



# FGFOA GASB 87: Practical Considerations

Presented by:

Wayne Durrett, CPA, Manager

Ben Clark, CPA, Senior Accountant



# Your Presenters



## **MEET** Wayne Durrett, CPA Manager

Wayne has over five years of professional auditing and accounting experience. Wayne focuses primarily on our clients in the government, nonprofit and higher education industries and performs single audits as well as general financial statement audits. His previous work at the Florida Auditor General, where he reviewed audits to ensure they include key compliance areas, gives him a valuable perspective on these complex engagements.



## **MEET** Ben Clark, CPA Senior Accountant

Ben has over five years of experience providing accounting, auditing and consulting services. A key member of the firm's Accounting & Auditing Services Team, he works on compilations, audits and reviews. The vast majority of his work focuses on nonprofit organizations and government entities, giving him in-depth knowledge of Uniform Guidance and other federal and state audit guidelines.

# Agenda

- GASB 87 pronouncement
- Implementation guide
- Q&A

# GASB 87

# Leases: Statement 87

## WHAT

- Statement 87 requires the recognition of lease assets and liabilities for leases that previously were classified as operating leases.

## WHY

- Better meet the information needs of financial statement users by improving accounting and financial reporting for leases by governments.

## WHEN

- Effective for periods beginning after June 15, 2021\*.

# GASB 87: Overview

- What it is: A comprehensive change to the way we account for leases, putting both operating and capital lease assets and related liabilities on the balance sheet.
- What it is not: The same as the FASB Lease standard. The FASB standard establishes two type of leases, finance leases and operating leases. The GASB standard does not differentiate leases.

# Scope and Approach

- Applied to any contract that meets the definition of a lease (unless specifically excluded):
  - “A lease is a contract that conveys the 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”
- Control of Right to Use:
  - Obtain present service capacity
  - Determine nature/manner of use



# Lease Term

- Includes noncancelable period of a lease, plus:
  - Periods covered by a lessee's option to renew, if it is reasonably certain the option will be exercised
  - Periods covered by a lessee's option to terminate, if it is reasonably certain the option will not be exercised
  - Same rules for lessor options to renew/terminate
- Fiscal funding/cancellation clauses considered like any other option to terminate
- Reassessed when an option is exercised or not exercised contrary to the previous expectation



# Short-term Leases

- Maximum possible term  $\leq$  12 months regardless of likelihood

**EXEMPT**

# Proposed Lessee Reporting

- Lessee recognition and measurement
  - Recognize an intangible asset for the right to use the underlying asset and a liability for future payments; asset amortized over time
- Initial measurement of a lease liability includes:
  - Fixed payments to be made over the lease term
  - Variable payments based on an index or rate, using the rate in effect at that date
  - Variable payments that are in-substance fixed
  - Residual value guarantees if reasonably certain of being required
  - Purchase options (including bargains) if reasonably certain of being exercised
  - Termination penalties if the termination option was considered reasonably certain of being exercised
  - Lease incentives
  - Discounting of gross liability

**Liability does not include lease payments that are dependent on a lessee's performance or usage of an underlying asset (i.e. excess mileage on auto lease)**

# Polling Question #1

# Lease Liability Simplified



**DISCOUNT**

# Proposed Lessee Reporting

- Initial measurement of a lease **asset** includes:
  - Lease liability
  - Any prepayments prior to measuring the lease liability
  - Initial direct costs if they are ancillary charges to place the leased asset into use
- Lease incentives received should be reductions in the cost of lease assets
- Initial direct costs should be expensed if they are costs other than ancillary charges to place the leased asset into use

# Proposed Lessor Reporting

## Lessor recognition and measurement

- Recognize a lease receivable and deferred inflow of resources
  - Do not derecognize the underlying asset
- Discount the lease receivable at the rate the lessor charges
- The leased asset should be depreciated, unless it is required to be returned in its original or enhanced condition or the leased asset has an indefinite useful life
- Initial measurement of a lease receivable includes:
  - Fixed payments to be made over the lease term
  - Variable payments based on an index or rate, using the rate in effect at that date
  - Variable payments that are in-substance fixed
  - Residual value guarantees that are in-substance fixed
- Amortization of amounts as payments made and disclosures

# Other Considerations

- Various parts to a single contract (i.e. leased asset and service or other component)
  - Allocation of contract price based on contract or best judgment if specific breakdown not available
- Lease Changes
  - Terminations: write off asset and liability, record gain or loss (unless purchasing – then reclass to asset)
  - Modification or change in significant circumstances: re-measure lease, change prospectively. Also remeasure asset.
- Subleases
  - Separate, independent transaction
- \$1 Leases (or similar)
  - No impact (not an exchange or exchange-like transaction)

