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

**Re: Project No. 3-24 — Exposure Draft of Proposed Implementation Guide,
*Leases***

Dear Mr. Bean:

Deloitte & Touche LLP is pleased to respond to the GASB's exposure draft (ED) of the proposed Implementation Guide *Leases*.

We believe that the ED addresses many of the common questions that have arisen with the issuance of GASB Statement No. 87, *Leases* ("Statement 87"), and we commend the GASB for its efforts to provide this guidance concurrently with the implementation of Statement 87.

We have reviewed the implementation guidance, and our comments related to specific questions and answers or topics are provided in the attached appendix.

If you have any questions concerning our responses, please contact Mike Fritz, partner, at +1 614 229 4806 or Reem Samra, managing director, at +1 214 840 7376.

Yours truly,

Deloitte & Touche LLP
cc: Robert Uhl

Appendix

General

We believe that each of the question-and-answer combinations should provide references to the specific paragraph guidance of Statement 87 to assist readers in understanding the Board's responses.

Further, we suggest that the Board review each answer to ensure that a clear conclusion is provided. In certain instances (i.e., the answers to questions 4.3 and 4.17), the answers are not clear or conclusions are not reached.

Suggested edits to specific questions and answers are highlighted below in **bold**.

Scope and Applicability

4.3 — Easements — We recommend that the Board revise the question as follows to clarify what type of easements are excluded from the scope of Statement 87:

Q — Are **certain all right of way agreements and** easements excluded from the scope of Statement 87?

4.7 — Multiple component agreements — We recommend that the Board revise the answer as follows if the purpose of the example is to demonstrate an agreement in which there are multiple components, including a right to use the land and a contract for oil and gas exploration:

A — No. **In this example, the government entered into a lease in which the land itself is the underlying asset. In contrast, if the government's agreement only provided the company with the right to explore for oil and gas but did not convey control of the right to use the land, that lease would be excluded from Statement 87.** While paragraph 8a of Statement 87 excludes "leases of intangible assets, including rights to explore for or to exploit natural resources such as oil, gas, and minerals," that exclusion applies only when the underlying asset in the lease is the intangible right to those resources. ~~In this example, the land itself is the underlying asset. In contrast, if the government only provided the company with the right to explore for oil and gas but did not convey control of the right to use the land, that lease would be excluded from Statement 87.~~

4.11 — Right to use asset — We recommend that the Board edit the answer to this question to remove the reference to the "lessee" since it has been determined that the agreement is not a lease. Our suggested edit is as follows:

A — No. The agreement does not convey the right to determine the nature and manner of use of the underlying asset because the **lessee rancher** cannot prevent others from accessing, using, or altering the land. (See also Questions 4.8 and 4.10.)

4.13 — Supply contract vs. right to use asset — We recommend that the Board review this question in relation to question 4.5, in which a government obtains the entire present service capacity of an asset for a certain period. The Board should explain how it came up with different answers and why it referenced different paragraphs of the standard (paragraphs 5 and 8f) in these scenarios. In addition, we note that the answer to question 4.13 refers to the government's "*right* to all of the power," while the question indicates that the "contract *requires* the government to purchase all of the power" (emphasis added). The Board should make the answer consistent with the question.

Lease Term

4.16 to 4.18 — Cancelable lease vs. noncancelable lease — We recommend that the Board consider adding a question to clarify the difference between a termination clause in a noncancelable lease and a cancelable lease.

4.17 — Cancellation penalties — The facts of this question-and-answer combination, along with paragraph 12 of Statement 87, conclude that cancellation penalties do not affect the exclusion of cancelable periods. We recommend that the Board consider whether guidance should be added for circumstances in which both the lessee and lessor have the right to cancel without permission even though cancellation penalties for either of the parties or both would be so great that it is reasonably certain that neither party would exercise the termination option.

Short-Term Leases

4.19 — Noncancelable lease — We recommend that the Board edit the question as follows to indicate that this lease is a noncancelable lease:

Q — A government enters into a 12-month **noncancelable** lease with the lessee having options to renew for 12 months at a time, up to 49 times. Is this agreement a short-term lease under Statement 87?

4.22 — Contract combinations — The facts of this question-and-answer combination, along with paragraphs 69 and 70 of Statement 87, conclude that the contracts would be combined and would not qualify for the short-term lease exception. However, this appears to provide a road map for entities to use so they can circumvent lease accounting by entering into a second stand-alone contract rather than modifying an existing contract (with sufficient time in between). We recommend that the Board consider whether (1) guidance should be added for circumstances in which two short-term contracts are economically and substantively the same as one long-term contract and (2) this answer should refer to paragraph 71 of Statement 87 on lease modifications (lengthening the lease) rather than contract combinations.

