amounts (see paragraph 40), plus the amount of any payments received at or prior to the beginning of the lease that relate to future periods (for example, the final month's rent). A lessor subsequently should recognize deferred revenue in a systematic and rational manner over the term of the lease.
49. The deferred revenue should generally be adjusted using the same amount as the change resulting from the remeasurement of the lease receivable as discussed in paragraphs 45-46.

UNDERLYING ASSET

50. A lessor should **not** derecognize the asset underlying the lease. A lessor should continue to apply other applicable guidance to the underlying asset, including depreciation and impairment. However, if the lease agreement requires the lessee to return the asset in its original or enhanced condition, a lessor should not depreciate the asset during the lease term.

DISCLOSURES FOR LESSORS

51. A lessor should disclose the following about its lease activities (which may be grouped for purposes of disclosure), other than short-term leases:
- a. A general description of its leasing arrangements, including the basis, terms, and conditions on which any variable lease payments not included in the lease receivable are determined
 - b. The carrying amount of assets on lease or held for leasing, by major classes of assets, and the amount of accumulated depreciation
 - c. The total amount of revenue (for example, lease revenue, interest revenue, and any other lease-related revenue) recognized in the reporting period from leases
 - d. The amount of revenue recognized in the reporting period for variable lease payments and other payments not previously included in the lease receivable, including revenue related to residual value guarantees and termination penalties
 - e. The existence, terms, and conditions of options by the lessee to terminate the lease if the lessor federal entity has issued debt for which the principal and interest payments are secured by the lease payments.
52. In addition to the disclosures in paragraph 51, if a federal entity's principal ongoing operations consist of leasing assets to other entities, the federal entity should disclose a schedule of future lease payments that are included in the lease receivable, showing principal and interest, for each of the five subsequent years and in five-year increments thereafter.

CONTRACT/AGREEMENTS WITH MULTIPLE COMPONENTS

53. Lessors and lessees may enter into one contract/agreement that contains multiple components, such as a contract/agreement that contains both a lease component and a nonlease component, or a lease that contains multiple underlying assets.
54. If a lessor or lessee enters into a contract/agreement that contains both a lease (such as the right to use a building) and a nonlease component (such as a maintenance services for the building), the federal entity should account for the lease and nonlease components as separate contract/agreements, unless the contract/agreement meets the exception in paragraph 57.b or paragraph 57.c.

55. If a lease involves multiple underlying assets, lessors and lessees should account for each underlying asset as a separate lease component if the assets have different lease terms. The provisions of this paragraph should be applied unless the contract/agreement meets the exception in paragraph 57.b or paragraph 57.c
56. To allocate the consideration required under the contract/agreement to the different components, lessors and lessees should first use any prices for individual components that are included in the contract/agreement if they are reasonable based on other observable stand-alone prices. Stand-alone prices are those that would be paid or received if the same or similar assets were leased or if the same or similar nonlease components (such as services) were contracted individually. Some contract/agreements provide discounts for bundling multiple leases or lease and nonlease components together in one contract/agreement. These discounts may be taken into account when determining whether individual component prices are reasonable. For example, if the individual component prices are each discounted by the same percentage from normal market prices, those component prices would be considered reasonable.
57. If a contract/agreement does not include prices for individual components, or if those prices are not reasonable based on other observable stand-alone prices, lessors and lessees should do the following, unless the components as a whole are insignificant:
- a. If observable stand-alone prices are readily available for *all* components, the federal entity should allocate the consideration based on the relative values of the observable stand-alone prices.
 - b. If observable stand-alone prices are readily available for *some* (but not all) components, the federal entity should allocate the observable stand-alone price to each component for which it is readily available. The federal entity may (1) estimate the allocation of the remaining consideration to the remaining components or (2) account for the remaining components as a single lease unit.
 - c. If observable stand-alone prices are not readily available for *any* of the components, the federal entity may (1) estimate the prices for each component or (2) account for the entire contract/agreement as a single lease unit.
58. When multiple components are accounted for as a single unit, as provided for in paragraphs 57.b and 57.c, the accounting for that unit should be based on the primary lease component within that unit. For example, the primary lease component's lease term should be used for the unit if the lease components have different lease terms.

CONTRACT/AGREEMENT COMBINATIONS

59. Contract/agreements that are entered into at or near the same time with the same counterparty should be considered to be part of the same lease contract/agreement if either of the following criteria is met:
- a. The contract/agreements are negotiated as a package with a single objective.

- b. The amount of consideration to be paid in one contract/agreement depends on the price or performance of the other contract/agreement.
60. If multiple contract/agreements are determined to be part of the same lease contract/agreement, that lease should be evaluated in accordance with the guidance on contract/agreements with multiple components in paragraphs 53–58.

SHORT-TERM LEASES

61. A short-term lease is a lease that, at the beginning of the lease, has a maximum possible term under the contract/agreement of 24 months or less, including any options to extend, regardless of its probability of being exercised. For a lease that is cancelable by either the lessee or the lessor, such as a month-to-month lease or a year-to-year lease, the maximum possible term is the noncancelable period, including any notice periods. For a lease that is cancellable only by the lessee, the maximum possible term should be evaluated under the requirements of the lease term as defined in paragraph 16.

LESSEE TREATMENT OF SHORT-TERM LEASES

62. A lessee should recognize short-term lease payments as expense based on the payment provisions of the contract/agreement. The lessee should not apply the recognition and measurement requirements of paragraphs 21–37 but should recognize an asset if payments are made in advance of the period to which they relate, or a liability for rent due if payments are made subsequent to that period. The lessee should recognize any rent holiday period (for example, one or more months free) as reductions of lease rental expense on a straight-line basis over the lease term.

LESSOR TREATMENT OF SHORT-TERM LEASES

63. A lessor should recognize short-term lease payments as revenue based on the payment provisions of the contract/agreement. The lessor should not apply the recognition and measurement requirements of paragraphs 38–52 but should recognize a liability if payments are received in advance of the period to which they relate, or an asset for rent due if payments are received subsequent to that period. The lessor should recognize any rent holiday period (for example, one or more months free) as reductions of lease rental income on a straight-line basis over the lease term.

LEASE TERMINATIONS AND MODIFICATIONS

64. A lease contract/agreement may be amended while it is in effect. Examples of amendments include a change in consideration, a lengthening or shortening of the lease term (see paragraphs 27 and 45), or adding or removing an underlying asset. An amendment to a lease contract/agreement should be considered a lease modification unless the lessee's right to use the underlying asset decreases. If the lessee's right to use the underlying asset decreases (for example, the lease term is shortened or the number of underlying assets is reduced), that change should be accounted for as a partial lease termination.

65. If a lease modification gives the lessee an additional right to use an underlying asset that was not included in the original lease and is reasonably priced compared to its stand-alone price (in the context of that particular contract/agreement), both the lessee and the lessor should account for that additional portion of the modified lease as a new lease, separate from the original portion of the lease.

LEASE TERMINATIONS

LESSEE TREATMENT OF LEASE TERMINATIONS

66. A lessee generally should account for the full or partial termination of a lease by reducing the carrying values of the lease asset and lease liability and recognizing a gain or loss for the difference. However, if the lease is terminated as a result of the lessee purchasing the underlying asset from the lessor, the lease asset should be reclassified to the appropriate class of owned asset. The lease liability should be changed to reflect only those payments yet to be made, and that change should be reflected in the cost of the purchased asset.

LESSOR TREATMENT OF LEASE TERMINATIONS

67. A lessor should account for the full or partial termination of a lease by reducing the carrying values of the lease receivable and related deferred revenue, and recognizing a gain or loss for the difference. If the lease is terminated as a result of the lessee purchasing an underlying asset from the lessor, the carrying value of the underlying asset also should be derecognized and included in the calculation of any resulting gain or loss.

LEASE MODIFICATIONS

LESSEE TREATMENT OF LEASE MODIFICATIONS

68. A lessee should account for a lease modification by remeasuring the lease liability. The lease asset should be adjusted by the difference between the remeasured liability and the liability immediately before the lease modification. However, if the change reduces the carrying value of the lease asset to zero, any remaining amount should be reported in the flows statement as a gain.

LESSOR TREATMENT OF LEASE MODIFICATIONS

69. A lessor should account for a lease modification by remeasuring the lease receivable. The deferred revenue should be adjusted by the difference between the remeasured receivable and the receivable immediately before the lease modification. However, if the change relates to payments for the current period, the change should be recognized in the flows statement for the current period as revenue.

SUBLEASES

70. A sublease involves three parties: the original lessor, the original lessee (who also is the lessor in the sublease), and the new lessee. The original lessor should continue to apply the general lessor guidance. The federal entity that is the original lessee and becomes the lessor in the sublease, should account for the original lease and the sublease as two separate transactions, as a lessee and a lessor, respectively. Those two separate

transactions should not be offset against one another. The new lessee should apply the general lessee guidance.

71. The original lessee (and now the lessor in a sublease) should include the sublease in its disclosure of the general description of lease arrangements. Its lessor transactions related to subleases should be disclosed separately from its lessee transactions related to the original lease.

SALE-LEASEBACK TRANSACTIONS

72. Sale-leaseback transactions involve the sale of an underlying asset by the owner and a lease of the property back to the seller. A sale-leaseback transaction should include a qualifying sale⁶ in order to be eligible for sale-leaseback accounting. A sale-leaseback transaction that does not include a qualifying sale should be accounted for as a borrowing by both the seller-lessee and the buyer-lessor.
73. The sale and leaseback portions of a sale-leaseback transaction should be accounted for as two separate transactions – a sale transaction and a lease transaction – except that the difference between the carrying value of the capital asset that was sold and the net proceeds from the sale should be reported as a deferred revenue or deferred expense to be recognized in the flow statement over the term of the lease. However, if the leaseback portion of the transaction qualifies as a short-term lease, any gain or loss on the sale should be recognized immediately.
74. A sale-leaseback transaction is considered to have off-market terms if there is a significant difference between (a) the sales price and the estimated fair value of the asset or (b) the present value of the contractual lease payments and the estimated present value of what the lease payments for that asset would be at a market price, whichever of the two differences is more readily determinable. The difference should be reported based on the substance of the transaction (for example, as a borrowing, a nonexchange transaction, or an advance lease payment) rather than as a part of the sales-leaseback transaction. The following are examples of off-market terms:
 - a. A transaction has a sale price and lease payments that are both significantly higher than market
 - b. A transaction has a sale price that is significantly higher than market but the lease payments are at or below market
 - c. A transaction has a sale price that is significantly lower than market.

⁶ GASB references GASB No. 62, *Codification of Accounting and Financial Reporting Guidance in Pre-November 30, 1989 FASB and AICPA Pronouncement* – paragraphs 287-323, to describe a qualifying sale. Paragraph 287 states, “A sale should not be considered consummated until (a) the parties are bound by the terms of a contract, (b) all consideration has been exchanged, (c) any permanent financing for which the seller is responsible has been arranged, and (d) all conditions precedent to closing have been performed. Usually, those four conditions are met at the time of closing or after closing, not when an agreement to sell is signed or at a preclosing.”

75. A seller-lessee should disclose the terms and conditions of sale-leaseback transactions in addition to the disclosures required of a lessee (paragraph 37). A buyer-lessor should provide the disclosures required of a lessor (paragraph 51).

LEASE-LEASEBACK TRANSACTIONS

76. In a lease-leaseback transaction an asset is leased by one party (first party) to another party and then leased back to the first party. The leaseback part of the transaction may involve an additional asset (such as leasing a building that has been constructed by a developer on land owned by and leased back to a federal entity) or only a portion of the original asset (such as leasing back only one floor of a building to the owner). A lease-leaseback transaction should be accounted for as a net transaction. Both parties to a lease-leaseback transaction should disclose the gross amounts of each portion of the transaction.

STANDARDS FOR INTRAGOVERNMENTAL LEASES

77. This section describes an exception for intragovernmental leases to the overall recognition, measurement, and disclosure requirements for lessees and lessors. An intragovernmental lease is a contract or agreement that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration occurring within a consolidation entity or between two or more consolidation entities as defined under SFFAS 47 (Reporting Entity). Any lease that meets the definition of an intragovernmental lease would be required to follow the accounting guidance described in paragraphs 79 – 97 below.

