



IMPLEMENTATION GUIDANCE FOR LEASES

Federal Financial Accounting Technical Release

Exposure Draft

Written comments are requested by [date 90 days after issuance]

[Month day, year]

Working Draft – Comments Are Not Requested on This Draft

THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

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

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

Additional background information and other items of interest are available at www.fasab.gov:

- [Memorandum of Understanding](#) among the Government Accountability Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board
- [Mission statement](#)
- [Documents for comment](#)
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The Accounting and Auditing Policy Committee

The Accounting and Auditing Policy Committee (AAPC) was organized in May 1997 by the Department of the Treasury, the Office of Management and Budget (OMB), the Government Accountability Office (GAO), the Chief Financial Officers Council (CFOC), and the Council of the Inspectors General on Integrity and Efficiency (CIGIE—formally the President's Council on Integrity and Efficiency) as a body to research accounting and auditing issues requiring guidance.

The AAPC serves as a permanent committee established by the Federal Accounting Standards Advisory Board (FASAB). The mission of the AAPC is to assist the federal government in improving financial reporting through the timely identification, discussion, and recommendation of solutions to accounting and auditing issues as they relate to the specific application of existing authoritative literature.

The AAPC is intended to address issues that arise in implementation that are not specifically or fully discussed in federal accounting standards. The AAPC's guidance is cleared by FASAB before being published.

Additional background information on the AAPC is available from [FASAB's website](#).

November XX, 2020

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

Your comments on the exposure draft of the proposed Federal Financial Accounting Technical Release, *Implementation Guidance for Leases*, and the proposed Statement of Federal Financial Accounting Standards, *Omnibus Amendments on Leases-Related Topics*, are requested.

We recommend providing one set of comments on these two interrelated proposals. You are welcome to comment on any aspect of these proposals. If you do not agree with specific matters or proposals, your responses will be most helpful to the Committee and the Board if you explain the reasons for your positions, the paragraph number(s) and/or topic areas of the proposals that are related to your positions, and any alternatives you propose.

Responses are requested by February XX, 2021.

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

Please provide your comments by email to fasab@fasab.gov. We will confirm receipt of your comments. If you do not get a confirmation, please contact our office at (202) 512-7350 or fasab@fasab.gov to determine if your comments were received.

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

Sincerely,

Monica R. Valentine
AAPC Chair

George A. Scott
FASAB Chair

EXECUTIVE SUMMARY

This Technical Release (TR) would assist reporting entities in implementing Statement of Federal Financial Accounting Standards (SFFAS) 54, *Leases: An Amendment of SFFAS 5, Accounting for Liabilities of the Federal Government, and SFFAS 6, Accounting for Property, Plant, and Equipment*.

Soon after SFFAS 54 was issued in April 2018, the Accounting and Auditing Policy Committee (AAPC)—which operates under the general oversight of the Board—undertook a project to develop this proposed implementation guidance. This proposed guidance

Questions and answers are included in this proposed Technical Release—organized by topic areas—to address issues raised by the Board’s stakeholders through

- technical inquiries posed to the FASAB, the AAPC, and FASAB staff during and prior to the inception of this project;
- comments submitted in response to FASAB due process documents; and
- an AAPC-established task force;

Still others address issues identified by the FASAB and its staff in anticipation of questions that could arise during implementation of SFFAS 54.

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

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QUESTIONS FOR RESPONDENTS

The Accounting and Auditing Policy Committee (AAPC or “the Committee”) encourages you to become familiar with the proposed guidance in the Technical Release (TR) before responding to the questions in this section. In addition to the questions below, the Committee also welcomes your comments on other aspects of the proposed TR. Because the proposed guidance may be further modified before a final TR is issued, it is important that you comment on aspects that you favor as well as any that you do not favor. Comments that include the reasons for your views are especially appreciated. All responses are requested by **[insert date]**.

The Committee believes that this TR would improve federal financial reporting and contribute to meeting the federal financial reporting objectives. In responding, please consider the expected benefits and challenges and communicate any concerns that you may have regarding this proposed implementation guidance.

Because this proposed TR may be modified before it is cleared as a final TR, it is important that you comment on any aspects with which you agree as well as any with which you disagree. To facilitate our analysis of comment letters, it would be helpful if you explain the reasons for your views, including alternatives that you believe the Committee should consider. Please include references to the related paragraph numbers in your responses.

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

Monica R. Valentine, Executive Director
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New Question 

INTRODUCTION

PURPOSE

1. SFFAS 54, *Leases: An Amendment of SFFAS 5, Accounting for Liabilities of the Federal Government, and SFFAS 6, Accounting for Property, Plant, and Equipment*, provides a comprehensive set of lease accounting standards to recognize federal lease activities in the reporting entity's general purpose federal financial reports (GPFFR) and includes appropriate disclosures.
2. Questions and answers in this TR provide guidance for applying the requirements of SFFAS 54.

DRAFT

PROPOSED TECHNICAL GUIDANCE

SCOPE

3. Readers of this Technical Release (TR) should first refer to the hierarchy of accounting standards in 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*. This TR supplements the relevant accounting standards but is not a substitute for and does not take precedence over the standards.

SCOPE AND DEFINITION

4. **A reporting entity obtains the right to use a building, which has a market rent of \$500,000 per year, for a cost of \$100 per year. Should the reporting entity apply the requirements in SFFAS 54 to that transaction?**

Yes, the reporting entity should apply SFFAS 54 requirements to the transaction. The definition of a lease in paragraph 2 of SFFAS 54 specifies that a lease is a contract or agreement whereby one entity (lessor) conveys the right to control the use of property, plant, and equipment (PP&E) (the underlying asset) to another entity (lessee) for a period of time as specified in the contract or agreement in exchange for consideration. In addition, to the extent that the consideration provided is less than full cost in an inter-entity transaction, the receiving entity should determine whether to recognize the difference (\$499,900 per year) in its accounting records as a financing source based on SFFAS 4, *Managerial Cost Accounting Standards and Concepts* paragraphs 8-9 and 108-113A.

5. **A reporting entity enters into a multiyear agreement for the right to use a facility. The government has exclusive use of the facility four months per year. Other parties use the facility on the other eight months. To meet the definition of a lease, is the government required to have uninterrupted control of the right to use the facility?**

No. In determining whether a contract conveys control of the right to use an underlying asset, the reporting entity should assess whether it has both (a) the right to obtain economic benefits or services from use of the underlying asset as specified in the contract or agreement and (b) the right to control access to the economic benefits or services of the underlying asset as specified in the contract or agreement (paragraph 3 of SFFAS 54). If the contract specifies that the government has control of those rights during four months of each year, the control criterion is met. The provision in the lease definition that the contract be for a period of time does not require uninterrupted control of the right to use the facility.

6. **Do easements meet the definition of a lease?**

Some easements meet the definition of a lease, while other easements do not.

Paragraph 2 of SFFAS 54 states that, among other things, a lease is defined as a contract or agreement whereby the “*right to control the use of property, plant, and equipment*”

(underlying asset) is conveyed to another entity for a period of time as specified in the contract or agreement in exchange for consideration.”

Land rights easements meet the PP&E definition criteria (see paragraph 2; and SFFAS 6 paragraph 18 and footnote 18) and, therefore, may meet the definition of a lease.

Permanent easements which last indefinitely without cancellation options would not meet the “period of time” criterion and, therefore, may not meet the definition of a lease.

In addition, easements obtained without consideration do not meet the “in exchange for consideration” criterion.

Paragraph 3 of SFFAS 54 provides other criteria that may be relevant in determining whether an easement meets the definition of a lease. For example, the entity granting the easement may retain certain rights that may limit the rights of the lessee to control economic benefits or services derived from using the use of the underlying asset. The entity granting the easement may also retain the right to control access the economic benefits or services of the underlying asset.

7. **A reporting entity enters into separate and distinct agreements, each with a private party, for the right to use public lands, each for a period of 10 years, in exchange for consideration. Do each of these respective agreements meet the definition of a lease?**

- a. **Agreement #1: An underground pipeline to transmit and distribute electricity for commercial purposes. The agreement does not convey the right to control access to the economic benefits derived from agricultural or other uses of that land derived by other parties.**

Yes. The agreement conveys the right to control the use of the underlying asset as provided for in paragraph 3 of SFFAS 54. The agreement gives the lessee both of the following: (a) the right to obtain economic benefits or services from use of the right-of-way (the underlying asset) as specified in the contract or agreement, and (b) the right to control access to the economic benefits or services derived from the underlying asset as specified in the contract or agreement. Although other economic benefits or services are derived from use of the public land, such rights are not relevant in establishing the right to control the use of this particular underlying asset specified in the agreement: the underground right-of-way for transport and distribution of electricity.

- b. **Agreement #2: Public lands for livestock grazing. These lands must by law be managed for multiple uses, including public access and enjoyment, wildlife habitat conservation, wilderness, watershed protection, and other uses under various federal statutes. The terms and conditions, such as stipulations on forage use and seasons of use, for grazing on the lands are set forth in permits.**

Yes. Although other economic benefits or services may be derived by other parties from use of the public land, such rights are not relevant in establishing the right that

was specified in the contract to control the use of this particular economic benefit (grazing rights) derived from the underlying asset.

