



August 14, 2014

Memorandum

To: Members of the Board
M.R. Valentine

From: Monica R. Valentine, Assistant Director

Through: Wendy M. Payne, Executive Director
Wendy M. Payne

Subject: Leases Project – Tab H¹

MEETING OBJECTIVE

To review proposed accounting guidance for intragovernmental lease arrangements.

BRIEFING MATERIAL

Staff Memo

Background

In June 2014 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, including similar intragovernmental lease 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.

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.

MEMBER FEEDBACK

If you require additional information or wish to suggest another alternative not considered by staff, please contact staff as soon as possible. In most cases, staff would be able to respond to your request for information and prepare to discuss your suggestions with the Board, as needed, in advance of the meeting. If you have any questions or comments prior to the meeting, please contact me by telephone at 202-512-7362 or by e-mail at valentinem@fasab.gov with a cc to paynew@fasab.gov

Questions for Board Discussion

- 1. Does the Board agree with the proposed definition of *intragovernmental*?**
- 2. Does the Board agree with the proposed definitions of *lease* and *intragovernmental lease arrangement*?**
- 3. Does the Board agree that lessee intragovernmental lease arrangement payments be recognized as an expense on a straight-line basis over the lease term, unless another systematic basis is representative of the time pattern of the user's benefit, even if the payments are not on a straight line basis? Or should the payments be recognized on a cash basis?**
- 4. Does the Board agree that the related intragovernmental lease arrangement executory costs (e.g., insurance, maintenance, taxes, etc.) should be recognized separately from lease payments as period expenses? Or should those costs be recognized as part of the lease payments?**
- 5. Does the Board agree that lessees should disclose future minimum rental payments in the aggregate and for each of the five succeeding fiscal years over the period of expected or planned occupancy? Or should the lessee only disclose future minimum rental payments in the aggregate and for each of the five succeeding fiscal years if there is better than a remote chance of continued occupancy?**
- 6. Does the Board agree that the lessor recognition of lease rental income should be symmetrical to the lessee recognition of lease rental expense?**
- 7. Does the Board agree that the lessor's initial direct costs [i.e., those incremental direct costs incurred by the lessor in negotiating and consummating leasing transactions (e.g., commissions and legal fees)] should be deferred and allocated over the lease term in proportion to the recognition of rental income? Or should all of the lessor's initial direct cost be expensed in the period incurred regardless of materiality?**
- 8. Does the Board agree that lessors should disclose future minimum lease rental income in the aggregate and for each of the five succeeding fiscal years over the period of expected or planned occupancy? Or should the lessor only disclose future minimum lease rental income in the aggregate and for each of the five succeeding fiscal years if there is better than a remote chance of continued occupancy?**

Staff Analysis and Questions for Board Consideration on the FASAB Leases Project

At an earlier meeting the Board agreed to explore a single-model lease accounting approach as opposed to a dual-model approach as with the current lease accounting model and the FASB/IASB proposals. At the June meeting the Board decided that a simplified approach for recognizing amounts arising from intragovernmental lease arrangements is warranted and that intragovernmental lease arrangements should be accounted for differently than leases between federal entities and non-federal entities. Staff was directed to develop a model that simplifies intragovernmental eliminations while relying on other means to provide information about use of assets and continuing obligations.

The Board agreed to use the current operating lease model as the basis for developing the intragovernmental lease arrangement model. The current FASAB standards briefly address the accounting for operating leases in SFFAS 5, *Accounting for Liabilities of the Federal Government*, par. 43, “If a lease does not meet at least one of the above [capital lease] criteria it should be classified as an **operating lease**.” In addition, SFFAS 1 *Accounting for Selected Assets and Liabilities* addresses “rents due to others” in the accounts payable standard and “rents paid to a lessor at the beginning of a rental period” in the advances and prepayments standard. FASAB, as well as GASB, has relied primarily on the FASB standards to account for operating leases (FASB Codification 840-20).

In an effort to develop a simplified approach for intragovernmental lease arrangement accounting, staff would like to discuss with the Board the following definitions, recognition, and disclosures for the model.

Definitions

Although FASAB standards have used the term intragovernmental in several of its standards in the context of intragovernmental assets, liabilities, funds, etc., the term has not been defined. Staff proposes the following definition of intragovernmental to assist in defining intragovernmental lease arrangements.

Proposed Definition - Intragovernmental: Occurring within or between two or more reporting entities considered “consolidation entities,” consistent with SFFAS 47 (Reporting Entity).

