Statement of Federal Financial Accounting Standards 54: Leases

Status

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Related Guidance	• Technical Release 20 • Technical Release 21 • Technical Release 22

Summary

This Statement revises the financial reporting standards for federal lease accounting. It provides a comprehensive set of lease accounting standards to recognize federal lease activities in the reporting entity's general purpose federal financial reports and includes appropriate disclosures.

This Statement requires that federal lessees recognize a lease liability and a lease asset at the commencement of the lease term, unless it meets the scope exclusions or the definition/criteria of a non-intragovernmental short-term lease, contract or agreement that transfers ownership, or intragovernmental lease. A federal lessor would recognize a lease receivable and unearned revenue, unless it meets any of the scope exclusions or the definition/criteria of a non-intragovernmental short-term lease, contract or agreement that transfers ownership, or intragovernmental lease.

The provisions of this Statement need not be applied to immaterial items. The determination of whether an item is material depends on the degree to which omitting or misstating information about the item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement.

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Standards

Scope

1. This Statement applies to federal entities that present general purpose federal financial reports, including the consolidated financial report of the U.S. Government (CFR), in conformance with generally accepted accounting principles, 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. For purposes of applying this Statement, a **lease**[1] is defined as a contract or agreement whereby one entity (lessor) conveys the right to control the use of property, plant, and equipment (PP&E)[2] (the underlying asset) to another entity (lessee) for a period of time as specified in the contract or agreement in exchange for consideration. 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.

3. To determine whether a contract or agreement conveys the right to control the use of the underlying asset, a federal entity should assess whether the contract or agreement gives the lessee both of the following:

    a. The right to obtain economic benefits or services from use of the underlying asset as specified in the contract or agreement

    b. The right to control access to the economic benefits or services of the underlying asset as specified in the contract or agreement

4. The lease definition excludes contracts or agreements for services, except those contracts or agreements that contain both a lease component and a service component (par. 73). A service contract is a contract that directly engages the time and effort of a contractor whose primary purpose is to perform an identifiable task rather than to provide a tangible asset.

[1] Terms defined in the Glossary are shown in **bold-face** the first time they appear.

[2] SFFAS 6, *Accounting for Property, Plant, and Equipment*.

5. This Statement does not apply to

   a. accounting for leases of assets prior to the commencement of the lease term, such as during construction periods or[2A]

   b. leases (licenses) of internal use software (SFFAS 10, *Accounting for Internal Use Software*, as amended).

Definitions

Definitions in paragraphs 6 through 13 are presented within the standards because they are new terms intended to have a specific meaning when applying the standards.

6. **Lease** – A lease is defined as a contract or agreement whereby one entity (lessor) conveys the right to control the use of PP&E (the underlying asset) to another entity (lessee) for a period of time as specified in the contract or agreement in exchange for consideration.

7. **Short-Term Lease** – A short-term lease is a non-intragovernmental lease with a lease term (as defined in par. 14-21) of 24 months or less.

8. **Intragovernmental Lease** – An intragovernmental lease is a contract or agreement occurring within a consolidation entity or between two or more consolidation entities as defined in SFFAS 47, *Reporting Entity*[3] whereby one entity (lessor) conveys the right to control the use of PP&E (the underlying asset) to another entity (lessee) for a period of time as specified in the contract or agreement in exchange for consideration.

9. **Lease Incentives** – Lease incentives include lessor payments made to or on behalf of the lessee to entice the lessee to sign a lease. Lease incentives may include up-front cash payments to the lessee; for example, moving costs, termination fees to the lessee's prior

[2A] For leases other than short-term leases and intragovernmental leases, the lessee would account for payments prior to commencement of the lease term as advances paid in contemplation of the future receipt of the lease asset. The lessor would account for receipts prior to commencement of the lease term as advances received. These advances would be accounted for in a manner consistent with SFFAS 1, *Accounting for Selected Assets and Liabilities,* par. 57-61, prior to the lease commencement date. Such advances would be considered assets of the lessee and liabilities of the lessor. At lease commencement, the lessee would then reclassify the asset and include it in the measurement of the lease asset in accordance with SFFAS 54, par. 49, and the lessor would reclassify the advances received as unearned revenue in accordance with par. 64.b.

[3] SFFAS 47, *Reporting Entity*, par. 38-42.

lessor, or the lessor's assumption of the lessee's lease obligation under a different lease with another lessor.

10. **Lease Concessions** – Lease concessions are rent discounts made by the lessor to entice the lessee to sign a lease. For example, lease concessions may include rent holidays/free rent periods or reduced rents.

11. **Leasehold Improvements** – Leasehold improvements are additions, alterations, remodeling, renovations, or other changes to a leased property that either extend the useful life of the existing property or enlarge or improve its capacity and are paid for (financed) by the lessee.

12. **Lessor Improvements** – Lessor improvements are additions, alterations, remodeling, renovations, or other changes to a leased property that either extend the useful life of the existing property or enlarge or improve its capacity and are paid for (financed) by the lessor rather than by the lessee.

13. **Initial Direct Lease Costs** – Initial direct lease costs are costs that are directly attributable to negotiating and arranging a lease or portfolio of leases that would not have been incurred without entering into the lease.

Lease Term

14. The lease term is the noncancelable period plus certain periods subject to options to extend or terminate the lease. The noncancelable period is the shorter of

    a. the period identified in the lease contract or agreement that precedes any option to extend the lease or

    b. the period identified in the lease contract or agreement that precedes the first option to terminate the lease.

15. The lessee's lease term includes the noncancelable period and the following periods, if applicable:

    a Those periods specified in the lease contract or agreement that relate to a lessee's option to extend the lease if it is probable, based on all relevant factors, that the lessee will exercise that option

    b. Those periods specified in the lease contract or agreement that follow a lessee's option to terminate the lease (up until the point in time when there is another option or, if none,

the end of the lease) if it is probable, based on all relevant factors, that the lessee will not exercise that option

c. Those periods specified in the lease contract or agreement that relate to a lessor's option to extend the lease if there is significant evidence, based on all relevant factors, that the lessor will exercise that option

d. Those periods specified in the lease contract or agreement that follow a lessor's option to terminate the lease (up until the point in time when there is another option or, if none, the end of the lease) if there is significant evidence, based on all relevant factors, that the lessor will not exercise that option

16. The options should be considered in chronological order. If a determination is made that an additional period will not be added to the lease term for an option based on the likelihood criteria above, subsequent options would not be considered. For example, if the lessee determined that it was not probable that a lessee option to extend would be exercised; any subsequent option periods would not be evaluated.

17. The lessor's lease term includes the noncancelable period and the following periods, if applicable:

a. Those periods specified in the lease contract or agreement that relate to a lessor's option to extend the lease if it is probable, based on all relevant factors, that the lessor will exercise that option

b. Those periods specified in the lease contract or agreement that follow a lessor's option to terminate the lease (up until the point in time when there is another option or, if none, the end of the lease) if it is probable, based on all relevant factors, that the lessor will *not* exercise that option

c. Those periods specified in the lease contract or agreement that relate to a lessee's option to extend the lease if there is significant evidence, based on all relevant factors, that the lessee will exercise that option

d. Those periods specified in the lease contract or agreement that follows a lessee's option to terminate the lease (up until the point in time when there is another option or, if none, the end of the lease) if there is significant evidence, based on all relevant factors, that the lessee will not exercise that option

18. The options should be considered in chronological order. If a determination is made that an additional period will not be added to the lease term for an option based on the likelihood criteria above, subsequent options would not be considered. For example, if the lessor

determined that it was not probable that a lessor option to extend would be exercised; any subsequent option periods would not be evaluated.