INTRAGOVERNMENTAL LEASES – LESSEE ACCOUNTING

78. The following sections articulate the general recognition guidance for lessees of intragovernmental leases and detailed recognition guidance regarding several specific intragovernmental lease topics, as well as disclosure guidance.

RECOGNITION AND MEASUREMENT

GENERAL GUIDANCE FOR RECOGNITION OF INTRAGOVERNMENTAL LEASES⁷

79. A lessee should recognize lease payments, including lease-related operating cost (for example, maintenance, utilities, taxes, etc.) paid to the lessor, as expenses based primarily on the payment provisions of the lease. A lessee would not recognize a lease asset and a corresponding liability for an intragovernmental lease. Accordingly, a lessee would not recognize amortization expense related to a lease asset or interest expense on a lease liability.
80. Recognition should be based on the payment provisions of the lease. Prepaid rent or a payable for rent due should be recognized as an asset or liability, respectively, and an expense should be recognized in the appropriate period based on the specifics of the lease provisions.

GUIDANCE FOR RECOGNITION OF SPECIFIC INTRAGOVERNMENTAL LEASE TOPICS

81. Rental Increases – Rental increases may be fixed in the lease and take place with the passage of time (for example, be based on such factors as anticipated increases in costs or anticipated appreciation in property values, but the amount of the increase is specified in the lease) or they may be contingent on future events.
82. Contingent rental increases are based on changes in specific economic factors, for example, future activity levels or future inflation (for example, tied to a specific economic indicator where the specific amount of the change is not known).

⁷ SFFAS 4, *Managerial Cost Accounting Standards and Concepts*, par. 105-115 (as amended by SFFAS 30), continue to apply for non-reimbursed or under reimbursed intragovernmental lease arrangements.

83. If the lease provides for rental increases a lessee should recognize the expense in the period of the increase as provided in the lease, rather than allocating the increased rent expense over the lease term as one does for non-intragovernmental leases.
84. Lease Incentives – Lease incentives include lessor payments made to or on behalf of the lessee to entice the lessee to sign a lease. Lease incentives may include up-front cash payments to the lessee; for example, moving costs, termination fees to lessee’s prior lessor, or lessor’s assumption of the lessee’s lease obligation under a different lease with another lessor.
85. Lease incentives should be recognized as reductions of lease rental expense by the lessee on a straight-line basis over the lease term. The lessee should recognize the expenses or losses to which the incentives relate in the period the costs are incurred. For example, an incentive equal to the moving expense incurred to occupy the leased space reduces rent expense over the lease term and the moving expense is recognized in the period incurred (that is, when the move occurs). [guidance on entries or illustrations will be provided in implementation guidance]
86. Lease Concessions – Lease concessions are rent discounts made by the lessor to entice the lessee to sign a lease. Lease concessions include rent holidays/free rent periods, reduced rents, or commission credits.
87. Lease concessions should be recognized as reductions of lease rental expense by the lessee on a straight-line basis over the lease term. [guidance on entries or illustrations will be provided in implementation guidance]
88. Leasehold Improvements – Leasehold improvements are additions, alterations, remodeling, renovations or other changes to a leased property that either extend the useful life of the existing property or enlarge or improve its capacity and are paid for (financed) by the lessee rather than by the lessor. Leasehold improvements that are placed in service at or after the beginning of the lease term should be amortized over the useful life (the normal operating life in terms of utility to the owner) of the leasehold improvement, but no longer than the expected lease term.

DISCLOSURES

89. Lessees should disclose a broad summary of significant intragovernmental leasing arrangements, including
- a. Existence of intragovernmental leases and annual expense
 - b. General lease disclosures with specific intragovernmental requirements
 - c. Annual lease expense by major leased asset category.

INTRAGOVERNMENTAL LEASE ARRANGEMENTS – LESSOR ACCOUNTING

90. The following sections articulate general recognition guidance for lessors of intragovernmental leases. They also provide more detailed recognition guidance regarding several specific intragovernmental lease topics as well as disclosure guidance.

RECOGNITION AND MEASUREMENT

GENERAL GUIDANCE FOR RECOGNITION OF INTRAGOVERNMENTAL LEASES

91. A lessor should recognize lease receipts, including lease-related operating cost (for example, maintenance, utilities, or taxes) received from the lessee as income based primarily on the provisions of the lease.

GUIDANCE FOR RECOGNITION OF SPECIFIC INTRAGOVERNMENTAL LEASES

92. Lease Incentives – Lease incentives include lessor payments made to or on behalf of the lessee to entice the lessee to sign a lease. Lease incentives may include up-front cash payments to the lessee (for example, moving costs, termination fees to lessee’s prior lessor, or lessor’s assumption of the lessee’s lease obligation under a different lease with another lessor). Lease incentives should be recognized as reductions of lease rental income by the lessor on a straight-line basis over the lease term.
93. Lease Concessions – Lease concessions are rent discounts made by the lessor to entice the lessee to sign a lease. Lease concessions include rent holidays/free rent periods, reduced rents, or commission credits.
94. Lease concessions should be recognized by the lessor as reductions in rental income on a straight-line basis over the lease term.
95. Tenant Improvements – Tenant improvements are additions, alterations, remodeling, renovations or other changes to a leased property that either extend the useful life of the existing property or enlarge or improve its capacity and is paid for (financed) by the lessor rather than by the lessee. These capital improvements are components of the leased property and should be capitalized and depreciated by the lessor over their useful life consistent with the lessor’s accounting for property, plant, and equipment.⁸
96. Initial Direct Costs – Lessor initial direct costs should be expensed when incurred by the lessor.

DISCLOSURES

97. Lessors should disclose the following regarding intragovernmental leases:
- a. Future lease rental income as of the date of the latest balance sheet presented, in the aggregate and for each of the five succeeding fiscal years for lease

⁸ This recognition is consistent with PP&E capital improvements outlined in SFFAS 6, paragraph 37.

arrangements over the period of expected or planned occupancy, which includes the lease term.

- b. A broad summary of significant leases, including a breakdown of the number of leases with federally-owned assets and privately-owned assets.

Effective Date

98. The requirements of this Statement are effective for reporting periods beginning after September 30, 20XX.

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

APPENDIX A: BASIS FOR CONCLUSIONS

This appendix discusses some factors considered significant by Board members in reaching the conclusions in this Statement. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others. The standards enunciated in this Statement—not the material in this appendix—should govern the accounting for specific transactions, events, or conditions.

PROJECT HISTORY

- A1. This project was undertaken primarily because
- a. the current lease accounting standards, Statement of Federal Financial Accounting Standards (SFFAS) 5, *Accounting for Liabilities of the Federal Government* and SFFAS 6, *Accounting for Property, Plant, and Equipment*, have been criticized as ineffective because they do not make meaningful distinctions between capital and operating leases based on the substance of lease transactions, and
 - b. the lease accounting standards in SFFAS 5 and 6 are based on Financial Accounting Standards Board (FASB) lease accounting standards which have been amended; in addition existing FASAB standards are not comprehensive and do not provide meaningful information on federal leasing activities.
- A2. Lease accounting was first addressed by the FASAB during the development of SFFAS 5 and 6. At that time the Board decided to use the high level language on lease accounting from FASB Accounting Standards Codification (ASC) - Topic 840 *Leases*. This minimal lease guidance included the definition of a capital lease, the criteria for capital leases, and the measurement of a capital lease asset and liability. The Board had plans to use this preliminary guidance as a placeholder until the Board was prepared to add lease accounting to its agenda as a separate project. Lease accounting had been on the list of potential Board agenda items each time the Board has considered its agenda for new projects.
- A3. There are several areas of lease accounting that were covered by the FASB standards that were never specifically covered in the FASAB standards. Some of those topics include leasehold improvements, lease terms, leveraged leases, and subleases. The federal community often stressed that the federal standards on lease accounting should be comprehensive to alleviate questions on when and if FASB standards apply to federal entities when the federal standards are silent on a topic.
- A4. In August 2011, FASAB began a project to revise its current standards on lease accounting. A task force was formed to assist in developing the proposed standards for leases. Task force members included accounting, budget, and subject matter experts from federal agencies and independent public accounting firms.
- A5. The task force met several times over the course of the project and also exchanged numerous ideas and recommendations electronically. The task force views and recommendations were sought by staff in developing and describing alternatives to present to the Board during the development of these standards. The task force's

assistance was essential and its views carefully considered by members during deliberations. The task force played an important role in the research and release of this exposure draft.

- A6. At the inception of the project the Board decided they would like to coordinate with GASB on the lease project because of the similarities in issues with governmental entities. Staff worked very closely with GASB staff during the development of the proposals. In 2014 FASAB and GASB met jointly to discuss similar issues related to each of their ongoing lease accounting projects. The Board specifically directed staff to use the GASB proposal on Leases as a platform for developing the federal standards on non-intragovernmental leases.
- A7. This Statement amends the lease accounting standards in SFFAS 5 and SFFAS 6. This Statement also establishes distinct standards for intragovernmental leases.

KEY AREAS OF IMPROVEMENT

- A8. This lease proposal will improve the existing lease accounting standards in SFFAS 5 and SFFAS 6 by
- a. providing relevant and meaningful financial information needed by federal financial statement users and
 - b. ensuring comprehensive lease standards appropriately address the various lease transactions/activities of the federal community.
- A9. As with GASB, the Board believes that in “a lease transaction, a lessee receives the right to use an underlying asset (the asset that is subject to the lease, such as a vehicle or building) at the beginning of the lease term. In exchange, the lessee promises to make payments over time for the right to use that underlying asset.” The guidance in SFFAS 5 and 6 “was based on the notion that some leases are essentially financed purchases of the underlying asset (classified as capital leases) and other leases (classified as operating leases) are not. Therefore, the accounting approach for a lease was dependent on that classification. The classification of a lease as capital or operating depended on whether the lease met any of four tests. Those tests were intended to determine whether most of the risks and benefits of ownership of the underlying asset were transferred to the lessee. If so, the lease essentially was a financed purchase of the asset and would be accounted for as a capital lease. Those tests have been criticized because their bright-line nature often resulted in very similar leases being accounted for in different ways.”⁹

SCOPE

- A10. For purposes of applying this Statement, a lease is defined as a contract or agreement that conveys the right to use a nonfinancial asset¹⁰ (the underlying asset) for a period of time in an exchange transaction. Leases include contracts or agreements that, although not explicitly identified as leases, meet the definition of a lease (which reflects the substance

⁹ GASB Leases Exposure Draft – January 25, 2016, paragraph B2 and B3

¹⁰ Examples of nonfinancial assets include land, buildings, vehicles, equipment, internal use software, and intangible assets. Examples of financial assets include cash, investments, and receivables.

of a lease). This definition does not include contracts or agreements for services unless that contract or agreement also conveys the right to use a nonfinancial asset (the underlying asset) for a period of time in an exchange transaction.

- A11. This Statement does not apply to leases of federal natural resources as defined in Technical Bulletin (TB) 2011-1: *Accounting for Federal Natural Resources Other than Oil and Gas*; and leases of federal oil and gas resources as defined in SFFAS 38: *Accounting for Federal Oil and Gas Resources*.
- A12. GASB's leases exposure draft specifically excludes, "Contracts that meet the definition of a service concession arrangement in paragraph 4 of Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements* (SCAs)." Currently FASAB standards are silent on SCAs. Through discussions with the lease task force it was noted that several federal entities have SCAs and there was a concern that the proposed lease definition could inadvertently scope in SCAs. The Board considered specifically excluding SCAs from the lease standard. To accomplish the exclusion, the Board considered adopting the GASBS 60 definition of SCA due to the lack of a federal definition of SCA.
- A13. Because SCAs are not currently addressed in federal accounting standards, the Board decided that specifically excluding SCAs from the lease standard would raise more questions. Furthermore, SCAs are expected to be addressed in the P3 recognition and measurement project and therefore the Board agreed to remain silent on SCAs in the lease proposal. In conclusion, the Board believes the GAAP hierarchy will guide preparers and auditors in addressing SCA accounting issues.

