

Memorandum

Leases

April 6, 2023

To: Members of the Board
From: Ricky A. Perry, Jr., Senior Analyst
Thru: Monica R. Valentine, Executive Director
Subject: **Leases implementation clarification discussion** (Topic F)

INTRODUCTION

This briefing material includes a staff summary of the purpose of the clarification discussion (Attachment 1), invitations from the Chairman to the panelists (Attachment 2), potential questions for the clarification discussion (Attachment 2 enclosure), and SFFAS 54 basis for conclusions excerpt (Attachment 3). These materials are intended to facilitate preparation for the clarification discussion. Invitations were sent to panelists on March 8, 2023.

REQUEST FOR FEEDBACK

This topic does not include requests for member feedback. If members have follow-up questions on this material, please contact staff by April 14, 2023, at perryra@fasab.gov with a cc to Monica Valentine at valentinem@fasab.gov.

NEXT STEPS

N/A.

ATTACHMENTS

1. Staff summary of the purpose of the clarification discussion
2. Invitations from the Chairman (with potential questions for panelists enclosed)
3. SFFAS 54 basis for conclusions excerpt

REFERENCE MATERIAL

1. [February 2023 Board meeting material, Topic E](#)

Staff Analysis

Leases

April 6, 2023

CONTEXT

At the February meeting, staff provided implementation updates and observations to the Board (see [February 2023 Topic E](#)). Following the release of the meeting materials, several reporting entities submitted letters to the Chairman (see [February 2023 Topic E addenda E1-E5](#)). The contents of those letters were consistent with the implementation themes and observations of staff under Topic E. Staff did not propose any tentative Board decisions or recommendations for reasons discussed under the topic. Several members concurred with staff's position, while some members expressed an interest in obtaining additional information on leases implementation experiences through a clarification discussion. Staff consulted with the Executive Director and the Chairman to organize the below clarification discussion panels for the April meeting.

PANELISTS

Panel #1

Jeffrey Carr, Director of Financial Reporting, Office of Finance and Accounting, **Department of Energy**
Joanne Choi, Deputy Assistant Secretary for Finance, Office of Finance, **Veterans Affairs**
Tonya R. Johnson, Deputy Chief Financial Officer, **Department of the Interior**
Donald L. Wood, Director, Office of Financial Reporting and Analysis, **Department of State**

Panel #2

Tremayne O. Cobb, Director, Office of Financial Management, **Federal Aviation Administration**
April M. Pratt, Director, PBS Financial Operations Division, **General Services Administration**

PURPOSE OF THE CLARIFICATION DISCUSSION

The clarification discussion will allow members to obtain additional information from panelists and learn specific details of interest about implementation experiences not discussed in previous meeting materials or letters to the Chairman.

As noted by the Chair (Attachment 2), Statement 54 was unanimously approved and issued in 2018 after extensive research, deliberations, and due process. The Board duly considered a wide range of views from interested parties in accordance with its due process.

The basis for conclusions of Statement 54 summarizes the objectives and benefits of the standard, including:

- Comprehensive lease standards that appropriately address lease transactions of the federal community (par. A17)
- Relevant, comparable, and meaningful financial information for users to assess operating performance and monitor investments in PP&E (underlying assets to leases) and lease financing activities (par. A17-A18)
- Improved accountability over resources and obligations, faithful compliance with legal requirements and administrative policies, efficiency and economy of operations, and results of programs and activities (par. A19)
- A more complete and representationally faithful reporting of PP&E, liabilities, and costs (par. A19-A21)
- The Board made its assessments based on the available evidence of expected benefits and perceived costs with a goal of a balance between maximizing benefits and minimizing costs (par. A16)

The above paragraphs are a summary. The full basis for conclusions of Statement 54 is included in Attachment 3 for reference. Staff has consistently observed the perceived benefits noted under the basis through implementation monitoring and outreach activities, as described under the February briefing materials.

The Board made appropriate accommodations and clarifications,¹ and unanimously approved Statements 54, 58, 60, and 61; Technical Bulletin 2023-1; and Technical Release 20.

