



OFFICE OF THE UNDER SECRETARY OF DEFENSE
1100 DEFENSE PENTAGON
WASHINGTON, DC 20301-1100

COMPTROLLER

JAN 05 2017

Wendy M. Payne, Executive Director
Federal Accounting Standards Advisory Board
Mailstop 6H19
441 G Street, NW, Suite 6814
Washington, DC 20548

Dear Ms. Payne:

The Department of Defense (DoD) is pleased to submit the attached comments to the Federal Accounting Standards Advisory Board (FASAB) on the Exposure Draft (ED), *Accounting for Leases*. Our response to FASAB's request for comments is organized into two Sections: (1) Responses to the ED questions; and, (2) Comments on other matters contained in the ED.

The DoD understands that the Board undertook this effort in response to questions raised during the development of the Financial Accounting Standards Board's guidance in Accounting Standards Codification 842, *Leases*. However, the DoD notes that there is a divergence between that standard and FASAB's proposal, as discussed in detail in the appendix to this letter.

The DoD does not believe that FASAB has made a compelling case that the information available to a financial statement user under the proposed accounting model represents a significant improvement over the current accounting model, or that it necessarily achieves the goal of comprehensive view of an entity's total obligations that will result in cash outflows in future periods. For these reasons, the DoD does not support the codification of this ED as a FASAB standard.

Thank you for considering the Department's responses and comments. If you have any questions concerning our comments, please contact me.

Sincerely,

A handwritten signature in black ink, appearing to read "Alaleh A. Jenkins".

Alaleh A. Jenkins
Assistant Deputy Chief Financial Officer

Attachments:
As stated



SECTION 1 – RESPONSES TO EXPOSURE DRAFT QUESTIONS

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.

DoD Response:

DoD does not agree with the proposed definition. The definition is too broad and all-encompassing. The DoD believes that the definition of a lease should specifically exclude agreements such as those excluded from the recently issued Financial Accounting Standards Board (FASB) Accounting Standards Update (ASU) on Leases (Topic 842). ASC 842, as enumerated in ASC 842-10-15-1 specifically excludes leases of intangible assets; leases to explore for or use minerals, oil, natural gas, and similar nonrenewable resources; leases of biological assets, including timber; leases of inventory; and assets under construction. In addition the DoD proposes to exclude other intangible assets such as (but not limited to) land rights and rights of way, various types of easements (e.g., utility easements), air rights, mineral rights, and infeasible rights of use. ASC 842 defines leases more specifically and states [in part], “A contract...that conveys the right to control the use of identified property, plant, or equipment (an identified asset) for a period of time in exchange for consideration”. Because of the breadth and complexity of the DoD, the DoD enters into many different types of complex agreements that, under the proposed FASAB standard, would be difficult to categorize as a lease instead of a service arrangement. Therefore, the DoD suggests that the Board provide specific guidance in distinguishing service arrangements from leases, and suggests that the Board expand the guidance currently in paragraph A11 of the ED, and specifically define Service Concession Arrangements (SCAs) as service agreements.

In addition, the DoD believes that FASAB should consider narrowing the definition to specifically state that a lease (1) conveys the “right to control” and (2) that a lease covers “identified property, plant, or equipment (an identified asset)”. The DoD believes that the Exposure Draft should address the concept of “control” as discussed in Statement of Federal Financial Accounting Concepts (SFFAC) 5, *Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements*, and the current language referring to “right to use” is too broad a term and may result in inconsistent and incorrect application of the definition of a lease. For example, service agreements may convey a right to use an asset when control is effectively retained by the supplier. Similarly, the DoD believes that the term “nonfinancial asset” is too broadly defined in footnote 16 of paragraph A11, and should not include internal use software, intangible assets, and the types of assets excluded by ASC 842.

The DoD suggests that the Board consider including a flowchart depicting a prescribed decision process to follow in identifying whether a contract is a lease or a service arrangement, and conform the ED to the concepts in the flowchart in ASC 842-10-55-1, including (but not limited to) the concept of substantive substitution rights of the supplier. The DoD enters into many contracts that involve use of assets of a supplier that may not qualify as leases when considering the guidance in ASC 842.

