IMPLEMENTING GASB STATEMENT NO. 87, LEASES

ICCCFO CONFERENCE
APRIL 2022
GASB S-87 LEASES

Agenda

<table>
<thead>
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<th>GASB 87 – Technical Overview</th>
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<td>GASB 87 – Practical Implementation Guidance</td>
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Speakers

<table>
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<tr>
<th>Anthony Cervini</th>
<th>Sikich LLP</th>
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<tbody>
<tr>
<td>Darla Essalih</td>
<td>Waubonsee Community College</td>
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GASB S-87 LEASES

- **What:** GASB issued S-87 to improve lease accounting and financial reporting
- **Why:**
  - The existing standards had been in effect for decades without review to determine if they remain appropriate in light of GASB conceptual framework and continue to result in useful information
  - FASB and IASB conducted a joint project to update their lease standards
  - An opportunity to increase comparability and usefulness of information and reduce complexity for preparers
- **When:** Effective date is periods beginning after June 15, 2021 (June 30, 2022, and thereafter)
- **Implementation Guide:** IG No. 2019-3, *Leases* was issued in August 2019 and is effective for periods beginning after June 15, 2021 (June 30, 2022, and thereafter) to coincide with the implementation of GASB S-87
GASB S-87 SCOPE AND APPROACH

- Applied to any contract that meets the definition of a lease: “A lease is a contract that conveys control of the right to use another entity’s nonfinancial asset (the underlying asset) for a period of time in an exchange or exchange-like transaction.”
  - The right-to-use asset is that “specified in the contract”
  - Control is manifested by (1) the right to obtain 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

- Leases are financings of the right to use an underlying asset
  - Therefore, single approach applied to accounting for leases with some exceptions, such as short-term leases
GASB S-87 UNIFIED REPORTING MODEL FOR LEASES

- 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)
ISSUES TO FOCUS ON AS SOON AS POSSIBLE

Debt limits and bond covenants
- All leases lasting more than a year will be reported by lessees as long-term liabilities
- Review state and local laws and agreements to determine whether that could impact compliance with debt limitations and bond covenants

Lease policies and procedures
- May need to consider changing policies and procedures for tracking and reporting leases, both as lessee and lessor
- May need better communication between departments that enter into leases and central accounting staff
- Need procedures that identify when lease agreements have been initiated and when existing leases are modified (such as changes in lease term or estimated payment amounts)
- Should review capital asset policies, such as the capitalization thresholds, especially in light of the need to report intangible right-to-use assets
Statement 87 requires that leases be recognized and measured using the facts and circumstances as of the beginning of the period of implementation.

For example:
- As of July 1, 2021 for FYE June 30, 2022
LEASE TERM

- For financial reporting purposes, when does the lease start and end?
  - Start with the noncancelable period

  2021…………………………………………………..2027

  - Plus periods covered by options to:
    - Extend lease, if reasonably certain of being exercised
    - Terminate lease, if reasonably certain of not being exercised

  - Excludes cancelable periods
    - Periods for which lessee and lessor both have option to extend or terminate (such as rolling month-to-month leases)

  - Fiscal funding and cancellation clauses are ignored unless reasonably certain of being exercised
# GASB S-87 INITIAL ACCRUAL BASIS REPORTING

<table>
<thead>
<tr>
<th>Assets</th>
<th>Liability</th>
<th>Deferred Inflow</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Lessee</strong></td>
<td>Intangible lease asset (right to use underlying asset)—value of lease liability plus prepayments and initial direct costs that are ancillary to place asset in use</td>
<td>Present value of future lease payments (incl. fixed payments, variable payments based on index or rate, reasonably certain residual guarantees, etc.)</td>
</tr>
<tr>
<td><strong>Lessor</strong></td>
<td>• Lease receivable (generally includes same items as lessee's liability) • Continue to report the leased asset</td>
<td>NA</td>
</tr>
</tbody>
</table>
## GASB S-87 Subsequent Accrual Basis Reporting

<table>
<thead>
<tr>
<th></th>
<th>Assets</th>
<th>Liability</th>
<th>Deferred Inflow</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Lessee</strong></td>
<td>Amortize the intangible lease asset over shorter of useful life or lease term</td>
<td>Reduce by lease payments (less amount for interest expense)</td>
<td>NA</td>
</tr>
</tbody>
</table>
| **Lessor**     | • Depreciate leased asset (unless indefinite life or required to be returned in its original or enhanced condition)  
• Reduce receivable by lease payments (less amount needed to cover accrued interest) | NA | Recognize revenue over the lease term in a systematic and rational manner |
GASB S-87 GENERAL LESSEE DISCLOSURES

