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January 17, 2017

Ms. Wendy M. Payne  
Executive Director  
Federal Accounting Standards Advisory Board  
441 G Street, NW, Suite 6814  
Mailstop 6H19  
Washington, DC 20548

**RE: Proposed Statement of Federal Financial Accounting Standards, *Leases***

Dear Ms. Payne:

We appreciate the opportunity to respond to the proposed Statement of Federal Financial Accounting Standards, *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 exposure draft (ED). We commend the Board for devoting resources to develop a comprehensive lease accounting standard, and we support the simplified accounting for intragovernmental leases. We encourage the Board to collaborate with the Office of Management and Budget on the budgetary accounting guidance to minimize confusion about the differences in concepts and terminology between the proprietary and budgetary accounting guidance.

We believe there are certain aspects of the ED that are unclear, which will make implementation problematic, and in some instances will impact the auditability. Therefore, we provide the following comments for the Board's consideration.

**1. Non-Intragovernmental and Intragovernmental Leases Sections**

The clarity of the standard would be improved if the non-intragovernmental leases section and intragovernmental leases section were individually comprehensive and consistently worded, where possible. We noted the following inconsistencies.

- a) Paragraphs 14 through 18 in the standards for non-intragovernmental leases provide the basis for determining the lease term. Because lease term is a fundamental concept which we believe is equally relevant to intragovernmental leases, we recommend that these paragraphs be moved to a general section outside of the non-intragovernmental and intragovernmental leases sections. Because the determination of the lease term is critical to consistent adoption of the standard, we believe paragraphs 14 through 18 warrant a flowchart.
- b) The non-intragovernmental leases section provides the accounting treatment for the following scenarios, which we believe are equally relevant to intragovernmental leases. Therefore, we recommend that the accounting also be included in the intragovernmental leases section:
  - Contracts/agreements with multiple components (paragraphs 51 through 56)
  - Contract/agreement combinations (paragraphs 57 and 58)

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- Subleases (paragraphs 68 and 69)
- c) The intragovernmental leases section provides the accounting treatment for the following scenarios, which we believe are equally relevant to non-intragovernmental leases. Therefore, we recommend that the accounting also be included in the non-intragovernmental leases section:
  - Lease concessions (paragraphs 84 and 91)
  - Leasehold improvements (paragraph 86)
  - Initial direct costs (paragraph 94)

## 2. Scope

- a) Paragraph 6 uses the phrase “in an *exchange* transaction [emphasis added].” The significance of “in an exchange transaction” is unclear. We recommend that the Board delete the phrase or modify the paragraph to provide additional guidance about what is meant by the phrase.
- b) Footnote 3 states “Examples of nonfinancial assets include land, buildings, vehicles, equipment, internal use software. . .” We recommend that the Board specifically state in the scope section that the standard applies to leases of internal use software as defined in SFFAS 10, *Accounting for Internal Use Software*.

## 3. Definitions

- a) The following terms are defined outside of the definitions section. We recommend that the Board define them in the definitions section.
  - a. Fiscal funding or cancellation clause (paragraph 16c)
  - b. Short-term lease (paragraph 59)
  - c. Lease concessions (paragraphs 84 and 91)
  - d. Leasehold improvements (paragraph 86)
- d) The following terms are discussed, often with examples, throughout the standard. We recommend that the Board define these terms in the definitions section:
  - a. Nonfinancial asset (footnote 3)
  - b. Residual value guarantee (paragraph 21d)
  - c. Lease modification (paragraphs 66 and 67)
  - d. Lease incentives (paragraphs 82 and 90)
- e) Paragraph 9 -- Refer to our earlier comment number 2b on paragraph 6.

## **Standards for Non-Intragovernmental Leases**

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While we recognize that the Board leveraged the Governmental Accounting Standards Board’s Exposure Draft, *Leases*, in drafting the standards for non-intragovernmental leases, certain changes would enhance the understanding and usability of the standard.

## 4. Lease Term

- a) Paragraphs 14 to 18 – Refer to our earlier comment number 1a.

