



May 18, 2016

Mr. David Bean
Director of Research and Technical Activities
Governmental Accounting Standards Board
401 Merritt 7
Norwalk, CT 06856-5116

Dear Mr. Bean:

On behalf of the National Association of State Auditors, Comptrollers and Treasurers, we appreciate the opportunity to respond to the Governmental Accounting Standards Board's Exposure Draft (ED), *Leases*.

We generally agree with the provisions of the ED and believe the proposed changes will bring the GASB standards more in line with the FASB and provide valuable information to the users of financial statements. However, we have the following specific comments that we believe the Board should consider as it finalizes this statement.

Paragraph 5.a.

We appreciate software being excluded from this standard but are concerned that physical servers upon which the software resides will be a capital lease asset while the software itself will not. There are also situations in which the software and hardware are bundled together in the same contract. Please clarify if it is the intent of the Board for the hardware to be a capital lease and the software for which the hardware was leased be excluded.

Paragraph 5.b.

We ask that the Board provide a definition of the term "biological assets."

Paragraph 6

This paragraph supersedes all but five amended paragraphs from Statement No. 62. It is easier from a preparer/auditor standpoint to have all applicable requirements contained in one standard when possible. We request that the Board incorporate these five amended paragraphs within the new standard.

Paragraphs 10-12

We request the Board provide guidance on the consideration that should be given for the possible exercising of hold over clauses in lease agreements. Some lease contracts contain a provision that states the lease is automatically extended on a month-to-month basis should the state remain in possession of the asset after the expiration of the lease and would only be subject to a termination notice.

Paragraph 14

The paragraph states that a lease contract that transfers the underlying asset's ownership to the lessee at or before the lease's end and does not contain termination options should be reported as a financed purchase of that asset. Although the capitalization of an asset under a financed purchase is straightforward, not everyone may report the inception of financed purchases in the governmental funds consistently. Specifically, while the provisions of



paragraphs 29 and 30 follow existing capital lease and general long-term obligations principles, some governments currently apply the provisions of paragraphs 29 and 30 and lease-like disclosures to financed purchases, and others do not apply these provisions and disclosures. We request that the Board clarify whether a financed purchase should or should not follow the provisions of paragraph 29 and 30, and which note disclosures apply. Paragraph B25 explains that “such a contract would follow guidance for acquisitions of capital assets with related long-term liabilities instead of the guidance for leases.” However, because paragraph 14 does not clarify the meaning of “reported as a financed purchase,” interpretations of the paragraph could lead to a wide variety of practices. Therefore, we recommend clarification of the intent of paragraph 14, preferably by referencing the applicable standards.

Paragraph 15.a.

The paragraph requires that lease incentives receivable from the lessor reduce the fixed payments included in the lease liability. However, there is no discussion about how to report the lease incentives when received. Perhaps a moving expense reimbursement would be reported as a reduction of moving expense if the incentive was received in the same year or miscellaneous income if received in later years. However, it is less clear about how cash payment lease incentives should be reported. For example, interest expense may be reduced in the year received, or perhaps the lease incentive might be amortized as interest expense over the lease term, similar to GASB Statement No. 62, paragraph 185, requirements for notes payable discounts. To avoid confusion and inconsistency, we request the Board include specific guidance for reporting lease incentives received after the lease’s inception, in particular as it relates to cash payment lease incentives.

Paragraph 15.g.

We ask that the Board provide examples of items that may fall into “any other payments.” It is unclear if the intent could be to require the lessee to include executory costs (e.g., utilities and maintenance costs) in the measurement of the liability.

Paragraphs 20 and 43

These paragraphs state that the lease liability or lease receivable, respectively, are not required to be remeasured solely for a change in an index or rate used to determine variable lease payments. For lessees, this provision does not seem consistent with paragraph 19.d. because it appears a change in the rate or index would change the estimated payment amounts included in the liability. Further, for lessees and lessors, if the lease liability/receivable is not remeasured when a change in the index or rate occurs, the proposed standard does not address how the difference between the variable lease payment amount included in the lease liability/receivable and the actual lease payment should be recognized. It appears these amounts should be recognized similar to other variable rate payments discussed in paragraphs 16 and 38 that are not included in the lease liability/receivable. We request that the Board clarify whether a change in an index or rate used to determine variable lease payments would result in a change in the estimated payment amounts included in the lease liability and provide guidance on how to recognize the difference between the variable lease payment amount included in the lease liability/receivable and the actual lease payment.

Paragraph 30

The paragraph states that the leased asset amount should be reflected as an expenditure and other financing source in governmental fund statements. This appears appropriate for the



portion of the lease asset amount recognized for the lease liability in accordance with paragraph 24.a. However, it appears the portion of the lease asset amount recognized for lease payments at or before the lease's beginning and ancillary charges recognized in accordance with paragraph 24.b. and 24.c. should be reflected as an expenditure and a reduction in cash because these amounts represent actual cash outlays rather than an inflow of resources. We ask that the Board clarify that an expenditure and other financing source should be recognized only for the lease liability portion of the lease asset.

