

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"/>	
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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.

The Department of State (State) generally supports the proposed Statement and TR proposal as a whole. State recognizes that accounting for leases is an important topic and that the issuance of a new FASAB standard and guidance for this area is essential. Although Statement of Federal Financial Accounting Standard (SFFAS) 54, *Leases*, will result in significant implementation costs and challenges for agencies, we believe that the standard will ultimately benefit agencies by limiting opportunities to structure leasing transactions in a way that achieves a particular outcome, expanding internal controls over lease data, and improving comparability and understanding of financial statements and disclosures. We also appreciate FASAB's support in minimizing these implementation challenges for agencies. As a large agency that operates both domestically and internationally, State will be significantly affected by SFFAS 54, and we appreciate this opportunity to provide comments and draw attention to any concerns.

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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.

Our comments on the proposed TR are as follows:

Questions 5/9: We found the scenarios and responses to be unclear with regard to the “right to control” the use of the underlying asset. This lack of clarity creates opportunities for inconsistencies in how agencies interpret and apply the “right to control” criterion. Specifically, the Statement and TR state that, to determine if the contract conveys the “right to control” the use of the underlying asset, the entity must assess a) the right to obtain economic benefits, and b) the right to control access to the economic benefit. Without more detailed definitions, an agency may establish its own interpretation of the criterion and determine that it must have the right to receive a certain percentage or substantially all of the asset’s economic benefit, or to have uninterrupted or exclusive access to the economic benefit for a period of time. We therefore suggest that FASAB re-examine the responses to questions 5 and 9 and provide specific language to clarify the “right to control” criterion. This language could be similar to the language used in Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 842, which defines this criterion as “a) the right to obtain substantially all economic benefits or services from use of the underlying asset, and b) the right to direct the use of the economic benefits or services of the underlying asset.”

Question 20: We found the scenario to be a common occurrence; however, we believe that FASAB’s response may cause challenges and place an unintended burden on entities. Specifically, State tracks lease term start and end dates, rather than the signature dates written in the contracts or agreements. We do not currently have contract signature dates as a data point within our leasing systems, and adding these dates for use in calculating the right-to-use asset and lease liability would likely require us to implement specialized modifications to our leasing systems. In addition, when contracts or agreements expire while we are still negotiating terms for the renewal, we generally issue an official contract to renew within one year of the expiration; however, the lessee’s continued occupancy or use of the underlying asset during the negotiation period essentially executes an automatic lease renewal.

We concur with FASAB’s response to the scenario, including removing right-to-use lease assets and the related accumulated depreciation from the books and treating the lease as a short-term lease while negotiations occur. However, if occupancy or use of the underlying asset continues between the end date for the original lease term and the approval for the renewal period, we suggest that agencies be allowed to measure the lease period using the terms as stated in the renewal contract or agreement.

Question 25: The answer provides additional examples of factors to consider for renewal options; however, it does not include the word “additional” before the word “factors” at the beginning of the fourth sentence. We recommend that FASAB revise

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the answer to clearly indicate that these factors are in addition to the relevant factors identified in paragraph 20 of SFFAS 54.

Question 92: We found the scenario to be a common occurrence; however, we believe that FASAB's response, which states that agencies should account for this scenario as an original lease (and sublease), may cause reporting challenges. In particular, we are unclear how Agency ABC would account for these lease scenarios when a) Agency ABC does not receive the revenue from the occupancy agency (i.e., the lessee) because the occupancy agency makes its payments directly to the lessor, and b) Agency ABC is not making the lease payments because another agency is occupying the leased asset. For example, how would Agency ABC drawdown the lease liability if it is not making lease payments? We recommend that FASAB provide posting models to aid agencies in understanding its response for this scenario.

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.

State would like to draw attention to implementation issues related to our unique responsibilities in the area of foreign operations and leasing. In particular, State enters into leases on behalf of the United States Government (USG), rather than on behalf of a particular agency. As a result, a property that State has leased may actually be occupied by another agency. For example, over a 10-year period, an asset may be transferred from State to the Department of Defense to the U.S. Agency for International Development and vice versa. With each transfer, the balance sheets may reflect vastly different balances for the same asset. Based on the Statement and the proposed TR, it is unclear how State should account for this type of situation and whether each occupying agency would be required to re-measure the asset based on the lease term remaining upon receipt of the asset. It is also not clear which agency would be responsible for the initial capital investment, given the potential frequent transfer of lessee responsibilities.

State is committed to more than 15,900 real property leases, including leases for office and functional properties and leases for residential units for diplomatic missions overseas. In addition, State is committed to more than 800 non-governmental personal property leases, including leases for office and communication equipment, as well as an unknown number of contracts and agreements that contain a lease component. This extensive portfolio of leases includes an abundance of complex situations that must be considered as part of our implementation of SFFAS 54. For example, the Foreign Service Building Act of 1926, as amended (the "Act"), authorizes the Secretary of State to acquire by purchase, construction, exchange, or **lease**, sites and buildings in foreign cities for use by the diplomatic and consular establishments of the United States (emphasis ours). The Act also authorizes the Secretary of State to provide residential and office space and necessary related facilities to other agencies abroad whose employees are under the authority of the chief of mission (COM). State's Overseas Building Operations (OBO) bureau acts as the single real property

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manager (SRPM) for all nonmilitary USG real property abroad, unless statutory exceptions apply.

