

The background of the entire image is a close-up of a calculator's display. A red pencil is positioned diagonally across the screen, with its tip touching the display. The display shows several numbers in a grid-like format, some of which are circled in red. The numbers visible include 1.256.000,00, 34.250.000,00, 841.500,00, 2.100,00, 200,00, 35, 414, 261.9, and 23.471. The LSL logo is in the top left corner.

LSL

# *“Back to Basics”* **WEBINAR**

**Leases & SBITAS**

1 CPE CREDIT

**Tue, Aug 26**  
**1:30PM PST**



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# Your Presenter



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Manager, Assurance & Advisory



# Objectives

- Overview of the GASB 87 and GASB 96 Statements
- Refresh on the journal entries and disclosures required by the Statements
- Learn about the challenges faced by governmental agencies while complying with GASB 87 and GASB 96 requirements and how to address them.
- Discuss best practices for documentation and preparation for an audit



# POLLING QUESTION #1

**How comfortable are you with GASB Statements 87 and 96?**

- A. I am an expert
- B. I understand them for the most part
- C. I am somewhat comfortable
- D. I wish these Statements would go away



# Technical Guidance



# Lease/SBITAs Defined

- Paragraph 4 of GASB 87 defines a lease as:
  - Contract that conveys **control** of the right to use another entity's nonfinancial asset as specified in the contract for **a period of time** in an **exchange or exchange-like** transaction
- Paragraph 6 of GASB 96 defines a subscription-based information technology arrangement (SBITA) as:
  - Contract that conveys **control** of the right to use another entity's IT software, alone or in combination with tangible capital assets, as specified in the contract for **a period of time** in an **exchange or exchange-like** transaction



# Control

- The lease/SBITA contract conveys the right to use the underlying asset if the government has both of the following:
  - The right to obtain the **present service capacity** from use of the underlying asset as specified in the contract
  - The right to determine the **nature and manner** of use of the underlying asset as specified in the contract
- The “right to use” is a resource that provides present service capacity to the government.
- Within the **confines of the contract**, it is at the discretion of the government to decide whether, and to what extent, it will use the underlying assets



# Lease/SBITA Term

- The lease/SBITA term is the period during which a lessee/government has a noncancelable right to use an underlying asset (referred to as the noncancelable period), plus:
  - Periods covered by the option to extend if reasonably certain that the lessee/government or lessor/SBITA vendor will exercise that option
  - Periods covered by the option to terminate if reasonably certain that the lessee/government or lessor/SBITA vendor **will not** exercise that option
- Periods for which **both** the lessee/government and the lessor/SBITA vendor have an **option to terminate** the lease without permission from the other party (or if both parties have to agree to extend) are cancelable periods and are excluded from the lease term
  - For example, a rolling month-to-month lease



# Modifications

- An amendment should be considered a **lease/SBITA modification** unless the lessee's right to use the underlying asset decreases
- Amendment examples:
  - Change in contract price
  - Change in contract term
  - Adding or removing an underlying asset
- The lessee and lessor should account for an amendment during the reporting period resulting in a decrease in the lessee's right to use the underlying asset (for example, the lease term is shortened or the number of underlying assets is reduced) as a partial or full lease **termination**
- A modification will result in a **separate** lease/SBITA if it results in an additional asset by adding access to more underlying lease/SBITA assets in exchange for a reasonable increase in payments



# GASB 87 Exclusions

- Short-term leases
  - Maximum possible term under the lease contract of 12 months (or less), including any options to extend, regardless of their probability of being exercised
  - GASB 99 prevented potential loophole
- \$1 Lease agreements
- Cancelable agreements
- Financed purchase
  - Contracts that transfer ownership with no termination options
- Regulated leases (lessors)
  - U.S. Department of Transportation
  - Federal Aviation Administration (FAA)
  - Require special disclosures



