STAFF ANALYSIS AND RECOMMENDATIONS FOR PROPOSED NON-INTRAGOVERNMENTAL LEASE 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** is defined as a contract or agreement that conveys the right to use a nonfinancial asset[1] (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.
3. 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.
4. 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*.

[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 discussions with our task force we have been informed that several federal entities have SCAs. Staff is concerned that the proposed definition of lease could inadvertently scope in SCAs. Because the current FASAB standards are silent on SCAs it would not be diligent to simply exclude SCAs without providing direction on how

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

to account for SCAs. Therefore, staff would like to further analyze possible options for the accounting of SCAs.]

Q2. Does the Board agree with the proposed Scope of the Lease standard?

DEFINITIONS

5. **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.

6. **Intragovernmental Lease –** A lease occurring within a consolidation entity or between two or more consolidation entities as defined under SFFAS 47, *Reporting Entity.*[2]

7. **Lease Term –** 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, covered by a lessee's option to:

    a. **Extend** the lease if it is probable, based on all relevant factors, that the lessee will exercise that option
    b. **Terminate** the lease if it is probable, based on all relevant factors, that the lessee will not exercise that option.

    Periods for which both the lessee and the lessor have an option to terminate the lease, or for which only the lessor has that option, are cancelable periods and are excluded from the lease term. 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 termination options.

8. **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.

9. **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.

10. **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. *[The Board previously agreed to define short-term as 24 months or less, which is different from the GASB definition as short-term of 12 months or less.]*

Q3. Does the Board agree with the proposed lease definitions?

[2] 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 TERM

11. 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, covered by a lessee's option to:

    a. **Extend** the lease if it is probable, based on all relevant factors, that the lessee will exercise that option

    b. **Terminate** the lease if it is probable, based on all relevant factors, that the lessee will not exercise that option.

    Periods for which both the lessee and the lessor have an option to terminate the lease, or for which only the lessor has that option, are cancelable periods and are excluded from the lease term. 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 termination options.

12. 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 <u>only when it is probable that the clause will be exercised</u>.

[GASB and FASAB's definitions of "probable" are different. GASB's threshold of "probable" is higher than FASAB's "probable" threshold. FASAB's "probable" definition equates to "more likely than not." (>50% probability) GASB's "probable" definition equates to "likely to occur". The FASAB previously agreed to not changing the definition of "probable" to be a higher threshold with respect to when certain lease payments should be included in the measurement of the lease.

Since the previous FASAB decision, the GASB has changed its PV proposal from "probable" to "reasonably certain" with respect to when certain lease payments should be included in the measurement of the lease liability. "Reasonably certain" has an even higher threshold than probable. Since FASAB previously noted that it was comfortable with the differences between our "probable" and GASB's "probable," staff had recommended not accepting GASB's change to "reasonably certain" and staying with the FASAB "probable" definition, because there seemed to be no compelling reason to introduce a new term for the sake of a higher threshold. FASAB did not disagree with staff's recommendation.]

Staff asks the Board to please also consider the appropriateness of "probable" with regard to fiscal funding clauses.]

Q4. Does the Board still agree to use probable instead of GASB's reasonably certain?

13. Month-to-month lease holdovers, or rolling lease extensions, or any lease that continues into a holdover period until a new contract or agreement is signed would 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.

[The standard section of the GASB proposal does not include the above language relating to lease holdovers. However, given the existing issues related to lease holdovers in the federal arena the Board had previously asked staff to include language on lease holdovers in the proposed standards. GASB does include the following language in its BFC.

> *GASB Leases Exposure Draft – par. B19. – "The determination of the likelihood 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), an enforceable contract does not exist beyond that point. For example, a month-to-month or rolling lease, or a lease that continues into a holdover period until a new contract is signed, would not be enforceable because either the lessee or lessor could cancel the lease at any time. When a lease contains a lessor-only option to terminate the lease, the Board believes that the difficulty for a lessee to evaluate the likelihood of that option being exercised outweighs the potential benefits of including the extra periods in the lease term."]*

Q5. Does the Board agree with staff's proposed guidance on lease holdovers?

