



April 30, 2019

David R. Bean, CPA
Director of Research and Technical Activities
GASB
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

Re: February 19, 2019 GASB Proposed Implementation Guide, Leases (Project No. 3-24)

Dear Mr. Bean:

The American Institute of CPAs (AICPA) is the world's largest member association representing the accounting profession, with more than 418,000 members in 143 countries, and a history of serving the public interest since 1887. One of the objectives that the Council of the AICPA established for the Private Company Practice Section (PCPS) Executive Committee is to speak on behalf of local and regional firms and represent those firms' interests on professional issues in keeping with the public interest, primarily through the Technical Issues Committee (TIC). This communication is in accordance with that objective. These comments, however, do not necessarily reflect the positions of the AICPA.

TIC appreciates the Board's work in developing an Implementation Guide (IG) to provide guidance that clarifies, explains, or elaborates on the requirements of Statement No. 87, *Leases*. TIC has some comments on some of the questions and answers in the IG as noted below.

Question 4.1

Q—A government leases land, which has a market rent of \$100,000 per year, for \$1 per year. Should the government apply the guidance in Statement 87 to that transaction?

A—No. The definition of a lease in paragraph 4 of Statement 87 specifies that the Statement should be applied only to exchange or exchange-like transactions. Paragraph 1 of Statement No. 33, Accounting and Financial Reporting for Nonexchange Transactions, classifies all transactions of state and local governments into two categories: (a) exchange and exchange-like and (b) nonexchange. The government's lease of land for \$1 does not meet the description of an exchange or exchange-like transaction in that each party does not receive or give up essentially equal value or not quite equal value.

TIC appreciates that the question above is the first in the series of questions since it often has been asked by clients of TIC members. TIC would ask the Board to consider providing additional

information in the answer as to which guidance would then apply and whether any additional disclosures would be necessary when this issue arises in practice.

Question 4.2

Q—A government enters into a multi-year lease of a facility. The government has exclusive use of the facility four days a week. Other parties use the facility on the other days. To meet the definition of a lease, is the government, as the lessee, required to have sole control of the right to use the facility?

A—No. In determining whether a contract conveys control of the right to use an underlying asset, paragraph 5 of Statement 87 requires a government to assess whether it has (a) the right to obtain the present service capacity from use of the underlying asset and (b) the right to determine the nature and manner of use of the underlying asset “as specified in the contract.” If the contract specifies that the government has control of those rights during four days of each week, the control criterion is met. The requirement that the contract be for a period of time does not require uninterrupted usage.

TIC understands the logic in this answer but is concerned readers may infer that control is met due to the fact that four out of seven days is the majority of time in a week. TIC suggests modifying this question or adding a question using the same example but only using only two or three days out of the week to show that this would not change the answer.

Question 4.3

Q—Are certain easements excluded from the scope of Statement 87?

A—Yes. An easement is a lease only if it meets the definition of a lease. Paragraph 4 of Statement 87 states that, among other things, a lease is “for a period of time in an exchange or exchange-like transaction” (footnote reference omitted). Permanent easements do not meet the period-of-time criterion. In addition, easements obtained for an amount that does not meet the Statement 33, as amended, description of exchange or exchange-like transactions do not meet the exchange or exchange-like criterion.

Building on this question, TIC would ask what is a reasonable value for an easement to be considered an exchange or exchange-like transaction? Is it when the easement approximates fair value? TIC believes this issue also should be addressed in a question and answer format or perhaps the answer provided here could be expanded upon to give additional context and examples.

Question 4.5

Q—To obtain access to additional power during the warmest months of the year, a government enters into a contract with a private party wherein the government has full control of a portion of a power plant, specifically, a steam turbine, from March through October for three years. The government makes fixed payments to obtain exclusive rights to the present service capacity and

to determine the nature and manner of use of the steam turbine. In addition, the government makes variable payments that are based on actual usage and output. Does this contract include a lease?

A—Yes. Paragraph 8f of Statement 87 states that the Statement does not apply to supply contracts. However, this contract conveys control of the right to use the underlying asset (a steam turbine) as specified in the contract for a period of time in addition to the right to the output generated by the underlying asset. The portion of the contract that requires fixed payments pertains to the full control of a steam turbine and meets the definition of a lease in paragraphs 4 and 5 of Statement 87. The variable payments based on actual usage and output are supply contract payments and are therefore excluded from the lease liability. (See also Question 4.12.)