19. In determining the lease term for both the lessee and lessor, the following specific provisions should be applied:

    a. 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 example, month-to-month lease holdovers, also referred to as rolling lease extensions, or any lease that continues into a holdover period until a new contract or agreement is signed would be considered cancelable if both the lessee and the lessor have an option to terminate. Therefore, either could cancel the lease at any time. These holdover periods are cancelable periods and should be excluded from the lease term.[4]

    b. An option to terminate is an unconditional right that exists within the contract. A provision that gives a lessee or lessor the right to terminate the lease conditional upon certain circumstances or upon the occurrence of certain events, such as the action or inaction of the other party to the lease contract, should not be considered an option to terminate the lease for purposes of determining the lease term. For example, provisions that allow for termination of a lease due to a violation of terms and conditions, such as a default on payments, are not considered options to terminate the lease.

    c. An availability of funds or cancellation clause allows federal lessees to cancel a lease agreement, typically on an annual basis, if funds for the lease payments are not appropriated. This type of clause should affect the lease term only when it is probable that the clause will be exercised.

    d. If a lessee has the option to purchase the underlying asset during the lease term and the contract is not a contract that transfers ownership (required to be reported in accordance with par. 25), the lease term should exclude the period, if any, after the date at which the option is probable of being exercised.

20. At the commencement of a lease term, lessors and lessees should assess all factors relevant to the likelihood that the lessee or lessor will exercise options identified in paragraphs 15-19, whether these factors are contract or agreement based, underlying asset based, market based, or federal specific. The assessment often will require the

[4] SFFAS 1, *Accounting for Selected Assets and Liabilities*, applies to any related accounts payable or accounts receivable amounts.

consideration of a combination of these interrelated factors. Examples of factors to consider include, but are not limited to, the following:

a. A significant economic incentive, such as contractual or agreement terms and conditions for the optional periods that are favorable compared with current market rates

b. A significant economic disincentive, such as costs to terminate the lease and sign a new lease (for example, negotiation costs, relocation costs, abandonment of significant leasehold improvements, costs of identifying another suitable underlying asset, costs associated with returning the underlying asset in a contractually specified condition or to a contractually specified location, or a substantial cancellation penalty)

c. The history of exercising options to extend or terminate

d. The extent to which the asset underlying the lease is mission critical to the federal entity

21. Lessors and lessees should reassess the lease term only if one or more of the following events occur:

a. The lessor or lessee elects to exercise an option that was previously presumed would not be exercised under the likelihood criteria in paragraphs 15 and 17

b. The lessor or lessee does not elect to exercise an option that was previously presumed would be exercised under the likelihood criteria in paragraphs 15 and 17

c. An event specified in the lease contract or agreement that requires an extension or termination of the lease takes place.

d. A lease modification that amends the noncancelable period and results in remeasurement in accordance with paragraphs 85-86.

Short-Term Leases

22. A short-term lease is a non-intragovernmental lease with a lease term (as defined in paragraphs 14-21) of 24 months or less.

Lessee Treatment of Short-Term Leases

23. A lessee should recognize short-term lease payments as an expense based on the payment provisions of the contract or agreement and standards regarding recognition of accounts payable and other related amounts. The lessee should recognize an asset if payments are made in advance of the reporting period to which they relate or a liability for rent due and unpaid at the end of the reporting period to which they relate. Rental increases, rental decreases, lease incentives, and lease concessions should be recognized when incurred as increases/reductions to lease rental expense.

Lessor Treatment of Short-Term Leases

24. A lessor should recognize short-term lease payments as revenue based on the payment provisions of the contract or agreement and standards regarding recognition of accounts receivable and other related amounts. The lessor should recognize a liability if payments are received in advance of the reporting period to which they relate or an asset for rent due and to be received subsequent to the reporting period to which they relate. Rental increases, rental decreases, lease incentives, and lease concessions should be recognized when incurred as increases/reductions to lease rental income.

Contracts or Agreements that Transfer Ownership

25. A contract or agreement that (a) transfers ownership of the underlying asset to the lessee by the end of the contract or agreement and (b) does not contain options to terminate (par. 14-19), but that may contain an availability of funds or cancellation clause that is not probable of being exercised (par. 19.c), should be reported as a purchase of that asset by the lessee or a financed sale of the asset by the lessor.5 For this purpose, options to purchase the underlying asset prior to the transfer of ownership are not considered options to terminate.[5]

Intragovernmental Leases

26. An intragovernmental lease is a contract or agreement occurring within a consolidation entity or between two or more consolidation entities as defined in SFFAS 47 whereby one entity (lessor) conveys the right to control the use of PP&E (the underlying asset) to another entity (lessee) for a period of time as specified in the contract or agreement in exchange for

[5]See SFFAS 6, par. 26A.

consideration. Any lease that meets the definition of an intragovernmental lease would be required to follow the accounting and disclosure guidance described in paragraphs 27-38.

27. A lessee should recognize lease payments, including lease-related operating costs (for example, maintenance, utilities, taxes, etc.) paid to the lessor, as expenses based on the payment provisions of the contract or agreement and standards regarding recognition of accounts payable and other related amounts. Prepaid rent or a payable for rent due should be recognized as an asset or liability, respectively, and an expense should be recognized in the appropriate reporting period based on the specifics of the lease provisions.

28. A lessor should recognize lease receipts, including lease-related operating costs (for example, maintenance, utilities, or taxes) received from the lessee as income based on the provisions of the contract or agreement and standards regarding recognition of accounts receivable and other related amounts. Rent paid in advance or a receivable should be recognized as a liability or asset, respectively, and income should be recognized in the appropriate reporting period based on the specifics of the lease provisions.

29. Rental increases/decreases may be fixed in the lease and take place with the passage of time (for example, be based on such factors as anticipated increases/decreases in costs or anticipated appreciation/depreciation in property values, but the amount of the increase/decrease is specified in the lease) or they may be contingent on future events.

30. Rental increases/decreases may also be variable and based on future changes in specific economic factors on which lease payments are based, for example, future sales or usage activity levels or future inflation/deflation (tied to a specific economic indicator where the specific amount of the change is not known).

31. Rental increases, rental decreases, lease incentives, and lease concessions should be recognized by the lessee and lessor when incurred as increases/reductions to lease rental expense and income, respectively.

32. Paragraph 32 was rescinded by SFFAS 60.

33. Paragraph 33 was rescinded by SFFAS 60.

34. 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.

35. Lessor improvements are components of the leased property and should be capitalized and depreciated by the lessor over their useful life consistent with the lessor's accounting for PP&E.[6]

36. Initial direct lease costs incurred by the lessee should be expensed when incurred. Initial direct lease cost incurred by the lessor should be expensed when incurred.

Disclosures for Intragovernmental Leases

37. Lessees should disclose the following regarding intragovernmental lease activities (which may be grouped for purposes of disclosure):

    a. A general description of significant intragovernmental leasing arrangements, including general lease terms with any applicable specific intragovernmental requirements

    b. Annual lease expense in total and by major underlying asset category

38. Lessors should disclose the following regarding intragovernmental lease activities (which may be grouped for purposes of disclosure):

    a. A general description of significant leases

    b. Future lease payments that are to be received to the end of the lease term for each of the five subsequent fiscal years and in five-year increments thereafter

Lessee Recognition, Measurement, and Disclosures for Leases Other than Short-Term Leases, Contracts or Agreements that Transfer Ownership, and Intragovernmental Leases

39. At the commencement of the lease term, a lessee should recognize a lease liability and a right-to-use lease asset (hereinafter referred to as the lease asset), except as provided in paragraphs 22-24 (short-term leases), paragraph 25 (contracts or agreements that transfer ownership), and paragraphs 26-38 (intragovernmental leases).

