



Federal Accounting Standards Advisory Board

IMPLEMENTATION GUIDANCE FOR LEASES

Federal Financial Accounting Technical Release **XX**

Exposure Draft

~~Written comments are requested by February 5, 2021~~

November 2, 2020 Month **DD**, 202**Y**

THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

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

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

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

- [Memorandum of Understanding](#) among the Government Accountability Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board
- [Mission statement](#)
- [Documents for comment](#)
- [Statements of Federal Financial Accounting Standards and Concepts](#)
- [FASAB newsletters](#)

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The Accounting and Auditing Policy Committee

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

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

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

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

November 2, 2020

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

Your comments on the exposure draft of the following proposals are requested:

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

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

Responses are requested by February 5, 2021.

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

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

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

Sincerely,

PENDING BALLOT

PENDING BALLOT

Monica R. Valentine

George A. Scott

AAPC Chair

FASAB Chair

EXECUTIVE SUMMARY

WHAT IS THE BOARD PROPOSING?

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

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

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

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

Other topic areas address issues identified by FASAB and its staff in anticipation of questions that could arise during implementation of SFFAS 54.

MATERIALITY

The provisions of this ~~proposed~~ TR ~~would not need~~ ~~not to~~ be applied to information if the effect of applying the provision(s) is immaterial.¹ 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.

¹Refer 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.

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QUESTIONS FOR RESPONDENTS

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

In addition to the questions below, the Board and the Committee also welcome your comments on other aspects of the proposed Statement and TR. Because these proposals may be further modified before a final Statement and TR are issued, it is important that you comment on aspects that you favor as well as any that you do not favor. Comments that include the reasons for your views are especially appreciated. All responses are requested by February 5, 2024.

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

To facilitate our analysis of comment letters, it would be helpful if you explain the reasons for your views, including alternatives that you believe the Board and/or the Committee should consider. Please include references to the related paragraph numbers in your responses.

The questions in this section are available for your use at <https://www.fasab.gov/documents-for-comment/>. Your responses should be sent to fasab@fasab.gov. If you are unable to submit your comment letter via email, please contact 202-512-7350.

QFR 1. Do you generally support the proposed Statement and TR proposals as a whole? Please provide reasons for your views.

QFR 2. Are there specific aspects of the proposed Statement and/or TR that you disagree with? If so, please explain the reasons for your positions, the paragraph number(s), and/or topic area(s) of the proposals that are related to your positions, and any alternatives you propose and the authoritative basis for such alternatives.

QFR 3. Are you aware of any implementation issues that are not addressed in the proposed Statement and/or TR? Do any ambiguous areas remain that could lead to challenges with implementing SFFAS 54 requirements? If so, please provide examples of the issues and any references to applicable guidance, and/or topic area(s) related to the issues, and any potential solutions you propose.

QFR 4. Are there specific aspects of these proposals that you favor or wish to provide comments on?

SMC 1. Is the proposed guidance under paragraph 4 of the proposed TR applicable to federal lease scenarios to your knowledge? Please provide feedback regarding the usefulness of the proposed guidance in the context of those scenarios and/or the extent to which you believe the proposed guidance addresses implementation issues under potential scenarios. Please describe any alternative views or suggestions for improvement.

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

SMC 3. Is the proposed guidance under paragraph 95 of the proposed TR potentially applicable to intragovernmental transactions that are similar to a sale leaseback to your knowledge? Please provide feedback regarding the usefulness of the proposed guidance in the context of those scenarios and/or the extent to which you believe the proposed guidance addresses implementation issues under potential scenarios. Please describe any alternative views or suggestions for improvement.

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

INTRODUCTION

PURPOSE

1. Statement of Federal Financial Accounting Standards (SFFAS) 54, *Leases*, provides a comprehensive set of lease accounting standards to recognize federal lease activities in the reporting entity's general purpose federal financial reports (GPFFR) and includes appropriate disclosures.
2. Questions and answers in this ~~proposed~~ Federal Financial Accounting Technical Release (TR) would be intended to provide guidance for applying the accounting and financial reporting requirements for leases in accordance with SFFAS 54.

~~PROPOSED~~ TECHNICAL GUIDANCE

SCOPE OF TECHNICAL GUIDANCE

3. Readers of this TR should first refer to the hierarchy of accounting standards in SFFAS 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*. This TR ~~proposal would~~ supplements the relevant accounting standards but ~~does would~~ not substitute for or take precedence over the standards. This TR clarifies but does not change guidance provided in SFFAS 54.

SCOPE AND DEFINITIONS

~~A reporting entity obtains the right to use a building, which has a market rent of \$500,000 per year, for a cost of \$100 per year. Should the reporting entity apply the requirements in SFFAS 54 to that transaction? Yes, the reporting entity should apply SFFAS 54 requirements to the transaction. The definition of a lease in paragraph 2 of SFFAS 54 specifies that a lease is a contract or agreement whereby one entity (lessor) conveys the right to control the use of property, plant, and equipment (PP&E) (the underlying asset) to another entity (lessee) for a period of time as specified in the contract or agreement in exchange for consideration, even though the consideration provided is less than full cost.~~

~~For inter-entity transactions (that is, intragovernmental leases), SFFAS 54 requirements continue to apply. Additionally, to the extent that the consideration provided is less than the full cost incurred by the lessor, the receiving entity (lessee) should determine whether to recognize the difference in its accounting records as a financing source based on SFFAS 4, *Managerial Cost Accounting Standards and Concepts* (as amended by SFFAS 55, *Amending Inter-entity Cost Provisions*), paragraphs 8-9 and 108-113A. This difference would be based on the full cost to the lessor (for example, depreciation) rather than the market rent.~~

4. **A reporting entity enters into a multiyear 5-year agreement for the right to use a facility with no termination options. This entity has exclusive use of the facility 4 months per year. Other parties use the facility for the other 8 months. To meet the definition of a lease, is the entity required to have uninterrupted control of the right to use the facility?**

No, uninterrupted control is not required to meet the definition of a lease. In determining whether a contract conveys control of the right to use an underlying asset, the reporting entity should assess whether it has both: (a) the right to obtain economic benefits or services from use of the underlying asset as specified in the contract or agreement; and (b) the right to control access to the economic benefits or services of the underlying asset as *specified in the contract or agreement (emphasis added) in accordance with* paragraph 3 of SFFAS 54). If the contract specifies that the government has control of those rights during 4 months of each year, the control criterion is met. The provision in the lease definition that

the contract be for a period of time does not require uninterrupted control of the right to use the facility. In this example, the lease term would be five years.

5. **Do easements, water and water power rights, diversion rights, submersion rights, rights-of-way, and other like interests in land meet the definition of a lease?**

~~Some easements~~Each of these can meet the definition of a lease, ~~while other easements do not.~~

Paragraph 2 of SFFAS 54 states that, among other things, a lease is defined as a contract or agreement whereby the *“right to control the use of property, plant, and equipment (underlying asset) is conveyed to another entity for a period of time as specified in the contract or agreement in exchange for consideration.”* ~~Temporary~~ land rights, easements, rights-of-way, and other like interests in land can qualify as a lease under paragraph 2 of SFFAS 54, with land being the underlying asset (see SFFAS 6, Accounting for Property, Plant and Equipment, paragraph-par. 17-18, and footnote 18).

