



## Federal Accounting Standards Advisory Board

**August 7, 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 E**<sup>1</sup>

### **MEMBER ACTION REQUESTED:**

Staff requests preliminary responses to Board questions by August 19<sup>th</sup>.

### **MEETING OBJECTIVES**

1. Review and discuss omnibus amendments candidates.
2. In light of the meeting deliberations, discuss next steps proposed by staff and poll the Board regarding their comfort level with staff's timeline for pre-balloting and balloting.

### **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: *SFFAS XX, Omnibus Amendments on Leases-Related Topics*

**Attachment 2** – Illustrative copy of SFFAS 54 with amendments

**Attachment 3** – Leases project plan

### Development Phase

The Leases Omnibus project is in the development phase where the Board deliberates to develop an exposure draft to clarify aspects of SFFAS 54, *Leases*.

## Background

As part of the leases implementation guidance project, staff has identified issues that cannot be addressed in a technical release. A technical release 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 thanks the leases implementation task force and the AAPC for their continued assistance in identifying these issues. Since the Board's June meeting, the task force has continued to meet collectively and provide extensive feedback and input to staff electronically and through small group video conference working meetings.


Staff views the omnibus amendments working draft file as a "near-final" working draft proposal that can likely be pre-balloted in October.

## Staff Analysis of Omnibus Amendments Candidates

Staff recommends the following proposed omnibus amendments. See Attachment 1 for the working draft. Proposed edits are highlighted in [blue text](#) to facilitate Board review.

Members may wish to also view these amendments in Attachment 2, which illustrates how the proposals would appear within SFFAS 54 untracked. Deletions are not tracked with strikethrough in Attachment 2; however, any new or revised text resulting from omnibus amendment proposals in Attachment 1 are displayed in burgundy font in Attachment 2.

 = Discussed in June; no changes     
  = Discussed in June; changes made     
  = New

1. **SFFAS 54, Scope section** – *Staff proposes amending paragraph 5.a of SFFAS 54 which scopes out leases under construction and inserting a clarifying footnote thereto.* 

In consideration of Board member feedback, staff has revised the approach to this paragraph. The new proposal amends paragraph 5.a, rather than rescinding it. The proposed footnote describes how payments during the construction period should be recognized while maintaining the intent of the original exclusion. The language in the footnote aligns with GASB's Implementation Guide 2019-3, questions 4.12 and 4.32.

This proposed amendment, along with implementation guidance under development, will serve to clarify, but not alter, the accounting treatment of assets under construction. As a reminder, the rationale for these amendments is to (1) improve the clarity and precision of the scope exclusion, (2) clarify, within the footnote, the accounting treatment for payments made during the construction period and the subsequent accounting once the lease term of the underlying asset, previously under construction, commences, as provided for under paragraph 49.b.

2. **SFFAS 54, Lease Term section** – *Staff proposes edits to paragraph 19.a.* 🟡

Staff withdraws its proposal to amend paragraph 19.a, thus the previous proposal is no longer present in Attachment 1. Staff now recommends keeping 19.a as written for the following reasons:

- There is, practically speaking, an indistinguishable fine line between the single-party option framework addressed in paragraphs 15 and 17 of SFFAS 54 and the dual-party options framework that staff was attempting to create with revisions to paragraph 19.a.
- Federal reporting entities are unlikely to have financial reporting incentives to minimizing their lease terms and lease liabilities on the balance sheet. Moreover, lessees and lessors oftentimes have financial and operational incentives to avoid situations where both parties must agree to extend or have the ability to terminate at any time, although these situations may arise from time to time.
- There would likely be considerable costs devoted to providing documentation evidencing that no counter-evidence to general rule to exclude such periods from the lease term is present.
- Staff can continue to monitor the extent to which 19.a is or is not exploited once SFFAS 54 goes into effect. In the unlikely event that exploitation of the provision comes to fruition, staff would likely be made aware of the issue and would bring that to the Board for their consideration at that time.