Lease Liability

40. A lessee initially should measure the lease liability at the present value of payments expected to be made during the lease term. Measurement of the lease liability should include the following, if required by a lease:

    a. Fixed payments

[6]This recognition is consistent with PP&E capital improvements outlined in SFFAS 6, par. 37.

b. Variable payments that depend on an index or a rate (such as the Consumer Price Index or a market interest rate), initially measured using the index or rate as of the commencement of the lease term

c. Variable payments that are fixed in-substance as described in paragraph 41

d. Amounts that are probable of being required to be paid by the lessee under residual value guarantees

e. The exercise price of a purchase option if it is probable that the lessee will exercise that option

f. Payments for penalties for terminating the lease, if the lease term reflects the lessee exercising (1) an option to terminate the lease or (2) an availability of funds or cancellation clause

g. Any lease incentives (par. 70-71) receivable from the lessor

h. Any other payments to the lessor that are probable of being required based on an assessment of all relevant factors

41. Variable payments based on future performance of the lessee or usage of the underlying asset should not be included. Rather, these variable payments should be recognized as an expense in the reporting period in which those payments are incurred. However, any component of these variable payments that is fixed in-substance should be included in the lease liability. An example is a lease payment based on a percentage of sales or usage but with a required minimum amount to be paid. That required minimum payment is fixed in-substance.

42. The future lease payments should be discounted using the interest rate the lessor charges the lessee. If the interest rate is not stated in the lease, the interest rate should be based on the interest rate on marketable Treasury securities at the commencement of the lease term (or at the subsequent financial reporting date in accordance with par. 44), with a similar maturity to the term of the lease.[7]

42A. If the interest rate is based on marketable Treasury securities, it should be consistent with the interest rate on marketable Treasury securities at the commence of the lease term, in accordance with paragraphs 40 and 42 (or the interest rate on marketable Treasury securities on the subsequent financial reporting date, in accordance with par. 46 and 48).

[7]Footnote 7 was rescinded by SFFAS 61.

The interest rate may be based on a recent interest rate on marketable Treasury securities or historical average interest rate on marketable Treasury securities of a similar maturity to the term of the lease, provided that the interest rate is consistent with the interest rate on marketable Treasury securities at the commencement of the lease term (or subsequent financial reporting date).

42B. When selecting an interest rate based on marketable Treasury securities of similar maturity to the term of the lease, reporting entities may round up or down to the nearest maturity or interpolate the interest rate for the period between two maturities. The methodology for selecting an interest rate based on marketable Treasury security maturities should be consistent from period to period.

42C. Reporting entities should not extrapolate beyond the longest Treasury maturity when the lease term exceeds it; rather, reporting entities should select the longest Treasury maturity. For example, if the longest Treasury maturity at commencement of the lease term is 30 years, reporting entities should select the 30-year rate as the discount rate for a lease with a 75-year term.

43. In subsequent financial reporting periods, the lessee should calculate the amortization of the discount on the lease liability and recognize that amount as interest expense for the period. Any payments made should be allocated first to the accrued interest liability and then to the lease liability.

44. The lessee should remeasure the lease liability at subsequent financial reporting dates if one or more of the following changes[8] have occurred at or before that financial reporting date, based on the most recent lease contract or agreement before the changes, and if the changes individually or in the aggregate, are expected to significantly affect the amount of the lease liability since the previous measurement:

    a. There is a change in the lease term.

    b. An assessment of all relevant factors indicates that the likelihood of a residual value guarantee being required to be paid has changed from probable to not probable or vice versa.

    c. An assessment of all relevant factors indicates that the likelihood of a purchase option being exercised has changed from probable to not probable, or vice versa.

[8] Changes arising from amendments to a lease contract or agreement should be accounted for under the provisions of par. 80-86 for lease modifications and terminations.

d. There is a change in the estimated amounts for payments already included in the liability (except as provided in par. 45).

e. There is a change in the interest rate the lessor charges the lessee if used as the initial **discount rate**.

f. A contingency, upon which some or all of the variable payments that will be made over the remainder of the lease term are based, is resolved such that those payments now meet the criteria for measuring the lease liability in paragraph 40. For example, an event occurs that causes variable payments that were contingent on the performance or use of the underlying asset to become fixed payments for the remainder of the lease term.

45. If a lease liability is remeasured for any of the changes in paragraph 44, the liability also should be adjusted for any change in an index or rate used to determine variable lease payments if that change in the index or rate is expected to significantly affect the amount of the liability since the previous measurement. A lease liability is not required to be remeasured solely for a change in an index or rate used to determine variable payments.

46. The lessee also should update the discount rate as part of the remeasurement if one or both of the following changes have occurred and the changes individually or in the aggregate are expected to significantly affect the amount of the lease liability:

a. There is a change in the lease term.

b. An assessment of all relevant factors indicates that the likelihood of a purchase option being exercised has changed from probable to not probable, or vice versa.

47. A lease liability is not required to be remeasured, nor is the discount rate required to be reassessed, solely for a change in the interest rate on marketable Treasury securities.

48. If the discount rate is required to be updated based on the provisions in paragraph 46, the discount rate should be based on the revised interest rate the lessor charges the lessee at the time the discount rate is updated. If that interest rate cannot be readily determined, the interest rate on marketable Treasury securities with a similar maturity to the term of the lease at the time the discount rate is updated should be used (see par. 42-42C above).

Lease Asset

49. A lessee should initially measure the lease asset as the sum of the following:

a. The amount of the initial measurement of the lease liability (par. 40)

b. Lease payments made to the lessor at or before the commencement of the lease term, less any lease incentives (par. 70-71)

c. Initial direct lease costs that are necessary to place the lease asset into service

50. A lease asset should be amortized in a systematic and rational manner over the shorter of the lease term or the useful life of the underlying asset, except as provided in paragraph 51. The amortization of the lease asset should be reported as amortization expense.

51. If a lease contains a purchase option that the lessee has determined is probable of being exercised, the lease asset should be amortized over the useful life of the underlying asset. However, if the underlying asset will be capitalizable and nondepreciable in the reporting period the purchase option is expected to be exercised, the lease asset should not be amortized. If the underlying asset will be non-capitalizable in the reporting period the purchase option is expected to be exercised, the lease asset should be amortized over the remaining lease term.[8A]

52. The lease asset generally should be adjusted by the same amount when the lease liability is remeasured based on paragraphs 44-48. However, if this change reduces the carrying value of the lease asset to zero, any remaining amount should be reported in the statement of net cost as a gain. Changes arising from amendments to a lease contract or agreement should be accounted for under the provisions of paragraphs 80-86 for lease terminations and modifications.

