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GASB 87,94, and 96 – Refresh and Common Errors



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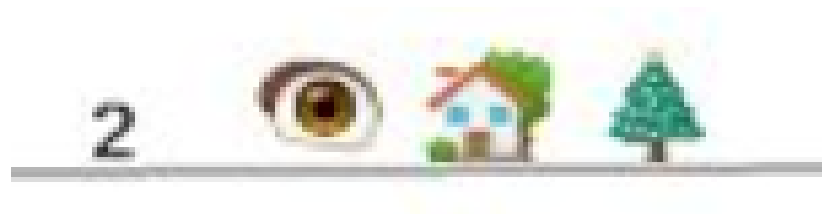
- ▶ Navigate to <https://mdcpa.cnf.io> and tap the session titled "8: GASB 87 and 96, Common Errors"
- ▶ OR just point your phone's camera at the QR code to join directly



Agenda

- **Statement Refresher**
 - **Common accounting and implementation issues related to GASB Nos. 87, 94, and 96**
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GASB 87



What is a Lease?

- **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**

Lease Term

- The period during which a lessee has a noncancelable right to use an underlying asset, plus:
 - Periods covered by a lessee's or lessor's option to extend the lease if it is reasonably certain
 - Periods covered by a lessee's or lessor's option to terminate the lease if it is reasonably certain
 - Period for which both the lessee and lessor have an option to terminate without permission from the other party (or if both have to agree to extend) are cancelable periods and are excluded from the lease term (rolling month-to-month lease)

Period of Time

Periods for which **both** the government and the vendor have an option to terminate without permission or **both** have to agree to renew.

X

Extension periods **not** reasonably expected to be exercised

X

Termination periods reasonably expected **to be** exercised

X

Automatic renewals are considered to be termination periods and should be assessed accordingly

?

Lessee Reporting

INITIAL

- ❑ Record an **intangible lease asset** for the value of lease liability plus prepayments and initial direct costs incurred to place asset in use
- ❑ Record a **liability** equal to the present value of future lease payments

SUBSEQUENT

- ❑ **Amortize** the intangible lease asset for the useful life or lease term, whichever is shorter
- ❑ **Reduce** the liability by lease principal payments

Lessors Reporting

INITIAL

- ❑ Record a **lease receivable** which generally includes same items as lessee's liability
- ❑ Record a **deferred inflow** equal to the lease receivable plus any cash received up front that relates to future period

SUBSEQUENT

- ❑ **Depreciate** leased asset unless indefinite life or asset is required to be returned in its original or enhanced condition
- ❑ **Recognize revenue** over the lease term in a systematic and rational manner

Other Lease Considerations

- ❑ Lease incentives
- ❑ Contracts with multiple components
- ❑ Lease modifications
- ❑ Lease termination
- ❑ Change in discount rate
- ❑ Change in the lease term
- ❑ Likelihood of purchase option being exercised has changed

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GASB 94



What are Public-private and Public-public Partnership Arrangements?

- “PPP”

Defined as:

- an arrangement in which a government (the transferor) **contracts** with an operator (a governmental or nongovernmental entity) **to provide public services by conveying control of the right** to operate or use a nonfinancial asset, such as infrastructure or other capital asset (the **underlying PPP asset**), for a **period of time** in an **exchange or exchange-like transaction**

Underlying Assist is an Existing Asset at Outset of Arrangement

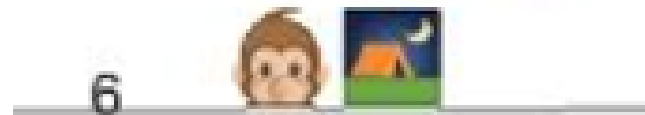
Transferor (Gov)

- ❑ Asset – no entry as already have asset recorded; capitalize improvements when placed into service, if applicable
- ❑ Receivable – recognize at commencement for PV of any installment payments
- ❑ Deferred inflow of resources – recognize at commencement at PV for any installment payments

Operator (Gov/Non-Gov)

- ❑ Liability – recognize at commencement for installment payments, if any
- ❑ Intangible right-to-use asset – recognize at commencement at PV for any installment payments

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GASB 96

What is a Subscription-Based IT Arrangement?