3. **SFFAS 54, Lease Term section** – *In paragraph 20, staff proposes a clarifying edit to address the assessment of both lessee and lessor options.* 🟢

The Board agreed with this proposal in June. No additional changes have been made to the proposal since the June Board meeting.

4. **SFFAS 54, Lease Term section** – *Staff proposes adding a bullet to address lease term changes resulting from modifications.* 🌸

Paragraph 21 addresses when a lease term should be reassessed; however, it is not clear if the lease term should be reassessed when a modification that was not originally specified in the lease amends the noncancelable period. Paragraph 21.c allows for reassessment of the lease term when an event specified in the lease contract or agreement that requires an extension or termination of the lease takes place; this, however, does not clearly address amendments to the lease term.

There could be an amendment to the lease that was not initially specified in the lease contract or agreement. Such modifications are not currently addressed in paragraph 21. The proposed amendment would clarify that the lease term should be reassessed with any modification to the noncancelable period, whether or not it was originally specified in the lease contract or agreement. Staff consulted directly with

several subject matter experts on this proposal, receiving concurrence from all parties.

5. **SFFAS 54, Short-term Leases section** – *Staff proposes adding language for step rent increases/decreases that mirrors paragraph 31 for intragovernmental leases.* 🟡

In paragraphs 23-24, staff revised the proposal to move the new sentence to the end of each paragraph and clarified that this guidance only applies if the increase/decrease is not a lease concession. A footnote was also added to reference the lease concession definition.

6. **SFFAS 54, Short Term and Intragovernmental Leases sections** – *In paragraphs 29-31 (and 23-24 above), staff proposes including step rent decreases along with step rent increases.* 🟡

Staff revised this proposal to clarify that this guidance only applies if the increase/decrease is not a lease concession. The amendments were moved to the end of each of the two SFFAS 54 paragraphs. A footnote was also added to reference the lease concession definition in paragraph 10 of SFFAS 54.

The Board agreed with this omnibus proposal in June; however, staff implemented the aforementioned minor edits to the proposal based on feedback from a Board member and task force members.

7. **SFFAS 54, Intragovernmental Leases section** – *In paragraph 31, staff proposes addressing the lessor treatment of rental increases/decreases, in addition to the lessee treatment.* 🟢

This edit was to simply strike “a lessee” from the paragraph to avoid the implication that the guidance was not applicable to lessors. The amendment is consistent with the original intent of the Board and the foundational principle of symmetrical accounting that the Board intended.<sup>1</sup>

The Board agreed with this proposal in June. No additional changes have been made to the proposal since the June Board meeting.

8. **SFFAS 54, Disclosures for Intragovernmental Leases sub-section** – *In paragraph 37.b, staff proposes changing the term “leased PP&E” to “underlying asset.”* 🟡

To better align with paragraph 26 of SFFAS 54, staff is proposing to change the term “leased PP&E” to “underlying asset.” This is consistent with other changes proposed and will maintain uniformity throughout the Statement.

9. **SFFAS 54, Disclosures for Intragovernmental Leases sub-section** – *In paragraph 38.a, staff proposes changing the term “privately-owned” to “non-federally*

<sup>1</sup>See SFFAS 54, Basis for Conclusions, par. A45

owned.” ●

The Board agreed with this proposal in June. No additional changes have been made to the proposal since the June Board meeting.

10. **SFFAS 54, Lessee Recognition/Measurement section** – *In paragraph 39, staff proposes an edit to clarify the type of asset being recognized.* ●

Staff removed the term “intangible,” as discussed at the June Board meeting. The Board agreed with this proposal in June. No additional changes have been made to the proposal since the June Board meeting.

