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WEBINAR

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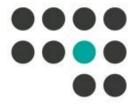*Leases & SBITA Accounting:*
Year Two & Beyond

Tue, June 18
10:30AM PST

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Your Presenters

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Objectives

- Learn about the challenges faced by governmental agencies while complying with GASB 87 and GASB 96 requirements, and how to address them.

- Learn a step-by-step approach to updating Leases and SBITAs each year.

- Discuss best practices for documentation and preparation for an audit.

Polling Question #1

Have you been involved in the implementation of GASB 87 and/or 96?

A. Yes, GASB 87
B. Yes, GASB 96
C. Yes, Both
D. Neither

Lessons Learned from GASB 87/96

- **Understand the GASB** – Stay current; utilize additional resources provided after issuance of GASB 87 and GASB 96.

- **Prepare Early** – It takes time to meet with your departments to verify changes are incorporated. Initiate early in your close process. Don't make this the last item of your close.

- **Consider Separate Expense Accounts –** Separate expense accounts to make for easier tracking.

- **Plan for Challenges** – Whether you are using a software solution or calculating it manually, it will take time to verify the data and complete the calculations, journal entries and footnote information.

- **Document everything** – Make sure to document anything that could be applicable, AND not applicable.

- **Plan to be done early** – Delays caused from implementation should be in the past.

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Considerations in Year Two and Beyond

- Review <u>Existing</u> Lease/SBITAs
  - Modifications
    - Early terminations or re-negotiations
    - Term extensions or expanded scope/compensation

- Evaluate <u>New</u> Lease/SBITAs

- Reevaluate GL account structure related to leases/SBITAs

- Review prior year process and establish efficient standard operating procedure

Technical Guidance

Lease/SBITAs Defined

- Requirements that are applicable to Leases and SBITAs
    - Contract conveys control of the right to use another party's property or IT software
    - The property or IT software must be controlled for a period of time in an exchange transaction
    - Term longer than 12 months, including extension options, regardless of reasonable certainty of extending

- Requirements that are <u>unique</u> to SBITAs under GASB 96
    - Does the contract include hardware? If so, is the software insignificant compared to the hardware?
    - If a contract is solely for IT support services then it is excluded, but if the contract is IT support and right-to-use IT asset (and the cost cannot be separated) then it is included

Note: If you use a software solution, you really need to review and enter these in correctly. The software may not account for this part correctly.

Terms

"Noncancellable Period"

- The period during which a government has a noncancellable right to use the underlying asset, **_plus_** the following periods, if applicable:
  - Option to extend, IF reasonably certain TO exercise
  - Option to terminate, IF reasonably certain NOT TO exercise

"Cancellable Periods"

- If <u>both parties</u> have an option to terminate without permission from other party, or if both parties have to agree to extend.
  - These are excluded from terms
  - Examples – rolling month to month, or holdover period until new contract is entered into

Provisions

What if there is a cancellation option in a default provision?

- DOES NOT COUNT AS A CANCELLATION PROVISION
- Example: Provision allows for termination of agreement as a result of either payment of all sums due or default on payments or if there is a list of actions that have to happen in order for this provision to kick in.

What if there is a fiscal funding or cancellation clause?

- ONLY COUNTS IF REASONABLY CERTAIN TO BE EXERCISED
- Example: Provision allows a government to cancel on an annual basis if the government does not appropriate funds for payments.

Subscriptions In Progress

An agreement may not be considered a SBITA if the software is not yet in service (hasn't gone LIVE)

How is this accounted for:

- Accumulate subscription fees and one-time implementation costs paid through go-live
- Record a "Subscription in Progress" for all costs accumulated through <mark>year end</mark> similar to CIP.

When does it become a subscription:

- Not until the asset has 'service capacity' and is LIVE
- The Subscription in Progress is transferred to a depreciable asset along with the future subscription fees
- Subscription Liability is recorded equal to the NPV of the remaining subscription fees due

Polling Question #2

Do you use a software for GASB 87 and/or GASB 96?

A. Yes
B. No

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LSL's Approach to Year-End Close

Step 1: Review the Prior Year Workpaper

- Evaluate the roll forward schedule to review reductions.

- Identify reductions that will zero out the remaining balance as of fiscal year end.

  - Consider the asset or service when reviewing the workpaper. Consider these examples:

    - If it's a lease for golf course, did the agency sell the golf course? Likely not. Is there a new agreement? Is there an amendment pending adjusting the term?

    - If it's a subscription for services, has the subscription service terminated? Has the agency shifted to a different subscription service by a different vendor?

