



YESTERDAY, TOMORROW AND FINANCE  
2020 CSMFO ANNUAL CONFERENCE  
JANUARY 28-31, 2020  
DISNEYLAND CA



# Lease Accounting of Tomorrow







## SPEAKER PRESENTATION

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# Today's Presenters

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# Presentation Overview

- The Basics
- Lessee Examples
- Lessor Examples
- Stranger Things
- Resources and Communication





# Big Picture

“Operating” leases and “Capital” leases no longer exist

Don’t get hung up on the word “lease”

## The New Definition of a Lease

“A 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”

Timing of Implementation: 12/31/2020 year end and later

# Identify what isn't a Lease

Leases for \$1

Contracts that  
transfer  
ownership

Supply  
contracts

Easements

Leases of  
intangible  
assets

Short-term  
leases

# Short Term Leases



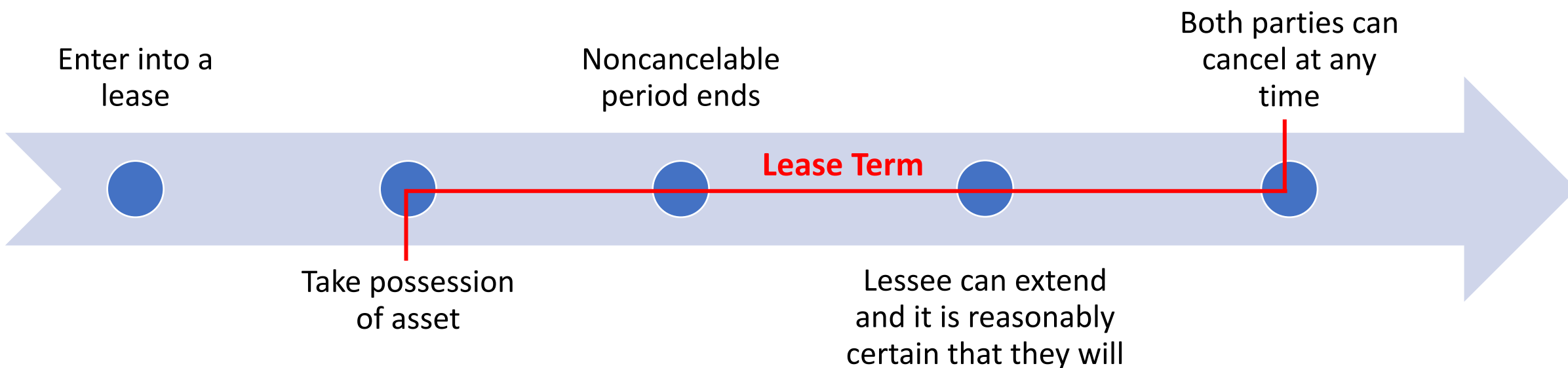
Term of 12 months or less

Cannot have options to extend

All month-to-month leases are short term because they can be cancelled

If either party can cancel, the term is the noncancelable period

# Calculating the Lease Term



# Resources

- GASB Statement No. 87
- GASB Implementation Guide 2019-3: Leases  
<https://www.gasb.org/home>
- GFOA Leases Tool  
<https://www.gfoa.org/accounting-resource-center>







# Accounting for the Lessee

- Lease liability
  - Present value of payments expected to be made during the lease term
- Intangible right-to-use asset (capital asset)
  - Lease liability
  - Payments made on the lease prior to the commencement of the lease term
  - Direct costs necessary to place the lease asset into service

# Example Lease of Police Vehicles

- 60 month lease
- Lease can be extended month-to-month after initial lease term
- Monthly payment of \$10,000
- 4% interest
- \$8,000 for delivery
- \$7,000 for added equipment

		PV of Lease Payments
A	monthly payments	\$ 10,000
B	number of periods	60
C	Annual interest rate	4.00%
D	Monthly interest rate (C / 12 months)	0.333%
E	Future Value	\$ -
	Type: "1" if payments are made at beginning of period, "0" if payments are made at end of	
F	period	1
G	First payment date	7/1/2019
	Increments between payments (if	
H	monthly "1", if bi-monthly "2")	1
<b>Present value of lease payments</b>		<b>\$544,801</b>

# Example Lease of Police Vehicles

## Lease Asset

Total lease liability	\$ 544,801	<i>GASB Statement No. 84, paragraph 30.a</i>
Government lessee incurs transportation costs and other expenditures to make equipment ready for	\$ 15,000	<i>GASB Statement No. 84, paragraph 30.c</i>

