



ELFA Accounting Committee Responds to GASB's Preliminary Views on Lease Accounting

Background - On November 11, 2014 the Government Accounting Standards Board ("GASB") issued a report entitled "Preliminary Views of the GASB on major issues related to Leases", seeking comments by March 6, 2015.

This represents the first phase in a GASB project to change the accounting for leases by government entities. The ELFA Accounting Committee reviewed the Preliminary Views document and issued its comment letter to the GASB. The comment did not support the GASB's model, as the model did not consider the nature of lease transactions.. The GASB received a total of 37 comment letters, of which ELFA's was one of the most comprehensive.

On April 8th representatives of the Accounting Committee delivered a statement to the GASB at a public hearing in New York, and participated in a question and answer session concerning the basis of the ELFA's position. The summary below pertains to that session and the actual comment letter and the ELFA's statement delivered at the public hearing are available on the ELFA's website.

Summary – Previously the GASB has adopted the FASB's pronouncements regarding lease accounting. In this instance, however, given the differences between the FASB and IASB's lease models, the GASB decided to consider the deliberations of both the FASB and IASB before reaching their preliminary view on lease accounting. An additional element the GASB considers in establishing a standard is the expected benefits and perceived costs of implementing the standard. While the FASB must also consider this in their standards, the GASB appears to place additional weight on this when setting accounting standards

The GASB's Preliminary Views on lease accounting provided a "Foundational Principle" that "all leases are financings of the right to use an underlying asset" and therefore concluded that a single approach should be used for lease accounting. The GASB felt that the single approach (which follows the IASB's model) would be less complex than both the current lease accounting model as well as the proposed lease accounting standard currently expected to be finalized by the FASB later this year.

The potentially most significant affect of the GASB's suggested new lease accounting standard would be that not only would governmental entities capitalize all leases (except for certain short-term leases), but that the capitalized leases would all be treated as the financing of a capital asset. In this manner, the capitalized asset would be depreciated and the offsetting liability would be treated as an amortizing debt instrument. This approach differs from the FASB two-model approach.

As such the accounting for all such leases will create a "front-end loaded" expense pattern consisting of depreciation and interest expense. The ELFA's Accounting Committee believed that for many shorter-term lease transactions which represent payment for the usage of an asset, this model would not provide an appropriate representation of the cost to use the asset.

The ELFA suggested for instance, that when a state-owned hospital leases an MRI or a CT Scan machine, the revenue generated by the machine continues to be level in nature while the cost to use it (the lease cost) starts high and gradually decreases over the term of the lease. The ELFA wondered whether this front-end loaded expense pattern would create a disincentive for government hospitals to acquire newer equipment. This expense pattern would also be in contrast to the single, level expense pattern that would be reported by non-governmental hospitals acquiring the same asset financed by the same lease.

The ELFA also believed that such approach would result in less useful information being provided to credit analysts seeking to extend credit to such governmental entities and thus might create higher borrowing costs for those entities.

The GASB posed several questions to the ELFA representatives, including whether the different accounting approach suggested by the GASB as compared to the FASB might affect a governmental entity's ability to obtain extensions of credit for such leases. The ELFA members responded that while the answer to that question would largely depend on the magnitude of leases relied on by a governmental lessee, in theory if such an entity relied on a large volume of leases in its financing strategy, the lease accounting would potentially distort the periodic financial results of the governmental entity.

Conclusion – While the GASB appreciated the leasing-industry's insight into the possible effect of such a change, they still believed that a simpler, single-model approach would suite their constituents better given (i) the relative lack of accounting expertise often found in such entities to adopt a complex accounting standard and (ii) the marginal cost-benefit that they felt would be achieved adopting a more complex financial reporting model.

We suggest members reflect on whether and/or how this accounting change might affect (i) their business and (ii) the willingness of such governmental entities to acquire new equipment given the propensity of them to lease such equipment. If governmental entities will materially change their behavior because of this change, such observations should be made to the GASB.