

THE KNOWLEDGE GROUP

Live CLE/CPE Webinar Invitation

GASB 87 IS HERE... WHAT YOU SHOULD KNOW



Wednesday,
June 16, 2021



3:00 pm - 4:00 pm (ET)

PRESENTING SPEAKERS



Stephen G. Austin, CPA, MBA
Firm Managing Partner
Swenson Advisors, LLP



Joel Colbourn, CPA, MBA
Lease Accounting Director
Swenson Advisors, LLP

AGENDA

Introduction of Presenters

Introduction to GASB 87 Lease Accounting

Leases Overview

Lessee Accounting

Lessor Accounting

Lease Components and Multiple Components

Other Considerations/Issues

Discount Rate

Lessee Disclosures and Lessor Disclosures

Differences Between Prior Accounting and GASB 87

Closing Thoughts

Q&A

PRESENTING SPEAKERS



Stephen G. Austin, CPA, MBA

Firm Managing Partner
Swenson Advisors, LLP

Steve is a Certified Public Accountant in the states of California and Georgia. Steve manages audit, SEC, Sarbanes-Oxley, and business and lease accounting consulting engagements with a focus on technology, manufacturing, service, real estate, social media, and non-profit organizations. He is the author of the book *Rise of the New Ethics Class*. Steve speaks worldwide on governance, Sarbanes-Oxley, and IFRS matters and writes articles published by the AICPA. Prior to joining Swenson Advisors, Steve held Partner positions with McGladrey & Pullen, LLP and Price Waterhouse, LLP. Steve earned a BS in Accounting and Finance from Bob Jones University and an MBA from the University of Georgia, Terry College of Business. Steve serves on numerous community boards and audit committees including Summit Ministries, Family Heritage Foundation, Brandman University and InSoCal CONNECT.

PRESENTING SPEAKERS (CONTINUED)



Joel Colbourn, CPA, MBA

Lease Accounting Director
Swenson Advisors, LLP

Joel Colbourn is a Certified Public Accountant and has several years of experience directing accounting and treasury consulting engagements, including several successful lease accounting implementations. He is a frequent speaker on lease accounting and publishes articles published by the AICPA. He has also directed accounting and treasury operations for complex global organizations. His industry experience includes more than 20 years in the areas of retail distribution, healthcare, aerospace and defense, technical services and solutions, and consumer products. Early in his career he worked for Ernst & Whinney where his clients included several government entities. Joel earned a B.S from the University of California, Berkeley and an MBA from the University of Southern California.

INTRODUCTION TO GASB 87 LEASE ACCOUNTING

- With COVID-19 delay, **Statement No. 87 of the Government Accounting Standards Board, Leases** ("GASB 87"), is now required for fiscal years beginning after **June 15, 2021**
- Applicable to both lessees and lessors
- No difference between operating leases and capital leases – now just "leases"
- All lease balances must be calculated using the applicable discount rate
 - Lessees record right-to-use (RTU) asset and lease liability
 - Lessors record lease receivable and deferred inflow of resources
- All leases must be recorded as of the implementation date
- Implementation as of the earliest period presented, unless impracticable
 - Impracticable does not mean inconvenient

LEASES OVERVIEW – DEFINITION OF A LEASE

Lease – 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. Examples of nonfinancial assets include buildings, land, vehicles, and equipment.

In determining the right to use the underlying asset, a government entity must have both:

- a. The right to obtain the present service capacity from use of the underlying asset
- b. The right to determine the nature and manner of use of the underlying asset

LEASES OVERVIEW – DEFINITION OF A LEASE (CONTINUED)

- Leases include contracts that, although not specifically identified as leases, meet the definition of a lease. Also includes leases embedded in contracts.
- Leases exclude:
 - Intangibles (including licenses)
 - Biological assets
 - Inventory
 - Service concession arrangements (GASB 60)
 - Conduit debt arrangements
 - Supply contracts
- A lease that transfers ownership by the end of the term treated as a financed purchase.