□ SBITA”

Defined as:

- A contract that **conveys control** of the right to use another party’s information technology (IT) software, **alone or in combination with tangible capital assets**, as specified in the contract for a **period of time** in an exchange or exchange-like transaction

□ Think of it as a lease of IT software

Subscription Term

- ❑ Starts when subscription asset is placed into service and continues for all noncancelable periods along with any options to extend with reasonable certainty
- ❑ Exclude: Cancelable periods where both parties have the option to terminate or both parties must mutually agree to extend
- ❑ Automatic Renewals
 - Clear future payment terms vs. unclear future payment terms

SBITA with Multiple Modules

- ❑ Subscription asset is placed into service when initial implementation is completed for the first independently functioning module or first set of modules
- ❑ Additional modules completed after the asset is placed into service is considered a subsequent implementation outlay
- ❑ Additional outlay will be capitalized to the current subscription asset if either of the following result (otherwise expense):
 - Increase in the functionality of the asset
 - Increase in efficiency

Alone or in Combination

- When a contract is for a combination of IT software and tangible capital assets:
 - If software is insignificant compared to the cost of the underlying asset, follow GASB 87
 - Otherwise, follow GASB 96

Government-Wide

Subscription Lease
Asset: Recognize
and amortize over
life of lease/asset

Subscription Lease
Liability: Amortize
over life of the
lease

Fund Statements

Other Financing Source
to record new
subscription with an
offsetting expense in the
appropriate function

Debt service expense to
record payments on
subscription

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Common Issues



Misconception

This is a one-time implementation

Actual

Adopting GASB 87, 94, 96 requires ongoing efforts to monitor and update lease, SBITA, and PPP arrangements.

Regular review of contracts is necessary in order to identify new contracts that require evaluation, events that may trigger remeasurement, and contract amendments

Misconception

Software will solve everything

Actual

While software may assist in automating processes, manual review of terms and conditions is necessary to ensure the right lease/SBITA/PPP term and payments are being included in calculation.

Review of contracts is necessary in order to identify which accounting standard to follow and the applicable terms of the contract

Misconception

Only the finance department needs to be involved

Actual

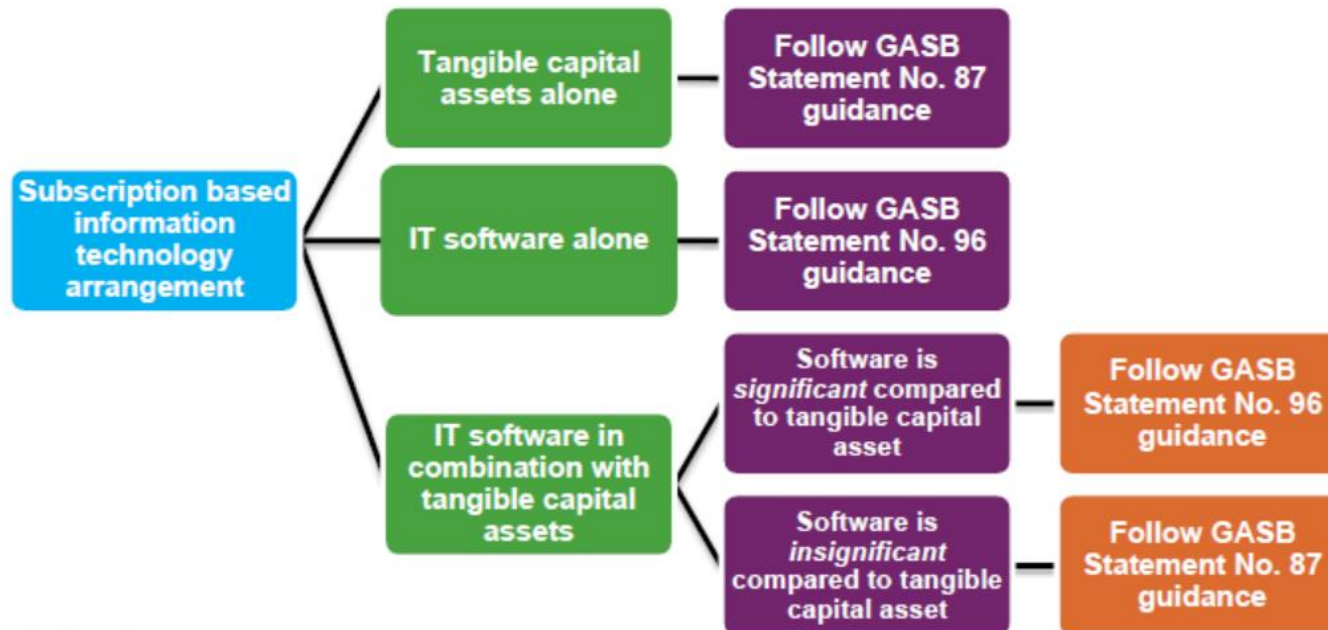
Continuous successful accounting requires collaboration across multiple departments.

