

FASAB Exposure Draft: Questions for Respondents due January 6, 2017

Leases: An Amendment of SFFAS 5, Accounting for Liabilities of the Federal Government and SFFAS 6, Accounting for Property, Plant, and Equipment

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"/>	
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Q1. The Board is proposing to define a **lease** as a contract or agreement that conveys the right to use a nonfinancial asset (the underlying asset) for a period of time in an exchange transaction. The current lease standards, Statement of Federal Financial Accounting Standards (SFFAS) 5, *Accounting for Liabilities of the Federal Government* and SFFAS 6, *Accounting for Property, Plant, and Equipment*, do not specifically define a lease. SFFAS 5 and SFFAS 6 only define a capital lease as a "lease that transfers substantially all the benefits and risks of ownership to the lessee." The Board believes that the more concise definition being proposed is broad enough to capture the diversity of federal leasing activities. The proposed lease definition is presented in paragraph 9 and further explained in paragraph A15.

Do you agree or disagree with the proposed definition of lease presented in paragraph 9 and further explained in paragraph A15? Please provide the rationale for your answer.

I believe that the definition is a bit broad and generic, and needs to be enhanced. In our organization we have various groups and staffs that participate in the leasing activities; leasing and contracting officers, property staff and the accounting team, and we all have to be on the same page. Possibly providing examples of the types of contracts and agreements in the appendix would be helpful. I thought that the

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issuance of Technical Release 16: Implementation Guidance for Internal Use Software, was nicely done, and provided us with information and examples that we could share with our Information Technology (IT) staff to get them on point so we could better communicate. I think we need to do something similar, in terms of spelling out we are interested in, with this lease pronouncement.

- Q2.** The Board is proposing that the **lease term** be determined as the period during which a lessee has a noncancelable right to use an underlying asset (referred to as the noncancelable period) plus each option period if it is probable, based on all relevant factors, that the lessee will exercise that option to extend the lease. The lease term proposal also provides guidance on the noncancelable period and on how specific provisions (such as fiscal funding/cancellation clauses and month-to-month lease holdovers) should be applied. The proposed lease term requirements are presented in paragraphs 14 – 18 and further explained in paragraphs A16 – A18.

Do you agree or disagree with the proposed guidance on determining the lease term as presented in paragraphs 14 - 18 and further explained in A16 – A18? Please provide the rationale for your answer.

I understand the rationale for the proposed guidance for determining the lease term. I like the use of “probable”, per paragraph A18, when evaluating the lease renewal options that are five or ten years out. It is a challenge for the Real Property Leasing Officer (RPLO), Contracting Officer and/or the accountant to readily determine whether an individual lease will be renewed because the actual tenant/user (State / Program representative) needs to provide input as to whether the property meets his/her needs when determining whether to renew or terminate the lease when approaching the effective renewal date. During my 5+ years of working with real property leases, our agency has opted to renew a higher percentage of leases than it terminates. So the rule of thumb, and the more conservative approach, has been to include the option renewal period(s) as stated in the lease agreement when performing our lease determination analysis (operating or capital lease).

- Q3.** The Board is proposing that at the beginning of the lease term, a lessee should recognize a lease liability and a property, plant, and equipment right-to-use lease asset (the lease asset), except for intragovernmental and short-term leases. The proposed lease recognition requirements are presented in paragraph 19.

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Do you agree or disagree with the proposed lessee recognition of a lease at the beginning of the lease term as presented in paragraph 19? Please provide the rationale for your answer.

I disagree with the proposal that leases with non-federal entities should be recognized as capital leases because I do not believe that this treatment provides more meaningful and relevant data for federal financial statement users, i.e., the general public.

A summary of the agency's future lease payments is prepared and provided in the notes to the financial statements. The effort and cost to provide the existing summary info is far less than it would be compared to running our lease transactions through the accounting and inventory systems in an effort to report these non-federal leases as capital leases.

Secondly, our agency has approximately 600 leases for office space with non-federal entities, and I am fairly certain that our agency and our parent agency do not have statutory or budget authority to freely purchase any of these buildings. Given that the agency mission is totally unrelated to property and/or property leases, Lease Expense and not Property Plant and Equipment is the correct functional description. Attempting to treat the lease transactions as a financing for a potential purchase, and to account for the payments (NPV) as "government assets" instead of as operating expenses does not make the financial presentation "more meaningful" for the general public. Per paragraph A26, the goal should be to take a 'simplified approach for leases which would be pragmatic and cost efficient'.

