

Addendum Memo Leases

February 10, 2023

To: Members of the Board
From: Ricky A. Perry, Jr., Senior Analyst
Thru: Monica R. Valentine, Executive Director
Subject: **Letter from James Walsh, Department of State** (Topic E addendum)

On February 9, 2023, the Chairman received the enclosed letter from the Department of State (State or “the Department”). Staff requests that members carefully study this cover memo and the enclosed letter.

The enclosed letter does not affect the implementation themes, observations, and conclusions reached by staff under Topic E. State was one of the eight CFO Act reporting entities interviewed by staff, as discussed in the methodology section of Topic E. The implementation activities, themes, and staff observations in Topic E are based in part on those discussions. Staff did not propose any tentative Board decisions or recommendations for reasons discussed therein. Staff hereby reaffirms this position.

Staff analysis of the enclosed letter:

1. In fiscal year 2022, the Department’s “internal control structure continued to exhibit several deficiencies that negatively affected the Department’s ability to account for real and personal property in a complete, accurate, and timely manner,” according to its independent auditor (see [FY 2022 AFR, p. 53-58](#)). Based on information provided in the letter, previous staff discussions with the Department and research, and the deficiencies reported by the auditor, the Department’s system of control for reporting overseas residential leases in accordance with the current generally accepted accounting principles under Statements 5 and 6 seems deficient.
2. Board post-issuance actions, such as implementation guidance, clarifying amendments, and other guidance, are not a basis to delay implementing significant changes in generally accepted accounting principles. The Board’s post-issuance project activities did not alter the requirements of Statement 54 or delay implementation activities. Rather, they modestly reduced implementation burden.
3. Technical Release 20, paragraph 91, is based on the requirements of Statement 54. The assertions made by State in its letter regarding this paragraph are mostly irrelevant. Other aspects of State’s analysis of paragraph 91 simply summarize

existing management challenges and internal control deficiencies. The Department is the original lessee (and often the intragovernmental sublessor) for the overseas residential leases of the U.S. government.

4. Pages 4-5 of the enclosure's appendix documents a delayed implementation approach taken by the Department. There are no implementation activities of substance documented prior to or during the Statement 58 deferral period. This practice is consistent with many of the management challenges and themes summarized by staff under Topic E related to organizational change management, project management, and systems.
5. The Department was invited to participate in the leases project during the early research phase of Statement 54. The current and previous executive director made efforts to include the Department in the due process. The Department declined to participate repeatedly. State also did not comment on the exposure draft prior to the issuance of Statement 54.

During the leases post-issuance project, staff repeatedly reached out to the Department and welcomed its participation in the research and due process. The Department did not engage with the task force. The Department did not comment on the exposure draft prior to Statement 58. The Department only drafted and provided comments on the joint exposure draft, dated February 5, 2021, after FASAB staff requested them to do so. Many of the concerns expressed in the enclosed letter were expressed in this comment letter, and the Board and staff have duly considered all concerns.

Closing staff remark:

The federal financial reporting objectives are “a framework for assessing the existing financial reporting systems of the federal government and for considering how new accounting standards might help to enhance accountability and decision-making in a cost-effective manner.”¹ Topic E and the issues discussed in this enclosed letter highlight the anticipated benefits of Statement 54 and its expected contributions to the federal financial reporting objectives when the Statement becomes effective in fiscal year 2024.

Enclosure

¹ Statement of Federal Financial Accounting Concepts 1.



