National Association of College and University Business Officers

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Technical Director
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, Connecticut 06856-5116

Re: File Reference No. 2013-270

Dear Technical Director:

On behalf of the National Association of College and University Business Officers (NACUBO), we submit the following comments on the Proposed Accounting Standards Update, "Leases (Topic 842) " (the ASU). NACUBO's comments on the proposal were developed with input from our member institutions and our Accounting Principles Council (APC). The APC consists of experienced business officers from various types of institutions who, collectively, possess a thorough knowledge of higher education accounting and reporting issues and practices.

NACUBO is a nonprofit professional organization representing chief financial and administrative officers at more than 2,100 nonprofit colleges and universities. In its capacity as a professional association, NACUBO issues accounting and reporting guidance for the higher education industry and educates over 2,000 higher education professionals annually on accounting and reporting issues and practices.

Overall Comments on the ASU

We appreciate the need for users of financial statements to have a complete understanding of an entity's leasing transactions. As such, we generally agree with the overall aim of the ASU. We believe, however, that the proposed guidance does not achieve that goal. Our primary concerns include:

- Some colleges and universities are lessors with long term land leases. The proposed guidance could result in such leases being classified as Type A leases and the land being derecognized as if it had been sold. Such a presentation would not properly reflect economic reality, ownership, or the institution's financial position.
- Although both boards recognize that some lessors enter into leases for investment purposes, the Financial Accounting Standards Board (FASB) does not acknowledge that fair value measurement of an asset leased for investment is acceptable for not-for-profit (NFP) entities such as higher education institutions. The proposal recognizes that International Financial Reporting Standards (IFRS) would allow fair value measurement and proposes that leases of investment property be measured at fair value. Higher education seeks the same guidance that the Boards reached for followers of IFRS.
- Separating lease expense into amortization and interest expense rather than showing it all as lease expense will create issues for research institutions that are subject to Office of Management and Budget (OMB) compliance requirements.

- Recording a right-of-use asset and related liability will create issues for NFP institutions that are subject to Department of Education financial responsibility requirements.
- No effective date or implementation time line has been proposed. Higher education institutions are subject to federal regulations that are monitored by various federal agencies. Significant lead time will be needed to allow for regulatory change. Without sufficient implementation time, the proposed guidance is likely to adversely affect many areas such as debt covenants, OMB compliance, Department of Education financial responsibility calculations, National Center for Educational Statistics requirements, and Equity in Athletics Reporting.
- Without explicit reference to materiality in the guidance, auditors may require entities to record a right-of-use asset and lease liability for all leases – even those that are immaterial to the organization's financial position. We do not believe that leases of assets whose value is immaterial to an organization should be required to be recorded on the balance sheet. The relatively low cost and short life span of these assets would result in a lease expense (as determined in accordance with the proposed guidance) roughly equal to the monthly payments. The administrative burden and cost to the organization of accounting for such assets would far outweigh any value that showing these amounts on the face of the financial statements would provide.

Question 1: Identifying a Lease
Do you agree with the definition of a lease and the proposed requirements in paragraphs 842-10-15-2 through 15-16 for how an entity would determine whether a contract contains a lease? Why or why not? If not, how would you define a lease? Please supply specific fact patterns, if any, to which you think the proposed definition of a lease is difficult to apply or leads to a conclusion that does not reflect the economics of the transaction.

We agree that the basic definition of a lease should be "a contract that conveys the right to use an asset for a period of time in exchange for consideration." The means by which an entity would assess whether a contract contains a lease, however, seems overly complex. By introducing the issues of identified assets and control of those assets, the Boards have gone beyond the fundamental definition and, thereby, increased the likelihood of inconsistency in application. If there are particular situations that the Boards are attempting to address by using the terms "identified asset" and "substantive right to substitute the asset" then simpler, more direct language would be preferable.

Question 2: Lessee Accounting
Do you agree that the recognition, measurement, and presentation of expenses and cash flows arising from a lease should differ for different leases, depending on whether the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset? Why or why not? If not, what alternative approach would you propose and why?

We generally agree with the method proposed for initial measurement of the asset. Since the proposed guidance seeks to provide greater transparency about leverage, to the extent that the leased asset is material to the overall financial position of an entity, it should be recorded on the balance sheet.