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

In addition, easements, rights-of-way, and land rights obtained without consideration do not meet the “in exchange for consideration” criterion.

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

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

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

Although the agreement does not convey the right to control the use of the property for an explicitly-specified period of time, it specifies that the occupant shall give advance notice of intent to discontinue use, and that the party granting occupancy shall give advance notice to vacate. Therefore, in substance, this arrangement provides for a short, noncancelable period for use. The noncancelable period would be equal to the shorter of the required

notice period for discontinuing use or notice period for vacating. The noncancelable period should be included in the lease term in accordance with SFFAS 54, paragraph 14.

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

Cancelable periods are defined as periods when both the lessee and the lessor have an option to terminate. In this case, the cancelable period(s) is the period beyond *both* the notice period for discontinuing use and the notice period for vacating. Cancelable periods should not be included in the lease term in accordance with paragraph 19.a of SFFAS 54.

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

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

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

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

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

Yes. Although other economic benefits or services may be derived by other parties from use of the public land, such rights are not relevant in establishing the right that was specified in the contract to control the use of this particular economic benefit (grazing rights) derived from the underlying asset.

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

No, it does not. To meet the definition of a lease, a contract is required to convey control of the right to use the underlying asset. Paragraph 3 of SFFAS 54 provides two criteria that should be present for a contract to convey control. In this example, the reporting entity has the right to obtain economic benefits from the solar farm but does not have the right to control access to the economic benefits derived from the power generated. Therefore, the component of the contract that provides the reporting entity with the right to the power generated by the solar farm does not convey control and does not meet the definition of a lease. Furthermore, the component of the contract that allows the private party to use the reporting entity's property is not a lease because there is no exchange for consideration for use of that land as required by paragraph 2 of SFFAS 54 to meet the definition of a lease.

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

It depends; these agreements typically meet the definition of a lease. If the agreements meet the definition in paragraphs 2-4 of SFFAS 54, including the control criterion, then such agreements are leases. The control criterion generally is met if a cell phone tower or antenna placement agreement conveys control of the right to use the land on which the tower is placed or a connection point to which the antenna is affixed (see also TR par. 1142).

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

No, it does not affect the evaluation. A lease conveys control of the *right to use* another entity's asset. That right is distinct from the underlying asset. That is, the right-to-use relates to both the right to obtain and control access to *economic benefits or services from use of* an underlying asset, rather than conveying control of the underlying asset itself. Substitution with an essentially identical asset allows the lessee to maintain control of the economic benefits or services from use of another entity's underlying asset and is consistent with the definition of a lease in paragraphs 2-4 of SFFAS 54.

If a lease modification results in a substitution with an associated increase/decrease in price, then a lease modification would have occurred and the lease liability would have been remeasured in accordance with paragraph 44 as a result of the price change.

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

Yes, this is a lease. In this example, the reporting entity (lessor) conveys the right to use a connection point on the pole. A right of substitution (changing the location on a pole) does not affect the determination of whether a contract conveys control of the right to use an underlying asset. Even though the reporting entity can change the specific connection point, the telecommunications company maintains the substantive right to obtain economic benefits and services from use of a connection point (see also TR par. 940).

12. ~~A reporting entity (lessor) enters into a lease agreement that conveys control of the right to use a parcel of federal land to a company that engages in oil and gas exploration, development, and production. Does the agreement meet the definition of a lease under SFFAS 54?~~ Yes, leases of land for purposes of oil and gas exploration, development, and production are within the scope of SFFAS 54. Such agreements convey the right to obtain and control access to economic benefits from use of PP&E for a period of time in exchange for consideration, as provided for in paragraphs 2-3 of SFFAS 54. The lease liability would include all variable payments that are fixed in-substance in accordance with paragraphs 40.c and 41 of SFFAS 54. However, variable payments that are based on future performance of the lessee or usage of the underlying asset (that is, variable payments based on levels of exploration, development, and production) should not be included in the lease liability. A reporting entity obtains the right to use a building, which has a market rent of \$500,000 per year, for a cost of \$100 per year. Should the reporting entity apply the requirements in SFFAS 54 to that transaction?

Commented [PR(1)]: Question deleted.

Commented [PR(2)]: Moved from #4 to #12

Yes, the reporting entity should apply SFFAS 54 requirements to the transaction. The definition of a lease in paragraph 2 of SFFAS 54 provides that a lease is a contract or agreement whereby one entity (lessor) conveys the right to control the use of property, plant, and equipment (PP&E) (the underlying asset) to another entity (lessee) for a period of time as specified in the contract or agreement in exchange for consideration. The reporting entity's right to use the building for \$100 per year meets the description of consideration. Each party does not need to receive or give up equal value.

For inter-entity transactions (that is, intragovernmental leases), to the extent that the consideration provided is less than the full cost incurred by the lessor, the receiving entity (lessee) should determine whether to recognize the difference in its accounting records as a financing source based on SFFAS 4, *Managerial Cost Accounting Standards and Concepts* (as amended by SFFAS 55, *Amending Inter-entity Cost Provisions*), paragraphs 8-9 and 108-113A. This difference would be based on the full cost to the lessor (for example, depreciation) rather than the market rent.

13. A reporting entity (lessee) enters into a lease agreement with a private company which will commence on October 1, 20X5, for a 5-year lease term. The underlying asset is under construction and scheduled to be completed on the date of lease

commencement. The reporting entity is required to make payments to the lessor on October 1, 20X3 and October 1, 20X4 during the construction period in contemplation of the future receipt of the right-to-use asset. How should the reporting entity (lessee) account for these payments?

The reporting entity (lessee) would account for payments during the construction of the underlying asset as advances paid in contemplation of the future receipt of the lease asset. These advances would be accounted for in a manner consistent with SFFAS 1, *Accounting for Selected Assets and Liabilities*, paragraphs 57-61, prior to the lease commencement date. Such advances and prepayments would be considered assets of the lessee. At lease commencement, the advance would be reclassified and included in the amount classified as the lease asset in accordance with SFFAS 54 paragraph 49.b (see also TR par. 5554).

14. A reporting entity (lessee) enters into an agreement to use an underlying asset. No payments are required for this use, nor does the lessee provide any in-kind services in the agreement. Does this agreement meet the definition of a lease in SFFAS 54?

No, this agreement does not meet the definition of a lease because there is no consideration.

15. The term “consideration” is used throughout this Statement. Does “consideration” only refer to monetary consideration?

No, consideration can be monetary or non-monetary. For example, in-kind services can also be consideration.

16. The term “probable” is used throughout this Statement. How is “probable” defined?

“Probable” is defined elsewhere in FASAB literature as that which can reasonably be expected or is believed to be more likely than not (greater than 50% probability). See SFFAS 5, *Accounting for Liabilities of the Federal Government*, paragraph 33. Reporting entities should continue to consistently apply the FASAB definition here.¹

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

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

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

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

¹In light of the discussion in SFFAS 54 basis for conclusions par. A35—although not authoritative in and of itself—this paragraph reflects the basis for the use of the term “probable” and the intended definition to be applied when implementing the Statement.

