May 25, 2016

David R. Bean, Director of Research and Technical Activities
Governmental Accounting Standards Board
Project No. 3-24E
401 Merritt 7
P.O. Box 5116
Norwalk, Connecticut 06856-5116

Re: Exposure Draft-Leases, Project No. 3-24E

Dear Mr. Bean:

The following is the response of the Government Accounting and Auditing Committee of the Washington Society of Certified Public Accountants (WSCPA). The views expressed are the views of the Committee and not necessarily the views of the individual members or the WSCPA as a whole. We are pleased to have the opportunity to respond to the Governmental Accounting Standards Board’s (GASB) Exposure Draft (ED) Leases.

We support the mission of GASB, to establish and improve standards of state and local governmental accounting and financial reporting.

Overview of Our Response:

We generally support this ED to allow comparability of financial statements of lease transactions among governmental and non-governmental entities. However, there are many governmental, both state and local, agencies that have thousands of leases and act as lessees and lessors. A change in lease accounting could result in a significant burden due to resource constraints or system limitation in tracking the various components needed to comply with some of the accounting and disclosure requirements being considered in the ED. Also, the concern of using operating lease accounting model (as executory contract) would result in “leased asset”, such as a private jet, is not recorded in either lessor or lessee’s financial statements is less relevant to governmental entities. For significant operating leases of a government serving as a lessor, the leased assets are most likely funded by tax-exempt bond which requires the capital expenditures be spent for governmental purpose and not sell to private entity due to IRS rules. As a result, it is most likely the leased asset is recorded on the governmental entities’ Statement of Net Position (balance sheet).
Specific Comments:

Scope and Application of the Statement:

We agree that leases with certain characteristics are out of scope of this new standard. However, we suggest grouping them all in the beginning of the standard, paragraph 5, instead of embedded in the body of the document throughout.

- Paragraph 35. Leases of assets that are investments
- Paragraph 36. Certain regulated leases
- Paragraph 60. Short-term leases

Lessee Accounting:

We agree that in the following paragraph that “outflow of resources” is used to recognize and record the amortization of the discount by the lessee. However, we suggest adding clarification on whether lease transactions would fall under operating or non-operating activities. For example, for a proprietary fund, would the “outflow of resources” be classified as operating expenses or nonoperating expenses or the classification of expense follow paragraph 102 of GASB No. 34 which stated to consider mirroring the classification as in preparing a statement of cash flows? As such, are lease assets related to capital assets, and would then fall under “Capital and related financing activities” in the statement of cash flows, hence, the “outflow of resources” will be classified as nonoperating expense for both the lease expense (principal) and interest expense (interest) portion?

- Paragraph 18. “…amortization of the discount on the lease liability and report that amount as an outflow of resources for the period. Any payments made should be allocated first to the accrued interest liability and then to the lease liability.”

We agree that the lease asset should be amortized in a systematic and rational manner over the shorter of the lease term or the useful life of the underlying asset per paragraph 25. We also agree that lease asset generally should be adjusted by the same amount when the corresponding lease liability is remeasured per paragraph 27. However, we suggest clarification be added for the amortization period of the lease asset being adjusted by the same duration if the lease term changed based on paragraph 19. Would the change of amortization period be accounted for prospectively as a change in accounting estimates?

We agree that lease modification should require reassessment of lease receivable and liability. However, we suggest to either add reference of lease modification of paragraphs 63, 64, 67, and 68 to paragraphs 19 and 42 or move lease modification related paragraphs up to the front part of the standard so remeasurement of lease receivable and liability in paragraphs 19 and 42, respectively, can include the triggering event of lease modifications.
**Lessor Accounting:**

We agree that in the following paragraphs that “outflow of resources” and “interest revenue” are used to recognize and record the amortization of the discount on the receivable by the lessor. However, for a proprietary fund, would the “outflow of resources”, “interest revenue”, and “lease revenue (related to principal portion)” be classified as operating revenue/expense following the classification of revenue/expense per paragraph 102 of GASB No. 34 as it relates to the government’s principal ongoing operations, such as a landlord in a port district? Hence, the classification in the statement of cash flows would be “operating activities” instead of “financing activities”?

- Paragraph 33. “Any initial direct costs incurred by the lessor should be reported as an outflow of resources of the period.”
- Paragraph 41. “… lessor should calculate the amortization of the discount on the receivable and report that amount as interest revenue for the period.”