# GASB 96 Exclusions

- Short-term SBITAs
  - Maximum possible term under the lease contract of 12 months (or less), including any options to extend, regardless of their probability of being exercised
  - GASB 99 prevented potential loophole
- Contract combinations
  - Contracts for tangible capital assets and IT software, in which the software component is **insignificant** when compared to the cost of underlying tangible capital asset (i.e. smart copier)
- Perpetual computer software licensing arrangements
- IT services arrangements (outsourced IT department)
- Cancelable agreements



# Key GASB 96 Considerations

- The guidance only applies to SBITA users (i.e., lessees)
- Implementation costs (3 stages)
  1. **Preliminary project** – needs determination, RFP process, vendor assessment, and final selection
  2. **Initial implementation** - configuration, coding, testing, and installation associated with the government's access to the underlying IT assets
  3. **Operation and Additional Implementation** – maintenance, troubleshooting, and additional implementation activities
- Costs associated with phases 1 and 3 should be expensed as incurred.
- Phase 2 costs should be capitalized as part of the SBITA asset or a prepaid asset (i.e., subscriptions in progress) if not placed into service yet
- Training costs should be expensed as incurred, regardless of the stage in which they are incurred



# POLLING QUESTION #2

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

A. Yes

B. No



# Financial Reporting



# Measurement: Lessee

- Lease/SBITA liability should be measured at the **present value** of payments expected to be made during the lease term using the implicit rate in the agreement or the government's incremental borrowing rate
- Right-to-use lease/SBITA asset should be measured as the initial measurement of the lease/SBITA liability, plus prepayments and any initial direct costs to place the asset into service
- A Right-to-use lease/SBITA asset should be amortized in a systematic and rational manner over the shorter of the lease term or the useful life of the underlying asset
- When reporting lease/SBITA activity under the current financial resources measurement focus the government should record:
  - Capital outlay expenditure and other financing source when the lease/SBITA is initially recognized
  - Subsequent lease/SBITA payments should be recorded as debt service payments



# Measurement: Lessor

- At the commencement of the lease term, a lessor should recognize a lease receivable and a deferred inflow of resources.
- Lessor initially should measure the lease receivable at the present value of lease payments expected to be received during the lease term, reduced by any provision for estimated uncollectible amounts.
- The deferred inflow of resources should initially be measured as the initial measurement of the lease receivable, less any payments received from the lessee prior to commencement of the lease term.
- A lessor subsequently should recognize the deferred inflow of resources as inflows of resources (revenue) in a systematic and rational manner over the term of the lease.



# Example Journal Entries

## Current Financial Resources/Modified Accrual

To record initial recognition of lease/SBITA at beginning of term

Account	DR	CR
Expenditures - capital outlay	xxx	
Other financing sources - leases/SBITAs		yyy

To record subsequent lease/SBITA payments

Account	DR	CR
Debt service - principal	xxx	
Debt service - interest	xxx	
Cash		yyy

## Economic Resources/Full Accrual

To record initial recognition of lease/SBITA at beginning of term

Account	DR	CR
Right-to-use lease/SBITA asset	xxx	
Lease/SBITA liability		yyy

To record subsequent lease/SBITA payments and amortization expense

Account	DR	CR
Lease/SBITA liability	xxx	
Interest expense	xxx	
Cash		yyy
Amortization expense	xxx	
Accumulated amortization		yyy



# Example Journal Entries

## Current Financial Resources/Modified Accrual

To record initial recognition of (lessor) lease at beginning of term

Account	DR	CR
Lease receivable	xxx	
Deferred inflow - leases		yyy

To record subsequent (lessor) lease payments

Account	DR	CR
Cash	xxx	
Interest revenue		yyy
Lease receivable		yyy
Deferred inflow - leases	xxx	
Lease revenue		yyy

## Economic Resources/Full Accrual

To record initial recognition of (lessor) lease at beginning of term

Account	DR	CR
Lease receivable	xxx	
Deferred inflow - leases		yyy

To record subsequent (lessor) lease payments

Account	DR	CR
Cash	xxx	
Interest revenue		yyy
Lease receivable		yyy
Deferred inflow - leases	xxx	
Lease revenue		yyy