For agencies where property is a significant and material part of their activities, such as GSA, then maybe it makes sense to capitalize the non-federal leases. But for other agencies where property leases are a tool needed to perform tasks for the mission, the accounting should be simple and cost efficient as previously stated. The agencies can continue to use their money for their mission and programs, and not have to spend it to enhance accounting and inventory systems, and to hire accountants.

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Thirdly, most if not all leases have a short period (2 to 4 months) where the lessee can terminate the lease. I believe the best presentation remains as an ongoing operating cost and not a capital cost. To have an asset and liability based on 10 to 20 years worth of rent payments is not an accurate presentation at lease inception because the lessee can terminate the lease within the first year.

I feel that the current disclosures in the notes to the financial statements for leases (future payments) provide a good overview for the readers of the financial statements, without having to run the lease-level asset and liability transactions through the general ledger.

- Q4.** The Board is proposing that a lessee should measure the **lease liability** initially at the present value of payments to be made for the lease term. In addition, the measurement of the lease liability should include the several types of payments that might be required by a lease. The proposed lease liability measurement and recognition requirements are presented in paragraphs 21– 29 and further explained in paragraphs A20 – A21.

Do you agree or disagree with the proposed lessee measurement and recognition of the lease liability as presented in paragraphs 21 - 29 and further explained in paragraphs A20 – A21? Please provide the rationale for your answer.

Valuing the lease liability at the Net Present Value (NPV) of the cash flows for the duration of the lease term potentially overstates the debt for an agreement that can be terminated when the shorter noncancelable period has expired. This requirement is also inconsistent with valuing the asset at the lesser of fair market value (FMV) or NPV.

Another unaddressed question is whether the agency will need to establish an obligation (budgetary resources) to cover the lease liability at lease inception. Some or most agencies will need to have access to additional “no year funding” as the duration of the funding is supposed to match or exceed the lease period.

- Q5.** The Board is proposing that the future lease payments should be discounted using the rate the lessor charges the lessee, which may be the interest rate implicit in the lease. If the rate cannot be reasonably estimated by the lessee, the lessee’s incremental borrowing rate (the estimated rate that would be charged for borrowing the lease payment amounts for the lease term) should be used. The specific proposed requirement is presented in paragraph 23.

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- a. Do you agree or disagree that the rate the lessor charges the lessee, which may be the interest rate implicit in the lease, should be used to measure the future lease payments as presented in paragraph 23? Please provide the rationale for your answers.
- b. Do you agree or disagree that the lessee's incremental borrowing rate should be used to measure the future lease payments when the lessor rate cannot be reasonably estimated by the lessee as presented in paragraph 23? Please provide the rationale for your answers.

I agree that either the implied rate or the published Treasury rate should be used.

Q6. The Board is proposing that the lessee should remeasure the lease liability at subsequent financial reporting dates if certain changes have occurred and are expected to significantly affect the amount of the lease liability. The Board is also proposing that the lease asset should generally be adjusted by the same amount when the corresponding lease liability is remeasured based on those changes. Additionally, if the change reduces the carrying value of the lease asset to zero, any remaining amount should be reported in the flows statement as a gain. The proposed lessee requirements for remeasurement are presented in paragraphs 25 – 29, 33, and further explained in paragraph A19.

- a. Do you agree or disagree with the circumstances when the lessee must remeasure the lease liability as presented in paragraph 25? Please provide the rationale for your answer.

The circumstances requiring re-measurement appear reasonable.

- b. Would the requirements triggering remeasurement cause undue costs? Please provide the rationale for your answer.

Based on the info provided, I cannot determine whether there would be undue costs for the re-measurement processes. However, I believe that there will be undue costs for the agencies to enhance their accounting systems and lease inventory systems in order to account for all non-federal leases as capital leases, and to add staff to the accounting teams.

- c. Do you agree or disagree with the effect of the remeasurement on the carrying value of the lease asset as presented in paragraph 33 and further explained in paragraph A19? Please provide the rationale for your answer.

Generally the re-measurement of an intangible property asset is achieved through: (1) systemic amortization based on the expected / estimated life of the asset; and (2) adjustments for changes to the

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residual value, changes to the annual rental cost, etc. The amortization and adjustment amounts provide an audit trail from the historical cost to the current valuation (net book value). I am not convinced that the re-pricing of the liability should drive the asset balance.

