

## Memorandum

### Leases

June 6, 2023

To: Members of the Board  
From: Ricky A. Perry, Jr., Assistant Director  
Thru: Monica R. Valentine, Executive Director  
Subject: **Leases – transitional accommodation** (Topic C)

### INTRODUCTION

The briefing material includes a pre-ballot draft transitional accommodation for “embedded leases.” The supporting staff analysis focuses on recommended updates and improvements to the proposal based on the May 31 Board meeting and a draft alternative view submitted to staff.

### REQUEST FOR FEEDBACK BY JUNE 8

**Prior to the Board’s June meeting**, please review the attached staff analysis (attachment 1), updated draft proposal (attachment 2), draft alternative view from Mr. McNamee (attachment 3), and project plan (attachment 4). Please respond to the ensuing questions **by June 8**.

Please provide responses to Mr. Perry at [PerryRA@fasab.gov](mailto:PerryRA@fasab.gov), with a cc to Ms. Valentine at [ValentineM@fasab.gov](mailto:ValentineM@fasab.gov).

### NEXT STEPS

**Pending Board member feedback**, staff will further revise the attached draft proposal and move provide members with a ballot draft following the June meeting.

### ATTACHMENTS

1. Staff analysis
2. Pre-ballot exposure draft: *Transitional Amendment to SFFAS 54* – changes tracked
3. Mr. McNamee’s draft alternative view
4. Project plan

### REFERENCE MATERIAL - N/A

## Staff Analysis

### Transitional accommodation proposal (Attachment 1)

June 6, 2023

#### CONTEXT

At the May 2023 Board meeting, staff presented an issue paper and proposed transitional accommodation for “embedded leases.” Embedded leases, although not defined under SFFAS 54, generally refers to contracts and agreements with multiple components that contain both lease and nonlease components, such as services, and serve a primary purpose attributable to nonlease components.

The Board generally agreed with the proposed approach, but provided several improvements and feedback to staff to improve the clarity of the proposal, revise certain elements, and expand the basis for conclusions based on Board deliberations.

#### SUMMARY OF RECOMMENDATIONS AND ANALYSES

Staff recommends the following revisions based on the May 2023 meeting. The below summary outline corresponds to the detailed staff analysis item numbers that follow:

**A.** Improving the clarity and cogency of the proposal by:

1. Folding the assessment criteria into the eligibility criteria.
2. Discussing flexibilities under the accommodation, including groupings, in a standalone paragraph.
3. Clarifying accommodation provisions to improve clarity (without revising the design).

**B.** Improving the technical comprehensiveness of the proposal by:

1. Addressing lease modifications that may (a) affect the primary purpose assessment and/or (b) result in a separate lease asset under SFFAS 54, paragraph 84.
2. Addressing accommodation period selection flexibilities for reporting entities, including those with multiple components or subcomponents.

**C.** Removing the previously proposed disclosure requirement for a general description of the nature of contracts or agreements for which the accommodation was elected.

**D.** Improving the basis for conclusions by:

- 1.** Including additional context for the embedded leases accommodation proposal.
- 2.** Further explanation regarding the proposed accommodation design based on the Board's level of effort discussions, the perceived limited and transitory nature of the informational costs, and the considerable perceived benefits.
- 3.** Discussion regarding the consideration of alternative view, more expansive accommodations for multiple component contracts in general. This discussion was informed in part by the alternative view submitted; however, staff recommends inclusion of this discussion notwithstanding members' final decisions with respect to alternative view(s).
- 4.** Conforming the basis to items **A-C** above.

**E.** Conforming the questions for respondents to items **A-C** above and providing additional instructions for respondents under question for respondents (QFR) 3.

**F.** Including the non-authoritative illustrative Appendix B to explain the scope and applicability of paragraphs 96-97 of SFFAS 54 and the proposed paragraphs 96A-96E on reporting entities' universes of contracts and agreements.

## ANALYSIS

At the May 31 Board meeting, members generally agreed with the proposal's design and intent while expressing reservations regarding the clarity and readability of the proposal. Staff engaged directly with Messrs. Dacey and McNamee following the meeting. Both members had previously provided similar technical and editorial feedback directly to staff to improve clarity and readability and generously offered to provide follow-up technical assistance to staff following the meeting.

**Item A.1. Staff recommends folding assessment criteria language into the eligibility criteria of paragraph 96A.** These criteria were presented separately at the May meeting under paragraphs 96A and 96B of the earlier draft. The revisions highlighted below (and tracked under Attachment 2) improve the overall clarity of the proposal by joining the closely related criteria under one cohesive paragraph.

**96A.** The transitional accommodation applies only to contracts or agreements that meet both of the following criteria:

- a. The contracts or agreements contain nonlease component(s) and may contain lease component(s), and
- b. The purpose of the contracts or agreements is primarily attributable to the nonlease component(s), such as service components. **To assess whether the primary purpose of contracts or agreements is attributable to the nonlease component(s), lessees and lessors should understand the nature of the contracts or agreements. The primary purpose may only be attributed to the nonlease component(s) provided that the attribution does not appear to be unreasonable based on the nature of the contracts or agreements and professional judgment.**

### Question for the Board #1:

1. Do members have additional feedback on the proposed paragraph 96A (and **Item A.1**)?

**Items A.3 and B.1. Staff recommends clarifying the accommodation provisions to improve clarity (without revising design), and addressing lease modifications that may affect the primary purpose assessment and/or result in a separate lease asset under SFFAS 54, paragraph 84.**

The following items were clarified in the drafted updates:

- Explicit explanation regarding the accommodation in the first sentence of paragraph 96B. Previously, the accommodation was not as explicit or clear.
- Replacing the term “reporting period of transition,” which could be confused with the SFFAS 54, paragraph 98 effective date, and with the more precise term

“accommodation period.” Subsequent sentences further define the term and the flexibilities to select a shorter accommodation period if desired.

