

GASB's Lease (87), SBITA (96) and P3 (94) Standards: Practical Implications and Adoption Challenges

IGFOA February 2023

What We Will Cover Today

Overview of the GASB standards

Scope considerations

Accounting for leases (lessee) and SBITAs

Identifying and documenting key provisions

Outlays other than subscription payments

Separating components and allocating contract prices

Selection of discount rate

Preparing required disclosures

Common questions/issues

Terminology and Abbreviations

AICPA	American Institute of CPAs
BAML	Bank of America Merrill Lynch
CPE	Continuing Professional Education
EMMA	Municipal Securities Rulemaking Board's Electronic Municipal Market Access
FYE	Fiscal Year End
GASB	Governmental Accounting Standards Board
GAQC	Governmental Audit Quality Center
IG	Implementation Guide
IT	Information Technology
OAS	Option-Adjusted Spread
MD&A	Management discussion and analysis
PV	Present Value
SBITAs	Subscription-Based Information Technology Arrangements
SLGs	State and Local Governments

► Overview of the GASB Standards

Scope and Timing

GASB Statement No. 87, <i>Leases</i>	GASB Statement No. 96, <i>Subscription-Based Information Technology Arrangements (SBITAs)</i>
Establishes a single reporting model for lease accounting based on the foundational principle that leases are financings of the right to use an asset.	Establishes standards of accounting and financial reporting for SBITAs by a government end user.
Effective for annual reporting periods beginning after June 15, 2021, and interim periods beginning the year after. Apply retroactively to all periods presented.	Effective for periods beginning after June 15, 2022. Apply retroactively to all periods presented
GASB Statement No. 96 amends GASB Statement No. 87 to exclude SBITAs from the scope of the Lease standard. Tangible capital assets associated with a SBITA that were recognized under GASB Statement No. 87 will be restated when GASB Statement No. 96 is adopted.	

SBITA Transition Considerations

- ▶ Following are relevant dates for a calendar year-end:

**Beginning of the earliest period
presented**

July 1, 2021

**Effective date
(date of adoption)**

July 1, 2022

June 30, 2023



- ▶ Other considerations:

- Use facts and circumstances that existed at the beginning of the earliest period restated, **NOT** the commencement date of the SBITA.

Definitions

Leases	SBITAs
<p>A contract (e.g., an agreement between two or more parties that creates enforceable rights and obligations) that conveys control of the right to use another entity's nonfinancial asset (the underlying asset) as specified in the contract for a period of time in an exchange or exchange-like transaction.</p>	<p>A contract that conveys control of the right to use another party's (a SBITA vendor's) IT software, alone or in combination with tangible capital assets (the underlying IT assets), as specified in the contract for a period of time in an exchange or exchange-like transaction.</p>
<p>In order to “convey control of the right to use of the underlying asset”, a contract should have both of the following:</p> <ul style="list-style-type: none">• The right to obtain the present service capacity from use of the underlying asset• The right to determine the nature and manner of use of the underlying asset	<p>In order to “convey control of the right to use of the underlying asset”, a contract should have both of the following:</p> <ul style="list-style-type: none">• The right to obtain the present service capacity from use of the underlying IT asset• The right to determine the nature and manner of use of the underlying IT asset

Types of SBITAs

Short-Term SBITAs

- Maximum possible term at commencement of the subscription term of 12 months or less
- No recognition of subscription liability or subscription asset required
- Short term payments are expensed as incurred

All Other SBITAs

- Subscription liability and subscription asset are recognized at the commencement of the subscription term

Topics That Are The Same For Leases and SBITAs

- Lease/Subscription Term
- Short-Term Lease/SBITA
- General Recognition and Measurement
- Contracts with Multiple Components
 - Generally, account for lease (etc.) and non-lease (etc.) components as separate contracts and multiple underlying assets as separate lease (etc.) components
 - Allocate contract price to different components
- Modifications and Terminations



► Is This Contract in Scope?

What Is Excluded?



