GASB 87: Leases

October 26, 2018

SPEAKERS

Rob Churchman, CPA
rchurchman@cbh.com
Agenda

What Is GASB 87?

Lessee Accounting

Lessor Accounting

Transition

Conclusions
Why?

- FASB/IASB
- Conceptual framework
- Statements reflect the economic reality
How?

- **April 2011**: Pre-agenda Research
- **November 2014**: Preliminary Draft
- **January 2016**: Exposure Draft
- **June 2017**: Issuance
When?

Reporting periods beginning after December 15, 2019

Early adoption encouraged
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.
Nonfinancial asset?

Examples of nonfinancial assets:

- Buildings
- Land
- Vehicles
- Equipment

Any contract that meets this definition should be accounted for under the leases guidance, unless specifically excluded in the Statement.
What Is Control?

Need both:

- Right to obtain the present service capacity from the underlying asset
- Right to determine the nature and manner of use of the underlying asset

Contracts that fit this definition need to use lease guidance.
Changes

Old: Capital and Operating Leases

New: Substantially all leases are treated as Financing Leases (Similar to Capital Lease)
Lessee Accounting

**Right of use ASSET (intangible)**
- Amort over shorter of useful life or lease term
- Straightline typically

**LIABILITY for PV of future lease payments**
- Reduced by lease payments
- Effective interest rate
Lease Payments

- Fixed payments
- Variable payments that depend on an index or a rate
- Variable payments that are fixed in substance
- Amounts that are reasonably certain of being required to be paid by the lessee under residual value guarantees
- The exercise price of a purchase option if it is reasonably certain that the lessee will exercise that option
- Payments for penalties for terminating the lease
- Any lease incentives receivable from the lessor
- Other payments that are reasonably certain of being required
Discount Rate

- Interest rate charged by lessor (first choice)
- Estimated incremental borrowing rate (if first choice is not readily available)
Lease Asset

- The initial measurement of the lease liability
- Payments made to the lessor at or before the commencement of the lease term
- Initial direct costs
Poll Question
Lessor Accounting

- Lease receivable (generally will match Lessee’s liability)
  - Reduce by lease payments
- Deferred inflow
  - Recognize revenue systemically
- Underlying asset remains on books
  - Depreciate as appropriate
## Summary – Initial Recognition

<table>
<thead>
<tr>
<th></th>
<th>Asset</th>
<th>Liability</th>
<th>Deferred Inflow</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Lessee</strong></td>
<td>Intangible Asset (PV Lease Payments, Prepaids, Initial Direct Costs)</td>
<td>Present Value Future Lease Payments</td>
<td>None</td>
</tr>
<tr>
<td><strong>Lessor</strong></td>
<td>Lease Receivable</td>
<td>None</td>
<td>Lease Receivable, Up Front Pymts,</td>
</tr>
</tbody>
</table>
## Summary – Subsequent Measurement

<table>
<thead>
<tr>
<th></th>
<th>Asset</th>
<th>Liability</th>
<th>Deferred Inflow</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Lessee</strong></td>
<td>Amortized (Shorter of Useful life or Lease Term)</td>
<td>Reduced by payments (after interest)</td>
<td>None</td>
</tr>
<tr>
<td><strong>Lessor</strong></td>
<td>Reduced by payments</td>
<td>None</td>
<td>Amortized over lease term (straightline)</td>
</tr>
</tbody>
</table>
Exceptions

- Investments Assets
  - Rental property
- Regulated leases
  - Airports and air carriers
- Service concession arrangements
  - GASB 60
- Donated Assets

- Intangible Assets
  - Software licenses
- Biological assets
  - Timber, animals, plants
- Inventory
- Supply contracts
  - Power supply arrangements
- Intra-entity leases
- Less than 1 year
Ownership Transfer

Transfer of Ownership

- Financed purchase of underlying asset by lessee
- Sale by lessor of the asset
Short-term Leases

Less than 1 year, month-to-month, year-to-year

- Lessee – Recognize expense, no asset/liability
- Lessor – Recognize revenue, no receivable/deferred inflow
- No resource flow during rent holidays
- No required disclosure
Multiple Component

Lease/non-lease components
Separate and treat as different contracts

Multiple leased assets
Separate as practicable
If cannot be readily separated, treat as one
Lease Incentives

- Payments made to lessee or concessions to lessee
- Payments to lessee at or before commencement
  - Include in initial measurement of the lease asset
- After commencement
  - Should be consistent with liability (lessee) or receivable (lessor)
- Variable/contingent – not included in initial measurement
Lease Terms

Non-cancelable period, plus options to:

- Extend lease, if *reasonably certain* to exercise
- Terminate, if reasonably certain NOT to exercise

Excludes cancelable periods:

- Periods each have the option to term
- Both parties have to agree to extend
- Rolling month to month
Lease Terms (continued)

5-year lease with lessee only option to cancel at the end of 4\textsuperscript{th} year

<table>
<thead>
<tr>
<th>Lessee Option</th>
<th>Lessor Option</th>
<th>Term</th>
</tr>
</thead>
<tbody>
<tr>
<td>Uncertain</td>
<td>n/a</td>
<td>n/a</td>
</tr>
<tr>
<td>Reasonably Certain</td>
<td>n/a</td>
<td>n/a</td>
</tr>
</tbody>
</table>
Reassessment of Lease Term

