

Memorandum

Updates to TR 20

March 31, 2023

To: Members of the AAPC
From: Ricky A. Perry, Jr., Senior Analyst
Thru: Monica R. Valentine, Executive Director / AAPC Chair
Subject: **Proposed Updates to TR 20** (Attachment A)

INTRODUCTION

The memo includes a summary of the content analysis performed by staff and independent coders, [as discussed in February](#). Staff proposes updates to Technical Release (TR) 20, *Implementation Guidance for Leases* (TR 20), with (a) conforming amendments related to SFFAS 61 and TB 2023-1, and (b) additional Q&A based on GASB implementation guidance updates and issue submissions.

Staff requests feedback and discussion on these proposals at the April AAPC meeting.

REQUEST FOR FEEDBACK

Committee members should review these materials in advance of the meeting.

Although staff is not requiring technical feedback in advance of the meeting, members that have extensive comments or edits are encouraged to submit them in advance to Mr. Perry at PerryRA@fasab.gov, with a cc to Ms. Valentine at ValentineM@fasab.gov.

NEXT STEPS

Pending Committee feedback and discussions, staff intends to update the draft exposure draft and distribute a pre-ballot of the exposure draft following the meeting.

ATTACHMENTS

- B. Draft exposure draft: *Leases Implementation Guidance Updates*
- C. Project plan (approved in February)

REFERENCE MATERIAL

1. [SFFAS 54: Leases](#)
2. [SFFAS 60: Omnibus Amendments 2021, Leases-Related Topics](#)
3. [SFFAS 61: Omnibus Amendments 2023, Leases-Related Topics II](#)
4. [Technical Release 20: Implementation Guidance for Leases](#)

5. [SFFAC 5: Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements](#)
6. [GASB Implementation Guide No. 2020-1—Implementation Guidance Update—2020 \(IG\)](#)
7. [GASB Implementation Guide No. 2021-1—Implementation Guidance Update—2021](#)
8. [GASB Exposure Draft—Implementation Guidance Update 2023](#)

Summary:

Staff recommends the following TR 20 update candidates to the AAPC:

A. One conforming amendment candidate:

Par. to amend	TR 20 topic area	Source	Att. B par.
78	Contracts and agreements with multiple components	SFFAS 61, par. 6-10	5

B. Seven new implementation guidance candidates:

Par. to add	TR 20 topic area	GASB source	Att. B par.
11A	Scope and definitions	IG 2020-1, par. 4.6	6
24A	Lease term	IG 2021-1, par. 4.6	7
24B		IG 2023-1, par. 4.1	
32A	Short-term leases	IG 2020-1, par. 4.11	8
45A	Lessee rec. and measurement	IG 2021-1, par. 4.11	9
52A		IG 2023-1, par. 4.4	
75A	Lease incentives and concessions	IG 2021-1, par. 4.17	10

C. Two staff-proposed candidates:

Par. to add	TR 20 topic area	Source	Att. B par.
8A	Scope and definitions	SFFAS 54, par. 3 SFFAC 5, par. 29-35	6

D. One technical correction candidate:

TR 20 par. to correct	TR 20 topic area	GASB source	Att. B par.
25	Lease term	IG 2023-1, par. 5.1	11

Detailed Analysis

Part 1 of 4 TR 20 conforming amendment content analysis¹

Green	<i>Agreement reached with independent coders</i>
Red	<i>Agreement with independent coders not reached</i>

TR 20 par.	Analysis	Source*	Att. B par.
1-38	No conforming amendment candidates identified	N/A	N/A
39-40	Analyzed SFFAS 61, par. 5, amendment to par. SFFAS 54, par. 25. Given the irrelevance of the amendment to the question's scenario and related answer, no conforming amendment is necessary.	SFFAS 61, par. 5	N/A
41-58	No conforming amendment candidates identified	N/A	N/A
59	Staff and independent coders agreed it would not be appropriate to add a footnote to reference intragovernmental leasehold reimbursable work agreements, as this Question and Answer (Q&A) applies to the lease assets topic area. Accordingly, the Q&A is not applicable to intragovernmental leases.	Technical Bulletin 2023-1	N/A
60-77	No conforming amendment candidates identified	N/A	N/A
78	Staff and independent coders agreed it would be appropriate to align the terminology and paragraph citations with SFFAS 61 amendments to SFFAS 54, par. 42-42C and 59-59C.	SFFAS 61, par. 6-10	5
79-99	No conforming amendment candidates identified	N/A	N/A

* Reviewed each TR 20 paragraph against SFFAS 61 and Technical Bulletin 2023-1.