LEASES OVERVIEW – LEASE TERM

Lease commencement is the date the lessor makes available the underlying asset for use by the lessee

- May or may not align with the date rent payment commences.

The lease term is the period during which the lessee/lessor has/provides a non-cancelable right to use an underlying asset (non-cancelable period), plus “reasonably certain” extension/renewal options or termination option

- Assessment factors include contract-based, underlying asset-based, market-based, and government specific-based considerations.
- “Reasonably certain” considered a high threshold, generally a likelihood of 75% or more.

Periods for which both the lessee and the lessor have an option to terminate the lease without permission from the other party are cancelable periods and are excluded from the lease term.

Recording of asset and liability not required for short-term leases where maximum possible lease term at commencement is 12 months or less.

LESSEE ACCOUNTING

At lease commencement, a right-to-use (RTU) asset and lease liability will be recognized at the present value of the fixed lease component amounts over the lease term.

Fixed lease component amounts directly relate to use of the underlying asset and include:

- Fixed payments for a lease component, including measurable increases
- Index-based variable payments measured as of the commencement date,
- Variable payments for a lease component that are fixed in substance,
- Amounts reasonably certain to be paid under a residual value guarantee,
- Purchase option determined to be reasonably certain at lease commencement,
- Lease incentives to be received after commencement.

LESSEE ACCOUNTING (CONTINUED)

The RTU asset is

- Adjusted for payments from lessor, including lease incentives, prior to commencement
- Adjusted for initial direct costs
- Amortized on a straight-line basis over lease term, or over economic life if exercise of purchase option is reasonably certain

Recurring rent payments allocated to interest expense (outflow of resources) and liability reduction.

Variable rent recognized as outflow of resources in period incurred.

LESSEE ACCOUNTING – EXAMPLE

LEASE EXAMPLE ASSUMPTIONS	
Lease Term In Months	60
Initial Monthly Rent	\$1,000
Payment Terms	Monthly in advance
Lease Commencement	7/1/2021
Lease Expiry	6/30/2026
Monthly Amortization of RTU Asset	\$962 (\$57,712/60)
Annual Increase	3.00%
Discount Rate	4.00%

LESSEE ACCOUNTING – EXAMPLE (CONTINUED)

LIABILITY AMORTIZATION SCHEDULE				
Date	Payment	Interest	Liability Adjustment	Lease Liability Balance
7/1/2021				\$57,712
7/1/2021	(\$1,000)			\$56,712
8/1/2021	(\$1,000)	\$189	\$811	\$55,901
9/1/2021	(\$1,000)	\$186	\$814	\$55,087
10/1/2021	(\$1,000)	\$184	\$816	\$54,271
11/1/2021	(\$1,000)	\$181	\$819	\$53,452
2/1/2026	(\$1,126)	\$19	\$1,107	\$4,467
3/1/2026	(\$1,126)	\$15	\$1,111	\$3,356
4/1/2026	(\$1,126)	\$11	\$1,115	\$2,241
5/1/2026	(\$1,126)	\$7	\$1,119	\$1,122
6/1/2026	(\$1,126)	\$4	\$1,122	\$0

LESSEE ACCOUNTING – ENTRIES

7/1/21	dr. Right-to-use asset	\$57,712
	cr. Lease liability	\$57,712
	To record right-to-use asset and lease liability at lease commencement	
	dr. Lease liability	\$1,000
	cr. Cash	\$1,000
	To record first scheduled lease payment	
7/31/21	dr. Interest (outflow of resources)	\$189
	cr. Interest payable	\$189
	To accrue interest for July 2021	
	dr. Amortization (outflow of resources)	\$962
	cr. Right-to-use asset	\$962
	To record July 2021 monthly amortization of right-to-use asset	

LESSEE ACCOUNTING – ENTRIES (CONTINUED)

8/1/2021	dr. Interest payable	\$189
	dr. Lease liability	\$811
	cr. Cash	\$1,000
	To record second scheduled lease payment	
8/31/21	dr. Interest (outflow of resources)	\$186
	cr. Interest Payable	\$186
	To accrue interest for August 2021	
	dr. Amortization (outflow of resources)	\$962
	cr. Right-to-use asset	\$962
	To record August 2021 monthly amortization of right-to-use asset	

LESSOR ACCOUNTING

At lease commencement, a lease receivable and deferred inflow of resources will be recognized at the present value of the fixed lease component amounts over the lease term.

