

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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Accounting Firm	<input type="checkbox"/>	
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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.

PFM: Agree. The definition is concise enough to capture federal leasing activities and yet not too restrictive. Specifically, the inclusion of “agreement” in the definition provides flexibility for the inclusion of leasing activities that may not be legally enforceable but have financial impacts on the reporting entity.

BIO: Agree. It is left open enough to provide flexibility. If you look in a dictionary, the definition of lease is a contract by which one party conveys land, property, services, etc., to another for a specified time, usually in return for a periodic payment. So, I think the proposed definition provides clarity with flexibility.

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BOEM/BSEE: Agree.

BOR: Disagree. Suggest clarifying where easements and land rights, licenses, concession agreements, etc. fall under this definition.

DO: Agree with the definition.

IA: Agree.

OSM: Agree. This provides a clearer understanding of what a lease is.

- 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.

PFM: Disagree with the definition. Lease Term is defined as “the period during which a lessee has a noncancelable right to use an underlying asset, plus each option period if it is probable...”. Disagree with the use of the phrase “**noncancelable right**” as it seems to imply that the lease term is the period during which the lessee’s right to use the underlying asset cannot be canceled by the lessor. Suggest rephrasing to something such as “the period during which either the lessor or lessee cannot terminate the contract or agreement without penalty”. Also suggest rephrasing “option period” to “option renewal period” to be clear.

In addition, Paragraph 15 is confusing. 15a and 15b seem to be the same, and only 15c defines “noncancelable period”. Agree with paragraphs 16 - 18.

BIO: I disagree with the definition. When a lease is negotiated, the lease is identified by a term (10 years for example) with a firm term (5 years) for example. The firm term is the timeframe that the Lessor amortizes the tenant improvements over in order to get his investment back. If the tenant cancels the lease during this firm term period, then the tenant will owe the unamortized tenant improvements to the Lessor in a lump sum payment. The term after the firm term and before the expiration date of the lease is still part of the lease term and is not considered option years. Option years are called renewal periods in the leasing world. These are negotiated for after the lease term (10 years). So, for example a lease could be a 10 year lease, 5 year firm, with 4 one-year renewal periods. So, this lease could technically be 14 years long.

BOEM/BSEE: Agree.

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BOR: Agree.

DO: Agree with the proposed guidance.

IA: Agrees (in part). IA believes that determining probabilities of extensions will pose problems.

OSM: Agree, it makes sense that we should account for the lease for the amount of time the lessee has a right to use the asset.

- 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.

PFM: Agree. This is consistent with the asset and liability definitions in SFFAC 5.

BIO: I agree.

BOEM/BSEE: Clarification and/or confirmation of interpretation of the subleases section of the ED needed. Our interpretation of subleases: when GSA is the original lessee with a non-intragovernmental lessor and then leases that non-intragovernmental lease to another government entity, the other government entity is the new lessee and should apply the "intragovernmental" general lessee guidance for this lease. Is this the correct interpretation? There is no definition of what 'general lessee guidance' is in the ED. 'General lessee guidance', specifically, is only used under the Subleases section, but 'general guidance' is used only under the 'intragovernmental' section of the ED.

BOR: Agree.

DO: Disagree with the proposed lessee recognition of a liability and asset at the beginning of a lease term. It appears that in this case FASAB is creating guidance to mirror private sector guidance. However, Federal accounting standards do not always need to mimic private sector standards as government missions are often distinctly different than a private company's mission and the information stakeholders might need or want differs as well. According FASB's Amendment of the FASB Accounting Standards Codification No. 2016-02, Leases (Topic 842), "Previous leases accounting was criticized for failing to meet the needs of users of financial statements because it did not always provide a faithful representation of leasing transactions." The users of private sector financial statement differ from the users of Federal government users.

When a private company enters into a lease agreement, they may very well need to record a liability as stakeholders certainly have a need to know of the future liabilities of a

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company. However, recording a liability for the Federal government for leases in certain instances, such as noted in Paragraph 16c, "A fiscal funding or cancellation clause should be considered in determining the lease term only when it is probable that the clause will be exercised," I do not believe is accurate. In the case of the Federal government, a change in administration or an abrupt end to a specific project may result in the cancellation of a lease with no future obligation. If the purpose of the financial statements of the Federal government is to paint a true picture of its financial position, I would argue that certain lease liabilities are not true liabilities for the actual going concern of the Federal government. Additionally, by recording a liability and an associated asset, there is no impact on the net position of the Federal government, only an inflation of balance sheet figures. I believe that the current OMB Circular A-136 guidance regarding the disclosure of leases within the footnotes of agencies' financial reports is adequate for reporting the financial position of the Federal government. Requiring the recording of liabilities and assets for leases adds a burden to agencies where the benefit does not outweigh the cost.

IA: Need clarification. GSA Operating agreements shall not be capitalized and no liability shall be reported? When there's a purchase option on a newly signed lease contract- will the asset purchase be recorded at that time or will a lease asset/liability still be recorded until the time of purchase and then the Asset purchase will be recorded? Paragraph 21E seems to confuse this issue.