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

19. **If the underlying asset of a lease is a heritage asset or stewardship land as defined by SFFAS 29, *Heritage Assets and Stewardship Land*, do the disclosure requirements of SFFAS 29 apply?**

If the agreement meets the definition of a lease in paragraphs 2-4 of SFFAS 54, then the SFFAS 29 disclosure requirements would not apply to lessees.

In accordance with paragraph 66 of SFFAS 54, lessors should not derecognize heritage assets underlying their leases. They would continue to apply other applicable guidance, including SFFAS 29 disclosure requirements.

LEASE TERM

20. **A developer builds and leases a building to a reporting entity (lessee). The reporting entity is required to make payments during the 3-year construction period. The reporting entity does not have access to the building until right to occupancy is established at the end of the construction period. When does the lease term begin?**

The lease term begins when occupancy rights are established because that is when the reporting entity has the right to control the use of the underlying asset. Paragraph 3 of SFFAS 54 explains that control of the right to use the underlying asset is the right to both (a) obtain the economic benefits or services from its use as specified in the contract or agreement and (b) control access to the economic benefits or services as specified in the contract or agreement. Thus, the lease term commences when the lessee's right to occupancy is established and access to use the building is attained (see also: TR par. ~~55~~54 and 98).

21. **A lease contract has a noncancelable period of 5 years and specifies that at the end of the 5 years, both the lessor and lessee have the right to cancel the lease or may continue the lease, using the same terms on a month-to-month basis. Is the month-to-month period included in the initial assessment of the lease term?**

No, the month-to-month periods following the 5-year noncancelable period are excluded from the lease term under paragraph 19.a of SFFAS 54 in this scenario because both parties have the right to cancel. The lessee has not contracted for a noncancelable right to use the underlying asset beyond the 5 years, and the lessor is not required to continue providing the asset.

22. **A lease contract has a noncancelable period of 5 years and specifies that at the end of the 5 years, both parties have a right to cancel or continue the lease. Periods**

beyond year 5 were not included in the original lease term by the lessee. At the end of the fifth year on May 31, 20X1, the lessee has not returned or vacated the underlying asset. Instead the lessee continues to occupy the premises while a new lease is negotiated with the lessor. One year later on June 1, 20X2, the lessee and lessor negotiate final terms of the lease with an effective date of June 1, 20X1, and ending May 31, 20X7. In this example, at May 31, 20X1, the lessee has no knowledge of the expected duration of the holdover period. How should the lessee account for these lease changes after May 31, 20X1?

At the end of the original 5-year lease, the lessee would remove the right-to-use lease asset and accumulated amortization from its books. From June 1, 20X1, through May 31, 20X2, each period would be treated as a short-term lease. Once terms have been finalized on June 1, 20X2, the lessee should not measure the lease retroactively, as in substance, the long-term lease was not executed until June 1, 20X2, regardless that the lease documentation reflects an effective date of June 1, 20X1.

On June 1, 20X2 the lessee should record a lease liability and lease asset at the net present value of payments due on June 1, 20X2 (a 5-year lease term) and thereafter, with the start date for amortization based on the signature date of the lease, in this particular case, rather than the effective date.

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

Paragraph 20 of SFFAS 54 requires that, at the commencement of the lease term, a reporting entity assess all factors relevant to the likelihood that the lessee or the lessor will exercise lease extension or termination options identified in paragraphs 15-19. Relevant factors include significant economic incentives and disincentives, such as the cost of exercising the renewal option. In this example, if the reporting entity (lessee) determines that it is probable that the option will be exercised, the lease term would be 25 years.

24. **A lease contract allows either party to unilaterally terminate the lease at any time but also provides for cancellation penalties. The cancellation penalties are so great that there is significant evidence that neither party will terminate the lease. Should the cancelable periods be included in the lease term?**

No, these cancelable periods are excluded from the lease term. Paragraph 19.a of SFFAS 54 states that periods for which *both* the lessee and the lessor have an option to terminate the lease without permission from the other party are excluded from the lease term as cancelable periods.

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

Yes, the cancelable periods should be included in the lease term in this particular case. Paragraph 15.b of SFFAS 54 requires lessees to include periods in the lease term covered

Commented [PR(3): Pending Board decision re: whether 19.a will stay as-is (no omnibus) or not (omnibus).

by their options to terminate if it is probable, based on all relevant factors, that they will not exercise those options. In determining whether it is probable that it will not exercise the option to terminate the lease, the lessee should assess all factors relevant to the likelihood that it will not exercise the option. Those factors include significant economic disincentives, such as cancellation penalties, as discussed in paragraph 20 (see also: TR par. [2624-2725](#)).

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

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

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

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

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

The lessee would need to determine if there is significant evidence that the renewal option will be exercised in accordance with paragraph 15.c of SFFAS 54. Determining whether or not significant evidence exists is a matter of professional judgment. In this example, the renewal option offers below-market rates, which may make it less likely to be exercised by the lessor. Without knowing the additional relevant factors of the lessor (for example, lessor dependency on revenue stream from this asset, ease of replacing tenant, cost of replacing tenant, past experience with lessor for similar types of leases), it may be challenging to gain the significant evidence needed to include this option in the lease term. However, counterevidence that the lessor will exercise the renewal option should also be considered. For example, perhaps the economic benefits derived from the underlying asset are of limited value to other parties and uniquely suited to the lessee.

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

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

30. **One year into a lease with an original lease term of 2 years, a lessee elects to exercise a one-year renewal option that was previously assessed as not probable of being exercised. What is the new lease term?**

The lease should be reassessed in accordance with paragraph 21.a of SFFAS 54. At the time of reassessment, the lease term would be 3 years. This would require a change from short-term lease treatment to lease liability/lease asset treatment for the lessee. The calculation of the lease liability should be based on the remaining lease payments in accordance with paragraphs 40-41. In this example, although the new lease term is 3 years the lease liability would be calculated for 2 years of lease payments.

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

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

SHORT-TERM LEASES

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

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

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

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

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

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

Not necessarily. Although each contract individually would meet the definition of a short-term lease, the reporting entity should consider whether either of the criteria for contract combinations in paragraph 78 are met. If so, these contracts would be considered part of the same lease contract and result in a 3-year lease term; it would not be a short-term lease.

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

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

Six months into the lease, when the reporting entity elects to exercise the option, the lease term should be reassessed (par. 21 of SFFAS 54). The noncancelable term is 24 months and the exercised option period is 12 months. Therefore, the reassessed lease term is 36 months. For reporting periods beginning after the election is made, the lease should no longer be considered a short-term lease.

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

It depends. Lease concessions are rent discounts made by the lessor to entice the lessee to sign a lease. Professional judgment may be required when it is not clear whether or not a contract includes lease concessions. In the absence of significant evidence to the contrary, lessees would not treat rent increases/decreases as lease concessions.

