NACUBO

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May 31, 2016

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

Re: Project No. 3-24E

Dear David:

On behalf of the National Association of College and University Business Officers (NACUBO), we submit the following comments on the Exposure Draft (ED) of the Governmental Accounting Standards Board, "Leases." NACUBO's comments on the proposal were developed with input from member institutions and our Accounting Principles Council (APC). The APC is comprised of experienced business officers from both independent and public colleges and universities.

NACUBO is a nonprofit professional organization representing chief financial and administrative officers at approximately 2,200 colleges and universities. In its capacity as a professional association, NACUBO assembles and communicates financial accounting and reporting best practices for the higher education industry and offers professional development on a wide array of financial management and accounting related topics.

Overall observations on the ED

We recognize the need for users of financial statements to understand the extent of a governmental entity's leasing transactions. We also appreciate the Board's goal to provide greater comparability and reduced complexity for lease accounting among state and local governments. We struggle, however, with the foundational principle that all leases are financings. Although we agree that lease contracts represent a governmental entity's "right to use" an underlying leased asset (creating an intangible asset), we believe that examining the economic substance of a transaction is the only way to discern if the intangible asset is fundamentally a financing or a rental.

Treating all leases as financing transactions and requiring the separate recognition of interest on the lease liability and amortization of the right-of-use asset, would typically result in higher total expense in the earlier years of the lease and lower total expense in the later years of the lease. There are, however, lease contracts in which the lessee receives equal benefits from use of the underlying asset and pays equal amounts in each period. In such cases, a financing approach does not reflect the economics of receiving equal benefits for equal payments over the life of the lease. In other cases, a financing arrangement does not align with either the asset's useful life or entity's economic consumption of the asset.

The Financial Accounting Standards Board (FASB) has been studying lease accounting for a longer period of time, and ultimately concluded that **not** all leases are in effect financings. FASB received considerable pushback on a proposed single approach with many respondents noting that because leases vary widely, ranging from those covering almost all of the life of the underlying asset to those covering a very short portion of the life of the underlying asset, a single-approach lessee accounting model does not accurately reflect the economics of all lease transactions.

Governmental entity commenters to GASB's Preliminary Views on leases submitted similar concerns to the single approach financing view as did commenters to FASB's single approach. Although GASB believes that the single approach better suits the needs of most of its constituents, there are special-purpose governmental entities (such as higher education and healthcare) that believe it is equally important to have industry comparability. As you know, the higher education industry is fairly evenly split between the two standards boards; this makes comparability difficult and creates confusion for financial statement users. It is frustrating that two standard setting bodies can reach such different conclusions.

A dual approach requiring capitalization of "right to use" leased assets would foster both accountability and comparability, regardless of whether or not the lease contract more closely resembles a financing or a rental. Further, when only leases that economically resemble financings are combined with financed acquisitions, users will have a greater understanding of leverage. We urge the Board to reconsider its proposed single approach.

Many higher education institutions are dependent on debt financing for their capital needs. We are concerned that the ED's characterization of all leases as financings may cause public institutions to be out of compliance with debt limits and covenants. Again, we ask the Board to reconsider its proposed single approach.

Other observations on the ED

<u>Lease Term Definitions</u>
Under the proposed standard, the lease term is defined as the period during which a lessee has a non-cancelable right to use an underlying asset, adjusted for extension periods or termination options whose exercise is "reasonably certain". There can be numerous external forces that influence an organization's assessment of "reasonably certain". Examples include both favorable and unfavorable market driven incentives (such as rates costs, or negotiation enticements), historic renewal or termination patterns, change in an entity's strategic direction, and so on. Consequently, we think that the "reasonably certain" provision may create compliance challenges because the term is subject to interpretation.

<u>Contracts with Multiple Components</u>
Leasing contracts for multiple pieces of like equipment are very common. Although these proposed provisions are acceptable, we think that an illustrative example would be helpful.

Net investment in plant

GASB staff has helped us find authoritative citations which indicate that the intangible right-to-use lease asset would be classified the same way as any other capital asset; it would affect the amount reported as invested in capital assets, net of any related debt. However it would be helpful to have a section, or paragraph, of the new standard dedicated to "financial reporting display." In addition, we ask the Board to clarify the presentation on the Statement of Revenue, Expenses, and Changes in Net Position (SRECNP) for the portion of grants that are designated for equipment rentals. Meaning, if "right to use" assets are reported as "net investments in capital assets," would grant amounts designated for equipment leases flow through the SRECNP as a type of "capital appropriation?" Also, we think the final standard should clarify if lease contract activity is presented with "cash flows from capital related financing activities" on the Statement of Cash Flows.

Transition

We believe that an additional year will be needed to successfully transition to the proposed requirements. The standard may require a significant number of institutions to install new lease accounting software and centralize processes to ensure complete and accurate capitalization of leases (both as lessee and lessor). Some institutions may not find it "practicable" to restate prior years because lease capitalization software is not currently in place. Public colleges and universities subject to federal regulations that are monitored by various federal agencies will also need lead time to allow for regulatory change. Without sufficient implementation time, the proposed guidance could adversely affect debt covenants, OMB compliance, National Center for Educational Statistics requirements, and Equity in Athletics Reporting.

In closing, 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. Please contact me at 202-861-2542 or sue.menditto@nacubo.org.

Sincerely,

Susan M. Menditto
Director, Accounting Policy