**From:** Sharon Heinle [mailto:sheinle@gwu.edu] **Sent:** Friday, September 13, 2013 1:16 PM

**To:** Director - FASB **Cc:** Sharon Heinle

**Subject:** File Reference No. 2013-270

We wish to first thank the Financial Accounting Standards Board for inviting comments from financial statement users and preparers on the proposed changes to accounting for leases.

While there were several questions posed in the exposure draft for consideration, we are offering responses only on those for which we have constructive feedback.

### Question 4: Classification of Leases

Do you agree that the principle on the lessee's expected consumption of the economic benefits embedded in the underlying asset should be applied using the requirements set out in paragraphs 842-10-25-5 through 25-8, which differ depending on whether the underlying asset is property? Why or why not? If not, what alternative approach would you propose and why?

We agree that the consumption of the economic benefits of the underlying asset provides a reasonable basis for determining the classification of the lease. However, we do not agree with the criteria set out in paragraph 842-10-25-7 for leases of property. We recommend that leases of land should always be considered Type B, without consideration of the additional criteria in the specified paragraph. As currently written, long-term ground leases could fall into Type A treatment based on the criterion in 842-10-25-7(b) to consider the present value of the lease payments in relation to the fair value of the asset. However, this is inconsistent with the ASU's underlying premise of the consumption of the asset's economic benefits given that land is not 'consumed' by the lessee. We believe that it will materially misrepresent the lessor's balance sheet to derecognize significant real estate assets owned by the entity as a result of the proposed treatment.

We note that the Basis for Conclusions (BC93) suggests that Type A treatment is appropriate for long-term land leases because it results in accounting that is similar to a sale. This would only be appropriate if the lessor's intent is to make a sale. For entities that enter into long-term ground leases of property held for investment purposes, the intent is clearly not to sell, but to generate a return on those investments while retaining ownership of the underlying assets. Derecognition of those underlying assets would misrepresent the economic substance of the arrangement and of the lessor's investment portfolio.

Paragraph 842-10-25-9 allows an entity to look at all assets included in a lease and make a determination as to the 'primary' asset for purposes of determining the lease classification. This recognition of the economic substance of the transaction is appropriate. However, paragraph 842-10-25-10 applies an arbitrary override to this determination for leases that involve the right to use both land and a building, presumably because land does not have a limited economic useful life. It is easy to envision arrangements where land is the primary asset being leased, but there may be structures on the property which are merely incidental. Consider leases of agricultural farmland where there are storage buildings, grain silos, or the like which are clearly ancillary to the primary asset of the land. The arbitrary 'bright line' introduced in paragraph 10 is

inconsistent with the principle-driven approach throughout the rest of the proposed standard and is unnecessary.

We also believe that the proposed standard overlooks a number of U.S. preparers that carry real estate assets at fair value as investments. The standard only discusses investment real estate for entities following IFRS and suggests that fair value accounting is precluded for U.S. preparers (BC189). However, there are many entities following U.S. GAAP which apply fair value accounting to such investments, including not-for-profits (particularly those with endowments) and pension funds. As discussed in the Basis for Conclusions (BC94-95; BC276), the most meaningful financial statement elements for such investment assets are the cash flows derived from the asset along with the change in fair value (unrealized gain/loss) to provide the total return generated by the asset. The standard should recognize that there are U.S. GAAP preparers who apply fair value accounting to investment properties, and that the income recognition principles for such assets should consider the total return, consistent with other investments. Derecognition of significant investment assets would be inconsistent with the intent for which the assets are held and the accurate reflection of the return on those assets. Endowments, pensions, and others with fair value investment portfolios report the total return to donors, participants, stakeholders, regulatory agencies, and others, and utilize this information to set appropriate spending policies. Currently, those total return calculations are supported by audited financial statements. Removing selected assets and the fair value gains/losses from the financial statements undermines the reliability of this information and the consistency and comparability across preparers.

## Question 7: Transition

Subparagraphs 842-10-65-1(b) through (h) and (k) through (y) state that a lessee and a lessor would recognize and measure leases at the beginning of the earliest period presented using either a modified retrospective approach or a full retrospective approach. Do you agree with those proposals? Why or why not? If not, what transition requirements do you propose and why?

Are there any additional transition issues the Boards should consider? If yes, what are they and why?

We appreciate the Board's solicitation of input on transition and effective date, as well as the recognition that this proposal affects nearly every reporting entity, some of which will have many individual leases. The relief of a modified retrospective approach is obviously preferable to a full retrospective approach.