If the lower payments in months 1-12 are determined to meet the definition of a lease concession to entice the lessee to sign, these should be straight-lined as reductions to lease rental expenses over the lease term (see SFFAS 54, par. 10 and 23). The rent increase, absent other justifying factors, may be economic evidence that this was a lease concession in months 1-12. Additional information, however, may be needed to make that determination regarding the purpose of the reduction.

If not determined to be a lease concession, lessees may recognize the expense in the period of the increase in accordance with SFFAS 54, paragraph 23.

Commented [PR(4)]: Question would be removed in the event that the Board agrees to amend par. 23-24 lease incentives/ concessions straight-lining as a practical expedient.

Commented [PR(5)]: This will need to be modified if the Board agrees to the Omnibus proposal for SFFAS 54, par 23-24 that would allow lease concessions and incentives to be recognized in the period in which they occur.

CONTRACTS OR AGREEMENTS THAT TRANSFER OWNERSHIP

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

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

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

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

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

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

40. **A reporting entity (lessee) has a lease with a purchase option that is probable of being exercised. Is this a contract or agreement that transfers ownership?**

No, a purchase option that is probable of being exercised is not a transfer of ownership as specified in paragraph 25 of SFFAS 54. Rather, the purchase option should be included in the lease liability calculation in accordance with paragraph 40.e.

INTRAGOVERNMENTAL LEASES

~~A reporting entity (lessor) leases office space to another reporting entity (lessee) for \$50,000/year in years 1-5 and \$45,000/year in years 6-10. Should this rent decrease be treated as a lease concession or should it be recognized in the period in which it occurs in a manner consistent with step rent decreases? Both the lessee and lessor should treat this as a step rent decrease in accordance with paragraph 31 of SFFAS 54 unless the decreased rate meets the definition of a lease concession. Paragraph 10 states that lease concessions are rent discounts made by the lessor to entice the lessee to sign a lease. Lease concessions include rent holidays/free rent periods, reduced rents, or commission credits. Although years 6-10 meet the definition of reduced rent when compared to years 1-5, the reporting entities would also need to have knowledge that the reduction was made by the lessor to induce the lessee to sign in order to treat the rent decrease as a lease concession.~~

~~A reporting entity leases space to another reporting entity for \$50,000/year in years 1-5 and \$53,000/year in years 6-10. Should this rent increase be straight-lined over the 10-year lease term? No, according to paragraph 31 of SFFAS 54, if the lease provides for rental increases, a lessee should recognize the increases in expense in the periods of the increase (years 6-10). Examples of rent increases, including those that are fixed in nature based on anticipated increases in costs or appreciation in property values (which appears to~~

Commented [PR(6)]: Deletion of next three questions is pending omnibus proposal.

Commented [PR(7)]: Pending an omnibus change that will be proposed to the Board.

be the case in this example), contingent on future events (not applicable in this example), or variable in nature (not applicable in this example) are described in paragraphs 29-30.

Lease concessions, however, should be recognized by the lessees as straight-lined reductions to rental expense in accordance with paragraph 33 (see also: TR par. 37). There are no indications of lease concessions in this example. Absent economic / pricing indicators or other significant evidence that there are lease concessions in the contract or agreement, it is appropriate that contracts or agreements similar to this example be treated as rent increases rather than lease concessions.

A reporting entity (lessor) pays the moving costs for another reporting entity (lessee) upon commencement of a lease. Are the moving costs considered a lease incentive? Yes, paragraph 70 of SFFAS 54 states that lease incentives include lessor payments made to or on behalf of the lessee to entice the lessee to sign a lease. In this example, the moving costs paid by the lessor would be considered a lease incentive and should be accounted for by the lessee and the lessor in a manner consistent with paragraph 32 of SFFAS 54.

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

- The lessor should recognize the lease incentives provided as reductions of lease rental income on a straight-line basis over the lease term.

Commented [PR(8)]: New question discussed at task force meeting on 2/22 no longer needed, pending omnibus. Will add back if omnibus is rejected.

DISCLOSURES FOR INTRAGOVERNMENTAL LEASES

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

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

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

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

intragovernmental lease payments that are to be received to the end of the lease term for each of the 5 subsequent fiscal years and in 5-year increments thereafter.

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

The reporting entity should disclose such agreements separately in accordance with paragraphs 87-88 of SFFAS 54. Therefore, the original lease agreement should be disclosed per the requirements in paragraph 54, and the sub-lease agreement should be disclosed per the requirements in paragraph 38.

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

LEASE LIABILITY

44. **A reporting entity (lessee) enters into a lease with a non-federal entity that includes an optional extension period of 3 years, exercisable only by the lessee. The payment amounts for the optional period will be negotiated at the time the option is exercised. The lessee has an ongoing relationship with the lessor, and it is probable that it will exercise its option to extend. Therefore, the optional renewal period is included in the lease term in accordance with paragraph 15.a of SFFAS 54. How should the lessee measure the lease liability if the payment amount for the optional period is not specified in the contract?**

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

45. **A lease contract for copy machines requires that a minimum amount be paid for toner and paper regardless of whether these supplies are obtained. Should some portion of**

the minimum amount to be paid for supplies be included in the measurement of the lease liability?

Typically this component of the contract would be excluded from measurement. As discussed in paragraphs 75-76 of SFFAS 54, if the price allocation for the supplies component of the contract does not appear to be unreasonable, regardless of whether supplies are obtained, the reporting entity should account for the supplies component separately from the lease and therefore not include that amount in the measurement of the lease liability. If the price allocated to the supplies component of the contract appears to be unreasonable, professional judgment may be needed to determine whether some or all of the minimum amount is, in substance, a fixed lease payment that should be included in the amounts allocated to the lease component and included in the lease liability under paragraph 40.c of SFFAS 54.

- 46. Lease payments for a 5-year lease are indexed to the Consumer Price Index (CPI). The lease payments for the first year are \$50,000 per month, which is the market rate based on the current CPI, and payments for subsequent years will increase or decrease based on the change in the CPI during the preceding year. The CPI at the commencement of the lease is 251. How should the initial lease liability be calculated?**

Paragraph 40.b of SFFAS 54 requires that variable payments that depend on an index or a rate initially be measured using the index or rate as of the commencement of the lease term. If lease payments are indexed to the CPI, the payments to be included in the initial measurement of the lease liability should be based on the CPI at the commencement of the lease. If the CPI is 251 at the commencement of the lease, a reporting entity would assume it will stay at 251 throughout the lease, which would result in consistent lease payments for initial measurement of the lease liability. Therefore, the lease liability should be measured at the present value of \$50,000 per for 60 months. Any variation from \$50,000 paid in future periods due to changes in CPI will be recognized as expenses or reductions of expenses of those periods.

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

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

- 48. A reporting entity leases cars for 3 years and is required to make variable payments based on the number of miles driven. There is no minimum payment requirement stated in the lease agreement. The reporting entity can establish a probable minimum**

number of miles that will be driven based on historical usage. Paragraph 40.h of SFFAS 54 requires that a lease liability include “any other payments to the lessor that are probable of being required based on an assessment of all relevant factors.” Should the lease liability include the probable variable lease payments?

