Bond Case Briefs

Municipal Finance Law Since 1971

GASB: Lease Accounting - Reexamination of NCGA Statement 5 and GASB Statement.13

Project Description:

The objective of this project is to reexamine issues associated with lease accounting, considering improvements to existing guidance. This project will provide a basis for the Board to consider whether operating leases meet the definitions of assets or liabilities. Current guidance is provided by National Council on Governmental Accounting (NCGA) Statement 5, *Accounting and Financial Reporting Principles for Lease Agreements of State and Local Governments*, GASB Statement No. 13, *Accounting for Operating Leases with Scheduled Rent Increases*, GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, and GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*. Statement 62 incorporates the provisions of FASB Statement No. 13,*Accounting for Leases*, as amended and interpreted, into the GASB's authoritative literature.

Status:

Added to Current Agenda: April 2013
Added to Research Agenda: April 2011

- Project Plan
- Recent Minutes
- Tentative Board Decisions to Date
- Project staff:
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LEASE ACCOUNTING—PROJECT PLAN

Background: Governments routinely enter into leases. Under the current authoritative literature, many of these leases are reported as operating leases. Even though operating leases represent long-term commitments to make payments, no liabilities are reported, although there are disclosures. Likewise, no assets are reported when governments have long-term rights to receive operating lease payments. In Concepts Statement No. 4, *Elements of Financial Statements,* the Board established definitions of assets and liabilities. This project provides an opportunity for the Board to consider whether operating leases meet the definitions of assets or liabilities.

The FASB and the International Accounting Standards Board (IASB) have current projects that propose to replace private sector guidance. Because of the potentially significant changes of the FASB/IASB project, the staff has received technical inquiries regarding whether there are any plans for the GASB to update its leasing guidance.

This project undertaken by the GASB is being performed in concert with the similar FASB/IASB project to maximize efficiency and timeliness. A simultaneous lease accounting project on the GASB agenda provides the opportunity to follow the progress of the FASB/IASB leasing project to assess any proposed new or amended leasing guidance in the context of the state and local government environment on a contemporaneous basis. This allows the Board to consider and address amendments to FASB Statement 13 (GASB Statement 62) in a timely manner.

Finally, part of the GASB's strategic plan is to evaluate the effectiveness and impact of existing standards that have been in effect for a sufficient length of time. NCGA Statement 5 was issued in 1982 and GASB Statement 13 in 1990. This project provides an opportunity for a fresh look at the existing guidance for any improvements not contemplated by the FASB/IASB project given the unique nature of governmental entities and the complexities of their leasing transactions.

Accounting and Financial Reporting Issues: The major topic being researched is the forms of financial reporting display and disclosure that would meet essential financial statement user needs. The project is considering the following issues:

1. What types of leases are entered into by state and local governments?
2. What specific user needs exist regarding governmental leases and what decision-useful or accountability information is needed to meet those needs?
3. Are current accounting and financial reporting standards appropriate to meet essential user needs?
4. Should there be a distinction between types of leases, such as operating and capital?
5. If current standards are not considered adequate, what additional potential requirements should be considered?

Project History: A proposal to add the project to the research agenda was discussed by the GASAC at its March 2011 meeting and the project was added to the research agenda in April 2011.

At its February 2013 meeting, the GASAC ranked the project fifth in priority among research and potential projects. The project was added to the current agenda in April 2013.

The project was added to the current agenda in April 2013. At the June 2013 meeting, the FASB staff presented an education session on the proposed revisions to lease accounting contained in its revised Exposure Draft that was issued in May 2013.

At its August 2013 meeting, the Board discussed the scope of the project, the definition of a lease, and related scope issues. The Board tentatively agreed with the timeline and scope of the project. The Board then discussed minor revisions to the definition of a lease. The Board tentatively decided to replace "agreement" with "contract" and replace "capital assets (land and/or depreciable assets)" with "an asset (the underlying asset). The Board also tentatively decided to add the phrase "in an exchange or exchange-like transaction" to the definition of a lease.

The Board then discussed the inclusions and exclusions to the scope of lease guidance.

The Board tentatively decided to continue to include contracts not identified as leases but that meet the definition of a lease. The Board tentatively decided to not provide an example of such a contract, and remove the example currently provided. The Board tentatively decided to continue to exclude the following from the scope of the guidance: agreements that are contracts for services that do not transfer the right to use capital assets from one contracting party to the other; leases to explore for or use of minerals, oil, natural gas, and similar nonregenerative resources; licensing agreements for such items as motion picture films, video recordings, plays, manuscripts, patents, and copyrights; and agreements that meet the definition of a service concession arrangement (SCA). In addition, the Board tentatively decided that biological assets, including timber should be excluded from the scope of the lease guidance, while intangible assets other than licensing agreements would continue to be included in the scope.

