



Federal Accounting Standards Advisory Board

August 16, 2017

Memorandum

To: Members of the Board

Monica R. Valentine

From: Monica R. Valentine, Assistant Director

Wendy M. Payne

Through: Wendy M. Payne, Executive Director

Subj: **Draft Leases Standard —Tab A¹**

MEMBER ACTION REQUESTED:

- Review a draft Leases Statement and give staff feedback, by **August 25, 2017** so that a pre-ballot draft can be provided to the Board after the August meeting.
- Provide feedback to staff on the five questions on page 5 of this transmittal memo by **August 25, 2017**.

MEETING OBJECTIVE

The objective is for the Board to review a draft Leases Statement and give staff feedback so that a pre-ballot draft can be provided to the Board after the August meeting. Staff has made the necessary edits to the Leases Exposure Draft (ED) to convert the document from an ED to a draft Statement.

BRIEFING MATERIAL

The briefing material includes this memorandum and the following attachments and appendices:

Attachment 1: Draft Leases Standard - **Marked**

Attachment 2: Draft Leases Standard - **Clean**

Appendix A: Original *Leases* Exposure Draft

Appendix B: GASB Statement No. 87, *Leases*

Appendix C: History of Board Lease Discussions

¹ The staff prepares Board meeting materials to facilitate discussion of issues at the Board meeting. This material is presented for discussion purposes only; it is not intended to reflect authoritative views of FASAB or its staff. Official positions of FASAB are determined only after extensive due process and deliberations.

DEFINITION OF A LEASE AND SCOPE EXCLUSIONS

At the June meeting the Board agreed with the broader definition of a lease over the more narrow definition of a lease that would only include property, plant, and equipment (PP&E). The broader definition will allow flexibility for leases that are not PP&E or those not specifically scoped out to be considered for recognition in accordance with the standards.

The broader lease definition is, “a lease is defined as a contract or agreement that conveys the right to control the use of another entity’s nonmonetary asset (the underlying asset) for a period of time as specified in the contract or agreement in exchange for consideration.” As discussed at the June meeting, the broader definition necessitates the development of a definition of “nonmonetary asset” in the standard. Whereas with the narrower definition, “a lease is defined as a contract or agreement that conveys the right to control the use of another entity’s identified property, plant, or equipment (an identified asset) for a period of time in exchange for consideration,” a definition of “nonmonetary” would not be necessary.

Additionally, the broader definition will require the following five scope exclusions, leases of natural resources, inventory, assets under construction, software, and intangibles. The Board also stated that in order to exclude intangibles a definition for intangibles would also have to be included in the standard. The narrower definition would require two scope exclusions--software, and assets under construction. The narrower definition would not require that a definition of intangibles be included in the standard. (Note that members previously discussed excluding “land rights.”² However, staff concluded doing so results in leases of land being excluded. Staff concluded that land rights that provide only limited uses of land such as water rights would not meet the definition of leases because the control tests would not be met.)

On June 26, 2017 staff requested the assistance of the Leases task force to provide feedback on the types of assets being leased by federal entities (as the lessee) from non-federal entities and assets federal entities (as the lessor) are leasing to non-federal entities. As of the date of this memo, staff has received seven responses to our question. Most of the responses were a simple “none.” Other task force members mentioned livestock, inventory, and service contracts.

As the Board continues to look for ways to reduce the preparer’s burden, staff requests that the Board reconsider its decision to maintain the broader definition of lease and to reevaluate the benefits of the narrower lease definition. It should also be noted that the original FASB lease standards were scoped to only include PP&E, as were the FASAB lease standards which were modeled after FASB.

² Per SFFAS 6 - “Land rights” are interests and privileges held by the entity in land owned by others, such as leaseholds, easements, water and water power rights, diversion rights, submersion rights, rights-of-way, and other like interests in land.

SERVICE CONTRACTS

Based on comments received on the Leases exposure draft and comments expressed at the April Leases clarification discussion the Board asked staff to include a definition of service contracts (contracts for services) in the standard to ensure readers of the standard fully understand what constitutes a service contract and how they related to the leases standards.

Staff reviewed the Federal Acquisition Regulation (FAR) to find a definition for service contracts. The following is an excerpt from the FAR.

Adapted from FAR: Subpart 37.1—Service Contracts—General

For purposes of the Statement, a contract for service or a service contract is a contract that directly engages the time and effort of a contractor whose primary purpose is to perform an identifiable task rather than to provide a tangible asset. In this document these contracts will be referred to as “service contracts.” A service contract may be either a non-personal or personal contract. It can also cover services performed by either professional or nonprofessional personnel whether on an individual or organizational basis.

The following are some of the areas in which service contracts are found:

- (1) Maintenance, overhaul, repair, servicing, rehabilitation, salvage, modernization, or modification of supplies, systems, or equipment.
- (2) Routine recurring maintenance of real property.
- (3) Housekeeping and base services.
- (4) Advisory and assistance services.
- (5) Operation of Government-owned equipment, real property, and systems.
- (6) Communications services.
- (7) Architect-Engineering.
- (8) Transportation and related services.
- (9) Research and development.

A non-personal service contract means the contract furnishes labor, time, or effort by a contractor, and not involving delivery of a specific end product other than reports which are merely incidental to the required performance.

A personal services contract is characterized by the employer-employee relationship it creates between the Government and the contractor's personnel

To address the commenters' concerns as it relates to service contracts, staff has included the first sentence from the above FAR excerpt into the draft *Leases* standard to provide clarification in the standard on service contracts, “*a contract that directly engages the time and effort of a contractor whose primary purpose is to perform an identifiable task rather than to provide a tangible asset.*”

LEASE TERM

Staff has revised the lease term language to clarify how to determine the lease term in paragraphs 14 – 18.

OTHER REVISIONS

Staff also made other revisions to the draft Leases standard to improve the clarity of the standard. The revisions are based on

- suggestions from ED respondents,
- revisions adapted from the GASB final lease standard, and
- staff suggested revisions.

NEXT STEPS

If all unresolved substantive issues have been resolved by the Board staff will make all revisions agreed to by the Board and present a pre-ballot draft of the final Leases standard to the Board.

MEMBER FEEDBACK

Please contact staff as soon as possible to convey your questions or suggestions. Communication before the meeting will help make the meeting more productive. You can contact Monica by telephone at 202-512-7362 or by e-mail at ValentineM@fasab.gov with a cc to PayneW@fasab.gov.

QUESTIONS FOR THE BOARD

Question 1: Does the Board agree with staff's recommendation to define lease more narrowly as, *"a contract or agreement that conveys the right to control the use of another entity's identified property, plant, or equipment (an identified asset) for a period of time in exchange for consideration"*?

Question 2: Does the Board agree with staff's proposed definition of service contracts to help clarify the scope of the Leases standard, *"a contract that directly engages the time and effort of a contractor whose primary purpose is to perform an identifiable task rather than to provide a tangible asset"*?

Question 3: Does the Board agree with staff's proposed edits to the lease term language in paragraphs 14 – 18 in **Attachment 2**?

Question 4: Does the Board agree with staff's recommendation to change the effective date of the Statement to reporting periods beginning after September 30, 2020? Staff expects the final Statement to be balloted at the October 2017 meeting, however in addition to the 90-day Sponsor review, the Statement will also be subject to the 45-day Congressional review.

Question 5: Does the Board agree with the other revisions to draft Leases standard?



Federal Accounting Standards Advisory Board

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

Statement of Federal Financial Accounting Standards **XX**

MARKED VERSION

August 30, 2017

WORKING DRAFT

THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General of the United States, established the Federal Accounting Standards Advisory Board (FASAB or "the Board") in October 1990. FASAB is responsible for promulgating accounting standards for the United States government. These standards are recognized as generally accepted accounting principles (GAAP) for the federal government.

An accounting standard is typically formulated initially as a proposal after considering the financial and budgetary information needs of citizens (including the news media, state and local legislators, analysts from private firms, academe, and elsewhere), Congress, federal executives, federal program managers, and other users of federal financial information. The proposed standards are published in an exposure draft for public comment. In some cases, a discussion memorandum, invitation for comment, or preliminary views document may be published before an exposure draft is published on a specific topic. A public hearing is sometimes held to receive oral comments in addition to written comments. The Board considers comments and decides whether to adopt the proposed standard with or without modification. After review by the three officials who sponsor FASAB, the Board publishes adopted standards in a Statement of Federal Financial Accounting Standards. The Board follows a similar process for Statements of Federal Financial Accounting Concepts, which guide the Board in developing accounting standards and formulating the framework for federal accounting and reporting.

Additional background information is available from FASAB or its website:

- ["Memorandum of Understanding among the Government Accountability Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board."](#)
- ["Mission Statement: Federal Accounting Standards Advisory Board"](#), [exposure drafts](#), [Statements of Federal Financial Accounting Standards and Concepts](#), [FASAB newsletters](#), and other items of interest are posted on FASAB's website at: www.fasab.gov .

Copyright Information

This is a work of the U. S. government and is not subject to copyright protection in the United States. It may be reproduced and distributed in its entirety without further permission from FASAB. However, because this work may contain copyrighted images or other material, permission from the copyright holder may be necessary if you wish to reproduce this material separately. The GASB material used in this ~~exposure draft~~[Statement](#) is copyrighted by the Financial Accounting Foundation, 401 Merritt 7, Norwalk, CT 06856, USA, and is used with permission.

Contact us:

Federal Accounting Standards Advisory Board
441 G Street, NW, Suite 6814
Mailstop 6H19
Washington, DC 20548
Telephone 202-512-7350
FAX 202-512-7366
www.fasab.gov

SUMMARY

This Statement revises the accounting and financial reporting standards for ~~the existing~~ federal lease accounting standards. The ~~proposal would~~Statement provides a comprehensive set of lease accounting standards to recognize federal lease activities in the reporting entity's general purpose federal financial reports and include appropriate disclosures.

This Statement requires that federal lessees recognize a lease liability and a leased asset at the beginning of the lease, unless it meets any of the scope exclusions, is an intragovernmental lease, or a short-term lease. A federal lessor would recognize a lease receivable and deferred revenue, unless it meets any of the scope exclusions, is an intragovernmental lease, or a short-term lease.

The provisions of this Statement need not be applied to immaterial items. The determination of whether an item is material depends on the degree to which omitting or misstating information about the item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement.

TABLE OF CONTENTS

Summary	4
Standards	6
Scope	6
Definitions	7
Lease Term	8
Short-Term Leases.....	10
Lessee Recognition and Measurement for Leases Other Than intragovernmental leases, Short-Term Leases and Contracts That Transfer Ownership	14
Disclosure Requirements for lessees.....	18
Lessor Recognition and Measurement for Leases Other.....	18
Than Short-Term Leases and Contracts or agreements That Transfer.....	18
Ownership	18
Disclosures for Lessors	21
Lease incentive and lease concessions	22
Contracts or Agreements with Multiple Components	22
Contract or Agreement Combinations.....	23
Lease Terminations and Modifications	24
Subleases	25
Sale-Leaseback Transactions	26
Lease-Leaseback Transactions	27
Amendments to SFFAS 5, <i>Accounting for Liabilities of the Federal Government</i> and SFFAS 6, <i>Accounting for Property, Plant, and Equipment</i>	28
implementation	30
Effective Date	31
Appendix A: Basis for Conclusions	32
Project history	32
Key Areas of Improvement.....	33
Scope	34
Definitions	35
Lease Term -- Options to extend or terminate	35
Short-term Leases.....	36
Intragovernmental Leases	36
Leases other than Short-Term Leases, Contracts or Agreements that Transfer Ownership, and Intragovernmental Leases	37
Appendix B: Abbreviations.....	41
Appendix C: Glossary	42

STANDARDS

SCOPE

1. This Statement applies to federal entities that present general purpose federal financial reports, including the consolidated financial report of the U.S. Government (CFR), in conformance with generally accepted accounting principles, as defined by paragraphs 5 through 8 of Statement of Federal Financial Accounting Standards (SFFAS) 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*.
2. For purposes of applying this Statement, a **lease**¹ is defined as a contract or agreement that conveys the right to control the use of another entity's nonfinancial property, plant, and equipment² (the underlying asset) for a period of time as specified in the contract or agreement in an exchange for consideration~~transaction~~. To qualify as a lease, the underlying asset typically should be identified by being explicitly specified in a contract or agreement. However, an asset also can be identified by being implicitly specified at the time that the asset is made available for use by the lessee. Leases include contracts or agreements that, although not explicitly identified as leases, meet the definition of a lease.
3. To determine whether a contract or agreement conveys the right to control the use of the underlying asset, an entity should assess whether the federal entity has both of the following:
 - a. The right to obtain economic benefits or services from use of the underlying asset as specified in the contract or agreement.
 - b. The right to control access to the economic benefits or services of the underlying asset as specified in the contract or agreement.
- 2.4. This definition excludes contracts or agreements for services except those contracts or agreements that contain both a lease component and a service component. This definition. A service contract is a contract that directly engages the time and effort of a contractor whose primary purpose is to perform an identifiable task rather than to provide a tangible asset. does not include contracts or agreements for services unless that contract or agreement also conveys the right to use a nonfinancial asset (the underlying asset) for a period of time in an exchange transaction.

~~This Statement amends the lease accounting standards in SFFAS 5, Accounting for Liabilities of the Federal Government, and SFFAS 6, Accounting for Property, Plant, and Equipment. This Statement also establishes distinct standards for intragovernmental leases.~~

¹ Terms defined in the Glossary are shown in bold-face the first time they appear.

² ~~Examples of nonfinancial assets include land, buildings, vehicles, equipment, internal use software, and intangible assets. Examples of financial assets include cash, investments, and receivables. See SFFAS 6, Accounting for Property, Plant, and Equipment.~~

5. This Statement does not apply to:

- a. ~~leases of federal natural resources as defined in Technical Bulletin (TB) 2011-1, Accounting for Federal Natural Resources Other than Oil and leases of federal oil and gas resources as defined in SFFAS 38, Accounting for Federal Oil and Gas Resources. Leases of assets under construction.~~
- b. ~~Leases (licenses) of internal use software (See SFFAS 10, Accounting for Internal Use Software, as amended).~~

DEFINITIONS

~~3-6. **Lease** – A lease is defined as a contract or agreement that conveys the right to control the use of another entity's property, plant, and equipment (PP&E) (the underlying asset) for a period of time as specified in the contract or agreement in exchange for consideration. A lease is 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.~~

~~4-7. **Intragovernmental Lease** – An intragovernmental lease is a contract or agreement that conveys the right to control the use of another entity's PP&E asset (the underlying asset) for a period of time as specified in the contract or agreement in exchange for consideration occurring within a consolidation entity or between two or more consolidation entities as defined under SFFAS 47, Reporting Entity. An intragovernmental lease is a lease occurring within a consolidation entity or between two or more consolidation entities as defined under SFFAS 47, Reporting Entity.³~~

~~**Lease Option Periods** – Lease option periods are additional lease periods beyond the initial lease term. The options may be included in the initial lease or may be agreed to later in the lease term.~~

~~5-8. **Initial Direct Costs** – Initial direct costs are costs that are directly attributable to negotiating and arranging a lease or portfolio of leases and would not have been incurred without entering into the lease.~~

~~9. **Short-Term Lease** – a lease with a lease term (as defined in paragraph 14) of 24 months or less. A short-term lease is a lease that, at the beginning of the lease, has a maximum possible term under the contract or arrangement of 24 months or less, including any options to extend, regardless of their probability of being exercised.~~

~~10. **Lease Incentives** – Lease incentives include lessor payments made to or on behalf of the lessee to entice the lessee to sign a lease. Lease incentives may include up-front cash payments to the lessee; for example, moving costs, termination fees to lessee's prior lessor, or lessor's assumption of the lessee's lease obligation under a different lease with another lessor.~~

³ See SFFAS 47, Reporting Entity, par. 38-42.

11. Lease Concessions – Lease concessions are rent discounts made by the lessor to entice the lessee to sign a lease. Lease concessions include rent holidays/free rent periods, reduced rents, or commission credits.

12. Leasehold Improvements – Leasehold improvements are additions, alterations, remodeling, renovations or other changes to a leased property that either extend the useful life of the existing property or enlarge or improve its capacity and are paid for (financed) by the lessee.

~~6-13.~~ **Lessor Improvements** – Lessor improvements are additions, alterations, remodeling, renovations or other changes to a leased property that either extend the useful life of the existing property or enlarge or improve its capacity and are paid for (financed) by the lessor rather than by the lessee.

~~STANDARDS FOR NON-INTRAGOVERNMENTAL LEASES~~

LEASE TERM

14. The lease term is the period during which a lessee has a noncancelable right to use an underlying asset (referred to as the noncancelable period), plus the following periods, if applicable:~~plus each option period if it is **probable**, based on all relevant factors, that the lessee will exercise that option to extend the lease.~~

a. Those periods specified in the lease contract or agreement that include a lessee's option to extend the lease if it is probable, based on all relevant factors, that the lessee will exercise that option

b. Those periods specified in the lease contract or agreement that include a lessee's option to terminate the lease if it is probable, based on all relevant factors, that the lessee will *not* exercise that option

c. Those periods specified in the lease contract or agreement that include a lessor's option to extend the lease if it is probable, based on all relevant factors, that the lessor will exercise that option

d. Those periods specified in the lease contract or agreement that include a lessor's option to terminate the lease if it is probable, based on all relevant factors, that the lessor will *not* exercise that option.

~~7-15.~~ The period during which a lessee has a noncancelable right is the shorter of~~The noncancelable period is the shorter of~~

a. the initial lease period, before considering ~~renewal~~ option periods for additional periods to extend the lease; or

~~the period of the lease preceding an option for the lessee to terminate the lease if it is probable, based on all relevant factors, that the lessee will exercise that option to terminate; or~~

- b. the period of the lease preceding a point at which either ~~the lessor only or both~~ the lessee ~~and or~~ the lessor have an option to terminate the lease, regardless of the probability of termination.⁴

~~8-16.~~ In determining the lease term, the following specific provisions should be applied:

- a. ~~When the noncancelable period is less than the initial lease term (due to options to terminate discussed in par. 15b and 15c) there should be no option periods added to the noncancelable period in calculating the lease term.~~

- b. Month-to-month lease holdovers, also referred to as rolling lease extensions, or any lease that continues into a holdover period until a new contract or agreement is signed would be considered cancelable if both the lessee and the lessor have an option to terminate, and therefore either could cancel the lease at any time. These holdover periods are cancelable periods and should be excluded from the lease term.⁵

- ~~b-c.~~ Provisions that allow for termination of a lease due to (a) purchase of the underlying asset, (b) payment of all sums due, or (c) default on payments are not considered options to terminate.

- ~~c-d.~~ A fiscal funding or cancellation clause ~~(a clause that allows federal lessees to cancel a lease agreement, typically on an annual basis, if funds for the lease payments are not appropriated).~~ This type of clause should affect the lease term only when it is probable that the clause will be exercised~~should be considered in determining the lease term only when it is probable that the clause will be exercised.~~

~~Month-to-month lease holdovers, also referred to as rolling lease extensions, or any lease that continues into a holdover period until a new contract or agreement is signed should be considered cancelable because either the lessee or lessor could cancel the lease at any time. These holdover periods should be excluded from the lessee's lease liability and the lessor's lease receivable.~~⁶

~~9-17.~~ At the beginning commencement of a lease term, lessors and lessees should assess all factors relevant to the likelihood that the lessee will exercise options identified in paragraph 14, whether these factors are contract ~~/ or~~ agreement based, underlying asset based, market based, or federal specific. The assessment often will require the consideration of a combination of these interrelated factors. Examples of factors to consider include, but are not limited to, the following:

⁴ ~~Periods for which either the lessor only or both the lessee and the lessor have an option to terminate the lease are cancelable periods and are excluded from the lease term.~~

⁵ SFFAS 1, Accounting for Selected Assets and Liabilities, applies to any related accounts payable or accounts receivable amounts.

⁶ ~~SFFAS 1, Accounting for Selected Assets and Liabilities, applies to any related accounts payable or accounts receivable amounts.~~

- a. A significant economic incentive, such as contractual or agreement terms and conditions for the option al periods that are favorable compared with current market rates
- b. A significant economic disincentive, such as costs to terminate the lease and sign a new lease (for example, negotiation costs, relocation costs, abandonment of significant leasehold improvements, costs of identifying another suitable underlying asset, costs associated with returning the underlying asset in a contractually specified condition or to a contractually specified location, or a substantial cancellation penalty)
- c. The lessee's history of exercising renewal or termination options options to extend or terminate
- d. The extent to which the lease-asset underlying the lease is considered-mission critical to the federal entity

~~10-18.~~ Lessors and lessees should reassess the lease term only if the lessee does either of the following:

- a. The lessor or lessee Elects to exercise an option even though the lessor or lessee had it was previously determined that it was not-probable that the lessee would not exercise that option
- b. The lessor or lessee Does not elect to exercise an option even though the lessor or lessee had it was previously determined that it was probable that the lessee would exercise that option
- ~~b-c.~~ An event specified in the lease contract or agreement that requires an extension or termination of the lease takes place.

~~RECOGNITION AND MEASUREMENT FOR LESSEES~~

~~11. At the beginning of the lease term, a lessee should recognize a lease liability and a property, plant, and equipment (PP&E)⁷-right to-use lease asset (hereinafter referred to as the lease asset), except as provided in paragraph 20 and paragraphs 59-61 (short-term leases).~~

SHORT-TERM LEASES

~~12-19. A short-term lease is a lease with a lease term (as defined in paragraph 1419) of 24 months or less 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. For a lease that is cancelable by either the lessee or the lessor, such as a month-to-month lease or a year-to-year lease, the maximum possible term is the noncancelable period, including any notice periods. For a lease that is~~

⁷ ~~The lease asset should be classified as PP&E unless the underlying asset is not PP&E. In those instances, such assets should be classified with the underlying asset.~~

~~cancellable only by the lessee, the maximum possible term should be evaluated under the requirements of the lease term as defined in paragraph 14.~~

LESSEE TREATMENT OF SHORT-TERM LEASES

~~13-20.~~ A lessee should recognize short-term lease payments as expense based on the payment provisions of the contract ~~/ or~~ agreement. The lessee ~~should not apply the recognition and measurement requirements of paragraphs 19–35 but~~ should recognize an asset if payments are made in advance of the reporting period to which they relate, or a liability for rent due if payments are made subsequent to that reporting period. The lessee should recognize any rent holiday period (for example, one or more months free) as reductions of lease rental expense on a straight-line basis over the lease term.

LESSOR TREATMENT OF SHORT-TERM LEASES

~~14-21.~~ A lessor should recognize short-term lease payments as revenue based on the payment provisions of the contract ~~/ or~~ agreement. The lessor ~~should not apply the recognition and measurement requirements of paragraphs 36–50 but~~ should recognize a liability if payments are received in advance of the reporting period to which they relate, or an asset for rent due if payments are received subsequent to that reporting period. The lessor should recognize any rent holiday period (for example, one or more months free) as reductions of lease rental income on a straight-line basis over the lease term.

LEASES CONTRACTS OR AGREEMENTS THAT TRANSFER OWNERSHIP

~~15-22.~~ A ~~lease~~ contract ~~or /~~ agreement that (a) transfers ownership of the underlying asset to the lessee by at or before the end of the lease contract or agreement, and (b) does not contain termination options options to terminate (see par. 141914 - 152015), but that may contain a fiscal funding or cancellation clause that is not probable of being exercised (see par. 16.d), should be reported as a purchase of that asset by the lessee or as a financed sale of the asset by the lessor.⁸

STANDARDS FOR INTRAGOVERNMENTAL LEASES

~~16-23.~~ ~~This section describes the overall recognition, measurement, and disclosure requirements for intragovernmental leases. An intragovernmental lease is a contract or agreement that conveys the right to control the use of another entity's PP&E asset (the underlying asset) for a period of time as specified in the contract or agreement in exchange for consideration occurring within a consolidation entity or between two or more consolidation entities as defined under SFFAS 47, Reporting Entity. 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~~

⁸ See SFFAS 6, *Accounting for Property, Plant, and Equipment*, par. 26.

~~Entity.~~ Any lease that meets the definition of an intragovernmental lease would be required to follow the accounting guidance described in paragraphs ~~2477~~ – ~~364395~~ below.

~~INTRAGOVERNMENTAL LEASES—LESSEE ACCOUNTING~~

~~17. The following sections articulate the general recognition guidance for lessees of intragovernmental leases and detailed recognition guidance regarding several specific intragovernmental lease topics, as well as disclosure guidance.~~

~~RECOGNITION AND MEASUREMENT~~

~~GENERAL GUIDANCE FOR RECOGNITION OF INTRAGOVERNMENTAL LEASES⁹~~

~~24. A lessee should recognize lease payments, including lease-related operating costs (for example, maintenance, utilities, taxes, etc.) paid to the lessor, as expenses based primarily on the payment provisions of the lease. Prepaid rent or a payable for rent due should be recognized as an asset or liability, respectively, and an expense should be recognized in the appropriate reporting period based on the specifics of the lease provisions.~~

~~25. A lessee would not recognize a lease asset and a corresponding liability for an intragovernmental lease. Accordingly, a lessee would not recognize amortization expense related to a lease asset or interest expense on a lease liability.~~

~~18.26. A lessor should recognize lease receipts, including lease-related operating costs (for example, maintenance, utilities, or taxes) received from the lessee as income based primarily on the provisions of the lease.~~

~~Recognition should be based on the payment provisions of the lease. Prepaid rent or a payable for rent due should be recognized as an asset or liability, respectively, and an expense should be recognized in the appropriate period based on the specifics of the lease provisions.~~

~~GUIDANCE FOR RECOGNITION OF SPECIFIC INTRAGOVERNMENTAL LEASE TOPICS~~

~~19.27. Rental Increases—Rental increases may be fixed in the lease and take place with the passage of time (for example, be based on such factors as anticipated increases in costs or anticipated appreciation in property values, but the amount of the increase is specified in the lease) or they may be contingent on future events.~~

~~20.28. Contingent Variable rental increases are based on changes in specific economic factors, for example, future activity levels or future inflation (for example, tied to a specific economic indicator where the specific amount of the change is not known).~~

~~21.29. If the lease provides for rental increases, a lessee should recognize the expense in the period of the increase as provided in the lease.⁴⁹~~

⁹ ~~SFFAS 4, *Managerial Cost Accounting Standards and Concepts*, par. 105-115 (as amended by SFFAS 30), continue to apply for non-reimbursed or under reimbursed intragovernmental lease arrangements.~~

~~Lease Incentives—Lease incentives include lessor payments made to or on behalf of the lessee to entice the lessee to sign a lease. Lease incentives may include up-front cash payments to the lessee; for example, moving costs, termination fees to lessee's prior lessor, or lessor's assumption of the lessee's lease obligation under a different lease with another lessor.~~

30. Lease incentives should be recognized by the lessee as reductions of lease rental expense ~~by the lessee~~ on a straight-line basis over the lease term. The lessee should recognize the expenses or losses to which the incentives relate in the reporting period the costs are incurred. For example, an incentive equal to the moving expense incurred to occupy the leased space reduces rent expense over the lease term and the moving expense is recognized in the reporting period incurred (that is, when the move occurs). Lease incentives should be recognized by the lessor as reductions of lease rental income on a straight-line basis over the lease term.

~~Lease Concessions—Lease concessions are rent discounts made by the lessor to entice the lessee to sign a lease. Lease concessions include rent holidays/free rent periods, reduced rents, or commission credits.~~

22.31. Lease concessions should be recognized by the lessee as reductions of lease rental expense ~~by the lessee~~ on a straight-line basis over the lease term. Lease concessions should be recognized by the lessor as reductions in rental income on a straight-line basis over the lease term.

23.32. Leasehold Improvements—~~Leasehold improvements are additions, alterations, remodeling, renovations or other changes to a leased property that either extend the useful life of the existing property or enlarge or improve its capacity and are paid for (financed) by the lessee.~~ **Leasehold improvements** that are placed in service at or after the beginning of the lease term should be amortized over the useful life (the normal operating life in terms of utility to the owner) of the leasehold improvement, but no longer than the expected lease term.

24.33. Lessor improvements are components of the leased property and should be capitalized and depreciated by the lessor over their useful life consistent with the lessor's accounting for property, plant, and equipment.¹¹

25.34. Initial Direct Costs—~~Lessor~~ **Initial direct costs** incurred by the lessee should be expensed when incurred ~~by the lessor~~. Initial direct cost incurred by the lessor should be expensed when incurred.

DISCLOSURES

¹⁰ Par. 79—81 outlines the general guidance for increases in rental payments; however guidance for other changes in rental payments is outlined in par. 82—85.

¹¹ This recognition is consistent with PP&E capital improvements outlined in SFFAS 6, par. 37.

~~26-35.~~ Lessees should disclose a broad summary of significant intragovernmental leasing arrangements, including

- a. existence of intragovernmental leases and annual expense,
- b. general lease terms with specific intragovernmental requirements (which may be grouped for purposes of disclosure), and
- c. annual lease expense by major leased asset category.

~~27-36.~~ Lessors should disclose the following regarding intragovernmental leases:

- a. Future lease ~~rental income as of the date of the latest balance sheet presented, in the aggregate and payments that are to be received~~ for each of the five succeeding fiscal years for lease arrangements over the lease term
- b. A broad summary of significant leases (which may be grouped for purposes of disclosure), including a breakdown of the number of leases with federally-owned assets and privately-owned assets

LESSEE RECOGNITION AND MEASUREMENT FOR LEASES OTHER THAN INTRAGOVERNMENTAL LEASES, SHORT-TERM LEASES AND CONTRACTS THAT TRANSFER OWNERSHIP **STANDARDS FOR NON-INTRAGOVERNMENTAL LEASES**

RECOGNITION AND MEASUREMENT FOR LESSEES

~~28-37.~~ At the commencement of the lease term, a lessee should recognize a lease liability and a property, plant, and equipment (PP&E)¹² right-to-use lease asset (hereinafter referred to as the lease asset), except as provided in, paragraphs ~~1924 - 2126~~ (short-term leases), paragraph ~~2227~~ (contracts or agreements that transfer ownership), and paragraph ~~2328 - 3641~~ (intragovernmental leases) -

LEASE LIABILITY

~~29-38.~~ A lessee **initially** should measure the lease liability ~~initially~~ at the present value of payments **expected** to be made ~~for during~~ the lease term. Measurement of the lease liability should include the following, ~~if types of payments that might be~~ required by a lease:

- a. Fixed payments, ~~less any lease incentives (such as a cash payment or reimbursement of moving costs) receivable from the lessor~~

- b. Variable ~~lease~~ payments that depend on an index or a rate (such as the Consumer Price Index or a market interest rate), initially measured using the index or rate as of the beginning commencement of the lease term
- c. Variable ~~lease~~ payments that are fixed in-substance as described in paragraph par. 394622
- d. Amounts that are probable of being required to be paid by the lessee under residual value guarantees
- e. The exercise price of a purchase option if it is probable that the lessee will exercise that option
- f. Payments for penalties for terminating the lease, if the lease term reflects the lessee exercising (1) an option to terminate the lease or (2) a fiscal funding or cancellation clause
- f.g. Any lease incentives (as discussed in par 6774 and 6875) receivable from the lessor
- g.h. Any other payments that are probable of being required based on an assessment of all relevant factors

30-39. Variable payments based on future performance of the lessee or usage of the underlying asset should not be included. Rather, these variable payments should be recognized as an expense in the statement of net cost in the reporting period in which those payments are incurred. However, any component of these variable payments that is fixed in-substance should be included in the lease liability. An example is a lease payment based on a percentage of sales or usage but with a required minimum amount to be paid. That required minimum payment is fixed in-substance.