SBITAs

Contracts that solely provide IT support services

Contracts that convey control of the right to use another party's combination of IT software and tangible capital assets that meets the definition of a lease in GASB Statement No. 87, *Leases*, in which the software component is insignificant when compared to the cost of the underlying tangible capital asset

Governments that provide the right to use their IT software and associated tangible capital assets to other entities through SBITAs

Contracts that meet the definition of a P3 in GASB Statement No. 94, *Public-Private and Public-Public Partnerships and Availability Payment Arrangements*

Licensing arrangements that provide a perpetual license to governments to use a vendor's computer software, which are subject to Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*

Relationship Between Leases and SBITAs

- All SBITAs meet definition of lease
- Accounting depends on what the underlying asset is:
 - Tangible capital assets alone – GASB Statement No. 87
 - IT software alone – GASB Statement No. 96
 - IT software in combination with tangible capital assets:
 - Software component is insignificant compared to cost of underlying tangible capital asset – GASB Statement No. 87
 - Otherwise – GASB Statement No. 96

Multifunctional Printer

Features include:

- Printing, copying, scanning, faxing, and other tasks
- Software to connect to an IT system



Intelligent Vehicles

- ▶ Features include:
- Autopilot
- Full self-driving capabilities



Website Subscriptions

- ▶ Including:
- News services
- Bloomberg
- Morningstar



Laptops

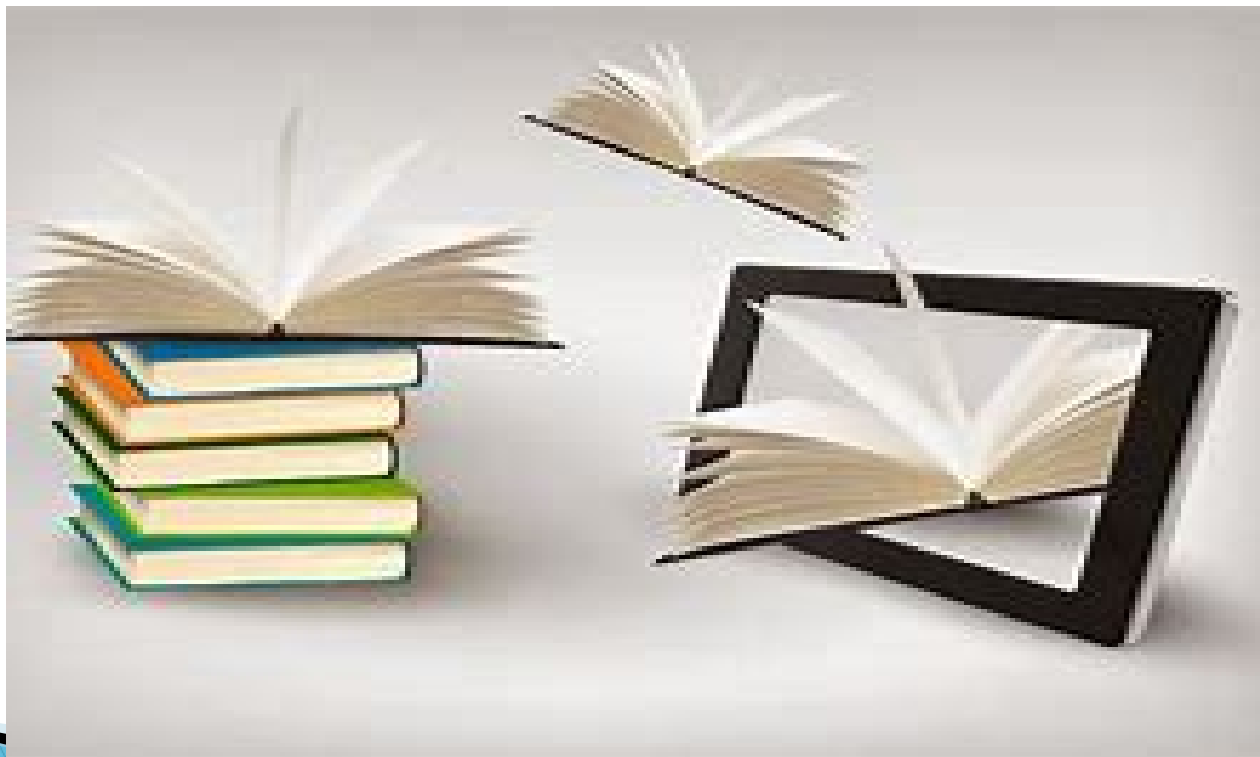
- ▶ Features include:
- Operating software
- Microsoft 365



Cloud Computing Arrangements



Digital Textbooks



Software

- ▶ Including:

- Microsoft 365
- QuickBooks Online
- ERP Software



What about Software that automatically renews?