8. **A reporting entity enters into a contract with a private party wherein the private party will design and build a solar farm based on the reporting entity's specifications. The solar farm will be located on the reporting entity's property, but per the agreement the private party will not pay for the use of the land. During this time, the title to the solar equipment will be retained by the private party. The contract requires the reporting entity to purchase power generated from the solar farm and make payments at prevailing market rates based solely on the amount of power generated. The private party is not precluded from selling any remaining power generated to other private parties. The contract also requires the private party to dismantle and remove the solar farm at the end of the contract. Does this contract result in a lease?**

No. To meet the definition of a lease, a contract is required to convey control of the right to use the underlying asset. Paragraph 3 of SFFAS 54 provides two criteria that should be present for a contract to convey control. In this example, the reporting entity has the right to obtain economic benefits from the solar farm but does not have the right to control access to the economic benefits derived from the power generated. Therefore, the component of the contract that provides the reporting entity with the right to the power generated by the solar farm does not convey control and does not meet the definition of a lease. Furthermore, the component of the contract that allows the private party to use the reporting entity's property is not a lease because there is no exchange for consideration as required by paragraph 2 of SFFAS 54 to meet the definition of a lease. (See also: Question # regarding equipment placed on reporting entity's property, question # regarding the removal of assets, and question # regarding public-private partnerships.)

9. **Are cell phone tower or antenna placement agreements leases?**

It depends. If the agreements meet the definition of a lease in paragraphs 2-4 of SFFAS 54, including the control criterion, then such agreements are leases. The control criterion generally is met if a cell phone tower or antenna placement agreement conveys control of the right to use the land on which the tower is placed or the connection point to which the antenna is affixed.

10. **A contract allows the vendor to replace the underlying asset with an essentially identical asset. Does that substantive right of substitution affect the evaluation of whether the contract conveys control of the right to use the asset?**

A—No. A lease conveys control of the *right to use* another entity's asset. That right is distinct from the underlying asset. That is, the right-to-use relates to the both the right to obtain and control access to *economic benefits or services from use of* an underlying asset, rather than conveying control of the underlying asset itself. Substitution with an essentially identical asset allows the lessee to maintain control of the economic benefits or services from use of another entity's underlying asset and is consistent with the definition of a lease in paragraphs 2-4 of SFFAS 54.

11. A reporting entity enters into a lease agreement that conveys control of the right to use a parcel of federal land to a company that engages in oil and gas exploration, development, and production. Is this lease excluded from SFFAS 54?

A—In this example, the company has “control of the right to use the parcel of land.” As such, the transaction meets the definition of a lease insofar as it relates to the “right to use the parcel of land.”

If the agreement also conveys the right to explore, develop, and/or produce oil and gas on federal land, those rights would not meet the definition of a lease. Although such agreements may be referred to as “leases” in practice, they do not convey an underlying asset that meets the definition of PP&E (see paragraph 2 of SFFAS 54; and SFFAS 6 paragraph 18 and footnote 18). Therefore, in such a case, the oil and gas exploration and exploitation component of the agreement would not meet the definition of a lease under SFFAS 54, and the reporting entity would account for any non-lease component separately (see also: Contracts or Agreements with Multiple Components section below). SFFAS 38, *Accounting for Federal Oil and Gas Resources*, provides accounting principles to guide preparers of GPFFR in accounting for and reporting federal oil and gas resources under lease, while Technical Bulletin 2011-1, *Accounting for Federal Natural Resources Other than Oil and Gas*, provides guidance for preparers of GPFFR in accounting for and reporting other federal nature resources other than oil and gas under lease.

12. A reporting entity (lessee) enters into a lease agreement with a company which will commence on October 1, 20X5. The underlying asset is under construction and scheduled to be completed on the date of lease commencement. The reporting entity is required to make payments to the lessor on October 1, 20X3 and October 1, 20X4 during the construction period in contemplation of the future receipt of the right-to-use asset. How should the reporting entity (lessee) account for these payments, given that leases of assets under construction are scoped out of SFFAS 54 (paragraph 5.a)?

The reporting entity (lessee) would account for payments during the construction of the underlying asset as advances paid in contemplation of the future receipt of the right-to-use asset. These advances would be accounted for in a manner consistent with SFFAS 1, *Accounting for Selected Assets and Liabilities*, paragraphs 57-61, prior to the lease commencement date. Advances and prepayments paid out are considered assets of the reporting entity. At lease commencement, the asset would be reclassified and included in the lease asset in accordance with SFFAS 54 paragraph 49 (also see question # below).

13. The term “probable” is used throughout this Statement. Is “probable” defined?

“Probable” is defined elsewhere in FASAB literature as that which can reasonably be expected or is believed to be more likely than not (greater than 50% probability); reporting entities should continue to consistently apply the FASAB definition here. In light of the discussion in SFFAS 54 basis for conclusions paragraph A35—although not authoritative in and of itself—this paragraph reflects the basis for the use of the term “probable” and the intended definition to be applied when implementing the Statement.¹

¹See SFFAS 5, *Accounting for Liabilities of the Federal Government*, par. 33.

14. **Paragraphs 37.b and 54.e of SFFAS 54 require disclosures of “annual lease expense.” Since this term is not defined elsewhere, what types of lease expenses are included in these disclosures?**

Disclosures of annual lease expenses by lessees of intragovernmental leases (paragraph 37.b) include amounts incurred during the fiscal year as expenses paid and/or due to the lessor in accordance with paragraphs 27 and 31-36.

Disclosures of annual lease expenses by lessees of right-to-use lease assets (paragraph 54.b) include amounts incurred during the fiscal year for the amortization of the lease assets, as initially capitalized in accordance with paragraph 49, and interest expense.

LEASE TERM

15. **A developer builds and leases a building to a reporting entity (lessee). The reporting entity is required to make payments during the three-year construction period. The reporting entity does not have access to the building until occupancy is established at the end of the construction period. When does the lease term begin?**

The lease term begins when occupancy is established because that is when the reporting entity has the right to control the use of the underlying asset. Paragraph 3 of SFFAS 54 explains that control of the right to use the underlying asset is the right to both (a) obtain the economic benefits or services from its use as specified in the contract or agreement and (b) control access to the economic benefits or services as specified in the contract or agreement. Thus, the lease term commences when the lessee establishes occupancy and attains access to use the building.

16. **A lease contract has a noncancelable period of five years and specifies that at the end of the five years, both the lessor and lessee have the right to cancel the lease or may continue the lease, using the same terms on a month-to-month basis. Is the month-to-month period included in the initial assessment of the lease term?**

It depends. During the month-to-month period, the lessee does not have a noncancelable right to use an underlying asset, and the lessor is not required to continue providing the asset. That is, the month-to-month period is cancelable by either party and, therefore, is considered, along with economic incentives of the lessor and lessee and other relevant factors that may provide significant evidence that it would be misleading to exclude certain cancelable periods, when determining the lease term, as specified in paragraph 19.a of SFFAS 54. There may not be significant evidence at the commencement of the lease term to reach such a conclusion when performing the initial measurement, however.

17. **A lease contract has a noncancelable period of 5 years and specifies that at the end of the five years, both parties have a right to cancel or continue the lease. Periods beyond year 5 were not included in the original lease term by the lessee. At the end of the fifth year on May 31 20X1, the lessee has not returned or vacated the underlying asset. Instead the lessee intends to occupy the premises while a new lease is negotiated with the lessor. One year later on June 1, 20X2, the lessee and lessor**

negotiated final terms of the lease with an effective date June 1, 20X1 ending May 31, 20X7. In this example, at May 31, 20X1 the lessee has no knowledge of the duration of the holdover period. How should the lessee account for these lease changes?

At the end of the original five-year lease, the lessee would remove the right-to-use lease asset and accumulated amortization/depreciation from its books. From June 1, 20X1 through May 31, 20X2 each period would be treated as a short-term lease. Once terms have been finalized on June 1, 20X2, the lessee should not remeasure the lease retroactively, as in substance, the long-term lease was not executed until June 1, 20X2, regardless that the lease documentation reflects an effective date of June 1, 20X1.

On June 1, 20X2 the lessee should record a lease asset at the net present value of payments due after June 1, 20X2 (a five-year lease term) with amortization based on the signature date of the lease, in this particular case, rather than the effective date.

18. How does a bargain renewal option, such as a 20-year lease at a market rate with a lessee option to renew the lease for an additional 5 years at a 30 percent discount, affect the lessee's initial assessment of the lease term?

19. Paragraph 20 of SFFAS 54 requires that, at the commencement of the lease term, a reporting entity assess all factors relevant to the likelihood that the lessee or the lessor will exercise lease extension or termination options identified in paragraphs 15-19. Relevant factors include significant economic incentives and disincentives, such as the cost of exercising the renewal option. In this example, if the reporting entity (lessee) determines that it is probable that the option will be exercised, the lease term would be 25 years. **A lease contract allows either party to unilaterally terminate the lease at any time but also provides for cancellation penalties. The cancellation penalties are so great that there is significant evidence that neither party will terminate the lease. Should the cancelable periods be included in the lease term?**

Yes. Paragraph 19.a of SFFAS 54 states that periods for which *both* the lessee and the lessor have an option to terminate the lease without permission from the other party are typically excluded from the lease term as cancelable periods. However, the presence of cancellation penalties affects that conclusion. In this example, both parties have significant evidence that the lease will not be terminated; therefore, the cancelable periods should be included in the lease term, as it would be misleading to exclude such periods.

20. A lease contract allows only the lessee to unilaterally terminate the lease at any time but also provides for cancellation penalties. The cancellation penalties are so great that that it is probable the lessee will not terminate the lease. Should the cancelable periods be excluded from the lease term by the lessee (reporting entity)?

Paragraph 15.b of SFFAS 54 requires that periods covered by a lessee option to terminate the lease be included in the lease term if it is probable, based on all relevant factors, that the lessee will not exercise the option. In determining whether it is probable that the lessee will not exercise the option to terminate the lease, the lessee should assess all factors relevant to the likelihood that it will not exercise the option. Those factors include significant economic disincentives, such as cancellation penalties, as discussed in paragraph 20 (also see question xx).