# Other Considerations

- Exemptions
  - Lease with transfer of ownership (use traditional capital lease accounting)
  - Leases of assets that are investments
  - Service contracts (unless lease component exists)
  - Computer software licensing
- Related Parties
  - No changes from regular lease accounting
  - Emphasis on substance of transaction, not form
- Sale-Leaseback Transactions
  - Sale and lease as independent transactions
  - Difference between carrying value of sold asset and net proceeds from sale = deferred inflow/outflow recognized over term of lease



# Accounting Considerations

- Initial Discounting of Lease Payments
  - Explicit/implicit rate, if available
  - Incremental borrowing rate (note: leases do NOT have to be re-measured if such rate changes)
- Ongoing Impact
  - Lease Liability
    - Amortization of discount as interest expense
    - Payments first pay off accrued interest then lease liability
  - Lease Asset
    - Amortize in “Systematic and rational manner”
    - Shorter term of asset life or lease liability

# Practical Accounting Considerations

- **Governmental Funds**
  - Expenditure and other financing source in period of initial lease recognition
- **Materiality**
  - No official de minimis threshold
  - Consider setting policy (similar to a capitalization policy)

# Practical Accounting Considerations (continued)

- Best practices regarding implicit interest rates
- Embedded Leases
- Best practices to separate out non-lease components in a given contract

# Note Disclosures

- General Description of Leasing
  - Highlight any significant items in determination of liability
- Total Amount of Lease Assets
  - Gross, Accumulated Amortization, Net
  - Separate from other capital assets
- Amount of Lease Assets by Major Class
- Current Year Outflows for Variable Payments Not in Lease
- Principal and Interest in 5 year format
- Components of any loss with impairment
- Details on any sublease/sale-leaseback transactions

# Polling Question #2



# Polling Question #3



# Polling Question #3 Answer

Yes, the Lessor would report BOTH the leased asset and a lease receivable asset

# Visual Refresher – Initial Reporting

	Assets	Liability	Deferred Inflow
Lessee	Intangible asset (right to use underlying asset)—value of lease liability plus prepayments and initial direct costs that are ancillary to place asset in use	Present value of future lease payments (including fixed payments, variable payments based on index or rate, reasonably certain residual guarantees, etc.)	NA
Lessor	<ul style="list-style-type: none"><li>• Lease receivable (generally including same items as lessee liability)</li><li>• Continue to report leased asset</li></ul>	NA	Equal to lease receivable plus any cash received up front that relates to a future period



# Visual Refresher – Initial Reporting (Example)

**Basic Facts and Circumstances:** Road Equipment Lease

**Term** – Noncancelable 60 months. Option to extend 24 months (not likely)

**Payment** – Base of \$1,000 per month. Base payment includes 200 hours of use per month. \$5 additional payment required for every additional hour used (estimated to use 300 hours per month). In addition, set \$80 monthly payment for repairs and maintenance.

**Rate stated** in the lease contract is 4%

**Additional charges** - \$800 for delivery and \$700 installation.

# Visual Refresher – Initial Reporting (Example Continued)

**What is relevant to the recording of the lease?**

**Lease term** = 60 months only since it is not reasonably certain the option to extend will be exercised.

Initial measurement of lease liability:

**Lease Liability** = sum of all base payments, discounted by 4% = \$54,480

**Excess use charge** for additional hours – Excluded = \$0

**Repairs and maintenance** – Excluded - \$0

**Lease Asset** = Amounts above Plus:

**Delivery and installation** -\$1,500

**Total** = \$55,980

# Visual Refresher – Initial Reporting – Debits and Credits

	Lessee			Lessor	
	Debit	Credit		Debit	Credit
Cash		1,500	Cash	1,500	
Lease Asset	55,980		Lease Receivable	54,480	
Lease Liability		54,480	Deferred Inflow Revenue		54,480 1,500

# Visual Refresher – Ongoing Reporting

	Assets	Liability	Deferred Inflow
Lessee	Amortize the intangible asset over shorter of useful life or lease term	Reduce by lease payments (less amount for interest expense)	NA
Lessor	<ul style="list-style-type: none"><li>• Depreciate leased asset (unless indefinite life or required to be returned in its original or enhanced condition)</li><li>• Reduce receivable by lease payments (less payment needed to cover accrued interest)</li></ul>	NA	Recognize revenue over the lease term in a systematic and rational manner

# Visual Refresher – Ongoing Reporting – Debits and Credits

	Lessee			Lessor	
	Debit	Credit		Debit	Credit
Cash		\$1,000	Cash	1,000	
Lease Liability	822		Lease Receivable		822
Interest Expense	178		Deferred Inflow	822	
Lease asset		933	Lease Revenue		822
Amortization expense	933		Interest Revenue		178

# Implementation Considerations

- Assess bond/debt covenants
  - Debt to XYZ measurements in jeopardy?
- Lease Policies
  - Working “capitalization” threshold
  - Definition of “reasonably certain”
  - Allocation procedures for non-lease components (if significant)
  - Separate from other capital assets
- Begin summarizing lease terms
- Great starting points:
  - Operating lease note disclosure
  - Rent expense



# Polling Question #4





# Implementation Guide



# Implementation Guide 2019-3

## WHAT

- Questions and answers to address issues raised by the GASB's stakeholders through inquiries posed to the GASB or through comments submitted in response to GASB due process documents.