► Overview of Accounting for Leases (Lessee) and SBITA

Initial Reporting

	Assets	Liability
Leases (Lessee)	Intangible right-to-use lease asset = Lease liability plus prepayments and any ancillary costs to place asset to use	Lease liability = PV of expected lease payments over lease term
SBITA (End User)	Intangible right-to-use subscription asset = Subscription liability + prepayments + capitalizable initial implementation costs	Subscription liability = PV of expected SBITA payments over SBITA term

Subsequent Reporting

	Assets	Liability
Leases (Lessee)	Amortize lease asset over shorter of useful life of asset or lease term	Reduce lease liability by principal portion of lease payments Recognize (accrue) interest payable
SBITA (End User)	Amortize subscription asset over shorter of useful life of IT asset or SBITA term	Reduce subscription liability by principal portion of SBITA payments Recognize (accrue) interest payable

Identifying and Documenting Key Provisions

Subscription Term



The SBITA term excludes periods in which both the government and SBITA vendor have options to terminate regardless of probability.

Fiscal funding or cancelation clauses ignored *unless* reasonably certain of being exercised

Subscription Payments

Subscription payments include:	
Fixed payments	\$ 200,000
Variable payments that depend on an index or rate	150,000
Variable payments fixed in substance	—
Termination penalties ¹	—
(Subscription contract incentives) ²	(—)
Any other payments ¹	—
Total subscription payments	\$ 350,000

¹ Included only if reasonably certain to be exercised/required.

² Subscription contract incentives receivable from the SBITA vendor after commencement of the subscription term are ordinarily a reduction (offset) in the calculation of total subscription payments.

Initial Measurement of Subscription Liability

**Subscription
Liability**
\$309,950

=

PV of *Expected*
SBITA Payments

Payment Date	Amount
At Signing - Deposit	\$ 50,000
Beginning of Year 2	\$ 50,000
Beginning of Year 3	\$ 50,000
Beginning of Year 4	\$ 50,000
Beginning of Year 5	\$ 50,000
End of Year 5	\$150,000

The security deposit is not a SBITA payment.

► Outlays Other Than Subscription Payments

Accounting for Stages of Implementation

Preliminary Project Stage

- Outlays expensed as incurred

Initial Implementation Stage

- Outlays should be capitalized as part of the subscription asset
- If no subscription asset is recognized (for example, short-term SBITA), outlays should be expensed as incurred

Operational & Additional Implementation Stage

- Outlays expensed as incurred unless they meet specific capitalization criteria

Outlays related to the implementation of the SBITA can overlap or occur in multiple cycles and are recognized based on the nature and timing of the outlay (activity).

Stages of Implementation

Preliminary Project Stage

- Conceptual formulation and evaluation of alternatives
- Determination of the existence of needed technology
- Final selection of alternatives for the SBITA

Initial Implementation Stage

- Ancillary charges related to designing the chosen path, such as configuration, coding, testing, and installation associated with the government's access to the underlying IT assets
- Other ancillary charges necessary to place the subscription asset into service
- Initial implementation stage completed when the subscription asset is placed into service

Operation and Additional Implementation Stage

- Maintenance, troubleshooting, and other activities associated with the government's ongoing access to the underlying IT assets
- Additional implementation activities, such as those related to additional modules that occur after the subscription asset is placed into service

Data conversion is considered an activity of the initial implementation stage **only** when necessary to place the subscription asset into service. Otherwise, considered an activity of the operation and additional implementation stage.