53. Leased assets are subject to SFFAS 44, *Accounting for Impairment of General Property, Plant, and Equipment Remaining in Use.* The presence of impairment indicators (described in par. 8-15 of SFFAS 44) with respect to the underlying asset may result in a change in the manner or duration of use of the lessee's rights to obtain and control access to economic benefits and services derived from the underlying asset and the application of SFFAS 44. The change in the manner or duration of use of the underlying asset is an indicator that the lease asset may be impaired. If impaired, the lease asset should be reduced first for any change in the lease liability resulting from remeasurement under paragraphs 44-48 of SFFAS 54 or terminations or modifications under paragraphs 80-86 of SFFAS 54. Any remaining amount should be recognized as an impairment loss. Paragraphs 16-25 of SFFAS 44 provide criteria for testing for impairment, along with recognizing, reporting, and disclosing impairment losses. This guidance should be applied to lease assets to the extent

[8A] Once SFFAS 59, *Accounting and Reporting of Government Land*, becomes fully effective, underlying assets that are general PP&E land will become non-capitalizable. For reporting periods prior to this, general PP&E land is capitalizable and nondepreciable.

that impairment losses exceed any reduction to the lease liability and lease asset that may stem from the impairment.[9]

Component Reporting Entity Disclosure Requirements for Lessees

54. Lessees should disclose the following regarding lease activities (which may be grouped for purposes of disclosure), other than short-term leases, contracts or agreements that transfer ownership, and intragovernmental leases:

    a. A general description of its leasing arrangements, including the basis, terms, and conditions on which variable lease payments not included in the lease liability are determined

    b. The total amount of lease assets and the related accumulated amortization, to be disclosed separately from PP&E assets

    c. The amount of lease expense recognized for the reporting period for variable lease payments not previously included in the lease liability

    d. Principal and interest requirements to the end of the lease term, presented separately, for the lease liability for each of the five subsequent years and in five-year increments thereafter

    e. The amount of the annual lease expense and the discount rate used to calculate the lease liability

Lessor Recognition, Measurement, and Disclosures for Leases Other than Short-Term Leases, Contracts or Agreements that Transfer Ownership, and Intragovernmenal Leases

55. At the commencement of the lease term, a lessor should recognize a lease receivable and unearned revenue, except as provided in paragraph 22-24 (short-term leases), paragraph 25 (contracts or agreements that transfer ownership), and paragraphs 26-38 (intragovernmental leases). Any initial direct lease costs incurred by the lessor should be reported as an expense of the period.

[9] Footnote 9 was stricken by SFFAS 60 amendments to paragraph 53.

Lease receivable

56. A lessor initially should measure the lease receivable at the present value of lease payments to be received for the lease term, reduced by any provision for uncollectible amounts. Measurement of the lease receivable should include the following types of payments that might be required by a lease:

    a Fixed payments

    b. Variable payments that depend on an index or a rate (such as the Consumer Price Index or a market interest rate), initially measured using the index or rate as of the commencement of the lease term

    c. Variable lease payments that are fixed in-substance as described in paragraph 57

    d. Residual value guarantees that are fixed payments in substance (par. 57)

    e. Any lease incentives (par. 70-71) payable to the lessee

57. Variable payments based on future performance of the lessee or usage of the underlying asset should not be included in the measurement of the lease receivable. Rather, those payments should be recognized as revenue in the reporting period to which those payments relate. However, any component of those variable payments that is fixed in substance should be included in the lease receivable. For example, if a lease payment is based on a percentage of sales but has a required minimum payment, that required minimum is a fixed payment in substance. Similarly, a residual value guarantee is an in-substance fixed payment if it stipulates the underlying asset will be sold at the end of the lease term, with the lessee assuming a liability for any shortfall if the sales price is less than an agreed-upon minimum amount.

58. Amounts to be received under residual value guarantees (that are not fixed in substance) should be recognized as a receivable and revenue when (a) a guarantee payment is required (as agreed to by the lessee and lessor) and (b) the amount can be reasonably estimated. Amounts to be received for the exercise price of a purchase option or penalty for lease termination should be recognized as a receivable and revenue when those options are exercised.

59. The future lease payments to be received should be discounted using the interest rate the lessor charges the lessee. If the interest rate is not stated in the lease, the interest rate should be based on the interest rate on marketable Treasury securities at the commencement of the lease term (or at the subsequent financial reporting date, in accordance with par. 61), with a similar maturity to the term of the lease.[9A]

59A. If the interest rate is based on marketable Treasury securities, it should be consistent with the interest rate on marketable Treasury securities at the commencement of the lease term, in accordance with paragraphs 56 and 59 (or the interest rate on marketable Treasury securities on the subsequent financial reporting date, in accordance with par. 63). The interest rate may be based on a recent interest rate on marketable Treasury securities or historical average interest rate on marketable Treasury securities of a similar maturity to the term of the lease, provided that the interest rate is consistent with the interest rate on marketable Treasury securities at the commencement of the lease term (or subsequent financial reporting date).

59B. When selecting an interest rate based on marketable Treasury securities of similar maturity to the term of the lease, reporting entities may round up or down to the nearest maturity or interpolate the interest rate for the period between two maturities. The methodology for selecting an interest rate based on marketable Treasury security maturities should be consistent from period to period.

59C. Reporting entities should not extrapolate beyond the longest Treasury maturity when the lease term exceeds it; rather, reporting entities should select the longest Treasury maturity. For example, if the longest Treasury maturity at commencement of the lease term is 30 years, reporting entities should select the 30-year rate as the discount rate for a lease with a 75-year term.

60. In subsequent financial reporting periods, the lessor should calculate the amortization of the discount on the receivable and report that amount as interest revenue for the period. Any payments received should be allocated first to the accrued interest receivable and then to the lease receivable.

61. 61.The lessor should remeasure the lease receivable at subsequent financial reporting dates if one or more of the following changes have occurred at or before that financial reporting date, based on the most recent lease contract or agreement before the changes,[10]

[9A]Footnote 9A was rescinded by SFFAS 61.

[10]Changes arising from amendments to a lease contract or agreement should be accounted for under the provisions of par. 80-86 for lease modifications and terminations

and the changes individually or in the aggregate, are expected to significantly affect the amount of the lease receivable since previous measurement:

a. There is a change in the lease term.

b. There is a change in the interest rate the lessor charges the lessee.

c. A contingency, upon which some or all of the variable payments that will be received over the remainder of the lease term are based, is resolved such that those payments now meet the criteria for measuring the lease receivable in paragraph 56. For example, an event occurs that results in variable payments that were contingent on the performance or use of the underlying asset becoming fixed payments for the remainder of the lease term.

62. If a lease receivable is remeasured for any of the changes in paragraph 61, the receivable also should be adjusted for any change in an index or rate used to determine variable lease payments if that change in the index or rate is expected to significantly affect the amount of the receivable since the previous measurement. A lease receivable is not required to be remeasured solely for a change in an index or rate used to determine variable lease payments.

63. The lessor also should update the discount rate as part of the remeasurement if one or both of the following changes have occurred and the changes individually or in the aggregate are expected to significantly affect the amount of the lease receivable:

a. There is a change in the lease term.

b. There is a change in the interest rate the lessor charges the lessee.

Unearned Revenue

64. A lessor initially should measure the unearned revenue to include the following:

a. The amount of the initial measurement of the lease receivable (par. 56)

b. Lease payments received from the lessee at or before the commencement of the lease term that relate to future periods (for example, the final month's rent), less any lease incentives (par. 70-71) paid to, or on behalf of, the lessee at or before the commencement of the lease term

65. A lessor subsequently should amortize the unearned revenue, recognizing it as earned revenue, in a systematic and rational manner over the term of the lease. The unearned

revenue generally should be adjusted using the same amount as the change resulting from the remeasurement of the lease receivable as discussed in paragraphs 61-63. However, if the change reduces the carrying value of the unearned revenue to zero, any remaining amount should be reported in the statement of net cost as a loss.

Underlying Asset

66. A lessor should not derecognize the asset underlying the lease. A lessor should continue to apply other applicable guidance to the underlying asset, including depreciation and impairment. However, if the lease contract or agreement requires the lessee to return the asset in its original or enhanced condition, a lessor should not depreciate the asset during the lease term.

