



TRANSITIONAL AMENDMENT TO SFFAS 54

Statement of Federal Financial Accounting Standards 62

November 30, 2023

THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

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SUMMARY

This Statement of Federal Financial Accounting Standards (SFFAS) amends the implementation section of SFFAS 54, *Leases*, by providing transitional accommodations to reporting entities implementing SFFAS 54 in the area of “embedded leases.” “Embedded leases” is a common industry term which generally describes contracts or agreements that contain lease component(s) and nonlease component(s), such as service components, and serve a primary purpose attributable to the nonlease component(s).

Under these amendments, reporting entities may elect not to assess whether contracts or agreements meeting the eligibility criteria for “embedded leases” are or contain lease component(s) as of October 1, 2023, as well as those subsequently entered into or modified through the end of the accommodation period. The contracts or agreements for which this accommodation is applied would be accounted for as nonlease contracts or agreements for their remaining term, unless they are subsequently modified after the end of the accommodation period. The Statement requires reporting entities electing the accommodation to prospectively apply the provisions of SFFAS 54 to lease components of new or modified contracts or agreements meeting the “embedded leases” eligibility criteria—depending on the end of the elected accommodation period—beginning October 1, 2023; October 1, 2024; October 1, 2025; or October 1, 2026.

Leases that do not meet the “embedded leases” eligibility criteria—and those for which the accommodation election is not applied—should follow the implementation provisions of paragraphs 96 and 97 of SFFAS 54. The amendments also require disclosure for reporting entities electing the accommodation.

MATERIALITY

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

¹ 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.

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STANDARDS

SCOPE

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

TRANSITIONAL AMENDMENT TO SFFAS 54

3. Paragraph 72 of SFFAS 54, *Leases*, acknowledges that lessees and lessors may enter into contracts or agreements that contain both a lease component and a nonlease component. Paragraph 73 provides that the federal entity should account for lease and nonlease components of a contract or agreement separately, unless the contract or agreement meets the exception under paragraph 76 of SFFAS 54.
4. Contracts or agreements that contain both lease component(s) and nonlease component(s), such as service components, and serve a primary purpose attributable to the nonlease component(s), are often viewed in practice as containing “embedded leases.”
5. Paragraphs 96A-96E are added to SFFAS 54 as follows:
 - 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).

FN 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.

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.

FN 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.

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

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.

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.

EFFECTIVE DATE

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

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

APPENDIX A: BASIS FOR CONCLUSIONS

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—govern the accounting for specific transactions, events, or conditions.

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

PROJECT HISTORY

- A1. The Federal Accounting Standards Advisory Board (FASAB or “the Board”) issued SFFAS 54 in April 2018 with an effective date for reporting periods beginning after September 30, 2020. The effective date was later amended by SFFAS 58, *Deferral of the Effective Date of SFFAS 54, Leases*, to reporting periods beginning after September 30, 2023.
- A2. Following the issuance of SFFAS 54, the Board and the Accounting and Auditing Policy Committee (AAPC) commenced projects on their technical agendas to identify implementation challenges and develop guidance related to SFFAS 54.
- A3. The Board and the AAPC have issued the following pronouncements to facilitate implementation of SFFAS 54:
 - a. SFFAS 60: *Omnibus Amendments 2021, Leases-Related Topics I*
 - b. SFFAS 61: *Omnibus Amendments 2023, Leases-Related Topics II*
 - c. Technical Bulletin 2023-1: *Intragovernmental Leasehold Reimbursable Work Agreements*
 - d. Technical Release 20: *Implementation Guidance for Leases*
- A4. In February 2023, the Board received implementation updates from staff regarding implementation experiences and challenges within the federal environment. The Board also received letters from some reporting entities highlighting implementation challenges that they were experiencing.
- A5. Following an April 2023 clarification discussion, the Board decided to provide transitional accommodations to reporting entities in the area of “embedded leases” based on the research presented by technical staff and additional information provided during the discussion.
- A6. The Board is aware that SFFAS 54 requires entities to identify and evaluate leases, which also improves accountability for their resources and obligations. As noted in paragraph 74

of Statement of Federal Financial Accounting Concepts 1, *Objectives of Federal Financial Reporting*, “accounting can and should contribute to achieving and demonstrating several kinds of accountability, such as

- a. accountability for financial resources;
- b. accountability for faithful compliance or adherence to legal requirements and administrative policies;
- c. accountability for efficiency and economy in operations; and
- d. accountability for the results of government programs and activities, as reflected in accomplishments, benefits, and effectiveness.”

