

*Transitional Amendment to SFFAS 54*

**Please select the type(s) of organization responding to this exposure draft. If you are not responding on behalf of an organization, please select “individual.”**

Accounting Firm	<input type="checkbox"/>	
Federal Entity (user)	<input type="checkbox"/>	
Federal Entity (preparer)	<input checked="" type="checkbox"/>	
Federal Entity (auditor)	<input type="checkbox"/>	
Federal Entity (other)	<input checked="" type="checkbox"/>	If other, please specify: <u>Financial Management Policy</u>
Association/Industry Organization	<input type="checkbox"/>	
Nonprofit organization/Foundation	<input type="checkbox"/>	
Other	<input type="checkbox"/>	If other, please specify: <u></u>
Individual	<input type="checkbox"/>	

**Please provide your name.**

Name: Lauren Webster

**Please identify your organization, if applicable.**

Organization: Consolidated Department of Justice

*Please email your responses to [fasab@fasab.gov](mailto:fasab@fasab.gov). If you are unable to respond by email, please call (202) 512-7350 to make alternate arrangements.*

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.

DOJ generally agrees with the proposed transitional amendment as a whole, but would prefer the alternate approach in QFR7 as it could permanently solve the issues arising from implementing paragraph 73 of SFFAS 54 while accurately representing our lease liabilities. At a minimum, the transitional amendment will allow DOJ time to implement systemic reporting systems for leases and identify and update contracting practices to more successfully implement the reporting for embedded leases. To achieve accurate financial reporting for embedded leases, DOJ components feel they will need to work with Acquisitions staff on solutions to identify reportable items, for example, including a clause in a service contract requiring vendors to separate reportable items. The transitional amendment will also allow DOJ to focus on accurate reporting of direct leases required under SFFAS 54 in FY2024.

**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.

DOJ generally feels that paragraphs 3-4 and paragraph 5 provide sufficient criteria for the scope of the transitional accommodation for “embedded leases.” We request that the Board consider further defining or providing criteria for entities to determine the primary purpose of a contract between lease and non-lease components to support consistent identification of lease vs. non-lease contracts or agreements across entities.

Our current reporting for the standard is entirely manual, and different DOJ components have different procurement practices (centralized vs de-centralized). Due to these factors, the highest level of effort (LOE) would mainly be incurred before and during the first year of implementation (2024) to review contract types and assess whether the contract is primarily a lease or primarily not a lease and develop guidance for future contract monitoring. This amendment reduces the full burden of implementation for embedded leases in FY2024 as the complex calculations for allocating contract costs between leases and non-lease components, and performing right to control evaluations will be avoided for the leases categorized as primarily “non-lease” purpose and must only be performed on the primarily “lease” related contracts.

Once the initial assessment is made, components will be required to continuously monitor new contract types to determine the appropriate categorization and reporting requirements. Additional LOE will be required during the transitional period to update/develop processes to identify embedded leases that must be reported once the transitional period ends and to coordinate with Procurement Managers to update processes to improve the identification of lease components in contracts as the contracts are executed.

We expect there to be additional technology requirements as well to identify and report on embedded leases where they are not the primary purpose of the contract to reduce the manual nature of this reporting process. We are also still working on technical solutions for recording all leases in accordance with the standard.

**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) and the expected level of effort for applying the accommodation.

DOJ requests clarification on the “modification” language of paragraphs 86B and 96C. We read the paragraphs to state that contracts assessed as primarily non-lease do not need to be reported during the transitional accommodation period UNLESS a modification changes the primary purpose of the contract to a lease contract. In addition, after the transitional accommodation period has ended, existing contracts will not be assessed for reporting unless modified. Please consider adding clarification on the types of modifications that would result in reporting after the transitional accommodation period has passed. SFFAS 54 parage 80 currently states, “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**” Modifications are often executed to add funding to new option periods that were previously unfunded or to process administrative changes to update certain non-financial or SOW attributes on a contract (such as a modification to change the COR). These types of modifications would not change the lease/non-lease components initially assessed and should not result in the entity being required to report a new lease asset/liability.