- Additional language to clarify the treatment of lease modifications was incorporated into the draft based on the Board’s May deliberations and member feedback presented at the May meeting. Additional clarifications are proposed (and tracked) in Attachment 2 to address lease modifications in the event that they affect the primary purpose attribution or meet paragraph 84 criteria (footnote 12). Staff also recommends the addition of footnote 13. This clarification is generally consistent with the Board’s intent and previous deliberations, which have focused on providing maximum transitional relief for embedded leases. Absent such clarification, lessees and lessors may lack sufficient guidance for modifications meeting paragraph 84 criteria and the extent to which the prospective transitional provisions of would apply.
- Staff does not recommend discussion of discount rates under paragraph 96C. Inclusion of such guidance could inadvertently deemphasize the recognition and measurement guidance provided of other relevant topic areas, which must be applied in tandem. This is consistent with the approach used by the Board under paragraphs 96-97, which omitted duplicative guidance for similar reasons.

**96B.** For contracts or agreements meeting the paragraph 96A criteria above, a reporting entity may elect to account for such contracts or agreements, including the lease component(s), as nonlease contracts or agreements in their entirety. This election applies to contracts or agreements existing as of October 1, 2023, and/or those subsequently entered into or modified on or prior to September 30, 2025 (end of the accommodation period).<sup>12</sup> The entity may elect a shorter accommodation period (contracts or agreements subsequently entered into or modified on or prior to September 30, 2024, or those existing as of October 1, 2023). The contracts or agreements under this election shall be accounted for as nonleases for their remaining term, unless they are subsequently modified (see below).

**FN 12 – Unless the modification affects the primary purpose assessment under par. 96A and results in the primary purpose attribution changing from nonlease component(s) to lease component(s) based on the nature of the modified contract or agreement and professional judgment.**

**96C.** Entities electing to apply the accommodation should prospectively apply the provisions of SFFAS 54, paragraph 73, to new or modified contracts or agreements meeting the paragraph 96A criteria above that commence after (or are effective after) the accommodation period.<sup>13</sup> For lease component modifications effective after the accommodation period that relate to contracts or agreements for which the accommodation was previously applied, the lease terms for such leases would assume that the lease term began as of the effective date of the modification for purposes of initial recognition and measurement. For such modifications, the lease liability and lease asset (for lessees) or lease receivable and unearned revenue (for lessors) should initially be measured based on the remaining lease term and associated lease payments.

**FN 13 – Unless the modification is reported as a separate lease as provided in par. 84. In such cases, the additional lease would be recognized as a new lease, while the original lease component(s) may continue to be accounted for as a nonlease component under the accommodation without prospective application of par. 73.**

**Question for the Board #2:**

2. Do members have additional feedback on the proposed paragraphs 96B-96C (and **Items A.3 and B.1**)?

**Items A.2 and B.2. Staff recommends discussing accommodation period selection flexibilities for reporting entities, including those with multiple components or subcomponents, in a standalone paragraph.** At the May meeting, and during direct staff consultations with individual members prior thereto, some members observed that the selection flexibilities should be clarified. The Board generally agreed with the flexibilities, however.

Following the May meeting, staff received feedback from a task force member suggesting to include clarifying language for reporting entities with multiple components or subcomponents as well—analogous to provisions under SFFAS 6, as amended by [SFFAS 50](#), paragraph 13 (see par. 40.d) for selecting alternative valuation methods for opening balances of general property, plant, and equipment. Staff views this feedback as inherently consistent with the previous staff recommendations and Board discussions in May; however, staff believes that explicit discussion will benefit preparers and likely prevent respondent feedback and/or questions on this matter.

**96D.** A reporting entity may apply the provisions of paragraphs 96A-96C to groups of contracts or agreements, the nature of which is reasonably consistent based on nature of the contracts or agreements within the groups. A reporting entity may select different accommodation periods under paragraph 96B for different groupings of contracts or agreements. The reporting entity may have multiple component or subcomponent reporting entities select various accommodation periods under paragraph 96B.

**Question for the Board #3:**

3. Do members have additional feedback on the proposed paragraph 96D (and **Items A.2 and B.2**)?

**Item C** was discussed and agreed to by a majority of the Board in May (6 of 9 members). No further analysis or discussion is necessary. Staff removed the previously proposed disclosure requirement from the pre-ballot draft (Attachment 2).

**Item D. Staff recommends several improvements to the basis for conclusions to facilitate respondent reviews of the proposals.**

**Item D.1.** Staff recommends clarifying the context and rationale for providing transitional accommodations for embedded leases. Specifically, staff recommends striking paragraph A8 from the previous draft and replacing it with contextual information based in part on



ASU 2016-2, Section C, par. BC144.<sup>1</sup> Under previous GAAP, federal reporting entities are required to account for lease elements within “multiple-element arrangements” in accordance with ASC Topic 840.<sup>2</sup> Staff finds this language to be relevant to the federal environment, given the historical incorporation of FASB guidance through reference under SFFAS 5, *Accounting for Liabilities of the Federal Government*, paragraphs 43-46; SFFAS 6, *Accounting for Property, Plant, and Equipment*, paragraphs 20 and 29; and the federal GAAP hierarchy.<sup>3</sup>

**Item D.2.** Staff recommends explanation regarding the proposed accommodation design based on the Board’s level of effort discussions, the perceived limited and transitory nature of the informational costs, and the considerable perceived benefits. Staff recommends focusing such discussion on the four items (a-d) discussed under paragraph A11 of Attachment 2. Items a-d are consistent with the Board’s deliberations in May.

**Item D.3.** Staff recommends that the basis for conclusions discuss more expansive accommodations for multiple component contracts in general and the reasons for not proposing them under the exposure draft proposals. Staff recommends the proposed language in paragraph A13 of Attachment 2.

Staff respectfully recommends that the Board expose the transitional accommodation reflected under Attachment 2 for public comment as soon as possible. The transitional accommodation would provide additional time to monitor implementation of SFFAS 54. Staff finds the pre-ballot draft proposal to be entirely consistent with the research presented in February and April and related due process findings and instructions from the Board. Additional or more expansive actions, *particularly those of a nature that would result in more expansive, pervasive, and permanent changes to the operation of the standard*, require extensive and robust research and careful study prior to reaching tentative Board decisions.