A7. When developing SFFAS 54, the Board made several decisions in the interest of reducing implementation costs associated with contracts or agreements with multiple components, including, but not limited to, provisions regarding the following:

- a. The allowance of a short-term lease exception
- b. Allocation of the contract price to multiple components of a lease that allows the stated prices to be used if they do not appear to be unreasonable
- c. Allocation of the contract price to multiple components that allow best estimates to be used for allocation if no separate prices are included in the contract or if the stated prices appear to be unreasonable
- d. The requirement to treat an entire multiple-component contract as a single lease unit if determining a best estimate is not practicable
- e. The exclusion of intragovernmental leases from balance sheet recognition and measurement as lease liabilities and corresponding lease assets (for intragovernmental lessees) and lease receivables and unearned revenues (for intragovernmental lessors)
- f. The deferral of the effective date until fiscal year 2024
- g. Prospective implementation at transition, as opposed to a retrospective approach

A8. Many contracts or agreements contain both lease and nonlease (generally, but not always, service) components. The Board expects that lease components for such contracts or agreements with a primary purpose *attributable to the lease components* were generally accounted for separately. However, the Board recognizes that separate accounting for lease and nonlease components may not have been consistently performed by many reporting entities for “embedded leases” (that is, contracts or agreements with a primary purpose *attributable to nonlease components*) under previous GAAP.

A9. Accordingly, the Board also agreed that reporting entities should have the flexibility to begin recognizing lease liabilities and correspondent lease assets (for lessees) and lease receivables and unearned revenues (for lessors) for lease components of new or modified

contracts or agreements meeting the paragraph 96A criteria prospectively beginning in fiscal year 2027, or earlier.

- A10. The Board expects that SFFAS 54 implementation activities, such as assessing control of the underlying assets for component(s) that may be leases and allocating contract prices to lease and nonlease component(s), among other complexities, are likely to be relatively time consuming for contracts or agreements meeting the paragraph 96A criteria (“embedded leases”). Prospective implementation of paragraph 73 for new or modified contracts or agreements meeting the paragraph 96A criteria provides reporting entities electing the accommodation with additional time to (a) focus and prioritize implementation activities for contracts or agreements with a primary purpose attributable to lease components and (b) prepare for prospective implementation of paragraph 73 for new or modified “embedded leases.”
- A11. The Board recognizes that reporting entities would need to assess the eligibility of contracts or agreements for the transitional accommodation. In crafting this Statement, the Board carefully considered the level of effort necessary to balance the informational benefits of implementing paragraph 73 while also accommodating the identified implementation challenges associated with “embedded leases.” The Statement includes several features to provide that balance:
- a. Allowing reporting entities to assess the primary purpose of contracts or agreements based on their nature and professional judgment, provided that such attributions do not appear to be unreasonable based on those factors. The Board concluded that this phrasing provides for an appropriate level of preparer discretion and professional judgment.
 - b. Allowing reporting entities the flexibility to elect the accommodation period and determine the prospective application date of paragraph 73 for eligible contracts or agreements based on the expected level of time and effort to implement SFFAS 54.
 - c. Allowing reporting entities to apply the provisions of paragraphs 96A-96C to groups of contracts or agreements, provided that the nature of the contracts within such groups is reasonably similar.
 - d. Limiting resulting disclosures to simply disclosing the election of the transitional accommodation in the reporting period(s) covered by the accommodation period and during the reporting period immediately following the accommodation period. The Board discussed other potential disclosure options, but elected to minimize disclosure burden to provide maximum transitional relief.
- A12. The Board expects that most contracts meeting paragraph 96A criteria will have lease terms that are comparatively shorter in relation to contracts with a purpose primarily attributable to lease components (real property leases, for example), given the nature of the related contracts. Accordingly, the Board expects that the perceived benefits of this accommodation outweigh the perceived informational costs.
- A13. The Board duly considered alternative accommodations for multiple component contracts when developing the exposure draft (ED) for this Statement. Members considered allowing reporting entities to account for contracts or agreements according to their

primary purpose (either lease or nonlease) indefinitely. The design of paragraphs 72-77 of SFFAS 54 underwent extensive research, due process, and deliberations. These unamended paragraphs include considerable design accommodations, which are described in paragraph A7.b-d above.

