

WHY? BECAUSE GASB SAYS SO!



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- *The Opinions expressed during this presentation are my own. They do not necessarily represent the views of the Tennessee Comptroller of the Treasury, his representatives, or the Tennessee Department of Audit.*



LEASES – BECAUSE GASB SAYS SO!

GASB 87, Leases



WHAT DO/DID YOU LIKE LEAST ABOUT THE PANDEMIC

- 🌟 Masks
- 🌟 Shots
- 🌟 Schools Closed
- 🌟 Favorite Restaurant Closed
- 🌟 Sports/Concert Venues Closed
- 🌟 Restricted Travel
- 🌟 Other



LEASES – BECAUSE GASB SAYS SO!

- 🌟 **Effective for the Year Ended June 30, 2022**
- 🌟 **Calculations to be performed as of July 1, 2021
(see paragraph 94)**



IMPLEMENTATION DATE

New Statement		Implement for Fiscal Years Ending				
Statement #	Periods (*Fiscal Years)	March 31	June 30	September 30 /		
	Beginning After			October 31	December 31	
83 AROs	June 15, 2019	2021	2020	2020	2020	
84 Fiduciary	Dec. 15, 2019	2021	2021	2021	2020	
87 Leases	June 15, 2021*	2023	2022	2022	2022	
88 Debt	June 15, 2019	2021	2020	2020	2020	
89 Interest Capitalization	Dec. 15, 2020	2022	2022	2022	2021	
90 MEI	Dec. 15, 2019	2021	2021	2021	2020	
91 Conduit	Dec. 15, 2021	2023	2023	2023 ₇	2022	

LEASES – BECAUSE GASB SAYS SO!

DEFINITION:

- 🇺🇸 A **contract** that conveys **control** of the **right to use** another entity's **nonfinancial asset** (the underlying asset) as specified by the contract for **a period of time** in an **exchange or exchange-like** transaction.



LEASES – BECAUSE GASB SAYS SO!

What I told you last year, and the year before, and the year before (i.e. 2017)

- ❁ Develop a listing of all lease agreements – Lessee or Lessor
- ❁ Determine the most likely “noncancelable” lease period?
- ❁ Determine which leases are operating, if any, Capital Leases, and other GASB 87 leases.
- ❁ Recalculate the lease for remaining lease period.
Determine the interest current interest rate.

LEASES – BECAUSE GASB SAYS SO!

What I told you last year, and the year before, and the year before (i.e. 2017)

- ⊛ Combine like leases (copiers, computers) into similar remaining lease periods. Consider materiality for the assets and the liability.
- ⊛ Consider your capitalization threshold for the intangible asset and the corresponding liability.
- ⊛ Work with vendors to get all the information in the contract.
- ⊛ If you are using comparative financial statements, you have even more work.

LEASES – BECAUSE GASB SAYS SO!

This Year:

 Let's get a little more
into the weeds (I mean
details)



LEASES – BECAUSE GASB SAYS SO!

What I told you last year, and the year before, and the year before (i.e. 2017)

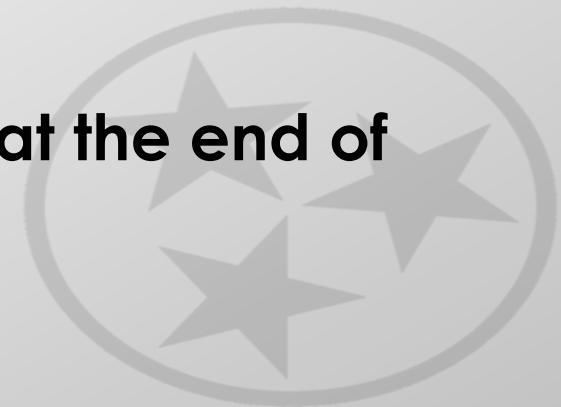
- 🌟 **Gather** all lease agreements (including operating leases) from all funds, all departments.
- 🌟 **Make a legible digital copy or photocopy of the lease**
- 🌟 **Make a list** of all the leases by category – Two Main Categories:
 - **Lessee**
 - **Lessor**



LEASES – BECAUSE GASB SAYS SO!