United States Department of State
Comptroller
Washington, DC 20520

FEB - 9 2023

Mr. George A. Scott
Chairman
Federal Accounting Standards Advisory Board
441 G. Street, NW, Suite 1155
Washington, DC 20548

Dear Chairman Scott:

The Department of State (State) is providing this paper to FASAB to reiterate and provide additional information on the previously described serious concerns and challenges with meeting the upcoming SFFAS 54 implementation deadline. It also serves to reaffirm that without resolution of the accounting treatment for overseas leases serving 30+ agencies, especially residential leases through State-administered housing pools (estimated minimum Net Present Value of \$2B), State's ability to comply with SFFAS 54 is at risk with strong implications for its internal control assertions. In addition, the Department would be at risk of losing a clean audit opinion for FY2024 with the current implementation date. **To be clear, State is not in position to successfully comply with the implementation of SFFAS 54.**

The primary factors that are impeding State's ability to comply with SFFAS 54 are summarized below:

1. Specialized Complex Accounting: State and the 30+ agencies with employees occupying overseas residential leases **cannot implement SFFAS 54** and associated TR 20 (Question 91) by FY 2024 without additional discussion and guidance from FASAB, OMB and Treasury. The existing guidance assumes either:
 - a. The established business arrangements for overseas leasing and lease payments would need to be significantly altered, which could not be executed before FY 2024 reporting, and would create additional **ongoing** costs for State and the agencies involved for the services provided (and real questions around the value-added benefit to the USG and taxpaying in the additional reporting), or
 - b. Agencies impacted would need to establish **alternative accounting** to simulate these arrangements and record non-cash intragovernmental lease payments without aligning budgetary authority with the right to use asset as prescribed by OMB and Treasury, also problematic.
2. Lack of Timely Guidance: Sufficient implementation guidance has not been provided or was not provided timely to allow agencies with material right-to-use assets and liabilities to meet implementation timelines. The complexities within SFFAS 54 require detailed guidance to produce consistent reporting for consolidating federal financial statements. Guidance is still forthcoming from FASAB, Treasury and OMB, **handicapping State and other federal agencies** from updating processes and IT system requirements, **system providers** from developing necessary automated functionality, and **auditors** from planning their testing.

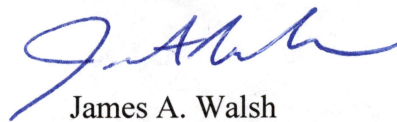
3. IT Systems Readiness: The complexities of SFFAS 54 demand automated processes, controls, and transfer of data to achieve sustainable compliance. Due to the delays in federal guidance and based on the time it takes for system providers to update their products to meet that guidance, automated functionality for federal lease reporting through financial and lease management systems is not readily available to State or the rest of the federal financial community at this time. To achieve SFFAS 54 implementation by FY 2024, State would need to dedicate (and ultimately waste) additional resources to develop higher-risk, less reliable short-term solutions, in addition to the significant investment required to develop, test, customize, and fully implement State's long-term system solution.

Unfortunately, while there has been some progress since SFFAS 58 was issued in June 2020, from State's perspective, many of the primary conditions that resulted in the Board's prior decision (SFFAS 58) to defer the effective date of SFFAS 54 (i.e., implementation challenges such as acquiring IT, core systems requirements, resource limitations together with outstanding and extensive preparation activities, and the need for full guidance) still exist. Therefore, we are providing the following supplementary request for the FASAB consideration:

1. A deferral in the SFFAS 54 required effective date (paragraph 98) to October 2027 to allow federal agencies to continue to address lease reporting challenges, including **engagement with FASAB, Treasury and OMB Staff** to resolve accounting for the unique overseas residential housing leases along with a system solution, and
2. Removal or modification of TR 20, question 91.

We sincerely appreciate FASAB's assistance on this matter to date. We thank FASAB for thorough consideration in these matters and look forward to the ongoing collaboration to address them and allow for clarified, auditable financial reporting.

