



March 19, 2015

Mr. David R. Bean
Director of Research and Technical Activities
Project No. 3-24P
Governmental Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Dear Mr. Bean:

The American Institute of Certified Public Accountants (AICPA) has reviewed the Governmental Accounting Standards Board (GASB) Preliminary Views (PV), *Leases*, and is pleased to offer its comments. Overall, we support the Board's efforts to improve and simplify lease accounting and financial reporting.

We recognize that the PV format is limited and does not lend itself to describing the Board's rationale or providing information on how Board positions address user needs and concerns. We recommend the Board provide this information in the Basis for Conclusions section of the next round of due process. In particular, the Board should discuss feedback received from users and any other general feedback from the field test currently underway.

The remainder of this letter focuses on the key areas where we (1) disagree with the Board, (2) have questions, or (3) believe further clarity is needed.

Lease Definition. We are concerned about the "exchange or exchange-like transaction" portion of the lease definition in paragraph 4 of chapter 2, as we believe it will introduce practice challenges. Paragraph 6 of chapter 2 states that "specifying that a lease is an exchange or exchange-like transaction would exclude arrangements in which the consideration is nominal (nonexchange transactions)" and that the "existing guidance on nonexchange transactions would be applied in those cases." We recommend that GASB reevaluate this position after considering the following comments:

- First, we are unclear about the population of transactions the GASB is attempting to carve out by the inclusion of the "exchange and exchange-like transaction" portion of the definition. If it is a limited population of transactions, we believe it would be more efficient and effective for the Board to scope out specific transactions rather than modifying the lease definition to address them.

- We question whether GASB Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*, would provide adequate guidance for transactions that would fall into the “nonexchange” category. In practice, current nonexchange “lease” transactions are generally being treated as operating leases. In light of the move away from operating lease accounting, we are unclear as to the appropriate accounting for such a lease going forward.
- We are aware of situations in which one government leases space to another government for a multi-year period for a nominal fee (e.g., \$1). It is unclear whether this would be the type of transaction that GASB is attempting to carve out of the lease accounting requirements. In the Financial Accounting Standards Board (FASB) not-for-profit arena, this transaction would be deemed a contribution. GASB Statement 33 does not appear to adequately address the appropriate accounting for this type of transaction.

Lessee “Single Approach” versus “Dual Approach” Accounting. During our consideration of the PV, we had significant discussions regarding GASB’s decision that lessee accounting be based on a single approach, whereas FASB is heading on the path of a dual approach. We understand that FASB received considerable feedback from various constituency groups that the dual approach was preferable. Some reviewing the PV questioned whether the GASB’s and FASB’s constituencies are different enough to support the different approaches. We strongly recommend GASB gather more specific feedback in this regard and to clearly articulate in the next due process document the results of what GASB heard from its constituency.

Bargain Purchase Options. We disagree with the Board’s view in paragraph 9 of chapter 2 that bargain purchase options should be reported as financed purchases of the underlying asset. Instead, we believe that leases containing a bargain purchase option should be evaluated under the lease guidance. GASB’s position seems to be based on the belief that bargain purchase options are always exercised and are thus, in substance, the same as an immediate transfer of ownership. However, we are aware of many governments that do not exercise bargain purchase options. Our view is that title will not transfer in a bargain purchase option situation until it is exercised. As such, there is no sale until that time. Finally, we are concerned that GASB is setting a precedent for other types of transactions.

Contracts Containing Both Lease and Service Components. We recommend the Board further consider its view on contracts that contain both lease and service components. Paragraph 10 of chapter 2 indicates that a contract containing both lease and service components should be separated so that each component is accounted for on its own. While this is a more theoretically sound position, we question whether it will be cost beneficial for some lessees, particularly when the lease and service components are not clearly differentiated in the contract and the nature of the service clearly indicates its value is inconsequential compared with the total lease value. Most service components cover the

entire lease term, and are provided ratably over the lease term. Therefore, the effect on expenses of separating the components versus not separating the components should be inconsequential in most cases. The main accounting difference would relate to the initial measurements on the statement of net position and classification of the subsequent expense (amortization versus service expense).