What I told you last year, and the year before, and the year before (i.e. 2017)

- ❁ **Gather** all lease agreements (including operating leases) for all funds, all departments (con'td).
- ❁ Under the two Main Categories, Separate and List each transaction by **sub-category**:
 - **GASB 87 Leases** (by **lessee** and **lessor** lease agreements)
 - Short-Term Leases
 - Contracts that transfer Ownership to the government at the end of the Contract.
 - Leases that are not exchange transactions



LEASES – BECAUSE GASB SAYS SO!

What I told you last year, and the year before, and the year before (i.e. 2017)

🌟 Under the two Main Categories, Separate and List each transaction by **sub-category**:

➤ **Short-Term Leases:**

➤ Is the maximum possible lease term 12 months or less, including options to extend, and without regard to appropriation or annual cancellation clauses (i.e., depending on intent)



LEASES – BECAUSE GASB SAYS SO!

What I told you last year, and the year before, and the year before (i.e. 2017)

🌟 Under the two Main Categories, Separate and List each transaction by **sub-category**:

- Contracts (Leases) that do not Meet the Definition of a Lease under GASB 87 because they are **not exchange** transactions:
- Does the lease have an insignificant lease payment (such as \$1.00 for a piece of land for 99 years)
- If the lease continues into perpetuity for a nominal amount



LEASES – BECAUSE GASB SAYS SO!

What I told you last year, and the year before, and the year before (i.e. 2017)

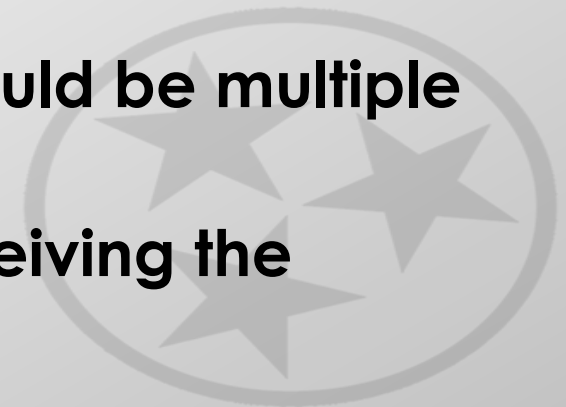
🌐 Under the two Main Categories, Separate and List each transaction by **sub-category**:

- Contracts that transfer **Ownership** to the government at the end of the Contract.
- These should be reported as a financed purchase of the underlying asset by a government lessee (or sale by a government lessor)
- **(Some exceptions if the contract includes termination or funding options, paragraph 19)**

LEASES – BECAUSE GASB SAYS SO!

What I told you last year, and the year before, and the year before (i.e. 2017)

- 🌟 **Gather** all lease agreements (including operating leases) for all funds, all departments (con'td).
- 🌟 **Make a list** of all the leases which should include:
 - Is the Government the **Lessee/Lessor**
 - Vendor – Who are you leasing from or leasing to.
 - Asset Description (bus, copier, building, etc.). This could be multiple items combined.
 - Fund or Department utilizing the leased asset. Or receiving the lease revenue.



LEASES – BECAUSE GASB SAYS SO!

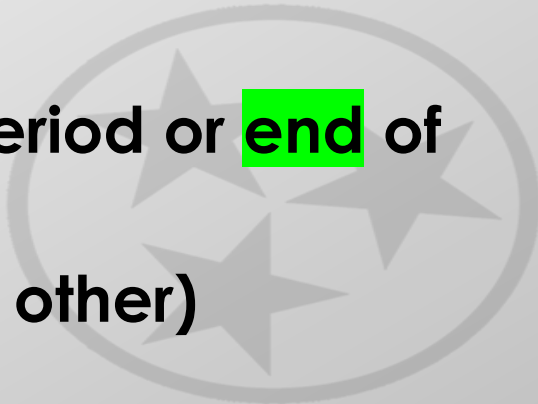
What I told you last year, and the year before, and the year before (i.e. 2017)

