

DebtBook

How to Implement GASB-87 & Maintain Compliance

SPEAKERS

Louis is the Managing Director of Strategic Partnerships at DebtBook. He is a Certified Public Accountant (CPA) who now works with innovative fintech companies to transform the lives of finance and accounting professionals. In addition to serving public sector clients in his accounting role and holding leadership positions at Blackbaud and Porte Brown, Louis has also served as an adjunct professor of Accounting, Auditing, Finance, and Management.



**Louis Stratton,
CPA, CITP, CGMA, MBA**

Managing Director of Strategic
Partnerships



STEP 2: Collecting and Organizing Leases

- Start with what you know: current capital and operating leases
- Organize the contracts into folders:

Short-Term

Contracts with a lease term of 12 months or less

Contract That Transfers Ownership

Ownership of the underlying asset transfers and the contract does not contain termination options

Leases

The remaining contracts

- Consider your service contracts and review for any embedded leases

Collecting and Organizing Leases: *Embedded Leases*

- Often found in services contracts
 - Examples: *cloud computing services, food service contracts, transportation service contracts*

- Questions to ask:
 - Is there an underlying physical asset discussed in the contract?
 - Do you have the right to obtain the present service capacity from use of the underlying asset?
 - Do you have the right to determine the nature and manner of use of the underlying asset?
 - Does the contract cover a specific period of time?
 - Is it an exchange or exchange-like transaction?

STEP 3: Extracting the Data

- Consider using a checklist
- Include those who are familiar with the contract details
- There are three primary categories of information
 - 1 *Lease Term*
 - 2 *Payments*
 - 3 *Initial Direct Costs, Incentives, and Prepayments*

Extracting the Data: *Lease Term*

- Extension options
- Termination options
- Fiscal funding or cancelation clauses
- Cancelable periods
 - Both lessee and lessor can terminate without permission from the other or both parties must agree to extend
 - Ex: rolling month-to-month lease and holdover periods*

Extracting the Data: *Payments*

- Fixed payments
- Variable payments
 - Variable payments fixed in substance
 - Variable payments based on an index or rate
 - Variable payments based on future performance (exclude)
- Residual value guarantees, exercise price of purchase option, termination penalties

Extracting the Data: *IDC, Incentives, & Prepayments*

— Initial Direct Costs (IDC)

- Examples: *fees to prepare and process lease documents, closing costs, costs to negotiate the lease terms*

— Incentives

- Paid/received at or before commencement
- Paid/received after commencement

— Prepayments

- Paid/received at or before commencement
- Paid/received after commencement

Lease and Nonlease Components

- Multiple underlying assets
 - Different lease terms *or*
 - Different major asset classes
- Nonlease components
 - Common examples: common area maintenance (CAM) service, warranty
 - Treat separately from lease component
- Allocate contract price
 - Prices included in the contract
 - Best estimate; if not practicable, treat as one component

STEP 4: Crafting the Initial Schedules

- Discount the lease payments using the appropriate interest rate to determine your lease liability/receivable beginning balance
- Use initial direct costs, incentives, and prepayments to adjust the lease asset/deferred inflow of resources
- Consider materiality