Training cost are expensed as incurred, regardless of the stage the costs are incurred

- ▶ Separating Components and Allocating Contract Prices

Separating Components

Step 1: Identify separate components



- Contracts may contain multiple components (e.g., multiple pieces of equipment)
- If components have different subscription terms, they must be accounted for separately
- If underlying assets are in different major classes of assets for disclosure purposes, they must be accounted for separately **Disclosure of major classes of subscription assets is not required. Required for Leases only!**

Step 2: Identify any nonsubscription components



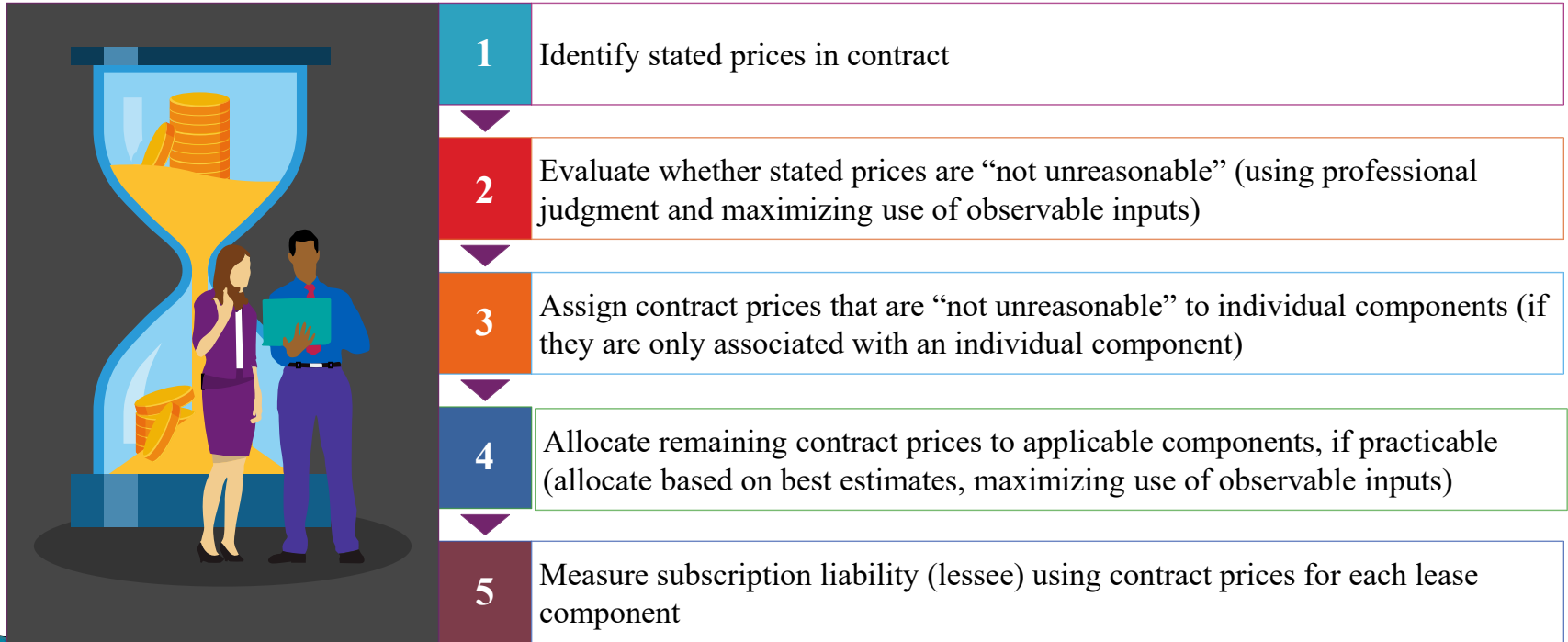
- Nonsubscription components must be separated from subscription components and accounted for separately
- Nonsubscription components should be accounted for under applicable nonsubscription guidance. Many times, these components are service contracts.

Step 3: Allocate the contract price



- Use prices for individual components that are included in the contract, as long as not unreasonable
- If contract doesn't include separate prices for individual components or they seem unreasonable, use judgment to determine the best estimate for allocation to each component, but always maximizing the use of observable information

Separating Components: Allocating Contract Prices



▶ Selection of Discount Rate

Discount Rate

- Most SBITAs do not explicitly state SBITA vendor's rate
 - Even if it does, may be difficult to evaluate whether stated rate is reasonable
- Most governments (end users) will use their incremental borrowing rate
 - Will not be one size fits all (different rates across subscriptions)
 - Should be based on facts and circumstances of subscription (payment amounts, payment structure, length of subscription, etc.)
 - Will be significant effort in year of adoption, as well as subsequent periods
 - Helpful to develop yield curve for transition date



Discount Rate: Determining Incremental Borrowing Rate

- Entity-specific rate that reflects the creditworthiness of a government
 - Start with debt issuance of government, debt issuance of a comparable government, or risk-free rate
 - Adjust for any financing specific items (credit rating, secured vs. unsecured, taxable vs non-taxable, collateral)
 - Adjust for specific terms (term, payment structure, payment amounts, geographical location)

BAML Ice Index has data on various government debt issuances, including different ratings, durations, types.