Some TIC members wonder whether there could be additional examples that further demonstrate this concept as it is new with GASB 87 and adding some additional concrete examples and fact patterns might be helpful.

Question 4.6

Q—Are cell phone tower or antenna placement agreements leases?

A—If they meet the criteria to be a lease, including the control criterion, then such agreements are leases. The control criterion generally is met if a cell phone tower or antenna placement agreement conveys control of the right to use the land on which the tower is placed or the connection point to which the antenna is affixed.

TIC recommends the Board elaborate on the factors to consider cell phone tower or antenna placement agreements as leases. The answer provided to Question 4.6 is very generic as to how the control criterion may be met and just refers back to the lease standard. While these agreements are common in practice, how they are structured can vary tremendously. Thus, practitioners would benefit from some elaboration and perhaps some of the more common examples.

Question 4.7

Q—A government enters into a lease agreement that conveys control of the right to use a parcel of land to a company that engages in oil and gas exploration and production. Is this lease excluded from Statement 87?

A—No. While paragraph 8a of Statement 87 excludes “leases of intangible assets, including rights to explore for or to exploit natural resources such as oil, gas, and minerals,” that exclusion applies only when the underlying asset in the lease is the intangible right to those resources. In this example, the land itself is the underlying asset. In contrast, if the government only provided the company with the right to explore for oil and gas but did not convey control of the right to use the land, that lease would be excluded from Statement 87.

TIC was curious what the answer would be if the land portion of the contract was for \$1 (not exchange-like transaction) and the real payments were made through the production/generation

of royalties. This would be excluded, correct? One TIC member noted that, in New Mexico, they lease the land for \$3/acre. TIC would also suggest referring to question 4.28 involving tires in a transit fleet.

Question 4.11

Q—A government enters into an agreement that allows a rancher to use the government’s land for grazing. The agreement states that the rancher is required to allow access to the land for compatible public recreation activities. In addition, the agreement states that the government can construct roads and buildings, or otherwise alter the land, without permission from the rancher. Is the grazing rights agreement a lease?

A—No. The agreement does not convey the right to determine the nature and manner of use of the underlying asset because the lessee cannot prevent others from accessing, using, or altering the land. (See also Questions 4.8 and 4.10.)

If you take the criteria of question 4.2 that indicates leases can be for an intermittent period of time and apply it to the hunting example, if the government indicates it will not do those activities during hunting season, wouldn’t that then constitute a lease because during the hunting season they would then have control of the asset? TIC believes that additional clarification regarding this issue would be helpful.

Question 4.16

Q—How does a bargain renewal option, such as a 20-year lease with a \$1 option to renew the lease for an additional 5 years, affect the initial assessment of the lease term?

A—Paragraph 14 of Statement 87 requires that, at the commencement of the lease term, the lessee and the lessor assess all factors relevant to the likelihood that the lessee or lessor will exercise lease extension or termination options identified in paragraphs 12a–12d of that Statement. Relevant factors include significant economic incentives and disincentives, such as the cost of exercising the renewal option and the expected condition and maintenance requirements for the underlying asset during the extension period. In this example, if the governmental lessee or lessor determines that it is reasonably certain that the option will be exercised, the lease term for the lessee or lessor would be 25 years.

TIC would ask that it be made clear in this question and answer who makes the determination about the likelihood of using the Bargain Purchase Option (BPO) and if both parties need to agree. TIC also believes it would be helpful to explain that the lessee and lessor could end up having different lease terms based on their assessment of relevant factors. TIC also believes that having an example that shows how the accounting would differ both across the lease term and in the final years when the bargain purchase option is exercised would be helpful.

The following example illustrates this point further:

Let's assume a lease term is \$1 million per year for a period of 10 years, then drops to \$200k per year for years 11 and 12. The total lease payments over the 12-year term are \$10,400,000 (ignore the required present value calculation for simplicity). If the lessee believes based on relevant factors that this is a bargain purchase option, it would show \$866 million in expense over the 12-year term. If the lessor believed it was not a bargain purchase option, it would show \$1 million revenue a year, then \$200k revenue the last two years.

Question 4.19

Q—A government enters into a 12-month lease with the lessee having options to renew for 12 months at a time, up to 49 times. Is this agreement a short-term lease under Statement 87?

A—No. According to paragraph 16 of Statement 87, the maximum possible term is required to be 12 months or less, including any options to extend. The presence of lessee renewal options, regardless of their probability of being exercised, means this lease does not meet the definition of a short-term lease.