EXAMPLE

FUND ACTIVITIES:	Balance as of July 1, 2022	Additions	Reductions	Balance as of June 30, 2023
Subscription Liability Software				
Gartner Inc. (124-21) v#8448-Core IT Research	25,896.39	-	12,772.91	13,123.48
Software One Inc. (595-20) v#7100-Software Assurance	402,561.48	-	402,561.48	-
CCG Systems Inc. (41-19) v#104 FASTER's Technical S	120,532.56	-	16,445.36	104,087.20
Comcate Inc. (421-18) v#469 -Web based Customer Ser	202,978.96	-	30,787.89	172,191.07
Granicus, Inc. (660-18) v#698-Communications Cloud	792,965.94	-	140,202.18	652,763.76
International Business Systems (689-17) v#6033-Softwar	15,967.85	-	2,524.43	13,443.42
Tyler Technologies, Inc. (576) v#3608-Public User API -	408,713.93	-	189,765.12	218,948.81
Accellion USA, LLC (23000593) v#3551-File Sharing Sof	-	73,482.57	24,989.99	48,492.58
Asana, Inc. (23001022) v#10006-Project Software	17,509.23	-	5,876.05	11,633.18
ESI Acquisition, Inc. (23000779) v#2271-Webeoc Softwa	92,555.63	-	15,884.11	76,671.52
Intervision Systems LLC (23000570) v#9665-Intervision S	47,254.85	-	9,794.21	37,460.64
Nitro Software, Inc. (23000600) v#9789-Nitro Software - I	-	156,161.80	40,071.71	116,090.09
Powerdms, Inc. (23000440) v#6471-PowerPolicy Profes	47,831.39	-	8,321.25	39,510.14
Powerphone, Inc. (23000439) v#4319-Powerphone Softv	-	10,919.46	5,512.50	5,406.96
Proofpoint, Inc. (23000281) v#8180-PSAT - Cyber Secur	52,992.26	-	17,986.00	35,006.26
Streamline Automation Systems, LLC (23000550) v#943(	70,008.92	-	14,459.96	55,548.96
Towne Communications, Inc. (23001068) v#6867-RedSk	105,726.08	-	21,311.09	84,414.99
Vigilant Solutions, LLC (2669) v#7103-Camera License K	142,412.09	-	35,064.84	107,347.25

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Step 2: Review Information in Lease/SBITA Software

- If you use a software for lease/SBITAs, USE IT! Review items that are terming out.

AT&T Interoperable Communications Systems	AT&T Interoperable Communications Systems	Lessor	Lease	10/01/2021	07/31/2031	Infrastructure	⊘ Verified	Active
Enterprise Fleet Vehicles #15	Enterprise Fleet Vehicles #15	Lessee	Lease	10/01/2021	03/31/2023	Vehicles	⊘ Verified	Term Ended
Enterprise Fleet Vehicles #21	Enterprise Fleet Vehicles #21	Lessee	Lease	10/01/2021	09/23/2023	Vehicles	⊘ Verified	Term Ended
Enterprise Fleet Vehicles #25	Enterprise Fleet Vehicles #25	Lessee	Lease	05/01/2022	04/30/2026	Vehicles	⊘ Verified	Active

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Step 3: Read the Minutes

- Identify agendas/minutes with new agreements.
- Review prior fiscal year minutes to identify:
  - New Agreements
  - Amendments or modifications to existing Leases/SBITAs
- No cost agreements should be noted. It is a best practice that agencies maintain a listing with supporting documentation of all evaluated agreements, even those that are determined to not be subject to GASB 87 or 96.

Step 4: Meet with Departments

- Engage your departments, early AND often!
  - We recommend meeting at least 2x yearly.
    - December and June or mid-year and year-end for your agency
  - Keep the information fresh and limit a backlog of new items to evaluate.
- Look internally… Engage Purchasing!
  - Request reports at least 2x yearly. This can be a resource used internally or shared with departments as a guide.
  - Submit documentation requests for quotes/terms and conditions/PO 2x yearly to correspond.

Step 5: Review GL Activity

- Scrub your GL
  - Scan account details for revenue/expense accounts that may hold lease/SBITA transactions.
  - Use keywords or past vendor names to search and identify any new recurring lease/SBITA transactions.

Step 6: Gather Relevant Data

- Confirm Software is active as of FYE or roll forward excel
- Lease/SBITA Payment Data
  - Annual payments, frequency, project implementation cost, prepayments.
  - First/Second payment dates since GASB measurement period.

- Term
  - Lease/SBITA start date, expiration date, term length, renewal options.
- Incremental Borrowing Rate
- Supporting Documentation
- GL Allocations
- Repeat for ALL lease/SBITA components input into software

Step 7: Does it Qualify?