Fixed lease component amounts directly relate to the lessee's use of the underlying asset and include:

- Fixed payments for a lease component, including measurable increases
- Index-based variable payments measured as of the commencement date,
- Variable payments for a lease component that are fixed in substance,
- Amounts reasonably certain to be received under a residual value guarantee,
- Lessee purchase option or termination penalty determined to be reasonably certain at lease commencement,
- Lease incentives to be paid after commencement.

LESSOR ACCOUNTING (CONTINUED)

The deferred inflow of resources is,

- Adjusted for payments received from lessee prior to commencement
- Adjusted for lease incentives or other payments made to lessee prior to commencement
- Amortized on a straight-line basis over lease term

Recurring rent payments allocated to interest income (inflow of resources) and receivable reduction.

Variable rent and initial direct costs recognized as outflow of resources in period incurred.

Underlying asset remains on lessor's books and depreciation continues

LESSOR ACCOUNTING – EXAMPLE

LEASE EXAMPLE ASSUMPTIONS	
Lease Term In Months	60
Initial Monthly Rent	\$1,000
Payment Terms	Monthly in advance
Lease Commencement	7/1/2021
Lease Expiry	6/30/2026
Monthly Amortization Deferred Inflow of Resources	\$962 (\$57,712/60)
Annual Increase	3.00%
Discount Rate	4.00%
Monthly Depreciation	\$500 Continuing

LESSOR ACCOUNTING – EXAMPLE (CONTINUED)

LEASE RECEIVABLE AMORTIZATION SCHEDULE				
Date	Payment	Interest	Receivable Adjustment	Lease Receivable Balance
7/1/2021				\$57,712
7/1/2021	(\$1,000)			\$56,712
8/1/2021	(\$1,000)	\$189	\$811	\$55,901
9/1/2021	(\$1,000)	\$186	\$814	\$55,087
10/1/2021	(\$1,000)	\$184	\$816	\$54,271
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6/1/2026	(\$1,126)	\$4	\$1,122	\$0

LESSOR ACCOUNTING – ENTRIES

7/1/21	dr. Lease receivable	\$57,712
	cr. Deferred inflow of resources	\$57,712
	To record right-to-use asset and lease liability at lease commencement	
	dr. Cash	\$1,000
	cr. Lease receivable	\$1,000
	To record first scheduled lease payment received	
7/31/21	dr. Interest receivable	\$189
	cr. Interest (inflow of resources)	\$189
	To accrue interest for July 2021	
	dr. Deferred inflow of resources	\$962
	cr. Amortization (inflow of resources)	\$962
	To record July 2021 monthly amortization of deferred inflow of resources	

LESSOR ACCOUNTING – ENTRIES (CONTINUED)

	dr. Depreciation	\$500
	cr. Accumulative depreciation capital asset	\$500
	To record July 2021 capital asset depreciation	
8/1/2021	dr. Cash	\$1,000
	cr. Interest receivable	\$189
	cr. Lease receivable	\$811
	To record second scheduled lease payment received	
8/31/2021	dr. Interest receivable	\$186
	cr. Interest (inflow of resources)	\$186
	To accrue interest for August 2021	

LESSOR ACCOUNTING – ENTRIES (CONTINUED)

	dr. Deferred inflow of resources	\$962
	cr. Amortization (inflow of resources)	\$962
	To record August 2021 monthly amortization of deferred inflow of resources	
	dr. Depreciation	\$500
	cr. Accumulative depreciation capital asset	\$500
	To record August 2021 capital asset depreciation	

LEASE COMPONENTS AND MULTIPLE COMPONENTS

A lease component is the cost element of a lease that directly relates to the right to use the underlying asset (i.e., rent cost).

