UNITED STATES DEPARTMENT OF COMMERCE
Chief Financial Officer and
Assistant Secretary for Administration
Washington, D.C. 20230

JAN 10 2017

Wendy M. Payne
Executive Director
Federal Accounting Standards Advisory Board
Washington, DC

Dear Ms. Payne:

The Department of Commerce has reviewed the Statement of Federal Financial Accounting Standards Exposure Draft, *Leases: An Amendment of SFFAS 5 and SFFAS 6*, dated September 26, 2016.

Please find the enclosed answers to the questions that were asked of respondents, and please further find updated (to include a comment to paragraph 25, item e.) additional Departmental comments to the Exposure Draft. If you have any questions, please contact me at (202) 482-0646 or bhenshel@doc.gov.

Sincerely,

B Henshel

Bruce Henshel
Accountant, Office of Financial Management

Enclosure

cc: Gordon T. Alston
Julie Tao
Eric Carter

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*

Please select the type(s) of organization responding to this exposure draft. If you are not responding on behalf of an organization, please select "individual."

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Individual			

Please provide your name.

Name: Bruce Henshel

Please identify your organization, if applicable.

Organization: Department of Commerce

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 agrees with the proposed definition of a lease presented in paragraph 9 and further explained in paragraph A15. The definition appears to be broad enough to address the various lease options into which the Federal government enters.

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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 agrees with the proposed guidance on determining the lease term as presented in paragraphs 14-18. The Department agrees that the lease term should be considered the period that the lessee has a noncancelable right to use an underlying asset in addition to each option period that it is "probable" that the lessee will exercise the option to extend the lease.

The Department recommends that FASAB consider the below situation (if not already considered by FASAB) for inclusion as an additional situation that causes a remeasurement of the lease term, and include a discussion of FASAB's consideration of this situation in Appendix A: Basis for Conclusions if this situation is not included in the situations that cause a remeasurement of the lease term. If the below situation was already considered by FASAB; we recommend that FASAB include a discussion of FASAB's previous consideration in Appendix A: Basis for Conclusions.

- An assessment of all relevant factors indicates that the likelihood of an option being exercised has changed from probable to not probable, or vice versa.

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 lessee recognition of a lease at the beginning of the lease term, because the Department believes that the recognition of events as events occur is consistent with accrual accounting for proprietary transactions.

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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 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.

The Department recommends that the proposed standard specifically address the exclusion from the lease liability of the portion of the present value of the rental and other minimum lease payments during the lease term that represents executory costs to be paid by the lessor. Paragraph 44 of SFFAS 5 specifically addresses such executory costs, and the Department recommends continuing to specifically address the treatment of such executory costs in this proposed standard.

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 at this time strongly disagrees that the rate that 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. Obtaining this rate from the lessor, or reasonably estimating this rate, assumed to be an implicit rate for purposes of the Department's response as the primary requirement (if able to be met) we believe is a significant requirement change from paragraph 45 of SFFAS 45, which states:

> "The discount rate to be used in determining the present value of the minimum lease payments ordinarily would be the lessee's incremental borrowing rate unless (1) it is practicable for the lessee to learn the implicit rate computed by the lessor and (2) the implicit rate computed by the lessor is less than the lessee's incremental borrowing rate. If both these conditions are met, the lessee shall use the implicit rate."

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The Department believes that ED paragraph 23 may be a significant additional cost and level of effort for federal entities to carry out, that ED paragraph 23 makes the proposed standard more complex to carry out, while the ED has not included any discussion in Appendix A: Basis for Conclusions for why the change in practice from paragraph 45 of SFFAS 5 is proposed:

- There is no discussion included in the ED Appendix A: Basis for Conclusions explaining why the lessor rate (obtained from the lessor or reasonably estimated by the lessee) is considered preferable to Treasury's incremental borrowing rate, and there is no discussion included in the ED of FASAB weighing the additional efforts, of both the lessor and the lessee, involved with the lessee obtaining from the lessor or reasonably estimating the lessor's rate versus the benefits of utilizing the obtained or estimated lessor rate.

- The lessor may not be willing to provide the lessor rate, for example, the rate may be considered by the lessor to be proprietary or sensitive information that it does not wish to or will not provide to the lessee. The lessee under paragraph 23 would be required to ***attempt to*** "reasonably estimate" the lessor rate if the lessor rate cannot be obtained from the lessor, prior to utilizing the lessee's incremental borrowing rate.

- FASAB has not included any guidance in the proposed standard on how a federal entity would reasonably estimate the lessor rate if not known to the lessee or provided by the lessor.

It appears to the Department that the lessee's incremental borrowing rate may generally provide an easier and more consistent method for obtaining a discount rate, and would eliminate the additional efforts of both the lessee and the lessor in pursuing the lessor rate, thus reducing the costs of implementing this proposed standard.