Sincerely,



James A. Walsh
Comptroller

Enclosure

CC: Acting Controller, Office of Management and Budget
Assistant Secretary for Management and Chief Financial Officer, Department of Veterans Affairs
Acting Chief Financial Officer (CFO), Department of Energy
Principal Deputy Assistant Secretary exercising the Delegated Authorities of the Assistant Secretary and CFO, Department of the Interior
Executive Director, FASAB
Commissioner of the Bureau of the Fiscal Service, Department of the Treasury

Department of State Challenges Implementing SFFAS 54 and Request for Action from FASAB

Appendix A: Detailed Analysis

Throughout development of SFFAS 54, *Leases*, the Department of State (State) has engaged with FASAB staff and the Leases Task Force to share perspective, questions, and feedback. In July 2022, State submitted a comment letter (Letter) regarding State's challenges implementing SFFAS 54 and associated guidance for overseas leases by the existing effective date of October 1, 2023.

As stated in our July 2022 Letter, and through discussions with FASAB Staff, State has unresolved concerns on the requirements of SFFAS 54 including the Implementation Guidance outlined in TR 20, specifically question 91, as it relates to the treatment of overseas residential leases. Of the approximately 17,000 overseas real property leases administered by State, over 14,500 leases are residential leases that are executed through housing pools (described in more detail in the following pages and Appendix B), of which approximately 5,000 are occupied by employees from more than 30 federal agencies. These arrangements are unique and do not align with traditional and expected real property lease scenarios, as outlined in SFFAS 54, in the following manner:

- State does not execute subleases or occupancy agreements to federal agencies.
- State does not establish reimbursable agreements, bill, or collect reimbursement (i.e., cash consideration) from agencies occupying leases through the housing pools overseas.
- State operates with disbursing authority and provides a service to make disbursements overseas for federal agencies to include payments in foreign currencies, such as for lease payments to landlords.
- State does not pay landlords on behalf of agencies who do not provide their appropriate funds cite timely. Instead, they work with the occupying agency to obtain the fund cite.
- State funds do not back overseas residential leases.

We appreciate FASAB's initial consideration of the overseas-specific scenario, and the guidance provided under TR 20, question 91 as well as the continued support we receive through the Lease Task Force. However, we identified remaining gaps in our ability to effectively implement the guidance as promulgated by FASAB. As a result of these outstanding unique accounting challenges, and even with the additional guidance provided by the Treasury Leases Working Group for Right to Use Asset accounting scenarios, **State cannot finalize the accounting entries, processes and IT system requirements and execute the necessary financial reporting preparation and IT system implementations without further guidance, which would ultimately impact our internal control assertions and audit opinion.**

Therefore, we are providing the following supplementary request for the FASAB's consideration:

1. A deferral in the SFFAS 54 required effective date (paragraph 98) to October 2027 to allow federal agencies to continue to address lease reporting challenges, including through **engagement with FASAB, Treasury and OMB Staff** to resolve the accounting for the unique overseas residential housing leases and allow time for other SFFAS 54 guidance needing clarification to be provided to agencies and for State to develop a system solution to address the standard; and

2. Removal or modification of TR 20, question 91.

Justification for Extending the SFFAS 54 Required Effective Date to October 2027:

- State-specific complex accounting entries – SFFAS 54 and associated guidance do not provide sufficient clarity applicable to the unique nature of leases administered by State but occupied by other agency employees overseas. As we outline in further detail below, State cannot implement SFFAS 54 in accordance with TR 20 question 91 as provided currently because the guidance does not take into account the accounting complexities associated with these unique business events.

State's association with lease payments for leases occupied by non-State employees overseas is as a Disbursing Office akin to Treasury and these lease payments are not associated with State's budget and financial records. State needs additional time to engage with FASAB, Treasury, and OMB staff as well as the more than 30 other agencies to identify accounting entries that will sufficiently satisfy the intent of SFFAS 54, Treasury tie points, and budgetary accounting without initiating significant changes or unnecessary costs to the business processes for arranging and paying for housing for federal employees serving at overseas posts. The options we identified during preliminary discussions with FASAB staff (described below) involve unprecedented and complex accounting scenarios, without resolution to the underlying issues.