DEFINITIONS

- A14. In this Statement, a lease is defined as a contract or agreement that conveys the right to use a nonfinancial asset (the underlying asset) for a period of time in an exchange transaction. In the early stages of the project the Board deliberated over the use of "contract" or "agreement" in the definition of a lease. According to the GASB proposal, the term contract is more precise and limiting and requires that a lease be legally enforceable. Because legal enforceability is not the primary driver in intragovernmental leasing transactions, the Board decided to add agreement alongside contract in the lease definition to alleviate ambiguity in the application of the definition, especially in the case of intragovernmental leases which are often referred to as "lease agreements."

LEASE TERM -- RENEWAL AND TERMINATION OPTIONS

- A15. Based on the Board's review of the GASB proposal on renewal and termination options in the lease term, the Board agreed with GASB and their rationale for the proposed guidance. Below is GASB's BFC¹¹ on renewal and termination options in the lease term.

Many leases include clauses that allow a lease to be renewed or extended at the option of the lessee. Likewise, many leases include clauses that allow the lessee the option of terminating or cancelling the lease at or after a certain point in time. The Board considered whether renewal periods and periods after a potential termination date should be included in the lease term. Limiting the lease term to only the noncancelable period could lead to opportunities to structure leases with short noncancelable periods and many renewal options (even when all parties understand the intent is to renew) or with an early termination option (even when all parties understand there is no intent to terminate). Therefore, the Board concluded that the lease term should include certain periods covered by renewal options and termination options (determined by the likelihood of those options being exercised) so that the lease term reflects how long the lease is expected to be in effect. (GASB Leases Exposure Draft – January 25, 2016, paragraph B18)

The determination of the likelihood of a renewal or termination option being exercised applies only if that option pertains to the lessee alone. If either the lessee or the lessor has the option to cancel a lease (or if both parties have to agree to renew), an enforceable contract does not exist beyond that point. For example, a month-to-month or rolling lease, or a lease that continues into a holdover period until a new contract is signed, would not be enforceable because either the lessee or lessor could cancel the lease at any time. When a lease contains a lessor-only option to terminate the lease, the Board believes that the difficulty for a lessee to evaluate the likelihood of that option being exercised outweighs the potential benefits of including the extra periods in the lease term. (GASB Leases Exposure Draft – January 25, 2016, paragraph B19)

- A16. Similar to GASB, the Board considered several potential probability thresholds for including a period covered by a renewal or termination option in the lease term. The Board considered its own definition of probable, GASB's definition of probable, and FASB's probability threshold "reasonably certain." FASB's probable definition equates to more likely than not (>50% probability). GASB's probable definition equates to likely to occur and has a higher threshold of probability than more likely than not. FASB's reasonably certain has an even higher threshold than likely to occur. The Board agreed to stay with its

¹¹ **GASB DISCLAIMER:** The inclusion of certain text herein which have been prepared independently by the Government Accounting Standards Boards are being provided by FASAB for informational purposes only. Users should be advised that the same may be subject to revision, amendment or substitution, and there is no guarantee that the included text is the most current form of content. Further, the inclusion of such text herein should not be deemed to suggest an endorsement by GASB of any third party content, positions, opinions or releases which may be a part of this text as presented. ©2016 Financial Accounting Foundation, Norwalk, Connecticut

definition of probable because it is more clearly defined and there seemed to be no compelling reason to introduce a new term for the sake of a higher threshold.

NON-INTRAGOVERNMENTAL LEASES

RECOGNITION AND MEASUREMENT FOR LESSEES – LEASE LIABILITY

A17. Based on the Board's review of the GASB proposal on the recognition and measurement of the lease liability for lessees, the Board agreed with GASB and their rationale for the proposed guidance. Below is GASB's BFC on the recognition and measurement of the lease liability for lessees.

The Board believes that the lessee taking possession of the underlying asset or gaining access to use the underlying asset is an event that creates such an obligation. The lessee already has received the right to use the underlying asset and has a present obligation to make the payments in exchange for that right. Unless the lessee renegotiates the lease, the lessee has little or no discretion to avoid the contractual lease payments (or termination penalties) before the end of the lease term. (GASB Leases Exposure Draft – January 25, 2016, paragraph B26.)

The Board concluded that the lease liability should be measured at the present value of future lease payments to be made for the lease term, which represent the obligations of the lessee under the contract. The present value calculation is consistent with the notion that a lease is a financing transaction and recognizes the cost of the financing. (GASB Leases Exposure Draft – January 25, 2016, paragraph B27.)

RECOGNITION AND MEASUREMENT FOR LESSEES – LEASE ASSET

A18. Based on the Board's review of the GASB proposal on the recognition and measurement of the lease asset for lessees, the Board agreed with GASB and their rationale for the proposed guidance. Below is GASB's BFC on the recognition and measurement of the lease asset for lessees.

This Statement requires lessees to recognize a lease asset to correspond with the lease liability. Assets are defined in Concepts Statement 4 as resources with present service capacity that the government presently controls. At the beginning of a lease, the lessee obtains the right to use the underlying asset by either gaining physical possession of the asset or attaining access to use the underlying asset. The right to use makes the underlying asset a resource to the lessee and gives the lessee access to the underlying asset's present service capacity. Therefore, the Board believes that this right meets the definition of an asset. The lease asset is the right to use the underlying asset rather than the underlying asset itself. (GASB Leases Exposure Draft – January 25, 2016, paragraph B36.)

The Board concluded that the initial measurement of the lease asset should be based on the measurement of the associated lease liability. The Board considered whether the lease asset should be measured independently of the lease liability (for example, on a fair value basis) but decided against that approach. Capital assets generally are measured at historical cost, which is the amount paid for those assets. The lease liability represents the amount to be paid for the lease asset. Therefore, basing the measurement of the lease asset on the lease liability is consistent with the accounting for most capital assets at historical cost. Additionally, it recognizes the relationship between the liability and the asset because they arise from the same transaction. (GASB Leases Exposure Draft – January 25, 2016, paragraph B37.)

RECOGNITION AND MEASUREMENT FOR LESSORS

A19. Based on the Board’s review of the GASB proposal on the recognition and measurement for lessors, the Board agreed with GASB and their rationale for the proposed guidance. Below is GASB’s BFC on the recognition and measurement for lessors.

The Board believes that governmental lessees and lessors should account for the same transaction in a way that mirrors how the other party accounts for it. Consequently, the Board determined that symmetry between the lessee and lessor accounting models is an important consideration in establishing accounting and financial reporting standards. (GASB Leases Exposure Draft – January 25, 2016, paragraph B58.)

The lease contract gives the lessor the right to receive payments in exchange for the lessee’s right to use the underlying asset. The Board believes that right meets the definition of an asset in Concepts Statement 4. Assets are defined as resources with present service capacity that the government presently controls. The right to receive payments is a resource that can be drawn upon, and the lessor presently controls that right. (GASB Leases Exposure Draft – January 25, 2016, paragraph B62.)

For this Statement, the Board considered derecognition of the underlying asset but concluded that doing so would present problems that were not prevalent under the former guidance, which resulted in many leases being classified as operating leases. For example, if only a portion of a building is leased to another party, the lessor would derecognize only a portion of the historical cost of the building. The amount recognized as a lease receivable would likely not be equivalent to the portion of the historical cost that would be derecognized because the underlying asset is valued at historical cost rather than the present value of the right to use that asset. (GASB Leases Exposure Draft – January 25, 2016, paragraph B69.)

SHORT-TERM LEASE EXCEPTION

A20. Based on the Board's review of the GASB proposal on allowing for a short-term lease exception, the Board agreed with GASB and their rationale for the exception. Below is GASB's BFC allowing for a short-term lease exception.

The Board considered whether governments should be required or permitted to apply the short-term exception to the reporting requirements. It concluded that establishing the short-term exception as a requirement rather than an accounting policy election would enhance comparability among governments. The Board believes that comparability would be reduced if governments were allowed to choose whether to report leases as short term. (GASB Leases Exposure Draft – January 25, 2016, paragraph B99.)

The reporting of short-term leases in this Statement is intended to provide some measure of cost relief from the overall recognition and measurement provisions for lessees and lessors. Allowing lessees and lessors to simply recognize expense/expenditures and revenue based on the payment provisions of the contract eliminates the need for preparers to calculate amounts for assets and liabilities with useful lives or maturities of less than one year [FASAB proposes less than 24 months]. This approach is not equivalent to cash-basis recognition, as governments would still be required to recognize assets and liabilities for payments paid or received before or after the period to which they apply. (GASB Leases Exposure Draft – January 25, 2016, paragraph B100.)

A21. The Board agreed to extend the short-term lease exception to 24 months to remain consistent with the existing criteria of a 2-year useful life for PP&E capitalization (SFFAS 6).

INTRAGOVERNMENTAL LEASES

A22. During the research phase of the project, the General Services Administration (GSA) provided an educational session to the Board where GSA representatives explained in-depth GSA's role in federal leasing. Based primarily on that discussion, the Board agreed that intragovernmental leases should be accounted for differently than leases between federal entities and non-federal entities. The Board agreed that a simplified approach for recognizing intragovernmental leases would be pragmatic and cost efficient.

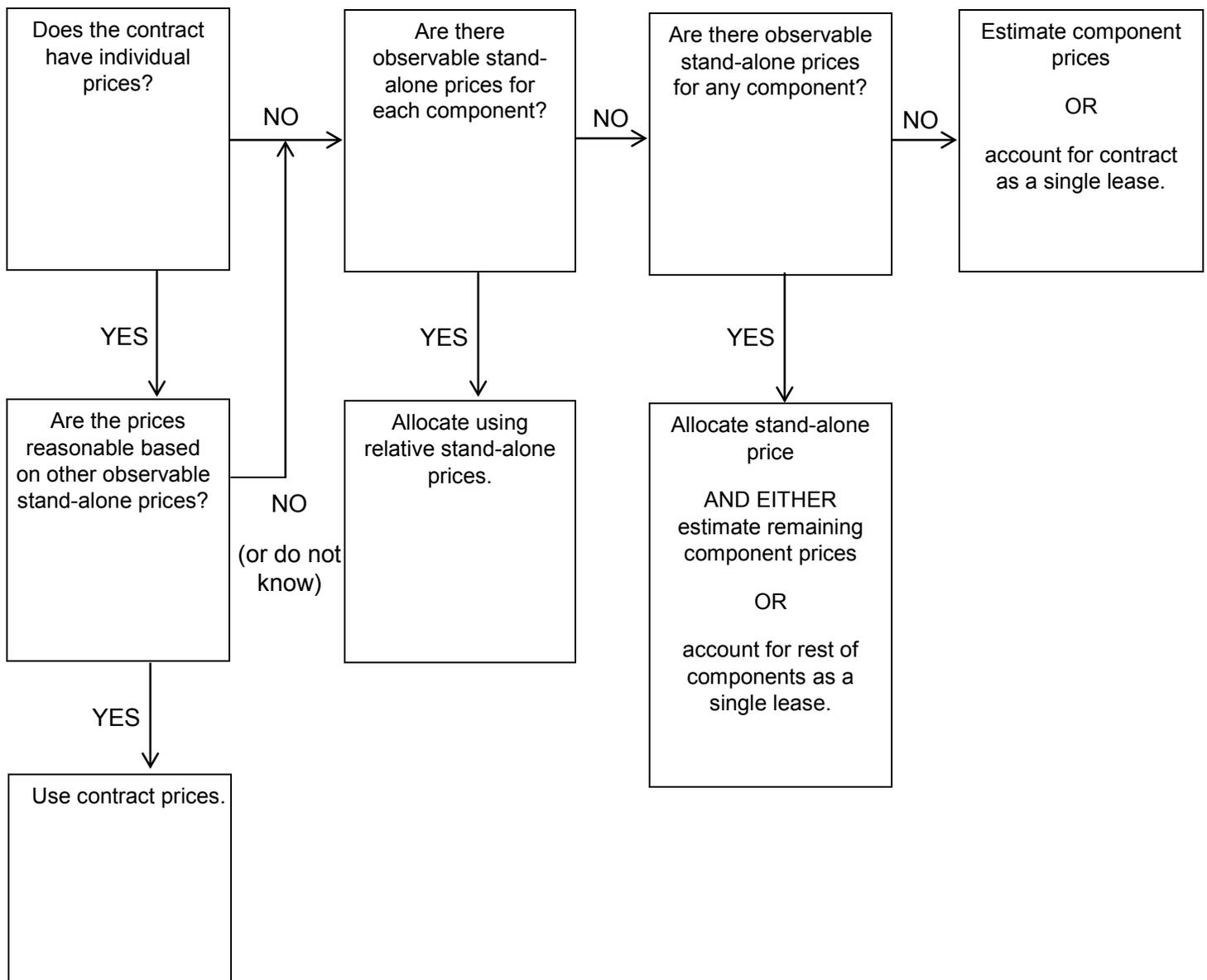
A23. This Statement allows for an exception for intragovernmental leases to the overall recognition, measurement, and disclosure requirements for lessees and lessors. An intragovernmental lease is a contract or agreement that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration occurring within a consolidation entity or between two or more consolidation entities as defined under SFFAS 47, *Reporting Entity*.