Include legal, procurement, and IT (amongst others) to ensure appropriate identification of new and amended contracts or events that may require remeasurement. Training is key to ensure relevant staff understand their roles in identifying leases, PPPs, and SBITAs as well as events that may impact the measurement of liabilities and receivables

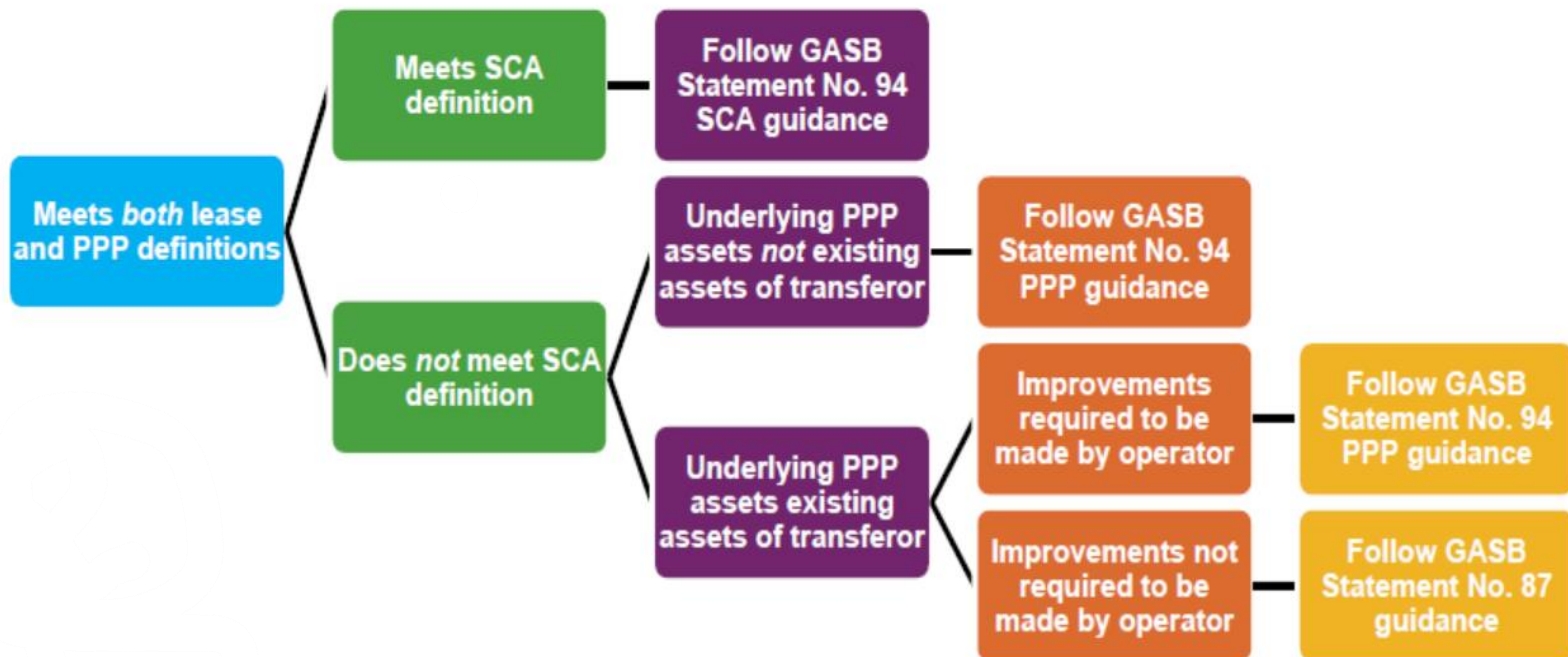
Common Errors

- ❑ Incorrect identification of the applicable accounting standard
 - Is it a lease, SBITA or PPP?
- ❑ Incomplete population of leases, SBITAs, and PPPs
 - Contracts identified in current year that should have been measured in a previous period
 - New contracts missed
- ❑ Materiality
 - Not considering each element separately

Is it a Lease or a SBITA?



