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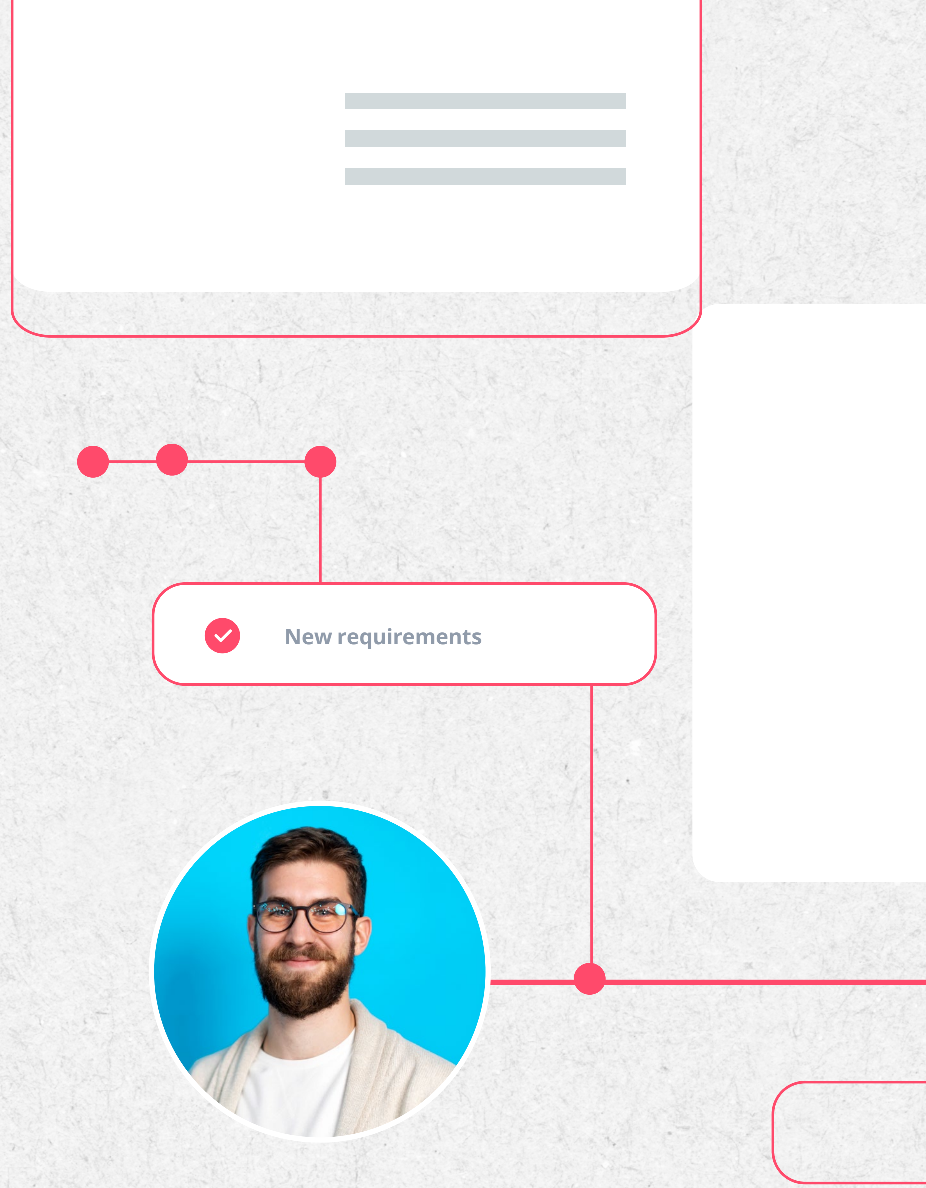
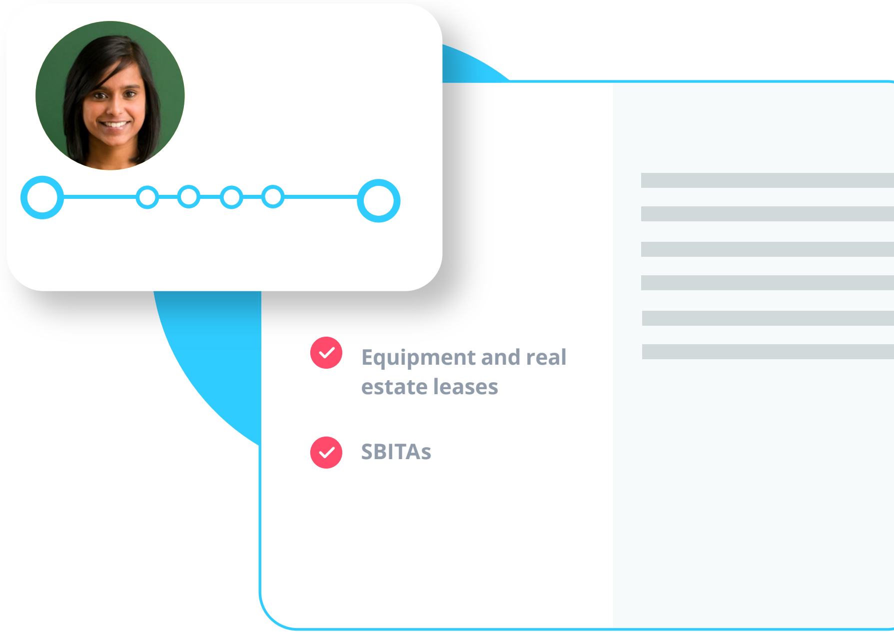
GASB 87 and GASB 96 handbook