Component Reporting Entity Disclosures for Lessors

67. Lessors should disclose the following regarding lease activities (which may be grouped for purposes of disclosure), other than short-term leases, contracts or agreements that transfer ownership, and intragovernmental leases:

    a. A general description of its leasing arrangements, including the basis, terms, and conditions on which any variable lease payments not included in the lease receivable are determined

    b. The carrying amount of assets on lease by major classes of assets, and the amount of related accumulated depreciation

    c. The total amount of revenue (for example, lease revenue, interest revenue, and any other lease-related revenue) recognized in the reporting period from leases

    d. The amount of revenue recognized in the reporting period for variable lease payments and other payments not previously included in the lease receivable, including revenue related to residual value guarantees and termination penalties

68. In addition to the disclosures in paragraph 67, if a federal entity's principal ongoing operations consist of leasing assets through the use of non-intragovernmental leases, the federal entity should disclose a schedule of future lease payments that are included in the lease receivable, showing principal and interest, for each of the five subsequent years and in five-year increments thereafter.

Financial Report of the U.S. Government Disclosures

69. If applicable, the financial report of the U.S. Government should disclose the following regarding its lease activities:

    a. A general description of its leasing arrangements

    b. The total amount of lease assets, and the related accumulated amortization, to be disclosed separately from PP&E assets

    c. Principal and interest requirements to the end of the lease term, presented separately, for the lease liability for each of the five subsequent years and in five-year increments thereafter

    d. A general reference to relevant component reporting entity reports

Lease Incentives and Lease Concessions

70. Lease incentives include lessor payments made to or on behalf of the lessee to entice the lessee to sign a lease. Lease incentives may include up-front cash payments to the lessee, for example, moving costs, termination fees to lessee's prior lessor, or lessor's assumption of the lessee's lease obligation under a different lease with another lessor. Lease concessions are rent discounts made by the lessor to entice the lessee to sign a lease. For example, lease concessions may include rent holidays/free rent periods or reduced rents.

71. Lease incentives and lease concessions reduce the amount that a lessee is required to pay for a lease. For leases other than short-term leases and intragovernmental leases, lease incentives and lease concessions that provide payments to, or on behalf of, a lessee at or before the commencement of a lease term are included in initial measurement by directly reducing the amount of the lease asset (par. 49). Lease incentive and lease concession payments to be provided after the commencement of the lease term should be accounted for by lessees and lessors as reductions of lease payments for the periods in which the incentive or concession payments will be provided. Those payments should be measured by lessees consistently with the lessee's lease liability (par. 40-48) and by lessors consistently with the lessor's lease receivable (par. 56-63). Accordingly, lease incentive and lease concession payments to be provided after the commencement of the lease term are included in initial measurement and any remeasurement if they are fixed or fixed in substance, whereas variable or contingent lease incentive or lease concession payments are not included in initial measurement. Lessor improvements that are made to or on behalf of the lessee without additional cost to the lessee should be accounted for by the lessee and

the lessor consistent with other lease incentives and lease concessions. As leasehold improvements are paid for (financed) by the lessee, leasehold improvements would not be considered a lease incentive or concession received from the lessor.[10A]

Contracts or Agreements with Multiple Components

72. Lessors and lessees may enter into contracts or agreements that contain multiple components, such as a contract or agreement that contains both a lease component and a nonlease component, or a lease that contains multiple underlying assets.

73. If a lessor or lessee enters into a contract or agreement that contains both a lease (such as the right to use a building) and a nonlease component (such as a maintenance services for the building), the federal entity should account for the lease and nonlease components as separate contracts or agreements, unless the contract or agreement meets the exception in paragraph 76.

74. If a lease involves multiple underlying assets and the assets have different lease terms, the lessor and lessee should account for each underlying asset as a separate lease component. The provisions of this paragraph should be applied unless the contract or agreement meets the exception in paragraph 76.

75. To allocate the contract or agreement price to the different components, lessors and lessees should first use any prices for individual components that are included in the contract or agreement, as long as the price allocation does not appear to be unreasonable based on the terms of the contract or agreement and professional judgment, maximizing the use of observable information, for example, using readily available observable stand-alone prices. Stand-alone prices are those that would be paid or received if the same or similar assets were leased individually or if the same or similar nonlease components (such as services) were contracted individually. Some contract or agreements provide discounts for bundling multiple leases or lease and nonlease components together in one contract or agreement. These discounts may be taken into account when determining whether individual component prices do not appear to be unreasonable. For example, if the individual component prices are each discounted by the same percentage from normal market prices, those component prices would not be considered unreasonable.

76. If a contract or agreement does not include prices for individual components or if any of those prices appear to be unreasonable as provided in paragraph 75, lessors and lessees

[10A]The treatment of lease incentives and lease concessions is addressed in par. 23-24 for short-term leases and par. 31 for intragovernmental leases.

should use professional judgment to determine their best estimate for allocating the contract or agreement price to those components, maximizing the use of observable information. If it is not practicable to determine a best estimate for price allocation for some or all components in a contract or agreement, a federal entity should account for those components as a single lease unit.

77. If multiple components are accounted for as a single lease unit as provided for in paragraph 76 , the accounting for that unit should be based on the primary lease component within that unit. For example, the primary lease component's lease term should be used for the unit if the lease components have different lease terms.

Contract or Agreement Combinations

78. Contracts or agreements that are entered into at or near the same time with the same counterparty should be considered to be part of the same lease contract or agreement if either of the following criteria is met:

    a. The contracts or agreements are negotiated as a package with a single objective.

    b. The amount of consideration to be paid in one contract or agreement depends on the price or performance of the other contract or agreement.

79. If multiple contracts or agreements are determined to be part of the same lease contract or agreement, that contract or agreement should be evaluated in accordance with the guidance for contracts or agreements with multiple components in paragraphs 72-77.

Lease Terminations and Modifications

80. The provisions of a lease contract or agreement may be amended while the contract or agreement is in effect. Examples of amendments to lease contracts or agreements include changing the contract or agreement price, lengthening or shortening the lease term, and adding or removing an underlying asset. An amendment should be considered a lease modification unless the lessee's right to use the underlying asset decreases, in which case the amendment should be considered a partial or full lease termination. By contrast, exercising an existing option, such as an option to extend or terminate the lease as discussed in paragraphs 15-19, is subject to the guidance for remeasurement.

Lease Terminations

81. The lessee and lessor should account for an amendment during the reporting period resulting in a decrease in the lessee's right to use the underlying asset (for example, the lease term is shortened or the number of underlying assets is reduced) as a partial or full lease termination.

Lessee Treatment of Lease Terminations

82. A lessee generally should account for the partial or full lease termination by reducing the carrying values of the lease asset and lease liability and recognizing a gain or loss for the difference. However, if the lease is terminated as a result of the lessee purchasing the underlying asset from the lessor, the lease asset should be reclassified to the appropriate class of owned asset.

Lessor Treatment of Lease Terminations

83. A lessor should account for the full or partial termination of a lease by reducing the carrying values of the lease receivable and related unearned revenue and recognizing a gain or loss for the difference. However, if the lease is terminated as a result of the lessee purchasing an underlying asset from the lessor, the carrying value of the underlying asset also should be derecognized and included in the calculation of any resulting gain or loss.

Lease Modifications

84. The lessee and lessor should account for an amendment during the reporting period resulting in a modification to a lease contract or agreement as a separate lease (that is, separate from the most recent lease contract or agreement before the modification) if both of the following conditions are present:

    a. The lease modification gives the lessee an additional lease asset by adding one or more underlying assets that were not included in the original lease contract or agreement.

    b. The increase in lease payments for the additional lease asset does not appear to be unreasonable based on (1) the terms of the amended lease contract or agreement and (2) professional judgment, maximizing the use of observable information (for example, using readily available observable stand-alone prices).

Lessee Treatment of Lease Modifications

85. Unless a modification is reported as a separate lease as provided in paragraph 84, a lessee should account for a lease modification by remeasuring the lease liability. The lease asset should be adjusted by the difference between the remeasured liability and the liability immediately before the lease modification. However, if the change reduces the carrying value of the lease asset to zero, any remaining amount should be reported in the statement of net cost as a gain.