A non-lease component is the cost element of a lease that is related to the underlying asset but does not directly relate to the right to use the underlying asset (i.e., charges for common area maintenance).

Some lease payment amounts are fixed and some payment amounts may be variable

- Fixed and variable payments applicable to both lease components and non-lease components
- May be multiple lease components, multiple non-lease components, or both

Note: Identifying fixed lease component payments is critical since these are the amounts upon which the lease asset/lease receivable and lease liability/deferred inflow of resources calculations are performed.

LEASE COMPONENTS AND MULTIPLE COMPONENTS (CONTINUED)

If individual pricing for the lease and non-lease components are not stated in contract or if pricing provided does not appear reasonable, an allocation of pricing to the components using observable information, comparable information, and professional judgement.

- If allocating contract pricing to individual components is not practicable, the lessee may account for the consideration in the contract as though one unit. Not practicable does not mean inconvenient.

Lease component variable rent includes index-based adjustments (such as Consumer Price Index) subsequent to implementation.

OTHER CONSIDERATIONS/ISSUES

Amendments

- An amendment is treated as a separate lease if there are one or more assets that were not part of the original lease and the rent increase is considered reasonable.
- An amendment that reduces the lessee's right to use the underlying asset is a partial or full termination.

Remeasurement

- A lessee will remeasure the lease liability if any of the following occur:
 - A change in the lease term
 - An assessment of the likelihood of a residual value guarantee being paid changes from not reasonably certain to reasonably certain, or vice versa

OTHER CONSIDERATIONS/ISSUES (CONTINUED)

- An assessment of the likelihood of a purchase option being exercised changes from not reasonably certain to reasonably certain, or vice versa
- A change in the estimated remaining payments upon which the liability was initially determined
- A change in the stated interest rate charged by the lessor
- For remeasurement under a contract with index-based rent adjustments (such as Consumer Price Index), the rent as of the remeasurement date will be used in determining the new lease liability.
- Upon remeasurement, an updated discount rate will be used as applicable for the lease term remaining at that time.
- In recording the remeasurement, the lessee will adjust the RTU asset by the same amount as the lease liability, but not below zero. If the
- RTU balance is reduced to zero, any remaining amount is recognized as a gain.

OTHER CONSIDERATIONS/ISSUES (CONTINUED)

Lease Incentives

- Lessor payments to or on behalf of lessee including reimbursement of costs
- Accounting based on whether incentives paid before or after commencement
 - If at or before commencement, recorded as reduction of RTU asset (lessee) or deferred inflow of resources (lessor)
 - If after commencement, accounted for as adjustment to lease payments (lessee) or lease collections (lessor)

Multiple Contracts Negotiated at the Same Time

- Contracts that are entered into at or near the same time with the same counterparty should be considered part of the same contract if contracts are negotiated as single package or consideration in one contract depends on price or performance of the other contract.

OTHER CONSIDERATIONS/ISSUES (CONTINUED)

- If multiple contracts are in substance part of the same contract, the arrangement should be accounted for as the same contract.

Lease Termination

- An amendment that shortens the lease term or reduced the number of assets is a partial termination, not a modification.
- Upon partial or full termination of a lease, the carrying values of the asset and liability will be reduced with current gain or loss recognition for the difference.

Lease Impairment

- A significant decrease in an underlying asset's service utility as determined by a change in the period of use and/or manner of use.
- Carrying value of asset is reduced to recognize impairment.

DISCOUNT RATE

Lease payments are discounted using the interest rate the lessor charges the lessee, if disclosed, which may be the rate implicit in the lease.

- Use interest rate stated in the agreement or provided by the lessor.
- If the interest rate is not provided or disclosed by lessor, use lessee's incremental borrowing rate (IBR).
- The lessee's IBR is an estimate of the interest rate that would be charged for borrowing the lease payment amounts for the term of the lease.
- The IBR should be based on observed rates for financings offered to the lessee, borrowing rates for recent financings of the lessee or other comparable borrowers, or indicative rates provided by lending institutions for various financing terms.
- The IBRs used should reflect the term of the arrangement.

