FASB Leases - Topic 842

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Respondent information

Type of entity or individual:

United Way is a worldwide network in 45 countries and territories, including nearly 1,200 local organizations in the USA. Each United Way is a separate legal entity formed under Section 501(c)(3) of the IRS Code, maintains its own records and Board.

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Questions and responses

This revised Exposure Draft defines a lease as "a contract that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration." An entity would determine whether a contract contains a lease by assessing whether: 1. Fulfillment of the contract depends on the use of an identified asset.2. The contract conveys the right to control the use of the identified asset for a period of time in exchange for consideration. A contract conveys the right to control the use of an asset if the customer has the ability to direct the use and receive the benefits from use of the identified asset. Do you agree with the definition of a lease and the proposed requirements in paragraphs 842-10-15-2 through 15-16 for how an entity would determine whether a contract contains a lease? Why or why not? If not, how would you define a lease? Please supply specific fact patterns, if any, to which you think the proposed definition of a lease is difficult to apply or leads to a conclusion that does not reflect the economics of the transaction.

We agree with the definition of a lease and the proposed requirements in paragraphs 842-10-15-2 through 15-16 for how an entity would determine whether a contract contains a lease (right of use and control of the use of the identified asset by lessee).

This revised Exposure Draft would require an entity to recognize assets and liabilities arising from a lease. When assessing how to account for a lease, a lessee and a lessor would classify a lease on the basis of whether a lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset. This revised Exposure Draft would require an entity to apply that consumption principle by presuming that leases of property are Type B leases and leases of assets other than property are Type A leases, unless specified classification criteria are met. Those classification criteria are different for leases of property and leases of assets other than property to reflect the different natures of property (which often embeds a land element) and assets other than property. The Boards acknowledge that, for some leases, the application of the classification criteria might result indifferent outcomes than if the consumption principle were to be applied without additional requirements. Nonetheless, this revised Exposure Draft would require an entity to classify leases by applying the classification criteria in paragraphs 842-10-25-5 through 25-8 to simplify the proposals.Lessee AccountingA lessee would do the following: 1. For all leases, recognize a right-of-use asset and a lease liability, initially measured at the present value of lease payments (except if a lessee elects to apply the recognition exemption for short-2. For Type A leases, subsequently measure the lease liability on an amortized cost basis and amortize the right-of-use asset on a systematic basis that reflects the pattern in which the lessee expects to consume the right-of-use asset's future economic benefits. The lessee would present the unwinding of the discount on the lease liability as interest separately from the amortization of the right-of-use asset. 3. For Type B leases, subsequently measure the lease liability on an amortized cost basis and amortize the right-of-use asset in each period so that the lessee would recognize the total lease cost on a straight-line basis over the lease term. In each period, the lessee would present a single lease cost combining the unwinding of the discount on the lease liability with the amortization of the right of use asset.Lessor AccountingA lessor would do the following: 1. For Type A leases, derecognize the underlying asset and recognize a lease receivable and a residual asset. The lessor would recognize both of the following: a. The unwinding of the discount on both the lease receivable and the residual asset as interest income over the lease term b. Any profit relating to the lease (as described in paragraph 842-30-30-7) at the commencement date.2. For Type B leases (and any short-term leases if the lessor elects to apply the exemption for shortterm leases), continue to recognize the underlying asset and recognize lease income over the lease term, typically on a straight-line basis.Question 2: Lessee AccountingDo you agree that the recognition, measurement, and presentation of expenses and cash flows arising from a lease should differ for different leases, depending on whether the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset? Why or why not? If not, what alternative

We do agree with the proposed lessee accounting. For a Type A lease, it makes sense that the lessee would record expense at a faster rate earlier in the lease term as the lessee consumes more of the economic benefit of the asset. We would like to have additional guidance on the determination of "insignificant" (see # 4 below).

approach would you propose and why?

3. Do you agree that a lessor should apply a different accounting approach to different leases, depending on whether the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset? Why or why not? If not, what alternative approach would you propose and why?