11. **SFFAS 54, Lease Liability section** – *In paragraph 42, staff proposes to remove the implicit interest rate option and clarify that the incremental borrowing rate for leases with a lease term greater than the 30-year Treasury rate, should simply use the 30-year rate as the discount rate.* ★

In discussion with the task force members, the issue was raised that it can be very difficult for agencies to determine the fair value of a lease asset—a requisite variable in determining implicit interest rates—and the percentage of service capacity and fair value consumed during the lease term. This is especially true for leases that occupy a small portion of a building. Staff is concerned that these calculations could be prone to error, inconsistent methodologies, and additional complexities that would not yield financial information with sufficient predictive value. Therefore, staff recommends that agencies use their estimated incremental borrowing rate when the interest rate the lessor charges the lessee is unknown.

One task force member provided the following commentary in line with staff’s view:

*“...determining the PV [present value] has the potential result of creating wide disparities and inconsistencies in the discount factors applied to such leases ... With assets such as real property, many geographic areas reflect regular market increases in values over time which could substantially increase an asset PV valuation, offsetting decrements for usage. With such a broad range of factors that could go into estimating an asset’s PV, the calculated discounts rates used for subsequent recognition of interest expense are less reliable. This could be another reason to support prioritizing the Federal borrow rates be used as discount rates rather than imputing discount rates.”*

For reasons discussed above, staff believes that federal entities will often determine that the interest rate cannot be reasonably estimated anyhow. Moreover, staff is concerned that the effects of higher interest rates on long-term leases may result in the over-discounting of the deep future, which may countervail the informational value and comparability of the resulting lease asset and lease liability values.

For lease terms longer than 30 years, staff proposes that reporting entities simply use the 30-year Treasury when selecting the incremental borrowing rate for discounting such leases.

Treasury does not publish or offer bonds with terms exceeding 30 years. They also do not extrapolate the Treasury yield curve beyond 30 years. Thus, it would be

impracticable for reporting entities to estimate such a rate.

Staff proposes referring to the 30-year Treasury rate in the proposed amendment as the “maximal constant maturity Treasury rate,” (CMTs) to allow for continued alignment between published CMTs and the Statement. There may be variations in the maximal CMT in the event that the 30-year CMTs are discontinued, or longer CMTs are introduced in the future.<sup>2</sup> Staff views this as the appropriate approach but would be receptive to alternative terminology.

12. **SFFAS 54, Lease Asset section** – *In paragraphs 52-53, staff proposes edits to clarify the type of asset being recognized, and to clarify the appropriate methodological sequence in accounting for asset impairments.* ◆

Additional changes to this proposal have been made since the June Board meeting.

When impairment indicators exist that affect the manner and duration of use of an underlying asset, lessees and lessors often renegotiate and modify their leases as a result. To the extent that lessees are still on the hook for future lease payments that exceed any resulting reductions to the lease liability, only then would it be appropriate for the lessee to consider the need to recognize an impairment loss. Edits to address this matter were discussed at the June meeting; those edits were designed to align paragraph 53 with GASB 87; however, upon further consideration, staff, task force members, and a Board member found that additional clarifying edits would prove useful.

Paragraph 52 already refers to reductions in lease liabilities resulting from lease modifications, but the connection is very indirect: Paragraph 44—which is cited in the paragraph—includes a footnote that cross-references to paragraphs 80-86. Task force members and staff believe that these edits serve to clarify the original intent of the Board.

Staff also expanded cross-references to SFFAS 44, *Accounting for Impairments of General Property, Plant, and Equipment Remaining in Use*, to include paragraphs 8-17 and explain the context in which such paragraphs should be considered. Originally, paragraph 53 only referenced paragraphs 12 and 18-25 of SFFAS 44.

Staff worked extensively with task force subject matter experts, the Executive Director, and a Board member to carefully craft and develop this modified proposal.

13. **SFFAS 54, Lessee and Lessor Disclosures sub-sections** – *In paragraphs 54 and 67, staff proposes edits to clarify that the disclosure requirements in these paragraphs pertain to lease activities other than short-term leases, contracts or agreements that transfer ownership, and intragovernmental leases.* ●

The Board agreed with this proposal in June. No additional changes have been

<sup>2</sup>30-year CMTs were discontinued on February 18, 2002 and reintroduced on February 9, 2006.

made to the proposal since the June Board meeting.