A24. The terms “intragovernmental” and “inter-entity” have been used interchangeably. Earlier FASAB standards predominately used “inter-entity.” However, government-wide usage of “intragovernmental” has become more common and therefore the Board decided to use intragovernmental in this Statement to describe leases occurring within a consolidation entity or between two or more consolidation entities as defined under SFFAS 47.

APPENDIX B: ILLUSTRATION

This appendix illustrates the application of the provisions of this Statement to assist in clarifying their meaning. The facts assumed in these examples are illustrative only and are not intended to modify or limit the requirements of this Statement or to indicate the Board's endorsement of the situations or methods illustrated. Additionally, these illustrations are not intended to provide guidance on determining the application of materiality. Application of the provisions of this Statement may require assessing facts and circumstances other than those illustrated here and require reference to other applicable Standards.

The following flowchart is intended to aid in the application of the provisions for contracts with multiple components of this Statement.



APPENDIX C: ABBREVIATIONS

ASC	Accounting Standards Codification
CFR	Consolidated financial report of the U.S. government
ED	Exposure draft
FASAB	Federal Accounting Standards Advisory Board
FASB	Financial Accounting Standards Board
GAAP	Generally Accepted Accounting Principles
GAO	Government Accountability Office
GASB	Governmental Accounting Standards Board
IPSASB	International Public Sector Accounting Standards Board
OMB	Office of Management and Budget
SFAS	Statement of Financial Accounting Standards (FASB)
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards

APPENDIX D: GLOSSARY

Lease

A lease is a contract or agreement that conveys the right to use a nonfinancial asset (the underlying asset) for a period of time in an exchange transaction.

Intragovernmental Lease

A lease occurring within a consolidation entity or between two or more consolidation entities as defined under SFFAS 47, *Reporting Entity*.¹²

Lease Term

The period during which a lessee has a noncancelable right to use an underlying asset (referred to as the noncancelable period), plus the following periods, if applicable, covered by a lessee's option to:

- a. Extend the lease if it is probable, based on all relevant factors, that the lessee will exercise that option
- b. Terminate the lease if it is probable, based on all relevant factors, that the lessee will not exercise that option.

Periods for which both the lessee and the lessor have an option to terminate the lease, or for which only the lessor has that option, are cancelable periods and are excluded from the lease term. Provisions that allow for termination of a lease due to (a) purchase of the underlying asset, (b) payment of all sums due, or (c) default on payments are not considered options to terminate.

Probable

That which can reasonably be expected or believed to be more likely than not on the basis of available evidence or logic but which is neither certain nor proven.

Lease Option Periods

Lease option periods are additional lease periods beyond the initial lease term – the options may be included in the initial lease or may be agreed to later in the lease term.

Initial Direct Costs

Initial direct costs are costs that are directly attributable to negotiating and arranging a lease or portfolio of leases and would not have been incurred without entering into the lease.

¹² SFFAS 47, *Reporting Entity*, outlines the characteristics as a whole that an organization would have to be considered a consolidated entity (see SFFAS 47 par. 38-42).

Short-Term Lease

A short-term lease is a lease that, at the beginning of the lease, has a maximum possible term under the contract or arrangement of 24 months or less, including any options to extend, regardless of their probability of being exercised.

Lessee's Incremental Borrowing Rate

The lessee's incremental borrowing rate is the estimated rate that would be charged for borrowing the lease payment amounts for the lease term.

Discount Rate

A discount rate is an interest rate that is used in present value calculations to equate amounts that will be received or paid in the future to their present value.

**FULL TEXT OF FASAB LEASE TASK FORCE RESPONSES
(APRIL – MAY 2016)**

➤ **Probability Threshold (1)**

Excerpts from Draft FASAB Lease Standard:

LEASE TERM

The lease term is the period during which a lessee has a noncancelable right to use an underlying asset (referred to as the noncancelable period), plus the following periods, if applicable, covered by a lessee’s option to:

- a. **Extend** the lease if it is probable, based on all relevant factors, that the lessee will exercise that option
- b. **Terminate** the lease if it is probable, based on all relevant factors, that the lessee will not exercise that option.

Periods for which both the lessee and the lessor have an option to terminate the lease, or for which only the lessor has that option, are cancelable periods and are excluded from the lease term. Provisions that allow for termination of a lease due to (a) purchase of the underlying asset, (b) payment of all sums due, or (c) default on payments are not considered termination options.

A fiscal funding or cancellation clause (a clause that allows federal lessees to cancel a lease agreement, typically on an annual basis, if funds for the lease payments are not appropriated) should be considered in determining the lease term only when it is probable that the clause will be exercised.

FASAB Staff Discussion:

GASB and FASAB’s definitions of “probable” are different. GASB’s threshold of “probable” is higher than FASAB’s “probable” threshold. FASAB’s “probable” definition equates to “more likely than not.” (>50% probability) GASB’s “probable” definition equates to “likely to occur”. The FASAB previously agreed to not changing the definition of “probable” to be a higher threshold with respect to when certain lease payments should be included in the measurement of the lease.

The BFC of the GASB Lease ED (paragraph B.20) fully explains GASB’s rationale for using “reasonably certain” rather than probable. In short, “reasonably certain” has a higher threshold than “probable” and is less speculative. Also, “reasonably certain” is more consistent with “reasonably assured” used in their existing lease standards in GASB Stmt. 62.

Task Force (TF) Question 1: Do you believe FASAB’s definition of probable (more likely than not - >50%) will make it easier or harder or neither for federal entities to assess the probability of the options as well as the funding clause? Please explain your reasoning.

TF Responses:

TF Rep. #1: *I believe reasonably certain is a little easier to assess than more likely than not. I state only a little bit easier as in both cases management needs to consider all the facts and circumstances as part of its assessment and therefore most likely will incur the same effort for the assessment.*

TF Rep. #2: *While it is true that defining “probable” as “more likely than not” or “>50%” is subjective, it should not make it harder for federal entities to assess probability. Defining it as “more likely than not” will give the individual entities flexibility or individual scrutiny for making the determination. While GASB’s logic for using a higher threshold is sound and may even be easier for entities, the risk of overstating/understating the cost and liability for leased assets is not increased because of the lower threshold, more so, the risk for overstatement/understatement of the cost for leasing assets may be mitigated by the use of a lower threshold.*

Per the ED, the cost of a leasing an asset is determined using the “lease term” and the probability of the extension or termination of an option year or early termination of a lease due to the lack of funding. At inception, there is an expectation that the lease will continue through the end of the term; hence the reason for the initial term of the lease. There is less probability that an entity will terminate the lease prior to the end of the initial agreed upon period. On the other hand, the probability that an entity will exercise option years will vary. For example, option years added for “space” may be less certain if the entity’s lease of the space is only during a period in which an entity awaits the completion of construction on permanent space, making the probability of exercising option years less certain in option years that are closer to the expected delivery of permanent space. In another instance, an entity may use option years as a method for decreasing rental costs. Additional years may have provided the entity with overall lower annual rental payments. In addition, it may be historical practice that the entity generally exercises option years, increasing the probability that the entity will exercise the option years more certain. The increased flexibility for making the determination may prove more beneficial.

As was the case with legal definition for probable in respect to contingent liabilities, the subjective nature of defining probable as “more likely than not” may impact the ability of external auditors to understand or audit an entity’s leasing costs. Given the flexibility to define “more likely than not”, it is recommended that each entity further define probability in entity level guidance to ensure standardization across the entity and decreasing the impact on the external financial statement audit community.

TF Rep. #3: We believe FASAB’s threshold of probable (“more likely than not - >50%”) will make it easier for federal entities to assess the probability of the options as well as the funding clauses because GASB’s definition of probable (“likely to occur”) would likely result in more subjective determinations and less consistent application (i.e., without a defined threshold, something can be 10 percent likely to occur so what is the actual threshold for “likely to occur” – 25, 75, 90, 99 percent?). SFFAS 12, Recognition of Contingent Liabilities Arising from Litigation, paragraph 10, notes that the definition of probable for pending litigation was changed from “more likely than not” to “likely to occur” because “[t]he concept of probability is imprecise and difficult to apply with respect to most legal matters” and “[t]he ‘more likely than not’ phrase suggests greater precision than is attainable when assessing the outcome of matters in litigation.” SFFAS 12, paragraph 6, states that FASAB’s probability threshold in SFFAS 5 of “more likely than not - >50%” raised “serious objection” from lawyers who desired the threshold be changed to “likely to occur” in order to avoid their probability determinations from being “used as admission against interest” or resulting in “the disclosure of information protected by the lawyer-client privilege, disadvantaging the government in any dispute, and violating the American Bar Association’s Code of Professional Responsibility.” The implied effect of this change is that the probability threshold of “more likely than not - > 50%” would have resulted in a larger population of litigation cases than a probability threshold of “likely to occur”; in addition, the probability threshold of “likely to occur” provided lawyers with greater flexibility in determining which cases to assess as probable losses so as to prevent their determinations from being “used as admission against interest.” As noted above with respect to leases, a probability threshold of “likely to occur” would provide agencies with more flexibility in determining which leases to consider, which would likely result in more subjective determinations and less consistent application.

TF Rep. #4: Neither, both require information to assess probability.

TF Rep. #5: From a financial management policy perspective for our agency (not from the real estate leasing expert) - a greater than 50% likelihood that an option period would be used to extend the lease would probably have all lease term options included in the lease term, at least at the beginning of the lease term, when the amortization period is being calculated originally. If you build those options into the initial lease, the thought should be that they are at least 50% probable of being used, or why would they be negotiated. This can change as the lease term is being utilized, which could have an effect in later periods if the lease term has to be adjusted "downward" when additional budget data or alternate management decisions drops the option extension likelihood to below 50%. Based on the wording of the ED draft however, the term would not be

modified until an option was not exercised, when it had originally been included in the asset calculation. This would result in the writeoff of the remaining asset since the option election would coincide closely with the expiration of the original lease term, unless the lease provides a longer period of notice for an option to be exercised. This may be a question for GSA / leasing experts as to how long is the typical period of acceptance required to exercise an option? An agency may know earlier that it won't exercise the option, but may not have to recognize that writeoff until they actually refuse to exercise the option under this language.

The lower probability likely will lead to longer initial lease terms in the calculations with the greater chance that later in the period, a writeoff may be recorded, presumably as a lump sum expense in the year of recording. Whereas, the greater probability threshold may result in more of the lease options being excluded from the initial lease term calculations, and "new" shorter term assets recognized for an option period when it is elected but had been previously excluded (as the original asset would have been fully amortized as of the end of the original probable lease term, and if you don't reassess the lease term until the option has been exercised, it probably coincides fairly closely with the end of the original lease term. either option has its burdens for the accounting staff compared to the real estate staff. The lower probability has the potential for greater lump sum adjustments hitting the financial statements than using the higher probability.

To know the true effect will still have to be related to how long the acceptance period is typical for a lease option, and the likelihood that this period will cross a financial reporting date as the "lease liability" will only be remeasured if there is a change in lease term by a financial reporting date. If it falls in the middle of a period, to increase the liability for a term that has been exercised when originally "not probable", will functionally result in the calculation of a new asset for the option period, rather than a reassessment and extension of the original asset as it would be fully amortized before this re-evaluation was performed.