We do agree with the proposed lessor accounting. We believe that the accounting for the lessor and lessee should be consistent with each other. For a Type A lease, it makes sense that the lessor would record income at a faster rate earlier in the lease term if the lessee consumes more of the economic benefit of the asset. For Type B leases it also makes sense that the lessor records revenue on a straight line basis (like an operating lease) as the management of the Type B leases (generally property) is maintained by the lessor.

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 with the principles on the classification of leases. We think there should be some additional guidance or examples in the following paragraphs to better define "insignificant" as it related to the classification of a Type A or Type B lease. Is there any percentage threshold for an insignificant lease term as compared to the remaining economic life or PV of lease payments to the fair value of underlying assets that could be presented as a guide? 842-10-25-6 a. The lease term is for an "insignificant" part of the total economic life of the underlying asset. b. The present value of the lease payments is "insignificant" relative to the fair value of the underlying asset at the commencement date. It seems that there is a lot of judgment left to the lessee and lessor to determine if the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset. Similarly, we believe there should be some additional guidance or examples in the following paragraphs to better define "major part", "substantially all" and "economic life". 842-10-25-7 a. The lease term is for the "major part" of the remaining "economic life" of the underlying asset. (Would the "major part" be 90% or more of the remaining life? and could the IRS asset life guidance be used to help define "economic life", particularly for property?) b. The present value of the lease payments accounts for "substantially all" of the fair value of the underlying asset at the commencement date. (Would "substantially all" be 90% or more of the fair value?)

5.

This revised Exposure Draft would require that a lessee and a lessor measure assets and liabilities arising from a lease on a basis that:1. Reflects a lease term determined as the noncancellable period, together with both of the following: a. Periods covered by an option to extend the lease if the lessee has a significant economic incentive to exercise b. Periods covered by an option to terminate the lease if the lessee has a significant economic incentive not to exercise that option.2. Includes fixed lease payments and variable lease payments that depend on an index or a rate (such as the Consumer Price Index or a market interest rate) but excludes other variable lease payments unless those payments are in-substance fixed payments. The lessee and lessor would measure variable lease payments that depend on an index or a rate using the index or rate at the commencement date. A lessee would reassess the measurement of the lease liability, and a lessor would reassess the measurement of the lease receivable, if either of the following occurs: 1. There is a change in relevant factors that would result in a change in the lease term (as described in paragraph 842-10-55-5). 2. There is a change in an index or a rate used to determine lease payments. Question 5: Lease TermDo you agree with the proposals on lease term, including the

reassessment of the lease term if there is a change in relevant factors? Why or why not? If not, how do you propose that a lessee and a lessor should determine the lease

We agree with the proposals on lease term. We suggest adding language to clarify paragraph 842-10-25-1 An entity shall determine the lease term as the non-cancellable period of the lease, together with both of the following: a. Periods covered by an option to extend the lease if the lessee has a significant economic incentive to exercise that option ("that is, add the option period to the original lease term"). b. Periods covered by an option to terminate the lease if the lessee has a significant economic incentive not to exercise that option ("that is, do not SHORTERN the original term to end at the termination date"). We also agree with the reassessment of the lease term if there is a change in relevant factors since the economic value of the lease should reflect the current lease terms in order for the information disclosed to be relevant to the reader of the financial statements.

and why?

Do you agree with the proposals on the measurement of variable lease payments, including reassessment if there is a change in an index or a rate used to determine lease payments? Why or why not? If not, how do you propose that a lessee and a lessor should account for variable lease payments and why?

We agree with the proposals on the measurement of variable lease payments, including reassessment as discussed in Question 5.

7.