Preparing for lease accounting under GASB 87 and GASB 96

While the decision to lease or purchase an asset is not new, the accounting and financial reporting implications of the decision are changing. The Governmental Accounting Standards Board (GASB) issued two new standards, GASB 87 and GASB 96, which outline new requirements for governmental entities when it comes to lease accounting.



GASB 87 applies to most equipment and real estate leases and is effective for fiscal years beginning after June 15, 2021.

GASB 96 applies to subscription-based information technology arrangements (SBITAs) was announced. GASB 96 is effective for fiscal years beginning after June 15, 2022.

GASB 87 changes the financial reporting requirements of organizations that enter into contractual relationships that meet the definition of a lease for assets such as real estate, vehicles and equipment. It can significantly affect your organization if you have arrangements that need to be accounted for under the standard.

- Financial statements are impacted with the lease-related assets, receivables, liabilities and deferred inflows of resources coming on to the statement of net position
- Agreements beyond traditional leases may need to be accounted for under the standard
- Financial arrangements such as debt covenants may be negatively affected
- Additional financial statement disclosures are needed
- Internal training, policies and procedures and new internal controls regarding application of the standard need to be implemented

What is GASB 87?

GASB 87 replaces operating and capital lease categories with a single model for lease accounting based on the concept that leases are a means to finance the right to use an asset. Under the new rules, a lessee recognizes a lease liability and an intangible asset while the lessor recognizes a lease receivable and a deferred inflow of resources. However, in order to properly implement this standard, there are some key definitions and concepts to understand first.

Lease

A contract that conveys control of the right to use a non-financial asset (the underlying asset) for a period of time in an exchange or exchange-like transaction. Right to use includes both the right to obtain the present service capacity and the right to determine the nature and manner of use.

Lease term

Period in which a lessee has a non-cancelable right to use the asset plus periods covered by an option to extend if it is reasonably certain the option will be exercised, and periods covered by an option to terminate if it is reasonably certain the option will not be exercised. Note that cancelable periods including those where either party can terminate without permission or both parties have to agree to extend are not included.

In addition to these key definitions, there are some important exceptions or types of contracts that do not qualify for lease accounting under GASB 87. These include contracts for intangible assets, biological assets, inventory, service concession arrangements, supply contracts and leases with a maximum possible term of 12 months or less.

Under the standard, a lessee needs to recognize a lease liability equal to the present value of the payments expected to be made for the lease term and an intangible asset equal to the lease liability plus any payments made upfront. The standard does clarify that if the contract provides for variable payments based on performance or usage those are not part of the lease liability and should be expensed as incurred.

