

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

Due: November 4, 2022

Intragovernmental Leasehold Reimbursable Work Agreements

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 agree or disagree with the proposed Technical Bulletin as a whole?
Please provide reasons for your views.

QFR 1 Response:

The Department of State (DOS) appreciates the opportunity to review and provide comments on FASAB's exposure draft of a proposed Technical Bulletin related to Intragovernmental Leasehold Reimbursable Work Agreements. We also appreciate the FASAB in allowing DOS to put forth our position related to these agreements and including us in development of the draft.

DOS agrees that additional guidance is needed to address existing gaps in current accounting guidance and the unique scenarios that arise from intragovernmental lease arrangements. Specifically, accounting for intragovernmental leasehold improvements and other reimbursable agreements that give rise to lease relationships between federal agencies. We also agree that this guidance should be consistent and in conjunction with Statement of Federal Financial Accounting Standards (SFFAS) SFFAS 54 - Leases.

DOS does not agree with the proposed approach in the Technical Bulletin. The Technical Bulletin requires agencies to report, by way of amortized assets and liabilities, a reciprocal relationship for certain type of lease arrangements. However, we

find this inconsistent with the approach for intragovernmental leasing arrangements under SFFAS 54.

Under SFFAS 54, intragovernmental leases are required to be disclosed in the notes to the financial statements but are not reported on the face of the financial statements. The result of this requirement allows the Government-Wide Statements to only report the actual carrying costs of agency owned buildings and leases as a whole. DOS believes that Intragovernmental Reimbursable Work Agreements should be treated in a consistent manner, whereby the lessor records the underlying asset and any other reciprocal relationship resulting from the overall agreement would be disclosed.

Overall DOS recommends the following:

1. Modify the guidance to clearly define which agency should report an asset under the two outlined scenarios (leasehold improvement vs intragovernmental leasehold reimbursables)
2. Remove the reciprocal accounting requirements for Intragovernmental Reimbursable Work Assets and Liabilities
3. Clearly specify that the assets obtained through intragovernmental leasehold reimbursables should be treated similarly to intragovernmental leases in accordance with SFFAS 54, and the relationship and attributable costs be disclosed only

Further, DOS has concerns over the implementation timeline of the proposed Technical Bulletin. While we understand that the guidance is associated with SFFAS 54, requiring additional changes to agency reporting less than a year before implementation is problematic.

To implement the proposed guidance successfully:

- new general ledger accounts will need to be established by Treasury and then integrated in agency financial systems,
- agencies will need to incorporate the required treatment into their business processes and financial policy, and
- agencies will also need to collaborate with each other in the creation of agreed upon policies and accounting treatment/judgements to ensure intragovernmental reporting differences do not arise.

Given the proposed Technical Bulletin is still in draft as of November 2022, DOS considers the October 2023 implementation date unreasonable and recommends that FASAB consider moving the implementation date to October 2024.

In addition to these recommendations, we have provided our comments on the draft Technical Bulletin to highlight areas that need clarification or further considerations by the board for DOS to implement the Technical Bulletin as written.

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

QFR 2 Response:

Concerns over Lease-Terms for Intragovernmental Leases:

DOS has identified potential implementation and recognition issues within the proposed Technical Bulletin for Leasehold Improvements and Intragovernmental Reimbursable Work Assets as it relates to the “lease term” which is defined by SFFAS 54. Specifically, we would like to highlight the following:

Leasehold Improvements: Paragraph 12 of the proposed Technical Bulletin states that for intragovernmental reimbursable arrangements, where the lessee is considered the predominate beneficiary, agencies should account for the transaction as a leasehold improvement in accordance with SFFAS 6 and SFFAS 54. Paragraph 34 of SFFAS 54, provides that *“leasehold improvements that are placed in service at or after the beginning of the lease term should be amortized over the useful life (the normal operating life in terms of utility to the lessee) of the leasehold improvement, but no longer than the expected lease term.”*

Lease-Terms are defined under SFFAS 54. In determining the lease term for both the lessee and lessor, specific provisions of paragraph 19 should be applied: paragraph 19a, states *“Periods for which both the lessee and lessor (1) have an option to terminate the lease without permission from the other party or (2) have to agree to extend are cancelable periods and are excluded from the lease term.”* For many intragovernmental lease arrangements, it is common for leases to have very short non-cancelable periods (typically under two years) and the options to terminate the lease without permission of the other party. Termination notice periods for example, can be as little as 4 months.