Current Developments: At the September 2013 meeting, the Board discussed issues associated with lease classifications and lease terms that drive the accounting treatment of leases. After discussing characteristics of various types of leases, the Board considered alternate methods to classify leases for accounting purposes. The Board tentatively agreed that while there might be inherent differences in leases, a single accounting model could be developed in the interest of not creating unnecessary complexity, with potential exceptions for certain circumstances.

The Board then discussed elements relevant to the duration of a lease, including the definition of a lease term, how to account for fiscal funding clauses, and the reassessment of a lease’s term. The Board tentatively decided that the lease term should start with the noncancellable period. The Board also tentatively decided that the lease term should include the periods covered by renewal options (or exclude periods covered by termination options) that are probable of being exercised based on an assessment of qualitative factors. The Board tentatively agreed to include in the noncancellable period of the lease term periods covered by fiscal funding and cancellation clauses with a remote possibility of cancellation. Leases that contain a fiscal funding or cancellation clause with a more than remote possibility of cancellation should be treated as having a termination option. The Board also tentatively agreed the lease term should be reevaluated when there is a change in relevant factors that would result in a change in judgment as to the lessee’s likelihood to exercise or terminate the lease, or when the lessee actually exercises or terminates the lease opposite of what was previously expected. The Board tentatively decided the relevant factors used in the initial assessment also should be the factors that trigger a reassessment.

At the October 2013 meeting, the Board discussed lessee recognition and measurement, including the foundation for recognition and measurement, and lessee recognition of assets and liabilities. The Board also began discussions on the lessee initial measurement of liabilities. The Board tentatively decided that the notion of leases as financings be the foundation for the governmental leasing model.

The Board continued deliberations by discussing the recognition of assets and liabilities for lessees. The Board tentatively agreed that the right to use the underlying asset be recognized as an asset by the lessee and that the obligation to make lease payments be recognized as a liability by the lessee. Furthermore, the Board tentatively decided that the obligation to return the underlying asset at the end of the lease not be recognized as a liability by the lessees; it also should not be recognized as a deferred inflow of resources or an outflow of resources. The Board then discussed other rights and obligations that may arise from a lease. The Board tentatively agreed that other rights be considered part of the overall lease asset and that other obligations be evaluated on a case-by-case basis.

The Board then discussed potential exceptions to the overall lease model. The Board tentatively decided that exceptions be made for short-term leases, under which the lessee government is not required to recognize assets or liabilities. The Board tentatively decided that a short-term lease be defined as a lease that, at the beginning of the lease, has a maximum possible term under the contract, including any options to extend, of 12 months or less. The Board tentatively agreed that the presence of a purchase option not affect the definition of a short-term lease. However, the Board also tentatively decided that leases that transfer ownership not qualify for the short-term lease exception, even if those leases meet the other criteria.

The Board then discussed the overall approach to the measurement of lease assets and liabilities for lessees. The Board tentatively decided that the general approach to measuring lease assets and liabilities be to measure the liabilities first and base the assets on that amount. The Board also tentatively decided that the general measurement approach for a lease liability be based on the present value of future payments.

The Board discussed the lessee measurement of lease liabilities and the types of payments that should be included. The Board tentatively decided that the following types of lease payments be included in the measurement of the initial lease liability:

- Fixed payments for the lease term
- Variable payments based on an index or rate, using the rate in effect at that date
- Variable payments that are in-substance fixed.

The Board tentatively decided that lease payments that depend on a lessee's performance or usage of an underlying asset not be a component of the initial lease liability. The Board also discussed residual value guarantees as a potential component of the lease liability as well, and requested additional staff research before making a tentative decision.

At the November 2013 teleconference, the Board discussed certain topics related to the initial measurement of assets that are created when entering into a lease. Specifically, the Board discussed prepayments, lease incentives, and initial direct costs. The Board tentatively agreed that prepayments (amounts paid for the lease prior to measuring the lease liability) should be included in the value of the reported lease asset. The Board also tentatively decided that lease incentives received should be reductions in the cost of lease assets. The Board tentatively decided that initial direct costs should be either capitalized (if they are ancillary charges to place the asset into use) or expensed (all other costs). The Board also discussed measurement in governmental funds and tentatively decided that lease liabilities should be measured consistent with the current measurement requirements for capital leases.

At the December 2013 meeting, the Board continued discussions on issues related to initial measurement of a lease liability and asset for lessees. The Board also discussed issues related to subsequent measurement of lease liabilities and assets, additional issues related to short-term leases, and issues related to leases with multiple components, noncore assets, and other expense topics.

Work Plan: In addition to the topics below that will be deliberated by the Board, the project staff will continue to monitor the progress of the FASB and IASB projects on leases.

Work Plan:

Board meetings	*Topics to be considered*
January 2014:	Discuss lessee disclosures.
March 2014:	Discuss lessor—recognition and measurement
April 2014:	Continue discussion of lessor—recognition and measurement.

May 2014:	Discuss lessor disclosures.
July 2014:	Discuss special topics.
August 2014:	Review draft Standards section.
September 2014:	Review preballot draft of proposed Statement.
November 2014:	Review ballot draft and issue Exposure Draft.
December 2014–March 2015:	Due process, including field test.
April–October 2015:	Redeliberations.
November 2015:	Review preballot draft of final Statement.
December 2015(T/C):	Review ballot draft and issue final Statement.