- 14. SFFAS 54, Lessee Disclosures sub-section** – *In paragraph 54.a.ii, staff proposes an edit clarifying what should be disclosed for residual value guarantees.* ♦

In response to feedback from a Board member, staff revised the proposal to require all residual value guarantees be disclosed and that the disclosure include whether or not the residual value guarantee is included in the lease liability. Staff agreed with the suggestion.

- 15. SFFAS 54, Consolidated Financial Report sub-section** – *In paragraph 54.b, staff proposes an edit to clarify the type of asset being disclosed.* ★

Staff is proposing an edit to strike the term “other” to clarify that right-to-use lease assets are distinct from the underlying PP&E from which the lease asset and related economic benefits and services are derived. This clarity is needed to ensure proper disclosure of lease assets.

- 16. SFFAS 54, Lease Receivable sub-section** – *In paragraph 59, staff proposes to remove the implicit interest rate option and provide the option to use the lessor’s incremental borrowing rate.* ★

Staff is proposing to amend paragraph 59 to allow for the use of the lessor’s incremental borrowing rate when the interest rate charged to the lessee is unknown. These amendments are consistent with the original intent of the Board and the foundational principle of symmetrical accounting that the Board intended.<sup>3</sup>

- 17. SFFAS 54, Deferred Revenue sub-section** – *In paragraph 65, staff proposes an edit to add guidance for calculating a loss when necessary.* ★

Paragraph 65 does not currently explain what should be done when the deferred revenue cannot be reduced by the same amount as the lease receivable. This could occur in rare instances when a lease incentive is present in the lease. In such cases, the deferred revenue would be reduced by the amount of the lease incentive. This could lead to a situation where the deferred revenue is reduced to zero when the lease receivable is remeasured and the remaining amount should be reported as a loss.

- 18. SFFAS 54, Consolidated Financial Report sub-section** – *In paragraph 69.a, staff proposes an edit to make the general description of leasing arrangements more reflective of the agency requirements in paragraphs 37-38.* ★

In response to feedback from a Board member, staff proposes amending the general description of leasing arrangements disclosure to include a breakdown of the number of leases with federally-owned assets and non-federally owned assets. This

<sup>3</sup>See item 11 above, SFFAS 54, par. 59, and basis for conclusion par. A45.



will better align the consolidated financial report with the agency requirements.

**19. SFFAS 54, Consolidated Financial Report sub-section** – *In paragraph 69.b, staff proposes an edit to clarify the type of asset being disclosed. ★*

Staff is proposing an edit to strike the term “other” to clarify that right-to-use lease assets are distinct from the underlying PP&E from which the lease asset and related economic benefits and services are derived. This clarity is needed to ensure proper disclosure of lease assets.

**20. SFFAS 54, Lease Incentives and Lease Concessions sub-section** – *In paragraph 71, staff proposes an edit to exclude short term and intragovernmental leases from this treatment. ★*

Staff is proposing an amendment to this paragraph to delineate when this guidance applies. The treatment of lease incentives and lease concessions for short-term leases is addressed in par. 23-24, and paragraphs 32-33 address this topic for intragovernmental leases. Paragraph 71 is meant to address the topic for the lease assets and lease liabilities, but the current wording is ambiguous. Staff is proposing this amendment to provide a clear distinction.

**21. SFFAS 6 and SFFAS 57** – *Staff also proposes clarifying amendments to clarify the nature and characteristics of lease assets. 🍌*

Staff removed the proposed bullet on leasehold improvements under par. 18 of SFFAS 6 as discussed at the June Board meeting. Staff also revised par. 19A of SFFAS 6 to define where lease assets should be reported.

Staff also amended paragraph 15 of SFFAS 57 to remove references to the paragraphs that are being rescinded.

Staff recommends these, and other aforementioned clarifying edits, to better delineate lease assets—which are an intangible rights to derive economic benefits and services *derived from PP&E*—from PP&E assets.