31-40. The future lease payments should be discounted using the interest rate the lessor charges the lessee, which may be the interest rate implicit in the lease. If the interest rate cannot be reasonably estimated by the lessee, the **lessee's estimated incremental borrowing rate**¹³ (the estimated rate that would be charged for borrowing the lease payment amounts for the lease term) should be used.

32-41. At-In subsequent financial reporting datesperiods, the lessee should calculate the amortization of the discount on the lease liability and recognize that amount as interest expense for the period. Any payments made should be allocated first to the accrued interest liability and then to the lease liability.

33-42. The lessee should remeasure the lease liability at subsequent financial reporting dates if one or more of the following changes¹⁴ have occurred at or before that financial reporting date, based on the most recent lease contract or agreement before the changes, and the changes individually or in the aggregate are expected to significantly affect the amount of

¹³ A federal lessee's incremental borrowing rate would be the Treasury borrowing rate for securities of similar maturity to the term of the lease unless the entity has its own borrowing authority.

¹⁴ Changes arising from amendments to a lease contract or agreement should be accounted for under the provisions of paragraphs X-X for lease modifications and terminations.

~~the lease liability since the previous measurement. 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:~~

- ~~a. There is a change in the lease term due to a reassessment (see par. 18), a modification (see par. 66), or a termination (see par. 64).~~
- ~~b. An assessment of all relevant factors indicates that the likelihood of a residual value guarantee being required to be paid ~~being paid~~ has changed from probable to not probable, or vice versa.~~
- ~~c. An assessment of all relevant factors indicates that the likelihood of a purchase option being exercised has changed from probable to not probable, or vice versa.~~
- ~~d. There is a change in the estimated amounts for payments already included in the liability (except as provided in par. 4148).~~
- ~~e. There is a change in the interest rate the lessor charges the lessee, if used as the initial **discount rate**.~~
- ~~e.f. A contingency, upon which some or all of the variable payments that will be made over the remainder of the lease term are based, is resolved such that those payments now meet the criteria for measuring the lease liability under paragraph 3845. For example, an event occurs that causes variable payments that were contingent on the performance or use of the underlying asset to become fixed payments for the remainder of the lease term.~~

~~34.43.~~ If a lease liability is remeasured for any of the changes in paragraph ~~424925~~, the liability also should be ~~remeasured-adjusted~~ for any change in an index or rate used to determine variable lease payments if that change in the index or rate is expected to significantly affect the amount of the liability since the previous measurement. A lease liability is not required to be remeasured solely for a change in an index or rate used to determine variable ~~lease~~ payments.

~~35.44.~~ The lessee also should update the discount rate as part of the remeasurement if one or both of the changes in par. 42.a49-a. or 42.c49-c have occurred and the changes individually or in the aggregate are expected to significantly affect the amount of the lease liability ~~The lessee also should update the discount rate as part of the remeasurement if any of the following changes have occurred and, are expected to significantly affect the amount of the lease liability:~~

- ~~a. There is a change in the lease term due to a reassessment (see par. 18), a modification (see par. 66), or a termination (see par. 64).~~
- ~~b. An assessment of all relevant factors indicates that the likelihood of a purchase option being exercised has changed from probable to not probable, or vice versa.~~

~~36.45.~~ 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.

~~37.46.~~ If the discount rate is required to be updated based on the provisions in ~~paragraph par. 445127~~, the discount rate should be based on the revised interest rate the lessor charges the lessee at the time the discount rate is updated. If that interest rate cannot be readily

determined, the lessee's estimated incremental borrowing rate at the time the discount rate is updated should be used.

LEASE ASSET

~~38.47.~~ A lessee should initially measure the lease asset as the sum of the following:

- a. The amount of the initial measurement of the lease liability (see par. ~~38.45~~24)
- b. Lease payments made to the lessor at or before the beginning commencement of the lease term, less any lease incentives ~~received from the lessor~~(as discussed in par. 6774. and 6875)
- c. Initial direct costs that are ~~ancillary charges~~ necessary to place the lease asset into service

~~39.48.~~ ~~The A~~ lease asset should be amortized in a systematic and rational manner over the shorter of the lease term or the useful life of the underlying asset, except as provided in paragraph par. 495632. The amortization of the lease asset should be reported as amortization expense.

~~40.49.~~ ~~If a lease contains a purchase option that the lessee has determined is probable of being exercised, the lease asset should be amortized over the useful life of the underlying asset. In that circumstance, if the underlying asset is nondepreciable, such as land, the lease asset should not be amortized. The presence of a bargain purchase option in a lease contract/agreement is not equivalent to a provision that transfers ownership of the underlying asset; therefore a bargain purchase option should be treated as any other purchase option included in a lease. If the lease contains a purchase option that the lessee has determined is probable of being exercised, the lease asset should be amortized over the useful life of the underlying asset. In this circumstance, if the underlying asset is non-depreciable, such as land, then the lease asset should not be amortized.~~

~~41.50.~~ The lease asset generally should be adjusted by the same amount when the corresponding lease liability is remeasured based on paragraphs par. 424925–465329. However, if this change reduces the carrying value of the lease asset to zero, any remaining amount should be reported in the flows statement as a gain.

~~42.51.~~ ~~Leased assets classified as property, plant, and equipment are subject to The presence of impairment indicators (described in par. 12 of SFFAS 44, Accounting for Impairment of General Property, Plant, and Equipment Remaining in Use) with respect to the underlying asset may result in a change in the manner or duration of use of the lease asset. The change in the manner or duration of use of the lease underlying asset is an indicator that the lease-right of use asset may be impaired (described in par. 12 of SFFAS 44). The period for which the underlying asset has less usable capacity should be the relevant factor(s) in determining the magnitude of the decline in service utility of the lease asset. If a lease the underlying asset is impaired, it should be reduced first for any change in the~~

corresponding lease liability. Any remaining amount should be recognized as an impairment.¹⁵

DISCLOSURE REQUIREMENTS FOR LESSEES

~~43.~~52. A lessee should disclose the following about its lease activities (which may be grouped for purposes of disclosure), other than short-term leases:

- a. A general description of its leasing arrangements, including:
 - i. the basis, terms, and conditions on which variable lease payments not included in the lease liability are determined
 - ii. the existence, terms, and conditions of residual value guarantees provided by the lessee
- b. The total amount of lease assets, and the related accumulated amortization, to be disclosed separately from other PP&E assets
- c. The amount of lease expense recognized for the reporting period for variable lease payments not previously included in the lease liability
- d. Principal and interest requirements to maturity, presented separately, for the lease liability for each of the five subsequent years and in five-year increments thereafter
- e. The amount of the annual lease expense and the discount rate used to calculate the lease liability

~~RECOGNITION AND MEASUREMENT FOR LESSORS~~LESSOR RECOGNITION AND MEASUREMENT FOR LEASES OTHER

THAN SHORT-TERM LEASES AND CONTRACTS OR AGREEMENTS THAT TRANSFER

OWNERSHIP

~~44.~~53. At the beginning-commencement of the lease term, a lessor should recognize a lease receivable and a deferred revenue, except as provided in paragraph 19 - 21 (short-term leases) paragraph 22 (contracts or agreements that transfer ownership), and paragraphs 23 - 36 (intragovernmental leases). Any initial direct costs incurred by the lessor should be reported as an expense of the period.

~~LEASES THAT TRANSFER OWNERSHIP~~

¹⁵ See SFFAS 44, *Accounting for Impairment of General Property, Plant, and Equipment Remaining in Use*, par. 18 – 25.

~~45. 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) should be reported as a financed sale of that asset.~~

LEASE RECEIVABLE

~~46-54.~~ A lessor initially should measure the lease receivable ~~initially~~ at the present value of lease payments to be received for the lease term, reduced by any provision for uncollectible amounts. Measurement of the lease receivable should include the following types of payments that might be required by a lease:

- a. Fixed payments
- b. Variable payments that depend on an index or a rate (such as the Consumer Price Index or a market interest rate), initially measured using the index or rate as of the beginning-commencement of the lease term
- c. Variable lease payments that are fixed in-substance as described in paragraph~~Portions of variable payments that are fixed in substance (as described in par. 556239)~~
- d. Residual value guarantees that are fixed payments in substance (as described in par. 566340).
- ~~d-e.~~ Any lease incentives (as discussed in par. 6774 and 6875) payable to the lessee.

~~47-55.~~ Variable payments based on future performance of the lessee or usage of the underlying asset should not be included in the measurement of the lease receivable. ~~Those Rather those~~ payments should be recognized as revenue in the reporting period to which those payments relate. However, any component of those variable payments that is fixed in substance should be included in the lease receivable. For example, if a lease payment is based on a percentage of sales but has a required minimum payment, that required minimum is a fixed payment in substance. Similarly, a residual value guarantee is an in-substance fixed payment if it stipulates the underlying asset will be sold at the end of the lease term, with the lessee assuming a liability for any shortfall if the sales price is less than an agreed-upon minimum amount.

~~48-56.~~ Amounts to be received under residual value guarantees (that are not fixed in substance) should be recognized as a receivable and revenue when (a) a guarantee payment is required (as agreed to by the lessee and lessor) and (b) the amount can be reasonably estimated. Amounts to be received for the exercise price of a purchase option or penalties-penalty for lease termination should be recognized as a receivable and revenue when those options are exercised.

~~49-57.~~ The future lease payments to be received should be discounted using the rate the lessor charges the lessee, which may be the interest rate implicit in the lease. Lessors are not required to apply imputed interest but may do so as a means of determining the interest rate implicit in the lease.

~~50-58.~~ At In subsequent financial reporting datesperiods, the lessor should calculate the amortization of the discount on the receivable and report that amount as interest revenue for the period. ~~It should be calculated so as to produce a constant periodic rate of return on the receivable.~~ Any payments received should be allocated first to the accrued interest receivable and then to the lease receivable.

~~51-59.~~ The lessor should remeasure the lease receivable at subsequent financial reporting periods if one or more of the following changes have occurred at or before that financial reporting period, based on the most recent lease contract or agreement before the changes¹⁶, and the changes individually or in the aggregate are expected to significantly affect the amount of the lease receivable since the previous measurement:~~The lessor should remeasure the lease receivable and update the discount rate at subsequent financial reporting dates if either of the following changes have occurred and are expected to significantly affect the amount of the receivable:~~

a. There is a change in the lease term~~There is a change in the lease term.~~

b. There is a change in the interest rate the lessor charges the lessee.

~~b-c.~~ A contingency, upon which some or all of the variable payments that will be received over the remainder of the lease term are based, is resolved such that those payments now meet the criteria for measuring the lease receivable under paragraph 5461. For example, an event occurs that results in variable payments that were contingent on the performance or use of the underlying asset becoming fixed payments for the remainder of the lease term.

~~52-60.~~ If a lease receivable is remeasured for either of the changes in paragraph 0043, the receivable also should be remeasured-adjusted for any change in an index or rate used to determine variable lease payments if that change in the index or rate is expected to significantly affect the amount of the receivable since the previous measurement. A lease receivable is not required to be remeasured solely for a change in an index or rate used to determine variable lease payments.

~~53-61.~~ The lessor also should update the discount rate as part of the remeasurement if one or both of the following changes in paragraph 59.a66.a. or 59.b66.b have occurred and the changes individually or in the aggregate are expected to significantly affect the amount of the lease receivable~~If the discount rate is updated based on the provisions in paragraph 43, the receivable should be discounted using the revised rate.~~

DEFERRED REVENUE

62. A lessor initially should measure the deferred revenue as follows:

a. The amount of the initial measurement of the lease receivable (see par. 5461)

¹⁶ Changes arising from amendments to a lease contract or agreement should be accounted for under the provisions of paragraphs X-X for lease modifications and terminations.

b. Lease payments received from the lessee at or before the commencement of the lease term that relate to future periods (for example, the final month's rent), less any lease incentives (as discussed in par. X and X) paid to, or on behalf of, the lessee at or before the commencement of the lease term.

~~A lessor should measure the deferred revenue at the initial value of the lease receivable, less any provision for uncollectible amounts (see par. 38), plus the amount of any payments received at or prior to the beginning of the lease that relate to future periods (for example, the final month's rent). A lessor subsequently should recognize deferred revenue in a systematic and rational manner over the term of the lease.~~

~~54-63.~~ A lessor subsequently should recognize deferred revenue in a systematic and rational manner over the term of the lease. The deferred revenue generally should ~~generally~~ be adjusted using the same amount as the change resulting from the remeasurement of the lease receivable as discussed in paragraphs ~~5966-6168~~.

UNDERLYING ASSET

~~55-64.~~ A lessor should **not** derecognize the asset underlying the lease. A lessor should continue to apply other applicable guidance to the underlying asset, including depreciation and impairment. However, if the lease contract or agreement requires the lessee to return the asset in its original or enhanced condition, a lessor should not depreciate the asset during the lease term.

DISCLOSURES FOR LESSORS

~~56-65.~~ A lessor should disclose the following about its lease activities (which may be grouped for purposes of disclosure), other than short-term leases:

- a. A general description of its leasing arrangements, including the basis, terms, and conditions on which any variable lease payments not included in the lease receivable are determined
- b. The carrying amount of assets on lease ~~or held for leasing~~, by major classes of assets, and the amount of accumulated depreciation
- 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
- 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.

~~66.~~ In addition to the disclosures in paragraph ~~657249~~, if a federal entity's principal ongoing operations consist of leasing assets through the use of non-intragovernmental leases, the federal entity should disclose a schedule of future lease payments that are included in the lease receivable, showing principal and interest, for each of the five subsequent years and in five-year increments thereafter.

LEASE INCENTIVE AND LEASE CONCESSIONS

67. Lease incentives include lessor payments made to or on behalf of the lessee to entice the lessee to sign a lease. Lease incentives may include up-front cash payments to the lessee; for example, moving costs, termination fees to lessee's prior lessor, or lessor's assumption of the lessee's lease obligation under a different lease with another lessor. Lease concessions are rent discounts made by the lessor to entice the lessee to sign a lease. Lease concessions include rent holidays/free rent periods, reduced rents, or commission credits.

68. Lease incentives and lease concessions reduce the amount that a lessee is required to pay for a lease. Lease incentives and lease concessions that provide payments to, or on behalf of, a lessee at or before the commencement of a lease term are included in initial measurement by directly reducing the amount of the lease asset (see par. 30). Lease incentive and lease concession payments to be provided after the commencement of the lease term should be accounted for by lessees and lessors as reductions of lease payments for the periods in which the incentive payments will be provided. Those payments should be measured by lessees consistently with the lessee's lease liability (par. 21–29) and by lessors consistently with the lessor's lease receivable (par. 44–52). Accordingly, lease incentive and lease concession payments to be provided after the commencement of the lease term are included in initial measurement and any remeasurement if they are fixed or fixed in substance, whereas variable or contingent lease incentive or lease concession payments are not included in initial measurement. Lessor improvements that are made to or on behalf of the lessee without additional cost to the lessee should be accounted for by the lessee and the lessor consistent with other lease incentives and lease concessions.

CONTRACT~~S~~ OR AGREEMENTS WITH MULTIPLE COMPONENTS

57-69. Lessors and lessees may enter into ~~one contract~~s/ or ~~agreements~~s that contains multiple components, such as a contract~~/ or~~ agreement that contains both a lease component and a nonlease component, or a lease that contains multiple underlying assets.

58-70. If a lessor or lessee enters into a contract~~/ or~~ agreement that contains both a lease (such as the right to use a building) and a nonlease component (such as a maintenance services for the building), the federal entity should account for the lease and nonlease components as separate contract~~s/ or~~ agreements, unless the contract~~/ or~~ agreement meets the exception in paragraph ~~73-55.b. or paragraph 55.c.~~

59-71. If a lease involves multiple underlying assets and the assets have different lease terms, ~~the~~ lessors~~s~~ and lessees~~s~~ should account for each underlying asset as a separate lease component ~~if the assets have different lease terms~~. The provisions of this paragraph should be applied unless the contract~~/ or~~ agreement meets the exception in paragraph 73.

72. To allocate the ~~consideration required under the~~ contract~~/ or~~ agreement price to the different components, lessors and lessees should first use any prices for individual components that are included in the contract ~~or~~ agreement, as long as the price allocation does not appear to

~~be unreasonable based on the terms of the contract or agreement and professional judgment, maximizing the use of observable information; for example, using readily available if they are reasonable based on other~~ observable stand-alone prices. Stand-alone prices are those that would be paid or received if the same or similar assets were leased ~~individually~~ or if the same or similar nonlease components (such as services) were contracted individually. Some contract ~~or~~ /agreements provide discounts for bundling multiple leases or lease and nonlease components together in one contract ~~or~~ /agreement. These discounts may be taken into account when determining whether individual component prices ~~are reasonable~~ do not appear to be unreasonable. For example, if the individual component prices are each discounted by the same percentage from normal market prices, those component prices would ~~not~~ be considered ~~un~~reasonable.

~~60-73. If a contract or agreement does not include prices for individual components, or if any of those prices appear to be unreasonable as provided in paragraph 7279, lessors and lessees should use professional judgment to determine their best estimate for allocating the contract or agreement price to those components, maximizing the use of observable information. If it is not practicable to determine a best estimate for price allocation for some or all components in a contract or agreement, a federal entity should account for those components as a single lease unit.~~

~~If a contract/agreement does not include prices for individual components, or if those prices are not reasonable based on other observable stand-alone prices, lessors and lessees should do the following, unless the components as a whole are insignificant:~~

~~61. If observable stand-alone prices are readily available for all components, the federal entity should allocate the consideration based on the relative values of the observable stand-alone prices.~~

~~62. If observable stand-alone prices are readily available for some (but not all) components, the federal entity should allocate the observable stand-alone price to each component for which it is readily available. The federal entity may (1) estimate the allocation of the remaining consideration to the remaining components or (2) account for the remaining components as a single lease unit.~~

~~If observable stand-alone prices are not readily available for any of the components, the federal entity may (1) estimate the prices for each component or (2) account for the entire contract/agreement as a single lease unit.~~

~~63-74. When If multiple components are accounted for as a single lease unit, as provided for in paragraph 7380, paragraphs 55.b. and 55.e., the accounting for that unit should be based on the primary lease component within that unit. For example, the primary lease component's lease term should be used for the unit if the lease components have different lease terms.~~

CONTRACT ~~/~~ OR AGREEMENT COMBINATIONS

~~64-75. Contracts or /agreements that are entered into at or near the same time with the same counterparty should be considered to be part of the same lease contract or /agreement if either of the following criteria is met:~~

- a. The contract~~/s or~~ agreements are negotiated as a package with a single objective.
- b. The amount of consideration to be paid in one contract~~/ or~~ agreement depends on the price or performance of the other contract~~/ or~~ agreement.

~~65-76.~~ If multiple contract~~/s or~~ agreements are determined to be part of the same lease contract ~~or /~~ agreement, that ~~lease contract or agreement~~ should be evaluated in accordance with the guidance ~~on for~~ contracts~~s or~~ /agreements with multiple components in paragraphs ~~697651–748156~~.

LEASE TERMINATIONS AND MODIFICATIONS

~~66-77.~~ ~~The provisions of Aa~~ lease contract ~~or /~~ agreement may be amended while ~~if the contract or agreement~~ is in effect. Examples of amendments ~~to lease contracts or agreements~~ include ~~a change in consideration~~~~changing the contract or agreement price~~, a lengthening or shortening of the lease term ~~(see par. 25 and 43)~~, ~~or and~~ adding or removing an underlying asset. An amendment ~~to a lease contract/agreement~~ should be considered a lease modification unless the lessee's right to use the underlying asset decreases, ~~in which case the amendment should be considered a partial or full lease termination. By contrast, exercising an existing option, such as an option to extend or terminate the lease as discussed in paragraph 14, is subject to the guidance for remeasurement.~~ If the lessee's right to use the underlying asset decreases (for example, the lease term is shortened or the number of underlying assets is reduced), that change should be accounted for as a partial lease termination (see par. 64–65).

~~If a lease modification gives the lessee an additional right to use an underlying asset that was not included in the original lease and provides a price comparable to its stand-alone price (in the context of that particular contract/agreement), both the lessee and the lessor should account for that additional portion of the modified lease as a new lease, separate from the original portion of the lease.~~

LEASE TERMINATIONS

~~78.~~ ~~The lessee and lessor should account for an amendment during the reporting period resulting in a decrease in the lessee's right to use the underlying asset (for example, the lease term is shortened or the number of underlying assets is reduced) as a partial or full lease termination.~~

~~67.~~

Lease Terminations

LESSEE TREATMENT OF LEASE TERMINATIONS

~~68-79.~~ A lessee generally should account for the ~~full or partial~~~~partial or full lease~~ termination ~~of a lease~~ by reducing the carrying values of the lease asset and lease liability, and recognizing a gain or loss for the difference. However, if the lease is terminated as a result

of the lessee purchasing the underlying asset from the lessor, the lease asset should be reclassified to the appropriate class of owned asset. ~~The lease liability should be changed to reflect only those payments yet to be made, and that change should be reflected in the cost of the purchased asset.~~

LESSOR TREATMENT OF LEASE TERMINATIONS

~~69-80.~~ A lessor should account for the full or partial termination of a lease by reducing the carrying values of the lease receivable and related deferred revenue and recognizing a gain or loss for the difference. ~~However, if~~ the lease is terminated as a result of the lessee purchasing an underlying asset from the lessor, the carrying value of the underlying asset also should be derecognized and included in the calculation of any resulting gain or loss.

LEASE MODIFICATIONS

~~81.~~ The lessee and lessor should account for an amendment during the reporting period resulting in a modification to a lease contract or agreement as a separate lease (that is, separate from the most recent lease contract or agreement before the modification) if both of the following conditions are present:

- ~~a. The lease modification gives the lessee an additional lease asset by adding one or more underlying assets that were not included in the original lease contract or agreement.~~
- ~~b. The increase in lease payments for the additional lease asset does not appear to be unreasonable based on (1) the terms of the amended lease contract or agreement and (2) professional judgment, maximizing the use of observable information (for example, using readily available observable stand-alone prices).~~

LESSEE TREATMENT OF LEASE MODIFICATIONS

~~70-82.~~ ~~A~~ ~~Unless a modification is reported as a separate lease as provided in paragraph 8188,~~ a lessee should account for a lease modification by remeasuring the lease liability. The lease asset should be adjusted by the difference between the remeasured liability and the liability immediately before the lease modification. However, 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.

LESSOR TREATMENT OF LEASE MODIFICATIONS

~~71-83.~~ ~~Unless a modification is reported as a separate lease as provided in paragraph 8188,~~ a lessor should account for a lease modification by remeasuring the lease receivable. The deferred revenue should be adjusted by the difference between the remeasured receivable and the receivable immediately before the lease modification. However, ~~if to the extent~~ the change relates to payments for the current period, the change should be recognized ~~as revenue or expense in the flows statement~~ for the current period ~~as revenue~~.

SUBLEASES

- ~~72-84.~~ A sublease involves three parties: the original lessor, the original lessee (who also is the lessor in the sublease), and the new lessee. The original lessor should continue to apply the general lessor guidance. The federal entity that is the original lessee and becomes the lessor in the sublease should account for the original lease and the sublease as two separate transactions, as a lessee and a lessor, respectively. Those two separate transactions should not be offset against one another. The new lessee should apply the general lessee guidance.
- ~~73-85.~~ The original lessee (and now the lessor in a sublease) should include the sublease in its disclosure of the general description of lease arrangements. Its lessor transactions related to subleases should be disclosed separately from its lessee transactions related to the original lease.

SALE-LEASEBACK TRANSACTIONS

- ~~74-86.~~ Sale-leaseback transactions involve the sale of an underlying asset by the owner and a lease of the property back to the seller (original owner). A sale-leaseback should include a transaction that includes an exchange transaction that qualifies as a sale¹⁷ ~~in order to be eligible for sale-leaseback accounting.~~ A sale-leaseback transaction that does not include an exchange transaction that qualifies as a sale should be accounted for as a borrowing by both the seller-lessee and the buyer-lessor.
- ~~75-87.~~ The sale and lease leaseback portions of a sale-leaseback transaction should be accounted for as two separate transactions – a sale transaction and a lease transaction – except that the difference between the carrying value of the capital asset that was sold and the net proceeds from the sale should be reported as a deferred revenue or deferred expense to be recognized in the flow statement in a systematic and rational manner over the term of the lease. However, if the leaseback portion of the transaction qualifies as a short-term lease, any difference between the carrying value of the capital asset that was sold and the net proceeds from gain or loss on the sale should be recognized immediately.
- ~~76.~~ A sale-leaseback transaction is considered to have off-market terms if there is a significant difference between (a) the sales price and the estimated fair value of the asset or (b) the present value of the contractual lease payments and the estimated present value of what the lease payments for that asset would be at a market price, whichever of the two differences is more readily determinable. The difference should be reported based on the substance of the transaction (for example, as a borrowing, a nonexchange transaction, or an advance lease payment) rather than as a part of the sales-leaseback transaction. ~~The following are examples of off-market terms:~~
- ~~77. A transaction has a sale price and lease payments that are both significantly higher than market~~
- ~~78. A transaction has a sale price that is significantly higher than market but the lease payments are at or below market~~

¹⁷ See SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*, par. 295.

~~79-88. A transaction has a sale price that is significantly lower than market.~~

~~80-89.~~ A seller-lessee should disclose the terms and conditions of sale-leaseback transactions in addition to the disclosures required of a lessee (par. ~~525935~~). A buyer-lessor should provide the disclosures required of a lessor (par. ~~657249~~).

LEASE-LEASEBACK TRANSACTIONS

~~81-90.~~ In a lease-leaseback transaction, an asset is leased by one party (first party) to another party and then leased back to the first party. The leaseback ~~part of the transaction~~ may involve an additional asset (such as leasing a building that has been constructed by a developer on land owned by and leased back to a federal entity) or only a portion of the original asset (such as leasing back only one floor of a building to the owner). A lease-leaseback transaction should be accounted for as a net transaction. Both parties to a lease-leaseback transaction should disclose the ~~gross~~ amounts of the lease and the leaseback separately~~each portion of the transaction~~.

AMENDMENTS TO SFFAS 5, ACCOUNTING FOR LIABILITIES OF THE FEDERAL GOVERNMENT AND SFFAS 6, ACCOUNTING FOR PROPERTY, PLANT, AND EQUIPMENT

82.91. This Statement replaces the measurement and reporting requirements for lease accounting established in SFFAS 5, *Accounting for Liabilities of the Federal Government*, paragraphs 43 – 46. Therefore, the paragraphs marked below are rescinded.

SFFAS 5: Accounting for Liabilities of the Federal Government

~~[43.] **Capital leases** are leases that transfer substantially all the benefits and risks of ownership to the lessee. If, at its inception, a lease meets one or more of the following four criteria, the lease should be classified as a capital lease by the lessee:~~

- ~~• The lease transfers ownership of the property to the lessee by the end of the lease term.~~
- ~~• The lease contains an option to purchase the leased property at a bargain price.~~
- ~~• The lease term is equal to or greater than 75 percent of the estimated economic life of the leased property.~~
- ~~• The present value of rental and other minimum lease payments, excluding that portion of the payments representing executory cost, equals or exceeds 90 percent of the fair value of the leased property.~~

~~The last two criteria are not applicable when the beginning of the lease term falls within the last 25 percent of the total estimated economic life of the leased property. If a lease does not meet at least one of the above criteria it should be classified as an operating lease.~~

~~[44.] The amount to be recorded by the lessee as a liability under a capital lease is the present value of the rental and other minimum lease payments during the lease term, excluding that portion of the payments representing executory cost to be paid by the lessor. [footnote ²⁰: “The cost of general property, plant, and equipment acquired under a capital lease shall be equal to the amount recognized as a liability for the capital lease at its inception. See SFFAS No. 6, Accounting for Property, Plant, and Equipment.”] However, if the amount so determined exceeds the fair value of the leased property at the inception of the lease, the amount recorded as the liability should be the fair value. If the portion of the minimum lease payments representing executory cost is not determinable from the lease provisions, the amount should be estimated.~~

~~[45.] 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. The lessee’s incremental borrowing rate shall be the Treasury borrowing rate for securities of similar maturity to the term of the lease.~~

~~[46.] During the lease term, each minimum lease payment should be allocated between a reduction of the obligation and interest expense so as to produce a constant periodic rate of interest on the remaining balance of the liability. [footnote ²¹: OMB Circular No. A-11, “Preparation and Submission of Annual Budget Estimates,” explains the measurement of budget authority, outlays, and debt for the budget in the case of lease purchases and other capital leases. Circular A-94, “Guidelines and Discount Rates for Benefit-Cost~~

Analysis of Federal Programs,” provides the requirements under which a lease purchase or other capital lease has to be justified and the analytical methods that need to be followed.]

83.92. This Statement replaces the measurement and reporting requirements for lease accounting established in SFFAS 6, *Accounting for Property, Plant, and Equipment*, paragraphs 20 and 29. Therefore, the paragraphs marked below are rescinded.

SFFAS 6: Accounting for Property, Plant, and Equipment

[20.] Capital leases are leases that transfer substantially all the benefits and risks of ownership to the lessee. If, at its inception, a lease meets one or more of the following four criteria, [footnote⁷: Note that the criteria for identifying capital leases for financial reporting purposes differ from OMB criteria for budget scoring of leases. OMB Circular No. A-11, *Preparation and Submission of Budget Estimates*, includes criteria for identifying operating leases in Appendix B. OMB provides four additional criteria which relate to the level of private sector risk involved in a lease purchase agreement. This is necessary because, for budget purposes, there is a distinction between lease purchases with more or less risk. This distinction is not made in the financial reports and, therefore, FASAB does not include the four criteria related to risk levels.] the lease should be classified as a capital lease by the lessee. Otherwise, it should be classified as an operating lease. [footnote⁸: “Operating leases” of PP&E are leases in which the Federal entity does not assume the risks of ownership of the PP&E. Multi-year service contracts and multi-year purchase contracts for expendable commodities are not capital leases.]

- The lease transfers ownership of the property to the lessee by the end of the lease term.
- The lease contains an option to purchase the leased property at a bargain price.
- The lease term is equal to or greater than 75 percent of the estimated economic life [footnote⁹: “Estimated economic life of leased property” is the estimated remaining period during which the property is expected to be economically usable by one or more users, with normal repairs and maintenance, for the purpose for which it was intended at the inception of the lease, without limitation by the lease term.] of the leased property.
- The present value of rental and other minimum lease payments, excluding that portion of the payments representing executory cost, equals or exceeds 90 percent of the fair value [footnote¹⁰: “Fair value” is the price for which an asset could be bought or sold in an arm’s-length transaction between unrelated parties (e.g., between a willing buyer and a willing seller). (adapted from Kohler’s Dictionary for Accountants)] of the leased property.