If left as written, agencies that enter into reimbursable work agreements that are required to be accounted for as leasehold improvements under the Technical Bulletin (and in accordance with SFFAS 54), will amortize the leasehold improvement asset for a much shorter period than the overall life of the improvement and likely the overall time period in which the agency will occupy the lease. This in turn, creates a large misallocation between the costs associated with the underlying asset and the period in which they would be attributed.

Intragovernmental Reimbursable Work Assets and Liabilities: Paragraphs 25 and 31 of the proposed Technical Bulletin provide those agreements that meet the definitions of Intragovernmental Reimbursable Work Assets and Liabilities, should be *“amortized in a systematic and rational manner over the shorter of (a) the remainder of the lease term or (b) the useful life of the underlying asset acquired/constructed, or improvements/alterations thereto associated with the reimbursable work.”*

Again, as noted above, intragovernmental lease terms as promulgated by SFFAS 54 could cause a misallocation between the costs associated with the underlying asset and the period in which they would be attributed.

DOS Recommendations to Mitigate concerns over Lease-Terms for

Intragovernmental Leases: DOS recommends that SFFAS 54, paragraph 19 be amended, or a new paragraph be added to “Intragovernmental Leases” within SFFAS 54 to better address intragovernmental lease-terms.

We recommend FASAB consider whether lease-terms for intragovernmental leases should include all stated/available periods for the underlying agreement, regardless of cancelation rights. If an agency determines that cancelation of the agreement is probable, the lease-term would be amended to reflect the expected end date.

QFR 3 Do any ambiguous areas remain that could lead to challenges with implementing the requirements? If so, please provide examples of the issues, references to applicable guidance, and any potential solutions you propose.

QFR 3 Response:

Determining which agency benefits more from an agreement: Paragraph 12 of the proposed Technical Bulletin states that for intragovernmental reimbursable assets/liabilities recognition to apply, that the lessee would not be considered the “primary beneficiary”. Further paragraph 13 states “*For acquisitions, construction, improvements, and/or alterations with an expected useful life beyond the remaining lease term and for which the provider-lessor is expected to derive a more-than-insignificant level of residual economic benefits and services from the reimbursable work, the customer-lessee would not be considered the predominant beneficiary.*”

The Technical Bulletin does not define what “more-than-insignificant level of residual economic benefits” means for the reader, or what types of considerations should be made when applying this judgment. For example, if an improvement is completed close to the end of a lease term, where the lessor could in effect benefit from the improvement for more than ½ of the estimated useful life, would that be more-than-insignificant level of residual economic benefits?

Further, the proposed guidance asserts that to meet the criteria for reporting Reimbursable Work Assets and Liabilities, that the useful life of the asset must extend beyond the remaining lease term. However, if the acquisition/construction of a new asset is funded by a lessee, will be owned by the lessor, and the occupancy exceeds the expected useful life, doesn't the lessor still have a more-than-insignificant level of residual economic benefits? DOS would assert that in all instances, regardless of useful life or lease terms, where the lessor has obtained a new asset through a reimbursable work authorization, and whereby the lessor has the right to sell the underlying asset and retain proceeds from sale, that the lessor has more-than-insignificant level of residual economic benefits.

DOS Recommendations over determining agency benefits: DOS understands that accounting judgments are determined by agency management, but given the reciprocal nature of these agreements, two agencies must establish accounting judgements/treatment and then agree. To assist agencies in defining and collaborating on these judgements, we recommend that FASAB consider providing additional guidance (i.e.: examples or bright-line tests) for how these judgments should be made.

Further, we recommend that FASAB consider whether the established criteria around lease terms and useful life is the best indication of whether an agency benefits from an improvement. An alternative would be for FASAB to outline, within the guidance, the specific types of improvements likely to fall under the Reimbursable Work Assets and Liabilities treatment or general leasehold improvement treatment.

Rent Reduction Considerations: It is not clear whether a rent reduction would be required to trigger recognizable assets and liabilities for reimbursable leasehold work agreements based on the Technical Bulletin.

Paragraph 19 of the Technical Bulletin provides clarity as to what types of rights and obligations are established under reimbursable leasehold work agreements that might give rise to recognizable assets and liabilities. In the following paragraph, paragraph 20, the following is stated “*Intragovernmental leasehold reimbursable work*

agreements give rise to a reduction in the lease rental amounts that would otherwise be incurred by the provider-lessor and subsequently charged to the customer-lessee. These agreements provide for reimbursable work that is beyond (or “above-standard” for) what is included in the tenant improvement allowances of the lease agreement for the related underlying asset.”

The guidance does not explicitly state that in-order for paragraphs 24-26 (asset recognition) and 30-32 (liability recognition) to apply, that rent reductions are required.