| Date | LEASE LIABILITY | | | | LEASE ASSET | | |
|----------|-------------------|---------------|------------------|----------------|-------------------|----------------------|----------------|
| | Beginning Balance | Lease Payment | Interest Expense | Ending Balance | Beginning Balance | Amortization Expense | Ending Balance |
| 1/31/21 | \$ 5,849.09 | \$ 225.00 | \$ 10.97 | \$ 5,635.06 | \$ 5,999.09 | \$ 166.64 | \$ 5,832.45 |
| 2/28/21 | \$ 5,635.06 | \$ 225.00 | \$ 10.57 | \$ 5,420.62 | \$ 5,832.45 | \$ 166.64 | \$ 5,665.81 |
| 3/31/21 | \$ 5,420.62 | \$ 225.00 | \$ 10.16 | \$ 5,205.79 | \$ 5,665.81 | \$ 166.64 | \$ 5,499.17 |
| 4/30/21 | \$ 5,205.79 | \$ 225.00 | \$ 9.76 | \$ 4,990.55 | \$ 5,499.17 | \$ 166.64 | \$ 5,332.52 |
| 5/31/21 | \$ 4,990.55 | \$ 225.00 | \$ 9.36 | \$ 4,774.90 | \$ 5,332.52 | \$ 166.64 | \$ 5,165.88 |
| 6/30/21 | \$ 4,774.90 | \$ 225.00 | \$ 8.95 | \$ 4,558.86 | \$ 5,165.88 | \$ 166.64 | \$ 4,999.24 |
| 7/31/21 | \$ 4,558.86 | \$ 225.00 | \$ 8.55 | \$ 4,342.41 | \$ 4,999.24 | \$ 166.64 | \$ 4,832.60 |
| 8/31/21 | \$ 4,342.41 | \$ 225.00 | \$ 8.14 | \$ 4,125.55 | \$ 4,832.60 | \$ 166.64 | \$ 4,665.96 |
| 9/30/21 | \$ 4,125.55 | \$ 225.00 | \$ 7.74 | \$ 3,908.28 | \$ 4,665.96 | \$ 166.64 | \$ 4,499.32 |
| 10/31/21 | \$ 3,908.28 | \$ 225.00 | \$ 7.33 | \$ 3,690.61 | \$ 4,499.32 | \$ 166.64 | \$ 4,332.68 |

Crafting the Initial Schedules - *Example*

Present value calculation inputs in Excel:

- Rate: 5% = Stated, Implicit or IB Rate
- Number of Periods (nper): 24 = calculated lease term
- Payment (pmt): \$5,000 = Total lease payment
- Type: 0 for payments at the end of the period or 1 for payments at the beginning of the period

Interest Rates

**Stated
Rate**

**Implicit
Rate**

**Incremental
Borrowing
Rate**

STEP 5: Launching the Internal Review Process



- Identify who will be the internal reviewer(s) well in advance
- Make sure all assumptions are properly documented with support
- Consider time and personnel constraints and evaluate using an outside specialist

STEP 6: Understanding the Importance of Journal Entries

- These entries may not be as complex as you think
- All entries related to GASB-87 will be highly susceptible to auditor scrutiny
- In some cases, a restatement will be necessary

| FULL ACCRUAL JOURNAL ENTRIES | | | |
|----------------------------------|--|-------------|-------------|
| 1/1/21 | Right-of-Use Asset | \$ 5,999.09 | |
| | Lease Liability | | \$ 5,849.09 |
| | Cash (Initial Direct Costs) | | \$ 150.00 |
| | <i>To record initial right-of-use asset and lease liability.</i> | | |
| 12/31/21 | Amortization Expense | \$ 166.64 | |
| | Accumulated Amortization | | \$ 166.64 |
| | <i>To record the first year of amortization expense of the right-of-use asset.</i> | | |
| 12/31/21 | Lease Liability | \$ 214.03 | |
| | Interest Expense | \$ 10.97 | |
| | Cash | | \$ 225.00 |
| | <i>To record the first payment on the lease liability.</i> | | |
| MODIFIED ACCRUAL JOURNAL ENTRIES | | | |
| 1/1/21 | Expenditure: Right-of-Use Asset | \$ 5,999.09 | |
| | Other Financing Source: Lease | | \$ 5,849.09 |
| | Cash (Initial Direct Costs) | | \$ 150.00 |
| | <i>To record initial right-of-use asset and lease liability.</i> | | |
| 12/31/21 | Expenditure: Lease Principal | \$ 214.03 | |
| | Expenditure: Lease Interest | \$ 10.97 | |
| | Cash | | \$ 225.00 |
| | <i>To record the first payment on the lease liability.</i> | | |

