March 6, 2015

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

Re: Project No. 3-24P - Preliminary Views, Leases

To whom it may concern:

PricewaterhouseCoopers LLP appreciates the opportunity to comment on the Preliminary Views of the Governmental Accounting Standards Board on major issues related to Leases ("Preliminary Views"). We support the GASB’s ("Board’s") continuing effort to enhance the usefulness of the financial reporting model for state and local governmental entities.

In the past, we have encouraged the GASB and FASB to consider whether opportunities for convergence exist in areas that are not uniquely governmental. In the area of leasing, the GASB and FASB standards are largely converged at present, and we believe continued convergence would be beneficial to financial statement users. Convergence is particularly important in those capital markets where governmental entities and private sector non-for-profit entities compete for capital (for example, the tax-exempt debt market). Both types of entities share certain defining characteristics—absence of a profit motive, no owners to whom a return on investment must be provided—and, in our experience, generally enter into leasing agreements under similar commercial terms with similar motives.

We believe that any differences in lease accounting within U.S. GAAP (as defined by the GASB and the FASB) should be limited to specific distinctions in the nature of the leasing transactions entered into by governmental entities in relation to those transactions entered into by business entities. In our experience, the types of transactions entered into by governmental businesses and their not-for-profit counterparts are similar, as are some of their underlying motives—e.g., to acquire the use of assets with minimal initial cash outlays, to manage the risk of technical obsolescence, or to outsource the responsibilities and economic risks associated with acquiring and disposing of physical assets. We believe these motives would also apply to many routine leasing transactions (e.g., facilities/office space, equipment, land) entered into by general purpose governments.

A goal of the approach set forth in the Preliminary Views is to “enhance the consistency and comparability of the reporting for leases.” In that respect, it appears the Board is focusing solely on consistency within the governmental sector. We encourage the Board to also consider the broader issue of consistency within U.S. GAAP. As previously noted, existing leasing guidance (notwithstanding the criticisms of some aspects of the guidance) already provides for considerable consistency and comparability among GASB and FASB entities. We encourage the Board to capitalize on that common platform and maintain convergence to the greatest extent possible. If differences between the FASB and GASB models to account for similar transactions can be minimized, stakeholders will benefit.

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The balance of our response focuses on four areas where we believe maintaining consistency between governmental and private sector entities is especially important: definition of a lease, lessee accounting, lessor accounting, and sale-leasebacks.

**Definition of a lease**

The preliminary views document defines a lease in a single sentence, as follows: “a lease is a contract that conveys the right to use a nonfinancial asset (the underlying asset) for a period of time in an exchange transaction.” It further states the Board’s belief that this definition “would provide sufficient guidance for determining what transactions should be accounted for as leases.” We are concerned that this definition will not prove to be sufficient guidance. In our experience, a persistent challenge in evaluating governmental lease arrangements over the years has been the lack of guidance on determining whether a service contract or similar arrangement is, or includes, a lease (i.e., guidance similar to that provided by ASC 840-10-15 par. 6 through 21). Such guidance requires an assessment of whether fulfillment of the arrangement is dependent on the use of a specific asset or assets (including assets implicitly specified), and whether the arrangement conveys the right to control the use of the underlying asset.

Although control is not explicitly part of the stated definition of a lease, we note that in Chapter 4 of the preliminary views, assets are defined per paragraph 8 of Concept Statement 4 as “resources with present service capacity that the government presently controls (emphasis added).” We believe that this implicitly requires that control be present for an arrangement to contain a lease similar to the guidance provided by ASC 840-10-15. By not explicitly addressing which party to an arrangement controls an underlying asset (and thus, recognizes an asset and a liability), the Board’s definition may not be sufficiently robust to ensure that lessees and lessors identify, in a consistent manner, whether an arrangement contains a lease or not.

Over the course of the joint FASB/IASB projects, we closely monitored the feedback and redeliberation process related to the scope of the lease project. We noted that control was viewed as fundamental to recognizing a right to use an asset. The FASB and IASB had difficulty identifying which actions demonstrate that a customer controls property that a supplier uses in fulfilling an arrangement. In many cases, this will be obvious; however, the distinction may be more difficult when the supplier operates property at the direction of the customer. The FASB and IASB struggled to determine how both the nature and the timing of a customer’s ability to direct how the underlying property is used affected whether a customer obtained control over the property (and, hence, the arrangement was a lease).

