State of West Virginia
FARS Annual Closing Book Training

A closer look at the new leases standard – GASB 87

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Objectives

- Identify impact of lease accounting changes on governments
- Recognize potential implementation concerns or considerations regarding leases

Agenda

Overview

Scope and scope exceptions

Key concepts

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Overview

- The Governmental Accounting Standards Board (GASB) issued Statement 87 in 2017 to establish a single model for lease accounting based on the principle that leases are financings of the right to use an underlying asset
- The standard eliminates the distinction between operating and capital leases and brings substantially all leases on the statement of net position
- It changes the presentation in the statement of activities and cash flow statement
- The key difference between GASB 87 and existing GASB guidance on leases relates to lease classification and recognition in the financial statements
- Under the existing standards, organizations do not reflect operating lease agreements within the statement of net position
- The new guidance is effective for fiscal years beginning after 15 June 2021 and all reporting periods thereafter and will be applied retroactively by restating financial statements, if practicable, for all prior periods presented
- Adopting the standard may require a significant effort upfront
- To sustain compliance, an entity will likely need to develop new processes and controls or adjust existing ones to identify and account for leases

Overview
Highlights of the new standard for lessees

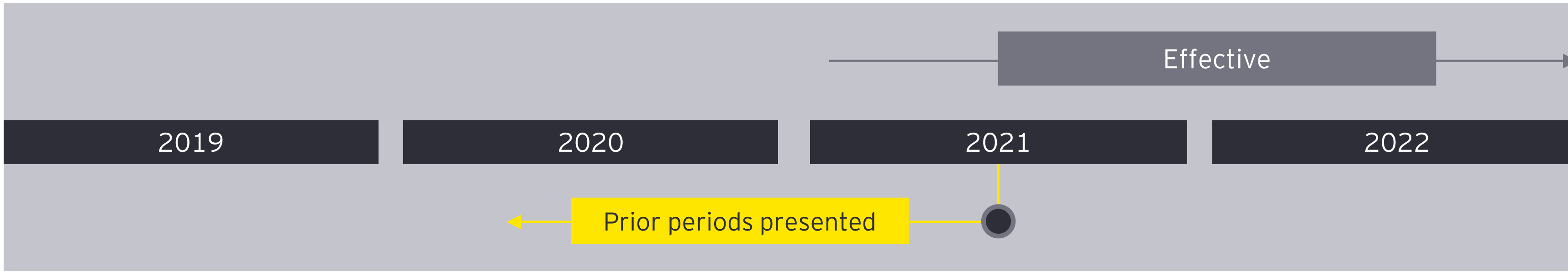
1	Leases on statement of net position	▸ Required to recognize a lease liability and an intangible right-to-use ("RTU") lease asset for virtually all leases, generally measured at the present value of lease payments expected to be made during the lease term
2	Statement of activities	▸ Interest expense on the lease liability and amortization expense on the lease asset to be appropriately reflected
3	Cash flows	▸ Cash flows (including the interest portion) should be included in capital and related financing activities as an outflow in the lessee's statement of cash flows
4	Disclosures	▸ New qualitative and quantitative disclosure requirements, including variable payments not included in measurement of liability

Overview

Highlights of the new standard for lessors

1	Leases on statement of net position	▶ Required to recognize a lease receivable and a deferred inflow of resources, in most cases, generally measured at the present value of lease payments expected to be received during the lease term
2	Statement of activities	▶ Lessor should recognize interest revenue on the lease receivable and an inflow of resources (for example, revenue) from the deferred inflows of resources
3	Cash flows	▶ Classify inflows consistent with how the underlying asset is classified on the statement of net position, that is, as an investing or capital and related financing activity
4	Disclosures	▶ New qualitative and quantitative disclosure requirements, including variable payments not included in measurement of lease receivable

Overview
Effective date and transition



- The provisions of this Statement are effective for fiscal years beginning after June 15, 2021 and all reporting periods thereafter
  - The provisions of this Statement should be applied retroactively by restating financial statements, "if practicable", for all prior periods presented
  - Statement also encourages early application
  - Leases should be recognized and measured using the facts and circumstances that exist at the beginning of the period of implementation (or, if applied to earlier periods, the beginning of the earliest period restated)
  - Disclosures in the notes of financial statement in the first period of implementation
    - Nature of the restatement and its effect
    - Reason for not restating prior periods presented

Overview

Illustration – Effective date and transition

Fact pattern: In a period prior to the implementation of Statement 87, a government entered into a capital lease with an interest rate of 5% and recognized a capital asset and a liability of $45,600. At the beginning of the earliest period restated, the carrying value of the capital asset is $20,900, and the liability (principal outstanding) is $21,500. The government determines that the liability at that date should be $22,500 under Statement 87 due to a change in the assessment of the lease term.

Question: For leases that were reported as capital leases prior to the implementation of Statement 87, can the government use the carrying value of the capital lease asset at the beginning of the earliest period restated as the measurement of the lease asset?

Answer: Paragraph 94 of Statement 87 states that leases are measured using the facts and circumstances that exist at the beginning of the period of implementation. This allows for use of the carrying value of the existing capital lease asset, adjusted to the new carrying value of the lease liability under Statement 87. Therefore, the government reports a $1,000 increase in the lease liability to $22,500 due to the reassessment of the lease term. Accordingly, the lease asset is increased by $1,600 to $22,500. The $600 difference is included in the restatement of beginning net position.

