



August 12, 2015

Memorandum

To: Members of the Board
From: *M.R. Valentine*
Monica R. Valentine, Assistant Director
Wendy M. Payne
Through: Wendy M. Payne, Executive Director
Subj: Lease Project – **Tab D**¹

MEETING OBJECTIVES

The objective of this memo is to provide the Board with an update on the progress of the GASB Lease project.

BRIEFING MATERIAL

- **Staff Memo**
- **GASB Lease Project Update**
- **Appendix A:** History of Board Lease Discussions

BACKGROUND

Since the April meeting staff has been working with GSA officials and other task force members to further develop the intragovernmental lease accounting standards. Thus far several additional intragovernmental leasing matters have being raised and are being researched for Board discussion.

GASB met in June and July to continue its deliberations on the comments received on their Lease preliminary views in preparation of an exposure draft. They have discussed the scope of the lease standard, foundational principle, lease term, lessee model and lessor model. Staff has reviewed the related GASB staff discussion papers to assess if any of the issues raised in the GASB discussion papers need to be brought to our

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 the FASAB or its staff. Official positions of the FASAB are determined only after extensive due process and deliberations.

Board for discussion. Those issues are outlined in the attached GASB lease project update.

NEXT STEPS

Staff will continue to work with the task force to further develop the lease standards, including the intragovernmental lease standards. Staff will also continue to follow the progress of the other standard setters' lease accounting projects.

MEMBER FEEDBACK

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

GASB LEASE PROJECT UPDATE

(Preliminary Views Deliberations)

GASB Meeting – April 2015

- I. Defining “nonfinancial” – GASB tentatively agreed to define “nonfinancial assets” (which is used in the definition of a lease) as “an asset that is not a *financial asset*, as the term is defined in *Statement No. 72, Fair Value Measurement and Application*¹. Nonfinancial assets include land, buildings, use of facilities, materials and supplies, intangible assets, or services.”

FASAB Staff Analysis: FASAB has tentatively decided to define lease as – a contract or agreement that conveys the right to use a **nonfinancial** asset (the underlying asset) for a period of time in exchange for consideration. The Board also tentatively decided that if a federal entity leases a **nonfinancial** asset as an investment, the lessee should consider the lease as a financing purchase and not apply the requirements of the lease standard. FASAB does not currently define financial asset or nonfinancial asset. Staff agrees with the addition of this definition for clarity.

- II. Intangible assets – Nonfinancial assets include intangible assets – The PV specifically excluded the following intangible assets:
 - a. Lease contracts concerning the rights to explore for or to exploit natural resources such as oil, gas, minerals, and similar nonregenerative resources and
 - b. Licensing contracts for items such as motion picture films, video recordings, plays, manuscripts, patents, and copyrights.

GASB tentatively agreed to exclude all intangible assets from the scope of the lease guidance, including computer software. GASB has Statement No. 51, Accounting and Financial Reporting for Intangible Assets.

FASAB Staff Analysis: SFFAS 10 currently classifies internal use software as G-PP&E and further states that software licenses should apply lease accounting standards. Footnote 27 in SFFAS 6 also states that, “Software and land [See SFFAS 10 for standard regarding internally developed software] rights, while associated with

¹ In GASB Statement No. 72, Fair Value Measurement and Application, a **financial asset** is defined as follows: Cash, evidence of an ownership in an entity, or a contract that conveys to one entity a right to do either of the following:

- a. Receive cash or another financial instrument from a second entity
- b. Exchange other financial instruments on potentially favorable terms with the second entity (for example, an option).

tangible assets, may be classified as intangible assets by some entities. In this event, they would be subject to amortization rather than depreciation. “Amortization” is applied to intangible assets in the same manner that depreciation is applied to general PP&E—tangible assets.” FASAB will have to address software licenses as a part of the lease standards.

- III. The role of “control” in determining whether a transaction qualifies as an asset. – FASB provided explanatory guidance in their lease exposure draft that states, a lease “conveys the right to control the use of the underlying asset for a period of a time.” GASB tentatively agreed to provide explanatory guidance and examples in the implementation guidance on the role of control when determining whether a transaction qualifies as an asset.

