



July 12, 2016

Mr. David R. Bean
Director of Research and Technical Activities
Project No. 3-24E
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) Exposure Draft (ED), *Leases*, and is pleased to offer its comments. Overall, we support the GASB's efforts to improve accounting and financial reporting for leases. We also appreciate the Board's responsiveness to certain issues we raised in our previous comment letter on the related Preliminary Views (PV). However, we are concerned that several of the more significant comments from our previous letter were not addressed.

In this letter, we reiterate our previous comments that were not addressed in the ED that we strongly recommend be reconsidered by the Board. We also include our additional observations on the ED.

Our most significant comments are included in the next section of this letter. The "Other Comments" section below includes editorial comments and other matters that could improve the clarity of standard.

SIGNIFICANT COMMENTS

Lessee "Single Approach" versus "Dual Approach" Accounting. During our consideration of both the PV and the ED, we had significant discussions regarding GASB's decision that lessee accounting be based on a single approach model. Ultimately, we agree with the Board that the single approach model adopted in the ED is a more conceptually sound answer. However, we are concerned that the Board did not address our previous comment which asked for (1) more specific feedback to be gathered on the challenges that the single approach model may present to certain types of governmental entities; and (2) the Board to clearly articulate in the ED what GASB heard from its constituency on these challenges and whether the Board found the concerns to be valid.

As GASB is aware, the Financial Accounting Standards Board (FASB) has adopted a dual approach model. In particular, the concerns that we have heard regarding the single

approach model primarily come from governmental entities that directly compete for capital with entities that apply FASB standards. For example, because of the significance of the lease standard to governmental health care organizations (HCOs), the ED was also of great interest to the AICPA's Health Care Expert Panel (HCEP). The HCEP is very concerned that use of a single approach model that differs significantly from the FASB's dual approach model will be costly for governmental HCOs and potentially make them appear to be at a significant disadvantage when their financial statements are reviewed by banks, financing companies, and bond market users that are comparing them to entities that report under the FASB reporting framework. We understand that individual members of the HCEP recently met with the GASB and further articulated their concerns. We also noted a number of comment letters submitted to the GASB from other types of governmental entities expressing similar concerns.

We again strongly recommend that the Board ensure that appropriate efforts have been made to understand the issues that certain types of entities have with the proposed single approach model. If the Board ultimately decides to adopt the single approach model, we recommend the Basis for Conclusions of the final standard address this topic directly and in more detail than has been included in the ED. For example, it could describe the work that GASB did to understand the issues that the single approach model presents for some governmental entities and the related cost-benefit concerns that have been expressed by various constituencies.

Leases in a Nonexchange Transaction. Paragraph 3 of the ED defines a lease as a contract that conveys the right to use a nonfinancial asset (the underlying asset) for a period of time in an exchange or exchange-like transaction. Consistent with our comments on the PV, we continue to have concerns about the "exchange or exchange-like transaction" portion of the lease definition, as we believe it will introduce practice challenges. While we acknowledge the addition of footnote 1 to the ED, we are concerned that the guidance provided in that footnote does not address the issues raised in our letter on the PV. Our specific concerns are as follows:

- First, we continue to be 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.
- Second, paragraph B10 of the Basis for Conclusions attempts to address the concern we raised in our previous letter regarding the fact that GASB Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*, does not provide adequate guidance for transactions that would fall into the "nonexchange" category. It acknowledges that the existing guidance on nonexchange transactions in GASB Statement No. 33 does not specifically address leases and that professional judgment will be needed to determine the appropriate accounting. We continue to believe this gap will lead to inconsistent accounting. In practice, current nonexchange "lease"

transactions are generally being treated as operating leases. In light of the move away from operating lease accounting in the ED, it is very unclear as to the appropriate accounting for such a lease going forward. If the Board maintains its exchange or exchange-like transaction limitation on the lease definition, it should move quickly to take on a project to close this gap in the standards.

- Finally, paragraph B9 of the Basis for Conclusions indicates that contracts that transfer the right to use an asset for a nominal amount should be accounted for under the provisions of GASB Statement No. 33. However, in such cases, it is unclear whether such a transaction should be considered a lease or a contribution. The Board should clarify this point.

Lease Term – Exclusion of Lessor-Only Cancellable Periods. We agree with the provision in paragraph 9 that if both the lessee and lessor have the option to terminate the lease that such cancellable periods would be excluded from the lease term. However, we continue to disagree with the Board’s view that a lessor-only option to terminate the lease should be excluded from the lease term. We believe it would not be appropriate for the lessee to exclude such a period from the lease term as the lessee has little or no discretion to avoid the contractual lease payments (or termination penalties) before the end of the lease term, unless the lease is renegotiated (as discussed in paragraph B26 of the Basis for Conclusions). We recommend the Board revise the final standard to remove the lessor-only option or consider separate guidance for the lessee and lessor based on the information known to each party. See our related comment below titled, “Symmetry in Lessee and Lessor Accounting.”

Symmetry in Lessee and Lessor Accounting. The Board’s intention to create symmetry in accounting for lessee and lessors causes confusion throughout the ED. We have noted several instances of specific concerns in this area elsewhere in this letter. While we understand the desire for symmetry between lessors and lessees, it generally complicates the accounting. While symmetry is a desirable goal, leasing today often results in asymmetrical results and this is not confined only to leasing. It has been our experience that symmetry is often the exception rather than the rule. Thus, we encourage the Board to consider allowing for different accounting between lessors and lessees, particularly in the areas we have cited in this letter.

Reassessment of the Lease Term. In paragraph 12 of the ED, the Board has continued the PV approach to 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 International Accounting Standards Board (IASB) in this area. We continue to 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. The Board includes its rationale for this decision in B23 in the Basis for Conclusions citing concerns about the lessor not having adequate information about the lessee’s circumstances to make an assessment, as well as the potential costliness of a triggering approach.