14. 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 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 lessee's history of exercising renewal or termination options

d. The extent to which the lease is essential to the provision of federal services.

15. 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 probable that the lessee would not 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.

Q6. Does the Board agree with the proposed guidance on the lease term?

RECOGNITION AND MEASUREMENT FOR LESSEES

16. At the beginning of the lease term, a lessee should recognize a lease liability and a right-to-use lease asset (hereinafter referred to as the lease asset), except as provided in paragraph 17 and paragraphs 59-61 (short-term leases).

[GASB specifically identifies the right-to-use lease asset as an intangible asset. In its basis for conclusions, GASB noted the following.

> *GASB Leases Exposure Draft – par. B17. –The Board considered whether amortization should be guided by a government's depreciation policy for owned assets. That alternative was ultimately rejected, however, because the lease asset is an intangible asset that is distinct from the underlying asset being leased, and that lease asset may have a shorter useful life (lease term) than the useful life of the underlying asset.*

SFFAS 6: Accounting for Property, Plant, and Equipment currently classifies capital leases as a PP&E asset. Although the GASB ED proposes that the underlying asset be recognized as an intangible asset, FASAB standards do not specifically require assets to be classified as tangible or intangible and there are currently no FASAB standards on intangibles. Since the proposal includes both PP&E assets and intangible asset as lease assets, staff proposes that the lease asset not be classified as either an intangible or a PP&E asset but as a non-classified asset.]

Q7. Does the Board agree with staff's recommendation to not classify a lease asset as an intangible or a PP&E asset?

LEASES THAT TRANSFER OWNERSHIP

17. 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 paragraph 12), should be reported as a financed purchase of that asset.

LEASE LIABILITY

18. 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 19

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.

19. 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 flows statement in the period in which those payments are incurred. However, any component if these variable payments that is fixed in-substance should be included in the lease liability. An example would be 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.

20. 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. <u>If the rate cannot be readily determined by the lessee, the lessee's incremental borrowing rate[3] (the estimated rate that would be charged for borrowing the lease payment amounts for the lease term) should be used.</u>

[The 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 the current FASAB standards as well. However, the incremental rate for federal borrowers is the Treasury rate – a risk-free rate. The GASB addressed use of the risk free rate in its basis for conclusions:

> *GASB Leases Exposure Draft – par. B33. – The Board also considered but rejected the use of a risk-free rate because leases are not risk free. The Board also considered a discount rate based on a municipal bond index. However, it determined that the rate that the lessor charges the lessee or the lessee's estimated incremental*

[3] SFFAS 5: "The Treasury borrowing rate for securities of similar maturity to the term of the lease."

borrowing rate is more specific to the transaction and the parties to the lease agreement and is a better representation of the actual transaction than a more generic market rate.]

Q8. Does the Board wish to consider options for the discount rate other than the Treasury rate? For example, the incremental rate available to the lessor or a lessor with similar characteristics and if that is also not readily determinable, the rate for AAA-rated bonds of similar maturity.

21. At subsequent financial reporting dates, the lessee should calculate the amortization of the discount on the lease liability and report 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.

22. 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. 15), a modification (see par. 66), or a termination (see par. 67).
    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 rate the lessor charges the lessee, if used as the initial discount rate.

23. If a lease liability is remeasured for any of the changes in paragraph 22, 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.

24. 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. 15), a modification (see par. 66), or a termination (see par. 67).

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.

25. 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.

26. If the discount rate is required to be updated based on the provisions in paragraph 24, 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 estimated incremental borrowing rate should be used.

Q9. Does the Board agree with the proposed lessee measurement, recognition, and remeasurement of the lease liability?

LEASE ASSET

27. 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 paragraph 18)

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.

28. 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 29. The amortization of the lease asset should be reported as amortization expense.

29. 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.

