

GASB 87: Leases

What Preparers & Auditors Need to Know to be Ready for Implementation
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WHY IS THIS A BIG DEAL???

<p>GOVERNMENTS ARE LESSEES</p> <ul style="list-style-type: none"> • Global Change (including FASB / International) • 89,000 governments+ may be effected, including Tribal Nations • Existing GAAP largely from the 1970's (if not before) • GASB-62 adopted mostly FASB-13 (GASB Cod Sec. L20) 	<p>GOVERNMENTS ARE LESSORS</p> <ul style="list-style-type: none"> • Airports • Stadiums • Parks & Recreation • Ports / marinas • Utilities • Institutions of Higher Education
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*Governments may be **both** Lessees and Lessors!*



Existing gaap is something ingrained...

- Capital leases have the 'famous 4' that if one are hit, it's capitalized - akin to financed purchases -
 - The present value of the minimum lease payments is 90% (or more) of fair value at inception
 - Lease term is 75% (or more) of asset economic life
 - There is a bargain purchase option - often \$1
 - Ownership transfers at conclusion - cost is sometimes embedded in liability
- All others are operating
- Disclosure:
 - Capital leases - minimum payments
 - Operating leases, expenses / expenditures
 - Noncancelable leases disclose minimum payments
- Problem - many operating leases in government are really noncancelable - current accounting does not meet GAAP definition of a liability (present obligation with little or no discretion to avoid)



Existing GAAP for leases

- › GASB Codification Section L20 – Leases
 - NCGA Statement 5, *Accounting and Financial Reporting Principles for Lease Agreements of State and Local Governments*
 - GASB Statement 13, *Accounting for Operating Leases with Scheduled Rent Increases*
 - GASB Statement 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*



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Leases – The Main Points!

- › No classification of leases into operating/capital or other categories
- › Underlying assumption that leases are financings
- › Exceptions (lessors and lessees)
 - Short-term leases
 - Leases that transfer ownership and do not contain termination options
- › Exceptions for lessors
 - Leases of assets that are investments
 - Certain regulated leases (e.g., airport-airline agreements)



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Definition of a Lease

A contract that conveys control of the right to use another entity's nonfinancial asset (the underlying asset) as specified by the contract for a period of time in an exchange or exchange-like transaction.



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Definition of a lease

Control requires both of the following:

1. the right to obtain the present service capacity from use of the underlying asset, and
2. the right to determine the nature and manner of use of the underlying asset

Control applied to the right-to-use lease asset (a capital asset) "specified in the contract"

- Control criteria NOT limited to contracts that convey substantially all of the present service capacity from use of the underlying asset
- Right-to-use lease assets include rights to use underlying assets for portions of time, such as certain days each week or certain hours each day



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Leases scope exclusions

Intangible assets (mineral rights, patents, software, copyrights)

- Except for the sublease of an intangible right-to-use asset

Biological assets (including timber, living plants, and living animals)

Inventory

Service concession arrangements (See GASB Statement 60)

Assets financed with outstanding conduit debt unless both the asset and conduit debt are reported by lessor

Supply contracts (such as typical power purchase agreements, which do not convey control of the right to use the underlying power generating facility)

Software - Current guidance see Question Z.51.21 - Multiyear agreement requires recognition of Intangible Asset and a long-term liability (current guidance)

GASB Project - Future recognition based on Subscription Based IT Arrangements (SBITAs)

Tentative decisions have been made that are currently similar to Smt 07



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Contracts that transfer ownership exception

If a contract

- Transfers ownership of the underlying asset to the lessee by the end of the contract **AND**
- Does not contain termination options (other than fiscal funding or cancellation clauses)

This type of contract is not a lease and should be reported as a financed purchase

These contracts are not subject to the measurement or financial reporting requirements of the Leases statement



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Contracts that transfer ownership exception

▶ “At the end of such term LESSEE shall acquire legal title to the Vehicles and terminate this Lease with respect thereto by paying to LESSOR all amounts that are due and unpaid hereunder and the remaining principal balance with respect to such Vehicles as shown on the Schedule relating thereto.”