- Q7.** The Board is proposing that a lessee should measure the lease asset initially as the sum of (1) the amount of the initial measurement of the lease liability, (2) lease payments made to the lessor at or before the beginning of the lease, less any lease incentives received from the lessor, and (3) initial direct costs that are ancillary charges necessary to place the lease asset into service. The proposed lessee lease asset measurement and recognition requirements are presented in paragraphs 30 – 34 and further explained in paragraph A22.

Do you agree or disagree with the proposed lessee measurement and recognition of the lease asset as presented in paragraphs 30 - 34 and further explained in paragraph A22? Please provide the rationale for your answer.

I disagree as I see the cost of a lease as a period cost, and not an asset; i.e., pay as you go. Accounting for the leases with non-federal entities as an asset overly complicates a fairly simple transaction. I do not believe this approach is meaningful for anyone other than accountants.

The original valuation for capitalized leased property was the lesser of the NPV or FMV. It appears that this concept has been thrown out the window in favor of the calculated lease liability amount.

- Q8.** The Board is proposing that at the beginning of the lease term, a lessor should recognize a lease receivable and deferred revenue, except for intragovernmental and short-term leases. The proposed requirements for the measurement and recognition of the lessor lease receivable and deferred revenue are presented in paragraphs 36 – 48 and further explained in paragraphs A23 - A24.

Do you agree or disagree with the proposed lessor measurement and recognition of the lease receivable and deferred revenue as presented in paragraphs 36 - 48 and further explained in paragraphs A23 - A24? Please provide the rationale for your answer.

I disagree based on the similar reasons stated in Q3.

- Q9.** The Board is proposing to define a short-term lease as a lease that, at the beginning of the lease, has a maximum possible term under the contract/agreement of 24 months or less, including any options to extend, regardless of its probability of being exercised. The

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proposed requirements for the measurement and recognition of a short-term lease are presented in paragraphs 59 – 61 and further explained in paragraph A25.

Do you agree or disagree with the proposed definition and measurement and recognition of a short-term lease as presented in paragraphs 59 - 61 and further explained in paragraph A25? Please provide the rationale for your answer.

Our agency capitalizes assets that meet a certain dollar threshold that have a useful life of 2 or more years. So I am fine with short term defined as 24 months or less.

- Q10.** The Board is proposing to establish distinct standards for intragovernmental leases. An intragovernmental lease is a contract or agreement that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration occurring within a consolidation entity or between two or more consolidation entities as defined under SFFAS 47, Reporting Entity. The proposed requirements for the measurement, recognition, and disclosure of intragovernmental leases are presented in paragraphs 75 – 95 and further explained in paragraphs A26 - A29.

Do you agree or disagree with the proposed definition, measurement, recognition, and disclosures of intragovernmental leases as presented in paragraphs 75 - 95 and further explained in paragraphs A26 - A29? Please provide the rationale for your answer.

I concur with most of the info for the intragovernmental leases, which is to treat the rents as operating expenses for the current period. The exception is the proposed treatment of lease incentives and concessions as reductions to expense (for lessee) and income (lessor) over the lease term. I am not aware that our agency receives or gives any incentives or concessions, but if so, I believe that they are immaterial to the total dollars spent for rents, and to the financial statements as a whole.

- Q11.** The Board is proposing that leases unexpired at the beginning of the reporting period in which the standard is implemented be recognized and measured using the facts and circumstances that exist at the beginning of the reporting period. The proposed implementation requirements are presented in paragraphs 99 -100.

Do you agree or disagree with the proposed prospective implementation approach as presented in paragraphs 99 - 100? Please provide the rationale for your answer.

I cannot offer an opinion at this time as I have some unanswered questions; specifically, (1) will the liability for the leases with non-federal entities need to be funded (obligated); (2) do we undo the

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existing accounting that is currently done for the existing capital leases that have been recorded; and (3) would the unused funds from the existing capital leases be available to use to fund the liability in the new world of lease accounting.

- Q12.** The Board is proposing that the requirements of this Statement be effective for reporting periods beginning after September 30, 2018. The proposed effective date is presented in paragraph 101.

Do you agree or disagree with the proposed effective date as presented in paragraph 101? Please provide the rationale for your answer.

The federal agencies have used SFFAS 5 and 6, and FASB 13 for any years so I think there is some flexibility with the implementation of any successor accounting pronouncements for leases.

If this exposure draft is implemented as is, which I am not in favor of, I am not in a position to project whether our agency would be ready for the changes to our accounting and lease inventory systems by September 30, 2018.

I would suggest asking the CFOs and IT teams for their thoughts and projections for an implementation date.