

**DebtBook**

# Building an Action Plan for GASB-87 Compliance

# SPEAKERS

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**Kasey Harris**

Head of Accounting  
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## 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

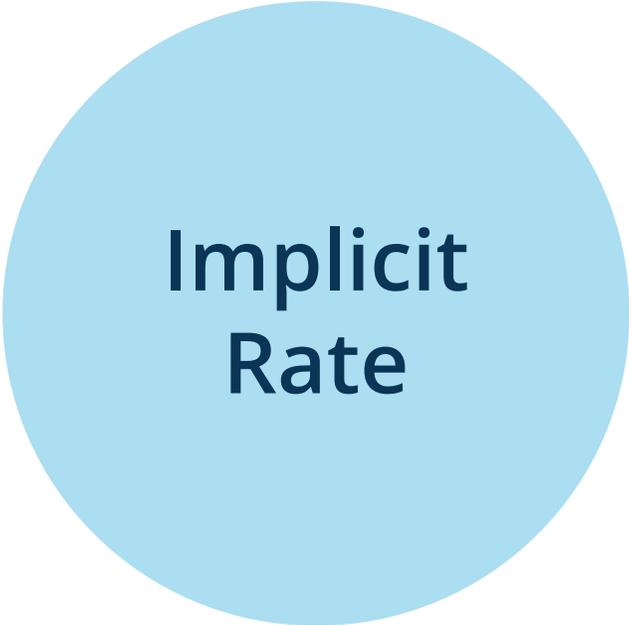
Present value calculation inputs in Excel:

- **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

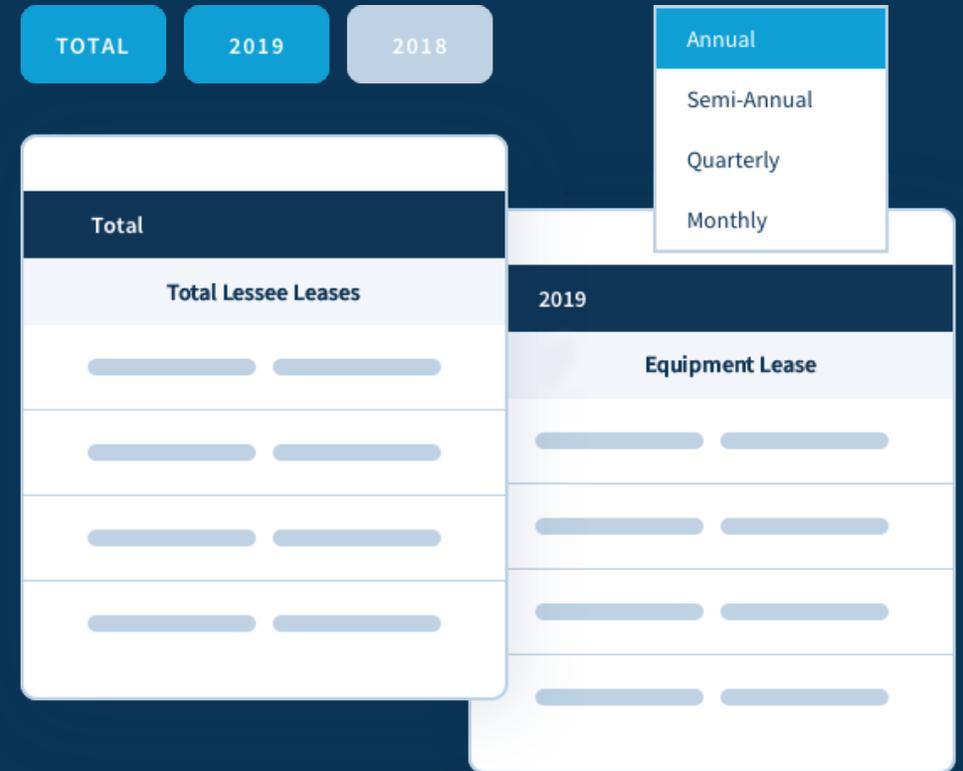


# STEP 8: Preparing Note Disclosures

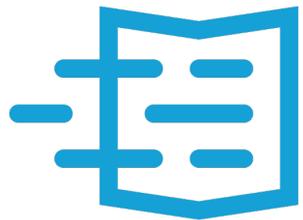
- Many of the disclosures required by GASB-87 will be familiar – they are just more robust under the new standard
- Be sure to list right-of-use assets separately from other capital assets
- Lessees:
  - Variable payments not originally included in the Lease Liability
  - Residual value guarantees not 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?



## DebtBook

[www.DebtBook.com](http://www.DebtBook.com)



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