The last two criteria are not applicable when the beginning of the lease term falls within the last 25 percent of the total estimated economic life of the leased property.

[29.] The cost of general PP&E acquired under a **capital lease** shall be equal to the amount recognized as a liability for the capital lease at its inception (i.e., the net present value of the lease payments calculated as specified in the liability standard [footnote²⁴: See Statement of Recommended Accounting Standards No. 5, *Accounting for Liabilities of the Federal Government*.] unless the net present value exceeds the fair value of the asset).

84.93. This Statement also amends Technical Release (TR) 16, *Implementation Guidance for Internal Use Software*, paragraphs 26, 27, and 29 to delete the “capital and operating lease” references, as follows.

Technical Release 16: *Implementation Guidance for Internal Use Software*

[26.] Software License: If the term of software license(s) is 2 years or more with periodic payments, the license should be evaluated against lease criteria as stated in ~~SFFAS X~~ SFFAS 5 paragraphs 43–46 and ~~SFFAS 6~~ paragraph 20 to determine if it is a capital or operating lease. If the license(s) is perpetual with an upfront cost [footnote ⁹: The cost could be charged as a one-time payment or financed over a set period of time.] to use the software for its entire lifetime, then the entity is purchasing IUS and should apply its existing policy for capitalization thresholds to determine if the license should be capitalized or expensed.

[27.] A license agreement may include executory costs for maintenance and technical support. Agency judgment should apply in determining what portions of license fees are attributable to software capitalizable costs versus executory costs. Assuming lease capitalization criteria and thresholds are met, software license capitalization amounts [footnote ¹⁰: ~~SFFAS X~~ SFFAS 5, paragraph 44.] may be derived from the payment schedule contained in the license agreement. ~~As stated in SFFAS 5, If the portion of the minimum~~ lease payments representing executory cost is not determinable from the lease provisions, the amount should be estimated. Agencies may also want to consider having each license agreement specifically identify the various costs throughout the license lifecycle, for example, initial license, maintenance, and enhancement.

[29.] If a cloud computing arrangement includes a software license, the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses in accordance with the lease criteria stated in ~~SFFAS X~~ SFFAS 5 and ~~SFFAS 6~~, and as discussed in paragraph 26 of this TR. ~~SFFAS 10~~ is not applicable to a cloud computing arrangement that does not convey a contractual right to the IUS or to ones that do not include an IUS license. The entity that develops and owns the software, platform, or infrastructure that is used in the cloud computing arrangement would account for the software development in accordance with ~~SFFAS 10~~. If the funding to develop cloud computing is shared among entities without clear ownership, the service provider entity that receives funding and is responsible for maintaining the software, platform, or infrastructure should account for the software in accordance with ~~SFFAS 10~~ and the full cost/inter-entity cost requirements of ~~SFFAS 4~~.

IMPLEMENTATION

85.94. This Statement requires 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. Therefore, in the period of implementation,

- a. the determination of the lease term would assume that the lease term began as of the beginning of the period of implementation and

- b. the lease liability and lease asset should initially be measured based on the remaining lease term and associated lease payments as of the beginning of the period of implementation.

~~86-95.~~ The following implementation addresses specific leasing circumstances.

- a. Prospective Implementation - Entities should report the effect of implementing this Statement on existing leases prospectively in accordance with paragraph 13 of SFFAS 21, *Reporting Correction of Errors and Changes in Accounting Principles, Amendment of SFFAS 7, Accounting for Revenue and Other Financing Sources*. Accordingly, any changes in assets or liabilities related to existing leases should be treated prospectively. The change should be accounted for in the period of implementation and applicable future periods. No adjustments should be made to previously reported expenses or revenue.
- b. Lease Term - The lease term should be determined based on the provisions of this Statement (see par. ~~141914~~ – ~~182318~~). However, the lease term of an existing lease should be based on the number of years remaining in the lease contract ~~/ or~~ agreement as of the beginning of the period of implementation and not the number of years in the initial lease term. For example, if the initial lease term was 20 years, with no options to extend, at the beginning of Year 20X1 and the entity implements this Statement in Year 20X7 (6 years into the lease at the beginning of Year 20X7), the initial lease term upon implementation would be 14 years.
- c. Short-term leases - A short-term lease would be determined based on the provisions of this Statement (see par. ~~19159~~ – ~~21161~~). However, if the remaining lease term of an existing lease meets the definition of a short-term lease (has a maximum possible term under the contract or arrangement of 24 months or less, including any options to extend, regardless of their probability of being exercised) that lease should apply the short-term lease guidance. For example, if the initial lease term was 60 months as of the beginning of Year 20X1, with no options to extend, and the entity implements this Statement in Year 20X5 (48 months into the lease at the beginning of Year 20X5); the initial lease term at implementation would be 12 months and the lease would meet the definition of a short-term lease. Hence, the entity should account for the lease as a short-term lease.

EFFECTIVE DATE

~~87-96.~~ The requirements of this Statement are effective for reporting periods beginning after September 30, ~~2018~~2020. Early adoption is not permitted.

The provisions of this Statement need not be applied to immaterial items.

APPENDIX A: BASIS FOR CONCLUSIONS

This appendix discusses some factors considered significant by Board members in reaching the conclusions in this Statement. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others. The standards enunciated in this Statement—not the material in this appendix—should govern the accounting for specific transactions, events, or conditions.

PROJECT HISTORY

A1. This Statement amends the lease accounting standards in SFFAS 5, *Accounting for Liabilities of the Federal Government*, and SFFAS 6, *Accounting for Property, Plant, and Equipment*. The lease standards in SFFAS 5 and SFFAS 6 had been in effect since 1995. Under SFFAS 5 and 6, leases were classified as either capital or operating depending on whether the lease met any of four tests.

A1-A2. This project was undertaken primarily because

- a. the current lease accounting 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*, have been criticized as ineffective because they do not make meaningful distinctions between capital and operating leases based on the substance of lease transactions, and
- b. the lease accounting standards in SFFAS 5 and 6 are based on Financial Accounting Standards Board (FASB) lease accounting standards which have been amended; in addition existing FASAB standards are not comprehensive and do not provide meaningful information on federal leasing activities.

A2-A3. Lease accounting was first addressed by the FASAB during the development of SFFAS 5 and 6. At that time the Board decided to use the high level language on lease accounting from FASB Statement of Financial Accounting Standards (SFAS) No. 13 *Accounting for Leases* [subsequently codified in Accounting Standards Codification (ASC) - Topic 840 *Leases*]. This minimal lease guidance included the definition of a capital lease, the criteria for capital leases, and the measurement of a capital lease asset and liability. The Board had plans to use this preliminary guidance as a placeholder until it was prepared to add lease accounting to its agenda as a separate project. Lease accounting had been on the list of potential Board agenda items each time the Board has considered its agenda for new projects.

A3-A4. There are several areas of lease accounting that were covered by the FASB standards that were never specifically covered in the FASAB standards. Some of those topics include leasehold improvements, lease terms, leveraged leases, and subleases. The federal community often stressed that the federal standards on lease accounting should be comprehensive to alleviate questions on when and if FASB standards apply to federal entities when the federal standards are silent on a topic.

A4-A5. In August 2011, FASAB began a project to revise its current standards on lease accounting. FASAB staff formed a task force to assist in developing the proposed

standards for leases. Task force members included accounting, budget, and subject matter experts from federal agencies and independent public accounting firms.

| A5-A6. The task force met several times over the course of the project and also exchanged numerous ideas and recommendations electronically. The task force views and recommendations were sought by staff in developing and describing alternatives to present to the Board during the development of these standards. The task force's assistance was essential and its views carefully considered by members during deliberations. The task force played an important role in the research and release of this exposure draft.

| A6-A7. In evaluating an approach applicable to federal leases, the Board considered the approaches used in the following documents:

- Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards (SFAS) 13, *Accounting for Leases* [Superseded by FASB Accounting Standards Codification (ASC) 840, which was subsequently superseded by ASC 842]
- Governmental Accounting Standards Board (GASB) Exposure Draft, *Leases*, January 25, 2016
- International Accounting Standards Board (IASB) International Accounting Standard (IAS) 17, *Leases*, which was superseded by International Financial Reporting Standard (IFRS) 16.
- International Public Sector Accounting Standards Board (IPSASB) International Public Sector Accounting Standard (IPSAS) 13, *Leases*.

| A7-A8. At the inception of the project the Board decided to coordinate with GASB on the lease project because of the similarities among governmental entities regarding lease activities and reporting objectives. Staff worked closely with GASB staff during the development of the proposals. In 2014 FASAB and GASB met jointly to discuss similar issues related to each of their ongoing lease accounting projects. As a result of this collaboration, similar wording may appear in some sections of the FASAB and GASB standards.¹⁸

| A8-A9. This Statement amends the lease accounting standards in SFFAS 5, SFFAS 6, and TR 16. This Statement also establishes distinct standards for intragovernmental leases.

KEY AREAS OF IMPROVEMENT

| A9-A10. This lease proposal will improve the existing lease accounting standards in SFFAS 5 and SFFAS 6 by

- a. providing relevant and meaningful financial information needed by federal financial statement users and
- b. providing comprehensive lease standards that appropriately address the various lease transactions/activities of the federal community.

¹⁸ The GASB material is copyrighted by the Financial Accounting Foundation, 401 Merritt 7, Norwalk, CT 06856, USA, and is used with permission.

~~A10-A11.~~ The Board believes that in a lease transaction, a lessee receives the right to use an underlying asset (the asset that is subject to the lease, such as a vehicle or building) at the beginning of the lease term. In exchange, the lessee promises to make payments over time for the right to use that underlying asset. The guidance in SFFAS 5 and 6 was based on the notion that some leases are essentially financed purchases of the underlying asset (classified as capital leases) and other leases (classified as operating leases) are not. The classification of a lease as capital or operating depended on whether the lease met any of four tests. Those tests were intended to determine whether most of the risks and benefits of ownership of the underlying asset were transferred to the lessee. Those tests have been criticized because their bright-line nature often resulted in very similar leases being accounted for in different ways.

SCOPE

~~A11-A12.~~ For purposes of applying this Statement, A lease is defined as a contract or agreement that conveys the right to control the use of another entity's property, plant, and equipment (PP&E) (the underlying asset) for a period of time as specified in the contract or agreement in exchange for consideration~~a lease is defined as a contract or agreement that conveys the right to use a nonfinancial asset¹⁹ (the underlying asset) for a period of time in an exchange transaction.~~ Leases include contracts or agreements that, although not explicitly identified as leases, meet the definition of a lease (which reflects the substance of a lease). This definition does not include contracts or agreements for services unless that contract or agreement also conveys the right to use a nonfinancial asset (the underlying asset) for a period of time in an exchange transaction.

~~A12-A13.~~ This Statement does not apply to leases of assets under construction or leases (licenses) of internal use software, of federal natural resources as defined in Technical Bulletin (TB) 2011-1, Accounting for Federal Natural Resources Other than Oil and Gas and leases of federal oil and gas resources as defined in SFFAS 38, Accounting for Federal Oil and Gas Resources.

~~A13-A14.~~ GASB's Leases exposure draft specifically excludes, "contracts that meet the definition of a service concession arrangement in paragraph 4 of Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements* (SCAs)." Currently FASAB standards are silent on SCAs. Through its discussions the lease task force identified several federal entities that have SCAs, and there was a concern that the proposed lease definition could inadvertently include SCAs. The Board considered specifically excluding SCAs from the lease standard. To accomplish the exclusion, the Board considered adopting GASB's definition of SCA from Statement No. 60 due to the lack of a federal definition of SCA.

~~A14-A15.~~ Because SCAs are not currently addressed in federal accounting standards, the Board decided that specifically excluding SCAs from the lease standard would raise more questions. Furthermore, SCAs are expected to be addressed in the public-private partnership recognition and measurement project and therefore the Board agreed to

¹⁹ ~~Examples of nonfinancial assets include land, buildings, vehicles, equipment, internal use software, and intangible assets. Examples of financial assets include cash, investments, and receivables.~~

remain silent on SCAs in the lease proposal. In conclusion, the Board believes the GAAP hierarchy will continue to guide preparers and auditors in accounting for SCAs.

DEFINITIONS

~~A15-A16.~~ In this Statement, A lease is defined as a contract or agreement that conveys the right to control the use of another entity's property, plant, and equipment (PP&E) (the underlying asset) for a period of time as specified in the contract or agreement in exchange for consideration ~~a lease is defined 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.~~ In the early stages of the project the Board deliberated over the use of “contract” or “agreement” in the definition of a lease. The Board considered the GASB approach that the term contract is more precise and limiting and requires that a lease be legally enforceable. Because legal enforceability is not the primary driver in intragovernmental leasing transactions, the Board decided to add “agreement” in addition to “contract” in the lease definition to alleviate ambiguity in the application of the definition, especially in the case of intragovernmental leases which are often referred to as “lease agreements.”

LEASE TERM -- ~~RENEWAL AND TERMINATION~~ OPTIONS TO EXTEND OR TERMINATE

~~A16-A17.~~ Federal leases often include lessee options to ~~renew~~, extend, or terminate a lease. Due to federal budget scoring rules and fiscal funding mechanisms, many federal leases include relatively short noncancelable periods. The Board concluded that the lease term used to measure the lease liability should not be limited to the noncancelable lease periods, but should include certain probable ~~renewal~~ options to extend the lease periods and consider the probability of ~~termination~~ options being exercised to terminate, so that the lease term reflects how long the lease is expected to be in effect.

~~A17-A18.~~ The probability of ~~a renewal or termination option being exercised~~ options to extent or terminate the lease applies only if that option pertains to the lessee alone. If either the lessee or the lessor has the option to ~~cancel~~ terminate a lease (or if both parties have to agree to ~~renew~~ extend), the lease contract ~~s or~~ agreement is not enforceable beyond that point. In those cases when either the lessee or the lessor could cancel the lease at any time, for example month-to-month lease holdovers, rolling lease extensions, or any lease that continues into a holdover period until a new contract or agreement is signed, the contract or agreement would be considered cancelable. When a lease contains a lessor-only option to terminate the lease, a lessee would have difficulty evaluating the likelihood of that option being exercised. This difficulty and the resulting cost outweigh the potential benefits of including the extra periods in the lease term. The Board also agreed that the presence of a ~~bargain~~ purchase option in a lease contract ~~/ or~~ agreement is not equivalent to a provision that transfers ownership of the underlying asset; therefore, a ~~bargain~~ purchase option should be treated as any other ~~purchase~~ option included in a lease.

~~A18-A19.~~ The Board considered several potential probability thresholds for including a period covered by a renewal or termination option ~~options to extend or terminate the lease~~ in the lease term. The Board considered its own definition of probable, GASB's definition of probable, and FASB's probability threshold "reasonably certain." FASAB's probable definition equates to more likely than not (>50% probability). GASB's probable definition equates to likely to occur and has a higher threshold of probability than more likely than not. FASB's reasonably certain has an even higher threshold than likely to occur. The Board agreed to retain its definition of probable because it is more clearly defined and there seemed to be no compelling reason to introduce a new term for the sake of a higher threshold.

REMEASUREMENT

A20. This Statement requires that when a lease liability is remeasured, the corresponding lease asset be adjusted by the same dollar amount (except in cases of impairment and in cases in which the adjustment would cause the asset to be reported as a negative amount). While acknowledging that adjusting the lease asset for a change in the lease liability results in the lease asset no longer being measured at adjusted historical cost, the Board believes that such an adjustment is practical.

SHORT-TERM LEASES

A21. The Board considered the short-term lease exception GASB proposed, which requires governments to recognize leases with useful lives or maturities of less than one year. The Board decided to align the lease short-term exception with the PP&E standard which defines PP&E as a tangible asset with an estimated useful life of 24 months or more. The reporting of short-term leases in this Statement is intended to reduce the cost to federal entities of implementing these standards. This short-term exception eliminates the need for preparers to calculate amounts for short-term lease assets and liabilities. This exception requires lessees and lessors to recognize expense and revenue based on the payment provisions of those lease contracts or agreements with useful lives or maturities of less than two years. This measurement approach is not cash-basis recognition, as federal entities are still required to recognize receivables and payables for lease payments paid or received before or after the period to which they apply.

INTRAGOVERNMENTAL LEASES

A22. During the research phase of the project, the General Services Administration (GSA) provided an educational session to the Board where GSA representatives explained in-depth GSA's role in federal leasing. Based primarily on that discussion, the Board agreed that intragovernmental leases should be accounted for differently than leases between federal entities and non-federal entities. The Board agreed that a simplified approach for recognizing intragovernmental leases would be pragmatic and cost efficient.

A23. This Statement provides the overall recognition, measurement, and disclosure requirements 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*. A lessee would not recognize a lease asset and a corresponding liability for an intragovernmental lease. Accordingly, a lessee would not recognize amortization expense related to a lease asset or interest expense on a lease liability.

A24. The terms “intragovernmental” and “inter-entity” have been used interchangeably. Earlier FASAB standards predominately used “inter-entity.” However, government-wide usage of “intragovernmental” has become more common, and therefore the Board decided to use intragovernmental in this Statement to describe leases occurring within a consolidation entity or between two or more consolidation entities as defined under SFFAS 47.

LEASES OTHER THAN SHORT-TERM LEASES, CONTRACTS OR AGREEMENTS THAT TRANSFER OWNERSHIP, AND INTRAGOVERNMENTAL LEASES

RECOGNITION AND MEASUREMENT FOR LESSEES – LEASE LIABILITY

~~A19.~~A25. SFFAC 5 defines a liability as a present obligation of the federal government to provide assets or services to another entity at a determinable date, when a specified event occurs, or on demand. The Board believes that the lessee taking possession of the underlying asset or gaining access to use the underlying asset is an event that creates such an obligation until the end of the lease term.

~~A20.~~A26. The Board believes the present value of future lease payments to be made for the lease term, which represent the obligations of the lessee under the lease contract ~~and~~ or agreement, is the appropriate measurement of the liability. Such a calculation is consistent with the premise that a lease is a financing transaction and supports recognition of the cost of the financing.

RECOGNITION AND MEASUREMENT FOR LESSEES – LEASE ASSET

~~A21.~~A27. Assets are defined in SFFAC 5 as resources that embodies economic benefits or services the federal government controls. Lessees should recognize a lease asset to correspond with the lease liability. At the beginning of a lease, the lessee obtains the right to use the underlying asset and that right is a resource embodying economic benefits. The Board believes this right meets the definition of an asset. Because the lease liability represents the amount to be paid for the lease asset, the Board concluded that the initial measurement of the lease asset should be based on the measurement of the associated

lease liability. PP&E assets generally are measured at historical cost, which is the amount paid for those assets. Therefore, measuring the lease asset based on the lease liability is consistent with historical cost accounting applicable to PP&E.

RECOGNITION AND MEASUREMENT FOR LESSORS

~~A22-A28.~~ Symmetry between the lessee and lessor accounting models is important in establishing accounting and financial reporting standards. The Board believes that federal entity lessees and lessors should account for the same transaction in a way that mirrors how the other party accounts for it.

~~A23-A29.~~ The lease contract or agreement gives the lessor the right to receive payments in exchange for the lessee's right to use the underlying asset. The Board believes that right meets the definition of an asset in SFFAC 5. Assets are defined as a resource that embodies economic benefits or services that the federal government controls. The right to receive payments is a resource that can be drawn upon, and the lessor presently controls that right.

SHORT-TERM LEASE EXCEPTION

~~A24.~~ The Board considered the short-term lease exception GASB proposed, which requires governments to recognize leases with useful lives or maturities of less than one year. The Board decided to align the lease short-term exception with the PP&E standard which defines PP&E as a tangible asset with an estimated useful life of 24 months or more. The reporting of short-term leases in this Statement is intended to reduce the cost to federal entities of implementing these standards. This short-term exception eliminates the need for preparers to calculate amounts for short-term lease assets and liabilities. This exception requires lessees and lessors to recognize expense and revenue based on the payment provisions of those lease contracts/agreements with useful lives or maturities of less than two years. This measurement approach is not cash-basis recognition, as federal entities are still required to recognize receivables and payables for lease payments paid or received before or after the period to which they apply.

INTRAGOVERNMENTAL LEASES

~~A25.~~ During the research phase of the project, the General Services Administration (GSA) provided an educational session to the Board where GSA representatives explained in-depth GSA's role in federal leasing. Based primarily on that discussion, the Board agreed that intragovernmental leases should be accounted for differently than leases between federal entities and non-federal entities. The Board agreed that a simplified approach for recognizing intragovernmental leases would be pragmatic and cost-efficient.

~~A26.~~ This Statement provides the overall recognition, measurement, and disclosure requirements 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*.~~

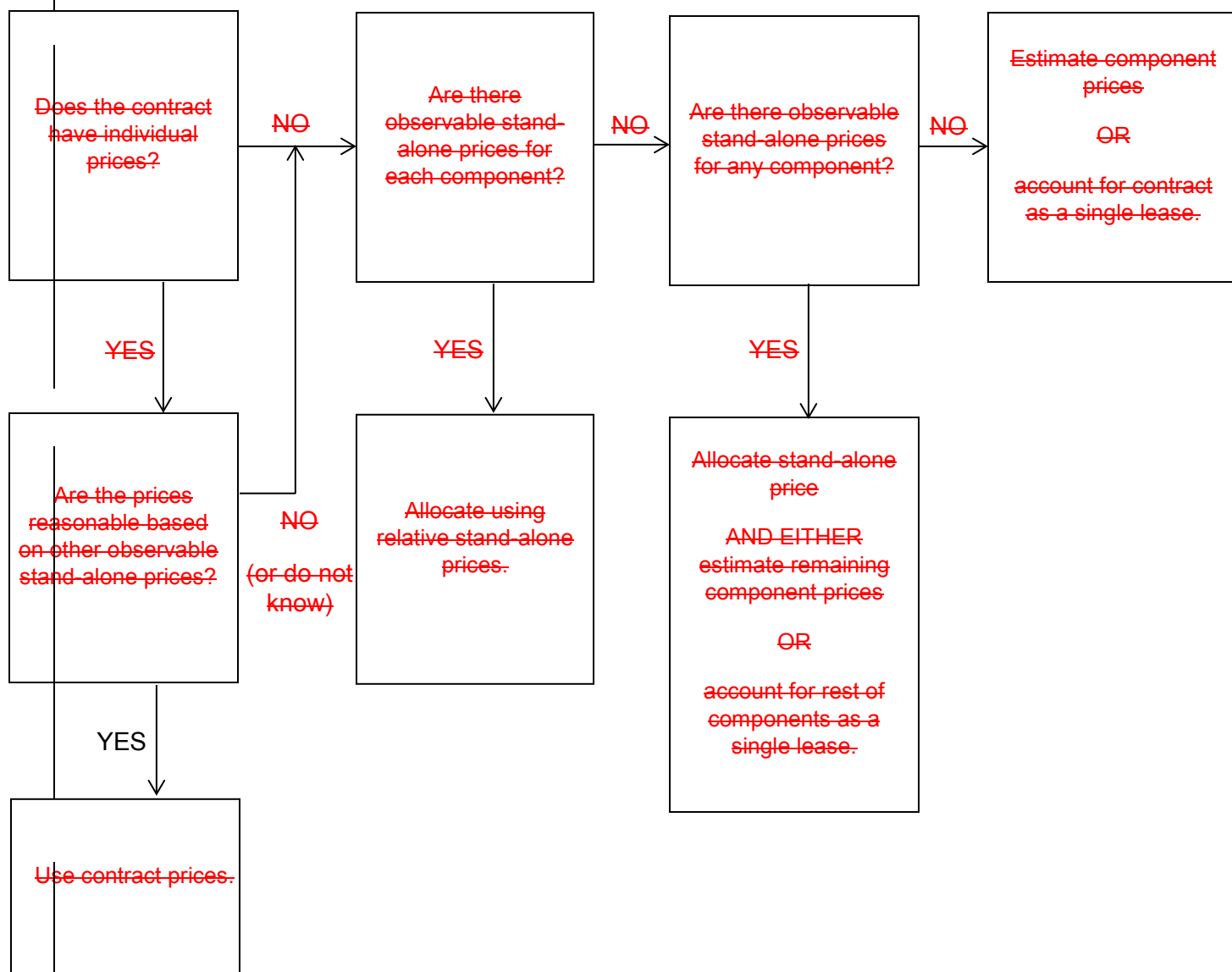
~~A27. The terms “intragovernmental” and “inter-entity” have been used interchangeably. Earlier FASAB standards predominately used “inter-entity.” However, government-wide usage of “intragovernmental” has become more common, and therefore the Board decided to use intragovernmental in this Statement to describe leases occurring within a consolidation entity or between two or more consolidation entities as defined under SFFAS 47.~~

~~A28. This Statement provides general guidance on the recognition and measurement of lease rental increases, as well as guidance on other changes in the lease payments, such as lease incentives and lease concessions. The Board believes that rent increases are related to economic events, while lease incentives and concessions are more closely aligned with marketing cost. Therefore lessee rental increases should be recognized as expense in the period of the increase as provided in the lease; lease incentives and concessions should be recognized by the lessee/lessor as reductions of lease rental expense/lease rental income on a straight line basis over the lease term.~~

APPENDIX B: ILLUSTRATION

This appendix illustrates the application of the provisions of this Statement to assist in clarifying their meaning. The facts assumed in these examples are illustrative only and are not intended to modify or limit the requirements of this Statement or to indicate the Board's endorsement of the situations or methods illustrated. Additionally, these illustrations are not intended to provide guidance on determining the application of materiality. Application of the provisions of this Statement may require assessing facts and circumstances other than those illustrated here and require reference to other applicable Standards.

The following flowchart²⁰ is intended to aid in the application of the provisions for contracts with multiple components of this Statement—paragraphs 51–56.



²⁰ This illustration has been adapted from the GASB Lease ED, Appendix C, *Flowchart for Allocation of Consideration to Multiple Components*.

APPENDIX CB: ABBREVIATIONS

ASC	Accounting Standards Codification
CFR	Consolidated financial report of the U.S. Government
ED	Exposure draft
FASAB	Federal Accounting Standards Advisory Board
FASB	Financial Accounting Standards Board
GAAP	Generally Accepted Accounting Principles
GAO	Government Accountability Office
GASB	Governmental Accounting Standards Board
IPSASB	International Public Sector Accounting Standards Board
PP&E	Property, Plant, and Equipment
SCA	Service Concession Arrangement
OMB	Office of Management and Budget
SFAS	Statement of Financial Accounting Standards (FASB)
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards
TB	Technical Bulletin
TR	Technical Release

APPENDIX DC: GLOSSARY

Lease

~~A lease is a contract or agreement that conveys the right to control the use of another entity's property, plant, and equipment (PP&E) (the underlying asset) for a period of time as specified in the contract or agreement in exchange for consideration. A lease is 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.~~

Intragovernmental Lease

~~An intragovernmental lease is a contract or agreement that conveys the right to control the use of another entity's PP&E asset (the underlying asset) for a period of time as specified in the contract or agreement in exchange for consideration occurring within a consolidation entity or between two or more consolidation entities as defined under SFFAS 47, *Reporting Entity*. A lease occurring within a consolidation entity or between two or more consolidation entities as defined under SFFAS 47, *Reporting Entity*.²¹~~

Probable

That which can reasonably be expected or believed to be more likely than not on the basis of available evidence or logic but which is neither certain nor proven.

Lease Option Periods

~~Lease option periods are additional lease periods beyond the initial lease term—the options may be included in the initial lease or may be agreed to later in the lease term.~~

Initial Direct Costs

Initial direct costs are costs that are directly attributable to negotiating and arranging a lease or portfolio of leases and would not have been incurred without entering into the lease.

Short-Term Lease

~~a lease with a lease term (as defined in paragraph 14) of 24 months or less. A short-term lease is a lease that, at the beginning of the lease, has a maximum possible term under the contract or arrangement of 24 months or less, including any options to extend, regardless of their probability of being exercised.~~

Lessee's Incremental Borrowing Rate

The lessee's incremental borrowing rate is the estimated rate that would be charged for borrowing the lease payment amounts for the lease term.

²¹ SFFAS 47, *Reporting Entity*, outlines the characteristics as a whole that an organization would have to be considered a consolidated entity (see SFFAS 47 par. 38-42).

Discount Rate

A discount rate is an interest rate that is used in present value calculations to equate amounts that will be received or paid in the future to their present value.

Lease Incentives

Lease incentives include lessor payments made to or on behalf of the lessee to entice the lessee to sign a lease. Lease incentives may include up-front cash payments to the lessee; for example, moving costs, termination fees to lessee's prior lessor, or lessor's assumption of the lessee's lease obligation under a different lease with another lessor.

Lease Concessions

Lease concessions are rent discounts made by the lessor to entice the lessee to sign a lease. Lease concessions include rent holidays/free rent periods, reduced rents, or commission credits.

Leasehold Improvements

Leasehold improvements are additions, alterations, remodeling, renovations or other changes to a leased property that either extend the useful life of the existing property or enlarge or improve its capacity and are paid for (financed) by the lessee.

Lessor Improvements

Lessor improvements are additions, alterations, remodeling, renovations or other changes to a leased property that either extend the useful life of the existing property or enlarge or improve its capacity and are paid for (financed) by the lessor rather than by the lessee.

FASAB Board Members

D. Scott Showalter, Chairman

Gila J. Bronner

Robert F. Dacey

George A. Scott

Michael H. Granof

Christina Ho

Patrick McNamee

Mark Reger

Graylin E. Smith

FASAB Staff

Wendy M. Payne, Executive Director

Monica R. Valentine, Assistant Director

Federal Accounting Standards Advisory Board

441 G Street NW, Suite 6814

Mail Stop 6H19

Washington, D.C. 20548

Telephone (202) 512-7350

Fax (202) 512-7366

www.fasab.gov



Federal Accounting Standards Advisory Board

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

Statement of Federal Financial Accounting Standards XX

CLEAN VERSION

August 30, 2017

WORKING DRAFT

THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General of the United States, established the Federal Accounting Standards Advisory Board (FASAB or "the Board") in October 1990. FASAB is responsible for promulgating accounting standards for the United States government. These standards are recognized as generally accepted accounting principles (GAAP) for the federal government.

An accounting standard is typically formulated initially as a proposal after considering the financial and budgetary information needs of citizens (including the news media, state and local legislators, analysts from private firms, academe, and elsewhere), Congress, federal executives, federal program managers, and other users of federal financial information. The proposed standards are published in an exposure draft for public comment. In some cases, a discussion memorandum, invitation for comment, or preliminary views document may be published before an exposure draft is published on a specific topic. A public hearing is sometimes held to receive oral comments in addition to written comments. The Board considers comments and decides whether to adopt the proposed standard with or without modification. After review by the three officials who sponsor FASAB, the Board publishes adopted standards in a Statement of Federal Financial Accounting Standards. The Board follows a similar process for Statements of Federal Financial Accounting Concepts, which guide the Board in developing accounting standards and formulating the framework for federal accounting and reporting.

