

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.

Partially agree.

The inclusion of an accommodation period (of up to two years) is beneficial as it provides reporting entities with additional time to adequately prepare for the implementation of new or modified embedded leases. Identifying embedded leases in the Department of Defense (DoD) is a complex process that requires significant effort and resources as it requires collaboration with all program and mission support offices. This amendment helps address the challenges associated with identifying and accounting for pre-existing contracts with embedded leases. The allowance for grouping contracts or agreements similar in nature will add some relief to the entity in identifying and accounting for pre-existing contracts already in place.

While we agree with implementing the transitional accommodations, we believe that the time period allowed (2 years) is not long enough for large organizations such as the DoD. We recommend incorporating some of the alternative views of select Board members mentioned within Appendix A paragraph A15 – A26, specifically incorporating a long-term approach rather than temporary approach to embedded leases.

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 component(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.

It will take considerable resources to determine the breadth and scope of all embedded leases in a large, mostly decentralized organization such as the DoD. Guidelines for scoping in embedded leases within the transitional accommodation are helpful, although the level of effort will vary based on the volume and complexity of contracts/agreements different DoD components are dealing with.

The proposed criteria introduces an element of subjectivity by relying on management's assessment and professional judgment to determine the primary purpose attribution to the nonlease component(s). While professional judgment is common in accounting, it may lead to challenges in consistent application and could be a source of potential disputes during audits or assessments. Additional guidance would be valuable for determining how FASAB interprets “primary purpose” (considering factors such as dollar value, percentage thresholds, or original or modified intention of procurement) to enhance understanding. Consider providing specific examples to help reporting entities apply these criteria consistently.

Ability to create own criteria for assessment could also be an option. This will require diligent application of a well-documented process and concurrence from auditors.

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.

While DoD components generally agree with the proposed transitional accommodation which allows entities to refrain from reporting certain embedded leases during the defined accommodation period, we suspect that this might create a tendency to account for all affected contracts as nonlease contracts/agreements.

Some components expressed that further guidance would be helpful to address if a lease footnote disclosure will be needed around the amount that was previously considered a nonlease, and disclosure around the amount that will be considered a lease if there is a modification to the lease during the accommodation period.

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.

While some of the smaller DoD components find the length and sufficiency of the proposed accommodation acceptable, the larger DoD components (such as a military service) do not believe that the accommodation period is long enough. This is especially true for the components with a disclaimer audit opinion, as they work through much larger reporting challenges on their way to an audit opinion. For e.g., for those who are starting their review of lease agreements/contracts from scratch in a contracting system feeding into an accounting and reporting system, we doubt a large entity would be able to comply in two years.

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.

DoD components agree with the option to group reasonably similar contracts/agreements for the sake of efficiency. Some components have suggested that examples of "reasonably similar" contracts be provided to add clarity, such as which attributes (vendor, contract length, contract terms, etc.) would have to align to be considered "reasonably similar".

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.

DoD components agree with the proposed disclosure requirements, although we are concerned that independent auditors might question a choice to not disclose annually.

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.

DoD components expressed mixed opinions regarding the alternative view; however, the majority of the components who submitted comments generally agreed with the alternative view or parts of it.

Some components think that that the alternative view approach would likely lead to a simplified and streamlined implementation, thus reducing cost without significantly altering reporting quality, provided the differentiation and application of the standard was disclosed. This especially applies to large reporting entities within the DoD who have difficulty identifying "embedded leases" and controlling/monitoring/accounting for them at the level of detail required in SFFAS 54.

Other components expressed a concern that the practical expedient can be abused due to lack of criteria for defining the primary purpose of the contract, which, in turn, will diminish the quality of financial reporting of leases. To avoid that, they suggest guidance or limitations be defined on when the practical expedient can be used.