

June 7, 2016

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

Re: January 25, 2016 Exposure Draft of a Proposed Statement of the Governmental Accounting Standards Board, *Leases* [Project No. 3-24E]

Dear Mr. Bean:

The American Institute of CPAs (AICPA) is the world's largest member association representing the accounting profession, with more than 412,000 members in 144 countries, and a history of serving the public interest since 1887. One of the objectives that the Council of the AICPA established for the 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 has reviewed the ED and is providing the following comments for your consideration.

GENERAL COMMENTS

TIC noted that the Board has made a number of improvements in the ED compared to the Preliminary Views (PV) document. TIC especially appreciates the following changes:

- The lessee's bargain purchase option will now be evaluated in the same manner as any other purchase option.
- The threshold for assessment of renewal options for inclusion in the lease term has been changed from "probable" to "reasonably certain."
- A lease liability is not required to be remeasured solely for a change in an index or rate used to determine variable lease payments.
- Guidance for disclosures relating to leases of investment assets and certain regulated leases has been added.

- The lessor’s schedule of future lease payments included in the lease receivable is required only if the government’s principal ongoing operations consist of leasing assets to other entities.
- Leases of all intangible assets are scoped out (not just those relating to various licensing contracts and rights to explore for or exploit natural resources).
- The scope-out of licenses for computer software has been transferred from implementation guidance to the Standard.
- Disclosures of short-term lease expenditures have been suspended.

Although TIC commends the Board for making the above changes, TIC believes more can be done to improve the clarity of the ED and mitigate the cost of implementation. TIC’s suggestions are presented below.

SPECIFIC COMMENTS

Scope and Applicability—Biological Assets

Paragraph 5(b) of the ED states that the proposal does not apply to “leases of biological assets, including timber.” TIC believes a common understanding of the term “biological assets” may not exist among governmental entities, especially since it is not defined within the GASB Codification. Without a clear definition of the term, constituents could erroneously assume that leases of land used for agricultural purposes fall within the scope of the definition.

TIC noted, however, that the term is defined internationally. International Public Sector Accounting Standards Board Statement No. 27, *Agriculture*, and International Accounting Standards Board International Accounting Standard No. 41, *Agriculture*, defined a biological asset as a “living animal or plant.” Both standard setters exclude leases of land related to agricultural activity from the scope of the definition of a biological asset. However, these exclusions might not be obvious to U.S. constituents without specific guidance. TIC therefore recommends that the final leases standard include a definition of “biological assets.”

Lease Contracts with Multiple Components

TIC’s March 13, 2015 letter to the Board on the *Leases* Preliminary Views document expressed concern about the complexity and cost governments will face in performing price allocations for contracts with leasing and nonleasing components. The requirements in the ED vary slightly depending on whether the lessor has provided separate pricing for each component v. one stated price for all components in the contract. In either case, however, the ED continues to require governments to obtain observable standalone prices, if readily available, for the various leasing and nonleasing components in the contract as a basis for confirming the reasonableness of the lessor’s component pricing or allocating the total consideration stated in the contract when only a single price is given.

TIC believes checking for observable prices for each component of a lease would be very burdensome for governments, and the cost of making this determination each period would outweigh the benefits of developing a more precise price allocation. TIC believes additional practical expedients and guidance should be developed to simplify the final standard and to lower the costs of accounting for multiple-component contracts.

The ED includes a provision that permits the governmental entity to use the prices for individual components that are included in the contract, if the contract prices are reasonable based on observable stand-alone prices for leasing the same or similar assets or contracting for the same or similar services. [Emphasis added]

The Board's justification for this conclusion was discussed in Chapter 2, paragraph 12, of the PV document, as follows:

...the provision that these prices should be reasonable is intended to minimize the effect of a component price artificially being inflated or deflated, thereby shifting expenses to one component or another.

As a practical expedient, TIC recommends that the requirement be changed to allow the governmental entity to use the prices for individual components that are included in the contract, as long as the price allocation does not appear to be unreasonable based on various terms of the contract. Rather than obtain positive evidence that the prices are reasonable, the government should be able to use the stated prices as long as there is no evidence that they are unreasonable.

In other words, TIC believes, in most cases, grossly unreasonable (i.e., artificially skewed) prices will be evident without having to obtain direct comparisons to observable standalone prices. For example, if the contract allocates \$99 to the maintenance component of a copier lease and \$1 to the lease component, this would be an indication of an unreasonable allocation that would require further investigation. In addition, the nature of the leased asset and the terms of the service component of the contract, among other provisions, can provide information as to appropriate proportions of the leasing v. nonleasing components.

When a lessor provides separate prices for leasing and nonleasing components in a contract, TIC believes, in most cases, the lessor's pricing represents a good-faith effort to reasonably allocate the cost of the contract. If TIC's proposal is accepted by the Board, governments may be less likely to account for the entire contract as a single lease unit because they can avoid the difficulties involved in obtaining observable standalone pricing. TIC believes this is a reasonable compromise since, theoretically speaking, an imprecise allocation of a multiple component contract is better than no allocation at all. This expedient would mitigate the potential costs of separating contracts with multiple components and would provide a reasonable estimation of the various contract components.

