

**OFFICE OF THE UNDER SECRETARY OF DEFENSE**

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WASHINGTON, DC 20301-1100**

COMPTROLLER

February 2, 2021

Monica R. Valentine
Executive Director
Federal Accounting Standards Advisory Board
441 G Street, NW, Suite 1155
Washington, DC 20548

Dear Ms. Valentine:

The Department of Defense (DoD) is pleased to submit the attached comments on the Federal Accounting Standards Advisory Board (FASAB) and Accounting and Auditing Policy Committee (AAPC) Joint Exposure Draft (ED) of the proposed Federal Financial Accounting Technical Release, "Implementation Guidance for Leases," and the proposed Statement of Federal Financial Accounting Standards, "Omnibus Amendments to Leases-Related Topics." The DoD generally agrees with the proposed Joint ED with a few exceptions. Detailed responses to FASAB and AAPC's questions and additional comments are provided in the enclosure.

Thank you for considering the DoD's input.

Sincerely,

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Kim R. Laurance
Acting Assistant Deputy Chief Financial
Officer

Enclosure:
As stated

Exposure Draft Questions for Respondents (QFR)
and Specific Matters for Comment (SMC)

Due: February 5, 2021

Implementation Guidance for Leases & Omnibus Amendments to Leases-Related Topics

Please select the type(s) of organization responding to this exposure draft. If you are not responding on behalf of an organization, please select “individual.”

Accounting Firm	<input type="checkbox"/>	
Federal Entity (user)	<input type="checkbox"/>	
Federal Entity (preparer)	<input checked="" type="checkbox"/>	
Federal Entity (auditor)	<input type="checkbox"/>	
Federal Entity (other)	<input type="checkbox"/>	If other, please specify: <input type="text"/>
Association/Industry Organization	<input type="checkbox"/>	
Nonprofit organization/Foundation	<input type="checkbox"/>	
Other	<input type="checkbox"/>	If other, please specify: <input type="text"/>
Individual	<input type="checkbox"/>	

Please provide your name.

Name:

Please identify your organization, if applicable.

Organization:

Please email your responses to fasab@fasab.gov. If you are unable to respond by email, please call (202) 512-7350 to make alternate arrangements.

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

DoD Response: *We generally support the proposed Federal Financial Accounting Technical Release, “Implementation Guidance for Leases,” (TR) and Statement of Federal Financial Accounting Standards (SFFAS), “Omnibus Amendments to Leases-Related Topics” (Statement). SFFAS 54 is a significant change in accounting practice. Therefore, the proposed TR would assist Federal agencies in implementing the new lease standard. The proposed Statement addresses implementation issues that were identified during the Leases Implementation Task Force, by clarifying ambiguities and improving consistency throughout SFFAS 54, SFFAS 57, and SFFAS 6. The updates and supplemental guidance help to more clearly distinguish arrangements that qualify as leases and related accounting and reporting treatment. By providing a multitude of different scenarios and responses, a reporting entity can gain a better understanding as to how SFFAS 54 will impact their organization once effective.*

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

DoD Response: *During the Leases Implementation Task Force meetings, it was agreed to include illustrations for some of the questions and answers in the TR. These illustrations were supposed to be included in Appendix B of the TR. However, it appears that the proposed TR does not include any illustrations. These illustrations would be beneficial as they would illustrate the application of the proposed provisions of the TR to assist in clarifying their meaning.*

It was suggested to add an illustration equivalent to Governmental Accounting Standards Board (GASB) Illustration B1, for the initial and subsequent measurement of the lease asset and lease liability. Additionally, it was agreed to add illustrations for paragraphs 45, 50, 67, and 76 of the proposed TR, and paragraph 54.e of SFFAS 54 to address what is included in the “annual lease expense.” Accordingly, it is highly recommended for FASAB to take into consideration the inclusion of these illustrations in the TR which will clarify the application of the proposed provisions of the TR and assist with the implementation of SFFAS 54.

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

DoD Response:

1. *SFFAS 54, paragraph 2 provides guidance regarding identification of the underlying asset as follows: “To qualify as a lease, the underlying asset typically should be identified by being explicitly specified in a contract or agreement.” However, an asset also can be identified by being implicitly specified at the time that the asset is made available for use by the lessee. Leases include contracts or agreements that, although not explicitly identified as leases, meet the definition of a lease. This wording is similar to the wording in Financial Accounting Standard Board Accounting Standards Codification (ASC) 842. During the review of ASC 842, and implementation guides offered from national Certified Public Accountant firms, we found several examples of manufacturing arrangements for which implicit leases were identified because the “lessee” is the only customer for a particular facility or piece of equipment. See the following example:*

In the Defense community, there may be contracts for weapon systems or components for which the only customers are within DoD. If SFFAS 54 is interpreted in a manner similar to ASC 842, we are concerned that manufacturing contracts for products unique to the Defense community may be identified as containing embedded leases. Clarification in the Statement

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(level A guidance) is preferred to ensure audit firms do not question departure from outcomes seen under ASC 842 and GASB 87. Due to similarities in the definitions, similar outcomes would be expected.

