DATE: May 6, 2016

TO: Director of Research and Technical Activities - Project No. 3-24E

FROM: Teresa MacCartney, State CFO and Director of OPB
       Alan Skelton, State Accounting Officer

RE: Leases – Exposure draft

The State of Georgia appreciates the opportunity to respond to the Government Accounting Standard Board’s (Board) exposure draft relative to leases. The State generally agrees with the exposure draft as presented and the basis for the Board’s conclusions. We are very pleased that the Board continues to acknowledge that this guidance does not need to be applied to immaterial items and the use of a capitalization threshold would be a matter of accounting policy for each government based on its facts and circumstances, consistent with treatment of other long-lived assets. The Board’s acknowledgement that materiality is applicable to this standard is very relevant and appreciated.

We have provided additional comments for the Board’s consideration that seek to clarify paragraphs in the document.

**Paragraph 3 – Scope and Applicability of this Statement**

We would like to recommend that the Board reconsider agreements that may not be as formal as a contract but have documentation and formality nonetheless. If a state has two leases and the first was executed via purchase order only (never signed by either party and potentially not considered a “contract”) with all the same financial provisions as the second “signed and written contract” would the two transactions be accounted for differently? In substance they are the same, but the standards would suggest otherwise.

The Board makes this point relative to the identification of a lease. The draft “applies to transactions that meet the definition of a lease even when they are not identified as such.” We agree with this position since it puts substance over form. We believe the same logic should be applied to the formality of the agreement.

**Paragraph 5 – Statement does not apply to software**

We appreciate software being excluded from this standard but are concerned about recognizing physical servers upon which software resides as capital lease assets but not the software itself. We are not suggesting that the Board’s position on software be revised but rather as an area the Board may want to consider before issuing final guidance. This would be especially relevant in those instances when software and hardware are bundled together in the same contract.

**Paragraph 9 – Lease term**

Leases in the State of Georgia have clauses in which the lease automatically terminates at year-end and must be affirmatively renewed each subsequent year for a limited number of renewal periods. Initially, we believed paragraph
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9.a. would imply that the lease term would include these renewal periods since they are likely to be used. Also included in this paragraph, however, is a provision that delineates “periods for which both the lessee and lessor have the option to terminate….are cancelable periods and are excluded from the lease term”. Paragraph B19 also states that “if either the lessee or lessor has the option to cancel a lease (or if both parties have to agree to renew), an enforceable contract does not exist beyond that point.” We concur with the Board’s position and appreciate this perspective.

**Paragraph 17 - Discounted rate of return**

The State appreciates the Boards reconsideration of the discount rate and inclusion of the incremental borrowing rate if the implicit rate is not known.

**Paragraph 52 - Contracts with multiple components**

We are concerned that accounting for leases and other components separately, such as CAM charges or paper costs, could prove too burdensome and costly. We respectfully recommend the board reconsider this requirement.

**General Comment - Transition period**

We suggest the Board reconsider applicability to leases already in existence at the effective date of this plan. We do not prefer retroactive reporting for obvious reasons. Our main concern with retroactive reporting and the proposed transition period is the inability for governments to address impact on debt calculations relative to bond and constitutional debt limits. In many cases, capital leases will impact these numbers and could have the effect of adding hundreds of millions of dollars to the Statement of Net Position not considered debt when originally executed. If retroactive reporting cannot be re-considered, we encourage the Board to set an appropriate implementation date so that leases can be renegotiated with this standard in mind.

**Final Comments**

We appreciate the opportunity to provide comments on the proposed statement and hope the Board will consider our feedback when determining how to proceed.

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