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- b) As we stated in our earlier comment number 1a, the lease term is a fundamental concept in this standard. We believe that there are gaps in paragraphs 14 through 18 which prevent the standard from providing a comprehensive and precise definition of lease term. For example, what is the noncancelable period if it is not probable that the lessee will exercise the option to terminate the lease? We recommend the Board refer to the Financial Accounting Standards Board's Accounting Standards Codification (ASC) 842-10-20 for an example of a more precise definition of lease term.
- c) Paragraph 15a uses the phrase "renewal options for additional periods." Paragraph 11 defines "lease option periods". We recommend that the Board replace "renewal options for additional periods" with "lease option periods".
- d) Paragraph 16d states: "Month-to-month lease holdovers...should be considered cancelable because either the lessee or lessor could cancel the lease at any time." In our experience, the lessor generally doesn't have the option to cancel the lease, only the lessee has such option.
- e) Paragraph 16d states: "These holdover periods should be excluded from the lessee's lease liability and the lessor's lease receivable." This paragraph is included within the "Lease Term" section of the ED. We recommend that the Board either move paragraph 16d to the section on recognition and measurement or revise this language to indicate that the holdover periods should be excluded from the *lease term*.
- f) Paragraph 17 states: "At the beginning of a lease..." and paragraph 19 states "At the beginning of the lease term..." It is unclear what difference, if any, exists between the two phrases. Also, it is unclear when the Board intends for lease accounting to begin. The beginning of a lease could be the date upon which a lessee signs a lease, begins occupancy or takes delivery of the underlying asset, or another date. We recommend that the Board use consistent wording between paragraphs 17 and 19 and provide guidance on when a lease begins.
- g) Paragraph 17c lists the "lessee's history of exercising renewal or termination options" among the factors to consider. It is unclear whether the Board intends this consideration to be the history of exercising options in all leases or to be limited to the history of exercising options in leases for the same type of underlying asset. We recommend that the Board provide clarification.
- h) Paragraph 17d states "extent to which the lease asset is considered mission critical." We believe that the Board should replace "lease asset" with "underlying asset".

#### **4. Recognition and Measurement for Lessee--Lease Liability**

- a) Paragraph 21g states "Any other payments that are probable of being required based on an assessment of all relevant factors." It is unclear what these other payments would be. We recommend that the Board include examples of these payments.
- b) Paragraph 25 states "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* [emphasis added] the amount of the lease liability." It is unclear how a lessee would determine whether or not a change is expected to affect, or significantly affect, the lease liability without actually performing the remeasurement. This could result in an assessment or remeasurement every reporting period. We believe the cost would outweigh the expected benefits to financial statement users.

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The term “significantly” in paragraph 25 is not defined. It is unclear whether the consideration of significance is for an individual year or the cumulative change to the lease liability. This will result in inconsistent application. We recommend that the Board provide clarification.

- c) Paragraph 25b uses the phrase “being paid” whereas paragraph 21d uses the phrase “being required to be paid”. We recommend that the Board conform the phrases.
- d) Paragraph 26 -- Refer to our earlier comment number 4b on paragraph 25.
- e) Paragraph 27 -- Refer to our earlier comment number 4b on paragraph 25.
- f) The interaction between paragraphs 25 and 27 is confusing. We recommend that the Board revise paragraph 27 to clarify its intent or revise paragraph 27 to read as follows:

“If a lease liability is remeasured for the changes in paragraph 25a or 25c, the lessee should also update the discount rate as part of the remeasurement.”

## **5. Lease Asset**

- a) Paragraph 30c states “Initial direct costs that are ancillary charges necessary to place the lease asset in service.” However, paragraph 12 defines initial direct costs as “costs that are directly attributable to negotiating and arranging a lease or portfolio of leases”. We recommend that the Board address the discrepancy.
- b) We believe the first two sentences of paragraph 34 are circular. We recommend that the Board replace the first sentence with the following:

“The lease assets classified as property, plant and equipment are subject to SFFAS 44, *Accounting for Impairment of General Property, Plant, And Equipment Remaining In Use.*”

In addition, we recommend that the Board delete the third sentence because SFFAS 44 provides a list of factors to consider in determining impairment.

## **6. Disclosure Requirements for Lessees**

- a) Paragraph 35 lists required disclosures. We recommend that the Board add disclosure of renewal and termination options and the existence of subleases. We do not believe that these are captured within the requirement for a “general description of its leasing arrangements” included in paragraph 35a.
- b) Paragraph 35a(i) states “the basis, terms and conditions on which variable lease payments not included in the lease liability are determined.” It is unclear what is meant by “variable lease payments not included in the lease liability.” We recommend that the Board include examples.
- c) Paragraph 35c states “The amount of lease expense recognized for the period for variable lease payments not previously included in the lease liability.” It is unclear what is meant by “variable lease payments not previously included in the lease liability.” We recommend that the Board include examples, similar to those included in paragraph 49d.

## **7. Recognition and Measurement for Lessors -- Lease Receivable**

- a) Paragraph 42 discusses the concept of “producing a constant periodic rate.” We believe this concept is also applicable to paragraph 24. We recommend that the Board include the concept in paragraph 24.

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- b) Paragraphs 43 and 44 - Refer to our earlier comments numbers 4b and 4d on paragraphs 25 through 27.
- c) Paragraph 43a refers to a “change in the lease term” whereas paragraph 25a refers to a “change in the lease term due to a reassessment (see par. 18), a modification (see par. 66), or a termination (see par. 64).” We believe the Board should use consistent terminology.

#### **8. Disclosures for Lessors**

- a) Paragraph 49a -- Refer to our earlier comment number 6b on paragraph 35a.
- b) Paragraph 49b uses the phrase “assets on lease or held for leasing” whereas “underlying assets” is used elsewhere in the standard. We believe the Board should use consistent terminology.