Lessor Treatment of Lease Modifications

86. Unless a modification is reported as a separate lease as provided in paragraph 84, a lessor should account for a lease modification by remeasuring the lease receivable. The unearned revenue should be adjusted by the difference between the remeasured receivable and the receivable immediately before the lease modification. However, to the extent the change relates to payments for the current period, the change should be recognized as revenue or expense for the current period.

Subleases

87. A sublease involves three parties: the original lessor, the original lessee (who also is the lessor in the sublease), and the new lessee. The original lessor should continue to apply the general lessor guidance. The federal entity that is the original lessee and becomes the lessor in the sublease should account for the original lease and the sublease as two separate transactions, as a lessee and a lessor, respectively. Those two separate transactions should not be offset against one another. The new lessee should apply the general lessee guidance.

88. The original lessee (and now the lessor in a sublease) should include the sublease in its disclosure of the general description of lease arrangements. Its lessor transactions related to subleases should be disclosed separately from its lessee transactions related to the original lease.

Sale-Leaseback Transactions

89. Sale-leaseback transactions involve the sale of an underlying asset by the owner and a lease of the property back to the seller (original owner). A sale-leaseback should include a transaction that qualifies as a sale[11] to be eligible for sale-leaseback accounting. A sale-

[11] See SFFAS 7, *Accounting for Revenue and Other Financial Sources and Concepts for Reconciling Budgetary and Financial Accounting*, par. 295 (with the public) and par. 314-315 (intragovernmental)..

leaseback transaction that does not include a transaction that qualifies as a sale should be accounted for as a borrowing by both the seller-lessee and the buyer-lessor.

90. The sale and lease portions of a sale-leaseback transaction should be accounted for as two separate transactions—a sale transaction and a lease transaction—except that the difference between the carrying value of the capital asset that was sold and the net proceeds from the sale should be reported as unearned revenue or deferred expense to be recognized in the statement of net cost in a systematic and rational manner over the term of the lease. However, if the lease portion of the transaction qualifies as a short-term lease, any difference between the carrying value of the capital asset that was sold and the net proceeds from the sale should be recognized immediately.

91. A sale-leaseback transaction is considered to have off-market terms if there is a significant difference between (a) the sales price and the estimated fair value of the asset or (b) the present value of the contractual lease payments and the estimated present value of what the lease payments for that asset would be at a market price, whichever of the two differences is more readily determinable. The difference should be reported based on the substance of the transaction (for example, as a borrowing, a nonexchange transaction, or an advance lease payment) rather than as a part of the sales-leaseback transaction.

92. A seller-lessee should disclose the terms and conditions of sale-leaseback transactions as part of the disclosures required of a lessee (par. 37 or 54, as applicable). A buyer-lessor should disclose the terms and conditions as part of the disclosures required of a lessor (par. 38 or 67, as applicable).

Lease-Leaseback Transactions

93. In a lease-leaseback transaction, an asset is leased by one party (first party) to another party and then leased back to the first party. The leaseback may involve an additional asset (such as leasing a building that has been constructed by a developer on land owned by and leased back to a federal entity) or only a portion of the original asset (such as leasing back only one floor of a building to the owner). A lease-leaseback transaction should be displayed in the financial statements as a net transaction. Both parties to a lease-leaseback transaction should disclose the amounts of the lease and the leaseback separately.

Amendments to SFFAS 5, *Accounting for Liabilities of the Federal Government,* and SFFAS 6, *Accounting for Property, Plant, and Equipment*

94. This Statement replaces the measurement and reporting requirements for lease accounting established in SFFAS 5, *Accounting for Liabilities of the Federal Government,* paragraphs 43-46. Therefore, the paragraphs marked below are rescinded.

SFFAS 5: *Accounting for Liabilities of the Federal Government*

[43.] ~~Capital leases are leases that transfer substantially all the benefits and risks of ownership to the lessee. If, at its inception, a lease meets one or more of the following four criteria, the lease should be classified as a capital lease by the lessee:~~

- ~~The lease transfers ownership of the property to the lessee by the end of the lease term.~~
- ~~The lease contains an option to purchase the leased property at a bargain price.~~
- ~~The lease term is e -=qual to or greater than 75 percent of the estimated economic life of the leased property.~~
- ~~The present value of rental and other minimum lease payments, excluding that portion of the payments representing executory cost, equals or exceeds 90 percent of the fair value of the leased property.~~

~~The last two criteria are not applicable when the beginning of the lease term falls within the last 25 percent of the total estimated economic life of the leased property. If a lease does not meet at least one of the above criteria it should be classified as an operating lease.~~

[44.] ~~The amount to be recorded by the lessee as a liability under a capital lease is the present value of the rental and other minimum lease payments during the lease term, excluding that portion of the payments representing executory cost to be paid by the lessor. [footnote 20: "The cost of general property, plant, and equipment acquired under a capital lease shall be equal to the amount recognized as a liability for the capital lease at its inception. See SFFAS No. 6, Accounting for Property, Plant, and Equipment.] However, if the amount so determined exceeds the fair value of the leased property at the inception of the lease, the amount recorded as the liability should be the fair value. If the portion of the minimum lease payments representing executory cost is not determinable from the lease provisions, the amount should be estimated.~~

[45.] ~~The discount rate to be used in determining the present value of the minimum lease payments ordinarily would be the lessee's incremental borrowing rate unless (1) it is practicable for the lessee to learn the implicit rate computed by the lessor and (2) the implicit rate computed by the lessor is less than the lessee's incremental borrowing~~

rate. If both these conditions are met, the lessee shall use the implicit rate. The lessee's incremental borrowing rate shall be the Treasury borrowing rate for securities of similar maturity to the term of the lease.

[46.] During the lease term, each minimum lease payment should be allocated between a reduction of the obligation and interest expense so as to produce a constant periodic rate of interest on the remaining balance of the liability. [footnote 21: OMB Circular No. A-11, "Preparation and Submission of Annual Budget Estimates," explains the measurement of budget authority, outlays, and debt for the budget in the case of lease-purchases and other capital leases. Circular A-94, "Guidelines and Discount Rates for Benefit-Cost Analysis of Federal Programs," provides the requirements under which a lease-purchase or other capital lease has to be justified and the analytical methods that need to be followed.]

95. This Statement replaces the measurement and reporting requirements for lease accounting established in SFFAS 6, *Accounting for Property, Plant, and Equipment*, paragraphs 20 and 29. Therefore, the paragraphs marked below are rescinded.

SFFAS 6: *Accounting for Property, Plant, and Equipment*

[20.] Capital leases are leases that transfer substantially all the benefits and risks of ownership to the lessee. If, at its inception, a lease meets one or more of the following four criteria, [footnote21: Note that the criteria for identifying capital leases for financial reporting purposes differ from OMB criteria for budget scoring of leases. OMB Circular No. A-11, *Preparation and Submission of Budget Estimates*, includes criteria for identifying operating leases in Appendix B. OMB provides four additional criteria which relate to the level of private sector risk involved in a lease-purchase agreement. This is necessary because, for budget purposes, there is a distinction between lease-purchases with more or less risk. This distinction is not made in the financial reports and, therefore, FASAB does not include the four criteria related to risk levels.] the lease should be classified as a capital lease by the lessee. Otherwise, it should be classified as an operating lease.

[footnote 22: "Operating leases" of PP&E are leases in which the Federal entity does not assume the risks of ownership of the PP&E. Multi-year service contracts and multi-year purchase contracts for expendable commodities are not capital leases.]