- TR 20 Question 91 Assertion 1: State is considered a lessor to other agencies under sublease. In this situation, State needs to consider how to recognize sublease revenue without sublease agreements, reimbursable agreements, and absent payments from other agencies to State. Otherwise, the established business arrangements for overseas leasing and lease payments will need to be significantly altered, resulting in additional **ongoing** costs for the services provided.
- TR 20 Question 91 Assertion 2: State is considered a lessee for leases where another agency funds and pays for the lease directly. In this situation, State needs to consider how to calculate the lease liability and draw down on the liability over time without cash ever being exchanged between State and the Landlord. Further, because State does not receive funding for these leases, we would be forced to an unfunded lease liability for the duration of the lease term. In effect, State would be recording a large unfunded liability on our financial statements that will never be funded by direct or reimbursable authority. Other agencies are also impacted and will need to record **alternative accounting entries** to simulate the business processes with non-cash intragovernmental lease payments without aligning budgetary authority and the right to use asset as prescribed by OMB and Treasury. In addition, these entries may adversely impact Treasury GTAS and established financial reporting tie points for intragovernmental revenue.

For each of these scenarios, State and the associated agencies involved need additional time to determine whether existing FASAB standards can be used in conjunction with SFFAS 54 to resolve the implementation challenges or if new guidance will be required from FASAB, OMB, and/or Treasury.

- Clarification and additional guidance from FASAB, Treasury, and OMB across Lease Scenarios – FASAB’s issuance of SFFAS 58 included justification for the deferral of SFFAS 54 due to “the need for the federal financial accounting and reporting community to **receive, understand, and apply** forthcoming implementation guidance due to the extensive complexity and breadth of implementation issues identified by the leases implementation guidance task force.” Multiple comment letters stated, “providing the federal financial accounting and reporting community with the implementation guidance during fiscal year 2021 to be a critical factor for the successful implementation of SFFAS 54 by the new effective date.” However, SFFAS 54 implementation guidance through TR 20 was not released until FY 2022. Accounting scenarios were provided through the Treasury Leases Working Group in draft toward the end of FY 2022 but did not address the common lease complexities. Agencies still haven’t **received** guidance for the following:
 - FASAB:
 - Updated TR-20 Implementation Guide, not expected until FY 2023 Q4
 - Additional requirements and issuance of Intragovernmental Leasehold Reimbursable Work Agreements not expected until mid-2023
 - Treasury:
 - Additional guidance for right-to-use real property lease scenarios, which were not included in the approved scenarios but represent the largest portion of federal lease spending
 - Right-to-Use operating leases executed with single-year and multi-year funding for leases that extend beyond the fund’s period of availability, which were not included in the approved scenarios
 - OMB:
 - OMB Circular A-136 detailed guidance on principal statement and/or footnote disclosures.
 - Consideration around streamlining OMB Circular A-11 lease scoring requirements and continued designation of capital leases which requires agencies to evaluate and calculate a significant number of leases under two completely different sets of guidance, creating the need for two separate lease reporting ledgers.

Additional time would allow FASAB to update TR 20 with guidance that addresses challenges identified across the federal financial accounting and reporting community, including State-identified challenges. The guidance could also support identification and reporting of new leases within the SFFAS 54 lease definition such as embedded leases, to improve consistency across agencies and to achieve sustained completeness and accuracy. With this updated information, agencies could truly **understand and apply** this guidance to implement SFFAS 54.

Without these clarifications, additional implementation guidance and consideration to deconflict OMB guidance, State, and other federal agencies are unable to effectively plan for process and IT system requirements and associated IT system upgrades.