## Total lease asset at inception of lease

\$ 559,801



# Example Lease of Police Vehicles

	DR	CR
<b>General Fund</b>		
1. Expenditures - capital outlay	\$ 544,801	
Other financing source - inception of lease		\$ 544,801
<i>To record the inception of the lease on 7/1/2019</i>		
2. Expenditures - capital outlay	\$ 15,000	
Cash		\$ 15,000
<i>To record payment for transportation costs and other expenditures to make equipment ready for use.</i>		
3. Expenditures - debt service principal	\$ 76,510	
Expenditures - debt service interest	13,490	
Cash		\$ 90,000
<i>To record debt service payments for the fiscal year. The numbers come from tab "2. Lease Liability Schedules."</i>		

# Example Lease of Police Vehicles

Government-wide adjustments			
4.	Other financing source - inception of lease	\$ 544,801	
	Lease liability		\$ 544,801
	<i>Replace other financing sources with permanent account – lease liability.</i>		
5.	Lease asset (intangible right-to-use)	\$ 559,801	
	Expenditures - capital outlay		\$ 559,801
	<i>Replace expenditures with capital assets – intangible right-to use lease asset</i>		
6.	Lease liability	\$ 76,510	
	Expenditures - debt service principal		\$ 76,510
	<i>Eliminate temporary accounts – principal repayment.</i>		
7.	Amortization expense	\$ 111,960	
	Accumulated depreciation - lease asset (intangible right-to-use)		\$ 111,960
	<i>Record amortization expense for the fiscal year. The numbers come from tab "3. Lease Asset Amort Schedules."</i>		

# Other Considerations for Leases

- Exclude variable payments such as charges based on number of copies made on a copier lease
- If interest rate cannot be determined, use the lessee's incremental borrowing rate
- Lease asset should be amortized over the shorter of the life of the lease or the useful life of the assets
- Debt issuance costs are expensed in the period incurred





# Accounting for the Lessor

- Lease receivable
- Deferred inflow of resources
- Initial direct costs – current period expense
- Recognition of both lease revenue **and** interest revenue
- Continue to account for the underlying asset (depreciation and impairment) **unless** the contract requires lessee to return the asset in original or enhanced condition



# Lease Receivable



- Present value of lease payments **including** fixed, certain variable, residual value guarantee, and lease incentives
- **Not including** portion of variable payment that is based on performance or usage, variable portion of residual value guarantee unless it is both a) required *and* b) can be estimated
- Discounted using the interest rate in the lease (implicit or explicit), *Note*: This is the portion of the future payments that will be recorded as interest income. Payments received will relieve accrued interest first and then lease receivable.
- Should be remeasured if changes occur to the contract or an event occurs resulting in a variable component becoming fixed.

## Amortization Schedule

PMT	Interest	Principal	Balance
1	\$150	\$347	\$29,653
2	\$148	\$349	\$29,304
3	\$147	\$351	\$28,953
4	\$145	\$352	\$28,601
5	\$143	\$354	\$28,247
6	\$141	\$356	\$27,891
7	\$139	\$358	\$27,533

## Deferred Inflow of Resources

- Amount of lease receivable
- Any “pre-payments” less lease incentives (ex: final month’s rent)
- Amortization should generally match that of the lease receivable



# Journal Entries

## At the Commencement of the Lease:

**Debit-** Lease Receivable

**Credit-** Deferred Inflow of Resources

## Monthly Amortization:

**Debit-** Deferred Inflow of Resources **and** Interest Revenue Receivable

**Credit-** Interest Revenue **and** Lease Revenue

## Payment Received:

**Debit-** Cash

**Credit-** Interest **and** Lease Revenue Receivable



# Example: Vail Lake Land Lease

- 40 year lease beginning 5/1/19
- Tenant has option to extend for 2 periods of 10 years
  - 1<sup>st</sup> extension period fee \$250,000
  - 2<sup>nd</sup> extension period fee \$500,000
- Annual rent
  - Year 1-5: \$150,000, \$175,000, \$200,000, \$225,000 and \$250,000, respectively
  - Year 6-20: \$400,000/yr + CPI not less than 3% or more than 10% + % of revenue
  - Year 21-40: \$625,000/yr + CPI not less than 3% or more than 10% + % of revenue
  - Year 41-60: Unspecified, assumed to be the same as years 21-40 + extension fees

# Is it a Lease or a Service Concession Arrangement?

- Service Concession Arrangement: An arrangement between the government and an operator in which all of the following criteria are met:
  - The government conveys to an operator the right and related obligation to provide a public service through the use of infrastructure or another public asset in exchange for significant consideration
    - Public service relates to the primary function of the facility (like a toll road)
  - The operator collects and is compensated by fees from third parties
  - The government determines what services the operator is required to provide, to whom the operator is required to provide the services, and the prices or rates that can be charged for the services



