

GASB Statement No. 87; Leases



January 28, 2020

Agenda

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Objectives

- After completing this program, you should
 - Understand key technical elements of GASB Statement No. 87; *Leases*
 - Better understand the implementation considerations specific to your organization

GASB Statement No. 87; *Leases* - Overview

GASB 87 – Leases

- Issued – June 2017
- Effective - Fiscal periods **beginning after December 15, 2019;**
 - Retroactive implementation
 - **No deferral!**
- Implementation Guide No. 2019-3, *Leases*
- Implementation Guide No. 2020-1
 - Exposure draft; comment period ends January 31, 2020;
 - Estimated final release 2nd QRT, 2020

GASB 87 – Leases

- Scope

- 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
 - Examples of nonfinancial assets include buildings, land, vehicles, and equipment
 - Any contract that meets this definition should be accounted for under the leases guidance, unless specifically excluded in this Statement

GASB 87 – Leases (continued)

- Scope exclusions - this Statement does not apply to:
 - Leases of intangible assets
 - Leases of biological assets, timber as example
 - Leases of inventory
 - Contracts that meet the definition of a service concession arrangement in paragraph 4 of GASB No. 60, *Accounting and Financial Reporting for Service Concession Arrangements*
 - Leases in which the underlying asset is financed with outstanding conduit debt, unless both the underlying asset and the conduit debt are reported by the lessor
 - Supply contracts, such as power purchase agreements

GASB 87 – Leases (continued)

- Lease term is the period during which a lessee has a noncancelable right to use the underlying asset (referred to as the noncancelable period), plus the following periods, if applicable:
 - Periods covered by lessee's/lessor's option to extend the lease if it is reasonably certain, based on all relevant factors, the lessee will exercise that option
 - Periods covered by lessee's/lessor's option to terminate the lease if it is reasonably certain, based on all relevant factors, the lessee will NOT exercise that option

GASB 87 – Leases (continued)

- Reasonably certain – factor to consider include, but are not limited to, the following:
 - A significant economic incentives (i.e. favorable contractual terms and conditions compared with current market rates)
 - A significant economic disincentive (i.e. negotiation costs, relocation costs, abandonment of significant leasehold improvements, costs of identifying another suitable underlying asset, costs to return the underlying asset in a contractually specified condition or to a contractually specified location, or a substantial cancellation penalty)
 - The history of exercising options to extend or terminate
 - The extent to which the asset underlying the lease is essential to the provision of government services.

GASB 87 – Leases (continued)

- Periods for which both the lessee and the lessor have an option to terminate the lease, or for which only the lessor has that option, are cancelable periods and are excluded from the lease term.
 - Provisions that allow for termination of a lease due to (a) purchase of the underlying asset, (b) payment of all sums due, or (c) default on payments, are not considered termination options
- A fiscal funding or appropriation clause should be considered in determining the lease term only when it is **reasonably certain** that the clause will be exercised

GASB 87 – Leases

- Short-term leases
 - 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. For a lease that is cancelable by either the lessee or the lessor, such as a rolling month-to-month lease or a year-to-year lease, the maximum possible term of the non-cancelable period, including any notice periods
 - Note: this is considered equivalent to the current operating lease model

GASB 87 – Leases (continued)

- Lessee Recognition and Measurement for Leases Other than Short-Term Leases and Contracts that Transfer Ownership
 - At the commencement of the lease term, a lessee should recognize a lease liability and an intangible right-to-use lease asset (a capital asset referred to as the lease asset)
- Lease liability – lessee should initially measure the lease liability at the present value of payments expected to be made during the lease term less any lease incentives.
 - Lease Incentives are (a) payments made to, or on behalf of, the lessee for which the lessee has a right of offset with its obligation to the lessor, or (b) other concessions granted to the lessee

GASB 87 – Leases (continued)

- Lease Asset – a lessee initially should measure the lease asset as the sum of the following:
 - The amount of the initial measurement of the lease liability
 - Lease payments made to the lessor at or before the commencement of the lease term, less any lease incentives received from the lessor at or before the commencement of the lease term
 - Initial direct costs that are ancillary charges necessary to place the lease asset into service
 - Any initial direct costs that would be considered debt issuance costs, should be recognized as an expense in the period in which they are incurred

GASB 87 – Leases (continued)

- 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 (except as noted below).
 - Exception – If a lease contains a purchase option that the lessee has determined is reasonably certain of being exercised, the lease asset should be amortized over the useful life of the underlying asset
- Amortization of lease asset should be reported as an expense (example, amortization expense) which may be combined with depreciation expense related to other capital assets for financial reporting purposes

