



January 30, 2020

Mr. David R. Bean
Director of Research and Technical Activities
Project No. 24-16e
Governmental Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Dear Mr. Bean:

Members of the American Institute of Certified Public Accountants (AICPA) State and Local Government Expert Panel have reviewed the Governmental Accounting Standards Board (GASB) Exposure Draft (ED), *Implementation Guidance Update — 2020*, and are pleased to offer our comments.

The following section of this letter includes our significant concerns on the ED. Our other observations are included in the “Other Comments” section of this letter and presented in the order of their appearance in the ED. Finally, within the final section of this letter, “Proposed Additional Lease Questions,” we have provided areas we recommend the Board address in future questions and answers.

Significant Concerns

Question 4.1

The criteria in paragraph 16(b) (“Levy taxes or set rates or charges without approval by another government”) of GASB Statement No. 14, *The Financial Reporting Entity*, has been analogized in this question in terms of whether the plan should be considered fiscally dependent on another government. It is our understanding the rate setting criteria in paragraph 16(b) was included for circumstances in which a government does not have the ability to set their own rates charged for services provided. Payment of benefits for a defined benefit pension plan is not the service provided by the plan; rather, the service provided is the administration of the plan.

Whether the plan or the employer has the ability to establish the contribution amount in a given year does not change the fact that the employer is ultimately responsible for funding the plan. Said another way, it is not a matter of whether the employer is responsible for funding the plan, but rather a matter of when. The employer funding of a defined benefit pension plan is a consideration of whether there is a financial burden as required by paragraph 7 of GASB Statement No. 84, *Fiduciary Activities*. However, in our view, it is not a factor for considering whether there is fiscal dependency. If this question were to move forward as it is currently written, it would be a significant change

that could have broad implications to a number of different situations around the country.

We suggest the Board reconsider whether the answer provided to Question 4.1 is a change or an interpretation of GASB Statement No.14. Our strong recommendation is for the Board to remove this question and answer from the final Implementation Guide and address it through the issuance of category A generally accepted accounting principles (i.e., an amendment to GASB Statement No. 14). Taking this action will ensure that there is full due process and a more expansive exploration of the potential consequences of such a change.

If the GASB does not accept our recommendation, we strongly suggest the Board provide further clarity. Applying the concept of an “employer having the ability” to a broad set of entities and circumstances will likely result in confusion and inconsistency in interpretation. For example, what happens when an entity has the ability to change the contribution amount, but does not? Also, to what extent does the employer’s involvement in rate/assumption setting lead to the “ability to change the contribution amount?” We are aware of situations where the plan works in conjunction with the employer to set certain assumptions, but ultimately, the plan is the only entity with the authority to adopt assumptions and set the contribution amounts. We believe, absent further guidance, that the answer to this proposed question could be too easily misapplied in these situations.

Questions 4.5 and 4.6

These questions attempt to distinguish whether a school district has administrative involvement for purposes of determining the applicability of paragraph 11c (2) of GASB Statement No. 84. The fact patterns are very similar with the main difference being that one school policy is specifically stating that funds raised need to be used for a ski trip (but not identifying the specific types of expenditures) and the other, a slightly broader school policy, stating that resources raised can only be spent on senior class activities that benefit the class. The result of this slight nuance is a proposed difference between the answers with Question 4.5 concluding that there is administrative involvement and Question 4.6 concluding that there is not. We are concerned that the GASB is trying to make a distinction between these two fact patterns without there being a substantive difference when it comes to administrative involvement. Further, governmental involvement may be more extensive than what a policy states such that there may be administrative involvement regardless of what the policy says. In our view, the key factor in determining administrative involvement in both questions is that the school district has established a spending policy—in essence, placing limitations, no matter how specific or restrictive—on each club’s spending ability. Therefore, we recommend that the Board delete Question 4.6, and revise the answer to Question 4.5 to conclude that there is administrative involvement because the school district sets a spending policy over the use of the funds raised. If the Board retains Question 4.6, we recommend

that it be revised to emphasize that there may be other factors not discussed in the scenario that could result in administrative involvement.

Question 4.8

We recommend the Board remove this question and answer because the fact pattern is overly simplistic and does not include all the relevant information needed to conclude whether there is an identifiable asset that should be reported as a lease under GASB Statement No. 87, *Leases*. We also believe the answer will be misapplied to other circumstances based on the limited information provided.