- The lease transfers ownership of the property to the lessee by the end of the lease term.
- The lease contains an option to purchase the leased property at a bargain price.
- The lease term is equal to or greater than 75 percent of the estimated economic life [footnote 23: "Estimated economic life of leased property" is the estimated

remaining period during which the property is expected to be economically usable by one or more users, with normal repairs and maintenance, for the purpose for which it was intended at the inception of the lease, without limitation by the lease term.] of the leased property.

- The present value of rental and other minimum lease payments, excluding that portion of the payments representing executory cost, equals or exceeds 90 percent of the fair value [footnote 24: "Fair value" is the price for which an asset could be bought or sold in an arm's-length transaction between unrelated parties (e.g., between a willing buyer and a willing seller). (adapted from Kohler's Dictionary for Accountants)] of the leased property.

The last two criteria are not applicable when the beginning of the lease term falls within the last 25 percent of the total estimated economic life of the leased property.

[29.] The cost of general PP&E acquired under a **capital lease** shall be equal to the amount recognized as a liability for the capital lease at its inception (i.e., the net present value of the lease payments calculated as specified in the liability standard [footnote 35: See Statement of Recommended Accounting Standards No. 5, *Accounting for Liabilities of the Federal Government*.] unless the net present value exceeds the fair value of the asset).

Implementation

96. This Statement requires that leases unexpired at the beginning of the reporting period in which the Statement is implemented be recognized and measured using the facts and circumstances that exist at the beginning of the reporting period. Therefore, in the period of implementation,

    a. the determination of the lease term would assume that the lease term began as of the beginning of the period of implementation and

    b. the lease liability and lease asset should initially be measured based on the remaining lease term and associated lease payments as of the beginning of the period of implementation.

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).

b. The purpose of the contracts or agreements is primarily attributable to the nonlease component(s), such as service components, based on management's assessment of the nature of the contracts or agreements and professional judgment. The primary purpose attribution to the nonlease component(s) should not appear to be unreasonable based on the nature of the contracts or agreements and professional judgment.

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, 2026 (end of the accommodation period).[11A] The entity may elect a shorter accommodation period (contracts or agreements subsequently entered into or modified on or prior to September 30, 2025; September 30, 2024, or those existing as of October 1, 2023). The contracts or agreements under this election should be accounted for as nonleases for their remaining term, unless they are subsequently modified after the end of the accommodation period (see par. 96C below).

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 become effective after) the accommodation period.[11B] 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.[11C] 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.

96D. A reporting entity may apply the provisions of paragraphs 96A-96C to groups of contracts or agreements that are reasonably similar in nature. A reporting entity may select different accommodation periods under paragraph 96B for different groupings of contracts or agreements.

[11A] 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.

[11B] 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.

[11C] Unless the modification is reported as a separate lease under par. 84. See footnote 11B.

96E. A reporting entity electing the above transitional accommodation should disclose the election of the transitional accommodation during the reporting period(s) covered by the accommodation period and the reporting period immediately following the accommodation period. The disclosure need not be repeated during subsequent reporting periods.

97. The following implementation guidance addresses specific leasing circumstances.

a. Prospective Implementation – Entities should report the effect of implementing this Statement on existing leases prospectively in accordance with paragraph 13 of SFFAS 21, *Reporting Correction of Errors and Changes in Accounting Principles, Amendment of SFFAS 7, Accounting for Revenue and Other Financing Sources*. Accordingly, any changes in assets or liabilities related to existing leases should be treated prospectively. The change should be accounted for in the period of implementation and applicable future periods. No adjustments should be made to previously reported expenses or revenue.

b. Lease Term – The lease term should be determined based on the provisions of this Statement (par. 14-21). However, the lease term of an existing lease should be based on the number of years remaining in the lease contract or agreement as of the beginning of the period of implementation and not the number of years in the initial lease term. For example, if the initial lease term was 20 years, with no options to extend, at the beginning of Year 20X1 and the entity implements this Statement in Year 20X7 (six years into the lease at the beginning of Year 20X7), the initial lease term upon implementation would be 14 years.

c. Short-Term Leases – A short-term lease would be determined based on the provisions of this Statement (par. 22-24). However, if the remaining lease term of an existing lease meets the definition of a short-term lease that lease should apply the short-term lease guidance. For example, if the initial lease term was 60 months as of the beginning of Year 20X1, with no options to extend, and the entity implements this Statement in Year 20X5 (48 months into the lease at the beginning of Year 20X5); the initial lease term at implementation would be 12 months and the lease would meet the definition of a short-term lease. Hence, the entity should account for the lease as a short-term lease.

Effective Date

98. The requirements of this Statement are effective for reporting periods beginning after September 30, 2023. Early adoption is not permitted.

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

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

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

Project History

A1. This Statement amends the lease accounting standards in SFFAS 5 and 6, which had been in effect since 1995. Under SFFAS 5 and 6, leases were classified as either capital or operating depending on whether the lease met any of four tests.

A2. The Federal Accounting Standards Advisory Board (FASAB or “the Board”) undertook this project primarily because SFFAS 5 and 6

a. do not make meaningful distinctions between capital and operating leases based on the substance of lease transactions and

b. are based on Financial Accounting Standards Board (FASB) lease accounting standards, which have been amended.

A3. Lease accounting was first addressed by FASAB during the development of SFFAS 5 and 6. At that time, the Board decided to use the high-level language on lease accounting from FASB Statement of Financial Accounting Standards (SFAS) No. 13 *Accounting for Leases* [subsequently codified in Accounting Standards Codification (ASC) – Topic 840 *Leases*]. This minimal lease guidance included the definition of a capital lease, the criteria for capital leases, and the measurement of a capital lease asset and liability. The Board had plans to use this preliminary guidance as a placeholder until it was prepared to add lease accounting to its agenda as a separate project. Lease accounting had been on the list of potential Board agenda items each time the Board has considered its agenda for new projects.

A4. There are several areas of lease accounting that were covered by the FASB standards that were never specifically addressed in the FASAB standards. Some of those topics include leasehold improvements, lease terms, leveraged leases, and subleases. The federal community often stressed that the federal standards on lease accounting should be comprehensive to reduce confusion on whether FASB standards apply to federal entities when FASAB's are silent on a topic.

A5. Because FASB revised its standards, it was imperative for the Board to revisit lease accounting. One alternative was for the Board to issue detailed implementation guidance on the existing standards. The Board believed that the effort needed to issue such implementation guidance would be better used amending SFFAS 5 and 6. The Board closely reviewed the lease proposals of four standards setters (as stated in paragraph A8) to determine what underlying concepts, if any, would be applicable for federal financial reporting of leases. The Board believes this Statement offers the appropriate guidance for the accounting and financial reporting of leases for federal entities.

A6. In August 2011, FASAB began a project to revise its current standards on lease accounting. FASAB staff formed a task force to assist in developing this Statement. Task force members included accounting, budget, and subject matter experts from federal agencies and independent public accounting firms.

A7. The task force met several times over the course of the project and also exchanged numerous ideas and recommendations electronically. Staff sought the task force's views and recommendations in developing and describing alternatives to present to the Board. The task force's assistance was essential and its views carefully considered by members during deliberations. The task force played an important role in the research and release of the exposure draft (ED) preceding this Statement.