1. Does the Board agree with the proposed definition of *intragovernmental*?

Like GASB, the Board has agreed to explore the single model approach for all leases, with the exception of FASAB’s decision to treat intragovernmental lease arrangements differently. Given the similar approaches, staff proposes using GASB’s tentative lease definition, “a contract that conveys the right to use an asset (the underlying asset) for a period of time in an exchange or exchange-like transaction,” as the basis for the federal lease definitions, along with prior Board discussions. Likewise, the proposed intragovernmental lease arrangement definition is based on the proposed definition of lease and the proposed definition of intragovernmental.

Proposed Definition - Lease: A 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.

Proposed Definition - Intragovernmental Lease Arrangement: A lease agreement that is between two or more reporting entities considered “consolidation entities”² consistent with SFFAS 47 (Reporting Entity).

2. Does the Board agree with the proposed definitions of lease and *intragovernmental lease arrangement*?

Recognition & Disclosures

The following **proposed** recognition and disclosures for intragovernmental lease arrangements is based on current operating lease guidance from Financial Accounting Standards Board (FASB) Codification 840-20, International Accounting Standards (IAS) 17 and International Public Sector Accounting Standards Board (IPSASB) 13.

Lessee Accounting – Intragovernmental Lease Arrangements

Recognition

Current operating lease guidance on lessee recognition states:

- Rental lease payments should be recognized as an expense over the lease term as it becomes payable.
- Payments should be recognized on a straight line basis, even if payments are not made on a straight line basis, unless another systematic and rational basis is more representative of the time pattern in which use benefit is derived.
- Executory costs such as insurance, maintenance, and taxes should be excluded from the lease payments. (*Current FASB standards do not require this exclusion for lessee operating leases payments only capital lease payments. However IAS and IPSASB standards do require this exclusion for lessee operating leases as well.*)

Staff proposes that lessees of intragovernmental lease arrangements recognize the following:

- Lessees should recognize lease payments as an expense on a straight-line basis over the lease term, unless another systematic basis is representative of the time pattern of the user's benefit, even if the payments are not on a straight line basis.
- Lessees should recognize related intragovernmental lease arrangements executory costs (e.g., insurance, maintenance, taxes, etc.) separately from lease payments as period expenses.

3. Does the Board agree that lessee intragovernmental lease arrangement payments be recognized as an expense on a straight-line basis over the lease term, unless another systematic basis is representative of the time pattern of the user's benefit, even if the payments are not on a straight line basis? Or should the payments be recognized on a cash basis?

² SFFAS 47 provides that certain entities meeting the inclusion principle will be consolidated. Only transactions among entities to be consolidated are considered intragovernmental and eliminated upon consolidation.

4. Does the Board agree that the related intragovernmental lease arrangement executory costs (e.g., insurance, maintenance, taxes, etc.) should be recognized separately from lease payments as period expenses? Or should those costs be recognized as part of the lease payments?

Disclosures

Current operating lease guidance on lessee disclosures states:

- Lessees shall disclose the following for operating leases having initial or remaining noncancelable lease terms in excess of one year:
 - Future minimum rental payments required as of the date of the latest balance sheet presented, in the aggregate and for each of the five succeeding fiscal years.
 - The total of minimum rentals to be received in the future under noncancelable subleases as of the date of the latest balance sheet presented.
- For all operating leases, rental expense for each period for which a Statement of Net Cost is presented, with separate amounts for minimum rentals, contingent rentals, and sublease rentals. Rental payments under leases with terms of a month or less that were not renewed need not be included.
- A general description of the lessee's leasing arrangements including, but not limited to, the following:
 - The basis on which contingent rental payments are determined.
 - The existence and terms of renewal or purchase options and escalation clauses.
 - Restrictions imposed by lease agreements, such as those concerning dividends, additional debt, and further leasing.

Staff proposes that lessees of intragovernmental lease arrangements disclose the following:

- Lessees should disclose future minimum rental payments required as of the date of the latest balance sheet presented, in the aggregate and for each of the five succeeding fiscal years for intragovernmental lease arrangements over the period of expected or planned occupancy.
- Lessees should disclose rental expense for each period for which a statement of net cost is presented. Rental payments under leases with terms of a month or less that were not renewed need not be included.
- Lessees should disclose a general description of the lessee's leasing arrangements including, but not limited to, the existence and terms of renewal or transfer of ownership agreements and escalation clauses.