LEASE ACCOUNTING —RECENT MINUTES

Minutes of Meetings, April 8-10, 2014

The Board began deliberations by discussing potential note disclosure requirements for lessees in relation to the general description of leasing arrangements. The Board tentatively agreed to propose a requirement for lessees to disclose a general description of the lessee's leasing arrangements, including the basis, and terms and conditions, on which variable lease payments are determined and the existence, and terms and conditions, of residual value guarantees provided by the lessee. The Board also tentatively decided not to propose a requirement for lessees to disclose the existence and terms of purchase options; the existence, and terms and conditions, of renewal and termination options; the restrictions or covenants imposed by leases; or information about significant assumptions and judgments made in accounting for leases.

The Board continued deliberations by discussing potential disclosure requirements for lessees related to assets and liabilities. The Board tentatively agreed to propose that lessees be required to disclose only the general reconciliations of the changes in the lease liability and of the changes in capital assets currently required by Statement No. 34, Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments, and not to include a requirement for a more detailed reconciliation. Furthermore, the Board tentatively agreed to propose a requirement for the total amount of assets recorded under leases, and the related accumulated amortization, to be disclosed separately from owned assets. The Board also tentatively decided not to propose a requirement for lease assets to be disaggregated by major classes of underlying assets.

The Board then discussed potential disclosure requirements for lessees involving expenses related to leases. The Board tentatively decided not to propose that lessees separately disclose the amount of amortization expense recognized for lease assets. The Board also tentatively decided to propose a requirement for lessees to disclose the total variable lease payments actually incurred. Furthermore, the Board tentatively decided to propose that the due process document supersede any existing disclosures related to operating leases.

The Board continued deliberations by discussing potential disclosure requirements for lessees in relation to future lease obligations. The Board tentatively agreed to propose a requirement for lessees to disclose a maturity analysis of future minimum lease payments that shows the payments for each of the first five years and five-year increments thereafter, with the payments shown undiscounted and total interest summed for all years. The Board also tentatively decided not to propose that the lessee disclosure requirements include amounts of sublease rentals to be received. The Board agreed that this topic would be addressed in the lessor disclosure deliberations.

Furthermore, the Board tentatively decided to propose a requirement for lessees to disclose commitments relating to leases, other than short-term leases, for which the lease term has not begun with a conforming edit to NCGA Statement 1, Governmental Accounting and Financial Reporting Principles. The Board also tentatively decided not to propose a requirement for lessees to disclose a maturity analysis of the nonlease components of a contract.

The Board then discussed other considerations regarding lessee disclosures. The Board tentatively decided not to propose that the due process document refer to the noncash transaction disclosure requirement in Statement No. 9, Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting. The Board also tentatively agreed to replace the example in Statement 9 of "obtaining an asset by entering into a capital lease" with "obtaining a right-of-use asset by entering into a lease." Furthermore, the Board tentatively decided not to propose that the due process document refer to the related party disclosures in Statement No. 62, Codification of Accounting and Financial Reporting Guidance Contained in pre-November 30, 1989 FASB and AICPA Pronouncements.

The Board continued deliberations by discussing other potential disclosure requirements. The Board tentatively decided not to propose a requirement for disclosure of the discount rate(s) used in measuring lease liabilities. The Board also tentatively decided to propose an amendment to Statement 62 to exempt lease liabilities from imputed interest guidance. Furthermore, the Board tentatively decided not to propose a requirement for lessees to disclose the fair value of the lease liability, the amount of initial direct costs capitalized as part of lease assets during the reporting period, and information about arrangements that upon transition no longer meet the definition of a lease. The Board also tentatively decided not to propose a requirement for lessees to disclose the amount of interest expense related to leases or a requirement for lessees to disclose together all lease-related expenses. In addition, the Board tentatively decided not to propose a requirement for lessees to disclose cash paid for principal and interest on leases.

The Board tentatively agreed to propose a requirement for disclosure of payments made in excess of contractual requirements, such as residual value guarantees or penalties. The Board also tentatively decided not to propose a requirement for lessees to disclose the actual lease terms for significant leases and the weighted-average lease term of all leases, as well as the categorization of renewal options by likelihood.

The Board tentatively agreed to propose that lessee disclosure requirements not include information about below-market leases. The Board tentatively decided not to propose a requirement for lessees to disclose information about a government's decision-making. Furthermore, the Board tentatively agreed to propose an amendment to Statement 62 to exempt disclosure of the underlying asset as collateral. The Board also tentatively agreed to propose that lessee disclosure requirements include the components of a net impairment loss (that is, gross impairment loss and adjustment to the lease liability).