The DoD believes that the proposed definition, as written, will:

- 1) Create a large administrative burden on agencies on an ongoing basis. Including the term "agreement" in the definition adds ambiguity and confusion as to what should or should not be considered as a lease. At a minimum, the DoD suggests that for an "agreement" to be considered a lease for accounting purposes, an agreement should be required to be in writing and executed by each of the parties to the transaction, by individuals who are duly authorized to enter into such an agreement.
- 2) Will not prove to be cost-beneficial to federal government agencies. As federal government agencies are dependent upon ongoing appropriations, the related fulfillment of an agency's future obligations that will result in cash outflows in future periods is entirely dependent on these ongoing appropriations. The DoD believes that this is inconsistent with the concept of Budgetary Integrity in paragraph 13 of SFFAC 1: *Objectives of Federal Financial Reporting*, where "Federal financial reporting should assist in fulfilling the government's duty to be publicly accountable for monies raised through taxes and other means and for their expenditure in accordance with the appropriations laws that establish the government's budget for a particular fiscal year and related laws and regulations".
- 3) We believe that this is different from a commercial entity where these obligations are important to the portrayal of a commercial entity's financial health and viability, because unilateral rights (i.e., to make alterations at any time to the contract requirements) are not found in commercial relationships as they are with the government.
- 4) Potentially mislead the users of federal agencies' balance sheets by recording assets that have different characteristics than the other assets recorded on the balance sheet. Typically lessees do not have many of the rights in using the leased asset as they would as the owner. Often the owner/lessor retains the right to require lessees to obtain lessor approval to make changes to the leased asset that the lessee desires in order to have the asset in a condition suitable for lessee use. As a result, it does not appear proper to record an asset on the lessee's financial statements unless the terms of the lease provide the lessee with unconditional control of the asset.
- 5) Cause the rights of the parties to the arrangement to all be treated the same, and arrangements that are structured as capital leases (with specific rights of ownership under the current construct) would be accounted for the same as those arrangements that do not contain the same rights.

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.

DoD Response:

The DoD does not agree with the proposed guidance. The DoD believes that for the lessee, fiscal funding

clauses should be considered in determining the noncancelable period, without regard to probability of exercising the fiscal funding clause. Specifically, not considering a fiscal funding/cancellation clause (unless it's probable of being exercised) as a reason to exclude future periods from the noncancelable period will:

- 1) Result in reflecting liabilities on the balance sheet that are analogous to liabilities that are contingent on future events rather than liabilities reflecting events that have already occurred.
- 2) Include liabilities on the balance sheet which are not liabilities based on current laws or regulations, which is contrary to most, if not all, other liabilities recorded on the balance sheet. The DoD, like many federal government agencies, is subject to mandates from Congress such as sequestration, and the annual budget process, which can affect DoD's ability to satisfy obligations such as lease liabilities. At any given time, recording these liabilities would not be an accurate depiction of the DoD's obligations because Congressional mandates could (like sequestration) render certain contracts (like lease contracts) short-term in nature (i.e., they can be cancelled subject to these mandates). Since the federal government lessee can unilaterally terminate the contract at any time, the probability of whether or not this will occur should not be a factor. Fiscal funding clauses in lease contracts should be considered since this reflects both the legal form and economic substance of the lease transaction. Recognizing the legal enforceability and substance of the fiscal funding clause in a lease contract, a maximum of one fiscal year would be the lessee's minimum lease term, thereby qualifying the lease as a short-term lease. These unilateral contractual rights of a federal government lessee are not found in leases where a commercial entity is the lessee. Leases with commercial entity lessees legally commit the commercial entity lessee to a minimum lease term that cannot be unilaterally altered. For leases greater than one year, commercial leases are not similar to government leases, which typically have annual option periods in which the government lessee can unilaterally exercise or terminate the remainder of the lease term without any further liability. This annual opportunity to "opt out" of the remainder of the lease is not included in commercial leases. This major difference of the terms in the lease between commercial entities and federal entities should be considered and respected in how the lease is accounted for since it represents a fundamental difference in the legal liability the entity is committed to. This is supported by the American Institute of Certified Public Accountants' Audit and Accounting Guide, *Federal Government Contractors*, which acknowledges that government contractors are subject to a degree of risk different from their commercial counterparts because of the unilateral contractual right of the government to terminate a contract.
- 3) Cause the accounting for leases to be inconsistent with the accounting for other types of liabilities, such as entitlement programs, as they are reflective of the current legal obligations of the federal government and would only be changed based on changes in law. Recording a liability for a non-finance or non-sales type lease is recording a liability for a future event that may not occur (e.g., the occupancy of a building or office space in the future). This is inconsistent with the definition of a liability as discussed in paragraphs 42 and 46 of SFFAC 5.
- 4) Include as liabilities amounts which are not real liabilities since the federal government can contractually reduce them to zero through a non-appropriation. Including these amounts as liabilities does not provide the user of the financial statements with an accurate depiction of the agency's financial condition, and can be misleading to the users of the financial statements. Instead, this information (significant lease terms) could be included in the notes to the financial statements to achieve the same objective of reporting future use of resources in satisfaction of the respective leases.
- 5) Result in unfunded lease liabilities recorded in the balance sheet and no corresponding obligation in

the Statement of Budgetary Resources (SBR), creating a difference between the obligation in the SBR and the liability on the balance sheet.

- 6) Impose undue hardship on agency financial statement preparers to analyze, prepare, record, and retain information for numerous lease transactions that otherwise would not be needed.
- 7) Be inconsistent with Office of Management and Budget (OMB) budget requirements, which state in OMB A-11:

“For operating leases, budget authority is required to be obligated up front in the amount necessary to cover the Government's legal obligations, consistent with the requirements of the Antideficiency Act. This will include the estimated total payments expected to arise under the full term of the contract or, if the contract includes a cancellation clause, an amount sufficient to cover the lease payments for the first year plus an amount sufficient to cover the costs associated with cancellation of the contract. For each subsequent year, sufficient budget authority is required to be obligated to cover the annual lease payment for that year plus any additional cancellation costs. For operating leases funded by the General Services Administration's Federal Buildings Fund (which is self-insuring under existing authority), only the amount of budget authority needed to cover the annual lease payment is required to be obligated.”

“For operating leases, budget authority will be scored against the legislation in the year in which the budget authority is first made available in the amount necessary to cover the Government's legal obligations. The amount scored will include the estimated total payments expected to arise under the full term of a lease contract or, if the contract will include a cancellation clause, an amount sufficient to cover the lease payments for the first fiscal year during which the contract is in effect, plus an amount sufficient to cover the costs associated with cancellation of the contract. For funds that are self-insuring under existing authority, only budget authority to cover the annual lease payment is required to be scored.”

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.

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.

DoD Response:

Please see the response to Q2 above.

In addition, the DoD agrees that intragovernmental and short-term leases should be exempted from the requirement to recognize a lease liability and a right-to-use lease asset. However, the DoD does not agree with the proposed recognition at the beginning of the lease term (for leases other than intragovernmental and short-term) for the following reasons.

- 1) The government does not always have the benefits of an asset and often has limited control over the use of the asset being leased.
- 2) Lessees typically do not have many of the rights in using the leased asset as they would as the owner. Often the owner/lessor retains the right to require lessees to obtain their approval to make

changes to the leased asset that the lessee desires in order to have the asset in a condition suitable for the lessee's use. As a result, it does not appear proper to record an asset in the lessee's financial statements unless the terms of the lease provide the lessee with right to obtain substantially all of the economic benefits from control of the asset throughout the period of use (for example, by having exclusive use of the asset throughout that period) and unconditional use of the asset.

- 3) The government has no title to or control of these assets under contracts that would potentially be considered leases. The government obtains the right to use an asset owned by others, but has no right to pledge, assign, or encumber these assets; or claims to these assets, and therefore recording a right to use asset in the government's financial statements does not seem to be appropriate accounting. Additionally, because the lessor (as owner) would record the asset on its balance sheet, the lessee's recording of a right to use asset would result in double counting of the asset.