TF Rep. #6: *FASAB should stick to one definition of "probable." The existing definition is fine, while creating a different definition of probable would create havoc. Because of the low threshold for "probable", the document should acknowledge that circumstances may change for future events, and clearly state that changes as to whether a lease will be extended or terminated are changes in estimate to be handled prospectively. The may help alleviate cost concerns.*

TF Rep. #7: *We believe FASAB's definition of "probable" is more subjective and susceptible to greater speculation than GASB's use of "reasonably certain". Thus, using FASAB's definition of "probable" will require increased professional judgement and in-depth knowledge of the lease contracts, making it possibly more difficult to assess the probability of the options as well as the funding clause. In addition, the word "probable" does have different interpretations in practice that could cause misinterpretation of data. GASB's definition of "reasonably certain" is more definitive, concrete, and may make decisions regarding renewal and termination periods easier to*

determine and less questionable. Providing a more concrete definition eliminates “guess work” and allows for more valid reporting.

It appears that in addition to GASB using “reasonably certain” in their exposure draft, that International Financial Reporting Standards (IFRS) 16, Leases, is also using “reasonably certain.” For standardization and uniformity, it would be beneficial if all standards used the same terminology for similar lease clauses/situations.

TF Rep. #8: *The FASAB’s definition of probable will make it harder for federal entities to assess the probability of the options as well as the funding clause. The likelihood of “more likely than not” (>50%) is too close to equal likelihood (50/50) causing confusions as the determination is more susceptible to guessing. The GASB definition (>75%) is clearer and less confusion.*

However, FASAB has consistently used the “more likely than not” definition in the FASAB standards except for legal contingencies, for which the definition of “probable” is more aligned with the GASB definition. If the Board decides to follow the GASB definition of “probable” in the lease standard, the Board should explicitly point that out in the lease standard. Either way requires a lot of work in making assumptions as to whether renewals are more likely than not or reasonably certain to occur. While the “probability” consideration is only one factor, other variables are considered such as location, safety, access to metro, price per square footage, and amenities for the disabled weigh in. The assumptions used would end up being arbitrary.

TF Rep. #9: *It is our agency’s opinion that the FASAB definition is more easily implementable for the simple reason that it is already quantified (>50%). The GASB “Likely to Occur” standard sounds like it would be the same (>50% would be considered “likely”) but the context of the question implies that a higher likelihood than the FASAB definition is intended. As such, implementing the GASB standard would run the risk of disparate application across agencies, as each agency would have to quantify its own ‘likelihood threshold’, with no consistency or uniformity. Alternatively, if FASAB were to quantify a different ‘likelihood threshold’ as part of the standard, but that causes problems when applying the current definition in existing FASAB standards.*

TF Rep. #10: *Making determinations of the likelihood of an occurrence under the definition of probable at >50% does prove more difficult to execute than the GASB threshold. Similar to assessing likelihood for contingent legal liabilities, having the higher “likely” standard has been found to provide more examples of indicators that can be used to support management’s conclusions. When applying the >50% threshold, reaching conclusions regarding whether an outcome is probable or not, is generally harder to support, more prone to inconsistencies in reaching determinations, and more subject to change in re-assessments (of whether an outcome is probable or not) for relatively minor changes in conditions. Applying the >50% “more likely than not” terminology also deviates with the terminology many staff are more familiar with, related to contingent liability recognition, which could lead to greater confusion in making assessments. Accordingly, we would find it preferable in the FASAB leasing standard*

that language be used more similar to the definitions FASAB has provided for contingent legal liabilities, or GASB language, rather than the “more likely than not” approach. In general, we also consider it preferable that liability and cost recognition be based on more conclusive indicators that the “likely” terminology provides.

In association with this discussion, it would be most useful for FASAB implementation guidance to discuss conditions, determining factors, etc., that would be used in reaching probably determinations. As an example, in OMB Circular A-11 for budgetary lease scoring, options are excluded from calculations when exercising an option requires a special act of Congress (other than normal appropriation acts). We would expect implementation guidance to include discussion of such legal barriers related to probability determinations, as they are so unique to the Federal environment.

TF Rep. #11: *FASAB's definition of probable will not have a significant impact on a federal entity's ability to assess the probability of either the options clause or funding clause.*

Depending on the type of lease involved federal agencies have the ability to predict with reasonable certainty whether a lease option will be exercised or receive appropriated funding. After all, the requirements for scoring leases under Office of Management and Budget (OMB) Circular A-11, are not changing. An option for any mission critical leases or leases that imminently impacts an agency's operations will "more likely than not" be exercised or received. The Department would rather wait to see a definition prior to providing a definitive answer to the question.

➤ **Probability Threshold (2)**

One Board member stated that GASB's use of a higher threshold would shrink the pool of leases available for consideration and therefore affect the liability and asset recognition. It also may decrease the level of effort on the part of preparers because the threshold is so high.

TF Question 2: Do you agree or disagree with this Board member's thoughts? Please explain your reasoning.

TF Responses:

TF Rep. #1: *I agree that a higher threshold would shrink the pool of leases that are reflected as assets and liabilities on the financial statements. I also agree there is additional effort to assess and record the initial asset and liability entries; however, the subsequent activity should not take more effort.*

TF Rep. #2: *The use of a higher threshold could impact the pool of leases to be considered and result in a smaller number of leases included for consideration. Reasonable assurance may require more near term certainty for a “likely” assessment to be made. In the response to TF question 1, the probability of exercising an option*

year was used as an example. Although an entity's past performance in respect to the exercising option years may increase the probability that an entity will exercise future option years on lease, it may not be enough for an entity to determine that the exercising of the future option years are "reasonably assured". Additionally, if an entity is trying to determine if early termination is reasonably assured, the certainty of the decision to terminate is usually made more near term to actual termination and may not be certain enough at inception to be "reasonably assured" therefore the entity would include the period in their costs; overstating leasing costs. If the entity were able to apply the definition of more likely than not, and there was a >50% chance (but not reasonably assured) that the lease may be terminated early, then the entity would have the flexibility to exclude the period in question. Of course, in all instances, documentation will be key and entity guidance will help an entity support the determination made by the entity.

TF Rep. #3: Our agency agrees that the use of GASB's use of a higher threshold would shrink the pool of leases available for consideration **if the actual threshold of "likely" is well-defined and is above 50 percent**. As noted in our response to TF Question 1, something can be 10 percent likely to occur so what is the actual threshold for "likely to occur" – 25, 75, 90, 99 percent? Without being well-defined, the use of the definition of probable as "likely to occur" is so much more subjective than "more likely than not - >50%" that it obscures the actual probability.

TF Rep. #4: Agree. A higher threshold will likely shrink the pool of leases available and decrease level of effort on the part of preparers.

TF Rep. #5: As I stated above, this may result in smaller asset / liability balances being recognized, with the caveat that new assets will be recognized if options are picked up later, but less lump sum writeoffs when options are declined that had previously been included in the lease term calculation. I think that the level of effort will probably be lower with the higher probability as processing and explaining the lump sum writeoffs will be more work on the audit side, then recognizing a new asset for the option period.

TF Rep. #6: FASAB should stick to one definition of "probable." The existing definition is fine, while creating a different definition of probable would create havoc. Because of the low threshold for "probable", the document should acknowledge that circumstances may change for future events, and clearly state that changes as to whether a lease will be extended or terminated are changes in estimate to be handled prospectively. The may help alleviate cost concerns.

TF Rep. #7: The change of recording most non-intragovernmental operating leases to capital leases may increase the reporting of capital leases and the financial statements will show the effect of increases in leased assets and financial liabilities. However, we agree that the use of a more defined threshold may limit or shrink the non-intragovernmental leases applicable to reporting. The use of "probable" defined as "greater than 50% probability" includes a much broader base and increases the pool of non-intragovernmental leases that could be considered for reporting and probably

includes many leases, because of such a broad definition, that may not require reporting. “Reasonably certain,” which is a higher threshold could decrease the pool considered for non-intragovernmental lease reporting. However, our goal should be to capture the non-intragovernmental leases that meet specific criteria that we believe are important to report. We should not be concerned with the volume of leases reported.

We believe that a greater level of effort is given in considering the “greater than 50%” threshold as a lot of professional judgement is required and the end result, due to conservatism, may include greater lease contracts included for reporting than needed or required. As “reasonably certain” is more specific, a decreased level of effort may result as preparers of financial information have a more definitive idea of what to report.

TF Rep. #8: *Agree. The higher threshold related to the lease options will not affect the number of leases reported but will reduce the asset and liability recognized as less option periods are included in the calculation; the higher threshold related to the funding clause would reduce the lease pool for consideration thus reducing the asset and liability recognition.*

TF Rep. #9: *Our agency partially agrees with the board member’s thoughts. While we agree that the pool of leases could be smaller under a higher threshold, the reduction in level of effort to identify leases under the new definition could be offset by the higher level of rigor that would need to be applied to each lease to determine lease term and support the higher threshold through the gathering of statistical evidence.*

TF Rep. #10: *In application with our agency’s real property leases, it is not likely that the alternative GASB definition would substantially change the pool of leases that would require liability and asset recognition, but rather, the alternative definitions could significantly impact the calculation of amounts to be recognized. Our agency’s lease are predominantly of a longer term period, that the base term of the leases will qualify them for asset/liability recognition, rather than operating lease treatment. Lease options then add to the term and values to be included in the present value calculations used for total recognition. Accordingly, the GASB-based definition would likely reduce somewhat the values recognized, as options are less likely to meet the “likely to occur” vs the “more likely than not” definition. Applying the recognition requirement based on the higher level of likelihood would therefore reduce workload associated with calculating or recalculating (due to changes in assessments), as well as workload involved with maintaining the complete and accurate detailed records of all options (as there would be a lesser volume of options used for valuation purposes).*

TF Rep. #11: *The Department agrees that the current threshold of probable (more likely than not - >50%) is reasonable. Shrinkage in the pool of leases available for consideration could be possible with smaller agencies, especially ones without a lot of mission critical leases. For smaller agencies or agencies with limited resources, a higher threshold removes the administrative burdens for recording leases.*

➤ **Probability Threshold (3)**

Another Board member would like to be able to assess the cost-benefit factors of a higher-probability threshold versus a lower-probability threshold.

TF Question 3: What are your thoughts on the cost-benefit factors associated with a higher-probability threshold versus a lower-probability threshold?

TF Responses:

TF Rep. #1: *I believe that the benefits of a lower probability is that there will be more consistency in financial reporting as more leases will be reported at the full lease term versus part of the lease term. I believe that such benefits outweigh the costs, although if I had more information on costs, my conclusion may change.*

TF Rep. #2: *As stated in previously, one of the greatest benefits associated with a lower probability threshold is flexibility to the entities. The cost of that flexibility would be an increased pool of leases to which the consideration must be applied. An increase in the pool of leases considered could mitigate the risk understatement/overstatement in the financial statements. If the purpose of including costs of leasing on the face of the balance sheet is to provide additional understanding of government expenses to financial statement users, then the impact of the threshold to the pool of leases to be considered should be considered. If a higher threshold will diminish the pool of leases considered, it may also diminish the overall impact of the benefit expected to be derived from including the cost of leasing to government financial statement users.*

That being said, the benefit associated with a higher threshold may ease the determination. Due the higher threshold, it may be easier for entities to determine if an extension or termination would be “likely”. For example, in the example of the option years for temporary space, an entity may determine that is unlikely that the additional option years would be used and exclude all option periods from cost determination. With the lower threshold, there is a chance that one or more of the available option years would actually be included when determining cost. A very subjective decision and more complex than when using the higher threshold. Additionally, the use of a higher probability threshold may be the decrease in the pool of leases to be considered and possibly decreasing the intended benefit to financial statement users.