21. **When a reporting entity is making assessments to determine the term of a lease and evaluate option periods in accordance with SFFAS 54 paragraph 20, is it reasonable that entity management may consider one of the four examples provided to be a predominant factor that is most relied upon when making probability assessments? For instance, if one factor is particularly indicative that options will be exercised, such as historical information (20.c), would the entity need to consider other elements such as in paragraphs 20.a. or 20.d. that would only further justify deeming an option as probable of being exercised, and only address the other factors if there are known significant disincentives (20.b.) or information that the historical information may not be reliable for a particular lease?**

Yes to both questions. Particularly for reporting entities with large volumes of leasing activity that have reliable evidence (such as historical information) that is strongly predictive as to the probability of exercising options, management may place greater weight on such evidence in assessing elements of paragraph 20. In the example of an entity having historical trend evidence showing it to be very likely that options will (or will not) be exercised, management may make general assumptions when entering into new leases that the likelihood would continue to apply, limiting the need for further assessment of other factors. However, management must be cognizant of and consider known information that make the historical trends less applicable for a particular lease. For instance, management may know that it has definitive plans to cease use of an asset in a particular time frame that makes exercising extension options very unlikely and outweigh historical information that lease options are normally exercised. In such a case management would consider all relevant factors of a particular lease in making the probability assessment.

22. **A lease contract has a 20 year noncancelable period and a 5 year renewal option (exercisable only by the lessee) with below-market rates. How does the lessee determine if the renewal option should be included in the lease term?**

The lessee must assess whether the renewal option is probable of being exercised in accordance with paragraph 15.a of SFFAS 54. In this example, the renewal option offers below-market rates, which would make it more likely of being exercised by the lessee. However, the lessee must assess all relevant factors identified in paragraphs 15-20 of SFFAS 54. Factors may include, but are not limited to, longevity of the operational need for the asset, level of dependency, ease of replacing the asset (e.g., availability of other options), replacement costs, and possible operational disruptions associated such transitioning.

23. **A lease contract has a 20 year noncancelable period and a 5 year renewal option (exercisable only by the lessor) with below-market rates. How does the lessee determine if the renewal option should be included in the lease term?**

The lessee would need to determine if there is significant evidence that the renewal option will be exercised in accordance with paragraph 15.c of SFFAS 54. Determining whether or not significant evidence exists is a matter of professional judgment. In this example, the renewal option offers below-market rates, which may make it less likely to be exercised by the lessor. Without knowing the additional relevant factors of the lessor (e.g., lessor dependency on revenue stream from this asset, ease of replacing tenant, cost of replacing tenant, past experience with lessor for similar types of leases), it may be challenging to gain

the significant evidence needed to include this option in the lease term. However, counterevidence that the lessor will exercise the renewal option can also be considered. For example, perhaps the economic benefits derived from the underlying asset are of limited value to other parties and uniquely suited to the lessee.

- 24. A reporting entity (lessee) enters into a 10-year lease with a 5-year renewal option. At the beginning of the lease term, it is determined that it is not probable that the lessee will exercise this option. Therefore, the lease term is determined to be 10 years. In year 8 of the lease, the lessee decides that they will exercise the renewal option; however, this intent is not communicated to the lessor nor is the renewal option exercised until year 9. At what point should the lease term be reassessed by the lessee and lessor?**

In accordance with paragraph 21.a of SFFAS 54, the lease term should be reassessed when the lessee elects to exercise an option that was previously presumed would not be exercised under the likelihood criteria in paragraphs 15 and 17. In this example, the lessee would reassess the lease term in year 9 when the renewal option election is made. The renewal option election is not made until the lessee communicates its intention to exercise the option. This requirement imposes less of a burden on preparers because there will be little or no judgment involved and no requirement for ongoing reassessments.

SHORT-TERM LEASES

- 25. A reporting entity (lessee) enters into a 24-month noncancelable lease in which the lessee has options to renew for 12 months at a time, up to 3 times. Is this agreement a short-term lease under SFFAS 54?**

It depends. According to paragraph 22 of SFFAS 54, a short-term lease is required to be 24 months or less, including any options to extend if those options are probable to be exercised (paragraphs 14-16, 19-21). If the probability of the lessee exercising first renewal option were assessed as probable, then the lease term would be greater than 24 months and this would not be a short-term lease. However, if it is not probable that the first renewal option will be exercised by the lessee, then the lease term would be 24 months and this would be considered a short-term lease under paragraph 22.

- 26. A reporting entity (lessee) enters into a lease with a lessor for 36 months. The reporting entity can cancel the lease at any time after 6 months. The lessor does not have the option to cancel the lease. Would this be considered a short-term lease?**

It depends. According to paragraph 22 of SFFAS 54, a short-term lease is defined as a lease with a term of 24 months or less. The lease term must be determined in accordance with paragraphs 14-16, 19-21, which includes consideration of the period beyond a lessee's option to terminate the lease.

If the likelihood of the lessee exercising the option to terminate the lease were assessed as probable, then the period following that option would be excluded from the lease term. If the remaining lease term is estimated to be 24 of months or less, this would be considered a short-term lease.

27. **A reporting entity (lessee) signs a contract for a lease beginning January 1, 20X2, and ending December 31, 20X3. During the negotiations of that contract, a second contract with the same lessor for a lease of the same underlying asset was also being negotiated. Near the same time that the first contract was signed, the reporting entity signs the second contract with a term beginning January 1, 20X4, and ending December 31, 20X4. The amount of consideration in each contract is independent of the other contract. Can the reporting entity account for both contracts as short-term leases?**

Although each contract individually would meet the definition of a short-term lease, the reporting entity should consider whether either of the criteria for contract combinations in paragraph 78 are met. If so, these contracts would be considered part of the same lease contract and result in a three-year lease term; it would not be a short-term lease.

28. **A reporting entity enters into a lease with a noncancelable term of 24 months and a 12 month option to extend. At the commencement of the lease term, it is determined that the reporting entity will not exercise the option. However, 6 months into the lease the reporting entity elects to exercise the option. Is this a short-term lease?**

From the commencement of the lease term up until the time that the election is made to exercise the option, this was a short-term lease because the lease term, at that time, was determined to be 24 months or less.

Six months into the lease, when the reporting entity elects to exercise the option, the lease term should be reassessed (paragraph 21 of SFFAS 54). The remaining noncancelable term is 18 months and the exercised option period is 12 months. Therefore, the remaining lease term is 30 months. For reporting periods beginning after the election is made, the lease should no longer be considered a short-term lease.

29. **A reporting entity (lessee) enters into a lease with a 24 month noncancelable term. The lease payment is \$10,000 per month in months 1-12 and \$15,000 per month in months 13-24. Is straight-lining of the related expenses necessary?**

It depends. If the reduced payments in months 1-12 meet the definition of a lease concession to entice the lessee to sign, these should be straight-lined as reductions to lease rental expenses (see paragraphs 10, 23-24). Given the significant increase in rent (50% increase), absent other justifying factors, there appears to be compelling economic evidence that this was a lease concession in months 1-12.

However, for a less significant rent increase between months 12 and 13 (for example, 5%) lessees may recognize the expense in the period of the increase in accordance with SFFAS 54 paragraph 23. Professional judgment may be required in certain instances when it is not clear whether a contract includes rent increases/decreases or lease concessions. In the absence of significant evidence to the contrary, lessees would not treat rent increases/decreases as embedded lease concessions.

CONTRACTS OR AGREEMENTS THAT TRANSFER OWNERSHIP

30. **A vendor installs equipment in a reporting entity's building to increase energy efficiency. The reporting entity will own the equipment at the end of the agreement, and the contract does not contain a termination option. For financial reporting purposes, should this transaction be reported as a lease or a purchase?**

This transaction should be reported as a purchase by the reporting entity. If title to the equipment will transfer to the lessee at the end of the contract, the transaction is not accounted for as a lease for financial reporting purposes. Rather, the transaction is a purchase, as discussed in paragraph 25 of SFFAS 54.

31. **A reporting entity (lessee) leases medical equipment from a manufacturer (lessor) and distributes them to hospitals for use. At the end of the reporting entity's lease term, hospitals are given the option to purchase the medical equipment from the reporting entity. Regardless of whether or not the hospitals purchase the equipment, the reporting entity is required to purchase the equipment from the lessor. The hospital does not have a termination option. Should this arrangement be reported as a lease or a purchase of the medical equipment by the reporting entity?**

This arrangement should be reported as a purchase. Paragraph 25 of SFFAS 54 states that one criterion of a purchase is that the contract transfers ownership of the underlying asset to the lessee by the end of the contract. In this example the lessee is the reporting entity, not the hospitals. The contract transfers ownership of the medical equipment because the purchase by the reporting entity is required. The sale of the equipment to the hospitals is a separate transaction.

INTRAGOVERNMENTAL LEASES

32. **A reporting entity (lessee) leases spaces to another reporting entity (lessor) for \$50,000/year in years 1-5 and \$45,000/year in years 6-10. Should this rent decrease be treated as a lease concession or should it be recognized in the period in which it occurs in a manner consistent with step rent decreases?**

Both the lessee and lessor should treat this as a step rent decrease in accordance with paragraph 31 of SFFAS 54 unless there is significant evidence that the decreased rate meets the definition of a lease concession. Paragraph 10 states that lease concessions are rent discounts made by the lessor to entice the lessee to sign a lease. Lease concessions include rent holidays/free rent periods, reduced rents, or commission credits. Although years 6-10 meet the definition of reduced rent when compared to years 1-5, the reporting entities would also need to have knowledge that the reduction was made by the lessor to induce the lessee to sign in order to treat the rent decrease as a lease concession.