**Item D.4.** Staff updated the basis for conclusions with conforming changes based on items A-C above (see Attachment 2).

#### Question for the Board #4:

4. Do members have additional feedback on the proposed basis for conclusions (and **Items D.1-D.4**)?

**Item E.** Staff updated the questions for respondents with conforming changes based on items A-C above. Staff added additional instructions for respondents under QFR 3, as discussed by the

<sup>1</sup> Pending copyright permission from the Financial Accounting Foundation, which will be requested during the balloting phase.

<sup>2</sup> See ASC 840-10-15-17, which states that “*If an arrangement contains a lease and related executory costs, as well as other nonlease elements, the classification, recognition, measurement, and disclosure requirements of this Topic [840] shall be applied by both the purchaser and the supplier to the lease element of the arrangement.*”

<sup>3</sup> Federal reporting entities have been following FASB ASC Topic 840 under the practices consistent with SFFAS 5 and SFFAS 6.

Board in the May meeting. Staff also added an additional QFR in response to the alternative view submitted by Mr. McNamee. Lastly, staff added reference to the non-authoritative illustration appendix requested by the Board. Staff recommends including reference to this appendix under the QFRs section to facilitate respondent review of the proposals when answering the QFRs.

**Question for the Board #5:**

5. Do members have feedback on the proposed QFRs (and **Item E**)?

**Item F.** Staff designed and recommends the non-authoritative illustration under Appendix B of Attachment 2. The illustration explains the scope and applicability of paragraphs 96-97 of SFFAS 54 and the proposed paragraphs 96A-96E on reporting entities' universes of contracts and agreements. The illustration will facilitate respondent understanding and evaluations of the proposals.

**Question for the Board #6:**

6. Do members have feedback on the proposed Appendix B (and **Item F**)?





# TRANSITIONAL AMENDMENT TO SFFAS 54

**Statement of Federal Financial Accounting Standards XX**

**Pre-ballot Exposure Draft**

Written comments are requested by June XX, 2023

July XX, 2023

**Public comments are not requested on this draft**

## THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

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

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

Additional background information and other items of interest are available at [www.fasab.gov](http://www.fasab.gov):

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

Federal Accounting Standards Advisory Board  
441 G Street, NW  
Suite 1155  
Washington, D.C. 20548  
Telephone (202) 512-7350  
Fax (202) 512-7366  
[www.fasab.gov](http://www.fasab.gov)



June XX, 2023

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

The Federal Accounting Standards Advisory Board (FASAB or "the Board") requests your comments on the exposure draft of a proposed Statement of Federal Financial Accounting Standards (SFFAS) titled *Transitional Amendment to SFFAS 54*. Specific questions for your consideration appear on page **Error! Bookmark not defined.**, but you are welcome to comment on any aspect of this proposal. If you do not agree with specific matters or proposals, your responses will be most helpful to the Board if you explain the reasons for your positions and any alternatives you propose.

Responses are requested by July XX, 2023.

All comments received by FASAB are considered public information. Those comments may be posted to [FASAB's website](#) and will be included in the project's public record.

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

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

Sincerely,

Signature to be added after receipt of ballots

George A. Scott  
Chair

## EXECUTIVE SUMMARY

### WHAT IS THE BOARD PROPOSING?

This Statement of Federal Financial Accounting Standards (SFFAS) would amend the implementation section of SFFAS 54, *Leases*, by providing transitional accommodations to reporting entities implementing SFFAS 54 in the area of “embedded leases” (a common industry term which generally describes contracts or agreements that contain lease component[s] and non-lease component[s], such as service components, and serve a primary purpose attributable to the nonlease component[s]; and the related requirements of SFFAS 54, paragraphs 72-77).

Under the proposal, a reporting entity may elect not to assess whether contracts or agreements meeting the eligibility criteria for “embedded leases” are or contain lease component(s) as of October 1, 2023, as well as those subsequently entered into or modified prior to the reporting period of transition (fiscal year 2026, or earlier). The reporting period of transition is defined as the reporting period immediately after the end of the period in which the accommodation is applied. The contracts or agreements for which this accommodation was applied would be accounted for as nonlease contracts or agreements for their remaining term, unless they are subsequently modified during the reporting period of transition or thereafter.

The proposal would allow reporting entities electing to apply the accommodation to prospectively apply the provisions of SFFAS 54 to lease components of new or modified contracts or agreements meeting all of the embedded leases eligibility criteria beginning after September 30, 2025, or earlier October 1, 2023; October 1, 2024; or October 1, 2025.

Leases that do not meet the embedded leases eligibility criteria under this proposal would continue to follow the implementation provisions of paragraphs 96-98 of SFFAS 54. The proposal also would require certain disclosures for reporting entities electing the transitional accommodation.

The proposal will provide additional time needed for several reporting entities to review, analyze, and apply the requirements of SFFAS 54 to contracts or agreements with embedded leases meeting the eligibility criteria in this proposal.

### MATERIALITY

The provisions of this Statement of Federal Financial Accounting Standards would not need to be applied to information if the effect of applying the provision(s) is immaterial.<sup>1</sup> A misstatement, including omission of information, is material if, in light of surrounding facts and circumstances, it could reasonably be expected that the judgment of a reasonable user relying on the information would change or be influenced by the correction or inclusion of the information. Materiality should be evaluated in the context of the specific reporting entity. Determining materiality requires appropriate and reasonable judgment in considering the specific facts, circumstances, size, and nature of the misstatement. Consequently, after quantitative and

<sup>1</sup> Refer to Statement of Federal Financial Accounting Concepts 1, *Objectives of Federal Financial Reporting*, chapter 7, titled *Materiality*, for a detailed discussion of the materiality concepts.

qualitative factors are considered, materiality may vary by financial statement, line item, or group of line items within an entity.

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## QUESTIONS FOR RESPONDENTS

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

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

Please also review appendices A (basis for conclusions) and B (non-authoritative illustration), which are intended to inform respondent understanding and evaluation of the proposal when responding to the below questions.