As noted by the Chair (Attachment 2), the clarification discussion will not serve to revisit decisions, cost-benefit analyses, accommodations, clarifications, and pronouncements summarized above. Rather, the discussion is intended to provide insightful implementation monitoring information as the Statement 54 effective date approaches.

¹ For examples, see SFFAS 54 basis for conclusions par. A23-A27, A33, A36, and A38-A41; SFFAS 58 basis for conclusions par. A3-A13; SFFAS 60 basis for conclusions par. A3-A4 and A7; and SFFAS 61 basis for conclusions par. A4-A11.



441 G St. N.W., Suite 1155
Washington, DC 20548

March 9, 2023

Dear Mses. Dasuki, Johnson, and Pratt, and Messrs. Rychalski and Walsh –

At the February meeting, the Board expressed interest in obtaining additional information on leases implementation. Thank you for the information you have already provided, including the letters that some of you submitted prior to that meeting.

The Board will hold a leases clarification discussion the morning of April 19, 2023. In accordance with the Federal Advisory Committee Act, the discussion will be held in a public forum during the Board's regularly scheduled meeting over Zoom for Government. It is my understanding that each of you (or your staff) have accepted verbal invitations from FASAB staff in accordance with my instructions. I am hereby formally inviting you, *or an appropriate designee*, to participate in the discussion.

The clarification discussion will allow the Board to obtain additional information and learn about your implementation experiences. Staff compiled a list of potential questions to facilitate discussion and preparation (enclosed). Panelists are expected to be familiar with the historical implementation experiences of their respective agencies. Panelists are also expected to have a working knowledge of Statement 54, *Leases*, as amended. Panelists need not submit formal statements for the record or other documents to the Board. If provided, such documents would be included in the public record.

As I noted during the February meeting, Statement 54 was issued after extensive due process and deliberations. The Board duly considered a wide range of views from interested parties throughout the due process. The Board studied and duly considered costs and benefits. The Board made appropriate accommodations and clarifications, and unanimously approved Statements 54, 58, 60, and 61; Technical Bulletin 2023-1, and Technical Release 20. The clarification discussion will not serve to redeliberate those decisions, cost-benefit analyses, accommodations, clarifications, and pronouncements. Rather, the discussion will provide additional information to the Board for purposes of monitoring implementation as we move into the effective reporting period. Please reach out to Alan Perry, Senior Analyst, at PerryRA@fasab.gov with a cc to Ms. Valentine, Executive Director, at ValentineM@fasab.gov regarding meeting logistics, arrangements, and questions. If you have not designated a panelist, please inform staff of your selection by no later than March 30th.

Thank you for your participation and willingness to answer the Board's questions at the forthcoming clarification discussion. Practitioner participation in the Board's activities contributes to our mission and service to the public interest. I look forward to speaking with you in April.