Considering the substantial changes in lease accounting, the large volume of arrangements involved, and the complexity of the required calculations, reporting entity's will almost certainly look to systems modifications or software tools to facilitate this transition. Given that the proposed accounting treatment over the life of this project has evolved and had significant shifts from the earlier exposure draft, we would expect that developers will wait for the issuance of the final standard to release (or perhaps even begin) such tools. With that in mind and with the knowledge of the extensive efforts that reporting entities will need to undertake to identify and gather the required data on all existing lease arrangements, it is crucial that the standard allow sufficient lead time between issuance and effective date. We suggest a minimum of 2 years.

We also recommend the board consider a tiered implementation, providing a one-year deferral of the effective date for not-for-profit and nonpublic entities as an additional specified relief. This

will help ease the burden for these organizations in a number of ways. First, it simply allows extra time. Second, they will be able to benefit from the experiences of the early implementers for systems implementations without competing with those entities for the same resources (which would potentially increase the cost of implementation even more). Third, the organizations will also be able to leverage the experience of first adopters' for audit purposes as well as disclosure preparation.

### Question 8: Disclosure

Paragraphs 842-10-50-1, 842-20-50-1 through 50-10, and 842-30-50-1 through 50-13 set out the disclosure requirements for a lessee and a lessor. Those proposals include maturity analyses of undiscounted lease payments, reconciliations of amounts recognized in the statement of financial position, and narrative disclosures about leases (including information about variable lease payments and options). Do you agree with those proposals? Why or why not? If not, what changes do you propose and why?

The stated objective of the disclosure requirements "to enable users of financial statements to understand the amount, timing, and uncertainty of cash flows arising from leases" is sound on its face. The maturity analysis of undiscounted lease payments clearly supports this objective. However, the detailed reconciliation of balance sheet amounts, particularly for lessors in Type A arrangements, and the narrative information about options and variable lease payments, are onerous. These disclosures may be relevant for an entity whose primary business is leasing, or even for significant individual lease arrangements for other entities. However, for organizations like universities who are party to a large number of arrangements as both a lessee and a lessor – all of which are ancillary to our primary mission of education, research, and public service - the suggested disclosure requirements have the potential to add pages of footnotes on largely immaterial transactions without adding significant value to the users of our financial statements. The sheer volume of disclosures create the impression that this is a significant portion of the entity's business and financial condition, while the careful analysis of the substance of the disclosures would reveal this not to be the case. The specified relief for nonpublic entities may be helpful in allaying this issue (see response to next question), but given the FASB's ongoing projects for defining public and nonpublic entities, it is still not clear where not-for-profit organizations will fall in these definitions. To ensure financial statements are useful, disclosures should be proportional to their relevance and there should be some latitude for reduced disclosures if the leasing activity is immaterial to the overall financial operations of the entity. (See also our recent comment letter on the Disclosure Framework dated November 30, 2012.)

# Question 9: Nonpublic Entities (FASB Only)

To strive for a reasonable balance between the costs and benefits of information, the FASB decided to provide the following specified reliefs for nonpublic entities:

- 1. To permit a nonpublic entity to make an accounting policy election to use a risk-free discount rate to measure the lease liability. If an entity elects to use a risk-free discount rate, that fact should be disclosed.
- 2. To exempt a nonpublic entity from the requirement to provide a reconciliation of the opening and closing balance of the lease liability.

Will these specified reliefs for nonpublic entities help reduce the cost of implementing the new lease accounting requirements without unduly sacrificing information necessary for users of their financial statements? If not, what changes do you propose and why?

The specified reliefs will be helpful to reduce the cost of implementation (and audits) and #2 will help to remove potentially irrelevant disclosures from the financial statements of a nonpublic entity. In fact, they could go even further to allow judgment regarding the narrative disclosures such as options and variable payments depending upon materiality and relevance to overall financial statements as suggested in the previous response.

However, it should be noted that the FASB's current project on *Definition of a Nonpublic Entity* leaves not-for-profits in an indeterminate state as neither public nor nonpublic, so it is not clear if not-for-profit entities will be able to take advantage of the specified reliefs. Given this ambiguity, **the standard should specifically identify that the relief is available to not-for-profit entities in addition to nonpublic entities.** As noted in response to Question 8 above, the volume of additional required disclosures which are not directly relevant to a not-for-profit entity's mission, business activities, or financial statements would detract from the usefulness of the financial statements to stakeholders and other users of those statements.

Thank you for the opportunity to comment on this exposure draft. We appreciate the careful analysis that FASB gives to comments received through this process.

Sincerely,

#### **Sharon Heinle**

Associate Vice President & Comptroller
THE GEORGE WASHINGTON UNIVERSITY
703-726-1087 | sheinle@gwu.edu |comptroller.gwu.edu