¹ Content analysis is an approach to quantify or categorize qualitative information by systematically sorting and comparing items of information in order to summarize them. Under this plan, staff evaluated implementation guidance information and code it in order to determine the appropriate actions.

Recommendation 1 of 4: Staff proposes one conforming amendment to par. 78 of TR 20

5. Paragraph 78 of TR 20 is amended as follows, to conform with paragraph 42 of SFFAS 54, as amended by paragraph 6 of SFFAS 61:

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

Yes. Paragraph 74 of SFFAS 54 requires that lease contracts involving multiple underlying assets be accounted for as separate lease components if the underlying assets have different lease terms. The ~~interest-estimated incremental borrowing~~ rate in this scenario would likely differ between the two components because of the difference in lease terms. When the interest rates for each component are not stated in the lease agreement, the ~~interest-estimated incremental borrowing~~ rate for each component should be based on the interest rate on marketable Treasury securities at the commencement of the lease term (or at the subsequent financial reporting date) with a similar maturity to the term of the lease used, in accordance with paragraphs 42-42C (for lessees) and 59-59C (for lessors).

SFFAS 54 excerpt: Paragraph 42, as amended by paragraph 6 of SFFAS 61

42. *The future lease payments should be discounted using the interest rate the lessor charges the lessee. If the interest rate is not stated in the lease, the interest rate should be based on the interest rate on marketable Treasury securities at the commencement of the lease term (or at the subsequent financial reporting date in accordance with par. 44), with a similar maturity to the term of the lease.*

For committee discussion: Do members agree with or have feedback on staff's conforming amendments content analysis and recommendation 1?

Part 2 of 4: Additional TR 20 Q&A on control

TR 20 and SFFAS 54 provide helpful guidance related to the definition of a lease and the concept of control (and the essential elements of control). Staff believes additional guidance would likely be helpful to practitioners.

The Board incorporated the two essential elements of control from Statement of Federal Financial Accounting Concepts (SFFAC) 5, *Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements* (see par. 29-35 of SFFAC 5) into the definition of a lease under paragraphs 2-3 of SFFAS 54. Inclusion of guidance related to this concepts statement would benefit practitioners and facilitate understanding of paragraphs 2-3 of SFFAS 54.

Recommendation 2 of 4: Staff proposes two implementation guidance Q&A on control.

6. Paragraphs 8A, 8B, and 11A are added to TR 20 (under the topic area for scope and definitions) as follows:

8A. A reporting entity enters into a 10-year contract with a utility company for the right to use a specified capacity of fiber optic cable connecting two operational sites (over a specifically identified route) in exchange for consideration. The reporting entity controls access to the specified capacity provided for in the contract. Does this contract convey control and meet the definition of a lease?

Yes, this contract conveys control and meets the definition of a lease. Paragraph 3 of SFFAS 54 provides that the reporting entity should assess whether the contract gives the lessee both of the following when determining whether a contract or agreement conveys the right to control the use of the underlying asset:

- a. The right to obtain economic benefits or services from the use of the underlying asset as specified in the contract
- b. The right to control access to the economic benefits or services of the underlying asset as specified in the contract

The fiber optic cable is inherently expected to provide the reporting entity with the right to obtain economic benefits or services of the underlying asset (criterion 1 of 2). Through a lease contract the government may control access to the economic benefits or services embodied in an underlying asset it does not own. In this scenario, the contract allows the reporting entity to deny or regulate the access of other entities to the economic benefits or services of the specified capacity and route provided for under the contract (criterion 2 of 2). Therefore, the control criterion is met. Relatedly, in accordance with paragraph 2, the contract in this scenario specifies, either explicitly or implicitly (in this case, explicitly) the underlying asset.

8B. A reporting entity enters into a service contract with a utility company for the right to use a fiber optic cable network in exchange for consideration. The contract does not provide the reporting entity with specific capacity rights, cables, or wavelengths; nor does it provide the ability to deny and regulate the access of others to the fiber optic cable network. Does this contract convey control and meet the definition of a lease?