FASAB Staff Analysis: SFFAC 5: Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements defines an asset as “a resource that embodies economic benefits or services that the federal government **controls**.” It also states that an asset must possess two characteristics – one of which is “the government **controls** access to the economic benefits or services and, therefore, can obtain them and deny or regulate the access of other entities.” Since “control” is embedded in our definition of an asset, staff agrees with GASB to provide explanatory guidance and examples in the implementation guidance on the role of control when determining whether a transaction qualifies as an asset.

- IV. GASB reaffirmed its tentative decision that service concession agreements (SCA) will be excluded from the lease standards.

FASAB Staff Analysis: The Board has previously agreed that SCA will be addressed in the Public Private Partnership project.

GASB Meeting – June 2015

- V. Bargain Purchase Options (BPO) – In its 2014 Lease PV GASB proposed that leases that contain a BPO should be reported as a finance purchase and not be subject to the lease guidance. GASB tentatively agreed that BPO should be viewed as another option to be assessed and not automatically excluded.

FASAB Staff Analysis: Staff agrees with the GASB proposed change.

- VI. Month-to-Month Holdover Periods – Month-to-month holdover periods are not a part of the lease terms but are considered a cancelable period. In essence, mutual options are cancelable and unilateral options are not cancelable. GASB tentatively

agreed that the exposure draft would not specifically address month-to-month holdover periods.

FASAB Staff Analysis: Staff believes that the month-to-month holdover periods should be addressed in either the standard or in implementation guidance because the issue has been raised by the taskforce previously.

- VII. Probability Threshold – When assessing the lessee’s options to extend or terminate the lease the GASB PV proposed that the probability of the lessee exercising the option to extend or terminate the lease should be at the probable threshold. GASB has tentatively agreed to change its PV proposal to change to a greater threshold from “probable” to “reasonably certain.” The GASB also tentatively agreed to change its PV proposal to change from “probable” to “reasonably certain” with respect to when certain lease payments should be included in the measurement of the lease liability.

FASAB Staff Analysis: GASB and FASAB’s definitions of “probable” are different. GASB’s threshold of “probable” is higher than FASAB’s “probable” threshold which is defined as more likely than not (>50% probability). The Board previously agreed to not changing the definition of “probable” to be a higher threshold as it relates to assessing the likelihood of a renewal option being exercised.

- VIII. Lessee Renewal/Termination Options – In its 2014 Lease PV GASB proposes that “significant economic disincentives” are among the factors that should be assessed to help determine the likelihood that a lessee will exercise a lease renewal or termination option. Significant economic disincentives include, “costs relating to terminating the lease and signing a new lease (for example, negotiation costs, relocation costs, abandonment of significant leasehold improvements, costs of identifying another suitable underlying asset, or costs associated with returning the underlying asset in a contractually specified condition or to a contractually specified location).” The **GASB tentatively agreed** that the inclusion of substantial penalty to the listing of examples will assist preparers with identifying relevant economic disincentives to evaluate.

FASAB Staff Analysis: Staff agrees with this inclusion for clarity.

- IX. Fiscal Funding Clauses –The GASB PV does not specify how to treat a fiscal funding clause if the possibility of cancellation is more than remote. The GASB project staff believes the treatment of a reasonably possible fiscal funding clause should be clarified in the ED – fiscal funding clauses are the same as those for any other option to terminate a lease. The **GASB tentatively agreed** with staff’s recommendation that

the ED provide clarification that fiscal funding clauses are a type of termination option that should be considered in the same manner as any other termination option for the purposes of determining the lease term.

FASAB Staff Analysis: Staff agrees with this inclusion for clarity.

GASB Meeting – July 2015

- X. Lease Liability Remeasurement – GASB tentatively decided that the ED should not carry forward the provision from the Preliminary Views that the effects of a lease liability remeasurement due to a change in an index or rate used to determine variable lease payments that relates to the current period be recognized in the flows statement and instead proposed to recognize such changes as an adjustment to the lease asset.

FASAB Staff Analysis: Staff disagrees with this change and believes that the PV proposal is more appropriate.

- XI. Allocation of Consideration to Multiple Components – GASB tentatively decided that the ED should propose that the allocation of consideration in a multiple component lease contract follow a three-step approach: (1) use any separate contract prices if reasonable, (2) use observable stand-alone prices if readily available, and (3) choose either to develop reasonable estimates to allocate consideration to remaining components or to treat remaining consideration as a single lease unit.

FASAB Staff Analysis: Staff agrees with this change for clarity.

History of Board 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.