TF Rep. #3: *Regardless of which threshold is selected by the board, federal agencies must still track the total amount of all contracts, including option years, to be able to determine whether future funding requirements under all of the agency’s combined contracts can be met through anticipated funding. There should not be an increased cost for tracking lease costs and option years if a lower-probability threshold is chosen.*

TF Rep. #4: *A higher threshold may achieve the benefits desired at a reasonable cost.*

TF Rep. #5: *I think the higher probability threshold has a better cost-benefit factor for the accounting staff, and audit staff. Large write-offs are usually more of a burden for the audit than new assets.*

TF Rep. #6: *FASAB should stick to one definition of “probable.” The existing definition is fine, while creating a different definition of probable would create havoc. Because of the low threshold for “probable”, the document should acknowledge that circumstances may change for future events, and clearly state that changes as to whether a lease will be extended or terminated are changes in estimate to be handled prospectively. The may help alleviate cost concerns.*

TF Rep. #7: *We do not think an assessment of the cost-benefit factors of a higher-probability threshold versus a lower-probability threshold is required. We need to determine what we want reported and ensure our criteria captures that data for proper reporting of non-intragovernmental leases in accordance with guidance.*

TF Rep. #8: *In order to assess the cost-benefits of a higher probability threshold versus a lower probability threshold, agencies will need to complete an analysis using both lower and higher thresholds. This would cause more work for the agencies. Suggest using a higher threshold to reduce efforts. In general there is substantial concern about abandoning the capital lease concept and including a much larger pool of leases for reporting consideration regardless of how the probability threshold is defined. Options to reduce reporting costs are encouraged.*

TF Rep. #9: *There would be a higher level of effort for the higher probability threshold than the lower probability threshold. The GASB definition, and FASAB’s questions imply that the GASB standard is something greater than the FASAB standard of >50% but does not quantify the difference. As such, if the GASB definition were adopted, each agency would have to establish its own “likely to occur” threshold, document the methodology and requirements to achieve the new threshold, and then apply that methodology to its lease population to ascertain the actual reportable lease value. It is not clear what the benefit of this additional effort would be; as stated above, the likelihood that this approach would result in a smaller balance being reported on the balance sheet does not relieve the agency from applying this rigor to its entire population of leases, which it must to in order to support the completeness assertion for financial statement audit purposes.*

TF Rep. #10: *While there would certainly be an impact on cost, depending on which threshold is selected (as discussed in question 2), the significance of the impact is not known, and would require piloting or similar modeling of processes required to implement the standard for any conclusions to be reached. The FASAB’s final direction/guidance related to indicators of probability could make a significant difference in determining workload and effort that would be required.*

TF Rep. #11: *If FASAB has already agreed on not changing the definition of "probable" to a higher threshold, conducting a cost benefit assessment of the higher and lower thresholds for accounting for leases is not necessary. However, if the FASAB is willing to consider moving towards the GASB definition of probable, then a cost benefit analysis of the changes in funds saved and spent due to the use of higher or lower lease accounting thresholds would be beneficial.*

➤ **Lease Asset Classification**

Excerpts from Draft FASAB Lease Standard:

RECOGNITION and MEASUREMENT for LESSEES

At the beginning of the lease term, a lessee should recognize a lease liability and a right-to-use lease asset (hereinafter referred to as the lease asset), except as provided in paragraph 17 and paragraphs 59-61 (short-term leases).

FASAB Staff Discussion:

GASB specifically identifies the right-to-use lease asset as an intangible asset. In its basis for conclusions, GASB noted the following.

GASB Leases Exposure Draft – par. B17. –The Board considered whether amortization should be guided by a government’s depreciation policy for owned assets. That alternative was ultimately rejected, however, because the lease asset is an intangible asset that is distinct from the underlying asset being leased, and that lease asset may have a shorter useful life (lease term) than the useful life of the underlying asset.

SFFAS 6: Accounting for Property, Plant, and Equipment currently classifies capital leases as a PP&E asset. Although the GASB ED proposes that the underlying asset be recognized as an intangible asset, FASAB standards do not specifically require assets to be classified as tangible or intangible and there are currently no FASAB standards on intangibles.

Since the proposal includes both PP&E assets and intangible asset as lease assets, FASAB staff proposes that the lease asset not be classified as either an intangible or a PP&E asset but as a “leased asset” on the balance sheet if considered material.

TF Question 4: Do you agree with FASAB staff’s proposal to not classify the lease asset as an intangible or a PP&E asset, but as a “leased asset” on the balance sheet? Please explain your reasoning.

TF Responses:

TF Rep. #1: I believe it would be better to present the PP&E leased assets with PP&E and the intangible assets with the intangible categories that they would normally be reported under on the balance sheet because this is more consistent and the term “lease asset” is not sufficiently meaningful because it does not provide information on what type of assets are leased.

TF Rep. #2: While it is agreed that lease costs will include both tangible and intangible assets, I would recommend classifying leased assets as PP&E and the costs associated with leased assets as a separate major category of PP&E. Considering

substance over form concept, although the costs are related to a legal agreement, the costs are associated with the use of an underlying asset. Treating leased assets as a separate major category of PP&E would be consistent with how software, often thought of as an intangible assets, is currently treated. If the purpose is “clarity”, a separate line on the balance sheet is not required, simply identifying leased assets in the financial statement notes as a separate major category would provide clarity for all general PP&E listed on the balance sheet line.

SFFAS 6 specifically defines PP&E as tangible assets. Recommend adding language for the inclusion of certain assets such as leased assets and software.

TF Rep. #3: *Our agency believes “leased asset” is a more appropriate term than “intangible asset” or “PP&E asset” as “leased asset” is more descriptive of the actual nature of the asset.*

TF Rep. #4: *Yes. These assets have different characteristics than PP&E assets and should be reported separately.*

TF Rep. #5: *I agree with the creation of a leased asset category. If the asset is a PP&E asset, the note disclosure would be included with the other PP&E note disclosures, and could create a complicated PP&E note. A separate category would create a separate note in the financial statements for the required financial statement lease disclosures.*

TF Rep. #6: *Recommend that FASAB remain silent. The document should state that the asset should be capitalized. Agencies should be allowed to figure out how to disclose it. We don’t think there is value added in raising the tangible / intangible discussion.*

TF Rep. #7: *We believe leased assets, in theory, should be classified as intangibles since the leased asset may have a shorter useful life (lease term) than the useful life of the underlying asset. However, since FASAB does not have an “intangible” standard, the next most similar type of classification, we believe, is utilizing Property, Plant, and Equipment (PP&E) because it is grouping like transactions together, i.e. capitalized or fixed assets. By definition, a lease is a contract or agreement that conveys the right to use a nonfinancial asset for a period of time in an exchange transaction. Since the lease is for a long-term capital or fixed asset, we believe we should group leased assets with other PP&E assets.*

Classification of leased assets as PP&E is supported by SFAS 6, which in paragraph 18 states, “Property, Plant, and Equipment also includes, assets acquired through capital leases, including leasehold improvements.” Furthermore, IFRS 16, Leases, supports this position by requiring the lessee to report capitalized leases on the balance sheet with PP&E or as their own line item(s), if that is relevant to understanding the lessee’s financial position.

Since, the Federal Government already groups leases and leasehold improvements as PP&E, we don't believe there is a need for creating a new line of reporting, as this new line item would not add relevance to understanding the lessee's financial position.

TF Rep. #8: *Agree with FASAB staff's proposal to classify the lease asset as a "leased asset" on the balance sheet and not classify the lease asset as an intangible or a PP&E asset.*

The right-to-use is an intangible asset and amortization is over the lease term and not the useful life of the underlying asset. Therefore, leased assets should not be treated as PP&E. But since FASAB does not have any standards on intangible assets, it's best to treat the assets as "leased assets" on the balance sheet.

TF Rep. #9: *Our agency DOES NOT concur with the FASAB Staff Proposal. An intangible asset is defined as a "non-physical asset having a useful life greater than one year. These assets are generally recognized as part of an acquisition, where the acquirer is allowed to assign some portion of the purchase price to acquired intangible assets." It is our agency's position that a lease agreement that provides a 'right to use' an asset, and that 'right to use' meets the definition of an intangible asset with its own useful life separate from the useful life of the leased asset itself, in accordance with the GASB definition. Additionally, it is our agency's opinion that the current lack of FASAB standards on intangibles is a policy gap that needs to be addressed more generally, and as such should not serve as the basis for the creation of a new term and definition to cover the gap only in this specific area.*

TF Rep. #10: *The FASAB staff proposal does not appear to sufficiently address the underlying issues. While an entity such as our agency expects to have material balances for the new reporting requirements (with associated presentation on the face of the balance sheet), the proposal doesn't help entities where the balances are not material but are significant enough for asset recognition. For amounts that do not meet the threshold of being material, such assets would then need to be presented within an existing Balance Sheet line, which FASAB should define to either be PP&E or another categorization (such as Other Assets on a Balance Sheet).*

Also, determining these assets as being intangible or PP&E could impact presentation, disclosures, etc., of PP&E recorded for related leasehold improvements (LI) or capitalized tenant-funded improvements (TI). When there are such related assets, we would consider it preferable that all costs associated with the lease be captured in the same Balance Sheet category (suggests PP&E, though segregation within PP&E is still needed for material component amounts). Accordingly, especially in consideration of real property leases which often have significant PP&E from LI and TI, classifying the right-to-use assets as PP&E would create greater consistency in presentation of interrelated costs.

TF Rep. #11: *Our agency agrees with FASAB staffs proposal to not classify the leased asset as an intangible or PP & E asset on the balance sheet because it avoids disparity with the definition of tangible versus intangible assets between federal agencies.*

➤ **Lease Asset Meets the Definition of an Investment**

Excerpts from Draft FASAB Lease Standard:

LEASES OF ASSETS THAT ARE INVESTMENTS

If the underlying asset in a lease meets the definition of an investment, the lessor should account for that asset as an investment and should not apply the recognition and measurement provisions of this Statement.

FASAB Staff Discussion:

The Board instructed FASAB staff to include a definition of “investment” in the proposed Lease standard if the above section [*Leases of Assets that are Investments*] is to be included in the proposal.

TF Question 5: Before developing a specific definition for “investments” in the Lease proposal, we want to query the task force about the prevalence of non-intragovernmental federal lessors involved in leases of assets that are investments. If your federal entity is a federal lessor of leased assets that are considered investment assets please provide us a description of the asset and the nature of the non-intragovernmental lease.

TF Responses:

TF Rep. #1: *I am not aware of federal entities having investment leases.*

TF Rep. #2: *N/A*

TF Rep. #3: *N/A - Our agency is not a federal lessor of leased assets.*

TF Rep. #4: *Not applicable.*

TF Rep. #5: *Does not apply to our agency*

TF Rep. #6: *No comment.*

TF Rep. #7: *We do not have any leased assets that are investments; hence, we defer this question to those agencies that have such arrangements and can provide an informative response.*

TF Rep. #8: *Our agency is not a federal lessor of leased assets that are considered investments.*

TF Rep. #9: *Our agency does not have any known leases that are investments.*

TF Rep. #10: *It would be very rare for our agency to obtain or retain assets for purposes of investment/leasing to non-Federal entities. While conditions may exist in the short term where an asset is leased to a non-federal entity, it is not the mission of our agency to hold assets for such investment purposes. Accordingly no significant examples were identified for this response.*

TF Rep. #11: *The Department is not aware of any Departmental leased assets that are considered investment assets.*

➤ **Rent Holidays**

Excerpts from Draft FASAB Lease Standard:

LESSEE TREATMENT OF SHORT-TERM LEASES

A lessee should recognize short-term lease payments as expense based on the payment provisions of the contract/agreement. The lessee should not apply the recognition and measurement requirements of paragraphs 16–31 but should recognize an asset if payments are made in advance of the period to which they relate, or a liability for rent due if payments are made subsequent to that period. The lessee should recognize any rent holiday period (for example, one or more months free) as reductions of lease rental expense on a straight-line basis over the lease term.

LESSOR TREATMENT OF SHORT-TERM LEASES

A lessor should recognize short-term lease payments as revenue based on the payment provisions of the contract/agreement. The lessor should not apply the recognition and measurement requirements of paragraphs 33–47 but should recognize a liability if payments are received in advance of the period to which they relate, or an asset for rent due if payments are received subsequent to that period. The lessor should recognize any rent holiday period (for example, one or more months free) as reductions of lease rental income on a straight-line basis over the lease term

FASAB Staff Discussion:

The GASB Lease exposure draft proposes not to straight-line rent holidays. However, the FASAB has tentatively agreed to recognize rent holidays on a straight-line basis over the lease term. The Board would like to be able to assess the cost-benefit factors associated with the straight-line recognition of rent holidays versus as rent holiday payments are made/received.

TF Question 6: What are your thoughts on the cost-benefit factors associated with the straight-line recognition of rent holidays versus recognition of rent holiday payments as they are made/received? Please explain your reasoning.