No, this contract does not convey control or meet the definition of a lease. Unlike the scenario under paragraph 8A above, the contract under this scenario does not meet the control criterion under paragraph 3.b of SFFAS 54 (criterion 2 of 2). The reporting entity cannot deny or regulate the access of other parties to the economic benefits or services of the underlying asset, as the contract does not convey specific capacity rights, cables, or wavelengths. Relatedly, paragraph 2 of SFFAS 54 provides that the underlying asset should be identified either through explicit specification in the contract or implicit specification at the time the underlying asset is made available for use. The contract in this scenario does not specify, either explicitly or implicitly, the underlying asset.

11A. [Abridged. See recommendation 3 below]

For committee discussion: Do members agree with or have feedback on staff's conforming amendments content analysis and recommendation 2?

Part 3 of 4: GASB implementation guidance updates content analysis²

Green	Agreement reached with independent coders
Red	Agreement with independent coders not reached

GASB IG	IG par. no.	Candidate ?	Added ?	Analysis	Att. B (TR 20) par.
2020-1	4.6	Y	Y	Added with modifications to address differences between GASB 87, par. 5b and SFFAS 54, par. 3	6 (11A)
2020-1	4.7	Y	N	Covered by TR 20, par. 11	N/A
2020-1	4.8	Y	N	Covered by TR 20, par. 29	N/A
2020-1	4.9	Y	N	Covered by TR 20, par. 6	N/A
2020-1	4.10	Y	N	Covered by TR 20, par. 6	N/A
2020-1	4.11	Y	Y	Added with modifications to address differences between GASB and FASAB short-term definitions	8 (32A)
2020-1	4.12	Y	N	Covered by TR 20, par. 39	N/A
2020-1	4.13	Y	N	Covered by SFFAS 54 and candidate below (Att. B, par. 10)	N/A
2020-1	4.14	N	N	Appears to be specific to state and local reporting entities only	N/A
2020-1	4.15	Y	N	Covered by SFFAS 54 (SFFAS 61 omnibus addresses this topic)	N/A

² [GASB Implementation Guide No. 2020-1—Implementation Guidance Update—2020](#)
[GASB Implementation Guide No. 2021-1—Implementation Guidance Update—2021](#)
[GASB Exposure Draft—Implementation Guidance Update 2023](#)

GASB IG	IG par. no.	Candidate ?	Added ?	Analysis	Att. B (TR 20) par.
2020-1	4.16	Y	N	Covered by SFFAS 54 (SFFAS 60 omnibus addresses this topic)	N/A
2020-1	4.17	Y	N	Covered by SFFAS 5 and 54	N/A
2021-1	4.4	N	N	Appears to be specific to state and local reporting entities only	N/A
2021-1	4.5	N	N	Focuses on the definition of an exchange or exchange-like transaction, which is irrelevant to SFFAS 54	N/A
2021-1	4.6	Y	Y	Added with modifications to address differences between GASB and FASAB short-term definitions	7 (24A)
2021-1	4.7	Y	N	Covered by TR 20. AAPC guidance cannot conflict with SFFAS 54	N/A
2021-1	4.8	N	N	SFFAS 7 guidance is out of scope for this project	N/A
2021-1	4.9	Y	N	Covered by SFFAS 54, par. 43	N/A
2021-1	4.10	Y	N	Covered by SFFAS 54, par. 43	N/A
2021-1	4.11	Y	Y	Added with significant modifications. AAPC guidance cannot conflict with SFFAS 54.	9 (45A)
2021-1	4.12	N	N	Appears to be specific to state and local reporting entities only	N/A
2021-1	4.13	N	N	GASB-specific	N/A
2021-1	4.14	Y	N	Covered by SFFAS 54, exceptionally rare scenario	N/A
2021-1	4.15	Y	N	Covered by SFFAS 54, par. 40, 49.b, 56, 64.b	N/A

GASB IG	IG par. no.	Candidate ?	Added ?	Analysis	Att. B (TR 20) par.
2021-1	4.16	Y	N	Covered by SFFAS 54, par. 70-71	N/A
2021-1	4.17	Y	Y	Added	10 (75A)
2021-1	4.18	Y	N	Covered by SFFAS 54, par. 70-71	N/A
2021-1	4.19	Y	N	Covered by SFFAS 54, par. 21.d, 84-86	N/A
2021-1	4.20	Y	N	Covered by SFFAS 54, par. 46, 48	N/A
2021-1	4.21	Y	N	Covered by SFFAS 54, par. 21.d, 84-86	N/A
2021-1	4.22	Y	N	Covered by SFFAS 54, par. 96-97	N/A
2023-1*	4.1	Y	Y	Added	7 (52A)
2023-1*	4.2	N	N	N/A due to differences between the GASB and FASAB definitions of short-term lease	N/A
2023-1*	4.3	Y	N	Covered by SFFAS 54, par. 22, 84-86	N/A
2023-1*	4.4	Y	N	Added	9 (52A)
2023-1*	4.5	N	N	N/A to most federal entities, foreign currency payments are covered under the Treasury Financial Manual, chapter 3200	N/A
2023-1*	4.6	N	N	SFFAS 7 guidance is out of scope for this project	N/A

