

GASB 87 Lessons Learned & GASB 96

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Different Types of Leases

- **Short-Term Leases** – Defined as “a lease that, at the commencement of the lease term, has a maximum possible term under the lease contract of 12 months (or less), including any options to extend, regardless of their probability of being exercised.”
- **Financed Purchases** – Defined as “a contract that transfers ownership of the underlying asset to the lessee by the end of the contract and does not contain termination options.”
- **GASB 87 Leases** – Leasing arrangements that do not meet the definition of short-term leases or financed purchases, as defined above, and are not specifically excluded from the standard.

GASB 87 – LESSONS LEARNED

Getting Started: Taking an Inventory of Your Lease (and SBITA!) Contracts

Begin the process early!

Don't rely solely on the accounting department. Talk to the individuals in charge at your various departments and ask them about their leasing arrangements and SBITAs.

Understand what you're asking for.

Accumulate contracts, identify the lease term and any renewal options, and determine the minimum payments required under the agreements.

Consider using a third-party provider to assist with implementation and ongoing reporting requirements for both standards.

GASB 87 – LESSONS LEARNED

Getting Started: Taking an Inventory of Your Lease (and SBITA!) Contracts

Perform your own completeness test. Completeness testing should include an audit of transactions in the following types of accounts:

- Rent expense/expenditures
- Contractual services (SBITAs and Leases)
- Vehicle expense/expenditures
- Office equipment
- Small equipment
- Software and subscription accounts (SBITAs)

GASB 87 – LESSONS LEARNED

Getting Started: Taking an Inventory of Your Lease (and SBITA!) Contracts

Don't forget about leasing arrangements where your government is the lessor!
Some accounts to be looked at include:

- Rent revenue
- Other revenue
- Miscellaneous revenue

GASB 87 – LESSONS LEARNED

How in the World do We Determine the Lease Term?

- **Holdover period:** A holdover period (where at the end of the stated lease term the contract may continue on a month-to-month or year-to-year basis, but both parties have the option to terminate) should not be included in the determination of the lease term.
- **Annual (12-month) leases with renewal options.** Keep in mind that GASB 87 defines a short-term lease as having a *maximum* term of 12 months or less, including renewal options. You will need to estimate how many renewal periods are *reasonably certain* of being exercised.
- **Annual (12-month) leases with renewal options subject to entirely new contract and approval by governance.** In this situation, the new and separate contract requirement makes this lease a short-term lease.

GASB 87 – LESSONS LEARNED

How in the World do We Determine the Lease Term?

Example: A contract to lease a helicopter has an initial term of 12 months, and automatically renews for successive one-year periods unless a notice of cancellation is given by the lessee within 30 days of the expiration of the initial term. What is the term?



GASB 87 – LESSONS LEARNED

How in the World do We Determine the Lease Term?

Answer: It depends! How long does your government intend on needing a helicopter? Are you *reasonably certain* about your answer?

What if after the initial term, both the lessor and the lessee can cancel the arrangement with a 30-day notice to the other party? What is the maximum possible term under this arrangement?

GASB 87 – LESSONS LEARNED

How to Address Contracts with Multiple Components

Assume a building lease arrangement with the following elements:

- Base rental monthly is \$50,000.
- Common-area maintenance (CAM) charges are an additional \$5,000 per month, fixed through the life of the contract.

Are the CAM charges included with the base rent to arrive at a \$55,000 monthly payment for GASB 87 calculation?



GASB 87 – LESSONS LEARNED

How to Address Contracts with Multiple Components

The answer is “No.”

The maintenance costs are indicative of a non-lease component. GASB 87 defines leases as the “right to use an underlying asset.” Governments should account for lease and non-lease components of a contract separately.

You will see a lot of this with SBITAs.

GASB 87 – LESSONS LEARNED

How Do I Know Which Leases and SBITAs to Report?

Determine a *Reasonable* Threshold for Reporting

- Consider the volume of leases that your government currently has and whether significant leasing activities are expected in the future.
 - Generally, if your government is involved in a significant number of leases, you will want to establish a smaller threshold.
 - Conversely, if your government only periodically enters into long-term lease arrangements and SBITAs, you may want to set a higher threshold.
 - Consider using your capital asset threshold, because ultimately a GASB 87 lease liability and a SBITA liability will be offset by a right-to-use leased asset.

GASB 87 – LESSONS LEARNED

Accounting for Lease Liabilities and SBITAs

Example 1 – Let's assume that during a fiscal year, a building lease has been executed that meets the criteria to be reported as a lease liability under GASB 87. The lease has a term of 20 years and is reported in **governmental activities**. The present value of future minimum payments is \$500,000. What is the fund-level entry at inception of the lease?