### Classification Amendments

SFFAC 5, *Definitions of Elements and Basic Recognition Criteria for Accrual Basis Financial Statements*, paragraph 27, provides that “economic benefits or services that a property can provide can be distinguished from the property itself, whether it is tangible or intangible, such as a right.” Paragraph 28 further states that “lease arrangements unbundle the economic benefits or services embodied in leased property and may, for example, give the lessee the right to hold and use the property and the lessor the right to receive rentals and any residual value. Thus, both parties may have assets corresponding to their respective rights”

This fundamental concept is the crux of staff’s recommendation. It is the same fundamental concept upon which SFFAS 54 and GASB Statement No. 87 were



based. While PP&E is defined as tangible assets, lease assets are inherently intangible in nature. PP&E—coupled with the related receivable and deferred revenue—are assets and liabilities of the lessor that reflect their respective rights and obligations, while the lease asset and liability reflect the respective rights of the lessee to derive economic benefits and services from use of the underlying asset and their related obligations to the lessor to provide consideration.

Although never intended by the Board, unclear delineations between lease assets and PP&E in SFFAS 54, SFFAS 6, and SFFAS 57 would likely result in additional implementation burdens, technical inquiries and requests for amendments, systems design flaws, and accounting errors that would stem from the resulting confusion, including classification, presentation, measurement, and recognition errors.

The edits proposed by staff in this memo will also result in helpful clarifications for purposes of drafting the related changes to OMB's Circular A-136 form and content financial reporting requirements. Staff believes that SFFAS 54 strikes a balance that provides OMB with the appropriate level of prescriptiveness and flexibility in executing their responsibilities for developing quality form and content requirements that align with the Statement. These omnibus edit proposals maintain that balance.

#### **BOARD QUESTIONS:**

**Question 1:** Are there matters that members wish to discuss in response to staff's proposed amendments?

#### Next Steps

The leases implementation project plan remains on schedule (see Attachment 3). Staff will continue to finalize the implementation guidance with input and review from the task force and the AAPC. The implementation guidance working draft exposure document is projected to be cleared by the AAPC at their September meeting to be released for public comment.

Staff will also update the working draft of the omnibus amendments working draft, including the basis for conclusions, based on today's discussions. Staff will also develop questions for respondents to be included in the joint exposure document.

The next two months will be a critical phase of the project in determining the timing of the ultimate release of the implementation guidance and omnibus amendments. Staff believes that the omnibus amendments proposal can be pre-balloted at the October meeting, balloted electronically, and released for 90-day public comment in November 2020.

**BOARD QUESTION:**

**Question 2:** Does this Board wish to discuss staff's proposed next steps or provide additional considerations for staff as we move forward with the leases implementation project? Does the Board concur with staff's project plan timeline to release the joint ED in November based on the results of today's meeting?

**BOARD QUESTIONS (ALL):**

**Question 1:** Are there matters that members wish to discuss in response to staff's proposed amendments?

**Question 2:** Does this Board wish to discuss staff's proposed next steps or provide additional considerations for staff as we move forward with the leases implementation project? Does the Board concur with staff's project plan timeline to release the joint ED in November based on the results of today's meeting?

**MEMBER FEEDBACK**

Please provide feedback to Mr. Perry and Ms. Dewhirst at [PerryRA@fasab.gov](mailto:PerryRA@fasab.gov) and [gsa-fasab.detail@gsa.gov](mailto:gsa-fasab.detail@gsa.gov) with a cc to Ms. Valentine at [ValentineM@fasab.gov](mailto:ValentineM@fasab.gov), by **August 19, 2020**.



Federal Accounting Standards Advisory Board

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# OMNIBUS AMENDMENTS ON LEASES-RELATED TOPICS

**Statement of Federal Financial Accounting Standards XX**

**Exposure Draft**

Written comments are requested by February XX, 2021

November XX, 2020

**Working draft – Comments are not requested on this draft**

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## 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](http://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 XX, 2020

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

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

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

Responses are requested by January/February XX, 2021.