Specifically, we believe there are other factors that should be potentially considered when evaluating if there is an identifiable asset, including the primary purpose of the asset and the unit of account. In the question, is the underlying asset, or the unit of account, the utility pole or a space on the utility pole? One view is that the entire utility pole would be identified as the underlying asset that is to be evaluated, which differentiates itself from a multi-tenant office building, a cellular tower, or a satellite with multiple transponders. This is partly because the utility pole's primary purpose is to permit the utility company to provide its core service of supplying electricity. The utility's ability to generate economic benefit from the sale of the excess pole space is secondary to its primary intended benefit. In contrast, for the multi-tenant office building, the cellular tower, and the satellite, not only are there individual floors, rungs, and transponders typically both physically and mechanically separable, but the larger asset has been constructed, or subsequently repurposed, for the primary purpose of being subdivided and providing economic benefits from use to different parties simultaneously.

Another example of when the primary purpose of the underlying asset might come into consideration of whether a lease exists includes use of space on the side of a building for advertising. In this circumstance, we believe the primary purpose of the side of the building is to enclose the interior of the building, while the use of the outside of the wall to display advertising is secondary to the wall's intended purpose. In this example, we believe the space where the advertising is displayed is not an identified asset, and no lease exists because the advertising space customer is not obtaining substantially all of the economic benefits from use of the larger identified asset. In contrast, if a building owner attached a frame or billboard to the building that is itself a nonfinancial (capital) asset, that frame or billboard can be leased.

Question 4.17

This question states that in the absence of a stated interest rate, lessors should determine whether the rate implicit in the lease can be estimated by using the lessee's estimated incremental borrowing rate or published borrowing rates for similar instruments and, if not practicable, that the lessor's own incremental borrowing rate can be used. Our experience is that it is not likely that lessors will have knowledge of the lessee's incremental borrowing rate. Therefore, many lessors will default to using their own rate. We appreciate that the GASB is attempting to provide a practical concession by permitting the lessor to use its own incremental borrowing rate as a proxy for the rate implicit in the lease. However, conceptually, we are unable to identify a reasonable justification for why using the lessor's incremental borrowing rate would be appropriate as a proxy for the rate stated or implicit in the lease. The lessor's incremental borrowing rate has no economic correlation to the risk factors that a lessor may consider when negotiating the lease payment.

We have significant empathy for the challenges that lessors have in identifying an appropriate discount rate to use when the lease payment is based on a market rent (e.g. lease involving real property) and there is no real consideration of a "finance" charge. If it is the Board's intent to provide a practical concession for these circumstances, we recommend the Board allow the use of a benchmark interest rate, such as the risk free, AA muni bond index, or another similar rate. Doing this will significantly enhance consistency in how lessors make this determination. If the Board does not accept this recommendation, the Board should provide more rationale to support the use of the lessor's incremental borrowing rate.

Other Comments

Question 4.7

This question is hard to understand because it uses a double negative. We also believe the answer can be improved by more closely linking the example in the question to the guidance in the answer. Therefore, we recommend the Board make the following revisions:

Q. A city enters into an agreement that allows a not-for-profit organization to use one of its buildings. The contract states that the building is to be used only for the not-for-profit organization's job training program. ~~Does this restriction mean that the not-for-profit organization does not have control of the right to determine the nature and manner of the use of the building for purposes of evaluating whether the arrangement meets the criterion in paragraph 5b of Statement No. 87, Leases?~~ In this circumstance, does the not-for-profit organization have control of the right to use nonfinancial asset (building) as specified in the contract for purposes of meeting the criterion in paragraph 5b, GASB 87, Leases?

A. ~~No.~~ **Yes.** Paragraph 5b.....The not-for-profit organization has control of the right to determine the nature and manner of use of the building within the parameters of the contract **(i.e., the building is to be used only for the not-for-profit organization's job training program)**; therefore, the criterion of paragraph 5b is met.

Question 4.12

The fact pattern to this question states that a governmental housing authority enters into a 12-month residential lease where the lessee has the option to renew, but there is no specified period for the renewal. The answer concludes that because the lessee has the option to renew, without a specified renewal period, the lessee does not have a unilateral right to extend the contract and thus, the result is a short-term lease. We believe an agreement allowing an entity to enter into a separate lease agreement at a later date would not be considered an option to renew unless there are specific criteria or terms included. Our preference would be for this question to be deleted. If it is retained, the Board should clarify how this fact pattern is an option to extend in the final Implementation Guide.