We are concerned, however, that not all entities will be able to determine the appropriate discount rate to use in the measurement calculation. Few leases explicitly specify the rate that the lessor is charging and not all entities can determine an incremental borrowing rate. We appreciate the Board's exception for use of a risk-free rate for nonpublic entities. Such use, however, is likely to result in a greater asset and liability being recorded which may, in turn, trigger violations of debt covenants or other calculations based on financial ratios.

Using two methods for expense recognition will not result in greater transparency for users. In fact, it is likely to do just the opposite: using a straight-line method for one type of lease and an amortization method for another obscures the total lease income/expense on the statements of activities and cash flows. In order to provide meaningful information to users, significant additional disclosures would be required to summarize the leasing activity in a single location within the statements and sufficiently explain the concept of significant consumption.

Finally, the two model approach will be extremely complex and burdensome with very little benefit to users. Therefore, we urge the Boards to consider only one model for recognition and presentation of leases. For purposes of simplicity, we recommend using the straight-line method for all leases and reporting all income/expense as leasing activity in the statements (as opposed to interest and amortization expense).

Question 3: Lessor Accounting
Do you agree that a lessor should apply a different accounting approach to different leases, depending on whether the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset? Why or why not? If not, what alternative approach would you propose and why?

The proposed guidance for lessor accounting seems to stem, in large part, from a need to provide symmetry between lessee and lessor accounting. The current guidance for lessors has not drawn the same amount of criticism as that of lessee accounting. As such, we recommend that the Board give serious consideration to the need for symmetry between lessee and lessor accounting before changing a model that does not appear to be flawed. If, however, the Boards ultimately decide that symmetry is necessary, we believe that there should be only one model for recognition, measurement and presentation of leasing transactions as we recommend above for lessee accounting. The complexities of a two model approach would outweigh the benefits to users of financial statements as it would disaggregate leasing information within the statements.

Question 4: Classification of Leases
Do you agree that the principle on the lessee's expected consumption of the economic benefits embedded in the underlying asset should be applied using the requirements set out in paragraphs 842-10-25-5 through 25-8, which differ depending on whether the underlying asset is property? Why or why not? If not, what alternative approach would you propose and why?

While we agree that leases of other than property are akin to the financed purchase of an asset, there is a significant difference: when an asset is purchased, it is still available for use by the purchaser when the financing obligation has been fully satisfied. In the case of a leased asset, it is often returned to the lessor at the end of the lease term and a new lease for similar property may be entered into. Because the lessee no longer has use of the asset at the end of the lease, we believe that the nature of the transaction is more akin to rent and, therefore, should be treated in the same manner as a lease of property.

In BC39 the Board concludes that amortizing the right-of-use asset consistent with other nonfinancial assets would not provide the best reflection of the nature of *all* leases. We note, however, that neither would the proposed two model approach provide the best reflection of the nature of *all* leases.

Many NFPs have unique leasing arrangements that, under the proposed guidance, would be misrepresented. For example, many universities own land which can never be sold. In order for these institutions to utilize the land to provide funds for their mission, the land may be leased. These leases may be for long periods of time (typically between 50 and 99 years) or relatively short periods of time depending on the lessees' intended use of the land.

Under the proposed guidance, there would be times when leases of property may meet the criteria of a Type A lease under 842-10-25-7, as the present value of the lease payments may account for substantially all of the fair value of the land at the commencement date. As discussed in BC39c, the Board concluded that long-term land leases determined to be Type A leases should be accounted for as if the land was sold. That, of course, is not the case and to derecognize the asset would create the false impression that the university was not complying with the restrictions placed on the land by donors. We believe that this presentation is inappropriate and misrepresents the economics of the transaction and the university's financial position in general. In addition, it is unclear how, and at what amount, the land would be reinstated to the organization's balance sheet at the end of the lease term.

Another issue related to long-term land (or other real property) leases is that often the college or university lessor enters into the leasing arrangement as an investment. Contrary to the statement in BC189 that U.S. GAAP does not permit the fair value measurement of investment property, many higher education institutions (and other NFPs) carry real estate investments at fair value in accordance with paragraphs 1 and 2 of ASC 958-325-35 and adjust the fair value at each reporting date. We note that the ASU contains proposed changes to International Accounting Standards (IAS) 40, *Investment Property*, which would require leases of investment property to be measured at fair value. In addition, there would be no recognition of a lease receivable and derecognition of the underlying asset. As noted in BC73a, this treatment of leased investment property would better reflect the economics of the transaction by recognizing rental income over the term of the lease.

