

FASAB Exposure Draft: Questions for Respondents due January 6, 2017

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.

The Department of the Treasury agrees with the proposed definition of lease presented in paragraph 9 and further explained in paragraph 15. It provides enough information to capture the various types of lease activities. Also, the definition appears to be consistent with that in the "Capital and Operating Leases, A Research Report" published in 2003 and on the FASAB site. In addition, there should be further clarification or examples as to what is included or excluded from the definition of a lease. This definition appears to cover "Share-in Savings Contracts" or "Energy Savings Performance Contracts" (ESPC's), for definitions see attached. The Department has these contracts, and has been specifically told that for GTAS reporting ESPC's are not to be recognized as lease

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liabilities (capital lease liabilities), that they are considered "Other Liabilities Without Related Budgetary Obligations" (SGL 299000). Under these proposed guidelines, the Department will encounter a difference in reporting for GTAS versus for the audited financial statements.

- Q2.** The Board is proposing that the **lease term** be determined as the period during which a lessee has a noncancelable right to use an underlying asset (referred to as the noncancelable 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 noncancelable 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 of the Treasury agrees with the proposed guidance in determining the lease term as presented in paragraphs 14-18 and A16-A18. The standard provides sufficient guidance for determining the "lease term" as well as factors to consider when assessing the likelihood of exercising option years.

- 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 of the Treasury agrees with the proposed lessee recognition as presented in paragraph 19. We agree that at the beginning of a lease, the lessee obtains the right to use the underlying asset and that this right meets the definition of an asset.

- 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.

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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 of the Treasury agrees with the proposed lessee measurement and recognition of the lease liability as presented in paragraphs 21-29 and further explained in paragraphs A20-A21. This appears to be a practical and straightforward measurement approach.

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 of the Treasury agrees with the rate the lessor would charge as discussed in paragraph 23. This approach appears to be reasonable and consistent with current practices. The Board may consider including the following in footnote 9 "...Treasury borrowing rate for securities of similar maturity (see *OMB Circular A-94 Appendix C*)."

- 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 of the Treasury agrees with the lessee's incremental borrowing rate also discussed in paragraph 23. This approach appears to be practical and straightforward.

Q6. The Board is proposing that the lessee should remeasure 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 remeasured 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 remeasurement are presented in paragraphs 25 – 29, 33, and further explained in paragraph A19.

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

The Department of the Treasury agrees with the circumstances when the lease must be remeasured as presented in paragraph 25. Each of the five different situations listed could result in a significant change of the lease liability -- change that would warrant its remeasurement.

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

The Department of the Treasury generally does not believe the requirements triggering remeasurement would cause an undue cost. However, agency accountants may have to develop a new process (es) to reevaluate leases during reporting periods while already at capacity compiling required reports and statements. Agencies that have a large number of leases may need to establish a monitoring program and evaluating the probability of exercising option years will also need to be assessed each year.

- c. **Do you agree or disagree with the effect of the remeasurement 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 of the Treasury agrees with the carrying value of the lease asset as presented in paragraph 33 and further explained in paragraph A19. This appears to be a practical approach and is reasonable that the "right of use" of personal property or lease asset carrying value be impacted when the liability is remeasured. However, there is a question of what would happen in a subsequent period if the remeasurement increases the lease, would you then increase the asset?

- 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 of the Treasury agrees with proposed lessee measurement and recognition of the lease asset as presented in paragraphs 30-34 and further explained in paragraph A22. This measurement approach is consistent with historical cost accounting applicable to PP&E.

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- 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 of the Treasury agrees 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. The Board's basis for its conclusion that federal entity lessees and lessors should account for the same transaction in a way that mirrors how the other party accounts for it is important in establishing accounting and financial reporting standards.

- 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.

The Department of the Treasury agrees 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. Treasury agrees with aligning short-term leases with the PP&E standard which prescribes an estimated useful life of 2 years or more. We also support the cost reduction rationale the Board has included in the basis for its conclusion for this proposal.

- 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.

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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 of the Treasury agrees with the proposed definition, measurement, recognition, and disclosures of intragovernmental leases as presented in paragraphs 75-95 and further explained in paragraphs A26-A29 as this approach appears to be consistent with SFFAS 47, Reporting 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.

The Department of the Treasury generally agrees that the proposed prospective implementation approach as presented in paragraphs 99-100 is appropriate. However, implementing this standard and applying the requirements to leases in the middle of the lease period could potentially present a hardship for agencies with a large number of leases. Due to the number of changes proposed in this exposure draft, it could take a significant amount of time to compile and evaluate all of the leases an agency has. Agencies will have to evaluate leases, assess probabilities of option years, calculate the interest rate in the year of the lease, obtain prices for maintenance and other costs included in the lease payment, calculate and track balances and place them on the balance sheet. The Board should consider phasing in this standard for newly awarded leases.

- 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 of the Treasury generally agrees with the effective date as presented in paragraph 101. However, given some of the challenges that agencies with a large number of leases may face, it could potentially pose a hardship on certain agencies as mentioned above. Therefore, the Board may want to consider an effective date starting with reporting period beginning 2 to 3 years after the FASAB publish date.

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