The Board continued deliberations by discussing short-term lease disclosures for lessees. The Board tentatively decided that the existing disclosure requirements for accounting policies are sufficient to cover disclosure of accounting treatment for short-term leases and that no additional guidance is necessary in the due process document. The Board also tentatively agreed to propose a requirement for lessees to disclose the amount of expense and expenditure recognized for the period related to short-term leases. The Board also tentatively decided not to propose a requirement for lessees to disclose commitments under short-term leases or qualitative information about circumstances when the next period's short-term lease expense is expected to be significantly different than the current period's expense.

Minutes of Meetings, March 3-5, 2014

The Board met in a joint session with the Federal Accounting Standards Advisory Board (FASAB). The Board and FASAB began by discussing the foundation of a new accounting model for lessors. The Board tentatively decided that a new accounting model for lessors should be considered and that symmetry between the lessee and lessor accounting models should be a key factor in development of the lessor model.

The Board and FASAB then discussed the tentative decisions the Board has made to date. No further tentative decisions were made by the Board.

Minutes of Meetings, February 13, 2014

The Board discussed topics related to impairment of a lease asset. The Board tentatively decided to propose that in circumstances in which an asset underlying a lease is damaged and requires restoration or replacement, the time period during which the underlying asset is not usable generally is the relevant factor in assessing whether the impairment test has been met. This amended the Board's previous tentative decision that a lessor's responsibility to repair or replace an impaired underlying asset may indicate that impairment of the lease asset (right to use) will be temporary.

The Board continued deliberations by discussing impairment indicators. The Board tentatively decided to propose that the following be included in the text of a proposed Leases standard:

a) Impairment indicators present with respect to the underlying asset may result in a change in the manner or duration of use of the lease asset
b) A change in the manner or duration of use of the lease asset may indicate impairment of that asset.

The Board then discussed whether a lessor's responsibility to restore or replace the underlying asset may indicate that the magnitude of the decline in service utility of the lease asset is not significant. The Board tentatively decided not to include that statement in a potential Leases standard.

The Board continued deliberations by discussing how to measure and recognize the impairment of a lease asset. The Board tentatively decided to propose that the lease asset should be adjusted first by the same amount as any change in the related lease liability. If the carrying value of the lease asset is reduced to zero, any further adjustments should be recognized in the flows statement. The Board also tentatively decided to propose that an impaired lease asset first be adjusted by any change in the corresponding lease liability, with any remaining adjustment recognized as the impairment loss.

The Board continued its discussions by reviewing examples of different impairment scenarios presented by the project staff. The Board provided suggestions to staff for changes to the examples if they are to be included in a due process document or future implementation guidance.

Minutes of Meetings, January 27-29, 2014

The Board began deliberations by discussing a possible exception to the overall lease accounting model for noncore assets, which could be defined as assets that are not essential to a government's operations. The Board tentatively decided to propose that there not be an exception made to the overall leases model for leases of noncore assets.

The Board continued deliberations by discussing topics on lease-related expenses. The Board tentatively decided to propose that the existing guidance related to the accounting treatment for operating leases with scheduled rent increases be superseded. The Board also tentatively decided to propose that lease payments for short-term leases that have a rent holiday or rent reduction provisions be recognized as expenses based on the terms of the contract. Furthermore, the Board tentatively decided to propose that lease payments not included in the liability measurement be recognized as expense in the accrual accounting-based flows statement in the period in which the obligation for those payments is incurred.

The Board then discussed recognition in governmental funds. The Board tentatively decided to propose conforming edits to the existing guidance on accounting for leases in governmental funds. Furthermore, the Board tentatively decided to propose that the general guidance for recognition of liabilities in governmental funds adequately addresses short-term leases, and only limited amendments to existing provisions are needed.

The Board then discussed issues relating to the lease asset. The Board tentatively decided to propose that the right-of-use asset in a lease is an intangible asset that should be accounted for in accordance with existing authoritative guidance for capital assets. The Board also tentatively decided to propose that the relationship between the underlying asset and the lease asset could mean that the lease asset is impaired if indicators of impairment are present with respect to the underlying asset. Furthermore, the Board tentatively decided to propose that a lessor's responsibility to repair or replace an impaired underlying asset may indicate that an impairment of the lease asset (right to use) will be temporary. The Board discussed how a lessee would measure an impairment of the lease asset and requested that the staff develop example calculations.

The Board continued deliberations by discussing guidance on presentation of lease assets and liabilities. The Board tentatively decided to propose that existing guidance on presentation of capital assets would apply to the lease asset. The Board also tentatively decided to propose that existing guidance on presentation of general long-term liabilities apply to the lease liability and that it be referred to as a long-term liability in a proposed Statement. Additionally, the Board tentatively decided to propose that specific guidance on the presentation of lease activities in the statement of cash flows be provided through implementation guidance rather than in the proposed Leases standard as existing standards related to the statement of cash flows are sufficient.