Additional background information is available from FASAB or its website:

- ["Memorandum of Understanding among the Government Accountability Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board."](#)
- ["Mission Statement: Federal Accounting Standards Advisory Board"](#), [exposure drafts](#), [Statements of Federal Financial Accounting Standards and Concepts](#), [FASAB newsletters](#), and other items of interest are posted on FASAB's website at: www.fasab.gov .

Copyright Information

This is a work of the U. S. government and is not subject to copyright protection in the United States. It may be reproduced and distributed in its entirety without further permission from FASAB. However, because this work may contain copyrighted images or other material, permission from the copyright holder may be necessary if you wish to reproduce this material separately. The GASB material used in this Statement is copyrighted by the Financial Accounting Foundation, 401 Merritt 7, Norwalk, CT 06856, USA, and is used with permission.

Contact us:

Federal Accounting Standards Advisory Board
441 G Street, NW, Suite 6814
Mailstop 6H19
Washington, DC 20548
Telephone 202-512-7350
FAX 202-512-7366
www.fasab.gov

SUMMARY

This Statement revises the accounting and financial reporting standards for federal lease accounting standards. The Statement provides a comprehensive set of lease accounting standards to recognize federal lease activities in the reporting entity's general purpose federal financial reports and include appropriate disclosures.

This Statement requires that federal lessees recognize a lease liability and a leased asset at the beginning of the lease, unless it meets any of the scope exclusions, is an intragovernmental lease, or a short-term lease. A federal lessor would recognize a lease receivable and deferred revenue, unless it meets any of the scope exclusions, is an intragovernmental lease, or a short-term lease.

The provisions of this Statement need not be applied to immaterial items. The determination of whether an item is material depends on the degree to which omitting or misstating information about the item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement.

TABLE OF CONTENTS

Summary	4
Standards	6
Scope	6
Definitions	7
Lease Term	7
Short-Term Leases.....	9
Lessee Recognition and Measurement for Leases Other Than Short-Term Leases, Contracts That Transfer Ownership and intragovernmental leases.....	11
Disclosure Requirements for lessees.....	14
Lessor Recognition and Measurement for Leases Other than Short-Term Leases, Contracts or Agreements that Transfer Ownership, and Intragovernmental Leases.....	15
Disclosures for Lessors	17
Lease incentive and lease concessions	18
Contracts or Agreements with Multiple Components	18
Contract or Agreement Combinations.....	19
Lease Terminations and Modifications	19
Subleases	21
Sale-Leaseback Transactions	21
Lease-Leaseback Transactions	22
Amendments to SFFAS 5, <i>Accounting for Liabilities of the Federal Government</i> and SFFAS 6, <i>Accounting for Property, Plant, and Equipment</i>	23
implementation	25
Effective Date	26
Appendix A: Basis for Conclusions	27
Project history	27
Key Areas of Improvement.....	28
Scope	29
Definitions	29
Lease Term -- Options to extend or terminate	30
Short-term Leases.....	31
Intragovernmental Leases	31
Leases other than Short-Term Leases, Contracts or Agreements that Transfer Ownership, and Intragovernmental Leases	32
Appendix B: Abbreviations.....	33
Appendix C: Glossary	34

STANDARDS

SCOPE

1. This Statement applies to federal entities that present general purpose federal financial reports, including the consolidated financial report of the U.S. Government (CFR), in conformance with generally accepted accounting principles, as defined by paragraphs 5 through 8 of Statement of Federal Financial Accounting Standards (SFFAS) 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*.
2. For purposes of applying this Statement, a **lease**¹ is defined as a contract or agreement that conveys the right to control the use of another entity's property, plant, and equipment² (the underlying asset) for a period of time as specified in the contract or agreement in exchange for consideration. To qualify as a lease, the underlying asset typically should be identified by being explicitly specified in a contract or agreement. However, an asset also can be identified by being implicitly specified at the time that the asset is made available for use by the lessee. Leases include contracts or agreements that, although not explicitly identified as leases, meet the definition of a lease.
3. To determine whether a contract or agreement conveys the right to control the use of the underlying asset, an entity should assess whether the federal entity has both of the following:
 - a. The right to obtain economic benefits or services from use of the underlying asset as specified in the contract or agreement.
 - b. The right to control access to the economic benefits or services of the underlying asset as specified in the contract or agreement.
4. This definition excludes contracts or agreements for services except those contracts or agreements that contain both a lease component and a service component. A service contract is a contract that directly engages the time and effort of a contractor whose primary purpose is to perform an identifiable task rather than to provide a tangible asset.
5. This Statement does not apply to:
 - a. Leases of assets under construction.
 - b. Leases (licenses) of internal use software (See SFFAS 10, *Accounting for Internal Use Software*, as amended).

¹ Terms defined in the Glossary are shown in bold-face the first time they appear.

² See SFFAS 6, *Accounting for Property, Plant, and Equipment*.

DEFINITIONS

6. **Lease** – A lease is defined as a contract or agreement that conveys the right to control the use of another entity's property, plant, and equipment (PP&E) (the underlying asset) for a period of time as specified in the contract or agreement in exchange for consideration.
7. **Intragovernmental Lease** – An intragovernmental lease is a contract or agreement that conveys the right to control the use of another entity's PP&E asset (the underlying asset) for a period of time as specified in the contract or agreement in exchange for consideration occurring within a consolidation entity or between two or more consolidation entities as defined under SFFAS 47, *Reporting Entity*..³
8. **Initial Direct Costs** – Initial direct costs are costs that are directly attributable to negotiating and arranging a lease or portfolio of leases and would not have been incurred without entering into the lease.
9. **Short-Term Lease** – a lease with a lease term (as defined in paragraph 14) of 24 months or less.
10. **Lease Incentives** – Lease incentives include lessor payments made to or on behalf of the lessee to entice the lessee to sign a lease. Lease incentives may include up-front cash payments to the lessee; for example, moving costs, termination fees to lessee's prior lessor, or lessor's assumption of the lessee's lease obligation under a different lease with another lessor.
11. **Lease Concessions** – Lease concessions are rent discounts made by the lessor to entice the lessee to sign a lease. Lease concessions include rent holidays/free rent periods, reduced rents, or commission credits.
12. **Leasehold Improvements** – Leasehold improvements are additions, alterations, remodeling, renovations or other changes to a leased property that either extend the useful life of the existing property or enlarge or improve its capacity and are paid for (financed) by the lessee.
13. **Lessor Improvements** – Lessor improvements are additions, alterations, remodeling, renovations or other changes to a leased property that either extend the useful life of the existing property or enlarge or improve its capacity and are paid for (financed) by the lessor rather than by the lessee.

LEASE TERM

14. The lease term is the period during which a lessee has a noncancelable right to use an underlying asset (referred to as the noncancelable period), plus the following periods, if applicable:

³ See SFFAS 47, *Reporting Entity*, par. 38-42.

- a. Those periods specified in the lease contract or agreement that include a lessee's option to extend the lease if it is probable, based on all relevant factors, that the lessee will exercise that option
- b. Those periods specified in the lease contract or agreement that include a lessee's option to terminate the lease if it is probable, based on all relevant factors, that the lessee will *not* exercise that option.
- c. Those periods specified in the lease contract or agreement that include a lessor's option to extend the lease if it is probable, based on all relevant factors, that the lessor will exercise that option
- d. Those periods specified in the lease contract or agreement that include a lessor's option to terminate the lease if it is probable, based on all relevant factors, that the lessor will *not* exercise that option.

15. The period during which a lessee has a noncancelable right is the shorter of

- a. the initial lease period, before considering option periods to extend the lease; or
- b. the period of the lease preceding a point at which either the lessee or the lessor have an option to terminate the lease, regardless of the probability of termination.

16. In determining the lease term, the following specific provisions should be applied:

- a. Month-to-month lease holdovers, also referred to as rolling lease extensions, or any lease that continues into a holdover period until a new contract or agreement is signed would be considered cancelable if both the lessee and the lessor have an option to terminate, and therefore either could cancel the lease at any time. These holdover periods are cancelable periods and should be excluded from the lease term.⁴
- b. Provisions that allow for termination of a lease due to (a) purchase of the underlying asset, (b) payment of all sums due, or (c) default on payments are not considered options to terminate.
- c. A fiscal funding or cancellation clause allows federal lessees to cancel a lease agreement, typically on an annual basis, if funds for the lease payments are not appropriated. This type of clause should affect the lease term only when it is probable that the clause will be exercised.

17. At the commencement of a lease term, lessors and lessees should assess all factors relevant to the likelihood that the lessee will exercise options identified in paragraph 14, whether these factors are contract or agreement based, underlying asset based, market based, or federal specific. The assessment often will require the consideration of a combination of these interrelated factors. Examples of factors to consider include, but are not limited to, the following:

⁴ SFFAS 1, *Accounting for Selected Assets and Liabilities*, applies to any related accounts payable or accounts receivable amounts.

- a. A significant economic incentive, such as contractual or agreement terms and conditions for the optional periods that are favorable compared with current market rates
 - b. A significant economic disincentive, such as costs to terminate the lease and sign a new lease (for example, negotiation costs, relocation costs, abandonment of significant leasehold improvements, costs of identifying another suitable underlying asset, costs associated with returning the underlying asset in a contractually specified condition or to a contractually specified location, or a substantial cancellation penalty)
 - c. The history of exercising options to extend or terminate
 - d. The extent to which the asset underlying the lease is mission critical to the federal entity
18. Lessors and lessees should reassess the lease term only if the lessee does either of the following:
- a. The lessor or lessee elects to exercise an option even though it was previously determined that it was probable that the lessee would not exercise that option
 - b. The lessor or lessee does not elect to exercise an option even though it was previously determined that it was probable that the lessee would exercise that option
 - c. An event specified in the lease contract or agreement that requires an extension or termination of the lease takes place.

SHORT-TERM LEASES

19. A short-term lease is a lease with a lease term (as defined in paragraph 14) of 24 months or less.

LESSEE TREATMENT OF SHORT-TERM LEASES

20. A lessee should recognize short-term lease payments as expense based on the payment provisions of the contract or agreement. The lessee should recognize an asset if payments are made in advance of the reporting period to which they relate, or a liability for rent due if payments are made subsequent to that reporting period. The lessee should recognize any rent holiday period (for example, one or more months free) as reductions of lease rental expense on a straight-line basis over the lease term.

LESSOR TREATMENT OF SHORT-TERM LEASES

21. A lessor should recognize short-term lease payments as revenue based on the payment provisions of the contract or agreement. The lessor should recognize a liability if payments are received in advance of the reporting period to which they relate, or an asset for rent due if payments are received subsequent to that reporting period. The lessor should recognize

any rent holiday period (for example, one or more months free) as reductions of lease rental income on a straight-line basis over the lease term.

CONTRACTS OR AGREEMENTS THAT TRANSFER OWNERSHIP

22. A contract or agreement that (a) transfers ownership of the underlying asset to the lessee by the end of the contract or agreement, and (b) does not contain options to terminate (see par. 14 - 15), but that may contain a fiscal funding or cancellation clause that is not probable of being exercised (see par. 16.c), should be reported as a purchase of that asset by the lessee or as a financed sale of the asset by the lessor.⁵

INTRAGOVERNMENTAL LEASES

23. An intragovernmental lease is a contract or agreement that conveys the right to control the use of another entity's PP&E asset (the underlying asset) for a period of time as specified in the contract or agreement in exchange for consideration occurring within a consolidation entity or between two or more consolidation entities as defined under SFFAS 47, *Reporting Entity*. Any lease that meets the definition of an intragovernmental lease would be required to follow the accounting guidance described in paragraphs 24 – 35 below.
24. A lessee should recognize lease payments, including lease-related operating costs (for example, maintenance, utilities, taxes, etc.) paid to the lessor, as expenses based on the payment provisions of the lease. Prepaid rent or a payable for rent due should be recognized as an asset or liability, respectively, and an expense should be recognized in the appropriate reporting period based on the specifics of the lease provisions.
25. A lessor should recognize lease receipts, including lease-related operating costs (for example, maintenance, utilities, or taxes) received from the lessee as income based primarily on the provisions of the lease.
26. Rental increases may be fixed in the lease and take place with the passage of time (for example, be based on such factors as anticipated increases in costs or anticipated appreciation in property values, but the amount of the increase is specified in the lease) or they may be contingent on future events.
27. Variable rental increases are based on changes in specific economic factors, for example, future activity levels or future inflation (for example, tied to a specific economic indicator where the specific amount of the change is not known).
28. If the lease provides for rental increases, a lessee should recognize the expense in the period of the increase as provided in the lease.
29. **Lease incentives** should be recognized by the lessee as reductions of lease rental expense on a straight-line basis over the lease term. The lessee should recognize the expenses or losses to which the incentives relate in the reporting period the costs are incurred. For example, an incentive equal to the moving expense incurred to occupy the leased space reduces rent expense over the lease term and the moving expense is recognized in the

⁵ See SFFAS 6, *Accounting for Property, Plant, and Equipment*, par. 26.

reporting period incurred (that is, when the move occurs). Lease incentives should be recognized by the lessor as reductions of lease rental income on a straight-line basis over the lease term.

30. **Lease concessions** should be recognized by the lessee as reductions of lease rental expense on a straight-line basis over the lease term. Lease concessions should be recognized by the lessor as reductions in rental income on a straight-line basis over the lease term.
31. **Leasehold improvements** that are placed in service at or after the beginning of the lease term should be amortized over the useful life (the normal operating life in terms of utility to the owner) of the leasehold improvement, but no longer than the expected lease term.
32. **Lessor improvements** are components of the leased property and should be capitalized and depreciated by the lessor over their useful life consistent with the lessor's accounting for property, plant, and equipment.⁶
33. **Initial direct costs** incurred by the lessee should be expensed when incurred. Initial direct cost incurred by the lessor should be expensed when incurred.

DISCLOSURES

34. Lessees should disclose a broad summary of significant intragovernmental leasing arrangements, including
 - a. existence of intragovernmental leases and annual expense,
 - b. general lease terms with specific intragovernmental requirements (which may be grouped for purposes of disclosure), and
 - c. annual lease expense by major leased asset category.
35. Lessors should disclose the following regarding intragovernmental leases:
 - a. Future lease payments that are to be received for each of the five succeeding fiscal years for lease arrangements over the lease term
 - b. A broad summary of significant leases (which may be grouped for purposes of disclosure), including a breakdown of the number of leases with federally-owned assets and privately-owned assets

LESSEE RECOGNITION AND MEASUREMENT FOR LEASES OTHER THAN SHORT-TERM LEASES, CONTRACTS THAT TRANSFER OWNERSHIP AND INTRAGOVERNMENTAL LEASES

⁶ This recognition is consistent with PP&E capital improvements outlined in SFFAS 6, par. 37.

36. At the commencement of the lease term, a lessee should recognize a lease liability and a property, plant, and equipment (PP&E) right-to-use lease asset (hereinafter referred to as the lease asset), except as provided in, paragraphs 19 - 21 (short-term leases), paragraph 22 (contracts or agreements that transfer ownership), and paragraph 23 - 35 (intragovernmental leases)

LEASE LIABILITY

37. A lessee initially should measure the lease liability at the present value of payments expected to be made during the lease term. Measurement of the lease liability should include the following, if required by a lease:
- a. Fixed payments
 - b. Variable payments that depend on an index or a rate (such as the Consumer Price Index or a market interest rate), initially measured using the index or rate as of the commencement of the lease term
 - c. Variable payments that are fixed in-substance as described in par. 38
 - d. Amounts that are probable of being required to be paid by the lessee under residual value guarantees
 - e. The exercise price of a purchase option if it is probable that the lessee will exercise that option
 - f. Payments for penalties for terminating the lease, if the lease term reflects the lessee exercising (1) an option to terminate the lease or (2) a fiscal funding or cancellation clause
 - g. Any lease incentives (as discussed in par 66 and 67) receivable from the lessor
 - h. Any other payments that are probable of being required based on an assessment of all relevant factors
38. Variable payments based on future performance of the lessee or usage of the underlying asset should not be included. Rather, these variable payments should be recognized as an expense in the statement of net cost in the reporting period in which those payments are incurred. However, any component of these variable payments that is fixed in-substance should be included in the lease liability. An example is a lease payment based on a percentage of sales or usage but with a required minimum amount to be paid. That required minimum payment is fixed in-substance.
39. The future lease payments should be discounted using the interest rate the lessor charges the lessee, which may be the interest rate implicit in the lease. If the interest rate cannot be reasonably estimated by the lessee, the **lessee's estimated incremental borrowing rate**⁷

⁷ A federal lessee's incremental borrowing rate would be the Treasury borrowing rate for securities of similar maturity to the term of the lease unless the entity has its own borrowing authority.

(the estimated rate that would be charged for borrowing the lease payment amounts for the lease term) should be used.

40. In subsequent financial reporting periods, the lessee should calculate the amortization of the discount on the lease liability and recognize that amount as interest expense for the period. Any payments made should be allocated first to the accrued interest liability and then to the lease liability.
41. The lessee should remeasure the lease liability at subsequent financial reporting dates if one or more of the following changes⁸ have occurred at or before that financial reporting date, based on the most recent lease contract or agreement before the changes, and the changes individually or in the aggregate are expected to significantly affect the amount of the lease liability since the previous measurement:
- a. There is a change in the lease term
 - b. An assessment of all relevant factors indicates that the likelihood of a residual value guarantee being required to be paid has changed from probable to not probable, or vice versa.
 - c. An assessment of all relevant factors indicates that the likelihood of a purchase option being exercised has changed from probable to not probable, or vice versa.
 - d. There is a change in the estimated amounts for payments already included in the liability (except as provided in par. 40).
 - e. There is a change in the interest rate the lessor charges the lessee, if used as the initial **discount rate**.
 - f. A contingency, upon which some or all of the variable payments that will be made over the remainder of the lease term are based, is resolved such that those payments now meet the criteria for measuring the lease liability under paragraph 37. For example, an event occurs that causes variable payments that were contingent on the performance or use of the underlying asset to become fixed payments for the remainder of the lease term.
42. If a lease liability is remeasured for any of the changes in paragraph 41, the liability also should be adjusted for any change in an index or rate used to determine variable lease payments if that change in the index or rate is expected to significantly affect the amount of the liability since the previous measurement. A lease liability is not required to be remeasured solely for a change in an index or rate used to determine variable payments.
43. The lessee also should update the discount rate as part of the remeasurement if one or both of the changes in par. 41.a. or 41.c have occurred and the changes individually or in the aggregate are expected to significantly affect the amount of the lease liability .:
44. 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.

⁸ Changes arising from amendments to a lease contract or agreement should be accounted for under the provisions of paragraphs X–X for lease modifications and terminations.

45. If the discount rate is required to be updated based on the provisions in par. 43, the discount rate should be based on the revised interest rate the lessor charges the lessee at the time the discount rate is updated. If that interest rate cannot be readily determined, the lessee's estimated incremental borrowing rate at the time the discount rate is updated should be used.

LEASE ASSET

46. A lessee should initially measure the lease asset as the sum of the following:

- a. The amount of the initial measurement of the lease liability (see par. 37)
- b. Lease payments made to the lessor at or before the commencement of the lease term, less any lease incentives (as discussed in par. 66. and 67)
- c. Initial direct costs that are necessary to place the lease asset into service

47. A lease asset should be amortized in a systematic and rational manner over the shorter of the lease term or the useful life of the underlying asset, except as provided in par. 48. The amortization of the lease asset should be reported as amortization expense.

48. If a lease contains a purchase option that the lessee has determined is probable of being exercised, the lease asset should be amortized over the useful life of the underlying asset. In that circumstance, if the underlying asset is nondepreciable, such as land, the lease asset should not be amortized.

49. The lease asset generally should be adjusted by the same amount when the corresponding lease liability is remeasured based on par. 41–45. However, if this change reduces the carrying value of the lease asset to zero, any remaining amount should be reported in the flows statement as a gain.

50. Leased assets classified as property, plant, and equipment are subject to SFFAS 44, *Accounting for Impairment of General Property, Plant, and Equipment Remaining in Use*. The change in the manner or duration of use of the underlying asset is an indicator that the right of use asset may be impaired (described in par. 12 of SFFAS 44). If the underlying asset is impaired, it should be reduced first for any change in the corresponding lease liability. Any remaining amount should be recognized as an impairment.⁹

DISCLOSURE REQUIREMENTS FOR LESSEES

51. A lessee should disclose the following about its lease activities (which may be grouped for purposes of disclosure), other than short-term leases:

- a. A general description of its leasing arrangements, including:
 - i. the basis, terms, and conditions on which variable lease payments not included in the lease liability are determined

⁹ See SFFAS 44, *Accounting for Impairment of General Property, Plant, and Equipment Remaining in Use*, par. 18 – 25.

- ii. the existence, terms, and conditions of residual value guarantees provided by the lessee
- b. The total amount of lease assets, and the related accumulated amortization, to be disclosed separately from other PP&E assets
- c. The amount of lease expense recognized for the reporting period for variable lease payments not previously included in the lease liability
- d. Principal and interest requirements to maturity, presented separately, for the lease liability for each of the five subsequent years and in five-year increments thereafter
- e. The amount of the annual lease expense and the discount rate used to calculate the lease liability

LESSOR RECOGNITION AND MEASUREMENT FOR LEASES OTHER THAN SHORT-TERM LEASES, CONTRACTS OR AGREEMENTS THAT TRANSFER OWNERSHIP, AND INTRAGOVERNMENTAL LEASES

52. At the commencement of the lease term, a lessor should recognize a lease receivable and a deferred revenue, except as provided in paragraph 19 - 21 (short-term leases) paragraph 22 (contracts or agreements that transfer ownership), and paragraphs 23 - 35 (intragovernmental leases). Any initial direct costs incurred by the lessor should be reported as an expense of the period.

LEASE RECEIVABLE

53. A lessor initially should measure the lease receivable at the present value of lease payments to be received for the lease term, reduced by any provision for uncollectible amounts. Measurement of the lease receivable should include the following types of payments that might be required by a lease:
- a. Fixed payments
 - b. Variable payments that depend on an index or a rate (such as the Consumer Price Index or a market interest rate), initially measured using the index or rate as of the commencement of the lease term
 - c. Variable lease payments that are fixed in-substance as described in paragraph 54
 - d. Residual value guarantees that are fixed payments in substance (as described in par. 55).
 - e. Any lease incentives (as discussed in par. 66 and 67) payable to the lessee.
54. Variable payments based on future performance of the lessee or usage of the underlying asset should not be included in the measurement of the lease receivable. Rather those payments should be recognized as revenue in the reporting period to which those payments relate. However, any component of those variable payments that is fixed in substance should be included in the lease receivable. For example, if a lease payment is based on a

percentage of sales but has a required minimum payment, that required minimum is a fixed payment in substance. Similarly, a residual value guarantee is an in-substance fixed payment if it stipulates the underlying asset will be sold at the end of the lease term, with the lessee assuming a liability for any shortfall if the sales price is less than an agreed-upon minimum amount.

55. Amounts to be received under residual value guarantees (that are not fixed in substance) should be recognized as a receivable and revenue when (a) a guarantee payment is required (as agreed to by the lessee and lessor) and (b) the amount can be reasonably estimated. Amounts to be received for the exercise price of a purchase option or penalty for lease termination should be recognized as a receivable and revenue when those options are exercised.
56. The future lease payments to be received should be discounted using the rate the lessor charges the lessee, which may be the interest rate implicit in the lease. Lessors are not required to apply imputed interest but may do so as a means of determining the interest rate implicit in the lease.
57. In subsequent financial reporting periods, the lessor should calculate the amortization of the discount on the receivable and report that amount as interest revenue for the period. Any payments received should be allocated first to the accrued interest receivable and then to the lease receivable.
58. The lessor should remeasure the lease receivable at subsequent financial reporting periods if one or more of the following changes have occurred at or before that financial reporting period, based on the most recent lease contract or agreement before the changes¹⁰, and the changes individually or in the aggregate are expected to significantly affect the amount of the lease receivable since the previous measurement::
 - a. There is a change in the lease term.
 - b. There is a change in the interest rate the lessor charges the lessee.
 - c. A contingency, upon which some or all of the variable payments that will be received over the remainder of the lease term are based, is resolved such that those payments now meet the criteria for measuring the lease receivable under paragraph 59. For example, an event occurs that results in variable payments that were contingent on the performance or use of the underlying asset becoming fixed payments for the remainder of the lease term.
59. If a lease receivable is remeasured for either of the changes in paragraph 58, the receivable also should be adjusted for any change in an index or rate used to determine variable lease payments if that change in the index or rate is expected to significantly affect the amount of the receivable since the previous measurement. A lease receivable is not required to be remeasured solely for a change in an index or rate used to determine variable lease payments.

¹⁰ Changes arising from amendments to a lease contract or agreement should be accounted for under the provisions of paragraphs 76–82 for lease modifications and terminations.

60. The lessor also should update the discount rate as part of the remeasurement if one or both of the following changes in paragraph 58.a. or 58.b have occurred and the changes individually or in the aggregate are expected to significantly affect the amount of the lease receivable

DEFERRED REVENUE

61. A lessor initially should measure the deferred revenue as follows:

- a. The amount of the initial measurement of the lease receivable (see par. 53)
 - b. Lease payments received from the lessee at or before the commencement of the lease term that relate to future periods (for example, the final month's rent), less any lease incentives (as discussed in par. 66 and 67) paid to, or on behalf of, the lessee at or before the commencement of the lease term.
62. A lessor subsequently should recognize deferred revenue in a systematic and rational manner over the term of the lease. The deferred revenue generally should be adjusted using the same amount as the change resulting from the remeasurement of the lease receivable as discussed in paragraphs 58-60.

UNDERLYING ASSET

63. A lessor should **not** derecognize the asset underlying the lease. A lessor should continue to apply other applicable guidance to the underlying asset, including depreciation and impairment. However, if the lease contract or agreement requires the lessee to return the asset in its original or enhanced condition, a lessor should not depreciate the asset during the lease term.

DISCLOSURES FOR LESSORS

64. A lessor should disclose the following about its lease activities (which may be grouped for purposes of disclosure), other than short-term leases:
- a. A general description of its leasing arrangements, including the basis, terms, and conditions on which any variable lease payments not included in the lease receivable are determined
 - b. The carrying amount of assets on lease, by major classes of assets, and the amount of accumulated depreciation
 - 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
 - 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.

65. In addition to the disclosures in paragraph 64, if a federal entity's principal ongoing operations consist of leasing assets through the use of non-intragovernmental leases, the federal entity should disclose a schedule of future lease payments that are included in the lease receivable, showing principal and interest, for each of the five subsequent years and in five-year increments thereafter.

LEASE INCENTIVE AND LEASE CONCESSIONS

66. Lease incentives include lessor payments made to or on behalf of the lessee to entice the lessee to sign a lease. Lease incentives may include up-front cash payments to the lessee; for example, moving costs, termination fees to lessee's prior lessor, or lessor's assumption of the lessee's lease obligation under a different lease with another lessor. Lease concessions are rent discounts made by the lessor to entice the lessee to sign a lease. Lease concessions include rent holidays/free rent periods, reduced rents, or commission credits.
67. Lease incentives and lease concessions reduce the amount that a lessee is required to pay for a lease. Lease incentives and lease concessions that provide payments to, or on behalf of, a lessee at or before the commencement of a lease term are included in initial measurement by directly reducing the amount of the lease asset (see par. 46). Lease incentive and lease concession payments to be provided after the commencement of the lease term should be accounted for by lessees and lessors as reductions of lease payments for the periods in which the incentive payments will be provided. Those payments should be measured by lessees consistently with the lessee's lease liability (par. 37–45) and by lessors consistently with the lessor's lease receivable (par. 53–60). Accordingly, lease incentive and lease concession payments to be provided after the commencement of the lease term are included in initial measurement and any remeasurement if they are fixed or fixed in substance, whereas variable or contingent lease incentive or lease concession payments are not included in initial measurement. Lessor improvements that are made to or on behalf of the lessee without additional cost to the lessee should be accounted for by the lessee and the lessor consistent with other lease incentives and lease concessions.

CONTRACTS OR AGREEMENTS WITH MULTIPLE COMPONENTS

68. Lessors and lessees may enter into contracts or agreements that contain multiple components, such as a contract or agreement that contains both a lease component and a nonlease component, or a lease that contains multiple underlying assets.
69. If a lessor or lessee enters into a contract or agreement that contains both a lease (such as the right to use a building) and a nonlease component (such as a maintenance services for the building), the federal entity should account for the lease and nonlease components as separate contracts or agreements, unless the contract or agreement meets the exception in paragraph 72.
70. If a lease involves multiple underlying assets and the assets have different lease terms, the lessor and lessee should account for each underlying asset as a separate lease component. The provisions of this paragraph should be applied unless the contract or agreement meets the exception in paragraph 72.

71. To allocate the contract or agreement price to the different components, lessors and lessees should first use any prices for individual components that are included in the contract or agreement, as long as the price allocation does not appear to be unreasonable based on the terms of the contract or agreement and professional judgment, maximizing the use of observable information; for example, using readily available observable stand-alone prices. Stand-alone prices are those that would be paid or received if the same or similar assets were leased individually or if the same or similar nonlease components (such as services) were contracted individually. Some contract or agreements provide discounts for bundling multiple leases or lease and nonlease components together in one contract or agreement. These discounts may be taken into account when determining whether individual component prices do not appear to be unreasonable. For example, if the individual component prices are each discounted by the same percentage from normal market prices, those component prices would not be considered unreasonable.
72. If a contract or agreement does not include prices for individual components, or if any of those prices appear to be unreasonable as provided in paragraph 71, lessors and lessees should use professional judgment to determine their best estimate for allocating the contract or agreement price to those components, maximizing the use of observable information. If it is not practicable to determine a best estimate for price allocation for some or all components in a contract or agreement, a federal entity should account for those components as a single lease unit.
73. If multiple components are accounted for as a single lease unit as provided for in paragraph 72, the accounting for that unit should be based on the primary lease component within that unit. For example, the primary lease component's lease term should be used for the unit if the lease components have different lease terms.

CONTRACT OR AGREEMENT COMBINATIONS

74. Contracts or agreements that are entered into at or near the same time with the same counterparty should be considered to be part of the same lease contract or agreement if either of the following criteria is met:
- a. The contracts or agreements are negotiated as a package with a single objective.
 - b. The amount of consideration to be paid in one contract or agreement depends on the price or performance of the other contract or agreement.
75. If multiple contracts or agreements are determined to be part of the same lease contract or agreement, that contract or agreement should be evaluated in accordance with the guidance for contracts or agreements with multiple components in paragraphs 68–73.

LEASE TERMINATIONS AND MODIFICATIONS

76. The provisions of a lease contract or agreement may be amended while the contract or agreement is in effect. Examples of amendments to lease contracts or agreements include changing the contract or agreement price, a lengthening or shortening of the lease term, and adding or removing an underlying asset. An amendment should be considered a lease

modification unless the lessee's right to use the underlying asset decreases, in which case the amendment should be considered a partial or full lease termination. By contrast, exercising an existing option, such as an option to extend or terminate the lease as discussed in paragraph 14, is subject to the guidance for remeasurement.

