



Federal Accounting Standards Advisory Board

October 7, 2020

Memorandum

MEMBER ACTION REQUESTED:

Staff requests follow-up comments on the pre-ballot draft by October 21.

To: Members of the Board
From: Ricky A. Perry, Jr., Senior Analyst
Christi M. Dewhirst, FASAB Fellow
Through: Monica R. Valentine, Executive Director
Subject: Leases Omnibus – Pre-ballot version (**Addendum to Tab B**)¹

MEETING OBJECTIVES

1. Review and discuss the joint exposure draft's (ED) cover letter, executive summary, questions for respondents, and basis for conclusion for the leases omnibus.
2. Finalize pre-ballot and move to ballot.

BRIEFING MATERIAL

You may electronically access all of the briefing material at <https://fasab.gov/board-activities/briefing-materials/>.

The briefing materials in this addendum to Tab B include the following attachment:

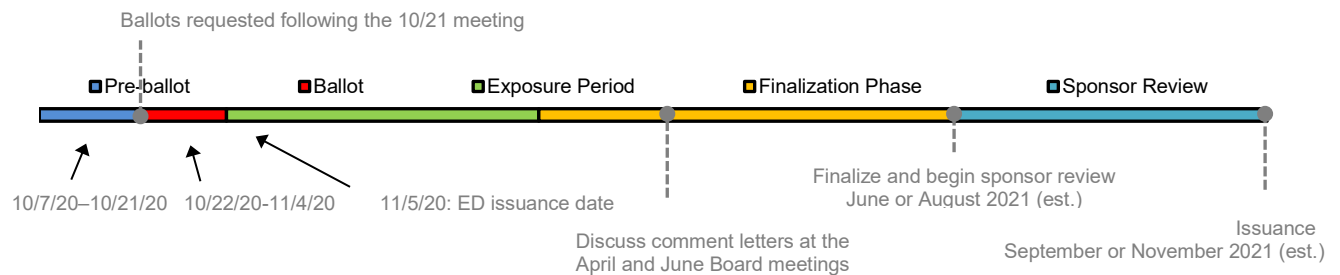
Attachment 4 – Pre-ballot Draft: *Omnibus Amendments on Leases-Related Topics* – word version

Development Phase

The Leases Omnibus project is in the development phase where the Board deliberates to develop an exposure draft.

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

Timeline



Background

Members were asked to review a working draft (Attachment 2) of SFFAS XX: *Omnibus Amendments to Leases-Related Topics*, prior to receiving the attached pre-ballot version (Attachment 4). Edits resulting from member reviews are tracked.

Summary of Edits

1. Two minor, clarifying edits to the executive summary under the “What Is the Board Proposing” sub-header.
2. Two corrective edits to the materiality section at the bottom of the executive summary, including:
 - a. Replacing the previous version of the paragraph—which is based on an older template prior to the issuance of Statement of Federal Financial Accounting Concepts (SFFAC) 9—with updated materiality language based on the latest template (updated as a result of SFFAC 9).
 - b. Replacing “TR” with “Statement.”
3. Clarifying edit to Question for Respondents (QFR) 3.
4. Two additional specific matters for comment (SMC) suggested during the balloting of the Technical Release.
 - a. SMC 2: Request for respondent feedback regarding paragraph 13 and related guidance pertaining to federal oil and gas leases.
 - b. SMC 4: Request for respondent feedback regarding paragraph 98 and related guidance pertaining to intragovernmental lease-leasebacks.

Staff believes that including these two additional specific matters for comment will provide useful feedback from constituents and the public regarding the proposed technical guidance in these areas. This, in turn, will help the Board and the Accounting and Auditing Policy Committee (AAPC) finalize and potentially improve upon the proposals on these two topics, if necessary.

5. Minor edits to SMC 1 and 3.

6. No edits were provided to the proposed technical guidance or the basis for conclusions.

Next Steps

- Staff will release a ballot version of the proposal, along with electronic ballots, to members on October 22, following the meeting on October 21.
- Members are asked to submit their ballots no later than November 4. Once staff receives six ballots in favor of releasing the proposal for public comment, staff will release the joint exposure draft for public comment.

BOARD QUESTION:

Are there any additional edits that members wish to make to the pre-ballot draft (see Attachment 4) or matters members wish to discuss prior to receiving their ballots and voting on the release of the proposals for public comment?

MEMBER FEEDBACK

Please provide feedback to Mr. Perry and Ms. Dewhirst at PerryRA@fasab.gov and gsa-fasab.detail@gsa.gov with a cc to Ms. Valentine at ValentineM@fasab.gov, by **October 21, 2020**.



OMNIBUS AMENDMENTS ON LEASES-RELATED TOPICS

Statement of Federal Financial Accounting Standards XX

Exposure Draft

Written comments are requested by February 4, 2021

November 5, 2020

Pre-ballot version – public comments 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](#)
- [Statements of Federal Financial Accounting Standards and Concepts](#)
- [FASAB newsletters](#)

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Federal Accounting Standards Advisory Board

November 5, 2020

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

Your comments on the following exposure drafts are requested:

- Proposed Federal Financial Accounting Technical Release, *Implementation Guidance for Leases*
- Proposed Statement of Federal Financial Accounting Standards, *Omnibus Amendments on Leases-Related Topics*

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 4, 2021.

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

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. If you are unable to email your responses, please call (202) 512-7350 to make alternate arrangements.

We may hold one or more public hearings on any exposure draft. No hearing has yet been scheduled for these exposure drafts. 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

WHAT IS THE BOARD PROPOSING?

This Statement of Federal Financial Accounting Standards (SFFAS) would amend paragraphs in SFFAS 54, *Leases*; SFFAS 57, *Omnibus Amendments 2019*; and SFFAS 6, *Accounting for Property, Plant, and Equipment*.

In August 2019, the Accounting and Auditing Policy Committee (AAPC)—which operates under the general oversight of the Federal Accounting Standards Advisory Board (FASAB or “the Board”)—undertook a project to develop proposed implementation guidance for SFFAS 54 as a Technical Release. During the course of the project, implementation issues were identified that are best addressed through omnibus amendments to leases guidance, mostly clarifying in nature, rather than through a Technical Release. The issues noted require modifications to the existing Statements to provide clarity and address areas of concern.

This proposal would address those issues by clarifying ambiguities and improving consistency throughout SFFAS 54, SFFAS 57, and SFFAS 6. It would also rescind certain disclosure requirements in SFFAS 54 that were determined to be unlikely to provide less likely to yield meaningful information.

~~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.~~

MATERIALITY

The provisions of this proposed Statement need not be applied to immaterial items. A misstatement, including omission of information, is material if, in light of surrounding facts and circumstances, it could reasonably be expected that the judgment of a reasonable user relying on the information would change or be influenced by the correction or inclusion of the information. Materiality should be evaluated in the context of the specific reporting entity. Determining materiality requires appropriate and reasonable judgment in considering the specific facts, circumstances, size, and nature of the misstatement. Consequently, after quantitative and qualitative factors are considered, materiality may vary by financial statement, line item, or group of line items within an entity.

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QUESTIONS FOR RESPONDENTS

Federal Accounting Standards Advisory Board (FASAB or “the Board”) and Accounting and Auditing Policy Committee (AAPC or “the Committee”) encourage you to become familiar with the proposed Statement and Federal Financial Accounting Technical Release (TR) before responding to the questions for respondents (QFR) and specific matters for comment (SMC) in this section.

In addition to the questions below, the Board and the Committee also welcome your comments on other aspects of the proposed Statement and TR. Because these proposals may be further modified before a final Statement and TR are 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 February 4, 2021.

The Board and the Committee believe that these proposals would improve federal financial reporting and contribute to meeting the federal financial reporting objectives. The Board has considered the perceived costs associated with the proposed Statement. In responding, please consider the expected benefits and challenges, and communicate any concerns that you may have regarding these proposals.

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 Board and/or 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 submit your comment letter via email, please contact 202-512-7350.

- QFR 1.** Do you generally support the proposed Statement and TR proposals as a whole? Please provide reasons for your views.
- QFR 2.** Are there specific aspects of the proposed Statement and/or TR that you disagree with? If so, please explain the reasons for your positions, the paragraph number(s), and/or topic area(s) of the proposals that are related to your positions, and any alternatives you propose and the authoritative basis for such alternatives.
- QFR 3.** Are you aware of any implementation issues that are not addressed in the proposed Statement and/or TR? Do any ambiguous areas remain that could lead to challenges with implementing SFFAS 54 requirements? If so, please provide examples of the issues and any references to applicable guidance, and/or topic area(s) related to the issues, and any potential solutions you propose.
- QFR 4.** Are there specific aspects of these proposals that you favor or otherwise wish to provide comments on?
- SMC 1.** Is the proposed guidance under paragraph 4 of the proposed TR applicable to **any** federal lease scenarios to your knowledge? Please provide feedback regarding the usefulness of the proposed guidance in the context of those scenarios and/or the extent to which you believe the proposed guidance addresses implementation issues under potential scenarios. Please describe any alternative views or suggestions for improvement.

SMC 2. Please provide feedback regarding the usefulness of the proposed guidance under paragraph 13 and/or the extent to which you believe the proposed guidance addresses implementation issues related to federal oil and gas leases. Please describe any alternative views or suggestions for improvement.

SMC 32. Is the proposed guidance under paragraph 95 of the proposed TR potentially applicable to ~~any~~ intragovernmental transactions that are similar to a sale-leaseback to your knowledge? Please provide feedback regarding the usefulness of the proposed guidance in the context of those scenarios and/or the extent to which you believe the proposed guidance addresses implementation issues under potential scenarios. Please describe any alternative views or suggestions for improvement.

SMC 4. Is the proposed guidance under paragraph 98 of the proposed TR applicable to existing and/or potential intragovernmental lease-leaseback transactions to your knowledge? Please provide feedback regarding the usefulness of the proposed guidance in the context of those scenarios and/or the extent to which you believe the proposed guidance addresses implementation issues under potential scenarios. Please describe any alternative views or suggestions for improvement.

PROPOSED STANDARDS

SCOPE

1. This Statement applies to federal entities that present general purpose federal financial reports (GPFFRs), including the consolidated financial report of the U.S. Government (CFR), in conformance with generally accepted accounting principles (GAAP), as defined by paragraphs 5 through 8 of Statement of Federal Financial Accounting Standards (SFFAS) 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*.
2. This Statement amends SFFAS 54, *Leases*; SFFAS 6, *Accounting for Property, Plant, and Equipment*; and SFFAS 57, *Omnibus Amendments 2019*, by providing necessary technical corrections and clarifications.

AMENDMENTS TO SFFAS 54

3. Paragraph 5.a of SFFAS 54 is amended as follows:

5.a accounting for leases of assets prior to the commencement of the lease term, such as during under-construction periods or ^{2A}

FN 2A – For leases other than short-term leases and intragovernmental leases, the lessee would account for payments prior to commencement of the lease term as advances paid in contemplation of the future receipt of the lease asset. The lessor would account for receipts prior to commencement of the lease term as advances received. These advances would be accounted for in a manner consistent with SFFAS 1, *Accounting for Selected Assets and Liabilities*, par. 57-61, prior to the lease commencement date. Such advances would be considered assets of the lessee and liabilities of the lessor. At lease commencement, the lessee would then reclassify the asset and include it in the measurement of the lease asset in accordance with SFFAS 54 par. 49, while the lessor would reclassify the advances received as unearned revenue in accordance with par. 64.b.

4. Paragraph 20 of SFFAS 54 is amended as follows:

20. At the commencement of a lease term, lessors and lessees should assess all factors relevant to the likelihood that the lessee or lessor will exercise options identified in paragraph s 15-19, whether these factors are contract or agreement based, underlying asset based, market based, or federal specific. The assessment often will require the consideration of a combination of these interrelated factors. Examples of factors to consider include, but are not limited to, the following: ...

5. Paragraph 21.d of SFFAS 54 is added as follows:

21. Lessors and lessees should reassess the lease term only if one or more of the following events occur:

21.d A lease modification that amends the noncancelable period and results in remeasurement in accordance with paragraphs 85-86.

6. Paragraph 23 of SFFAS 54 is amended as follows:

23. A lessee should recognize short-term lease payments as an expense based on the payment provisions of the contract or agreement and standards regarding recognition of accounts payable and other related amounts. The lessee should recognize an asset if payments are made in advance of the reporting period to which they relate or a liability for rent due if payments are made subsequent to that reporting period. The lessee should recognize lease incentives and lease concessions (for example, a rent holiday period of one or more months free) as reductions of lease rental expense on a straight-line basis over the lease term. Rental increases or rental decreases that are not lease concessions should be recognized in the period of the increase/decrease.^{4A}

FN 4A – See par. 10 for the definition of lease concessions.

7. Paragraph 24 of SFFAS 54 is amended as follows:

24. A lessor should recognize short-term lease payments as revenue based on the payment provisions of the contract or agreement and standards regarding recognition of accounts receivable and other related amounts. The lessor should recognize a liability if payments are received in advance of the reporting period to which they relate or an asset for rent due if payments are received subsequent to that reporting period. The lessor should recognize any lease incentive or concession (for example, a rent holiday period with one or more months free) as reductions of lease rental income on a straight-line basis over the lease term. Rental increases or rental decreases that are not lease concessions should be recognized in the period of the increase/decrease.^{4B}

FN 4B – Ibid.

8. Paragraph 29 of SFFAS 54 is amended as follows:

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

9. Paragraph 30 of SFFAS 54 is amended as follows:

30. Rental increases/decreases may also be variable and based on future changes in specific economic factors on which lease payments are based, for example, future sales or usage activity levels or future inflation/deflation (tied to a specific economic indicator where the specific amount of the change is not known).

10. Paragraph 31 of SFFAS 54 is amended as follows:

31. ~~Rental increases~~ or rental decreases that are not lease concessions, a lessee should be recognized ~~the expense~~ in the period of the increase/decrease.^{5A}

FN 5A – See par. 10.

11. Paragraph 37.b of SFFAS 54 is amended as follows:

37.b Annual lease expense in total and by major underlying asset-leased PP&E category.

12. Paragraph 38.a of SFFAS 54 is amended as follows:

38.a A general description of significant leases, ~~including a breakdown of the number of leases with federally owned assets and privately owned assets~~

13. Paragraph 39 of SFFAS 54 is amended as follows:

39. At the commencement of the lease term, a lessee should recognize a lease liability and a PP&E-right-to-use lease asset (hereinafter referred to as the lease asset), except as provided in paragraphs 22-24 (short-term leases), paragraph 25 (contracts or agreements that transfer ownership), and paragraph s 26-38 (intragovernmental leases).

14. Paragraphs 52-53 of SFFAS 54 are amended as follows:

52. The lease asset generally should be adjusted by the same amount when the corresponding-lease liability is remeasured based on paragraph s 44-48. However, if this change reduces the carrying value of the lease asset to zero, any remaining amount should be reported in the statement of net cost as a gain. Changes arising from amendments to a lease contract or agreement should be accounted for under the provisions of paragraphs 80-86 for lease modifications and terminations.

53. Leased assets ~~classified as PP&E~~ are subject to SFFAS 44, *Accounting for Impairment of General Property, Plant, and Equipment Remaining in Use*. The presence of impairment indicators (described in paragraphs 8-15 of SFFAS 44) with respect to the underlying asset may result in a change in the manner or duration of use of the lessee's rights to obtain and control access to economic benefits and services derived from the underlying asset and the application of SFFAS 44. The change in the manner or duration of use of the underlying asset is an indicator that the right of use-lease asset may be impaired (SFFAS 44, par. 12). ~~If the underlying asset is impaired, it~~ If impaired, the lease asset should be reduced first for any change in the corresponding-lease liability resulting from remeasurement under paragraphs 44-48 of SFFAS 54, or modifications or terminations under paragraphs 80-86 of SFFAS 54. Any remaining amount should be recognized as an impairment loss. Paragraphs 16-25 of SFFAS 44 provide criteria for testing for impairment, along with recognizing, reporting, and disclosing impairment losses. This guidance should be analogized to lease assets to the extent that impairment losses exceed any reduction to the lease liability and lease asset that may stem from the impairment.

15. Paragraph 54 of SFFAS 54 is amended as follows:

54. Lessees should disclose the following regarding lease activities (which may be grouped for purposes of disclosure), other than short-term leases, contracts or agreements that transfer ownership, and intragovernmental leases: ...

16. Paragraph 54.a. of SFFAS 54 is amended as follows:

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

~~ii. the existence, terms, and conditions of residual value guarantees provided by the lessee~~

17. Paragraph 54.b of SFFAS 54 is amended as follows:

54.b The total amount of lease assets and the related accumulated amortization, to be disclosed separately from ~~other~~ PP&E assets

18. Paragraph 59 of SFFAS 54 is amended as follows:

59. The future lease payments to be received should be discounted using the rate the lessor charges the lessee, which may be the interest rate implicit in the lease. Lessors are not required to apply imputed interest but may do so as a means of determining the interest rate implicit in the lease. If the interest rate cannot be reasonably estimated by the lessor, the lessor's estimated incremental borrowing rate should be used.^{9A}

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

19. Paragraph 65 of SFFAS 54 is amended as follows:

65. A lessor subsequently should ~~amortize-recognize~~ the deferred revenue, recognizing it as earned revenue, in a systematic and rational manner over the term of the lease. The deferred revenue generally should be adjusted using the same amount as the change resulting from the remeasurement of the lease receivable as discussed in paragraphs 61–63. However, if the change reduces the carrying value of the deferred revenue to zero, any remaining amount should be reported in the statement of net cost as a loss.

20. Paragraph 67 of SFFAS 54 is amended as follows:

67. Lessors should disclose the following regarding lease activities (which may be grouped for purposes of disclosure), other than short-term leases, contracts or agreements that transfer ownership, and intragovernmental leases: ...

21. Paragraph 69.b of SFFAS 54 is amended as follows:

69. If applicable, the financial report of the U.S. Government should disclose the following regarding its lease activities:

b. The total amount of lease assets, and the related accumulated amortization, to be disclosed separately from ~~other~~ PP&E assets ...

22. Paragraph 71 of SFFAS 54 is amended as follows:

71. Lease incentives and lease concessions reduce the amount that a lessee is required to pay for a lease. For leases other than short-term leases and intragovernmental leases, L lease incentives and lease concessions that provide payments to, or on behalf of, a lessee at or before the commencement of a lease term are included in initial measurement by directly reducing the amount of the lease asset (par. 49). Lease incentive and lease concession payments to be provided after the commencement of the lease term should be accounted for by lessees and lessors as reductions of lease payments for the periods in which the incentive or concession payments will be provided. Those payments should be measured by lessees consistently with the lessee's lease liability (par. 40-48) and by lessors consistently with the lessor's lease receivable (par. 56-63). Accordingly, lease incentive and lease concession payments to be provided after the commencement of the lease term are included in initial measurement and any remeasurement if they are fixed or fixed in substance, whereas variable or contingent lease incentive or lease concession payments are not included in initial measurement. Lessor improvements that are made to or on behalf of the lessee without additional cost to the lessee should be accounted for by the lessee and the lessor consistent with other lease incentives and lease concessions. As leasehold improvements are paid for (financed) by the lessee, leasehold improvements would not be considered a lease incentive or concession received from the lessor.^{10A}

FN 10A - The treatment of lease incentives and lease concessions is addressed in par. 23-24 for short-term leases and par. 32-33 for intragovernmental leases.

