

GASB Update: Wait, I thought we were getting a break?

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Part 1

- ▶ P3s (GASB 94)
- ▶ SBITAs (GASB 96)
- ▶ Leases year 2 (GASB 87)



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What We Will Cover Today

- Overview of these specific GASB standards
- Scope considerations
- Accounting for leases (lessee) and SBITAs (very similar)
- Identifying and documenting key provisions
- Outlays other than subscription payments
- Separating components and allocating contract prices
- Selection of discount rate
- Preparing required disclosures
- Similarity of P3s to leases
- 87 issues arising in year 2 of implementation
- Common questions/issues



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Terminology and Abbreviations

AICPA	American Institute of CPAs
BAML	Bank of America Merrill Lynch
CPE	Continuing Professional Education
EMMA	Municipal Securities Rulemaking Board's Electronic Municipal Market Access
FYE	Fiscal Year End
GASB	Governmental Accounting Standards Board
GAQC	Governmental Audit Quality Center
IG	Implementation Guide
IT	Information Technology
OAS	Option-Adjusted Spread
MD&A	Management discussion and analysis
PV	Present Value
SBITAs	Subscription-Based Information Technology Arrangements
SLGs	State and Local Governments



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- ▶ Overview of these specific GASB Standards



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Scope and Timing

GASB Statement No. 87, <i>Leases</i>	GASB Statement No. 96, <i>Subscription-Based Information Technology Arrangements (SBITAs)</i>
Establishes a single reporting model for lease accounting based on the foundational principle that leases are financings of the right to use an asset.	Establishes standards of accounting and financial reporting for SBITAs by a government end user.
Effective for annual reporting periods beginning after June 15, 2021, and interim periods beginning the year after. Apply retroactively to all periods presented.	Effective for periods beginning after June 15, 2022. Apply retroactively to all periods presented

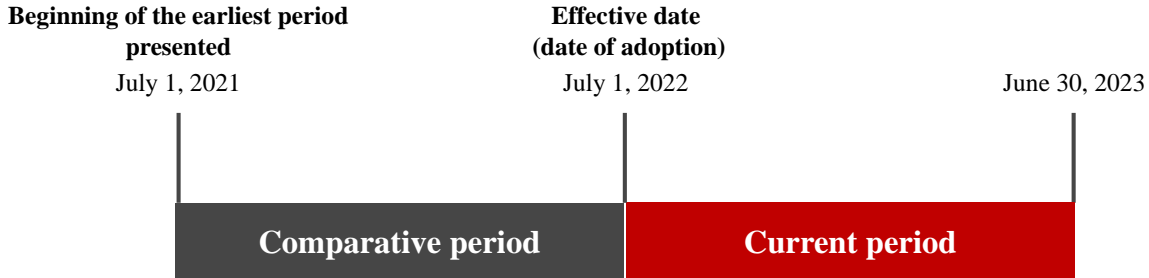
GASB Statement No. 96 amends GASB Statement No. 87 to exclude SBITAs from the scope of the Lease standard. Tangible capital assets associated with a SBITA that were recognized under GASB Statement No. 87 will be restated when GASB Statement No. 96 is adopted.



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SBITA Transition Considerations

- ▶ Following are relevant dates for a calendar year-end:

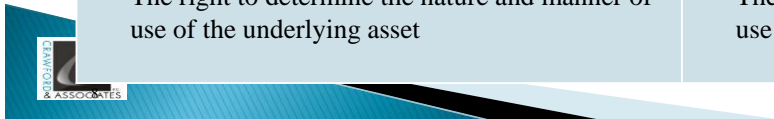


- ▶ Other considerations:
 - Use facts and circumstances that existed at the beginning of the earliest period restated, **NOT** the commencement date of the SBITA.



Definitions

Leases	SBITAs
A contract (e.g., an agreement between two or more parties that creates enforceable rights and obligations) that conveys control of the right to use another entity’s nonfinancial asset (the underlying asset) as specified in the contract for a period of time in an exchange or exchange-like transaction.	A contract that conveys control of the right to use another party’s (a SBITA vendor’s) IT software, alone or in combination with tangible capital assets (the underlying IT assets) , as specified in the contract for a period of time in an exchange or exchange-like transaction.
In order to “convey control of the right to use of the underlying asset”, a contract should have both of the following: <ul style="list-style-type: none"> • The right to obtain the present service capacity from use of the underlying asset • The right to determine the nature and manner of use of the underlying asset 	In order to “convey control of the right to use of the underlying asset”, a contract should have both of the following: <ul style="list-style-type: none"> • The right to obtain the present service capacity from use of the underlying IT asset • The right to determine the nature and manner of use of the underlying IT asset



Types of SBITAs

Short-Term SBITAs	All Other SBITAs
<ul style="list-style-type: none"> • Maximum possible term at commencement of the subscription term of 12 months or less • No recognition of subscription liability or subscription asset required • Short term payments are expensed as incurred 	<ul style="list-style-type: none"> • Subscription liability and subscription asset are recognized at the commencement of the subscription term



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Topics That Are The Same For Leases and SBITAs

- Lease/Subscription Term
- Short-Term Lease/SBITA
- General Recognition and Measurement
- Contracts with Multiple Components
 - Generally, account for lease (etc.) and non-lease (etc.) components as separate contracts and multiple underlying assets as separate lease (etc.) components
 - Allocate contract price to different components
- Modifications and Terminations



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► Is This Contract in Scope?



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What Is Excluded?