No, paragraph 41 of SFFAS 54 requires that variable payments based on future performance of the lessee or usage of the underlying asset not be included in the measurement of the lease liability. Because such payments are covered by paragraph 41 they should not be included in the measurement of the lease liability in accordance with paragraph 40.h, even if it is probable that they will be required and they are estimable. Rather, those variable payments should be recognized as an expense in the reporting period incurred (see also: TR par. 6264).

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

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

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

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

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

Yes, the fair value may be used. Discounting the lease payments at the rate the lessor charges the lessee, explicitly or implicitly, arrives at the fair value of the right to use the vehicles, which is not necessarily equivalent to the fair value of the vehicles. Using the \$2 million fair value of the vehicles at the commencement of the lease to determine the implicit discount rate in a lease may be appropriate if the reporting entity has determined that, considering the facts and circumstances of the agreement, the fair value of the vehicles approximates the fair value of the lessee's right to use the vehicles at that time. If those values differ because the lease term is less than the entire useful life of the vehicles, the fair value of the right to use the vehicles for the lease term may be estimated using professional judgment, maximizing the use of observable information. In this example, the reporting entity has estimated that the fair value of the right to use the vehicles is \$1 million because the length of the lease term is half of the vehicles' estimated useful lives. The reporting entity assumes the fair value of the *right to use the vehicles* decreases ratably over the lease term because the service capacity of the vehicles remains the same throughout the lease term, even though the fair value of the *vehicles* decreases faster at the beginning of the lease term. Therefore, the interest associated with the lease is \$100,000, and the discount rate is approximately 7.5 percent.

It should be noted, however, that oftentimes the implicit interest rate cannot be reasonably estimated. In such cases, paragraphs 42 and 59 of SFFAS 54 allow lessees and lessors to use the estimated incremental borrowing rate that would be charged for borrowing the lease payment amounts for the lease term.

52. **A reporting entity (lessee) enters a lease agreement for 10 years with a 5-year renewal option. At lease commencement, the reporting entity determines that it is not probable that the renewal option will be exercised, and the lease term is determined to be 10 years. However, at the end of year 8 the reporting entity elects to exercise the renewal option. Should the lease liability be remeasured at that time?**

Yes, in accordance with paragraph 21.a of SFFAS 54, the lease term should be reassessed when the reporting entity elects to exercise the renewal option at the end of year 8. Paragraph 44.a would require the reporting entity to also remeasure the lease liability as a result of the change in the lease term at that time.

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

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

LEASE ASSET

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

Generally it is not appropriate to apply PP&E capitalization thresholds to lease assets without considering the unique qualitative and quantitative characteristics of lease assets,

and the lease liabilities to which they correspond, and their individual and collective significance in relation to the financial statements. Lease assets and liabilities that are significant, either individually or in the aggregate, should be recognized. Authoritative pronouncements do not provide specific guidance related to a determination of capitalization threshold amounts. However, reporting entities often establish capitalization thresholds. When applying a capitalization threshold to leases, lessees should consider the quantitative and qualitative significance of the lease assets, *in addition to* the quantitative and qualitative significance of the corresponding lease liabilities, both individually and in the aggregate. Capitalization thresholds should be established in a manner that provides due consideration to the materiality fundamentals discussed in Statement of Federal Financial Accounting Concepts 1, *Objectives of Federal Financial Reporting*, paragraphs 164.a-164.g.²

55. A reporting entity (lessee) makes prepayments for rent related to a building lease during a construction period before gaining access to the building. Can rental prepayments made during the construction period be reported as a lease asset at the time they are paid?

No, rental payments made before commencement of the lease term should be reported as prepayments (assets) rather than as lease assets. At the commencement of the lease term the right to occupancy is established. The right to use makes the underlying asset a resource to the lessee and provides the lessee with access to the underlying asset's present service capacity. Therefore, at the commencement of the lease term, the rental prepayments should be reclassified as part of the initial measurement of the lease asset, as provided in paragraph 49.b of SFFAS 54 (see also: TR par. 2048 and 98).

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

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

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

No. If a lease contract includes a purchase option and the lessee determines that it is probable of being exercised, paragraph 51 of SFFAS 54 requires that the lease asset be amortized over the useful life of the underlying asset, unless the underlying asset is nondepreciable. If the reporting entity does not deem it probable at the commencement of the lease that it will purchase the land but later determines it is probable, the reporting entity

²Fundamentals are the underlying concepts of financial accounting that guide the selection of transactions, events, and circumstances to be accounted for; their recognition and measurement; and the means of summarizing and communicating them to interested parties. See Preamble to Statements of Federal Financial Accounting Concepts.

should cease amortizing the lease asset as of the date that the reporting entity determines that it is probable that it will purchase the underlying asset. The reporting entity should not reclassify the lease asset as land until the purchase occurs. However, the lessee should determine whether exercising the purchase option is expected to significantly affect the amount of the lease liability. A lease asset generally should be adjusted by the same amount as the corresponding lease liability when that liability is remeasured based on paragraphs 44-48 of SFFAS 54. Paragraph 44.c requires the lessee to remeasure the lease liability when an assessment of all relevant factors indicates that the likelihood of a purchase option being exercised has changed from probable to not probable, or vice versa.

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

No. The reporting entity should continue to amortize its lease asset once it is determined to be probable that it will purchase a depreciable underlying asset. However, the reporting entity should prospectively amortize the lease asset over the remaining useful life of the underlying asset, if different from the lease term. Additionally, the lease asset value that is amortized may change if the lease liability is adjusted for the change in likelihood of the purchase option being exercised (see also: TR par. 5756).

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

No, this would not be a reportable impairment. Paragraph 19 of SFFAS 44, *Accounting for Impairment of General Property, Plant, and Equipment Remaining in Use*, describes impairment as (1) a significant decline in service utility and (2) expected to be permanent. In this case, the loss in service utility was not permanent. Moreover, the PP&E subject to impairment is on the books of the lessor in accordance with paragraph 66 of SFFAS 54; not the lessee. Therefore, this is not impairment for the lessee. However, since future lease payments will be reduced, the lessee should remeasure the lease liability in accordance with paragraph 44.d and subsequently adjust the lease asset as required by paragraph 52.

COMPONENT REPORTING ENTITY DISCLOSURE REQUIREMENTS FOR LESSEES

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

No, SFFAS 6 disclosure requirements are only applicable to PP&E. Lease assets are not PP&E for lessees; lease assets are a right to use and access economic benefits derived from underlying PP&E assets. Lessees should provide disclosures on lease assets required by paragraph 54 of SFFAS 54; they should not apply PP&E disclosure requirements to their lease assets. Accounting and reporting requirements for PP&E rests with lessors (see also: par. 66 of SFFAS 54, and TR par. 1847).