In the majority of cases, however, TIC believes that contracts will not include separate pricing for the leasing v. nonleasing components. In such cases, the ED requires the government to attempt to find readily available standalone observable prices for each component. TIC believes this will be very difficult and time-consuming exercise that, in many cases, will lead to a conclusion that the contract would have to be accounted for as a single lease. Unlike commercial leases, government leases can have unusual characteristics and very long lease terms, such that finding observable prices would be almost impossible. This outcome runs counter to the Board's objective of separate recognition and measurement for the individual components of a multiple component contract. Effectively, the complexity of the measurement requirements could drive governments to conclude that separate pricing for the components cannot be obtained.

TIC suggests that the Board eliminate the requirement to obtain readily available observable standalone prices and allow governments to develop an estimate of the price allocation based on an analysis of the contract provisions and professional judgment (similar to the alternative mentioned in paragraph 56[c]). Obtaining observable standalone prices could be an option to consider but should not be a requirement. Under this approach, TIC believes contracts with multiple components are less likely to be accounted for as single lease units.

In addition, TIC believes the requirements will not be consistently applied if no guidance is provided as to the extent of the work effort that the Board intends for obtaining readily available standalone observable prices. Paragraph B90 states:

B90. Many contracts require only one total payment amount for all of the components of the contract. For these contracts, the use of observable stand-alone prices provides an objective, external basis for making the allocation and helps promote consistency among governments. However, these prices are required to be used only if they are readily available. The Board does not believe that governments should be required to go to great lengths to obtain such prices. [Emphasis added]

Guidance is needed as to what makes a price "readily available," as well as how much evidence the Board expects the governments to accumulate. Some governments may perform a targeted internet search to obtain pricing information from multiple vendors, while others may do nothing more than ask the lessor for a breakdown of the pricing components.

The ED also fails to address the responsibilities of a lessor government that enters into a multiple component lease with a lessee government. In this case, would the lessor be required to identify the pricing for each component in the contract and disclose the pricing to the lessee government? Would independent verification of standalone prices for each component also be required?

TIC therefore recommends that the Board reconsider its requirements for leases with multiple components and provide additional measurement simplifications and guidance to lower costs for governments and to better achieve its accounting objectives.

Classification of the Lessee's Right-to-Use Asset

TIC noted that the PV document provides clearer guidance than the ED on the classification of the lessee's right-to-use asset. Paragraph 3 of the ED defines a lease as "...a contract that conveys the right to use a nonfinancial asset (the underlying asset), and paragraph B36 emphasizes that, "The lease asset is the right to use the underlying asset rather than the underlying asset itself." Although both paragraphs imply that the right-to-use asset is an intangible asset in all cases, the language used in the ED is not as explicit as the guidance in the PV. Paragraph B43 of the ED is the only place in the document that refers to the leased asset as an "intangible," but this paragraph will be included in the Original Pronouncement only—not the GASB Codification.

Therefore, TIC recommends that paragraph 3 of the final leases standard include some of the guidance from Chapter 4, paragraphs 2-3, of the PV to ensure clarity on this issue. TIC also believes classification of the right-to-use asset should be mentioned in paragraph 24, which is part of the section entitled "Lease Asset."

Effective Date and Transition

This standard has the potential of having a pervasive impact on many state and local governments. They will need time to read, understand and apply the standard to determine how it will affect their financial statements. Each existing lease will need to be analyzed, and some governments will have to address potential debt covenant violations, grant reimbursement issues and the inevitable system changes. Governments with a high volume of leases will need to figure out how to aggregate the presentation of lease assets and develop disclosures that are meaningful without being voluminous. Therefore, TIC recommends a transition period of three years from the date of issuance of the final standard to the required effective date (i.e., periods beginning after 12/15/18, assuming issuance before the end of 2016).

Basis for Accounting Differences with FASB on Leases and Other Standards

TIC is noticing that FASB and GASB are reaching differing accounting conclusions on identical transactions for leases and other topics that the nongovernmental and governmental arenas have in common. While TIC understands that each Board is a separate standard setter following its own conceptual framework and that differences of opinion can occur, practitioners that serve both public sector and private sector clients often don't understand why different accounting conclusions should apply to essentially the same transactions. In addition, such accounting differences cause public and private sector entities in higher education and health care (such as public and private universities and public and private hospitals) to account for similar transactions differently. When such differences of opinion occur on major accounting issues, TIC recommends that the Basis for Conclusions of the applicable GASB standard explain how the differences in the respective conceptual frameworks prevent the GASB from adopting a FASB accounting position for identical transactions.

Note Disclosures

One of the potentially challenging aspects of the ED involves the appropriate aggregation of note disclosures for governments that have a high volume of lease contracts. TIC recommends that disclosure objectives be added to the final standard to help governments assess which disclosures would be most meaningful for financial statement users. A list of disclosure objectives, accompanied by factors to consider when aggregating disclosures, may help constituents prioritize disclosures and find ways to reduce unnecessary disclosure volume wherever possible.

TIC noted that the ED does not provide disclosure requirements relating to the existence of renewal options or the extent to which renewal options have been included in the lease term. Without clarification of the Board's intent, diversity in practice could result. TIC recommends disclosure guidance be provided in the final standard to address the existence and length of renewal options.

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