SBITAs

Contracts that solely provide IT support services

Contracts that convey control of the right to use another party's combination of IT software and tangible capital assets that meets the definition of a lease in GASB Statement No. 87, *Leases*, in which the software component is insignificant when compared to the cost of the underlying tangible capital asset

Governments that provide the right to use their IT software and associated tangible capital assets to other entities through SBITAs

Contracts that meet the definition of a P3 in GASB Statement No. 94, *Public-Private and Public-Public Partnerships and Availability Payment Arrangements*

Licensing arrangements that provide a perpetual license to governments to use a vendor's computer software, which are subject to Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*



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Relationship Between Leases and SBITAs

- All SBITAs meet definition of lease
- Accounting depends on what the underlying asset is:
 - Tangible capital assets alone – GASB Statement No. 87
 - IT software alone – GASB Statement No. 96
 - IT software in combination with tangible capital assets:
 - Software component is insignificant compared to cost of underlying tangible capital asset – GASB Statement No. 87
 - Otherwise – GASB Statement No. 96



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Multifunctional Printer

Features include:

- Printing, copying, scanning, faxing, and other tasks
- Software to connect to an IT system



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Intelligent Vehicles

- ▶ Features include:
- Autopilot
- Full self-driving capabilities



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Website Subscriptions

- ▶ Including:
- News services
- Bloomberg
- Morningstar



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Laptops

- ▶ Features include:
 - Operating software
 - Microsoft 365



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Cloud Computing Arrangements



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Software

▶ Including:

- Microsoft 365
- QuickBooks Online
- ERP Software



What about Software that automatically renews?

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▶ Overview of Accounting for Leases (Lessee) and SBITA

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Initial Reporting

	Assets	Liability
Leases (Lessee)	Intangible right-to-use lease asset = Lease liability plus prepayments and any ancillary costs to place asset to use	Lease liability = PV of expected lease payments over lease term
SBITA (End User)	Intangible right-to-use subscription asset = Subscription liability + prepayments + capitalizable initial implementation costs	Subscription liability = PV of expected SBITA payments over SBITA term



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Subsequent Reporting

	Assets	Liability
Leases (Lessee)	Amortize lease asset over shorter of useful life of asset or lease term	Reduce lease liability by principal portion of lease payments Recognize (accrue) interest payable
SBITA (End User)	Amortize subscription asset over shorter of useful life of IT asset or SBITA term	Reduce subscription liability by principal portion of SBITA payments Recognize (accrue) interest payable

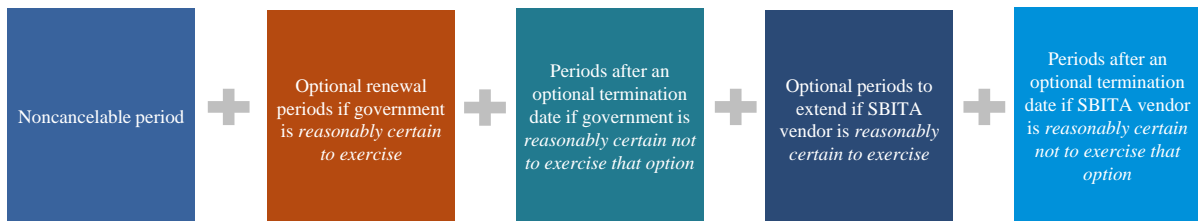


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Identifying and Documenting Key Provisions

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Subscription Term



The SBITA term excludes periods in which both the government and SBITA vendor have options to terminate regardless of probability.

Fiscal funding or cancellation clauses ignored *unless* reasonably certain of being exercised



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Exposure Draft – IG 2023

- ▶ 4.7. Q—Is a licensing agreement for a vendor’s computer software that automatically renews until cancelled a licensing agreement that provides a perpetual license?
- ▶ A—No. A provision under which a licensing agreement automatically renews until cancelled is an option to terminate the agreement at each renewal date. An agreement that includes an option to terminate is not a purchase, whereas a perpetual license is a purchase in which a government is granted a permanent right to use the vendor’s computer software. Therefore, a licensing agreement for a vendor’s computer software that automatically renews until cancelled does not provide a perpetual license.



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Subscription Payments

Subscription payments include:	
Fixed payments	\$ 200,000
Variable payments that depend on an index or rate	150,000
Variable payments fixed in substance	—
Termination penalties ¹	—
(Subscription contract incentives) ²	(—)
Any other payments ¹	—
Total subscription payments	\$ 350,000

¹ Included only if reasonably certain to be exercised/required.

² Subscription contract incentives receivable from the SBITA vendor after commencement of the subscription term are ordinarily a reduction (offset) in the calculation of total subscription payments.



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Initial Measurement of Subscription Liability

Subscription Liability <u>\$309,950</u>	=	PV of <i>Expected</i> SBITA Payments
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Payment Date	Amount
At Signing - Deposit	\$ 50,000
Beginning of Year 2	\$ 50,000
Beginning of Year 3	\$ 50,000
Beginning of Year 4	\$ 50,000
Beginning of Year 5	\$ 50,000
End of Year 5	\$150,000

The security deposit is not a SBITA payment.



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► Outlays Other Than Subscription Payments



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Accounting for Stages of Implementation

Preliminary Project Stage	Initial Implementation Stage	Operational & Additional Implementation Stage
<ul style="list-style-type: none"> • Outlays expensed as incurred 	<ul style="list-style-type: none"> • Outlays should be capitalized as part of the subscription asset • If no subscription asset is recognized (for example, short-term SBITA), outlays should be expensed as incurred 	<ul style="list-style-type: none"> • Outlays expensed as incurred unless they meet specific capitalization criteria

Outlays related to the implementation of the SBITA can overlap or occur in multiple cycles and are recognized based on the nature and timing of the outlay (activity).

Stages of Implementation

Preliminary Project Stage	Initial Implementation Stage	Operation and Additional Implementation Stage
<ul style="list-style-type: none"> • Conceptual formulation and evaluation of alternatives • Determination of the existence of needed technology • Final selection of alternatives for the SBITA 	<ul style="list-style-type: none"> • Ancillary charges related to designing the chosen path, such as configuration, coding, testing, and installation associated with the government's access to the underlying IT assets • Other ancillary charges necessary to place the subscription asset into service • Initial implementation stage completed when the subscription asset is placed into service 	<ul style="list-style-type: none"> • Maintenance, troubleshooting, and other activities associated with the government's ongoing access to the underlying IT assets • Additional implementation activities, such as those related to additional modules that occur after the subscription asset is placed into service

Data conversion is considered an activity of the initial implementation stage **only** when necessary to place the subscription asset into service. Otherwise, considered an activity of the operation and additional implementation stage.