DOS Recommendations Rent Reduction Considerations: DOS recommends that FASAB update the draft Technical Bulletin to directly state that for paragraphs 24-26 and 30-32 to apply, that the transaction must result in the reduction of the lease rental amount in addition to stating that it is *“reimbursable work that is beyond (or “above-standard” for) what is included in the tenant improvement allowances of the lease agreement for the related underlying asset.”*

QFR 4 Are there specific aspects of this proposal that you otherwise wish to provide comments on?

QFR 4 Response:

Considerations of Ownership by the Lessor: In reviewing the proposed Technical Bulletin, DOS noted that there is no mention as to whether agencies should consider lessor ownership of the underlying asset in determining whether a transaction should be accounted for as a leasehold improvement or accounted for as a Reimbursable Work Asset/Liability. DOS asserts that the ownership of the underlying asset is an important consideration when determining which agency benefits from an improvement. For example, in cases where the lessor agency does not own the underlying asset, any improvements or alterations made to the property by the lessee through reimbursement work arrangements, is likely to only benefit the lessee agency. In this case, the lessor agency has no rights to the residual value of the improvement as the underlying asset is owned by a public entity.

Alternatively, lessor ownership of the underlying asset, and therefore the rights to residual value of improvements should be used by agencies to help support accounting judgments around whether *“a more-than-insignificant level of residual economic benefits”* exists within an arrangement.

DOS Recommendations on Ownership: DOS recommends that FASAB consider adding ownership considerations to the proposed Technical Bulletin to provide agencies clarity on how the *“predominant beneficiary”* of an arrangement should be determined.

Considerations of Property Lease Types: In reviewing the proposed Technical Bulletin, DOS noted that there is no mention as to whether the guidance is explicitly confined to real property leases. While it may be uncommon for other property lease types (personal property for example) to have improvements, reimbursable work arrangements for improvements or betterments to personal property could exist.

DOS Recommendations on Property Type: DOS recommends that FASAB explicitly state whether the proposed Technical Bulletin pertains to real property only or all property issued under intragovernmental leases. This could be added within the definitions or a footnote within the guidance.

- SMC 1** Paragraph 15 of the proposed Technical Bulletin provides that entities should establish, document, and consistently follow policies for recognizing leasehold improvement assets between reporting entities and reach agreement on such recognition. Please provide feedback on the extent to which you believe this would (or would not) facilitate consistent implementation of the intragovernmental accounting requirements. Also, please provide feedback on the inclusion of paragraph 15 as a proposed requirement in a Technical Bulletin and any potential implementation challenges. Please describe any alternative views or approaches, suggestions for improvement, and the reasons for your views.

SMC 1 Response:

DOS agrees that agencies should establish, document, and consistently follow policies for recognizing leasehold improvement assets between reporting entities and reach agreement on such recognition. However, because these policies, must consider not only an agency's accounting policy, but also affected programs within the agency, the likelihood of having full consistency across federal agencies is not likely.

Further, well established policies and controls should be repeatable, easily understood and applied consistently across an organization. Therefore, creating policies that consider a specific relationship, such as those related other another agency's leasehold improvement reporting policies, would require policy "tailoring" to fit multiple organizations.

We also believe inconsistent treatment is likely due to materiality thresholds and other accounting judgments across agencies.

DOS understands that FASAB does not set management level policy for federal agencies and agrees with this practice. However, we would recommend that FASAB consider providing examples of arrangements in the guidance or "bright line tests" to provide more detailed guidelines for agencies use when establishing consistent policies across the government.

- SMC 2** Paragraphs 28 and 34 provide proposed disclosure requirements. Please provide feedback on the extent to which these proposed disclosure requirements are appropriate. For example, is such information necessary to make the financial statements informative and relevant to users in assessing accountability? Please describe your views, the costs and benefits of including these proposed disclosures, and other reasons for your views. Also, please provide feedback on the inclusion of these paragraphs as proposed requirements in a Technical Bulletin and any potential implementation challenges.

SMC 2 Response:

Notwithstanding the ambiguity of the Technical Bulletin as previously discussed, DOS believes that the content of the disclosures for both Lessee and Lessor are appropriate.

DOS recommends that Technical Bulletin paragraphs 28 and 34, be updated to specifically require the disclosures for Intragovernmental Reimbursable Work Assets and Liabilities, be included as part of agency's Intragovernmental Lease disclosures as outlined in paragraphs 37 and 38 of SFFAS 54. This will provide consistency across agency-level reporting.