Sincerely,

/S/

George A. Scott
Chairman

Enclosure

cc: Monica R. Valentine, Executive Director

Enclosure

List of Potential Questions¹

Potential clarification questions for all panelists

1. Please describe the specific timeline and milestones of your implementation activities since April 2018.
2. How many leases does your entity have? Are leases material to your agency?
3. Where are your entity's lease contracts maintained? Have you gathered these contracts in a central location for analysis? What is your process for analyzing the contracts to gather the information necessary to adopt Statement 54? How much time per lease contract (on average) is it taking you to gather the required information for each lease? How much information have you already gathered?
4. Have you determined the data elements that you need to meet Statement 54 requirements? If not, please describe the basis for your delays in making such determinations? Have you modified your IT systems for the new standard? If not, please describe the timeline of your activities for identifying and developing systems requirements. Be specific.
5. Please share any views related to FFMIA implications and government-wide coordination with vendors and the extent to which this is or is not contributing to implementation challenges.
6. What specific FASAB guidance issued after Statement 54 delayed your implementation and how did it delay it? Be specific.
7. Do you believe there are any significant gaps in the current Board guidance that will prevent your entity from fully implementing Statement 54? If so, be specific. Also, have you notified staff of these gaps through task force participation or direct contact with FASAB technical staff?
8. What should the Board be aware of concerning the complexities with respect to relationships between budgetary and proprietary accounting in the context of leases? Be specific.
9. Do you believe that internal or external users of your financial statements would benefit from the accounting information pursuant to Statement 54? If so, please explain whether or not you believe this information will be helpful in FY 2024 in light of factors such as the pandemic and decisions related to management of your lease portfolio.
10. Whether or not your agency is prepared to account for intragovernmental leases in FY 2024. If not, explain any challenges in accounting for intragovernmental leases. Be specific.
11. Whether or not your agency is prepared to account for non-intragovernmental short-term leases in FY 2024. If not, explain any challenges in accounting for non-intragovernmental short-term leases. Be specific.
12. Whether or not your agency is prepared to account for contracts and agreements that transfer ownership in FY 2024 (if applicable). If not, explain any challenges in accounting for transfers of ownership. Be specific.
13. Whether or not your agency is prepared to account for non-intragovernmental leases in FY 2024. If not, explain any challenges in accounting for non-intragovernmental leases. Be specific.
14. Have there been any changes in your estimated timeframes for implementing Statement 54 since March 2020? If so, how and why have your estimated timeframes changed?

¹ This enclosure was not prepared by the Chairman. It was prepared by the FASAB project manager. Questions are rarely used as written by the project manager. Rather, the formulated list of potential questions will facilitate the discussion and the preparation of Board members and the participating panelists.

15. Statement 54 has a 5.5 year implementation period. Why do you believe (or not believe) it is reasonable for the Board to provide 4 additional years, as suggested in certain letters?
16. To what extent are material weaknesses or significant deficiencies, and/or challenges in accounting for leases under the current standards contributing to the challenges you face in implementing Statement 54?
17. Please explain the importance of Treasury and OMB guidance for implementing Statement 54 and your views regarding the timeliness of such guidance.

Potential clarification questions for specific panelists

18. Please describe your rationale for suggesting that the Board rescind Statement 54 (Energy).
19. Do you believe you are on track to implement Statement 54 by its effective date? If you do successfully implement in FY 2024, what factors do you think will be the main contributors to such success (GSA, FAA)?
20. What challenges have you overcome thus far, and what challenges are you working through right now (GSA, FAA)?
21. Implications to your agency if the Board were to further defer the implementation date or make additional changes to Statement 54 in the future (GSA)?

Appendix A: Basis for Conclusions

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

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

Project History

- A1. This Statement amends the lease accounting standards in SFFAS 5 and 6, which had been in effect since 1995. Under SFFAS 5 and 6, leases were classified as either capital or operating depending on whether the lease met any of four tests.
- A2. The Federal Accounting Standards Advisory Board (FASAB or "the Board") undertook this project primarily because SFFAS 5 and 6
 - a. do not make meaningful distinctions between capital and operating leases based on the substance of lease transactions and
 - b. are based on Financial Accounting Standards Board (FASB) lease accounting standards, which have been amended.
- A3. Lease accounting was first addressed by FASAB during the development of SFFAS 5 and 6. At that time, the Board decided to use the high-level language on lease accounting from FASB Statement of Financial Accounting Standards (SFAS) No. 13 *Accounting for Leases* [subsequently codified in Accounting Standards Codification (ASC) – Topic 840 *Leases*]. This minimal lease guidance included the definition of a capital lease, the criteria for capital leases, and the measurement of a capital lease asset and liability. The Board had plans to use this preliminary guidance as a placeholder until it was prepared to add lease accounting to its agenda as a separate project. Lease accounting had been on the list of potential Board agenda items each time the Board has considered its agenda for new projects.