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

Please provide your comments by email to [fasab@fasab.gov](mailto: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](mailto:fasab@fasab.gov) to determine if your comments were received.

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

Sincerely,

Monica R. Valentine  
AAPC Chair

George A. Scott  
FASAB Chair



## EXECUTIVE SUMMARY

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### WHAT IS THE BOARD PROPOSING?

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These amendments would provide greater clarity to aspects of SFFAS 54 and ensure consistency throughout the standard.

### HOW WOULD THIS PROPOSAL IMPROVE FEDERAL FINANCIAL REPORTING AND CONTRIBUTE TO MEETING THE FEDERAL FINANCIAL REPORTING OBJECTIVES?

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Provide a plain English explanation of what problem the Board is solving, what improvements will result and how this improvement helps meet objectives. The executive summary should not exceed two pages. [Style code is Normal.]

### MATERIALITY

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The provisions of this 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

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The Federal Accounting Standards Advisory Board (FASAB or “the Board”) encourages you to become familiar with all proposals in the Statement before responding to the questions below. In addition to the questions below, the Board also welcomes your comments on other aspects of the proposed Statement. Because FASAB may modify the proposals before a final Statement is issued, it is important that you comment on proposals that you favor as well as any that you do not favor. Comments that include the reasons for your views are especially appreciated.

The Board believes that this proposal would improve federal financial reporting and contribute to federal financial reporting objectives. The Board has considered the perceived costs associated with this proposal. In responding, please consider the expected benefits and perceived costs and communicate any concerns that you may have regarding implementing this proposal.

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](mailto:fasab@fasab.gov). If you are unable to respond by email, please fax your responses to (202) 512-7366. Alternatively, you may mail your responses to:

Monica R. Valentine, Executive Director  
Federal Accounting Standards Advisory Board  
441 G Street, NW  
Suite 1155  
Washington, D.C. 20548

All responses are requested by [insert date].

Q1. A summary of the issue (one paragraph) should be presented followed by a question. If multiple questions follow one issue summary, use letters to distinguish them.

Q2. New Question

## 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 <sup>2A</sup>

FN 2A - The lessee would account for payments prior to commencement of the lease term as advances paid in contemplation of the future receipt of the right-to-use 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 and prepayments 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 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: ...

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 decreases that are not lease concessions should be recognized in the period of the increase/decrease.<sup>4A</sup>

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 decreases that are not lease concessions, should be recognized in the period of the increase/decrease.<sup>4B</sup>

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 decreases that are not lease concessions, a lessee should be recognized the expense~~ in the period of the increase/decrease.<sup>5A</sup>

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 non-federally 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. Paragraph 42 of SFFAS 54 is amended as follows:

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**<sup>7</sup> (the estimated rate that would be charged for borrowing the lease payment amounts for the lease term) should be used.

FN 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. For leases with a lease term greater than the maximal constant Treasury maturity rate, lease payments should simply be discounted using the maximal constant Treasury maturity rate.

15. 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 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~~ The lease asset should be reduced first for any change in the corresponding lease liability resulting from remeasurement under paragraphs 44-48, or modifications or terminations under paragraphs 80-86. 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.~~

16. 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: ...

17. Paragraph 54.a.ii of SFFAS 54 is amended as follows:

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

18. 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

19. 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. If the interest rate cannot be reasonably estimated by the lessor, the lessor's estimated incremental borrowing rate should be used.<sup>9A</sup>, 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.

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. For leases with a lease term greater than the maximal constant Treasury maturity rate, lease receipts should simply be discounted using the maximal constant Treasury maturity rate.

20. 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.

21. 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: ...

22. Paragraph 69.a-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:

a. A general description of its leasing arrangements, including a breakdown of the number of leases with federally-owned assets and non-federally owned assets

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

23. 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.<sup>10A</sup>

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



## AMENDMENTS TO SFFAS 6 and SFFAS 57

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

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

15. Paragraphs 3 through [68](#), 11, and 12 of this Statement are effective for reporting periods beginning after September 30, 2023. Early adoption is not permitted.