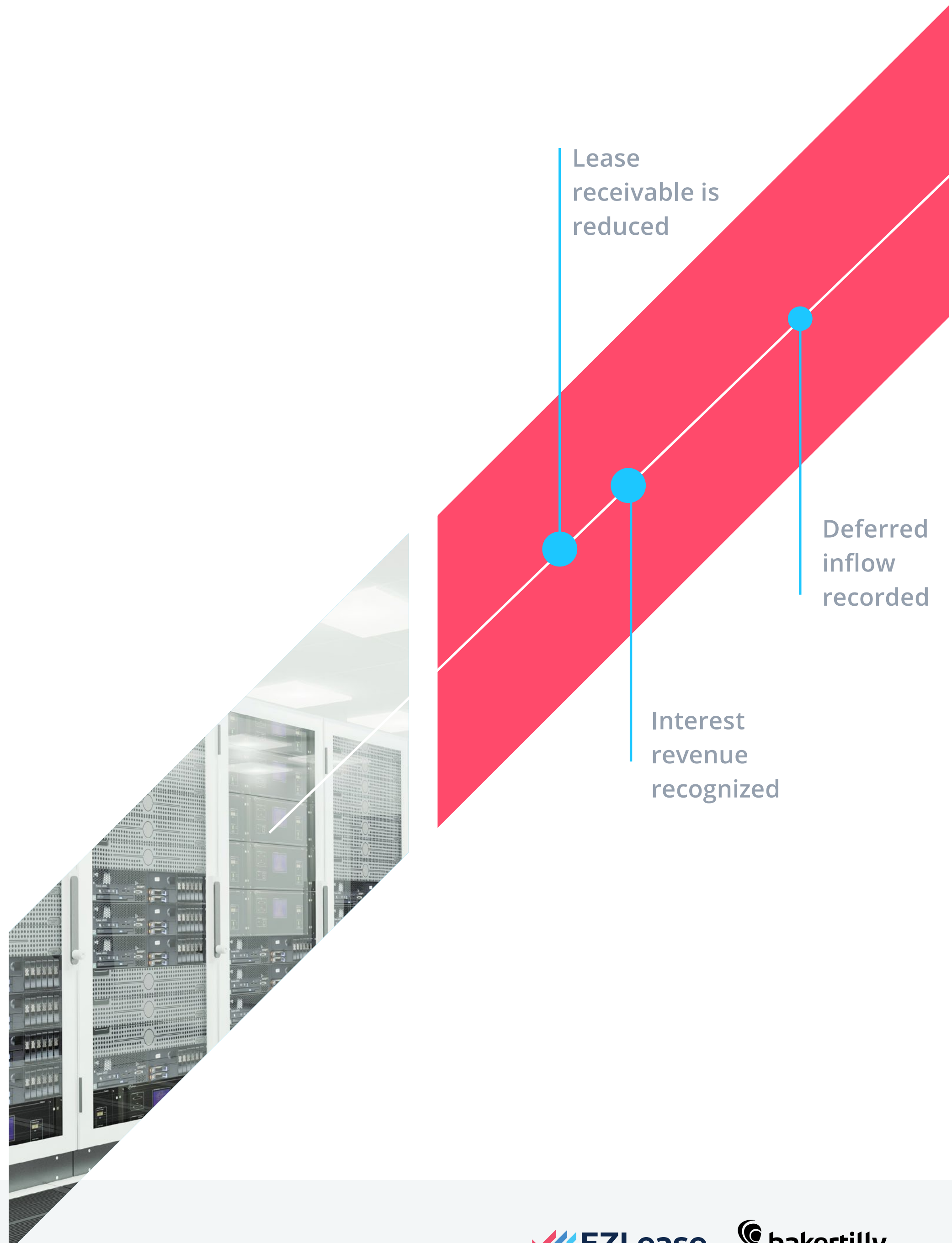
As payments are made, the lease liability is reduced and interest expense is recognized. The intangible asset is amortized over the shorter of the lease term or the life of the asset. Financial statement disclosures need to include a description of the leases, total lease assets recognized (gross and net) and a schedule of future lease payments, including principal and interest.

GASB 87 exceptions

- Intangible assets
- Biological assets
- Inventory
- Service concession arrangements
- Supply contracts and leases with a maximum possible term of 12 months or less.

The accounting for a lessor is complementary. A lease receivable is established at contract inception equal to the present value of the expected payments over the lease term. As payments are received the lease receivable is reduced and interest revenue is recognized. A deferred inflow is recorded equal to the lease receivable and any payments that are made at the beginning of the lease. This deferred inflow is recognized as revenue in a systematic and rational manner over the life of the lease.

The lessor is required to disclose a description of the leasing arrangement, the amount of lease revenue recognized in the current period, any revenue recognized from variable or other payments and certain other circumstances if applicable.



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What is GASB 96?