33. **A reporting entity leases space to another reporting entity for \$50,000/year in years 1-5 and \$53,000/year in years 6-10. Should this rent increase be straight-lined over the 10-year lease term?**

No. According to paragraph 31 of SFFAS 54, if the lease provides for rental increases, a lessee should recognize the increases in expense in the periods of the increase (years 6-10). Examples of rent increases, including those that are fixed in nature based on

anticipated increases in costs or appreciation in property values (which appears to be the case in this example), contingent on future events (not applicable in this example), or variable in nature (not applicable in this example) are described in paragraphs 29-30.

Lease concessions, however, should be recognized by the lessees as straight-lined reductions to rental expense in accordance with paragraph 33 (see question XX above). There are no indications of lease concessions in this example. Absent economic / pricing indicators or other significant evidence that there are lease concessions in the contract or agreement, it is appropriate that contracts or agreements similar to this example be treated as rent increases rather than lease concessions.

34. A reporting entity (lessor) pays the moving costs for another reporting entity (lessee) upon commencement of a lease. Are the moving costs considered a lease incentive?

Yes. Paragraph 70 of SFFAS 54 states that lease incentives include lessor payments made to or on behalf of the lessee to entice the lessee to sign a lease. In this example, the moving costs paid by the lessor would be considered a lease incentive and should be accounted for by the lessee and the lessor in a manner consistent with paragraph 32 of SFFAS 54.

DISCLOSURES FOR INTRAGOVERNMENTAL LEASES

35. A reporting entity (lessee) has 120 lease agreements with a federal lessor. The majority of the leases are for office space with a typical term of 10 years. What information is required to be disclosed in the reporting entity's financial reports?

The reporting entity should disclose a general description of significant intragovernmental leasing arrangements and the annual lease expense in total and by major underlying asset category in accordance with paragraph 37 of SFFAS 54. In this example, that would include language in the financial disclosures stating that the reporting entity has 120 leases with a federal lessor and that most are for office space (or buildings) with a typical term of 10 years. The annual lease expense for the year being reported should be disclosed as well.

36. A reporting entity (lessor) has 500 lease agreements with several federal lessees. The majority of the leases are for office space with a typical term of 10 years. The reporting entity (lessor) owns 300 of the assets and leases space from non-federal entities for 200 assets. What information is required to be disclosed in the reporting entity's financial reports?

The reporting entity should disclose a general description of significant leases, including a breakdown of federally-owned assets and non-federal assets in accordance with paragraph 38 of SFFAS 54. In this example, that would include language in the financial disclosures stating that the reporting entity has 300 leases with federal lessees in federally-owned space and 200 leases with federal lessees in non-federally-owned space. In both cases, the majority of leases are for office space with a typical term of 10 years. The reporting entity should also disclose the future lease payments that are to be received to the end of the lease term for each of the five subsequent fiscal years and in five-year increments thereafter.

37. **A reporting entity leases space from a non-federal lessor and then subleases the space to a federal entity. Both leases are for a term of 10 years. How should the reporting entity disclose this arrangement?**

The reporting entity should disclose each agreement separately in accordance with paragraphs 87-88 of SFFAS 54. Therefore, the lessee agreement should be disclosed per the requirements in paragraph 54, and the lessor agreement should be disclosed per the requirements in paragraph 38.

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

LEASE LIABILITY

38. **A reporting entity (lessee) enters into a lease with a non-federal entity that includes an optional extension period of three years, exercisable only by the lessee. The payment amounts for the optional period will be negotiated at the time the option is exercised. The lessee has an ongoing relationship with the lessor, and it is probable that it will exercise its option to extend. Therefore, the optional renewal period is included in the lease term in accordance with paragraph 15.a of SFFAS 54. How should the lessee measure the lease liability if the payment amount for the optional period is not specified in the contract?**

Paragraph 15.a of SFFAS 54 requires that periods covered by a lessee option to extend the lease be included in the lease term if it is probable, based on all relevant factors, that the lessee will exercise that option. Payments for that optional period should be included in the lease liability, even if the amount is estimated. In many cases, a reporting entity will not find a renewal to be probable without having an estimate of the payment amount or range of amounts. In this example, the payments may be estimated based on the lessee and lessor's ongoing relationship and professional judgment, maximizing the use of observable information. For example, if appropriate, the estimate may be based on the last known payment amount.

39. **A lease contract for copy machines requires that a minimum amount be paid for toner and paper regardless of whether these supplies are obtained. Should some portion of the minimum amount to be paid for supplies be included in the measurement of the lease liability?**

As discussed in paragraphs 75 and 76 of SFFAS 54, if the price allocation for the supplies component of the contract does not appear to be unreasonable, regardless of whether supplies are obtained, the reporting entity should account for the supplies component separately from the lease and therefore not include that amount in the measurement of the lease liability. If the price allocated to the supplies component of the contract appears to be unreasonable, professional judgment may be needed to determine whether some or all of the minimum amount is, in substance, a fixed lease payment that should be included in the

amounts allocated to the lease component and included in the lease liability under paragraph 40.c of SFFAS 54.



40. **Lease payments for a five-year lease are indexed to the Consumer Price Index (CPI). The lease payments for the first year are \$5,000 per month, which is the market rate based on the current CPI, and payments for subsequent years will increase or decrease based on the change in the CPI during the preceding year. The CPI at the commencement of the lease is 251. How should the initial lease liability be calculated?**

Paragraph 40.b of SFFAS 54 requires that variable payments that depend on an index or a rate initially be measured using the index or rate as of the commencement of the lease term. If lease payments are indexed to the CPI, the payments to be included in the initial measurement of the lease liability should be based on the CPI at the commencement of the lease. If the CPI is 251 at the commencement of the lease, a reporting entity would assume it will stay at 251 throughout the lease, which would result in consistent lease payments for initial measurement of the lease liability because the subsequent years' payments are based on the change in the CPI. Therefore, the lease liability should be measured at the present value of \$5,000 per month for 60 months. Any variation from \$5,000 paid in future periods will be recognized as expenses or reductions of expenses of those periods. (See Illustration TBD in non-authoritative Appendix TBD.)

41. **A reporting entity (lessee) enters into two leases. The first lease requires monthly lease payments based on a fixed percentage of sales or \$10,000, whichever is more. The second lease includes a choice to pay either (a) a fixed monthly payment of \$30,000 or (b) \$100 per hour of equipment use with a monthly minimum payment of \$10,000. The choice is made by the lessee at the beginning of each month. Which payment amounts from the two leases should be included in the lease liability?**

The minimum payment of \$10,000 per month should be included for both leases. Paragraph 40.c and 41 of SFFAS 54 require that the lease liability include "variable payments that are fixed in substance" and exclude "variable payments based on future performance of the lessee or usage of the underlying asset." For both leases, the minimum amount that is required to be paid (\$10,000 per month) is fixed in substance and therefore should be included in the lease liability.

42. **A reporting entity leases cars for three years and is required to make variable payments based on the number of miles driven. There is no minimum payment requirement stated in the lease agreement. The reporting entity can establish a probable minimum number of miles that will be driven based on historical usage. Paragraph 40.h of SFFAS 54 requires that a lease liability include "any other payments to the lessor that are probable of being required based on an assessment of all relevant factors." Should the lease liability include the probable variable lease payments?**

No. Paragraph 41 of SFFAS 54 requires that variable payments based on future performance of the lessee or usage of the underlying asset not be included in the measurement of the lease liability. Because those payments are covered in paragraph 41, they should not be included in the measurement of the lease liability in accordance with

paragraph 40.h, even if it is probable that they will be required and they are estimable. Rather, those variable payments should be recognized as an expense in the reporting period in which those payments are incurred. (See also Question XX)

43. **Paragraph 40.f of SFFAS 54 states that measurement of the lease liability should include “payments for penalties for terminating the lease, if the lease term reflects the lessee exercising (1) an option to terminate the lease or (2) an availability of funds or cancellation clause.” Does “term” refer to a provision of the contract or does it refer to the lease term as defined in paragraphs 14–21 of SFFAS 54?**

In paragraph 40.f of SFFAS 54, *term* refers to the lease term as defined in paragraphs 14–21 of that Statement. If the lease term was calculated to reflect the lessee terminating the lease, whether through a termination option or an availability of funds or cancellation clause, the measurement of the lease liability should include all penalties that are expected to be incurred.

44. **A reporting entity (lessee) installs physical assets on leased land and is required by the lease contract to remove those assets and restore the land to pre-lease condition at the end of the lease. Should the lessee include projected payments to remove the physical assets in the lease liability or should the lessee report a separate liability?**

It depends. Paragraph 40.h of SFFAS 54 requires that the lease liability include any other payments that are probable of being required based on an assessment of all relevant factors. However, that requirement does not permit the inclusion of payments that are probable of being required from the lessee *to parties other than the lessor* in the lease liability, nor does it include payments that are not in exchange for the right to use the underlying asset. Such liabilities would be reported separately in accordance with other existing Statements, such as: SFFAS 5, *Accounting for Liabilities of the Federal Government*, standards on liability recognition and measurement and SFFAS 6, *Accounting for Property, Plant, and Equipment*, on cleanup costs. If, however, these payments are deemed probable and would be made to the lessor, inclusion of these payments would be appropriate.

Lessees should also disclose any deferred maintenance and repairs associated with underlying PP&E assets if such maintenance and repairs are the responsibility of the lessee, in accordance with SFFAS 42, *Deferred Maintenance and Repairs*, and provided that they are not payable to the lessor and already included in the lease liability under paragraph 40.h.