TF Responses:

TF Rep. #1: *I agree with the straight-line recognition of rent holidays as the alternative is more costly to assess and track.*

TF Rep. #2: *There is benefit to straight-lining the rent holidays. Straight-lining a rent holiday can provide users of the financial statements the true cost of leasing arrangements overall and not just in the current fiscal year. How has the rent holiday*

benefitted the government today and in out years. In beginning years the rental expense would exceed actual outlays and in the out years, the outlays would exceed rental expense, but the net position of the government would not be impacted by these fluctuations because rent expense would be straight-lined. This may improve the understandability of the financial statements. That is a benefit that should be taken into consideration. Would the cost of completing straight-lining outweigh the benefit to users of financial statements? Some financial systems are able to produce a straight-line schedules, reducing the costs, while other entities will rely on more manual methods (e.g., excel and access) to complete requirement. Overall government wide, the costs associated with the pool of leases that would require straight-lining for rent holidays may not exceed the benefit of understandability to the financial statement user.

TF Rep. #3: *Our agency currently straight-lines rent holidays in order to recognize expense in line with the utility of its office space. Our agency began following this practice in FY 2006 upon the recommendation of its financial statement auditor. Prior to FY 2006, Our agency recorded its lease expense in the period in which the actual payments were made, rather than on a straight-line basis, as required by the Financial Accounting Standards Board's (FASB) Statement of Financial Accounting Standards No. 13, Accounting for Leases, paragraph 15 (now codified in FASB Accounting Standards Codification® (ASC) 840-20-25) which states, "if rental payments are not made on a straight-line basis, rental expense nevertheless shall be recognized on a straight-line basis unless another systematic and rational basis is more representative of the time pattern in which use benefit is derived from the leased property, in which case that basis shall be used."*

There is little cost incurred to straight-line expenses because the total annual rent payments are added to an Excel spreadsheet as each lease is signed or amended and then rolled forward and updated, as needed, in each subsequent reporting period.

TF Rep. #4: *Recognition of rent holiday payments as they are made/received would cost less than straight-line recognition. Rent holidays may not be material.*

TF Rep. #5: *Straight-lining the rent holiday will create a burden on the accounting staff. Since the rent holiday typically applies to the beginning of the term, this affects which fiscal year's appropriation is being hit for the rent payments. A straight-line calculation for the financial statements will not affect the availability of resources for the appropriation, or change which appropriation is used to pay the rent that is actually due. Its strictly a financial statement impact, that matters more if you are attempting to show a profit/loss, but when you are a government entity, this has no value as we are not trying to prove a profit / loss exists.*

TF Rep. #6: *We concur with FASAB's draft language on rent holidays. We believe that the minimal cost of calculating and recognizing rent holidays over the term of the lease on a straight-line basis is more than offset by the benefit of accurate financial reporting. (We assume that the GASB proposal would be to skew the recognition of rent expense*

to follow cash payment, and we disagree with that proposal.) We believe that the proposed requirement to recognize rent holidays over the term of the lease on a straight-line basis should apply to both long-term and short-term leases.

TF Rep. #7: *We believe any rental holiday, applicable for short-term leases, should be amortized over the length of the lease contract, as it would smooth out any fluctuations on a month-to-month basis, which is the basis of accrual accounting.*

TF Rep. #8: *Since under the FASAB lease standard the leases will be treated as assets and liabilities, rent holidays should be recognized as they are made/received as the payment/receipt reduces future liabilities.*

On the revenue/expense perspective, currently GASB requires the recognition on a straight-line basis (matching principle for revenue/expenses or for tax purpose). However, the federal government's mission is not to generate revenue. The straight-line approach has caused extra work as payments based on invoices are different from the expenses. We strongly suggest that FASAB does not require straight-lining the expense for leases in the standard.

TF Rep. #9: *Our agency does not generally benefit from rent holidays. However, it is our opinion that since rent holidays are not guaranteed and can not necessarily be planned for, it makes sense to recognize and record them as what they are: single events with benefit limited to one accounting period. Furthermore, from a practical perspective, it is much easier to record any rent holiday-related transactions as incurred rather than amortizing them over the remainder of the lease, and it is more likely that existing accounting systems could support such a transaction without requiring additional costly system changes.*

TF Rep. #10: *While the tracking and straight-line recording of rent holidays does place addition cost and resource burden, the primary time and effort goes into establishing the original schedules required, while automation techniques have been found to help reduce monthly transaction recording. Accordingly, while our agency has a significant number of leases with free rent periods, the cost associated with the accounting is not exorbitant. The benefit achieved provides for timely recognition of hundreds of millions of dollars of value being assigned to the periods cost was applicable to rather than an absence of cost (if cash-basis were used) for extended periods of time, in some instances up to a year or more. Conceptually, matching cost to the periods services are received is always preferable to cash basis accounting.*

However, there are additional factors for considerations and impacts when an entity has a significant volume of leases as a lessee that are then sublet to clients, as is the case for our agency. Current straight-lining rules require the allocation to occur over the fixed term of a lease. Our agency has repeatedly had instances where the terms of a straight-lined lease are not matched in the sub-lease agreements. This results in mismatching of revenues vs expenses, generally producing losses on our Statement of

Net Cost and confusion that leads to internal management presentation of financial information where such adjustments are excluded. We would request consideration of an agency's contracts as a lessee, where the leased asset is intended to be substantially sublet in reaching conclusions related to both cost and revenue recognition for periods of free rent/rent holidays. This subleasing consideration is particularly important given the very different accounting treatment proposed for accounting for leases with non-Federal entities vs intra-governmental leases.

TF Rep. #11: *The cost benefit of applying rental holidays on a straight line basis versus recognizing the rental holidays payments as they are made or received is negligible. The matching principle is consistently applied when the "rental holidays" are allocated over the remaining term of the lease. Nonetheless, the amount of paid by the lessee and received by the lessor remains the same regardless of recognition methodology used.*

➤ **Certain Regulated Leases**

Excerpts from Draft FASAB Lease Standard:

(Par. 39) For leases for which external laws, regulations, or legal rulings (a) establish the cost that may be recovered through lease payments and (b) significantly limit the ability of the lessor to set rates in excess of those costs, the lessor should not apply the general recognition and measurement provisions of this Statement. For example, U.S. Department of Transportation regulates aviation leases between airports and airlines. For such leases, the lessor should recognize revenue based on the payment provisions of the contract/agreement and provide the disclosures in paragraph 53.

(Par. 53) A lessor with one or more regulated leases as described in paragraph 39 should disclose the following about those lease activities (which may be grouped for purposes of disclosure), other than short-term leases:

- a. A general description of its agreements
- b. The carrying amount of assets subject to exclusive use by one counterparty under agreements, by major class of assets, and the amount of accumulated depreciation
- c. The total amount of revenue (for example, lease revenue, interest revenue, and any other lease-related revenue) recognized in the reporting period from agreements, if the total is not displayed on the face of the financial statements
- d. A schedule of future minimum payments under the agreement for each of the subsequent five years and in five-year increments thereafter
- e. The amount of lease revenue recognized in the reporting period for variable payments not included in the future minimum payments
- f. The existence, terms, and conditions of options by the lessee to terminate the lease, if the lessor federal entity has issued debt for which the principal and interest payments are secured by the lease payments.

FASAB Staff Discussion:

According to GASB this provision arises because there are higher jurisdictions (state for local and federal for state) which can impose laws, regulations, and legal rulings. However, for the federal government, there may be no external laws, regulations or legal rulings imposed. FASAB staff believes this provision may be confusing to federal entities because they may think any laws are external. Therefore FASAB staff questions the need for this provision and would like to seek input from the task force as to the need for this provision in the proposed lease accounting standards.

TF Question 7: Based on your entity’s leasing activities, would there be a need for any “Certain Regulated Leases” provisions in the proposed federal lease accounting standards? If so, please provide us a description of your entity’s “regulated” leasing activities.

TF Responses:

TF Rep. #1: *I am not aware of federal entities with regulated leases.*

TF Rep. #2: *N/A*

TF Rep. #3: *No, Our agency does not engage in “regulated leasing activities.”*

TF Rep. #4: *Not applicable.*

TF Rep. #5: *No comment from the our agency.*

TF Rep. #6: *No comment.*

TF Rep. #7: *No response provided.*

TF Rep. #8: *Our agency is not aware of any higher jurisdictions which can impose laws, regulations, and legal rulings outside of the our agency. We concur that this section may not be needed.*

TF Rep. #9: *Our agency does not have any known “regulated” leasing activities that would apply to this question.*

TF Rep. #10: *Yes, there is a need for clarity in this regard, as silence in the FASAB standard in this regard then leaves open for interpretation of other authoritative guidance by the audit and financial communities, and potentially result in differing interpretations and application of unintended guidance. The existing wording was unclear whether it was intended to include laws, regulations, and legal rules directly applicable to Federal activities*

As lessors, Federal entities generally have unique authorizing legislation that defines rate setting/cost recovery for the each fund/entity providing reimbursable services. An entity’s authorizing language can vary and include concepts of full cost recovery, market driven rates, pricing variations for Federal vs non-Federal customers, and specialized pricing for different conditions (such as Congressionally directed GSA rent pricing at cost for agencies funded by Trust Funds vs commercially equivalent rates for other agencies). While disclosure of significant alternative pricing mechanisms is appropriate, the standards should address FASAB’s preferred accounting treatment in such instances, especially where another authoritative standard setting body had defined unique accounting treatment of these lease conditions.

Many Federal entities also have operations in foreign countries where such external laws may impact their ability to set pricing, which the FASAB should consider in determining any unique treatment for those circumstances.

TF Rep. #11: *The Department would rather wait to see a definition prior to providing a definitive answer to the question.*

History of Board Lease Discussions

- ❖ At the April Board meeting staff members presented to the Board one issue related to developing the exposure draft (ED) of the proposed standards on non-intragovernmental lease accounting. The Board previously directed staff to use the Governmental Accounting Standards Board's (GASB) proposal on Leases as a platform for developing the federal standards on non-intragovernmental lease – the GASB ED was released for comment in January 2016.

The objective of the session was to address the issue of service concession arrangements (SCAs) in the proposed lease standards. Staff noted GASB's Leases ED specifically excludes, "Contracts that meet the definition of a service concession arrangement in paragraph 4 of Statement No. 60, Accounting and Financial Reporting for Service Concession Arrangements." Currently FASAB standards are silent on SCAs.

The Board agreed that because SCAs is a topic not previously addressed in federal accounting standards, specifically excluding SCAs from the lease standard would raise more questions about SCAs. Therefore, members concluded that SCAs should not be addressed in the lease standard. Although SCAs are expected to be addressed in the P3 recognition and measurement project, the Board agreed to remain silent about SCAs in the lease proposal but to include the Board's rationale in its BFC. The Board may also consider asking a question about SCAs of the respondents to the ED.

- ❖ At the February 2016 meeting staff updated the Board on the lease project, including the status of the GASB lease project. The Board had previously directed staff to use the GASB lease proposal as a platform for developing the FASAB standards on non-intragovernmental leases.

Staff made several revisions to the language contained in the GASB proposal to reflect differences at the federal level, any conflicts with existing FASAB standards, and any changes to which the Board had previously agreed. In addition, staff also posed 23 questions to the Board related to the draft. The questions highlight areas where the FASAB proposal deviates from the GASB proposal, areas where the task force has raised questions, and areas where overall general questions on the proposal were appropriate.

Mr. Showalter asked staff to highlight only the areas in which Board members had additional questions, as well as the areas in which staff would like further direction from the Board, due to the number of questions put forth by the staff.

Capitalization Thresholds: Staff stated that because SFFAS 6, Accounting for Property, Plant, and Equipment (PP&E) specifically addresses capitalization

thresholds, a task force member questioned whether the lease standards would allow federal entities to establish capitalization thresholds for lease assets. Staff also noted that GASB does not address the issue of capitalization thresholds in the standards sections of the lease ED, but in the basis for conclusions.

The Board agreed to not specifically address capitalization thresholds in the lease proposal but to discuss overall materiality in the application of the standard, which would then apply to the materiality of the related lease liability and lease asset.

Lessee Incremental Borrowing Rate: Staff noted that GASB proposes use of the incremental borrowing rate if the actual or implicit rate charged by the lessor cannot be readily determined. This is consistent with current FASAB standards. However, the incremental rate for federal borrowers is the Treasury rate—a risk-free rate.

