Financial Accounting Standards Board (FASB) Exposure Draft on Leases (Topic 842)

General Services Administration (GSA) General Comments:

- 1. Need to define accounting treatment and recognition treatment for existing balances related to rent abatements, rent credits, broker rebates, etc.
- 2. It is not clear how to account for (on the Lessors books) betterments and repairs and alterations on assets that are leased.
- 3. Please consider a longer term for short-term classification, based on asset class life expectancy. For instance a 2 or 3 year lease would not seem to warrant asset/liability recognition due to workload. We suggest the board consider allowing this new accounting method to apply to leases that meet the entity's capitalization timeframe instead of a set time period. For example, if an entity has a capitalization time period of 2 years or more, then short term would be less than 2 years. This prevents an entity from having a lease asset on the books that does not meet its capitalization criteria compared to an outright purchase.
- 4. For shorter term real property leases (i.e. less than 5 years), the benefit may not be worth the costs. The shorter the term of the lease, the benefit will be less. It is indeterminable at this point, what the long term costs will be for entities with significant leasing operations. There will be significant costs for systems enhancements to account for this.
- 5. GSA takes exception to the core principle of the proposed requirements that an entity should recognize assets and liabilities arising from a lease. There is disagreement with the concept of right-of-use assets and lease liability accounting for leases as described in the Exposure Draft for one important reason. There has been no legal transfer of title in the underlying asset. The lessor has leased an owned asset based on pricing in the risks of ownership and maintenance of the asset in order to generate a profit, after incorporating those risks into the analysis. The lessee has leased the asset specifically because the lessee did not want to take ownership responsibility for an asset or did not have and/or did not desire to apply its capital to complete an acquisition and was willing to pay a negotiated price for that convenience over a period certain in an arm's length transaction. GSA believes that the economic benefits to the lessor and lessee are thus asymmetrical and it is not appropriate or reasonable to attempt to match the two. GSA also believes that it is inappropriate for the accounting community to begin to create illusory concepts that have little basis in fact and create excessive requirements that may produce little benefit overall.
- 6. When Would the Amendments Be Effective. The Public Building Service (PBS) has over 9,000 property leases with external lessors currently and over 11,000 sub-leases with its Federal agency customers. The time necessary for PBS to prepare for such a significant change on such a massive scale would be many years, at least 5

years and perhaps longer given the need to formulate and implement necessary policies, procedures and training for numerous regional and field offices, not to mention the time necessary to plan, program, and implement the required changes to the organization's accounting and other business line feeder systems. We expect that some private sector companies also have large numbers of leases. In their interest and the interest of PBS, we would ask the Board's consideration of these relevant factors when setting the effective date.

Question 1: Identifying a Lease

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.

GSA Comments:

Yes, we agree with the definition of a lease. However, GSA does not see how the present definition leads to the accounting requirements that are identified in the remainder of the FASAB Exposure draft for right-of-use assets and lease liabilities. GSA notes that the right to use an asset is distinct from the right to own the asset; therefore, believes that the concept of a right-to-use asset is a theoretical accounting contraption that goes beyond the scope of reasonableness in the accounting for income and expense and/or assets and liabilities.

The Accounting Model

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 in different 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 Accounting

A 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-term leases).
- 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 Accounting

A 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 short-term leases), continue to recognize the underlying asset and recognize lease income over the lease term, typically on a straight-line basis.

Question 2: Lessee Accounting

Do 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 approach would you propose and why?

GSA Comments:

No, GSA does not 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. Regardless of portion of economic benefit consumed of the underlying asset, the Net Present Value (NPV) of the total lease payments plus direct and indirect costs associated with the lease is the economic cost for the total benefit received. This amount should be recognized as the right of use asset and amortized on a straight line basis. This change in lease accounting is intended to improve financial reporting on the balance sheet for assets and liabilities. Unless the end result of the lease results in ownership/possession of the asset, there should be no "interest expense" involved, since there is technically no financing of an asset. In the example where GSA is the lessee and will pay \$100 over 10 years for office space, the entries should be:

Debit: Right of Use Asset	\$80		(NPV of \$100)
Credit: Lease Liability		\$80	

The entries for yearly recognition of expense:

Debit: Lease Expense	\$10		
Credit: Right of Use Asset		\$8	
Credit: Lease Liability		\$2	

The entries for yearly payment is:

Debit: Lease Liability	\$10		
Credit: Cash		\$10	

Since GSA will not have a physical asset at the end of the lease, unless this lease is scored (based on OMB Circular A-11) as a capital lease, it will not have any associated budgetary entries. Then, if/when GSA is the lessor of this same space, and the GSA customer has an Occupancy Agreement for \$110:

Debit: Lease Receivable	\$110		
Credit: Right of Use Asset		\$110	

Yearly collection:

Debit: Cash	\$11		
Credit: Lease Receivable		\$11	

In this example, GSA will have a negative Right of Use Asset balance and a positive/offsetting Lease Receivable. And, this entire scenario is based on the

presumption that the lease is non-cancelable. If it is cancelable, then it would be presumptive to record the entire lease.

Question 3: Lessor Accounting

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?

GSA Comments:

No, we do not agree that the 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. See response to #2.

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?

GSA Comments:

No, we do not 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. See response to #2.

Measurement

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 that option
 - 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 Term

Do 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 term and why?

GSA Comments:

Yes, this seems reasonable.

Question 6: Variable Lease Payments

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?

GSA Comments: N/A

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?

GSA Comments:

These proposals are OK, as long as entities are given at least 2 years to implement this guidance.

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?

GSA Comments:

GSA agrees with disclosing high level, summary qualitative and quantitative information about leases, significant judgments and amounts recognized on the financial

statements. GSA disagrees with detailed (at the lease level) qualitative and quantitative information. For example, providing details on all the options on leases, subleases, or non-commenced leases, may be reasonable for an entity with 5 leases, but not for an entity with 9,000 leases.

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?

GSA Comments: N/A

Related Party Leases (FASB Only)

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?

GSA Comments: N/A

Question 11: (FASB Only)

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?

GSA Comments: N/A

Question 12: Consequential Amendments to IAS 40 (IASB Only)

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?

GSA Comments: N/A