The Department respectfully requests, that, if paragraph 23 is retained as currently proposed, that FASAB include, in Appendix A: Basis for Conclusions, a discussion of the basis for the change in practice from paragraph 45 of SFFAS 5.

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, as currently proposed, 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, however, see the Department's response to Question 5a. regarding a significant disagreement with the proposed standard as currently written.

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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.

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 agrees with the circumstances when the lessee must remeasure the lease liability as presented in paragraph 25. The Department recommends that a lessee's lease liability should not be remeasured solely because of a change in the lessor's interest rate. This recommendation is consistent with paragraph 28, which provides that a lease liability is not required to be remeasured solely for a change in the lessee's incremental borrowing rate.

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

The Department believes that the burden associated with remeasurement of a lease liability will vary based on the circumstances surrounding the lease; however, the Department supports the proposed remeasurements treatment.

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 agrees 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, because the asset valuation is tied to the liability valuation. Also, if a change **would** reduce the carrying valuation of the asset **below zero**, it is appropriate to record a gain as a result of the reduction in valuation below zero.

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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 lessee measurement and recognition of the lease asset as presented in paragraphs 30 - 34 and further explained in paragraph A22, because the measurement and recognition methods proposed appears to be consistent with existing Property, Plant, and Equipment guidance.

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 as presented in paragraphs 36 - 48 and further explained in paragraphs A23 - A24, primarily because the Department believes that recognition of events as events occur appears to be consistent with accrual accounting for proprietary transactions.

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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 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.

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 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. The proposed guidance aligns with OMB A-11 for intragovernmental agreements and requires minimal disclosures as compared to non-intragovernmental leases.

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. The Department believes that this approach will allow for implementation of the requirements on a forward-looking basis, without the complications of retroactive changes.

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 as presented in paragraph 101, because the Department believes that the expected issuance date of this proposed standard should allow sufficient time for most federal entities to implement the proposed standard timely.

Additional Department of Commerce Comments.

Paragraph 25 (under Lease Liability), item e.:

Paragraph 28 (also under Lease Liability) states the following:

> "28. "A lease liability is not required to be remeasured, nor is the discount rate required to be reassessed solely for a change in the lessee's incremental borrowing rate."

In contrast with Paragraph 28, paragraph 25 introductory clause, and item e. state the following:

> "25. The lessee should remeasure the lease liability at subsequent financial reporting dates if any of the following changes have occurred and are expected to significantly affect the amount of the lease liability:"
>
> "e. There is a change in the interest rate the lessor charges the lessee, if used as the initial **discount rate**."

It is not understood by the Department, as to why there is not ***similarly, also,*** an exclusion of the requirement for remeasurement of the lease liability if there is ***solely*** a change in the lessor's discount rate (if used as the initial discount rate)—in other words, if only item 25.e. is applicable, and there is no applicability for items 25.a. through 25.d.

The Department respectfully requests that FASAB consider or reconsider the above noted issue, and include a discussion of FASAB's consideration of this issue in Appendix A: Basis for Conclusions.

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Paragraph 35 (Disclosure Requirements for Lessees), item c.:

The Department believes the below paragraph 35c proposed disclosure requirement is not necessary for a fair and useful presentation of a federal entity's leasing activity as a lessee that should be required by generally accepted accounting principles, and may be costly and burdensome for federal entities to carry out, while it appears to the Department that the proposed disclosure requirement does not provide a significant benefit to users of the financial statements/notes to the financial statements. The Department, accordingly, respectfully recommends that FASAB reconsider the below proposed disclosure requirement:

- "c. The amount of lease expense recognized for the period for variable lease payments not previously included in the lease liability"

Further Elaboration on Request for Consideration of Deletion of Proposed Requirement: Proprietary-based disclosure requirements are generally based on a Balance Sheet approach (i.e. support the Balance Sheet), and there is not a recorded liability for these variable lease payments. There are many, many significant expenses a federal entity incurs that are not disclosed in the notes to the financial statements, since the proprietary-based disclosure requirements generally take a Balance Sheet approach. The Department believes the lessee disclosures should primarily be focused on the lease liability.

Paragraph 35, item d.:

The Department believes that the proposed disclosure requirement for principal and interest requirements to maturity beyond the five subsequent years of ***"and in five-year increments thereafter"*** as currently proposed is not necessary for a fair and useful presentation of a federal entity's leasing activity as a lessee that should be required by generally accepted accounting principles, and may be costly and burdensome for federal entities to carry out, while it appears to the Department that the proposed disclosure requirement does not provide a significant benefit to users of the financial statements/notes to the financial statements. The Department respectfully requests that FASAB consider a revised disclosure requirement of ***"Thereafter"*** (deleting the five-year increments requirement).