* Exposure draft. Final IG 2023-1 expected in June 2023.

Recommendation 3 of 4: Seven proposed Q&A based on GASB guidance updates

6. Paragraphs 8A, 8B, and 11A are added to TR 20 (under the topic area for scope and definitions) as follows:

8A. [Abridged. See recommendation 2 above]

8B. *[Abridged. See recommendation 2 above]*

11A. A reporting entity (lessor) enters into an agreement that allows a private party (lessee) to use one floor of the reporting entity's building at a market rate for a period of time in exchange for consideration. The contract states that the space is to be used only for a restaurant. Does the contract convey the right to control the use of the underlying asset?

In accordance with paragraph 3 of SFFAS 54, the reporting entity should assess whether the contract gives the lessee both the right to obtain economic benefits or services from the use of the underlying asset *as specified in the contract* (emphasis added) and the right to control access to the economic benefits or services of the underlying asset *as specified in the contract* (emphasis added). In this example, the paragraph 3 control criterion are met notwithstanding the parameters of the contract regarding the nature and manner of use (see also TR par. 7.b).

7. Paragraphs 24A-B are added to TR 20 (under the topic area for lease term) as follows:

24A. A reporting entity (lessee) enters into a 120-month lease with a private party (lessor). Both the lessee and the lessor have a right to cancel at any time, without permission from the other party, with X months' advance notice. Therefore, the initial lease term is X months because the remaining 120 - X months are cancellable periods at the commencement date of the lease. At the end of the reporting entity's reporting period, neither the reporting entity nor the lessor have exercised their rights to cancel. Should the reporting entity reassess the lease term?

Yes. In this example, as long as neither party provides notice exercising the right to cancel, the remaining lease term at any point during the first 120 - X months of the lease would be equal to X months. Therefore, the government should reassess the lease term at the end of the first reporting period and subsequent reporting periods, as applicable. If the advance notice period (X) is less than or equal to 24 months, the lease will remain a short-term lease regardless of these reassessments. If the advance notice period is greater than 24 months, however, these reassessments will prevent inappropriate short-term classification.

24B. A lease contract states that it will remain in effect for three years unless terminated before then. The contract allows the lessee to terminate the lease for any reason with 60 days' notice. The contract allows the lessor to terminate the lease with 60 days' notice only if the lessee defaults on payments. It is probable, based on all relevant factors, that the lessee will

not exercise its termination option at any time during the three year contract. Is this a short-term lease?

No. Although the lessee has an unconditional right to terminate, the lessor does not have an unconditional right to terminate because the lessor is only allowed to terminate on the condition that the lessee defaults on payments (see par. 19.b of SFFAS 54). Accordingly, there are no periods for which both the lessee and lessor have an option to terminate, and paragraph 19.a criteria for excluding cancellable periods from the lease term are not triggered.

8. Paragraph 32A is added to TR 20 (under the topic area for short-term leases) as follows:

32A. For the past 20 years, every two years a reporting entity (lessee) has consistently entered into new 24-month noncancellable lease contract with another party (lessor) for the use of building space. The lease contract for the building space does not contain options to extend beyond the 24-month noncancellable lease term. The reporting entity expects to continue this practice. Is this a short-term lease?

Yes. According to paragraph 14 of SFFAS 54, the lease term is the noncancellable period (24 months or less) plus all periods subject to options to extend or terminate the lease, of which there are none in this scenario. Although historical behaviors and expectations may be relevant factors in assessing the *likelihood of exercising options* (see par. 20 of SFFAS 54) when determining the lease term, such factors are only applicable to *assessing options*. This contract does not contain options to extend beyond the 24-month noncancellable term.