🌟 Make a list of all the leases which should include (cont'd):

- Beginning lease date of the original lease (e.g., July 15, 2019), prior to implementing GASB 87
- (Keep in mind that most of the leases will be operating leases under Pre-GASB 87 guidance.)
- Are there any termination options in the lease? (lessee and/or lessor) Is it reasonably certain to be exercised?
- Are there any options to extend the lease? (lessee and/or lessor) Is it reasonably certain to be exercised?

LEASES – BECAUSE GASB SAYS SO!

What I told you last year, and the year before, and the year before (i.e. 2017)

- 🌐 **Make a list of all the leases which should include (cont'd):**
 - **Remaining** duration of the original lease as of **July 1, 2021** (e.g., 5 years or 60 months) or; **January 1, 2021** for a calendar year government)
 - Payment frequency (monthly, annually)
 - Monthly payment amount (more discussion later)
 - Are payments made at the **beginning** of the month/period or **end** of month/period
 - Interest rate if stated (or, implicit, or borrowing rate, or other)
- 

Progress Report?

- 🌟 I have gathered all my leases.
- 🌟 I am about half-way through.
- 🌟 I am about one-third through.
- 🌟 I have started.
- 🌟 I have not started yet.



How many Leases?

- 🌟 Between 1-10
- 🌟 Between 10-50
- 🌟 Between 50-100
- 🌟 Between 100-250
- 🌟 Between 250-500
- 🌟 Between 500-1000
- 🌟 Over 1000



Who will calculate the lease liability?

- 🌟 Finance Office Staff
- 🌟 The Auditor
- 🌟 Auditor, but we will supply the information
- 🌟 Other Contractor



LEASES – BECAUSE GASB SAYS SO!

This Year:

 Now for the easy part
– calculating the
liability



You must know **four** things?

- 🌐 **When** the payments start (beginning or end of month or period)
- 🌐 The **amount** of the payment.
- 🌐 The **number** of payments
- 🌐 The **interest** rate



You must know **four** things?

- 🌟 Need to have a present value calculator
- 🌟 Or, you can use Excel.



LEASES – BECAUSE GASB SAYS SO!

This Year:

 **Prior Year Example**

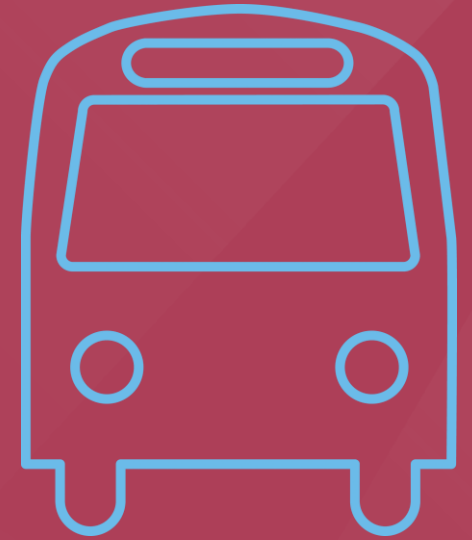


LESSEE – BUS LEASE EXAMPLE (CONT.)

The government has a long-standing process of leasing its buses.

- On January 1, 2021, the government enters into a **contract** for **five buses**. The contract states the **term is 5 years**, with monthly **payments of \$2,000** due every 1st of the month. Lessor provided the borrowing rate of 6%.
- After three years, the government may cancel the contract.
- After the fifth year, the purchase price for each bus is \$12,000.
- The government regularly leases buses and has historically utilized the buses for the full term of the contract and have **never terminated** early. The contract **does not provide the lessor an option to terminate**. At the date of the contract, the government **does not have any intent to terminate** early. At the end of the lease, the government intends to return the buses, there is no transfer of ownership provision.