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- A4. There are several areas of lease accounting that were covered by the FASB standards that were never specifically addressed in the FASAB standards. Some of those topics include leasehold improvements, lease terms, leveraged leases, and subleases. The federal community often stressed that the federal standards on lease accounting should be comprehensive to reduce confusion on whether FASB standards apply to federal entities when FASAB's are silent on a topic.
- A5. Because FASB revised its standards, it was imperative for the Board to revisit lease accounting. One alternative was for the Board to issue detailed implementation guidance on the existing standards. The Board believed that the effort needed to issue such implementation guidance would be better used amending SFFAS 5 and 6. The Board closely reviewed the lease proposals of four standards setters (as stated in paragraph A8) to determine what underlying concepts, if any, would be applicable for federal financial reporting of leases. The Board believes this Statement offers the appropriate guidance for the accounting and financial reporting of leases for federal entities.
- A6. In August 2011, FASAB began a project to revise its current standards on lease accounting. FASAB staff formed a task force to assist in developing this Statement. Task force members included accounting, budget, and subject matter experts from federal agencies and independent public accounting firms.
- A7. The task force met several times over the course of the project and also exchanged numerous ideas and recommendations electronically. Staff sought the task force's views and recommendations in developing and describing alternatives to present to the Board. The task force's assistance was essential and its views carefully considered by members during deliberations. The task force played an important role in the research and release of the exposure draft (ED) preceding this Statement.
- A8. In evaluating an approach applicable to federal leases, the Board considered the approaches used in the following documents:
- a. FASB's SFAS 13, *Accounting for Leases* [superseded by FASB's ASC 840, which was subsequently superseded by ASC 842]
 - b. Governmental Accounting Standards Board's (GASB) Statement No. 87, *Leases*
 - c. International Accounting Standards Board's International Accounting Standard 17, *Leases* [superseded by International Financial Reporting Standard 16]
 - d. International Public Sector Accounting Standards Board's International Public Sector Accounting Standard 13, *Leases*
- A9. At the inception of the project, the Board decided to coordinate with GASB on the lease project because of the similarities among governmental entities regarding lease activities and reporting objectives. Staff worked closely with GASB staff during the development of

this Statement. In 2014, FASAB and GASB met to discuss issues related to each of their ongoing lease accounting projects. As a result of this collaboration, similar wording may appear in some sections of the FASAB and GASB standards.¹²

A10. This Statement amends the lease accounting standards in SFFAS 5 and SFFAS 6. This Statement also establishes distinct standards for intragovernmental leases.

Summary of Outreach Efforts and Responses

A11. FASAB issued the ED, titled *Leases*, on September 26, 2016, with comments requested by January 6, 2017. Upon release of the ED, FASAB provided notices and press releases to the FASAB email listserv, the Federal Register, *FASAB News*, the *Journal of Accountancy*, Association of Government Accountants *Topics*, the *CPA Journal*, *Government Executive*, the *CPA Letter*, the Chief Financial Officers Council, the Council of the Inspectors General on Integrity and Efficiency, the Financial Statement Audit Network, and committees of professional associations generally commenting on EDs in the past (for example, the Greater Washington Society of CPAs, Association of Government Accountants Financial Management Standards Board).

A12. FASAB followed up this broad announcement with direct mailings of the ED to the following relevant congressional committees:

- a. House Committee on Oversight and Government Reform
- b. House Committee on Transportation
- c. House Committee on Budget
- d. Senate Committee on Homeland Security and Governmental Affairs
- e. Senate Committee on Budget
- f. Senate Committee on Environment and Public Works

A13. FASAB received 25 responses from preparers, auditors, professional associations, and citizens. Many respondents had concerns with the definition of leases and the scope of the Statement. Some respondents also identified certain issues that could be clarified within the Statement or addressed in the basis for conclusions.

¹²The GASB material is copyrighted by the Financial Accounting Foundation, 401 Merritt 7, Norwalk, CT 06856, USA, and is used with permission.

A14. The Board extended an invitation to the respondents of the Leases ED to discuss with the Board their comments on the ED and provide further clarification on their responses. In April 2017, five federal entities addressed the Board to further elaborate on their written comments.