Overview
Summary of key differences between GASB 62 and GASB 87

- All leases are financings and, therefore, reported as such in the financial statements (with the exception of leases that meet the criteria for the short-term lease exception)
- No distinction between operating or capital leases neither for lessee nor lessor
- Allocation of the contract price to the different components of the lease is based on the stated contract prices, as long as they do not appear to be unreasonable
- Lessee no longer has to compare its incremental borrowing rate to the implicit rate. If the implicit rate is available, the lessee uses it; otherwise, lessees use their incremental borrowing rate which may be challenging to derive
- Continuing involvement determination for real estate leasebacks is no longer necessary
- Sale-leaseback transactions are accounted for as separate sale and lease transactions

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Scope and scope exceptions

Overview

The guidance applies to :

- Contract that conveys the right to use another entity's non-financial asset (e.g., land, buildings, vehicles and equipment)
- Applies to leases of assets embedded in contracts not explicitly identified as leases (i.e., embedded leases)

The guidance does not apply to:

- Leases of intangible assets (e.g., natural resources, intellectual property, and software)
- Leases of biological assets
- Leases of inventory
- Contracts that meet the definition of a service concession arrangement in GASB 60
- Supply contracts, such as power purchase agreements
  - Assets being used in supply contracts could be in GASB 87 as embedded leases
- Leases in which the construction of the underlying asset is financed with outstanding conduit debt (with certain exception)

Scope and scope exceptions

Determining whether an arrangement contains a lease

A lease is defined as "a contract 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"

- To determine whether a contract conveys control of the right to use the underlying asset, an entity should assess whether it has 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
- The definition also specifies that a lease should be an exchange or exchange-like transaction, thereby excluding transactions for nominal amounts (i.e., a donation or grant)
- Leases include contracts that, although not explicitly identified as leases, meet the definition of a lease (e.g., leases in substance and not in legal form)

Scope exception: A contract that (a) transfers ownership of the underlying asset to the lessee by the end of the contract and (b) does not contain termination options, but that may contain a fiscal funding or cancellation clause that is not reasonably certain of being exercise should be reported as financed purchase of the underlying asset by the lessee and sale of the asset by the lessor

Scope and scope exceptions
Illustration – Exchange or exchange-like transaction

Question: A government obtains the right to use land, which has a market rent of $100,000 per year, for $1 per year. Should the government apply the requirements in Statement 87 to that transaction?

Answer: No, the government's right to use land for $1 does not meet the description of an exchange or exchange-like transaction in Paragraph 1 of Statement No. 33 because each party does not receive or give up essentially equal value or not quite equal value.

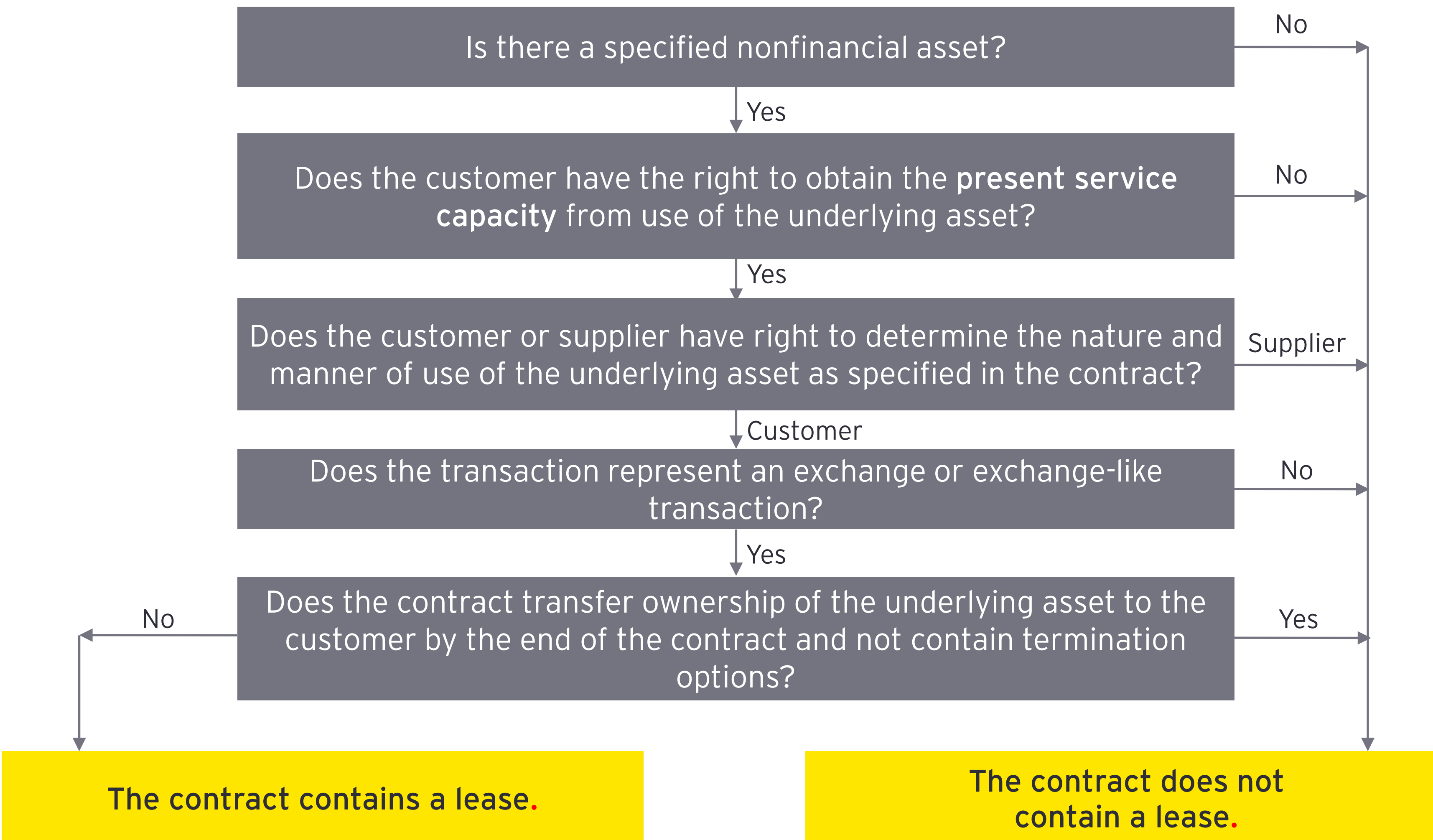
Scope and scope exceptions
Illustration – Contract conveys control of the right to use

Question: A government enters into a five-year agreement to provide another entity with the right to use the government's land. The entity plans to use the land for hunting and is the only party that is allowed to access and use the land during hunting season each year for the term of the agreement. Is the hunting rights agreement a lease?

Answer: Yes, the hunting rights meet the definition of lease. The lessee is the only party allowed to access and use the land during the hunting season each year for the term of the-agreement, and, therefore, the contract conveys control of the right to use the underlying asset (the land).