Is it a Lease or a PPP?



Is it Acceptable to Use a Recognition Threshold?

❑ Common Errors

- Evaluate effect of non-recognition on a “net” basis
- Base this threshold on one used for another policy
- Considering effect of excluding non-recognized agreements on their disclosures

Common Errors

- ❑ Measurement of Liabilities and Receivables
 - **Inappropriate assessment of the term**
 - Incorrect assessment of the payments included in the measurement
 - Inaccurate estimate of incremental borrowing rate

What Does Reasonably Certain Mean?

- ❑ Reasonably certain is a high threshold of probability that must be met to include optional payments in measurement of assets and liabilities or receivables and deferred inflows of resources
- ❑ The party has compelling economic reason to exercise extension or purchase option (or not to exercise termination option)
- ❑ Consider all economic factors relevant to assessment

Short-term Exemption

- A short-term **lease** is 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
- A short-term **SBITA** is a SBITA that, at the commencement of the subscription term, has a maximum possible term under the SBITA contract of 12 months (or less), including any options to extend, regardless of their probability of being exercised

Common Errors

- ❑ Measurement of Liabilities and Receivables
 - Inappropriate assessment of the term
 - **Incorrect assessment of the payments included in the measurement**
 - Inaccurate estimate of incremental borrowing rate

Fixed Payments

- ❑ **Fixed payments** – Contractually fixed and not subject to any variability
- ❑ **Variable payments that are fixed in substance** – May be described as variable but are “in-substance fixed”
- ❑ **Incentives** - Defined as payments or other concessions made to, or on behalf of, the lessee/government end user, for which the lessee/government end user has a right of offset with its obligation to the lessor/SBITA vendor

Variable Payments

- Only variable payments that depend on an index or rate are included
- Use index or rate a commencement date
- Variable payments based on future performance or usage are not included, even if they are highly certain

Payments

Payments include:

Type	Lessee (GASB 87)	Lessor (GASB 87)	Operator (GASB 94)	Transferor (GASB 94)	End user (GASB 96)
Fixed payments	✓	✓	✓	✓	✓
Variable payments fixed in substance	✓	✓	✓	✓	✓
Variable payments that depend on an index or rate	✓	✓	✓	✓	✓
Residual value guarantees ¹	✓	✓	✓	✓	
Purchase options ²	✓				
Termination penalties ²	✓		✓		✓
(Incentives) ³	✓	✓			✓
Any other payments ²	✓		✓		✓

¹ For lessees/operators/end users, RVGs are included if reasonably certain of being required. For lessors/transferors, they are included if fixed in substance.

² Included only if reasonably certain to be exercised/required.

³ Incentive receivable by the lessee/end user (payable by the lessor) after commencement are ordinarily a reduction (offset) in the calculation of total payments.

Common Errors

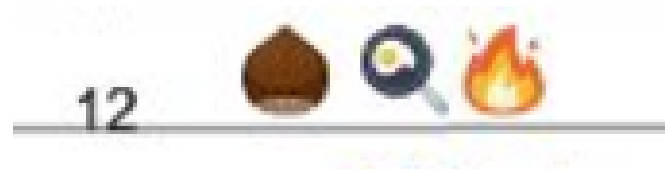
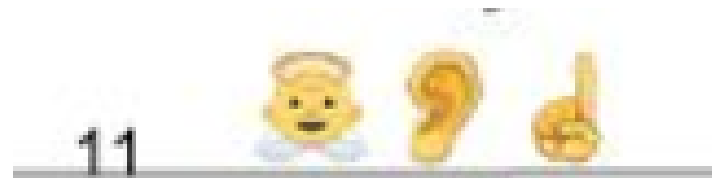
- ❑ Measurement of Liabilities and Receivables
 - Inappropriate assessment of the term
 - Incorrect assessment of the payments included in the measurement
 - **Inaccurate estimate of incremental borrowing rate**

