Federal Accounting Standards Advisory Board

August 5, 2011

Memorandum

To: Members of the Board

Monica R. Valentine

From: Monica R. Valentine, Assistant Director

Wendy M. Payne

Through: Wendy M. Payne, Executive Director

Subj: Lease Accounting Project Plan – **Tab F**[1]

OBJECTIVE

The objective of this session is to **approve the attached project plan** for the project on Lease Accounting, **so that staff may take action on the next agreed-upon step**.

BRIEFING MATERIAL

The proposed Project Plan is attached to this transmittal memorandum. In addition, there is a separate Appendix containing reference material that provides additional information should you desire more details. You may electronically access all of the briefing material at http://www.fasab.gov/board-activities/meeting/briefing-materials/.

MEMBER FEEDBACK

If you require additional information or wish to suggest another alternative not considered in the staff proposal, please contact staff as soon as possible. In most cases, staff would be able to respond to your request for information and prepare to discuss your suggestions with the Board, as needed, in advance of the meeting. If you have any questions or comments prior to the meeting, please contact me by telephone at 202-512-7362 or by e-mail at valentinem@fasab.gov with a cc to paynew@fasab.gov .

Attachments:

Project Plan
Appendix

[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 the FASAB or its staff. Official positions of the FASAB are determined only after extensive due process and deliberations.

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LEASE ACCOUNTING

PROJECT PLAN

AUGUST 2011

Why

Why is a project on lease accounting needed?

- Distinctions between capital and operating leases criticized as not meaningful
- New lease accounting guidance being proposed by FASB/IASB
- Current FASAB guidance is not comprehensive enough to address all federal leasing activities

What

What questions / issues does the lease accounting project plan to address?

- How to apply new "asset" and "liability" definitions (SFFAC 5)
- Whether to consider the FASB/IASB revised leasing standards
- Effects of alignment between accounting standards and OMB Circular A-11
- Enhanced use leases
- Comprehensive lease accounting standards

TABLE OF CONTENTS

PROJECT PLAN 3
Purpose **3**
Applicability **3**
Objectives **3**
Assigned staff **3**
Other resources **3**
Timeline **4**
PROPOSED APPROACH 6
POTENTIAL PROJECT MANAGEMENT CONCERNS 9

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LEASE ACCOUNTING

PROJECT PLAN

Purpose: This project is being undertaken by Federal Accounting Standards Advisory Board (FASAB) primarily because 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 regarding the substance of lease transactions. In addition, the lease accounting standards in SFFAS 5 and 6 are based on Financial Accounting Standards Board (FASB) lease accounting standards which are currently being revised. The FASB and International Accounting Standards Board (IASB) have undertaken a joint project on lease accounting that focuses on the conveyance of rights to future economic benefits (such as the right of use). For additional information, you may read the Background section of the Appendix to Tab F.

Applicability: This project applies to all federal entities that present general purpose financial reports in conformance with SFFAS 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*.

Objectives: The primary objectives of this project are to:

a. Develop an approach to lease accounting that would ensure that all assets and liabilities [consistent with Statement of Federal Financial Accounting Concepts (SFFAC) 5 definitions] arising under lease contracts are recognized in the statement of financial position and related costs are recognized in the statement of net cost.

b. Evaluate and revise as needed the current lease-related definitions and recognition guidance in SFFAS 5 and 6, including consideration of the advantages and disadvantages of applying the FASB/IASB lease standard in the federal environment.

c. Ensure that the standards to be developed fully address the various lease transactions/activities currently being used in the federal community (e.g. enhanced use leases).

d. Consider the differences between lease accounting and the budgetary treatment of lease-purchases and leases of capital assets as outlined in Office of Management and Budget (OMB) Circular A-11.

Assigned staff: Monica R. Valentine

Other resources: Staff will consult with both FASB and GASB staff members assigned to their Board's respective lease accounting projects. Staff will also organize a task force of knowledgeable federal and non-federal participants who have relevant experience or interest in lease accounting within the federal government.

Timeline: *Note: Many of the proposed steps in this timeline are subject to the timing of the release of the FASB/IASB revised exposure draft and the final release of their standards.*

July – August 2011

- Draft a project plan for review by the Board at the August meeting
- Meet with officials at General Services Administration (GSA) to discuss their leasing programs
- Develop a questionnaire to be used to gather data from federal entities on their leasing practices.

September – December 2011

- Identify individual task force participants
- Develop a task force plan
- Send out questionnaire to agency officials
- Hold first task force meeting
- Work with task force to identify lease activities and lease accounting issues
- Begin research on identified leasing activities and issues

December 2011 Meeting

- Present preliminary data gathered from federal entities on their leasing practices.

January – April 2012

- Analyze FASB/IASB revised lease accounting proposal
- Continue research and work with task force to develop a comprehensive list of lease accounting issues

April 2012 Meeting

- Present an overview of revised FASB/IASB lease accounting proposals
- Present final data gathered from federal entities on their leasing practices.