Minutes of Meetings, December 10-12, 2013

The Board continued its discussion on the measurement of lease liabilities by a lessee and the types of payments that should be included. The Board tentatively decided to propose that the following types of lease payments be included in the measurement of the initial lease liability:

- The best estimate or minimum of range of residual value guarantees probable of being paid based on an assessment of qualitative factors
- Purchase options probable of being exercised based on an assessment of qualitative factors
- Termination penalties, if based on the determination of the lease term, the termination option is probable of being exercised.

The Board then discussed several alternatives with respect to the determination of the discount rate.

The Board tentatively decided to propose that lease liability payments be discounted using the rate the lessor charges the lessee. However, if that rate cannot be readily determined, the lessee's incremental borrowing rate should be used. The Board tentatively decided not to propose an exception to use a risk-free interest rate in certain situations. The Board also continued its discussion of the initial measurement of lease assets and tentatively decided to propose that the first component of the lease asset be the initial measurement of the lease liability.

The Board continued deliberations by discussing subsequent measurement of the lease asset and lease liability by a lessee during the term of the lease. The Board tentatively decided to propose that a lessee remeasure a lease liability by calculating the amortization of the discount on the lease liability and reducing the lease liability by the actual lease payment amount less the amortization of the discount. The Board tentatively decided to propose that lease assets be amortized using a systematic and rational basis. The Board also tentatively decided to propose that lease assets be amortized over the shorter of the useful life of the underlying asset or the lease term. However, the Board also tentatively decided to propose that the lessee amortize the right-of-use asset as if the lessee owns the underlying asset, using the lessee's depreciation policy, if the lease transfers ownership or if by assessing qualitative factors, it is probable that a purchase option will be exercised. In those situations, if the underlying asset is a non-depreciable asset such as land, the lessee should not amortize the right-of-use asset. Furthermore, the Board tentatively decided that the proposed guidance on leases that transfer ownership be included in the text of a standard.

The Board then discussed classification in the accrual-basis flows statement and the Board tentatively decided to propose that the lessee report the amortization of the lease asset as amortization expense and the amortization of the discount on the lease liability as interest expense.

The Board then discussed the reassessment of lease liabilities for lessees. The Board tentatively decided to propose that there be a reassessment of a lease liability when there is a change in the likelihood (probable to not probable or vice versa) of a purchase option being exercised based on an assessment of qualitative factors. The Board also tentatively decided to propose that, based on an assessment of qualitative factors, there be a reassessment of the residual value guarantee component of a lease liability when there is either a change in the amounts expected to be payable or when there is a change in the likelihood (probable to not probable or vice versa) that a payment will be required. Furthermore, the Board tentatively decided to propose that there be a reassessment of a lease liability when the result of a change in an index or a rate used to determine lease payments during the reporting period may be significant.

The Board tentatively decided to propose that a reassessment of the discount rate be required in any of the following situations:

- The lease term is changed
- There is a change in the likelihood (probable to not probable or vice versa) that a purchase option will be exercised
- The result of a change in the reference rate used to determine a variable lease payment may be significant.

The Board also tentatively decided to propose that in the event of a reassessment the Board's tentative decision regarding the initial selection of a discount rate also be the approach for selection of a discount rate.

The Board continued deliberations by discussing the recalculation of the lease liability and asset. The Board tentatively decided to propose that adjustments arising from remeasurements of lease liabilities also adjust the right-of-use asset. The exception is adjustments due to a change in the rate upon which a variable lease payment is based, which should be recognized as revenue or expense in the current period.

The Board then discussed whether a lease asset should be subject to existing guidance on impairment. The Board requested to defer a tentative decision on this question until it discusses classification of the lease asset. The Board then considered a situation in which a lease asset also meets the proposed definition of an investment. The Board tentatively decided to propose that the asset be measured in accordance with guidance for investments rather than leases.

The Board then continued discussions on short-term leases. The Board tentatively decided to propose that a short-term exception be an accounting requirement, rather than a policy election, for all leases that qualify. The Board also tentatively decided to propose that lessees not be required to recognize assets or liabilities associated with the right to use the underlying asset for short-term leases. Furthermore, the Board tentatively decided to propose that lease payments for short-term leases be recognized as expenses/expenditures based on the terms of the contract.

The Board also discussed cancellable leases and tentatively decided to propose that cancellable periods (those periods for which a lessee and lessor each have the right to cancel the lease) be excluded from the lease term. The Board also tentatively decided to propose that the maximum possible term for a cancellable lease be defined as any noncancellable period, including any notice periods.

The Board then discussed whether contracts with multiple components (lease and nonlease, or multiple leases) should be bifurcated for accounting purposes and, if so, how the consideration should be allocated to the different components. The Board tentatively decided to propose that governments separate contracts into lease and nonlease components, subject to a practicality exception related to measurement. The Board also tentatively decided to propose that governments separate lease contracts involving multiple assets into multiple lease components only if there are different lease terms, subject to a practicality exception related to measurement.