Scope and scope exceptions

Determining whether an arrangement contains a lease (continued)



Scope and scope exceptions
Illustration – Contracts that transfer ownership

Question: A vendor installs equipment in a government's building to increase energy efficiency. The government will own the equipment at the end of the agreement, and the contract does not contain a termination option. Should this transaction be reported as a lease or a financed purchase?

Answer: The transaction is reported as a financed purchase since title to the equipment transfers to the lessee at the end of the contract, as discussed in paragraph 19 of Statement 87.

Scope and scope exceptions

Embedded leases implementation issues

- Governments doing an inventory of leases should analyze all their service contracts for embedded leases
  - Advertising, information technology, transportation or construction contracts-etc.
  - Evaluation needed to determine whether right to control use of an asset is created by one of these contracts
- Arrangements may not be reported as leases pre-GASB 87
- Governments should establish policies and procedures to search for these embedded leases in documents not called leases

Scope and scope exceptions

Contracts with multiple components – Multiple underlying assets

- Some contracts contain the right to use multiple underlying assets (e.g., a building and equipment, multiple pieces of equipment).
- The right to use each asset is considered a separate lease component if

1. Each of the underlying asset have different lease term

OR

2. Underlying assets are in different major classes of assets for disclosure purpose

- For a contract that contains multiple underlying assets and meets abovementioned criteria’s, the government should account for the right to use each asset as a separate contract unless both the following criteria's are met
  - If a contract does not include prices for each individual unit, or if any of those prices appear to be unreasonable and
  - It is not practicable to determine a best estimate for price allocation for some or all components in the contract

Scope and scope exceptions

Contracts with multiple components – Lease and non-lease components

- Lease components (such as the right to use a building) and non-lease components (such as maintenance services for the building) of a contract are to be accounted for as separate contracts unless the exception is met
- To allocate the contract price to different components, lessees and lessors should:
  - First — Use stated contract prices for individual components as long as they do not appear to be unreasonable based on professional judgment (maximizing the use of observable information)
  - Second — If no stated prices or unreasonable contract prices, lessee and lessors to use professional judgment to determine their best estimate (maximizing the use of observable information)

Exception

- **If determining a best estimate is not practicable,** multiple components in a lease contract should be accounted for as a single lease unit

Scope and scope exceptions
Illustration – Contracts with multiple components

Question: A government leases two floors of an eight-floor building. A part of the lease payments covers the government's share of utilities and janitorial costs for maintaining a lobby that all tenants share. Should the share of utilities and janitorial costs be included in the government's lease liability?

Answer: Utilities and janitorial costs for the lobby are non-lease components. If it is practicable to separate and estimate the costs for those services, the government does not include those costs in its lease liability (paragraph 64 of Statement 87). If it is not practicable to separate and estimate these costs, the government includes them in its lease liability

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Key concepts
Short-term leases

- Short-term lease accounting is not a policy election
- Short-term lease is defined as a lease that, at commencement, has a **maximum** possible term of 12 months (or less), including any options to extend, **regardless of their probability of being exercised**
- For a lease that is cancellable by either the lessee or the lessor, such as a rolling month-to-month lease, the maximum possible term is the noncancelable period, including any notice periods
- Short-term leases are required to be excluded from measurement of lease assets and liabilities and instead are treated as follows:
  - Lessees recognize lease payments on short-term leases as outflows of resources (for example, expense) based on the payment provisions of the lease
  - Lessors should recognize lease payments on short-term leases as inflows of resources (for example, revenue) based on the payment provisions of the lease

Governments may be motivated to conclude that a contract is a short-term lease to avoid effort involved with GASB 87 recognition and measurement requirements.

Key concepts
Determining a lease recognition threshold

Capitalization thresholds – We expect that entities may adopt a reasonable capitalization threshold below which RTU lease assets and lease liabilities will not be recognized on the statement of net position, but need to consider the materiality individually and in aggregate

Governments should:

- Not evaluate the effect of non-recognition on a net basis (lease asset less lease liability) but separately
- Not default to the capitalization threshold for capital assets
- Consider separate thresholds for non-recognition of lease assets and liabilities
  - Establish lower threshold for non-recognition of liability
  - Reconsider capital asset threshold based on effect of expensing capital assets including lease assets
- Consider the effect of thresholds on disclosures

Key concepts

Lease term

Lease term

Noncancelable period

+

Periods covered by lessee's option to extend, if reasonably certain to exercise

Periods covered by lessee's option to terminate, if reasonably certain to *not* exercise

Periods covered by lessor's option to extend, if reasonably certain to exercise

Periods covered by lessor's option to terminate, if reasonably certain to *not* exercise

- Periods for which both the lessee and the lessor have an option to terminate the lease without permission from the other party (or if both parties have to agree to extend) are cancellable periods and are excluded from the lease term

Key concepts

Lease term (continued)

At the commencement of the lease term, lessees and lessors assess all factors relevant to the likelihood that the lessee or lessor will exercise options, including factors that are contract based, asset based, market based or entity specific. Examples include:

- Significant economic incentives (e.g., favorable terms)
- Significant economic disincentives (e.g., relocation or abandonment costs)
- History of exercising options to extend or terminate
- Extent to which leased asset is essential to government services

- "Reasonably certain" is considered a higher threshold and less speculative than the "probable" threshold used in GASB 62 for recognizing a liability arising from a contingency
  - Guidance essentially retains the threshold of "reasonably assured" from the prior guidance
- This determination is made at lease term commencement and reassessed only upon certain events

Key concepts
Lease payments

- Lease payments should be consistent with the lease term

Lease payments				
Fixed payments (including variable payments that are fixed in substance)	Variable payments based on an index or rate	Exercise price of purchase option or termination penalties, if reasonably certain	Residual value guarantee payments that are fixed in substance (lessor only)	Any lease incentives payable to the lessee (lessor) or receivable from the lessor (lessee)

- Additional payments to be included by **lessees only**:
  - Amounts that are **reasonably certain** of being required to be paid by the lessee under residual value guarantees
  - Any other payments that are **reasonably certain** of being required based on an assessment of all relevant factors

Key concepts
Lease payments (continued)

Variable lease payments	
Dependent on an index or rate	**Not dependent on an index or rate**
Include in lease payments?	
Yes	**No**