A8. In evaluating an approach applicable to federal leases, the Board considered the approaches used in the following documents:

a. FASB's SFAS 13, *Accounting for Leases* [superseded by FASB's ASC 840, which was subsequently superseded by ASC 842]

b. Governmental Accounting Standards Board's (GASB) Statement No. 87, *Leases*

c. International Accounting Standards Board's International Accounting Standard 17, *Leases* [superseded by International Financial Reporting Standard 16]

d. International Public Sector Accounting Standards Board's International Public Sector Accounting Standard 13, *Leases*

A9. At the inception of the project, the Board decided to coordinate with GASB on the lease project because of the similarities among governmental entities regarding lease activities and reporting objectives. Staff worked closely with GASB staff during the development of

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

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

Summary of Outreach Efforts and Responses

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

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

a. House Committee on Oversight and Government Reform

b. House Committee on Transportation

c. House Committee on Budget

d. Senate Committee on Homeland Security and Governmental Affairs

e. Senate Committee on Budget

f. Senate Committee on Environment and Public Works

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

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

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

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

Considerations Related to Benefits and Costs

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

Benefits

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

a. relevant and meaningful financial information needed by federal financial statement users and

b. comprehensive lease standards that appropriately address the various lease transactions/activities of the federal community.

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

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

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

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

a. accountability for financial resources;

b. accountability for faithful compliance or adherence to legal requirements and administrative policies;

c. accountability for efficiency and economy in operations; and

d. accountability for the results of government programs and activities, as reflected in accomplishments, benefits, and effectiveness

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

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

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

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

Costs

A22. The Board understands that many federal entities—particularly those having a significant number of long-term leases with non-federal entities—will incur additional costs as a result of this Statement. Based on feedback from the task force and ED responses, the initial costs to implement the revised standards will most likely result from reviewing existing lease agreements, ensuring all leases are appropriately identified, educating staff about how to apply the new requirements, implementing processes and controls to ensure all material leasing activity is captured going forward, and some system changes. Those costs will vary based on the number of leases that an entity has and the complexity of those arrangements. For example, it may take more effort to account for a lease agreement with options to extend and multiple components than a lease without those elements.

A23. Respondent comments related to costs and benefits raised concerns about the overall effort and resources needed to implement the proposed guidance. Some respondents also raised concerns regarding limited resources to assess a significant volume of leases. Overall, the evaluation and analysis needed to implement this Statement is similar to the capital leases evaluation and analysis needed in SFFAS 5 and 6, which should help mitigate some of the costs of implementation.

A24. Once implementation of the Statement is complete, the ongoing costs for many entities are unlikely to be significantly higher than the costs of complying with the previous standards. In the previous leases standards, entities were also required to identify leases, evaluate each lease to determine the applicable accounting model to apply (capital or operating), and to subsequently account for each lease, including the ongoing disclosure requirements. This Statement does not substantially change this level of effort and entities may be able to apply the requirements of this Statement using similar systems and processes as those used in previous leases standards to meet those reporting and disclosure requirements.

A25. Additionally, the Board made several decisions in the interest of reducing implementation costs. These include, but are not limited to, the provisions regarding:

a. Allowing a short-term lease exception and not requiring disclosures related to short-term leases by either lessees or lessors

b. Not requiring a lessor to derecognize the underlying asset or calculate a residual value

c. Allocation of the contract price to multiple components of a lease that allows the stated contract prices to be used if they do not appear to be unreasonable

d. Allocation of the contract price to multiple components that allow best estimates to be used for allocation if no separate prices are included in the contract or if stated prices appear to be unreasonable

e. The requirement to treat an entire multiple-component contract as a single lease unit if determining a best estimate is not practicable

f. The exclusion of intragovernmental leases from balance sheet recognition and measurement as a lease asset and corresponding liability

g. The extension of the effective date until fiscal year 2021 which allows more time to prepare and reduces the number of existing leases to be evaluated

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

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

Scope

A28. For purposes of applying this Statement, a lease is defined as a contract or agreement whereby one entity (lessor) conveys the right to control the use of PP&E (the underlying asset) to another entity (lessee) for a period of time as specified in the contract or agreement in exchange for consideration. Leases include contracts or agreements that, although not explicitly identified as leases, meet the definition of a lease (which reflects the substance of a lease). This definition does not include contracts or agreements for services,

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

A29. This Statement does not apply to leases of assets under construction or leases (licenses) of internal use software.

A30. GASB's Leases Statement No. 87 specifically excludes "contracts that meet the definition of a service concession arrangement in paragraph 4 of Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements* (SCAs)." Currently, FASAB standards are silent on SCAs. Through its discussions, the task force identified several federal entities that have SCAs, and there was a concern that the proposed lease definition could inadvertently include SCAs. The Board considered specifically excluding SCAs from this Statement. To accomplish this, the Board considered adopting GASB's definition of SCA from Statement No. 60 because there is no federal definition.

A31. The Board eventually decided that specifically excluding SCAs from the standards would raise more questions. Furthermore, SCAs are expected to be addressed in the public-private partnership recognition and measurement project; therefore, the Board agreed to remain silent on SCAs in this Statement until such guidance is issued. The Board believes the generally accepted accounting principles hierarchy will continue to guide preparers and auditors in accounting for SCAs.

Definitions

A32. In this Statement, a lease is defined as "a contract or agreement whereby one entity (lessor) conveys the right to control the use of PP&E (the underlying asset) to another entity (lessee) for a period of time as specified in the contract or agreement in exchange for consideration." In the early stages of the project, the Board deliberated over the use of "contract" or "agreement" in the definition of a lease. The Board considered GASB's approach—where the term contract is more precise and limiting and requires that a lease be legally enforceable. Because legal enforceability is not the primary driver in intragovernmental leasing transactions, although legal enforceability is a primary driver for the non-intragovernmental leases, the Board decided to add "agreement" in addition to "contract" in the lease definition to alleviate ambiguity in its application. This should be especially relevant in the case of intragovernmental leases, which are often referred to as "lease agreements."

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

Lease Term – Options to Extend or Terminate

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

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

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

a. The “noncancelable period” language should be clarified.

b. Both the lessee and the lessor’s options to extend or terminate the lease contract or agreement, if probable, should be included in the lease term at its commencement.

c. When the lessee or lessor is assessing its own options to extend or terminate the contract or agreement, the level of probability is at the probable threshold; however, when the lessee or lessor is assessing the other party’s options to extend or terminate

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

Remeasurement

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

Short-Term Leases

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

Intragovernmental Leases

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

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

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

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

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

Recognition and Measurement for Lessees – Lease Liability

A42 SFFAC 5, defines a liability as a “present obligation of the federal government to provide assets or services to another entity at a determinable date, when a specified event occurs, or on demand.” The Board believes that the lessee taking possession of the underlying asset or gaining access to control the use of the underlying asset is an event that creates such an obligation until the end of the lease term.

A43. The Board believes the present value of future lease payments to be made for the lease term, which represent the obligations of the lessee under the lease contract or agreement, is the appropriate measurement of the liability. Such a calculation is consistent with the premise that a lease is a financing transaction and supports recognition of the cost of the financing.

Recognition and Measurement for Lessees – Lease Asset

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

Recognition and Measurement for Lessors

A45. Symmetry between the lessee and lessor accounting models is important in establishing accounting and financial reporting standards. The Board believes that federal entity lessees and lessors should account for the shared transaction in a way that mirrors how the other party accounts for it.

A46. The lease contract or agreement gives the lessor the right to receive payments in exchange for the lessee's right to control the use of the underlying asset. The Board believes that right meets the definition of an asset in SFFAC 5. The right to receive payments is a resource that can be drawn upon, and the lessor presently controls that right.

Board Approval

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

Appendix B: Abbreviations

ASC	Accounting Standards Codification
ED	Exposure Draft
FASAB	Federal Accounting Standards Advisory Board
FASB	Financial Accounting Standards Board
GASB	Governmental Accounting Standards Board
GSA	General Services Administration
OMB	Office of Management and Budget
PP&E	Property, Plant, and Equipment
SCA	Service Concession Arrangement
SFAS	Statement of Financial Accounting Standards (FASB)
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards