

Addendum #3 Memo Leases

February 16, 2023

To: Members of the Board
From: Ricky A. Perry, Jr., Senior Analyst
Thru: Monica R. Valentine, Executive Director
Subject: **Letter from John Rychalski, Department of Veterans Affairs** (Topic E addendum #3)

On February 15, 2023, the Chairman received the enclosed letter from the Department of Veterans Affairs (VA or “the Department”). Staff requests that members carefully study this cover memo and the enclosed letter.

The enclosed letter does not affect the implementation themes, observations, and conclusions reached by staff under Topic E. The Department of Veterans Affairs was one of the eight CFO Act reporting entities interviewed by staff, as discussed in the methodology section of Topic E. The implementation activities, themes, and staff observations in Topic E are based in part on those discussions. Staff did not propose any tentative Board decisions or recommendations for reasons discussed therein. Staff hereby reaffirms this position.

Staff analysis of the enclosed letter:

1. Statement 54, *Leases*, was issued in April 2018 after extensive due process and deliberations. The Statement received unanimous Board approval. The Department did not comment on the exposure draft (ED). As part of the due process, the Board duly considered comments from all interested parties, including those that expressed alternative views and disagreements with the proposals within the ED.
2. Statement 58, *Deferral of the Effective Date of SFFAS 54, Leases*, was issued in June 2020 after extensive due process and deliberations. The Statement received unanimous Board approval. As part of the due process, the Board duly considered ED comments that expressed alternative views. VA submitted a comment letter concurring with a proposed two-year deferral and stating that “the additional two years should allow Federal Entities to address the significant challenges noted in the exposure draft” (see [p. 1 of comment letter](#))
3. Board post-issuance actions, such as implementation guidance, clarifying amendments, and other guidance, are not a basis to delay implementing significant changes in generally accepted accounting principles. The Board’s post-issuance project activities did not alter the requirements of Statement 54 or

delay implementation activities. Rather, they modestly reduced implementation burden.

4. The timing of interest rate selection for purposes of initial measurement is based on the transition requirements of paragraph 96.b of Statement 54. This has always been an inherent reality of the transition requirements. These requirements underwent extensive due process and staff included a question for respondents requesting feedback on transition requirements. Staff has not received similar complaints from other agencies, given the inherent simplistic and automated processes that can be implemented for pulling rates based on the lease term data element.
5. The Board did not adopt “private sector leasing practices.” The Board aligned with the Governmental Accounting Standards Board as a foundation, with numerous accommodations for the federal environment (as discussed in the basis for conclusions of Statement 54).
6. VA summarized several management challenges in the enclosed letter. These are consistent with the management challenges and themes summarized by staff under Topic E related to organizational change management, project management, and systems. In fiscal year 2022, VA’s independent auditor reported a material weakness in internal control over financial reporting (see [FY 2022 AFR, p. 125](#)). The auditor noted that VA’s financial management system has limited functionality to meet current financial management needs.
7. Management is responsible for implementing significant changes in accounting principles in accordance with transition requirements and the effective date of the Board’s final pronouncements. This entails project management and modifications to systems and controls. The Board duly considered the costs and challenges of the standard. See SFFAS 54 paragraphs A23-A27, A33, A36, and A38-A41 for examples.
8. Statement 54 contributes significantly to each of the federal financial reporting objectives. The processes of preparing and auditing financial reports enhances the government’s overall accountability structure and provides assurance to users, including Veterans, that (a) resources, obligations, and costs of leases are recorded and reported accurately, (b) budgetary resources for leases have been obtained and used in accordance with the legal authorization, and (c) the effectiveness and efficiency of lease contracts and agreements are appropriately managed. Accrual-based standards are an essential and foundational element of meeting these accountability responsibilities, all of which are highly relevant to users of the Department’s financial reports, especially Veterans, and maintaining the public trust.

Closing staff remark:

The federal financial reporting objectives are “a framework for assessing the existing financial reporting systems of the federal government and for considering how new accounting standards might help to enhance accountability and decision-making in a cost-effective manner.”¹ Topic E and the issues discussed in this enclosed letter highlight the anticipated benefits of Statement 54 and its expected contributions to the federal financial reporting objectives when the Statement becomes effective in fiscal year 2024.

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¹ Statement of Federal Financial Accounting Concepts 1.