Dr. Capital Outlay	\$500,000
Cr. Other Financing Sources – Leases	\$500,000

GASB 87 – LESSONS LEARNED

Accounting for Lease Liabilities and SBITAs (Continued)

Example 1 – Let's assume that during a fiscal year, a building lease has been executed that meets the criteria to be reported as a lease liability under GASB 87. The lease has a term of 20 years and is reported in **governmental activities**. The present value of future minimum payments is \$500,000 and the first annual payment of \$40,000 has been made. What are the fund-level entries?

Dr. Debt Service - Principal	\$30,000	
Dr. Debt Service – Interest	\$10,000	
Cr. Cash		\$40,000

Knowledge Check 1

How are the principal payments on lease liabilities and SBITAs to be recorded in proprietary funds?

1. Record them to debt service expense accounts
2. Reduce the liability directly
3. I have no idea.

GASB 87 – LESSONS LEARNED

Accounting for Lease Liabilities and SBITAs (Continued)

Example 2 – Let's assume that during a fiscal year, a building lease has been executed that meets the criteria to be reported as a lease liability under GASB 87. The lease has a term of 20 years and is reported in **business-type activities**. The present value of future minimum payments is \$500,000. What is the fund-level entry at inception of the lease?

Dr. Right-to-Use Lease Asset (Capital Asset)	\$500,000	
Cr. Lease Liability		\$500,000

GASB 87 – LESSONS LEARNED

Accounting for Lease Liabilities (Continued)

Example 2 – Let's assume that during a fiscal year, a building lease has been executed that meets the criteria to be reported as a lease liability under GASB 87. The lease has a term of 20 years and is reported in **business-type activities**. The present value of future minimum payments is \$500,000 and the first annual payment of \$40,000 has been made. What are the fund-level entries?

Dr. Lease Liability		\$30,000
Dr. Interest Expense	\$10,000	
Cr. Cash		\$40,000

GASB 87 – LESSONS LEARNED

Accounting for Lease Receivables

Lease receivables and related deferred inflows are to be recorded at the fund-level for governmental activities.

On the next few slides, you'll see how a lease receivable is recorded and then subsequently reduced when payments are received.

GASB 87 – LESSONS LEARNED

Lease Payments						Deferred Inflows	
Payment	Payments	Principal	Interest	Balance	Amortization	Balance	
1	\$ 28,000	\$ 26,258	\$ 1,742	\$ 623,742	\$ 27,083	\$ 622,917	
2	28,000	26,328	1,672	597,414	27,083	595,833	
3	28,000	26,399	1,601	571,015	27,083	568,750	
4	28,000	26,470	1,530	544,546	27,083	541,667	
5	28,000	26,540	1,460	518,005	27,083	514,583	
6	28,000	26,612	1,388	491,394	27,083	487,500	
7	28,000	26,683	1,317	464,711	27,083	460,417	
8	28,000	26,754	1,246	437,956	27,083	433,333	
9	28,000	26,826	1,174	411,130	27,083	406,250	
10	28,000	26,898	1,102	384,232	27,083	379,167	
11	28,000	26,970	1,030	357,262	27,083	352,083	
12	28,000	27,042	958	330,219	27,083	325,000	
13	28,000	27,115	885	303,104	27,083	297,917	
14	28,000	27,188	812	275,917	27,083	270,833	
15	28,000	27,260	740	248,656	27,083	243,750	
16	28,000	27,334	666	221,323	27,083	216,667	
17	28,000	27,407	593	193,916	27,083	189,583	
18	28,000	27,480	520	166,436	27,083	162,500	
19	28,000	27,554	446	138,882	27,083	135,417	
20	28,000	27,628	372	111,254	27,083	108,333	
21	28,000	27,702	298	83,552	27,083	81,250	
22	28,000	27,776	224	55,776	27,083	54,167	
23	28,000	27,851	149	27,926	27,083	27,083	
24	28,000	27,925	75	-	27,083	-	

GASB 87 – LESSONS LEARNED

Accounting for Lease Receivables

Let's assume a government is a lessor and a third party is leasing a building where the net present value of future payments is determined to be \$650,000. **What are the fund-level entries at inception?**

Dr. Lease Receivable	\$650,000	
Cr. Deferred Inflows of Resources – Leases		\$650,000

GASB 87 – LESSONS LEARNED

Accounting for Lease Receivables

Let's assume a government is a lessor and a third party is leasing a building where the net present value of future payments is determined to be \$650,000. **What are the fund-level entries for the first monthly payment?**

Entry #1a

Dr. Cash	\$28,000	
Cr. Lease Receivable		\$26,258
Cr. Interest income		\$1,742

Entry #1b

Dr. Deferred inflows - Leases	\$27,083	
Cr. Rental income		\$27,083

GASB 87 – LESSONS LEARNED

Final Thoughts

Reference the Implementation Guide when unusual situations arise.