- IT System Updates – FASAB’s issuance of SFFAS 58 included justification for the deferral of SFFAS 54 due to “the need to develop and acquire information technology, data elements, core systems requirements, and internal controls at the government-wide and component reporting entity levels.” Given the number of leases (greater than 17,000) and the frequency of lease modifications in State’s portfolio, the ability to maintain complete and accurate lease data in reliable systems is critical to sustainable and auditable lease reporting in accordance with SFFAS 54 requirements. State has been working to identify, analyze, and document the significant changes needed for our lease, property inventory, and global accounting systems. As noted by other agencies, such as the Department of Interior and the Department of Veterans Affairs, the complexity of the standard along with the interpretations and judgments required to facilitate establishing new procedures, policies, and systems functionality (identification, data cleansing, conversions, additional functionality impacted by the change) for lease reporting and integration of lease payments to leasing data as well as the substantial amount of testing required for system upgrades takes time, substantial resources, and investment.

State uses an off-the-shelf financial system to conduct our global operations, with separate instances for domestic and international operations. State anticipates the basic lease functionality from our financial system vendor, which services many impacted federal agencies, to be implemented in Spring 2024 for the domestic ERP, with additional lease functionality to become available domestically in spring 2025. The leasing module of this financial management software would require a worldwide standardized implementation to over 245 posts in 160 countries including associated training, data quality testing, and internal control validation.

Establishing the accounting and leasing requirements and the subsequent impact to financial systems has been and will continue to be further delayed as long as the final Treasury scenarios to account for leases and specifically the accounting for overseas residential leases is uncertain. This specific uncertainty impacts lease reporting for over 30 customer agencies. Given the complex nature of these processes, the impact it has to State and other agencies’ operations, and our need to successfully update our systems, policies, and procedures around this treatment and the overall SFFAS 54 implementation, we are concerned about our implementation timeline and the resources needed to become and sustain compliance by FY 2024. With additional time to achieve full compliance, State would also be able to prevent wasting resources on high-risk short-term solutions and focus its resources on the long-term sustainable solutions.

State presents the following timeline to demonstrate the activities that have taken place since SFFAS 58 was issued and the planned activities for the next three years (dependent on timely receipt of the above-mentioned guidance) to establish sustained readiness for accurate lease reporting.

FY 2020 (Completed):

- Engaged with FASAB staff, through the Lease Task Force, regarding the overseas leases that service multiple agencies without reimbursable arrangements and the specifics for those leasing scenarios.
- Submitted a question for TR 20 regarding the overseas leases that service multiple agencies without reimbursable arrangements in place, to assist in implementation.

FY 2021 (Completed):

- Provided Exposure Draft comments to TR 20 including the overseas leases that service multiple agencies.
- Awaited TR 20 implementation guidance to apply guidance to 17,000+ overseas leases.

FY 2022 (Completed):

- Following issuance of TR 20, evaluated its impact and drafted a position paper for FASAB staff review.
- Met with FASAB staff and submitted a comment letter in July 2022 documenting challenges with SFFAS 54 and TR 20.
- Continued readiness activities for SFFAS 54 implementation.

FY 2023 (In Progress):

- (Dependent on FASAB, Treasury, and OMB) Determine future accounting treatment for overseas residential leases in housing pools through engagement with FASAB, Treasury, and OMB.
- (Dependent on Treasury) Receive final guidance from Treasury for short-term (completed), intragovernmental (completed), and RTU assets (in progress).
- Engage with 30+ federal partners who occupy leases abroad and provide support and implementation processes.
- Provide requirements to financial and lease system vendors.
- Implement pilot for an enhanced real property lease management operations intake system, which will produce lease documents and capture underlying data fields for SFFAS 54 reporting.
- Finalize population for domestic real property, personal property, and embedded leases.
- Continue initiatives to improve standardization of the operational leasing processes and improvements to data quality.

FY 2024 (Planned):

- Continue initiatives to improve standardization of operational leasing processes and data quality.
- Validate internal controls for intragovernmental lease reporting.
- Spring: Implement Financial System Upgrade (Momentum v.8.1) with SFFAS 54 lessee capabilities.