Discount Rate: Lessee/Government – End User/Operator

- ❑ Most contracts do not explicitly state the rate

- ❑ Most will use their incremental borrowing rate
 - Will not be one size fits all
 - Should be based on facts and circumstances of the contract
 - Payment amounts
 - Payment structure
 - Length of contract

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Discount Rate: Lessor

- ❑ Most lessors do not include stated rate in leases
- ❑ Implicit rate will be hard to calculate
- ❑ Most lessors will use their incremental borrowing rate
 - Will not be one size fits all
 - Should be based on facts and circumstances of the contract
 - Payment amounts
 - Payment structure
 - Length of contract

Discount Rate: Determining Incremental Borrowing Rate

- ❑ Entity-specific rate that reflects the creditworthiness of the government
- ❑ Start with debt issuance of government or risk-free rate
- ❑ Adjust for any financing specific items
- ❑ Adjust for contract specific terms

Identifying Events that Require Remeasurement

Common Errors

- ❑ Not monitoring events that could require remeasurement
- ❑ Not identifying amendments (modification or terminations) to require remeasurement
- ❑ Not identifying options exercised that require reassessment of the term
- ❑ Not recognizing remeasurement timely

Remeasurement Events

	Change in term ²	Change in the interest rate charged ^{1,2}	Change in assessment of purchase option exercise ²	Change in assessment of residual value guarantee	Change in estimated amounts included in measurement of liability	Resolution of contingency
Lessee (GASB 87)	✓	✓	✓	✓	✓	✓
Lessor (GASB 87)	✓	✓	✗	✗	✗	✗
Operator (GASB 94)	✓	✓	✗	✓	✓	✓
Transferor (GASB 94)	✓	✓	✗	✗	✗	✗
Government end user (GASB 96)	✓	✓	✗	✗	✓	✓

1 For lessees, government end users, and operators, this is interest rate the third party (lessor, SBITA vendor, or transferor, respectively) charges, if that rate is used as the initial discount rate

2 Requires update to discount rate used if changes individually or in the aggregate are expected to significantly affect the amount of the liability or receivable

Term Reassessment

- ❑ Option is exercised even though it was previously determined that it was reasonably certain that it would not be exercised
- ❑ Option is not exercised even though it was previously determined that it was reasonably certain that it would be exercised
- ❑ An event specified in the contract occurs that requires extension or termination of the contract

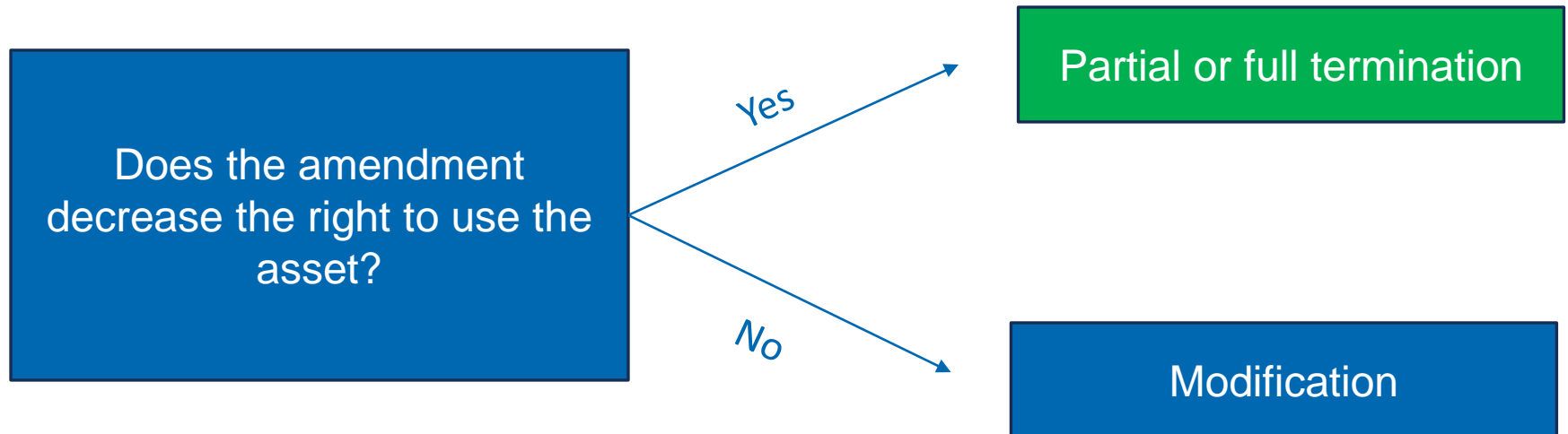
Short-Term Consideration (GASB No. 99)