GASB 87 – Leases (continued)

- Lessor Recognition and Measurement for Leases Other Than Short-Term Leases and Contracts that Transfer Ownership
 - At the commencement of the lease term, a lessor should recognize a lease receivable and a deferred inflow of resources, except for short-term leases and transfer of ownership, as well as two additional exceptions:
 - If the underlying asset in a lease meets the requirements in Statement 72 to be reported as an investment measured at fair value
 - Certain regulated leases

GASB 87 – Leases (continued)

GASB 87, paragraph 43

- Certain regulated leases – certain leases that are subject to external laws, regulations, or legal rulings that establish **all of the** following requirements:
 - a. Lease rates cannot exceed a reasonable amount, with reasonableness being subject to determination by an external regulator
 - b. Lease rates should be similar for lessees that are similarly situated
 - c. 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

GASB 87 – Leases (continued)

- Implementation Guide:
 - 4.46; Certain regulated leases – aeronautical and nonaeronautical elements
- Exposure draft Implementation Guide 2020-1:
 - 4.16; Port Authority – criteria of 43c

GASB 87 – Leases (continued)

- Lease asset measurement – lessor should measure the lease receivable at the present value of lease payments expected to be received during the lease term, reduced by any provision for estimated uncollectible amounts. Measurement of the lease receivable should include the following, if required by a lease:
 - Fixed payments
 - Variable payments that depend on an index or rate initially measured at the beginning of the lease term
 - Variable payments that are fixed in substance
 - Residual value guarantee payments that are fixed in substance
 - Any lease incentives payable to the lessee

GASB 87 – Leases (continued)

- Lease asset measurement, continued
 - Future lease payments to be received should be discounted using the interest rate the lessor charges the lessee
 - Exposed Implementation Guide includes Q&A around what rate can be used
 - In subsequent financial reporting periods, the lessor should calculate the amortization of the discount on the lease asset and report that amount as an inflow of resources (example – interest revenue)
 - Triggers for potential remeasurement

GASB 87 – Leases (continued)

- Deferred Inflow of Resources – a lessor initially should measure the deferred inflow of resources as follows:
 - The amount of the initial measurement of the lease receivable
 - Lease payments received from the lessee at or before the commencement of the lease term that relate to future periods, less any lease incentives paid to, or on behalf of, the lessee at or before the commencement of the lease term
- Underlying asset
 - A lessor should not derecognize the asset underlying the lease
 - A lessor should continue to apply other applicable guidance to the underlying asset, including depreciation and impairment
 - However, if the lease contract requires the lessee to return the asset in its original or enhanced condition, a lessor should NOT depreciate the asset during the lease term

GASB 87 – Leases (continued)

- Additional guidance provided for:
 - Lease incentive
 - Contracts with multiple components
 - Contract combinations
 - Lease modifications
 - Lease terminations
 - Subleases
 - Sale-leaseback transactions
 - Lease-leaseback transactions
 - Intra-entity leases
 - Leases between related parties

IMPLEMENTATION CONSIDERATIONS

GASB 87 implementation phase

The following slide highlights the different workstreams in the GASB 87 implementation phases. RSM will work with you to setup you project management office and strategy; develop strategy for data collection and abstraction; implement your selected technology; develop accounting, business process and controls; assess tax needs; and provide training on the standard, technology and new controls.

Strategy and planning

- Develop a project management plan to implement the new standard

Data collection

- Find, prepare and centralize lease documents, abstract lease documents and perform validation procedures

Technology solution

- Implement a technology solution to help comply with the new standard and manage lease portfolio

Accounting and financial reporting

- Prepare calculations, adjustments, disclosures required with transition to the new standard; preparation of memos such as policies, transition memo etc.

Business processes and controls

- Develop new or update current business processes and controls for the new requirements

Training

- Train various stakeholders across the company on the new standard, technology solution and new controls

Slide 26

HM17 Bob - taxes won't be an issue for SLG - can this be removed from this slide?
Horaney, Michelle, 1/23/2020

GASB 87 Implementation key activities and deliverables

Project management

- Project plan detailing the activities and estimate due dates of completing
- Ongoing agenda and coordination for project meeting
- Periodic project status updates
- Periodic project economics update
- Coordination with various team members and stakeholders