The questions in this section are available for your use at <https://www.fasab.gov/documents-for-comment/>. Your responses should be sent to [fasab@fasab.gov](mailto:fasab@fasab.gov). If you are unable to respond by email, please fax your responses to (202) 512-7366.

All responses are requested by **July XX, 2023**.

**QFR1.** Do you generally agree or disagree with the proposed transitional amendment to SFFAS 54 as a whole? Please provide reasons for your views.

**QFR2.** Proposed paragraph 96A provides that the transitional accommodation, if elected by the reporting entity, would apply to contracts or agreements ~~(or portfolios thereof)~~ that meet both of the following criteria: (a) the contracts or agreements contain nonlease component(s) and may contain lease component(s), and (b) the purpose of the contracts or agreements is primarily attributable to the nonlease component(s), such as service components. Paragraph 96B provides ~~additional~~ criteria for assessing the primary purpose in accordance with 96A.b.

Please provide feedback on ~~these proposed transitional accommodation scope and applicability criteria~~ paragraphs 3-4 and paragraph 5 (96A criteria), which are intended to provide transitional accommodation for “embedded leases.” Respondents are encouraged to refer to basis for conclusions and provide feedback on the design of these proposals and the extent to which they effectively scope in “embedded leases,” and the level of effort for applying such criteria.

**QFR3.** ~~Proposed paragraph 96C provides that reporting entities may elect not to assess whether contracts or agreements meeting all of the paragraph 96A criteria are or contain leases (a) existing as of October 1, 2023, and (b) subsequently entered into or modified prior to the beginning of the reporting period of transition. The entity making such an election would prospectively apply the provisions of paragraph 73 of SFFAS 54 to new or modified contracts or agreements meeting all of the paragraph 96A criteria for~~



~~reporting periods beginning after September 30, 2025, or earlier. In the reporting period of transition, the lease terms for any modified leases would assume that the lease term began as of the effective date of the modification. The lease liability and lease asset (for lessees) or lease receivable and unearned revenue (for lessors) would initially be measured based on the remaining lease term and associated lease payments. Please provide feedback on these proposed transitional accommodation provisions under paragraphs 96B-96C, which are intended to provide practitioners with additional time for identifying, analyzing, and reporting “embedded leases” embedded in their portfolios of contracts or agreements (on a prospective basis to new or modified contracts or agreements beginning in fiscal year 2026, or earlier). Please describe any alternative views or approaches, suggestions for improvements, and the reasons for your views. Respondents are encouraged to refer to the basis for conclusions and provide additional information or feedback on the design of these proposals and the expected benefits and costs.~~

- QFR4.** Proposed paragraph 96D provides that reporting entities may apply the provisions of paragraphs 96A-96C to groups of contracts or agreements, the nature of which is reasonably consistent based on the terms of the contracts or agreements within the groups. A reporting entity may select the beginning of the reporting period of transition for all eligible contracts or agreements, or it may select different reporting periods of transition for different groupings of contracts or agreements. The reporting entity may have multiple component or subcomponent reporting entities select various reporting periods of transition.

Please provide feedback on the proposed criteria and the flexibilities therein. Please describe any alternative views or approaches, suggestions for improvements, and the reasons for your views.

- QFR5.** Proposed paragraph 96ED provides that reporting entities electing the transitional accommodation would (a) disclose the election of the transitional accommodation during the reporting period(s) presented covered by the accommodation period and the reporting period immediately following the accommodation period. The disclosure would not need to be repeated during reporting periods thereafter, and (b) the nature of any significant contracts and agreements (or portfolios thereof) for which the transitional accommodation was elected.

Please provide feedback on the proposed disclosure requirements. Please describe any alternative views or approaches, suggestions for improvements, and the reasons for your views.

- QFR6.** One Board member provided an alternative view, which is documented under the basis for conclusions (appendix A), paragraphs A15-A24. Please refer to these paragraphs to review the alternative view as presented.

Do you agree, partially agree, or disagree with the alternative view? Please provide the rationale for your answer.

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## PROPOSED STANDARDS

### SCOPE

1. This Statement applies to federal entities that present general purpose federal financial reports (GPFFRs), including the consolidated financial report of the U.S. Government (CFR), in conformance with generally accepted accounting principles (GAAP), as defined by paragraphs 5 through 8 of Statement of Federal Financial Accounting Standards (SFFAS) 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*.
2. This Statement amends SFFAS 54, *Leases*, by inserting paragraphs 96A-96ED in between paragraphs 96 and 97.

### PROPOSED TRANSITIONAL AMENDMENT TO SFFAS 54

3. Paragraph 72 of SFFAS 54, *Leases*, acknowledges that lessees and lessors may enter into contracts or agreements that contain both a lease component and a nonlease component. Paragraph 73 provides that the federal entity should account for lease and nonlease components as separate contracts or agreements.
4. Contracts and agreements that contain both lease component(s) and nonlease component(s), such as service components, and serve a primary purpose attributable to the nonlease component(s), are often viewed in practice as containing “embedded leases.”
5. Paragraphs 96A-96ED are added to SFFAS 54 as follows:

**96A.** The ~~below~~ transitional accommodation applies only to contracts or agreements ~~(or portfolios thereof)~~ that meet both of the following criteria:

a. The contracts or agreements contain nonlease component(s) and may contain lease component(s), and

b. The purpose of the contracts or agreements is primarily attributable to the nonlease component(s), such as service components. ~~See paragraph 96B criteria for assessing the primary purpose.~~ To assess whether the primary purpose of contracts or agreements ~~(or portfolios thereof)~~ is attributable to the nonlease component(s), lessees and lessors should understand the nature of the contracts or agreements. The primary purpose may only be attributed to the nonlease component(s) provided that ~~both of the following criteria are met: a.~~ the attribution does not appear to be unreasonable based on the nature ~~terms~~ of the contracts or agreements and professional judgment. ~~, and b. the nature of the contracts or agreements within the portfolio assessed is reasonably consistent based on the terms of the contracts or agreements and professional judgment.~~

**96BC.** ~~A reporting entity may elect not to assess whether contracts or agreements (or portfolios thereof) meeting all of the paragraph 96A criteria above are or contain lease components (a) existing as of October 1, 2023, and (b) subsequently entered into or modified prior to the reporting period of transition (fiscal year 2026, or~~