45. **A reporting entity leases a fleet of vehicles for half of the vehicles’ estimated useful lives. The lease term is 30 months. The lease does not specify the discount rate. Total monthly lease payments over the term of the lease are \$1.1 million, and the fair value of the vehicles at the commencement of the lease is \$2 million. May the fair value of the vehicles be used in determining the implicit discount rate of the lease?**

Yes. Discounting the lease payments at the rate the lessor charges the lessee, explicitly or implicitly, arrives at the fair value of the right to use the vehicles, which is not necessarily equivalent to the fair value of the vehicles. Using the \$2 million fair value of the vehicles at the commencement of the lease to determine the implicit discount rate in a lease may be

appropriate if the reporting entity has determined that, considering the facts and circumstances of the agreement, the fair value of the vehicles approximates the fair value of the lessee's right to use the vehicles at that time. If those values differ because the lease term is less than the entire useful life of the vehicles, the fair value of the right to use the vehicles for the lease term may be estimated using professional judgment, maximizing the use of observable information. In this example, the reporting entity has estimated that the fair value of the right to use the vehicles is \$1 million because the length of the lease term is half of the vehicles' estimated useful lives. The reporting entity assumes the fair value of the *right to use the vehicles* decreases ratably over the lease term because the service capacity of the vehicles remains the same throughout the lease term, even though the fair value of the *vehicles* decreases faster at the beginning of the lease term. Therefore, the interest associated with the lease is \$100,000, and the discount rate is approximately 7.5 percent.

46. **If a lease term falls between two known Treasury bond yield terms, a reporting entity uses interpolation to calculate an equivalent discount rate for the lease term. For example, a lease has a 15 year term, and Treasury yields are known for 10 and 20 year terms, so the entity uses the mid-point between the 10- and 20-year yields as the equivalent rate for the 15 year lease. If a lease term goes beyond the term that Treasury bonds are available (i.e. more than 30 years), the entity uses the Treasury 30-year rate for the discount rate applicable to the lease. Are these methods of determining discount rates reasonable when borrowing rates for the exact term of a lease are unavailable?**

Yes, both of these methodologies for estimating discount rates for using in NPV calculations are reasonable. The use of interpolation is a common mechanism used for computing an estimated interest rate when the term of a borrowing falls between two terms where borrowing rates are known. Entities should use the 30-year Treasury rates to determine the discount rate when the lease term extends beyond 30 years.

47. **A reporting entity (lessee) entered a lease agreement for 10 years with a 5 year renewal option. At lease commencement, the reporting entity determined that it was not probable that the renewal option would be exercised, and the lease term was determined to be 10 years. However, at the end of year 8 the reporting entity elected to exercise the renewal option. Should the lease liability be remeasured at that time?**

Yes. In accordance with paragraph 21.a of SFFAS 54, the lease term should be reassessed when the reporting entity elected to exercise the renewal option. Paragraph 44.a would require the reporting entity to also remeasure the lease liability as a result of the change in the lease term.

48. **Should operating costs, such as utilities and janitorial services, included in a lease agreement, be excluded from the lease liability calculation?**

Yes. Paragraph 73 of SFFAS 54 requires reporting entities with agreements that contain a lease and nonlease component to account for the lease and nonlease components as separate contracts or agreements, unless the contract or agreement meets the exception in paragraph 76.

LEASE ASSET

49. A reporting entity adopts a capitalization threshold and expenses acquisitions, including lease assets that fall below that threshold. Can the reporting entity apply the same capitalization threshold used for PP&E?

Lease assets and liabilities that are significant, either individually or in the aggregate, should be recognized. Authoritative pronouncements do not provide specific guidance related to a determination of capitalization threshold amounts. However, reporting entities often establish capitalization thresholds. When applying a capitalization threshold to leases, lessees should consider the quantitative and qualitative significance of the lease assets, *in addition to* the quantitative and qualitative significance of the corresponding lease liabilities, both individually and in the aggregate. Capitalization thresholds should be established in a manner consistent with the fundamentals described in SFFAC 1 para. 164.a-164.g.

50. A reporting entity makes payments related to a building lease during a construction period before gaining access to the building. Can payments made during the construction period be reported as a lease asset at the time they are paid?

No. Payments made before commencement of the lease term should be reported as prepayments (assets), not as a lease asset. At the commencement of the lease term, establishes occupancy and attains access to use the building. The right to use makes the underlying asset a resource to the lessee and provides the lessee with access to the underlying asset's present service capacity. Therefore, at the commencement of the lease term, the prepayments should be reclassified as part of the initial measurement of the lease asset, as provided in paragraph 49.b of SFFAS 54. (See also question XX.)

51. Can composite or group methods be used to amortize lease assets?

Yes. If a reporting entity has many similar leases, it may choose to amortize the lease assets as a group rather than individually. Similarly, if a collection of dissimilar leases comprises, for example, a network subsystem, composite amortization may be applied to the lease assets of the subsystem. However, assets should not be grouped in a way that would prevent the reporting entity from meeting the disclosure requirements of paragraph 54 of SFFAS 54.

52. A reporting entity leases land and amortizes the lease asset because it is not probable that it will purchase the land. If the reporting entity subsequently determines that it is probable that it will purchase the land, should the lease asset be remeasured to the amount of the initial measurement before the lease asset was amortized (as though it had been a nondepreciable PP&E asset)?

No. If a lease contract includes a purchase option and the lessee determines that it is probable of being exercised, paragraph 51 of SFFAS 54 requires that the lease asset be amortized over the useful life of the underlying asset, unless the underlying asset is nondepreciable. If the reporting entity does not deem it probable at the commencement of the lease that it will purchase the land but later determines it is probable, the reporting entity should cease amortizing the lease asset as of the date that the reporting entity determines that it is probable that it will purchase the underlying asset. (The reporting entity should not reclassify the lease asset as land until the purchase occurs.) However, the lessee should determine whether exercising the purchase option is expected to significantly affect the

amount of the lease liability. A lease asset generally should be adjusted by the same amount as the corresponding lease liability when that liability is remeasured based on paragraphs 44-48 of SFFAS 54. Paragraph 44.c of that Statement requires the lessee to remeasure the lease liability when 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.

53. **A reporting entity leases equipment and amortizes the lease asset because it is not probable that it will purchase the equipment. If the reporting entity subsequently determines that it is probable that it will purchase the equipment, should the lease asset be remeasured to the amount of the initial measurement before the lease asset was amortized?**

No. The reporting entity should continue to amortize its lease asset—in this case, equipment—once it is determined to be probable that it will purchase a depreciable underlying asset. However, the reporting entity should amortize the lease asset over the remaining useful life of the underlying asset, if different from the lease term. Additionally, the asset value that is amortized may change if the lease liability is adjusted for the change in likelihood of the purchase option being exercised, as described in the answer to question XX.

54. **At the end of year 9 of a 10-year lease, a flood damages a leased building. Before the flood, the lessee reported a lease asset, net of amortization, of \$275,000, and a lease liability of \$300,000. Because of the damage, the lessor reduces the lessee's remaining payments by \$20,000 (NPV), and the lessee determines that the remaining service utility of the lease asset is only \$100,000. How should the lessee report the impairment?**

Paragraph 53 of SFFAS 54 states that the lease asset should be reduced first for any change in the corresponding lease liability, with any remaining amount of the decrease in the lease asset's service utility being recognized as an impairment. Accordingly, the lessee should reduce the lease liability and lease asset by \$20,000 for the reduction of remaining payments due to the lessor. The lessee also should reduce the lease asset by an additional \$155,000 and record an impairment of \$155,000 to reflect the remaining decrease in service utility of the lease asset. However, if the change in the lease liability had been sufficient to reduce the carrying value of the lease asset to zero, any remaining reduction of the lease liability should be reported as a gain as discussed in paragraph 52 of SFFAS 54.

55. **At the end of year 4 of a 5-year lease, a pipe bursts and damages a leased building. Before the flood, the lessee reported a lease asset, net of amortization, of \$50,000, and a lease liability of \$60,000. Because of the damage, the lessor reduces the lessee's payments for 2 months by \$3,000 per month. The damage is repaired, and the lessee is able to continue using the building for the remainder of the lease term. Would the lessee report this as impairment?**

No. Paragraph 19 of SFFAS 44 describes impairment as (1) a significant decline in service utility and (2) expected to be permanent. In this case, the loss in service utility was not permanent. Moreover, the PP&E subject to impairment is on the books of the lessor in accordance with paragraph 66 of SFFAS 54; not the lessee. Therefore, this is not

impairment for the lessee. However, since future lease payments will be reduced, the lessee should remeasure the lease liability in accordance with paragraph 44.d of SFFAS 54 and subsequently adjust the lease asset as required by paragraph 52 of SFFAS 54.

COMPONENT REPORTING ENTITY DISCLOSURE REQUIREMENTS FOR LESSEES

56. Are SFFAS 6 paragraph 45 disclosure requirements applicable to lease assets?

No. Lease assets are not PP&E for lessees; lease assets are an intangible right to use and access economic benefits derived from underlying PP&E assets. Lessees should provide disclosures on lease assets required by paragraph 54 of SFFAS 54; they should not apply PP&E disclosure requirements to their lease assets. Accounting and reporting requirements for PP&E rests with lessors (see paragraph 66 of SFFAS 54 and question XX).

57. Does a lessee's ability to group lease activities for the purpose of disclosure also apply to disclosures in other paragraphs, such as disclosures of sublease transactions required by paragraph 88 of SFFAS 54?

Yes. The grouping provisions in paragraph 54 of SFFAS 54 apply to disclosures in which a grouping option is not specifically addressed in other disclosure requirements.

58. A reporting entity makes lease payments based solely on the use of leased equipment. Future payments are variable based on usage of the underlying asset; therefore, the reporting entity does not record a lease asset or a lease liability. Is the reporting entity required to disclose the lease?

Yes. The lessee should apply the disclosure requirements of SFFAS 54 paragraph 54 to leases other than short-term leases, contracts or agreements that transfer ownership, and intragovernmental leases.