We agree that the deferred inflow of resources should be amortized in a systematic and rational manner over the lease term per paragraph 45. We also agree that deferred inflow of resources generally should be adjusted by the same amount when the corresponding lease receivable is remeasured per paragraph 46. However, we suggest clarification be added for the amortization period of the deferred inflow of resources being adjusted by the same duration if lease term changed based on paragraph 42, and will the amortization period change be accounted for prospectively, the same manner as a change in accounting estimates?

While we agree with the overall disclosure requirements for lessor accounting, the implementation of paragraphs 49(b) and 51(b) will be very challenging for leased assets of only part of a building, such as a section of a cruise terminal is used for internal operation (not available for lease) its costs (or carrying amount) may not be objectively and reasonably determinable to segregate the value of the assets held for leasing. The carrying value of a leased facility or building may include many component assets such as electrical systems, sewer systems, flooring, roofing, etc. which were recorded in capital assets subledger or system in various in-use periods different from the commencement of lease agreements. Hence, the proportion, relationship and linkage of leased assets and the carrying value of the underlying capital assets for mixed use facilities is extremely difficult to be objectively and reasonably defined. Furthermore, the same disclosure requirement added the carrying amount of assets held for leasing which included the carrying value of vacant facilities? Since those assets are held for lease, i.e. vacant facilities, there will be no tracking of information in the lease management system to link them to capital assets subledger. Or a building was used for internal purpose for a period of time and now become an asset held for lease in different time period, how would the carrying amount of the capital assets and related accumulated depreciation be determined?

**Contracts with Multiple Components:**

While we agree that the nonlease component to be accounted for separately from the lease component in the same lease contract, we suggest consider adding more examples in the standard to help clarify the implementation of the multiple element arrangement concepts. For example,
would Common Area Maintenance (CAM) charges qualify as nonlease component and be accounted for as separate nonlease component as executory contract?

**Effective Date and Transition:**

As this new standard requires retroactive adoption by restating financial statements for all periods presented, we suggest adding clarification regarding removal of carrying balances of unamortized straightline rent accounted for under GASB No. 13 and 62 during transition to the beginning balance of net position.

**Other comments**

Often a government enters a ground lease with the lessee for a fixed rent and requires the lessee to build a building or facility. The government may or may not share the costs of the construction of the building but receive the title and ownership of the building upon its completion as in-lieu of additional rent. Given the agreement does not meet the criteria to be accounted for as a service concession agreement, should the estimated (variable) construction costs (in-lieu of additional rent) be included in the net present value measurement of lease receivable of the lessor accounting? How should the lessor account for the capital assets owned upon the completion of the construction? Should the building constructed by the lessee be amortized over the shorter of the lease term or the useful life of the underlying asset? How would the accounting treatment be changed if the ownership of the building reverts to the government at the end of the lease term instead of the completion or in-service date?

Some of the lease agreement under the scope of this standard requires rent security in the form of cash deposit (refundable and nonrefundable), surety bond or a letter of credit which was not recorded in the financial statements. Should nonrefundable cash deposit be accounted for as part of the net present value of the lease liability or receivable for the lessee and lessor accounting, respectively? Some of the rent security is not a fixed amount as it is adjusted when rent increases over time based on an index. How should variable nonrefundable cash deposit be measured if included in net present value of the lease liability or receivable? How would the accounting treatment be changed if the cash deposit is refundable? Should refundable cash deposit be accounted for separately and follow GASB No. 62, paragraph 34 (see excerpt below) to account for as current liabilities even though the historical pattern of utilization of the refundable cash deposit is low and held till the end of lease term?

“34. The term current liabilities is used principally to designate obligations whose liquidation is reasonably expected to require the use of existing resources properly classifiable as current assets, or the creation of other current liabilities. …Other liabilities whose regular and ordinary liquidation is expected to occur within one year also are intended for inclusion, such as short-term debts arising from the acquisition of capital assets, serial maturities of long-term obligations, amounts required to be expended within one year under sinking fund provisions, and certain agency obligations arising from the collection or acceptance of cash or other assets for the account of third parties. The current liability classification also is intended to include obligations that, by their terms,
are due on demand or will be due on demand within one year from the date of the financial statements, even though liquidation may not be expected within that period.”

Thank you for the opportunity to respond. If you have any questions or need additional information regarding this response, please contact Lisa Lam at (206) 787-4334.

Sincerely,

SENT VIA E-MAIL to director@gasb.org

Olga Darlington, Chair
Government Accounting and Auditing Committee
Washington Society of Certified Public Accountants