Training cost are expensed as incurred, regardless of the stage the costs are incurred

Old But Applicable Guidance – Z.51.22

- ▶ Q—Statement 51 provides guidance for the treatment of outlays associated with data conversion and user training activities for internally generated computer software. How should such outlays be accounted for when the activities are associated with the acquisition of computer software that is not considered internally generated?
- ▶ ...Outlays associated with **data conversion activities** should be capitalized as an ancillary cost of the acquired computer software only if those activities are determined to be necessary to make the software operational. Otherwise, such outlays should be expensed as incurred. **Outlays associated with user training should not be considered an ancillary cost of acquired computer software**, and, therefore, those outlays should be expensed as incurred.






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- ▶ Separating Components and Allocating Contract Prices




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Separating Components

Step 1: Identify separate components 	<ul style="list-style-type: none"> • Contracts may contain multiple components (e.g., multiple pieces of equipment) • If components have different subscription terms, they must be accounted for separately • If underlying assets are in different major classes of assets for disclosure purposes, they must be accounted for separately Disclosure of major classes of subscription assets is not required. Required for Leases only!
Step 2: Identify any nonsubscription components 	<ul style="list-style-type: none"> • Nonsubscription components must be separated from subscription components and accounted for separately • Nonsubscription components should be accounted for under applicable nonsubscription guidance. Many times, these components are service contracts.
Step 3: Allocate the contract price 	<ul style="list-style-type: none"> • Use prices for individual components that are included in the contract, as long as not unreasonable • If contract doesn't include separate prices for individual components or they seem unreasonable, use judgment to determine the best estimate for allocation to each component, but always maximizing the use of observable information

 Nonsubscription components include separate perpetual licensing arrangement (excluded from GASB Statement No. 96) and maintenance services for the IT assets.

Separating Components: Allocating Contract Prices



1	Identify stated prices in contract
2	Evaluate whether stated prices are “not unreasonable” (using professional judgment and maximizing use of observable inputs)
3	Assign contract prices that are “not unreasonable” to individual components (if they are only associated with an individual component)
4	Allocate remaining contract prices to applicable components, if practicable (allocate based on best estimates, maximizing use of observable inputs)
5	Measure subscription liability (lessee) using contract prices for each lease component

 ASSOCIATES

▶ Selection of Discount Rate



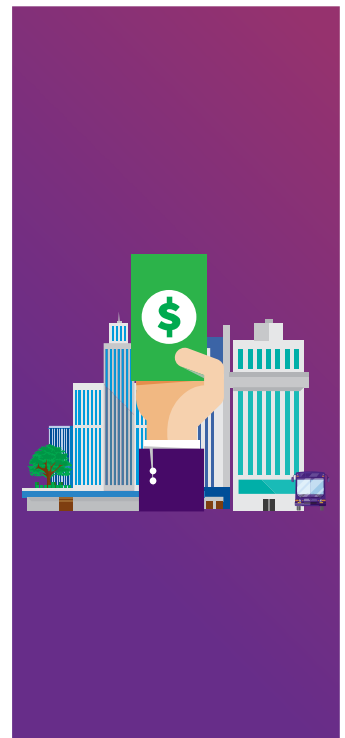
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Discount Rate

- Most SBITAs do not explicitly state SBITA vendor's rate
 - Even if it does, may be difficult to evaluate whether stated rate is reasonable
- Most governments (end users) will use their incremental borrowing rate
 - Will not be one size fits all (different rates across subscriptions)
 - Should be based on facts and circumstances of subscription (payment amounts, payment structure, length of subscription, etc.)
 - Will be significant effort in year of adoption, as well as subsequent periods
 - Helpful to develop yield curve for transition date



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Discount Rate: Determining Incremental Borrowing Rate

- Entity-specific rate that reflects the creditworthiness of a government
 - Start with debt issuance of government, debt issuance of a comparable government, or risk-free rate
 - Adjust for any financing specific items (credit rating, secured vs. unsecured, taxable vs non-taxable, collateral)
 - Adjust for specific terms (term, payment structure, payment amounts, geographical location)

BAML Ice Index has data on various government debt issuances, including different ratings, durations, types.



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► Preparing Required Disclosures



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Disclosures - SBITAs

- 1 General description of SBITA arrangements
- 2 Total amount of subscription assets, related accumulated amortization, separate from other capital assets
- 3 Amount of variable payments not previously included in liability
- 4 Amount of other payments not previously included in liability
- 5 Principal and interest requirements to maturity
- 6 Commitments under SBITAs before commencement date
- 7 Impairment loss and any related change in subscription liability

For disclosure purposes, SBITAs may be grouped. Disclosure of major classes of subscription assets is not required. Required for GASB Statement No. 87.



For disclosure purposes, subscription liabilities are not considered debt that is subject to disclosures required in GASB Statement No. 88, *Certain Disclosures Related to Debt, including Direct Borrowings and Direct Placements*.