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.

DoD Response:

The DoD agrees with the requirement in principle, if in fact there was a liability to be recognized. However, the DoD does not agree with the proposed requirement to measure and recognize a lease liability when there is the presence of a fiscal funding clause as discussed in Q2 above.

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.

- 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.**

DoD Response:

The DoD does not agree. The "interest rate implicit in the lease" is not defined in the ED. ASC 842 defines the interest rate implicit in the lease as "The rate of interest that, at a given date, causes the aggregate present value of (a) the lease payments and (b) the amount that a lessor expects to derive from the underlying asset following the end of the lease term to equal the sum of (1) the fair value of the underlying asset minus any related investment tax credit retained and expected to be realized by the lessor and (2) any deferred initial direct costs of the lessor". If there was a requirement to apply the definition in ASC 842, it would cause significant judgment on the part of lessees that may lead to assumptions that are not accurate. In addition, Appendix B of OMB Circular A-11 requires the use of the treasury borrowing rate to calculate the present value of the minimum lease payments and using an interest rate implicit in the lease would depart from this requirement.

- 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.**

DoD Response:

The DoD agrees that the rate used to discount future lease payments should be the lessee's incremental borrowing rate, not the lessor's rate implicit in the lease. The DoD believes that the incremental borrowing rate is more appropriate because it is less subjective and would lessen the burden of determining future lease payments by the lessee, and at the same time be reflective of the rate the lessee would have incurred to borrow, over a similar term, the funds necessary to purchase the leased asset. A Treasury bill rate using a term commensurate with the term of the lease would result in a more objective measure of the future lease payments and result in consistency in application between federal government agencies. This would also be consistent with the concepts embodied in OMB Circular A-11.

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.**

DoD Response:

The DoD believes that it would be appropriate to remeasure the lease liability due to the circumstances in paragraph 25, however, the DoD believes that clarity may be needed to define "certain changes". For practical reasons, it would be necessary to adjust the liability in these circumstances. The remeasurement should take place upon the actual occurrence (versus the likelihood) taking place based on conclusive evidence, since the terms and conditions of the signed lease contract or agreement still exist and the lessee has a non-cancellable right to use the asset.

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

DoD Response:

The DoD believes that the requirements triggering remeasurement will significantly increase the costs of accounting for a lease. The DoD believes that federal government entities would have to change existing processes, and design and implement systems and controls to account for these changes. Current systems are not configured to handle the complexities of accounting for lease remeasurements.

- 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.**

DoD Response:

The DoD believes that it would be appropriate to remeasure the lease asset as presented in paragraph 33 and further explained in paragraph A19. For practical reasons, it would be necessary to adjust the lease asset in the same manner as the lease liability.

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.

DoD Response:

Regarding initial direct costs, the DoD believes that initial direct costs that are ancillary charges necessary to place the lease asset into service (i.e., commissions and/or payments made to an existing tenant to incentivize that tenant to terminate its lease) should be excluded from the determination of the lease asset as those costs are expected to be minimal (as they are with most commercial leases) and to include these costs as part of the lease asset would cause undue costs of identifying, assessing, and accounting for these costs that would outweigh the benefit of presenting these costs as an asset. ASC 842-10-30-10 specifically states that costs to negotiate or arrange a lease that would have been incurred regardless of whether the lease was obtained, such as fixed employee salaries, are not initial direct costs. The following items are examples of costs that the DoD believes should be excluded from the measurement of the lease liability that are not considered initial direct costs (as enumerated in ASC 842-10-30-10(a) through 30-10(c):

- General overheads, including, for example, depreciation, occupancy and equipment costs, unsuccessful origination efforts, and idle time;
- Costs related to activities performed by the lessor for advertising, soliciting potential lessees, servicing existing leases, or other ancillary activities;
- Costs related to activities that occur before the lease is obtained, such as costs of obtaining tax or legal advice, negotiating lease terms and conditions, or evaluating a prospective lessee's financial condition.

The DoD believes that a simpler and better accounting for these costs would be to include them as period expenses.