Discount Rate: BAML Ice Index

As of Date	Description	Face Value_ LOC	Maturity Date	Rating	Industry Lvl 4 Desc	Effective Duration	Modified Duration	OAS	Effective Yield
03/01/2021	TEXAS WATER DEV BRD	50	10/15/2055	AAA	Revenue - Water & Sewer	18.15	22.14	-25	1.72
03/01/2021	TEXAS WATER DEV BRD	58.69	10/15/2054	AAA	Revenue - Water & Sewer	12.04	18.14	-7	1.91
03/01/2021	TAMPA FLA	77.505	10/01/2054	AAA	Revenue - Utilities - Other	11.13	17.45	7	2.01
03/01/2021	UNIVERSITY VA	100	09/01/2054	AAA	Revenue - Education	14.41	21.47	-44	1.52
03/01/2021	ARLINGTON TEX HIGHER ED FIN	41.255	08/15/2054	AAA	Revenue - Leasing COPS & Appropriations	14.78	20.4	-5	1.91
03/01/2021	CLEVELAND TEX INDPT SCH DIS'	39.285	02/15/2054	AAA	GO - Local	12.39	19.13	-19	1.76
03/01/2021	TEXAS WATER DEV BRD	68.33	10/15/2052	AAA	Revenue - Water & Sewer	10.57	17.4	-21	1.81
03/01/2021	YSLETA TEX INDPT SCH DIST	74.245	08/15/2052	AAA	GO - Local	11.97	18.74	-26	1.7
03/01/2021	MONTGOMERY CNTY MD HSG OF	99.25	07/01/2052	AAA	Revenue - Multi-Family Housing	18.5	22.76	-62	1.35
03/01/2021	CLEVELAND TEX INDPT SCH DIS'	80.295	02/15/2052	AAA	GO - Local	12.18	17.92	-17	1.83
03/01/2021	SOUTH CAROLINA ST HSG FIN &	42.5	01/01/2052	AAA	Revenue - Single Family Housing	10.58	13.31	0	1.92
03/01/2021	SOUTH DAKOTA HSG DEV AUTH	32.455	11/01/2051	AAA	Revenue - Single Family Housing	19.44	18.71	49	1.91
03/01/2021	TEXAS WATER DEV BRD	76.02	10/15/2051	AAA	Revenue - Water & Sewer	9.67	17.35	-29	1.72

Source: <https://indices.theice.com>

Add OAS to benchmark to determine starting point

► Preparing Required Disclosures

Disclosures - SBITAs

- 1 General description of SBITA arrangements
- 2 Total amount of subscription assets, related accumulated amortization, separate from other capital assets
- 3 Amount of variable payments not previously included in liability
- 4 Amount of other payments not previously included in liability
- 5 Principal and interest requirements to maturity
- 6 Commitments under SBITAs before commencement date
- 7 Impairment loss and any related change in subscription liability

For disclosure purposes, SBITAs may be grouped. Disclosure of major classes of subscription assets is not required. Required for GASB Statement No. 87.



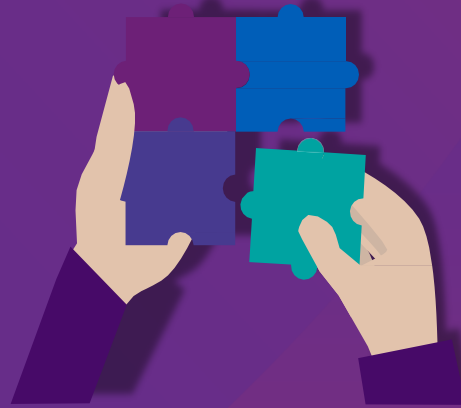
Key Considerations For Disclosures

Summary of Significant Accounting Policies

- Modification to basis of accounting
- Modification to capital assets
- New SBITA policy
- Modification to deferred outflows of resources/deferred inflows of resources (if applicable)