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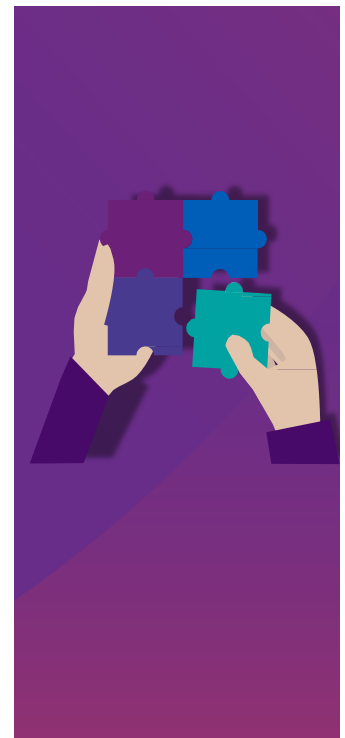
Key Considerations For Disclosures

Summary of Significant Accounting Policies

- Modification to basis of accounting
- Modification to capital assets
- New SBITA policy
- Modification to deferred outflows of resources/deferred inflows of resources (if applicable)

Where to include the new required disclosures

- New SBITA note; or,
- Modifications to the capital assets, long-term debt, and commitments note



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Example Disclosures

- ▶ **Intangible right-to-use lease and subscription IT assets**
- ▶ A summary of lease and subscription IT asset activity during the year ended June 30, 2023 is as follows:

	Balance beginning of year	Additions	Remeasurements	Deductions	Balance end of year
Lease assets:					
Buildings	\$				
Vehicles					
Equipment					
Total lease assets					
Less accumulated amortization:					
Lease assets:					
Buildings					
Vehicles					
Equipment					
Total accumulated amortization					
Total lease assets, net					
Subscription IT assets					
Less accumulated amortization					
Subscription IT assets, net					
Total lease and subscription IT assets, net	\$				

Note: In the year of implementation for GASB Statement No. 87 and 96, the balance at the beginning of the year *would not* include accumulated amortization.

Example Disclosures

- ▶ **Lease and subscription IT liabilities**
- ▶ A summary of the changes in the lease and subscription IT liabilities during the year ended June 30, 2023 is as follows:

	Balance beginning of year	Additions	Remeasurements	Deductions	Balance end of year	Amounts due within one year
Lease liabilities	\$					
Subscription IT liabilities						
Total	\$					

Example Disclosures

▶ **Capital assets**

▶ Capital asset activity for the year ended June 30, 2023 is as follows :

	Balance beginning of year	Additions	Deductions	Balance end of year
Capital assets being depreciated:	\$			
Building and building improvements				
Equipment				
Intangible assets				
Total capital asset being depreciated				
Less accumulated depreciation:				
Building and building improvements				
Equipment				
Intangible assets				
Total accumulated depreciation				
Total capital assets, net excluding lease and subscription IT assets	\$			
Lease and subscription IT assets, net (Note 7)				
Total capital assets, net as reported in the statement of net position				



Example Disclosures

▶ **Changes in long-term obligations**

▶ Changes in long-term obligations for the year ended June 30, 2023 are as follows :

	Balance beginning of year	Additions	Deductions	Balance end of year	Amounts due within one year
Bonds payable	\$				
General obligation bonds					
Special obligation bonds					
Revenue bonds					
Unamortized premiums					
Unamortized (discounts)					
Total bonds payable					
Other long-term obligations					
Certificates of participation					
Workers compensation					
Auto liability					
Pollution remediation obligations					
Net pension liability					
OPEB liability					
Total other long-term liabilities					
Total long-term obligations excluding lease and subscription IT liabilities	\$				
Lease and subscription IT liabilities (Note 7)					
Total long-term obligations as reported in the statement of net position					



▶ Common Questions



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Does the entity have to go back to the inception of the SBITA?

- No, it is not required. SBITAs are recognized and measured using the facts and circumstances that existed at the beginning of the fiscal year. However, if applied to earlier fiscal years, those assets and liabilities should be recognized and measured using the facts and circumstances that existed at the beginning of the earliest fiscal year restated



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Transition
Considerations

In the year of implementation is beginning net position always restated?

- Yes. GASB Statement No. 96 states, changes should be applied retroactively by restating the financial statements for all prior fiscal years presented, if practicable. If restatement is not practicable, the cumulative effect should be reported as a restatement of beginning net position (or fund balance/fund net position) for the earliest fiscal year presented.

Transition
Considerations



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If the financial statements are presented for a single year, does the MD&A need to be restated for the prior year?

- No. If single year financial statements are presented, the MD&A does not have to be restated for the prior year.

Transition
Considerations



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How does the entity estimate the incremental borrowing rate if they don't have any debt?

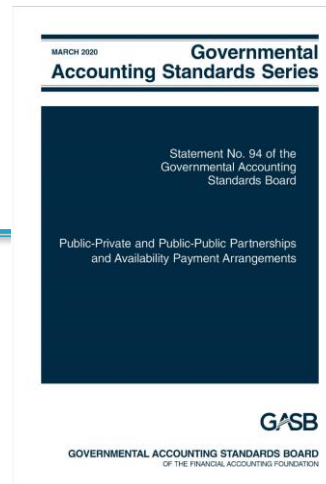
- Create or hire a firm to create a yield curve
- EMMA website
- BAML index
- Modify Treasury yield curve

Borrowing/
Discount rate



Public-Private and Public-Public Partnerships and Availability Payment Arrangements

Statement No. 94



P3s, APAs, and SCAs

What?

The Board issued guidance for public-private and public-public partnerships (P3s) that are not subject to Statements 60 or 87, and improvements to Statement 60

Why?

GASB research found that some P3 transactions are outside the scope of Statement 60 and identified opportunities to improve Statement 60's guidance for service concession arrangements (SCAs)

When?

Effective for reporting periods beginning after June 15, 2022



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Definitions: PPPs and APAs

Public-private partnerships and **public-public partnerships (P3s)** are arrangements “in which a government (the transferor) **contracts with an operator** [governmental or nongovernmental] to **provide public services** by conveying control of the **right to operate** a nonfinancial assets, such as infrastructure or other capital asset (the underlying PPP asset), for a period of time in an exchange or exchange-like transaction.”

Availability payment arrangements (APA):

- Government contracts with another entity to operate or maintain the government's nonfinancial asset
- Entity receives payments from the government based on the asset's availability for use
- Asset's availability may be based on the physical condition of the asset or the achievement of certain performance measures
- May include design, finance, construction, or service components



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APAs

An APA that is related to the design, finance, or construction of an infrastructure or other nonfinancial asset in which ownership of the asset transfers by the end of the contract would be reported as a financed purchase of the asset.