✓ **Does this meet the definition of a lease? YES**



LESSEE – BUS LEASE EXAMPLE (CONT.)

Assumptions for Lease Liability calculation:

Buses are delivered on January 1, 2021, date of 1st payment.

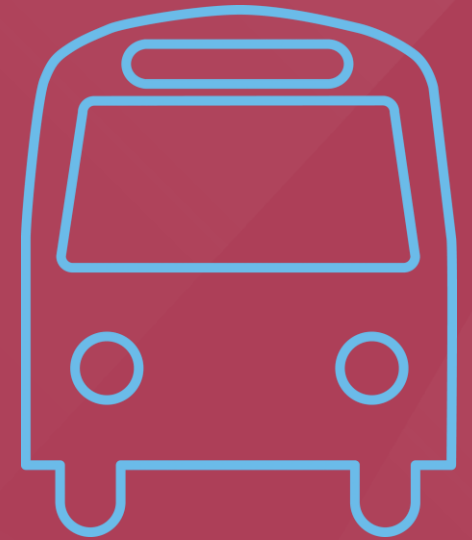
Payment schedule 5 years, assuming a 6% interest rate.

Purchase price, not certain of being exercised (exclude)

Present value of \$2,000 monthly payments for 5 years (60 months):

- Rate = (6% per year / 12 months to get rate per month)
- Nper (number of payments) = 60
- Pmt (monthly payment) = 2,000
- FV (future value) = 0
- Type = 1 if payments are made at beginning of period, 0 if payments are made at end of period

$$=PV(6\%/12,60,-2000,0,0)$$



**Present
Value =
\$103,451**

LESSEE – BUS LEASE EXAMPLE (CONT.)

Annualized Payment Schedule

	Principal	Interest	Total Payment
2021	18,290	5,710	24,000
2022	19,419	4,581	24,000
2023	20,616	3,384	24,000
2024	21,888	2,112	24,000
2025	<u>23,238</u>	<u>762</u>	<u>24,000</u>
	103,451	16,549	120,000

Year 1	Amortization	20,690
Year 2	Amortization	20,690
Year 3	Amortization	20,690
Year 4	Amortization	20,690
Year 5	Amortization	<u>20,691</u>
		103,451

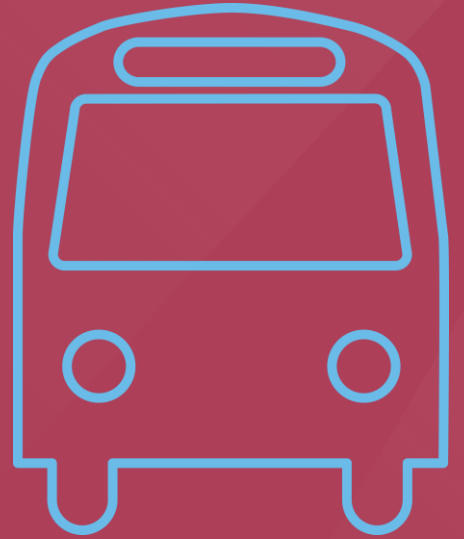


LESSEE – BUS LEASE EXAMPLE, EXPANDED

(CONT.)

Multiple contract components

- What if the lease agreement requires the government to pay an additional **\$500 per quarter for maintenance**, including oil change, tune ups, etc. for each bus?
- Should that be included in the lease liability? **NO**
- Does \$500 per quarter for five buses seem reasonable? **YES**
- Is it identifiable in the contract? **YES**



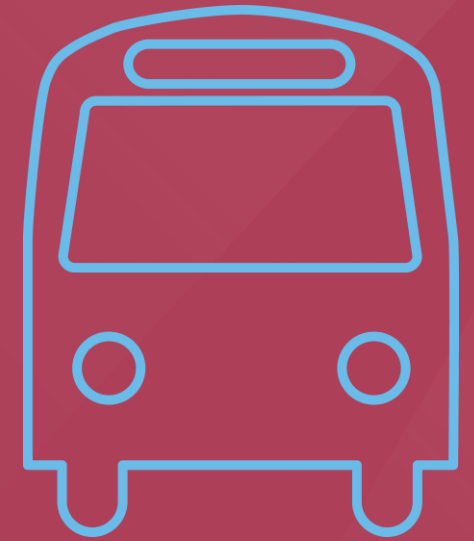
LESSEE – ACTIVITY BUS EXAMPLE, EXPANDED

(CONT.)