- 2. SFFAS 54, paragraphs 84 – 86 cover lease modifications, when to classify them as a new lease, and how to re-measure related amounts. Paragraph 21 also addresses when to reassess the lease term. There does not appear to be any guidance on what to do if the lease term changes from short-term to any of the other lease categories. Would such a change be treated prospectively like a change in an estimate? Please consider providing clarifying guidance on this in the Statement or TR.*
- 3. Certain privatization efforts within DoD create limited-liability corporations (LLC) and qualify as public-private partnerships (PPP). Existing federal-owned facilities are often transferred to an LLC (in which defense components have an equity interest). Under ASC 970-323-30-3 such transfers qualify as sales--the facilities are de-recognized and the new investment is recognized at fair value under the equity method. In addition, land may be provided to the LLC through a ground lease. These individual transactions are part of a larger investment in a PPP; however, they may appear to qualify as sale-leasebacks or lease-leasebacks covered in SFFAS 54. We believe such arrangements would be best addressed through forthcoming FASAB guidance on PPP recognition and measurement rather than through a segmented application of SFFAS 54. To avoid confusion during SFFAS 54 implementation, could FASAB clarify that such PPP arrangements are excluded from the scope of SFFAS 54? Guidance in the Statement is recommended in order to resolve this scope issue.*
- 4. SFFAS 54, paragraph 93 provides disclosure requirements for lease-leaseback arrangements. Specifically, paragraph 93 states: "A lease-leaseback transaction should be accounted for as a net transaction. Both parties to a lease-leaseback transaction should disclose the amounts of the lease and the leaseback separately." Although accounted for as a net transaction, disclosure is more detailed; this imposes greater cost to develop disclosures. Further, the disclosure requirement may need to be clarified. We request consideration of the following:*
 - a. Consider permitting a net disclosure for lease-leaseback amounts given that the federal government's detailed future cash in-flow and out-flow are not analyzed as closely as other types of entities. This would require level A guidance in the Statement.*
 - b. If the disclosure is retained, consider clarifying its meaning. Does the provision simply mean that the lessor amounts and the lessee amounts should be included in other related amounts (that is, gross amounts for related disclosures such as lease assets and lease receivables)?*

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Alternatively, does this require both gross amounts and a separate line in the lessor and lessee disclosures to identify lease-leaseback related amounts? An example is shown below for lease assets; however, additional lines would be needed in each of the required lessee and lessor disclosures. This could be clarified in the TR.

As of [Fiscal Year End Month and Day]	Current Fiscal Year	Prior Fiscal Year
(Amounts in thousands)		
Entity as Lessee, Lease Assets		
A. Land	\$ \$\$\$	\$ \$\$\$
B. Buildings, Structures, and Facilities	\$\$\$	\$\$\$
C. General Equipment	\$\$\$	\$\$\$
D. Lease assets under leaseback	\$\$\$	\$\$\$
E. Other	\$\$\$	\$\$\$
F. Accumulated Amortization	\$\$\$	\$\$\$
G. Total Lease Assets	<u>\$ \$\$\$</u>	<u>\$ \$\$\$</u>

5. Consider adding a scenario in the proposed TR similar to the following:

Suggested question: A reporting entity (lessee) enters into a multi-year agreement with a contractor (lessor) for warehousing and storage. The reporting entity will pay the contractor \$250,000 per month. The contractor will manage and execute receipt, storage, shipping, and distribution of the reporting entities' inventory. Under the agreement, the contractor owns the entire process including the facility. The reporting agency does not have the right to operate, control physical access, or substantially receive all benefits from the facility. In addition, the reporting entity will not be acquiring the facility at the conclusion of the agreement. Should the reporting entity record a lease?

Suggested response: No, the contractor owns the entire process, including the facility. The reporting entity does not have the right to operate, control physical access, or substantially receive all benefits from the facility. Additionally, the reporting entity will not be purchasing the facility at the end of the contract as such transactions should be recorded as expense.