A15. The Board did not rely on the number in favor of or opposed to a given position. Staff provides the Board information about the respondents' majority view only as a means of summarizing the comments. The Board considered each response and weighed the merits of the points raised.

Considerations Related to Benefits and Costs

A16. Throughout the course of developing this Statement, the Board sought to minimize the cost of improving the lease accounting requirements. The Board's assessment of the expected benefits and perceived costs of issuing new standards is often more qualitative than quantitative because it is difficult to accurately estimate the costs of implementing new standards. The Board has made its assessments based on the available evidence of expected benefits and perceived costs with the goal of a balance between maximizing benefits and minimizing costs.

Benefits

A17. This Statement will improve upon the existing guidance in SFFAS 5 and 6 by providing

- a. relevant and meaningful financial information needed by federal financial statement users and
- b. comprehensive lease standards that appropriately address the various lease transactions/activities of the federal community.

A18. One of the primary objectives of this Statement is providing federal leasing information needed to meet the operating performance reporting objective.¹³ Recognition of all PP&E leases, except for short-term leases and intragovernmental leases, and the related liabilities ensures the balance sheet informs users regarding the resources and obligations used to fulfill the entity's programs and activities. Additionally, this Statement requires the recognition of the interest cost associated with the entity's leases. This will ensure relevant

¹³SFFAC 1 establishes the operating performance objective and indicates that federal financial reporting should assist report users in evaluating the service efforts, costs, and accomplishments of the reporting entity; the manner in which these efforts and accomplishments have been financed; and the management of the entity's assets and liabilities.

and comparable information is available to assess the entity's operating performance as well as to monitor the entity's investment in PP&E and financing activities.

A19. The Board is aware that this Statement will require entities to ensure all of their leases are appropriately identified for evaluation, which can improve accountability of its resources and obligations. As noted in Statement of Federal Financial Accounting Concepts (SFFAC) 1, *Objectives of Federal Financial Accounting*, accounting can and should contribute to achieving and demonstrating several aspects of accountability, such as

- a. accountability for financial resources;
- b. accountability for faithful compliance or adherence to legal requirements and administrative policies;
- c. accountability for efficiency and economy in operations; and
- d. accountability for the results of government programs and activities, as reflected in accomplishments, benefits, and effectiveness

This Statement contributes to each of these aspects of accountability but is most helpful in achieving accountability for efficiency and economy in operations. By removing somewhat arbitrary and bright-line (rules-based) criteria, a more complete and representationally faithful reporting of PP&E, liabilities, and costs will be provided as discussed in paragraph A21.

A20. The Board believes that in a lease transaction, a lessee receives the right to control the use of another entity's PP&E (the underlying asset—the asset that is subject to the lease, such as a vehicle or building) for a period of time as specified in the contract or agreement. In exchange, the lessee promises to make payments over time for the right to control the use of that underlying asset. The guidance in SFFAS 5 and 6 was based on the notion that some leases are essentially financed purchases of the underlying asset (classified as capital leases) and other leases (classified as operating leases) are not. The classification of a lease as capital or operating depended on whether the lease met any of four tests. Those tests were intended to determine whether most of the risks and benefits of ownership of the underlying asset were transferred to the lessee. Those tests have been criticized because they often resulted in similar leases being accounted for in different ways; making it challenging to identify the total resources needed to support operations and the related obligations.

A21. The Board believes that this Statement increases the comparability among federal entities by recognizing those similar leases as lease assets and lease liabilities and disclosing key leasing information. This approach would replace bright-line distinctions between capital and operating leases. The increased comparability will allow financial report users to make

lease liability and interest cost comparisons among federal entities. This Statement also provides a clear definition of a lease that is intended to align with the concept of control established in SFFAC 5, *Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements*. The Board believes that this lease definition will reduce opportunities for entities to structure leasing transactions to achieve a specific accounting outcome. Such opportunities could result in misstated PP&E resources, related obligations, and costs.