- ❑ Par. 12 – A lease that previously had been determined to be short-term and that has been modified to extend the initial maximum possible term under the lease contract should be reassessed from the inception of the lease
- ❑ Par 24 – A SBITA that previously had been determined to be short-term and that has been modified to extend the maximum possible term under a SBITA contract should be reassessed from the inception of the SBITA

Remeasurements – Changes in Index or Rate

- ❑ If a remeasurement occurs, the liability or receivable should also be updated for any change in index or rate used to determine variable payments if that change is expected to significantly affect the amount of the liability or receivable

Modifications and Terminations



Termination Impact

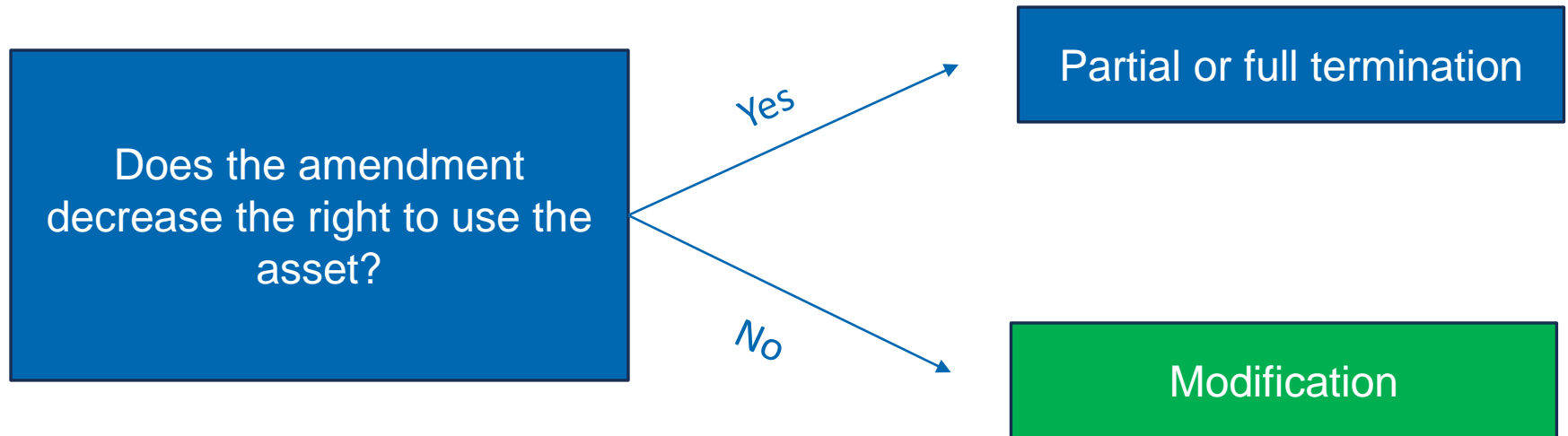
LESSEE/END USER/OPERATOR

- Reduce the carrying values of the asset and liability
- Recognize a gain or loss for the difference

LESSOR/TRANSFEROR

- Reduce the carrying values of the receivable and deferred inflow of resources
- Recognize a gain or loss for the difference

Modifications and Terminations



Modifications

Both of the following conditions are present:

- Modification gives user an additional asset by adding one or more underlying assets that were not included in original contract
- Increase in payments for the additional asset does not appear to be unreasonable

Yes

Account for amendment as separate lease, SBITA, PPP

No

Remeasure liability (lessee, end user, operator) or receivable (lessor, transferor)