The GASB 96 is a set of accounting standards defining SBITAs for government end users. It governs the accounting and financial disclosure of cloud-based software subscription payments. Before GASB 96, there was no specific accounting guidance for an SBITA. Overall, the standards for SBITAs are based on the standards established in Statement No. 87, Leases, as amended.

GASB 96 does the following:

- Establishes a standard requiring governmental organizations to keep track of SBITA statements
- Establishes the existence of an intangible right-to-use asset and a matching subscription liability resulting from an SBITA agreement
- Provides capitalization requirements for things like implementation
- Defines the subscription term as the time the lessee has an irrevocable right to use the basic IT assets
- Defines the disclosure requirement for SBITAs

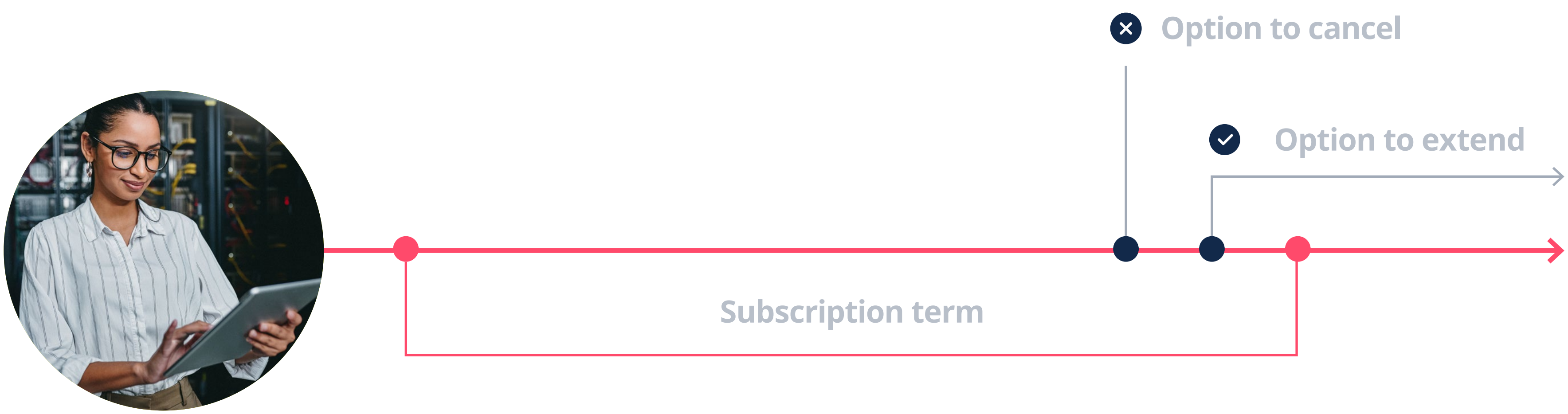
Determining the subscription term for SBITAs

The subscription term is the non-cancellable period during which you have the right to use the underlying asset. The term also includes the option to extend or the option to terminate the contract based on reasonable certainty.

GASB provides an exception for short-term SBITAs. These are contracts which are 12 months or less, including any options to extend, regardless of the option will be exercised or not. Subscription payments for short-term SBITAs would be recognized as outflows

Measuring and accounting for the subscription liability and subscription asset

The subscription liability is initially measured as the present value of subscription payments expected to be made during the subscription term. Future subscription payments should be discounted using the implicit rate, if it is readily determinable, or the incremental borrowing rate. You should recognize amortization of the discount on the subscription liability as an outflow of resources (for example, interest expense) in subsequent financial reporting periods.



The subscription asset would be recognized and initially measured as:

- The sum of the initial subscription liability amount,
- Plus payments made to the SBITA vendor before the start of the subscription term,
- Plus implementation costs eligible to be capitalized,
- Less any incentives received from the SBITA vendor at or before the commencement of the subscription term.

The subscription asset should be amortized and recorded as an outflow of resources over the subscription term.

Setup, payments, modifications, and terminations of SBITAs are essentially identical to leases. Modifications that result in a reduction of the right to use IT assets (including either a reduction in the assets or a shortening of the term) are treated as partial terminations, in which the asset and liability are reduced, and a gain or loss recognized for the difference between the two. This is the same as for GASB 87.

- Payments
- Modifications
- Terminations

Setup

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What do I have to disclose under GASB 96?