59. A reporting entity purchases an underlying asset from the lessor and, as a result, terminates a lease. The reporting entity reclassifies the right-to-use lease asset to the appropriate asset class. How should this reclassification be disclosed in the notes to the financial statements?

Paragraph 54.b of SFFAS 54 requires that lease assets, and the related accumulated amortization, be disclosed separately from other PP&E assets. Upon termination of the lease and purchase of the underlying asset, this disclosure will inherently reflect the reclassification (removal of) the lease asset in the ending balances of the related totals. The disclosure need not specifically identify amounts classified. The reclassification would also be reflected elsewhere in the notes to the financial statements to the extent that other disclosure requirements, such as SFFAS 6 paragraph 45, apply to the asset class.

60. A reporting entity makes a residual value guarantee payment during the reporting period. Should this payment be included with other payments not previously included in the measurement of the lease liability?



Yes. Paragraph 54.a.ii requires lessees to disclose the existence, terms, and conditions of residual value guarantees provided by the lessee and whether or not these are included in the measurement of the lease liability.

In addition, paragraph 54.c requires lessees to disclose the amount of lease expense recognized for the reporting period for variable lease payments not previously included in the lease liability. If such payments were included in the lease liability in the previous reporting period because they were deemed probable at initial measurement or during an earlier remeasurement, the disclosure requirement in paragraph 54.c would not apply, but the disclosure requirements of 54.a.ii would.

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

61. Paragraph 55 of SFFAS 54 requires that initial direct lease costs incurred by the lessor be reported as an expense of the period. What are initial direct lease costs?

Initial direct lease costs that are required to be reported as an expense by the lessor are (a) costs to originate a lease incurred in transactions with independent third parties that (1) result directly from and are essential to acquiring that lease and (2) would not have been incurred had that leasing transaction not occurred and (b) certain costs directly related to specified activities performed by the lessor for that lease. Those activities include evaluating the prospective lessee's financial condition; evaluating and recording guarantees, collateral, and other security arrangements; negotiating lease terms; preparing and processing lease documents; and closing the transaction. (see question XX.)

LEASE RECEIVABLE

62. A reporting entity leases retail space to a vendor for three years. The payment in the first year is \$100,000; this amount is also considered the "minimum annual guarantee." The payment in the second year depends on sales in the first year. If the first year's sales exceed \$1,000,000, the minimum annual guarantee for the second year is \$110,000, but if the first year's sales are less than \$1,000,000, the minimum annual guarantee for the second year is \$100,000. The minimum annual guarantee for the third year is \$90,000 regardless of sales. What amounts should be included in the lessor's lease receivable at the commencement of the lease?

The individual payments (undiscounted) to be included in the present value calculation of the lease receivable total \$290,000 (first year—\$100,000, second year—\$100,000, and third year—\$90,000). The lease receivable should include only the variable payments that are fixed in substance and not dependent upon the future performance of the lessee, as described in paragraph 57 of SFFAS 54. In this example, the payments that will be made if the lessee has \$0 in sales each year should be included in the lease receivable at the commencement of the lease because that is the amount that is fixed in-substance.

63. **In addition to fixed payments, a lease contract includes provisions for variable payments based on future performance and for a residual value guarantee that did not initially meet the criteria for inclusion in the lease receivable. If those variable payments and the residual value guarantee subsequently meet the criteria for recognition, should the amounts be added to the existing lease receivable or be considered separate receivables?**

When the variable payments and residual value guarantee meet the criteria for recognition, the amounts should be considered separate receivables, and revenue should be recognized in the period to which those payments relate. Paragraphs 57 and 58 of SFFAS 54 state that variable payments based on future performance and residual value guarantees that are not fixed in substance should not be included in the initial measurement of the lease receivable. Remeasurement of the lease receivable, as discussed in paragraph 61, is not required when those payments meet the criteria for recognition.

64. **Can methodologies other than the interest method, such as straight-line amortization, be used to amortize the discount on lease receivables?**

No. Lease receivables should be amortized using the interest method. Paragraph 59 of SFFAS 54 states that lessors are not required to apply imputed interest, but may do so as a means of determining the interest rate implicit in the lease; however, that option applies to the imputation of the interest rate, not to the method of amortizing the discount. Appendix B of provides an illustration.

65. **If the discount rate is updated based on the provisions in paragraph 63 of SFFAS 54, should the lease receivable be remeasured using the revised discount rate?**

Yes, if the criteria to update the discount rate are met in paragraph 63 of SFFAS 54, the lessor should remeasure the lease receivable using the revised discount rate.

DEFERRED REVENUE

66. **Paragraph 50 of SFFAS 54 requires lessees to amortize their lease asset over the shorter of the lease term or the useful life of the underlying asset. Can the lessor recognize the deferred revenue over the useful life of the underlying asset if it differs from the lease term?**

No. The requirements for leases are based on the foundational principle that leases are financings. In a lease transaction, the lessee agrees to make payments over time for the right to use an underlying asset. Accordingly, the lessor should recognize revenue, including interest revenue, over that period of time—the lease term, which may be different than the useful life of the underlying asset.

67. **Halfway through a 10-year lease, a lessor remeasures the lease receivable from \$500,000 to \$10,000, due to a reduction in the lease term. The related deferred revenue balance at that date is \$480,000. How does the remeasurement of the lease receivable affect the measurement of the remaining deferred revenue?**

The lessor should reduce the lease receivable by \$490,000 and the deferred revenue by \$480,000 and recognize a loss of \$10,000. According to paragraph 65 of SFFAS 54, the deferred revenue generally should be adjusted by the same amount as the corresponding lease receivable when the receivable is remeasured. However, if that change reduces the carrying value of the deferred revenue to zero, any remaining amount should be reported as a loss.

UNDERLYING ASSET

- 68. A reporting entity leases a building to a non-federal lessee. The lease includes an option for the lessee to purchase the building for a set price that reflects the estimated fair market value of the building at the end of the lease term. Should the reporting entity derecognize the building if it determines it is reasonably certain that the lessee will exercise the purchase option?**

No. The reporting entity should continue to report the building as a capital asset until the purchase option is exercised. Paragraph 66 of SFFAS 54 states that “a lessor should not derecognize the asset underlying the lease.” Paragraph 58 of SFFAS 54 states that amounts to be received for the exercise price of a purchase option should be recognized as a receivable and revenue when that option is exercised.

- 69. How should the lessor assess impairment of an underlying asset when the rights to that asset are controlled by the lessee and the lessor does not have physical access to the underlying asset?**

Absent any indication of impairment from the lessee, or other impairment information known to the lessor, the lessor should not recognize any impairment of the underlying asset, in accordance with the provisions of SFFAS 44. Paragraph 13 of SFFAS 44 states that annual or periodic surveys to identify potential impairments are not required. Rather, significant events or changes in circumstances affecting the PP&E that may indicate impairment are conspicuous or known to the entity’s management or oversight entities and are generally expected to have prompted consideration by management, oversight entities, or others. However, existing asset management processes and lease agreements may include such surveys by the lessor. If potential impairments are identified by the lessor, they may test for impairment in accordance with SFFAS 44.

COMPONENT REPORTING ENTITY DISCLOSURES FOR LESSORS

- 70. Does a lessor’s ability to group lease activities for the purpose of disclosure also apply to disclosures in other paragraphs, such as disclosures of sublease transactions required by paragraph 88 of SFFAS 54?**

Yes. The grouping provisions in paragraph 67 of SFFAS 54 apply to disclosures in which a grouping option is not specifically addressed in other disclosure requirements.

LEASE INCENTIVES AND LEASE CONCESSIONS

71. **Lease incentive payments provided by a lessor before the commencement of a lease term are included in the initial measurement of the lease asset. How are such payments reported by the lessee until the lease asset is recognized at the time the lease term commences?**

Lease incentives received by a lessee before the commencement of the lease term would reduce any lease advances and prepayments made by the lessee and be reclassified to the lease asset at the commencement of the lease. If there are no lease advances and prepayments, the advance incentives would result in a liability until the commencement of the lease term. At that time, the lease incentives should reduce the lease asset.

72. **A reporting entity (lessor) makes incentive payments to a lessee for moving costs. The payments are made prior to the commencement of the lease term. How are such payments reported by the reporting entity (lessor)?**

The reporting entity (lessor) should recognize an asset at the time the payments are made. Paragraph 64.b of SFFAS 54 provides that lease incentives paid at or before the commencement of the lease term should reduce the lessor's initial measurement of the deferred revenue. In this case, at the commencement of the lease, the asset should reduce the deferred revenue.

CONTRACTS OR AGREEMENTS WITH MULTIPLE COMPONENTS

73. **A reporting entity (lessee) leases equipment that will be installed by the lessor for an additional \$10,000. The lease contract requires that the reporting entity pay the lessor for installation of the equipment in the subsequent reporting period. Should the reporting entity (lessee) record the installation costs as part of the lease liability or as a separate liability?**

Initial direct costs are not included in the measurement of the lease liability. Installation costs generally are considered a nonlease component. Because the payments (totaling \$10,000) are for installation costs and not for the right to use the equipment, the payments are not considered lease payments under paragraph 40 of SFFAS 54 and should be accounted for as a separate liability. If the installation costs are ancillary charges necessary to place the lease asset into service, they should be included in the initial measurement of the lease asset in accordance with paragraph 49.c of SFFAS 54. (See Illustration XX in nonauthoritative Appendix B.)

