

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.

DHS Response: DHS agrees with the proposed definition of a lease. It covers all the required elements of a lease.

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

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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.

DHS Response: DHS agrees with the proposed guidance on determining the lease term. It provides specific provisions for determining the lease term.

- 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.

DHS Response: DHS generally agrees with the proposed lease recognition of a lease at the beginning of the lease term as presented in paragraph 19, but recommends FASAB consider re-wording paragraph 20 to reduce confusion. We believe the government would still be recording a liability when:

“20. A lease contract/agreement that transfers ownership of the underlying asset to the lessee at or before the end of the lease, and does not contain termination options (see par. 14 - 15), should be reported as a purchase of that asset.”

However, we believe FASAB is intending to say this would not be a “lease liability?” Perhaps FASAB would consider changing this to reduce confusion?

- 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.

DHS Response: DHS agrees that a lessee should measure the lease liability initially at the present value of payments to be made for the lease term. The ED provides comprehensive guidance on lessee measurement and recognition of the lease liability.

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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.

DHS Response: DHS agrees 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. In most instances, the rate should be able to be inferred from the terms of the lease.

- 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.

DHS Response: DHS agrees 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. This measurement considers the most relevant interest rate when the agreement rate cannot be reasonably estimated.

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.

DHS Response: DHS does not agree with the circumstances that dictate when the lessee must remeasure the lease liability. DHS does not anticipate the events outlined in paragraph 25 would materially affect the aggregate lease liability and remeasurement would present a significant undue cost based on the volume of leases across DHS.

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

DHS Response: The requirements triggering remeasurement would cause undue costs to most DHS components due to the large volume of leases and resource constraints.

- 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.

DHS Response: DHS agrees with the effect of the remeasurement on the carrying value of the lease asset. The asset value should equal the cumulative amount paid excluding finance charges.

- 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.

DHS Response: DHS agrees with the proposed lessee measurement and recognition of the lease asset. The calculation takes all factors into consideration for the recognition of the lease asset similar to the requirements. SFFAS 6 states that capitalized assets should include all costs incurred to bring the asset to a form and location suitable for its intended use. The costs discussed in paragraphs 30-34 are indeed required to bring the asset to a form and location suitable for its intended use.

- 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.

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DHS Response: DHS agrees with the proposed lessor measurement and recognition of the lease receivable and deferred revenue. The ED provides comprehensive guidance on lease receivable and deferred revenue.

- 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.

DHS Response: DHS agrees with the proposed definition and measurement and recognition of a short-term lease. The proposed definition and measurement recognition aligns with SFFAS 6 which defines PP&E as a tangible asset with an estimated useful life of 24 months or more.

- 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.

DHS Response: DHS agrees with the proposed definition, measurement, recognition, and disclosures of intragovernmental leases. The ED provides comprehensive guidance on intragovernmental leases accounting.

- 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.

DHS Response: DHS agrees with the proposed prospective implementation approach. The reporting period at implementation to record any changes in the leases treated prospectively will streamline the process.

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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.

DHS Response: DHS agrees with the proposed effective date. It should provide adequate time for DHS and components to prepare.

Other comments

1. Q.2: Recommend including FASAB's definition of "probable" as discussed in appendix A paragraph 18.
2. During the February 2, 2016 Task Force meeting, the US Customs and Border Protection (CBP) raised a question as to whether an agency's capitalization threshold should be considered. CBP was told that capitalization threshold would be addressed; however, it still isn't included in this exposure draft.
3. Paragraph 14 says Lease Term equals the noncancelable period, including option periods that are probable. Paragraph 59 says a Short-Term lease is a lease with a maximum possible term of 24 months or less, including options regardless of probability. If a lease has an initial term of 12 months, and 4 additional one-year options are considered not probable, what is the lease term for this lease? Is it a one-year regular (i.e., NOT short-term) lease.
4. Paragraph 16d says a month-to-month lease should be treated as cancelable. TSA has one lease that automatically renews every year and it is probable TSA will continue to allow the lease to renew every year. However, TSA has no future timeline for when we may terminate the lease and there is no established end date in the lease agreement. Should this lease be considered a cancelable lease? Should it be considered a short term lease?
5. Paragraph 60 says a lessee "should recognize an asset if payments are made in advance of the period to which they relate, or a liability for rent due if payments are made subsequent to that period." Is there a certain period of time that should be considered when determining if rent is paid in advance or in arrears? Most reasonable readers of this ED would likely agree that payments one year in advance should be recognized but payments one month in advance should not. Does the Board take any position on a specific time period or even set limits on a time period for recognizing a lease prepayment or liability?
6. The ED does not reference minimum lease payment (MLP) disclosures (we assume because a liability will be recognized). Does this mean no MLP

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disclosure will be required in the future for short-term and intragovernmental leases?

7. The ED only references recognizing rent expense on a straight-line basis for lease incentives, rent holidays, and lease-hold improvements included in the rent payments. Does this mean no adjustment to rent expense will be required in the future for leases that only have changing payments?