# Example Journal Entries

## Current Financial Resources/Modified Accrual

To record initial implementation costs for SBITAs

Account	DR	CR
Expenditures - capital outlay	xxx	
Cash		yyy

To record SBITA asset placed into service

Account	DR	CR
Expenditures - capital outlay	xxx	
Other financing sources - SBITAs		yyy

## Economic Resources/Full Accrual

To record initial implementation costs for SBITAs

Account	DR	CR
Subscriptions in progress	xxx	
Cash*		yyy

To record completion of initial implementation phase and place SBITA asset into service

Account	DR	CR
Right-to-use lease/SBITA asset	xxx	
Subscriptions in progress		yyy
SBITA liability		yyy

*\*Use "Expenditures - capital outlay" account if government-wide conversion entry*



# FS Disclosures

- **Lessees/SBITA users (can be grouped)**
  - A general description of its leases/SBITAs, including the basis, terms, and conditions
  - The total amount of subscription assets, and the related accumulated amortization
  - Variable payments
  - Principal and interest requirements to maturity, presented separately, for the lease/SBITA liability for each of the five subsequent fiscal years and in five-year increments thereafter
  - Commitments for leases/SBITAs that have not commenced
- **Lessors**
  - A general description of its leasing arrangements, including the basis, terms, and conditions
  - The total amount of inflows of resources (revenues) recognized, if not clearly displayed on the face of the financials
  - Variable payments
  - If leasing is part of principal ongoing activity, schedule of future payments of the lease receivable, showing principal and interest separately, for each of the five subsequent fiscal years and in five-year increments thereafter.
  - Regulated lease disclosures, if applicable



# FS Disclosures

## M. Subscription-based information technology arrangement

During the current fiscal year, the NAME OF GOVERNMENT entered into a four-year subscription-based information technology arrangement (SBITA) for the use of a vendor's cloud-based public safety ticketing software. An initial subscription liability was recorded in the amount of \$ 42,105 during the current fiscal year, which is the value of the lease liability as of June 30, 2027. The NAME OF GOVERNMENT is required to make annual subscription payments of \$15,000 through March 1, 2030. The SBITA has an interest rate of 3.4 percent. In addition, the NAME OF GOVERNMENT made a subscription payment before the subscription asset was placed into service of \$15,000, and incurred \$38,114 in implementation costs, both of which were added to the initial value of the subscription asset. The value of the subscription asset as of the end of the current fiscal year was \$95,219 and had accumulated amortization of \$23,805.

The future principal and interest subscription payments as of June 30, 2027, were as follows:

Fiscal Year Ending June 30,	Principal	Interest	Total
2028	\$ 13,568	\$ 1,432	\$ 15,000
2029	14,030	970	15,000
2030	14,507	493	15,000
Totals	\$ 42,105	\$ 2,895	\$ 45,000

## Governmental Activities

### Capital assets, not being depreciated

	Balance Beginning of Year	Additions	Deletions	Balance End of Year
Land	\$ 50,067,172	\$ -	\$ -	\$ 50,067,172
Development in progress	-	53,114	53,114	-
Construction in progress	22,974,097	12,357,720	25,461,699	9,870,118
Total capital assets, not being depreciated	73,041,269	12,410,834	25,514,813	59,937,290

### Capital assets, being depreciated

Buildings	191,856,915	24,608,316	-	216,465,231
Machinery, equipment and vehicles	33,208,145	3,377,142	935,135	35,650,152
Infrastructure	206,411,089	1,415,056	-	207,826,145

### Intangible assets

Subscription assets	-	95,219	-	95,219
Lease assets - equipment	938,657	60,017	938,657	60,017
Total capital assets, being depreciated	432,414,806	29,555,750	1,873,792	460,096,764

