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Leases: Financial Accounting Measuring and Recording Challenges Continue

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Abstract:
This article discusses how five financial accounting standards setting organizations (FASB, IASB, GASB, FASAB, PCC) have been and are addressing the ongoing challenges of measuring and reporting lease transactions and events. Prior to 2016, contracts for assets leased for more than one year did not appear as liabilities on the balance sheet. It was called off-balance-sheet financing. With the FASB ASU2016-02, contracts to lease assets for more than one year were to be measured and reported in the financial statements.The research reported in this article indicates that there are efforts by those who lease assets to return to off-balance sheet financing at least in part when some of lease amount varies due to the measurement method used.

Keywords:*Lease accounting, FASB, IASB, GASB, FASAB, PCC, financial accounting*

1. Introduction

This article presents research results regarding accounting for leases in financial reports. Tension exists between preparers of financial statements and users of financial statements. Preparers prefer the lease liability to be off-balance sheet while users prefer the information be included in the balance sheet. In 2016 the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-02 eliminating the option of off-balance sheet reporting of items leased for more than one year. Those (called lessees) leasing items were said to have the Right of Use (ROU) of the items owned by the lessor. If the lease was for more than one year, the lessee was required to report the future lease payments as a liability in the balance sheet. This could have a negative impact on the debt-to-equity ratio. Often financial institutions required certain debt-to-equity ratios to be maintained. If the ratios were not maintained the financial institutions could raise the interest rate being charged on borrowed funds or even call the borrowed funds to be paid back immediately.

To minimize the lease liability, lessees reported the lease liability adjusted to what is called present value. This is often an amount much smaller than merely taking the monthly lease payments and multiplying them by the total number of months of the lease. Since interest typically is not charged on leased items, lessees have used a variety of interest or discount rates to bring the future lease payments to a smaller amount called the present value. This appears among other issues in the next section of this article.

2. Disclosures in Corporate Financial Statements

Table 1 in Appendix A details the research results of examining 10 randomly selected public for-profit corporations' disclosures about lease accounting in their most recent annual reports as of December 28, 2021. Of the 10, five mentioned the net impact of adopting ASU 2016-02. Of the five, three reported that the net impact of adopting ASU-2016-02 increased their reported retained earnings. One reported that it decreased their reported earnings. One did not give any information regarding the impact of adopting ASU 2016-02.

Five corporations reported that they used an estimated or weighted average discount rate and/or borrowing rate to calculate the present values of their lease liability. The other five corporations did not give any information as to how they measured and reported their lease liabilities.

One corporation reported that the impairment method was used to change the reported lease asset and/or lease liability. The impairment method is used by public for-profit corporations to measure the book value of Goodwill. Numerous articles have been published about the challenges of the impairment method relative to measuring and reporting Goodwill (e.g., Matthew & Gray, 2018; Gray, Jorge & Rodriguez, 2016; Gray & Jorge, 2015). It remains to be seen if use of the impairment method of measuring and reporting lease assets and liabilities will face similar challenges.

The next section of this article reports the number of accounting standards issued by the five financial accounting standard setting bodies. The number of standards indicate the challenges addressed and indicate that more challenges might be coming.

3. Financial Accounting Pronouncements from 2016 through 2021

Table 2 in Appendix A lists the 18 accounting pronouncements issued starting in the year 2016 through the year 2021 by the five financial accounting standard-setting bodies. The five financial accounting standard-setting bodies are as follows: Financial Accounting Standards Advisory Board (FASAB); Financial Accounting Standards Board(FASB); Governmental Accounting Standards Board(GASB); International Accounting Standards Board(IASB) that issues International Financial Reporting Standards (IFRS); and the Private Company Council(PCC). In the year 2021, each of the five had a new pronouncement or exposure draft or pronouncement under review regarding accounting for leases.

Starting in the year 2016 through the year 2021, the FASB issued 11 new ASUs regarding accounting for leases. The FASAB issued one pronouncement in 2020 and another in 2021. The GASB issued one in 2017 and another in 2021. The IASB issued two IFRS in the year 2021. The PCC issued one in the year 2021. The couple of examples of statements in the pronouncements are as follows:

> "A lessor shall disclose a table of all lease-related income items in its interim financial statements (see paragraph 842-30-50-5 for lease-related income items)" (FASB, 2021c). This level of detail will probably motivate the preparers of financial statements to say that cost is greater than benefits. The cost versus benefit argument has been used successfully in the past. For example, implementation of the internal control requirements of the Sarbanes Oxley Act of 2002 were deferred until the massive identify thefts (e.g., Target Corporation) occurred (Gray & Ehoff, 2015).
>
> Per the PCC (2021) the FASB staff updated the PCC on the post-implementation review activities related to Topic 842 Leases. PCC members discussed the challenges of implementation, including implementing new software, complying with the detailed disclosure requirements, and auditor resource shortages. PCC members also discussed and expressed mixed views on an additional deferral of the guidance.

In addition to comments such as the two above, there were 87 Comment Letters (p. 7) submitted to the IFRS (2021) regarding the Exposure Draft "Pronouncement-in-review (PIR) Lease liability in a sale and leaseback." Often less than 20 Comment Letters are submitted for Exposure Drafts. Having 87 Comment Letters indicates that the controversy continues. The IFRS (2021) stated that"conceptually, many respondents questioned the basis for the difference in the measurement of leaseback liabilities and other lease liabilities while others commented that this difference in measurement would reduce comparability and understandability for users of financial statements" (p. 15).

4. Conclusions and Summary

Measuring and reporting the lease liability has been controversial for over six years beginning before 2016 and lasting through 2021. Controversy resulted in the major change introduced by FASB ASU 2016-2. It eliminated the option of off-balance sheet reporting of lease liabilities. It is anticipated that in the year 2022 and possibly a few years after that will see more financial accounting standards issued to attempt to resolve the controversy of accounting for leases.

5. References

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Appendix A

Questions	**1**	**2**	**3**	**4**
Corporations				
AT&T	Yes	No	N/I	N/I
Bank of America	No	N/I	Yes	N/I
Costco	No	N/I	Yes	N/I
Crown Castle International	Yes	N/I	Yes	Yes
CVS Health	Yes	No	N/I	N/I
Delta	No	N/I	N/I	N/I
FedEx	Yes	No	N/I	N/I
JPMorgan Chase & Company	No	N/I	Yes	N/I
Verizon	No	N/I	Yes	N/I
Walgreens Boots Alliance	Yes	Yes	N/I	N/I
N/I = No Information given				
Question 1: Did the 2020 annual report mention the net impact of adopting Accounting Standard Update (ASU) 2016-02?				
Question 2: If the answer to question 1 was yes, was the net impact a decrease to retained earning?				
Question 3: Was an estimated or weighted average discount rate and/or borrowing rate used to calculate the present value of the lease liability?				
Question 4: Was impairment used to assess and possibly change the net book value of the reported lease asset and/or lease liability?				

Table 1

FASAB	FASB	GASB	IFRS	PCC
2020	2016	2017	2021	2021
2021	2017	2021	2021, May	
	2018a			
	2018b			
	2019a			
	2019b			
	2020a			
	2020b			
	2021a			
	2021b			
	2021c			

Table 2

18 Financial Accounting Pronouncements Regarding Leases*

*Note: List of pronouncements
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