Multiple contract components

<u>Governmental Fund - Year 1 Journal Entry</u>	<u>Debit</u>	<u>Credit</u>
Interest expense	5,710	
Lease principal payment expenditure	18,290	
Maintenance expense	2,000	
Cash		26,000
<i>To record 12 monthly lease payments for first year</i>		

<u>Entity-wide - Year 1 Journal Entries</u>	<u>Debit</u>	<u>Credit</u>
Lease liability	18,290	
Lease principal payment expenditure		18,290
Amortization expense	20,690	
Accumulated amortization		20,690
<i>To eliminate fund level activity for first year</i>		



LESSEE – BUS LEASE EXAMPLE, EXPANDED (CONT.)

Additional payment factors in contract

- What if the lease agreement requires the government to pay \$50 per month, per bus for mileage, plus \$1 dollar per mile for every mile over 500 miles each month.
 - What should be included in the lease liability?
 - Is a piece of the contract “fixed in substance”?
 - Is a piece of the contract excluded from the lease liability?



LESSEE – BUS LEASE EXAMPLE, **EXPANDED** (CONT.)

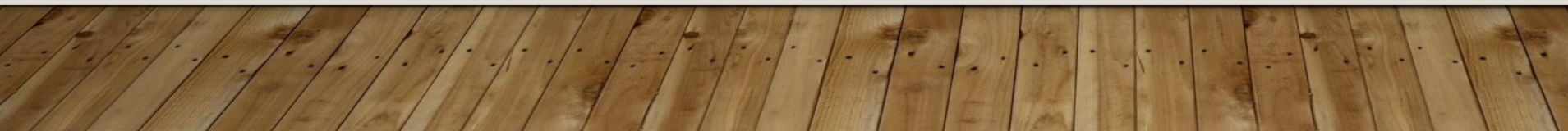
Additional payment factors in contract

Monthly payment = \$2,000

Additional monthly fixed payment for mileage = \$50

Monthly variable payment for mileage = \$1/ per mile for every mile over 500 miles each month.

- What additional payments should be included in lease liability?
 - Payments that are fixed in substance are included in the liability
- Is a piece of the contract “fixed in substance”?
 - Yes, the monthly charge of \$50 should be included
- Is a piece of the contract excluded from the lease liability?
 - Yes, the mileage fee is not based on an index or rate, it is based on the lessee’s usage of the underlying asset.



LESSEE – BUS LEASE EXAMPLE, **EXPANDED** (CONT.)

	Monthly	Fixed in Substance	Variable	Total			
Monthly payment	\$2,000	+	\$50	+	0	=	\$2,050
Variable payment	\$1/ mile over 500 per bus						



Annualized Payment Schedule			
	Principal	Interest	Total Payment
2021	18,748	5,852	24,600
2022	19,904	4,696	24,600
2023	21,132	3,468	24,600
2024	22,435	2,165	24,600
2025	23,819	781	24,600
	106,038	16,962	123,000

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GOVERNMENTAL FUNDS VS. GOVERNMENT-WIDE FINANCIAL STATEMENTS

- Finally,
- Keep in mind that the adjustments based on the lease calculations only affect the **Government-wide Financial Statements and Enterprise Funds** (e.g., Utilities).
- The **debit** to Intangible Lease Asset and **credit** to Lease Liability
- However, the lease payments, interest, other expenses (such as maintenance costs) have to be budgeted and recorded in the **Governmental Funds**. Adjustments are made to the **Governmental Funds** to recognize the asset and liability at the **Government-wide level**.

Questions

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