Remeasurement Impact – Lessee, End User, or Operator

- ❑ The liability should be adjusted up or down to reflect the outcome of the remeasurement
- ❑ The asset is generally adjusted by the same amount, but cannot be reduced below zero

Remeasurement Impact – Lessor or Transferor

- ❑ The receivable should be adjusted up or down to reflect the outcome of the remeasurement
- ❑ The deferred inflow of resources is generally adjusted by the same amount

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Financial Statement Presentation and Disclosure Errors



Statement of Net Position

- ❑ Presenting liabilities and receivables as only noncurrent
- ❑ Lease and subscription assets are not reported as capital assets
- ❑ Accrued interest is reported as part of the lease/PPP/SBITA liability or receivable
- ❑ Classification of assets and liabilities in the calculation of net investment in capital assets

Impact on Net Investment in Capital Assets

Capital Assets (both tangible and intangible

Less: Accumulated depreciation/amortization

Less: Outstanding principal of capital related debt, including lease and subscription liabilities, and excluding unspent proceeds

Less: any other (non-debt) capital related liabilities (AP or retainage payable)

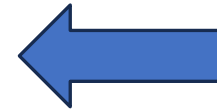
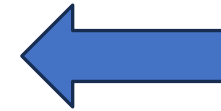
Less: Unamortized balance of original issue premiums on outstanding capital debt.

Less: Capital-related deferred inflows of resources (gains on refunding of capital debt, and operator-acquired underlying PPP assets, operator constructed underlying PPP assets, or operator-made improvements to transferor's underlying PPP assets that placed into service and have become property of the transferor)

Plus: Unamortized balance of original issue discounts on outstanding capital debt

Plus: Capital-related deferred outflows of resources (losses on refunding of capital debt)

Equals: Net Investment in capital assets



Statement of Revenues, Expenses, and Changes in Net Position

- ❑ Improper classification of revenues

- ❑ Improper classification of interest revenue related to leases/SBITA

- ❑ Under GASB No. 103, leases/SBITA revenue will be **operating revenue**

Statement of Cash Flows

- ❑ Improper classification of principal and interest repayments
- ❑ Improper classification of principal and interest receipts (lessor)
- ❑ Missing noncash disclosures

Note Disclosure

- ❑ Missing or incomplete significant accounting policies
- ❑ Lease and subscription assets are not disclosed in the capital asset roll forward
- ❑ Lease, subscription, and PPP liabilities are not reported as part of the long-term liabilities roll forward
- ❑ Missing or incomplete disclosures specific to nature and terms of agreements

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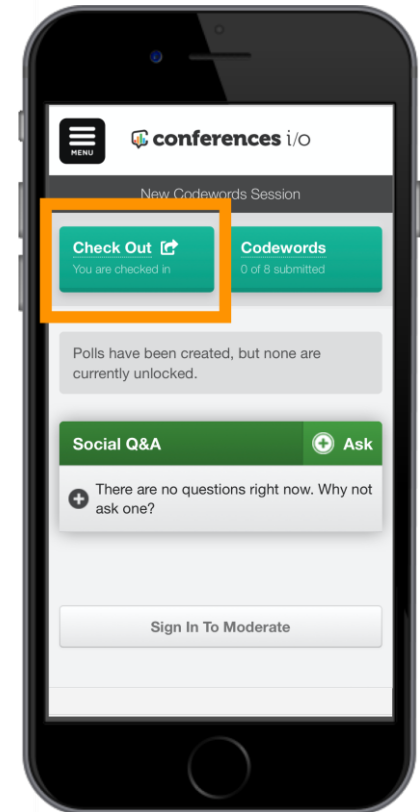
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Final Thoughts

- ❑ Does the client have a complete list of all possible contracts? What can they do to ensure it is complete?
 - Review GL for recurring expenses that might indicate subscriptions
 - Ask employees to provide logos of common applications they use
- ❑ Does the contract meet the definition of a Leases/PPP/SBITA?
 - Keep good record of considerations made
 - Expect to ask follow up questions to determine this
- ❑ Is the contract material to the financials?

Don't Forget To
Check-Out Before
You Leave!



Questions?

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Sources: GASB 87, 94, and 96; AICPA & CIMA GASB 87, 94, 96 – Common errors/misconceptions