~~earlier).~~<sup>12</sup> ~~The reporting period of transition is defined as the reporting period immediately after the end of the period in which this accommodation is applied. The contracts or agreements not assessed under this accommodation would be accounted for as nonlease contracts or agreements for their remaining term (rather than the separate accounting for the lease and nonlease components provided for under par. 73), unless they are subsequently modified during the reporting period of transition or thereafter.~~ FN 12 – ~~The reporting entity may elect the beginning of the reporting of transition to be October 1, 2023; October 1, 2024; or October 1, 2025.~~

For contracts or agreements meeting the paragraph 96A criteria above, a reporting entity may elect to account for such contracts or agreements, including the lease component(s), as nonlease contracts or agreements in their entirety. This election applies to contracts or agreements existing as of October 1, 2023, and/or those subsequently entered into or modified on or prior to September 30, 2025 (end of the accommodation period).<sup>12</sup> The entity may elect a shorter accommodation period (contracts or agreements subsequently entered into or modified on or prior to September 30, 2024, or those existing as of October 1, 2023). The contracts or agreements under this election shall be accounted for as nonleases for their remaining term, unless they are subsequently modified (see below).

FN 12 – Unless the modification affects the primary purpose assessment under par. 96A and results in the primary purpose attribution changing from nonlease component(s) to lease component(s) based on the nature of the modified contract or agreement and professional judgment.

**96C.** Entities electing to apply the accommodation should prospectively apply the provisions of SFFAS 54, paragraph 73, to new or modified contracts or agreements meeting ~~all of the~~ paragraph 96A criteria above that commence ~~on or after~~ (or are effective ~~on or after~~) the ~~beginning of the reporting period of transition~~accommodation period.<sup>13</sup> For lease component modifications effective ~~on or after the beginning of the reporting period of transition~~accommodation period that relate to contracts or agreements ~~for which previously not assessed under the accommodation was previously applied~~, the lease terms for such leases would assume that the lease term began as of the effective date of the modification for purposes of initial recognition and measurement. For such modifications, the lease liability and lease asset (for lessees) or lease receivable and unearned revenue (for lessors) should initially be measured based on the remaining lease term and associated lease payments.

FN 13 – Unless the modification is reported as a separate lease as provided in par. 84. In such cases, the additional lease would be recognized as a new lease, while the original lease component(s) may continue to be accounted for as a nonlease component under the accommodation without prospective application of par. 73.

**96D.** A reporting entity may apply the provisions of paragraphs 96A-96C to groups of contracts or agreements, the nature of which is reasonably consistent based on nature of the contracts or agreements within the groups. A reporting entity may select different accommodation periods under paragraph 96B for different groupings of contracts or agreements. The reporting entity may have multiple component or subcomponent reporting entities select various accommodation periods under paragraph 96B.

**96ED.** A reporting entity electing the above transitional accommodation should disclose ~~the following:~~a. ~~The~~ election of the transitional accommodation during the

reporting period(s) ~~presented~~ covered by the accommodation period and the reporting period immediately following the accommodation period. The disclosure need not be repeated during reporting periods thereafter.

~~b. The nature of any significant contracts and agreements (or portfolios thereof) for which the transitional accommodation was elected.~~

## EFFECTIVE DATE

6. The requirements of this Statement are effective for reporting periods beginning after September 30, 2023.

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

## APPENDIX A: BASIS FOR CONCLUSIONS

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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 proposed Statement—not the material in this appendix—would govern the accounting for specific transactions, events, or conditions.

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

### PROJECT HISTORY

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- A1. The Federal Accounting Standards Advisory Board (FASAB or “the Board”) issued SFFAS 54, *Leases*, in April 2018 with an effective date for reporting periods beginning after September 30, 2020. The effective date was later amended by SFFAS 58, *Deferral of the Effective Date of SFFAS 54, Leases*, to reporting periods beginning after September 30, 2023.
- A2. Following the issuance of SFFAS 54, the Board and the Accounting and Auditing Policy Committee (AAPC) commenced projects on their technical agendas to identify implementation challenges and develop guidance related to SFFAS 54.
- A3. The Board and the AAPC have issued the following pronouncements to facilitate implementation of SFFAS 54, including:
  - a. SFFAS 60: *Omnibus Amendments 2021, Leases-Related Topics I*;
  - b. SFFAS 61: *Omnibus Amendments 2023, Leases-Related Topics II*;
  - c. Technical Bulletin 2023-1: *Intragovernmental Leasehold Reimbursable Work Agreements*; and
  - d. Technical Release 20: *Implementation Guidance for Leases*.
- A4. In February 2023, the Board received implementation updates from staff regarding the implementation experiences and challenges within the federal environment. The Board also received several letters from some reporting entities highlighting implementation challenges that they were experiencing.
- A5. Following an April 2023 clarification discussion, the Board decided to provide transitional accommodations to reporting entities in the area of embedded leases based on the research presented by technical staff and additional information provided during the clarification discussion.



- A6. The Board is aware that SFFAS 54 requires entities to ensure their leases are appropriately identified for evaluation, which can improve accountability for their resources and obligations. As noted in Statement of Federal Financial Accounting Concepts (SFFAC) 1, *Objectives of Federal Financial Reporting*, 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.
- A7. When developing SFFAS 54, as amended, the Board made several decisions in the interest of reducing implementation costs associated with contracts or agreements with multiple components, including, but not limited to, provisions regarding:
- a. Allowing a short-term lease exception
  - b. Allocation of the contract price to multiple components of a lease that allows the stated prices to be used if they do not appear to be unreasonable
  - c. 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 the stated prices appear to be unreasonable
  - d. The requirement to treat an entire multiple-component contract as a single lease unit if determining a best estimate is not practicable
  - e. The exclusion of intragovernmental leases from balance sheet recognition and measurement as lease liabilities and corresponding lease assets (for intragovernmental lessees) and lease receivables and unearned revenues (for intragovernmental lessors)
  - f. The extension of the effective date until fiscal year 2024
  - g. Prospective implementation at transition, as opposed to a retrospective approach
- ~~A8. In developing this proposal—and notwithstanding the original decisions in reducing implementation costs—the Board generally agrees that the initial implementation of the standards to contracts or agreements meeting paragraph 96A criteria are necessary and appropriate when performed correctly and operationalized in a manner consistent with the concept of materiality. The Board also agreed, however, that reporting entities would benefit considerably from the proposed transitional accommodation, which will provide additional time to perform implementation activities for such contracts or agreements.~~
- A9-A8. Many contracts or agreements contain both lease and nonlease (generally, but not always, service) components. Previous GAAP provided limited guidance on how to separate lease components and nonlease components of contracts or agreements, even