Costs

- A22. The Board understands that many federal entities—particularly those having a significant number of long-term leases with non-federal entities—will incur additional costs as a result of this Statement. Based on feedback from the task force and ED responses, the initial costs to implement the revised standards will most likely result from reviewing existing lease agreements, ensuring all leases are appropriately identified, educating staff about how to apply the new requirements, implementing processes and controls to ensure all material leasing activity is captured going forward, and some system changes. Those costs will vary based on the number of leases that an entity has and the complexity of those arrangements. For example, it may take more effort to account for a lease agreement with options to extend and multiple components than a lease without those elements.
- A23. Respondent comments related to costs and benefits raised concerns about the overall effort and resources needed to implement the proposed guidance. Some respondents also raised concerns regarding limited resources to assess a significant volume of leases. Overall, the evaluation and analysis needed to implement this Statement is similar to the capital leases evaluation and analysis needed in SFFAS 5 and 6, which should help mitigate some of the costs of implementation.
- A24. Once implementation of the Statement is complete, the ongoing costs for many entities are unlikely to be significantly higher than the costs of complying with the previous standards. In the previous leases standards, entities were also required to identify leases, evaluate each lease to determine the applicable accounting model to apply (capital or operating), and to subsequently account for each lease, including the ongoing disclosure requirements. This Statement does not substantially change this level of effort and entities may be able to apply the requirements of this Statement using similar systems and processes as those used in previous leases standards to meet those reporting and disclosure requirements.
- A25. Additionally, the Board made several decisions in the interest of reducing implementation costs. These include, but are not limited to, the provisions regarding:
- a. Allowing a short-term lease exception and not requiring disclosures related to short-term leases by either lessees or lessors

- b. Not requiring a lessor to derecognize the underlying asset or calculate a residual value
- c. Allocation of the contract price to multiple components of a lease that allows the stated contract prices to be used if they do not appear to be unreasonable
- d. Allocation of the contract price to multiple components that allow best estimates to be used for allocation if no separate prices are included in the contract or if stated prices appear to be unreasonable
- e. The requirement to treat an entire multiple-component contract as a single lease unit if determining a best estimate is not practicable
- f. The exclusion of intragovernmental leases from balance sheet recognition and measurement as a lease asset and corresponding liability
- g. The extension of the effective date until fiscal year 2021 which allows more time to prepare and reduces the number of existing leases to be evaluated

A26. For many federal entities, the Board's decisions relating to intragovernmental leases will reduce the preparer's level of effort in comparison to the current lease accounting and financial reporting standards. The majority of federal entities engage primarily in intragovernmental leases. Consistent simplified treatment of intragovernmental leases will also reduce the cost of intragovernmental eliminations. These cost reductions were considered carefully by the Board.

A27. This Statement requires that leases unexpired at the beginning of the reporting period in which the Statement is implemented be recognized and measured using the facts and circumstances that exist at the beginning of the reporting period. The Board concluded that this approach to transition, as opposed to a retrospective approach, provides an appropriate balance between minimizing costs of transition and providing users of financial statements with comparable financial information. This implementation approach should further significantly reduce the costs associated with transitioning to the new lease requirements.

Scope

A28. For purposes of applying this Statement, 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. Leases include contracts or agreements that, although not explicitly identified as leases, meet the definition of a lease (which reflects the substance of a lease). This definition does not include contracts or agreements for services,

except those contracts or agreements that contain both a lease component and a service component. A service contract is a contract that directly engages the time and effort of a contractor whose primary purpose is to perform an identifiable task rather than to provide a tangible asset. Service contracts include maintenance of equipment or real property, advisory services, communications services, transportation services, and research and development.