30. The lease asset should be adjusted when the corresponding lease liability is remeasured based on paragraphs 22–26. *However, if the remeasurement of the lease liability would result in an index or rate that is attributable to the current*

period, the change should be reported in the flows statement for the period. If the carrying value of the lease asset has been reduced to zero, any remaining amount should be reported as a gain).

[The GASB Lease PV (11/2014) states that for the changes in measurement due to a change in index or rate, that change is seen as a period cost. That is because the factors that caused the change in that rate are attributable to events in the period of the change.

During deliberations at the June 2015 meeting, the GASB tentatively decided that a lease liability should not be remeasured solely for a change in an index or rate, but that such a change would be factored into the remeasurement if the lease liability already was being remeasured for another trigger. Therefore in July, GASB considered whether the exception to report such a change directly in the flows statement should continue. Accordingly, the portion attributable to the lease term change would adjust the lease asset because it changes the service utility of that asset, and the portion attributable to the index or rate change, if it is attributable to the current period, would go to the flows statement. However, GASB staff believes requiring this separation would result in more burden on governments.

The GASB project staff recommended 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). The GASB project staff believes this is primarily for cost-benefit concerns.

FASAB staff recommends 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 portion attributable to the index or rate change, if it is attributable to the current period) as a period cost that would go to the flows statement.]

Q10. Does the Board agree with staff's recommendation when the lease liability is remeasured due to a change in an index or rate used to determine variable payments to recognize that portion as a period cost as opposed to adjustment of the lease asset?

31. The presence of impairment indicators (described in paragraph 12 of Statement 44) 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.

Q11. Does the Board agree with the proposed lessee measurement, recognition, and remeasurement of the lease asset?

DISCLOSURE REQUIREMENTS FOR LESSEES

32. 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 capital assets

    ~~*c. The amount of lease assets by major classes of underlying assets, to be disclosed separately from other capital assets*~~

    d. The amount of lease expense recognized for the period for variable lease payments not previously included in the lease liability

    ~~*e. The amount of outflows of resources recognized for the period for other payments, such as residual value guarantees or penalties, not previously included in the lease liability*~~

    f. 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

    ~~*g. Commitments under leases that have not yet begun*~~

    ~~*h. The components of any net impairment loss (gross impairment loss less change in lease liability) recognized on the lease asset during the period.*~~

    ~~*i.*~~ *The amount of the annual lease expense and the discount rate used to calculate the lease liability*

[The Board previously agreed to eliminate four – c., e., g., & h. – of the above lessee disclosure requirements. The Board also agreed to add a disclosure requirement to 1.) the total amount of the annual lease expense and 2.) the discount rate used to calculate the lease liability.]

Q12. Does the Board agree with the revised lessee disclosure requirements?

RECOGNITION AND MEASUREMENT FOR LESSORS

33. At the beginning of the lease term, a lessor should recognize a lease receivable and a deferred revenue, except as provided in paragraphs 34–36 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

34. 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 paragraph 12), should be reported as a financed sale of that asset.

LEASES OF ASSETS THAT ARE INVESTMENTS

35. If the underlying asset in a lease meets the definition of an investment, the lessor should account for that asset as an investment and should not apply the recognition and measurement provisions of this Statement. The lessor should disclose the information in subparagraph 48e of this Statement but is not required to make the other disclosures in paragraph 48.

CERTAIN REGULATED LEASES

36. For leases for which external laws, regulations, or legal rulings (a) establish the cost that may be recovered through lease payments and (b) significantly limit the ability of the lessor to set rates in excess of those costs, the lessor should not apply the general recognition and measurement provisions of this Statement. For example, U.S. Department of Transportation regulates aviation leases between airports and airlines. For such leases, the lessor should recognize revenue based on the payment provisions of the contract/agreement and provide the disclosures in paragraph 49.

[For GASB this provision arises because there are higher jurisdictions (state for local and federal for state) which can impose laws, regulations, and legal rulings. However, for the federal government, there may be no external laws, regulations or legal rulings imposed. Staff believes this provision may be confusing to federal entities because they may think any laws are external. Therefore staff questions the need for this provision and would like to seek input from the task force.}

Q13. Does the Board agree with staff's approach to assessing the need for the "Certain Regulated Leases" provisions in the lease standard?