though it required that separation. The Board expects that lease components for such contracts or agreements with a primary purpose *attributable to the lease components* were generally accounted for separately. However, the Board recognizes that separate accounting for lease and nonlease components may not have been consistently performed by many reporting entities for “embedded leases” (that is, contracts or agreements with a primary purpose *attributable to nonlease components*) under previous GAAP.

A10-A9. Accordingly, ~~T~~the Board also agreed that reporting entities should have the flexibility to begin recognizing lease liabilities (and correspondent lease assets (for lessees) and lease receivables and unearned revenues (for lessors) for lease components of new or modified contracts or agreements meeting the paragraph 96A criteria prospectively beginning in fiscal year 2026, or earlier.

A11-A10. The Board expects that SFFAS 54 implementation activities, such as assessing control of the underlying assets for component(s) that may be leases, allocating contract prices to lease and nonlease component(s), among other complexities, are likely to be comparatively time consuming for contracts or agreements meeting the paragraph 96A criteria (“embedded leases.”) Prospective implementation of paragraph 73 for new or modified contracts or agreements meeting the paragraph 96A criteria would provide reporting entities electing the accommodation with additional time during fiscal years 2024 and/or 2025 to (a) focus and prioritize implementation activities for contracts or agreements with a primary purpose attributable to lease components and (b) prepare for prospective implementation of paragraph 73 for new or modified “embedded leases.”

A12-A11. The Board recognizes that reporting entities will need to assess the eligibility of contracts or agreements for the transitional accommodation. In crafting this proposal, the Board carefully considered the level of effort necessary in an effort to balance the informational benefits of implementing paragraph 73 while also accommodating the reported implementation challenges associated with “embedded leases.” With this in mind, the proposal includes several features to provide that balance, including:

- a. Allowing reporting entities to assess the primary purpose of contracts or agreements based on their nature and professional judgment, and providing that such attributions cannot appear to be unreasonable based on those factors. The Board believes that this phrasing provides for an appropriate level of preparer discretion and professional judgment.
- b. Allowing reporting entities to elect the accommodation period and prospective application period of paragraph 73 for eligible contracts or agreements (that is, fiscal year 2024, fiscal year 2025, or fiscal year 2026) based on the expected level of time and effort.
- c. Allowing reporting entities to apply the provisions of paragraphs 96A-96C to groups of contracts or agreements, provided that the nature of the contracts within such groups is reasonably consistent.
- d. Limiting resulting disclosures to simply disclosing the election of the transitional accommodation in the reporting period(s) covered by the accommodation period and during the reporting period immediately following the accommodation period. The

Board discussed other potential disclosure options, but elected to minimize disclosure burden in order to provide maximum transitional relief.

A13-A12. The Board expects that most contracts meeting paragraph 96A criteria will oftentimes have lease terms ~~(for any lease components)~~ that are comparatively shorter in relation to contracts with a purpose primarily attributable to lease components (real property leases, for example), given the nature of the related contracts. ~~As a result~~ Accordingly, the Board ~~believes-expects~~ that the perceived benefits of this accommodation would outweigh the perceived informational costs.

A14-A13. The Board duly considered alternative accommodations for multiple component contracts when developing this proposal. Members considered allowing reporting entities to account for contracts or agreements according to their primary purpose (either lease or nonlease) indefinitely. The design of paragraphs 72-77 of SFFAS 54 underwent extensive research, due process, and deliberations. These unamended paragraphs include considerable design accommodations, which are described in par. A7.b-d above. The Board does not have sufficient, appropriate evidence regarding the potential effects of expansive accommodations for multiple component contracts at this time. For example, the Board lacks evidence that such action would not have unintended adverse or material effects on (a) financial reporting and fair presentation for certain reporting entities with significant multiple component contracts, (b) reliability in application of the standards to lease and nonlease component(s), and/or (c) implementation processes. The proposed accommodation period would provide the Board with additional time to engage with the community and research multiple component contracts and their significance, study the application of paragraphs 72-77 and the viability of other potential relief mechanisms (and potential benefits, drawbacks, and key considerations under the federal environment), and develop implementation guidance and/or amendments to the standard based on such study, if warranted.

A14. The Board is also aware that the disclosure requirements of SFFAS 49, *Public-Private Partnerships*, may also apply to contracts that contain “embedded leases.” The transitional accommodation under this proposal would have no bearing on the ongoing implementation of SFFAS 49 disclosure requirements to such contracts, if applicable.

#### ALTERNATIVE VIEW

A15. Individual members sometimes choose to express an alternative view when they disagree with the Board’s majority position on one or more points in a proposed standard. The alternative view discusses the precise point or points of disagreement with the majority position and the reasons therefore. The ideas, opinions, and statements presented in the alternative view are those of the individual member alone. However, the individual member’s view may contain general or other statements that may not conflict with the majority position, and in fact may be shared by other members. The material following was prepared by an individual member and is presented as an alternative view.

A16. Mr. McNamee agrees with the Board that challenges some reporting entities face in implementing SFFAS 54 warrant relief. The transitional accommodation the Board proposes would provide some relief from the challenges inherent in implementing paragraph 73 of SFFAS 54, which addresses accounting by lessors and lessees for contracts that contain both a lease and a nonlease component. Such relief would be

limited, however, in that it would be temporary and would apply only to contracts or agreements whose purpose is primarily attributable to their nonlease components. Mr. McNamee believes that making available broader and permanent relief from the requirements of paragraph 73 would substantially reduce the cost of implementing SFFAS 54 without substantially diminishing the quality of financial reporting of leases.