3. TERM AND RENT. The Lease term shall commence as of the date that the Vehicles are delivered to LESSEE, or LESSOR's Agent (the "Commencement Date") and shall continue for the term shown on the attached Schedule relating thereto, unless Lessee notifies LESSOR that an Event of Non-appropriation (described below) has occurred or LESSEE exercises its option under Section 15. At the end of such term LESSEE shall acquire legal title to the Vehicles and terminate this Lease with respect thereto by paying to LESSOR all amounts then due and unpaid hereunder and the remaining principal balance with respect to such Vehicles as shown on the Schedule relating thereto. In lieu of such payment LESSOR hereby grants LESSEE the option to renew this Lease with respect to such Vehicles for the additional period as shown on the Schedule relating thereto, provided that the rate of interest applicable to such additional period shall be mutually agreed upon by LESSOR and LESSEE. LESSEE shall give written notice to LESSOR at least ninety (90) days prior to the end of the Lease term as to whether it will terminate this Lease and acquire the Vehicles or exercise its option to renew in accordance with the Section 3. LESSOR shall endeavor to give written notice to LESSEE at least sixty (60) days prior to the end of the Lease term if no such notice has been received from LESSEE. The rent under this Lease shall be payable in lawful money of the United States of America, from any and all legally available funds, and at the times and in the amounts as indicated on each attached Schedule. In lieu of cash, LESSOR will accept payment for checks or wire transfer of immediately available funds only. **Such payment will constitute a retention and interest commitment.**



Lease term – when does it start/end for financial reporting purposes?

Starts with the noncancelable period, plus periods covered by lessees' and lessors' options to:

- Extend the lease, if the option is reasonably certain of being exercised
- Terminate the lease, if the option is reasonably certain of NOT being exercised

Excludes “cancelable” periods

- Periods for which lessee and lessor each have the option to terminate or both parties have to agree to extend
 - Rolling month-to-month leases

Fiscal funding/cancellation clauses ignored unless reasonably certain of being exercised



Lease term – example

Step 1

Determine the noncancelable period

Contract provides the government control of the right-to-use a bus for 3 years.

After three years, there is an option to extend for 2 years

After two years, the government can terminate the lease



Lease term - example (cont.)

Step 1 Determine the noncancelable period - 2 years

Step 2 Assess the options

Contract provides the government control of the right-to-use a bus for 3 years.
After three years, there is an option to extend for 2 years
After two years, the government can terminate the lease

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Lease term - example (cont.)

Step 1 Determine the noncancelable period - 2 years

Step 2 Assess the options
Is it reasonably certain the termination option will be exercised by the government?

Contract provides the government control of the right-to-use a bus for 3 years.
After three years, there is an option to extend for 2 years
After two years, the government can terminate the lease

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Lease term - example (cont.)

Step 1 Determine the noncancelable period - 2 years

Step 2 Assess the options
Is it reasonably certain the termination option will be exercised by the government? **NO**
Is it reasonably certain the option to extend will be exercised by the government?

Contract provides the government control of the right-to-use a bus for 3 years.
After three years, there is an option to extend for 2 years
After two years, the government can terminate the lease

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Lease Term - example (cont.)

Step 1 Determine the noncancelable period - 2 years

Step 2 Assess the options

Is it reasonably certain the termination option will be exercised by the government? **NO**

Is it reasonably certain the option to extend will be exercised by the government? **YES**

Contract provides the government control of the right-to-use a bus for 3 years. After three years, there is an option to extend for 2 years. After two years, the government can terminate the lease

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Lease term - example (cont.)