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

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

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

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

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

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

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

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

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

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

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

Initial direct lease costs are defined in paragraph 13 of SFFAS 54. Examples of potential initial indirect lease costs are: that are required to be reported as an expense by the lessor ~~are:~~ (a) costs to originate a lease incurred in transactions with independent third parties that (1) result directly from and are essential to acquiring that lease, and (2) would not have been incurred had that leasing transaction not occurred; and (b) certain costs directly related to specified activities performed by the lessor for that lease. Those activities include evaluating the prospective lessee's financial condition; evaluating and recording guarantees, collateral, and other security arrangements; negotiating lease terms; preparing and processing lease documents; and closing the transaction (see also: TR par. 7776).

LEASE RECEIVABLE

66. **A reporting entity leases retail space to a vendor for 3 years. The payment in the first year is \$100,000; this amount is also considered the "minimum annual guarantee." The payment in the second year depends on sales in the first year. If the lessee's first year's sales exceed \$1,000,000, the minimum annual guarantee for the second year is \$110,000, but if the first year's sales are less than \$1,000,000, the minimum annual guarantee for the second year is \$100,000. The minimum annual guarantee for the third year is \$90,000 regardless of sales. What amounts should be included in the lessor's lease receivable at the commencement of the lease?**

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

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

When the variable payments and residual value guarantee meet the criteria for recognition, the amounts should be considered separate receivables, and revenue should be recognized in the period to which those payments relate. Paragraphs 57-58 of SFFAS 54 state that

variable payments based on future performance and residual value guarantees that are not fixed in-substance should not be included in the initial measurement of the lease receivable. Remeasurement of the lease receivable, as discussed in paragraph 61, is not required when those payments meet the criteria for recognition. Rather, the reporting entity would recognize a separate receivable and revenue when (a) a guarantee payment is required (as agreed to by the lessee and lessor) and (b) the amount can be reasonably estimated.

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

Lease receivables should be amortized using the interest method. Paragraph 59 of SFFAS 54 states that lessors are not required to apply imputed interest, but may do so as a means of determining the interest rate implicit in the lease; however, that option applies to the imputation of the interest rate, not to the method of amortizing the discount.

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

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

DEFERRED REVENUE

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

No, the lessor should recognize revenue, including interest revenue, over the lease term, which may be different than the useful life of the underlying asset. The requirements for leases are based on the foundational principle that leases are financings, whereby lessees agree to make payments over time for the right to use an underlying asset.

71. Halfway through a 10-year lease, a lessor remeasures the lease receivable from \$5,000,000 to \$100,000, due to a reduction in the lease term. The related deferred revenue balance at that date is \$4,800,000. How does the remeasurement of the lease receivable affect the measurement of the remaining deferred revenue?

The lessor should reduce the lease receivable by \$4,900,000 and the deferred revenue by \$4,800,000 and recognize a loss of \$100,000. According to paragraph 65 of SFFAS 54, the deferred revenue generally should be adjusted by the same amount as the corresponding lease receivable when the receivable is remeasured. However, if that change reduces the carrying value of the deferred revenue to zero, any remaining amount should be reported as a loss.

UNDERLYING ASSET

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

No, the reporting entity (lessor) should continue to report the building as PP&E until the purchase option is exercised by the lessee. Paragraph 66 of SFFAS 54 states that "a lessor should not derecognize the asset underlying the lease." Paragraph 58 of SFFAS 54 states that amounts to be received for the exercise price of a purchase option should be recognized as a receivable and revenue when that option is exercised.

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

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

COMPONENT REPORTING ENTITY DISCLOSURE REQUIREMENTS FOR LESSORS

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

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

LEASE INCENTIVES AND LEASE CONCESSIONS

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

Lease incentives received by a lessee before the commencement of the lease term would be recognized as advances received (liability), since they were received prior to the lease term.³ Upon commencement, paragraph 49.b of SFFAS 54 provides that lease incentives

³Par. 60 of SFFAS 1 provides that advances received (liabilities) should not be netted against advances paid out (assets) in financial reports of the entity.

received at or before the commencement of the lease term should reduce the lessee's initial measurement of the lease asset. In this case, the advances received liability would then be reclassified as a reduction to the lease asset.

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

The reporting entity (lessor) should recognize an advance (asset) at the time the payments are made, since they were made prior to the commencement of the lease term.⁴ Upon commencement, paragraph 64.b of SFFAS 54 provides that lease incentives paid at or before the commencement of the lease term should reduce the lessor's initial measurement of the deferred revenue. In this case, the advance asset previously recognized would then be reclassified as a reduction in deferred revenue upon commencement of the lease term.

CONTRACTS OR AGREEMENTS WITH MULTIPLE COMPONENTS

- 77. A reporting entity (lessee) leases equipment that will be installed by the lessor, prior to the commencement of the lease term, for an additional \$100,000. The lease contract requires that the reporting entity pay the lessor for installation of the equipment in the subsequent reporting period. Should the reporting entity (lessee) record the installation costs as part of the lease liability or as a separate liability?**

Initial direct costs are not included in the measurement of the lease liability. Installation costs generally are considered a nonlease component. ~~Because the payments (totaling \$100,000) are for installation costs and not for the right to use the equipment.~~ Accordingly, the payments are not considered lease payments under paragraph 40 of SFFAS 54 and should be accounted for as a separate liability. However, ~~if the~~ installation costs are ~~often~~ ancillary charges necessary to place the lease asset into service ~~and, therefore, they~~ should be included in the initial measurement of the lease asset in accordance with paragraph 49.c.

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

Based on paragraph 73 of SFFAS 54, if it is practicable for the reporting entity to separate and estimate the costs for those services, the costs should not be included in the reporting entity's lease liability. For example, if the lease contract itself does not specify the amount (in dollars or percentage), the reporting entity could request that information from the lessor. Additionally, ~~local real estate professionals may have statistics such as~~ average charges per square foot ~~age may be used for estimation~~. However, if it is not practicable for the reporting entity to separate the costs and estimate them, based on the provisions in paragraph 76 of

⁴Ibid.

SFFAS 54, the janitorial services and utility costs for the lobby should be included in the reporting entity's lease liability.

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

Yes. Paragraph 74 of SFFAS 54 requires that lease contracts involving multiple underlying assets be accounted for as separate lease components if the underlying assets have different lease terms. The reporting of two components instead of one may affect the discount rate implicit in the agreement. In addition, the estimated incremental borrowing rate may differ between the two components because of differences in lease terms. When the interest rates for each component cannot be reasonably estimated by the reporting entity, their estimated incremental borrowing rate for each of the two components should be used, in accordance with paragraphs 42 (for lessees) and 59 (for lessors).

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

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

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

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

In this case, the contract with multiple components would meet the exception in paragraph 76 of SFFAS 54 because the individual component prices are not easily determinable. If it is not practicable to determine a best estimate for price allocation for some or all components in a contract or agreement, a reporting entity should account for those components as a single lease unit in accordance with paragraph 77.

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

The lessee should account for each underlying asset as a separate lease component in accordance with paragraphs 74-75 of SFFAS 54. Lessees should first use any prices for individual components that are included in the contract or agreement, as long as the price allocation does not appear to be unreasonable based on the terms of the contract or agreement and use professional judgment when necessary, maximizing the use of observable information, in accordance with paragraph 76.