74. **A reporting entity (lessee) leases two floors of an eight-floor building. A part of the lease payments covers the reporting entity's share of utilities and janitorial costs for maintaining a lobby that all tenants share. Should the utilities and janitorial costs for the lobby be included in the reporting entity's lease liability?**

Based on paragraph 73 of SFFAS 54, if it is practicable for the reporting entity to separate and estimate the costs for those services, the costs should not be included in the reporting entity's lease liability. For example, if the lease contract itself does not specify the amount (in dollars or percentage), the reporting entity could request that information from the lessor. Additionally, local real estate professionals may have statistics such as average charges per

square footage. However, if it is not practicable for the reporting entity to separate the costs and estimate them, based on the provisions in paragraph 76 of SFFAS 54, the janitorial services and utility costs for the lobby should be included in the reporting entity's lease liability.

75. **A contract conveys the right to use a building for 30 years and the attached parking garage for 15 years. There is no stated interest rate included in the lease agreement. Should the discount rate be separately assessed for each component?**

Yes. Paragraph 74 of SFFAS 54 requires that lease contracts involving multiple underlying assets be accounted for as separate lease components if the underlying assets have different lease terms. The reporting of two components instead of one may affect the discount rate implicit in the agreement. In addition, the lessee's estimated incremental borrowing rate (paragraph 42 of SFFAS 54) may differ between the two components because of differences in lease terms.

76. **If a lease contract with multiple components meets the exception in paragraph 76 of SFFAS 54 to be accounted for as a single lease unit, paragraph 77 of that Statement requires that "the accounting for that unit should be based on the primary lease component within that unit." What factors may be useful in determining the primary lease component?**

The determination of which component is the primary lease component in a contract with multiple components requires professional judgment, maximizing the use of observable information. The following characteristics, among others, may be indicative of a primary component:

- a. The component performs a function that is the reporting entity's primary objective in entering into the contract.
- b. The component's fair value is substantial relative to the fair values of the other components.
- c. The lease term of the component is longer than the lease terms of the other components.
- d. The component's benefit to the reporting entity is substantial relative to the benefits of the other components.

77. **A reporting entity (lessee) leases office space, lab space, and a parking garage as part of one lease agreement. The prices for the individual components are not broken out in the lease and are not easily determinable by the lessee. Instead, the total price per square foot is included in the lease agreement. How should a reporting entity account for those lease components?**

In this case, the contract with multiple components would meet the exception in paragraph 76 of SFFAS 54. If it is not practicable to determine a best estimate for price allocation for some or all components in a contract or agreement, a federal entity should account for those components as a single lease unit and the requirements of paragraph 77 of SFFAS 54 should be followed.

- 78. A reporting entity (lessee) leases office space and has a flat-rate monthly fee included in the contract for print services. In this agreement, the lessor provides the printer/copier equipment, and the lessee pays a set monthly fee to use the equipment as part of the lease agreement. The payment amount does not change based on usage of the equipment, but rather it is fixed in nature. How should a reporting entity account for those lease components?**

The lessee should account for each underlying asset as a separate lease component in accordance with paragraphs 74 and 75 of SFFAS 54. Lessees should first use any prices for individual components that are included in the contract or agreement, as long as the price allocation does not appear to be unreasonable based on the terms of the contract or agreement and professional judgment, maximizing the use of observable information.

CONTRACT OR AGREEMENT COMBINATIONS

- 79. A reporting entity solicits bids for a fleet of vehicles and leases the assets from the lowest qualified bidder. A separate lease agreement is used for each vehicle. The leases are entered into over the course of several months as the reporting entity reviews the specifications of each agreement. The lease contracts do not provide information about the reporting entity's objective(s). Can the reporting entity's procurement processes be used to determine whether there is a single objective?**

Yes. Paragraph 78 of SFFAS 54 requires that contracts that are entered into at or near the same time with the same counterparty be considered part of the same contract if negotiated as a package with a single objective. In this situation, in the absence of explicit information in the contracts about the reporting entity's objective(s), the reporting entity's procurement processes provide sufficient information to determine the reporting entity's objective(s) for entering into the lease agreements.

- 80. A reporting entity enters into a master vendor agreement that specifies models, prices, and contract terms for computers. Services and departments within the reporting entity subsequently contact the vendor for individual contracts to lease the computers as needed. Should all the computers leased under a master vendor agreement be considered one contract for the purpose of applying the requirements in paragraph 78 of SFFAS 54?**

The use of a master vendor agreement does not require that the underlying individual contracts (which are all with the same counterparty) be accounted for as part of the same contract unless the contracts are entered into at or near the same time and at least one of the criteria in paragraphs 78 of SFFAS 54 is met.

LEASE TERMINATIONS AND MODIFICATIONS

- 81. While a lease contract is in effect, the provisions of the contract are amended to change the number of vehicles included in the contract. Are additions and subtractions of underlying assets in a lease accounted for as a lease modification or a lease termination?**

A lease amendment that adds an underlying asset to the contract is a lease modification (for example, increasing the lease from three vehicles to four). A lease modification should be accounted for as either a separate lease (if it meets the criteria in paragraph 84 of SFFAS 54) or a remeasurement of the existing lease. Alternatively, a lease amendment that removes an underlying asset from the contract (for example, decreasing the lease from three vehicles to two) should be accounted for as a partial lease termination.

82. **A 10-year lease contract includes an option to extend the lease for 5 years if both the lessor and lessee agree. The lease term was originally assessed as 10 years. Because both parties have to agree to extend, paragraph 19.a of SFFAS 54 refers to this as a cancellable period and, therefore, it has been excluded from the lease term. If, during the lease term, the lessor and the lessee agree to extend the contract for five years, should this be accounted for as a lease modification or as a new lease?**

Because both parties have to agree to the optional five-year period, it is considered cancellable and, therefore, not subject to the lease term reassessment guidance in paragraph 21 of SFFAS 54. However, once the lessor and the lessee agree to exercise the option to extend, the five-year period becomes noncancellable and should be accounted for as a lease modification. Paragraph 80 of SFFAS 54 states that lengthening a lease term while the contract is in effect is an amendment that should be considered a lease modification, unless it is due to a reassessment of the lease term under paragraph 21.

83. **Do paragraphs 80-86 of SFFAS 54 apply to short-term and intragovernmental leases?**

No, paragraphs 80-86 of SFFAS 54 do not apply to short-term and intragovernmental leases. These paragraphs describe when and how to remeasure a lease liability and receivable, which would only apply to leases other than short-term leases and intragovernmental leases.

84. **Two years into a 10-year lease, the lease term is reduced to 5 years. At the time of the amendment, the carrying value of the lease liability is \$80,000, and the carrying value of the lease asset is \$76,000. How should the lessee account for the partial termination of the lease?**

According to paragraph 82 of SFFAS 54, the lessee should account for the partial termination by reducing the carrying values of the lease liability and the lease asset and recognizing a gain or loss for the difference, if applicable. For example, if, in accordance with paragraph 44 of SFFAS 54, the lessee determines that the remeasured liability is \$50,000, the lease liability and the lease asset each should be reduced by \$30,000. Since both the liability and asset can be reduced by the same amount in this example, there would be no gain or loss to record.

85. **Two years into a 10-year lease, the remaining lease agreement is cancelled. The carrying value of the lease receivable is \$80,000, and the related deferred revenue is \$76,000. How should the lessor account for the full termination of the lease?**

According to paragraph 83 of SFFAS 54, once the lease is terminated, the carrying value of the lease receivable and the related deferred revenue should be eliminated. A loss of \$4,000 (the difference) would also be recognized.

86. **Three years into a 4-year lease, a reporting entity (lessee) modifies its lease from 200 vehicles to 230 vehicles, changing the remaining lease liability from \$200,000 to \$202,500. The reporting entity has determined that the increase in the lease payments appears to be unreasonable because it is very low when compared to the value of the additional underlying assets. How should the reporting entity account for the amendment to the lease?**

Because the reporting entity has determined that the increase in the lease payments appears to be unreasonable, the reporting entity should account for this as a lease modification, but not as a separate lease because the condition in paragraph 84.b of SFFAS 54 is not present. Paragraph 85 of SFFAS 54 states that unless a modification is reported as a separate lease as provided by paragraph 84, 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. Thus, the lease asset should be increased by \$2,500, which represents the difference between the remeasured liability and the liability immediately before the lease modification.

87. **A reporting entity (lessor) leases one floor of an office building to a private party for several years. In the middle of the lease, a significant downturn in the local real estate market occurs. The reporting entity and the lessee renegotiate the rental payments for the remainder of the lease. The lease receivable before the amendment was \$500,000 and after it was \$270,000. How should the reporting entity account for the lease modification?**

Paragraph 86 of SFFAS 54 states that unless a modification is reported as a separate lease as provided in paragraph 84, a lessor should account for a lease modification by remeasuring the lease receivable. Thus, the lease receivable should decrease by \$230,000, which represents the difference between the receivable before the lease modification and the remeasured receivable. Additionally, the deferred revenue should decrease by \$230,000. However, to the extent that the change in the lease receivable relates to payments for the current period, the change should be recognized as a decrease in revenue.

SUBLEASES

88. **Paragraphs 87-88 of SFFAS 54 require subleases to be accounted for as separate transactions and disclosed separately. Do these requirements apply to short-term and intragovernmental leases?**

Yes, the requirements in paragraphs 87-88 of SFFAS 54 apply to all leases.

89. **An officer of a reporting entity ABC signs a residential lease agreement on behalf of the U.S. government with a lease term of 10 years for the right to use a residential property on international soil. The occupancy assignments and transfers of the lease amongst various reporting entities within the U.S. government (including reporting entities other than ABC) and their related personnel is managed by the GSO and an inter-agency housing board. Residency assignments are based on tours of duty and**

oftentimes two years or less, but may extend beyond two years. Rental payments are made directly to the lessor by the occupying agency. How should such a lease be reported?

The requirements of paragraphs 87-88 would apply during reporting periods in which the original lessee becomes a sublessor, accounting for the original lease and sublease as two separate transactions. The original lease would meet the definition of a right to use lease asset on the books of the original lessee, whereas the sublease would meet the definition of an intragovernmental lease between the original lessee / sublessor and the sublessee.