▶ Examples include Consumer Price Index (CPI), London Interbank Offered Rate (LIBOR), prime interest rate, Treasury rates (with or without a spread)
▶ Variable lease payments are measured using the index or rate at the measurement date (e.g., commencement of the lease term for initial measurement)
▶ Lessees recognize changes to index and rate-based variable lease payments as outflows of resources (e.g., expense) in the period in which the obligation for those payments is incurred
▶ Lessors recognize such changes as inflows of resources (e.g., revenue) in the period to which those payments relate
	▶ Examples include performance or usage-based payments
	▶ Lessees recognize these payments as outflows of resources (e.g., expense) in the period in which the obligation for those payments is incurred
	    ▶ Any component that is fixed in substance is included in the measurement of the lease liability
	▶ Lessors recognize these payments as inflows of resources (e.g., revenue) in the period to which those payments relate
	    ▶ Any component of those variable payments that is fixed in substance is included in the measurement of the lease receivable.

Key concepts
Initial direct costs (IDCs) and discount rates

IDCs

- Ancillary charges necessary to place the lease asset into service
- Costs to originate a lease incurred in transactions with independent third parties that (1) result directly from and are essential to acquiring that lease and (2) would not have been incurred if the leasing transaction had not occurred
- Certain costs directly related to specified activities performed by the lessor for that lease

Discount rates

Lessors

- Required to use the interest rate they charge lessees, which may be the interest rate implicit in the lease
- Not required to apply the guidance for imputation of interest in GASB 62 but may do so to determine the interest rate implicit in the lease

Lessees

- May use their estimated incremental borrowing rate (an estimate of the interest rate that would be charged for borrowing the lease payment amounts during the lease term), if the lessor's implicit rate cannot be readily determined
- Not required to apply the guidance for imputation of interest in GASB 62 but may do so to determine the interest rate implicit in the lease
- Note: Guidance does not allow the use of a risk-free interest rate as a discount rate since leases are not risk free

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- Overview
- Scope and scope exceptions
- Key concepts
- **Lessee accounting**
- Lessor accounting
- Other considerations
- Implementation considerations

Lessee accounting
Recognition, measurement and presentation

	Lease asset	Lease liability
Initial recognition and measurement	Recognize an intangible RTU lease asset measured as the sum of the lease liability, plus lease payments made to the lessor at or before the commencement of the lease term, less any lease incentives, plus certain initial direct costs	Recognize a lease liability measured at the present value of lease payments expected to be made during the lease term using the applicable discount rate
Subsequent measurement	Lease asset should be amortized in a systematic and rational manner over the shorter of the lease term or the useful life of the underlying asset, subject to impairment	Lessee should calculate the amortization of the discount on the lease liability. Payments made should be allocated first to the accrued interest liability and then to the lease liability
Statement of activities	Amortization of lease asset should be reported as an outflow of resources (e.g., amortization expense)	Report amortization of lease liability as an outflow of resources (e.g., interest expense)
Statement of cash flows	N/A	Cash flows including interest to be included within capital and related financing activities category as an outflow Cash payments on short-term leases should be presented as an outflow within operating activities

Lessee accounting
Recognition and measurement exceptions

Exceptions to lessee accounting
Short-term leases ▸ Short-term lease payments are recognized as outflows of resources (e.g., expense) on a straight-line basis over the lease term ▸ Certain disclosures are required
Contracts that transfer ownership ▸ Contract that transfers ownership of underlying asset at the end of contract and does not contain termination option is reported as a financed purchase of the underlying asset by the lessee even if it contains a fiscal funding or cancellation clause that is not reasonably certain of being exercised
Contracts that contain unilateral options to terminate ▸ Contract that contains unilateral options to terminate does not contain enforceable rights and obligations and, therefore, is not subject to GASB 87

Lessee accounting
Remeasurement events

- The lessee should remeasure the lease liability at subsequent financial reporting dates if one or more of the following significant changes have occurred at or before that financial reporting date:
  - A lease modification that is not reported as a separate lease
  - **Change in the lease term***
  - The likelihood of a residual value guarantee being paid has changed from reasonably certain to not reasonably certain, or vice versa
  - **The likelihood of a purchase option being exercised has changed from reasonably certain to not reasonably certain, or vice versa***
  - Change in the estimated amounts for payments already included in the measurement of the lease liability
  - **Change in the interest rate the lessor charges the lessee, if used as the initial discount rate***
  - A contingency is resolved such that variable payments become fixed
- A lease asset generally should be adjusted by the same amount as the corresponding lease liability when that liability is remeasured. However, if that change reduces the carrying value of the lease asset to zero, any remaining amount should be reported in the resource flows statement.

* These changes may require updating the discount rate and/or the index or rate used to determine variable payments

Lessee accounting
Impairment considerations

- A lessee's RTU asset is subject to the impairment guidance in Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries* (Statement 42)
- The presence of impairment indicators (described in paragraph 9 of Statement 42) with respect to the underlying asset may result in a change in the manner or duration of use of the lessee's RTU asset
  - Such a change in the manner or duration of use of the lessee's RTU asset may indicate that the service utility of that lease asset is impaired
  - If a lease asset is impaired, the amount reported for the lease asset is reduced first for any change in the corresponding lease liability, and any remaining amount is recognized as an impairment

Lessee accounting
Disclosures

A lessee should disclose the following about its lease activities (which may be grouped for purposes of disclosure), other than short-term leases:

- A general description of its leasing arrangements, including:
  - The basis, terms, and conditions on which variable payments not included in the measurement of the lease liability are determined and
  - The existence, terms, and conditions of residual value guarantees provided by the lessee not included in the measurement of the lease liability
- The total amount of lease assets, and the related accumulated amortization, disclosed separately from other capital assets
- The amount of lease assets by major classes of underlying assets, disclosed separately from other capital assets
- The amount of outflows of resources recognized in the reporting period for variable payments not previously included in the measurement of the lease liability
- The amount of outflows of resources recognized in the reporting period for other payments, such as residual value guarantees or termination penalties, not previously included in the measurement of the lease liability
- Principal and interest requirements to maturity, presented separately, for the lease liability for each of the five subsequent fiscal years and in five-year increments thereafter
- Commitments under leases before the commencement of the lease term
- The components of any loss associated with an impairment