DISCOUNT RATE (CONTINUED)

The rate implicit in the lease is the lessor's internal rate of return

- The present value of expected future receipts (lease payments and asset value at the end of the lease) equals the fair value of the asset at commencement plus initial direct costs.



Lessor may use its incremental borrowing rate if

- Unable to determine the rate implicit in the lease, or
- Unable to obtain relevant observable market rate information.

LESSEE AND LESSOR DISCLOSURES

Lessee disclosures, other than short-term leases, include:

- A general description of its leasing activities, including variable payments not included in lease liability measurement and residual value guarantees
- The total amount of lease assets by major classes and related accumulated amortization, disclosed separately from other capital assets
- The amount of outflows of resources recognized in the reporting period for lease component variable payments not previously included in the measurement of the lease liability
- The amount of outflows of resources other lease-related payments, such as residual value guarantees or termination penalties, not the lease liability measurement
- Principal and interest to maturity presented, presented separately, for each of the subsequent five fiscal years and in five-year increments thereafter
- Other relevant disclosures such as lease commitments before commencement, impairments, collateral pledged/secured in excess of the underlying asset and impairments

LESSEE AND LESSOR DISCLOSURES (CONTINUED)

Lessor disclosures, other than short-term leases and certain regulated leases, include:

- A general description of its leasing activities, including variable payments not included in the lease receivable measurement
- The amount of inflows of resources (for example, lease revenue, interest revenue, and other lease-related inflows) from leases if not determinable on the face of the financial statements
- The amount of inflows of resources for variable and other payments not included in the lease receivable measurement including residual value guarantees and termination penalties
- Options provided to the lessee to terminate the lease or abate payments
- Future payments of principal and interest for each of the subsequent five fiscal years and in five-year increments thereafter if the lessor's principal ongoing operations consists of leasing assets
- Other relevant disclosures leases that are investments and certain regulated leases
- Separate additional disclosure requirements for certain regulated leases, such as aviation leases subject to U.S. Department of Transportation and Federal Aviation Administration requirements

DIFFERENCES BETWEEN PRIOR ACCOUNTING AND GASB 87

Under previous government lease accounting there were operating leases and capital leases;

- **Under GASB 87 there are just leases which are accounted for similar to capital leases.**

Under previous accounting (GASB 13), operating leases with scheduled rent increases were either accounted for either measured based on the terms of the lease contract when the pattern of the payment requirements, including increases, is systematic and rational (essentially cash basis), or measured on a straight-line basis when the fair value of the rental payments is not reasonably estimable;

- **Under GASB 87 the pattern of payments determines the present value calculation upon which the outflow of resources is calculated, with interest recorded using the interest method and the right-to-use asset amortized using the straight-line method.**

DIFFERENCES BETWEEN PRIOR ACCOUNTING AND GASB 87 (CONTINUED)

Under previous accounting, leases where title passes by the end of the lease are recorded as capital leases;

- Under GASB 87, leases where title passes by the end of the lease are recorded as financed purchases.

Under previous accounting, the lease term for an arrangement where both the lessee and lessor have an early termination option is that term reflecting the exercise by either if considered reasonably assured;

- Under GASB 87, the lease term for an arrangement where both the lessee and lessor have an early termination option is that term reflecting when both can exercise the option without regard to whether exercise is considered reasonably certain.

CLOSING THOUGHTS

- **Provide enough time (generally at least 6 months) and resources (including budget for technical assistance, project team, technology solution, system implementation, continuing requirements) and remain flexible**
- **Enlist the support of professionals and assemble a team with the needed talent and experience**
- **Selection of a technology solution should be made after leases have been identified**
- **Manage the project, monitor progress, and see through to completion**
- **Assess lessons learned for establishment of post-implementation compliance processes and controls**
- **Recognize the benefits and take advantage of integrating your teams and collaborating to achieve better long-term results across your organization**

Q&A

CONTACT US WHEN WE CAN HELP.



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