Technology vendor selection

- Evaluate business requirements , organizational readiness & process changes required for new lease technology solution
- Provide summary of vendors optimal for the company.
- Facilitate vendor demonstrations; review software contracts and pricing, and negotiate terms
- Technology impact assessment, including key findings and recommendations to be addressed during implementation
- Implementation roadmap

Business processes

- Future state lease processes
- New general ledger accounts to track information required under GASB 87
- Future state financial reporting process flow

Training

- New lease standard training
- Training on templates required to be populated for RSM's review
- Lease technology solution training
- New processes and controls training



Data abstraction

- Completed abstraction template that can be imported into the chosen lease technology solution
- Preparation of non contract template to be completed for abstraction
- Practical expedient elections; current/transition accounting decisions based on types of leases

Accounting and financial reporting

- Future state accounting policies
- Transition/Implementation memo
- Development of the quantitative and qualitative disclosures
- Assistance with specific topics such as portfolio approach, management estimates etc.
- Preparation of calculation and adjustments post abstraction

Embedded leases

- Embedded lease service arrangement survey to identify different types of service arrangements that exist.
- Embedded lease questionnaire
- Sample service contract analysis for embedded leases
- Preparation of data needed for abstraction, if embedded leases are identified

Data collection – ensuring lease completeness

- Have you identified all of your leases?
- Ensuring completing of the lease portfolio is critical under GASB 87.
- Procedures to verify completeness include:
 - Review of footnote disclosures
 - Surveys to business units
 - Cash disbursement analysis

Embedded leases (cont.)

- A contract contains a lease if it conveys control of the right to use the underlying asset. To make this determination, a government should assess whether it has both:
 - the right to obtain the present service capacity from use of the underlying asset as specified in the contract; and
 - the right to determine the nature and manner of use of the underlying asset as specified in the contract.
- A lessor's substitution rights do not preclude a contract from containing a lease.
 - Substitution with an essentially identical asset allows the lessee to maintain control of the right to use the service capacity of another entity's underlying asset and does not violate the definition of a lease.

Embedded leases – Do you have any?

Common examples could include:

**Advertising
space on
buildings or
billboards**

**Telecom ‘Last
mile’ network**

**IT-Data center /
co-location
arrangements**

**Medical devices
embedded in a
service contract**

**Equipment
rental for
special event
services**

**Dining service
contracts**

**Vending service
contracts**

Power plants

Data abstraction and review

Below provides an overview of RSM's abstraction process.

ABSTRACT

- Abstract data from lease documents and prepare templates to be imported into the technology solution
- Apply all judgments made in the preparation phase to the data being abstracted
- Ensure all documents are reviewed and abstracted into the system by checking the most current lease documents against the expenses being recorded in the GL

VALIDATE

- Validate the completeness of information entered into the system
- Validate the accuracy of data entered into the system
- Validate the GASB 87 calculations tie back to the current GL