Lease Term - Example	
Noncancelable period	Years 1 - 2
+ Period covered by option to terminate when it is NOT certain to be exercised	Year 3
+ Period covered by Option to Extend when it is reasonably certain to be exercised	Year 4 - 5
Total Lease Term	5 Years

Contract provides the government control of the right-to-use a bus for 3 years. After three years, there is an option to extend for 2 years. After two years, the government can terminate the lease

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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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Short-term lease exception

- ▶ A *short-term* lease is one that, at the beginning of the lease, has a "maximum possible term" under the contract, including any options to extend, of 12 months or less
- ▶ Practicality exception for short-term leases
 - For a lease that is cancelable either by the lessee or lessor, such as month-to-month or year-to-year leases, the maximum possible term is the noncancelable period including any notice period

No Balance Sheet Impact

No disclosures required

Flows statements reflect the activity based on contract provision

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Contracts with multiple components

- Separate contracts into lease and non-lease components or multiple lease components
- Allocate consideration to multiple underlying assets if:
 - Service components of contract
 - Differing lease terms, or
 - Are in differing major asset classes for disclosure

Consider **Contract Combinations** when reviewing Multiple Components

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Contracts with multiple components

Allocation process:

- Identify individual components, are they reasonable?
- Maximize observable information
- Estimate using professional judgment
- If not practicable to determine best estimate, may account for components as single lease unit

No Policy provision in Standard

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LESSEE – bus lease example,

Multiple contract components

- Lease agreement requires the government to pay an additional \$500 per quarter for maintenance, including oil change, tune ups, etc. for each bus?
- Should that be included in the lease liability? **NO**
- Does \$500 per quarter for five buses seem reasonable? **YES**
- Is it identifiable in the contract? **YES**




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Initial & Subsequent reporting

	Party	Assets	Liabilities	Deferred Inflow of Resources
Initial Reporting	Lessee	Intangible asset (lease liability + prepayments + initial direct costs placed into use)	Present value of future lease payments (FV of variable, including guarantees etc.)	None
	Lessor	Lease receivable, capital asset remains on books	Should be none	Lease receivable + cash that relates to future period (e.g. last month's rent)
Subsequent Reporting	Lessee	Amortize intangible over shorter of useful life or term of lease	Reduce by lease payments (effective interest)	None
	Lessor	Depreciate capital asset unless required to be returned in original or better condition Reduce receivable, taking into account accrued interest	Should be none	Recognize revenue in effective interest method (systematic & rational)

Lease liability does not include lease payments that are dependent on lessee's performance or usage of underlying asset

Lease liability payments discounted using the rate the lessor charges the lessee (may be implicit) or, if that rate cannot be readily determined, the lessee's incremental borrowing rate

Lessor continues to report capital asset

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LESSEE—disclosures

- A general description of leasing arrangements, including:
 - Basis, terms, and conditions, on which variable lease payments are determined
 - Existence, terms, and conditions of residual value guarantees provided by the lessee
- Total amount of assets recorded under leases, and the related accumulated amortization, disclosed separately from other capital assets
- Lease assets disaggregated by major classes of underlying assets, disclosed separately from other capital assets
- Variable lease payments recognized during the period but not previously included in the lease liability



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LESSEE—disclosures

- e. Other payments recognized during the period but not previously included in the lease liability (such as residual value guarantees or penalties)
- f. A maturity analysis of all future lease payments
 - Payments for each of the first five years
 - Payments in five-year increments thereafter
 - Show principal and interest separately
- g. Lease commitments, other than short-term leases, for which the lease term has not yet begun
- h. Components of any net impairment loss (gross impairment loss less change in lease liability)



LESSEE – bus lease disclosure example

Capital Assets – Year 2	Beginning Balance	Additions	Deletions	Ending Balance
Capital assets not being depreciated				
Land	\$ 1,000,000	\$ -	\$ -	\$ 1,000,000
Total Capital Assets not being depreciated	1,000,000	-	-	1,000,000
Capital assets being depreciated / amortized				
Building	5,000,000	500,000	-	5,500,000
Equipment	400,000	38,000	10,000	428,000
Leased Building (Intangible asset)	500,000	100,000	-	600,000
Leased Vehicles (Intangible asset)	163,451	-	-	163,451
Total capital assets being depreciated / amortized	6,003,451	638,000	10,000	6,629,451
Less: Accumulated depreciation for				
Building	3,300,000	110,000	-	3,410,000
Equipment	340,800	28,400	10,000	359,200
Less: Accumulated amortization for				
Leased building	20,000	20,000	-	40,000
Leased vehicles	20,680	20,690	-	41,380
Total depreciation and amortization	3,681,480	179,090	10,000	3,860,580
Net capital assets being depreciated and amortized	2,321,961	458,910	-	2,778,871
Total, net of accumulated depreciation	\$ 3,321,961	\$ 458,910	\$ -	\$ 3,778,871