AMENDMENTS TO SFFAS 6 and SFFAS 57

23. Paragraphs 7 and 8 of SFFAS 57, *Omnibus Amendments 2019*, are rescinded.

24. Paragraph 15 of SFFAS 57 is amended as follows:

15. Paragraphs 3 through ~~6~~8, 11, and 12 of this Statement are effective for reporting periods beginning after September 30, 2023. Early adoption is not permitted.

25. Paragraph 18 of SFFAS 6, *Accounting for Property, Plant, and Equipment*, is amended as follows:

18. Property, plant, and equipment also includes:

- ~~assets acquired through capital leases (See paragraph 20), including leasehold improvements;~~

- Property owned by the reporting entity in the hands of [or leased to](#) others (e.g., state and local governments, colleges and universities, or Federal contractors); and
- Land rights¹⁸

FN 18 - “Land rights” are interests and privileges held by the entity in land owned by others, such as ~~leaseholds~~, easements, water and water power rights, diversion rights, submersion rights, rights-of-way, and other like interests in land.

26. Paragraph 19A is added to SFFAS 6 as follows:

19A. Property, plant, and equipment also excludes lease assets and land rights that meet the definition of a lease under SFFAS 54, *Leases*.

EFFECTIVE DATE

27. The requirements of this Statement are effective for reporting periods beginning after September 30, 2023.

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

This Statement may be affected by later Statements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Statements that amend this Statement. The authoritative sections of the Statements 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 Statement for the rationale for each amendment.

PROJECT HISTORY

- A1. Statement of Federal Financial Accounting Standards (SFFAS) 54, *Leases*, was issued in April 2018 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. In June and August 2020, the Board discussed omnibus amendments candidates identified by project staff and the task force to include in the exposure draft. The major points of discussion included:

- a. Clarifying the treatment of assets under construction, including payments prior to the commencement of the lease term, in the context of the scope exclusion enumerated in paragraph 5.a. of SFFAS 54. The Board agreed to make clarifying edits to the scope exclusion in the proposal.
- b. Potential options for amending paragraph 19.a of SFFAS 54 to require detailed analyses of those cancelable periods that are, in substance, unlikely to be canceled by either the lessee or the lessor. After additional research and discussions, the Board concluded that paragraph 19.a should remain unamended. Board members noted that revising the paragraph would likely result in undue costs and preparer burdens. Moreover, the Board believes that reporting entities and their counterparties often have sufficient disincentives that deter them from prevalently engaging in significant off-balance-sheet financing through use of cancelable periods.
- c. The Board agreed to propose clarifying amendments to address step rent decreases throughout the Statement.
- d. The Board agreed to propose the rescission of certain disclosure requirements reflected in paragraphs 38.a and 54.a.ii of SFFAS 54 to alleviate the associated challenges and costs in implementing such requirements. After additional research and deliberations, members agreed that those requirements did not generally meet the qualitative characteristics of useful financial information. For example, members believed that the compilation and presentation of such information would not be consistent, comparable, or provide sufficient feedback or predictive value to decision-makers.
- e. The Board agreed to maintain the current discount rate guidance in paragraph 42 of SFFAS 54, and to propose the addition of comparable language for lessors in paragraph 59 with respect to use of estimated incremental borrowing rates when the interest rate of a lease cannot be reasonably estimated.
- f. The Board agreed to propose numerous clarifying amendments to paragraph 53 of SFFAS 54 to facilitate consistent and correct application of the requirements in SFFAS 54 and SFFAS 44, *Accounting for Impairment of General Property, Plant, and Equipment Remaining in Use*, when impairment indicators are present with respect to assets underlying a lease.
- g. The Board agreed to propose clarifying amendments related to the classification of lease assets, by striking the term “PP&E” in SFFAS 54 and SFFAS 57, *Omnibus Amendments 2019*, in certain locations where use of the term implies that lease assets—rather than the underlying assets—are PP&E. The Board discussed the potential benefits to defining intangible assets, but agreed that the most appropriate mechanism for doing so would be in a separate project focused on intangibles. The Board also agreed to propose amendments to SFFAS 6, *Accounting for Property, Plant, and Equipment*, to clarify that PP&E would not include lease assets or land rights that meet the definition of a lease.

APPENDIX B: ILLUSTRATIVE VERSION OF SFFAS 54 WITH PROPOSED AMENDMENTS

STANDARDS

SCOPE

1. This Statement applies to federal entities that present general purpose federal financial reports, including the consolidated financial report of the U.S. Government (CFR), in conformance with generally accepted accounting principles, as defined by paragraphs 5 through 8 of Statement of Federal Financial Accounting Standards (SFFAS) 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*.
2. For purposes of applying this Statement, a **lease**¹ is defined as a contract or agreement whereby one entity (lessor) conveys the right to control the use of property, plant, and equipment (PP&E)² (the underlying asset) to another entity (lessee) for a period of time as specified in the contract or agreement in exchange for consideration. To qualify as a lease, the underlying asset typically should be identified by being explicitly specified in a contract or agreement. However, an asset also can be identified by being implicitly specified at the time that the asset is made available for use by the lessee. Leases include contracts or agreements that, although not explicitly identified as leases, meet the definition of a lease.
3. To determine whether a contract or agreement conveys the right to control the use of the underlying asset, a federal entity should assess whether the contract or agreement gives the lessee both of the following:
 - a. The right to obtain economic benefits or services from use of the underlying asset as specified in the contract or agreement
 - b. The right to control access to the economic benefits or services of the underlying asset as specified in the contract or agreement
4. The lease definition excludes contracts or agreements for services, except those contracts or agreements that contain both a lease component and a service component (par. 73). A service contract is a contract that directly engages the time and effort of a contractor whose primary purpose is to perform an identifiable task rather than to provide a tangible asset.

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

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

5. This Statement does not apply to

- a. accounting for leases of assets prior to the commencement of the lease term, such as during construction periods or ^{2A}
- b. leases (licenses) of internal use software (SFFAS 10, *Accounting for Internal Use Software*, as amended).

DEFINITIONS

Definitions in paragraphs 6 through 13 are presented within the standards because they are new terms intended to have a specific meaning when applying the standards.

6. **Lease** – A lease is defined as a contract or agreement whereby one entity (lessor) conveys the right to control the use of 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.
7. **Short-Term Lease** – A short-term lease is a lease with a lease term (as defined in par. 14-21) of 24 months or less.
8. **Intragovernmental Lease** – An intragovernmental lease is a contract or agreement occurring within a consolidation entity or between two or more consolidation entities as defined in SFFAS 47, *Reporting Entity*³ whereby one entity (lessor) conveys the right to control the use of 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.
9. **Lease Incentives** – Lease incentives include lessor payments made to or on behalf of the lessee to entice the lessee to sign a lease. Lease incentives may include up-front cash payments to the lessee; for example, moving costs, termination fees to the lessee's prior lessor, or the lessor's assumption of the lessee's lease obligation under a different lease with another lessor.
10. **Lease Concessions** – Lease concessions are rent discounts made by the lessor to entice the lessee to sign a lease. Lease concessions include rent holidays/free rent periods, reduced rents, or commission credits.
11. **Leasehold Improvements** – Leasehold improvements are additions, alterations, remodeling, renovations, or other changes to a leased property that either extend the useful

^{2A} For leases other than short-term leases and intragovernmental leases, the lessee would account for payments prior to commencement of the lease term as advances paid in contemplation of the future receipt of the lease asset. The lessor would account for receipts prior to commencement of the lease term as advances received. These advances would be accounted for in a manner consistent with SFFAS 1, *Accounting for Selected Assets and Liabilities*, par. 57-61, prior to the lease commencement date. Such advances would be considered assets of the lessee and liabilities of the lessor. At lease commencement, the lessee would then reclassify the asset and include it in the measurement of the lease asset in accordance with SFFAS 54 par. 49, while the lessor would reclassify the advances received as unearned revenue in accordance with par. 64.b.

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

life of the existing property or enlarge or improve its capacity and are paid for (financed) by the lessee.

12. **Lessor Improvements** – Lessor improvements are additions, alterations, remodeling, renovations, or other changes to a leased property that either extend the useful life of the existing property or enlarge or improve its capacity and are paid for (financed) by the lessor rather than by the lessee.
13. **Initial Direct Lease Costs** – Initial direct lease costs are costs that are directly attributable to negotiating and arranging a lease or portfolio of leases that would not have been incurred without entering into the lease.

LEASE TERM

14. The lease term is the noncancelable period plus certain periods subject to options to extend or terminate the lease. The noncancelable period is the shorter of
 - a. the period identified in the lease contract or agreement that precedes any option to extend the lease or
 - b. the period identified in the lease contract or agreement that precedes the first option to terminate the lease.
15. The lessee's lease term includes the noncancelable period and the following periods, if applicable:
 - a. Those periods specified in the lease contract or agreement that relate to a lessee's option to extend the lease if it is probable, based on all relevant factors, that the lessee will exercise that option
 - b. Those periods specified in the lease contract or agreement that follow a lessee's option to terminate the lease (up until the point in time when there is another option or, if none, the end of the lease) if it is probable, based on all relevant factors, that the lessee will not exercise that option
 - c. Those periods specified in the lease contract or agreement that relate to a lessor's option to extend the lease if there is significant evidence, based on all relevant factors, that the lessor will exercise that option
 - d. Those periods specified in the lease contract or agreement that follow a lessor's option to terminate the lease (up until the point in time when there is another option or, if none, the end of the lease) if there is significant evidence, based on all relevant factors, that the lessor will not exercise that option
16. The options should be considered in chronological order. If a determination is made that an additional period will not be added to the lease term for an option based on the likelihood criteria above, subsequent options would not be considered. For example, if the lessee determined that it was not probable that a lessee option to extend would be exercised; any subsequent option periods would not be evaluated.

17. The lessor's lease term includes the noncancelable period and the following periods, if applicable:
- a. Those periods specified in the lease contract or agreement that relate to a lessor's option to extend the lease if it is probable, based on all relevant factors, that the lessor will exercise that option
 - b. Those periods specified in the lease contract or agreement that follow a lessor's option to terminate the lease (up until the point in time when there is another option or, if none, the end of the lease) if it is probable, based on all relevant factors, that the lessor will *not* exercise that option
 - c. Those periods specified in the lease contract or agreement that relate to a lessee's option to extend the lease if there is significant evidence, based on all relevant factors, that the lessee will exercise that option
 - d. Those periods specified in the lease contract or agreement that follows a lessee's option to terminate the lease (up until the point in time when there is another option or, if none, the end of the lease) if there is significant evidence, based on all relevant factors, that the lessee will not exercise that option
18. The options should be considered in chronological order. If a determination is made that an additional period will not be added to the lease term for an option based on the likelihood criteria above, subsequent options would not be considered. For example, if the lessor determined that it was not probable that a lessor option to extend would be exercised; any subsequent option periods would not be evaluated.
19. In determining the lease term for both the lessee and lessor, the following specific provisions should be applied:
- a. Periods for which both the lessee and lessor (1) have an option to terminate the lease without permission from the other party or (2) have to agree to extend are cancelable periods and are excluded from the lease term. For example, month-to-month lease holdovers, also referred to as rolling lease extensions, or any lease that continues into a holdover period until a new contract or agreement is signed would be considered cancelable if both the lessee and the lessor have an option to terminate. Therefore, either could cancel the lease at any time. These holdover periods are cancelable periods and should be excluded from the lease term.⁴
 - b. If the lease provisions allow for the termination of a lease due to (a) the purchase of the underlying asset, (b) the payment of all sums due, or (c) the default on payments, these provisions are not considered options to terminate.
 - c. An availability of funds or cancellation clause allows federal lessees to cancel a lease agreement, typically on an annual basis, if funds for the lease payments are

⁴ SFFAS 1 applies to any related accounts payable or accounts receivable amounts.

not appropriated. This type of clause should affect the lease term only when it is probable that the clause will be exercised.

20. At the commencement of a lease term, lessors and lessees should assess all factors relevant to the likelihood that the lessee or lessor will exercise options identified in paragraphs 15-19, whether these factors are contract or agreement based, underlying asset based, market based, or federal specific. The assessment often will require the consideration of a combination of these interrelated factors. Examples of factors to consider include, but are not limited to, the following:

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

21. Lessors and lessees should reassess the lease term only if one or more of the following events occur:

- a. The lessor or lessee elects to exercise an option that was previously presumed would not be exercised under the likelihood criteria in paragraphs 15 and 17
- b. The lessor or lessee does not elect to exercise an option that was previously presumed would be exercised under the likelihood criteria in paragraphs 15 and 17
- c. An event specified in the lease contract or agreement that requires an extension or termination of the lease takes place.
- d. A lease modification that amends the noncancelable period and results in remeasurement in accordance with paragraphs 85-86.

SHORT-TERM LEASES

22. A short-term lease is a lease with a lease term (as defined in paragraphs 14 - 21) of 24 months or less.

LESSEE TREATMENT OF SHORT-TERM LEASES

23. A lessee should recognize short-term lease payments as an expense based on the payment provisions of the contract or agreement and standards regarding recognition of accounts payable and other related amounts. The lessee should recognize an asset if payments are made in advance of the reporting period to which they relate or a liability for rent due if payments are made subsequent to that reporting period. The lessee should recognize lease incentives and lease concessions (for example, a rent holiday period of one or more months free) as reductions of lease rental expense on a straight-line basis over the lease term. Rental increases or rental decreases that are not lease concessions should be recognized in the period of the increase/decrease.^{4A}

LESSOR TREATMENT OF SHORT-TERM LEASES

24. A lessor should recognize short-term lease payments as revenue based on the payment provisions of the contract or agreement and standards regarding recognition of accounts receivable and other related amounts. The lessor should recognize a liability if payments are received in advance of the reporting period to which they relate or an asset for rent due if payments are received subsequent to that reporting period. The lessor should recognize any lease incentive or concession (for example, a rent holiday period with one or more months free) as reductions of lease rental income on a straight-line basis over the lease term. Rental increases or rental decreases that are not lease concessions should be recognized in the period of the increase/decrease.^{4B}

CONTRACTS OR AGREEMENTS THAT TRANSFER OWNERSHIP

25. A contract or agreement that (a) transfers ownership of the underlying asset to the lessee by the end of the contract or agreement and (b) does not contain options to terminate (par. 14–19), but that may contain an availability of funds or cancellation clause that is not probable of being exercised (par. 19.c), should be reported as a purchase of that asset by the lessee or as a financed sale of the asset by the lessor.⁵

INTRAGOVERNMENTAL LEASES

26. An intragovernmental lease is a contract or agreement occurring within a consolidation entity or between two or more consolidation entities as defined in SFFAS 47 whereby one entity (lessor) conveys the right to control the use of 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. Any lease that meets the definition of an intragovernmental lease would be required to follow the accounting and disclosure guidance described in paragraphs 27–38.

27. A lessee should recognize lease payments, including lease-related operating costs (for example, maintenance, utilities, taxes, etc.) paid to the lessor, as expenses based on the payment provisions of the contract or agreement and standards regarding recognition of accounts payable and other related amounts. Prepaid rent or a payable for rent due should

^{4A} See par. 10 for the definition of lease concessions.

^{4B} Ibid.

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

be recognized as an asset or liability, respectively, and an expense should be recognized in the appropriate reporting period based on the specifics of the lease provisions.

28. A lessor should recognize lease receipts, including lease-related operating costs (for example, maintenance, utilities, or taxes) received from the lessee as income based on the provisions of the contract or agreement and standards regarding recognition of accounts receivable and other related amounts. Rent paid in advance or a receivable should be recognized as a liability or asset, respectively, and income should be recognized in the appropriate reporting period based on the specifics of the lease provisions.
29. Rental increases/decreases may be fixed in the lease and take place with the passage of time (for example, be based on such factors as anticipated increases/decreases in costs or anticipated appreciation/depreciation in property values, but the amount of the increase/decrease is specified in the lease) or they may be contingent on future events.
30. Rental increases/decreases may also be variable and based on future changes in specific economic factors on which lease payments are based, for example, future sales or usage activity levels or future inflation/deflation (tied to a specific economic indicator where the specific amount of the change is not known).
31. Rental increases or rental decreases that are not lease concessions, should be recognized in the period of the increase/decrease.^{5A}
32. Lease incentives should be recognized by the lessee as deferred revenue when received from the lessor and then as reductions of lease rental expense on a straight-line basis over the lease term. The lessee should recognize the expenses or losses to which the incentives relate in the reporting period the costs are incurred. For example, an incentive equal to the moving expense incurred by the lessee to occupy the leased space reduces rent expense over the lease term, and the moving expense is recognized in the reporting period incurred (that is, when the move occurs). Lease incentives provided to the lessee should be recognized by the lessor as reductions of lease rental income on a straight-line basis over the lease term.
33. Lease concessions should be recognized by the lessee as reductions of lease rental expense on a straight-line basis over the lease term. Lease concessions should be recognized by the lessor as reductions in rental income on a straight-line basis over the lease term.
34. Leasehold improvements that are placed in service at or after the beginning of the lease term should be amortized over the useful life (the normal operating life in terms of utility to the lessee) of the leasehold improvement, but no longer than the expected lease term.
35. Lessor improvements are components of the leased property and should be capitalized and depreciated by the lessor over their useful life consistent with the lessor's accounting for PP&E.⁶

^{5A} See par. 10.

⁶ This recognition is consistent with PP&E capital improvements outlined in SFFAS 6, *Accounting for Property, Plant and Equipment*, par. 37.

36. Initial direct lease costs incurred by the lessee should be expensed when incurred. Initial direct lease cost incurred by the lessor should be expensed when incurred.

DISCLOSURES FOR INTRAGOVERNMENTAL LEASES

37. Lessees should disclose the following regarding intragovernmental lease activities (which may be grouped for purposes of disclosure):

- a. A general description of significant intragovernmental leasing arrangements, including general lease terms with any applicable specific intragovernmental requirements
- b. Annual lease expense in total and by major underlying asset category.

38. Lessors should disclose the following regarding intragovernmental lease activities (which may be grouped for purposes of disclosure):

- a. A general description of significant leases
- b. 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

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

39. At the commencement of the lease term, a lessee should recognize a lease liability and a right-to-use lease asset (hereinafter referred to as the lease asset), except as provided in paragraphs 22–24 (short-term leases), paragraph 25 (contracts or agreements that transfer ownership), and paragraphs 26–38 (intragovernmental leases).