Even though the exception provision in paragraph 10 may provide some relief, we suggest GASB proactively obtain feedback from government lessees with these types of contracts and financial statement users before issuing the next due process document. Both the FASB and the International Accounting Standards Board (IASB) lease projects are offering lessees the ability to make a policy election in this area. If the feedback obtained by GASB indicates that separating the lease and service components will be onerous, GASB may want to consider following the approach taken by FASB and IASB in this area to allow lessees to establish policies that drive whether the lease and service components are considered together or separate.

Contract Combinations. While we support the Board's overall view in paragraphs 16 through 18 of chapter 2, we question the need for the presumption in paragraph 16 that contracts entered into at or near the same time with the same counterparty are not part of the same lease unless there is evidence to the contrary. This same presumption is not included by the FASB and IASB in their lease projects (i.e., they begin the analysis process more neutrally without stating a presumption) and we are unclear why GASB is taking a different approach. While the criteria included in paragraph 17 are similar enough to the FASB and IASB criteria so that the resulting conclusion would likely be the same, we recommend that the Board remove the presumption in paragraph 16 to begin the analysis process more neutrally. If the Board does not accept this recommendation, it would be helpful for the next due process document to explain the Board's rationale as to why the presumption improves financial reporting for financial statement users.

"Probable" and Determining the Lease Term. Generally, we support the Board's view in paragraph 2 of chapter 3 to use a "probable" threshold for modifying a noncancellable lease term for lessee extension or termination options. Since determining probability in these instances will likely be very judgmental, we recommend the Board include specific examples and guidance to assist preparers in applying this judgment in the next due process document. We also recommend that the Board include its rationale for using a "probable" threshold versus the "reasonably certain" threshold used by the FASB and the IASB and also how the GASB's approach is better serving the GASB constituency.

Lease Term – Lessor Only Termination Option. We disagree with the Board's view in paragraph 3 of chapter 3 (third sentence) that both the lessee and lessor should exclude "cancellable" periods from the lease term relating to lessor-only options to terminate or cancel the lease after a certain point in time. Although the fourth sentence in this paragraph states that *neither* [emphasis added] the lessee or lessor would have an enforceable obligation, we believe that the lessor would have an enforceable obligation against the lessee

in this circumstance. This position is also inconsistent with current lease accounting and the current projects of the FASB and IASB. GASB should revise this position in the next due process document. We do agree that if both the lessee and lessor have the option to terminate or cancel at a certain point in time without a substantive penalty to either party, that it would make sense to exclude the period from the lease term because neither would have an enforceable obligation after that date.

Reassessments of the Lease Term. We need more information to determine whether we support the Board's view in paragraphs 6 and 7 of chapter 3 regarding a reassessment of a lease term. GASB has set the bar fairly high in terms of when a lease term would have to be reassessed as compared with the triggering event approach taken by the FASB and IASB in this area. We believe the result of the GASB approach will be that governmental entities will generally be able to take advantage of a longer period of time before having to reassess a lease term than private-sector entities. Since GASB has used a triggering events approach in other standards, we were unclear as to why it had not been considered for reassessing a lease term. For example, consider a situation in which a lessee makes a significant leasehold improvement, well before the lessee exercises an option to extend the lease. It seems like this might be a situation in which it would make sense for a reassessment of the lease term. From the discussion in paragraph 7, GASB's view in this area appears to be based on cost/benefit considerations. However, for purposes of the next due process document, the GASB should explain why a triggering event approach would be overly burdensome and describe more about the overall financial statement effect of providing governments a longer period of time before having to reassess a lease term.

Measuring the Lessee Lease Liability. We are unclear what other payments would be included under paragraph 7(g) of chapter 4 which would require lessees to include in the liability "any other payments that are probable of being required based on an assessment of qualitative factors." The Board should include examples of these payments in the next due process document to clarify the intent of this item.