LEASE TERMINATIONS

77. The lessee and lessor should account for an amendment during the reporting period resulting in a decrease in the lessee's right to use the underlying asset (for example, the lease term is shortened or the number of underlying assets is reduced) as a partial or full lease termination.

LESSEE TREATMENT OF LEASE TERMINATIONS

78. A lessee generally should account for the partial or full lease termination by reducing the carrying values of the lease asset and lease liability, and recognizing a gain or loss for the difference. However, if the lease is terminated as a result of the lessee purchasing the underlying asset from the lessor, the lease asset should be reclassified to the appropriate class of owned asset.

LESSOR TREATMENT OF LEASE TERMINATIONS

79. A lessor should account for the full or partial termination of a lease by reducing the carrying values of the lease receivable and related deferred revenue and recognizing a gain or loss for the difference. However, if the lease is terminated as a result of the lessee purchasing an underlying asset from the lessor, the carrying value of the underlying asset also should be derecognized and included in the calculation of any resulting gain or loss.

LEASE MODIFICATIONS

80. The lessee and lessor should account for an amendment during the reporting period resulting in a modification to a lease contract or agreement as a separate lease (that is, separate from the most recent lease contract or agreement before the modification) if both of the following conditions are present:
- a. The lease modification gives the lessee an additional lease asset by adding one or more underlying assets that were not included in the original lease contract or agreement.
 - b. The increase in lease payments for the additional lease asset does not appear to be unreasonable based on (1) the terms of the amended lease contract or agreement and (2) professional judgment, maximizing the use of observable information (for example, using readily available observable stand-alone prices).

LESSEE TREATMENT OF LEASE MODIFICATIONS

81. Unless a modification is reported as a separate lease as provided in paragraph 86, a lessee should account for a lease modification by remeasuring the lease liability. The lease asset should be adjusted by the difference between the remeasured liability and the liability immediately before the lease modification. However, 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.

LESSOR TREATMENT OF LEASE MODIFICATIONS

82. Unless a modification is reported as a separate lease as provided in paragraph 80, a lessor should account for a lease modification by remeasuring the lease receivable. The deferred revenue should be adjusted by the difference between the remeasured receivable and the receivable immediately before the lease modification. However, to the extent the change relates to payments for the current period, the change should be recognized as revenue or expense for the current period.

SUBLEASES

83. A sublease involves three parties: the original lessor, the original lessee (who also is the lessor in the sublease), and the new lessee. The original lessor should continue to apply the general lessor guidance. The federal entity that is the original lessee and becomes the lessor in the sublease should account for the original lease and the sublease as two separate transactions, as a lessee and a lessor, respectively. Those two separate transactions should not be offset against one another. The new lessee should apply the general lessee guidance.
84. The original lessee (and now the lessor in a sublease) should include the sublease in its disclosure of the general description of lease arrangements. Its lessor transactions related to subleases should be disclosed separately from its lessee transactions related to the original lease.

SALE-LEASEBACK TRANSACTIONS

85. Sale-leaseback transactions involve the sale of an underlying asset by the owner and a lease of the property back to the seller (original owner). A sale-leaseback should include a transaction that qualifies as a sale¹¹ to be eligible for sale-leaseback accounting. A sale-leaseback transaction that does not include a transaction that qualifies as a sale should be accounted for as a borrowing by both the seller-lessee and the buyer-lessor.
86. The sale and lease portions of a sale-leaseback transaction should be accounted for as two separate transactions – a sale transaction and a lease transaction – except that the difference between the carrying value of the capital asset that was sold and the net proceeds from the sale should be reported as a deferred revenue or deferred expense to be recognized in the flow statement in a systematic and rational manner over the term of the lease. However, if the lease portion of the transaction qualifies as a short-term lease, any difference between the carrying value of the capital asset that was sold and the net proceeds from the sale should be recognized immediately.

¹¹ See SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*, par. 295.

87. A sale-leaseback transaction is considered to have off-market terms if there is a significant difference between (a) the sales price and the estimated fair value of the asset or (b) the present value of the contractual lease payments and the estimated present value of what the lease payments for that asset would be at a market price, whichever of the two differences is more readily determinable. The difference should be reported based on the substance of the transaction (for example, as a borrowing, a nonexchange transaction, or an advance lease payment) rather than as a part of the sales-leaseback transaction.
88. A seller-lessee should disclose the terms and conditions of sale-leaseback transactions in addition to the disclosures required of a lessee (par. 51). A buyer-lessor should provide the disclosures required of a lessor (par. 64).

LEASE-LEASEBACK TRANSACTIONS

89. In a lease-leaseback transaction, an asset is leased by one party (first party) to another party and then leased back to the first party. The leaseback may involve an additional asset (such as leasing a building that has been constructed by a developer on land owned by and leased back to a federal entity) or only a portion of the original asset (such as leasing back only one floor of a building to the owner). A lease-leaseback transaction should be accounted for as a net transaction. Both parties to a lease-leaseback transaction should disclose the amounts of the lease and the leaseback separately.

AMENDMENTS TO SFFAS 5, ACCOUNTING FOR LIABILITIES OF THE FEDERAL GOVERNMENT AND SFFAS 6, ACCOUNTING FOR PROPERTY, PLANT, AND EQUIPMENT

90. This Statement replaces the measurement and reporting requirements for lease accounting established in SFFAS 5, *Accounting for Liabilities of the Federal Government*, paragraphs 43 – 46. Therefore, the paragraphs marked below are rescinded.

SFFAS 5: Accounting for Liabilities of the Federal Government

~~[43.] **Capital leases** are leases that transfer substantially all the benefits and risks of ownership to the lessee. If, at its inception, a lease meets one or more of the following four criteria, the lease should be classified as a capital lease by the lessee:~~

- ~~• The lease transfers ownership of the property to the lessee by the end of the lease term.~~
- ~~• The lease contains an option to purchase the leased property at a bargain price.~~
- ~~• The lease term is equal to or greater than 75 percent of the estimated economic life of the leased property.~~
- ~~• The present value of rental and other minimum lease payments, excluding that portion of the payments representing executory cost, equals or exceeds 90 percent of the fair value of the leased property.~~

~~The last two criteria are not applicable when the beginning of the lease term falls within the last 25 percent of the total estimated economic life of the leased property. If a lease does not meet at least one of the above criteria it should be classified as an operating lease.~~

~~[44.] The amount to be recorded by the lessee as a liability under a capital lease is the present value of the rental and other minimum lease payments during the lease term, excluding that portion of the payments representing executory cost to be paid by the lessor. [footnote ²⁰: “The cost of general property, plant, and equipment acquired under a capital lease shall be equal to the amount recognized as a liability for the capital lease at its inception. See SFFAS No. 6, Accounting for Property, Plant, and Equipment.”] However, if the amount so determined exceeds the fair value of the leased property at the inception of the lease, the amount recorded as the liability should be the fair value. If the portion of the minimum lease payments representing executory cost is not determinable from the lease provisions, the amount should be estimated.~~

~~[45.] 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. The lessee’s incremental borrowing rate shall be the Treasury borrowing rate for securities of similar maturity to the term of the lease.~~

~~[46.] During the lease term, each minimum lease payment should be allocated between a reduction of the obligation and interest expense so as to produce a constant periodic rate of interest on the remaining balance of the liability. [footnote ²¹: OMB Circular No. A-11, “Preparation and Submission of Annual Budget Estimates,” explains the measurement of budget authority, outlays, and debt for the budget in the case of lease purchases and other capital leases. Circular A-94, “Guidelines and Discount Rates for Benefit-Cost~~

Analysis of Federal Programs,” provides the requirements under which a lease purchase or other capital lease has to be justified and the analytical methods that need to be followed.]

91. This Statement replaces the measurement and reporting requirements for lease accounting established in SFFAS 6, *Accounting for Property, Plant, and Equipment*, paragraphs 20 and 29. Therefore, the paragraphs marked below are rescinded.

SFFAS 6: Accounting for Property, Plant, and Equipment

[20.] Capital leases are leases that transfer substantially all the benefits and risks of ownership to the lessee. If, at its inception, a lease meets one or more of the following four criteria, [footnote⁷: Note that the criteria for identifying capital leases for financial reporting purposes differ from OMB criteria for budget scoring of leases. OMB Circular No. A-11, *Preparation and Submission of Budget Estimates*, includes criteria for identifying operating leases in Appendix B. OMB provides four additional criteria which relate to the level of private sector risk involved in a lease purchase agreement. This is necessary because, for budget purposes, there is a distinction between lease purchases with more or less risk. This distinction is not made in the financial reports and, therefore, FASAB does not include the four criteria related to risk levels.] the lease should be classified as a capital lease by the lessee. Otherwise, it should be classified as an operating lease. [footnote⁸: “Operating leases” of PP&E are leases in which the Federal entity does not assume the risks of ownership of the PP&E. Multi-year service contracts and multi-year purchase contracts for expendable commodities are not capital leases.]

- The lease transfers ownership of the property to the lessee by the end of the lease term.
- The lease contains an option to purchase the leased property at a bargain price.
- The lease term is equal to or greater than 75 percent of the estimated economic life [footnote⁹: “Estimated economic life of leased property” is the estimated remaining period during which the property is expected to be economically usable by one or more users, with normal repairs and maintenance, for the purpose for which it was intended at the inception of the lease, without limitation by the lease term.] of the leased property.
- The present value of rental and other minimum lease payments, excluding that portion of the payments representing executory cost, equals or exceeds 90 percent of the fair value [footnote¹⁰: “Fair value” is the price for which an asset could be bought or sold in an arm’s-length transaction between unrelated parties (e.g., between a willing buyer and a willing seller). (adapted from Kohler’s Dictionary for Accountants)] of the leased property.

The last two criteria are not applicable when the beginning of the lease term falls within the last 25 percent of the total estimated economic life of the leased property.

[29.] The cost of general PP&E acquired under a **capital lease** shall be equal to the amount recognized as a liability for the capital lease at its inception (i.e., the net present value of the lease payments calculated as specified in the liability standard [footnote²⁴: See Statement of Recommended Accounting Standards No. 5, *Accounting for Liabilities of the Federal Government*.] unless the net present value exceeds the fair value of the asset).

92. This Statement also amends Technical Release (TR) 16, *Implementation Guidance for Internal Use Software*, paragraphs 26, 27, and 29 to delete the “capital and operating lease” references, as follows.

Technical Release 16: *Implementation Guidance for Internal Use Software*

[26.] Software License: If the term of software license(s) is 2 years or more with periodic payments, the license should be evaluated against lease criteria as stated in ~~SFFAS X~~ SFFAS 5 paragraphs 43–46 and ~~SFFAS 6~~ paragraph 20 to determine if it is a capital or operating lease. If the license(s) is perpetual with an upfront cost [footnote ⁹: The cost could be charged as a one-time payment or financed over a set period of time.] to use the software for its entire lifetime, then the entity is purchasing IUS and should apply its existing policy for capitalization thresholds to determine if the license should be capitalized or expensed.

[27.] A license agreement may include executory costs for maintenance and technical support. Agency judgment should apply in determining what portions of license fees are attributable to software capitalizable costs versus executory costs. Assuming lease capitalization criteria and thresholds are met, software license capitalization amounts [footnote ¹⁰: ~~SFFAS X~~ SFFAS 5, paragraph 44.] may be derived from the payment schedule contained in the license agreement. ~~As stated in SFFAS 5, If the portion of the minimum~~ lease payments representing executory cost is not determinable from the lease provisions, the amount should be estimated. Agencies may also want to consider having each license agreement specifically identify the various costs throughout the license lifecycle, for example, initial license, maintenance, and enhancement.

[29.] If a cloud computing arrangement includes a software license, the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses in accordance with the lease criteria stated in ~~SFFAS X~~ SFFAS 5 and ~~SFFAS 6~~, and as discussed in paragraph 26 of this TR. SFFAS 10 is not applicable to a cloud computing arrangement that does not convey a contractual right to the IUS or to ones that do not include an IUS license. The entity that develops and owns the software, platform, or infrastructure that is used in the cloud computing arrangement would account for the software development in accordance with SFFAS 10. If the funding to develop cloud computing is shared among entities without clear ownership, the service provider entity that receives funding and is responsible for maintaining the software, platform, or infrastructure should account for the software in accordance with SFFAS 10 and the full cost/inter-entity cost requirements of SFFAS 4.

IMPLEMENTATION

93. This Statement requires 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. Therefore, in the period of implementation,
- the determination of the lease term would assume that the lease term began as of the beginning of the period of implementation and

- b. the lease liability and lease asset should initially be measured based on the remaining lease term and associated lease payments as of the beginning of the period of implementation.

94. The following implementation addresses specific leasing circumstances.

- a. Prospective Implementation - Entities should report the effect of implementing this Statement on existing leases prospectively in accordance with paragraph 13 of SFFAS 21, *Reporting Correction of Errors and Changes in Accounting Principles, Amendment of SFFAS 7, Accounting for Revenue and Other Financing Sources*. Accordingly, any changes in assets or liabilities related to existing leases should be treated prospectively. The change should be accounted for in the period of implementation and applicable future periods. No adjustments should be made to previously reported expenses or revenue.
- b. Lease Term - The lease term should be determined based on the provisions of this Statement (see par. 19 – 23). However, the lease term of an existing lease should be based on the number of years remaining in the lease contract or agreement as of the beginning of the period of implementation and not the number of years in the initial lease term. For example, if the initial lease term was 20 years, with no options to extend, at the beginning of Year 20X1 and the entity implements this Statement in Year 20X7 (6 years into the lease at the beginning of Year 20X7), the initial lease term upon implementation would be 14 years .
- c. Short-term leases - A short-term lease would be determined based on the provisions of this Statement (see par. 19– 21). However, if the remaining lease term of an existing lease meets the definition of a short-term lease (has a maximum possible term under the contract or arrangement of 24 months or less, including any options to extend, regardless of their probability of being exercised) that lease should apply the short-term lease guidance. For example, if the initial lease term was 60 months as of the beginning of Year 20X1, with no options to extend, and the entity implements this Statement in Year 20X5 (48 months into the lease at the beginning of Year 20X5); the initial lease term at implementation would be 12 months and the lease would meet the definition of a short-term lease. Hence, the entity should account for the lease as a short-term lease.

EFFECTIVE DATE

95. The requirements of this Statement are effective for reporting periods beginning after September 30, 2020. Early adoption is not permitted.

The provisions of this Statement need not be applied to immaterial items.

APPENDIX A: BASIS FOR CONCLUSIONS

This appendix discusses some factors considered significant by Board members in reaching the conclusions in this Statement. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others. The standards enunciated in this Statement—not the material in this appendix—should govern the accounting for specific transactions, events, or conditions.

PROJECT HISTORY

- A1. This Statement amends the lease accounting standards in *SFFAS 5, Accounting for Liabilities of the Federal Government*, and *SFFAS 6, Accounting for Property, Plant, and Equipment*. The lease standards in *SFFAS 5* and *SFFAS 6* had been in effect since 1995. Under *SFFAS 5* and *6*, leases were classified as either capital or operating depending on whether the lease met any of four tests.
- A2. This project was undertaken primarily because
- a. the current lease accounting 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*, have been criticized as ineffective because they do not make meaningful distinctions between capital and operating leases based on the substance of lease transactions, and
 - b. the lease accounting standards in *SFFAS 5* and *6* are based on Financial Accounting Standards Board (FASB) lease accounting standards which have been amended; in addition existing FASAB standards are not comprehensive and do not provide meaningful information on federal leasing activities.
- A3. Lease accounting was first addressed by the FASAB during the development of *SFFAS 5* and *6*. At that time the Board decided to use the high level language on lease accounting from FASB *Statement of Financial Accounting Standards (SFAS) No. 13 Accounting for Leases* [subsequently codified in *Accounting Standards Codification (ASC) - Topic 840 Leases*]. This minimal lease guidance included the definition of a capital lease, the criteria for capital leases, and the measurement of a capital lease asset and liability. The Board had plans to use this preliminary guidance as a placeholder until it was prepared to add lease accounting to its agenda as a separate project. Lease accounting had been on the list of potential Board agenda items each time the Board has considered its agenda for new projects.
- A4. There are several areas of lease accounting that were covered by the FASB standards that were never specifically covered in the FASAB standards. Some of those topics include leasehold improvements, lease terms, leveraged leases, and subleases. The federal community often stressed that the federal standards on lease accounting should be comprehensive to alleviate questions on when and if FASB standards apply to federal entities when the federal standards are silent on a topic.
- A5. In August 2011, FASAB began a project to revise its current standards on lease accounting. FASAB staff formed a task force to assist in developing the proposed

standards for leases. Task force members included accounting, budget, and subject matter experts from federal agencies and independent public accounting firms.

- A6. The task force met several times over the course of the project and also exchanged numerous ideas and recommendations electronically. The task force views and recommendations were sought by staff in developing and describing alternatives to present to the Board during the development of these standards. The task force's assistance was essential and its views carefully considered by members during deliberations. The task force played an important role in the research and release of this exposure draft.
- A7. In evaluating an approach applicable to federal leases, the Board considered the approaches used in the following documents:
- Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards (SFAS) 13, *Accounting for Leases* [Superseded by FASB Accounting Standards Codification (ASC) 840, which was subsequently superseded by ASC 842]
 - Governmental Accounting Standards Board (GASB) Exposure Draft, *Leases*, January 25, 2016
 - International Accounting Standards Board (IASB) International Accounting Standard (IAS) 17, *Leases*, which was superseded by International Financial Reporting Standard (IFRS) 16.
 - International Public Sector Accounting Standards Board (IPSASB) International Public Sector Accounting Standard (IPSAS) 13, *Leases*.
- A8. At the inception of the project the Board decided to coordinate with GASB on the lease project because of the similarities among governmental entities regarding lease activities and reporting objectives. Staff worked closely with GASB staff during the development of the proposals. In 2014 FASAB and GASB met jointly to discuss similar issues related to each of their ongoing lease accounting projects. As a result of this collaboration, similar wording may appear in some sections of the FASAB and GASB standards.¹²
- A9. This Statement amends the lease accounting standards in SFFAS 5, SFFAS 6, and TR 16. This Statement also establishes distinct standards for intragovernmental leases.

KEY AREAS OF IMPROVEMENT

- A10. This lease proposal will improve the existing lease accounting standards in SFFAS 5 and SFFAS 6 by
- a. providing relevant and meaningful financial information needed by federal financial statement users and
 - b. providing comprehensive lease standards that appropriately address the various lease transactions/activities of the federal community.

¹² The GASB material is copyrighted by the Financial Accounting Foundation, 401 Merritt 7, Norwalk, CT 06856, USA, and is used with permission.

A11. The Board believes that in a lease transaction, a lessee receives the right to use an underlying asset (the asset that is subject to the lease, such as a vehicle or building) at the beginning of the lease term. In exchange, the lessee promises to make payments over time for the right to use that underlying asset. The guidance in SFFAS 5 and 6 was based on the notion that some leases are essentially financed purchases of the underlying asset (classified as capital leases) and other leases (classified as operating leases) are not. The classification of a lease as capital or operating depended on whether the lease met any of four tests. Those tests were intended to determine whether most of the risks and benefits of ownership of the underlying asset were transferred to the lessee. Those tests have been criticized because their bright-line nature often resulted in very similar leases being accounted for in different ways.

SCOPE

A12. For purposes of applying this Statement, A lease is defined as a contract or agreement that conveys the right to control the use of another entity's property, plant, and equipment (PP&E) (the underlying asset) for a period of time as specified in the contract or agreement in exchange for consideration. Leases include contracts or agreements that, although not explicitly identified as leases, meet the definition of a lease (which reflects the substance of a lease). This definition does not include contracts or agreements for services unless that contract or agreement also conveys the right to use a nonfinancial asset (the underlying asset) for a period of time in an exchange transaction.

A13. This Statement does not apply to leases of assets under construction or leases (licenses) of internal use software.

A14. GASB's Leases exposure draft specifically excludes, "contracts that meet the definition of a service concession arrangement in paragraph 4 of Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements* (SCAs)." Currently FASAB standards are silent on SCAs. Through its discussions the lease task force identified several federal entities that have SCAs, and there was a concern that the proposed lease definition could inadvertently include SCAs. The Board considered specifically excluding SCAs from the lease standard. To accomplish the exclusion, the Board considered adopting GASB's definition of SCA from Statement No. 60 due to the lack of a federal definition of SCA.

A15. Because SCAs are not currently addressed in federal accounting standards, the Board decided that specifically excluding SCAs from the lease standard would raise more questions. Furthermore, SCAs are expected to be addressed in the public-private partnership recognition and measurement project and therefore the Board agreed to remain silent on SCAs in the lease proposal. In conclusion, the Board believes the GAAP hierarchy will continue to guide preparers and auditors in accounting for SCAs.

DEFINITIONS

A16. In this Statement, A lease is defined as a contract or agreement that conveys the right to control the use of another entity's property, plant, and equipment (PP&E) (the underlying

asset) for a period of time as specified in the contract or agreement in exchange for consideration. In the early stages of the project the Board deliberated over the use of “contract” or “agreement” in the definition of a lease. The Board considered the GASB approach that the term contract is more precise and limiting and requires that a lease be legally enforceable. Because legal enforceability is not the primary driver in intragovernmental leasing transactions, the Board decided to add “agreement” in addition to “contract” in the lease definition to alleviate ambiguity in the application of the definition, especially in the case of intragovernmental leases which are often referred to as “lease agreements.”

LEASE TERM -- OPTIONS TO EXTEND OR TERMINATE

- A17. Federal leases often include lessee options to extend or terminate a lease. Due to federal budget scoring rules and fiscal funding mechanisms, many federal leases include relatively short noncancelable periods. The Board concluded that the lease term used to measure the lease liability should not be limited to the noncancelable lease periods, but should include certain probable options to extend the lease and consider the probability of options to terminate, so that the lease term reflects how long the lease is expected to be in effect.
- A18. The probability of options to extend or terminate the lease applies only if that option pertains to the lessee alone. If either the lessee or the lessor has the option to terminate a lease (or if both parties have to agree to extend), the lease contract or agreement is not enforceable beyond that point. In those cases when either the lessee or the lessor could cancel the lease at any time, for example month-to-month lease holdovers, rolling lease extensions, or any lease that continues into a holdover period until a new contract or agreement is signed, the contract or agreement would be considered cancelable. When a lease contains a lessor-only option to terminate the lease, a lessee would have difficulty evaluating the likelihood of that option being exercised. This difficulty and the resulting cost outweigh the potential benefits of including the extra periods in the lease term. The Board also agreed that the presence of a purchase option in a lease contract or agreement is not equivalent to a provision that transfers ownership of the underlying asset; therefore, a purchase option should be treated as any other option included in a lease.
- A19. The Board considered several potential probability thresholds for including options to extend or terminate the lease in the lease term. The Board considered its own definition of probable, GASB’s definition of probable, and FASB’s probability threshold “reasonably certain.” FASB’s probable definition equates to more likely than not (>50% probability). GASB’s probable definition equates to likely to occur and has a higher threshold of probability than more likely than not. FASB’s reasonably certain has an even higher threshold than likely to occur. The Board agreed to retain its definition of probable because it is more clearly defined and there seemed to be no compelling reason to introduce a new term for the sake of a higher threshold.

REMEASUREMENT

A20. This Statement requires that when a lease liability is remeasured, the corresponding lease asset be adjusted by the same dollar amount (except in cases of impairment and in cases in which the adjustment would cause the asset to be reported as a negative amount). While acknowledging that adjusting the lease asset for a change in the lease liability results in the lease asset no longer being measured at adjusted historical cost, the Board believes that such an adjustment is practical.

SHORT-TERM LEASES

A21. The Board considered the short-term lease exception GASB proposed, which requires governments to recognize leases with useful lives or maturities of less than one year. The Board decided to align the lease short-term exception with the PP&E standard which defines PP&E as a tangible asset with an estimated useful life of 24 months or more. The reporting of short-term leases in this Statement is intended to reduce the cost to federal entities of implementing these standards. This short-term exception eliminates the need for preparers to calculate amounts for short-term lease assets and liabilities. This exception requires lessees and lessors to recognize expense and revenue based on the payment provisions of those lease contracts or agreements with useful lives or maturities of less than two years. This measurement approach is not cash-basis recognition, as federal entities are still required to recognize receivables and payables for lease payments paid or received before or after the period to which they apply.

INTRAGOVERNMENTAL LEASES

A22. During the research phase of the project, the General Services Administration (GSA) provided an educational session to the Board where GSA representatives explained in-depth GSA's role in federal leasing. Based primarily on that discussion, the Board agreed that intragovernmental leases should be accounted for differently than leases between federal entities and non-federal entities. The Board agreed that a simplified approach for recognizing intragovernmental leases would be pragmatic and cost efficient.

A23. This Statement provides the overall recognition, measurement, and disclosure requirements 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*. A lessee would not recognize a lease asset and a corresponding liability for an intragovernmental lease. Accordingly, a lessee would not recognize amortization expense related to a lease asset or interest expense on a lease liability.

A24. The terms "intragovernmental" and "inter-entity" have been used interchangeably. Earlier FASAB standards predominately used "inter-entity." However, government-wide usage of "intragovernmental" has become more common, and therefore the Board decided to use intragovernmental in this Statement to describe leases occurring within a consolidation entity or between two or more consolidation entities as defined under SFFAS 47.

LEASES OTHER THAN SHORT-TERM LEASES, CONTRACTS OR AGREEMENTS THAT TRANSFER OWNERSHIP, AND INTRAGOVERNMENTAL LEASES

OWNERSHIP RECOGNITION AND MEASUREMENT FOR LESSEES – LEASE LIABILITY

- A25. SFFAC 5 defines a liability as a present obligation of the federal government to provide assets or services to another entity at a determinable date, when a specified event occurs, or on demand. The Board believes that the lessee taking possession of the underlying asset or gaining access to use the underlying asset is an event that creates such an obligation until the end of the lease term.
- A26. The Board believes the present value of future lease payments to be made for the lease term, which represent the obligations of the lessee under the lease contract or agreement, is the appropriate measurement of the liability. Such a calculation is consistent with the premise that a lease is a financing transaction and supports recognition of the cost of the financing.

RECOGNITION AND MEASUREMENT FOR LESSEES – LEASE ASSET

- A27. Assets are defined in SFFAC 5 as resources that embodies economic benefits or services the federal government controls. Lessees should recognize a lease asset to correspond with the lease liability. At the beginning of a lease, the lessee obtains the right to use the underlying asset and that right is a resource embodying economic benefits. The Board believes this right meets the definition of an asset. Because the lease liability represents the amount to be paid for the lease asset, the Board concluded that the initial measurement of the lease asset should be based on the measurement of the associated lease liability. PP&E assets generally are measured at historical cost, which is the amount paid for those assets. Therefore, measuring the lease asset based on the lease liability is consistent with historical cost accounting applicable to PP&E.

RECOGNITION AND MEASUREMENT FOR LESSORS

- A28. Symmetry between the lessee and lessor accounting models is important in establishing accounting and financial reporting standards. The Board believes that federal entity lessees and lessors should account for the same transaction in a way that mirrors how the other party accounts for it.
- A29. The lease contract or agreement gives the lessor the right to receive payments in exchange for the lessee's right to use the underlying asset. The Board believes that right meets the definition of an asset in SFFAC 5. Assets are defined as a resource that embodies economic benefits or services that the federal government controls. The right to receive payments is a resource that can be drawn upon, and the lessor presently controls that right.

APPENDIX B: ABBREVIATIONS

ASC	Accounting Standards Codification
CFR	Consolidated financial report of the U.S. Government
ED	Exposure draft
FASAB	Federal Accounting Standards Advisory Board
FASB	Financial Accounting Standards Board
GAAP	Generally Accepted Accounting Principles
GAO	Government Accountability Office
GASB	Governmental Accounting Standards Board
IPSASB	International Public Sector Accounting Standards Board
PP&E	Property, Plant, and Equipment
SCA	Service Concession Arrangement
OMB	Office of Management and Budget
SFAS	Statement of Financial Accounting Standards (FASB)
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards
TB	Technical Bulletin
TR	Technical Release

APPENDIX C: GLOSSARY

Lease

A lease is a contract or agreement that conveys the right to control the use of another entity's property, plant, and equipment (PP&E) (the underlying asset) for a period of time as specified in the contract or agreement in exchange for consideration

Intragovernmental Lease

An intragovernmental lease is a contract or agreement that conveys the right to control the use of another entity's PP&E asset (the underlying asset) for a period of time as specified in the contract or agreement in exchange for consideration occurring within a consolidation entity or between two or more consolidation entities as defined under SFFAS 47, *Reporting Entity*..¹³

Probable

That which can reasonably be expected or believed to be more likely than not on the basis of available evidence or logic but which is neither certain nor proven.

Initial Direct Costs

Initial direct costs are costs that are directly attributable to negotiating and arranging a lease or portfolio of leases and would not have been incurred without entering into the lease.

Short-Term Lease

a lease with a lease term (as defined in paragraph 14) of 24 months or less.

Lessee's Incremental Borrowing Rate

The lessee's incremental borrowing rate is the estimated rate that would be charged for borrowing the lease payment amounts for the lease term.

Discount Rate

A discount rate is an interest rate that is used in present value calculations to equate amounts that will be received or paid in the future to their present value.

Lease Incentives

Lease incentives include lessor payments made to or on behalf of the lessee to entice the lessee to sign a lease. Lease incentives may include up-front cash payments to the lessee; for example, moving costs, termination fees to lessee's prior lessor, or lessor's assumption of the lessee's lease obligation under a different lease with another lessor.

¹³ SFFAS 47, *Reporting Entity*, outlines the characteristics as a whole that an organization would have to be considered a consolidated entity (see SFFAS 47 par. 38-42).

Lease Concessions

Lease concessions are rent discounts made by the lessor to entice the lessee to sign a lease. Lease concessions include rent holidays/free rent periods, reduced rents, or commission credits.

Leasehold Improvements

Leasehold improvements are additions, alterations, remodeling, renovations or other changes to a leased property that either extend the useful life of the existing property or enlarge or improve its capacity and are paid for (financed) by the lessee.

Lessor Improvements

Lessor improvements are additions, alterations, remodeling, renovations or other changes to a leased property that either extend the useful life of the existing property or enlarge or improve its capacity and are paid for (financed) by the lessor rather than by the lessee.

FASAB Board Members

D. Scott Showalter, Chairman

Gila J. Bronner

Robert F. Dacey

George A. Scott

Michael H. Granof

Christina Ho

Patrick McNamee

Mark Reger

Graylin E. Smith

FASAB Staff

Wendy M. Payne, Executive Director

Monica R. Valentine, Assistant Director

Federal Accounting Standards Advisory Board

441 G Street NW, Suite 6814

Mail Stop 6H19

Washington, D.C. 20548

Telephone (202) 512-7350

Fax (202) 512-7366

www.fasab.gov



Federal Accounting Standards Advisory Board

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

Statement of Federal Financial Accounting Standards

Exposure Draft

Written comments are requested by January 6, 2017

September 26, 2016

THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General of the United States, established the Federal Accounting Standards Advisory Board (FASAB or “the Board”) in October 1990. FASAB is responsible for promulgating accounting standards for the United States government. These standards are recognized as generally accepted accounting principles (GAAP) for the federal government.