As a governmental organization, you should report SBITAs in your financial statements for categorization and disclosure purposes. The stipulation requires that you:

- Provide a basic summary of your SBITAs -- the foundation, terms, and circumstances for determining variable payments not contained in the subscription liability measurement.
- Report subscription assets and associated accrued amortization separately from other capital assets.
- Record the percentage of resource outflows in the variable payment reporting time that you did not earlier include in the subscription obligation measurement.
- Recognize extra termination penalty and other payments not formally calculated as the subscription liabilities in the reporting phase
- Show the subscription liability's principal and interest obligations to maturity separately for each of the five succeeding fiscal years and in five-year increments afterward.
- Make SBITA commitments before the start of the subscription term.
- Report any loss associated with faulty components

How does GASB 96 compare to GASB 87?

GASB 96 is a modified version of GASB 87.

A few distinctions exist between the two standards, as follows:

- **Scope:** GASB 87 specifies terms for leasing agreements, while GASB 96 specifies SBITAs.
- **Capitalization of SBITA implementation expenditures:** Vendors incorporate certain costs into the subscription asset and spread throughout the contract life in the GASB 96. However, the term does not exist for leases, only direct costs in GASB 87.
- **Presentation of the statement of net position with footnote disclosures:** The information disclosed validates both standards. Nevertheless, individual footnotes are necessary for leases and SBITAs since the statement of net position reflects the asset/liability balances in specific line items. It is possible to implement both standards simultaneously regardless of the variations, which require slightly different procedures.

SBITAs and leased tangible assets share a few similarities.

- The asset and liability balances use similar calculations: GASB 87 and GASB 96 derive liability from the current value of the outstanding payments in GASB 87 and GASB 96, while liability emanates from comparable assets.
- Funding structure and organization: The standards accommodate the exact organizational structure, funding, and user responsibilities.
- Stable successive accounting: Both standards account for regular contract activity in the same way. Their accounting terms handle terminations, modifications, impairments, and other contract changes in the same manner.

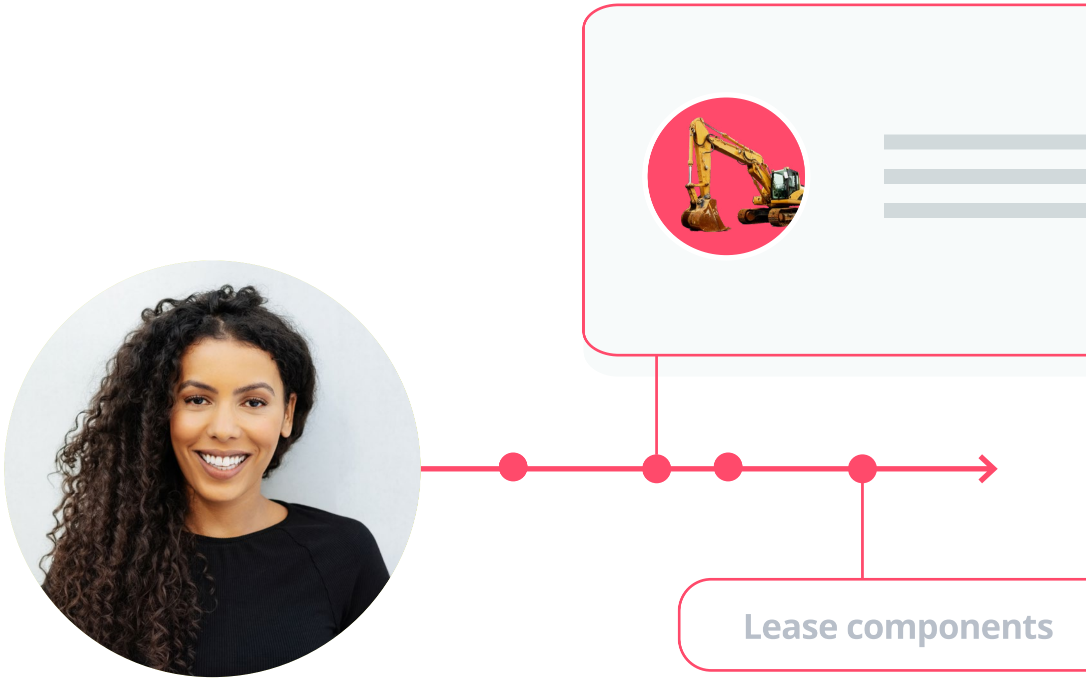
Effective dates

GASB 87: Fiscal years beginning after June 15, 2021

Organizations need to determine how much of an impact the changes have on financial statements, debt covenants, processes, documentation and controls. In addition, GASB 87 provides organizations with an opportunity to track various lease components that may have been under the radar to better inform decisions in the future.