- A17. Mr. McNamee proposes that, as a practical expedient, a reporting entity may elect to account for contracts or agreements according to their primary purpose, either lease and nonlease. That is, a contract whose purpose is primarily attributable to its lease components could be accounted for as a lease in its entirety. If a contract or agreement's purpose is primarily attributable to its nonlease components, it could be accounted for using the standards applicable to the nonlease components.
- A18. Mr. McNamee's proposal is similar to the practical expedient FASB provides in ASC 842-10-15-37, "[a]s a practical expedient, a lessee may, as an accounting policy election by class of underlying asset, choose not to separate nonlease components from lease components and instead to account for each separate lease component and the nonlease components associated with that lease component as a single lease component."
- A19. Mr. McNamee's proposed practical expedient differs from the FASB's in that it would apply to lessors as well as lessees, and it would allow exemption from lease accounting for contracts or agreements whose purpose is primarily attributable to nonlease components.
- A20. To avail themselves of this proposed practical expedient, reporting entities would first assess contracts and agreements to determine if their purpose is primarily attributable to lease components or to nonlease components, just as they would under paragraph 96B of the Board's proposed transitional accommodation. After that determination, reporting entities may choose not to separate nonlease components from lease components and instead:
- a. For contracts or agreements whose purpose is primarily attributable to the lease components, account for each separate lease component and the nonlease components associated with that lease component as a single lease component and
  - b. For contracts or agreements whose purpose is primarily attributable to the nonlease components, include the payments/receipts attributable to the lease components as part of the cost/revenue of the nonlease components, which would be accounted for in accordance with standards applicable to those nonlease components.
- A21. Some may view the practical expedient proposed in paragraph A20.a as unnecessary because reporting entities already have processes for separating lease and nonlease components in accounting for capital leases under the provisions of SFFAS 5 and 6 that were based on FASB ASC 840
- A22. Mr. McNamee would counter that viewpoint by noting that private-sector entities also had such processes in place to meet the requirement of ASC 840-10-15-17 that "[i]f an arrangement contains a lease and related executory costs, as well as other nonlease elements, the classification, recognition, measurement, and disclosure requirements of this Topic shall be applied by both the purchaser and the supplier to the lease element of

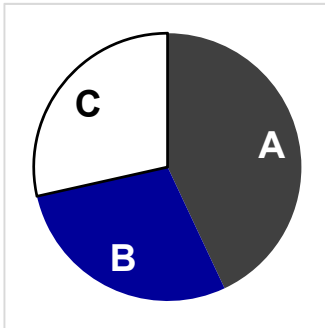
the arrangement.” Nonetheless, as a result of its due process FASB determined to provide the practical expedient of ASC 842-10-15-37 on the basis that “the costs and administrative burden of allocating consideration to separate lease and nonlease components may not be justified by the benefit of more precisely reflecting the right-of-use asset and the lease liability.”<sup>2</sup>

- A23. Mr. McNamee acknowledges that applying paragraph A20.a, above, would result in reporting lease assets and liabilities higher than would have been reported under paragraph 73 of SFFAS 54, and applying paragraph A20.b would result in reporting lower amounts. However, the application of these two provisions would offset each other to a degree, and Mr. McNamee believes their net effect would likely be immaterial to reporting entities’ balance sheets. This view is based on his understanding of amounts reporting entities currently report as capital leases and disclose as operating leases relative to their total non-intragovernmental assets. He also believes any resulting differences in the timing of expense/revenue recognition would likely be immaterial to statements of net cost.
- A24. Mr. McNamee recognizes that some might believe more research is needed before determining whether the practical expedient he proposes would be sufficiently cost beneficial. If the Board determines more research is needed to make this determination, then Mr. McNamee proposes a two-year deferral of the implementation of SFFAS 54 to allow for that research rather than the proposed two-year transitional accommodation.

<sup>2</sup> FASB Accounting Standards Update 2016-02, Leases (Topic 842), paragraph BC150.

## APPENDIX B: NON-AUTHORITATIVE ILLUSTRATION

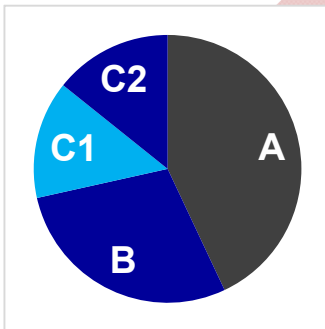
- B1. The below graphic explains the scope and applicability of paragraphs 96-97 and the proposed paragraphs 96A-96E on reporting entities' universes of contracts and agreements. The graphic is intended to facilitate understanding of the proposals. The Board may elect to omit this non-authoritative illustration from the final pronouncement.



Many contracts and agreements in the reporting entity's overall universe inherently do not include leases based on their nature (**part A** of the pie chart). For example, contracts to purchase a capital asset. Such contracts are not subject to SFFAS 54 and would not need to be reviewed for "embedded leases."

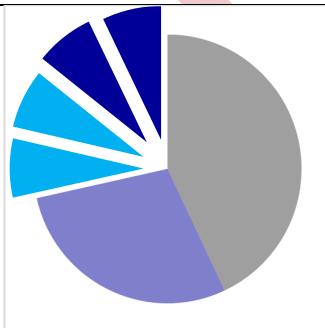
Some contracts and agreements in the universe are inherently known to serve a primary purpose attributable to lease component(s) (**part B** of the pie chart). For example, these generally would have been identified as capital or operating lease elements under previous GAAP. These contracts are subject to SFFAS 54 transitional requirements of par. 96 and 97 and their eligibility need not be assessed for the proposed accommodation.

Other contracts and agreements in the universe contain nonlease component(s) and may also contain lease component(s). The primary purpose of these contracts or agreements may not be inherently known (**part C** of the pie chart). These contracts or agreements may or may not meet both of the two criteria under par. 96A of the proposal.



