

Leases

An Amendment of SFFAS 5, Accounting for Liabilities of the Federal Government and SFFAS 6, Accounting for Property, Plant, and Equipment

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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.

We agree with the definition of a lease and the Board's inclusion of both contract and agreement in the definition. Additionally, we believe that the definition should incorporate the concept that a lease conveys the right to control the use of the non-financial asset, consistent with FASB standards.

- 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.

We agree with the proposed guidance on determining the lease term, including the non-cancelable period and the specific provisions. We believe that the specifics provided in paragraphs 15 – 18 will be useful in promoting consistency in application of the standard.

- 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.

We agree with the recognition of a lease at the beginning of the lease term as that is the date when the value (use of the non-financial asset) commences.

- 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.

We agree with the proposed lease measurement and recognition of the lease liability, except that penalties noted in paragraph 21f should only be included in the measurement if termination is probable (see “probable” language in paragraph 21d and 21e that is excluded from 21f). We agree that the lessee taking possession of the underlying asset or gaining access to use the underlying asset is an event that creates an obligation until the end of the lease term. We suggest for the Board’s consideration that “significantly” in paragraphs 25-27 be changed to “materially” to avoid ambiguity as the related term “materiality” is defined in paragraph 4.

- 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.**

We agree that the rate the lessor charges the lessee, which may be the interest rate contained in the lease, should be used to measure the future lease because a lease is a financing transaction and this treatment is consistent with the rate indicated in FASB's standard for leases.

- 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.**

We agree 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 since because a lease is a financing transaction and this treatment is consistent with FASB's rate for leases when a rate implicit in the lease cannot be readily determined.

- 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.**

We agree with the circumstances identified in paragraph 25; however, as worded, this list is narrow and does not seem to allow for re-measurement outside of these circumstances. We suggest that the Board consider adding broader situations that would require the lessee to re-measure at subsequent financial reporting dates, such as "Other changes that are expected to significantly affect the amount of the lease liability". Such a change would allow for flexibility by preparers for items possibly not considered by the Board.

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

At our agency, leases are not significant to the overall financial statements. We do not believe that the requirements triggering re-measurement would cause undue costs.

- 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.**

We agree with the effect of the re-measurement on the carrying value of the lease asset as presented, understanding that this would require a change from recognizing the asset at adjusted historical cost. We agree that should the adjustment reduce the carrying value of the lease asset to zero, then a gain would be appropriate. We suggest that the Board change "flows statement" to "Statement of Net Cost" for clarity in paragraph 33.

- 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.

We agree with the proposed lessee measurement and recognition of the lease asset, including how the initial measurement of lease liability is consistent with historical cost accounting applicable to Property, Plant and Equipment.

- 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.

We agree with the proposed lessor measurement and recognition of the lease receivable and deferred revenue as it appears to be meet revenue recognition standards, and aligns with measurement and recognition of lease liability to be consistent where applicable. However, we suggest for the Board's consideration that:

- 1) Guidance on the accounting for a financed sale of the nonfinancial asset as mentioned in paragraph 37 or applicable reference to guidance be provided; and
- 2) "Significantly" in paragraphs 43-44 be changed to "materially" to avoid ambiguity as the related term "materiality" is defined in paragraph 4.

It is unclear why the Board has determined that a difference should exist between lessee liability measurement (paragraph 21) and lessor asset (receivable) measurement (paragraph 40) related to the exercise price of a purchase option and penalties for lease termination. As such, we recommend including this determination in its Basis for Conclusions.

- 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.

We agree with the proposed definition and measurement and recognition of a short-term lease. We believe that 24 months or less is appropriate in defining short-term from a cost-benefit perspective and for consistency with Property, Plant & Equipment recognition.

- 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.

We agree with the proposed definition, measurement, recognition, and disclosures of intragovernmental leases, especially within the consolidation entity. With respect to the use of the term “intragovernmental” in OMB Circular No. A-136 where the transaction or event is outside the reporting entity, we suggest using the term “inter-entity” to avoid confusion and better identify the leases falling into this category.

We agree that a simplified approach for recognizing intragovernmental leases would be more realistic and cost efficient. We believe the guidance on lease incentives, concessions, and improvements are adequate and consistent between lessor and lessee within a consolidation entity.

- 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.

We agree with the proposed future implementation approach, if properly disclosed in the notes to the financial statements, and believe that the approach is practical and cost effective.

- 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.

#12

Department of Labor - OIG

Federal - Auditor

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

We agree with the statement effective for reporting periods beginning after September 30, 2018 as it should provide adequate time for agencies to properly plan for implementation.