GASB 96: fiscal years beginning after Jun 15, 2022

With GASB 96, organizations need to evaluate their cloud-based software subscription agreements to determine which ones fall under the standard and how that will affect their financial statements.



Transitioning to the standard

We recommend a six-step methodology to help you through the process of assessing impact, developing a plan and implementing that plan across your organization. This will help you evaluate whether you and your team can take on the process internally or if you'll need to engage an outside vendor to help, either with the entire process or with only specified steps for a more tailored approach.

Phase 1	Phase 2
Risk assessment	Roadmap development
Impact assessment	Implementation
Gap analysis	Internal controls evaluation

Step 1: Risk assessment

What leases are impacted?

During this first step, you'll want to establish a baseline of your current inventory of agreements that are required to be accounted for as leases and determine areas that may pose a risk of high impact.

- Overview of the standard with your **key stakeholders**
- Review of a **sample of contracts** and related documentation
- **Detailed discussions** with stakeholders to uncover and further understand issues such as current practices for assessing lease transactions, lease information locations and completeness of support for financial statement disclosures

At this time, you should also collect and evaluate lease data:

- Create an inventory of potential contracts to evaluate
- Determine which contracts meet the definition of a lease
- Review lease contracts for multiple components, such as multiple asset components and service components
- Identify any contracts that can be excluded based on an exception or materiality
- Gather key data from contracts in order to determine the lease term and calculate lease liability/asset or receivable/deferred inflow
- Gather data required for footnote disclosures

Step 2: Impact assessment

How does the change impact your financial statements?

It is important to understand how GASB 87 affects your financial statements so that you can begin preparations prior to the effective date. Some vendors have analysis tools to assist you in determining the impact of the new lease accounting standard, based on your existing leasing arrangements.

By quantifying the right-to-use assets and lease liabilities, as well as lease receivables and deferred inflows of resources, you can evaluate the impact of the standard on your financial statements, and potentially your financial covenants, prior to the standard taking effect.

- Review a sample of leases and categorize as operating vs. financing leases
- Identify other arrangements that could meet the definition of a lease under the standard
- Document where lease information exists in current environment and determine magnitude of leases that are outside these systems
- Determine information required for future accounting and disclosure
- Determine the new lease accounting and impact on your financial statements for a sample of leases
- Begin to understand any additional disclosures needed

Step 3: Gap analysis

What needs to be addressed to comply?

Consider a gap analysis to help you understand where processes, systems, controls and reporting should be updated to meet the needs of the lease standard. This will give you an understanding of the current processes and systems that need to be modified to effectively gather information needed to account for all leases under the standard. Determine what processes pose a risk and what steps you can take to mitigate issues and adapt to the changes.

Review **processes** for new and existing leases, available IT tools or systems, internal controls and related documentation

Determine **gap areas** against future reporting needs

Determine what **processes, systems, controls** and documentation to update

Step 4: Roadmap development

What is the right implementation plan for your organization?

Once the impact assessment and gap analysis are complete, you need a plan to address the findings. This is the time to build effective strategies for implementation, weigh the options to your end goal and develop a project plan to address the changes.

- Determine strategies to address gap analysis results
- Determine solution options and assist in identifying a relevant software solution
- Develop project plan for selected solution
- Involve a multidisciplinary team to address the plan