Where to include the new required disclosures

- New SBITA note; or,
- Modifications to the capital assets, long-term debt, and commitments note



Example Disclosures

- ▶ ***Intangible right-to-use lease and subscription IT assets***
- ▶ A summary of lease and subscription IT asset activity during the year ended June 30, 2023 is as follows:

	Balance beginning of year	Additions	Remeasurements	Deductions	Balance end of year
Lease assets:					
Buildings	\$				
Vehicles					
Equipment					
Total lease assets					
Less accumulated amortization:					
Lease assets:					
Buildings					
Vehicles					
Equipment					
Total accumulated amortization					
Total lease assets, net					
Subscription IT assets					
Less accumulated amortization					
Subscription IT assets, net					
Total lease and subscription IT assets, net	\$				

Note: In the year of implementation for GASB Statement No. 87 and 96, the balance at the beginning of the year **would not** include accumulated amortization.

Example Disclosures

- ▶ ***Lease and subscription IT liabilities***
- ▶ A summary of the changes in the lease and subscription IT liabilities during the year ended June 30, 2023 is as follows:

	Balance beginning of year	Additions	Remeasurements	Deductions	Balance end of year	Amounts due within one year
Lease liabilities	\$					
Subscription IT liabilities						
Total	\$					

Example Disclosures

- ▶ **Capital assets**
- ▶ Capital asset activity for the year ended June 30, 2023 is as follows :

	Balance beginning of year	Additions	Deductions	Balance end of year
Capital assets being depreciated:	\$			
Building and building improvements				
Equipment				
Intangible assets				
Total capital asset being depreciated				
Less accumulated depreciation:				
Building and building improvements				
Equipment				
Intangible assets				
Total accumulated depreciation				
Total capital assets, net excluding lease and subscription IT assets	\$			
Lease and subscription IT assets, net (Note 7)				
Total capital assets, net as reported in the statement of net position				

Example Disclosures

► *Changes in long-term obligations*

- Changes in long-term obligations for the year ended June 30, 2023 are as follows :

	Balance beginning of year	Additions	Deductions	Balance end of year	Amounts due within one year
Bonds payable					
General obligation bonds	\$				
Special obligation bonds					
Revenue bonds					
Unamortized premiums					
Unamortized (discounts)					
Total bonds payable					
Other long-term obligations					
Certificates of participation					
Workers compensation					
Auto liability					
Pollution remediation obligations					
Net pension liability					
OPEB liability					
Total other long-term liabilities					
Total long-term obligations excluding lease and subscription IT liabilities	\$				
Lease and subscription IT liabilities (Note 7)					
Total long-term obligations as reported in the statement of net position					

▶ Common Questions

Does the entity have to go back to the inception of the SBITA?

- No, it is not required. SBITAs are recognized and measured using the facts and circumstances that existed at the beginning of the fiscal year. However, if applied to earlier fiscal years, those assets and liabilities should be recognized and measured using the facts and circumstances that existed at the beginning of the earliest fiscal year restated

**Transition
Considerations**

In the year of implementation is beginning net position always restated?

- Yes. GASB Statement No. 96 states, changes should be applied retroactively by restating the financial statements for all prior fiscal years presented, if practicable. If restatement is not practicable, the cumulative effect should be reported as a restatement of beginning net position (or fund balance/fund net position) for the earliest fiscal year presented.

Transition Considerations

If the financial statements are presented for a single year, does the MD&A need to be restated for the prior year?

- No. If single year financial statements are presented, the MD&A does not have to be restated for the prior year.

**Transition
Considerations**

How does the entity estimate the incremental borrowing rate if they don't have any debt?

- Create or hire a firm to create a yield curve
- EMMA website
- BAML index
- Modify Treasury yield curve

Borrowing/
Discount rate

▶ Common Issues

What are some of the key implementation issues that were encountered during the implementation of GASB Statement No. 87?

Much of GASB Statement No. 87 is driven by the legal form of the contract

- If contract gives either party the option to cancel, even if it is highly unlikely that they won't, it is a cancellable period (Q4.15 in IG 2019-3)
- If renewal is an option within the contract *versus* there being a new contract:
 - Could change the short-term lease evaluation (Q4.10 in IG 2020-1)
 - It determines whether renewal history matters – it matters if there is a renewal option and it does not matter if it is a new contract (Q4.11 in IG 2020-1)

Key Implementation Issues

What are some of the key implementation issues that were encountered during the implementation of GASB Statement No. 87?