CONTRACT OR AGREEMENT COMBINATIONS

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

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

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

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

LEASE TERMINATIONS AND MODIFICATIONS

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

A lease amendment that adds an underlying asset to the contract is a lease modification (for example, increasing the lease from fifteen vehicles to twenty). A lease modification should be accounted for as either a separate lease (if it meets the criteria in par. 84 of SFFAS 54) or a remeasurement of the existing lease. Alternatively, a lease amendment that removes an underlying asset from the contract (for example, decreasing the lease from twenty vehicles to fifteen) should be accounted for as a partial lease termination (see par. 81-83 of SFFAS 54).

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

Because both parties have to agree to the optional 5-year period, it is considered cancelable and, therefore, not subject to the lease term reassessment guidance in paragraph 21 of SFFAS 54 prior to the lease modification. However, once the lessor and the lessee agree to exercise the option to extend, the 5-year period becomes noncancelable and should be accounted for as a lease modification, thereby subjecting the lease to reassessment criteria under paragraph 21.d. Paragraph 80 of SFFAS 54 states that lengthening a lease term while the contract is in effect is an amendment that should be considered a lease modification.

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

87. **Two years into a lease with an original lease term of 10 years, the remaining lease term is reassessed and reduced from 8 years to 5 years. At the time of the amendment, the carrying value of the lease liability is \$80,000, and the carrying value of the lease asset is \$76,000. How should the lessee account for the partial termination of the lease?**

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

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

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

89. **Three years into a 4-year lease, a reporting entity (lessee) modifies its lease from 200 vehicles to 230 vehicles which, if remeasured, would change the remaining lease liability from \$200,000 to \$202,500. The reporting entity has determined that the increase in the lease payments appears to be unreasonable (as discussed in par. 84.b of SFFAS 54) because it is very low when compared to the value of the additional underlying assets. How should the reporting entity account for the amendment to the lease?**

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

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

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

SUBLEASES

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

Yes, the requirements in paragraphs 87-88 of SFFAS 54 apply to short-term and intragovernmental leases that are part of sublease transactions.

92. Reporting entity "Agency ABC" enters into a lease agreement on behalf of the U.S. government with a lease term of 10 years for the right to use a residential property on international soil. The occupancy assignments and transfers of occupancy assignments amongst various reporting entities within the U.S. government (including reporting entities other than Agency ABC) and their related personnel is managed by a government services officer employed by Agency ABC and an inter-agency housing board. Occupancy assignment durations are based on tours of duty and oftentimes 2 years or less, but may extend beyond 2 years. Rental payments are made directly to the original lessor by the occupying agencies assigned. How should such a lease be reported by Agency ABC?

The requirements of paragraphs 87-88 would apply, and Agency ABC would account for the original lease (as original lessee) and subleases (as sublessor) as separate transactions. The original lease would meet the definition of a right-to-use lease asset on the books of the original lessee, whereas the sublease would meet the definition of an intragovernmental lease between the original lessee / sublessor and the sublessee. The original lease resides with the Agency ABC under its legislative authorities and, therefore, this is not a legal transfer or assignment of the lease contract to another reporting entity, but a sublease.

SALE-LEASEBACK TRANSACTIONS

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

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

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

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

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

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

Commented [PR(9)]: This section may also be pending omnibus changes. Several matters could be better clarified in SFFAS 54.

See comment letter #23. Staff agrees with these comments. Staff is still in the process of assessing whether or not to potentially adopt an approach similar to IPSASB ED 75, or at least certain elements thereof, which provides more detailed guidance for sale-leasebacks.

However, there are certain limitations in FASAB guidance that may prevent taking such an approach. (e.g., FASAB has no analogous standard to IPSAS 41 on financial instruments). FASAB also has limited guidance on measurement bases in general, including fair value, which is also cited here. See: <http://www.ifac.org/system/files/publications/files/IPSASB-Exposure-Draft-75-Leases.pdf> par. 99-102.

Interested in task force feedback.

TF not opposed but will need to look more carefully and provide direct feedback.

IPSAS 75

Transfer of the Asset is a Sale

99. If the transfer of an asset by the seller-lessee satisfies the requirements of [draft] IPSAS [X], (ED 70) to be accounted for as a sale of the asset:

- (a) The seller-lessee shall measure the right-of-use asset arising from the leaseback at the proportion of the previous carrying amount of the asset that relates to the right of use retained by the seller-lessee. Accordingly, the seller-lessee shall recognize only the amount of any gain or loss that relates to the rights transferred to the buyer-lessor.
- (b) The buyer-lessor shall account for the purchase of the asset applying applicable Standards, and for the lease applying the lessor accounting requirements in this [draft] Standard.

100. If the fair value of the consideration for the sale of an asset does not equal the fair value of the asset, or if the payments for the lease are not at market rates, an entity shall make the following adjustments to measure the sale proceeds at fair value:

- (a) Any below-market terms shall be accounted for as a prepayment of lease payments; and
- (b) Any above-market terms shall be accounted for as additional financing provided by the buyer-lessor to the seller-lessee.

101. The entity shall measure any potential adjustment required by paragraph 100 on the basis of the more readily determinable of:

- (a) The difference between the fair value of the consideration for the sale and the fair value of the asset; and
- (b) The difference between the present value of the contractual payments for the lease and the present value of payments for the lease at market rates.

Transfer of the Asset is not a Sale

102. If the transfer of an asset by the seller-lessee does not satisfy the requirements of [draft] IPSAS [X] (ED 70) to be accounted for as a sale of the asset:

- (a) The seller-lessee shall continue to recognize the transferred asset and shall recognize a financial liability equal to the transfer proceeds. It shall account for the financial liability applying IPSAS 41.
- (b) The buyer-lessor shall not recognize the transferred asset and shall recognize a financial asset equal to the transfer proceeds. It shall account for the financial asset applying IPSAS 41.

... [1]

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

Commented [C10]: Include reference, SFFAS 7?

LEASE-LEASEBACK TRANSACTIONS

Commented [PR(11): Section would need to be modified if omnibus amendments are made.

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

Paragraph 93 of SFFAS 54 requires that lease-leasebacks be reported as net transactions. In a lease-leaseback transaction, each party is both a lessor and a lessee. Because each portion of the transaction is with the same counterparty, a right of offset exists. The lease liability and the lease receivable should be offset and reported as either a net lease liability or a net lease receivable. Similarly, the lease asset and the deferred revenue should be offset. In this example, the reporting entity should report a lease receivable (net of the leaseback) and a deferred revenue (net of the leaseback) of \$2,300,000.

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

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

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

Prior to the new building being made available to the reporting entity, the lease of the land to the contractor should be reported as a standalone lease. Any lease payments made to the contractor prior to the new building being made available should be reported as an advance. Once the new building is made available to the reporting entity, the lease and the prepayment should be accounted for as a lease-leaseback transaction (see also: TR par. [2048](#) and [5554](#)).