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 agree with the transition requirements primarily because financial statements presented should be comparable and therefore it makes sense to recognize and measure leases at the beginning of the earliest period presented using either retrospective approach. Is the IRS aware of the required change to the beginning balance sheet (statement of financial position) and potential income statement (statement of activities) changes as a result of implementing the lease standard? We are assuming that there would be no requirement to amend tax returns as a result of the implementation. There may be added cost for implementation if this change to GAAP would result in the need to do amended 990 filings. Another transition issue could be around budgeting related to Type A leases where in many cases the lease expense would have occurred on a straight line basis and now the expense could be greater in the earlier years of the lease. This could have greater impact on smaller organizations with little flexibility in their budget. A final transition issue could be a negative change to the net asset that might have repercussions to an organization's current year financial operations (i.e. the reserves are lower than policy, debt covenants, etc.). We suggest that there be footnote disclosure around any negative changes to the prior year/earliest year presented net assets as well as future lease expense savings that would mitigate the negative effect.

8.

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?

We agree with most of the disclosure requirements with one exception - paragraph 842-20-50-3 b. Information about leases that have not yet commenced but that create significant rights and obligations for the lessee. We are unclear as to the value of this information to the reader of the financial statements. We often commit the organization in other ways (employment contracts with executive management team members, purchase orders for FF&E, etc.) but if neither party has taken action to commence execution on the commitment, then we are not required to disclose (except in the case of a significant item that would fall into a subsequent events disclosure); How/why is a lease any different? Is the issue related to the cancelability of a lease? If so, we suggest a modification to the standard such that, if there is no "non-cancelable" clause in the lease contract, then the lease would not be required to be disclosed. If there is disclosure required, should it be better presented in a "Subsequent Events" footnote in the financial statements? We see the value in the remaining disclosure requirements.

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?

We agree that the first relief - election to use the risk-free rate to measure the lease liability - is a cost saver for non-public entities. We did not see a significant amount of cost savings in exempting a nonpublic entity from the requirement to provide a reconciliation of the opening and closing balance of the lease liability. This information would most likely be requested by the auditor for the financial statement audit and the information would be arrived at by default as part of the process to gather the information for the remaining disclosure requirements.

10.

The FASB decided that the recognition and measurement requirements for all leases should be applied by lessees and lessors that are related parties based on the legally enforceable terms and conditions of the lease, acknowledging that some related party transactions are not documented and/or the terms and conditions are not at arm's length. In addition, lessees and lessors would be required to apply the disclosure requirements for related party transactions in Topic 850, Related Party Disclosures. Under existing U.S. GAAP, entities are required to account for leases with related parties on the basis of their economic substance, which may be difficult when there are no legally enforceable terms and conditions of the agreement. Question 10: (FASB Only)Do you agree that it is not necessary to provide different recognition and measurement requirements for related party leases (for example, to require the lease to be accounted for based on the economic substance of the lease rather than the legally enforceable terms and conditions)? If not, what different recognition and measurement requirements do you propose and why?

The United Way Network does not have much exposure to related party transactions and therefore we do not feel that we have the expertise to comment on Question 10.

11.

Do you agree that it is not necessary to provide additional disclosures (beyond those required by Topic 850) for related party leases? If not, what additional disclosure requirements would you propose and why?

The United Way Network does not have much exposure to related party transactions and therefore we do not feel that we have the expertise to comment on Question 11.

12.

The IASB is proposing amendments to other IFRSs as a result of the proposals in this revised Exposure Draft, including amendments to IAS 40, Investment Property. The amendments to IAS 40 propose that a right-of-use asset arising from a lease of property would be within the scope of IAS 40 if the leased property meets the definition of investment property. This would represent a change from the current scope of IAS 40, which permits, but does not require, property held under an operating lease to be accounted for as investment property using the fair value model in IAS 40 if it meets the definition of investment property. Do you agree that a right-of-use asset should be within the scope of IAS 40 if the leased property meets the definition of investment property? If not, what alternative would you propose and why?

The United Way Network does not have any exposure to IFRSs and therefore we do not feel that we have the expertise to comment on Question 12.

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None

Additional Please provide any comments on the electronic feedback process:

comments - process.

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