**ASSISTANT SECRETARY FOR MANAGEMENT
AND CHIEF FINANCIAL OFFICER
WASHINGTON**

February 15, 2023

Mr. George A. Scott
Chairman
Federal Accounting Standards Advisory Board
441 G. Street, NW, Suite 1155
Washington, DC 20548

Via email to fasab@fasab.gov

Dear Chairman Scott:

The Department of Veterans Affairs (VA) has significant concerns about the Statement of Federal Financial Accounting Standards (SFFAS 54): Leases. SFFAS 54 results from the Federal Accounting Standards Advisory Board's (the Board) adoption of private-sector lease accounting, and VA does not believe the current lease standard fully considers the unique challenges Federal agencies face when they execute leases outside the authority of the General Services Administration. VA identified numerous challenges to implementing SFFAS 54, and I am requesting the Board consider rescinding the standard or delaying its implementation date to October 2027.

VA places a high value on accurate financial reporting, and we have worked hard to earn 24 consecutive unmodified audit opinions. However, our ability to implement SFFAS 54 as written and within the prescribed timeframe is problematic for the following reasons. First, our existing disparate systems are antiquated and cannot accommodate SFFAS 54 requirements. While we are implementing a new accounting and acquisition solution, it will not be deployed until 2027. Second, there is no viable, cost-effective industry electronic solution available that we can successfully employ to comply. Finally, pursuing a manual solution by hiring additional staff is cost prohibitive. With the recent expansion of VA benefits to include Toxic Exposed Veterans and an aging infrastructure and facility correction cost estimate doubling from \$11.6 billion to \$22.6 billion, I cannot justify the extra expense to expedite compliance with SFFAS 54 as it would require diverting resources from direct Veteran support. Additionally, while I wholeheartedly support increased financial transparency and accountability, I do not believe that the standard provides additional value or utility to the typical users of our financial statements, Veterans.

The enclosure provides additional detail regarding VA's challenges and concerns, and I understand other Federal agencies face similar challenges.

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Mr. George Scott

I appreciate your consideration of this important matter. Should you have any questions, please contact me, or have a member of your staff contact Ms. Joanne Choi, Deputy Assistant Secretary for Finance, at 202-461-5529 or joanne.choi@va.gov.

Sincerely,



Jon J. Rychalski

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CC: Acting Controller, Office of Management and Budget
Comptroller, Department of State
Deputy Chief Financial Officer, Department of Energy
Principal Deputy Assistant Secretary Exercising the Delegated Authorities of the
Assistant Secretary and Chief Financial Officer, Department of the Interior
Executive Director, FASAB
Deputy Assistant Secretary for Finance and Deputy Chief Financial Officer,
Department of Health and Human Services
Chief Financial Officer, National Aeronautics and Space Administration

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Issues Related to the Statement of Federal Financial Accounting Standards 54 (SFFAS 54) Implementation Date

1) The Department of Veterans Affairs (VA) has approximately 1,400 lease agreements that are potentially impacted by implementation of SFFAS 54. However, VA has no automated solution to effectively support execution of the SFFAS 54 standard by the required completion date. VA's legacy core financial system is more than 30 years old and cannot be configured to meet SFFAS 54 requirements because it is no longer supported by the software provider.

2) While VA is in the process of replacing its legacy financial system, it is a multi-year effort that predates SFFAS 54. The new system alone will not fully integrate and automate the leasing process with the accounting system required by SFFAS 54. VA would also need a centralized lease procurement and lease management system. Until VA has such a system, the current disconnects between the initiation of the lease transaction and SFFAS 54 reporting will continue. Because real estate lies outside VA's core missions, VA's information technology (IT) investment priorities are not aligned with developing a comprehensive lease management system. Any such effort would be a multi-year project to potentially include interfacing with the modernized core financial system.

3) Since SFFAS 54 functionality was not required in existing Federal accounting systems such as SAP, Oracle, and Momentum (VA's new system provider), VA considered alternative commercial products with the necessary capabilities to support the standard. Unfortunately, a viable commercial lease system solution with SFFAS 54 functionality is unavailable. VA discussed potential software solutions with several vendors, but no Federal Risk and Authorization Management Program (FedRAMP) compliant solution was identified. FedRAMP compliance requires vendor investments to update their software and an agency sponsor. VA does not have the budget to support vendors achieving FedRAMP compliance.

4) VA also explored the option of a managed service lease solution instead of procuring a system solution. Based on the size of VA's lease portfolio, a managed serviced option will cost VA millions of dollars annually, making this solution cost prohibitive.