We believe the example we provided in our letter on the PV continues to be relevant to express our continuing concern. Consider a situation in which a lessee makes a significant leasehold improvement well before the lessee exercises an option to extend the lease. We believe reassessment of the lease term is reasonable in this situation. However, it would not meet the criteria in paragraph 12 of the ED as they are stated in terms of the lessee's actions to elect or not elect an option to extend. We again request the Board reconsider this reassessment guidance in light of this example and our previous related comment above titled, "Symmetry in Lessee and Lessor Accounting."

Limit Circumstances that Require Remeasurement of Lease Liability. Paragraph 19 of the ED requires lessees to remeasure the lease liability under various circumstances. In particular, we are concerned that the following criteria in paragraph 19 of the ED could result in remeasurement, or at least a required assessment to determine whether remeasurement is necessary, every reporting period:

"19(b). An assessment of all relevant factors indicates that the likelihood of a purchase option being exercised has changed;

19(d). A change in the estimated amounts for payments already included in the liability; and

19(e). A change in the rate the lessor charges the lessee, if used as the initial discount rate."

We believe the cost of such frequent remeasurements or reassessments would outweigh expected benefits to financial statement users. Accordingly, we recommend narrowing the lessee remeasurement criteria to the following circumstances:

- Lease term changes based on a significant triggering event;
- Change to the probability of the lessee exercising a purchase option based on a significant triggering event; and
- Change in the amount expected to be payable under a residual value guarantee. Note that we believe only the residual value guarantee should be remeasured in this situation.

In our view, these revised criteria for remeasurement will adequately capture changes to lease liabilities that are more than inconsequential, while also reducing cost and complexity for financial statement preparers.

Finally, if the Board ultimately adopts the approach proposed in the ED, we ask the Board to clarify paragraphs 19(d) and 19(e) of the ED as both of these items appear to be lease modifications rather than the exercising of a lease option. Rephrasing these items to discuss lease modifications that impact the liability may be a more clear approach.

Lessor Remeasurement of the Lease Receivable. Paragraph 42 of the ED addresses remeasurement of the lease receivable when there is a change in the lease term or a change in the rate the lessor charges the lessee. We question when either of these items would occur unless there was a lease modification. Therefore, we recommend that the Board revise paragraph 42 to state that the lease receivable should be remeasured if the lease is modified in a matter that impacts the amount to be received.

Remeasurement Contingent on Significant Effect. If the Board maintains the lessee remeasurement guidance as drafted, we have concerns with requiring the remeasurement to be contingent upon changes that have occurred and are expected to *significantly* affect the amount of the lease liability. Our concern also impacts paragraph 42 of the ED addressing lessor remeasurement of the lease receivable. Similar to comments we made in our comment letter on GASB's *Certain Asset Retirement Obligations* ED, it is difficult to know whether a change is significant without remeasurement. Further, it is not clear whether the consideration of significant effect is for an individual year or the cumulative change since the last remeasurement (e.g., change in estimated amount of payments). Preparers may overlook cumulative changes if focused solely on the changes in an individual year. Finally, we have concerns in that the term *significant* is not defined in the ED. The term is used in various other circumstances throughout the GASB financial reporting framework which adds to the difficulty of interpreting its meaning. Some, in fact, believe *significant* is equivalent to *material*.

Disclosures for Lessees and Lessors. We suggest adding disclosure requirements regarding renewal and termination options, as well as the existence of subleases, as this may not be captured in the requirements in paragraphs 31(a) and 49(a) under a general description of the leasing arrangement. We also believe it would be very beneficial for the Board to include illustrations of lessee and lessor disclosures as an Appendix to the final standard as opposed to issuing guidance at a later date as part of the Implementation Guide.

Lease Examples. The definition of a lease provided in paragraph 2 of the ED provides a high level principle. However, given the breadth and diversity of leasing agreements, there could be diversity in practice in the application of the principle. To promote a more consistent application, we recommend the Board include lease examples in an Appendix to the final standard.

OTHER COMMENTS

Measuring the Lessee Lease Liability. We continue to be unclear as to what other payments would be included under paragraph 15(g) of the ED which would require lessees to include in the liability "any other payments that are reasonably certain of being required based on an assessment of all relevant factors." We discussed the potential for paragraph 15(g) to address variable payments, but were unable to determine what type of payment(s) this element is meant to capture. We suggest the Board include examples of these payments or a discussion in the Basis for Conclusion to clarify the intent of this item.

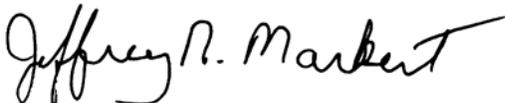
Lessee Accounting for Short-Term Leases. We believe that paragraph 61 of the ED is inconsistent in terms of how prepaid rent or a payable due for rent would be treated versus a rent holiday. We suggest GASB delete the rent holiday exception and simplify recognizing the lease based on the period in the contract. We also suggest in paragraph 60 that the short-term lease be considered upon the initial term rather than the maximum term. Using the maximum term defeats the purpose of offering short-term treatment as there will be fewer arrangements that meet the criteria.

Reasonably Priced. Paragraph 64 of the ED discusses “an additional right to use an underlying asset that was not included in the original lease and is *reasonably priced* [emphasis added] compared to its stand-alone price.....” We are unclear how to define “reasonably priced,” similar to our previous comments on the term *significant*.

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The AICPA appreciates the opportunity to comment on the ED. 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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Chair
AICPA State and Local Government
Expert Panel



Mary M. Foelster
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cc: State and Local Government Expert Panel
James Dolinar
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