Staff noted that the risk-free rate is not reflective of the lessor’s implicit rate, and the risk-free rate would understate the interest expense. Staff also suggested that the language in paragraph 20 be modified from “If the rate cannot be readily determined...” to “If the rate cannot be reasonably estimated by the lessee, the lessee’s incremental borrowing rate (the estimated rate that would be charged for borrowing the lease payment amounts for the lease term) should be used.”

The Board agreed with the revised language.

Lease Liability Remeasurement—Due to a Change in an Index or Rate: Staff noted that GASB proposes that the lease asset be adjusted when the corresponding lease liability is remeasured. GASB also proposes that the effects of a lease liability remeasurement, due to a change in an index or rate used to determine variable payments, be recognized the same way as the effects of remeasurement for other reasons. This would be an adjustment to the lease asset, rather than recognition in the flows statement (as proposed in the Preliminary Views). GASB proposed the change primarily due to cost-benefit concerns.

The Board agreed to remain consistent with GASB’s approach that the lease asset be adjusted when the corresponding lease liability is remeasured in all instances.

Insignificant Lease Components: Staff noted that the Board had previously agreed that the guidance should exempt leases with multiple insignificant and unpriced components from applying methods to disaggregate the components.

The draft language would read, “If a contract/agreement does not include prices for individual components, or if those prices are not reasonable based on other observable stand-alone prices, lessors and lessees should do the following, unless the components as a whole are not considered significant.”

The Board had no objections to the edit.

- ❖ At the December 2015 meeting staff updated the Board on the lease project, including the status of the GASB lease project. The Board had previously directed staff to use the GASB lease proposal as a platform for developing the FASAB standards on non-intragovernmental leases.

Staff noted that the GASB is in the final stages of finalizing their exposure draft (ED) and expects to release the ED for comment in early February 2016. FASB plans to release their final lease standard in early 2016 with an effective date of 2019.

Staff's goal is to have the FASAB lease ED available for comment by mid-2016. Staff also held a lease task force meeting in early-February 2016.

There was also a brief discussion on the accounting for lease holdovers, in light of a recent GAO report.

Lastly, there are plans to convene another FASAB/GASB joint meeting in 2016.

Staff will continue to work with the task force to further develop the lease standards and will continue to follow the progress of the GASB lease discussions.

- ❖ At the October 2015 meeting staff updated the Board on GASB's deliberations of their lease project. The Board had previously directed staff to use the GASB Lease proposal as a platform for developing the FASAB standards on non-intragovernmental leases.

Staff provided the Board with excerpts from the tentative GASB Board meeting minutes from their September 1, 2015 lease discussion. The following GASB lease topics were presented to the Board.

- Airport Leases and Related Issues
- Lessee Disclosures
- Lessor Disclosures
- Short-Term Lease Exception
- Lease Terminations and Modifications
- Subleases and Leaseback Transactions

Staff will continue to work with the task force to further develop the lease standards and will continue to follow the progress of the GASB lease discussions.

- ❖ At the August 2015 meeting staff updated the Board on GASB's deliberations of their lease project. The Board had previously directed staff to use the GASB Lease proposal as a platform for developing the FASAB standards on non-intragovernmental leases.

Staff provided the Board with eleven discussion items that staff compiled from the last three GASB lease discussions (April, June, and July 2015). The eleven issues represented those lease topics that GASB either changed its position from the November 2014 Lease Preliminary Views document or topics that FASAB will need to further discuss as the exposure draft is developed. The following discussion items were presented to the Board.

- Defining “nonfinancial asset”
- Intangible (lease) assets
- The role of “control” in determining whether a transaction qualifies as an asset
- Service concession agreements
- Bargain purchase options
- Month-to-month holdover periods
- Probability threshold
- Lessee renewal/termination options
- Fiscal funding clauses
- Lease liability remeasurement
- Allocation of consideration to multiple components

A Board member suggested just giving examples or asset classes of nonfinancial assets, if a clearer definition cannot be developed. The Board asked staff if federal leases would go beyond the scope of capital assets (real and personal property). The Board asked staff to come back with options to defining nonfinancial assets.

Staff noted that the FASAB “probable” definition equates to “more likely than not” and “reasonably certain” has an even higher threshold than GASB’s “probable (likely to occur).” Since FASAB previously noted that it was comfortable with the differences between our “probable” and GASB’s “probable,” staff recommends not accepting GASB’s change to “reasonably certain” and staying with the FASAB “probable” definition, because there seems to be no compelling reason to introduce a new term for the sake of a higher threshold. The Board did not disagree with staff’s recommendation.

The Executive Director reminded the Board that all of the issues will be brought back to the Board for more discussion before the exposure draft is finalized.

Staff will continue to work with the task force to further develop the lease standards and will continue to follow the progress of the GASB lease discussions.

- ❖ At the April meeting staff presented to the Board an initial draft exposure draft (ED) for the intragovernmental portion of the leases standard. Staff noted that the lease standard will include guidance for all federal leases, including intragovernmental leases. The Board has tentatively agreed that intragovernmental leases should be accounted for similar to current operating leases guidance. The draft ED included definitions of relevant terms, as well as specific provisions that address the recognition and measurement of intragovernmental leases for both the lessee and the lessor. Staff asked the Board if they agreed with the proposed language. The

Board generally agreed with the staff proposal and asked staff to provide clarifying language in several sections of the proposal.

Staff also presented to the Board a summary of possible FASAB-relevant comments from the Governmental Accounting Standards Board's (GASB) Preliminary Views (PV) on Leases. The Board had previously directed staff to use the GASB Lease PV as a platform for developing the FASAB standards on non-intragovernmental leases. GASB received 37 comment letters on their lease PV and held three public hearings and expects to issue its exposure draft in February 2016 and a final standard in early 2017. Since the Board previously agreed to use the GASB lease accounting proposal as the foundation for the FASAB lease account proposal and any wording differences could denote a difference in meaning, staff recommended that the FASAB ED also be released close to that same timeframe as the GASB ED. The Board agreed to stay in sync with the GASB timeline for the release of the lease ED and final standard.

- ❖ At the February meeting staff presented to the Board a discussion paper that provided an analysis of the final six chapters of the Governmental Accounting Standards Board (GASB) Preliminary Views (PV) on Leases. The GASB PV on Leases is being used as a foundation for the development of the FASAB lease standards on non-intragovernmental lease agreements – the GASB PV was released for comment in November 2015. The topics discussed included lessee accounting, lessor accounting, short-term exception, lease terminations and modifications, subleases and leaseback transactions, and leases with related parties, and intra-entity leases.
- ❖ At the December 2014 meeting staff presented to the Board proposed guidance for intragovernmental leases. The proposed guidance included definitions of relevant terms, as well as specific provisions that address features of leases and is based on the current Financial Accounting Standards Board operating lease guidance. The Board had previously directed staff to simplify the intragovernmental lease accounting guidance. Staff presented revisions to the previously proposed recognition and disclosure lessee and lessor guidance for intragovernmental lease arrangements. The Board stressed consistency and the need for symmetry between the lessee and lessor accounting for intragovernmental leases

Staff also presented an analysis of the first three chapters of the GASB Preliminary Views (PV) on Leases so that the Board could discuss the GASB concepts as it relates to the development of federal lease standards. The GASB PV on Leases will be used as a foundation for the development of the FASAB lease standards on non-intragovernmental lease agreements– the GASB PV was released for comment in November. The topics discussed were project objective, project background, applicability, scope, and lease term.

- ❖ At the October 2014 meeting staff presented to the Board proposed draft guidance for intragovernmental leases. The proposed guidance included definitions of relevant terms, as well as specific provisions that addressed features of leases and that is based on the current FASB operating lease guidance.

Staff proposed seven lease-related definitions to the Board for discussion. The first three definitions – lease, intragovernmental and intragovernmental lease agreement – were discussed and tentatively agreed to by the Board at previous meetings. The remaining four proposed lease-related definitions – intragovernmental lease inception, intragovernmental minimum lease payments, intragovernmental noncancelable lease term, and intragovernmental sublease – were adapted from FASB’s existing operating lease guidance. The Board asked staff to simplify the proposed definitions and discuss with the task force.

Staff also presented proposed recognition and disclosure lessee guidance for intragovernmental lease arrangements. The Board agreed that the lessee general guidance would be to recognize lease payments as they are received and specific provisions would address those instances when the “due and payable” is not applicable.

The Board also agreed that certain scheduled rent increases, rent holidays, and lease incentives should be recognized on a straight-line basis – possibly using the proposed language used for the amortization of leasehold improvements.

- ❖ At the August 2014 meeting the Board discussed and agreed to a definition for the term “intragovernmental” to refer to occurring within a consolidation entity or within or between two or more consolidation entities.

The Board discussed and agreed to proposed definitions of leases and of intragovernmental lease arrangements.

The Board discussed staff’s proposal for recognizing operating leases--straight-line for lease costs and in the current period for executory costs. The Board members agreed with the straight-line concept for lease payments, but would like additional information before deciding whether executory costs should be required to be separated from the rental payment.

The next decision related to the proposed disclosure of future lease payments. Some questioned whether this disclosure was necessary for intragovernmental lease arrangements. The Board agreed to exclude the disclosure, but to ask a question in the exposure document whether the disclosure is necessary.

The Board agreed that the lessor revenue recognition would match the lessee’s expense recognition—on the straight-line basis.

The Board agreed that upfront lease costs for lessors would be expensed

Regarding potential disclosures of future lease payments of lessors, there were no objections to the proposed disclosures.

- ❖ At the June 2014 Board meeting a majority of the Board agreed with a simplified approach for recognizing amounts arising from intragovernmental lease arrangements. The Board agreed that intragovernmental lease arrangements should be accounted for differently than leases between federal entities and non-federal entities.

The Board suggested referring to the project as “leases, including similar intragovernmental lease arrangements” (similar intragovernmental lease arrangements are in substance leases) to differentiate the intragovernmental arrangements from the non-federal arrangements. This would allow the two types of transactions to be disclosed separately.

The Board also agreed not to pursue issuing a preliminary views (PV) document on leases and to tentatively plan to issue its exposure draft (ED) on leases and other similar arrangements close to when the Governmental Accounting Standards Board (GASB) will issue its ED. Because GASB plans to issue a PV prior to its ED, staff will have an opportunity to seek informally feedback from the federal community on the GASB PV.

- ❖ At the April 2014 meeting the U.S. General Services Administration (GSA) provided an educational session with the goal of the Board gaining a better understanding of several GSA lease-related topics.
- ❖ At the March 2014 the Board met jointly with the GASB to discuss similar issues related to each of their ongoing lease accounting projects. Both Boards agreed that they should begin with the goal of developing symmetry between the lessee and lessor models. The FASAB was also very focused on the intragovernmental leasing issues involving federal entities and those federal-specific lease issues.
- ❖ In January 2014 staff asked the Board to provide their input in a survey format on the tentative decisions made by the GASB on their lease project to date. Based on the results of the survey, staff identified several topics for further discussion during the joint meeting with GASB.
- ❖ At the December 2013 meeting the Board briefly discussed the GASB tentative decisions on their leases project to date with the GASB Practice Fellow leading their leases project.
 - ✓ The Board tentatively agreed that based on Statement of Federal Financial Accounting Concepts (SFFAC) 5’s definition of an asset and liability a federal entity’s **right to use** a leased asset and the **obligation to make lease payments** are assets and liabilities of the entity.
 - ✓ All of the members agreed to explore the single-model approach as opposed to the dual-model approach.

Other Lease Discussions

- ❑ FASAB staff members met with OMB staff on April 30, 2014 to discuss budget scoring for capital leases. OMB staff explained that Appendix B of OMB Circular A-11, which provides instructions on the budgetary treatment of lease-purchases and leases of capital assets, is consistent with the scorekeeping rule developed by the executive (OMB) and legislative branches (CBO) originally in connection with the Budget Enforcement Act of 1990 (BEA). Statement of Financial Accounting

Standards 13, issued by FASB, was the “support” for the scorekeeping rules developed. Because the lease budget scoring rules were developed in connection with the BEA and cannot be changed unless all of the scorekeepers (OMB, CBO, and the Budget Committees) agree, it is not likely that the rules will change based on potential changes in the financial accounting for leases. OMB staff provided other helpful insights which we will explore further later in the project.