Contracts That Transfer Ownership

4.23 — Financed purchase — We recommend that the Board edit this question-and-answer combination as follows so that it asks a direct question and provides a direct answer about the nature of the contract:

Q — An equipment vendor installs equipment on a government's building to increase energy efficiency. The government makes payments to the equipment vendor based on a percentage of the government's energy cost savings. The government will own the equipment at the end of the agreement, and the contract does not contain a termination option. Is this transaction a lease **or a financed purchase** for financial reporting purposes?

A — **NoFinanced purchase.** If title to the equipment transfers to the lessee by the end of the contract, the transaction is not accounted for as a lease for financial reporting purposes. Rather, the transaction is a financed purchase, as discussed in paragraph 19 of Statement 87.

4.23 and 4.24 — Financed purchases — We recommend that the Board add references to the relevant paragraphs (20 and 40) within Statement 87 regarding the accounting for financed purchases.

Lease Recognition and Measurement for Leases Other Than Short-Term Leases and Contracts That Transfer Ownership

4.25 — Capitalization threshold — We recommend that the Board edit the answer as follows:

A — Authoritative pronouncements do not provide specific guidance related to **a determination of capitalization threshold amounts.** However, governments often use capitalization thresholds in practice so that limited resources are not spent accounting for insignificant items. **(See Questions 7.9.8 and 7.24.1 of Implementation Guide No. 2015-1.)** When applying a capitalization threshold to leases, lessees should consider the significance of the lease liability in addition to the significance of the lease asset in accordance with the guidance provided in Question 7.4.1 of *Implementation Guide No. 2015-1*, as amended. Significant lease liabilities, either individually or in the aggregate, should be recognized.

4.26 — Lease liability — We recommend that the Board revise this question to include an assumption that the criteria in paragraph 12a of Statement 87 have been met. Further, we suggest that the Board divide the question into two parts. Our recommended edits are as follows:

Q — A government enters into a lease with another government that includes an optional extension period of three years, exercisable only by the lessee. The payment schedule for the optional period will be negotiated at the time the option is exercised. The lessee has an ongoing relationship with the lessor

and is reasonably certain that it will exercise its option to extend. **(Assume that the criteria in paragraph 12a of Statement 87 are met.) Should the optional period be included in the liability?** How should the lessee measure the lease liability if the payment amount for the optional period is not specified in the contract?

A — Paragraph 12a of Statement 87 requires that periods covered by a lessee option to extend the lease should be included in the lease term if it is reasonably certain, based on all relevant factors, that the lessee will exercise that option. **In this example, the payments for the three-year extension period should be included in the lease liability as payments expected to be made during the lease term. These payments should be estimated based on the lessee and lessor's ongoing relationship and professional judgment by using observable information.**

4.28 — Lease liabilities — The example used in this question is based on a lease of tires. Governments typically account for tires as inventory, and therefore, this lease would be outside the scope of Statement 87 (paragraph 8c). We recommend that the Board replace "tires" in this example with items that are capital asset in nature, such as buses or copy machines.

4.31 — Payments based on usage — We recommend that the Board include additional language in the answer to this question that explains why variable payments based on usage that are reasonably certain do not qualify to be included in the lease liability as defined in paragraph 21 of Statement 87. Such payments, regardless of certainty, fall within the scope of paragraph 22 of Statement 87 because they are based on usage.

4.34 — Implicit discount rate — The answer to this question indicates that the fair value of the vehicles may be used in the determination of the implicit discount rate, and it uses 50 percent of cost at commencement of the lease to calculate fair value. We do not believe that these inputs represent an economic reality for vehicles.

4.36 — Composite method — The Board should specify in this question whether the assets being leased are reported in different asset classes since this would require separate treatment per paragraph 65 of Statement 87. As written, the answer could be interpreted to conflict with paragraph 65, which requires lessees to account for each underlying asset as a separate lease component if the underlying assets are in different major asset classes.

Notes to Financial Statements

4.42 — Variable payments — We suggest that the Board clarify which of the disclosure requirements in paragraphs 38 and 39 of Statement 87 are specifically applicable given the facts provided in the question.

4.44 — Capital asset disclosure — We suggest that the Board edit the question as follows (and make related edits to the answer as applicable):

Q — **Where** ~~Should~~ lease assets be included ~~with other capital assets~~ in the disclosure of changes in capital assets?