GASB 87 and 96 aren't going away, so it's important that each of you understand when a lease should be recorded.

Lease agreements and SBITAs will often have multiple elements of the required payments. Reference the Standard when assessing the inputs for your calculation.

Financed purchases should be reported separately from lease liabilities. Financed purchases are arrangements where ownership is transferred to the lessee at the end of the contract.



GASB 96

Subscription-Based Information Technology Agreement

Knowledge Check 2

How many pages long is the GASB 96 standard?

1. 25 pages
2. 37 pages
3. 72 pages
4. 132 pages

SBITAs

Issued:

- June 2020
- Implementation delayed as result of COVID-19

Effective:

- For fiscal years beginning after June 15, 2022
- All periods thereafter
- Early adoption encouraged

Changing Times

Governments more heavily relying on IT

- It has become more common for governments to enter subscription-based contracts to use vendor-provided IT.
- The agreements allow access to vendors IT software and related tangible capital assets for subscription payments without granting perpetual licenses.
- Previously issued statements did not address agreements.

Objectives of GASB 96

To better meet information needs of financial statement users by:

- Establishing uniform accounting and financial reporting requirements
- Improving comparability of financial statements among governments
- Enhancing the following information on SBITAs
 - Understandability
 - Reliability
 - Consistency



Scope and Applicability

The Statement establishes standards of accounting and financial reporting for SBITAs by a government end user (a government). The requirements of this Statement apply to financial statements of all state and local governments.

Scope and Applicability (continued)

Statement 96 does not apply to the following:

1. 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 Statement 87, in which the software component is insignificant compared to the cost of the underlying tangible capital asset.
2. Governments that provide the right to use their IT software and associated tangible capital assets to other entities through SBITAs
3. Contracts that meet the definition of a P3 in Statement 94
4. Licensing arrangements that provide a perpetual licenses to governments to use a vendor's computer software, which are subject to Statement 51

SBITA Defined

What is the definition of SBITA as stated in GASB 96?

A **S**ubscription-**B**ased **I**nformation **T**echnology **A**rrangement (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.”

Definition (Continued)

To determine whether a contract conveys control of the right to use the underlying IT assets, we need to assess if the contract has the following characteristics:

- 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.

Definition (Continued)

SBITAs include some contracts not explicitly defined as SBITAs in the previous definition. These contracts contain both:

- A right-to-use IT asset component
- An IT support service component

Services that are solely IT support services are excluded.

Subscription Term

The subscription term is the period during which a government has a noncancellable right to use the underlying IT assets (the non-cancellable period), plus the following periods :

- Governments options to extend if reasonably certain the options will be exercised
- Vendors options to extend if reasonably certain the options will be exercised
- Governments options to terminate if reasonably certain that option will not be exercised
- Vendors options to terminate if reasonably certain that option will not be exercised

Subscription Term (Continued)

At the beginning of a subscription term the relevant factors should be considered regarding whether each party will exercise an option. Examples of some factors to consider include, but are not limited to, the following:

- Significant economic incentives, i.e. optional periods terms are favorable to current market rates
- Technological changes that significantly affect the technology used by the underlying assets.
- A potential significant change in the governments demand for the SBITA vendor's assets

Subscription Term (Continued)

More examples include:

- A significant economic disincentive, such as costs to terminate the SBITA and sign a new SBITA (for example, negotiation costs, costs of identifying another suitable underlying IT asset or another suitable SBITA vendor, implementation costs, or a substantial cancellation penalty)
- The history of exercising options to extend or terminate
- The extent to which the underlying IT assets in the SBITA are essential to the provision of government services.

Subscription Term (Continued)

When should subscription terms be reassessed?

- The government or SBITA vendor elects to exercise an option even though it was previously determined that it was reasonably certain that the government or SBITA vendor would not exercise that option.
- The government or SBITA vendor elects not to exercise an option even though it was previously determined that it was reasonably certain that the government or SBITA vendor would exercise that option.
- An event specified in the SBITA contract that requires an extension or termination of the SBITA takes place.

Knowledge Check 3

Some SBITAs can be considered short-term. What is the maximum term for a SBITA to be considered short-term?