An APA that is related to operations would be accounted for as flows of resources (for example, expense) in the period to which the payments relate.



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P3s

Although sounds similar to a lease, the definition contains characteristics that the Board believes describe transactions in which a government is doing more than purchasing or financing a nonfinancial asset or entering into an arrangement to purchase services.

The operator in a P3 provides public services.

A P3 conveys control of the right to operate a nonfinancial asset.



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APAs

Transactions in which a government compensates an operator for activities that are related to designing, constructing, financing, maintaining, or operating a nonfinancial asset.

APAs are similar to P3s except that the government retains demand risk and responsibility for fee collection associated with the underlying asset.

Appendix C – Illustrations (state tollway, tunnel, & bridge)



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Transferor Reporting

For all P3s, recognize:

- Receivable for installment payments to be received, if any
- Deferred inflow of resources for the assets recognized, including payments received from the operator at or before start of the P3 term

If underlying P3 asset is a new asset or an existing asset that has been improved...

- ...and the P3 is an SCA: also recognize the capital asset at acquisition value when placed into operation
- ...and the P3 is not an SCA: also recognize a receivable for the capital asset, measured at operator's estimated carrying value as of the future date of the transfer in ownership



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Operator Reporting

For all P3s,
recognize:

- Liability for installment payments to be made, if any

If underlying P3 asset is (a) existing asset or improvement or (b) new asset and the P3 is an SCA...

- ...also recognize an intangible right-to-use asset

If underlying P3 asset is a new asset and the P3 is not an SCA...

- Also recognize the underlying P3 asset until ownership is transferred
- And a liability for the underlying P3 asset, measured at the estimated carrying value as of the future date of the transfer



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GASB 87: Year 2...Are We Done Yet?



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Topics

- ▶ General overview of GASB 87
- ▶ Areas of implementation issues
- ▶ Common Questions

- ▶ Open FAQ



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SCOPE – Is It Still A Lease?

- ▶ Applicability:
 - GASB Statement 94 - P3s
 - GASB Statement 96 – SBITAs
 - See next slide

- ▶ Require a review of leases identified in previous year to determine appropriate classification with adoption of Statements 94&96



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What is a lease?

A contract (e.g., an agreement between two or more parties that creates enforceable rights and obligations) that **conveys control** of the right to use another entity's **nonfinancial asset** (the underlying asset) as specified in the contract for a **period of time** in an **exchange or exchange-like transaction**.

- ▶ In order to “convey control of the right to use of the underlying asset”, a contract should have both of the following:
 - The right to obtain the present service capacity from use of the underlying asset
 - The right to determine the nature and manner of use of the underlying asset



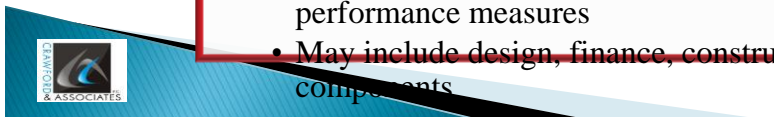
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What's a PPP (P3)

Public-private partnerships and **public-public partnerships (P3s)** are arrangements “in which a government (the transferor) **contracts with an operator** [governmental or nongovernmental] to **provide public services** by conveying control of the **right to operate** a nonfinancial assets, such as infrastructure or other capital asset (the underlying PPP asset), for a period of time in an **exchange or exchange-like transaction**.”

Availability Payment Arrangements (APA)

- Government contracts with another entity to operate or maintain the government's nonfinancial asset
- Entity receives payments from the government based on the asset's availability for use
- Asset's availability may be based on the physical condition of the asset or the achievement of certain performance measures
- May include design, finance, construction, or service components



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What's a SBITA?

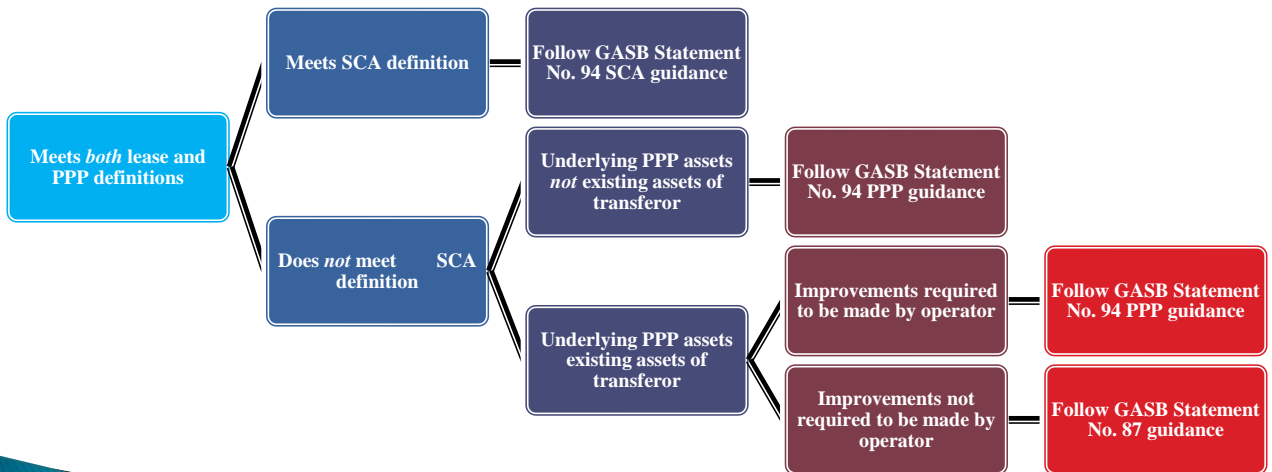
A subscription-based information technology arrangement (SBITA) “is a contract that conveys control of the right to use another party’s (a SBITA vendor’s) IT software, alone or in combination with tangible capital assets (the underlying IT assets) as specified in the contract for a period of time in an exchange or exchange-like transaction.”