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Lessor accounting
Recognition, measurement and presentation

	Lease receivable	Deferred inflow of resources
Initial recognition and measurement	Recognize and measure the lease receivable at the present value of lease payments expected to be received during the lease term using the applicable discount rate, less any provision for uncollectible amounts	Recognize and measure the deferred inflow of resources at the amount of the lease receivable, plus lease payments received from the lessee at or before commencement that relate to future periods, less any lease incentives
Subsequent measurement	Calculate the amortization of the discount on the lease receivable. Any payments received should be allocated first to the accrued interest receivable and then to the lease receivable.	Subsequently recognize decreases in the deferred inflow of resources in a systematic and rational manner over the lease term (e.g., straight-line)
Statement of activities	Amortization of discount on lease receivable to be reported as an inflow of resources (e.g., interest revenue) Report any initial direct costs as outflows of resources (for example, expense) in the period incurred	Recognize the deferred inflow of resources as inflows of resources (e.g., revenue) in a systematic and rational manner over the term of the lease
Statement of cash flows	Classify the inflows consistent with how the underlying asset is classified on the statement of net position, that is, as an investing or capital and related financing activity Receipts on short-term leases normally should be presented as operating activities unless factors indicate classification as an investing activities inflow	N/A

Lessor accounting
Recognition and measurement exceptions

Exceptions to lessor accounting

Short-term leases

- Short-term lease payments are recognized as inflows of resources (e.g., revenue) based on the payment provisions of the lease contract
- A liability is recognized if payments are received in advance
- An asset is recognized for rent due if payments are to be received after the reporting period
- An inflow of resources during any rent holiday period should not be recognized

Contracts that transfer ownership

- A contract that transfers ownership of an underlying asset at the end of the contract and does not contain a termination option is reported as a financed purchase of the underlying asset by the lessee or as a sale of the asset by the lessor even if it contains a fiscal funding or cancellation clause that is not reasonably certain of being exercised

Leases of assets that are investments

- Lease of an investment is measured at fair value

Certain regulated leases

- Certain leases are subject to external laws, regulations or legal rulings (e.g., US Department of Transportation and the Federal Aviation Administration regulate aviation leases between airports and air carriers and other aeronautical users)

Lessor accounting
Certain regulated leases

- Lessors would not recognize lease receivable for leases that external laws, regulations, or legal rulings establish all of the following requirements:
  - 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
- A lessor with one or more regulated leases is required to make certain disclosures about those lease activities (which may be grouped for purposes of disclosure), other than short-term leases
- A lessor recognizes lease payments as inflows of resources (e.g., revenue) based on the payment provisions of the lease

Lessor accounting
Remeasurement events

- The lessor should remeasure the lease receivable at subsequent financial reporting dates if one or more of the following **significant changes** have occurred at or before that financial reporting date:
  - A lease modification that is not reported as a separate lease
  - **Change in the lease term***
  - **Change in the interest rate the lessor charges the lessee***
  - A contingency is resolved such that variable payments become fixed
- The deferred inflow of resources generally should be adjusted by the same amount as any change resulting from the remeasurement of the lease receivable

* May require updating the discount rate used for discounting ("*") and/or the index or rate used to determine variable payments

Lessor accounting
Disclosures

A lessor should disclose the following about its lease activities (which may be grouped for purposes of disclosure), other than short-term leases and certain regulated leases:

- A general description of its leasing arrangements, including the basis, terms, and conditions on which any variable payments not included in the measurement of the lease receivable are determined
- The total amount of inflows of resources (for example, lease revenue, interest revenue, and any other lease-related inflows) recognized in the reporting period from leases, if that amount cannot be determined based on the amounts displayed on the face of the financial statements
- The amount of inflows of resources recognized in the reporting period for variable and other payments not previously included in the measurement of the lease receivable, including inflows of resources related to residual value guarantees and termination penalties
- The existence, terms, and conditions of options by the lessee to terminate the lease or abate payments if the lessor government has issued debt for which the principal and interest payments are secured by the lease payments
- Other disclosures may be required for certain types of transactions (e.g., sublease, sale-leaseback and lease-leaseback) or if the lessor's principal ongoing operations consist of leasing assets to other entities

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Other considerations
Lease modifications

- Amendments to lease contracts give rise to modifications or terminations
  - Changing prices, lengthening or shortening the lease term, and adding or removing an underlying asset
  - GASB does not provide examples
- The lessee and lessor account for an amendment during the reporting period resulting in a modification to a lease contract as a separate lease (i.e., separate from the most recent lease contract before the modification) if both of the following conditions are present:
  - The lease modification gives the lessee an additional lease asset by adding one or more underlying assets that were not included in the original lease contract
  - The increase in lease payments for the additional lease asset does not appear to be unreasonable based on (1) the terms of the amended lease contract or (2) professional judgment, maximizing the use of observable information (e.g., using readily available observable standalone prices)
- There are special considerations when changes to provisions of a lease result from a debt refunding by the lessor, including an advance refunding that results in defeasance of debt

Other considerations

Lease termination

- An amendment is considered a lease modification unless the lessee's right to use the underlying asset decreases, in which case it is considered a full or partial lease termination
- A full termination reduces the lease asset or liability and lease receivable or deferred inflows of resources to zero with a gain or loss recorded for the difference

Termination	
Decrease in the lessee's right to use the underlying asset (e.g., the lease term is shortened or the number of underlying assets is reduced) during the reporting period is accounted as a partial or full lease termination	
Lessee	**Lessor**
▸ Reduce the carrying values of the lease asset and lease liability and recognize a gain or loss for the difference ▸ However, if the lease is terminated as a result of the lessee purchasing an underlying asset from the lessor, the lease asset is reclassified to the appropriate class of owned asset	▸ Reduce the carrying values of the lease receivable and related deferred inflow of resources, and recognize a gain or loss for the difference ▸ However, if the lease is terminated as a result of the lessee purchasing an underlying asset from the lessor, the carrying value of the underlying asset is derecognized and included in the calculation of any resulting gain or loss

Other considerations
Subleases

Sublease
A transaction in which an **underlying asset** is re-leased by the **lessee** (or **sublessor**) to a third party (the sublessee), and the original (or head) **lease** between the lessor and the lessee remains in effect

Lessor → The accounting for the original lease doesn't change.