LEASE LIABILITY

40. A lessee initially should measure the lease liability at the present value of payments expected to be made during the lease term. Measurement of the lease liability should include the following, if required by a lease:

- a. Fixed payments
- b. Variable payments that depend on an index or a rate (such as the Consumer Price Index or a market interest rate), initially measured using the index or rate as of the commencement of the lease term
- c. Variable payments that are fixed in-substance as described in paragraph 41
- d. Amounts that are probable of being required to be paid by the lessee under residual value guarantees

- e. The exercise price of a purchase option if it is probable that the lessee will exercise that option
 - f. Payments for penalties for terminating the lease, if the lease term reflects the lessee exercising (1) an option to terminate the lease or (2) an availability of funds or cancellation clause
 - g. Any lease incentives (par. 70–71) receivable from the lessor
 - h. Any other payments to the lessor that are probable of being required based on an assessment of all relevant factors
41. Variable payments based on future performance of the lessee or usage of the underlying asset should not be included. Rather, these variable payments should be recognized as an expense in the reporting period in which those payments are incurred. However, any component of these variable payments that is fixed in-substance should be included in the lease liability. An example is a lease payment based on a percentage of sales or usage but with a required minimum amount to be paid. That required minimum payment is fixed in-substance.
42. The future lease payments should be discounted using the interest rate the lessor charges the lessee, which may be the interest rate implicit in the lease. If the interest rate cannot be reasonably estimated by the lessee, the **lessee's estimated incremental borrowing rate**⁷ (the estimated rate that would be charged for borrowing the lease payment amounts for the lease term) should be used.
43. In subsequent financial reporting periods, the lessee should calculate the amortization of the discount on the lease liability and recognize that amount as interest expense for the period. Any payments made should be allocated first to the accrued interest liability and then to the lease liability.
44. The lessee should remeasure the lease liability at subsequent financial reporting dates if one or more of the following changes⁸ have occurred at or before that financial reporting date, based on the most recent lease contract or agreement before the changes, and if the changes individually or in the aggregate, are expected to significantly affect the amount of the lease liability since the previous measurement:
- a. There is a change in the lease term.
 - b. An assessment of all relevant factors indicates that the likelihood of a residual value guarantee being required to be paid has changed from probable to not probable or vice versa.

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

⁸ Changes arising from amendments to a lease contract or agreement should be accounted for under the provisions of par. 80–86 for lease modifications and terminations.

- c. An assessment of all relevant factors indicates that the likelihood of a purchase option being exercised has changed from probable to not probable, or vice versa.
 - d. There is a change in the estimated amounts for payments already included in the liability (except as provided in par. 45).
 - e. There is a change in the interest rate the lessor charges the lessee if used as the initial **discount rate**.
 - f. A contingency, upon which some or all of the variable payments that will be made over the remainder of the lease term are based, is resolved such that those payments now meet the criteria for measuring the lease liability in paragraph 40. For example, an event occurs that causes variable payments that were contingent on the performance or use of the underlying asset to become fixed payments for the remainder of the lease term.
45. If a lease liability is remeasured for any of the changes in paragraph 44, the liability also should be adjusted for any change in an index or rate used to determine variable lease payments if that change in the index or rate is expected to significantly affect the amount of the liability since the previous measurement. A lease liability is not required to be remeasured solely for a change in an index or rate used to determine variable payments.
46. The lessee also should update the discount rate as part of the remeasurement if one or both of the following changes have occurred and the changes individually or in the aggregate are expected to significantly affect the amount of the lease liability:
- a. There is a change in the lease term.
 - b. An assessment of all relevant factors indicates that the likelihood of a purchase option being exercised has changed from probable to not probable, or vice versa.
47. A lease liability is not required to be remeasured, nor is the discount rate required to be reassessed, solely for a change in the lessee's estimated incremental borrowing rate.
48. If the discount rate is required to be updated based on the provisions in paragraph 46, the discount rate should be based on the revised interest rate the lessor charges the lessee at the time the discount rate is updated. If that interest rate cannot be readily determined, the lessee's estimated incremental borrowing rate at the time the discount rate is updated should be used.

LEASE ASSET

49. A lessee should initially measure the lease asset as the sum of the following:
- a. The amount of the initial measurement of the lease liability (par. 40)
 - b. Lease payments made to the lessor at or before the commencement of the lease term, less any lease incentives (par. 70–71)

c. Initial direct lease costs that are necessary to place the lease asset into service

50. A lease asset should be amortized in a systematic and rational manner over the shorter of the lease term or the useful life of the underlying asset, except as provided in paragraph 51. The amortization of the lease asset should be reported as amortization expense.

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

52. The lease asset generally should be adjusted by the same amount when the lease liability is remeasured based on paragraphs 44-48. However, if this change reduces the carrying value of the lease asset to zero, any remaining amount should be reported in the statement of net cost as a gain. Changes arising from amendments to a lease contract or agreement should be accounted for under the provisions of paragraphs 80-86 for lease modifications and terminations.

53. Leased assets are subject to SFFAS 44, *Accounting for Impairment of General Property, Plant, and Equipment Remaining in Use*. The presence of impairment indicators (described in paragraphs 8-15 of SFFAS 44) with respect to the underlying asset may result in a change in the manner or duration of use of the lessee's rights to obtain and control access to economic benefits and services derived from the underlying asset and the application of SFFAS 44. The change in the manner or duration of use of the underlying asset is an indicator that the lease asset may be impaired. If impaired, the lease asset should be reduced first for any change in the lease liability resulting from remeasurement under paragraphs 44-48 of SFFAS 54, or modifications or terminations under paragraphs 80-86 of SFFAS 54. Any remaining amount should be recognized as an impairment loss. Paragraphs 16-25 of SFFAS 44 provide criteria for testing for impairment, along with recognizing, reporting, and disclosing impairment losses. This guidance should be analogized to lease assets to the extent that impairment losses exceed any reduction to the lease liability and lease asset that may stem from the impairment.

COMPONENT REPORTING ENTITY DISCLOSURE REQUIREMENTS FOR LESSEES

54. Lessees should disclose the following regarding lease activities (which may be grouped for purposes of disclosure), other than short-term leases, contracts or agreements that transfer ownership, and intragovernmental leases:

- a. A general description of its leasing arrangements, including the basis, terms, and conditions on which variable lease payments not included in the lease liability are determined
- b. The total amount of lease assets and the related accumulated amortization, to be disclosed separately from PP&E assets

⁹ [Footnote 9 rescinded by SFFAS XX; elements of the original footnote are now included the body of paragraph 53, as amended.]

- c. The amount of lease expense recognized for the reporting period for variable lease payments not previously included in the lease liability
- d. Principal and interest requirements to the end of the lease term, presented separately, for the lease liability for each of the five subsequent years and in five-year increments thereafter
- e. The amount of the annual lease expense and the discount rate used to calculate the lease liability

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

55. At the commencement of the lease term, a lessor should recognize a lease receivable and a deferred revenue, except as provided in paragraph 22–24 (short-term leases), paragraph 25 (contracts or agreements that transfer ownership), and paragraphs 26–38 (intragovernmental leases). Any initial direct lease costs incurred by the lessor should be reported as an expense of the period.

LEASE RECEIVABLE

56. A lessor initially should measure the lease receivable at the present value of lease payments to be received for the lease term, reduced by any provision for uncollectible amounts. Measurement of the lease receivable should include the following types of payments that might be required by a lease:
- a. Fixed payments
 - b. Variable payments that depend on an index or a rate (such as the Consumer Price Index or a market interest rate), initially measured using the index or rate as of the commencement of the lease term
 - c. Variable lease payments that are fixed in-substance as described in paragraph 57
 - d. Residual value guarantees that are fixed payments in substance (par. 57)
 - e. Any lease incentives (par. 70–71) payable to the lessee
57. Variable payments based on future performance of the lessee or usage of the underlying asset should not be included in the measurement of the lease receivable. Rather, those payments should be recognized as revenue in the reporting period to which those payments relate. However, any component of those variable payments that is fixed in substance should be included in the lease receivable. For example, if a lease payment is based on a percentage of sales but has a required minimum payment, that required minimum is a fixed payment in substance. Similarly, a residual value guarantee is an in-substance fixed payment if it stipulates the underlying asset will be sold at the end of the lease term, with the

lessee assuming a liability for any shortfall if the sales price is less than an agreed-upon minimum amount.

58. Amounts to be received under residual value guarantees (that are not fixed in substance) should be recognized as a receivable and revenue when (a) a guarantee payment is required (as agreed to by the lessee and lessor) and (b) the amount can be reasonably estimated. Amounts to be received for the exercise price of a purchase option or penalty for lease termination should be recognized as a receivable and revenue when those options are exercised.
59. The future lease payments to be received should be discounted using the rate the lessor charges the lessee, which may be the interest rate implicit in the lease. Lessors are not required to apply imputed interest but may do so as a means of determining the interest rate implicit in the lease. If the interest rate cannot be reasonably estimated by the lessor, the lessor's estimated incremental borrowing rate should be used.^{9A}
60. In subsequent financial reporting periods, the lessor should calculate the amortization of the discount on the receivable and report that amount as interest revenue for the period. Any payments received should be allocated first to the accrued interest receivable and then to the lease receivable.
61. The lessor should remeasure the lease receivable at subsequent financial reporting periods if one or more of the following changes have occurred at or before that financial reporting period, based on the most recent lease contract or agreement before the changes,¹⁰ and the changes individually or in the aggregate, are expected to significantly affect the amount of the lease receivable since the previous measurement:
- a. There is a change in the lease term.
 - b. There is a change in the interest rate the lessor charges the lessee.
 - c. A contingency, upon which some or all of the variable payments that will be received over the remainder of the lease term are based, is resolved such that those payments now meet the criteria for measuring the lease receivable in paragraph 56. For example, an event occurs that results in variable payments that were contingent on the performance or use of the underlying asset becoming fixed payments for the remainder of the lease term.
62. If a lease receivable is remeasured for any of the changes in paragraph 61, the receivable also should be adjusted for any change in an index or rate used to determine variable lease payments if that change in the index or rate is expected to significantly affect the amount of the receivable since the previous measurement. A lease receivable is not required to be

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

¹⁰ Changes arising from amendments to a lease contract or agreement should be accounted for under the provisions of par. 80–86 for lease modifications and terminations.

remeasured solely for a change in an index or rate used to determine variable lease payments.

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

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

DEFERRED REVENUE

64. A lessor initially should measure the deferred revenue to include the following:

- a. The amount of the initial measurement of the lease receivable (par. 56)
- b. Lease payments received from the lessee at or before the commencement of the lease term that relate to future periods (for example, the final month's rent), less any lease incentives (par. 70–71) paid to, or on behalf of, the lessee at or before the commencement of the lease term

65. A lessor subsequently should **amortize** the deferred revenue, **recognizing it as earned revenue**, in a systematic and rational manner over the term of the lease. The deferred revenue generally should be adjusted using the same amount as the change resulting from the remeasurement of the lease receivable as discussed in paragraphs 61–63. However, if the change reduces the carrying value of the deferred revenue to zero, any remaining amount should be reported in the statement of net cost as a loss.

UNDERLYING ASSET

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

COMPONENT REPORTING ENTITY DISCLOSURES FOR LESSORS

67. Lessors should disclose the following regarding lease activities (which may be grouped for purposes of disclosure), other than short-term leases, **contracts or agreements that transfer ownership, and intragovernmental leases**:

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

- c. The total amount of revenue (for example, lease revenue, interest revenue, and any other lease-related revenue) recognized in the reporting period from leases
- d. The amount of revenue recognized in the reporting period for variable lease payments and other payments not previously included in the lease receivable, including revenue related to residual value guarantees and termination penalties

68. In addition to the disclosures in paragraph 67, if a federal entity's principal ongoing operations consist of leasing assets through the use of non-intragovernmental leases, the federal entity should disclose a schedule of future lease payments that are included in the lease receivable, showing principal and interest, for each of the five subsequent years and in five-year increments thereafter.

FINANCIAL REPORT OF THE U.S. GOVERNMENT DISCLOSURES

69. If applicable, the financial report of the U.S. Government should disclose the following regarding its lease activities:

- a. A general description of its leasing arrangements
- b. The total amount of lease assets, and the related accumulated amortization, to be disclosed separately from PP&E assets
- c. Principal and interest requirements to the end of the lease term, presented separately, for the lease liability for each of the five subsequent years and in five-year increments thereafter
- d. A general reference to relevant component reporting entity reports

LEASE INCENTIVES AND LEASE CONCESSIONS

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

71. Lease incentives and lease concessions reduce the amount that a lessee is required to pay for a lease. For leases other than short-term leases and intragovernmental leases, lease incentives and lease concessions that provide payments to, or on behalf of, a lessee at or before the commencement of a lease term are included in initial measurement by directly reducing the amount of the lease asset (par. 49). Lease incentive and lease concession payments to be provided after the commencement of the lease term should be accounted for by lessees and lessors as reductions of lease payments for the periods in which the incentive or concession payments will be provided. Those payments should be measured by lessees consistently with the lessee's lease liability (par. 40–48) and by lessors consistently

with the lessor's lease receivable (par. 56–63). Accordingly, lease incentive and lease concession payments to be provided after the commencement of the lease term are included in initial measurement and any remeasurement if they are fixed or fixed in substance, whereas variable or contingent lease incentive or lease concession payments are not included in initial measurement. Lessor improvements that are made to or on behalf of the lessee without additional cost to the lessee should be accounted for by the lessee and the lessor consistent with other lease incentives and lease concessions. As leasehold improvements are paid for (financed) by the lessee, leasehold improvements would not be considered a lease incentive or concession received from the lessor.^{10A}

CONTRACTS OR AGREEMENTS WITH MULTIPLE COMPONENTS

72. Lessors and lessees may enter into contracts or agreements that contain multiple components, such as a contract or agreement that contains both a lease component and a nonlease component, or a lease that contains multiple underlying assets.
73. If a lessor or lessee enters into a contract or agreement that contains both a lease (such as the right to use a building) and a nonlease component (such as a maintenance services for the building), the federal entity should account for the lease and nonlease components as separate contracts or agreements, unless the contract or agreement meets the exception in paragraph 76.
74. If a lease involves multiple underlying assets and the assets have different lease terms, the lessor and lessee should account for each underlying asset as a separate lease component. The provisions of this paragraph should be applied unless the contract or agreement meets the exception in paragraph 76.
75. To allocate the contract or agreement price to the different components, lessors and lessees should first use any prices for individual components that are included in the contract or agreement, as long as the price allocation does not appear to be unreasonable based on the terms of the contract or agreement and professional judgment, maximizing the use of observable information, for example, using readily available observable stand-alone prices. Stand-alone prices are those that would be paid or received if the same or similar assets were leased individually or if the same or similar nonlease components (such as services) were contracted individually. Some contract or agreements provide discounts for bundling multiple leases or lease and nonlease components together in one contract or agreement. These discounts may be taken into account when determining whether individual component prices do not appear to be unreasonable. For example, if the individual component prices are each discounted by the same percentage from normal market prices, those component prices would not be considered unreasonable.
76. If a contract or agreement does not include prices for individual components or if any of those prices appear to be unreasonable as provided in paragraph 75, lessors and lessees should use professional judgment to determine their best estimate for allocating the contract or agreement price to those components, maximizing the use of observable information. If it is not practicable to determine a best estimate for price allocation for some or all

^{10A} The treatment of lease incentives and lease concessions is addressed in par. 23-24 for short-term leases and par. 32-33 for intragovernmental leases.

components in a contract or agreement, a federal entity should account for those components as a single lease unit.

77. If multiple components are accounted for as a single lease unit as provided for in paragraph 76, the accounting for that unit should be based on the primary lease component within that unit. For example, the primary lease component's lease term should be used for the unit if the lease components have different lease terms.

CONTRACT OR AGREEMENT COMBINATIONS

78. Contracts or agreements that are entered into at or near the same time with the same counterparty should be considered to be part of the same lease contract or agreement if either of the following criteria is met:
- a. The contracts or agreements are negotiated as a package with a single objective.
 - b. The amount of consideration to be paid in one contract or agreement depends on the price or performance of the other contract or agreement.
79. If multiple contracts or agreements are determined to be part of the same lease contract or agreement, that contract or agreement should be evaluated in accordance with the guidance for contracts or agreements with multiple components in paragraphs 72–77.

LEASE TERMINATIONS AND MODIFICATIONS

80. The provisions of a lease contract or agreement may be amended while the contract or agreement is in effect. Examples of amendments to lease contracts or agreements include changing the contract or agreement price, lengthening or shortening the lease term, and adding or removing an underlying asset. An amendment should be considered a lease modification unless the lessee's right to use the underlying asset decreases, in which case the amendment should be considered a partial or full lease termination. By contrast, exercising an existing option, such as an option to extend or terminate the lease as discussed in paragraphs 15-19, is subject to the guidance for remeasurement.

LEASE TERMINATIONS

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

Lessee Treatment of Lease Terminations

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

Lessor Treatment of Lease Terminations

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

LEASE MODIFICATIONS

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

Lessee Treatment of Lease Modifications

85. Unless a modification is reported as a separate lease as provided in 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. However, if the change reduces the carrying value of the lease asset to zero, any remaining amount should be reported in the statement of net cost as a gain.

Lessor Treatment of Lease Modifications

86. 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. The deferred revenue should be adjusted by the difference between the remeasured receivable and the receivable immediately before the lease modification. However, to the extent the change relates to payments for the current period, the change should be recognized as revenue or expense for the current period.

SUBLEASES

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

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

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

SALE-LEASEBACK TRANSACTIONS

89. Sale-leaseback transactions involve the sale of an underlying asset by the owner and a lease of the property back to the seller (original owner). A sale-leaseback should include a transaction that qualifies as a sale¹¹ to be eligible for sale-leaseback accounting. A sale-leaseback transaction that does not include a transaction that qualifies as a sale should be accounted for as a borrowing by both the seller-lessee and the buyer-lessor.
90. The sale and lease portions of a sale-leaseback transaction should be accounted for as two separate transactions—a sale transaction and a lease transaction—except that the difference between the carrying value of the capital asset that was sold and the net proceeds from the sale should be reported as a deferred revenue or deferred expense to be recognized in the statement of net cost in a systematic and rational manner over the term of the lease. However, if the lease portion of the transaction qualifies as a short-term lease, any difference between the carrying value of the capital asset that was sold and the net proceeds from the sale should be recognized immediately.
91. A sale-leaseback transaction is considered to have off-market terms if there is a significant difference between (a) the sales price and the estimated fair value of the asset or (b) the present value of the contractual lease payments and the estimated present value of what the lease payments for that asset would be at a market price, whichever of the two differences is more readily determinable. The difference should be reported based on the substance of the transaction (for example, as a borrowing, a nonexchange transaction, or an advance lease payment) rather than as a part of the sales-leaseback transaction.
92. A seller-lessee should disclose the terms and conditions of sale-leaseback transactions in addition to the disclosures required of a lessee (par. 54). A buyer-lessor should provide the disclosures required of a lessor (par. 67).