Of the contracts or agreements under **part C**, the primary purpose of many are attributable to nonlease component(s), such as services. These contracts or agreements meet par. 96A criteria under the proposal, provided that the attributions do not appear to be unreasonable based on their nature and professional judgment. Accordingly, they would be eligible for the proposed par. 96B-96C accommodation (**part C1** of the pie chart).

Other contracts or agreements under **part C** may not have a primary purpose attributable to nonlease component(s) based on their assessed nature and professional judgment. These would not meet par. 96A criteria under the proposal and, therefore, they would be subject to the transitional requirements of par. 96 and 97 (**part C2** of the pie chart) along with those under **part B**.



Provisions of par. 96A-96C of the proposal—including primary purpose assessments—may be applied to groups of contracts or agreements, the nature of which is reasonably consistent, as provided by par. 96D of the proposal.

**Note:** The size of the "pie" segments are illustrative and not intended to represent the actual or expected relative volume of contracts or agreements in each respective segment.



## APPENDIX CB: ABBREVIATIONS

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CFR	Consolidated Financial Report of the U.S. Government
ED	Exposure Draft
FASAB	Federal Accounting Standards Advisory Board
FAF	Financial Accounting Foundation
<u>FASB</u>	<u>Financial Accounting Standards Board</u>
GASB	Governmental Accounting Standards Board
GPFFR	General Purpose Federal Financial Report
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards

### **FASAB Members**

George A. Scott, Chair

R. Scott Bell

Gila J. Bronner

Robert F. Dacey

Sallyanne Harper

Carol S. Johnson

Patrick McNamee

Terry K. Patton

Raymond Vicks

### **FASAB Staff**

Monica R. Valentine, Executive Director

Ricky A. Perry, Jr., Assistant Director

### **Federal Accounting Standards Advisory Board**

441 G Street, NW

Suite 1155

Washington, D.C. 20548

Telephone (202) 512-7350

Fax (202) 512-7366

[www.fasab.gov](http://www.fasab.gov)



## Alternative View

Standard Language included per FASAB Rules of Procedure:

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- A20. To avail themselves of this proposed practical expedient, reporting entities would first assess contracts and agreements to determine if their purpose is primarily attributable to lease components or to nonlease components, just as they would under paragraph 96B of the Board's proposed transitional accommodation. After that determination, reporting entities may choose not to separate nonlease components from lease components and instead:
- a. For contracts or agreements whose purpose is primarily attributable to the lease components, account for each separate lease component and the nonlease components associated with that lease component as a single lease component and

- b. For contracts or agreements whose purpose is primarily attributable to the nonlease components, include the payments/receipts attributable to the lease components as part of the cost/revenue of the nonlease components, which would be accounted for in accordance with standards applicable to those nonlease components.

- A21. Some might argue that the practical expedient proposed in paragraph 20a is unnecessary because reporting entities already have processes for separating lease and nonlease components in accounting for capital leases under the provisions of SFFASs 5 and 6 that were based on FASB ASC 840.
- A22. Mr. McNamee would counter that argument by noting that private-sector entities also had such processes in place to meet the requirement of ASC 840-10-15-17 that “[i]f an arrangement contains a lease and related executory costs, as well as other nonlease elements, the classification, recognition, measurement, and disclosure requirements of this Topic shall be applied by both the purchaser and the supplier to the lease element of the arrangement.” Nonetheless, as a result of its due process FASB determined to provide the practical expedient of ASC 842-10-15-37 on the basis that “the costs and administrative burden of allocating consideration to separate lease and nonlease components may not be justified by the benefit of more precisely reflecting the right-of-use asset and the lease liability.”<sup>1</sup>
- A23. Mr. McNamee acknowledges that applying paragraph 20 a, above, would result in reporting lease assets and liabilities higher than would have been reported under paragraph 73 of SFFAS 54, and applying paragraph 20b would result in reporting lower amounts. However, the application of these two provisions would offset each other to a degree, and Mr. McNamee believes their net effect would likely be immaterial to reporting entities’ balance sheets. This view is based on his understanding of amounts reporting entities currently report as capital leases and disclose as operating leases relative to their total non-intragovernmental assets. He also believes any resulting differences in the timing of expense/revenue recognition would likely be immaterial to statements of net cost.
- A24. Mr. McNamee recognizes that some might believe more research is needed before determining whether the practical expedient he proposes would be sufficiently cost beneficial. If the Board determines more research is needed to make this determination, then Mr. McNamee proposes a two-year deferral of the implementation of SFFAS 54 to allow for that research rather than the proposed two-year transitional accommodation.

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<sup>1</sup> FASB Accounting Standards Update 2016-02, *Leases (Topic 842)*, paragraph BC150.

## Leases Project Plan

	<b>Deferral</b> SFFAS 58 ✓	<b>Implementation Guidance</b> TR 20 ✓ Updates To TR 20	<b>Omnibus</b> SFFAS 60 ✓ SFFAS 61 ✓	<b>Leases-Related Intragov. RWAs</b> TB 2023-1 ✓	<b>Transitional Accommodation</b> SFFAS TBD	<b>Training / Outreach</b>
FY 2020	Draft Exposure Period Finalize / Approve Issuance SFFAS 58 ISSUED	Draft	Research Draft			Provide
FY 2021		Exposure Period Finalize / Approve Research	Exposure Period Finalize / Approve Research	Research Draft		Provide
FY 2022		Issuance TR 20 ISSUED Research	Issuance SFFAS 60 ISSUED Research Draft Exposure Period Finalize	Research Draft Exposure Period Finalize		Provide
FY 2023 Q1		Research	Finalize	Finalize		Draft FY 23 content
FY 2023 Q2		Research Draft	Finalize / Approve	Finalize / Approve Issuance TB 2023-1 ISSUED		Provide
FY 2023 Q3		Draft Exposure Period	Issuance SFFAS 61 ISSUED		Research Draft Exposure Period	Provide
FY 2023 Q4		Finalize / Approve Target Issuance			Exposure Period Finalize / Approve	
FY 2024 Q1	Effective reporting period				Target Issuance	
FY 2024 Q2 ...						

Last updated: June 2023.