### Less accumulated depreciation for:

Buildings	(78,425,803)	(4,767,749)	-	(83,193,552)
Machinery, equipment and vehicles	(21,468,057)	(2,138,804)	(925,961)	(22,680,900)
Infrastructure	(120,858,864)	(5,353,077)	-	(126,211,941)

### Intangible assets

Subscription assets	-	(23,805)	-	(23,805)
Lease assets - equipment	(375,464)	(57,165)	(426,203)	(6,426)

### Total accumulated depreciation

	(221,128,188)	(12,340,600)	(1,352,164)	(232,116,624)
Total capital assets, being depreciated, net	211,286,618	17,215,150	521,628	227,980,140
Total governmental activities capital assets	\$ 284,327,887	\$ 29,625,984	\$ 26,036,441	\$ 287,917,430



# Financial Statement Considerations

- Leases/SBITAs are capital assets and can be included in the capital assets footnote
- Leases/SBITAs are long-term liabilities and can be included in the long-term liabilities footnote
- Interest revenue is considered nonoperating revenue, even if leasing is principal ongoing activity (GASBIG 2023-1, Q4.6)
- Statement of cash flows considerations
  - Issuance of leases/SBITAs are noncash capital and financing activities
  - Lease/SBITA payments are capital and financing cash outflows



## POLLING QUESTION #3

**Is your government planning on or currently undergoing an ERP implementation?**

A. Yes

B. No



# Lessons Learned and Best Practices



# Lessons Learned from GASB 87/96

- **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.
- **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.
- **Lack of departmental communication** – be sure to communicate with all departments throughout the year, not just the IT department.
- **Document everything** – Make sure to document anything that could be applicable, AND not applicable.
- **Review for amendments** – The lease/SBITA listing may show that a certain arrangement has ended; however, the government amended the agreement without updating the listing.
- **Review rollforward for accuracy** – Ensure beginning balances agree to the prior year ending. Watch out for modifications and terminations.



# Best Practices

- Review listing of existing Lease/SBITAs
  - Consider modifications
    - Early terminations or re-negotiations
    - Term extensions or expanded scope/compensation
- Search for exclusions
  - Short-term
  - Cancelable
  - Non-exchange (i.e., \$1 agreement)



# Best Practices

- Perform keyword search on GL expense accounts to identify potentially missed leases/SBITAs
- Create separate GL accounts to track leases and SBITAs
- Review minutes to identify potential lease/SBITA arrangements
- Meet with purchasing department throughout the year to help identify new arrangements
- Consider using lease/SBITA management software (i.e., Debtbook)
  - Review journal entries and disclosures generated from software to verify accuracy
- Consider using consultants to assist with the review and input of lease/SBITA arrangements



# How Does This Info Get Audited?



# What Information Is Needed for Audit

- Workpapers Needed
  - Lease/SBITA Asset and Lease/SBITA 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, including government-wide conversion entries
  - General ledger detail
  - Financial statement disclosures



# 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
- Testing of financial statement disclosures
  - We will trace balances to the financial statements and disclosures
  - Verify that disclosures get updated with proper information



# POLLING QUESTION #4

**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



# Additional Resources

- California State Controller's Office:
  - [https://www.sco.ca.gov/sard\\_gaap\\_basis\\_reporting.html](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://lsicpas.com/gasb-87-implementation-lessons-learned-plus-what-to-do-if-you-havent-started/>
- GASB 96 – LSL Blog:
  - <https://lsicpas.com/gasb-96-lessons-learned-for-local-government-organizations/>
- LSL Government Webinars:
  - <https://lsicpas.com/webinars-government/>



# Next Back to Basics Webinar

Wednesday, September 10, 26 at 1:30 pm PST

## **Back to Basics | Uniform Guidance Encore Presentation**

Ryan Domino, CPA - Partner, Assurance & Advisory

You can sign up to register in the follow up email you will receive after this webinar. Please give it up to 24 hours.



# Questions



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