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

SUMMARY OF OUTREACH AND RESPONSES

- A15. The Board released an ED on June 27, 2023, for public comment, with comments requested by July 27, 2023. Upon release of the ED, FASAB notified constituents through the FASAB website and listserv, the Federal Register, and FASAB newsletter. FASAB also provided news releases to its press contacts, including various news organizations and committees of professional associations generally commenting on EDs in the past. To encourage responses, a reminder notice was provided to FASAB’s listserv near the comment deadline.
- A16. FASAB received 21 comment letters in response to the ED. Respondents were generally supportive of the proposed Statement. Respondents generally agreed that the proposals effectively scoped in “embedded leases” and provided a reasonable and balanced level of transitional relief. Some respondents requested further relief, such as lengthening the proposed accommodation period.
- A17. In response to feedback provided in comment letters, the Board agreed to implement further changes:
- a. Aligning the contextual information provided under paragraph 3 with the described provisions of SFFAS 54, paragraph 73. The information provided by paragraph 3 is solely intended to facilitate understanding of the transitional amendments under paragraph 5.
 - b. Extending the maximum accommodation period-end from September 30, 2025, to September 30, 2026.
- A18. The Board considered the following factors when analyzing the length of the accommodation period and related respondent feedback:
- a. Reporting entities may have material “embedded leases.” Users of their GPFFRs would benefit from the accountability and transparency associated with separating the lease and nonlease components of multiple component contracts and agreements containing material “embedded leases.”
 - b. Financial Accounting Standards Board (FASB) Accounting Standards Codification® (ASC) Topic 840-10-15-17 provided that “[i]f an arrangement contains a lease and related executory costs, as well as other nonlease elements, the classification, recognition, measurement, and disclosure requirements of this Topic shall be applied by both the purchaser and the supplier to the lease element of the arrangement.” The

Board elected to bring these provisions into SFFAS 54, paragraphs 72-77, based on extensive due process and deliberations.

- c. The transitional amendments provide significant relief on longstanding requirements brought from ASC 840 into paragraph 73 of SFFAS 54. The accommodations allow reporting entities to prospectively apply the provisions of paragraph 73 to only new or modified contracts or agreements following the accommodation period. The amendments also allow contracts or agreements existing prior to the accommodation period-end to continue to be accounted for as nonlease, unless they are modified after the end of the accommodation period.
 - d. The Board identified a number of concerns and considerations, including several that were raised by respondents, associated with more expansive or permanent accommodation alternatives, such as potential interactions and permanent effects on other topic areas in SFFAS 54 and other Statements.
- A19. The Board also considered the concept of unit of account, which refers to the level of aggregation or disaggregation applicable to one or more components of a contract or agreement to be considered for recognition, measurement, and disclosure in the financial statements and notes.
- A20. Some of the more expansive relief options considered by the Board (and suggested by some respondents) would have provided for contract-level unit of account measurement approaches based on primary purpose on a permanent basis. However, the component-level unit of account measurement approach (as provided for under paragraph 73 of SFFAS 54) provides more useful information to users, as contract components can have heterogeneous measurement attributes and characteristics. Contracts and agreements can also have material lease and nonlease components within them. A contract-level unit of account measurement approach based on primary purpose would introduce high levels of aggregation and subjectivity that may not always faithfully represent the measurable characteristics and underlying substance of the multiple component contracts' economic activity and transactions.
- A21. The Board decided to only provide *transitional* relief based on contract-level primary purpose assessments. The Board believes this will allow reporting entities to more manageably implement SFFAS 54 requirements for "embedded leases" on a transitional basis. The Board concluded this approach will avoid longer term accountability implications associated with permanent contract-level unit of account measurement approach alternatives.
- A22. A few respondents recommended removal of the term "may" from paragraph 96A.a. The Board's intent in using the term "may" is to express the *possibility* that the contract (or group of contracts) *may* contain a lease rather than otherwise implying that a contract (or group of contracts) *must* contain a lease to meet the eligibility criteria. The Board concluded that the level of effort for applying paragraph 96A eligibility criteria should enable efficient application of the transitional accommodation for entities electing to apply it. Requiring that reporting entities *conclusively* identify embedded leases for purposes of determining eligibility would be contrary to the transitional relief objectives of this Statement.