Head lease

Original lessee/sublessor →

- Original lease and the sublease shall be accounted as two separate transactions, as a lessee and a lessor, respectively
  - Two transactions should not be offset against one another
- Disclosure requirements
  - Include the sublease in its disclosure of the general description of lease arrangements
  - Lessor transactions related to subleases should be disclosed separately from its lessee transactions related to original leases.

Sublease

Lessee/sublessee → Sub-lessee to apply general lessee guidance

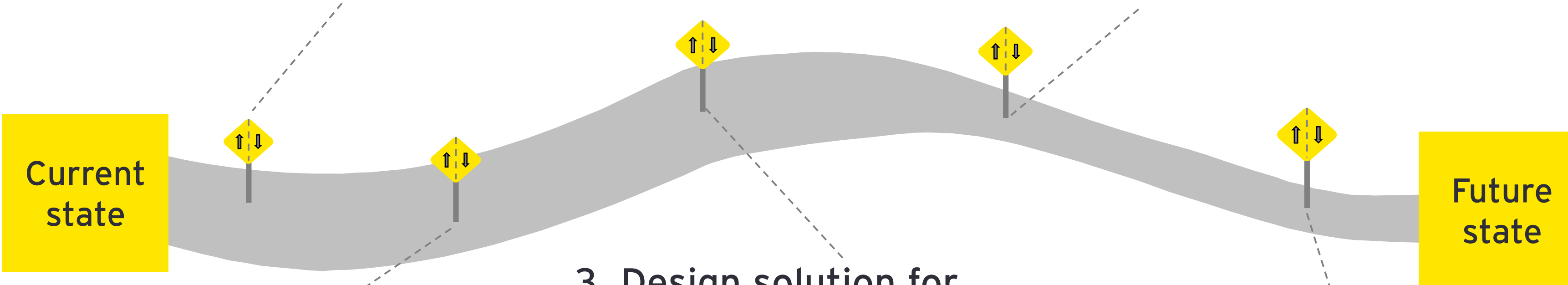
Other considerations
Transition

- GASB does not have the transition practical expedient options like ASC 842 although there is some relief inherent in the nature of the provisions
- Adjustment is made to beginning net position for the earliest period presented
- Impracticable does not mean inconvenient and we do not expect that any governments could realistically invoke impracticable to not implement as of the beginning of the earliest period presented when preparing comparative financial statements
  - Consider 1 year presentation in the year of implementation
  - Management's discussion and analysis does not need to be restated for periods prior to implementation
- Leases should be recognized and measured using the facts and circumstances that existed at the beginning of the period of implementation
- If applied to earlier periods, leases should be recognized and measured using the facts and circumstances that existed at the beginning of the earliest period restated
  - However, lessors should not restate the assets underlying their existing sales-type or direct financing leases. Any residual assets for those leases become the carrying values of the underlying assets

GASB 87 – Implementation Considerations

GASB 87 – Implementation Considerations

Lease accounting change journey



1. **Understand current state of leasing activities** (e.g., lease procurement, administration, accounting, reporting)
2. **Identify changes resulting from the new leases standard** (e.g., data gaps, processes, controls, systems)
3. **Design solution for accounting change** (e.g., new accounting policies, processes, controls, systems) to capture new lease data requirements and understand financial statement impact
4. **Implement** new accounting policies, processes, controls and systems as well as changes to financial statements and disclosures
5. **Transition** to the new leases standard

Understand the new leases standard

GASB 87 – Implementation Considerations
Drivers of complexity

Less complex	More complex
Organizational drivers	
▶ Entity is highly centralized ▶ It has one enterprise resource planning (ERP) system ▶ It has strong organizational change management	▶ Entity is decentralized ▶ It has multiple, disparate ERP systems ▶ It struggles to implement change
Leasing-specific drivers	
▶ Leasing is a significant part of the entity's operations ▶ Entity uses standard contract ▶ Entity uses existing lease management software ▶ Lease accounting is tied to lease administration system ▶ Volume of service contracts is low	▶ Leasing activity supplements entity's operations ▶ Entity uses nonstandard contracts ▶ Leases are tracked on a spreadsheet ▶ Lease accounting is often separated from lease administration system ▶ Volume of service contracts is high

GASB 87 – Implementation Considerations

Lease accounting change – not just compliance

Possible current state		Future state leading practice	
	People		**People**
	▸ Lease contracts managed locally, depending on geography, type of leased asset and business segment		▸ Utilization of a center of excellence – coordinating with lease administration, operations, legal, HR and treasury for data management
	Process and data		**Process and data**

	▸ Information collected for lease administration purposes may not be sufficient for lease accounting
	▸ Summary of lease arrangements maintained for footnote disclosure purposes with limited visibility into overall volume of leases
	▸ Embedded lease arrangements not widely documented
	▸ Lease-versus-buy decisions are informal (significant or material assets only)
			▸ Technical resources as part of capital budgeting to improve decision making around lease procurement
			▸ Comprehensive lease database with insight about overall lease portfolio to:
			  ▸ Aid asset/capital deployment decisions
			  ▸ Comply with accounting and reporting
			  ▸ Improve management of end-of-lease term options (i.e., whether to exit the lease, renew or buy the leased asset)

	Technology		**Technology**
	▸ Some entities may have lease management systems as part of their lease administration process for real estate ▸ Manual processes and spreadsheets to compile data for other leased asset types		▸ Long-term technology solutions that provide cross-functional support (e.g., lease procurement, lease administration, lease accounting and reporting)

GASB 87 – Implementation Considerations
The need for enabling technology

- Enable portfolio decisions through consolidated data and better analysis tools
- Streamline reporting
- Use single source of record for lease accounting data
- Improve lease portfolio performance and efficiency through automation and tracking
- Reduce risks of human error and portfolio management efforts through enforcement of good, repeatable practices
- Support audits and data validation
- Enable compliance and cost savings
  - Reduce up-front cost through competition
  - Improve return performance through equipment lease management
  - Improve savings in real estate lease audits, common area maintenance reduction, critical data and security deposit tracking