For allocation of consideration between multiple components, the Board tentatively decided to propose that lessees first use prices in the contract for individual components, if available, if those prices are reasonable based on other observable stand-alone prices. If individual prices are not included in the contract, or the prices are not reasonable, the Board also tentatively decided to propose that lessees allocate consideration based on relative observable stand-alone prices, if those prices are available for all components of the contract. If observable stand-alone prices are not available for all components, the Board tentatively decided to propose that lessees (1) allocate the stand-alone price to any components for which there are such prices and then (2) consider any remaining components to be a single unit of account and assign the remaining consideration to that unit.

The Board continued deliberations by discussing how to account for a contract if components are not separated and the idea of providing guidance for concurrent contracts. The Board tentatively decided to propose that guidance be provided when multiple lease components are considered one unit for accounting purposes. The Board also tentatively decided to propose that accounting for multiple lease components that are considered as one unit for accounting purposes be based on the primary component. Furthermore, the Board tentatively decided to propose that guidance be provided for treating separate contracts that were signed concurrently. The Board will consider issues associated with concurrently signed contracts at a later meeting.

Minutes of Meetings, October 29-31, 2013

The Board discussed lessee recognition and measurement, including the foundation for recognition and measurement, and lessee recognition of assets and liabilities. The Board also began discussions on the lessee initial measurement of liabilities. The Board tentatively agreed that the major criticisms of current lease accounting, opportunities for structuring around a bright-line classification test and omission of a perceived liability, are items that the Leases project should attempt to address. The Board also recognized that the proposed accounting model for leases may have differences from the private sector as a result of factors found in the state and local government environment. The Board tentatively decided that the model should attempt to measure resources available to provide services, and obligations to sacrifice such resources, with consideration given to the characterization of expenses. The Board also discussed whether leases are executory contracts but did not reach a tentative decision. The Board tentatively decided to propose that the notion of leases as financings be the foundation for the governmental leasing model.

The Board continued deliberations by discussing the recognition of assets and liabilities for lessees. The Board tentatively agreed to propose that the right to use the underlying asset be recognized as an asset by the lessee and that the obligation to make lease payments be recognized as a liability by the lessee. Furthermore, the Board tentatively decided to propose that the obligation to return the underlying asset at the end of the lease not be recognized as a liability by the lessees; it also should not be recognized as a deferred inflow of resources or an outflow of resources. The Board then discussed other rights and obligations that may arise from a lease. The Board tentatively agreed to propose that other rights be considered part of the overall lease asset and that other obligations be evaluated on a case-by-case basis.

The Board then discussed potential exceptions to the overall lease model. The Board tentatively decided to propose that exceptions be made for short-term leases, under which the lessee government is not required to recognize assets or liabilities. The Board tentatively decided to propose that a short-term lease be defined as a lease that, at the beginning of the lease, has a maximum possible term under the contract, including any options to extend, of 12 months or less. The Board tentatively agreed to propose that the presence of a purchase option not affect the definition of a short-term lease. However, the Board also tentatively decided to propose that leases that transfer ownership not qualify for the short-term lease exception, even if those leases meet the other criteria. Furthermore, the Board tentatively decided to propose that it not be necessary to make an exception for leases that transfer ownership of underlying assets.

The Board then discussed the overall approach to the measurement of lease assets and liabilities for lessees. The Board tentatively decided to propose that the general approach to measuring lease assets and liabilities be to measure the liabilities first and base the assets on that amount. The Board also tentatively decided to propose that the general measurement approach for a lease liability be based on the present value of future payments.

The Board discussed the lessee measurement of lease liabilities and the types of payments that should be included. The Board tentatively decided to propose that the following types of lease payments be included in the measurement of the initial lease liability:

- Fixed payments for the lease term
- Variable payments based on an index or rate, using the rate in effect at that date
- Variable payments that are in-substance fixed.

The Board tentatively decided to propose that lease payments that depend on a lessee’s performance or usage of an underlying asset not be a component of the initial lease liability. The Board also discussed residual value guarantees as a potential component of the lease liability as well, and requested additional staff research before making a tentative decision.

Minutes of Meetings, September 17-19, 2013

The Board discussed issues associated with lease classifications and lease terms that drive the accounting treatment of leases. After discussing characteristics of various types of leases, the Board considered alternate methods to classify leases for accounting purposes. The Board tentatively agreed that while there might be inherent differences in leases, a single accounting model could be developed in the interest of not creating unnecessary complexity, with potential exceptions for certain circumstances.

The Board then discussed elements relevant to the duration of a lease, including the definition of a lease term, how to account for fiscal funding clauses, and the reassessment of a lease's term. The Board tentatively decided that the lease term should start with the noncancellable period. The Board also tentatively decided that the lease term should include the periods covered by renewal options (or exclude periods covered by termination options) that are probable of being exercised based on an assessment of qualitative factors. The Board tentatively agreed to include in the noncancellable period of the lease term periods covered by fiscal funding and cancellation clauses with a remote possibility of cancellation. Leases that contain a fiscal funding or cancellation clause with a more than remote possibility of cancellation should be treated as having a termination option. The Board also tentatively agreed the lease term should be reevaluated when there is a change in relevant factors that would result in a change in judgment as to the lessee's likelihood to exercise or terminate the lease, or when the lessee actually exercises or terminates the lease opposite of what was previously expected. The Board tentatively decided the relevant factors used in the initial assessment also should be the factors that trigger a reassessment.