REVIEW

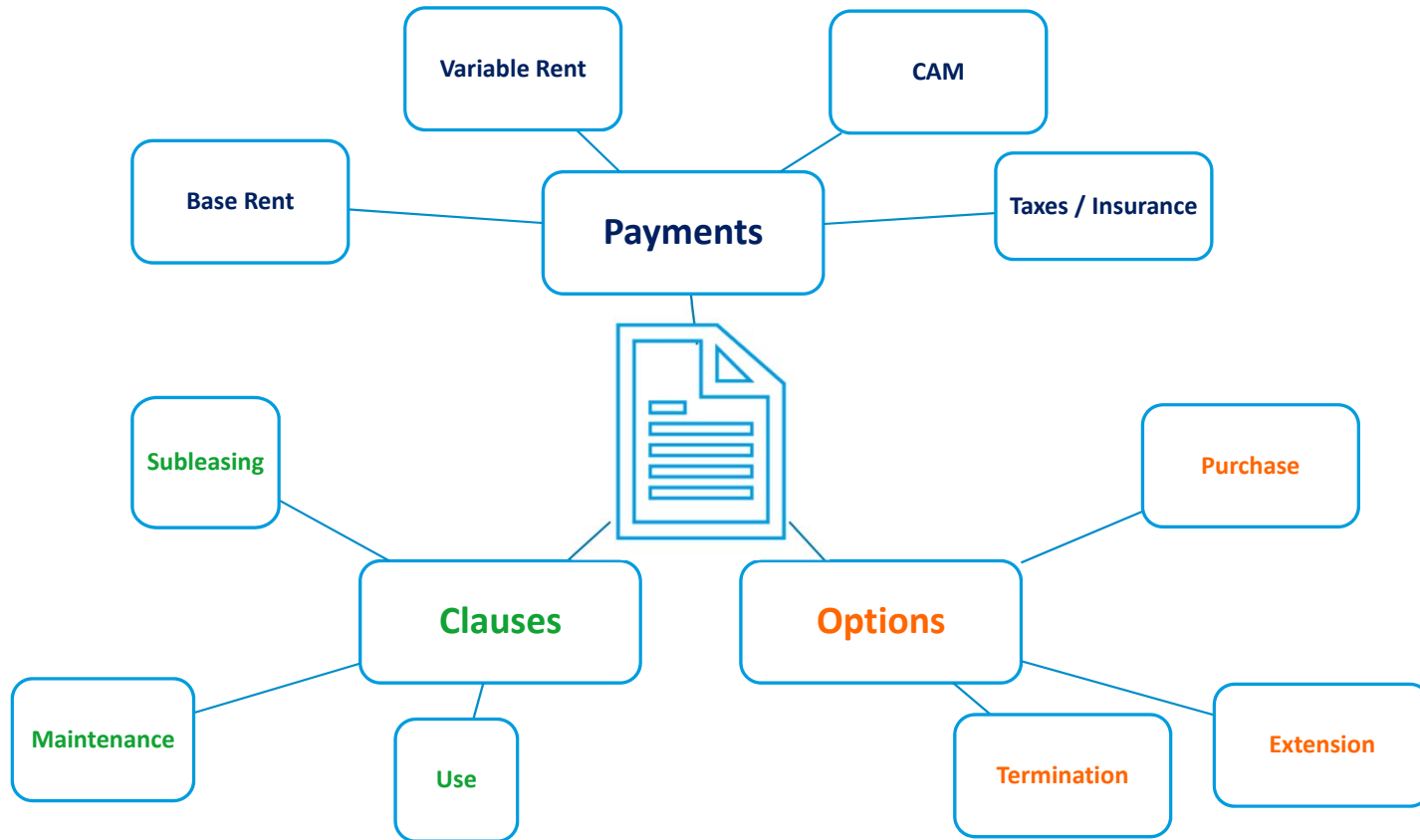
- Perform reviews to ensure accuracy of the information inputted
- Review of information inputted into the abstraction templates or lease technology solution
- Review the accounting calculations under GASB 87
- Provide population to you for review prior to finalizing the abstracts

Need for a Technology Solution

A technology solution can help centralize all leases onto a single platform, perform calculations, assist with lease administration and provide necessary information for reporting:

- **Calculate future lease liability** based on net present value (NPV) of future payments based on interest rates which could differ by contract. Systems will store appropriate data and calculate the liability
- **Calculate the right of use (ROU) asset** with adjustments, which can vary based on lease classification
- **Separately account for lease & non-lease components** for accounting purposes, but make payments and record expenses in aggregate or as appropriate
- **Track terms including renewals, options, expirations, etc.**; terms can be stored within the system and notifications can be generated
- **More comprehensive disclosure reporting** and systems can help with the quantitative disclosures – readily available reporting
- Lease software can also be used to **centralize and store lease information**, process payments and assist in establishing controls over lease procurement

Why not use Excel?