Similar to leases of land, if leases of these investment properties resulted in an institution derecognizing the asset over the term of the lease, it would misrepresent the economics of the transaction and the financial position of the institution. We recommend, therefore, that FASB incorporate the same treatment for leases of investment property in ASC 958-325-35 as that proposed by IASB.

Because of the issues arising from leases of land and other investment properties, we recommend that all leases of nondepreciable assets or assets carried at fair value be considered Type B leases. In fact, we reiterate that, for simplicity, all leases should use the straight- line method with the total payments showing as lease expense in the income statement. The classification in the statement of cash flows should be based on the use of the asset.

Question 5: Lease Term
Do you agree with the proposals on lease term, including the reassessment of the lease term if there is a change in relevant factors? Why or why not? If not, how do you propose that a lessee and a lessor should determine the lease term and why?

We agree with the proposed guidance on determination of a lease term, including reassessment if there are changes in the relevant factors related to the lease.

Question 6: Variable Lease Payments
Do you agree with the proposals on the measurement of variable lease payments, including reassessment if there is a change in an index or a rate used to determine lease payments? Why or why not? If not, how do you propose that a lessee and a lessor should account for variable lease payments and why?

We agree with the proposed measurement of variable lease payments, including reassessment for changes to an index or rate that is used to determine the payments.

Question 7: Transition
Subparagraphs 842-10-65-1(b) through (h) and (k) through (y) state that a lessee and a lessor would recognize and measure leases at the beginning of the earliest period presented using either a modified retrospective approach or a full retrospective approach. Do you agree with those proposals? Why or why not? If not, what transition requirements do you propose and why?
Are there any additional transition issues the Boards should consider? If yes, what are they and why?

For most NFPs, a full – or even the proposed modified – retrospective transition approach could be extremely burdensome. We recommend that for nonpublic business entities, including NFPs, the Board provide an option for lessees and lessors to record only those leases with 12 months or more remaining in the lease term at the end of the fiscal year in which the standard is adopted with a cumulative effect adjustment in the statement of activities. Nonpublic business entities that wish to apply the guidance retrospectively to the earliest period presented may, but would not be required to, do so. This approach would alleviate some of the administrative burden of adopting the guidance. As with any new standard, the cost of implementation is a concern for higher education institutions. Implementation of accounting standards that were not drafted with them in mind creates a significant resource and financial burden for these institutions which can ultimately translate into an increased cost of education. Also, retrospective application can cause problems for financial reports previously filed with certain federal agencies.

A significant amount of time will be required for entities that perform government-sponsored research to educate their relevant cognizant agency and government sponsors about the impact of the changes. Retrospective application to leases not previously recorded on the balance sheet would need to be addressed in order to determine if indirect cost rates would require adjustment or renegotiation. In addition, interest rates used in calculating the right-of-use asset will likely be challenged by the Defense Contract Audit Agency (DCAA) which provides audit and financial advisory services to the Department of Defense and other governmental agencies. Significant documentation about how the rates were determined will likely be required to justify the amounts recorded for leased assets and liabilities.

The bifurcation of some lease payments into interest and amortization expense will require research institutions to undertake potentially significant system modifications in order to properly capture the data for government reporting. Additionally, OMB Circular A-21 makes specific reference to current FASB leasing standards (specifically FAS 13), so changes to that guidance will require OMB to amend its guidance. Such a change will require ample lead time to implement.

Another, perhaps more significant, issue relates to the calculation of the financial responsibility composite scores required by the Department of Education (ED) for higher education institutions that receive Title IV funding. By adding right-of-use assets to total assets, an institution with significant leasing activity may find that it no longer meets the financial responsibility thresholds set by ED. This, then, may result in an institution having to incur additional expenses (a letter of credit is often required when the composite score falls below a certain level) in order to continue to receive Title IV student aid funds. ED historically has been unreceptive to changes in the formula for calculating the ratios and, as such, significant lead time (three to five years) will be required to educate them on necessary changes to the formulas as a result of the proposed guidance. It can take years to go through a negotiated rule making process to change ED regulations.