Minutes of Meetings, August 6-8, 2013

The Board began deliberations for the leases project by reviewing the history of leases and current literature, the tentative scope of the project, the definition of a lease, and related scope issues. The Board tentatively agreed with the timeline and scope of the project. The Board then discussed minor revisions to the definition of a lease. The Board tentatively decided to replace "agreement" with "contract," and "capital assets (land and/or depreciable assets)" with "an asset (the underlying asset)." The Board also tentatively decided to add the phrase "in an exchange or exchange-like transaction" to the proposed definition of a lease.

The Board then discussed the inclusions and exclusions to the scope of lease guidance. The Board tentatively decided to propose including contracts not identified as leases but that meet the definition of a lease. The Board tentatively decided to not provide in the proposal an example of such a contract, and remove the example currently provided. The Board tentatively decided to propose continuing to exclude the following from the scope of the guidance: agreements that are contracts for services that do not transfer the right to use capital assets from one contracting party to the other; leases to explore for or use of minerals, oil, natural gas, and similar nonregenerative resources; licensing agreements for such items as motion picture films, video recordings, plays, manuscripts, patents, and copyrights; and agreements that meet the definition of a service concession arrangement. In addition, the Board tentatively decided to propose that biological assets, including timber, be excluded from the scope of the lease guidance, while intangible assets other than licensing agreements would continue to be included in the scope of lease guidance.

Minutes of Meetings, June 25-27, 2013

The FASB project staff on leases provided the Board with background information on the provisions of the recently released revised Exposure Draft, *Leases*. The session was educational in nature. No deliberations were conducted and no decisions were reached.

LEASE ACCOUNTING—TENTATIVE BOARD DECISIONS TO DATE

The Board tentatively agreed to propose that:

- The definition of a lease be revised to be “a contract that conveys the right to use an asset (the underlying asset) for a period of time in an exchange or exchange-like transaction”
- The scope of the Leases guidance continue to include contracts not identified as leases but that meet the definition of a lease
- The scope of the Leases guidance continue to exclude:
  - Contracts for services that do not transfer the right to use assets from one contracting party to the other
  - Leases to explore for or use of minerals, oil, natural gas, and similar nonregenerative resources
  - Licensing agreements for such items as motion picture films, video recordings, plays, manuscripts, patents, and copyrights
  - Service concession arrangements
- The scope of the Leases guidance also exclude biological assets, including timber
- A single accounting model be developed, potentially with exceptions for certain circumstances
- The lease term include:
  - The noncancellable period
  - Periods covered by renewal options (or exclude periods covered by termination options) that are probable of being exercised based on an assessment of qualitative factors
  - Periods covered by fiscal funding and cancellation clauses if the possibility of cancellation is remote (If the possibility of cancellation is more than remote, the period should be treated as any other termination option when determining the lease term.)
- Cancellable periods be excluded from the lease term
- The lease term be reevaluated when there is a change in relevant factors that would result in a change in judgment as to the lessee’s likelihood to exercise or terminate the lease, or when the lessee actually exercises or terminates the lease opposite of what was previously expected
- The relevant factors used in the initial assessment of the lease term also be the factors that result in a reassessment
- The underlying assumption that leases are financings be the foundation for the governmental leasing model
- The right to use the underlying asset be recognized as an asset by the lessee
- The general approach to measuring lease assets and liabilities be to measure the liabilities first and base the assets on that amount
- The general measurement approach for a lease liability be based on the present value of future payments
- The obligation to make lease payments be recognized as a liability by the lessee
  - The obligation to return the underlying asset at the end of the lease not be recognized as a liability by the lessee
- A practicality exception be made for short-term leases
  - A short-term lease be defined as a lease that, at the beginning of the lease, has maximum possible term under the contract, including any options to extend, of 12 months or less
  - The maximum possible term for a cancellable lease be defined as any noncancellable period, including any notice periods
  - The definition of a short-term lease not depend on the presence of a purchase option