26. 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 rights<sup>18</sup>

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.

27. 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*. Leases assets should be presented and disclosed separately from PP&E.

## EFFECTIVE DATE

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28. 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. 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.<sup>1</sup>

A5. Due to the high volume of implementation guidance, project staff provided drafts of proposed questions and answers to the AAPC and the Board in piecemeal for their review and input prior to their respective actions to release the exposure draft for public comment.

A6. Pending

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<sup>1</sup>The 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

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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
OMB	Office of Management and Budget
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards

## APPENDIX C: GLOSSARY

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DRAFT

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## **LEASES:**

AN AMENDMENT OF STATEMENT OF FEDERAL FINANCIAL ACCOUNTING STANDARDS (SFFAS) 5, ACCOUNTING FOR LIABILITIES OF THE FEDERAL GOVERNMENT, AND SFFAS 6, ACCOUNTING FOR PROPERTY, PLANT, AND EQUIPMENT

### **Statement of Federal Financial Accounting Standards 54**

**April 17, 2018**

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## ILLUSTRATION OF OMNIBUS PROPOSALS

**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.

An accounting standard is 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. The proposed standards are published in an exposure draft for public comment. In some cases, a discussion memorandum, invitation for comment, or preliminary views document may be published before an exposure draft is published on a specific topic. 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 standard 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 is available from FASAB or its website:

- [“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: Federal Accounting Standards Advisory Board,” exposure drafts, Statements of Federal Financial Accounting Standards and Concepts, FASAB newsletters](#), and other items of interest are posted on FASAB’s website at [www.fasab.gov](http://www.fasab.gov).

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## SUMMARY

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This Statement revises the financial reporting standards for federal lease accounting. It provides a comprehensive set of lease accounting standards to recognize federal lease activities in the reporting entity's general purpose federal financial reports and includes appropriate disclosures.

This Statement requires that federal lessees recognize a lease liability and a leased asset at the commencement of the lease term, unless it meets any of the scope exclusions or the definition/criteria of short-term leases, or contracts or agreements that transfer ownership, or intragovernmental leases. A federal lessor would recognize a lease receivable and deferred revenue, unless it meets any of the scope exclusions or the definition/criteria of short-term leases, contracts or agreements that transfer ownership, or intragovernmental leases.

The provisions of this Statement 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.

## ILLUSTRATION OF OMNIBUS PROPOSALS

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## STANDARDS

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### SCOPE

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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**<sup>1</sup> 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)<sup>2</sup> (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.

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

<sup>2</sup> SFFAS 6, *Accounting for Property, Plant, and Equipment*.

## ILLUSTRATION OF OMNIBUS PROPOSALS

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
- 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*<sup>3</sup> 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

<sup>2A</sup> The lessee would account for payments prior to commencement of the lease term as advances paid in contemplation of the future receipt of the right-to-use 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 and prepayments 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.

<sup>3</sup> SFFAS 47, *Reporting Entity*, par. 38–42.

## ILLUSTRATION OF OMNIBUS PROPOSALS

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

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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.

## ILLUSTRATION OF OMNIBUS PROPOSALS

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.<sup>4</sup>
  - 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

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<sup>4</sup> SFFAS 1, *Accounting for Selected Assets and Liabilities*, applies to any related accounts payable or accounts receivable amounts.



## ILLUSTRATION OF OMNIBUS PROPOSALS

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.

## ILLUSTRATION OF OMNIBUS PROPOSALS

## 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 decreases that are not lease concessions should be recognized in the period of the increase/decrease.<sup>4A</sup>

## 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 decreases that are not lease concessions should be recognized in the period of the increase/decrease.<sup>4B</sup>

## 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.<sup>5</sup>

## 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

<sup>4A</sup> See par. 10 for the definition of lease concessions.

