


**Department of Energy**

Washington, DC 20585

January 5, 2017

**MEMORANDUM FOR THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD****FROM:**Tom Park   
Director, Office of Finance and Accounting**SUBJECT:**

Comments on the Federal Accounting Standards Advisory Board's Exposure Draft Leases: *An Amendment of Statement of Federal Financial Accounting Standards (SFFAS) 5, Accounting for Liabilities of the Federal Government and SFFAS 6, Accounting for Property, Plant, and Equipment.*

The Department of Energy (Department) appreciates the opportunity to comment on Exposure Draft Leases: *An Amendment of Statement of Federal Financial Accounting Standards (SFFAS) 5, Accounting for Liabilities of the Federal Government and SFFAS 6, Accounting for Property, Plant, and Equipment.* Generally, the Department found that many of the proposed changes correlate with the Financial Accounting Standards Board (FASB) and other accounting governing bodies.

Our responses to the questions in the exposure draft are as follows:

**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, do not specifically define a lease. SFFAS 5 and SFFAS 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 and further explained in paragraph A15.**

**Do you agree or disagree with the proposed definition of lease presented in paragraph 9 and further explained in paragraph A15? Please provide the rationale for your answer.**

Generally, the Department agrees with the Board's definition of a lease.

**Q2. The Board is proposing that the lease term be determined as the period during which a lessee has a non-cancelable right to use an underlying asset (referred to as the non-cancelable period) plus each option period if it is probable, based on all relevant factors, that the lessee will exercise that option to extend the lease. The lease term proposal also provides guidance on the non-cancelable period and on how specific**

provisions (such as fiscal funding/cancellation clauses and month-to-month lease holdovers) should be applied. The proposed lease term requirements are presented in paragraphs 14 – 18 and further explained in paragraphs A16 - A18.

**Do you agree or disagree with the proposed guidance on determining the lease term as presented in paragraphs 14 - 18 and further explained in A16 - A18? Please provide the rationale for your answer.**

The Department agrees with the Board's proposed determination of a lease term.

**Q3. The Board is proposing that at the beginning of the lease term, a lessee should recognize a lease liability and a property, plant, and equipment right-to-use lease asset (the lease asset), except for intragovernmental and short-term leases. The proposed lease recognition requirements are presented in paragraph 19.**

**Do you agree or disagree with the proposed lessee recognition of a lease at the beginning of the lease term as presented in paragraph 19? Please provide the rationale for your answer.**

The Department agrees with the proposed guidance for lease recognition. The guidance complements OMB Circular A-11 Appendix B scoring rules on leases. We would just request that any new standard be implemented in conjunction with the roll out of new SGL accounts and guidance on the transaction/posting models.

**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 21 – 29 and further explained in paragraphs A20 - A21.**

**Do you agree or disagree with the proposed lessee measurement and recognition of the lease liability as presented in paragraphs 21 - 29 and further explained in paragraphs A20 - A21? Please provide the rationale for your answer.**

The Department partially agrees with the proposed lessee measurement and recognition of lease liability presented paragraphs 21 - 29. We think an additional "required" lease payment type should be added in addition to the outlined criteria listed under paragraph 21 a-g as follows:

“Payments required to be made by the lessee under non-routine or unique circumstances (such as triple net leasing arrangements).”

**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 (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 23.**

**a. 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 as presented in paragraph 23? Please provide the rationale for your answers.**

The Department agrees the rate the lessor charges the lessee should be used to measure future lease payments.

**b. 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 as presented in paragraph 23? Please provide the rationale for your answers.**

The Department agrees with the proposed guidance for discounting lease payments and the lessee's use of its incremental borrowing rates when the lessor's borrowing rate cannot be readily estimated. However, we would like for FASAB to consider providing guidance on situations in which the lessor's incremental borrowing rate cannot be reasonably estimated, and the lessee's borrowing rate on the lease is less than Treasury's borrowing rate for securities of similar maturity to the term of the lease.

**Q6. The Board is proposing that the lessee should re-measure the lease liability at subsequent financial reporting dates if certain changes have occurred and are expected to significantly affect the amount of the lease liability. The Board is also proposing that the lease asset should generally be adjusted by the same amount when the corresponding lease liability is re-measured based on those changes. Additionally, 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. The proposed lessee requirements for re-measurement are presented in paragraphs 25 – 29, 33, and further explained in paragraph A19.**

**a. Do you agree or disagree with the circumstances when the lessee must re-measure the lease liability as presented in paragraph 25? Please provide the rationale for your answer.**

The Department partially agrees with the circumstances provided in which the lessee must re-measure the lease liability. We would like to know how FASAB is interpreting the distinction between "significantly affect" and "material".

The term "significantly affect", is not defined in the current version of the FASAB Handbook of Federal Accounting Standards (June 2016). Also, we are concerned the term "significantly affect", as it is discussed at paragraph 25, is subject to misinterpretation or misapplication in context with the re-measurement of lease liabilities.

**b. Would the requirements triggering re-measurement cause undue costs? Please provide the rationale for your answer.**

The requirements triggering re-measurement would cause undue costs if the change is not "material" to the agency's financial statements. Also, for agencies that have entered into leases

with "variable" interest rates, the re-measurement process may be burdensome because of the continuous change in interest rates.

**c. Do you agree or disagree with the effect of the re-measurement on the carrying value of the lease asset as presented in paragraph 33 and further explained in paragraph A19? Please provide the rationale for your answer.**

The Department would like for the Board to consider further explaining its position on the effects of re-measurement on the carrying value of the leased assets, as discussed in paragraph 33.

Paragraph 33 states, *"The lease asset generally should be adjusted by the same amount when the corresponding lease liability is re-measured based on paragraphs 25–29. 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."*

Specifically, the Department would like for FASAB to address under which circumstances a leased asset can have any "carrying value" left over to be reported as a "gain", if the associated lease liability has been reduced to zero?