    - A short-term exception be an accounting requirement for all leases that qualify
    - Lessees not be required to recognize assets or liabilities associated with the right to use the underlying asset for short-term leases
    - Lease payments be recognized as expenses/expenditures based on the terms of the contract
    - Lease payments for short-term leases rent holiday or rent reduction provisions be recognized as expenses in accrual accounting financial statements based on the terms of the contract
    - There not be a practicality exception made for leases of noncore assets
- The initial measurement of a lease liability for a lessee include:
    - Fixed payments to be made over the lease term
    - Variable payments based on an index or rate, using the rate in effect at that date
    - Variable payments that are in-substance fixed
    - Residual value guarantees probable of being required based on an assessment of qualitative factors
    - Purchase options probable of being exercised based on an assessment of qualitative factors
    - Termination penalties if based on the determination of the lease term, the termination option is probable of being exercised
- Lease payments that are dependent on a lessee's performance or usage of an underlying asset not be included in the measurement of the lease liability
- Payments not included in the liability measurement be recognized as expense in the accrual accounting-based flows statement in the period in which the obligation for those payments is incurred
- Lease liability payments be discounted using the rate the lessor charges the lessee and if that rate cannot be readily determined, the lessee's incremental borrowing rate should be used
- The initial measurement of a lease asset for a lessee include:
    - The value of the initial lease liability
    - Any prepayments (amounts paid for the lease prior to measuring the lease liability)
    - Initial direct costs if they are ancillary charges to place the leased asset into use
- Lease incentives received be reductions in the cost of lease assets
- Initial direct costs be expensed if they are costs other than ancillary charges to place the leased asset into use
- A lessee remeasure a lease liability by calculating the amortization of the discount on the lease liability and reducing the lease liability by the actual lease payment amount less the amortization of the discount
- Lease assets be amortized using a systematic and rational basis over the shorter of the useful life of the underlying asset or the lease term
- The lessee amortize the right-of-use asset as if the lessee owns the underlying asset, using the lessee's depreciation policy, if the lease transfers ownership or if by assessing qualitative factors a purchase option is determined to be probable of being exercised. In those situations, if the underlying asset is a non-depreciable asset such as land, the lessee should not amortize the right-of-use asset
- The lessee classify the amortization of the lease asset as amortization expense and the amortization of the discount on the lease liability as interest expense in the flows statement
- The right-of-use asset in a lease is an intangible asset that should be accounted for in accordance with existing authoritative guidance for capital assets
    - The relationship between the underlying asset and the lease asset could mean that indicators of impairment present with respect to the underlying asset may result in a change in the manner or duration of use of the lease asset
    - A change in the manner or duration of use of the lease asset may indicate impairment of that asset
    - In circumstances in which an asset underlying a lease is damaged and requires restoration or replacement, the time period during which the underlying asset is not usable generally is the

relevant factor in assessing whether the impairment test has been met.
    - An impaired lease asset first would be adjusted by any change in the corresponding lease liability, with any remaining adjustment recognized as the impairment loss
- A reassessment of a lease liability be required in any of the following situations:
    - When there is a change in the likelihood (probable to not probable or vice versa) of a purchase option being exercised based on an assessment of qualitative factors
    - A change in the amounts expected to be payable under a residual value guarantee or when there is a change in the likelihood (probable to not probable or vice versa) that a payment will be required based on an assessment of qualitative factors
    - Result of a change in an index or a rate used to determine lease payments during the reporting period may be significant
- A reassessment of the discount rate be required in any of the following situations:
    - Lease term is changed
    - A change in the likelihood (probable to not probable or vice versa) that a purchase option will be exercised based on an assessment of qualitative factors
    - Result of a change in the reference rate used to determine a variable lease payment may be significant
- Initial selection of a discount rate also be the approach for selection of a discount rate in the event of a reassessment
- Adjustments arising from remeasurements of lease liabilities also adjust the right-of-use asset by the same amount. The exception is adjustments due to a change in the rate upon which a variable lease payment is based, which are recognized as revenue or expense in the current period.
- If the adjustment to the lease liability is greater than the carrying value of the lease asset, the difference be recognized in the flows statement
- Contracts separated into lease and nonlease components or multiple lease components, subject to a practicality exception related to measurement
- Allocate consideration to multiple components, lessees:
    - First use prices in the contract for individual components, if available, and if those prices are reasonable based on other observable standalone prices
    - If individual prices are not available or not reasonable, allocate consideration based on relative observable standalone prices, if those prices are available for all components of the contract
    - If observable standalone prices are not available for all components,
        - Allocate the standalone price to any components for which there are such prices and then
        - Consider any remaining components to be a single unit of account and assign the remaining consideration to that unit
- Accounting for multiple lease components that are considered as one unit for accounting purposes be based on the primary component.
- The guidance in Statement 13 relating to the accounting treatment for operating leases with scheduled rent increases be superseded
- Lessees be required to disclose the following:
    - A general description of leasing arrangements, including the basis, and terms and conditions, on which variable lease payments are determined and the existence, and terms and conditions, of residual value guarantees provided by the lessee
    - Total amount of assets recorded under leases, and the related accumulated amortization, disclosed separately from owned assets
    - The total variable lease payments actually incurred during the reporting period
    - A maturity analysis of future minimum lease payments that shows payments for each of the first five years and five-year increments thereafter, with the payments shown undiscounted and total interest summed for all years
    - Lease commitments, other than short-term leases, for which the lease term has not begun
    - Payments made in excess of contractual requirements, such as residual value guarantees or

penalties
    - Components of a net impairment loss
- Amount of expense and expenditure recognized for the period related to short-term leases
- A new lessor accounting model be considered with symmetry between lessee and lessor accounting as a key factor in its development.
- The Board issue a Preliminary Views document for the Leases project.