

*Transitional Amendment to SFFAS 54*

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This [proposal](#) would amend the implementation section of Statement of Federal Financial Accounting Standards (SFFAS) 54, *Leases*, by providing transitional accommodations to reporting entities in the area of "embedded leases" (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] as well as the related requirements of SFFAS 54, par. 72-77).

**QFR 1** Do you generally agree, partially agree, or disagree with the proposed transitional amendment to SFFAS 54 as a whole? Please provide reasons for your views.

We generally agree with the proposed transitional amendment for the reasons enumerated within the following responses. As articulated in QFR 7, we also generally agree with the alternate view regarding making the transitional accommodation a permanent practical expedient.

**QFR 2** Proposed paragraph 96A provides that the transitional accommodation, if elected by the reporting entity, would apply to contracts or agreements that meet both of the following criteria: (a) the contracts or agreements contain nonlease components(s) and may contain lease component(s), and (b) the purpose of the contracts or agreements is primarily attributable to the nonlease component(s), such as service components.

Please provide feedback on paragraphs 3-4 and paragraph 5 (96A criteria), which are intended to provide criteria for the scope of the transitional accommodation for “embedded leases.” Respondents are encouraged to refer to the basis for conclusions and provide feedback on the design of these proposals and the extent to which they effectively scope in “embedded leases,” and the level of effort for applying such criteria.

The design of the proposed accommodation is well-conceived and establishes practical criteria for the scoping of embedded leases within the transitional accommodation. These criteria, while sufficient for the majority of contracts (for which the “primary purpose” is reasonably unambiguous based upon the nature of the contract and professional judgement), could be insufficient in the case of contracts with an ambiguous, not inherently known, or difficult to determine “primary purpose.”

Additional guidance could be valuable to indicate the precise definition FASAB would ascribe to “primary purpose” or make reference to any sample contract scenarios that appear to be roughly evenly split between a lease and a service contract. FASAB may wish to consider factors such as dollar value, percentage thresholds, or original or modified intention of procurement in order to go beyond leaving the determination of a contract’s primary purpose to only its “nature and professional judgement,” as contemplated in the current accommodation proposal.

**QFR 3** Please provide feedback on the proposed transitional accommodation provisions under paragraphs 96B-96C, which are intended to allow practitioners to reduce implementation time by not reporting certain “embedded leases” during the accommodation period. Please describe any alternative views or approaches, suggestions for improvements, and the reasons for your views. Respondents are encouraged to refer to the basis for conclusions and provide feedback on (1) the design of these proposals, (2) the expected effectiveness of the transitional accommodation, and (3) the expected level of effort for applying the accommodation.

The transitional accommodation as proposed will indeed achieve the goal of reducing implementation time for the new standard. The design, specifically the applicability to contracts with a “primary purpose attributable to the nonlease component(s),” is appropriate and, in practice, is a practical guideline for identifying contracts to be excluded from assessment during the accommodation period. Within our agency, contracts whose purpose is primarily for the conveyance of services are processed and tracked via a distinct set of procedures and systems from those whose purpose is primarily for the conveyance of items of PP&E. As part of the current implementation/adoption of the new standard, extensive accounting procedures have been performed to verify the fidelity of this bifurcation. As a result, this population of mainly-service contracts does not need to be assessed during the accommodation period (thus eliminating much of the Board’s concern about the “need to assess the eligibility of contracts or agreements for the transitional accommodation” in paragraph A11), and the expected level of effort for applying the accommodation is low.

**QFR 4** Proposed paragraph 96B provides that reporting entities may elect an accommodation period for up to two years prior to the prospective application requirements described in paragraph 96C. Please also refer to paragraphs A1-A13 of the basis for conclusions, including paragraph A10, which discusses the Board’s intent that this proposal would provide additional time to prepare for prospective implementation of paragraph 73 for new or modified “embedded leases.”

Please provide your views on the length and sufficiency of the proposed accommodation period and any views with respect to making the accommodation permanent. Please describe the reasons for your views and relevant considerations to facilitate the Board's analysis of your comments.