**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.

We agree that the proposed transitional accommodation would help DOJ implement the standard by allowing for resources to be focused on primarily lease contracts in FY2024, and to allow for further review of embedded leases before reporting in FY2026. This period will allow the Department more time to develop software solutions for all reporting under the standard. Having said that, we do however concur with Mr. Bell, Ms. Johnson, and Messrs. McNamee and Vicks’ opinion that “The transitional accommodation the Board proposed would provide some relief from the challenges inherent in implementing paragraph 73 of SFFAS 54...Such relief would be limited, however, in that it would be temporary and would apply only to contracts or agreements whose purpose is primarily attributable to their nonlease components...making available broader and permanent relief from the requirements of paragraph 73 would substantially reduce the cost of implementing SFFAS 54 without substantially diminishing the quality of financial reporting of leases.” Therefore, we strongly support making the accommodation permanent. Please see QFR7 for further discussion.

**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.

We agree with this proposal. We would also like the Board to consider incorporating the option to select varying accommodation periods for different categories of contracts or agreements into paragraph 96B.

**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.

Please consider amending paragraph 54 to clarify that embedded leases meeting the criteria outlined in paragraph 96A do not need to be disclosed as part of the Component Reporting Entity Disclosure Requirements for lease activities other than short-term leases, contracts or agreements that transfer ownership, and intragovernmental leases.

Consider including this prescribed disclosure notice within OMB's A-136 reporting requirements and remove these requirements from SFFAS 54.

**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.

DOJ fervently agrees with the alternative view. If the lease is not the primary component of the contract, excluding it would not negatively impact the quality and accuracy of the financial statements. Furthermore, this approach would still accurately reflect an entity's overall position concerning lease assets and liabilities. We also believe this alternate view aligns with the Board's practical expedient for embedded leases. This mitigates the challenges associated with tracking lease and non-lease components of the same contract separately, simplifying the reporting process.

DOJ's identified primarily "non-lease" contracts to date are primarily service contracts with embedded use of equipment or property. The value provided to the Department's mission is the entire package of services, and not just the use of the property. The services involve expertise that is cheaper and easier to contract for than to develop and provide in house by government FTEs. For example:

Bureau of Prisons (BOP) mission is “Corrections professionals who foster a humane and secure environment and ensure public safety by preparing individuals for successful reentry into our communities.” To support this mission the Bureau of Prisons funds rehabilitation programs to facilitate an inmates successful reentry into the general community. Residential Re-entry Contracts (RRC) are structured, supervised environments for inmates nearing release. These facilities provide inmates the opportunity to gradually rebuild their ties to the community, while receiving services such as counseling and job placement. Inmates also use this transition period to continue programs they may have participated in while incarcerated at a BOP facility; for example, the final phase of substance abuse treatment is completed at an RRC. These types of contracts are charged on a per inmate basis, at a flat fee for each day of services. This service includes housing, which would be considered an embedded lease of real property, but the primary purpose is the services intended to facilitate re-entry into the general community. BOP also maintains contracts for medical services for the inmate population at regional medical centers. These contracts can include a controlled space for healthcare for inmates (a “lease” of a small portion of the hospital’s building”), but the main purpose of the contract is the healthcare services received. Does a financial statement user receive value to see how much we are spending on housing inmates during medical treatment or during rehabilitation periods, compared to the services being provided at those times?

Additionally, all of our embedded lease examples are standard procurement contracts with option years, subject to availability of funding clauses, and options to terminate, therefore the long-term liability of these contracts even including the probability requirements of the standard is generally limited to 5 years and is easily canceled if necessary with little required termination costs. When you then bifurcate the contract costs between the lease and non-lease components, there is less value being reported on the balance sheet. What is the value in reporting balance sheet asset/liabilities for a portion of a service contract when all of the service costs will only be reported as liabilities once they have been incurred?

One of our primary challenges in the initial implementation is identifying the completeness of our lease population given that leases, or contracts with a primary lease purpose, may not be currently coded as such. The alternative view would still require DOJ to review contracts at a level that would improve financial reporting and classification, and standardize the classification of contracts in a more consistent and granular level of detail, even if the contracts categorized as non-leases are not included in the calculation of assets/liabilities for recognition on the balance sheet. This will still lead to improved financial reporting, including reporting through [usaspending.gov](https://usaspending.gov) as well as the financial statements.

However, we have identified two areas that require further clarification. Firstly, criteria should be defined for entities to determine the primary purpose of a contract between a lease and non-lease components. This would help support a consistent approach to identifying lease vs. non-lease contracts or agreements across different entities.

Secondly, we suggest adding language to paragraph A17, similar to paragraph 96D from the proposed amendment. This would allow entities to group contracts or agreements that are reasonably similar in nature and assess the contract's primary purpose, whether it is a lease or non-lease.

DOJ plans to submit an addendum of questions related to the standard for further consideration.