TIC was curious what the answer would be if the contract is silent on renewal terms, but the lessee has been renewing and there is no clear indication of when they will stop renewing. Is it important to acknowledge substance over form in certain situations? Without a clear indication as to the period of time should the lessee estimate this period?

Question 4.26

Q—A government enters into a lease with another government that includes an optional extension period of three years, exercisable only by the lessee. The payment schedule for the optional period will be negotiated at the time the option is exercised. The lessee has an ongoing relationship with the lessor and is reasonably certain that it will exercise its option to extend. How should the lessee measure the lease liability if the payment amount for the optional period is not specified in the contract?

A—Paragraph 12a of Statement 87 requires that periods covered by a lessee option to extend the lease should be included in the lease term if it is reasonably certain, based on all relevant factors, that the lessee will exercise that option. In this example, the payments may be estimated based on the lessee and lessor's ongoing relationship and professional judgment, maximizing the use of observable information. In that case, the payments for the three-year extension period would be included in the lease liability as payments expected to be made during the lease term.

TIC believes this response would be difficult to implement in practice. TIC members could not understand why a government would want to put the number on their financial statements knowing that they intend to go through negotiations. This, in effect, is causing negotiations to occur on the estimated number. TIC would assume governments would end up recording an amount on the very low end of what they plan to negotiate. Does the Board believe it might be preferable to require keeping the amount the same each year unless a significant amount of

evidence points otherwise? Would that get us a better estimated number? This appears to be how the answer to question 4.27 is handled in the IG so this could provide for conceptual consistency in the responses.

Question 4.35

Q—A government makes payments related to a building lease during a construction period before gaining access to the building. Can payments made during the construction period be reported as a lease asset at the time they are paid?

A—No. Payments made before commencement of the lease term represent prepayments. At the commencement of the lease term, the lessee obtains the right to use the underlying asset by either gaining physical possession of the asset or attaining access to use the underlying asset. The lease asset is the right to use the underlying asset rather than the underlying asset itself. The right to use makes the underlying asset a resource to the lessee and provides the lessee access to the underlying asset's present service capacity. Therefore, at the commencement of the lease term, the prepayments would be reclassified as part of the initial measurement of the lease asset, as provided in paragraph 30b of Statement 87.

TIC noted that this treatment is different than construction in process paid for with debt proceeds or government's own resources because the lease is for the right to use the asset, not the asset itself. TIC recommends that point be emphasized in this answer and potentially shorten the answer to reduce complexity. TIC also believes that a cross-reference to question 4.14 should be added here.

Question 4.36

Q—Can composite or group methods be used to amortize lease assets?

A—Yes. If a government has many similar leases, it may choose to amortize the lease assets as a group rather than individually. Similarly, if a collection of dissimilar leases comprises, for example, a network subsystem, composite amortization may be applied to the lease assets of the subsystem. (See also Questions 7.15.3 and 7.15.4 in Implementation Guide 2015-1.)

TIC believes that this answer is helpful. TIC believes that additional clarification of what constitutes similar leases might be warranted.

Question 4.40

Q—Can amortization expense for lease assets be combined with depreciation expense in the required disclosure by function?

A—Yes. Paragraph 117d of Statement No. 34, Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments, requires disclosure of amounts of depreciation expense "charged to each of the functions in the statement of activities." If the lease amortization expense is applicable to multiple functions in the statement of activities, it should

be charged to those functions accordingly. Therefore, lease amortization expense by function should be disclosed and may be combined with the disclosure of depreciation expense by function.

TIC believes the last sentence could be reworded to be more clear that a government would not be required to provide two separate tables (one for amortization and one for depreciation) that are combined into the same note disclosure.

Questions 4.79 and 4.80 Related to Effective Date and Transition

TIC expected more questions about what governments are required to do related to looking back at the facts and circumstances that exist. For example, what would be required for long-term leases on the balance sheet last year (i.e. does that mean they are considered short-term?). In addition, when describing the terms and conditions of a lease, does that imply the terms as of the beginning of the period restated or the initial terms? TIC believes that addressing these additional questions would be helpful.

TIC appreciates the opportunity to present these comments on behalf of PCPS member firms. We would be pleased to discuss our comments with you at your convenience.

Sincerely,

A handwritten signature in black ink that reads "Michael A. Westervelt". The signature is written in a cursive, slightly slanted style.

Michael A. Westervelt, Chair
PCPS Technical Issues Committee
cc: PCPS Executive and Technical Issues Committees