Question 8: Disclosure
Paragraphs 842-10-50-1, 842-20-50-1 through 50-10, and 842-30-50-1 through 50-13 set out the disclosure requirements for a lessee and a lessor. Those proposals include maturity analyses of undiscounted lease payments, reconciliations of amounts recognized in the statement of financial position, and narrative disclosures about leases (including information about variable lease payments and options). Do you agree with those proposals? Why or why not? If not, what changes do you propose and why?

Because of the complexity of the proposed guidance and the disaggregation of amounts presented in the financial statements, we believe that the majority of the required disclosures would be necessary in order for a user of the statements to begin to understand the entirety of an entity's leasing activities. Rather than requiring such detailed disclosures, we would recommend that the Boards focus on simplifying the recognition and measurement guidance, thus eliminating the need for some of the proposed disclosures.

We agree that a maturity analysis of the lease liability would be valuable to users of the statements. We do not, however, see the benefit in the additional requirement proposed in 842-20-50-3 to reconcile the undiscounted cash flows provided in the maturity analysis to the lease liability in the statement of financial position.

Question 9: Nonpublic Entities (FASB Only)
To strive for a reasonable balance between the costs and benefits of information, the FASB decided to provide the following specified reliefs for nonpublic entities:
1. To permit a nonpublic entity to make an accounting policy election to use a risk-free discount rate to measure the lease liability. If an entity elects to use a risk-free discount rate, that fact should be disclosed.
2. To exempt a nonpublic entity from the requirement to provide a reconciliation of the opening and closing balance of the lease liability.

Will these specified reliefs for nonpublic entities help reduce the cost of implementing the new lease accounting requirements without unduly sacrificing information necessary for users of their financial statements? If not, what changes do you propose and why?

As previously stated, we appreciate the Boards exception to allow nonpublic entities to use a risk-free rate when measuring the lease liability. While this may save a minimum of time and effort, any savings would be far outweighed by the fact that use of the risk-free rate is likely to result in larger assets and liabilities. This could result in violations of debt covenants and impact an entity's potential for future borrowing.

We agree with the Boards' proposal to exempt nonpublic entities from the reconciliation of the lease liability; not because of the effort or cost of producing it, but because we do not believe that it will provide relevant useful information to financial statement readers.

In short, these specified reliefs will do little to overcome the effort involved in implementing the standard due to its complexity.

Question 10 &Question 11: (FASB Only)
Do you agree that it is not necessary to provide different recognition and measurement requirements for related party leases (for example, to require the lease to be accounted for based on the economic substance of the lease rather than the legally enforceable terms and conditions)? If not, what different recognition and measurement requirements do you propose and why?
Do you agree that it is not necessary to provide additional disclosures (beyond those required by Topic 850) for related party leases? If not, what additional disclosure requirements would you propose and why?

Yes, we agree that there should be no differences in the recognition, measurement or disclosures for related-party leases. These leases should be accounted for using the terms and conditions as stated in the lease agreement.

Additional Observations
We appreciate the examples provided in the ASU as they do help in understanding the concepts of the proposed guidance. In practice, however, we had difficulty when trying to recreate them. We recommend that the Board consider providing sample spreadsheets in conjunction with the examples. These spreadsheets would be a valuable tool for NFPs and other small organizations that may lack the staff or expertise to work through the complexities of the proposed guidance.

Conclusions
Since the first preliminary views document was issued in 2009, the project to develop new lease accounting has met with significant resistance. The views of the many stakeholders vary widely and there does not seem to be an approach that pleases more than a slight majority. Given the extreme complexity of the proposed guidance, we suggest that the Board consider:

1) A simplified approach for all entities, or a simplified approach for nonpublic business entities, including NFPs
2) The unique needs of NFPs driven by donor restrictions and regulatory compliance
3) Current U.S. GAAP regarding fair value treatment of investment properties for NFPs

As previously stated, we agree that, to the extent a lease transaction is material to the financial position of an entity, it should be recorded on the balance sheet. In addition, for purposes of simplicity and transparency in reporting, we recommend that the right-of-use asset and associated liability be reduced on a straight-line basis with all income or expense being reflected as lease activity in the statement of activities. We believe that this approach, perhaps along with some enhanced disclosures would address the concerns of a majority of financial statement users.

We wish to express our appreciation for the opportunity to comment. We look forward to answering any questions the Board or the staff may have about our response. Please direct your questions to Sue Menditto at 202-861-2542 or sue.menditto@nacubo.org.

Sincerely,

Susan M. Menditto
Director, Accounting Policy