**Q7. 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 30 – 34 and further explained in paragraph A22.**

**Do you agree or disagree with the proposed lessee measurement and recognition of the lease asset as presented in paragraphs 30 - 34 and further explained in paragraph A22? Please provide the rationale for your answer.**

The Department agrees with the proposed lease measurement and recognition of the leased asset.

**Q8. The Board is proposing that at the beginning of the lease term, a lessor should recognize a lease receivable and deferred revenue, except for intragovernmental and short-term leases. The proposed requirements for the measurement and recognition of the lessor lease receivable and deferred revenue are presented in paragraphs 36 – 48 and further explained in paragraphs A23 - A24.**

**Do you agree or disagree with the proposed lessor measurement and recognition of the lease receivable and deferred revenue as presented in paragraphs 36 - 48 and further explained in paragraphs A23 - A24? Please provide the rationale for your answer.**

The Department agrees with the proposed lessor measurement and recognition of the lease receivable and deferred revenue.

**Q9. 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 59 – 61 and further explained in paragraph A25.**

**Do you agree or disagree with the proposed definition and measurement and recognition of a short-term lease as presented in paragraphs 59 - 61 and further explained in paragraph A25? Please provide the rationale for your answer.**

Generally, the Department agrees with the proposed definition, measurement, and recognition of a short term lease. However, we are concerned there is a possible misinterpretation between paragraphs 14 and 59 on the determination of a lease. We would like for the Board to clarify whether it is the Board's intent for Paragraph 14 to be the final qualifier for defining a lease term.

Paragraph 14 states, *"The lease term is the period during which a lessee has a non-cancelable right to use an underlying asset (referred to as the non-cancelable period), plus each option period if it is **probable**, based on all relevant factors, that the lessee will exercise that option to extend the lease."*

Paragraph 59 states, *"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 non-cancelable 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 14."*

Please consider the following examples:

- 1) The Department enters into a lease contract [as a lessee] that is 16 months with an option period of 9 months. If the Department has the option to cancel the 9 month option period of its lease, then the maximum lease term to be evaluated would be 16 months (the non-cancellable portion of the lease) under paragraphs 14 and 59.
- 2) The Department enters into a lease contract [as a lessee] for 16 months, with the probable exercise of a 9 month lease option period. Based on the Department's interpretation of paragraph 14, this lease contract will not qualify as a short term lease because the lease term is for 25 months. Therefore, this lease will have to be tracked and recorded as a capital lease.

**Q10. 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 75 – 95 and further explained in paragraphs A26 - A29.

**Do you agree or disagree with the proposed definition, measurement, recognition, and disclosures of intragovernmental leases as presented in paragraphs 75 - 95 and further explained in paragraphs A26 - A29? Please provide the rationale for your answer.**

The Department partially agrees with the proposed definition, measurement, recognition, and disclosures of intragovernmental leases.

At Paragraphs 90 and 91, we would like FASAB to clarify why the distinction was made between a "lease incentive" and "lease concession", when both terms as applied to intragovernmental leases, appear to be synonymous?

A "lease incentive" and a "lease concession" is a form of payment given by the lessor to entice the lessee to sign the lease. They both result in reduced rental income received by the lessor and paid by the lessee. Even the basis for conclusions at paragraph A29, which states *"lease incentives and concessions should be recognized by the lessee/lessor as reductions of lease rental expense/lease rental income"*, supports the analogous interpretation of these two terms.

**Q11. The Board is proposing that leases unexpired at the beginning of the reporting period in which the standard is implemented be recognized and measured using the facts and circumstances that exist at the beginning of the reporting period. The proposed implementation requirements are presented in paragraphs 99-100.**

**Do you agree or disagree with the proposed prospective implementation approach as presented in paragraphs 99 - 100? Please provide the rationale for your answer.**

The Department agrees with the proposed prospective implementation approach as presented in paragraphs 99 - 100.

**Q12. The Board is proposing that the requirements of this Statement be effective for reporting periods beginning after September 30, 2018. The proposed effective date is presented in paragraph 101.**

**Do you agree or disagree with the proposed effective date as presented in paragraph 101? Please provide the rationale for your answer.**

The Department agrees with the proposed effective date.

Other Matters

Although an update to SFFAS 10 (Accounting for Internal Use Software) is not specifically a topic for discussion under this exposure draft, for future FASAB activities, we thought it may be helpful for us to provide you with our questions pertaining to the treatment of software under the new lease standards.

Question #1: SFFAS 10 already classifies internal use software as PP & E. What other software besides internal use software is expected to be treated as a lease?

Question #2: Is internal use software included as a right-to-use asset? What assets would this definition include—only plant and equipment assets and internal use software? For example, would agreements for “software as a service” (SaAS) or cloud applications or data storage fall under this guidance, or are these items considered services and therefore exempt?

Question #3: Since SaAS applications are not controlled by the lessee in the same manner as a more customized Enterprise Resource Planning (i.e., Oracle) system, does that warrant different accounting treatment?

Question #4: Are annual payments for software licenses considered leases? If yes, are the annual renewals considered short term leases?

Question #5: Can the Board clarify or define “if and when” to include software licenses or maintenance licenses as a “lease” if the license is for a period longer than 2 years? For example:

- One-time perpetual leases with annual maintenance agreements.
- Non-perpetual licenses “lease” software for use for a specified period of time. Users are required to remove the software from their computer if they cease paying for the license fee.
- Some license agreements allow the user to purchase “maintenance” or “software assurance” along with the original license fee, which entitles the user to receive new versions of the software until the maintenance agreement expires.

Question #6: How are umbrella software agreements accounted for?