Paragraph 35, item e.:

The Department believes the following proposed disclosure requirement is not necessary for a fair and useful presentation of a federal entity's leasing activity as a lessee that should be required by generally accepted accounting principles, and may be costly and burdensome for federal entities to carry out, while it appears to the Department that the proposed disclosure requirement does not provide a significant benefit to users of the financial statements/notes to the financial statements. The Department, accordingly, respectfully recommends that FASAB reconsider the below proposed disclosure requirement:

- "e. The amount of the annual lease expense and the discount rate used to calculate the lease liability"

Further Elaboration on Request for Consideration of Deletion of Proposed Requirement: Proprietary-based disclosure requirements are generally based on a Balance Sheet approach (i.e. support the Balance Sheet), and there are adequate proposed disclosures for the lease liability. There are many, many significant expenses a federal entity incurs that are not disclosed in the notes to the financial statements, since the proprietary-based disclosure requirements generally take a Balance Sheet approach. The Department believes the lessee disclosures should primarily be focused on the lease liability. With regard to the proposed disclosure of the discount rate used to calculate the lease liability, the Department believes that is too detailed information for disclosure that does not significantly benefit the user of the financial statements/notes to the financial statements.

Paragraph 49 (included under Disclosure Requirements for Lessors), item b.:

The Department does not understand what significant benefits there would be to the users of the financial statements/notes to the financial statements of the following proposed disclosure requirement:

"b. The carrying amount of assets on lease or held for leasing, by major classes of assets, and the amount of accumulated depreciation"

It appears to the Department that the proposed disclosure requirement may not be necessary for a fair and useful presentation of a federal entity's leasing activity as a lessor that should be required by generally accepted accounting principles and may be costly and burdensome for federal entities to carry out, while it appears to the Department that the proposed disclosure requirement does not provide a significant benefit to users of the financial statements/notes to the financial statements. The Department, accordingly, respectfully recommends that FASAB reconsider the above noted proposed disclosure requirement:

Further Elaboration on Request for Consideration of Deletion of Proposed Requirement: Proprietary-based disclosure requirements are generally based on a Balance Sheet approach, and the Department believes that the lessor disclosure requirements should focus on the lease receivable. It appears to the Department that the proposed disclosure requirement with regard to the related assets are not of significant benefit to users of the financial statements/notes to the financial statements and may be costly and burdensome for federal entities to carry out.

The Department also is further concerned about the disclosure for assets "held for leasing" which do not relate to the recorded leases receivable. This disclosure of related assets "held for leasing" appears to the Department to be of ancillary information not directly related to the recorded leases receivable; and, again, appears to the Department to be of information not necessary for a fair and useful presentation of a federal entity's leasing activity as a lessor that should be required by generally accepted accounting principles and may be costly and burdensome for federal entities to carry out, while it appears to the Department that the proposed disclosure requirement does not provide a significant benefit to users of the financial statements/notes to the financial statements.

Paragraph 49, item c. and item d.:

The Department believes the following proposed disclosure requirements are not necessary for a fair and useful presentation of a federal entity's leasing activity as a lessor that should be required by generally accepted accounting principles, and may be costly and burdensome for federal entities to carry out, while it appears to the Department that the proposed disclosure requirement does not provide a significant benefit to users of the financial statements/notes to the financial statements. The Department, accordingly, respectfully recommends that FASAB reconsider the below proposed disclosure requirements:

"c. The total amount of revenue (for example, lease revenue, interest revenue, and any other lease-related revenue) recognized in the reporting period from leases"

and

"d. The amount of revenue recognized in the reporting period for variable lease payments and other payments not previously included in the lease receivable, including revenue related to residual value guarantees and termination penalties."

Further Elaboration on Request for Consideration of Deletion of Proposed Requirements: Proprietary-based disclosure requirements are generally based on a Balance Sheet approach (i.e. support the Balance Sheet), and there are adequate proposed disclosures for the lease receivable. There are many, many significant revenues a federal entity recognizes that are not disclosed in the notes to the financial statements, since the proprietary-based disclosure requirements generally take a Balance Sheet approach. The Department believes the lessor disclosures should primarily be focused on the leases receivables.

Paragraph 50 (included under Disclosure Requirements for Lessors):

The Department believes that the proposed disclosure requirement, when applicable, for future lease payments that are included in the lease receivable beyond the five subsequent years of ***"and in five-year increments thereafter"*** as currently proposed is not necessary for a fair and useful presentation of a federal entity's leasing activity as a lessor that should be required by generally accepted accounting principles, and may be costly and burdensome for federal entities to carry out, while it appears to the Department that the proposed disclosure requirement does not provide a significant benefit to users of the financial statements/notes to the financial statements. The Department respectfully requests that FASAB consider a revised disclosure requirement of ***"Thereafter"*** (deleting the five-year increments requirement).

Paragraphs 79 through 86 (under Intragovernmental Leases – Lessee Accounting section):

The definitions included in paragraphs 79 through 86, under the Guidance for Recognition of Specific Intragovernmental Lease Topics subsection, appear to the Department to be guidance/definitions that is applicable to the entire proposed standard. The Department therefore recommends that these definitions be moved to the Definitions section for the entire proposed standard (currently paragraphs 9 through 13).