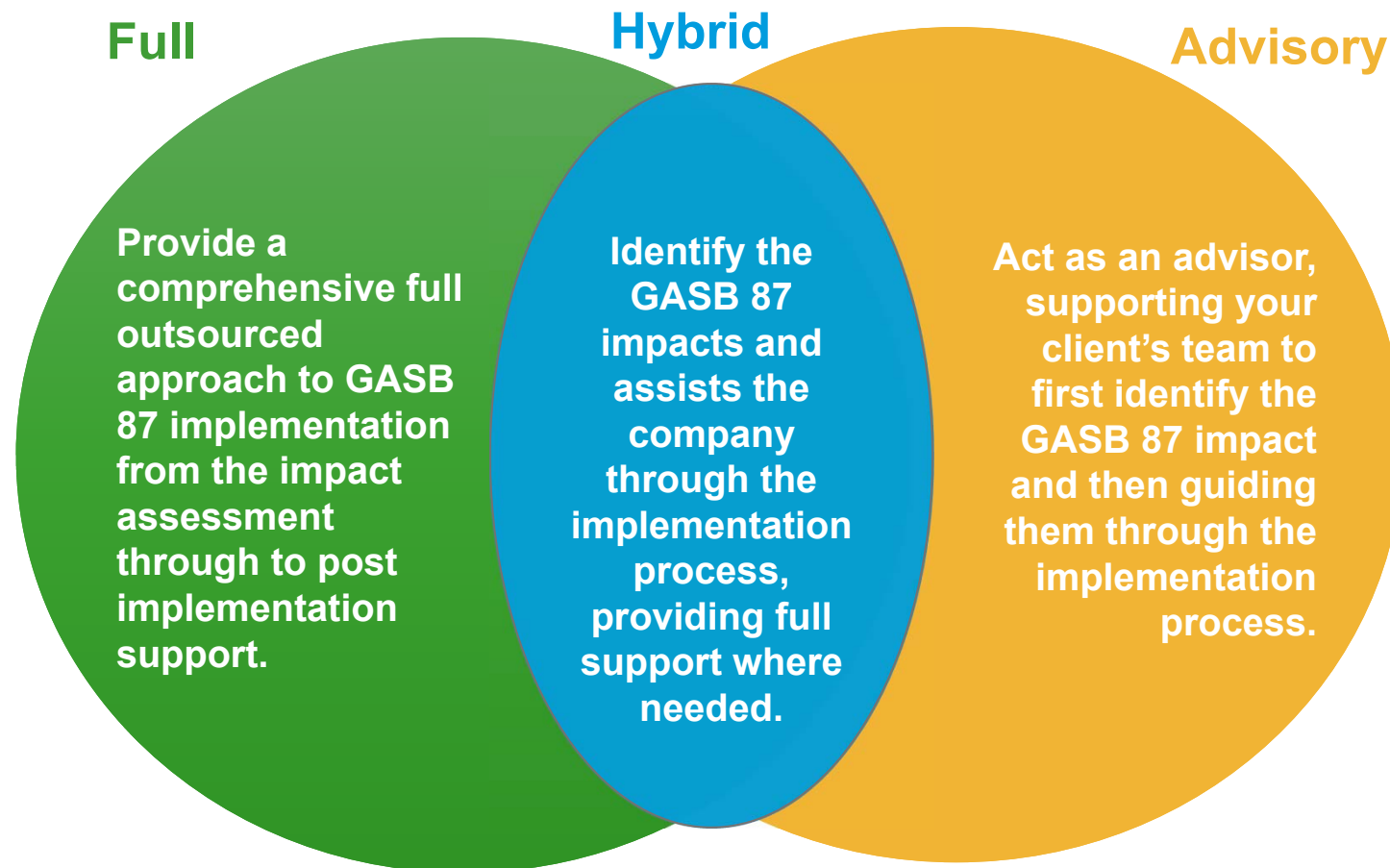


Vendor Selection Process

During the selection process, vendors are evaluated based on the following high-level criteria.

Criterion	Description
Ability to meet requirements	Assessment of the strengths of the software application relative to client's functional requirements. Included within this criteria is the ability of the product to meet demonstration requirements and overall ease of use.
Technical architecture / Ease of integration	Meets corporate standards, amount of customization required, and ability to integrate to client's current technical infrastructure
Functional fit / Ease of use	Key considerations related to functional fit within client's processes and ease of use by the end users
Ability to execute	Complexity of implementation, stability of latest version of the product, availability of skilled implementers and developers
Pricing and cost	Summary of prices, terms, and total cost of ownership

Customized implementation approach



Illustrative GASB 87 approaches (Full vs. Hybrid vs. Advisory)

Workstreams	Main Milestones / Main Activities	Full	Hybrid	Advisory
Strategy and planning	Project Governance & Setup	X	X	
	Stakeholder Communication	X	X	
	Implementation Roadmap	X	X	X
Accounting and financial reporting	Contract Reviews	X		
	Practical Expedients	X	X	X
	Transition memo	X	X	X
	Accounting Policy	X	X	
	Disclosures	X	X	X
	ROU & Lease Liability Validation	X		
Accounting and financial reporting – embedded leases	Embedded Lease Approach	X	X	X
	Service Arrangement Review	X		
	Embedded Lease Memo	X		
Business process and controls	Lease Completeness Approach	X	X	X
	Future State Process	X		
	New General Ledger	X		
	Non-contract Source Data	X	X	
Training	GASB 87 Overview	X	X	X
	Embedded Lease Training	X	X	X
Data abstraction	Abstraction & Validation	X	X	
	Reviews	X	X	
Technology	Express Fit Gap Assessment	X		
	Technology Implementation	X		
Range of effort	RSM compared to Client effort (%)	80% - 20%	60% - 40%	20% - 80%

QUESTIONS AND ANSWERS

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