The DoD further recommends adding illustrative examples of the concepts embodied in paragraphs 33 and 34 of the ED.

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.

DoD Response:

Other than Enhanced Use Leases (EULs), the DoD is generally not a lessor. EUL is a method for funding construction or renovations on federal property by allowing a private developer to lease underutilized property, subject to several provisions, with rent paid by the developer in the form of cash or in-kind services. Because of the structure of these arrangements, the long terms of EULs, and the complexities related to the compliance with requirements of Section 2667 of Title 10, U.S. Code, EULs are would prove difficult to account for under the proposed standard. Therefore, the DoD recommends adding illustrative examples of the concepts embodied in paragraphs 36 – 48 and revising the ED to address EULs.

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 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.

DoD Response:

The DoD agrees with the definition of 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”. However, the DoD does not agree that options to extend should be included without regard to their probability of being exercised. The DoD believes that options to extend would be excluded until those options are probable of being exercised. The DoD believes that this treatment is appropriate because of the unilateral rights afforded to the government related to termination of contracts.

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.

DoD Response:

The DoD agrees with the proposed definition, measurement, recognition, and disclosures of

intragovernmental leases as presented in paragraphs 75 – 95 and further explained in paragraphs A26 – A29. More specifically, the DoD believes that leases between federal government agencies that consolidate to the overall U.S. Government financial statements, and non-government entities that are required to be consolidated in a federal government agency's financial statements in accordance with SFFAS 47, *Reporting Entity*, would qualify as intragovernmental.

The DoD does not agree with the disclosure requirements for intragovernmental leases embodied in paragraphs 87 and 95 of the ED. The preparation of these disclosures would require systems and processes to track and account for these leases, which would contradict the purpose of the intragovernmental "exception" to recording lease assets and liabilities, and add complexity and cost.

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.

DoD Response:

The DoD disagrees with the proposed guidance. The DoD believes that the proposed standard should apply only to leases entered into after the effective date of the proposed standard. The DoD believes that federal government entities will need time to develop processes, and implement systems and controls to be able to apply the proposed standard. Requiring the determination of the lease term assuming that the lease term began as of the beginning of the period of implementation, and requiring that the lease liability and lease asset be initially measured based on the remaining lease term and associated lease payments as of the beginning of the period of implementation would cause undue cost.

The reason for the undue cost is that there is no consistent methodology or policy that has been followed to record monthly or periodic payments that are made on leasing arrangements. These payments could be recorded in various general ledger accounts, and searching for them and identifying them will be very labor intensive. Determining the population of leases subject to the accounting requirements in the ED will require identification, review and analysis of an enormous number of payment transactions. The DoD suggests that the proposed standard be applied only to leases entered into after the effective date of the proposed standard to reduce difficulties related to identifying and assessing current leases to allow for proper implementation of the proposed standard.

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.

DoD Response:

The DoD disagrees with the proposed effective date as presented in Paragraph 101. The DoD proposes that the effective date be approximately four years after the issuance date of the proposed standard. This amount of time is needed for federal government entities to develop processes, and design controls and develop systems in order to account for these lease transactions. As a point of reference, the FASB lease

standard issued in February 2016, is effective for fiscal years beginning after December 15, 2019 (approximately 46 months).