1. 6 months
2. 12 months
3. 18 months
4. 24 months

Short-term SBITAs

Short-term SBITAs are reported differently than other SBITAs

Definition

- A SBITA that has an initial term of 12 months or less, including any options to extend, regardless of the probability of the options being exercised.

Reporting

- Recorded as expenses as incurred and paid.
- An asset is recorded if payments are made in advance.
- A liability is recorded if payment are to be made if future periods.
- Deferred amounts are not recorded.

Recognition and Measurement

SBITAs should be reported under provisions effectively the same as those for lessee under GASB 87 – recognize a subscription asset and liability.

- Subscription Liability
- Subscription Asset

Recognition and Measurement: Subscription Liability

Initial recognition should be at the present value of payments expected to be made in the subscription term.

The liability should include:

- Fixed payments
- Variable payments (ex. CPI) at the at the start date
- Variable payment that are substantively fixed
- Penalties or payments to terminate if applicable
- Any subscription contract investives
- Any other payments reasonably certain to be paid.

Recognition and Measurement: Subscription Liability (Continued)

Variable payments not dependent on a rate should be expensed.

Examples:

- Payments based on future performance
- Usage of underlying assets
- Number of user seats

Variable payments that are fixed in substance should be included in the liability.

Recognition and Measurement: Subscription Liability (Continued)

Discount Rates:

- Subscription payments should be discounted using the rate charged by the vendor or an implicit rate in the SBITA.
- If a rate is not specified, then the governments incremental borrowing rate can be used.

Recognition and Measurement: Subscription Liability Remeasurement

Remeasurement of the subscription liability should be made in subsequent reporting periods if changes have occurred and the changes significantly affect the amount of the liability.

Examples of Changes:

- Change in term
- Change in estimated payments
- Change in interest rate charged
- Change in contingencies

Recognition and Measurement: Subscription Liability Remeasurement (continued)

- If a remeasurement is done, we should also consider any changes in index or rates used to determine variable payments.
- Discount rates should be updated if there is a change in subscription term that has a significant impact on the liability.
- A change in the governments incremental borrowing rate alone is not cause for remeasurement but should be considered if remeasurement is already being done.

Recognition and Measurement: Subscription Asset

Initial recognition of the subscription asset should include the sum of the following less any vendor incentives received at the start of the subscription term.

Amounts should include:

- The amount of the initial subscription liability, plus
- Payments associates with the contract at made at the start of the term, plus
- Initial implementation costs.

Implementation Costs and Other Outlays

Activities other than the subscription payments have different accounting requirements.

These outlays fall into the following categories:

- Preliminary Implementation Stage
- Initial Implementation Stage
- Operation and Additional Implementation Stage

Generally, only outlays during the implementation stage should be capitalized

Implementation Costs and Other Outlays

The Preliminary Implementation Stage:

Activities in this stage include the conceptual formulation and evaluation of alternatives, the determination of the existence of needed technology, and the final selection of alternatives for the SBITA.

Outlays incurred during this stage should be expensed as incurred.

Implementation Costs and Other Outlays

The Initial Implementation Stage:

Activities in this stage include 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 also should be included in this stage. The initial implementation stage for the SBITA is completed when the subscription asset is placed into service.

Outlays incurred during this stage should generally be capitalized unless the SBITA is short term.

Implementation Costs and Other Outlays

The Operational and Additional Implementation Stage:

Activities in this stage include maintenance, troubleshooting, and other activities associated with the government's ongoing access to the underlying IT assets. Activities in this stage also may include additional implementation activities, such as those related to additional modules that occur after the subscription asset is placed into service.

Outlays incurred during this stage should generally be expensed but there are exceptions.

Note Disclosures

The following items should be disclosed in the notes to the financial statements.

- A general description, including basis, terms, and conditions of variable payments not included in the measurement of the liability.
- The amount of subscription asset, and the related accumulated amortization, disclosed separately from the other capital assets.
- The amount of outflows of resources recognized in the current period for variable payments not previously included in the remeasurement of the subscription liability.

Note Disclosures (Continued)

The following items should be disclosed in the notes to the financial statements.

- The amount of outflows of resources recognized in the current period for other payments, such as termination penalties, not previously included in the remeasurement of the subscription liability.
- Principal and interest payment schedules for the subsequent 5 years and the remaining amounts thereafter.
- Commitments before the commencements of the subscription term.
- Components of any loss associated with impairment

Other Topics Covered in the Standard

GASB 96 also covers other areas that can be evaluated individually, as necessary.

- Impairment
- Incentives provided by and vendor
- Contract combinations
- Contracts with multiple components
- Modifications and terminations

QUESTIONS?

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Thank You!



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