FY 2025 - FY 2027 (Planned pending funding and management decisions):

- Spring 2025: Implement Financial System Upgrade (Momentum v.8.2) with additional SFFAS 54 leasing capabilities and integration across systems.
- Execute a worldwide rollout of the financial system leasing module integrated with core financial systems.
- Validate internal controls for lease processes and systems.

This extended plan also gives time for older leases to expire and new leases to be initiated with improved data quality standardization to meet the data requirements of SFFAS 54.

Justification for the Removal or Modification of TR 20, Question 91

As described in our comment letter from July 2022, State has identified implementation issues as it relates to SFFAS 54 in conjunction with TR 20, question 91. Our concerns are as follows:

- TR 20, question 91, asserts State is a lessee with a third party, but under the current guidance State cannot account for leases where payments are not made to a lessor [landlord] with State funding. SFFAS 54 paragraph 6, states: “A lease is defined as a contract or agreement whereby one entity (lessor) conveys the right to control the use of PP&E (the underlying asset) to another entity (lessee) for a period of time as specified in the contract or agreement in exchange for consideration.” While consideration is not defined under the standard as “payment” or “cash”, paragraph 40 requires the recognition of the lease liability be measured at the present value of payments. This liability is then drawn down as payments are made to the lessor. In many cases, as outlined further below, State is not responsible for and does not receive funding to pay for these leases. State’s association with lease payments for leases occupied by non-State employees overseas is as a Disbursing Office akin to the Department of Treasury and the lease payments are not associated with State’s financial records. Given the guidelines in SFFAS 54, we are unable to determine how State would assert we are a lessee and account for the corresponding liability and liquidation when no revenue is received, and no disbursement (expense) is made by State.
- TR 20, question 91, also asserts State is a lessor and other agencies are in a sub-lease relationship with State, but State cannot account for lease revenue as required in paragraph 38 of SFFAS 54. Under paragraph 38, point b, agencies are required to disclose “Future lease payments that are to be received to the end of the lease term for each of the five subsequent fiscal years and in five-year increments thereafter.” State is unable to implement this requirement as we do not receive payments from other agencies for these leases. Rather, the occupying agencies’ funds are used to pay the landlord directly in accordance with the original lease. State does not receive lease payments from the occupying agencies and therefore does not recognize rent revenue associated with these leases in accordance with GAAP. State also does not have sub-lease, occupancy, or reimbursable agreements with other agencies related to these rent payments.
- If the guidance is not modified or clarified, and State is expected to strictly adhere to TR 20 as promulgated, then State and more than 30 agencies would take on an undue ongoing burden to revise long-standing and current effective and accountable operational business processes for overseas leasing and housing support that were designed specifically to achieve efficiencies and reduce the administrative burden of administrative services overseas. In light of the Board’s efforts to contain and minimize the implementation costs of SFFAS 54, **we believe this is not the intention of the Board.**

While we agree this population of leases should be accounted for within the government-wide portfolio, we are still unclear as to how these leases should be accounted for by State or other agencies and are requesting additional engagement with FASAB staff and the impacted agencies and additional guidance or changes to the standard so that we may comply. Through our implementation planning and reviews of SFFAS 54, State believes that we have an effective and appropriate treatment for these leases that will comply with SFFAS 54 and provide each agency with accurate lease populations and amounts for reporting. We request the opportunity to discuss the accounting challenges and options to resolve these challenges in more detail with FASAB.

This affects over 14,500 leases, over 5,000 of which are occupied by non-State employees and is significant to State's financial statements.

We appreciate FASAB's assistance on this matter to date. We thank FASAB for consideration in these matters and look forward to ongoing collaboration to address them to allow for clarified, auditable financial reporting.

Appendix B: Comment Letter previously submitted by State (July 2022)

Refer to the State's Comment Letter submitted in July 2022 for background on the population and characteristics of leases administered overseas by State.

[LeasesOmnibusED 16 State.pdf \(fasab.gov\)](#)