May – June 2012

- Research and work with task force to analyze lease accounting issues, including FASB/IASB proposal

June 2012 Meeting

- Present identified lease accounting issues for Board consideration

July – August 2012

- Analyze final FASB/IASB lease accounting standard; working in conjunction with task force and FASB staff

August 2012 Meeting

- Present analysis of identified issues for Board consideration.
- Present analysis of final FASB/IASB lease accounting standards

December 2012 Meeting

- Present full analysis of issues and recommendations for Board decisions

February 2013 Meeting

- Present first draft Exposure Draft (ED) for Board review

April 2013 Meeting

- Present second ED draft for Board review

June 2013 Meeting

- Present pre-ballot draft ED for Board approval

August 2013 Meeting

- Present ballot draft ED for Board approval

December 2013 Meeting

- Present initial analysis of ED comment letters received

February 2014 Meeting

- Present full analysis of ED comment letters received along with issues identified for Board consideration
- Conduct public hearing

April 2014 Meeting

- Present first draft of final standard for Board consideration

June 2014 Meeting

- Present second draft of final standard for Board consideration

August 2014 Meeting

- Present pre-ballot draft standard for Board approval

October 2014 Meeting

- Present ballot draft standard for Board approval

February 2015

- Issue SFFAS

PROPOSED APPROACH

I. Consider Existing Concepts, Standards, Other Guidance, and Legislation:

- Federal Accounting Standards and Concepts
  - SFFAC 1, *Objectives of Federal Financial Reporting*
    - i. Operating performance objectives [pars. 122 – 133]
    - ii. Stewardship objectives [pars. 134 – 145]
  - SFFAC 5, *Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements*
    - i. Recognition criteria for assets and liabilities [pars. 5 – 9]
    - ii. Definitions of an asset and a liability [pars. 18 – 20 & 39 – 40]
  - SFFAS 5, *Accounting for Liabilities of the Federal Government*
    - i. Current federal standards on lease accounting [pars. 43 – 46]
  - SFFAS 6, *Accounting for Property, Plant, and Equipment*
    - i. Current federal standards on lease accounting [pars. 20 & 29]
- FASB/IASB's discussion papers, meeting notes, exposure drafts, comment letters, etc. on current lease accounting project.
- GASB's discussion papers, meeting notes, exposure drafts, comment letters, etc. on current lease accounting project.

II. Resources

A lease accounting task force will include individuals with relevant leasing experience or interest. Several federal entities will be asked to participate in the task force, such as OMB, Congressional Budget Office (CBO), GSA, Department of Defense (DoD), Department of Agriculture (USDA), Department of Justice, Department of the Interior, Department of Veterans Affairs (VA), Department of Justice, and Department of State. Staff will also seek to include knowledgeable non-federal professionals with federal experience, as well as other experienced federal professionals. The goal is to organize a task force of 12 – 15 participants. However, if the task force grows beyond 15 participants, staff will consider breaking the task force into subgroups. Staff will use the task force to gather data on current leasing practices throughout the federal government. The task force will also be used to evaluate the advantages and disadvantages of the FASB/IASB new lease accounting standards, as well as develop federal accounting guidance.

Staff will seek the support of a detailed federal employee with direct experience with both GSA intra-governmental (as lessor) and public (as lessee) lease agreements.

Staff will consult with both FASB/IASB and GASB staff members assigned their Board's respective lease accounting projects in order to gain an understanding of the basis for the decisions made during the development of their standards.

III. Research Steps

A. Gather data from federal entities on their leasing practices

1. Meet with officials at GSA to discuss their leasing program activities.
2. Develop a questionnaire to be used to gather data from federal entities on their leasing activities and practices.
3. Distribute questionnaire to relevant agency officials
4. Analyze the data gathered from federal entities
5. Report the results of the data gathered to Board

B. Organize a task force of both federal and non-federal participants

1. Develop a task force plan
2. Identify between 12 - 15 participants from the federal and non-federal community to serve on a FASAB task force.
3. Meet with task force to help identify federal lease activities and lease accounting issues
4. Work with task force to analyze lease accounting issues, including FASB/IASB proposal
5. Report task force results to Board

C. Evaluate the advantages and disadvantages of the FASB/IASB lease standard in the federal environment in order to make recommendations to the FASAB as to whether to:

1. Maintain the existing federal accounting standards, but provide guidance regarding pervasive issues.
2. Import the new FASB/IASB lease accounting standards largely “as is” into the federal accounting standards.
3. Use the new FASB/IASB lease accounting standards as a basis for developing new federal standards.
4. Develop new federal lease accounting standards independent of the new FASB/IASB standards.

D. Identify a comprehensive list of federal lease accounting issues

1. Issues previously identified include:
    - a How should enhanced use leases be accounted for?
    - b How should leasehold improvements be recognized (i.e., capitalize or expense)?
    - c Are occupancy agreements with GSA considered to be leases?
    - d Should the budgetary treatment of lease-purchases and leases of capital assets as outlined in OMB Circular A-11 and the accounting standards align? If not, should differences be acknowledged and explained since this is a frequently asked question?
    - e Are software licenses considered a lease?