Impact on Net Investment in Capital Assets

LESSOR – exceptions

Two main transactions do not apply the general lessor recognition and measurement guidance (but still required to provide certain disclosures)

- Leases of tangible assets that are investments
 - No lease receivable reported for leased investment assets because investments are reported at fair value
- Certain regulated leases (e.g., airport-airline agreements)
 - Airport-airline agreements have features that don't operate like financings



LESSOR – disclosures

Lease activities may be grouped for disclosure purposes

- a. A general description of leasing arrangements
 - The basis, terms, and conditions on which variable lease payments not included in the lease receivable are determined
- b. The total amount of inflows recognized in the reporting period related to leases, if not displayed on face of financials



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LESSOR – disclosures

- c. The lease inflows related to variable lease payments and other payments not previously included in the lease receivable
 - o Include inflows related to residual value guarantees and termination penalties
- d. If lease payments secure lessor's debt:
 - o The existence, terms, and conditions of options by the lessee to terminate a lease or abate lease payments

Similar disclosures required for certain regulated leases (airport-airline agreements)



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LESSOR – disclosures

If government's *principal ongoing operations* consist of leasing to other entities,

- Disclose maturity analysis of all future lease payments included in lease receivable
 - Payments for each of the first five years
 - Payments in five-year increments thereafter
 - Show principal and interest separately



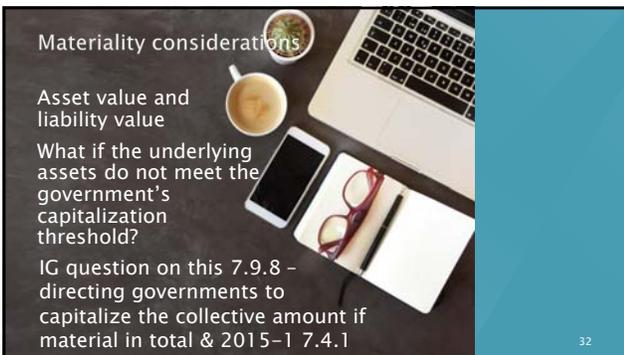
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Considerations for Implementation



Materiality considerations

Asset value and liability value
What if the underlying assets do not meet the government's capitalization threshold?
IC question on this 7.9.8 – directing governments to capitalize the collective amount if material in total & 2015-1 7.4.1



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Implementation ideas

- Start reviewing existing leases as soon as possible
- Implement IC to identify leases & lease modifications
- Update accounting systems for new information needs
- Consider impact on capitalization policy
- Consider impact on reporting lease liabilities on:
 - Debt limitations
 - Bond covenants
 - Grant agreements



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Effective date & transition

Effective for periods beginning after December 15, 2019

- Earlier application encouraged

Transition

- Apply retroactively
 - Restate if practicable, cumulative effect if not
- Leases recognized and measured *using the facts and circumstances that exist at the beginning of the period of implementation* (hindsight)
- Lessors should not restate the assets underlying their existing sales-type or direct financing leases
 - Any residual assets for those leases would become the carrying values of the underlying assets




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Other accounting and reporting provisions

Lease Incentives	Intra—Entity Leases
Subleases	Leases Between Related Parties
Sale—Leasebacks	
Lease—Leasebacks	




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LEASES Implementation Guide EXPOSURE DRAFT TOPICS

- Comments Due April 30 – 80 Questions, 3 – Illustrations
- Scope and Applicability
- Lease term
- Short-term leases
- Contracts that transfer ownership
- Lessee recognition and measurement (other than short-term leases and ownership transfers)
- Notes – lessees
- Lessor recognition and measurement (other than short-term leases and ownership transfers)
- Notes – lessors
- Incentives
- Multiple components
- Combinations
- Modifications and terminations
- Sale – leaseback transactions
- Lease – leaseback transactions
- Intra-entity leases
- Transition and effective date