Paragraph 30

The last sentence of this proposed paragraph may be understood as a change in reporting lease payments in governmental funds as being allocated to principal and interest expense rather than as functional expenditures. This would be a significant change from how lease expenditures are currently reported and therefore, we request that the Board clearly state in the final standard how leases payments should be reported in the governmental funds.

Paragraph 31.g.

We ask that the Board clarify if the proposed disclosure should be presented in the Lease Note or in the Commitment Note. An example of the disclosure would also be helpful.

Paragraph 49.b.

We request the Board clarify whether the amount of the assets on lease or held for leasing should include assets for which only a portion of the asset is leased or held for leasing and, if such assets should be included, whether the carrying amount disclosed should be the carrying amount for the entire asset or just the portion that is leased or held for leasing. For example, in the situation described in GASB Implementation Guide 2016-1, question 4.39, in which a city government owns a five-story office building, occupying three floors and leasing two floors, if the city determines the unit of account is the building, should the disclosure in paragraph 49.b. require the lessor to:

1. Exclude the building's carrying amount because the building is a single unit of account and is not solely leased or held for leasing;
2. Include two-fifths of the building's carrying amount because two of the five floors are leased or held for leasing, which would appear to be inconsistent with the unit of account principle; or
3. Include the building's full carrying amount because the building is a single unit of account and any portion is leased or held for leasing.

We ask that the Board clarify how lessors should disclose the carrying amount of assets when only a portion of the asset is leased or held for leasing.

Paragraphs 52-54

We are concerned about the practicability of separating and accounting for each component of a multiple component lease. Many leases do not break out the multiple components nor is it practical in many cases to measure the lease component and the service component separately. We request that the Board allow a more expedient approach to splitting these by including the following from FASB ASC:

842-10-15-29: An entity shall account for the right to use land as a separate lease component unless the accounting effect of doing so would be insignificant (separating the land element



would have no effect on lease classification or the amount recognized for the land lease would be insignificant).

842-10-15-37: As a practical expedient, a lessee may, as an accounting policy election by class of an underlying asset, choose not to separate nonlease components from lease components and instead to account for each separate lease component and the nonlease components associated with that lease as a single lease component.

Paragraph 60

The paragraph's first and last sentences do not appear consistent. Specifically, the first sentence indicates that all options to extend the lease term should be considered in determining the maximum possible lease term regardless of the option's probability of being exercised. However, the last sentence indicates that the maximum lease term should be determined as defined in paragraph 9, which requires that consideration be given for the extension options' probability of being exercised. If the Board intends that the lease term used to determine whether a lease is short-term be calculated differently than the lease term determined in accordance with paragraph 9, as indicated in paragraph 60's first sentence and Basis for Conclusions paragraph B96, we ask that the Board include all of the criteria for determining the term of short-term leases in paragraph 60 rather than cross-referencing to paragraph 9.

Paragraph B19

Actual situations in the states with respect to cancellable periods and lease terms become very complex. Upon reading this paragraph, the requirement is clearer. We are concerned that the Basis for Conclusions may not be authoritative, and that the information in this paragraph will not be part of the codified standards, resulting in more chances for these provisions to be misapplied or inconsistently applied. Therefore, we request that the content of paragraph B19 be added to the Lease Term (paragraphs 9-12) section of the proposed standard.

Paragraph B104

The paragraph states: "The Board views capitalization policies as methods to operationalize materiality; that is, those policies allow governments to specify amounts that they consider to be insignificant, individually and in the aggregate. The Board believes that a policy similar to those that establish capitalization thresholds could be used for leases." However, paragraph 54 seems to be stating that it is not acceptable for a government to establish a policy to address aggregation of leased items as it relates to disclosures. We request clarification on this issue. Additionally, the inclusion of examples of leasing scenarios would be extremely helpful.

General Comments

- We request that cross referencing be added to the standards that establish the accounting treatment for the following items: (a) paragraph 14, "financed purchase of the asset," (b) paragraph 30, "principles for general obligation debt," and (c) paragraph B25, "guidance for acquisitions of capital assets with related long-term liabilities."
- The ED does not have any examples in the appendices. Examples, while not authoritative, are always helpful in understanding of new standards. We request that GASB incorporate examples and include them within the appendices.
- We ask that the Board provide guidance on the difference between reporting proceeds and uses in cash flows for short-term versus long-term leases.
- We are concerned about the impact this standard will have on the way rating agencies



will assess the states. We request that GASB please conduct outreach to the rating agencies regarding these new lease reporting requirements so there are no unintended consequences from implementing the standard.

We appreciate the opportunity to provide our comments. Should you have any questions or need additional information regarding our response, please contact Kim O’Ryan of NASACT at (859) 276-1147 or me at (515) 281-4877.

Sincerely,

A handwritten signature in blue ink that reads "Calvin McKelvogue". The signature is written in a cursive, flowing style.

Calvin McKelvogue
President, NASACT
Chief Operating Officer, Iowa