- A29. This Statement does not apply to leases of assets under construction or leases (licenses) of internal use software.
- A30. GASB's Leases Statement No. 87 specifically excludes "contracts that meet the definition of a service concession arrangement in paragraph 4 of Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements* (SCAs)." Currently, FASAB standards are silent on SCAs. Through its discussions, the task force identified several federal entities that have SCAs, and there was a concern that the proposed lease definition could inadvertently include SCAs. The Board considered specifically excluding SCAs from this Statement. To accomplish this, the Board considered adopting GASB's definition of SCA from Statement No. 60 because there is no federal definition.
- A31. The Board eventually decided that specifically excluding SCAs from the standards would raise more questions. Furthermore, SCAs are expected to be addressed in the public-private partnership recognition and measurement project; therefore, the Board agreed to remain silent on SCAs in this Statement until such guidance is issued. The Board believes the generally accepted accounting principles hierarchy will continue to guide preparers and auditors in accounting for SCAs.

Definitions

- A32. In this Statement, 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." In the early stages of the project, the Board deliberated over the use of "contract" or "agreement" in the definition of a lease. The Board considered GASB's approach—where the term contract is more precise and limiting and requires that a lease be legally enforceable. Because legal enforceability is not the primary driver in intragovernmental leasing transactions, although legal enforceability is a primary driver for the non-intragovernmental leases, the Board decided to add "agreement" in addition to "contract" in the lease definition to alleviate ambiguity in its application. This should be especially relevant in the case of intragovernmental leases, which are often referred to as "lease agreements."

A33. The Board also reconsidered the broad scope of the lease definition, which included all nonfinancial assets not specifically excluded in the standards. During deliberations after receiving comment letters, the Board determined that the broader lease definition would necessitate the development of a definition of “nonmonetary assets” and “intangibles,” plus the inclusion of a more developed list of excluded transactions. Also, several respondents and task force members advocated a more narrow definition of leases. In an effort to reduce preparer burden, the Board reconsidered its decision and reevaluated the benefits of a narrower lease definition. The Board decided to narrow the scope of the definition to only include PP&E.

Lease Term – Options to Extend or Terminate

A34. Federal leases often include lessee options to extend or terminate a lease. Due to federal budget scoring rules and the availability of funds, many federal leases include relatively short noncancelable periods. The Board concluded that the lease term used to measure the lease liability should not be limited to the noncancelable lease periods, but it should include certain options to extend or terminate so that the lease term reflects how long the lease is expected to be in effect.

A35. The Board considered several potential probability thresholds for including options to extend or terminate the lease in the lease term. The Board considered its own definition of probable, GASB’s definition of probable, and FASB’s probability threshold “reasonably certain.” FASB’s probable definition equates to more likely than not (>50% probability). GASB’s probable definition equates to likely to occur and has a higher threshold of probability than more likely than not. FASB’s reasonably certain probability has an even higher threshold than likely to occur. The Board agreed to retain its definition of probable because it is more clearly understood with the federal reporting community and there seemed to be no compelling reason to introduce a new term for the sake of a higher threshold.

A36. During deliberations after receiving comment letters, the Board considered additional ways to reduce the preparer’s burden and agreed on the following points:

- a. The “noncancelable period” language should be clarified.
- b. Both the lessee and the lessor’s options to extend or terminate the lease contract or agreement, if probable, should be included in the lease term at its commencement.
- c. When the lessee or lessor is assessing its own options to extend or terminate the contract or agreement, the level of probability is at the probable threshold; however, when the lessee or lessor is assessing the other party’s options to extend or terminate

the contract or agreement, the level of probability is at a higher threshold, like reasonably certain, and should be based on significant evidence.

Remeasurement

A37. This Statement requires that when a lease liability is remeasured, the corresponding lease asset be adjusted by the same dollar amount (except in cases of impairment and in cases in which the adjustment would cause the asset to be reported as a negative amount). While acknowledging that adjusting the lease asset for a change in the lease liability results in the lease asset no longer being measured at adjusted historical cost, the Board believes that such an adjustment is practical.