To determine whether a contract conveys control of the right to use the underlying IT assets, a government should assess whether it has both:

- The right to obtain the present service capacity from use of the underlying IT assets as specified in the contract
- The right to determine the nature and manner of use of the underlying IT assets as specified in the contract.



Relationship Between Leases and PPPs



Relationship Between Leases and SBITAs

- All SBITAs meet definition of lease
- Accounting depends on what the underlying asset is:
 - Tangible capital assets alone – GASB Statement No. 87
 - IT software alone – GASB Statement No. 96
 - IT software in combination with tangible capital assets:
 - Software component is insignificant compared to cost of underlying tangible capital asset – GASB Statement No. 87
 - Otherwise – GASB Statement No. 96



**Wish we would
have implemented
early!!!!???**

**Transition
challenges**



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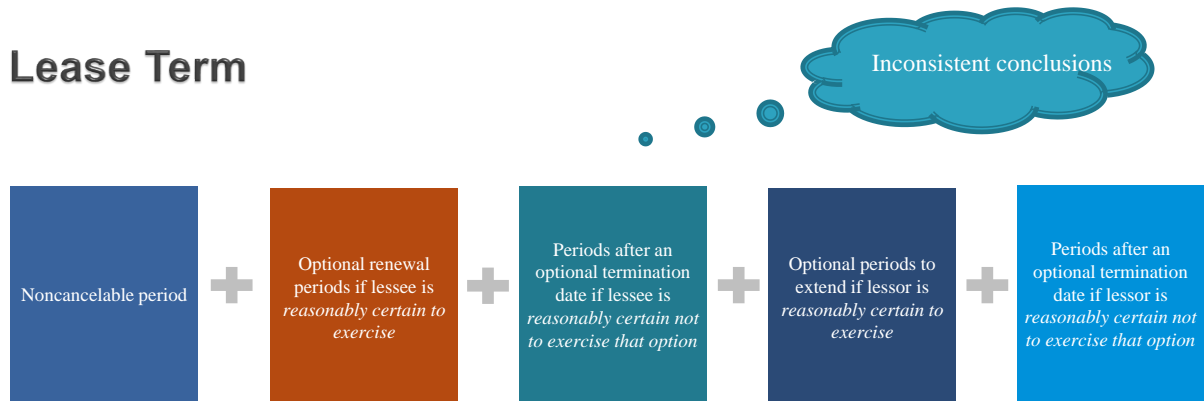
Completeness & the Population Year 2

- ▶ Start with existing population
 - Perform evaluation to determine if any impact from Stmts 94&96
 - Perform procedures to ensure evaluation of any new lease agreements
 - Perform procedures to identify any missed leases!
 - Never happens right!!!
 - Determine appropriate accounting (consideration of materiality, measurement)



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Lease Term



The lease term excludes periods in which both the lessee and lessor have options to terminate regardless of probability.

Fiscal funding or cancellation clauses ignored *unless* reasonably certain of being exercised



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Term vs Maximum Possible Term

- ▶ Lease Term – See previous slide
- ▶ Short-Term lease - Lease that has a “*maximum possible term*” under the contract, including any options to extend, of 12 months or less
 - Evaluation of 12 months or less (Q4.11 in IG 2021-1)
 - ...a three-year contract for the right to use a piece of equipment. However, the government only obtains the right to use the equipment from January through March for each of those three years...
 - Short-Term? Or Not Short-Term?



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Short-Term Considerations

- ▶ GASB Statement No. 99
 - Par. 12 - ... a lease that previously had been determined to be short-term and that has been modified to extend the initial maximum possible term under the lease contract should be reassessed from the inception of the lease.
 - If reassessment is greater than 12 months – No Longer Short-Term!
 - Lease term to be assessed at the date of modification for measurement of receivable/liability



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Reassessment of Lease Term

- ▶ Reassess the lease term only if one or more of the following occurs:
 - Lessee or lessor elects to exercise an option even though originally determined that the lessee or lessor would not exercise that option
 - Lessee or lessor elects to not exercise an option even though previously determined that the lessee or lessor would exercise that option
 - An event specified in the contract that requires an extension or termination of the lease takes place



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Perpetual/Automatic Renewal

- ▶ Common question – “Period of Time” if a contract automatically renews and there is no specific end date, is this outside the scope of the lease definition?
 - No, provision under which the licensing agreement automatically renews until cancelled is an option to terminate
 - Proposed IG 2023-1



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Term - Cancellable

- ▶ What is really *Cancellable*? Does probabilities matter?
 - If contract gives either party the option to cancel, even if it is highly unlikely that they wont, it is a cancellable period (Q4.15 in IG 2019-3)
- ▶ What if there is a termination penalty? What if penalty is significant? (Q4.15 in IG 2019-3)



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Termination Options

- ▶ GASB 99 – application of par 12 of 87:
 - Option to terminate is an unconditional right that exists within the lease contract
 - Termination based on certain circumstances are not considered termination options:
 - Due to violation of contract provisions (terms and conditions)
 - Default on payment



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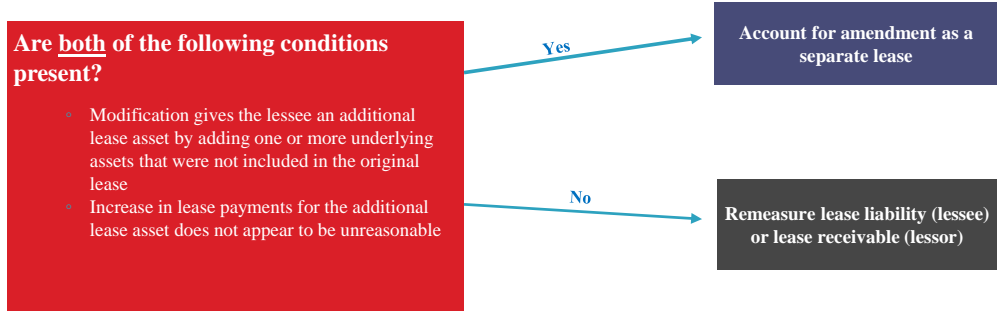
Lease Termination