## WHY

- To provide guidance that clarifies, explains, or elaborates on the requirements of GASB 87.

## WHEN

- Draft released February 2019; Comments due by April 2019; and Final issued August 2019.

# Implementation Guide 2019-3

- Includes 77 questions and answers about GASB 87
  - Will provide more robust guidance
  - Classification: Is the transaction an exchange?
- Includes three illustrations:
  - Lessee reporting of an equipment lease
  - Lessee reporting of a building lease with a lease incentive
  - Variable payments that depend on an index or a rate



# Polling Question #5

# Q&A from Guide

- 4.12 – A developer builds and leases a building to a government. The government is required to make payments during the three-year construction period. The government does not have access to the building until a certificate of occupancy is issued at the end of the construction period. When does the lease term begin?

# Q&A from Guide

- 4.15 – A lease contract allows either party to unilaterally terminate the lease at any time but also provides for cancellation penalties. The cancellation penalties are so great that it is reasonably certain that neither party will terminate the lease. Should the cancellable periods be excluded from the lease term?

# Q&A from Guide

- 4.16 – A lease contract allows only the lessee to unilaterally terminate the lease at any time but also provides for cancellation penalties. The cancellation penalties are so great that it is reasonably certain that the lessee will not terminate the lease. Should the cancellable periods be excluded from the lease term?

# Q&A from Guide

- 4.17 – A government enters into a 12-month lease with the lessee having options to renew for 12 months at a time, up to 49 times. Is this agreement a short-term lease under Statement 87?

# Q&A from Guide

- 4.23 – A government adopts a capitalization threshold and expenses acquisitions, including lease assets, that fall below that threshold. Can the government apply a similar threshold to recording lease liabilities?



# Q&A from Guide

- 4.31 – A government leases a fleet of vehicles for half of the vehicles' estimated useful lives. The lease term is 30 months. The lease does not specify the discount rate. Total monthly lease payments over the term of the lease are \$1.1 million, and the fair value of the vehicles at the commencement of the lease is \$2 million. May the fair value of the vehicles be used in determining the implicit discount rate of the lease?

# Q&A from Guide

- 4.37 – Can amortization expense for lease assets be combined with depreciation expense in the required disclosure by function?

# Q&A from Guide

- 4.49 – Can methodologies other than the interest method, such as straight-line amortization, be used to amortize the discount on lease receivables?

# Q&A from Guide

- 4.68 – A government leases one floor of an office building to a private party for several years. In the middle of the lease, a significant downturn in the local real estate market occurs. The government and the lessee renegotiate the rental payments for the remainder of the lease. The lease receivable (present value of lease payments expected to be received during the remaining lease term) before the amendment was \$500,000 and after it was \$270,000. How should the government account for the lease modification?



# Polling Question #6

# Where to Find More Information?

GASB 87 Full Text -

[https://www.gasb.org/jsp/GASB/Document\\_C/DocumentPage?cid=1176169170145&acceptedDisclaimer=true](https://www.gasb.org/jsp/GASB/Document_C/DocumentPage?cid=1176169170145&acceptedDisclaimer=true)

GASB 87 Summary -

[https://www.gasb.org/cs/ContentServer?c=Pronouncement\\_C&cid=1176169177502&d=&pagename=GASB%2FPronouncement\\_C%2FGASBSummaryPage](https://www.gasb.org/cs/ContentServer?c=Pronouncement_C&cid=1176169177502&d=&pagename=GASB%2FPronouncement_C%2FGASBSummaryPage)

Implementation Guide -

[https://www.gasb.org/jsp/GASB/Document\\_C/DocumentPage?cid=1176173189687&acceptedDisclaimer=true](https://www.gasb.org/jsp/GASB/Document_C/DocumentPage?cid=1176173189687&acceptedDisclaimer=true)

The background features a light green gradient with several white, hand-drawn question marks scattered throughout. In the center, there is a semi-transparent image of a person's forehead with their hand resting on it, suggesting a state of confusion or deep thought. A solid green horizontal band is positioned across the middle of the image, containing the text 'Q&A'.

# Q&A

# Contact



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