- General description of leasing arrangements
- Total amount of lease assets (by major classes of underlying assets), and the related accumulated amortization
- Amount of outflows of resources recognized for the period for variable payments and other payments (such as residual value guarantees or penalties) not previously included in the measurement of the lease liability
- Principal & interest requirements to maturity for each of the next 5 fiscal years and in 5-year increments thereafter
- Commitments under leases that have not yet begun (other than short-term leases)
- Components of any net impairment loss recognized on the lease asset during the period.
GASB S-87 GENERAL LESSOR DISCLOSURES

- General description of leasing arrangements
- Total amount of inflows of resources, such as lease revenue and interest revenue, if not otherwise displayed
- Amount of inflows of resources recognized for the period for variable payments and other payments, such as residual value guarantees or penalties, not previously included in the measurement of the lease receivable
- 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
DEVELOP AN ORGANIZATION & EVALUATION SYSTEM

- Develop a system to centralize and document lease information

- Documents the nature of the agreement in relation to new definition
  - Conveys control
  - Exchange or exchange like
  - Termination options
  - Ownership transfer

- Summarizes the lease terms contained within the agreement
  - Initial term
  - Extension options
  - Maximum lease term per new standard

- Supports determination whether the agreement is / is not a lease under GASB 87
RECORD KNOWN OPERATING LEASES PER GASB 87 (LESSEE)

- Known operating leases identified pre-GASB 87
  - Key info is accessible but not as easily as for existing capital leases

- Drop-into workbook/template for existing leases

- Prepare entry for these items only

- Communicate with auditors
## LESSEE EXAMPLE

### LEASE DETAILS

<table>
<thead>
<tr>
<th>Description</th>
<th>Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inception Date</td>
<td>August 1, 2021</td>
</tr>
<tr>
<td>Initial Term</td>
<td>60 months/5 years</td>
</tr>
<tr>
<td>Extension Options</td>
<td>Month-to-month renewal (optional)</td>
</tr>
<tr>
<td>Interest Rate</td>
<td>1.92%</td>
</tr>
<tr>
<td>Cancelable</td>
<td>No</td>
</tr>
<tr>
<td>Useful Life (Asset)</td>
<td>5 years</td>
</tr>
</tbody>
</table>
LESSEE EXAMPLE

Review Excel Template
GATHER, IDENTIFY & EVALUATE POTENTIAL LEASES

- Initially focus on lessee items only, repeat process for lessor items

- Review G/L activity
  - Accounts with rental revenue or expense

- Review central document archives
  - Agreement files
  - Financial audit documentation
  - Historical board reporting

- Reach out to other departments
  - Information Technology (IT)
  - Facilities
RECORD LESSOR ACCOUNTING PER GASB 87

- Modify your workbooks and schedules used for lessee accounting
  - PV and effective interest calculations carry over

- Prepare entry for these items only
  - Create new GL accounts for lease specific Lease Receivable, Deferred Inflows, Revenue and Interest

- Warning: this is more involved than lessee accounting
  - Unfamiliar territory – we’re used to simple accounting
  - Terms are not as explicit
  - Tend to be long lived agreements making documentation difficult to obtain

- Communicate with auditors
  - Expect more in-depth and slower moving process than with lessee accounting
# LESSOR EXAMPLE

<table>
<thead>
<tr>
<th>LEASE DETAILS</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Inception Date/Effective Date</td>
<td>July 1, 2020</td>
</tr>
<tr>
<td>Term</td>
<td>23 years (272 months)</td>
</tr>
<tr>
<td>Extension Options</td>
<td>None</td>
</tr>
<tr>
<td>Interest Rate</td>
<td>2.45%</td>
</tr>
<tr>
<td>Cancelable</td>
<td>No</td>
</tr>
<tr>
<td>Monthly Payments</td>
<td>See workbook</td>
</tr>
<tr>
<td>Additional Payments</td>
<td>$175,000 payment required during contract term</td>
</tr>
</tbody>
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Review Excel Template
QUESTIONS

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