Lessee	Lessor
<ul style="list-style-type: none"> • Reduce the carrying values of the lease asset and lease liability 	<ul style="list-style-type: none"> • Reduce the carrying values of the lease receivable and deferred inflow of resources
<ul style="list-style-type: none"> • Recognize a gain or loss for the difference 	<ul style="list-style-type: none"> • Recognize a gain or loss for the difference
<ul style="list-style-type: none"> • Exception: If the termination occurs because the lessee purchases the underlying asset, then the lease asset should be reclassified to the proper asset class 	<ul style="list-style-type: none"> • Exception: If the termination occurs because the lessee purchases the underlying asset, then the carrying value of the underlying asset should be derecognized and included in the resulting gain or loss



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Lease Modifications



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Lease modifications



Q—In Question 4.67 in Implementation Guide 2019-3, the school district remeasures the lease liability. Does that remeasurement require reassessment of the discount rate?

A—Yes. In accordance with paragraph 73 of Statement 87, a lease modification requires remeasurement of the lease liability. A remeasurement because of a lease modification is the same as reperforming an initial measurement. Therefore, reassessment of the discount rate is required.



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Options vs New Contract

- ▶ Not just semantics – Can affect the accounting!
- ▶ If renewal is an option within the contract *versus* there being a new contract:
 - Could change the short-term lease evaluation (Q4.10 in IG 2020-1) –
 - Q—A governmental housing authority enters into a 12-month residential lease contract that states the lessee may renew. If the lessee decides to renew, the housing authority and the lessee will enter into a separate lease contract at a later date for the subsequent 12-month period. Is the existing 12-month residential lease contract a short-term lease under Statement 87?
 - It determines whether renewal history matters – it matters if there is a renewal option and it does not matter if it is a new contract (Q4.11 in IG 2020-1)
 - Q—A city leases boat slips in its marina to boat owners. Each lease is for 12 months and does not contain an option to extend. A certain boat owner has signed a new lease every year for the past 20 years, and the city expects her to continue to do so. Is this a short-term lease?



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Transfer of Ownership

- ▶ Transfers ownership of the underlying asset to the lessee by the end of the contract and does not contain termination options
 - Exclude non-appropriation clause
 - These will meet the definition of debt – GASB Stmt 88
- ▶ Common question Bargain Purchase Options:
 - Basis of conclusions – Stmt 87 par B14.:
 - “.. the Board concluded that a lease that contains any purchase option, including a bargain purchase option, should not be treated as a financed purchase or sale until that option is exercised.”



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Existing Leases – Don't set it and forget it!

- ▶ Don't just roll information to the next year!
- ▶ Determine if existing lease terms are still applicable:
 - Any leases terminated?
 - Any lease terms modified?
 - Type of modification
 - What about assumptions used to evaluate options?
 - Did assumption occur?
 - Did assumption not occur?
 - Did my basis of evaluation change? Do I care 😊



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Considerations - Preparer

- ▶ Completeness ex.
- ▶ Establish key individual(s) to be responsible for leases
- ▶ Consideration for Centralized vs Decentralized data/support
 - Consider centralized data collection
 - Better understating for Year 2
- ▶ Policy/Procedures
 - Term – Options/Evaluation
 - Multiple Components - observable information, writing of contracts to included stated prices, professional judgement
 - Discount rate setting – process/how to determine
 - Materiality – reporting unit/opinion unit consideration
 - Capitalization



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Considerations - Auditor

- ▶ Completeness ex.
- ▶ Inquire of management and key individuals within organization to determine process and controls surround development of lease inventory
 - Including materiality consideration - Lease asset and lease liability
 - Procedures/assessment of expiring or terminated leases
 - Contracts/agreements determined to not be a lease and appropriateness



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Considerations - Auditor

- ▶ Completeness ex.
- ▶ Based on risk/procedure considerations:
 - Review board minutes and approvals
 - Scan gl detail and accounts that may be indicative of lease/rental payments/receipts (review support to ensure not a lease)
 - Evaluate lease contracts from population identified: conclusions where appropriate
 - Evaluate contracts concluded not to be leases: conclusions where appropriate (be aware of the embedded leases)



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Common Issues - Statement Presentation

- ▶ Classified Format:
 - Current/Non-Current presentation
 - Required for enterprise funds
- ▶ Leased assets – not reported as capital assets
- ▶ Reclassification of current year payments
 - Payments made on leases are debt service
 - Principal & Interest
- ▶ Current year activity – Lessee
 - New leases result in recognition of an expenditures and other financing source



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Common Issues - Note Disclosures

- ▶ Missing or inaccurate note disclosures, including –
 - Accounting policy descriptions
 - Capital assets – policies/thresholds inclusion of right to use assets (leased assets)
 - Deferred inflows of resources – existing disclosures not addressing those resulting from lessor agreements
 - Use of old lease language
 - Leasing arrangements – completeness of required disclosures
 - Lessee and Lessor
 - Regulated leases
 - Capital Asset Disclosures
 - Long-term Obligations
 - Over disclosing:
 - Are you an over disclosure?



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Disclosures - Lessees

- | | |
|---|---|
| <p>1 General description of leasing arrangements</p> <hr/> <p>2 Total amount of lease assets, related accumulated amortization</p> <hr/> <p>3 Amount of lease assets by major classes of underlying assets</p> <hr/> <p>4 Amount of variable payments not previously included in liability</p> <hr/> <p>5 Amount of other payments not previously included in liability</p> | <p>6 Principle and interest requirements to maturity</p> <hr/> <p>7 Commitments under leases before commencement date</p> <hr/> <p>8 Impairment loss and any related change in lease liability</p> |
|---|---|

Additional disclosures are required for any sublease transactions, sale-leaseback transactions and lease-leaseback transactions, if applicable.