#### **9. Contract/Agreements with Multiple Components**

- a) Paragraph 53 uses the phrase “if the assets have difference lease terms.” We believe that it is unclear whether the Board’s use of “lease terms” is intended to mean lease terms as defined in paragraph 14 or a generic phrase for other provisions included in a lease contract.
- b) Paragraph 55b uses the phrase “a single lease unit”. We recommend that the Board either include a definition in the definition section or modify paragraph 55b to provide additional guidance about what is meant by the phrase.
- c) Paragraph 55c -- Refer to our earlier comment number 9b on paragraph 55b.
- d) Paragraph 56 -- Refer to our earlier comment number 9b on paragraph 55b.

#### **Standards for Intragovernmental Leases**

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##### **10. Intragovernmental Leases – Lessee Accounting**

- a) Paragraph 77 states: “A lessee should recognize lease payments...based *primarily* [emphasis added] on the payment provisions of the lease.” Paragraph 78 states: “Recognition should be based on the payment provisions of the lease.” It is unclear what, if any, differences are intended between the two paragraphs. We recommend that the Board either remove the word “primarily” from paragraph 77 or provide examples of other items to consider in addition to the provisions of the lease.
- b) Paragraph 80 uses the phrase “contingent rental increases.” Paragraph 21b uses the phrase “variable lease payments”. It is unclear what, if any, differences are intended between the two phrases. We recommend that the Board either conform the wording or provide clarification.
- c) Paragraphs 83 and 85 -- Refer to our earlier comment number 1a on the phrase “lease term”
- d) Paragraph 86 -- Refer to our earlier comment number 4e on paragraphs 17 and 19.
- e) Paragraph 86 uses the phrase “expected lease term.” We recommend that the Board modify paragraph 86 to provide additional guidance about what is meant by the phrase.
- f) We recommend that the Board combine and revise the disclosure requirements in paragraphs 87a and 87c to read as follows: “annual lease expense by major category of leased asset and in the aggregate.”
- g) Paragraph 87b states “general lease terms with specific intragovernmental requirements.” We recommend that the Board modify paragraph 87b to provide additional guidance about what is meant by the phrase “specific intragovernmental requirements.”

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## 11. Intragovernmental Lease Arrangements – Lessor Accounting

- a) Paragraphs 90 and 92 -- Refer to our earlier comment number 1a on the phrase “lease term.”
- b) Paragraph 95a states “Future lease rental income as of the date of the latest balance sheet presented, in the aggregate and for each of the five succeeding fiscal years for lease arrangements over the lease term.” Rental income is an accrual concept. We recommend that the Board revise this paragraph as follows: “Future lease payments that are to be received for each of the five succeeding fiscal years and in total over the lease term.”
- c) Paragraph 95b uses the terms “federally-owned” and “privately-owned.” We recommend that the Board avoid introducing new terms, and use consistent terminology, such as intragovernmental and non-intragovernmental.

## 12. Appendix B: Illustration

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- a) The terminology used in paragraph 55 is different than the terminology used in Appendix B. We recommend that the Board conform the terminology used in Appendix B to match paragraph 55.

## 13. Editorial Matters

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- a) Paragraph 9 defines a lease as “a contract or agreement...” However, paragraphs 20, 32, and others use the phrase “a lease contract/agreement”. We recommend that the Board revise paragraphs 20, 32, and others to use the term “a lease”.
- b) “Guidance” is used in several subheadings in the Intragovernmental section. “Guidance” is not included in the similar subheadings in the non-intragovernmental leases section. We recommend that the Board eliminate “guidance” as the standards *prescribe* rather than *provide guidance on* the accounting treatment and related disclosures.
- c) The following titles are used in the standard: 1) “DISCLOSURE REQUIREMENTS FOR LESSERS”, 2) “DISCLOSURES FOR LESSORS”, and 3) “Disclosures”. We recommend that the Board match the titles of its sub-sections and subtopics within and between the intragovernmental leases and the non-intragovernmental leases sections to improve the cohesiveness of the overall standard.
- d) We recommend that the Board add “category” at the end of footnote 7 as follows: “...the underlying asset *category*.” (added text italicized)
- e) We recommend that the Board reverse the order of paragraphs 28 and 29 to provide a more logical flow.
- f) We believe paragraphs 21c and 38c, and similarly paragraphs 22 and 39, are intended to provide the same guidance. We recommend that the Board use the same language in these paragraphs.
- g) Paragraph 35d uses the singular “the discount rate.” We believe this should be revised to “the discount rates”.
- h) We believe paragraphs 76 and 88 are unnecessary. We recommend that the Board delete them.
- i) We recommend that the Board revise paragraph 87b to read as follows: “general lease requirements *including with* specific intragovernmental requirements...” (added text italicized; deleted text struck-out)

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If you have questions about our response, please contact Ms. Amanda Nelson at 202-533-5560 or [aenelson@kpmg.com](mailto:aenelson@kpmg.com).

Sincerely,

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