SECTION 2 – COMMENTS ON OTHER MATTERS CONTAINED IN THE EXPOSURE DRAFT

- 1) Purpose (Paragraphs 1 – 3) — Federal agency financial statements, and the users of those financial statements, are different than the financial statements of commercial entities and/or state and local government financial statements and their users. For this reason, the DoD requests that the Board consider the following reasons for not following the recent direction of the FASB and GASB in changing lease accounting.
 - The FASB revised lease accounting for commercial entities primarily due to a concern that the amount of off balance sheet debt related to leases was a large amount.
 - Based on a study of 2014 public company filings, FASB technicians found more than \$1 trillion in undiscounted lease obligations are reported in footnotes and not on the balance sheet.
 - FASB found that credit rating agencies, industry focused analysts, and sophisticated investors, were estimating lease obligations and adding them to the company's balance sheet for their analyses.
 - State and municipal financial statements are often used to evaluate their worthiness for industrial revenue bonds, tax-exempt securities, municipal bonds, etc.
 - The amount of debt carried by a commercial entity, or state or local entity usually impacts a user's analysis of the credit worthiness of the entity. More often than not, a user of the financial statements of a federal government entity would not consider credit worthiness of said entity as all federal government entities are fully backed by the full faith and credit of the Federal Government itself.
- 2) Scope exceptions (Paragraph 6) — ASC 842 excludes from its scope leases in which the customer does not have a right to use an identified asset if the supplier has the substantive right to substitute the asset throughout the period of use in certain circumstances. The Board should consider a similar scope exception for both lessees and lessors. While many government contracts would appear to be leases on the basis of the definition in the ED, they may, in substance, be providing the customer with access to certain assets to provide a service (e.g., use of airport runways and taxiways by airlines).
- 3) Intragovernmental leases (Paragraph 75) — In the Basis for Conclusions, paragraph A26, the ED references an educational session provided by the General Services Administration (GSA) to the FASAB. Based on the information received, the DoD believes that the Board should further define intragovernmental leases, and more specifically, whether leases with the GSA (as assignor to other federal government agencies) qualify as intragovernmental under the ED. It is unclear whether the GSA would be considered to be an agent for the federal government or the primary lessee and sublessor.
- 4) In the final version of the proposed standard, the DoD suggests providing illustrative examples (similar to those in ASC 842) of how to apply this proposed standard.
- 5) Impact on DoD Audit Efforts — Each military service and other components within the DoD are currently focused on financial improvement and audit readiness efforts. Most of these entities are preparing for their initial financial statement audit and a large amount of resources are being utilized

in this undertaking. Having to transition to the accounting as set forth in this ED would be a significant task for the following reasons:

- a) There is a finite amount of resources that DoD has to work on audit readiness. These resources are both internal (e.g. government employees) and outside contractors. In the current environment, it is virtually impossible to obtain additional funding for audit readiness efforts. As a result, having to transition to the accounting as set forth in this ED would divert some of the audit resources to work on implementing this proposed standard.
 - b) The effort for the implementation to this proposed standard and the required steps for transition and ongoing accounting go beyond accounting for leases. Currently, lease payments can be recorded to any one of hundreds of general ledger accounts since there is no written policy providing guidance. Each of the DoD entities most likely records lease payments using different general ledger accounts so there is not an efficient way to review all lease payments made. In addition, there is no way to identify a payment transaction in the general ledger is related to a lease versus other types of payments that are routinely made. As a result, in order to identify the population of lease payments made for analysis of what type of lease exists, would be an immense undertaking. Also, to properly account for leases on an ongoing basis, changes to policies, procedures, and systems would be needed so that lease payments are recorded in accordance with the proposed standard.
- 6) The ED proposes standards for classifying leases that are different than the scoring criteria in OMB A-11. Creating this difference between financial statement accounting and OMB lease classification will cause unnecessary additional confusion and complications between budgetary accounting and proprietary accounting.
 - 7) Paragraph 6 of the ED states, "This definition does not include contracts or agreements for services unless...". We suggest that this paragraph be expanded to define what is intended to be included in "services".
 - 8) The DoD suggests that the proposed standard specifically provide concepts related to capitalization thresholds similar to that provided in paragraph 13 of SFFAS 6, addressing situations where the dollar amounts of lease payments for the minimum lease term are less than the entity's capitalization threshold.
 - 9) Footnote 7 on page 13 of the ED states "The lease asset should be classified as PP&E unless the underlying asset is not PP&E. In those instances, such assets should be classified with the underlying asset." The DoD believes based on the principles underlying the proposed accounting treatment, since both the legacy operating leases and capitalized leases are now both categorized as operating leases, and since this is based on the right to use, that the asset reported on the balance sheet should be reported as an intangible asset, and not PP&E. These assets resulting from the lease are more akin to patents, copyrights, and trademarks than to hard tangible assets that are typical of the underlying assets reported as PP&E on the balance sheet.