<sup>4B</sup> Ibid.

<sup>5</sup> SFFAS 6, *Accounting for Property, Plant, and Equipment*, par. 26.

## ILLUSTRATION OF OMNIBUS PROPOSALS

accounts payable and other related amounts. Prepaid rent or a payable for rent due should 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 decreases that are not lease concessions, should be recognized in the period of the increase/decrease.<sup>5A</sup>
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.

<sup>5A</sup>See para. 10.

## ILLUSTRATION OF OMNIBUS PROPOSALS

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.<sup>6</sup>
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, including a breakdown of the number of leases with federally-owned assets and **non-federally-owned** assets
- 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 paragraph 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:

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

## ILLUSTRATION OF OMNIBUS PROPOSALS

- 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. If the interest rate cannot be reasonably estimated by the lessee, the **lessee's estimated incremental borrowing rate**<sup>7</sup> (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.

<sup>7</sup> 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. For leases with a lease term greater than the maximal constant Treasury maturity rate, lease payments should simply be discounted using the maximal constant Treasury maturity rate.

## ILLUSTRATION OF OMNIBUS PROPOSALS

44. The lessee should remeasure the lease liability at subsequent financial reporting dates if one or more of the following changes<sup>8</sup> 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.
  - 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.

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<sup>8</sup> 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.

## ILLUSTRATION OF OMNIBUS PROPOSALS

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 paragraph 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 the 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. The lease asset should be reduced first for any change in the lease liability resulting from remeasurement under paragraphs 44-48, or any modifications or terminations under paragraphs 80-86. Any remaining amount should be recognized as an impairment loss.<sup>9</sup>

## COMPONENT REPORTING ENTITY DISCLOSURE REQUIREMENTS FOR LESSEES

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



## ILLUSTRATION OF OMNIBUS PROPOSALS

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:
  - 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 and whether or not these are included in the measurement of the lease liability
- b. The total amount of lease assets and the related accumulated amortization, to be disclosed separately from PP&E assets
- 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



## ILLUSTRATION OF OMNIBUS PROPOSALS

- 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. *If the interest rate cannot be reasonably estimated by the lessor, the lessor's estimated incremental borrowing rate should be used.*<sup>9A</sup>
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,<sup>10</sup> and the changes individually or in the aggregate, are expected to significantly affect the amount of the lease receivable since the previous measurement:

<sup>9A</sup> 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. For leases with a lease term greater than the maximal constant Treasury maturity rate, lease receipts should simply be discounted using the maximal constant Treasury maturity rate.

<sup>10</sup> 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.

## ILLUSTRATION OF OMNIBUS PROPOSALS

- 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 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

## ILLUSTRATION OF OMNIBUS PROPOSALS

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, **including a breakdown of the number of leases with federally-owned assets and non-federally owned assets**
  - b. The total amount of lease assets, and the related accumulated amortization, to be disclosed separately from other 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

## ILLUSTRATION OF OMNIBUS PROPOSALS

## 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.<sup>10A</sup>

## 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.

<sup>10A</sup> The treatment of lease incentives and lease concessions for short-term leases is addressed in par. 23–24, and par. 32–33 address this topic for intragovernmental leases.

## ILLUSTRATION OF OMNIBUS PROPOSALS

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 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.

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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.

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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

## ILLUSTRATION OF OMNIBUS PROPOSALS

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

## ILLUSTRATION OF OMNIBUS PROPOSALS

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

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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

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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

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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 sale<sup>11</sup> 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

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



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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 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.~~



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~~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~~

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~~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

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- 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.

## Project Plan

	Deferral SFFAS	Implementation Guidance on Leases	Omnibus SFFAS / Interpretations	Conforming Amendments TR	Software Licenses Technical Bulletin	Training / Outreach
FY 2020 Q1	<del>Draft Exposure Period</del>	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	<del>Exposure Period</del>	Draft	Research			Provide
FY 2020 Q3	<del>Finalize Issuance</del> 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					