# Vail Lake: Minimum Lease Payments

- Step 1 is to schedule out the minimum rent
  - Includes CPI adjustment because there is a minimum 3% CPI increase in the lease agreement
  - Includes extension fee because it is reasonably certain that the lessee will extend the lease
  - Excludes the % of revenue calculation because amount is variable and there is no minimum

Minimum Annual Rent Calculation					
Lease Year	Month	Base Rent	CPI Adjustment	Extension Fee	Total Min Rent
39	Mar-57	156,250.00	109,755.15		266,005.15
39	Jun-57	156,250.00	109,755.15		266,005.15
39	Sep-57	156,250.00	109,755.15		266,005.15
39	Dec-57	156,250.00	109,755.15		266,005.15
40	Mar-58	156,250.00	117,735.30		273,985.30
40	Jun-58	156,250.00	117,735.30		273,985.30
40	Sep-58	156,250.00	117,735.30		273,985.30
40	Dec-58	156,250.00	117,735.30		273,985.30
41	Mar-59	156,250.00	117,735.30	250,000.00	523,985.30

A close-up, slightly blurred background image featuring a calculator with the word 'INTEREST' displayed on its LCD screen. A black pen lies diagonally across the lower right portion of the image. In the background, several US dollar bills are visible, including a \$5 bill with the portrait of Abraham Lincoln and a \$100 bill with the portrait of Benjamin Franklin. The overall tone is professional and financial.

INTEREST

# Vail Lake: Discount Rate

- No interest rate was specified in the agreement
- GASB believes that the lessor incorporated the rate into the transaction, so they have the information to determine the rate
- GASB believes “that a discount rate can be imputed on any future payment stream, even if it was not explicitly factored into the determination of the payment amounts”

# GASB 2020 Impl Guide Exposure Draft

4.17. Q—Paragraph 47 of Statement 87 requires a lessor to discount the future lease payments to be received using the interest rate the lessor charges the lessee. How should the lessor determine that rate?

A—If the lease contract contains a stated interest rate, the lessor should use that rate. In the absence of a stated rate, the lessor should determine whether the rate implicit in the lease can be estimated. Paragraph 47 of Statement 87 provides that lessors may apply the guidance for imputation of interest in paragraphs 173–187 of Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. Paragraph 183 of Statement 62 states that “the prevailing rates for similar instruments of issuers with similar credit ratings will normally help determine the appropriate interest rate. . . .” Lessors may use professional judgment to determine their best estimate for the interest rate, maximizing the use of observable information; for example, using the lessee’s estimated incremental borrowing rate or published market rates for similar instruments. If it is not practicable for the lessor to estimate the discount rate through those methods, the lessor’s own incremental borrowing rate may be used.



# Vail Lake: Calculate Lease Receivable

- Step 2 is to calculate the net present value of future payments
  - 2.5% estimated annual interest rate was used
  - Calculate principal and interest over the life of the lease using the net present value as the starting balance

Amortization of Lease Receipts Calculation				
<u>Payment</u>	<u>Payment</u>	<u>Interest</u>	<u>Principal</u>	<u>Balance</u>
153	266,005.15	120,205.95	145,799.20	19,087,152.85
154	266,005.15	119,294.71	146,710.44	18,940,442.40
155	266,005.15	118,377.77	147,627.38	18,792,815.02
156	266,005.15	117,455.09	148,550.06	18,644,264.96
157	273,985.30	116,526.66	157,458.64	18,486,806.32
158	273,985.30	115,542.54	158,442.76	18,328,363.56
159	273,985.30	114,552.27	159,433.03	18,168,930.53
160	273,985.30	113,555.82	160,429.48	18,008,501.04
161	523,985.30	112,553.13	411,432.17	17,597,068.88

# Vail Lake: Amortization of Deferral

- Step 3 is to calculate the amortization of deferred inflows
  - Amortized over a straight-line basis

Amortization of Deferred Inflow of Resources			
<u>Payment</u>	<u>Month</u>	<u>Amortization</u>	<u>Balance</u>
153	Mar-57	86,683.82	7,628,175.01
154	Jun-57	86,683.82	7,541,491.19
155	Sep-57	86,683.82	7,454,807.37
156	Dec-57	86,683.82	7,368,123.55
157	Mar-58	86,683.82	7,281,439.73
158	Jun-58	86,683.82	7,194,755.91
159	Sep-58	86,683.82	7,108,072.09
160	Dec-58	86,683.82	7,021,388.27
161	Mar-59	86,683.82	6,934,704.45