GASB 87 – Implementation Considerations

Technology implementation - common pitfalls and lessons learned

Failure

Some common pitfalls

- Existing system data not clean or current
- Expectations and communication of implementation timeline not well managed
- Differing priorities across the organization
- Not confirming buy-ins from all users
- Not confirming the system can meet defined requirements (GASB 87, etc.)
- Resource availability to support initiative (especially for testing and training)
- Not having a dedicated IT resource on the team capable of coding and liaising with the technical vendor resources
- Misalignment of client and vendor with regard to system capability of reporting and workflow features
- Not managing retention and losing key people across the organization during system transition (especially critical for testing)
- Systems not planned to run in parallel (recommended: one quarter)

Lessons learned

- Define system requirements prior to selecting a vendor and leverage them for decision making
- Require the vendor to develop a data dictionary
- Dedicate a seasoned IT professional to work in tandem with the vendor's technical team
- Dedicate an internal project manager to work in tandem with the vendor's project management team
- Maintain executive sponsorship of the implementation
- Align expectations regularly (especially with regard to timing and dependencies)
- Require the vendor to provide its internally developed and tested test scripts to be leveraged during user acceptance training
- Require system users to test converted data and system reporting
- Align milestones to vendor payments
- Plan for day-two process and control activities

Success

GASB 87 – Implementation Considerations

Lessons learned

- Accounting represents a small percentage of the overall project and/or level of effort
- Cross-functional cooperation, strong sponsorship and change management are critical
- When making leasing standard assessment and determining ultimate solution, entities need to consider all the organizational impacts and needs, not just accounting
- Entities often lacked understanding of their current processes for lease administration and accounting, resulting in:
  - Difficulties in transitioning to the new requirements – data that currently resides in Excel and/or lease system will need to be revisited and current lease accounting may need to be corrected if there are errors
  - Challenges in developing appropriate process change management systems
- Change will require new technologies, including a leasing system, as well as imaging and abstraction capabilities
- In certain instances, organizations that rushed to implement technology without the proper assessment have had to rethink their choices
- While entities may prefer using a single technology solution, it is becoming apparent that this approach may not be feasible
- Data collection has been recognized as a larger-than-expected issue for many organizations

GASB 87 – Implementation Considerations
Suggested next steps for entities

- Understand the requirements of the new standard
- Establish project management and planning activities (e.g., governance, objective, timeline, resource identification)
- Understand the lease-related activities throughout the organization and perform a current state **readiness assessment** for the new standard
- Evaluate changes to lease-related activities as a result of the new standard, including changes to accounting policies and procedures
- Perform an impact assessment to understand the magnitude of the changes from both a financial statement and business perspective
- Design a plan for transitioning to the new standard, including accumulation of lease data

Summary

Summary

You should now be able to

- Identify impact of lease accounting changes on governments
- Recognize potential implementation concerns or considerations regarding leases

Summary
GASB 87 Resources

- GASB 87, Leases
  - Basis for conclusions is important context
- GASB 92, Omnibus 2020, amended the effective date for interim financial statements
- GASB 95, Postponement of Effective Dates for Certain Authoritative Guidance, deferred the effective date 18 months
- Implementation Guide 2019-3 contains 77 questions and answers
- Implementation Guide 2020-1 Questions 4.6–4.17

Appendix – Additional accounting concepts and examples

Appendix
Sale and leaseback transactions

Sale and leaseback transaction

- Sale-leaseback transactions involve the sale of an underlying asset by the owner and a lease of the property back to the seller (original owner)
- A sale-leaseback transaction that does not include a qualifying sale should be accounted for as a borrowing activity by the seller-lessee and a lending activity by the buyer-lessor
- The sale and lease portions of a sale-leaseback transaction should be accounted for as two separate transactions, (i.e., a sale transaction and a lease transaction)
  - However the difference between the carrying value of the capital asset that was sold and the net proceeds from the sale should be reported as a deferred inflow of resources or a deferred outflow of resources and subsequently recognized in a systematic and rational manner over the lease term, except where lease qualifies as short term lease wherein difference is recognised immediately
- Disclose terms and conditions of sale-leaseback in notes to financial statements

Sale and leaseback transactions subject to off-market terms

- Off-market terms – If there is a significant difference between

  a) the sale price and the estimated fair value of the asset or

  b) the present value of the contractual lease payments and the estimated present value of what the lease payments for that asset would be at the market price
- whichever of the two differences is more readily determinable
- Difference should be reported based on the substance of the transaction (e.g., as a borrowing, a nonexchange transaction, or an advance lease payment) rather than as part of the sale-leaseback transaction.

Appendix
Lease-leaseback transactions

Lease-leaseback

- Asset leased by one party (first party) to another party and then leased back to the first party
- Account for as a net transaction because each part of transaction is with the same counterparty (right of offset exists)
- Both parties should disclose gross amounts of lease and leaseback in notes to financial statements

Leases between related parties

- In the separate financial statements of the related parties, the classification and accounting should be the same as for similar leases between unrelated Parties
- If terms of transaction have been significantly affected by the fact that lessee and lessor are related (i.e., substance is different from legal form, recognize substance of the transaction)
  - Example: A lease contract is structured to meet the terms of short-term lease, but mutual understanding by parties that the lease will be extended for several years – Account for as a long-term lease
- Disclosure requirements – Lessee and lessor should disclose nature and extent of leasing transactions with related parties

Appendix
Lessee examples – Illustration A-1

Illustration A-1: Lessee accounting for an Equipment lease

A city enters into a lease contract to obtain equipment. The lease begins on 1 January 20X1, the first day of the city's fiscal year, and is for 60 months. The city has an option to extend the lease for an additional 24 months. The city is unsure whether it will exercise the option to extend the lease.

After the end of the 60 months (if the city does not extend the lease) or 84 months (if the city does extend the lease), the lease may be continued on a month-to-month basis and cancelled by either the city or the lessor.

The base monthly payment is $1,000, due on the 1st of each month, and includes 200 machine hours. If the city uses more than 200 machine hours in a month, it is required to pay $5 for each additional hour. In addition, the contract requires an $80 monthly payment for repairs and maintenance, which is a reasonable amount for those services.