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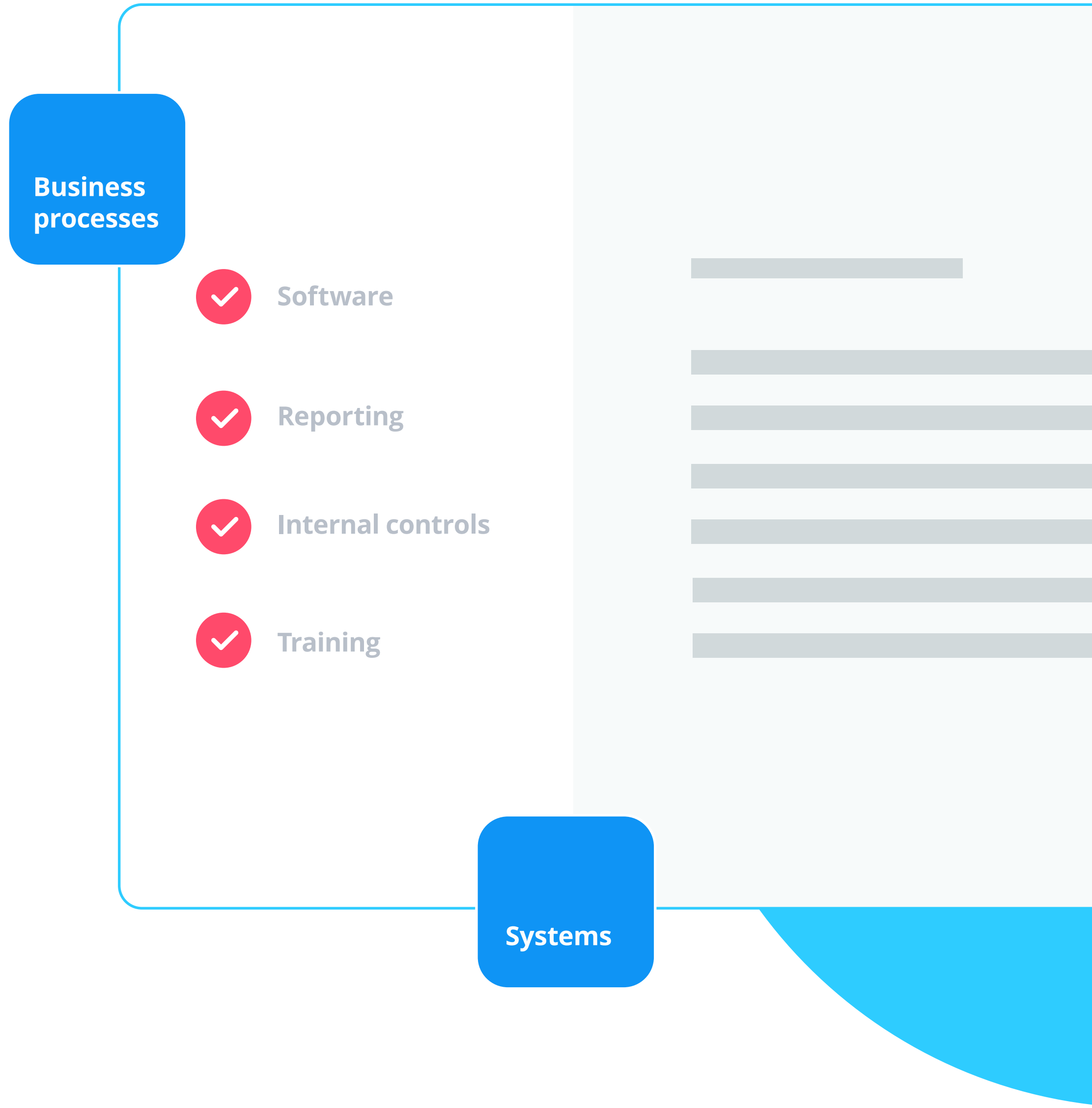
Step 5: Implementation

What should you expect in implementing your solution?

Think through the project management and change management requirements you have today and what you'll need on an ongoing basis into the future. The transition affects ongoing business processes, systems (including software, internal controls, reporting and education) and training needs.



- Document key processes and controls
- Determine design effectiveness
- Determine operating effectiveness

Step 6:
Internal controls evaluation

Have you addressed all controls?

After your solution has been identified and implemented, the controls in place need to be tested and evaluated for any weaknesses or changes needed with practical use. Consider what you need to get ready for your audit, ensuring you have the right framework in place.