Use of "Consider" in Chapters 4 and 5. We disagree with the use of "consider" in various parts of chapters 4 and 5. For example, paragraph 12 of chapter 4 states that lessees would "consider" remeasurement of the lease liability if any of the situations in items 12(a) – 12(f) occur. Similarly, paragraph 13 of chapter 4 states the lessees would "consider" reassessment of the discount rate used if any of the situations in paragraphs 13(a) – 13(c) occur. This same construct is also used in paragraphs 10 and 11 of chapter 5 regarding remeasurement of the lease receivable and the discount rate by the lessor. We believe the use of "consider" in these sections suggests too much flexibility. Therefore, we recommend the Board revise these sections to indicate that lessees or lessors "would" or "should" remeasure if the various situations discussed arise.

Lessee Remeasurement of the Lease Liability. We question whether requiring lessees to evaluate all leases annually to determine whether the criteria in items 12(a) – 12(f) in chapter 4 have occurred may be onerous for lessees. For example, for a lessee with

numerous leases to evaluate whether lease terms or indexes used have changed on an annual basis could be time consuming. Similar to our earlier comment above titled, "Reassessments of the Lease Term," we are unclear whether GASB considered a triggering event approach in this area more similar to that taken by the FASB and IASB and, if not, why. GASB should include more about its rationale in the next due process document and provide more background about the cost-benefit considerations for lessees.

Disclosures for Lessees. Overall, we recommend the Board reconsider whether all of the disclosures in paragraph 22 of chapter 4 are essential to users. Our initial view is that the required disclosures seem excessive in some cases and we suggest GASB carefully consider the feedback on the PV and the field study to base any disclosures recommended in the next due process document. For example, with regard to item 22(f), there is no current requirement to separately disclose future payments on debt obligations from general obligation bonds or revenue bonds, so we question why the Board is requiring a separate schedule of future lease payments. A similar analogy could be made in terms of requiring governments to separately disclose leased assets by major classes of assets.

Clarification Regarding the Discount Rate in Measuring the Lessor's Lease Receivable. We recommend the Board clarify the first sentence of paragraph 8 in chapter 5. As written, it implies that the lessor would default to a rate in the contract to determine the implicit rate in the lease. We believe this was not likely the Board's intent and ask the Board to provide further clarification.

Disclosures for Lessors. Similar to our comments above on lessee disclosures, we recommend that the Board reconsider whether all of the disclosures in paragraph 16 of chapter 5 are essential to users. We suggest GASB consider the feedback received on the PV and field test to assist GASB in making this determination. Our initial view is that the required disclosures seem to be excessive in some cases.

Lessee Accounting for Short-Term Leases. We are concerned that paragraph 8 of chapter 6 seems inconsistent in terms of how prepaid rent or a payable due for rent would be treated versus a rent holiday. We suggest GASB delete the rent holiday exception and simplify recognizing the lease based on the period in the contract. This would also be more consistent with the FASB/IASB approach.

Lease Amendments That Add or Remove Underlying Assets from the Contract. We question the Board's suggested accounting for lease amendments that add or remove underlying assets from the contract in paragraph 3 of chapter 7. The GASB's approach would result in an automatic remeasurement of the original lease in these cases. This differs from the approach taken by the FASB and IASB which would include an extra step to consider whether there is actually a new lease or a modification. Our initial view is that we prefer the FASB/IASB approach. However, if the GASB retains this provision in the next round of due

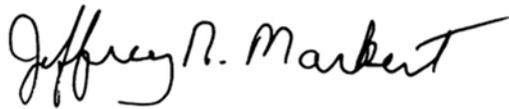
process, it would be helpful for the Board to include its rationale for the proposed approach and why it is better for users of governmental financial statements.

Lease Modifications and Changes in Accounting Estimates. We recommend the Board remove the references to a change in accounting estimate in paragraph 7 of chapter 7. While we agree that the accounting described in paragraph 7 may be similar to how a change in accounting estimate would be treated, we believe a lease modification is an economic event and not a change in accounting estimate. This can be easily addressed by deleting the second and third sentences of the paragraph.

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The AICPA appreciates the opportunity to comment on the PV. This comment letter was prepared by members of the AICPA's State and Local Government Expert Panel and was reviewed by representatives of the Financial Reporting Executive Committee who did not object to its issuance. Representatives of the AICPA would be pleased to discuss these comments with you at your convenience.

Sincerely,



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