Only if one of the following:

- Lessee or lessor newly elects to exercise an option
- Lessee or lessor newly elects to not exercise an option

An event specified in contract that triggers extension or termination
Subleases

- **Sublease**: Separate from the original lease
- **Sale-leaseback**: Separate transactions
- **Lease-leaseback**: Reported as net transaction
Disclosure

Lessee

- General description
- Lease assets & Accum Amort
- Amount of outflows
- Principal & interest
  - 5 years, then 5-year increments
- Commitments
- Impairment

Lessor

- General description
- Inflows
- Lessee’s options to term
- Future payments (if primary operation)
Example

The City of Cat Island enters into a 3-year lease for the assets below. The assets are being leased from the Cheetah County.

- Asset 1 – Boat named “Lion of the Sea” – Estimated FV $100,000
- Asset 2 – Warehouse – Estimated FV $500,000

Annual payments are as follows for both:

- Year 1 - $20,000, Year 2 - $22,000, Year 3 - $24,000

- The City noted they previously leased a similar boat for $5,000 per year.
- The City has a borrowing rate of 10%.
- No transfer of ownership; no options to purchase.
Assume boat lease payment schedule of $5,000; $5,500; $6,000 (judgment)

Therefore, warehouse payments will be $15,000; $16,500; $18,000
## Example – Lessee Initial Recognition

<table>
<thead>
<tr>
<th>PV of Boat Lease Liability</th>
<th>PV of Warehouse</th>
</tr>
</thead>
<tbody>
<tr>
<td>Term</td>
<td>Term</td>
</tr>
<tr>
<td>3 years</td>
<td>3 years</td>
</tr>
<tr>
<td>Payments</td>
<td>Payments</td>
</tr>
<tr>
<td>$5,000; $5,500; $6,000</td>
<td>$15,000; $16,500; $18,000</td>
</tr>
<tr>
<td>Rate</td>
<td>Rate</td>
</tr>
<tr>
<td>10%</td>
<td>10%</td>
</tr>
<tr>
<td>PV per TValue</td>
<td>PV per TValue</td>
</tr>
<tr>
<td>$13,600</td>
<td>$40,800</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Boat Asset</td>
<td>$13,600</td>
</tr>
<tr>
<td>Warehouse Asset</td>
<td>$40,800</td>
</tr>
<tr>
<td>Lease long term debt</td>
<td>$54,400</td>
</tr>
</tbody>
</table>
Example – Lessee Year 1

<table>
<thead>
<tr>
<th>Depreciation</th>
<th>Initial Value</th>
<th>Useful Life</th>
<th>CY Amtz</th>
<th>Accumulated Amtz</th>
<th>NBV</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lion of the Sea Boat</td>
<td>$13,600</td>
<td>3</td>
<td>$4,533</td>
<td>$4,533</td>
<td>$9,067</td>
</tr>
<tr>
<td>Warehouse</td>
<td>$40,800</td>
<td>3</td>
<td>$13,600</td>
<td>$13,600</td>
<td>$27,200</td>
</tr>
<tr>
<td></td>
<td>$54,400</td>
<td></td>
<td>$18,133</td>
<td>$18,133</td>
<td>$36,267</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Interest Expense</th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Total “borrowings”</td>
<td>$54,400</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rate</td>
<td>10%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest</td>
<td>$5,400</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>$18,133</td>
<td>$18,133</td>
</tr>
<tr>
<td>$14,600</td>
<td></td>
</tr>
<tr>
<td>$5,400</td>
<td>$20,000</td>
</tr>
</tbody>
</table>
**Example – Lessor Initial Recognition**

Assume Cheetah County knows City of Cat Island’s borrowing rate.

<table>
<thead>
<tr>
<th></th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lease Receivable</td>
<td>$54,400</td>
<td></td>
</tr>
<tr>
<td>Deferred Inflow</td>
<td></td>
<td>$54,400</td>
</tr>
</tbody>
</table>
# Example – Lessor Year 1

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>$20,000</td>
</tr>
<tr>
<td>Interest Income</td>
<td>$5,400</td>
</tr>
<tr>
<td>Lease Receivable</td>
<td>$14,600</td>
</tr>
<tr>
<td>Lease Revenue</td>
<td>$18,133</td>
</tr>
<tr>
<td>Deferred Inflow</td>
<td>$18,133</td>
</tr>
</tbody>
</table>
GASB vs. FASB

**GASB**
- Single method
- Long-term debt
- “Front-loaded” expense
- CF = capital financing outflow

**FASB**
- Operating and Capital/Financing
- Long-term operating liability
- Operating = SL rent
- Operating CF = operating outflow
Impact

- Loan and bond covenants
- Comparability to FASB
- Transparency
- Reflects substance of transaction
Transition

- Effective periods beginning after December 15, 2019
  - Early adoption encouraged
- Apply retroactively
  - Restate, if practicable
  - Otherwise, restate beginning net position/fund balance for cumulative effect
- Facts and circumstances
- Immaterial items may be ignored
Questions?

Rob Churchman, CPA
Partner
804-673-5733
804-647-8836
rchurchman@cbh.com