An accounting standard is typically formulated initially as a proposal after considering the financial and budgetary information needs of citizens (including the news media, state and local legislators, analysts from private firms, academe, and elsewhere), Congress, federal executives, federal program managers, and other users of federal financial information. The proposed standards are published in an exposure draft for public comment. In some cases, a discussion memorandum, invitation for comment, or preliminary views document may be published before an exposure draft is published on a specific topic. A public hearing is sometimes held to receive oral comments in addition to written comments. The Board considers comments and decides whether to adopt the proposed standard with or without modification. After review by the three officials who sponsor FASAB, the Board publishes adopted standards in a Statement of Federal Financial Accounting Standards. The Board follows a similar process for Statements of Federal Financial Accounting Concepts, which guide the Board in developing accounting standards and formulating the framework for federal accounting and reporting.

Additional background information is available from FASAB or its website:

- [“Memorandum of Understanding among the Government Accountability Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board.”](#)
- [“Mission Statement: Federal Accounting Standards Advisory Board”](#), [exposure drafts](#), [Statements of Federal Financial Accounting Standards and Concepts](#), [FASAB newsletters](#), and other items of interest are posted on FASAB’s website at: www.fasab.gov.

Copyright Information

This is a work of the U. S. government and is not subject to copyright protection in the United States. It may be reproduced and distributed in its entirety without further permission from FASAB. However, because this work may contain copyrighted images or other material, permission from the copyright holder may be necessary if you wish to reproduce this material separately. The GASB material used in this exposure draft is copyrighted by the Financial Accounting Foundation, 401 Merritt 7, Norwalk, CT 06856, USA, and is used with permission.

Contact us:

Federal Accounting Standards Advisory Board
441 G Street, NW, Suite 6814
Mailstop 6H19
Washington, DC 20548
Telephone 202-512-7350
FAX 202-512-7366
www.fasab.gov

September 26, 2016

TO: ALL WHO USE, PREPARE, AND AUDIT FEDERAL FINANCIAL INFORMATION

Your comments on the exposure draft of a proposed Statement of Federal Financial Accounting Standards, entitled *Leases: An Amendment of SFFAS 5, Accounting for Liabilities of the Federal Government and SFFAS 6, Accounting for Property, Plant, and Equipment*, are requested. Specific questions for your consideration appear on page 6 but you are welcome to comment on any aspect of this proposal. If you do not agree with the proposed approach, your response would be more helpful to the Board if you explain the reasons for your position and any alternative you propose. Responses are requested by January 6, 2017.

All comments received by FASAB are considered public information. Those comments may be posted to FASAB's website and will be included in the project's public record.

Mail delivery is delayed by screening procedures. Therefore, please provide your comments in electronic form by e-mail to fasab@fasab.gov. If you are unable to e-mail your responses, we encourage you to fax the comments to (202) 512-7366. Alternatively, you may mail your comments to:

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

We will confirm receipt of your comments. If you do not receive confirmation, please contact our office at 202.512.7350 to determine if your comments were received.

The Board's rules of procedure provide that one or more public hearings may be held on any exposure draft. No hearing has yet been scheduled for this exposure draft. Notice of the date and location of any public hearing on this document will be published in the Federal Register and in FASAB's newsletter.

Sincerely,

A handwritten signature in black ink, reading "D. Scott Showalter". The signature is written in a cursive, flowing style.

D. Scott Showalter
Chairman

EXECUTIVE SUMMARY

WHAT IS THE BOARD PROPOSING?

The Board is proposing revisions to the existing federal lease accounting standards. The proposal would provide a comprehensive set of lease accounting standards to recognize federal lease activities in the reporting entity's general purpose federal financial reports and include appropriate disclosures.

The Board is proposing that federal lessees recognize a lease liability and a leased asset at the beginning of the lease, unless it is an intragovernmental lease or a short-term lease. A federal lessor would recognize a lease receivable and deferred revenue, unless it is an intragovernmental lease or a short-term lease.

HOW WOULD THIS PROPOSAL IMPROVE FEDERAL FINANCIAL REPORTING AND CONTRIBUTE TO MEETING THE FEDERAL FINANCIAL REPORTING OBJECTIVES?

The Board first addressed lease accounting during the development 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*. At that time, the Board decided to use the high-level language on lease accounting from Financial Accounting Standards Board's (FASB) Statement of Financial Accounting Standards (SFAS) 13, *Accounting for Leases*. The Board chose to use this language as a placeholder until it was prepared to add lease accounting to its agenda as a separate project. Consequently the standards in SFFAS 5 and SFFAS 6 are minimal and only address the definition of a capital lease, the criteria for capital leases, and the measurement of a capital lease asset and liability.

The current lease accounting standards have been criticized for not making meaningful distinctions between types of leases and not providing sufficient guidance to the federal community. Additionally, the current federal standards are based on FASB's lease accounting standards which have since been revised.

This lease proposal would improve the existing lease accounting standards in SFFAS 5 and SFFAS 6 by

- providing relevant and meaningful financial information needed by federal financial statement users and
- providing comprehensive lease standards that appropriately address the various lease transactions/activities of the federal community.

TABLE OF CONTENTS

Executive Summary	4
What is the Board proposing?	4
How would this proposal improve federal financial reporting and contribute to meeting the federal financial reporting objectives?	4
Questions for Respondents	6
Introduction	10
Purpose	10
Materiality	10
Proposed Standards	11
Scope	11
Definitions	11
Standards for Non-Intragovernmental Leases	12
Lease Term	12
Recognition and Measurement For Lessees	13
Disclosure Requirements for lessees	16
Recognition and Measurement for Lessors	17
Disclosures for Lessors	19
Contract/Agreements with Multiple Components	19
Contract/Agreement Combinations	20
Short-Term Leases	21
Lease Terminations and Modifications	21
Subleases	22
Sale-Leaseback Transactions	23
Lease-Leaseback Transactions	24
Standards for Intragovernmental Leases	25
Amendments to SFFAS 5, <i>Accounting for Liabilities of the Federal Government</i> and SFFAS 6, <i>Accounting for Property, Plant, and Equipment</i>	28
implementation	31
Effective Date	32
Appendix A: Basis for Conclusions	33
Project history	33
Key Areas of Improvement	34
Scope	35
Definitions	35
Lease Term -- Renewal and Termination Options	36
Non-Intragovernmental Leases	37
Intragovernmental Leases	38
Appendix B: Illustration	39
Appendix C: Abbreviations	40
Appendix D: Glossary	41

QUESTIONS FOR RESPONDENTS

The Board encourages you to become familiar with all proposals in the Statement before responding to the questions in this section. In addition to the questions below, the Board also would welcome your comments on other aspects of the proposed Statement. Because the proposals may be modified before a final Statement is issued, it is important that you comment on proposals that you favor as well as any that you do not favor. Comments that include the reasons for your views will be especially appreciated.

The Board believes that this proposal would improve federal financial reporting and contribute to meeting the Federal financial reporting objectives. The Board has considered the perceived costs associated with this proposal. In responding, please consider the expected benefits and perceived costs and communicate any concerns that you may have in regard to implementing this proposal.

The questions in this section are available in a Word file for your use at www.fasab.gov/documents-for-comment/. Your responses should be sent by e-mail to fasab@fasab.gov. If you are unable to respond by e-mail, please fax your responses to (202) 512-7366. Alternatively, you may mail your responses to:

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

All responses are requested by **January 6, 2017**.

- 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.

- 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.

- 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.

- 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.

- 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**¹ (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.**
- 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.**

¹ A federal lessee's incremental borrowing rate would be the Department of the Treasury borrowing rate for securities of similar maturity to the term of the lease unless the entity has its own borrowing authority.

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

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.

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.

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.

- 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.

- 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.

- 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.

INTRODUCTION

PURPOSE

1. The Federal Accounting Standards Advisory Board (FASAB or “the Board”) undertook this project primarily because
 - a. the current lease accounting 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*, have been criticized as ineffective because they do not make meaningful distinctions between capital and operating leases based on the substance of lease transactions, and
 - b. the lease accounting standards in SFFAS 5 and SFFAS 6 are based on lease accounting standards from Financial Accounting Standards Board (FASB) which have since been amended. In addition, existing FASAB standards are not comprehensive and do not provide meaningful information on federal leasing activities.
2. SFFAC 5, *Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements*, defines both an asset and liability. In that concepts statement an asset is defined as “a resource that embodies economic benefits or services that the federal government controls.” A liability is defined as “a present obligation of the federal government to provide assets or service to another entity at a determinable date, when a specific event occurs, or on demand.” The SFFAC 5 definitions only address whether the asset or liability exists and not how it should be measured or whether or when it should be recognized. The current leasing activities/transactions of federal entities should be evaluated against these definitions to ensure proper measurement and recognition. This proposal seeks to adopt the most current concepts so that the accounting principles for leases provide comprehensive guidance for consistent reporting.
3. This Statement is intended to improve federal financial reporting for leases by requiring concise, meaningful, and transparent information about the cost and related asset and liability to improve users’ understanding of the operating performance of the federal government and component entities.

MATERIALITY

4. The provisions of this Statement need not be applied to immaterial items. The determination of whether an item is material depends on the degree to which omitting or misstating information about the item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement.

PROPOSED STANDARDS

SCOPE

5. This Statement applies to federal entities that present general purpose federal financial reports, including the consolidated financial report of the U.S. Government (CFR), in conformance with generally accepted accounting principles, as defined by paragraphs 5 through 8 of Statement of Federal Financial Accounting Standards (SFFAS) 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*.
6. For purposes of applying this Statement, a **lease**² is defined as a contract or agreement that conveys the right to use a nonfinancial asset³ (the underlying asset) for a period of time in an exchange transaction. Leases include contracts or agreements that, although not explicitly identified as leases, meet the definition of a lease. This definition does not include contracts or agreements for services unless that contract or agreement also conveys the right to use a nonfinancial asset (the underlying asset) for a period of time in an exchange transaction.
7. This Statement amends the lease accounting standards in SFFAS 5, *Accounting for Liabilities of the Federal Government*, and SFFAS 6, *Accounting for Property, Plant, and Equipment*. This Statement also establishes distinct standards for **intragovernmental leases**.
8. This Statement does not apply to leases of federal natural resources as defined in Technical Bulletin (TB) 2011-1, *Accounting for Federal Natural Resources Other than Oil* and leases of federal oil and gas resources as defined in SFFAS 38, *Accounting for Federal Oil and Gas Resources*.

DEFINITIONS

9. **Lease** – A lease is 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.
10. **Intragovernmental Lease** – An intragovernmental lease is a lease occurring within a consolidation entity or between two or more consolidation entities as defined under SFFAS 47, *Reporting Entity*.⁴
11. **Lease Option Periods** – Lease option periods are additional lease periods beyond the initial lease term. The options may be included in the initial lease or may be agreed to later in the lease term.

² Terms defined in the Glossary are shown in bold-face the first time they appear.

³ Examples of nonfinancial assets include land, buildings, vehicles, equipment, internal use software, and intangible assets. Examples of financial assets include cash, investments, and receivables.

⁴ See SFFAS 47, *Reporting Entity*, par. 38-42.

12. **Initial Direct Costs** – Initial direct costs are costs that are directly attributable to negotiating and arranging a lease or portfolio of leases and would not have been incurred without entering into the lease.
13. **Short-Term Lease** – A short-term lease is a lease that, at the beginning of the lease, has a maximum possible term under the contract or arrangement of 24 months or less, including any options to extend, regardless of their probability of being exercised.

STANDARDS FOR NON-INTRAGOVERNMENTAL LEASES

LEASE TERM

14. The lease term is 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.
15. The noncancelable period is the shorter of
 - a. the initial lease period, before considering renewal options for additional periods;
 - b. the period of the lease preceding an option for the lessee to terminate the lease if it is probable, based on all relevant factors, that the lessee will exercise that option to terminate; or
 - c. the period of the lease preceding a point at which either the lessor only or both the lessee and the lessor have an option to terminate the lease, regardless of the probability of termination.⁵
16. In determining the lease term, the following specific provisions should be applied:
 - a. When the noncancelable period is less than the initial lease term (due to options to terminate discussed in par. 15b and 15c) there should be no option periods added to the noncancelable period in calculating the lease term.
 - b. Provisions that allow for termination of a lease due to (a) purchase of the underlying asset, (b) payment of all sums due, or (c) default on payments are not considered options to terminate.
 - c. A fiscal funding or cancellation clause (a clause that allows federal lessees to cancel a lease agreement, typically on an annual basis, if funds for the lease payments are not appropriated) should be considered in determining the lease term only when it is probable that the clause will be exercised.

⁵ Periods for which either the lessor only or both the lessee and the lessor have an option to terminate the lease are cancelable periods and are excluded from the lease term.

- d. Month-to-month lease holdovers, also referred to as rolling lease extensions, or any lease that continues into a holdover period until a new contract or agreement is signed should be considered cancelable because either the lessee or lessor could cancel the lease at any time. These holdover periods should be excluded from the lessee's lease liability and the lessor's lease receivable.⁶
17. At the beginning of a lease, lessors and lessees should assess all factors relevant to the likelihood that the lessee will exercise options, whether these factors are contract/agreement based, underlying asset based, market based, or federal specific. The assessment often will require the consideration of a combination of these interrelated factors. Examples of factors to consider include, but are not limited to, the following:
- a. A significant economic incentive, such as contractual terms and conditions for the option periods that are favorable compared with current market rates
 - b. A significant economic disincentive, such as costs to terminate the lease and sign a new lease (for example, negotiation costs, relocation costs, abandonment of significant leasehold improvements, costs of identifying another suitable underlying asset, costs associated with returning the underlying asset in a contractually specified condition or to a contractually specified location, or a substantial cancellation penalty)
 - c. The lessee's history of exercising renewal or termination options
 - d. The extent to which the lease asset is considered mission critical to the federal entity
18. Lessors and lessees should reassess the lease term only if the lessee does either of the following:
- a. Elects to exercise an option even though the lessor or lessee had previously determined that it was not probable that the lessee would exercise that option
 - b. Does not elect to exercise an option even though the lessor or lessee had previously determined that it was probable that the lessee would exercise that option

RECOGNITION AND MEASUREMENT FOR LESSEES

19. At the beginning of the lease term, a lessee should recognize a lease liability and a property, plant, and equipment (PP&E)⁷ right-to-use lease asset (hereinafter referred to as the lease asset), except as provided in paragraph 20 and paragraphs 59-61 (short-term leases).

⁶ SFFAS 1, *Accounting for Selected Assets and Liabilities*, applies to any related accounts payable or accounts receivable amounts.

⁷ The lease asset should be classified as PP&E unless the underlying asset is not PP&E. In those instances, such assets should be classified with the underlying asset.

LEASES THAT TRANSFER OWNERSHIP

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.⁸

LEASE LIABILITY

21. A lessee should measure the lease liability initially at the present value of payments to be made for the lease term. Measurement of the lease liability should include the following types of payments that might be required by a lease:
- a. Fixed payments, less any lease incentives (such as a cash payment or reimbursement of moving costs) receivable from the lessor
 - b. Variable lease payments that depend on an index or a rate (such as the Consumer Price Index or a market interest rate), initially measured using the index or rate as of the beginning of the lease
 - c. Variable lease payments that are fixed in-substance as described in paragraph 22
 - d. Amounts that are probable of being required to be paid by the lessee under residual value guarantees
 - e. The exercise price of a purchase option if it is probable that the lessee will exercise that option
 - f. Payments for penalties for terminating the lease, if the lease term reflects the lessee exercising an option to terminate the lease or a fiscal funding or cancellation clause
 - g. Any other payments that are probable of being required based on an assessment of all relevant factors
22. Variable payments based on future performance of the lessee or usage of the underlying asset should not be included. Rather, these variable payments should be recognized as an expense in the statement of net cost in the period in which those payments are incurred. However, any component of these variable payments that is fixed in-substance should be included in the lease liability. An example is a lease payment based on a percentage of sales or usage but with a required minimum amount to be paid. That required minimum payment is fixed in-substance.
23. 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**⁹ (the estimated rate that would be charged for borrowing the lease payment amounts for the lease term) should be used.

⁸ See SFFAS 6, *Accounting for Property, Plant, and Equipment*, par. 26.

⁹ A federal lessee's incremental borrowing rate would be the Treasury borrowing rate for securities of similar maturity to the term of the lease unless the entity has its own borrowing authority.

24. At subsequent financial reporting dates, the lessee should calculate the amortization of the discount on the lease liability and recognize that amount as interest expense for the period. Any payments made should be allocated first to the accrued interest liability and then to the lease liability.
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:
- a. There is a change in the lease term due to a reassessment (see par. 18), a modification (see par. 66), or a termination (see par. 64).
 - b. An assessment of all relevant factors indicates that the likelihood of a residual value guarantee being paid has changed from probable to not probable, or vice versa.
 - c. An assessment of all relevant factors indicates that the likelihood of a purchase option being exercised has changed from probable to not probable, or vice versa.
 - d. There is a change in the estimated amounts for payments already included in the liability.
 - e. There is a change in the interest rate the lessor charges the lessee, if used as the initial **discount rate**.
26. If a lease liability is remeasured for any of the changes in paragraph 25, the liability also should be remeasured for any change in an index or rate used to determine variable lease payments if that change in the index or rate is expected to significantly affect the amount of the liability. A lease liability is not required to be remeasured solely for a change in an index or rate used to determine variable lease payments.
27. The lessee also should update the discount rate as part of the remeasurement if any of the following changes have occurred and are expected to significantly affect the amount of the lease liability:
- a. There is a change in the lease term due to a reassessment (see par. 18), a modification (see par. 66), or a termination (see par. 64).
 - b. An assessment of all relevant factors indicates that the likelihood of a purchase option being exercised has changed from probable to not probable, or vice versa.
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.
29. If the discount rate is required to be updated based on the provisions in paragraph 27, the discount rate should be based on the revised rate the lessor charges the lessee at the time the discount rate is updated. If that rate cannot be readily determined, the lessee's incremental borrowing rate should be used.

LEASE ASSET

30. A lessee should initially measure the lease asset as the sum of the following:
- a. The amount of the initial measurement of the lease liability (see par. 21)

- b. Lease payments made to the lessor at or before the beginning of the lease, less any lease incentives received from the lessor
 - c. Initial direct costs that are ancillary charges necessary to place the lease asset into service
- 31. The lease asset should be amortized in a systematic and rational manner over the shorter of the lease term or the useful life of the underlying asset, except as provided in paragraph 32. The amortization of the lease asset should be reported as amortization expense.
- 32. The presence of a bargain purchase option in a lease contract/agreement is not equivalent to a provision that transfers ownership of the underlying asset; therefore a bargain purchase option should be treated as any other purchase option included in a lease. If the lease contains a purchase option that the lessee has determined is probable of being exercised, the lease asset should be amortized over the useful life of the underlying asset. In this circumstance, if the underlying asset is non-depreciable, such as land, then the lease asset should not be amortized.
- 33. The lease asset generally should be adjusted by the same amount when the corresponding lease liability is remeasured based on paragraphs 25–29. However, if this change reduces the carrying value of the lease asset to zero, any remaining amount should be reported in the flows statement as a gain.
- 34. The presence of impairment indicators (described in par. 12 of SFFAS 44, *Accounting for Impairment of General Property, Plant, and Equipment Remaining in Use*) with respect to the underlying asset may result in a change in the manner or duration of use of the lease asset. The change in the manner or duration of use of the lease asset is an indicator that the lease asset may be impaired. The period for which the underlying asset has less usable capacity should be the relevant factor(s) in determining the magnitude of the decline in service utility of the lease asset. If a lease asset is impaired, it should be reduced first for any change in the corresponding lease liability. Any remaining amount should be recognized as an impairment.¹⁰

DISCLOSURE REQUIREMENTS FOR LESSEES

- 35. A lessee should disclose the following about its lease activities (which may be grouped for purposes of disclosure), other than short-term leases:
 - a. A general description of its leasing arrangements, including:
 - i. the basis, terms, and conditions on which variable lease payments not included in the lease liability are determined
 - ii. the existence, terms, and conditions of residual value guarantees provided by the lessee

¹⁰ See SFFAS 44, *Accounting for Impairment of General Property, Plant, and Equipment Remaining in Use*, par. 18 – 25.

- b. The total amount of lease assets, and the related accumulated amortization, to be disclosed separately from other PP&E assets
- c. The amount of lease expense recognized for the period for variable lease payments not previously included in the lease liability
- d. Principal and interest requirements to maturity, presented separately, for the lease liability for each of the five subsequent years and in five-year increments thereafter
- e. The amount of the annual lease expense and the discount rate used to calculate the lease liability

RECOGNITION AND MEASUREMENT FOR LESSORS

36. At the beginning of the lease term, a lessor should recognize a lease receivable and a deferred revenue, except as provided in paragraph 37 and paragraphs 59–61 (short-term leases). Any initial direct costs incurred by the lessor should be reported as an expense of the period.

LEASES THAT TRANSFER OWNERSHIP

37. 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) should be reported as a financed sale of that asset.

LEASE RECEIVABLE

38. A lessor should measure the lease receivable initially at the present value of lease payments to be received for the lease term, reduced by any provision for uncollectible amounts. Measurement of the lease receivable should include the following types of payments that might be required by a lease:
- a. Fixed payments
 - b. Variable payments that depend on an index or a rate (such as the Consumer Price Index or a market interest rate), initially measured using the index or rate as of the beginning of the lease
 - c. Portions of variable payments that are fixed in substance (as described in par. 39)
 - d. Residual value guarantees that are fixed payments in substance (as described in par. 40).
39. Variable payments based on future performance of the lessee or usage of the underlying asset should not be included in the receivable. Those payments should be recognized as revenue in the period to which those payments relate. However, any component of those variable payments that is fixed in substance should be included in the lease receivable. For example, if a lease payment is based on a percentage of sales but has a required minimum

payment, that required minimum is a fixed payment in substance. Similarly, a residual value guarantee is an in-substance fixed payment if it stipulates the underlying asset will be sold at the end of the lease term, with the lessee assuming a liability for any shortfall if the sales price is less than an agreed-upon minimum amount.

40. Amounts to be received under residual value guarantees (that are not fixed in substance) should be recognized as a receivable and revenue when (a) a guarantee payment is required (as agreed to by the lessee and lessor) and (b) the amount can be reasonably estimated. Amounts to be received for the exercise price of a purchase option or penalties for lease termination should be recognized as a receivable and revenue when those options are exercised.
41. The future lease payments to be received should be discounted using the rate the lessor charges the lessee, which may be the interest rate implicit in the lease. Lessors are not required to apply imputed interest but may do so as a means of determining the rate implicit in the lease.
42. At subsequent financial reporting dates, the lessor should calculate the amortization of the discount on the receivable and report that amount as interest revenue for the period. It should be calculated so as to produce a constant periodic rate of return on the receivable. Any payments received should be allocated first to the accrued interest receivable and then to the lease receivable.
43. The lessor should remeasure the lease receivable and update the discount rate at subsequent financial reporting dates if either of the following changes have occurred and are expected to significantly affect the amount of the receivable:
 - a. There is a change in the lease term.
 - b. There is a change in the rate the lessor charges the lessee.
44. If a lease receivable is remeasured for either of the changes in paragraph 43, the receivable also should be remeasured for any change in an index or rate used to determine variable lease payments if that change in the index or rate is expected to significantly affect the amount of the receivable. A lease receivable is not required to be remeasured solely for a change in an index or rate used to determine variable lease payments.
45. If the discount rate is updated based on the provisions in paragraph 43, the receivable should be discounted using the revised rate.

DEFERRED REVENUE

46. A lessor should measure the deferred revenue at the initial value of the lease receivable, less any provision for uncollectible amounts (see par. 38), plus the amount of any payments received at or prior to the beginning of the lease that relate to future periods (for example, the final month's rent). A lessor subsequently should recognize deferred revenue in a systematic and rational manner over the term of the lease.

47. The deferred revenue should generally be adjusted using the same amount as the change resulting from the remeasurement of the lease receivable as discussed in paragraphs 43-44.

UNDERLYING ASSET

48. A lessor should **not** derecognize the asset underlying the lease. A lessor should continue to apply other applicable guidance to the underlying asset, including depreciation and impairment. However, if the lease agreement requires the lessee to return the asset in its original or enhanced condition, a lessor should not depreciate the asset during the lease term.

DISCLOSURES FOR LESSORS

49. A lessor should disclose the following about its lease activities (which may be grouped for purposes of disclosure), other than short-term leases:
- a. A general description of its leasing arrangements, including the basis, terms, and conditions on which any variable lease payments not included in the lease receivable are determined
 - b. The carrying amount of assets on lease or held for leasing, by major classes of assets, and the amount of accumulated depreciation
 - 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
 - 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.
50. In addition to the disclosures in paragraph 49, if a federal entity's principal ongoing operations consist of leasing assets through the use of non-intragovernmental leases, the federal entity should disclose a schedule of future lease payments that are included in the lease receivable, showing principal and interest, for each of the five subsequent years and in five-year increments thereafter.

CONTRACT/AGREEMENTS WITH MULTIPLE COMPONENTS

51. Lessors and lessees may enter into one contract/agreement that contains multiple components, such as a contract/agreement that contains both a lease component and a nonlease component, or a lease that contains multiple underlying assets.
52. If a lessor or lessee enters into a contract/agreement that contains both a lease (such as the right to use a building) and a nonlease component (such as a maintenance services for the building), the federal entity should account for the lease and nonlease components as separate contract/agreements, unless the contract/agreement meets the exception in paragraph 55.b. or paragraph 55.c.

53. If a lease involves multiple underlying assets, lessors and lessees should account for each underlying asset as a separate lease component if the assets have different lease terms. The provisions of this paragraph should be applied unless the contract/agreement meets the exception in paragraph 55.b or paragraph 55.c
54. To allocate the consideration required under the contract/agreement to the different components, lessors and lessees should first use any prices for individual components that are included in the contract/agreement, if they are reasonable based on other observable stand-alone prices. Stand-alone prices are those that would be paid or received if the same or similar assets were leased or if the same or similar nonlease components (such as services) were contracted individually. Some contract/agreements provide discounts for bundling multiple leases or lease and nonlease components together in one contract/agreement. These discounts may be taken into account when determining whether individual component prices are reasonable. For example, if the individual component prices are each discounted by the same percentage from normal market prices, those component prices would be considered reasonable.
55. If a contract/agreement does not include prices for individual components, or if those prices are not reasonable based on other observable stand-alone prices, lessors and lessees should do the following, unless the components as a whole are insignificant:
- a. If observable stand-alone prices are readily available for *all* components, the federal entity should allocate the consideration based on the relative values of the observable stand-alone prices.
 - b. If observable stand-alone prices are readily available for *some* (but not all) components, the federal entity should allocate the observable stand-alone price to each component for which it is readily available. The federal entity may (1) estimate the allocation of the remaining consideration to the remaining components or (2) account for the remaining components as a single lease unit.
 - c. If observable stand-alone prices are not readily available for *any* of the components, the federal entity may (1) estimate the prices for each component or (2) account for the entire contract/agreement as a single lease unit.
56. When multiple components are accounted for as a single lease unit, as provided for in paragraphs 55.b. and 55.c., the accounting for that unit should be based on the primary lease component within that unit. For example, the primary lease component's lease term should be used for the unit if the lease components have different lease terms.

CONTRACT/AGREEMENT COMBINATIONS

57. Contract/agreements that are entered into at or near the same time with the same counterparty should be considered to be part of the same lease contract/agreement if either of the following criteria is met:
- a. The contract/agreements are negotiated as a package with a single objective.

- b. The amount of consideration to be paid in one contract/agreement depends on the price or performance of the other contract/agreement.
58. If multiple contract/agreements are determined to be part of the same lease contract/agreement, that lease should be evaluated in accordance with the guidance on contract/agreements with multiple components in paragraphs 51–56.

SHORT-TERM LEASES

59. A short-term lease is 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. For a lease that is cancelable by either the lessee or the lessor, such as a month-to-month lease or a year-to-year lease, the maximum possible term is the noncancelable period, including any notice periods. For a lease that is cancellable only by the lessee, the maximum possible term should be evaluated under the requirements of the lease term as defined in paragraph 14.

LESSEE TREATMENT OF SHORT-TERM LEASES

60. A lessee should recognize short-term lease payments as expense based on the payment provisions of the contract/agreement. The lessee should not apply the recognition and measurement requirements of paragraphs 19–35 but 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. The lessee should recognize any rent holiday period (for example, one or more months free) as reductions of lease rental expense on a straight-line basis over the lease term.

LESSOR TREATMENT OF SHORT-TERM LEASES

61. A lessor should recognize short-term lease payments as revenue based on the payment provisions of the contract/agreement. The lessor should not apply the recognition and measurement requirements of paragraphs 36–50 but should recognize a liability if payments are received in advance of the period to which they relate, or an asset for rent due if payments are received subsequent to that period. The lessor should recognize any rent holiday period (for example, one or more months free) as reductions of lease rental income on a straight-line basis over the lease term.

LEASE TERMINATIONS AND MODIFICATIONS

62. A lease contract/agreement may be amended while it is in effect. Examples of amendments include a change in consideration, a lengthening or shortening of the lease term (see par. 25 and 43), or adding or removing an underlying asset. An amendment to a lease contract/agreement should be considered a lease modification unless the lessee's right to use the underlying asset decreases. If the lessee's right to use the underlying asset decreases (for example, the lease term is shortened or the number of underlying assets is reduced), that change should be accounted for as a partial lease termination (see par. 64 - 65).

63. If a lease modification gives the lessee an additional right to use an underlying asset that was not included in the original lease and provides a price comparable to its stand-alone price (in the context of that particular contract/agreement), both the lessee and the lessor should account for that additional portion of the modified lease as a new lease, separate from the original portion of the lease.

LEASE TERMINATIONS

LESSEE TREATMENT OF LEASE TERMINATIONS

64. A lessee generally should account for the full or partial termination of a lease by reducing the carrying values of the lease asset and lease liability and recognizing a gain or loss for the difference. However, if the lease is terminated as a result of the lessee purchasing the underlying asset from the lessor, the lease asset should be reclassified to the appropriate class of owned asset. The lease liability should be changed to reflect only those payments yet to be made, and that change should be reflected in the cost of the purchased asset.

LESSOR TREATMENT OF LEASE TERMINATIONS

65. A lessor should account for the full or partial termination of a lease by reducing the carrying values of the lease receivable and related deferred revenue and recognizing a gain or loss for the difference. If the lease is terminated as a result of the lessee purchasing an underlying asset from the lessor, the carrying value of the underlying asset also should be derecognized and included in the calculation of any resulting gain or loss.

