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Things are Changing

- ▶ **The Old Way**
 - Capital leases - capital asset and long-term liability reported
 - Operating leases - expense/expenditure as payments made
- ▶ **The New Way**
 - No split between capital and operating leases
 - Leases are financings
 - Lessees - like existing capital lease guidance
 - Right to use & lease liability
 - Lessor - lease receivable and deferred inflow of resources

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What is a Lease?

- ▶ **Lease Defined**
 - 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.

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Is the Contract a Lease?


- Nonfinancial Asset
 - Usually seems obvious - not cash
 - Currently undefined by GAAP
- Period of Time
 - Does not require uninterrupted use
- Exchange Transaction
 - Exchange - essentially equal value for equal value
 - Exchange like - not quite value for value
- Control
 - Ability to use the asset as specified in the contract



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Is this Contract in Scope?


- ▶ Intangible assets (i.e. software) - GASB-96
- ▶ Service concession arrangements - GASB-94
- ▶ Lease involving conduit debt - GASB-91
- ▶ Specifically excluded from GASB-87
 - Biological assets, inventory contracts, power purchase contracts, non-exclusive use contracts
- ▶ If a contract transfers ownership by the end of the contract and does not contain termination options, the contract is a financed purchase



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The Lease Term

- ▶ The Short-Term Leases
 - Maximum possible term of 12 months or less, at the beginning of the lease, including any options to extend, regardless of the probability of being exercised
 - Equivalent to the current operating lease model
 - Month to month lease - what is the noncancellable period?
 - If the noncancellable portion is less than one year, it's short-term



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The Lease Term

- ▶ Excludes cancelable periods - Periods for which lessee and lessor each have the option to terminate or both parties have to agree to extend
- ▶ Budget appropriations

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Lease Term Reassessment

- ▶ Lessee or lessor elects to exercise an option even though originally determined that option would not be exercised
- ▶ Lessee or lessor elects to not exercise an option even though originally determined that option would be exercised
- ▶ An event specified in the contract that obligates lessee to extend or terminate lease occurs, resulting in change in lease term

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The Discount Rate


- ▶ Use the interest rate charged the lessee, if known
 - Unlikely, it's probably implicit
- ▶ If not readily determinable, use incremental borrowing rate
 - Consider lease term - does a 20-year bond rate for a 5-year lease make sense?
- ▶ Determine the implicit rate
 - If fair value is known

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The Discount Rate

- ▶ Choose an interest rate methodology you can replicate
- ▶ Use effective interest method to amortize
- ▶ Can you use a risk-free rate?



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Recognition & Measurement

▶ Initial Reporting - Lessee - Full Accrual

Item	Calculation
Lease Payable	Present value of future lease payments
Lease Asset	Lease payable plus prepayments (net of incentives) and initial direct costs

▶ Subsequent Reporting - Lessee - Full Accrual

Item	Calculation
Lease Payable	Principal portion of lease payment
Interest Expense	Interest portion of lease payment
Amortization of Lease Asset	Systematic and rational allocation



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Recognition & Measurement

▶ Initial Reporting - Lessee - Modified Accrual

Item	Calculation
Other Financing Sources	Present value of future lease payments
Expenditure - Capital	Present value of future lease payments

▶ Subsequent Reporting - Lessee - Modified Accrual


Item	Calculation
Interest Expenditure	Lease payment - interest portion
Lease Principal	Lease payment - principal portion



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Recognition Thresholds


- ▶ The Big Question - “Can I establish a threshold for recognizing a liability the same as our capital asset threshold?”
- ▶ GAAP requires liabilities that are *significant* either individually or in the aggregate to be recognized.
 - Consider qualitative and quantitative significance
 - Significant is *less* than material
 - It may just be easier to record it.



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Modifications & Terminations


- ▶ Remeasure the lease liability on the effective date of modification
 - May need an updated discount rate
- ▶ If term is extended, amortization is re-amortized based on shorter of useful life or asset life.
 - Change in accounting estimate
- ▶ If lease is terminated, could result in gain/loss.



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Lessee Disclosures


- ▶ General description, terms, conditions, etc.
- ▶ Total amount of assets recorded and related accumulated amortization, separate from other capital assets
- ▶ Lease assets disaggregated by major classes of underlying assets, separate from other capital assets



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Internal Controls


- ▶ How are lease records maintained?
- ▶ Who is authorized to execute, extend, modify, and terminate leases?
- ▶ Who decides the interest rates?
- ▶ Uniform Guidance
- ▶ How do we continue to update lease information?
- ▶ Related party leases?
- ▶ Impact on capital asset software and tracking?



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Implementation



- ▶ It's retroactive!
- ▶ Recognized using information at the date of transition (beginning of period implementation).
- ▶ Comparative financial statements - go back to earliest period...
- ▶ Embedded leases
 - > Agreements that bundle a service and a device
 - > Transportation services
 - > Maintenance services



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Implementation

- ▶ Does the contract have different components?
- ▶ Multiple underlying assets with different terms?
 - > Allocate if practical
- ▶ Collecting all the data
- ▶ Software?



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Contact Information



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Thank You!