6. Some DoD Components use real property assets that are under the jurisdiction of Military Departments for their mission, but makes no direct payments for that use. These are known as "Real Property Permits." The

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DoD Components are responsible for addressing premises repair and for complying with the Military Departments' regulations, guidance, and orders. Should these "Real Property Permits" be considered leases under the provisions of SFFAS 54? Please consider providing clarifying guidance on this in the Statement or TR.

- 7. This guidance does not address infeasible right of use (IRU) leases and how to determine if they are a lease, or a contract and the applicable accounting treatment. An IRU entails fiber optic communications networks that maximizes usage and recover the significant costs incurred to build the networks by granting to others the right to use network capacity. This type of arrangement typically has a significant up-front payment. Accounting for IRUs can be complicated because entities must first determine whether the IRU contract is or contains a lease. Please consider providing clarifying guidance on this in the Statement or TR.*
- 8. In addition, we would suggest asking for clarification on paragraph 5 of the Implementation Guidance for Leases. Paragraph 5 states that an "interrupted term of use" can still result in a lease because, uninterrupted control is not required to meet the definition of a lease. An example is provided in paragraph 5 where the lessee has the right to use the facility for 4 months per year. If, for example, the term is three years, how should the term of the lease be calculated for purposes of applying the "short term" lease definition? Should the term be considered 36 months and therefore not a short term lease, or should it be considered 12 months (4 months X 3) and therefore be classified as a short term lease.*

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

DoD Response: *The TR has over 100 helpful scenarios. Each of these scenarios has a reasoning section that helps explain how to treat various business events when dealing with the public or as an intragovernmental transaction. By providing these scenarios and explanations, reporting entities are more likely to be able to find guidance that is applicable to their specific business events, thus lowering the possibility of unaddressed ambiguous outcomes.*

*Implementation Guidance for Leases & Omnibus Amendments to Leases-Related Topics**Additional comments:*

- 1. Paragraph 6 of the proposed TR discusses easements and provides examples. It would be good to clarify whether the last two examples meet the definition of a lease.*
- 2. The response to paragraph 56 of the proposed TR is confusing. The asset being leased is land, which is non-depreciable, so the first portion of the response is confusing to the reader. As the scenario uses land as the underlying asset, the response should continue with that assumption and discuss the treatment of the amortized amount on the financial statement.*

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

DoD Response: *Yes, the proposed guidance under paragraph 4 appears to be applicable to federal lease scenarios, as federal entities can enter into lease agreements in which consideration provided is less than full cost of the lease asset.*

Additional Comment:

Consider stating that these would be arrangements between one federal reporting entity and another federal reporting entity--Imputed costs would not be related to arrangements with commercial entities. An example at the Component has resulted from the transfer of buildings from the working capital fund (WCF) to the general fund (GF) (separate reporting entities) in connection with the implementation of the DoD policy in respect of TB 2017-2. This is in effect a "defacto" lease and the WCF as a "business type activity" under SFFAS 55 will impute and record depreciation on the buildings as the value for use of the buildings in its operations.

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

DoD Response: *The proposed guidance listed within paragraph 13 of the proposed TR appears to sufficiently address implementation issues related to federal oil and gas leases. Although the fundamental aspect of leases within the scope of SFFAS 54 is unchanged relative to oil and gas exploration, it is a good idea to provide users with a wide variety of examples and scenarios as a means of reducing ambiguity when agencies attempt to apply the standards.*

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

DoD Response: *No, as intragovernmental sale-leaseback transactions do not include transactions that would qualify as a sale per paragraph 295 of SFFAS 7, and should be accounted for as a borrowing by both the seller-lessee and the buyer-lessor, in accordance with paragraph 89 of SFFAS 54.*

Additional Comments:

- 1. The reasoning within this paragraph is helpful. However, there is no statement within the reasoning paragraph that states explicitly whether disclosure requirements related to sale-leaseback transaction are applicable to intragovernmental leases. Based on the reasoning paragraph, a reader can assume the disclosure requirements are not applicable. However, in order to remove any potential for ambiguity, a statement could be added to the effect of "As such, the disclosure requirements for sale-leaseback transactions do not apply to intragovernmental leases."*
- 2. Concur that the TR response to the question posed in paragraph 95 is confusing and needs to be revised for clarity. Is the TR first paragraph response related to non-intragovernmental transactions while the second paragraph response is related to intragovernmental transactions? Consider that the TR specifically state that to distinguish the guidance or clarify in some other way.*

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

DoD Response: *The proposed guidance in this scenario is related to a federal entity and a contractor (non-federal entity). An intragovernmental lease-leaseback transaction will be between two federal entities. If there are lease-leaseback transactions between federal entities, we recommend adding a scenario that addresses specifically a lease that is under construction and qualifies as an intragovernmental lease-leaseback.*