2. Based on staff research, task force input, and analysis of FASB/IASB proposal lease accounting issues will be presented to Board for consideration

E. Analyze identified federal lease accounting issues

1. An analysis of identified issues, along with staff recommendations, will be presented to Board for review and deliberation

POTENTIAL PROJECT MANAGEMENT CONCERNS

- Leasing is a common activity across agencies and likely results in material costs, assets, and liabilities. Questions regarding topics such as leasehold improvements, cancellation clauses, and whether an agreement is in fact a lease are frequently directed to staff. This may mean that practice is inconsistent among agencies and/or that significant resources are being devoted to resolving implementation issues due to an absence of guidance. Government Accountability Office (GAO) has identified real property as a high risk area in 2011 and notes that, "agencies face long-standing problems with over reliance on leasing." GAO also found that GSA now leases more property than it owns. In addition, the 2003 research report on leases is among the top ten sites visited by users of the FASAB website (with 12,922 visits during 2010). These facts highlight the pervasiveness of lease accounting in the federal environment.
- 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 will need to be evaluated against these definitions to ensure proper measurement and recognition.
- The FASB/IASB began its joint lease accounting project in mid-2006. The Boards subsequently issued a preliminary views discussion paper in March of 2009 and later issued an exposure draft in August of 2010. The Boards also published a questionnaire in September of 2010 to survey organizations on their use of, and accounting for, leases. The Boards have held numerous public roundtable meetings and educational workshops. Based on the results of the exposure draft comment letters, roundtable meetings, and Board deliberations, the FASB/IASB has decided to re-expose the revised lease accounting proposals. The re-exposure will give the community an opportunity to comment on the revisions to the draft since the August 2010 exposure draft was released. That new exposure draft is expected to be released prior to the end of calendar year 2011. When the FASAB decided to add lease accounting to its agenda in April of this year, the FASB/IASB project was expected to be released as a final standard before the end of 2011. Given the timeline change in FASB/IASB's lease accounting project, the FASAB may want to adjust its original project timeline to coincide with the release of FASB/IASB's final standard. Alternatively, as envisioned in this timeline, the fundamental research could be conducted during the FASB/IASB exposure period.
- OMB Circular A-11, *Preparation, Submission, and Execution of the Budget*, includes in its Appendix B (*Budgetary Treatment of Lease-Purchases and Leases of Capital Assets*) instructions on the budgetary treatment of lease-purchases and leases of capital assets consistent with the scorekeeping rule. The scorekeeping rule focuses on leases and lease-purchases specifically authorized by law. However, these requirements apply to all lease-purchase arrangements and capital leases. In accordance with A-11, "when an agency is authorized to enter into a *lease-purchase* or *capital lease* contract, budget authority will be scored in the year in which the authority is first made available in the amount of the net present value of the Government's total estimated legal obligations

over the life of the contract. Outlays for lease-purchases in which the Federal Government assumes substantial risk will be spread across the period during which the contractor constructs, manufactures, or purchases the asset. Outlays for a capital lease or a lease-purchase in which the private sector retains substantial risk will be spread across the lease term. For *operating leases*, budget authority is required for the first year of the contract in the amount necessary to cover the Government's legal obligations, consistent with the requirements of the Anti-deficiency Act. This will include the estimated total payments expected to arise under the full term of the contract or, if the contract includes a cancellation clause, an amount sufficient to cover the lease payments for the first year plus an amount sufficient to cover the costs associated with cancellation of the contract. (For each subsequent year, sufficient budget authority is required to cover the annual lease payment plus any additional cancellation costs)." Currently, the criteria for classifying a lease as capital versus operating are not totally consistent between A-11 and SFFAS 5 & 6. Therefore, a lease may be classified as capital for budget scoring purposes and operating for financial reporting purposes. This inconsistency has been raised as a concern by the community on several occasions. Considerations should be made to determine if the budget and accounting guidance should be aligned.

- According to a 2009 GAO report (GAO-09-283R), "Some federal agencies have been granted authorities to enter into enhanced use leases (EUL)—typically long-term agreements with public and private entities for the use of federal property, resulting in cash and/or in-kind consideration for the agency—or to retain the proceeds from the sale of real property." The current federal standards do not address EUL and staff has received questions about the proper accounting for these leasing transactions.
- There are several areas of lease accounting that are currently covered by the FASB standards that are not covered in the FASAB standards. Some of those topics include leasehold improvements, lease terms, leveraged leases, and subleases. The 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.

The objective of this session is to approve this project plan for the project on Lease Accounting, so that staff may take action on the next agreed-upon step.

If you require additional information or wish to suggest another alternative not considered in the staff proposal, please contact staff as soon as possible. In most cases, staff would be able to respond to your request for information and prepare to discuss your suggestions with the Board, as needed, in advance of the meeting. If you have any questions or comments prior to the meeting, please contact me by telephone at 202-512-7362 or by e-mail at valentinem@fasab.gov.