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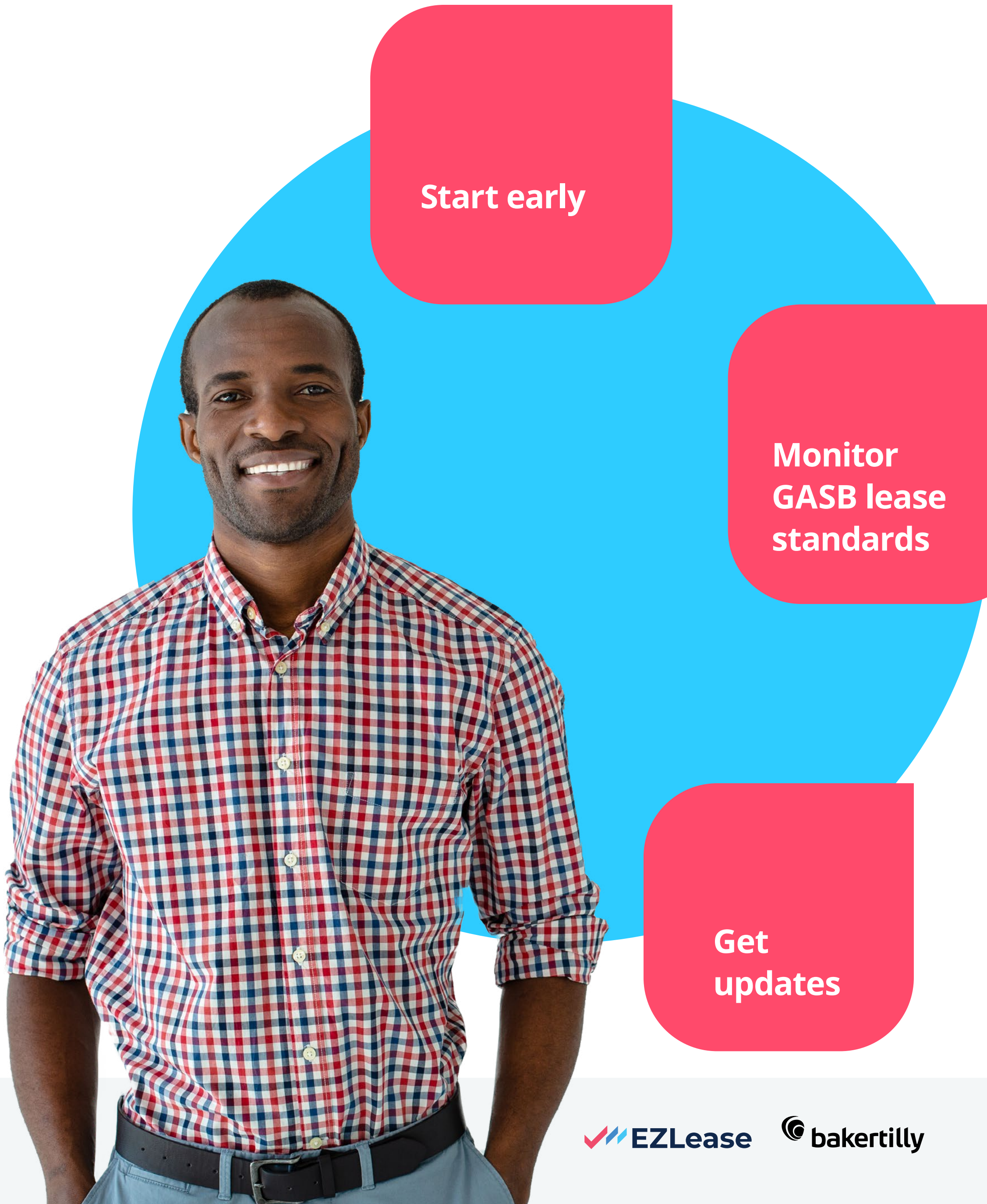
Choose the right provider

Look for solution providers who understand GASB 87 and GASB 96 and have technical expertise in governmental accounting. By monitoring GASB lease standard developments, the right providers can provide timely information and updates to make your transition easier. Software with full GASB support can make the process simpler and faster, accelerating the entire process with built-in expertise.

Although the deadline may seem far off now, it takes longer than you might think to get compliant. Start the process early so you can get it right, well before the deadline.



Get started today

If you have questions regarding GASB 87 or GASB 96 or are looking for help to adopt the standard, please contact us:

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EZLease

EZLease provides fast, simple lease accounting software for ASC 842, GASB 87, GASB 96, and IFRS 16 that ensures long-term compliance across equipment and real estate assets for lessees and lessors. With over 15 years of implementations across private, government and public organizations of all sizes, EZLease manages and automates lease data management and lease accounting and reporting processes, leveraging customer-first support and deep accounting expertise.

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