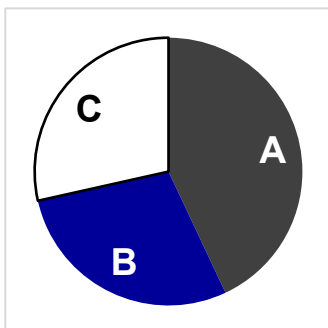
- A23. A few respondents suggested paragraph 4 provided a definition of “embedded leases.” Paragraph 4 is not intended to define “embedded leases.” Similar to paragraph 3, paragraph 4 is solely intended to provide contextual information to facilitate understanding of the transitional amendments under paragraph 5 of this Statement.
- A24. The Board considered other input provided by respondents that did not result in further modifications to the Statement.
- A25. In the ED, four members provided an alternative view aimed at offering practical expedients that would have provided permanent alternatives to the application of paragraphs 73, 85, and 86 of SFFAS 54 for both lessees and lessors. While many respondents expressed support for one or more of the proposals outlined in the alternative view, respondents also highlighted concerns that underscored additional research and due process would be necessary before the Board could consider additional actions. The Board determined that undertaking such research at this time would be contrary to its current objective of offering relief to preparers before the effective date of SFFAS 54.

BOARD APPROVAL

- A26. This Statement was approved by the Board with a vote of eight members in favor of its issuance and one member, Ms. Johnson, abstaining from the vote.

APPENDIX B: NON-AUTHORITATIVE ILLUSTRATION

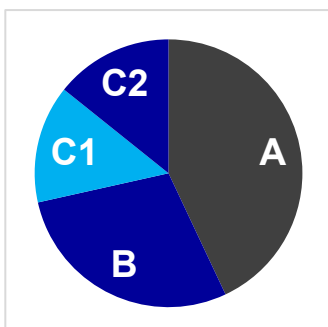
- B1. The below non-authoritative illustration is intended to facilitate understanding of the amendments to SFFAS 54 and explain the scope and applicability of paragraphs 96 and 97 and paragraphs 96A-96E on reporting entities' universes of contracts or agreements.



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

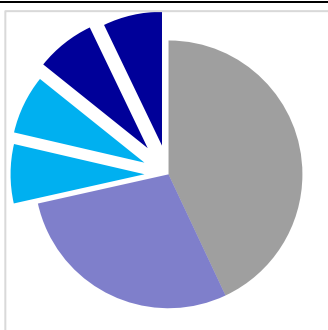
Some contracts and agreements in the universe are inherently known to serve a primary purpose attributable to lease component(s) (**part B** of the pie chart). For example, these generally would have been identified as capital or operating lease elements under previous GAAP. These contracts are subject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

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



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

Other contracts or agreements under **part C** may not have a primary purpose attributable to nonlease component(s) based on their assessed nature and professional judgment. These do not meet par. 96A criteria and, therefore, they are subject to the SFFAS 54 implementation requirements of par. 96 and 97 (**part C2** of the pie chart) along with those under **part B**.



Provisions of par. 96A-96C—including primary purpose assessments—may be applied to groups of contracts or agreements that are reasonably similar in nature, as provided by par. 96D.

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

APPENDIX C: ABBREVIATIONS

ASC	[FASB] Accounting Standards Codification®
ED	Exposure Draft
FASAB	Federal Accounting Standards Advisory Board
FAF	Financial Accounting Foundation
FASB	Financial Accounting Standards Board
GAAP	Generally Accepted Accounting Principles
GASB	Governmental Accounting Standards Board
GPFFR	General Purpose Federal Financial Reports
SFFAS	Statement of Federal Financial Accounting Standards

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