5) The lack of available systems and the volume of VA's lease portfolio will require VA to rely heavily on spreadsheets that are continuously and manually updated to comply with SFFAS 54 to:

- Calculate the present value of leases;
- Develop the lease amortization schedules;
- Identify the funded principal portion of lease liabilities each year based on the amortization schedules;
- Identify the interest portion of the year for payments that need to be funded;

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- Identify the monthly amounts of payments and receipts to apply to principal and interest to update the general ledger balances of lease liabilities and leased assets; and
- Generate the required disclosures of future payments due.

6) The standard requires agencies measure the full value of the lease at the present value of payments expected to be made during the lease term. This valuation requires multiple assumptions, to include the probability that an agency will exercise the option. VA's current systems do not capture the historic data necessary to make data-driven assumptions. The standard must provide alternative valuation methods for agencies lacking a centralized system and struggling to capture information to make reasonable assumptions.

7) Due to the size of VA's lease portfolio and the manual process that will be required to perform lease data extraction, maintain the portfolio, and accurately account for the leases as capital leases under the standard, VA will be required to make an unaffordable investment in additional financial staff. Because VA prioritizes investment decisions that prioritize fulfilling our core mission, the additional resources necessary to manually comply with SFFAS 54 would require the diversion of resources that benefit our Nation's approximately 20 million Veterans. This impediment to cost effective and efficient implementation is not unique to VA as other Federal agencies face similar issues.

8) Based on the volume of VA's lease portfolio and the complex manual processes described above, VA believes that the current implementation date could adversely impact the Department's financial statement audit opinion.

9) SFFAS 54's adoption of private sector leasing practices poses numerous challenges to federal agencies and will require excessive time and effort to create manual journal entries necessary to comply with the standard. As a result of the standard, straight line amortization of leases will not tie directly to lease payments and separate entries will be necessary to recognize funded versus unfunded lease liabilities. VA will be required to manually roll forward thousands of leases each year. Due to the funding requirements for Federal Government agencies, each lease liability that meets the definition of an operating lease for budgetary purposes under Office of Management and Budget Circular A-11 will start off as an unfunded lease, and the annual funded portion will be rolled forward each year to the annual appropriation and a funded general ledger account. The entry to move the annual funded liability balance to the annual appropriation is different from commercial accounting requirements and VA will need to perform this step manually, relying on spreadsheets to calculate the amounts. VA will need to prepare journal entries to move the balances, as VA does not have the systematic ability to roll forward thousands of leases. This manual effort will be cumbersome and labor intensive.

10) Due to the complexity of SFFAS 54, agencies are heavily relying on the US Standard General Ledger accounts and scenarios. Treasury only recently finalized the

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right-to-use lease scenario (January 2023) with other scenarios still in draft/unfinalized. VA has questions related to both lessee and lessor postings. Treasury will need to finalize all scenarios and provide clarifying answers on existing scenarios before VA can establish journal entry templates with the correct posting logic. For example, VA raised a question on how to address the current budgetary to propriety tie-point difference that exists in the Department of the Treasury (Treasury) Lease Scenario when a lessee establishes a funded liability in account 293000 Lessee Lease Liability without a corresponding entry to 490100 Delivered Orders, Obligations, Unpaid.

11) The Federal Accounting Standards Advisory Board still has an open Omnibus amendment related to SFFAS 54. That amendment will update the guidance on the selection of the interest rate used to calculate the lease liabilities and related assets, directing agencies to use a Treasury security interest rate of similar term as the lease, in the absence of a lease specified interest rate. VA's leases do not specify interest rates and VA will need to use the Treasury security interest rate to calculate the value of its capital leases under the standard. VA, and other agencies that need to use the Treasury security interest rate, will not be able to finalize any lease liability or asset calculations until the Omnibus amendment has passed and then the agency will need to wait until October 1, 2023, to select the Treasury rates as of the implementation date, which will be burdensome for agencies without a software solution.

12) Finally, the impact to VA's financial statements and additional disclosures required by SFFAS 54 will not assist the typical readers of VA's financial report, Veterans. The lease amortization concept is complex, resulting in a balance sheet gross-up, and most users do not have the financial sophistication necessary to understand the accounting focused impact of this statement. Moreover, VA decision makers do not use SFFAS 54 lease information to make programmatic lease decisions. VA determines lease requirements based on the Veteran population and the space requirements necessary to provide Veteran benefits, with Congress often mandating VA's Major Leases. VA's Contracting Officers solicit leases with terms and conditions based on clinical requirements and market conditions within a geographic area and do not rely on SFFAS 54 asset and liability valuations during the solicitation process. Therefore, this standard will be burdensome and costly to implement without providing benefit to VA and the Veterans we serve.

**Department of Veterans Affairs
February 2023**