Question 4.14

The answer to this question does not include the full scope of the guidance in paragraph 19 of GASB Statement No. 87. Therefore, we recommend the Board revise the answer as follows:

A. This transaction...Paragraph 19 of Statement 87 provides for a contract to be reported as a financed purchase only if that contract **transfers ownership of the underlying asset to the lessee by the end of the contract and the contract** does not contain termination options"

Question 4.15

We recommend the Board revise the answer to this question as it implies that the lease asset would be reduced by the lease incentive twice; once due to the initial measurement of the lease liability being included in the initial measurement of the lease asset, and then again based on the end of the last sentence of the answer. We also recommend that the answer refer specifically to paragraph 30 of GASB Statement No. 87. Our suggested revisions follow:

A—Paragraph 21 of Statement 87 requires that the lessee include the present value of the lease incentive receivable from the lessor in the initial measurement of the lease liability. In this example, the lessee should reduce the lease liability by the present value of \$500,000. Because **paragraph 30 of Statement 87 requires** the lessee **to** ~~should~~ include the amount of the initial measurement of the lease liability

in the amount of the initial measurement of the lease asset, the lease incentive also ~~should~~ reduces the lease asset ~~by the present value of \$500,000.~~

Proposed Additional Lease Questions

The following are suggestions we recommend the Board consider for future Implementation Guide questions. We have identified these questions based on observations we have encountered in practice.

Incremental borrowing rate(s) for lessees – We recommend the Board provide additional guidance, as well as an example, on how a lessee could or should determine its incremental borrowing rate(s). Absent such guidance, we believe there will be significant diversity in practice that will result in very material differences between governments with similar circumstances. Factors that need to be addressed include:

1. Whether it should be a taxable or tax-exempt rate.
2. What type of borrowings of the entity should be considered (i.e., general obligation bonds, revenue bonds, bank notes, etc.) and how they may be used/adjusted to develop an incremental borrowing rate?
3. The impact of the lease term and how precisely a government should consider its own yield curve.
4. Frequency of recalculating the discount rate for new leases or remeasurements.

“Other payments” included in measurement of lease liability – We recommend the Board provide additional guidance on what type of lease payments were intended to be included for “other payments that are reasonably certain of being required based on an assessment of all relevant factors” (paragraph 21h of GASB Statement No. 87) for the measurement of lease liability. We believe the intent of the Board was to only include variable payments that are fixed in substance and those that depend on a rate or index in the measurement of the lease liability. However, paragraph 22 of GASB Statement No. 87 only specifically excludes variable payments based on future performance of the lessee or usage of the underlying asset. There are other types of variable payments that could be interpreted to be included based on the notion they are reasonably certain of being required (e.g., lessee reimbursement to lessor for property taxes).

Lease and nonlease components – We recommend the Board provide additional guidance on the definition of lease components and nonlease components. For example, we generally believe that providing utilities, common area maintenance, or equipment maintenance is a nonlease component. In contrast, reimbursement of lessor costs for property taxes or insurance and residual value guarantees would not be a separate component (i.e., they are part of the lease).

Allocation of contract price to components – We recommend the Board provide examples on the allocation of the contract price to lease and nonlease components. We believe there is a significant lack of understanding in practice on how the contract price should

be allocated to components. Absent such additional guidance, we believe there will be inappropriate application of paragraphs 63 through 68 of GASB Statement No. 87, including the use of the allocation methodology in Financial Accounting Standards Board Accounting Standards Codification 842 (i.e., relative fair value of stand-alone prices) or inappropriately accounting for the arrangement as one lease.

Unit of account and primary purpose of underlying asset – Consistent with our comments on Question 4.8 above, we recommend the Board provide guidance on how the unit of account and primary purpose of the underlying lease asset could impact the identification of an underlying asset and whether there is a lease under GASB Statement No. 87.

Reporting remeasurements on modified accrual basis of accounting – We recommend the Board provide additional guidance on how remeasurements should be reported on the modified accrual basis of accounting. Absent such guidance, we believe that governments often will not report any amount for remeasurements for governmental fund financial statements prepared using the current financial resources measurement focus and modified accrual basis of accounting.

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The AICPA appreciates the opportunity to comment on the ED. As the nature of this ED is to further clarify and illustrate existing GASB Statements, this comment letter was prepared by members of the AICPA's State and Local Government Expert Panel and was not reviewed by the AICPA's Financial Reporting Executive Committee. Therefore, this response represents only the views of individual members of the State and Local Government Expert Panel and is not an official position of the AICPA. Representatives of the State and Local Government Expert Panel would be pleased to discuss these comments with you at your convenience.

Sincerely,



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cc: State and Local Government Expert Panel
Dan Noll