SALE-LEASEBACK TRANSACTIONS

90. **The difference between the carrying value of PP&E that was sold and the net proceeds of the sale in a sale-leaseback transaction is reported as a deferred revenue or a deferred expense and subsequently recognized in the statement of net cost. Should the amount of revenue or expense recognized in subsequent years be considered part of the sale transaction or the lease transaction?**

The recognition of the deferred revenue or deferred expense should be considered a component of the sale transaction because this amount represents the overall gain or loss on the sale of the PP&E.

91. **A reporting entity sells a building to a third party and leases a different but equivalent building from the same party. As part of the consideration for the building sale, the reporting entity receives rent concessions for the leased building. Is this a sale-leaseback transaction?**

No. A sale-leaseback transaction involves the sale and leaseback of the same underlying asset. Because the sale and the lease relate to two different underlying assets, the sale and the lease should be recorded as two separate transactions. The rent concessions should be recorded as part of the consideration for the sale rather than as a lease incentive and, therefore, should not affect the initial recording of the lease.

92. **Do the disclosures for sale-leaseback transactions apply to short-term and intragovernmental leases?**

Yes, the requirements of paragraphs 89-92 of SFFAS 54 apply to all leases.

LEASE-LEASEBACK TRANSACTIONS

93. **A reporting entity leases an office building to a non-federal party and determines that, as a lessor, its initial lease receivable and related deferred revenue are \$3,000,000. The reporting entity leases back one floor of the building to house its finance department and determines that, as a lessee, its initial lease liability and related lease asset are \$700,000. How should the lease-leaseback transaction be reported?**

Paragraph 93 of SFFAS 54 requires that lease-leasebacks be reported as net transactions. In a lease-leaseback transaction, each party is both a lessor and a lessee. Because each

portion of the transaction is with the same counterparty, a right of offset exists. The lease liability and the lease receivable should be offset and reported as either a net lease liability or a net lease receivable. Similarly, the lease asset and the deferred revenue should be offset. In this example, the reporting entity should report a lease receivable (net of the leaseback) and a deferred revenue (net of the leaseback) of \$2,300,000.

94. In the previous example, what information should be disclosed on the reporting entity's financial statements?

The reporting entity should disclose the amounts of the lease and leaseback separately. In this example, the reporting entity would include the \$3,000,000 in lease receivable and deferred revenue and \$700,000 in lease liability and lease asset in its lease-leaseback disclosures in accordance with paragraph 93.

95. A reporting entity leases land to a contractor on which the contractor will build a new building and lease both the land and the building back to the reporting entity. The reporting entity makes advance lease payments to the contractor during construction. How should the reporting entity report the lease during the construction period?

Prior to the new building being made available to the reporting entity, the lease of the land to the contractor should be reported as a stand-alone lease. Any lease payments made to the contractor prior to the new building being made available should be reported as an advance or prepayment. Once the new building is made available to the reporting entity, the lease and the prepayment should be accounted for as a lease-leaseback transaction. (See also Questions XX and XX.)

96. Do the disclosures for lease-leaseback transactions apply to short-term and intragovernmental leases?

Yes, the requirements of paragraph 93 of SFFAS 54 apply to all leases.

IMPLEMENTATION

97. For leases that were reported as operating leases prior to the implementation of SFFAS 54, should a reporting entity determine what the lease asset would have been on the date of implementation if it initially had been recognized and amortized in prior periods as a lease under the provisions of SFFAS 54?

No. Paragraph 96 of SFFAS 54 states that leases should be recognized and measured using the facts and circumstances that exist at the beginning of the reporting period for implementation. The reporting entity is not required to estimate what the lease asset would have been if it initially had been recognized and amortized in prior periods as a lease under the provisions of SFFAS 54. The lease liability should be measured using the remaining lease term and discount rate as of the beginning of the earliest period restated. The right-to-use asset should be measured based on the lease liability at that date and no restatement of beginning net position would be required because the lease asset and the lease liability would be the same.

98. In a period prior to the implementation of SFFAS 54, a reporting entity entered into a capital lease with an interest rate of 5 percent and recognized a capital asset and a liability of \$45,600. At the beginning of the period of implementation, the carrying value of the capital asset is \$20,900, and the liability (principal outstanding) is \$21,500. The government determines that the liability at that date should be \$22,500 under SFFAS 54 due to a change in the assessment of the lease term. For leases that were reported as capital leases prior to the implementation of SFFAS 54, can the reporting entity use the carrying value of the capital lease asset at the beginning of the period of implementation as the measure of the lease asset?

Paragraph 96 of SFFAS 54 states that leases should be measured using the facts and circumstances that exist at the beginning of the period of implementation. This allows for use of the carrying value of the existing capital lease asset, adjusted to the new carrying value of the lease liability under SFFAS 54. In this example, the reporting entity should report a \$1,000 increase in the lease liability to \$22,500 due to the reassessment of the lease term. The \$1,000 difference would not affect beginning net position because the increase would also be applied to the lease asset.

99. Should leases that were reported as capital leases prior to the implementation of SFFAS 54, but have 24 months or less remaining at implementation be removed from the balance sheet? If so, should the difference between the carrying value of the asset and the remaining lease liability be recognized as a change in accounting principle?

It should first be determined why the lease was previously reported as a capital lease. If there was a transfer of ownership at the end of the lease term, then paragraph 25 of SFFAS 54 may apply. If there was not a transfer of ownership, then the remaining lease term of 24 months or less would make this a short-term lease (paragraph 22 of SFFAS 54) in accordance with paragraph 97.b.

EFFECTIVE DATE

100. This Technical Release is effective upon issuance.

The provisions of this Statement need not be applied to information if the effect of applying the provision(s) is immaterial. Refer to Statement of Federal Financial Accounting Concepts 1, Objectives of Federal Financial Reporting, chapter 7, titled Materiality, for a detailed discussion of the materiality concepts.

APPENDIX A: BASIS FOR CONCLUSIONS

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

This Technical Release may be affected by later Technical Releases. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Technical Releases that amend this Technical Release. The authoritative sections of the Technical Releases are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Technical Release for the rationale for each amendment.

PROJECT HISTORY

- A1. Statement of Federal Financial Accounting Standards (SFFAS) 54, *Leases*, was issued in April 2017 with an effective date for reporting periods beginning after September 30, 2020. The effective date was later amended by SFFAS 58, *Deferral of the Effective Date of SFFAS 54, Leases*, to reporting periods beginning after September 30, 2023.
- A2. In August 2019, the FASAB and the Accounting and Auditing Policy Committee (AAPC or “the Committee”) commenced projects on their technical agendas to identify implementation challenges and develop guidance related to SFFAS 54.
- A3. The AAPC assembled a large group of task force members—over 100 stakeholders—as a means of crowdsourcing the identification and analysis of a wide breadth of potential SFFAS 54 implementation topics. The task force provided input to project staff by:
 - a. Reviewing project staff’s content analysis of questions and answers contained in Governmental Accounting Standards Board (GASB) *Implementation Guide 2019-3, Leases*, and determining the extent to which each question and answer contained therein was applicable in the federal context.
 - b. Suggesting implementation topics not addressed in GASB 2019-3.
 - c. Identifying and discussing potential omnibus SFFAS amendment candidates that may need to be issued in tandem with the implementation guidance for purposes of providing clarification or closing loopholes. Such candidates were then relayed to the FASAB for their consideration.
 - d. Providing editorial and technical comments and illustrative examples on draft versions of implementation guidance questions and answers developed by staff. The working drafts were developed and reviewed, by topic area, over the course of several task force meetings organized by project staff.

- A4. As a result of the prior collaboration between the FASAB and the GASB on SFFAS 54 and *Statement No. 87, Leases*, respectively, staff met with GASB staff during the development of the proposed guidance to discuss implementation issues and approaches for developing consistent guidance in areas where the related standards and implementation issues are aligned. As a result of this collaboration, similar wording appears in some sections of this proposal and analogous GASB implementation guidance.²
- A5. Due to the high volume of implementation guidance, project staff provided drafts of proposed questions and answers to the AAPC and the Board in piecemeal for their review and input prior to their respective actions to release the exposure draft for public comment.

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APPENDIX B: ILLUSTRATIONS

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

ILLUSTRATION B1: ESTIMATION OF IMPUTED INTEREST RATES

The following example illustrates the application of the lease incentive requirements in paragraphs 61 and 62 of SFFAS 54 by a lessee for a lease that includes a lease incentive.

Facts and Assumptions

Agency ABC (lessee) enters into a lease of property for a noncancellable term of 30 years. Fixed payments of \$100,000 are due at the beginning of each year.

ABC estimates the fair value of the property to be \$2,750,000 with a remaining useful life of 50 years. ABC assumes that the service capacity of the property decreases as time passes, estimating that the first 30 years of the useful life will provide 70% of the service capacity (rather than using 60% to reflect 30 of 50 remaining years).

Accounting and Financial Reporting

Imputed Rate of Interest

The calculation of the imputed interest rate is as follows:

APPENDIX C: ABBREVIATIONS

CFR	Consolidated Financial Report of the U.S. Government
ED	Exposure Draft
FASAB	Federal Accounting Standards Advisory Board
FASB	Financial Accounting Standards Board
GAAP	Generally Accepted Accounting Principles
GAO	Government Accountability Office
GASB	Governmental Accounting Standards Board
GPFFR	General Purpose Federal Financial Report
IPSASB	International Public Sector Accounting Standards Board
OMB	Office of Management and Budget
SFAS	Statement of Financial Accounting Standards (FASB)
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards

APPENDIX D: GLOSSARY

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