The lease contract states an interest rate of 4%. There is a separate contract with the lessor for delivery ($800) and installation ($700) of the equipment, and payments for those services are due with the first lease payment.

Appendix

Lessee examples – Illustration A-1 (continued)

Accounting and financial reporting

Lease term:

The non-cancellable period of the lease is 60 months. Because the city is not reasonably certain that it will exercise the option to extend the lease for an additional 24 months, it should not include those months in the lease term.

- The potential month-to-month extensions also would not be included in the lease term because these periods are not enforceable (either the city or the lessor can cancel).
- Therefore, the lease term includes only the non-cancellable period=(i.e., 60 months).

Initial measurement of lease liability and lease asset:

Base payment	$54,480 *($1000 p/m x 60 months discounted at 4%)*	Fixed payments are included
Excess use charge	-	Variable payments based on future usage are excluded
Repair and maintenance	-	Service (non-lease) components are excluded unless not practicable
Initial value of lease liability	**$54,480**	
Delivery and installation	$1,500 *($800 delivery+ $700 installation)*	Initial direct costs are included
Initial value of lease asset	**$55,980**	

Accounting and financial reporting (continued)

Subsequent measurement of lease liability and lease asset:

- The city chooses to amortize the lease asset on a straight-line basis—$933/month ($55,980 lease asset divided by 60 months). The monthly payment schedule for reducing the lease liability in the first year is as follows:

Date	Beginning Balance	Interest Accrued	Interest Paid	Principal Paid	Total Payment	Balance after Payment
1/1/20X1	$ 54,480	$ -	$ -	$ 1,000	$ 1,000	$ 53,480
2/1/20X1	53,480	178	178	822	1,000	52,658
3/1/20X1	52,658	176	176	824	1,000	51,834
4/1/20X1	51,834	173	173	827	1,000	51,007
5/1/20X1	51,007	170	170	830	1,000	50,177
6/1/20X1	50,177	167	167	833	1,000	49,344
7/1/20X1	49,344	164	164	836	1,000	48,508
8/1/20X1	48,508	162	162	838	1,000	47,670
9/1/20X1	47,670	159	159	841	1,000	46,829
10/1/20X1	46,829	156	156	844	1,000	45,985
11/1/20X1	45,985	153	153	847	1,000	45,138
12/1/20X1	45,138	150	150	850	1,000	44,289
12/31/20X1	44,289	148	-	-		
			$ 1,809	$ 10,191		

- Assuming the lease payments do not need to be remeasured at subsequent financial reporting dates, the annual lease liability amortization schedule for the remainder of the lease is as follows:

Date	Beginning Balance	Interest Paid	Principal Paid	Total Payment	Year-End Principal Balance	Year-End Accrued Interest
12/31/20X2	$ 44,289	$ 1,582	$ 10,418	$ 12,000	$ 33,871	$ 113
12/31/20X3	33,871	1,157	10,843	12,000	23,028	77
12/31/20X4	23,028	716	11,284	12,000	11,744	39
12/31/20X5	11,744	256	11,744	12,000	-	-

Appendix
Lessee examples – Illustration A-1 (continued)

Journal entries	Debit	Credit
Initial measurement on the date lease commencement		
Lease asset	$ 55,980	
Lease liability		$ 54,480
Cash		1,500
To initially recognize the lease asset, lease liability and the payment that qualifies as an IDC		
Subsequent measurement during the Year 1.		
Interest expense	$ 1,809	
Lease liability	$ 10,191	
Cash		$ 12,000
To record payment of interest expense and lease liability during the year.		
Amortization expense	$ 11,196	
RTU asset		$ 11,196
To record amortization expense on the RTU asset ($55,980 ÷ 5 years)		
Interest expense	$ 148	
Interest expense accrual		$ 148
To record the interest expense accrual for last month		

Appendix
Lessee examples – Illustration A-1 (continued)

Journal entries	Debit	Credit
Subsequent measurement- in the first month of Year 2		
Interest expense accrual	$ 148	
Cash		$ 148
To record payment of interest expense accrual as at the beginning of Year 2		
Amortization expense	$ 933	
RTU asset		$ 933
To record amortization expense on the RTU asset ($55,980 ÷ 5 years) for one month		
Interest expense	$ 145	
Lease liability	$ 855	
Cash		$ 1,000
To record payment of interest expense accrual as at the beginning of Year 2		

Appendix
Lessee examples – Illustration A-1 (continued)

Summary	Initial	Year 1	Year 2	Year 3	Year 4	Year 5
Cash lease payments	$ 1,500	$ 12,000	$ 12,000	$ 12,000	$ 12,000	$ 12,000
Income statement:						
Interest expense		$ 1,956	$ 1,547	$ 1,121	$ 678	$ 217
Amortization expense		$ 11,196	$ 11,196	$ 11,196	$ 11,196	$ 11,196
Total periodic expense		**$ 13,152**	**$ 12,743**	**$ 12,317**	**$ 11,874**	**$ 11,413**
Balance sheet:						
Lease asset	$ 55,980	$ 44,784	$ 33,588	$ 22,392	$ 11,196	$ -
Lease liability	$(54,480)	$ (44,289)	$ (33,871)	$ (23,028)	$(11,744)	$ -
Accrued interest		$ (148)	$ (113)	$ (77)	$ (39)	

Appendix
Lessee examples – Illustration A-2

Illustration A-2: Lessee accounting-Variable Payments That Depend on an Index

A school district enters into a five-year lease contract for a building. Lease payments are due at the beginning of each year. The payment for each year is 100 times the Consumer Price Index (CPI) as of 31 December of the prior year. The lease commences on 1 January-20X1. The CPI as of 31 December 20X0 was 251.

Accounting and financial reporting

- The first payment, due 1 January 20X1, will be $25,100 (100 times the CPI of 251). The variable payments initially are measured using the CPI as of the commencement of the lease term. Therefore, the initial measurement of the lease liability will be the present value of $125,500 ($25,100 multiplied by five).
- If the CPI at 31 December 20X1 increases to 253, the school district's payment on 1 January 20X2, will be $25,300. The additional $200 will be recognized as an outflow of the period.

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