# Vail Lake: Year 1 journal entries

## Normal JE for new leases

		DR	CR
1.	Lease receivable	20,804,115.65	
	Deferred inflow of resources		20,804,115.65
	<i>To record the inception of the lease on 5/1/2019</i>		
2.	Cash	50,000.00	
	Lease receivable	80,025.72	
	Interest revenue		130,025.72
	<i>To record lease payments received for the fiscal year</i>		
3.	Deferred inflow of resources	86,683.82	
	Lease revenue		86,683.82
	<i>To recognize lease revenue for the fiscal year</i>		

## Prior period adjustment entry in year of GASB Implementation

		DR	CR
1.	Lease receivable	20,724,089.93	
	Deferred inflow of resources		20,724,089.93
	<i>To record prior period adjustment as of 6/30/2019</i>		

There is no impact on equity in year of implementation because the standard requires you to measure the lease receivable as of the first day of the fiscal year of implementation and make deferred inflow of resources equal the lease receivable



# Vail Lake: Year 2 journal entries

4.	Cash	187,500.00	
	Lease receivable	337,674.92	
	Interest revenue		525,174.92
	<i>To record lease payments received for the fiscal year</i>		
5.	Deferred inflow of resources	346,735.28	
	Lease revenue		346,735.28
	<i>To recognize lease revenue for the fiscal year</i>		



# Vail Lake: The Capital Asset

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No Change in Accounting



# Vail Lake: Subsequent Adjustments?

- When CPI adjustment becomes known and is different than 3%?
  - Only required to remeasure if the lease is already being remeasured (not solely for a change in the rate)
- Change in the calculated interest rate of 2.5%?
  - Only required to remeasure if there is a change in the lease term
- In Year 41 when negotiated base rent is higher than the minimum amount that was originally calculated?
  - Yes, remeasure because a variable amount has now become fixed
- In year 51 when the lessee decides NOT to renew the extension
  - Yes, the lease receivable and deferred inflow would be reduced and a gain/loss recorded



# Other Considerations for Leases

- **Capitalization thresholds-** Capitalize the collective amount if material in total (Impl Guide 4.23)
- **Subsequent changes to lease terms and modifications** – Sometimes reported as a separate lease
- **Lease termination accounting** – Gain/loss from lease termination

# Other Considerations

- **Retroactive implementation-**

- For leases reported as Operating Leases prior to implementation, no prior period adjustment is required because the lease asset and the lease liability would be the same (Impl Guide 4.76)
- For leases reported as Capital Lease prior to implementation, calculate the new lease liability and adjust the book value of the leased capital asset. This results in a prior period adjustment (Impl Guide 4.77)



# Impact on Financing Authority Financials

- **Intra-entity leases-**
  - With or between **blended** component units, eliminate internal leasing activity in the CAFR.
  - For **stand alone** Public Financing Authority reports, the lease transaction needs to be recorded.
- Consider contacting bond council to see if the stand alone Financing Authority reports are still required or if the CAFR will satisfy the ongoing reporting requirements

# Impact on Housing Authority Activities (GASB Impl Guide Exposure Draft)

- 4.12. Q—A governmental housing authority enters into a 12-month residential lease agreement which states that the lessee has an option to renew. The renewal is not for a specified period. If the lessee exercises its option to renew, the housing authority and the lessee will enter into a separate lease agreement at a later date for the subsequent 12-month period. Is the existing 12-month residential lease agreement a short-term lease under Statement 87?

A—Yes. Paragraph 16 of Statement 87 provides that a short-term lease has a maximum possible term *under the contract* of 12 months or less, including any options to extend. Although the lease agreement states that the lessee has an option to renew, the lessee does not have a unilateral right to extend the contract. Because the housing authority and the lessee would enter into a new contract for the subsequent 12 months, the maximum possible term under the original contract is 12 months, and the lease is a short-term lease.



# Required Disclosures- Lessees

- General description of leasing arrangement
- Total amount of assets recorded under lease with the related accumulated amortization
  - Disclose in capital asset footnote, but present separately from other capital assets
- Variable lease payments, residual value guarantees, or penalties paid during the year that are not part of the lease liability
- Debt to maturity schedule separating principal and interest



# Required Disclosures- Lessors

- General description of leasing arrangement
- Total amount of inflows of resources from leases
  - Include lease revenue and interest revenue
- Total amount of inflows of resources for the reporting period pertaining to variable payments, residual value, guarantees and penalties.

# Communication



- Who needs to know? Board Members, Rating Agencies, Executive Management, Contracts and Procurement Administrators
- The magnitude of the entity's commitments will now be transparent
- Possible impact on debt ratios
- Language regarding Operating vs. Capital Leases will need to be corrected
- Future contracts should contain information regarding the interest rate, asset values, lease period and any other pertinent terms. Separate into lease and non-lease components

# Questions