OSM: Yes, if we have lease we need to recognize we should have a liability/PPE right to use lease asset on one side and a Receivable/Deferred revenue on the other.

- 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.

PFM: Partially agree. 21f, payments for penalties for terminating the lease, should not be considered in measuring the initial lease liability but should be considered in remeasurement of the liability when considering terminating the lease during the noncancelable period.

BIO: I agree with the majority of the paragraphs. I have concern about 21d and 21f. 21d is very vague. Measurement of lease liability includes "Amounts that are probable of being required to be paid by the lessee under residual value guarantees". In my mind, tax adjustments would be included in this purview. Tax adjustments are probable of being required, however, it is unknown what those adjustments would be until the Lessor provided the tax receipts from the previous year. So, how could those be included in a liability determination? As for 21f, measurement of lease liability includes payments for penalties for lease termination. If a lessee terminates the lease early (during the firm term

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of the lease), the Leasing Contracting Officer and the Lessor negotiate the terms of that penalty. It starts with the unamortized portion of the tenant improvements that have left to be paid and can be negotiated from there. If the Landlord has a tenant looking to move into that space right away, he may waive a good portion of that penalty to get the lessee out sooner. What I'm pointing out is that this amount is not firm and is negotiable, so how do you determine the amount to apply to the lease liability?

BOEM/BSEE: Undecided, see clarification and/or confirmation of interpretation is needed. See Q3 response.

BOR: Partially Agree. A lease does not really contain interest. Have concerns regarding the cost benefit. Do not see the value of discounting the lease and reporting the interest.

DO: Disagree with the proposed lessee measurement and recognition of the lease liability. Requiring the measurement of lease liabilities at the present value of payments could place an enormous burden on agencies to individually track each and every lease and adjust them every month for GTAS (Governmentwide Treasury Account Symbol Adjusted Trial Balance System) reporting. The current requirement of an annual footnote disclosure within agencies' annual financial reports seems adequate for Federal government reporting purposes. See Q3 response.

IA: Agree with the present value and other items to calculate the Liability. However- For A21- the full obligation would occur at the inception of the contract for the liability amount? What about ISA vs DLA leases- with DLA obligation s/b annual.

OSM: Agree-We should only have to recognized what is the current value of the lease when we enter into the lease and then adjust as needed.

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.**

PFM: Agree as it's the actual rate charged.

BIO: For private sector leases, this is acceptable. However, for Government leases, this is harder to determine. A Leasing Contracting Officer must get the interest rate the Lessor. This can prove to be difficult. In addition, that rate does not necessarily provide an accurate account for the escalation of the rents on the lease. In most cases, the operating expenses are the only portions of the rent that are escalated and they are

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escalated per the CPI Index rates. So, these rates could be significantly different depending on the time.

BOEM/BSEE: Undecided, if the lease is through GSA for a non-intragovernmental lease, what is spelled out in the occupancy agreement for rates/charges is what is billed, why would the future lease payments need to be discounted?

BOR: Partially Agree. See response to question 4.

DO: Disagree with discounting future lease payments. See Q3 and Q4 responses.

IA: Agree - this is the rate actually charged

OSM: Agree-we will leave this up the FASAB to determine

- 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.**

PFM: Agree but not sure how to determine lessee's incremental borrowing rate.

BIO: For private sector leases, this is acceptable. However, if this is a Government lease, there is no incremental borrowing rate for Government tenants. The Lessor's rate would need to be used and I disagree with using that per my answer above.

BOEM/BSEE: Undecided, where would a bureau get their incremental borrowing rate from?

BOR: Partially Agree. See response to question 4.

DO: Disagree with discounting future lease payments. See Q3 and Q4 responses.

IA: Agree - Lessor's rate should be the first consideration.

OSM: Agree-We will leave this up to FASAB to determine

- 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.**

PFM: Agree as the circumstances will affect the liability.

BIO: I agree. If significant changes are negotiated to a lease that affect the rates, square footage, or payments, then the lease liability should also change as well.

BOEM/BSEE: Might not be cost effective.

BOR: Agree. The change in the lease should trigger the remeasurement. Periodic remeasurements should not be required.

DO: Agree with the remeasure proposal.

IA: Agree - logical to re-measure in these circumstances.

OSM: Agree - We should always remeasure amounts we have on the financial statements whenever we prepare them to ensure they are accurate and reflect the current situation.

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

PFM: No, as only significant changes are considered for remeasurement.

BIO: I don't believe so.

BOEM/BSEE: Might not be cost effective.

BOR: Reevaluating the future liability would be necessary if the circumstances of the lease changed. If the requirement is to remeasure all leases periodically, this would cause undue costs.

DO: As stated in responses to previous questions, I believe the entire process of measuring and recording lease liabilities and assets creates an undue cost to the Federal government.

IA: Unsure at this point- certainly a possibility.

OSM: No I don't think so since it would be part of the normal process of doing business with a lease agreement.