Journal Entry

Understanding the Importance of Journal Entries: *Restatement*

- Previous Capital Lease → GASB 87 Short-Term Lease
- Previous Capital Lease → GASB 87 Lease with adjusted assumptions

STEP 7: Starting the External Review Process

- An external reviewer can provide a fresh set of eyes
- Identify who this reviewer will be and schedule early

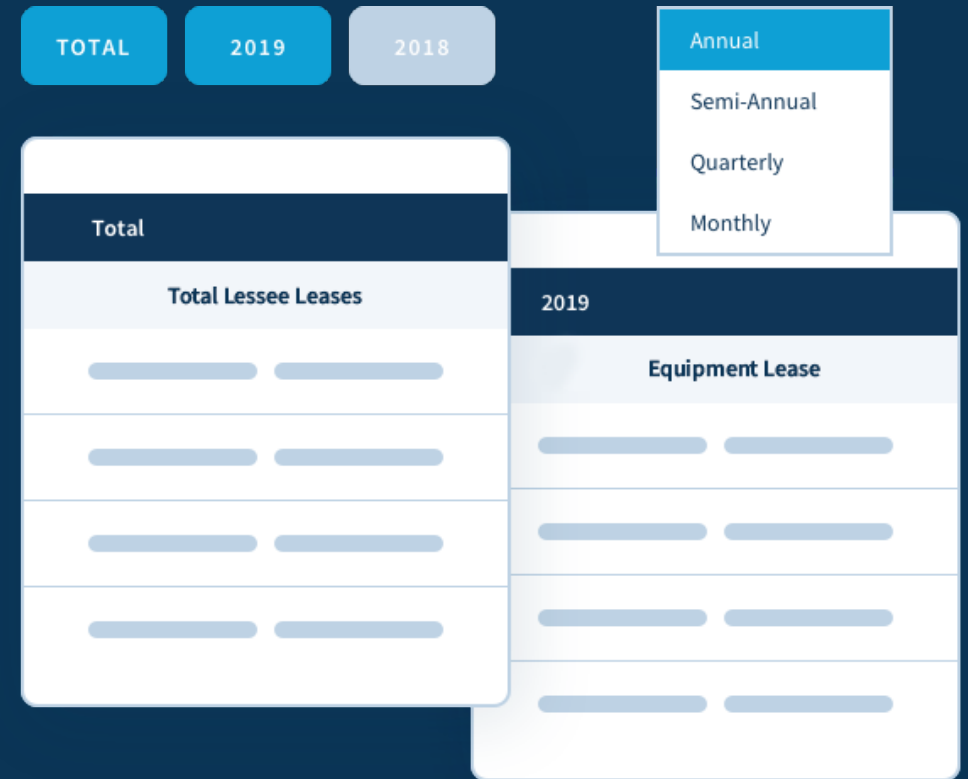


STEP 8: Preparing Note Disclosures

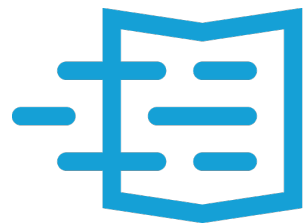
- Many of the disclosures required by GASB-87 will be familiar – they are just more robust under the new standard
- Be sure to list right-of-use assets separately from other capital assets
- Lessees:
 - Variable payments not originally included in the Lease Liability
 - Residual value guarantees not originally included in the Lease Liability
- Lessors:
 - Variable payments not originally included in the Lease Receivable
 - Terminations and abatements of lease payments used to secure debt
- Regulated:
 - Extant assets are subject to preferential or exclusive use

STEP 9: Adhering to Ongoing Compliance

- Use a central location for all contracts
- Document the processes as you work through them in the current fiscal year
- Review processes regularly



QUESTIONS?



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www.DebtBook.com



Louis Stratton

louis.stratton@debtbook.com