We encourage the GASB to expand the definition of a lease to explicitly include an assessment of when control exists and to give consideration to the FASB and IASB views on the matter, which we believe are equally applicable in the governmental sector. We believe it is important that the definition applied by all entities – governmental and private sector – be similar and sufficiently robust to result in consistent interpretation and application, regardless of the sector in which an entity operates. For example, two hospitals – one governmental, one not-for-profit – should not be able to reach different conclusions on whether a particular arrangement involving use of specialized medical equipment contains an embedded lease solely due to differences in the definition.
**Lessee accounting**

Under the Board’s proposal, all leases would be accounted for as capital leases. Thus, lessees would recognize expense for the amortization of the leased asset, as well as interest expense on the lease obligation calculated using the effective interest method (which results in a decreasing interest expense over the life of the lease as the liability is satisfied). While we agree that all leases contain an element of financing, we believe that the economic characteristics of leases take a variety of forms and that a single model approach may not result in representationally faithful reporting of a lessee’s expenses. Instead, as we commented to the FASB and the IASB, we support use of a dual model in which the amount and nature of the expense vary depending on lease classification, with leases similar to capital leases giving rise to interest expense and leases similar to operating leases giving rise to rent expense. The revised FASB proposal now uses this approach (using the current “dividing line” in IAS 17 to classify leases). We believe this approach is preferable for the GASB as well for the following reasons.

- While some leases are, in substance, financed purchases of assets, others are more akin to a right to access and use an asset – for example, when the leased asset is not available for sale and could not be purchased. In such cases, an expense pattern similar to that historically used for operating leases (e.g., straight-line over time) better reflects the use of the asset than would the “front-end loaded” expense recognition pattern associated with the financing model, in which higher expenses are reported in the earlier years of the lease and lower expenses in the later years.

- This approach would continue the expense recognition patterns with which financial statement users are familiar, without sacrificing the Board’s objective to recognize most leases as assets and liabilities. We believe that this aspect would be attractive to many constituents given its familiarity and would enhance the usefulness of information to users.

- This approach facilitates comparison between governments and not-for-profit counterparts for bondholders in the tax-exempt debt market. As stated previously, in our experience, governmental businesses and not-for-profit entities enter into leasing transactions for similar reasons. If the GASB requires a single-model approach while the FASB requires a dual-model approach, users will find it difficult to compare the expenses of borrowers whose operations may be similar.

- It is not unusual for government operations to be acquired by private sector entities or for private sector operations to come under the control of governments. Consistency in lease accounting would avoid the need to undertake a complicated GAAP conversion when control of an entity changes.

**Lessor accounting**

We share the Board’s belief that for lessors, derecognizing a portion of the underlying asset, especially assets like real estate that could be represented by varying units of account (e.g., a building with multiple suites, leased to several users, for various terms, with different start and
end dates), may require subjective measurements and could be complex to apply. However, we have concerns about the Board’s proposed solution, under which lessors’ balance sheets would include both the entire property underlying the lease agreement and a receivable for the present value of the lease payments to be received for the lease term (as well as deferred revenue). We do not believe that a balance sheet gross-up of the related assets and liabilities is useful for financial statement users.

Under the current accounting model, the lessor recognizes either the underlying asset for operating leases or a receivable for capital leases (in which case, the underlying asset is derecognized). This model is well understood and has not been challenged or criticized by the user community. We recommend that, instead of its single model approach, the Board consider the merits of substantially carrying forward the existing accounting guidance for lessors which, by contrast, is less subjective and less complex to apply. Because a similar approach is now being proposed by the FASB, this would be particularly helpful to stakeholders comparing the financial statements of governmental businesses with their private-sector counterparts.

**Sale-leaseback transactions**

In our experience, we have noted that governmental businesses and private sector not-for-profit organizations utilize sale-leaseback transactions with similar frequency and for similar reasons (for example, sale-leasebacks of equipment, build-to-suit arrangements); thus, we believe similar accounting should be applied. We believe the Board should reconsider its proposed requirement for seller-lessees in sale-leaseback transactions to derecognize the asset sold, while deferring all gains and losses resulting from the sale. We believe that deferring all gains and losses resulting from those transactions is inconsistent with the Board’s expressed view that “the sale and leaseback portions of a sale-leaseback transaction should be accounted for separately as a sale transaction and a lease transaction.” We do not believe that there is a sound conceptual basis for deferring gains and losses from transactions that are recognized as sales, and we note that this deferral will create another inconsistency between similar transactions with the private-sector with no clear difference in the underlying economics. Instead, we recommend that any gain or loss on a completed sale in a sale-leaseback transaction be accounted for consistent with the guidance that would apply to any other equivalent sale without the presence of a leaseback.

If you have any questions in relation to the letter please do not hesitate to contact Chad Soares (973 236 4569), or Martha Garner (973-236-7294).

Very truly yours,

PricewaterhouseCoopers LLP