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

Yes, the requirements of paragraph 93 of SFFAS 54 apply to short-term and intragovernmental leases that are part of lease-leaseback transactions.

IMPLEMENTATION TRANSITION GUIDANCE FOR IMPLEMENTATION

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

No. Paragraph 96 of SFFAS 54 states that leases should be recognized and measured using the facts and circumstances that exist at the beginning of the reporting period for implementation. The reporting entity should not estimate what the lease asset would have been if it initially had been recognized and amortized in prior periods as a lease under the provisions of SFFAS 54. The lease liability should be initially measured using the remaining lease term, associated lease payments, and discount rate as of the beginning of the period of implementation. The right-to-use lease asset should be measured based on the lease liability at that date, along with an adjustment for any unamortized lease payments made to the lessor (par. 49.b) and initial direct lease costs necessary to place the lease asset into service (par. 49.c) at or before the date of implementation and no restatement of beginning net position would be required because the lease asset and the lease liability would be the same.

In accordance with paragraph 13 of SFFAS 21, *Reporting Correction of Errors and Changes in Accounting Principles*, the cumulative effect of the change in prior periods should be reported as a "change in accounting principle" adjustment to the beginning balance of cumulative results of operations in the statement of changes in net position for the period the change is made. Prior period financials presented for comparative purposes should be presented as previously reported. The nature of the change in accounting principle and its effect on relevant balances should be disclosed in the period of implementation. Reporting entities need not repeat this disclosure in subsequent reporting periods.

~~In a period prior to the implementation of SFFAS 54, a reporting entity entered into a capital lease with an interest rate of 5 percent and recognized an asset under capital lease and a liability of \$450,600. At the beginning of the period of implementation, the carrying value of the asset under capital lease is \$200,900, and the liability (principal outstanding) is \$210,500. The reporting entity determines that the lease liability at that date should be \$220,500 under SFFAS 54. For leases that were reported as capital leases prior to the implementation of SFFAS 54, can the reporting entity use the carrying value of the capital lease asset at the beginning of the period of implementation as the measure of the lease asset?~~ Paragraph 96 of SFFAS 54 states that leases should be measured using the facts and circumstances that exist at the beginning of the period of implementation. This requires the determination of lease term to assume the term begins as of the beginning of the period of implementation and initially measuring the lease liability and lease asset based on the remaining lease term and

associated payments. In this example, the reporting entity should report a \$220,500 lease liability and lease asset at the date of implementation (beginning balance).

101. For leases that were reported as operating leases prior to the implementation of SFFAS 54, how should unamortized balances for lease incentives/concessions be reported at implementation of SFFAS 54?

Upon implementation of SFFAS 54, any unamortized balances for lease incentives/concessions should be reduced to zero. Leases should be evaluated in accordance with paragraphs 96-97 of SFFAS 54 at implementation.

In accordance with paragraph 13 of SFFAS 21, the cumulative effect of the change in prior periods should be reported as a "change in accounting principle" adjustment to the beginning balance of cumulative results of operations in the statement of changes in net position for the period the change is made (see also TR par. 10011).

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

If there was a transfer of ownership at the end of the lease term, then paragraph 25 of SFFAS 54 would apply. If there was not a transfer of ownership, then the remaining lease term of 24 months or less would make this a short-term lease (par. 22 of SFFAS 54) in accordance with paragraph 97.b. The adjustment for the difference in the lease asset and lease liability should be made to the beginning balance of cumulative results of operations in the statement of changes in net position for the period in which the change is required.

EFFECTIVE DATE

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

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

APPENDIX A: BASIS FOR CONCLUSIONS

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

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

PROJECT HISTORY

- A1. Statement of Federal Financial Accounting Standards (SFFAS) 54, *Leases*, was issued in April 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, 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:
- 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.¹
 - Suggesting implementation topics not addressed in GASB 2019-3.
 - 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 FASAB for its consideration.
 - Providing editorial and technical comments and illustrative examples on draft versions of implementation guidance questions and answers developed by staff. The working

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

APPENDIX B: ABBREVIATIONS

AAPC	Accounting and Auditing Policy Committee
FAF	Financial Accounting Foundation
FASAB	Federal Accounting Standards Advisory Board
GASB	Governmental Accounting Standards Board
GPFFR	General Purpose Federal Financial Report
PP&E	Property, Plant, and Equipment
QFR	Questions for Respondents
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards
SMC	Specific Matters for Comment
TR	Federal Financial Accounting Technical Release

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This section may also be pending omnibus changes. Several matters could be better clarified in SFFAS 54.

See comment letter #23. Staff agrees with these comments. Staff is still in the process of assessing whether or not to potentially adopt an approach similar to IPSASB ED 75, or at least certain elements thereof, which provides more detailed guidance for sale-leasebacks.

However, there are certain limitations in FASAB guidance that may prevent taking such an approach. (e.g., FASAB has no analogous standard to IPSAS 41 on financial instruments). FASAB also has limited guidance on measurement bases in general, including fair value, which is also cited here. See: <http://www.ifac.org/system/files/publications/files/IPSASB-Exposure-Draft-75-Leases.pdf> par. 99-102.

Interested in task force feedback.

TF not opposed but will need to look more carefully and provide direct feedback.

IPSAS 75

Transfer of the Asset is a Sale

99. If the transfer of an asset by the seller-lessee satisfies the requirements of [draft] IPSAS [X], (ED 70) to be accounted for as a sale of the asset:

(a) The seller-lessee shall measure the right-of-use asset arising from the leaseback at the proportion of the previous carrying amount of the asset that relates to the right of use retained by the seller-lessee. Accordingly, the seller-lessee shall recognize only the amount of any gain or loss that relates to the rights transferred to the buyer-lessor.

(b) The buyer-lessor shall account for the purchase of the asset applying applicable Standards, and for the lease applying the lessor accounting requirements in this [draft] Standard.

100. If the fair value of the consideration for the sale of an asset does not equal the fair value of the asset, or if the payments for the lease are not at market rates, an entity shall make the following adjustments to measure the sale proceeds at fair value:

(a) Any below-market terms shall be accounted for as a prepayment of lease payments; and

(b) Any above-market terms shall be accounted for as additional financing provided by the buyer-lessor to the seller-lessee.

101. The entity shall measure any potential adjustment required by paragraph 100 on the basis of the more readily determinable of:

(a) The difference between the fair value of the consideration for the sale and the fair value of the asset; and

(b) The difference between the present value of the contractual payments for the lease and the present value of payments for the lease at market rates.

Transfer of the Asset is not a Sale

102. If the transfer of an asset by the seller-lessee does not satisfy the requirements of [draft] IPSAS [X] (ED 70) to be accounted for as a sale of the asset:

(a) The seller-lessee shall continue to recognize the transferred asset and shall recognize a financial liability equal to the transfer proceeds. It shall account for the financial liability applying IPSAS 41.

(b) The buyer-lessor shall not recognize the transferred asset and shall recognize a financial asset equal to the transfer proceeds. It shall account for the financial asset applying IPSAS 41.