LEASE RECEIVABLE

37. 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 paragraph 38)
    d. Residual value guarantees that are fixed payments in substance (as described in paragraph 38).

38. 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.

39. 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.

40. 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.

41. 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.

42. 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.

43. If a lease receivable is remeasured for either of the changes in paragraph 46, 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.

44. If the discount rate is updated based on the provisions in paragraph 46, the receivable should be discounted using the revised rate.

DEFERRED REVENUE

45. A lessor should measure the deferred revenue at the initial value of the lease receivable, less any provision for uncollectible amounts (see paragraph 37), 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.

46. 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 42-43.

[GASB uses "Deferred Inflow of Resources" instead of "Deferred Revenue"]

UNDERLYING ASSET

47. 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.

Q14. Does the Board agree with the proposed lessor measurement, recognition, and remeasurement of the lease receivable and deferred revenue?

DISCLOSURES FOR LESSORS

48. 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 inflows 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
    e. The existence, terms, and conditions of options by the lessee to terminate the lease if the lessor federal entity has issued debt for which the principal and interest payments are secured by the lease payments.

49. In addition to the disclosures in paragraph 48, if a government's principal ongoing operations consist of leasing assets to other entities, the government 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.

50. A lessor with one or more regulated leases as described in paragraph 36 should disclose the following about those lease activities (which may be grouped for purposes of disclosure), other than short-term leases:

    a. A general description of its agreements
    b. The carrying amount of assets subject to exclusive use by one counterparty under agreements, by major class 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 agreements, if the total is not displayed on the face of the financial statements
    d. A schedule of future minimum payments under the agreement for each of the subsequent five years and in five-year increments thereafter

e. The amount of lease revenue recognized in the reporting period for variable payments not included in the future minimum payments
f. The existence, terms, and conditions of options by the lessee to terminate the lease, if the lessor federal entity has issued debt for which the principal and interest payments are secured by the lease payments.

Q15. Does the Board agree with the proposed lessor disclosure requirements?

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 55b or paragraph 55c.

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. In addition, lessees should account for each underlying asset as a separate lease component if the underlying assets are in different major classes of assets for disclosure purposes under paragraph 32c. The provisions of this paragraph should be applied unless the contract/agreement meets the exception in paragraph 55b or paragraph 55c.

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 not considered significant*:

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.

[The Board had previously agreed that the guidance should specifically state that methods in paragraph 55 should only be used when the amounts are considered significant.]

Q16. Does the Board still agree that the guidance should specifically state that the lease and nonlease components should only be separated using the methods in paragraph 55 when the amounts are considered significant?

56. When multiple components are accounted for as a single unit, as provided for in paragraphs 55b and 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.

Q17. Does the Board agree with the proposed guidance on separately reporting the lease and nonlease components of a lease agreement?

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.

Q18. Does the Board agree with the proposed contract/agreement combinations guidance?

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 11.

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 16–31 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 33–47 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.

Q19. GASB proposes not to straight-line rent holidays. However, the FASAB had previously agreed to recognize rent holidays on a straight-line basis over the lease term. Does the Board still agree with this recognition?

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 paragraphs 22 and 42), 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.

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 is reasonably priced compared 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.

Q.20 Does the Board agree with the proposed guidance on lease terminations and modifications?

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.

Q.21 Does the Board agree with the proposed guidance on subleases?

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 a qualifying sale in order to be eligible for sale-leaseback accounting. A sale-leaseback transaction that does not include a qualifying 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 in financial statements prepared using the economic resources measurement focus 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 (paragraph 32). A buyer-lessor should provide the disclosures required of a lessor (paragraph 48).

Q.22 Does the Board agree with the proposed guidance on sale-leaseback transactions?

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.

Q.23 Does the Board agree with the proposed guidance on lease-leaseback transactions?