What about capital asset or long-term liabilities disclosures?



Disclosures: Lessee

Q—Should lease assets be included in the disclosure of changes in capital assets?

A— Yes. Lease assets are capital assets and, therefore, should be included in the disclosure of changes in capital assets. Paragraph 37c of Statement 87 requires lessees to disclose “the amount of lease assets by major classes of underlying assets. . . separately from other capital assets.” Paragraphs 116 and 117 of GASB Statement No. 34, as amended, require disclosure of information about major classes of capital assets, including disclosure of changes in capital assets.

Similarly, changes in the lease liability should be included in the long-term liabilities roll forward as required by GASB Statement No. 34.



**GASB IG
2019-3,
Q 4.41**

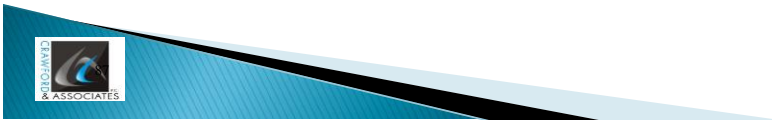
Disclosures - Lessor

- 1 General description of leasing arrangements

- 2 Amount of inflows of resources recognized, if amount cannot be determined from face financial statements

- 3 Amount of inflows of resources recognized for variable and other payments not previously included in lease receivable

- 4 Existence, terms and conditions of lessee options to terminate lease or abate payments if lessor has issued debt which is secured by lease payments



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Disclosures – Lessor (continued)

Relevant disclosures should be provided for the following, if applicable:

- Leases of assets that are investments
- Certain regulated leases
- Sublease transactions
- Sale-leaseback transactions
- Lease-leaseback transactions

If the lessor's principal ongoing operations consist of leasing assets to other entities, a schedule of future payments that are included in the measurement of the lease receivable for each of the next five years and in five-year increments thereafter should be provided



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Regulated Leases

- ▶ Lessors would scope out from balance sheet impact if the following criteria are met:
 - Lease rates cannot exceed a reasonable amount, with reasonableness being subject to determination by an external regulator
 - Lease rates should be similar for lessees that are similarly situated
 - The lessor cannot deny potential lessees the right to enter into leases if facilities are available, provided that the lessee's use of the facilities complies with generally applicable use restrictions



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Regulated Leases

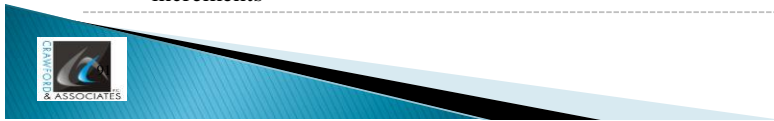
- ▶ Specific examples provided by GASB 87:
 - U.S. Department of Transportation and the Federal Aviation Administration regulate aviation leases between airports and air carriers and other aeronautical users
 - Meet criteria of aeronautics – out of financial statement recognition for receivable/D.Inflow
 - Not aeronautics – would be applicable to GASB 87 recognition
 - Cell tower agreements
 - Concessionaire agreements
 - Other Property/land/building agreements
 - Ex. Rental Car – property/office space agreements



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Disclosures – Regulated Leases

- 1 General description of leasing arrangements
- 2 Extent to which capital assets are subject to preferential or exclusive use (by class of asset/major counterparty)
- 3 Amount of inflows of resources recognized, if amount cannot be determined from face financial statements
- 4 Amount of inflows of resources recognized for variable and other payments not included in expected future minimum payments
- 5 Existence, terms and conditions of lessee options to terminate lease or abate payments if lessor has issued debt which is secured by lease payments
- 6 Schedule of expected future minimum payments under these agreements for each of the subsequent five years and in five-year increments



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Regulated Leases

- ▶ Q—A port authority is a marine terminal operator as defined by the Federal Maritime Commission. The United States Shipping Act requires, in part, that a “marine terminal operator may not (1) agree with another marine terminal operator or with a common carrier to boycott, or unreasonably discriminate in the provision of terminal services to, a common carrier or ocean tramp; (2) give any undue or unreasonable preference or advantage or impose any undue or unreasonable prejudice or disadvantage with respect to any person; or (3) unreasonably refuse to deal or negotiate.” For leases subject to those regulations, has the requirement in paragraph 43c of Statement 87 been met?
- ▶ A—**Yes.** Paragraph 43c of Statement 87 requires prohibition of unjust discrimination in leasing. The requirements of the United States Shipping Act quoted above related to terminal services meet that requirement.



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Intra Entity/Related parties

- ▶ Leases with/between blended component units
 - Eliminations for internal leasing activity take place before the financial statements are aggregated
- ▶ Leases with/between discretely-presented component units
 - Treat like normal leases, but - present receivables and payables separately
- ▶ Leases between ISF and departments/governmental funds
 - Doesn't convey control of another legal entities assets – not within scope
 - (Q4.4 in IG 2021-1)
- ▶ Recognize substance of the transaction, when substance is significantly different from legal form
 - For example, intent of short-term agreement is long-term
 - Disclose the nature and extent of related-party leases



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Materiality

- ▶ Year 2: Considerations:
 - Est. Materiality for year 2:
 - Reminder materiality considerations by aggregate (Q4.23 of IG 2019-3)
 - Receivables/Deferred inflows – Lessor
 - Capital Assets/Liabilities by Lessee
 - Capital Assets – (Q5.1 of IG 2021-1)
 - directing governments to capitalize the **collective** amount if material in total
 - Prior year leases determined to be immaterial
 - Consider Prior & Current year leases not recognized in the aggregate
 - Consider amounts by reporting unit as a preparer
 - Consider amounts by Opinion unit as an auditor



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Questions?