The length of the proposed accommodation period is sufficient to allow time for not only the implementation activities associated with embedded leases (and the Board is correct in determining that these activities [assessing control, allocating contract price, etc.] are relatively time-consuming in comparison with contracts with a primary purpose attributable to lease components) but also for the numerous operational, accounting, and reporting changes necessitated by the remainder of the guidance (that pertinent to leases other than embedded). The accommodation period, whether it be one or two additional years as determined by each adopting agency, will allow for 1) the training and alignment of the various groups within an agency that must collaborate in order to capture and account for embedded leases, 2) the analysis/assessment of the types of primarily-nonlease contracts into which a given agency typically enters, and 3) the institutionalization of procedures and controls for identifying and capturing these contracts as they are entered into.

Please see the response to QFR 7 below for feedback related to views on making the accommodation permanent.

**QFR 5** Proposed paragraph 96D provides that reporting entities 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.

Please provide feedback on the proposed criteria. Please describe any alternative views or approaches, suggestions for improvements, and the reasons for your views.

The guidance in the proposed paragraph 96D would grant valuable additional flexibility to agencies in implementing the transitional accommodation by allowing for an even more phased approach to adopting and implementing the new lease standard.

**QFR 6** Proposed paragraph 96E provides that reporting entities electing the transitional accommodation would 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 would not need to be repeated during subsequent reporting periods.

Please provide feedback on the proposed disclosure requirement. Please describe any alternative views or approaches, suggestions for improvements, and the reasons for your views.

The proposed disclosure requirement is appropriate and uncomplicated given the removal of the previously proposed secondary disclosure data point:

- Section 96D.b. of FASAB memo dated May 18, 2023, that would require reporting entities to disclose the nature of any significant contracts and agreements (or portfolio thereof) for which the transitional accommodation was elected.

The inclusion of this data point within the disclosure requirement could potentially have been burdensome on agencies, as was discussed during the 5.25.23 meeting of the Board, by requiring a complete contract assessment of the potential embedded lease population in order to enact the accommodation. This could potentially have eliminated any benefit provided by the accommodation.

A clarifying point that might be added is specification of whether either of the following should be disclosed: 1) an agency's selected ultimate effective date for the embedded lease guidance, or 2) the period during which the accommodation will be utilized.

**QFR 7** Four Board members provided an alternative view, which is documented under the basis for conclusions (appendix A), paragraphs A15-A26. Please refer to these paragraphs to review the alternative view as presented.

Do you agree, partially agree, or disagree with the alternative view? Please provide the rationale for your answer.

We agree with the alternative view of Mr. Bell, Ms. Johnson, and Messrs. McNamee and Vicks that, as a permanent practical expedient, reporting entities should be allowed to account for contracts based upon primary purpose for the following reasons:

- **Impact on Financial Reporting** – The impact of not requiring that nonlease components be separated from lease components in primarily lease-like contracts and that lease components be separated from nonlease components in primarily service-like contracts is likely offsetting and immaterial as proposed in the alternative view. Nonlease components within leases and lease components within service contracts are, by definition, insignificant to the overall purpose of the contract and are even less significant in comparison with total non-intragovernmental assets (as noted in exposure draft A25).

A practical consideration, that may imply even further reduced financial reporting impact, is the possibility that many nonlease components within leases and lease components within service contracts will not be separately accounted for under SFFAS 54 (either with or without a permanent practical expedient) due to the impracticability of determining a best estimate for price allocation (as allowed for under paragraph 76 of SFFAS 54).

- **Flexibility and Practicality** – It could be beneficial for entities that have contracts with both lease and non-lease components to have the option to elect a practical expedient to account for contracts based on their primary purpose. This approach would reduce the

administrative burden associated with separating lease and non-lease components that may not result in any significant impact to financial reporting (first paragraph above) or may even be avoided altogether by the leeway provided in paragraph 76 guidance (second paragraph above).

The alternative view expresses the notion that reporting entities may already have systems in place to separate lease and nonlease components, and that granting a practical expedient may therefore be unnecessary. Given the preponderance of operating rather than capital leases that likely exists at agencies under current guidance, we believe that most agencies do not currently have a system in place to separate the lease and nonlease components.

For these reasons, we agree with the FASB conclusion that “the costs and administrative burden of allocating consideration to separate lease and nonlease components may not be justified by the benefit of more precisely reflecting the right-of-use lease asset and the lease liability” (exposure draft A24) and that the transitional accommodation could be made a permanent practical expedient without substantially diminishing the quality of the financial reporting of leases.