9. Paragraphs 45A and 52A are added to TR 20 (under the topic area for lessee recognition, measurement, and disclosures for leases other than short-term leases, contracts or agreements that transfer ownership, and intragovernmental leases) as follows:

45A. A reporting entity (lessee) leases office space. In addition to fixed payments, the reporting entity is required to make payments to reimburse the lessor for the lessor's real estate taxes and insurance. The additional payment amounts are stated in the lease based on the lessor's estimate of taxes and insurance at the beginning of each year of the lease term. Annually, the lessor provides a reimbursement or requests an additional payment from the reporting entity for the difference between the actual and estimated taxes and insurance. Should these additional payments be included in the measurement of the lease liability? Is the lease liability required to be remeasured based on subsequently provided updates to the lessee at the beginning of each year of the lease term?

The tax and insurance amounts are variable payments that depend on an index or a rate, as provided by paragraph 40.b of SFFAS 54. Accordingly, these future payments should be included in the lease liability and initially measured using the index or rate as of the commencement of the lease term. Paragraph 45 of SFFAS 54 provides that the lease liability is not required to be remeasured solely for a change in an index or rate used to determine variable payments. However, if the lease liability is remeasured for any of the changes in paragraphs 44.a-44.f of SFFAS 54, the liability should also be adjusted for any changes in the tax and insurance rates if those changes are expected to significantly affect the amount of the liability since previous measurement (see par. 45 of SFFAS 54).

52A. A reporting entity (lessee) leases a building. The lease term is 10 years. At the commencement of the lease, the reporting entity provides payment for the first three years and recognizes a liability for the present value of the payments for the remaining seven years, which will be paid starting in the fourth year of the lease. Should the reporting entity recognize interest expense during each of the first three years of the lease?

Yes. In accordance with paragraph 43 of SFFAS 54, interest expense represents the amortization of the discount on the lease liability. That discount should be amortized over the entire lease term, including the each of first three years during which the reporting entity is not making payments. The interest liability will continue to accrue until the government starts making payments in the fourth year.

10. Paragraph 75A is added to TR 20 (under the topic area for lease incentives and lease concessions) as follows:

75A. A lease with a lease term of 10 years requires fixed payments totaling \$17 million to be made for each of the first 9 years. There is a rent holiday (during which the lessee is not required to pay any rent) for year 10. The useful life of the underlying asset is 15 years. How should the reporting entity (lessee) account for the rent holiday?

A rent holiday is a type of lease concession, as described in paragraph 70 of SFFAS 54. In this example, the rent holiday is at the end of the lease term and affects the expected fixed payments to be made during the lease term (see par. 40, 40.g of SFFAS 54). Therefore, the lease liability would be the present value of \$17 million per year for 9 years, and the discount (between \$17 million and the present value) would be amortized over 9 years. At the end of year 9, the lease liability would be zero. The *lease asset*, however, would be amortized over the entire 10-year lease term, in accordance with paragraph 50 of SFFAS 54 (as the lease term is shorter than the useful life of the underlying asset).

For committee discussion: Do members agree with or have feedback on staff's implementation guidance updates content analysis and recommendation 3?

Part 4 of 4: TR 20 Technical corrections analysis

Green	Agreement reached with independent coders
Red	Agreement with independent coders not reached

TR 20 par.	Analysis	Source	Att. B (TR 20) par.
1-3	No candidates identified since issuance of TR 20	Staff research	N/A
4	Candidate identified by independent coders, but rejected by staff. AAPC guidance cannot conflict with SFFAS 54.	GASB IG 2021-1, par. 4.7	N/A
5-24	No candidates identified since issuance of TR 20	Staff research	N/A
25	The term "cancellable period" (as defined by par. 19.a of SFFAS 54) is inadvertently used in par. 12 of SFFAS 54. Likewise, GASB IG 2019-3 par. 4.16 included an equivalent technical error. See also: Exposure Draft GASB 2023-1, Appendix B	GASB IG 2023-1, par. 5.1	11
26-103	No candidates identified since issuance of TR 20	Staff research	N/A

Recommendation 4 of 4: One proposed technical correction to TR 20, par. 25

11. Paragraph 25 of TR 20 is amended as follows:

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 covered by the lessee's option to terminate 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 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 included significant economic disincentives, such as cancellation penalties, as discussed in paragraph 20 (see also: TR par. 26-27).

For committee discussion: Do members agree with or have feedback on staff's technical corrections content analysis and recommendation 4?