Lease Incentives

4.60 — Lease incentives — We suggest that the Board include a basis for the answer provided since paragraph 62 of Statement 87 (referenced in the answer) does not address accounting by the lessor. Further, the answer refers to the recognition of a reduction of lease revenue in “that period.” The Board should define “that period.” It would also be helpful if the Board could provide an illustrative example using figures or calculations for this question-and-answer combination.

Contracts With Multiple Components

4.62 — Equipment vs. software — In the answer to this question, the Board should reference the guidance (paragraph 8a of Statement 87) that excludes intangible assets, such as computer software, from lease accounting.

4.63 — Verbiage — We recommend that the Board match the terminology in the answer to paragraph 67 of Statement 87 as follows:

A — Based on paragraph 64 of Statement 87, if **it is practicable for** the government ~~is able~~ to separate and estimate the costs for those services, the costs should not be included in the government’s lease liability. For example, if the lease contract itself does not specify the amount (in dollars or percentage), the government could request that information from the landlord. Additionally, local real estate professionals may have statistics such as average charges per square footage. However, if **it is not practicable for** the government ~~is unable~~ to separate the costs and estimate them, based on the provisions in paragraph 67 of Statement 87, the janitorial services and utility costs for the lobby should be included in the government’s lease liability.

4.64 — Discount rates — We suggest that the Board edit the example in this question and the answer as follows for clarification purposes:

Q — A contract conveys the right to use a building for 30 years and the attached parking garage for 15 years. **There is no stated interest rate included in the lease agreement.** Should the discount rate be separately assessed for each component?

A — Yes. Paragraph 65 of Statement 87 requires that lease contracts involving multiple underlying assets be accounted for as separate lease components if the underlying assets have different lease terms. The reporting of two components instead of one may affect the discount rate implicit in the agreement. The lessee’s ~~implicit incremental borrowing rate estimated~~

incremental borrowing rate (paragraph 23 of Statement 87) may differ between the two components because of differences in lease terms.

Lease Modifications and Terminations

4.69 — Lease extension — We recommend that the Board revise the answer to this question as follows to remove extraneous information and clearly conclude that this is a lease modification:

A — ~~Because both parties have to agree to the optional five-year period, it is considered cancellable and, therefore, not subject to the lease term reassessment guidance in paragraph 15 of Statement 87. However,~~ Once the lessor and lessee agree to exercise the five-year option, it becomes enforceable **and should be accounted for as a lease modification**. Paragraph 71 of Statement 87 states that lengthening a lease term while the contract is in effect is an amendment that should be considered a lease modification.

Lease Modifications — Lessees

4.70 — Modification to lease payment — We recommend that the Board remove the dollar amounts from the question and the answer since these amounts do not represent a valid scenario that would lead to a conclusion that lease payments are unreasonable and therefore that a remeasurement of the lease liability is required.

Effective Date and Transition of Statement 87

4.79 — Implementation for operating leases — The Board should rewrite the answer to this question in language that is consistent with that in paragraph 94 of Statement 87 to more clearly indicate the implementation requirements.

Illustrations

Appendix B — We suggest that the Board consider adding examples for lessor accounting that are parallel to the lessee examples provided in illustrations B1 through B3.

Illustration B1 — The facts and assumptions used in this example state that the “lease may be continued on a month-to-month basis.” The use of “month-to-month basis” in this example assumes that the lease is cancelable by both parties; however, other leases may be cancelable by only the lessee. We recommend that the Board clarify “month-to-month” as used in illustration B1 and throughout Statement 87 and the Implementation Guide.

Additional Comments

- *Leases between funds* — We suggest that the Board add a question or illustration that addresses how leases between funds are measured and presented.
- *Advertising and billboard space* — We recommend that the Board add a question directed at the lease of advertising or billboard space. It is common for transit agencies, airports, and governments to enter into such agreements with stadiums and performance venues, and the agreements could include traditional signage as well as electronic or digital advertising.
- *Incremental borrowing rate* — Paragraph 23 of Statement 87 indicates that “if the interest rate cannot be readily determined by the lessee, the lessee’s estimated incremental borrowing rate (an estimate of the interest rate that would be charged for borrowing the lease payment amounts during the lease term) should be used.” We understand from financial statement preparers that additional information is necessary to determine the appropriate rate to use as the incremental borrowing rate and suggest that the Board consider providing further guidance.