LEASE-LEASEBACK TRANSACTIONS

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

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

accounted for as a net transaction. Both parties to a lease-leaseback transaction should disclose the amounts of the lease and the leaseback separately.

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

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

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

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

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

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

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

~~[45.] The discount rate to be used in determining the present value of the minimum lease payments ordinarily would be the lessee's incremental borrowing rate unless (1) it is~~

practicable for the lessee to learn the implicit rate computed by the lessor and (2) the implicit rate computed by the lessor is less than the lessee's incremental borrowing rate. If both these conditions are met, the lessee shall use the implicit rate. The lessee's incremental borrowing rate shall be the Treasury borrowing rate for securities of similar maturity to the term of the lease.

[46.] During the lease term, each minimum lease payment should be allocated between a reduction of the obligation and interest expense so as to produce a constant periodic rate of interest on the remaining balance of the liability. [footnote 21: OMB Circular No. A-11, "Preparation and Submission of Annual Budget Estimates," explains the measurement of budget authority, outlays, and debt for the budget in the case of lease purchases and other capital leases. Circular A-94, "Guidelines and Discount Rates for Benefit-Cost Analysis of Federal Programs," provides the requirements under which a lease purchase or other capital lease has to be justified and the analytical methods that need to be followed.]

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

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

[20.] Capital leases are leases that transfer substantially all the benefits and risks of ownership to the lessee. If, at its inception, a lease meets one or more of the following four criteria, [footnote 21: Note that the criteria for identifying capital leases for financial reporting purposes differ from OMB criteria for budget scoring of leases. OMB Circular No. A-11, *Preparation and Submission of Budget Estimates*, includes criteria for identifying operating leases in Appendix B. OMB provides four additional criteria which relate to the level of private sector risk involved in a lease purchase agreement. This is necessary because, for budget purposes, there is a distinction between lease purchases with more or less risk. This distinction is not made in the financial reports and, therefore, FASAB does not include the four criteria related to risk levels.] the lease should be classified as a capital lease by the lessee. Otherwise, it should be classified as an operating lease.

[footnote 22: "Operating leases" of PP&E are leases in which the Federal entity does not assume the risks of ownership of the PP&E. Multi-year service contracts and multi-year purchase contracts for expendable commodities are not capital leases.]

- The lease transfers ownership of the property to the lessee by the end of the lease term.
- The lease contains an option to purchase the leased property at a bargain price.
- The lease term is equal to or greater than 75 percent of the estimated economic life [footnote 23: "Estimated economic life of leased property" is the estimated remaining period during which the property is expected to be economically usable by one or more users, with normal repairs and maintenance, for the

~~purpose for which it was intended at the inception of the lease, without limitation by the lease term.] of the leased property.~~

~~• The present value of rental and other minimum lease payments, excluding that portion of the payments representing executory cost, equals or exceeds 90 percent of the fair value [footnote 24: "Fair value" is the price for which an asset could be bought or sold in an arm's-length transaction between unrelated parties (e.g., between a willing buyer and a willing seller). (adapted from Kohler's Dictionary for Accountants)] of the leased property.~~

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

~~[29.] The cost of general PP&E acquired under a capital lease shall be equal to the amount recognized as a liability for the capital lease at its inception (i.e., the net present value of the lease payments calculated as specified in the liability standard [footnote 35: See Statement of Recommended Accounting Standards No. 5, *Accounting for Liabilities of the Federal Government*.] unless the net present value exceeds the fair value of the asset).~~

IMPLEMENTATION

96. This Statement requires that leases unexpired at the beginning of the reporting period in which the Statement is implemented be recognized and measured using the facts and circumstances that exist at the beginning of the reporting period. Therefore, in the period of implementation,

- a. the determination of the lease term would assume that the lease term began as of the beginning of the period of implementation and
- b. the lease liability and lease asset should initially be measured based on the remaining lease term and associated lease payments as of the beginning of the period of implementation.

97. The following implementation guidance addresses specific leasing circumstances.

- a. Prospective Implementation – Entities should report the effect of implementing this Statement on existing leases prospectively in accordance with paragraph 13 of SFFAS 21, *Reporting Correction of Errors and Changes in Accounting Principles, Amendment of SFFAS 7, Accounting for Revenue and Other Financing Sources*. Accordingly, any changes in assets or liabilities related to existing leases should be treated prospectively. The change should be accounted for in the period of implementation and applicable future periods. No adjustments should be made to previously reported expenses or revenue.
- b. Lease Term – The lease term should be determined based on the provisions of this Statement (par. 14-21). However, the lease term of an existing lease should be based on the number of years remaining in the lease contract or agreement as of the beginning of the period of implementation and not the number of years in the initial

lease term. For example, if the initial lease term was 20 years, with no options to extend, at the beginning of Year 20X1 and the entity implements this Statement in Year 20X7 (six years into the lease at the beginning of Year 20X7), the initial lease term upon implementation would be 14 years.

- c. Short-Term Leases – A short-term lease would be determined based on the provisions of this Statement (par. 22–24). However, if the remaining lease term of an existing lease meets the definition of a short-term lease that lease should apply the short-term lease guidance. For example, if the initial lease term was 60 months as of the beginning of Year 20X1, with no options to extend, and the entity implements this Statement in Year 20X5 (48 months into the lease at the beginning of Year 20X5); the initial lease term at implementation would be 12 months and the lease would meet the definition of a short-term lease. Hence, the entity should account for the lease as a short-term lease.

EFFECTIVE DATE

98. The requirements of this Statement are effective for reporting periods beginning after September 30, 2023. Early adoption is not permitted.

The provisions of this Statement need not be applied to immaterial items
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APPENDIX C: ABBREVIATIONS

AAPC	Accounting and Auditing Policy Committee
CFR	Consolidated Financial Report of the U.S. Government
ED	Exposure Draft
FASAB	Federal Accounting Standards Advisory Board
GAAP	Generally Accepted Accounting Principles
GASB	Governmental Accounting Standards Board
GPFFR	General Purpose Federal Financial Report
PP&E	Property, Plant, and Equipment
QFR	Questions for Respondents
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards
SMC	Specific Matters for Comment
TR	Federal Financial Accounting Technical Release

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Federal Accounting Standards Advisory Board

September 23, 2020

Memorandum

To: Members of the Board

From: Ricky A. Perry, Jr., Senior Analyst
Christi M. Dewhirst, FASAB Fellow

Through: Monica R. Valentine, Executive Director

Subject: Leases Omnibus – **Tab B**¹

MEMBER ACTION REQUESTED:

Staff requests members' review comments on the working draft by October 5th.

MEETING OBJECTIVES

1. Review and discuss the joint exposure draft's (ED) cover letter, executive summary, questions for respondents, and basis for conclusion for the leases omnibus.
2. Finalize pre-ballot and move to ballot.

BRIEFING MATERIAL

You may electronically access all of the briefing material at <https://fasab.gov/board-activities/briefing-materials/>.

The briefing materials include this memorandum and the following attachments:

Attachment 1 – Working Draft: Joint ED of SFFAS XX, *Omnibus Amendments on Leases-Related Topics* and TR XX, *Implementation Guidance for Leases*

Attachment 2 – Working Draft: *Omnibus Amendments on Leases-Related Topics* – word version (for purposes of providing edits/comments)

Attachment 3 – Leases project plan

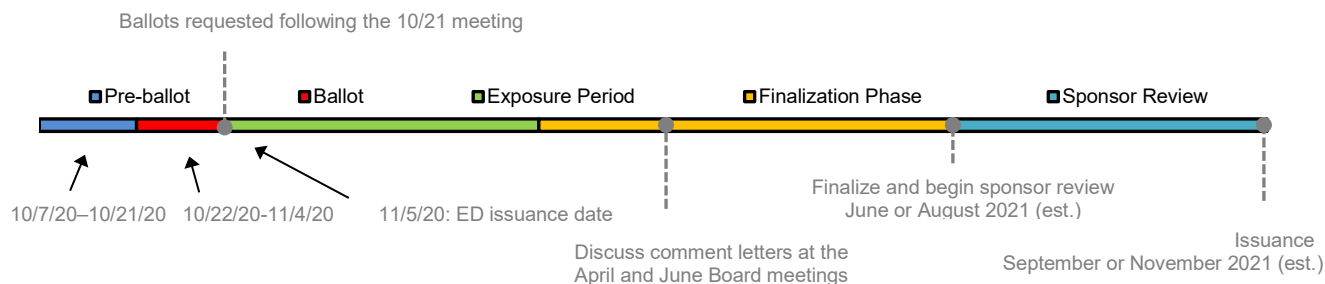
Note: *Members are asked to review Attachment 2, along with certain elements of the joint ED in Attachment 1. In Attachment 1, members are asked to review the joint cover page, joint cover letter to respondents, and the joint questions for respondents. Members may also wish to provide comments on the overall layout, structure, and navigability of the joint ED.*

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

Development Phase

The Leases Omnibus project is in the development phase where the Board deliberates to develop an exposure draft.

Timeline



Background

As part of the leases implementation guidance project, the Board has identified and agreed upon omnibus amendment proposals that cannot be addressed in a Technical Release (TR). TRs may provide guidance for applying existing Statements but may not promulgate new accounting standards. The issues noted require modifications to the existing Statements to provide clarity and address areas of concern amongst the task force. Staff views the omnibus amendments working draft file as ready to ballot for purposes of exposing for public comment.

Staff thanks the leases implementation task force and the AAPC for their continued assistance in identifying implementation issues. Since the Board's August meeting, the AAPC provided additional feedback and input to staff electronically and through small group video conference working meetings. As of the date of this memo, the AAPC is balloting the proposed TR. The AAPC is expected to clear the TR to be exposed for public comment. As noted above, staff has provided a copy of the draft TR exposure draft to ensure there are no member comments or questions before the exposure draft is released.

Omnibus Amendment Candidates

There have been no changes to the omnibus amendment candidates since the August Board meeting. The minor changes agreed to at the August meeting have been implemented. Those minor changes include:

1. Proposing a rescission of a portion of paragraph 38.a of SFFAS 54. At the August meeting, the Board agreed to propose a rescission of the requirement to "[include] a breakdown of the number of leases with federally-owned assets and privately-owned assets" within the overall general description of leasing arrangements disclosure requirement.
2. Removing the omnibus proposal to amend paragraph 42 of SFFAS 54. At the

August meeting, the Board agreed to leave the interest rate guidance for lessees in its original form, while accepting the omnibus proposal for paragraph 59 interest rate guidance. The proposal will allow lessors to use their estimated incremental borrowing rates when the implicit interest rate cannot otherwise be reasonably estimated.

3. Proposing a rescission of paragraph 54.a.ii in its entirety. At the August meeting, the Board agreed to propose this rescission.

See Attachment 1, pages 52-57 and Attachment 2.

Staff Recommendations

Staff has created a joint ED cover page, joint cover letter, questions for respondents (QFR), and specific matters for comment (SMC) for the Board's review. In addition, the exposure-draft-version of the basis for conclusions (BFC) is completed.

Joint ED Consolidation: Individual cover pages of the original draft SFFAS and TR files, description pages of the FASAB and AAPC in each file, cover letters in each file, and QFRs in those files have been merged in the joint ED. The master copies of each pronouncement will maintain each of those sections separately, for purposes of separately finalizing each proposal after the exposure period.

Cover Letter and Navigation Pane: Staff proposes the joint cover letter to facilitate exposure of the SFFAS and TR in tandem (see Attachment 1, page 8 and Attachment 2). As reflected, the documents will be combined into one PDF with a navigation pane to assist respondents in reviewing the joint ED.

QFRs and SMCs: Staff recommends a joint set of QFRs for the joint ED. This will facilitate cohesive and efficient responses. Staff proposes keeping the QFRs general, balanced, and open-ended. There are two SMCs that relate to the TR that the AAPC has included as well; responses to these specific questions will inform the AAPC's finalization of those specific aspects of the proposal. The AAPC assisted in drafting the QFRs and SMCs, and recommends the QFRs and SMCs presented in the attachments (see Attachment 1, page 9 and Attachment 2).

Omnibus BFC: Staff recommends a project history for the BFC in the leases omnibus ED (see Attachment 1, pages 58-59 and Attachment 2). Staff will update this with more information, including a summary of outreach and responses after the comment period.

BOARD QUESTIONS:

Question 1: Are there any edits that members wish to make or matters members wish to discuss prior to balloting?

Next Steps

The leases implementation project plan remains on schedule (see Attachment 3).

Staff believes that any edits pertaining to the pre-ballot draft of the omnibus amendments proposal can be finalized during the October meeting. Staff would like to ballot the omnibus electronically soon after the meeting and release it for a 90-day public comment on about November 5, 2020. Staff encourages members to return their electronic ballots soon after the October meeting so that staff may release the exposure draft earlier than November 5 if possible.

BOARD QUESTIONS (ALL):

Question 1: Are there any edits that members wish to make or matters members wish to discuss prior to the pre-ballot?

MEMBER FEEDBACK

Please provide feedback to Mr. Perry and Ms. Dewhirst at PerryRA@fasab.gov and gsa-fasab.detail@gsa.gov with a cc to Ms. Valentine at ValentineM@fasab.gov, by **October 5, 2020**.

Staff will provide the Board with a pre-ballot version soon after receiving members' feedback (on approximately October 7, 2020; see timeline above).



IMPLEMENTATION GUIDANCE FOR LEASES & OMNIBUS AMENDMENTS ON LEASES-RELATED TOPICS

Technical Release XX

and

Statement of Federal Financial Accounting Standards XX

A Joint Exposure Draft

Written comments are requested by February 4, 2021

November 5, 2020

Joint ED – Working draft

Public 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](#)
- [Statements of Federal Financial Accounting Standards and Concepts](#)
- [FASAB newsletters](#)

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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 5, 2020

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

Your comments on the following exposure drafts are requested:

- Proposed Federal Financial Accounting Technical Release, *Implementation Guidance for Leases* (see PDF pages 7-44)
- Proposed Statement of Federal Financial Accounting Standards, *Omnibus Amendments on Leases-Related Topics* (see PDF pages 45-79)

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 4, 2021.

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

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. If you are unable to email your responses, please call (202) 512-7350 to make alternate arrangements.

We may hold one or more public hearings on any exposure draft. No hearing has yet been scheduled for these exposure drafts. 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,

PENDING BALLOT

Monica R. Valentine
AAPC Chair

PENDING BALLOT

George A. Scott
FASAB Chair

QUESTIONS FOR RESPONDENTS

Federal Accounting Standards Advisory Board (FASAB or “the Board”) and Accounting and Auditing Policy Committee (AAPC or “the Committee”) encourage you to become familiar with the proposed Statement and Federal Financial Accounting Technical Release (TR) before responding to the questions for respondents (QFR) and specific matters for comment (SMC) in this section.

In addition to the questions below, the Board and the Committee also welcome your comments on other aspects of the proposed Statement and TR. Because these proposals may be further modified before a final Statement and TR are 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 February 4, 2021.

The Board and the Committee believe that these proposals would improve federal financial reporting and contribute to meeting the federal financial reporting objectives. The Board has considered the perceived costs associated with the proposed Statement. In responding, please consider the expected benefits and challenges, and communicate any concerns that you may have regarding these proposals.

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 Board and/or 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 submit your comment letter via email, please contact 202-512-7350.

- QFR 1.** Do you generally support the proposed Statement and TR proposals as a whole? Please provide reasons for your views.
- QFR 2.** Are there specific aspects of the proposed Statement and/or TR that you disagree with? If so, please explain the reasons for your positions, the paragraph number(s), and/or topic area(s) of the proposals that are related to your positions, and any alternatives you propose and the authoritative basis for such alternatives.
- QFR 3.** Are you aware of any implementation issues that are not addressed in the proposed Statement and/or TR? If so, please provide examples of the issues and any references to applicable guidance, and/or topic area(s) related to the issues, and any potential solutions you propose.
- QFR 4.** Are there specific aspects of these proposals that you favor or otherwise wish to provide comments on?
- SMC 1.** Is the proposed guidance under paragraph 4 of the proposed TR applicable to any federal lease scenarios to your knowledge? Please provide feedback regarding the usefulness of the proposed guidance in the context of those scenarios and/or the extent to which you believe the proposed guidance addresses implementation issues under potential scenarios. Please describe any alternative views or suggestions for improvement.

- SMC 2.** Is the proposed guidance under paragraph 95 of the proposed TR potentially applicable to any intragovernmental transactions that are similar to a sale-leaseback to your knowledge? Please provide feedback regarding the usefulness of the proposed guidance in the context of those scenarios and/or the extent to which you believe the proposed guidance addresses implementation issues under potential scenarios. Please describe any alternative views or suggestions for improvement.

DRAFT



Federal Accounting Standards Advisory Board

IMPLEMENTATION GUIDANCE FOR LEASES

Federal Financial Accounting Technical Release

Exposure Draft – Ballot Version

Written comments are requested by February XX, 2021 [90 days after]

November XX, 2020

Ballot version – Public comments are not requested on this draft.

EXECUTIVE SUMMARY

This Federal Financial Accounting Technical Release (TR) would assist reporting entities in implementing Statement of Federal Financial Accounting Standards (SFFAS) 54, *Leases*.

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

This proposed TR includes questions and answers—organized by topic areas—to address issues raised by stakeholders through

- technical inquiries posed to FASAB, the AAPC, and FASAB staff during and prior to the inception of this project;
- analogous implementation guidance promulgated by the Governmental Accounting Standards Board (GASB);
- comments submitted in response to FASAB due process documents; and
- an AAPC-established task force;

Other topic areas address issues identified by 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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INTRODUCTION

PURPOSE

1. 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*, 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 proposed Federal Financial Accounting Technical Release (TR) provide guidance for applying the accounting and financial reporting requirements for leases in accordance with SFFAS 54.

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PROPOSED TECHNICAL GUIDANCE

SCOPE

3. Readers of this TR should first refer to the hierarchy of accounting standards in SFFAS 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*. This TR proposal would supplement the relevant accounting standards but would not substitute for or take precedence over the standards.

SCOPE AND DEFINITIONS

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.

For inter-entity transactions (i.e., intragovernmental leases), to the extent that the consideration provided is less than full cost, 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, uninterrupted control is not required to meet the definition of a lease. 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, rights-of-way, and other like interests in land can qualify as a lease under paragraph 2 of SFFAS 54, with land being the underlying asset (see SFFAS 6 paragraph 17).¹

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 signs a revocable agreement that formalizes the terms of temporary occupancy of property without creating right to occupy the property for an explicitly-specified time in exchange for consideration. The agreement, however, specifies that the occupant shall give a notice of intent to discontinue use, and that party granting occupancy shall give notice to vacate. Does such an arrangement meet the definition of a lease?**

Yes; arrangements, as described in this question, would typically meet the definition of a short-term lease and be subject to the requirements of SFFAS 54, paragraphs 23-24. If such agreements are intragovernmental leases, they would be subject to the requirements of SFFAS 54, paragraphs 26-38, for intragovernmental leases.

Although the agreement does not convey the right to control the use of the property for an explicitly specified period of time, it specifies that the occupant shall give notice of intent to discontinue use, and that the party granting occupancy shall give notice to vacate.

Therefore, in substance, these arrangements provide for a short, noncancelable period for use. The noncancelable period would be equal to the shorter of the required notice period for discontinuing use or notice period for vacating. The noncancelable period should be included in the lease term in accordance with SFFAS 54, paragraph 14.

The additional period(s) subject to the requirements of SFFAS 54, paragraphs 15-18, for potential inclusion in the lease term, would be the period of time that beyond the noncancelable period and prior to the cancelable period.

Cancelable periods are defined as periods when both the lessee and the lessor have an option to terminate. In this case, the cancel period(s) are those beyond *both* the notice

period for discontinuing use and the notice period for vacating. Cancelable periods should not be included in the lease term in accordance with paragraph 19.a of SFFAS 54.

In summary, the total lease term for these types of agreements will usually, if not always, be 24 months or less. As such, these agreements typically meet the definition of short-term leases.

8. **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.

9. **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, it does not. 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 for use of that land as required by paragraph 2 of SFFAS 54 to meet the definition of a lease.

10. Are cell phone tower or antenna placement agreements leases?

It depends; these agreements typically meet the definition of a lease. If the agreements meet the definition 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 a connection point to which the antenna is affixed.

11. 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?

No, it does not affect the evaluation. 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.

12. A reporting entity enters into a contract with a telecommunications company that allows the telecommunications company to install an antenna on the reporting entity's property for a period of time in exchange for consideration. The reporting entity will determine the location of the antenna on the pole and retains the right to move the antenna to another location on the pole. Does this contract convey control of the right to use the underlying asset?

Yes, this is a lease. In this example, the reporting entity (lessor) conveys the right to use a connection point on the pole. A right of substitution does not affect the determination of whether a contract conveys control of the right to use an underlying asset. Even though the reporting entity can change the specific connection point, the telecommunications company maintains the substantive right to obtain economic benefits and services from use of a connection point (see also: question 10).

13. A reporting entity (lessor) 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. Does the agreement meet the definition of a lease under SFFAS 54?

Yes. Leases of land for purposes of oil and gas exploration, development, and production are within the scope of SFFAS 54. Such agreements convey the right to obtain and control access to economic benefits from use of the land for a period of time in exchange for consideration, as provided for in paragraphs 2-3 of SFFAS 54. The lease liability would include all variable payments that are fixed in-substance in accordance with paragraphs 40.c and 41 of SFFAS 54. However, variable payments that are based on future performance of the lessee or usage of the underlying asset (i.e., variable payments based on levels of exploration, development, and production) should not be included in the lease liability.

- 14. A reporting entity (lessee) enters into a lease agreement with a private company which will commence on October 1, 20X5, for a five year lease term. 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 lease 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. Such advances and prepayments would be considered assets of the lessee. At lease commencement, the asset would be reclassified and included in the lease asset in accordance with SFFAS 54 paragraph 49 (see also: question 54).

- 15. The term “probable” is used throughout this Statement. How 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). See SFFAS 5, *Accounting for Liabilities of the Federal Government*, paragraph 33. Reporting entities should continue to consistently apply the FASAB definition here.²

- 16. 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?**

For intragovernmental leases, disclosures of annual lease expenses by lessees (paragraph 37.b) include amounts incurred during the fiscal year as expenses in accordance with paragraphs 27 and 31-36.

²In light of the discussion in SFFAS 54 basis for conclusions par. 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.

For right-to-use lease assets, disclosures of annual lease expenses by lessees (paragraph 54.e) 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.

17. What is the difference between a right-to-use lease asset and the underlying asset?

The underlying asset is the PP&E being leased. Lease arrangements unbundle the economic benefits and services embodied in leased property and give lessees the right to derive economic services and benefits derived from assets underlying the lease, which is represented by the recognition of the right-to-use lease asset over the lease term. Lessors have the right to rentals and any residual value of the leased property and, therefore, do not derecognize the asset underlying the lease, in accordance with paragraph 66 of SFFAS 54.

LEASE TERM

18. 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 right to occupancy is established at the end of the construction period. When does the lease term begin?

The lease term begins when occupancy rights are 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's right to occupancy is established and access to use the building is attained.

19. 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?

No, the month-to-month periods following the five-year noncancelable period are excluded from the lease term under paragraph 19.a of SFFAS 54 in this scenario because both parties have the right to cancel. The lessee has not contracted for a noncancelable right to use an underlying asset, and the lessor is not required to continue providing the asset.

20. 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 liability and 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.

- 21. 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?**

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.

- 22. 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?**

No, these cancelable periods are excluded from the lease term. 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 excluded from the lease term as cancelable periods.

- 23. A lease contract allows only the lessee (reporting entity) 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 included in the lease term by the lessee?**

Yes, they should be included in this particular case. Paragraph 15.b of SFFAS 54 requires lessees to include periods in the lease term covered by their options to terminate if it is probable, based on all relevant factors, that they will not exercise those options. In determining whether it is probable that it 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 (see also: questions 24-25).

- 24. When a reporting entity is making assessments to determine the term of a lease and evaluate option periods in accordance with paragraph 20 of SFFAS 54, 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.

25. 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.

26. 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 should 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.

- 27. 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.

- 28. Do lease term reassessments consider periods prior to the reassessment date, or do they only consider periods following that date?**

Lease term reassessments must consider the entire lease term. The lease term is the noncancelable period plus certain periods subject to options to extend or terminate the lease under paragraphs 14-20. These periods include any applicable periods prior to the reassessment date, except as provided for when applying prospective implementation requirements under paragraph 97.b of SFFAS 54. Accordingly, lease term reassessments would not consider periods that precede the implementation effective date of SFFAS 54.

SHORT-TERM LEASES

- 29. 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.

- 30. 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 months or less, this would be considered a short-term lease.

31. **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?**

Not necessarily. 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.

32. **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.

33. **A reporting entity (lessee) enters into a lease with a 24 month noncancelable term. The lease payment is \$100,000 per month in months 1-12 and \$150,000 per month in months 13-24. Is straight-lining of the related expenses necessary?**

It depends. In the absence of significant evidence to the contrary, lessees would not treat rent increases/decreases as embedded lease concessions.

If the lower 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 may be economic evidence that this was a lease concession in months 1-12. Additional information, however, may be needed to make that determination regarding the purpose of the reduction.

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 embedded lease concessions.

CONTRACTS OR AGREEMENTS THAT TRANSFER OWNERSHIP

- 34. 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.

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

The reporting entity should report the arrangement with the manufacturer 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.

- 36. A reporting entity (lessee) leases PP&E from a non-federal entity. At the end of the agreement the reporting entity will own the PP&E unless it exercises its option to terminate the lease, which it may do at any time. For financial reporting purposes, should this transaction be reported as a lease or as a contract or agreement that transfers ownership?**

This transaction should be reported as a lease by the lessee. Paragraph 25 of SFFAS 54 does not provide for a contract that contains termination options to be reported as a purchase of the asset (although they may contain availability of funding or cancellation clauses that are not probable of being exercised). In substance, this contract includes a purchase option rather than an ownership transfer.

INTRAGOVERNMENTAL LEASES

- 37. A reporting entity (lessor) leases spaces to another reporting entity (lessee) 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 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.

- 38. 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 also: question 37). 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.

- 39. 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.

- The lessee should recognize the lease incentives as deferred revenue when received from the lessor and then amortize the deferred revenue as reductions of lease rental expense on a straight-line basis over the lease term. The lessee should recognize the expenses to which the incentives relate in the reporting period the costs are incurred.
- The lessor should recognize the lease incentives provided as reductions of lease rental income on a straight-line basis over the lease term.

DISCLOSURES FOR INTRAGOVERNMENTAL LEASES

- 40. 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.

- 41. A reporting entity (lessor) has several intragovernmental lease agreements with federal lessees. What information is required to be disclosed in the reporting entity's financial reports?**

The reporting entity (lessor) should disclose a general description of significant intragovernmental leases in accordance with paragraph 38 of SFFAS 54. The contents of the general description are left to the discretion of the reporting entity. For example, the lessor may elect to summarize and describe the nature and general purpose of its intragovernmental leases. The reporting entity should also disclose the future intragovernmental 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.

- 42. 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 original lease agreement should be disclosed per the requirements in paragraph 54, and the sub-lease 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

- 43. 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 ongoing relationship with the lessor and professional judgment, maximizing the use of observable information. For example, if appropriate, the estimate may be based on the last known payment amount.

- 44. 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?**

Typically this component of the contract would be excluded from measurement. 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.

- 45. Lease payments for a five-year lease are indexed to the Consumer Price Index (CPI). The lease payments for the first year are \$50,000 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 \$50,000 per month for 60 months. Any variation from \$50,000 paid in future periods will be recognized as expenses or reductions of expenses of those periods.

- 46. 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.

- 47. 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 incurred (see also: question 61).

- 48. 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. 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.

- 49. 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.

- 50. 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, the fair value may be used. 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.

It should be noted, however, that oftentimes the implicit interest rate cannot be reasonably estimated. In such cases, paragraphs 42 and 59 allow lessees and lessors to use the estimated incremental borrowing rate that would be charged for borrowing the lease payment amounts for the lease term.

- 51. 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 at the end of year 8. Paragraph 44.a would require the reporting entity to also remeasure the lease liability as a result of the change in the lease term at that time.

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

Yes, they should be excluded. 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

53. Can reporting entities apply the same capitalization thresholds used for PP&E to lease assets?

Generally it is not appropriate to apply PP&E capitalization thresholds to lease assets without considering the unique qualitative and quantitative characteristics of lease assets, and the lease liabilities to which they correspond, and their individual and collective significance in relation to the financial statements. 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 that provides due consideration to the materiality fundamentals discussed in Statement of Federal Financial Accounting Concepts 1 paragraphs 164.a-164.g.³

54. A reporting entity (lessee) 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) rather than as lease assets. At the commencement of the lease term the right to occupancy is established. 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 18).

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

Yes, composite or group methods can be used to amortize lease assets. 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.

³Fundamentals are the underlying concepts of financial accounting that guide the selection of transactions, events, and circumstances to be accounted for; their recognition and measurement; and the means of summarizing and communicating them to interested parties. See Preamble to Statements of Federal Financial Accounting Concepts.

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.

- 56. 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 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.

- 57. 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 prospectively amortize the lease asset over the remaining useful life of the underlying asset, if different from the lease term. Additionally, the lease 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 56.

- 58. 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, this would not be a reportable impairment. Paragraph 19 of SFFAS 44, *Accounting for Impairment of General Property, Plant, and Equipment Remaining in Use*, 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

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

No, SFFAS 6 disclosure requirements are only applicable to PP&E. Lease assets are not PP&E for lessees; lease assets are a 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 also: paragraph 66 of SFFAS 54, and question 17).

60. 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.

61. 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.

62. 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 PP&E assets. Upon termination of the lease and purchase of the underlying asset, this disclosure will 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.

63. A reporting entity (lessee) has a portfolio of leases, many of which include potential residual value guarantee payments. How would these potential payments be reported in the financial statements?

Paragraphs 40.d and 44.b of SFFAS 54 provide that amounts that are probable of being required to be paid by the lessee under residual value guarantees be included in the measurement of the lease liability.

Under SFFAS 5, paragraphs 40-42, contingent liabilities may be subject to disclosure requirements if the conditions for liability recognition are not met (i.e., the residual value guarantee payments are not probable and/or reasonably measurable) and there is at least a reasonable possibility that a loss may have been incurred. Disclosure should include the nature of the residual value guarantee payment and an estimate of the possible liability, an estimate of the range of the possible liability, or a statement that such an estimate cannot be made. In some cases, residual value guarantee payments may be identified but the degree of uncertainty is so great (or deemed remote) that no reporting is necessary under paragraph 42 of SFFAS 5.

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

64. 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 also: question 76).

LEASE RECEIVABLE

65. 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.

66. **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 57-58 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. Rather, the reporting entity would recognize a separate receivable and revenue when (a) a guarantee payment is required (as agreed to by the lessee and lessor) and (b) the amount can be reasonably estimated.

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

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.

68. **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

69. **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 lessor should recognize revenue, including interest revenue, over the lease term, which may be different than the useful life of the underlying asset. The requirements for leases are based on the foundational principle that leases are financings, whereby lessees agree to make payments over time for the right to use an underlying asset.

70. **Halfway through a 10-year lease, a lessor remeasures the lease receivable from \$5,000,000 to \$100,000, due to a reduction in the lease term. The related deferred**

revenue balance at that date is \$4,800,000. How does the remeasurement of the lease receivable affect the measurement of the remaining deferred revenue?

The lessor should reduce the lease receivable by \$4,900,000 and the deferred revenue by \$4,800,000 and recognize a loss of \$100,000. 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

- 71. A reporting entity (lessor) 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 (lessor) should continue to report the building as PP&E until the purchase option is exercised by the lessee. 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.

- 72. 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 through such processes, they would test for impairment in accordance with SFFAS 44.

COMPONENT REPORTING ENTITY DISCLOSURE REQUIREMENTS FOR LESSORS

- 73. 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

- 74. 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 be recognized as advances received (liability), since they were received prior to the lease term.⁴ Upon commencement, paragraph 49.b of SFFAS 54 provides that lease incentives received at or before the commencement of the lease term should reduce the lessee's initial measurement of the lease asset. In this case, the advances received liability would then be reclassified as a reduction to the lease asset.

- 75. 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 advance (asset) at the time the payments are made, since they were made prior to the commencement of the lease term.⁵ Upon commencement, 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, the advance asset previously recognized would then be reclassified as a reduction in deferred revenue upon commencement of the lease term.

CONTRACTS OR AGREEMENTS WITH MULTIPLE COMPONENTS

- 76. A reporting entity (lessee) leases equipment that will be installed by the lessor, prior to the commencement of the lease term, for an additional \$100,000. 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 \$100,000) 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.

- 77. 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**

⁴Paragraph 60 of SFFAS 1 provides that advances received (liabilities) should not be netted against advances paid out (assets) in financial reports of the entity.

⁵Ibid.

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.

78. 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 estimated incremental borrowing rate may differ between the two components because of differences in lease terms. When the interest rates for each component cannot be reasonably estimated by the reporting entity, their estimated incremental borrowing rate for each of the two components should be used, in accordance with paragraphs 42 (for lessees) and 59 (for lessors) of SFFAS 54.

79. 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.

80. 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 because the individual component prices are not easily determinable. 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 in accordance with paragraph 77 of SFFAS 54.

- 81. 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 use professional judgment when necessary, maximizing the use of observable information, in accordance with paragraph 76 of SFFAS 54.

CONTRACT OR AGREEMENT COMBINATIONS

- 82. 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.

- 83. 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 orders 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 orders (which are all with the same counterparty) be accounted for as part of the same contract

unless the orders 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

- 84. 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 fifteen vehicles to twenty). 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 twenty vehicles to fifteen) should be accounted for as a partial lease termination (see paragraphs 81-83 of SFFAS 54).

- 85. 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 cancelable 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 prior to the lease modification. 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, thereby subjecting the lease to reassessment criteria under paragraph 21.d. 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.

- 86. 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.

- 87. Two years into a lease with an original lease term of 10 years, the remaining lease term is reassessed and reduced from 8 years 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.

- 88. 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.

- 89. Three years into a 4-year lease, a reporting entity (lessee) modifies its lease from 200 vehicles to 230 vehicles, which if remeasured would change 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 (as discussed in paragraph 84.b of SFFAS 54) 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.

- 90. 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

91. **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 short-term and intragovernmental leases that are part of sublease transactions.

92. **Reporting entity, “Agency ABC” enters into a 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 occupancy assignments amongst various reporting entities within the U.S. government (including reporting entities other than Agency ABC) and their related personnel is managed by a government services officer employed by Agency ABC and an inter-agency housing board. Occupancy assignment durations 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 original lessor by the occupying agencies assigned. How should such a lease be reported by Agency ABC?**

The requirements of paragraphs 87-88 would apply and reporting entity ABC would account for the original lease (as original lessee) and subleases (as sublessor) as 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. The original lease resides with the Agency ABC under its legislative authorities and, therefore, this is not a legal transfer or assignment of the lease contract to another reporting entity, but a sublease.

SALE-LEASEBACK TRANSACTIONS

93. **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.

94. **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.

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

The requirements of paragraphs 89-92 of SFFAS 54 apply to short-term leases that are part of sale-leaseback transactions, provided that, the transaction qualifies as a sale under SFFAS 7, paragraph 295.

For intragovernmental leases, paragraph 89 of SFFAS 54 provides that a similar intragovernmental transaction would not qualify as a sale under SFFAS 7, paragraph 295. Paragraph 295 of SFFAS 7 only applies to sales transactions with the public. As such, intragovernmental sale-leaseback transactions do not include transactions that would qualify as a sale should be accounted for as a borrowing by both the seller-lessee and the buyer-lessor, in accordance with paragraph 89 of SFFAS 54.

LEASE-LEASEBACK TRANSACTIONS

96. 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.

97. 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.

98. 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. 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 18 and 54).

99. 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 short-term and intragovernmental leases that are part of lease-leaseback transactions.

IMPLEMENTATION

100. 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 should not 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.

101. 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 an asset under capital lease and a liability of \$450,600. At the beginning of the period of implementation, the carrying value of the asset under capital lease is \$200,900, and the liability (principal outstanding) is \$210,500. The government determines that the lease liability at that date should be \$220,500 under SFFAS 54. 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 requires the determination of lease term assume the term begins as of the beginning of the period of implementation and initially measuring the lease liability and lease asset based on the remaining lease term and associated payments. In this example, the reporting entity should report a \$220,500 lease liability and lease asset at the date of implementation (beginning balance).

102. **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?**

If there was a transfer of ownership at the end of the lease term, then paragraph 25 of SFFAS 54 would 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. The adjustment for the difference in the lease asset and lease liability should be made to the beginning balance of cumulative results of operations in the statement of changes in net position for the period in which the change is required.

EFFECTIVE DATE

103. This Technical Release is effective for reporting periods beginning after September 30, 2023.

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.⁶
- A5. Due to the high volume of implementation guidance, project staff provided drafts of proposed questions and answers to the AAPC in piecemeal for their review and input prior to their respective actions to release the exposure draft for public comment.
- A6. The AAPC discussed working drafts of the guidance at length following each piecemeal review. A majority of implementation issues identified by or communicated to the Committee are addressed in the proposed questions and answers. Implementation issues that could not be addressed in the proposed Technical Release are primarily excluded for reasons set forth in FASAB Rules of Procedure, which sets forth limitations regarding the purpose and scope of Technical Releases; such issues were referred to the Board and the AAPC Chair as deemed appropriate for their consideration for purposes of (a) developing omnibus amendment proposals related to leases, and/or (b) considering additional projects on leases-related topics.

⁶The GASB material is copyrighted by the Financial Accounting Foundation, 401 Merritt 7, P.O. Box 5116, Norwalk, CT 06856-5116 and was used with permission.

APPENDIX B: ABBREVIATIONS

AAPC	Accounting and Auditing Policy Committee
CFR	Consolidated Financial Report of the U.S. Government
ED	Exposure Draft
FASAB	Federal Accounting Standards Advisory Board
GAAP	Generally Accepted Accounting Principles
GASB	Governmental Accounting Standards Board
GPFFR	General Purpose Federal Financial Report
PP&E	Property, Plant, and Equipment
QFR	Questions for Respondents
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards
SMC	Specific Matters for Comment
TR	Federal Financial Accounting Technical Release



Federal Accounting Standards Advisory Board

OMNIBUS AMENDMENTS ON LEASES-RELATED TOPICS

Statement of Federal Financial Accounting Standards XX

Exposure Draft

Written comments are requested by February 4, 2021

November 5, 2020

Working draft – Public comments are not requested on this draft

EXECUTIVE SUMMARY

WHAT IS THE BOARD PROPOSING?

This Statement of Federal Financial Accounting Standards (SFFAS) would amend paragraphs in SFFAS 54, *Leases*; SFFAS 57, *Omnibus Amendments 2019*; and SFFAS 6, *Accounting for Property, Plant, and Equipment*.

In August 2019, the Accounting and Auditing Policy Committee (AAPC)—which operates under the general oversight of the Federal Accounting Standards Advisory Board (FASAB or “the Board”)—undertook a project to develop proposed implementation guidance for SFFAS 54. During the course of the project, implementation issues were identified that are best addressed through omnibus amendments to leases guidance, mostly clarifying in nature, rather than through a Technical Release. The issues noted require modifications to the existing Statements to provide clarity and address areas of concern.

This proposal would address those issues by clarifying ambiguities and improving consistency throughout SFFAS 54, SFFAS 57, and SFFAS 6. It would also rescind certain disclosure requirements in SFFAS 54 that were determined to be unlikely to provide meaningful information.

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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PROPOSED STANDARDS

SCOPE

1. This Statement applies to federal entities that present general purpose federal financial reports (GPFFRs), including the consolidated financial report of the U.S. Government (CFR), in conformance with generally accepted accounting principles (GAAP), as defined by paragraphs 5 through 8 of Statement of Federal Financial Accounting Standards (SFFAS) 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*.
2. This Statement amends SFFAS 54, *Leases*; SFFAS 6, *Accounting for Property, Plant, and Equipment*; and SFFAS 57, *Omnibus Amendments 2019*, by providing necessary technical corrections and clarifications.

AMENDMENTS TO SFFAS 54

3. Paragraph 5.a of SFFAS 54 is amended as follows:

5.a accounting for leases of assets prior to the commencement of the lease term, such as during under-construction periods or ^{2A}

FN 2A – For leases other than short-term leases and intragovernmental leases, the lessee would account for payments prior to commencement of the lease term as advances paid in contemplation of the future receipt of the lease asset. The lessor would account for receipts prior to commencement of the lease term as advances received. These advances would be accounted for in a manner consistent with SFFAS 1, *Accounting for Selected Assets and Liabilities*, par. 57-61, prior to the lease commencement date. Such advances would be considered assets of the lessee and liabilities of the lessor. At lease commencement, the lessee would then reclassify the asset and include it in the measurement of the lease asset in accordance with SFFAS 54 par. 49, while the lessor would reclassify the advances received as unearned revenue in accordance with par. 64.b.

4. Paragraph 20 of SFFAS 54 is amended as follows:

20. At the commencement of a lease term, lessors and lessees should assess all factors relevant to the likelihood that the lessee or lessor will exercise options identified in paragraph s 15-19, whether these factors are contract or agreement based, underlying asset based, market based, or federal specific. The assessment often will require the consideration of a combination of these interrelated factors. Examples of factors to consider include, but are not limited to, the following: ...

5. Paragraph 21.d of SFFAS 54 is added as follows:

21. Lessors and lessees should reassess the lease term only if one or more of the following events occur:

21.d A lease modification that amends the noncancelable period and results in remeasurement in accordance with paragraphs 85-86.

6. Paragraph 23 of SFFAS 54 is amended as follows:

23. A lessee should recognize short-term lease payments as an expense based on the payment provisions of the contract or agreement and standards regarding recognition of accounts payable and other related amounts. The lessee should recognize an asset if payments are made in advance of the reporting period to which they relate or a liability for rent due if payments are made subsequent to that reporting period. The lessee should recognize lease incentives and lease concessions (for example, a rent holiday period of one or more months free) as reductions of lease rental expense on a straight-line basis over the lease term. Rental increases or rental decreases that are not lease concessions should be recognized in the period of the increase/decrease.^{4A}

FN 4A – See par. 10 for the definition of lease concessions.

7. Paragraph 24 of SFFAS 54 is amended as follows:

24. A lessor should recognize short-term lease payments as revenue based on the payment provisions of the contract or agreement and standards regarding recognition of accounts receivable and other related amounts. The lessor should recognize a liability if payments are received in advance of the reporting period to which they relate or an asset for rent due if payments are received subsequent to that reporting period. The lessor should recognize any lease incentive or concession (for example, a rent holiday period with one or more months free) as reductions of lease rental income on a straight-line basis over the lease term. Rental increases or rental decreases that are not lease concessions should be recognized in the period of the increase/decrease.^{4B}

FN 4B – Ibid.

8. Paragraph 29 of SFFAS 54 is amended as follows:

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

9. Paragraph 30 of SFFAS 54 is amended as follows:

30. Rental increases/decreases may also be variable and based on future changes in specific economic factors on which lease payments are based, for example, future sales or usage activity levels or future inflation/deflation (tied to a specific economic indicator where the specific amount of the change is not known).

10. Paragraph 31 of SFFAS 54 is amended as follows:

31. ~~Rental increases~~ or rental decreases that are not lease concessions, a lessee should be recognized ~~the expense~~ in the period of the increase/decrease.^{5A}

FN 5A – See par. 10.

11. Paragraph 37.b of SFFAS 54 is amended as follows:

37.b Annual lease expense in total and by major underlying asset-leased PP&E category.

12. Paragraph 38.a of SFFAS 54 is amended as follows:

38.a A general description of significant leases, ~~including a breakdown of the number of leases with federally owned assets and privately owned assets~~

13. Paragraph 39 of SFFAS 54 is amended as follows:

39. At the commencement of the lease term, a lessee should recognize a lease liability and a PP&E-right-to-use lease asset (hereinafter referred to as the lease asset), except as provided in paragraphs 22-24 (short-term leases), paragraph 25 (contracts or agreements that transfer ownership), and paragraphs 26-38 (intragovernmental leases).

14. Paragraphs 52-53 of SFFAS 54 are amended as follows:

52. The lease asset generally should be adjusted by the same amount when the corresponding-lease liability is remeasured based on paragraphs 44-48. However, if this change reduces the carrying value of the lease asset to zero, any remaining amount should be reported in the statement of net cost as a gain. Changes arising from amendments to a lease contract or agreement should be accounted for under the provisions of paragraphs 80-86 for lease modifications and terminations.

53. Leased assets ~~classified as PP&E~~ are subject to SFFAS 44, *Accounting for Impairment of General Property, Plant, and Equipment Remaining in Use*. The presence of impairment indicators (described in paragraphs 8-15 of SFFAS 44) with respect to the underlying asset may result in a change in the manner or duration of use of the lessee's rights to obtain and control access to economic benefits and services derived from the underlying asset and the application of SFFAS 44. The change in the manner or duration of use of the underlying asset is an indicator that the right-of-use-lease asset may be impaired (SFFAS 44, par.12). ~~If the underlying asset is impaired, it~~ If impaired, the lease asset should be reduced first for any change in the corresponding-lease liability resulting from remeasurement under paragraphs 44-48 of SFFAS 54, or modifications or terminations under paragraphs 80-86 of SFFAS 54. Any remaining amount should be recognized as an impairment loss. Paragraphs 16-25 of SFFAS 44 provide criteria for testing for impairment, along with recognizing, reporting, and disclosing impairment losses. This guidance should be analogized to lease assets to the extent that impairment losses exceed any reduction to the lease liability and lease asset that may stem from the impairment.

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

15. Paragraph 54 of SFFAS 54 is amended as follows:

54. Lessees should disclose the following regarding lease activities (which may be grouped for purposes of disclosure), other than short-term leases, contracts or agreements that transfer ownership, and intragovernmental leases: ...

16. Paragraph 54.a. of SFFAS 54 is amended as follows:

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

~~ii. the existence, terms, and conditions of residual value guarantees provided by the lessee~~

17. Paragraph 54.b of SFFAS 54 is amended as follows:

54.b The total amount of lease assets and the related accumulated amortization, to be disclosed separately from ~~other~~ PP&E assets

18. Paragraph 59 of SFFAS 54 is amended as follows:

59. The future lease payments to be received should be discounted using the rate the lessor charges the lessee, which may be the interest rate implicit in the lease. Lessors are not required to apply imputed interest but may do so as a means of determining the interest rate implicit in the lease. If the interest rate cannot be reasonably estimated by the lessor, the lessor's estimated incremental borrowing rate should be used.^{9A}

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

19. Paragraph 65 of SFFAS 54 is amended as follows:

65. A lessor subsequently should ~~amortize-recognize~~ the deferred revenue, recognizing it as earned revenue, in a systematic and rational manner over the term of the lease. The deferred revenue generally should be adjusted using the same amount as the change resulting from the remeasurement of the lease receivable as discussed in paragraphs 61–63. However, if the change reduces the carrying value of the deferred revenue to zero, any remaining amount should be reported in the statement of net cost as a loss.

20. Paragraph 67 of SFFAS 54 is amended as follows:

67. Lessors should disclose the following regarding lease activities (which may be grouped for purposes of disclosure), other than short-term leases, contracts or agreements that transfer ownership, and intragovernmental leases: ...

21. Paragraph 69.b of SFFAS 54 is amended as follows:

69. If applicable, the financial report of the U.S. Government should disclose the following regarding its lease activities:

b. The total amount of lease assets, and the related accumulated amortization, to be disclosed separately from ~~other~~ PP&E assets ...

22. Paragraph 71 of SFFAS 54 is amended as follows:

71. Lease incentives and lease concessions reduce the amount that a lessee is required to pay for a lease. For leases other than short-term leases and intragovernmental leases, ~~Lease incentives and lease concessions that provide payments to, or on behalf of, a lessee at or before the commencement of a lease term are included in initial measurement by directly reducing the amount of the lease asset (par. 49). Lease incentive and lease concession payments to be provided after the commencement of the lease term should be accounted for by lessees and lessors as reductions of lease payments for the periods in which the incentive or concession payments will be provided. Those payments should be measured by lessees consistently with the lessee's lease liability (par. 40-48) and by lessors consistently with the lessor's lease receivable (par. 56-63). Accordingly, lease incentive and lease concession payments to be provided after the commencement of the lease term are included in initial measurement and any remeasurement if they are fixed or fixed in substance, whereas variable or contingent lease incentive or lease concession payments are not included in initial measurement. Lessor improvements that are made to or on behalf of the lessee without additional cost to the lessee should be accounted for by the lessee and the lessor consistent with other lease incentives and lease concessions. As leasehold improvements are paid for (financed) by the lessee, leasehold improvements would not be considered a lease incentive or concession received from the lessor.~~^{10A}

FN 10A - The treatment of lease incentives and lease concessions is addressed in par. 23-24 for short-term leases and par. 32-33 for intragovernmental leases.

AMENDMENTS TO SFFAS 6 and SFFAS 57

23. Paragraphs 7 and 8 of SFFAS 57, *Omnibus Amendments 2019*, are rescinded.

24. Paragraph 15 of SFFAS 57 is amended as follows:

15. Paragraphs 3 through ~~6~~⁸, 11, and 12 of this Statement are effective for reporting periods beginning after September 30, 2023. Early adoption is not permitted.

25. Paragraph 18 of SFFAS 6, *Accounting for Property, Plant, and Equipment*, is amended as follows:

18. Property, plant, and equipment also includes:

- ~~assets acquired through capital leases (See paragraph 20), including leasehold improvements;~~

- Property owned by the reporting entity in the hands of [or leased to](#) others (e.g., state and local governments, colleges and universities, or Federal contractors); and
- Land rights¹⁸

FN 18 - "Land rights" are interests and privileges held by the entity in land owned by others, such as ~~leaseholds~~, easements, water and water power rights, diversion rights, submersion rights, rights-of-way, and other like interests in land.

26. Paragraph 19A is added to SFFAS 6 as follows:

19A. Property, plant, and equipment also excludes lease assets and land rights that meet the definition of a lease under SFFAS 54, *Leases*.

EFFECTIVE DATE

27. The requirements of this Statement are effective for reporting periods beginning after September 30, 2023.

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

This Statement may be affected by later Statements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Statements that amend this Statement. The authoritative sections of the Statements 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 Statement for the rationale for each amendment.

PROJECT HISTORY

- A1. Statement of Federal Financial Accounting Standards (SFFAS) 54, *Leases*, was issued in April 2018 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. In June and August 2020, the Board discussed omnibus amendments candidates identified by project staff and the task force to include in the exposure draft. The major points of discussion included:

- a. Clarifying the treatment of assets under construction, including payments prior to the commencement of the lease term, in the context of the scope exclusion enumerated in paragraph 5.a. of SFFAS 54. The Board agreed to make clarifying edits to the scope exclusion in the proposal.
- b. Potential options for amending paragraph 19.a of SFFAS 54 to require detailed analyses of those cancelable periods that are, in substance, unlikely to be canceled by either the lessee or the lessor. After additional research and discussions, the Board concluded that paragraph 19.a should remain unamended. Board members noted that revising the paragraph would likely result in undue costs and preparer burdens. Moreover, the Board believes that reporting entities and their counterparties often have sufficient disincentives that deter them from prevalently engaging in significant off-balance-sheet financing through use of cancelable periods.
- c. The Board agreed to propose clarifying amendments to address step rent decreases throughout the Statement.
- d. The Board agreed to propose the rescission of certain disclosure requirements reflected in paragraphs 38.a and 54.a.ii of SFFAS 54 to alleviate the associated challenges and costs in implementing such requirements. After additional research and deliberations, members agreed that those requirements did not generally meet the qualitative characteristics of useful financial information. For example, members believed that the compilation and presentation of such information would not be consistent, comparable, or provide sufficient feedback or predictive value to decision-makers.
- e. The Board agreed to maintain the current discount rate guidance in paragraph 42 of SFFAS 54, and to propose the addition of comparable language for lessors in paragraph 59 with respect to use of estimated incremental borrowing rates when the interest rate of a lease cannot be reasonably estimated.
- f. The Board agreed to propose numerous clarifying amendments to paragraph 53 of SFFAS 54 to facilitate consistent and correct application of the requirements in SFFAS 54 and SFFAS 44, *Accounting for Impairment of General Property, Plant, and Equipment Remaining in Use*, when impairment indicators are present with respect to assets underlying a lease.
- g. The Board agreed to propose clarifying amendments related to the classification of lease assets, by striking the term “PP&E” in SFFAS 54 and SFFAS 57, *Omnibus Amendments 2019*, in certain locations where use of the term implies that lease assets—rather than the underlying assets—are PP&E. The Board discussed the potential benefits to defining intangible assets, but agreed that the most appropriate mechanism for doing so would be in a separate project focused on intangibles. The Board also agreed to propose amendments to SFFAS 6, *Accounting for Property, Plant, and Equipment*, to clarify that PP&E would not include lease assets or land rights that meet the definition of a lease.

APPENDIX B: ILLUSTRATIVE VERSION OF SFFAS 54 WITH PROPOSED AMENDMENTS

STANDARDS

SCOPE

1. This Statement applies to federal entities that present general purpose federal financial reports, including the consolidated financial report of the U.S. Government (CFR), in conformance with generally accepted accounting principles, as defined by paragraphs 5 through 8 of Statement of Federal Financial Accounting Standards (SFFAS) 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*.
2. For purposes of applying this Statement, a **lease**¹ is defined as a contract or agreement whereby one entity (lessor) conveys the right to control the use of property, plant, and equipment (PP&E)² (the underlying asset) to another entity (lessee) for a period of time as specified in the contract or agreement in exchange for consideration. To qualify as a lease, the underlying asset typically should be identified by being explicitly specified in a contract or agreement. However, an asset also can be identified by being implicitly specified at the time that the asset is made available for use by the lessee. Leases include contracts or agreements that, although not explicitly identified as leases, meet the definition of a lease.
3. To determine whether a contract or agreement conveys the right to control the use of the underlying asset, a federal entity should assess whether the contract or agreement gives the lessee both of the following:
 - a. The right to obtain economic benefits or services from use of the underlying asset as specified in the contract or agreement
 - b. The right to control access to the economic benefits or services of the underlying asset as specified in the contract or agreement
4. The lease definition excludes contracts or agreements for services, except those contracts or agreements that contain both a lease component and a service component (par. 73). A service contract is a contract that directly engages the time and effort of a contractor whose primary purpose is to perform an identifiable task rather than to provide a tangible asset.

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

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

5. This Statement does not apply to

- a. accounting for leases of assets prior to the commencement of the lease term, such as during construction periods or ^{2A}
- b. leases (licenses) of internal use software (SFFAS 10, *Accounting for Internal Use Software*, as amended).

DEFINITIONS

Definitions in paragraphs 6 through 13 are presented within the standards because they are new terms intended to have a specific meaning when applying the standards.

- 6. **Lease** – A lease is defined as a contract or agreement whereby one entity (lessor) conveys the right to control the use of 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.
- 7. **Short-Term Lease** – A short-term lease is a lease with a lease term (as defined in par. 14-21) of 24 months or less.
- 8. **Intragovernmental Lease** – An intragovernmental lease is a contract or agreement occurring within a consolidation entity or between two or more consolidation entities as defined in SFFAS 47, *Reporting Entity*³ whereby one entity (lessor) conveys the right to control the use of 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.
- 9. **Lease Incentives** – Lease incentives include lessor payments made to or on behalf of the lessee to entice the lessee to sign a lease. Lease incentives may include up-front cash payments to the lessee; for example, moving costs, termination fees to the lessee's prior lessor, or the lessor's assumption of the lessee's lease obligation under a different lease with another lessor.
- 10. **Lease Concessions** – Lease concessions are rent discounts made by the lessor to entice the lessee to sign a lease. Lease concessions include rent holidays/free rent periods, reduced rents, or commission credits.
- 11. **Leasehold Improvements** – Leasehold improvements are additions, alterations, remodeling, renovations, or other changes to a leased property that either extend the useful

^{2A} For leases other than short-term leases and intragovernmental leases, the lessee would account for payments prior to commencement of the lease term as advances paid in contemplation of the future receipt of the lease asset. The lessor would account for receipts prior to commencement of the lease term as advances received. These advances would be accounted for in a manner consistent with SFFAS 1, *Accounting for Selected Assets and Liabilities*, par. 57-61, prior to the lease commencement date. Such advances would be considered assets of the lessee and liabilities of the lessor. At lease commencement, the lessee would then reclassify the asset and include it in the measurement of the lease asset in accordance with SFFAS 54 par. 49, while the lessor would reclassify the advances received as unearned revenue in accordance with par. 64.b.

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

life of the existing property or enlarge or improve its capacity and are paid for (financed) by the lessee.

12. **Lessor Improvements** – Lessor improvements are additions, alterations, remodeling, renovations, or other changes to a leased property that either extend the useful life of the existing property or enlarge or improve its capacity and are paid for (financed) by the lessor rather than by the lessee.
13. **Initial Direct Lease Costs** – Initial direct lease costs are costs that are directly attributable to negotiating and arranging a lease or portfolio of leases that would not have been incurred without entering into the lease.

LEASE TERM

14. The lease term is the noncancelable period plus certain periods subject to options to extend or terminate the lease. The noncancelable period is the shorter of
 - a. the period identified in the lease contract or agreement that precedes any option to extend the lease or
 - b. the period identified in the lease contract or agreement that precedes the first option to terminate the lease.
15. The lessee's lease term includes the noncancelable period and the following periods, if applicable:
 - a. Those periods specified in the lease contract or agreement that relate to a lessee's option to extend the lease if it is probable, based on all relevant factors, that the lessee will exercise that option
 - b. Those periods specified in the lease contract or agreement that follow a lessee's option to terminate the lease (up until the point in time when there is another option or, if none, the end of the lease) if it is probable, based on all relevant factors, that the lessee will not exercise that option
 - c. Those periods specified in the lease contract or agreement that relate to a lessor's option to extend the lease if there is significant evidence, based on all relevant factors, that the lessor will exercise that option
 - d. Those periods specified in the lease contract or agreement that follow a lessor's option to terminate the lease (up until the point in time when there is another option or, if none, the end of the lease) if there is significant evidence, based on all relevant factors, that the lessor will not exercise that option
16. The options should be considered in chronological order. If a determination is made that an additional period will not be added to the lease term for an option based on the likelihood criteria above, subsequent options would not be considered. For example, if the lessee determined that it was not probable that a lessee option to extend would be exercised; any subsequent option periods would not be evaluated.

17. The lessor's lease term includes the noncancelable period and the following periods, if applicable:
- a. Those periods specified in the lease contract or agreement that relate to a lessor's option to extend the lease if it is probable, based on all relevant factors, that the lessor will exercise that option
 - b. Those periods specified in the lease contract or agreement that follow a lessor's option to terminate the lease (up until the point in time when there is another option or, if none, the end of the lease) if it is probable, based on all relevant factors, that the lessor will *not* exercise that option
 - c. Those periods specified in the lease contract or agreement that relate to a lessee's option to extend the lease if there is significant evidence, based on all relevant factors, that the lessee will exercise that option
 - d. Those periods specified in the lease contract or agreement that follows a lessee's option to terminate the lease (up until the point in time when there is another option or, if none, the end of the lease) if there is significant evidence, based on all relevant factors, that the lessee will not exercise that option
18. The options should be considered in chronological order. If a determination is made that an additional period will not be added to the lease term for an option based on the likelihood criteria above, subsequent options would not be considered. For example, if the lessor determined that it was not probable that a lessor option to extend would be exercised; any subsequent option periods would not be evaluated.
19. In determining the lease term for both the lessee and lessor, the following specific provisions should be applied:
- a. Periods for which both the lessee and lessor (1) have an option to terminate the lease without permission from the other party or (2) have to agree to extend are cancelable periods and are excluded from the lease term. For example, month-to-month lease holdovers, also referred to as rolling lease extensions, or any lease that continues into a holdover period until a new contract or agreement is signed would be considered cancelable if both the lessee and the lessor have an option to terminate. Therefore, either could cancel the lease at any time. These holdover periods are cancelable periods and should be excluded from the lease term.⁴
 - b. If the lease provisions allow for the termination of a lease due to (a) the purchase of the underlying asset, (b) the payment of all sums due, or (c) the default on payments, these provisions are not considered options to terminate.
 - c. An availability of funds or cancellation clause allows federal lessees to cancel a lease agreement, typically on an annual basis, if funds for the lease payments are

⁴ SFFAS 1 applies to any related accounts payable or accounts receivable amounts.

not appropriated. This type of clause should affect the lease term only when it is probable that the clause will be exercised.

20. At the commencement of a lease term, lessors and lessees should assess all factors relevant to the likelihood that the lessee or lessor will exercise options identified in paragraphs 15-19, whether these factors are contract or agreement based, underlying asset based, market based, or federal specific. The assessment often will require the consideration of a combination of these interrelated factors. Examples of factors to consider include, but are not limited to, the following:

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

21. Lessors and lessees should reassess the lease term only if one or more of the following events occur:

- a. The lessor or lessee elects to exercise an option that was previously presumed would not be exercised under the likelihood criteria in paragraphs 15 and 17
- b. The lessor or lessee does not elect to exercise an option that was previously presumed would be exercised under the likelihood criteria in paragraphs 15 and 17
- c. An event specified in the lease contract or agreement that requires an extension or termination of the lease takes place.
- d. A lease modification that amends the noncancelable period and results in remeasurement in accordance with paragraphs 85-86.

SHORT-TERM LEASES

22. A short-term lease is a lease with a lease term (as defined in paragraphs 14 - 21) of 24 months or less.

LESSEE TREATMENT OF SHORT-TERM LEASES

23. A lessee should recognize short-term lease payments as an expense based on the payment provisions of the contract or agreement and standards regarding recognition of accounts payable and other related amounts. The lessee should recognize an asset if payments are made in advance of the reporting period to which they relate or a liability for rent due if payments are made subsequent to that reporting period. The lessee should recognize lease incentives and lease concessions (for example, a rent holiday period of one or more months free) as reductions of lease rental expense on a straight-line basis over the lease term. Rental increases or rental decreases that are not lease concessions should be recognized in the period of the increase/decrease.^{4A}

LESSOR TREATMENT OF SHORT-TERM LEASES

24. A lessor should recognize short-term lease payments as revenue based on the payment provisions of the contract or agreement and standards regarding recognition of accounts receivable and other related amounts. The lessor should recognize a liability if payments are received in advance of the reporting period to which they relate or an asset for rent due if payments are received subsequent to that reporting period. The lessor should recognize any lease incentive or concession (for example, a rent holiday period with one or more months free) as reductions of lease rental income on a straight-line basis over the lease term. Rental increases or rental decreases that are not lease concessions should be recognized in the period of the increase/decrease.^{4B}

CONTRACTS OR AGREEMENTS THAT TRANSFER OWNERSHIP

25. A contract or agreement that (a) transfers ownership of the underlying asset to the lessee by the end of the contract or agreement and (b) does not contain options to terminate (par. 14–19), but that may contain an availability of funds or cancellation clause that is not probable of being exercised (par. 19.c), should be reported as a purchase of that asset by the lessee or as a financed sale of the asset by the lessor.⁵

INTRAGOVERNMENTAL LEASES

26. An intragovernmental lease is a contract or agreement occurring within a consolidation entity or between two or more consolidation entities as defined in SFFAS 47 whereby one entity (lessor) conveys the right to control the use of 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. Any lease that meets the definition of an intragovernmental lease would be required to follow the accounting and disclosure guidance described in paragraphs 27–38.
27. A lessee should recognize lease payments, including lease-related operating costs (for example, maintenance, utilities, taxes, etc.) paid to the lessor, as expenses based on the payment provisions of the contract or agreement and standards regarding recognition of accounts payable and other related amounts. Prepaid rent or a payable for rent due should

^{4A} See par. 10 for the definition of lease concessions.

^{4B} Ibid.

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

be recognized as an asset or liability, respectively, and an expense should be recognized in the appropriate reporting period based on the specifics of the lease provisions.

28. A lessor should recognize lease receipts, including lease-related operating costs (for example, maintenance, utilities, or taxes) received from the lessee as income based on the provisions of the contract or agreement and standards regarding recognition of accounts receivable and other related amounts. Rent paid in advance or a receivable should be recognized as a liability or asset, respectively, and income should be recognized in the appropriate reporting period based on the specifics of the lease provisions.
29. Rental increases/decreases may be fixed in the lease and take place with the passage of time (for example, be based on such factors as anticipated increases/decreases in costs or anticipated appreciation/depreciation in property values, but the amount of the increase/decrease is specified in the lease) or they may be contingent on future events.
30. Rental increases/decreases may also be variable and based on future changes in specific economic factors on which lease payments are based, for example, future sales or usage activity levels or future inflation/deflation (tied to a specific economic indicator where the specific amount of the change is not known).
31. Rental increases or rental decreases that are not lease concessions, should be recognized in the period of the increase/decrease.^{5A}
32. Lease incentives should be recognized by the lessee as deferred revenue when received from the lessor and then as reductions of lease rental expense on a straight-line basis over the lease term. The lessee should recognize the expenses or losses to which the incentives relate in the reporting period the costs are incurred. For example, an incentive equal to the moving expense incurred by the lessee to occupy the leased space reduces rent expense over the lease term, and the moving expense is recognized in the reporting period incurred (that is, when the move occurs). Lease incentives provided to the lessee should be recognized by the lessor as reductions of lease rental income on a straight-line basis over the lease term.
33. Lease concessions should be recognized by the lessee as reductions of lease rental expense on a straight-line basis over the lease term. Lease concessions should be recognized by the lessor as reductions in rental income on a straight-line basis over the lease term.
34. Leasehold improvements that are placed in service at or after the beginning of the lease term should be amortized over the useful life (the normal operating life in terms of utility to the lessee) of the leasehold improvement, but no longer than the expected lease term.
35. Lessor improvements are components of the leased property and should be capitalized and depreciated by the lessor over their useful life consistent with the lessor's accounting for PP&E.⁶

^{5A} See par. 10.

⁶ This recognition is consistent with PP&E capital improvements outlined in SFFAS 6, *Accounting for Property, Plant and Equipment*, par. 37.

36. Initial direct lease costs incurred by the lessee should be expensed when incurred. Initial direct lease cost incurred by the lessor should be expensed when incurred.

DISCLOSURES FOR INTRAGOVERNMENTAL LEASES

37. Lessees should disclose the following regarding intragovernmental lease activities (which may be grouped for purposes of disclosure):

- a. A general description of significant intragovernmental leasing arrangements, including general lease terms with any applicable specific intragovernmental requirements
- b. Annual lease expense in total and by major underlying asset category.

38. Lessors should disclose the following regarding intragovernmental lease activities (which may be grouped for purposes of disclosure):

- a. A general description of significant leases
- b. 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

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

39. At the commencement of the lease term, a lessee should recognize a lease liability and a right-to-use lease asset (hereinafter referred to as the lease asset), except as provided in paragraphs 22–24 (short-term leases), paragraph 25 (contracts or agreements that transfer ownership), and paragraphs 26–38 (intragovernmental leases).

LEASE LIABILITY

40. A lessee initially should measure the lease liability at the present value of payments expected to be made during the lease term. Measurement of the lease liability should include the following, if required by a lease:
- a. Fixed payments
 - b. Variable payments that depend on an index or a rate (such as the Consumer Price Index or a market interest rate), initially measured using the index or rate as of the commencement of the lease term
 - c. Variable payments that are fixed in-substance as described in paragraph 41
 - d. Amounts that are probable of being required to be paid by the lessee under residual value guarantees

- e. The exercise price of a purchase option if it is probable that the lessee will exercise that option
 - f. Payments for penalties for terminating the lease, if the lease term reflects the lessee exercising (1) an option to terminate the lease or (2) an availability of funds or cancellation clause
 - g. Any lease incentives (par. 70–71) receivable from the lessor
 - h. Any other payments to the lessor that are probable of being required based on an assessment of all relevant factors
41. Variable payments based on future performance of the lessee or usage of the underlying asset should not be included. Rather, these variable payments should be recognized as an expense in the reporting period in which those payments are incurred. However, any component of these variable payments that is fixed in-substance should be included in the lease liability. An example is a lease payment based on a percentage of sales or usage but with a required minimum amount to be paid. That required minimum payment is fixed in-substance.
42. The future lease payments should be discounted using the interest rate the lessor charges the lessee, which may be the interest rate implicit in the lease. If the interest rate cannot be reasonably estimated by the lessee, the **lessee's estimated incremental borrowing rate**⁷ (the estimated rate that would be charged for borrowing the lease payment amounts for the lease term) should be used.
43. In subsequent financial reporting periods, the lessee should calculate the amortization of the discount on the lease liability and recognize that amount as interest expense for the period. Any payments made should be allocated first to the accrued interest liability and then to the lease liability.
44. The lessee should remeasure the lease liability at subsequent financial reporting dates if one or more of the following changes⁸ have occurred at or before that financial reporting date, based on the most recent lease contract or agreement before the changes, and if the changes individually or in the aggregate, are expected to significantly affect the amount of the lease liability since the previous measurement:
- a. There is a change in the lease term.
 - b. An assessment of all relevant factors indicates that the likelihood of a residual value guarantee being required to be paid has changed from probable to not probable or vice versa.

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

⁸ Changes arising from amendments to a lease contract or agreement should be accounted for under the provisions of par. 80–86 for lease modifications and terminations.

- c. An assessment of all relevant factors indicates that the likelihood of a purchase option being exercised has changed from probable to not probable, or vice versa.
 - d. There is a change in the estimated amounts for payments already included in the liability (except as provided in par. 45).
 - e. There is a change in the interest rate the lessor charges the lessee if used as the initial **discount rate**.
 - f. A contingency, upon which some or all of the variable payments that will be made over the remainder of the lease term are based, is resolved such that those payments now meet the criteria for measuring the lease liability in paragraph 40. For example, an event occurs that causes variable payments that were contingent on the performance or use of the underlying asset to become fixed payments for the remainder of the lease term.
45. If a lease liability is remeasured for any of the changes in paragraph 44, the liability also should be adjusted for any change in an index or rate used to determine variable lease payments if that change in the index or rate is expected to significantly affect the amount of the liability since the previous measurement. A lease liability is not required to be remeasured solely for a change in an index or rate used to determine variable payments.
46. The lessee also should update the discount rate as part of the remeasurement if one or both of the following changes have occurred and the changes individually or in the aggregate are expected to significantly affect the amount of the lease liability:
- a. There is a change in the lease term.
 - b. An assessment of all relevant factors indicates that the likelihood of a purchase option being exercised has changed from probable to not probable, or vice versa.
47. A lease liability is not required to be remeasured, nor is the discount rate required to be reassessed, solely for a change in the lessee's estimated incremental borrowing rate.
48. If the discount rate is required to be updated based on the provisions in paragraph 46, the discount rate should be based on the revised interest rate the lessor charges the lessee at the time the discount rate is updated. If that interest rate cannot be readily determined, the lessee's estimated incremental borrowing rate at the time the discount rate is updated should be used.

LEASE ASSET

49. A lessee should initially measure the lease asset as the sum of the following:
- a. The amount of the initial measurement of the lease liability (par. 40)
 - b. Lease payments made to the lessor at or before the commencement of the lease term, less any lease incentives (par. 70–71)

c. Initial direct lease costs that are necessary to place the lease asset into service

50. A lease asset should be amortized in a systematic and rational manner over the shorter of the lease term or the useful life of the underlying asset, except as provided in paragraph 51. The amortization of the lease asset should be reported as amortization expense.
51. If a lease contains a purchase option that the lessee has determined is probable of being exercised, the lease asset should be amortized over the useful life of the underlying asset. In that circumstance, if the underlying asset is nondepreciable, such as land, the lease asset should not be amortized.
52. The lease asset generally should be adjusted by the same amount when the lease liability is remeasured based on paragraphs 44-48. However, if this change reduces the carrying value of the lease asset to zero, any remaining amount should be reported in the statement of net cost as a gain. Changes arising from amendments to a lease contract or agreement should be accounted for under the provisions of paragraphs 80-86 for lease modifications and terminations.
53. Leased assets are subject to SFFAS 44, *Accounting for Impairment of General Property, Plant, and Equipment Remaining in Use*. The presence of impairment indicators (described in paragraphs 8-15 of SFFAS 44) with respect to the underlying asset may result in a change in the manner or duration of use of the lessee's rights to obtain and control access to economic benefits and services derived from the underlying asset and the application of SFFAS 44. The change in the manner or duration of use of the underlying asset is an indicator that the lease asset may be impaired. If impaired, the lease asset should be reduced first for any change in the lease liability resulting from remeasurement under paragraphs 44-48 of SFFAS 54, or modifications or terminations under paragraphs 80-86 of SFFAS 54. Any remaining amount should be recognized as an impairment loss. Paragraphs 16-25 of SFFAS 44 provide criteria for testing for impairment, along with recognizing, reporting, and disclosing impairment losses. This guidance should be analogized to lease assets to the extent that impairment losses exceed any reduction to the lease liability and lease asset that may stem from the impairment.

COMPONENT REPORTING ENTITY DISCLOSURE REQUIREMENTS FOR LESSEES

54. Lessees should disclose the following regarding lease activities (which may be grouped for purposes of disclosure), other than short-term leases, contracts or agreements that transfer ownership, and intragovernmental leases:
- a. A general description of its leasing arrangements, including the basis, terms, and conditions on which variable lease payments not included in the lease liability are determined
 - b. The total amount of lease assets and the related accumulated amortization, to be disclosed separately from PP&E assets

⁹ [Footnote 9 rescinded by SFFAS XX; elements of the original footnote are now included the body of paragraph 53, as amended.]

- c. The amount of lease expense recognized for the reporting period for variable lease payments not previously included in the lease liability
- d. Principal and interest requirements to the end of the lease term, presented separately, for the lease liability for each of the five subsequent years and in five-year increments thereafter
- e. The amount of the annual lease expense and the discount rate used to calculate the lease liability

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

55. At the commencement of the lease term, a lessor should recognize a lease receivable and a deferred revenue, except as provided in paragraph 22–24 (short-term leases), paragraph 25 (contracts or agreements that transfer ownership), and paragraphs 26–38 (intragovernmental leases). Any initial direct lease costs incurred by the lessor should be reported as an expense of the period.

LEASE RECEIVABLE

56. A lessor initially should measure the lease receivable at the present value of lease payments to be received for the lease term, reduced by any provision for uncollectible amounts. Measurement of the lease receivable should include the following types of payments that might be required by a lease:
- a. Fixed payments
 - b. Variable payments that depend on an index or a rate (such as the Consumer Price Index or a market interest rate), initially measured using the index or rate as of the commencement of the lease term
 - c. Variable lease payments that are fixed in-substance as described in paragraph 57
 - d. Residual value guarantees that are fixed payments in substance (par. 57)
 - e. Any lease incentives (par. 70–71) payable to the lessee
57. Variable payments based on future performance of the lessee or usage of the underlying asset should not be included in the measurement of the lease receivable. Rather, those payments should be recognized as revenue in the reporting period to which those payments relate. However, any component of those variable payments that is fixed in substance should be included in the lease receivable. For example, if a lease payment is based on a percentage of sales but has a required minimum payment, that required minimum is a fixed payment in substance. Similarly, a residual value guarantee is an in-substance fixed payment if it stipulates the underlying asset will be sold at the end of the lease term, with the

lessee assuming a liability for any shortfall if the sales price is less than an agreed-upon minimum amount.