LEASE MODIFICATIONS

LESSEE TREATMENT OF LEASE MODIFICATIONS

66. A lessee should account for a lease modification by remeasuring the lease liability. The lease asset should be adjusted by the difference between the remeasured liability and the liability immediately before the lease modification. However, 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.

LESSOR TREATMENT OF LEASE MODIFICATIONS

67. A lessor should account for a lease modification by remeasuring the lease receivable. The deferred revenue should be adjusted by the difference between the remeasured receivable and the receivable immediately before the lease modification. However, if the change relates to payments for the current period, the change should be recognized in the flows statement for the current period as revenue.

SUBLEASES

68. A sublease involves three parties: the original lessor, the original lessee (who also is the lessor in the sublease), and the new lessee. The original lessor should continue to apply the general lessor guidance. The federal entity that is the original lessee and becomes the lessor in the sublease should account for the original lease and the sublease as two separate transactions, as a lessee and a lessor, respectively. Those two separate

transactions should not be offset against one another. The new lessee should apply the general lessee guidance.

69. The original lessee (and now the lessor in a sublease) should include the sublease in its disclosure of the general description of lease arrangements. Its lessor transactions related to subleases should be disclosed separately from its lessee transactions related to the original lease.

SALE-LEASEBACK TRANSACTIONS

70. Sale-leaseback transactions involve the sale of an underlying asset by the owner and a lease of the property back to the seller. A sale-leaseback transaction should include an exchange transaction sale¹¹ in order to be eligible for sale-leaseback accounting. A sale-leaseback transaction that does not include an exchange transaction sale should be accounted for as a borrowing by both the seller-lessee and the buyer-lessor.
71. The sale and leaseback portions of a sale-leaseback transaction should be accounted for as two separate transactions – a sale transaction and a lease transaction – except that the difference between the carrying value of the capital asset that was sold and the net proceeds from the sale should be reported as a deferred revenue or deferred expense to be recognized in the flow statement over the term of the lease. However, if the leaseback portion of the transaction qualifies as a short-term lease, any gain or loss on the sale should be recognized immediately.
72. A sale-leaseback transaction is considered to have off-market terms if there is a significant difference between (a) the sales price and the estimated fair value of the asset or (b) the present value of the contractual lease payments and the estimated present value of what the lease payments for that asset would be at a market price, whichever of the two differences is more readily determinable. The difference should be reported based on the substance of the transaction (for example, as a borrowing, a nonexchange transaction, or an advance lease payment) rather than as a part of the sales-leaseback transaction. The following are examples of off-market terms:
- a. A transaction has a sale price and lease payments that are both significantly higher than market
 - b. A transaction has a sale price that is significantly higher than market but the lease payments are at or below market
 - c. A transaction has a sale price that is significantly lower than market.
73. A seller-lessee should disclose the terms and conditions of sale-leaseback transactions in addition to the disclosures required of a lessee (par. 35). A buyer-lessor should provide the disclosures required of a lessor (par. 49).

¹¹ See SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*, par. 295.

LEASE-LEASEBACK TRANSACTIONS

74. In a lease-leaseback transaction, an asset is leased by one party (first party) to another party and then leased back to the first party. The leaseback part of the transaction may involve an additional asset (such as leasing a building that has been constructed by a developer on land owned by and leased back to a federal entity) or only a portion of the original asset (such as leasing back only one floor of a building to the owner). A lease-leaseback transaction should be accounted for as a net transaction. Both parties to a lease-leaseback transaction should disclose the gross amounts of each portion of the transaction.

STANDARDS FOR INTRAGOVERNMENTAL LEASES

75. This section describes the overall recognition, measurement, and disclosure requirements 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*. Any lease that meets the definition of an intragovernmental lease would be required to follow the accounting guidance described in paragraphs 77 – 95 below.

INTRAGOVERNMENTAL LEASES – LESSEE ACCOUNTING

76. The following sections articulate the general recognition guidance for lessees of intragovernmental leases and detailed recognition guidance regarding several specific intragovernmental lease topics, as well as disclosure guidance.

RECOGNITION AND MEASUREMENT

GENERAL GUIDANCE FOR RECOGNITION OF INTRAGOVERNMENTAL LEASES¹²

77. A lessee should recognize lease payments, including lease-related operating costs (for example, maintenance, utilities, taxes, etc.) paid to the lessor, as expenses based primarily on the payment provisions of the lease. A lessee would not recognize a lease asset and a corresponding liability for an intragovernmental lease. Accordingly, a lessee would not recognize amortization expense related to a lease asset or interest expense on a lease liability.
78. Recognition should be based on the payment provisions of the lease. Prepaid rent or a payable for rent due should be recognized as an asset or liability, respectively, and an expense should be recognized in the appropriate period based on the specifics of the lease provisions.

GUIDANCE FOR RECOGNITION OF SPECIFIC INTRAGOVERNMENTAL LEASE TOPICS

79. Rental Increases – Rental increases may be fixed in the lease and take place with the passage of time (for example, be based on such factors as anticipated increases in costs or anticipated appreciation in property values, but the amount of the increase is specified in the lease) or they may be contingent on future events.
80. Contingent rental increases are based on changes in specific economic factors, for example, future activity levels or future inflation (for example, tied to a specific economic indicator where the specific amount of the change is not known).

¹² SFFAS 4, *Managerial Cost Accounting Standards and Concepts*, par. 105-115 (as amended by SFFAS 30), continue to apply for non-reimbursed or under reimbursed intragovernmental lease arrangements.

81. If the lease provides for rental increases, a lessee should recognize the expense in the period of the increase as provided in the lease.¹³
82. Lease Incentives – Lease incentives include lessor payments made to or on behalf of the lessee to entice the lessee to sign a lease. Lease incentives may include up-front cash payments to the lessee; for example, moving costs, termination fees to lessee's prior lessor, or lessor's assumption of the lessee's lease obligation under a different lease with another lessor.
83. Lease incentives should be recognized as reductions of lease rental expense by the lessee on a straight-line basis over the lease term. The lessee should recognize the expenses or losses to which the incentives relate in the period the costs are incurred. For example, an incentive equal to the moving expense incurred to occupy the leased space reduces rent expense over the lease term and the moving expense is recognized in the period incurred (that is, when the move occurs).
84. Lease Concessions – Lease concessions are rent discounts made by the lessor to entice the lessee to sign a lease. Lease concessions include rent holidays/free rent periods, reduced rents, or commission credits.
85. Lease concessions should be recognized as reductions of lease rental expense by the lessee on a straight-line basis over the lease term.
86. Leasehold Improvements – Leasehold improvements are additions, alterations, remodeling, renovations or other changes to a leased property that either extend the useful life of the existing property or enlarge or improve its capacity and are paid for (financed) by the lessee. Leasehold improvements that are placed in service at or after the beginning of the lease term should be amortized over the useful life (the normal operating life in terms of utility to the owner) of the leasehold improvement, but no longer than the expected lease term.

DISCLOSURES

87. Lessees should disclose a broad summary of significant intragovernmental leasing arrangements, including
- a. existence of intragovernmental leases and annual expense,
 - b. general lease terms with specific intragovernmental requirements (which may be grouped for purposes of disclosure), and
 - c. annual lease expense by major leased asset category.

¹³ Par. 79 – 81 outlines the general guidance for increases in rental payments; however guidance for other changes in rental payments is outlined in par. 82 – 85.

INTRAGOVERNMENTAL LEASE ARRANGEMENTS – LESSOR ACCOUNTING

88. The following sections articulate general recognition guidance for lessors of intragovernmental leases and detailed recognition guidance regarding several specific intragovernmental lease topics as well as disclosure guidance.

RECOGNITION AND MEASUREMENT

GENERAL GUIDANCE FOR RECOGNITION OF INTRAGOVERNMENTAL LEASES

89. A lessor should recognize lease receipts, including lease-related operating costs (for example, maintenance, utilities, or taxes) received from the lessee as income based primarily on the provisions of the lease.

GUIDANCE FOR RECOGNITION OF SPECIFIC INTRAGOVERNMENTAL LEASES

90. Lease Incentives – Lease incentives include lessor payments made to or on behalf of the lessee to entice the lessee to sign a lease. Lease incentives may include up-front cash payments to the lessee (for example, moving costs, termination fees to lessee's prior lessor, or lessor's assumption of the lessee's lease obligation under a different lease with another lessor). Lease incentives should be recognized as reductions of lease rental income by the lessor on a straight-line basis over the lease term.
91. Lease Concessions – Lease concessions are rent discounts made by the lessor to entice the lessee to sign a lease. Lease concessions include rent holidays/free rent periods, reduced rents, or commission credits.
92. Lease concessions should be recognized by the lessor as reductions in rental income on a straight-line basis over the lease term.
93. Lessor Improvements – Lessor improvements are additions, alterations, remodeling, renovations or other changes to a leased property that either extend the useful life of the existing property or enlarge or improve its capacity and are paid for (financed) by the lessor rather than by the lessee. These capital improvements are components of the leased property and should be capitalized and depreciated by the lessor over their useful life consistent with the lessor's accounting for property, plant, and equipment.¹⁴
94. Initial Direct Costs – Lessor initial direct costs should be expensed when incurred by the lessor.

¹⁴ This recognition is consistent with PP&E capital improvements outlined in SFFAS 6, par. 37.

DISCLOSURES

95. Lessors should disclose the following regarding intragovernmental leases:

- a. 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
- b. A broad summary of significant leases (which may be grouped for purposes of disclosure), including a breakdown of the number of leases with federally-owned assets and privately-owned assets

AMENDMENTS TO SFFAS 5, *ACCOUNTING FOR LIABILITIES OF THE FEDERAL GOVERNMENT* AND SFFAS 6, *ACCOUNTING FOR PROPERTY, PLANT, AND EQUIPMENT*

96. This Statement replaces the measurement and reporting requirements for lease accounting established in SFFAS 5, *Accounting for Liabilities of the Federal Government*, paragraphs 43 – 46. Therefore, the paragraphs marked below are rescinded.

SFFAS 5: *Accounting for Liabilities of the Federal Government*

~~[43.] **Capital leases** are leases that transfer substantially all the benefits and risks of ownership to the lessee. If, at its inception, a lease meets one or more of the following four criteria, the lease should be classified as a capital lease by the lessee:~~

- ~~• The lease transfers ownership of the property to the lessee by the end of the lease term.~~
- ~~• The lease contains an option to purchase the leased property at a bargain price.~~
- ~~• The lease term is equal to or greater than 75 percent of the estimated economic life of the leased property.~~
- ~~• The present value of rental and other minimum lease payments, excluding that portion of the payments representing executory cost, equals or exceeds 90 percent of the fair value of the leased property.~~

~~The last two criteria are not applicable when the beginning of the lease term falls within the last 25 percent of the total estimated economic life of the leased property. If a lease does not meet at least one of the above criteria it should be classified as an operating lease.~~

~~[44.] The amount to be recorded by the lessee as a liability under a capital lease is the present value of the rental and other minimum lease payments during the lease term, excluding that portion of the payments representing executory cost to be paid by the lessor. [footnote ²⁰: "The cost of general property, plant, and equipment acquired under a capital lease shall be equal to the amount recognized as a liability for the capital lease at its inception. See SFFAS No. 6, *Accounting for Property, Plant, and Equipment*.] However, if the amount so determined exceeds the fair value of the leased property at the inception of the lease, the amount recorded as the liability should be the fair value. If the portion of the minimum lease payments representing executory cost is not determinable from the lease provisions, the amount should be estimated.~~

~~[45.] 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. The lessee's incremental borrowing rate shall be the Treasury borrowing rate for securities of similar maturity to the term of the lease.~~

~~[46.] During the lease term, each minimum lease payment should be allocated between a reduction of the obligation and interest expense so as to produce a constant periodic rate of interest on the remaining balance of the liability. [footnote²¹: OMB Circular No. A-11, "Preparation and Submission of Annual Budget Estimates," explains the measurement of budget authority, outlays, and debt for the budget in the case of lease purchases and other capital leases. Circular A-94, "Guidelines and Discount Rates for Benefit Cost Analysis of Federal Programs," provides the requirements under which a lease purchase or other capital lease has to be justified and the analytical methods that need to be followed.]~~

97. This Statement replaces the measurement and reporting requirements for lease accounting established in SFFAS 6, *Accounting for Property, Plant, and Equipment*, paragraphs 20 and 29. Therefore, the paragraphs marked below are rescinded.

SFFAS 6: *Accounting for Property, Plant, and Equipment*

~~[20.] Capital leases are leases that transfer substantially all the benefits and risks of ownership to the lessee. If, at its inception, a lease meets one or more of the following four criteria, [footnote⁷: Note that the criteria for identifying capital leases for financial reporting purposes differ from OMB criteria for budget scoring of leases. OMB Circular No. A-11, *Preparation and Submission of Budget Estimates*, includes criteria for identifying operating leases in Appendix B. OMB provides four additional criteria which relate to the level of private sector risk involved in a lease purchase agreement. This is necessary because, for budget purposes, there is a distinction between lease purchases with more or less risk. This distinction is not made in the financial reports and, therefore, FASAB does not include the four criteria related to risk levels.] the lease should be classified as a capital lease by the lessee. Otherwise, it should be classified as an operating lease. [footnote⁸: "Operating leases" of PP&E are leases in which the Federal entity does not assume the risks of ownership of the PP&E. Multi-year service contracts and multi-year purchase contracts for expendable commodities are not capital leases.]~~

- ~~• The lease transfers ownership of the property to the lessee by the end of the lease term.~~
- ~~• The lease contains an option to purchase the leased property at a bargain price.~~
- ~~• The lease term is equal to or greater than 75 percent of the estimated economic life [footnote⁹: "Estimated economic life of leased property" is the estimated remaining period during which the property is expected to be economically usable by one or more users, with normal repairs and maintenance, for the purpose for which it was intended at the inception of the lease, without limitation by the lease term.] of the leased property.~~
 - ~~• The present value of rental and other minimum lease payments, excluding that portion of the payments representing executory cost, equals or exceeds 90 percent of the fair value [footnote¹⁰: "Fair value" is the price for which an asset could be bought or sold in an~~

~~arm's-length transaction between unrelated parties (e.g., between a willing buyer and a willing seller). (adapted from Kohler's Dictionary for Accountants)] of the leased property.~~

~~The last two criteria are not applicable when the beginning of the lease term falls within the last 25 percent of the total estimated economic life of the leased property.~~

~~[29.] The cost of general PP&E acquired under a **capital lease** shall be equal to the amount recognized as a liability for the capital lease at its inception (i.e., the net present value of the lease payments calculated as specified in the liability standard [footnote ²⁴]. See Statement of Recommended Accounting Standards No. 5, *Accounting for Liabilities of the Federal Government*.] unless the net present value exceeds the fair value of the asset).~~

98. This Statement also amends Technical Release (TR) 16, *Implementation Guidance for Internal Use Software*, paragraphs 26, 27, and 29 to delete the "capital and operating lease" references, as follows.

Technical Release 16: *Implementation Guidance for Internal Use Software*

[26.] Software License: If the term of software license(s) is 2 years or more with periodic payments, the license should be evaluated against lease criteria as stated in SFFAS X ~~SFFAS 5 paragraphs 43-46 and SFFAS 6 paragraph 20 to determine if it is a capital or operating lease.~~ If the license(s) is perpetual with an upfront cost [footnote ⁹: The cost could be charged as a one-time payment or financed over a set period of time.] to use the software for its entire lifetime, then the entity is purchasing IUS and should apply its existing policy for capitalization thresholds to determine if the license should be capitalized or expensed.

[27.] A license agreement may include executory costs for maintenance and technical support. Agency judgment should apply in determining what portions of license fees are attributable to software capitalizable costs versus executory costs. Assuming lease ~~capitalization~~ criteria and thresholds are met, software license capitalization amounts [footnote ¹⁰: SFFAS X ~~SFFAS 5, paragraph 44.~~] may be derived from the payment schedule contained in the license agreement. ~~As stated in SFFAS 5, If the portion of the minimum lease payments representing executory cost is not determinable from the lease provisions, the amount should be estimated. Agencies may also want to consider having each license agreement specifically identify the various costs throughout the license lifecycle, for example, initial license, maintenance, and enhancement.~~

[29.] If a cloud computing arrangement includes a software license, the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses in accordance with the lease criteria stated in SFFAS X ~~SFFAS 5 and SFFAS 6~~, and as discussed in paragraph 26 of this TR. ~~SFFAS 10 is not applicable to a cloud computing arrangement that does not convey a contractual right to the IUS or to ones that do not include an IUS license. The entity that develops and owns the software, platform, or infrastructure that is used in the cloud computing arrangement would account for the software development in accordance with SFFAS 10. If the funding to develop cloud computing is shared among entities without clear ownership, the service provider entity that receives funding and is responsible for~~

maintaining the software, platform, or infrastructure should account for the software in accordance with SFFAS 10 and the full cost/inter-entity cost requirements of SFFAS 4.

IMPLEMENTATION

99. This Statement requires 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. Therefore, in the period of implementation,
 - a. the determination of the lease term would assume that the lease term began as of the beginning of the period of implementation and
 - b. the lease liability and lease asset should initially be measured based on the remaining lease term and associated lease payments as of the beginning of the period of implementation.
100. The following implementation addresses specific leasing circumstances.
 - a. Prospective Implementation - Entities should report the effect of implementing this Statement on existing leases prospectively in accordance with paragraph 13 of SFFAS 21, *Reporting Correction of Errors and Changes in Accounting Principles, Amendment of SFFAS 7, Accounting for Revenue and Other Financing Sources*. Accordingly, any changes in assets or liabilities related to existing leases should be treated prospectively. The change should be accounted for in the period of implementation and applicable future periods. No adjustments should be made to previously reported expenses or revenue.
 - b. Lease Term - The lease term should be determined based on the provisions of this Statement (see par. 14 – 18). However, the lease term of an existing lease should be based on the number of years remaining in the lease contract/agreement as of the beginning of the period of implementation and not the number of years in the initial lease term. For example, if the initial lease term was 20 years, with no options, at the beginning of Year 20X1 and the entity implements this Statement in Year 20X7 (6 years into the lease at the beginning of Year 20X7), the initial lease term upon implementation would be 14 years.
 - c. Short-term leases - A short-term lease would be determined based on the provisions of this Statement (see par. 59 – 61). However, if the remaining lease term of an existing lease meets the definition of a short-term lease (has a maximum possible term under the contract or arrangement of 24 months or less, including any options to extend, regardless of their probability of being exercised) that lease should apply the short-term lease guidance. For example, if the initial lease term was 60 months as of the beginning of Year 20X1, with no options to extend, and the entity implements this Statement in Year 20X5 (48 months into the lease at the beginning of Year 20X5); the initial lease term at implementation would be 12 months and the lease would meet the definition of a short-term lease. Hence, the entity should account for the lease as a short-term lease.

EFFECTIVE DATE

101. The requirements of this Statement are effective for reporting periods beginning after September 30, 2018. Early adoption is not permitted.

The provisions of this Statement need not be applied to immaterial items.

APPENDIX A: BASIS FOR CONCLUSIONS

This appendix discusses some factors considered significant by Board members in reaching the conclusions in this Statement. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others. The standards enunciated in this Statement—not the material in this appendix—should govern the accounting for specific transactions, events, or conditions.

PROJECT HISTORY

- A1. This project was undertaken primarily because
 - a. the current lease accounting 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*, have been criticized as ineffective because they do not make meaningful distinctions between capital and operating leases based on the substance of lease transactions, and
 - b. the lease accounting standards in SFFAS 5 and 6 are based on Financial Accounting Standards Board (FASB) lease accounting standards which have been amended; in addition existing FASAB standards are not comprehensive and do not provide meaningful information on federal leasing activities.
- A2. Lease accounting was first addressed by the FASAB during the development of SFFAS 5 and 6. At that time the Board decided to use the high level language on lease accounting from FASB Statement of Financial Accounting Standards (SFAS) No. 13 *Accounting for Leases* [subsequently codified in Accounting Standards Codification (ASC) - Topic 840 *Leases*]. This minimal lease guidance included the definition of a capital lease, the criteria for capital leases, and the measurement of a capital lease asset and liability. The Board had plans to use this preliminary guidance as a placeholder until it was prepared to add lease accounting to its agenda as a separate project. Lease accounting had been on the list of potential Board agenda items each time the Board has considered its agenda for new projects.
- A3. There are several areas of lease accounting that were covered by the FASB standards that were never specifically covered in the FASAB standards. Some of those topics include leasehold improvements, lease terms, leveraged leases, and subleases. The federal community often stressed that the federal standards on lease accounting should be comprehensive to alleviate questions on when and if FASB standards apply to federal entities when the federal standards are silent on a topic.
- A4. In August 2011, FASAB began a project to revise its current standards on lease accounting. FASAB staff formed a task force to assist in developing the proposed standards for leases. Task force members included accounting, budget, and subject matter experts from federal agencies and independent public accounting firms.
- A5. The task force met several times over the course of the project and also exchanged numerous ideas and recommendations electronically. The task force views and recommendations were sought by staff in developing and describing alternatives to

present to the Board during the development of these standards. The task force's assistance was essential and its views carefully considered by members during deliberations. The task force played an important role in the research and release of this exposure draft.

- A6. In evaluating an approach applicable to federal leases, the Board considered the approaches used in the following documents:
- Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards (SFAS) 13, *Accounting for Leases* [Superseded by FASB Accounting Standards Codification (ASC) 840, which was subsequently superseded by ASC 842]
 - Governmental Accounting Standards Board (GASB) Exposure Draft, *Leases*, January 25, 2016
 - International Accounting Standards Board (IASB) International Accounting Standard (IAS) 17, *Leases*, which was superseded by International Financial Reporting Standard (IFRS) 16.
 - International Public Sector Accounting Standards Board (IPSASB) International Public Sector Accounting Standard (IPSAS) 13, *Leases*.
- A7. At the inception of the project the Board decided to coordinate with GASB on the lease project because of the similarities among governmental entities regarding lease activities and reporting objectives. Staff worked closely with GASB staff during the development of the proposals. In 2014 FASAB and GASB met jointly to discuss similar issues related to each of their ongoing lease accounting projects. As a result of this collaboration, similar wording may appear in some sections of the FASAB and GASB standards.¹⁵
- A8. This Statement amends the lease accounting standards in SFFAS 5, SFFAS 6, and TR 16. This Statement also establishes distinct standards for intragovernmental leases.

KEY AREAS OF IMPROVEMENT

- A9. This lease proposal will improve the existing lease accounting standards in SFFAS 5 and SFFAS 6 by
- a. providing relevant and meaningful financial information needed by federal financial statement users and
 - b. providing comprehensive lease standards that appropriately address the various lease transactions/activities of the federal community.
- A10. The Board believes that in a lease transaction, a lessee receives the right to use an underlying asset (the asset that is subject to the lease, such as a vehicle or building) at the beginning of the lease term. In exchange, the lessee promises to make payments over time for the right to use that underlying asset. The guidance in SFFAS 5 and 6 was based on the notion that some leases are essentially financed purchases of the underlying asset (classified as capital leases) and other leases (classified as operating leases) are not. The classification of a lease as capital or operating depended on whether the lease met any of

¹⁵ The GASB material is copyrighted by the Financial Accounting Foundation, 401 Merritt 7, Norwalk, CT 06856, USA, and is used with permission.

four tests. Those tests were intended to determine whether most of the risks and benefits of ownership of the underlying asset were transferred to the lessee. Those tests have been criticized because their bright-line nature often resulted in very similar leases being accounted for in different ways.

SCOPE

- A11. For purposes of applying this Statement, a lease is defined as a contract or agreement that conveys the right to use a nonfinancial asset¹⁶ (the underlying asset) for a period of time in an exchange transaction. Leases include contracts or agreements that, although not explicitly identified as leases, meet the definition of a lease (which reflects the substance of a lease). This definition does not include contracts or agreements for services unless that contract or agreement also conveys the right to use a nonfinancial asset (the underlying asset) for a period of time in an exchange transaction.
- A12. This Statement does not apply to leases of federal natural resources as defined in Technical Bulletin (TB) 2011-1, *Accounting for Federal Natural Resources Other than Oil and Gas* and leases of federal oil and gas resources as defined in SFFAS 38, *Accounting for Federal Oil and Gas Resources*.
- A13. GASB's Leases exposure draft specifically excludes, "contracts that meet the definition of a service concession arrangement in paragraph 4 of Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements* (SCAs)." Currently FASAB standards are silent on SCAs. Through its discussions the lease task force identified several federal entities that have SCAs, and there was a concern that the proposed lease definition could inadvertently include SCAs. The Board considered specifically excluding SCAs from the lease standard. To accomplish the exclusion, the Board considered adopting GASB's definition of SCA from Statement No. 60 due to the lack of a federal definition of SCA.
- A14. Because SCAs are not currently addressed in federal accounting standards, the Board decided that specifically excluding SCAs from the lease standard would raise more questions. Furthermore, SCAs are expected to be addressed in the public-private partnership recognition and measurement project and therefore the Board agreed to remain silent on SCAs in the lease proposal. In conclusion, the Board believes the GAAP hierarchy will continue to guide preparers and auditors in accounting for SCAs.

DEFINITIONS

- A15. In this Statement, a lease is defined 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. In the early stages of the project the Board deliberated over the use of "contract" or "agreement" in the definition of a lease. The Board considered the GASB approach that the term contract is more precise and limiting and requires that a lease be legally enforceable. Because legal enforceability is not the primary driver in

¹⁶ Examples of nonfinancial assets include land, buildings, vehicles, equipment, internal use software, and intangible assets. Examples of financial assets include cash, investments, and receivables.

intragovernmental leasing transactions, the Board decided to add “agreement” in addition to “contract” in the lease definition to alleviate ambiguity in the application of the definition, especially in the case of intragovernmental leases which are often referred to as “lease agreements.”

LEASE TERM -- RENEWAL AND TERMINATION OPTIONS

- A16. Federal leases often include lessee options to renew, extend, or terminate a lease. Due to federal budget scoring rules and fiscal funding mechanisms, many federal leases include relatively short noncancelable periods. The Board concluded that the lease term used to measure the lease liability should not be limited to the noncancelable lease periods, but should include certain probable renewal option periods and consider the probability of termination options being exercised, so that the lease term reflects how long the lease is expected to be in effect.
- A17. The probability of a renewal or termination option being exercised applies only if that option pertains to the lessee alone. If either the lessee or the lessor has the option to cancel a lease (or if both parties have to agree to renew), the lease contract/agreement is not enforceable beyond that point. In those cases when either the lessee or the lessor could cancel the lease at any time, for example month-to-month lease holdovers, rolling lease extensions, or any lease that continues into a holdover period until a new contract or agreement is signed, the contract or agreement would be considered cancelable. When a lease contains a lessor-only option to terminate the lease, a lessee would have difficulty evaluating the likelihood of that option being exercised. This difficulty and the resulting cost outweigh the potential benefits of including the extra periods in the lease term. The Board also agreed that the presence of a bargain purchase option in a lease contract/agreement is not equivalent to a provision that transfers ownership of the underlying asset; therefore, a bargain purchase option should be treated as any other purchase option included in a lease.
- A18. The Board considered several potential probability thresholds for including a period covered by a renewal or termination option in the lease term. The Board considered its own definition of probable, GASB’s definition of probable, and FASB’s probability threshold “reasonably certain.” FASB’s probable definition equates to more likely than not (>50% probability). GASB’s probable definition equates to likely to occur and has a higher threshold of probability than more likely than not. FASB’s reasonably certain has an even higher threshold than likely to occur. The Board agreed to retain its definition of probable because it is more clearly defined and there seemed to be no compelling reason to introduce a new term for the sake of a higher threshold.

REMEASUREMENT

- A19. This Statement requires that when a lease liability is remeasured, the corresponding lease asset be adjusted by the same dollar amount (except in cases of impairment and in cases in which the adjustment would cause the asset to be reported as a negative amount). While acknowledging that adjusting the lease asset for a change in the lease liability

results in the lease asset no longer being measured at adjusted historical cost, the Board believes that such an adjustment is practical.

NON-INTRAGOVERNMENTAL LEASES

RECOGNITION AND MEASUREMENT FOR LESSEES – LEASE LIABILITY

- A20. SFFAC 5 defines a liability as a present obligation of the federal government to provide assets or services to another entity at a determinable date, when a specified event occurs, or on demand. The Board believes that the lessee taking possession of the underlying asset or gaining access to use the underlying asset is an event that creates such an obligation until the end of the lease term.
- A21. The Board believes the present value of future lease payments to be made for the lease term, which represent the obligations of the lessee under the lease contract/agreement, is the appropriate measurement of the liability. Such a calculation is consistent with the premise that a lease is a financing transaction and supports recognition of the cost of the financing.

RECOGNITION AND MEASUREMENT FOR LESSEES – LEASE ASSET

- A22. Assets are defined in SFFAC 5 as resources that embodies economic benefits or services the federal government controls. Lessees should recognize a lease asset to correspond with the lease liability. At the beginning of a lease, the lessee obtains the right to use the underlying asset and that right is a resource embodying economic benefits. The Board believes this right meets the definition of an asset. Because the lease liability represents the amount to be paid for the lease asset, the Board concluded that the initial measurement of the lease asset should be based on the measurement of the associated lease liability. PP&E assets generally are measured at historical cost, which is the amount paid for those assets. Therefore, measuring the lease asset based on the lease liability is consistent with historical cost accounting applicable to PP&E.

RECOGNITION AND MEASUREMENT FOR LESSORS

- A23. Symmetry between the lessee and lessor accounting models is important in establishing accounting and financial reporting standards. The Board believes that federal entity lessees and lessors should account for the same transaction in a way that mirrors how the other party accounts for it.
- A24. The lease contract gives the lessor the right to receive payments in exchange for the lessee's right to use the underlying asset. The Board believes that right meets the definition of an asset in SFFAC 5. Assets are defined as a resource that embodies economic benefits or services that the federal government controls. The right to receive payments is a resource that can be drawn upon, and the lessor presently controls that right.

SHORT-TERM LEASE EXCEPTION

A25. The Board considered the short-term lease exception GASB proposed, which requires governments to recognize leases with useful lives or maturities of less than one year. The Board decided to align the lease short-term exception with the PP&E standard which defines PP&E as a tangible asset with an estimated useful life of 24 months or more. The reporting of short-term leases in this Statement is intended to reduce the cost to federal entities of implementing these standards. This short-term exception eliminates the need for preparers to calculate amounts for short-term lease assets and liabilities. This exception requires lessees and lessors to recognize expense and revenue based on the payment provisions of those lease contracts/agreements with useful lives or maturities of less than two years. This measurement approach is not cash-basis recognition, as federal entities are still required to recognize receivables and payables for lease payments paid or received before or after the period to which they apply.

INTRAGOVERNMENTAL LEASES

A26. During the research phase of the project, the General Services Administration (GSA) provided an educational session to the Board where GSA representatives explained in-depth GSA's role in federal leasing. Based primarily on that discussion, the Board agreed that intragovernmental leases should be accounted for differently than leases between federal entities and non-federal entities. The Board agreed that a simplified approach for recognizing intragovernmental leases would be pragmatic and cost efficient.