- For <u>amended</u> items, confirm the revised terms still qualify.

- Evaluate <u>new</u> leases/SBITAs:
  - Prioritize the term to exclude short-term agreements (12 months or less).
  - Prioritize review of cancellability. Mutually cancellable agreements are not required to be reported as a liability under GASB 87/96.
  - If <u>either</u> party can terminate the agreement WITHOUT cause, the agreement is cancellable. If <u>either</u> party can NOT renew by way of notice of non-renewal, the portion of the term length subject to this clause is cancellable. That portion thereafter is not qualifiable.

Step 7: Does it Qualify?

- Evaluate Materiality/Items Exceeding Capitalization Threshold:
  - For GASB 87 LessOR leases, there is no materiality threshold.
  - For GASB 96 there is <u>NO</u> defined materiality threshold.
    - The only threshold for materiality in your financial statements is your capitalization threshold, which is $5k for many agencies.

Step 8: Enter Relevant Info into Tool

- If you confirmed you're using a software, USE IT!
  - For <u>amended</u> items, modify the original entry. Do not create a new entry (regardless of which software you're using).
  - Input the <u>new</u> leases/SBITAs as a new entry.

- If you're not using a software, you will need to complete the calculations manually and keep complete files easily referenceable for your auditors.

- For non-GASB lease/SBITAs, you may enter them in the software and/or keep a log substantiating your determinations.

Step 9: Evaluate Output for Accuracy

- Review the calculations for inconsistencies and red flags:
  - Do the repayment schedules look accurate?
  - Are the increases occurring at the right times and for the correct amounts?
  - Have you evaluated the likelihood of exercising extension or cancellation options accurately?
- If you're using a software, this step may include adding accounts and/or modifying the entries for posting in your financial system.

Step 10: Review and Post JEs

- If using a software, the system may not export the account numbers exactly as you would post them, especially for conversion from modified to full accrual.

- Review the entries for any unusual balances that may indicate costs being entered into the incorrect field.

- Post JEs to your financial software and tie out ending balances to the rollforward to ensure everything is accurate.

Polling Question #3

What do you think your biggest challenge will be with this process?

A. Maintaining a list of Leases/SBITAs
B. Engaging departments
C. Accuracy with the journal entries (software limitations)
D. All of the above

How Does This Info Get Audited

What Information Is Needed for Audit

- Workpapers Needed
  - Lease/Subscription Asset and Lease/Subscription Liability Rollforward

Fund (Rollforward Schedule)				
340 - DEVELOPMENT SERVICES	Balance as of July 1, 2023	Additions	Reductions	Balance as of June 30, 2024
Lease Liability				
Buildings				
1215 Center Street	634,944.69	-	154,292.36	480,652.33
Total Building Lease Liability	634,944.69	-	154,292.36	480,652.33
Total Lease Liability	634,944.69	-	154,292.36	480,652.33

  - Calculations for Interest Receivable and Interest Payable

What Information is Needed for Audit

- Additional Information Needed
  - Listing of leases/SBITAs considered that did not qualify
  - Copies of lease and SBITA agreements, amendments, terms and conditions, purchase orders, quotes, etc.
  - Documentation supporting determinations made for each lease/SBITA
    - Materiality (policy)
    - Reasonable likelihood of exercising extensions
    - Estimation of years for autorenewals
  - Journal entries
  - General ledger detail

How Does This Info Get Audited

- Testing of Activity Through Sampling
  - Accuracy and Reasonableness
  - Adherence to Established Capitalization Policy

- Completeness Testing for Unreported Items
  - Make sure you keep a copy of the items considered but not included in leases/SBITAs

Polling Question #4

Do you maintain a listing of Leases/SBITAs that you evaluated were not subject to GASB 87 or GASB 96?

A. Yes
B. No

Additional Resources

- California State Controller's Office:
  - https://www.sco.ca.gov/sard_gaap_basis_reporting.html

- GFOA GASB 87 and 96 Resource Center
  - https://www.gfoa.org/gasb-resource-center

- GFOA Just a T.A.D. YouTube videos
  - https://www.gfoa.org/justatad

LSL Resources

- GASB 87 – LSL Blog
  - https://lslcpas.com/gasb-87-implementation-lessons-learned-plus-what-to-do-if-you-havent-started/

- GASB 96 – LSL Blog
  - https://lslcpas.com/gasb-96-lessons-learned-for-local-government-organizations/

- LSL Government Webinars
  - https://lslcpas.com/webinars-government/

Questions

Next webinar in our series:

Back to Basics:
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