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- 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.**

PFM: Agree, as the position of the entity has not been changed due to the remeasurement (net effect 0 to the balance sheet).

BIO: I disagree. If the lease asset value is carried at the initial amount of lease liability, that is the total rent paid over the lease term. So, if that liability will be the asset value, how do you depreciate the lease asset? A leased asset is something you do not own. Therefore, how do you handle the accounting of that depreciation of that asset value?

BOEM/BSEE: Might not be cost effective.

BOR: Agree. If the carrying value of the leased asset is reduced to zero a gain should be reflected on the statement of cash flows.

DO: Agree.

IA: Need to elaborate as to why a gain would result.

OSM: Yes - assets and liabilities should always match between the lessor and the lessee.

- 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.

PFM: Agree. The benefits derived from the lease should be the same for each period in the lease term. Including these costs and amortizing over the lease term on a straight-line basis will match the costs to the benefits.

BIO: I disagree. See my answer in Q6c.

BOEM/BSEE: Undecided, see clarification and/or confirmation of interpretation is needed. See Q3 response.

BOR: Agree. Entities must include all costs associated with the leased asset.

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DO: If the Board is going to require a liability be recorded for leases, then I believe the asset should be recorded in the amount of the liability only. To require agencies to record other costs as an asset and then amortize the amounts creates a burden where to costs do not outweigh the benefits.

IA: Agree - inclusions/exclusions are logical.

OSM: Yes - gain whatever the lessor measurement and recognition standards are, the lessee should mirror it.

- 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.

PFM: Agree. This is consistent with the definitions of asset and liability in SFFAC 5.

O (Tami Skinner): I agree. However, this applies to private sector leasing, not Government leases.

BOEM/BSEE: Undecided, see clarification and/or confirmation of interpretation is needed. See Q3 response.

BOR: Agree.

DO: If the Board is going to implement the proposed lessee requirements, then I agree with the lessor measurement and recognition.

IA: Agree - this is consistent with the lessee accounting treatment (as the other party).

OSM: Yes, if we have lease we need to recognize we should have a liability/PPE right to use lease asset on one side and a Receivable/Deferred revenue on the other.

- 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.

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PFM: Agree, as recognizing an asset and liability for leases less than 24 months is not cost-effective.

BIO: I agree. It is good to have a specific definition and two years is a reasonable timeframe.

BOEM/BSEE: Agree.

BOR: Agree.

DO: Agree with the proposal.

IA: Agree. Costs outweigh benefits to implement the standards for leases 2 years or less and this is also consistent w/ the useful life determination for PP&E.

OSM: Agree - We will leave this up to FASAB to determine. One issue we might want to consider is maybe considering a short term lease to be one year or less since that is what we normally consider when classifying liabilities into current vs noncurrent. Maybe keeping the same time line would help the statements be more consistent.

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.

PFM: Agree. This will avoid double-counting assets and liabilities at the government-wide level, and it will avoid issues with intragovernmental reconciliations

BIO: I agree. No further comment.

BOEM/BSEE: Agree - see Q3 for clarification and/or confirmation of interpretation is needed. Also, for lease incentives and concessions, the guidance states these should be recognized as reductions of lease rental expense by the lessee on a straight-line basis over the lease term. If the expenses the lessee recognizes for these intragovernmental leases is different than what GSA has for revenue, this will potentially cause issues with intragovernmental eliminations, unless GSA is compensating or billing the lessee using the straight-line basis.

BOR: Agree. By not recording a lease asset, this resolves issues with eliminations and/or double recording of the asset at the department and government-wide level.

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DO: Agree with the proposal.

IA: Needs clarification. Paragraph #86- Currently, we expense TI if GSA has built it into the total cost and bills on a monthly basis. We would capitalize and amortize only if an RSA exists exceeding our threshold. Is this paragraph consistent with that approach? For paragraph #87- is this an expansion of our FMLP note for Federal leases?

OSM: Agree-we will leave this up to FASAB to determine.

- 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.

PFM: Agree as this is a new requirement and not a correction of prior year errors.

BIO: I disagree. This makes no sense at all. The lease liability and lease asset should initially be measured based on the remaining lease term (this part makes sense because that is what is left in the liability) and associated lease payments as of the beginning of the period of implementation (this makes no sense to me). These amounts would not match and therefore, cause a difference in accounting.

BOEM/BSEE: Agree.

BOR: Agree.

DO: Agree with the proposal.

IA: Agree - treating this prospectively will avoid additional costs during implementation.

OSM: Agree - if there is new reporting standard then it should be applicable to all leases involved.

- 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.

PFM: Agree as agencies need time to implement the new requirement.

BIO: I agree. Agencies will need at least a year and a half, if not longer, to be able to implement these changes.

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BOEM/BSEE: Undecided, refer to response on Q10. Does GSA need to change their methodology for billing?

BOR: Agree.

DO: Agree with the proposal.

IA: Agree - treating this prospectively will avoid additional costs during implementation.

OSM: Agree- Giving reporting entities a year to implement is a good time frame.