Short-Term Leases

A38. The Board considered the short-term lease exception GASB proposed, which requires governments to recognize leases with useful lives or maturities of less than one year. The Board decided to align the short-term lease exception with the PP&E standards, which define PP&E as a tangible asset with an estimated useful life of 24 months or more. The reporting of short-term leases in this Statement is intended to reduce the cost to federal entities implementing these standards. This short-term exception eliminates the need for preparers to calculate amounts for short-term lease assets and liabilities. This exception requires lessees and lessors to recognize those leases with useful lives or maturities of less than two years as expense and revenue based on the payment provisions of those lease contracts or agreements and those standards regarding recognition of accruals. This measurement approach is not cash-basis recognition, as federal entities are still required to recognize receivables and payables for lease payments paid or received before or after the period to which they apply.

Intragovernmental Leases

A39. During the research phase of the project, the General Services Administration (GSA) provided an educational session to the Board where GSA representatives explained in-depth GSA's role in federal leasing. Based primarily on that discussion, the Board agreed that intragovernmental leases should be accounted for differently than leases between federal entities and non-federal entities. The Board agreed that a simplified approach for recognizing intragovernmental leases would be pragmatic and cost efficient.

A40. This Statement provides the overall recognition, measurement, and disclosure requirements for intragovernmental leases. An intragovernmental lease is a contract or agreement occurring within a consolidation entity or between two or more consolidation entities as defined under SFFAS 47 whereby one entity (lessor) conveys the right to control

the use of PP&E (the underlying asset) to another entity (lessee) for a period of time as specified in the contract or agreement in exchange for consideration. A lessee would not recognize a lease asset and a corresponding liability for an intragovernmental lease. Accordingly, a lessee would not recognize amortization expense related to a lease asset or interest expense on a lease liability.

- A41. The terms “intragovernmental” and “inter-entity” have been used interchangeably. Earlier FASAB standards predominately used “inter-entity.” However, government-wide usage of “intragovernmental” has become more common; therefore, the Board used intragovernmental in this Statement to describe leases occurring within a consolidation entity or between two or more consolidation entities as defined under SFFAS 47.

Leases Other than Short-Term Leases, Contracts or Agreements that Transfer Ownership, and Intragovernmental Leases

Recognition and Measurement for Lessees – Lease Liability

- A42 SFFAC 5, defines a liability as a “present obligation of the federal government to provide assets or services to another entity at a determinable date, when a specified event occurs, or on demand.” The Board believes that the lessee taking possession of the underlying asset or gaining access to control the use of the underlying asset is an event that creates such an obligation until the end of the lease term.
- A43. The Board believes the present value of future lease payments to be made for the lease term, which represent the obligations of the lessee under the lease contract or agreement, is the appropriate measurement of the liability. Such a calculation is consistent with the premise that a lease is a financing transaction and supports recognition of the cost of the financing.

Recognition and Measurement for Lessees – Lease Asset

- A44. An asset is defined in SFFAC 5 as “a resource that embodies economic benefits or services that the federal government controls.” Lessees should recognize a lease asset to correspond with the lease liability. At the beginning of a lease, the lessee obtains the right to control the use of another entity’s PP&E (the underlying asset), and that right is a resource embodying economic benefits. The Board believes this right meets the definition of an asset. Because the lease liability represents the amount to be paid for the lease asset, the Board concluded that the initial measurement of the lease asset should be based on the measurement of the associated lease liability. PP&E assets generally are measured at historical cost, which is the amount paid for those assets. Therefore, measuring the lease asset based on the lease liability is consistent with historical cost accounting applicable to PP&E.

Recognition and Measurement for Lessors

- A45. Symmetry between the lessee and lessor accounting models is important in establishing accounting and financial reporting standards. The Board believes that federal entity lessees and lessors should account for the shared transaction in a way that mirrors how the other party accounts for it.
- A46. The lease contract or agreement gives the lessor the right to receive payments in exchange for the lessee's right to control the use of the underlying asset. The Board believes that right meets the definition of an asset in SFFAC 5. The right to receive payments is a resource that can be drawn upon, and the lessor presently controls that right.

Board Approval

- A47. This Statement was approved unanimously. Written ballots are available for public inspection at FASAB's offices.