58. Amounts to be received under residual value guarantees (that are not fixed in substance) should be recognized as a receivable and revenue when (a) a guarantee payment is required (as agreed to by the lessee and lessor) and (b) the amount can be reasonably estimated. Amounts to be received for the exercise price of a purchase option or penalty for lease termination should be recognized as a receivable and revenue when those options are exercised.
59. The future lease payments to be received should be discounted using the rate the lessor charges the lessee, which may be the interest rate implicit in the lease. Lessors are not required to apply imputed interest but may do so as a means of determining the interest rate implicit in the lease. If the interest rate cannot be reasonably estimated by the lessor, the lessor's estimated incremental borrowing rate should be used.^{9A}
60. In subsequent financial reporting periods, the lessor should calculate the amortization of the discount on the receivable and report that amount as interest revenue for the period. Any payments received should be allocated first to the accrued interest receivable and then to the lease receivable.
61. The lessor should remeasure the lease receivable at subsequent financial reporting periods if one or more of the following changes have occurred at or before that financial reporting period, based on the most recent lease contract or agreement before the changes,¹⁰ and the changes individually or in the aggregate, are expected to significantly affect the amount of the lease receivable since the previous measurement:
- There is a change in the lease term.
 - There is a change in the interest rate the lessor charges the lessee.
 - A contingency, upon which some or all of the variable payments that will be received over the remainder of the lease term are based, is resolved such that those payments now meet the criteria for measuring the lease receivable in paragraph 56. For example, an event occurs that results in variable payments that were contingent on the performance or use of the underlying asset becoming fixed payments for the remainder of the lease term.
62. If a lease receivable is remeasured for any of the changes in paragraph 61, the receivable also should be adjusted for any change in an index or rate used to determine variable lease payments if that change in the index or rate is expected to significantly affect the amount of the receivable since the previous measurement. A lease receivable is not required to be

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

¹⁰ Changes arising from amendments to a lease contract or agreement should be accounted for under the provisions of par. 80–86 for lease modifications and terminations.

remeasured solely for a change in an index or rate used to determine variable lease payments.

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

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

DEFERRED REVENUE

64. A lessor initially should measure the deferred revenue to include the following:

- a. The amount of the initial measurement of the lease receivable (par. 56)
- b. Lease payments received from the lessee at or before the commencement of the lease term that relate to future periods (for example, the final month's rent), less any lease incentives (par. 70–71) paid to, or on behalf of, the lessee at or before the commencement of the lease term

65. A lessor subsequently should **amortize** the deferred revenue, **recognizing it as earned revenue**, in a systematic and rational manner over the term of the lease. The deferred revenue generally should be adjusted using the same amount as the change resulting from the remeasurement of the lease receivable as discussed in paragraphs 61–63. **However, if the change reduces the carrying value of the deferred revenue to zero, any remaining amount should be reported in the statement of net cost as a loss.**

UNDERLYING ASSET

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

COMPONENT REPORTING ENTITY DISCLOSURES FOR LESSORS

67. Lessors should disclose the following regarding lease activities (which may be grouped for purposes of disclosure), **other than short-term leases, contracts or agreements that transfer ownership, and intragovernmental leases:**

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

- c. The total amount of revenue (for example, lease revenue, interest revenue, and any other lease-related revenue) recognized in the reporting period from leases
- d. The amount of revenue recognized in the reporting period for variable lease payments and other payments not previously included in the lease receivable, including revenue related to residual value guarantees and termination penalties

68. In addition to the disclosures in paragraph 67, if a federal entity's principal ongoing operations consist of leasing assets through the use of non-intragovernmental leases, the federal entity should disclose a schedule of future lease payments that are included in the lease receivable, showing principal and interest, for each of the five subsequent years and in five-year increments thereafter.

FINANCIAL REPORT OF THE U.S. GOVERNMENT DISCLOSURES

69. If applicable, the financial report of the U.S. Government should disclose the following regarding its lease activities:

- a. A general description of its leasing arrangements
- b. The total amount of lease assets, and the related accumulated amortization, to be disclosed separately from PP&E assets
- c. Principal and interest requirements to the end of the lease term, presented separately, for the lease liability for each of the five subsequent years and in five-year increments thereafter
- d. A general reference to relevant component reporting entity reports

LEASE INCENTIVES AND LEASE CONCESSIONS

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

71. Lease incentives and lease concessions reduce the amount that a lessee is required to pay for a lease. For leases other than short-term leases and intragovernmental leases, lease incentives and lease concessions that provide payments to, or on behalf of, a lessee at or before the commencement of a lease term are included in initial measurement by directly reducing the amount of the lease asset (par. 49). Lease incentive and lease concession payments to be provided after the commencement of the lease term should be accounted for by lessees and lessors as reductions of lease payments for the periods in which the incentive or concession payments will be provided. Those payments should be measured by lessees consistently with the lessee's lease liability (par. 40–48) and by lessors consistently

with the lessor's lease receivable (par. 56–63). Accordingly, lease incentive and lease concession payments to be provided after the commencement of the lease term are included in initial measurement and any remeasurement if they are fixed or fixed in substance, whereas variable or contingent lease incentive or lease concession payments are not included in initial measurement. Lessor improvements that are made to or on behalf of the lessee without additional cost to the lessee should be accounted for by the lessee and the lessor consistent with other lease incentives and lease concessions. As leasehold improvements are paid for (financed) by the lessee, leasehold improvements would not be considered a lease incentive or concession received from the lessor.^{10A}

CONTRACTS OR AGREEMENTS WITH MULTIPLE COMPONENTS

72. Lessors and lessees may enter into contracts or agreements that contain multiple components, such as a contract or agreement that contains both a lease component and a nonlease component, or a lease that contains multiple underlying assets.
73. If a lessor or lessee enters into a contract or agreement that contains both a lease (such as the right to use a building) and a nonlease component (such as a maintenance services for the building), the federal entity should account for the lease and nonlease components as separate contracts or agreements, unless the contract or agreement meets the exception in paragraph 76.
74. If a lease involves multiple underlying assets and the assets have different lease terms, the lessor and lessee should account for each underlying asset as a separate lease component. The provisions of this paragraph should be applied unless the contract or agreement meets the exception in paragraph 76.
75. To allocate the contract or agreement price to the different components, lessors and lessees should first use any prices for individual components that are included in the contract or agreement, as long as the price allocation does not appear to be unreasonable based on the terms of the contract or agreement and professional judgment, maximizing the use of observable information, for example, using readily available observable stand-alone prices. Stand-alone prices are those that would be paid or received if the same or similar assets were leased individually or if the same or similar nonlease components (such as services) were contracted individually. Some contract or agreements provide discounts for bundling multiple leases or lease and nonlease components together in one contract or agreement. These discounts may be taken into account when determining whether individual component prices do not appear to be unreasonable. For example, if the individual component prices are each discounted by the same percentage from normal market prices, those component prices would not be considered unreasonable.
76. If a contract or agreement does not include prices for individual components or if any of those prices appear to be unreasonable as provided in paragraph 75, lessors and lessees should use professional judgment to determine their best estimate for allocating the contract or agreement price to those components, maximizing the use of observable information. If it is not practicable to determine a best estimate for price allocation for some or all

^{10A} The treatment of lease incentives and lease concessions is addressed in par. 23-24 for short-term leases and par. 32-33 for intragovernmental leases.

components in a contract or agreement, a federal entity should account for those components as a single lease unit.

77. If multiple components are accounted for as a single lease unit as provided for in paragraph 76, the accounting for that unit should be based on the primary lease component within that unit. For example, the primary lease component's lease term should be used for the unit if the lease components have different lease terms.

CONTRACT OR AGREEMENT COMBINATIONS

78. Contracts or agreements that are entered into at or near the same time with the same counterparty should be considered to be part of the same lease contract or agreement if either of the following criteria is met:
- a. The contracts or agreements are negotiated as a package with a single objective.
 - b. The amount of consideration to be paid in one contract or agreement depends on the price or performance of the other contract or agreement.
79. If multiple contracts or agreements are determined to be part of the same lease contract or agreement, that contract or agreement should be evaluated in accordance with the guidance for contracts or agreements with multiple components in paragraphs 72–77.

LEASE TERMINATIONS AND MODIFICATIONS

80. The provisions of a lease contract or agreement may be amended while the contract or agreement is in effect. Examples of amendments to lease contracts or agreements include changing the contract or agreement price, lengthening or shortening the lease term, and adding or removing an underlying asset. An amendment should be considered a lease modification unless the lessee's right to use the underlying asset decreases, in which case the amendment should be considered a partial or full lease termination. By contrast, exercising an existing option, such as an option to extend or terminate the lease as discussed in paragraphs 15-19, is subject to the guidance for remeasurement.

LEASE TERMINATIONS

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

Lessee Treatment of Lease Terminations

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

Lessor Treatment of Lease Terminations

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

LEASE MODIFICATIONS

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

Lessee Treatment of Lease Modifications

85. Unless a modification is reported as a separate lease as provided in 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. However, if the change reduces the carrying value of the lease asset to zero, any remaining amount should be reported in the statement of net cost as a gain.

Lessor Treatment of Lease Modifications

86. 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. The deferred revenue should be adjusted by the difference between the remeasured receivable and the receivable immediately before the lease modification. However, to the extent the change relates to payments for the current period, the change should be recognized as revenue or expense for the current period.

SUBLEASES

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

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

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

SALE-LEASEBACK TRANSACTIONS

89. Sale-leaseback transactions involve the sale of an underlying asset by the owner and a lease of the property back to the seller (original owner). A sale-leaseback should include a transaction that qualifies as a sale¹¹ to be eligible for sale-leaseback accounting. A sale-leaseback transaction that does not include a transaction that qualifies as a sale should be accounted for as a borrowing by both the seller-lessee and the buyer-lessor.
90. The sale and lease portions of a sale-leaseback transaction should be accounted for as two separate transactions—a sale transaction and a lease transaction—except that the difference between the carrying value of the capital asset that was sold and the net proceeds from the sale should be reported as a deferred revenue or deferred expense to be recognized in the statement of net cost in a systematic and rational manner over the term of the lease. However, if the lease portion of the transaction qualifies as a short-term lease, any difference between the carrying value of the capital asset that was sold and the net proceeds from the sale should be recognized immediately.
91. A sale-leaseback transaction is considered to have off-market terms if there is a significant difference between (a) the sales price and the estimated fair value of the asset or (b) the present value of the contractual lease payments and the estimated present value of what the lease payments for that asset would be at a market price, whichever of the two differences is more readily determinable. The difference should be reported based on the substance of the transaction (for example, as a borrowing, a nonexchange transaction, or an advance lease payment) rather than as a part of the sales-leaseback transaction.
92. A seller-lessee should disclose the terms and conditions of sale-leaseback transactions in addition to the disclosures required of a lessee (par. 54). A buyer-lessor should provide the disclosures required of a lessor (par. 67).

LEASE-LEASEBACK TRANSACTIONS

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

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

accounted for as a net transaction. Both parties to a lease-leaseback transaction should disclose the amounts of the lease and the leaseback separately.

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

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

SFFAS 5: Accounting for Liabilities of the Federal Government

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

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

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

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

~~[45.] The discount rate to be used in determining the present value of the minimum lease payments ordinarily would be the lessee's incremental borrowing rate unless (1) it is~~

practicable for the lessee to learn the implicit rate computed by the lessor and (2) the implicit rate computed by the lessor is less than the lessee's incremental borrowing rate. If both these conditions are met, the lessee shall use the implicit rate. The lessee's incremental borrowing rate shall be the Treasury borrowing rate for securities of similar maturity to the term of the lease.

[46.] During the lease term, each minimum lease payment should be allocated between a reduction of the obligation and interest expense so as to produce a constant periodic rate of interest on the remaining balance of the liability. [footnote 21: OMB Circular No. A-11, "Preparation and Submission of Annual Budget Estimates," explains the measurement of budget authority, outlays, and debt for the budget in the case of lease purchases and other capital leases. Circular A-94, "Guidelines and Discount Rates for Benefit-Cost Analysis of Federal Programs," provides the requirements under which a lease purchase or other capital lease has to be justified and the analytical methods that need to be followed.]

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

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

[20.] Capital leases are leases that transfer substantially all the benefits and risks of ownership to the lessee. If, at its inception, a lease meets one or more of the following four criteria, [footnote 21: Note that the criteria for identifying capital leases for financial reporting purposes differ from OMB criteria for budget scoring of leases. OMB Circular No. A-11, *Preparation and Submission of Budget Estimates*, includes criteria for identifying operating leases in Appendix B. OMB provides four additional criteria which relate to the level of private sector risk involved in a lease purchase agreement. This is necessary because, for budget purposes, there is a distinction between lease purchases with more or less risk. This distinction is not made in the financial reports and, therefore, FASAB does not include the four criteria related to risk levels.] the lease should be classified as a capital lease by the lessee. Otherwise, it should be classified as an operating lease.

[footnote 22: "Operating leases" of PP&E are leases in which the Federal entity does not assume the risks of ownership of the PP&E. Multi-year service contracts and multi-year purchase contracts for expendable commodities are not capital leases.]

- The lease transfers ownership of the property to the lessee by the end of the lease term.
- The lease contains an option to purchase the leased property at a bargain price.
- The lease term is equal to or greater than 75 percent of the estimated economic life [footnote 23: "Estimated economic life of leased property" is the estimated remaining period during which the property is expected to be economically usable by one or more users, with normal repairs and maintenance, for the

purpose for which it was intended at the inception of the lease, without limitation by the lease term.] of the leased property.

~~• The present value of rental and other minimum lease payments, excluding that portion of the payments representing executory cost, equals or exceeds 90 percent of the fair value [footnote 24: "Fair value" is the price for which an asset could be bought or sold in an arm's-length transaction between unrelated parties (e.g., between a willing buyer and a willing seller). (adapted from Kohler's Dictionary for Accountants)] of the leased property.~~

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

[29.] The cost of general PP&E acquired under a **capital lease** shall be equal to the amount recognized as a liability for the capital lease at its inception (i.e., the net present value of the lease payments calculated as specified in the liability standard [footnote 35: See Statement of Recommended Accounting Standards No. 5, *Accounting for Liabilities of the Federal Government*.] unless the net present value exceeds the fair value of the asset).

IMPLEMENTATION

96. This Statement requires that leases unexpired at the beginning of the reporting period in which the Statement is implemented be recognized and measured using the facts and circumstances that exist at the beginning of the reporting period. Therefore, in the period of implementation,

- a. the determination of the lease term would assume that the lease term began as of the beginning of the period of implementation and
- b. the lease liability and lease asset should initially be measured based on the remaining lease term and associated lease payments as of the beginning of the period of implementation.

97. The following implementation guidance addresses specific leasing circumstances.

- a. **Prospective Implementation** – Entities should report the effect of implementing this Statement on existing leases prospectively in accordance with paragraph 13 of SFFAS 21, *Reporting Correction of Errors and Changes in Accounting Principles, Amendment of SFFAS 7, Accounting for Revenue and Other Financing Sources*. Accordingly, any changes in assets or liabilities related to existing leases should be treated prospectively. The change should be accounted for in the period of implementation and applicable future periods. No adjustments should be made to previously reported expenses or revenue.
- b. **Lease Term** – The lease term should be determined based on the provisions of this Statement (par. 14-21). However, the lease term of an existing lease should be based on the number of years remaining in the lease contract or agreement as of the beginning of the period of implementation and not the number of years in the initial

lease term. For example, if the initial lease term was 20 years, with no options to extend, at the beginning of Year 20X1 and the entity implements this Statement in Year 20X7 (six years into the lease at the beginning of Year 20X7), the initial lease term upon implementation would be 14 years.

- c. Short-Term Leases – A short-term lease would be determined based on the provisions of this Statement (par. 22–24). However, if the remaining lease term of an existing lease meets the definition of a short-term lease that lease should apply the short-term lease guidance. For example, if the initial lease term was 60 months as of the beginning of Year 20X1, with no options to extend, and the entity implements this Statement in Year 20X5 (48 months into the lease at the beginning of Year 20X5); the initial lease term at implementation would be 12 months and the lease would meet the definition of a short-term lease. Hence, the entity should account for the lease as a short-term lease.

EFFECTIVE DATE

98. The requirements of this Statement are effective for reporting periods beginning after September 30, 2023. Early adoption is not permitted.

The provisions of this Statement need not be applied to immaterial items
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APPENDIX C: ABBREVIATIONS

AAPC	Accounting and Auditing Policy Committee
CFR	Consolidated Financial Report of the U.S. Government
ED	Exposure Draft
FASAB	Federal Accounting Standards Advisory Board
GAAP	Generally Accepted Accounting Principles
GASB	Governmental Accounting Standards Board
GPFFR	General Purpose Federal Financial Report
PP&E	Property, Plant, and Equipment
QFR	Questions for Respondents
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards
SMC	Specific Matters for Comment
TR	Federal Financial Accounting Technical Release

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Attachment 2 is a Word version of p. 49-83 of Attachment 1 to facilitate Board review of the omnibus amendments proposal and, therefore, excluded from the consolidated PDF of Tab B.

Project Plan

	Deferral SFFAS	Implementation Guidance on Leases	Omnibus SFFAS / Interpretations	Conforming Amendments TR	Software Licenses Technical Bulletin	Training / Outreach
FY 2020 Q1	Draft Exposure Period	Draft	Research	On Hold. Will likely become a sub-project of a future intangibles / SBITAs project	Discontinued. Will likely be scoped into the future intangibles / SBITAs project	Draft FY 20 content
FY 2020 Q2	Exposure Period	Draft	Research			Provide
FY 2020 Q3	Finalize Issuance ISSUED	Draft	Draft			Provide
FY 2020 Q4		Draft	Draft			Provide
FY 2021 Q1		Exposure Period	Exposure Period			Draft FY 21 content
FY 2021 Q2		Finalize	Finalize			Provide
FY 2021 Q3		Finalize	Finalize			Provide
FY 2021 Q4		Issuance	Issuance			Draft FY 22 content
FY 2022 Q1						Draft FY 22 content
FY 2022 Q2						Provide
FY 2022 Q3		Research				Provide
FY 2022 Q4		Research				Provide
FY 2023 Q1		Research				Provide
FY 2023 Q2		Research				Provide
FY 2023 Q3		Research				Provide
FY 2023 Q4		Research				Provide
FY 2024 Q1	SFFAS 54 effective					