A27. This Statement provides the overall recognition, measurement, and disclosure requirements 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*.

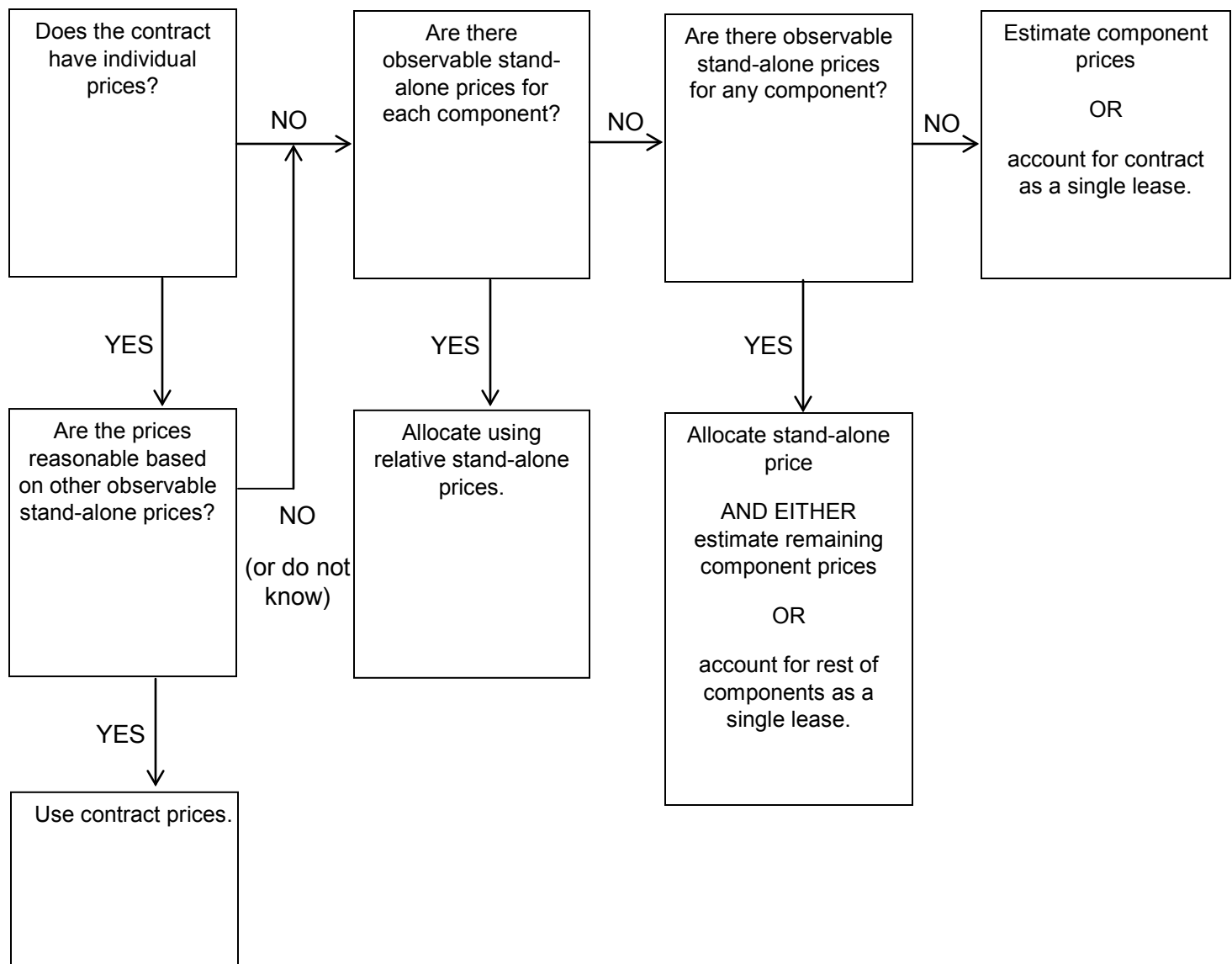
A28. The terms "intragovernmental" and "inter-entity" have been used interchangeably. Earlier FASAB standards predominately used "inter-entity." However, government-wide usage of "intragovernmental" has become more common, and therefore the Board decided to use intragovernmental in this Statement to describe leases occurring within a consolidation entity or between two or more consolidation entities as defined under SFFAS 47.

A29. This Statement provides general guidance on the recognition and measurement of lease rental increases, as well as guidance on other changes in the lease payments, such as lease incentives and lease concessions. The Board believes that rent increases are related to economic events, while lease incentives and concessions are more closely aligned with marketing cost. Therefore lessee rental increases should be recognized as expense in the period of the increase as provided in the lease; lease incentives and concessions should be recognized by the lessee/lessor as reductions of lease rental expense/lease rental income on a straight-line basis over the lease term.

APPENDIX B: ILLUSTRATION

This appendix illustrates the application of the provisions of this Statement to assist in clarifying their meaning. The facts assumed in these examples are illustrative only and are not intended to modify or limit the requirements of this Statement or to indicate the Board's endorsement of the situations or methods illustrated. Additionally, these illustrations are not intended to provide guidance on determining the application of materiality. Application of the provisions of this Statement may require assessing facts and circumstances other than those illustrated here and require reference to other applicable Standards.

The following flowchart¹⁷ is intended to aid in the application of the provisions for contracts with multiple components of this Statement – paragraphs 51 - 56.



¹⁷ This illustration has been adapted from the GASB Lease ED, Appendix C, *Flowchart for Allocation of Consideration to Multiple Components*.

APPENDIX C: ABBREVIATIONS

ASC	Accounting Standards Codification
CFR	Consolidated financial report of the U.S. Government
ED	Exposure draft
FASAB	Federal Accounting Standards Advisory Board
FASB	Financial Accounting Standards Board
GAAP	Generally Accepted Accounting Principles
GAO	Government Accountability Office
GASB	Governmental Accounting Standards Board
IPSASB	International Public Sector Accounting Standards Board
PP&E	Property, Plant, and Equipment
SCA	Service Concession Arrangement
OMB	Office of Management and Budget
SFAS	Statement of Financial Accounting Standards (FASB)
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards
TB	Technical Bulletin
TR	Technical Release

APPENDIX D: GLOSSARY

Lease

A lease is 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.

Intragovernmental Lease

A lease occurring within a consolidation entity or between two or more consolidation entities as defined under SFFAS 47, *Reporting Entity*.¹⁸

Probable

That which can reasonably be expected or believed to be more likely than not on the basis of available evidence or logic but which is neither certain nor proven.

Lease Option Periods

Lease option periods are additional lease periods beyond the initial lease term – the options may be included in the initial lease or may be agreed to later in the lease term.

Initial Direct Costs

Initial direct costs are costs that are directly attributable to negotiating and arranging a lease or portfolio of leases and would not have been incurred without entering into the lease.

Short-Term Lease

A short-term lease is a lease that, at the beginning of the lease, has a maximum possible term under the contract or arrangement of 24 months or less, including any options to extend, regardless of their probability of being exercised.

Lessee's Incremental Borrowing Rate

The lessee's incremental borrowing rate is the estimated rate that would be charged for borrowing the lease payment amounts for the lease term.

Discount Rate

A discount rate is an interest rate that is used in present value calculations to equate amounts that will be received or paid in the future to their present value.

¹⁸ SFFAS 47, *Reporting Entity*, outlines the characteristics as a whole that an organization would have to be considered a consolidated entity (see SFFAS 47 par. 38-42).

FASAB Board Members

D. Scott Showalter, Chairman

Gila J. Bronner

Robert F. Dacey

George A. Scott

Michael H. Granof

Christina Ho

Sam M. McCall

Mark Reger

Graylin E. Smith

FASAB Staff

Wendy M. Payne, Executive Director

Monica R. Valentine, Assistant Director

Federal Accounting Standards Advisory Board

441 G Street NW, Suite 6814

Mail Stop 6H19

Washington, D.C. 20548

Telephone (202) 512-7350

Fax (202) 512-7366

www.fasab.gov

Statement No. 87 of the Governmental Accounting Standards Board Leases

History of Board Lease Discussions

- ❖ The objective for the June meeting was for the Board to provide direction to staff on the issues raised in the briefing materials and to raise any other technical issues for staff to address. Staff would like to have any remaining technical issues addressed at the August meeting so that a pre-ballot draft can be provided to the Board after the August meeting.

At the February 2017 FASAB meeting the Board considered responses to its 2016 Leases Exposure Draft (ED) and at the April 2017 meeting representatives from five federal entities discussed their comments on the ED with the Board. The Board asked staff to consider additional scope exclusions, continue to highlight the benefits associated with revising the leases standard, and explore options to ease the anticipated burdens and costs of the lease revisions to federal preparers.

At the June meeting staff discussed the following three issues with the Board:

- Definition of a lease
- Scope of the revised lease standards
- Lease term determination

The Board agreed with the broader definition of a lease over the more narrow definition of a lease that would only include property, plant, and equipment (PP&E). The broader definition will allow flexibility for leases that are not PP&E or those not specifically scoped out to be considered for recognition in accordance with the standards.

The Board agreed with the additional scope exclusions. The scope exclusions will include, natural resources per SFFAS 38 and TB 2011-1, leases of inventory, leases of assets under construction, leases of intangibles, and leases (licenses) of internal use software. With the broader definition an entity would need to identify all items meeting the definition and justify the exclusions. The broader definition encourages entities to evaluate the substance of the transaction.

The Board agreed to revise the lease term determination language but retain the probable threshold. Staff will also work to ensure the lease term determination language is clear and includes the necessary explanations and definitions. The probable threshold gives the entity a better basis for assessing the lease term as opposed to the higher reasonably certain threshold which could be more challenging to establish.

Next Steps: Staff will make the necessary revisions to the draft standard based on all Board discussions since the exposure draft and present the draft to the Board at the August meeting.

- ❖ At the April 2017 meeting, five federal entities addressed the Board; each entity was given 40 minutes for opening remarks and questions from Board members.

AGENCY	PRESENTERS' NAMES
Department of Agriculture	Michael Moore
Department of Energy	William Truitt, John Wall, and Tynesha Douglass
Department of the Interior	Terri Windlan and Sherry Lee
Department of Defense	Alaleh Jenkins, Edwin Oshiba, Jim Omans, Michael Walsh, and Steven Hurwitz
General Services Administration	Robert (Bob) Smalskas and Edward Gramp

Mr. Showalter began the clarification discussion by informing the Board that the objective of the session was to listen to the presenters, ask questions of the presenters, and give staff direction on the next steps of the project.

During the discussion several points were made by the presenters, including some of the following:

- The lease proposal will require additional cost to entities by way of added personnel and system upgrades, both during the implementation period and ongoing periods. Most of the presenters were not prepared to give specific estimates of those additional costs.
- Implementation guidance with specific examples will be helpful in the application of the revised lease standards, including related U.S. Standard General Ledger (USSGL) accounts.
- Departments will need to assess the remeasurement of the lease liability quarterly.
- The proposed lease definition should be clearer and more narrowly scoped.
- Clarification is needed for contracts for services when an asset is involved; for example, how a department should unbundle the contracts.

The Board asked staff to address some of the issues raised by the presenters.

- Staff should develop a list of possible items to be scoped out, including intangibles.
- Staff should get a clearer understanding of the benefits associated with revising the leases standards.
- Staff should explore options to ease the anticipated burden and cost of the lease revisions to federal preparers.

Next Steps: Staff will reach out to the presenters as well as other members of the lease task force to address the issues identified by the Board and return with recommendations.

- ❖ At the February Board meeting, staff provided to the Board the 25 comment letters received on the *Leases* ED, several tables that summarized the comment letters, an initial staff analysis of issues identified by respondents, and questions for Board discussion.

Members agreed to extend an invitation to all respondents of the ED to address the Board and provide further clarification on their responses to the *Leases* ED at the April meeting.

The Board agreed with staff that implementation guidance would be necessary to assist entities to effectively implement the amendments to the Leases standards.

The Board discussed issues raised in the responses to the *Leases* ED. There were no Board decisions based on staff's recommendations because members wanted additional feedback from the respondents on the following issues:

- The addition of the notion of control to the lease definition as well as language connecting the definition to that of an asset in Statement of Federal Financial Accounting Concepts 5, *Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements*
- The change of the term “nonfinancial asset” to “nonmonetary asset” in the final amended *Leases* Statement
- The method used in determining the lease term, including what is considered the “noncancelable period” proposed in the ED
- The probability threshold used when assessing whether renewal and termination options will be exercised
- The initial lessee recognition proposed in the ED
- The recognition and measurement of the lease liability by the lessee proposed in the ED
- The interest rate used to calculate the lease liability proposed in the ED
- The circumstances when the lessee must remeasure the lease liability proposed in the ED
- The recognition and measurement of the lease asset by the lessee proposed in the ED

- The lease term of 24 months or less for a short-term lease proposed in the ED
- The change of the definition of short-term lease from “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” to “a lease with a lease term (as defined in paragraph 14) of 24 months or less”
- The change of the effective date of the amended leases standards to fiscal year 2020

Next Steps: Staff will extend an invitation to all 25 respondents of the *Leases* ED to allow them to speak before the Board to provide clarification on their responses to the ED and for the members to ask questions of the respondents. The clarifying discussion will take place on April 26, the first day of the next FASAB meeting. Staff will also prepare a package for the Board with materials to facilitate the discussion. Additionally, staff will continue with an analysis of the comments for Board consideration.

- ❖ The Board released for public comment on September 26, 2016 the proposed SFFAS entitled *Leases: An Amendment of SFFAS 5, Accounting for Liabilities of the Federal Government and SFFAS 6, Accounting for Property, Plant, and Equipment*, which was. The Board requested comments on the exposure draft by January 6, 2017.
- ❖ At the August Board meeting, staff provided to the Board a pre-ballot draft ED on lease accounting. The objective of the session was for the Board to provide feedback to staff and approve the Lease ED pre-ballot draft.

The following topics were presented by staff and discussed by the Board.

- Comment Period End Date – The Board agreed to the comment period end date of January 6, 2017.
- Proposed Effective Date – Staff proposed an effective date of periods beginning after September 30, 2019. Members agreed to propose an effective date of September 30, 2018, and revise the date to September 30, 2019, if the Board gets a negative reaction to the 2018 effective date. The Board also agreed to not allow early adoption of the standard to maintain consistency among the reporting entities.
- Public Hearing – Staff proposed scheduling a public hearing for April 26, 2017, and providing notice of the public hearing in the ED. The Board agreed that scheduling a public hearing should be determined based on the responses to the comment letters. Therefore, the ED will not include the scheduling of a public hearing; however, the possibility of a public hearing will be noted in the ED.

- Remeasurement Respondent Questions –The Board agreed to add a question to the ED to address the effect of remeasurement on the lease liability and asset, as well as language in the basis for conclusions to reflect the Board’s rationale. They also agreed to add a question to address whether certain remeasurement triggers would cause significant costs to the preparer.
- Implementation Guidance – The Board agreed to propose the prospective implementation approach, which requires that leases unexpired at the beginning of the reporting period be recognized and measured using the facts and circumstances that exist at the beginning of the period of implementation. This approach includes examples of implementation scenarios.

Next steps: The next steps are to incorporate all of the Board’s edits, send the Board a ballot draft of the ED for approval, and release the ED by the end of September.

- ❖ At the June Board meeting, staff provided to the Board a draft ED on lease accounting and task force responses to several lease-related questions posed by staff. The objective of the session was to review responses to seven questions staff had posed to the lease task force related to issues in which the Board had requested additional information and review a draft Lease ED.

The Board made the following tentative decisions.

- The Board agreed with the staff recommendation to propose the use of FASAB’s definition of probable (more likely than not – >50%) as the probability threshold in the Lease ED. The Board also directed staff to include probability threshold as a question in the ED.
- The Board agreed to propose that the leased asset be classified as property, plant, and equipment (PP&E) unless the underlying asset is not PP&E; in those cases the leased asset would be classified to align with the nature of the underlying asset.
- The Board agreed that the basis for conclusions should tell the story of how the Board arrived at its conclusions and the Board’s collaboration with the Governmental Accounting Standards Board (GASB). The basis for conclusions should not specifically note when FASAB’s proposed guidance diverges from GASB’s guidance unless the Board deliberated on GASB’s approach. In those instances when the Board considered GASB’s approach, staff will include the highlights of the discussion and how the Board came to its conclusions.
- The Board agreed to add some verbiage to the basis for conclusions on rent increases, lease incentives, and lease concessions.

Next steps: Staff will make the revisions discussed at the meeting to the draft ED and provide a pre-ballot draft for the August meeting.

- ❖ At the April Board meeting staff members presented to the Board one issue related to developing the exposure draft (ED) of the proposed standards on non-intragovernmental lease accounting. The Board previously directed staff to use the

Governmental Accounting Standards Board's (GASB) proposal on Leases as a platform for developing the federal standards on non-intragovernmental lease – the GASB ED was released for comment in January 2016.

The objective of the session was to address the issue of service concession arrangements (SCAs) in the proposed lease standards. Staff noted GASB's Leases ED specifically excludes, "Contracts that meet the definition of a service concession arrangement in paragraph 4 of Statement No. 60, Accounting and Financial Reporting for Service Concession Arrangements." Currently FASAB standards are silent on SCAs.

The Board agreed that because SCAs is a topic not previously addressed in federal accounting standards, specifically excluding SCAs from the lease standard would raise more questions about SCAs. Therefore, members concluded that SCAs should not be addressed in the lease standard. Although SCAs are expected to be addressed in the P3 recognition and measurement project, the Board agreed to remain silent about SCAs in the lease proposal but to include the Board's rationale in its BFC. The Board may also consider asking a question about SCAs of the respondents to the ED.

- ❖ At the February 2016 meeting staff updated the Board on the lease project, including the status of the GASB lease project. The Board had previously directed staff to use the GASB lease proposal as a platform for developing the FASAB standards on non-intragovernmental leases.

Staff made several revisions to the language contained in the GASB proposal to reflect differences at the federal level, any conflicts with existing FASAB standards, and any changes to which the Board had previously agreed. In addition, staff also posed 23 questions to the Board related to the draft. The questions highlight areas where the FASAB proposal deviates from the GASB proposal, areas where the task force has raised questions, and areas where overall general questions on the proposal were appropriate.

Mr. Showalter asked staff to highlight only the areas in which Board members had additional questions, as well as the areas in which staff would like further direction from the Board, due to the number of questions put forth by the staff.

Capitalization Thresholds: Staff stated that because SFFAS 6, Accounting for Property, Plant, and Equipment (PP&E) specifically addresses capitalization thresholds, a task force member questioned whether the lease standards would allow federal entities to establish capitalization thresholds for lease assets. Staff also noted that GASB does not address the issue of capitalization thresholds in the standards sections of the lease ED, but in the basis for conclusions.

The Board agreed to not specifically address capitalization thresholds in the lease proposal but to discuss overall materiality in the application of the standard, which would then apply to the materiality of the related lease liability and lease asset.

Lessee Incremental Borrowing Rate: Staff noted that GASB proposes use of the incremental borrowing rate if the actual or implicit rate charged by the lessor cannot be readily determined. This is consistent with current FASAB standards. However, the incremental rate for federal borrowers is the Treasury rate—a risk-free rate.

Staff noted that the risk-free rate is not reflective of the lessor's implicit rate, and the risk-free rate would understate the interest expense. Staff also suggested that the language in paragraph 20 be modified from "If the rate cannot be readily determined..." to "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 Board agreed with the revised language.

Lease Liability Remeasurement—Due to a Change in an Index or Rate: Staff noted that GASB proposes that the lease asset be adjusted when the corresponding lease liability is remeasured. GASB also proposes that the effects of a lease liability remeasurement, due to a change in an index or rate used to determine variable payments, be recognized the same way as the effects of remeasurement for other reasons. This would be an adjustment to the lease asset, rather than recognition in the flows statement (as proposed in the Preliminary Views). GASB proposed the change primarily due to cost-benefit concerns.

The Board agreed to remain consistent with GASB's approach that the lease asset be adjusted when the corresponding lease liability is remeasured in all instances.

Insignificant Lease Components: Staff noted that the Board had previously agreed that the guidance should exempt leases with multiple insignificant and unpriced components from applying methods to disaggregate the components.

The draft language would read, "If a contract/agreement does not include prices for individual components, or if those prices are not reasonable based on other observable stand-alone prices, lessors and lessees should do the following, unless the components as a whole are not considered significant."

The Board had no objections to the edit.

- ❖ At the December 2015 meeting staff updated the Board on the lease project, including the status of the GASB lease project. The Board had previously directed staff to use the GASB lease proposal as a platform for developing the FASAB standards on non-intragovernmental leases.

Staff noted that the GASB is in the final stages of finalizing their exposure draft (ED) and expects to release the ED for comment in early February 2016. FASB plans to release their final lease standard in early 2016 with an effective date of 2019.

Staff's goal is to have the FASAB lease ED available for comment by mid-2016. Staff also held a lease task force meeting in early-February 2016.

There was also a brief discussion on the accounting for lease holdovers, in light of a recent GAO report.

Lastly, there are plans to convene another FASAB/GASB joint meeting in 2016.

Staff will continue to work with the task force to further develop the lease standards and will continue to follow the progress of the GASB lease discussions.

- ❖ At the October 2015 meeting staff updated the Board on GASB's deliberations of their lease project. The Board had previously directed staff to use the GASB Lease proposal as a platform for developing the FASAB standards on non-intragovernmental leases.

Staff provided the Board with excerpts from the tentative GASB Board meeting minutes from their September 1, 2015 lease discussion. The following GASB lease topics were presented to the Board.

- Airport Leases and Related Issues
- Lessee Disclosures
- Lessor Disclosures
- Short-Term Lease Exception
- Lease Terminations and Modifications
- Subleases and Leaseback Transactions

Staff will continue to work with the task force to further develop the lease standards and will continue to follow the progress of the GASB lease discussions.

- ❖ At the August 2015 meeting staff updated the Board on GASB's deliberations of their lease project. The Board had previously directed staff to use the GASB Lease proposal as a platform for developing the FASAB standards on non-intragovernmental leases.

Staff provided the Board with eleven discussion items that staff compiled from the last three GASB lease discussions (April, June, and July 2015). The eleven issues represented those lease topics that GASB either changed its position from the November 2014 Lease Preliminary Views document or topics that FASAB will need to further discuss as the exposure draft is developed. The following discussion items were presented to the Board.

- Defining “nonfinancial asset”
- Intangible (lease) assets
- The role of “control” in determining whether a transaction qualifies as an asset
- Service concession agreements
- Bargain purchase options
- Month-to-month holdover periods
- Probability threshold
- Lessee renewal/termination options
- Fiscal funding clauses
- Lease liability remeasurement
- Allocation of consideration to multiple components

A Board member suggested just giving examples or asset classes of nonfinancial assets, if a clearer definition cannot be developed. The Board asked staff if federal leases would go beyond the scope of capital assets (real and personal property). The Board asked staff to come back with options to defining nonfinancial assets.

Staff noted that the FASAB “probable” definition equates to “more likely than not” and “reasonably certain” has an even higher threshold than GASB’s “probable (likely to occur).” Since FASAB previously noted that it was comfortable with the differences between our “probable” and GASB’s “probable,” staff recommends not accepting GASB’s change to “reasonably certain” and staying with the FASAB “probable” definition, because there seems to be no compelling reason to introduce a new term for the sake of a higher threshold. The Board did not disagree with staff’s recommendation.

The Executive Director reminded the Board that all of the issues will be brought back to the Board for more discussion before the exposure draft is finalized.

Staff will continue to work with the task force to further develop the lease standards and will continue to follow the progress of the GASB lease discussions.

- ❖ At the April meeting staff presented to the Board an initial draft exposure draft (ED) for the intragovernmental portion of the leases standard. Staff noted that the lease standard will include guidance for all federal leases, including intragovernmental leases. The Board has tentatively agreed that intragovernmental leases should be accounted for similar to current operating leases guidance. The draft ED included definitions of relevant terms, as well as specific provisions that address the recognition and measurement of intragovernmental leases for both the lessee and the lessor. Staff asked the Board if they agreed with the proposed language. The Board generally agreed with the staff proposal and asked staff to provide clarifying language in several sections of the proposal.

Staff also presented to the Board a summary of possible FASAB-relevant comments from the Governmental Accounting Standards Board’s (GASB) Preliminary Views (PV) on Leases. The Board had previously directed staff to use the GASB Lease PV as a platform for developing the FASAB standards on non-intragovernmental leases.

GASB received 37 comment letters on their lease PV and held three public hearings and expects to issue its exposure draft in February 2016 and a final standard in early 2017. Since the Board previously agreed to use the GASB lease accounting proposal as the foundation for the FASAB lease account proposal and any wording differences could denote a difference in meaning, staff recommended that the FASAB ED also be released close to that same timeframe as the GASB ED. The Board agreed to stay in sync with the GASB timeline for the release of the lease ED and final standard.

- ❖ At the February meeting staff presented to the Board a discussion paper that provided an analysis of the final six chapters of the Governmental Accounting Standards Board (GASB) Preliminary Views (PV) on Leases. The GASB PV on Leases is being used as a foundation for the development of the FASAB lease standards on non-intragovernmental lease agreements – the GASB PV was released for comment in November 2015. The topics discussed included lessee accounting, lessor accounting, short-term exception, lease terminations and modifications, subleases and leaseback transactions, and leases with related parties, and intra-entity leases.
- ❖ At the December 2014 meeting staff presented to the Board proposed guidance for intragovernmental leases. The proposed guidance included definitions of relevant terms, as well as specific provisions that address features of leases and is based on the current Financial Accounting Standards Board operating lease guidance. The Board had previously directed staff to simplify the intragovernmental lease accounting guidance. Staff presented revisions to the previously proposed recognition and disclosure lessee and lessor guidance for intragovernmental lease arrangements. The Board stressed consistency and the need for symmetry between the lessee and lessor accounting for intragovernmental leases

Staff also presented an analysis of the first three chapters of the GASB Preliminary Views (PV) on Leases so that the Board could discuss the GASB concepts as it relates to the development of federal lease standards. The GASB PV on Leases will be used as a foundation for the development of the FASAB lease standards on non-intragovernmental lease agreements– the GASB PV was released for comment in November. The topics discussed were project objective, project background, applicability, scope, and lease term.

- ❖ At the October 2014 meeting staff presented to the Board proposed draft guidance for intragovernmental leases. The proposed guidance included definitions of relevant terms, as well as specific provisions that addressed features of leases and that is based on the current FASB operating lease guidance.

Staff proposed seven lease-related definitions to the Board for discussion. The first three definitions – lease, intragovernmental and intragovernmental lease agreement – were discussed and tentatively agreed to by the Board at previous meetings. The remaining four proposed lease-related definitions – intragovernmental lease inception, intragovernmental minimum lease payments, intragovernmental noncancelable lease term, and intragovernmental sublease – were adapted from

FASB's existing operating lease guidance. The Board asked staff to simplify the proposed definitions and discuss with the task force.

Staff also presented proposed recognition and disclosure lessee guidance for intragovernmental lease arrangements. The Board agreed that the lessee general guidance would be to recognize lease payments as they are received and specific provisions would address those instances when the "due and payable" is not applicable.

The Board also agreed that certain scheduled rent increases, rent holidays, and lease incentives should be recognized on a straight-line basis – possibly using the proposed language used for the amortization of leasehold improvements.

- ❖ At the August 2014 meeting the Board discussed and agreed to a definition for the term "intragovernmental" to refer to occurring within a consolidation entity or within or between two or more consolidation entities.

The Board discussed and agreed to proposed definitions of leases and of intragovernmental lease arrangements.

The Board discussed staff's proposal for recognizing operating leases--straight-line for lease costs and in the current period for executory costs. The Board members agreed with the straight-line concept for lease payments, but would like additional information before deciding whether executory costs should be required to be separated from the rental payment.

The next decision related to the proposed disclosure of future lease payments. Some questioned whether this disclosure was necessary for intragovernmental lease arrangements. The Board agreed to exclude the disclosure, but to ask a question in the exposure document whether the disclosure is necessary.

The Board agreed that the lessor revenue recognition would match the lessee's expense recognition—on the straight-line basis.

The Board agreed that upfront lease costs for lessors would be expensed

Regarding potential disclosures of future lease payments of lessors, there were no objections to the proposed disclosures.

- ❖ At the June 2014 Board meeting a majority of the Board agreed with a simplified approach for recognizing amounts arising from intragovernmental lease arrangements. The Board agreed that intragovernmental lease arrangements should be accounted for differently than leases between federal entities and non-federal entities.

The Board suggested referring to the project as "leases, including similar intragovernmental lease arrangements" (similar intragovernmental lease arrangements are in substance leases) to differentiate the intragovernmental arrangements from the non-federal arrangements. This would allow the two types of transactions to be disclosed separately.

The Board also agreed not to pursue issuing a preliminary views (PV) document on leases and to tentatively plan to issue its exposure draft (ED) on leases and other similar arrangements close to when the Governmental Accounting Standards Board (GASB) will issue its ED. Because GASB plans to issue a PV prior to its ED, staff will have an opportunity to seek informally feedback from the federal community on the GASB PV.

- ❖ At the April 2014 meeting the U.S. General Services Administration (GSA) provided an educational session with the goal of the Board gaining a better understanding of several GSA lease-related topics.
- ❖ At the March 2014 the Board met jointly with the GASB to discuss similar issues related to each of their ongoing lease accounting projects. Both Boards agreed that they should begin with the goal of developing symmetry between the lessee and lessor models. The FASAB was also very focused on the intragovernmental leasing issues involving federal entities and those federal-specific lease issues.
- ❖ In January 2014 staff asked the Board to provide their input in a survey format on the tentative decisions made by the GASB on their lease project to date. Based on the results of the survey, staff identified several topics for further discussion during the joint meeting with GASB.
- ❖ At the December 2013 meeting the Board briefly discussed the GASB tentative decisions on their leases project to date with the GASB Practice Fellow leading their leases project.
 - ✓ The Board tentatively agreed that based on Statement of Federal Financial Accounting Concepts (SFFAC) 5's definition of an asset and liability a federal entity's **right to use** a leased asset and the **obligation to make lease payments** are assets and liabilities of the entity.
 - ✓ All of the members agreed to explore the single-model approach as opposed to the dual-model approach.

Other Lease Discussions

- ❑ FASAB staff members met with OMB staff on April 30, 2014 to discuss budget scoring for capital leases. OMB staff explained that Appendix B of OMB Circular A-11, which provides instructions on the budgetary treatment of lease-purchases and leases of capital assets, is consistent with the scorekeeping rule developed by the executive (OMB) and legislative branches (CBO) originally in connection with the Budget Enforcement Act of 1990 (BEA). Statement of Financial Accounting Standards 13, issued by FASB, was the "support" for the scorekeeping rules developed. Because the lease budget scoring rules were developed in connection with the BEA and cannot be changed unless all of the scorekeepers (OMB, CBO, and the Budget Committees) agree, it is not likely that the rules will change based on

potential changes in the financial accounting for leases. OMB staff provided other helpful insights which we will explore further later in the project.