Approximately 89 percent of the leases in State's lease portfolio relate to staff residential property. State manages these leases through consolidated housing pools, in which participating agencies have the right to be assigned to a residence within the housing pool. State expects to retain these leases for a period of at least 6 to 9 years, which may include at least three consecutive tours of duty at each post, regardless of the occupant. The USG also often makes significant capital improvements to increase the safety and security of its leased residences, per agreement with the landlord. Both the USG and the landlord may contribute to the costs for these improvements, and there are complicated rules regarding the funding responsibility for the improvements.

The costs associated with leases are the direct responsibility of the assigned/occupying agency. If a residence remains unassigned and vacant for more than 90 days, the costs are shared amongst all participating agencies. In addition, although the majority of the leases relate to a single residential unit that is occupied by a single agency, State is also committed to leases for single residential units that are occupied by multiple agencies, as well as leases for multiple residential units that are occupied by multiple agencies. Lease costs for residential units occupied by multiple agencies are split amongst the agencies and charged directly to each agency.

Lease terms for residential properties vary by market and region but often range from 2 to 9 years. State's model lease includes renewal language that gives the tenant the sole discretion to exercise renewal rights, and many residential leases contain renewal provisions for one to three additional periods under the lease term. State's model lease also includes a provision stating that the lease may be terminated at the tenant's sole discretion with 30-, 60-, or 90-days' notice. Notice periods exceeding 90 days are not typical and require additional levels of approval. A landlord's ability to terminate a lease during the base term of the renewal option periods is also highly restricted, and any changes to State's model lease language regarding landlord termination rights require additional levels of approval.

For the majority of residential properties, the ability to terminate a lease is delegated to the personnel in-country (i.e., posts) and does not require additional levels of approval. This allows posts to terminate residences that may be too large or too small for the current officers at post, or to terminate residences that have an unresponsive landlord, maintenance issues, or safety/security concerns. However, for high-value residences such as an Ambassador's residence or a sole-occupied housing compound, the post must request approval to terminate from headquarters in Washington, D.C. This right of termination is used frequently and effectively in all regions.

All non-residential leases require the post to seek authorization from headquarters before entering into the lease. The vast majority of non-residential leases are for residential parking spaces for cases in which a parking space is not included as part of the residence but the officer has brought a car. These parking spaces are funded from

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the same source that funds the related residential lease. Other types of non-residential leases include leases for antennae sites, boat docks, airplane hangars, scientific labs, warehouses, and office space. When a single agency or program uses a non-residential lease, the rent is charged directly to that agency. However, these spaces are often shared among several agencies, in which case the lease costs are paid through the International Cooperative Administrative Support Services (ICASS) platform. The ICASS platform bills agencies on an annual basis, with the agencies' payments going to replenish the fund.

Given the variety of locations in which State holds leases, there are occasions in which local law or even local practice prevent State from using its model lease. This most regularly occurs in Europe, where tenant rights are heavily protected. State has approved lease deviations that are specific to these countries. The most common instance of this in our experience has been the use of indefinite lease terms, which provide tenants with greater protections.

In addition, FASAB standards and Office of Management and Budget (OMB) Circular A-11 currently have the same lease reporting criterion (e.g., capital and operating). Specifically, if State scores a lease as an operating lease under the current scoring criteria, we charge the expenses directly to the occupying agency if there is only one, or share the costs in ICASS if there are occupants from multiple agencies. We treat capital leases as government-owned assets and fully fund them from our leasehold account. However, because OMB is not currently anticipating making changes to its Circular A-11 scoring criteria to match the revised FASAB requirements, agencies will be required to follow two separate sets of requirements once FASAB implements SFFAS 54, instead of just one. We are concerned with the increased cost and workload involved in maintaining two separate data sets (i.e., books) of more than 16,000 leases. State estimates that the cost of the system improvements needed to capture the data required to comply with SFFAS 54 will be substantial.

Lastly, we suggest that FASAB include illustrative guidance with posting models (e.g., general ledger accounts with debits and credits) in its scenario examples to aid in agencies' understanding and implementation of the requirements.

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

State has no additional comments.

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.

Yes, the proposed guidance under paragraph 4 of the proposed TR is applicable to federal lease scenarios. We are aware of instances in which federal entities enter into

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a lease contract or agreement for which the actual cost of the rent is less than the market value.

- 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.

The proposed guidance under paragraph 13 of the proposed TR is not necessary. The scenario clearly meets the definition of a lease; however, the response does not provide any clarification with regard to right-to-control and variable payments that FASAB has not addressed elsewhere in the proposed TR.

- 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.

Yes, the proposed guidance under paragraph 95 of the proposed TR is applicable to intragovernmental transactions; however, in our experience, this scenario is rare.

- 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.

State is not aware of any intragovernmental lease-leaseback transactions. However, the proposed guidance under paragraph 98 of the proposed TR is relevant to non-intragovernmental lease-leasebacks. For example, State's lease portfolio includes land-only leases. We treat these leases as standalone leases until State builds on the land and the building becomes available for use, at which point we account for the lease as a lease-leaseback transaction.