5. Does the Board agree that lessees should disclose future minimum rental payments in the aggregate and for each of the five succeeding fiscal years over the period of expected or planned occupancy? Or should the lessee only disclose future minimum rental payments in the aggregate and for each of the five succeeding fiscal years if there is better than a remote chance of continued occupancy?

Lessor Accounting - Intragovernmental Lease Arrangements

Recognition

Current operating lease guidance on lessor recognition states:

- The leased property shall be included with or near property, plant, and equipment in the balance sheet. The property shall be depreciated following the lessor's normal depreciation policy, and in the balance sheet the accumulated depreciation shall be deducted from the investment in the leased property.
- Rent shall be reported as income over the lease term as it becomes receivable according to the provisions of the lease. However, if the rentals vary from a straight-line basis, the income shall be recognized on a straight-line basis unless another systematic and rational basis is more representative of the time pattern in which use benefit from the leased property is diminished, in which case that basis shall be used.
- Initial direct costs shall be deferred and allocated over the lease term in proportion to the recognition of rental income. However, initial direct costs may be charged to expense as incurred if the effect is not materially different from that which would have resulted from the use of the method prescribed in the preceding sentence.

Staff proposes that lessors of intragovernmental lease arrangements recognize the following:

- Lessors should present assets subject to intragovernmental lease arrangements in their balance sheet as "leased assets" according to the asset's balance sheet classification. The depreciation policy for depreciable leased assets should be consistent with the lessor's normal depreciation policy for similar assets.
- Lessors should recognize lease rental income on intragovernmental lease arrangements as income over the lease term as it becomes receivable according to the provisions of the lease.
- Lessors should recognize lease rental income on a straight-line basis, unless another systematic basis is representative of the time pattern of the user's benefit, even if the payments are not on a straight line basis.
- Lessor's initial direct costs [i.e., those incremental direct costs incurred by the lessor in negotiating and consummating leasing transactions (e.g., commissions and legal fees)] should be deferred and allocated over the lease term in proportion to the recognition of rental income. However, initial direct costs may be charged to expense as incurred if the effect is not materially different from the basis used to recognize the rental income.

GSA currently recognizes these initial direct costs as an expense in the period incurred, primarily due to the cost benefit associated with tracking the costs for each lease.

6. Does the Board agree that the lessor recognition of lease rental income should be symmetrical to the lessee recognition of lease rental expense?

7. Does the Board agree that the lessor's initial direct costs [i.e., those incremental direct costs incurred by the lessor in negotiating and consummating leasing transactions (e.g., commissions and legal fees)] should be deferred and allocated over the lease term in proportion to the recognition of rental income? Or should all of the lessor's initial direct cost be expensed in the period incurred regardless of materiality?

Disclosures

Current operating lease guidance on lessor disclosures states:

- The cost and carrying amount, if different, of property on lease or held for leasing by major classes of property according to nature or function, and the amount of accumulated depreciation in total as of the date of the latest balance sheet presented.
- Minimum future rentals on noncancelable leases as of the date of the latest balance sheet presented, in the aggregate and for each of the five succeeding fiscal years.
- Total contingent rentals included in income for each period for which an income statement is presented.
- A general description of the lessor's leasing arrangements.

Staff proposes that lessors of intragovernmental lease arrangements disclose the following:

- Lessors should disclose future minimum 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 intragovernmental lease arrangements over the period of expected or planned occupancy.
- Lessors should disclose a general description of the lessor's leasing arrangements.

8. Does the Board agree that lessors should disclose future minimum lease rental income in the aggregate and for each of the five succeeding fiscal years over the period of expected or planned occupancy? Or should the lessor only disclose future minimum lease rental income in the aggregate and for each of the five succeeding fiscal years if there is better than a remote chance of continued occupancy?

Other Issues to be Addressed in the Intragovernmental Lease Arrangements Standards

At the last task force meeting the members identified the following intragovernmental topics that should be addressed in the standards.

- ✓ Leasehold improvements and GSA Reimbursable Work Authorizations (RWA)
- ✓ Subleases (including, leasing by one federal entity and used/operated by another federal entity)
- ✓ Rent holidays, nominal rent, and other lease considerations
- ✓ Escalation clauses
- ✓ Memorandum of Agreement or Understanding (MOA/MOU) and Interagency Agreements (IAA)
- ✓ Lease terms, cancelable periods, cancellation clauses, and termination clauses
- ✓ Renewal options

Brief History of Board Lease Discussions

- ❖ 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 30th 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.