The need to exercise professional judgement –

- Is it an exchange or an exchange-like transaction – definition of a lease
- Estimating the incremental borrowing rate (discount rate) if no similar debt has been issued
- Whether payments are fixed in substance

Materiality –

- Materiality is always a consideration

**Key
Implementation
Issues**

What are some of the key implementation issues that were encountered during the implementation of GASB Statement No. 87?

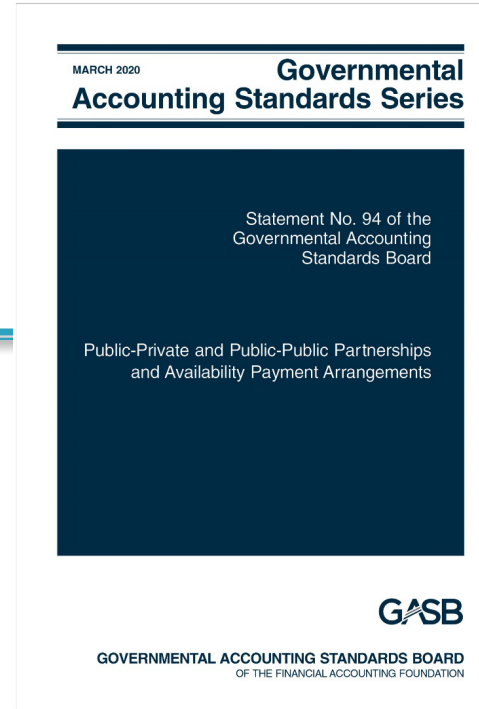
Transition Provisions –

- Statement No. 87 requires that leases be recognized and measured using the facts and circumstances as of the beginning of the period of implementation. For example:
 - As of January 1, 2022 for FYE December 31, 2022
 - As of July 1, 2021 for FYE June 30, 2022
- Not allowed to go back to the actual beginning of the lease

Key Implementation Issues

Public-Private and Public-Public Partnerships and Availability Payment Arrangements

Statement No. 94



P3s, APAs, and SCAs

What?

The Board issued guidance for public-private and public-public partnerships (P3s) that are not subject to Statements 60 or 87, and improvements to Statement 60

Why?

GASB research found that some P3 transactions are outside the scope of Statement 60 and identified opportunities to improve Statement 60's guidance for service concession arrangements (SCAs)

When?

Effective for reporting periods beginning after June 15, 2022

Definitions: PPPs and APAs

Public-private partnerships and **public-public partnerships (P3s)** are arrangements “in which a government (the transferor) **contracts with an operator** [governmental or nongovernmental] to **provide public services** by conveying control of the **right to operate** a nonfinancial assets, such as infrastructure or other capital asset (the underlying PPP asset), for a period of time in an exchange or exchange-like transaction.”

Availability payment arrangements (APA):

- Government contracts with another entity to operate or maintain the government’s nonfinancial asset
- Entity receives payments from the government based on the asset’s availability for use
- Asset’s availability may be based on the physical condition of the asset or the achievement of certain performance measures
- May include design, finance, construction, or service components

P3s

Although sounds similar to a lease, the definition contains characteristics that the Board believes describe transactions in which a government is doing more than purchasing or financing a nonfinancial asset or entering into an arrangement to purchase services.

The operator in a P3 provides public services.

A P3 conveys control of the right to operate a nonfinancial asset.

APAs

Transactions in which a government compensates an operator for activities that are related to designing, constructing, financing, maintaining, or operating a nonfinancial asset.

APAs are similar to P3s except that the government retains demand risk and responsibility for fee collection associated with the underlying asset.

Appendix C – Illustrations (state tollway, tunnel, & bridge)

Other Provisions

A P3 that meets the definition of a lease in Statement 87 – but not the definition of a service concession arrangement (SCA) – would be reported under Statement 87 unless (a) the underlying PPP assets are not existing assets of the transferor or (b) improvements are required to be made to those existing underlying P3 assets by the operator.

An APA that is related to the design, finance, or construction of an infrastructure or other nonfinancial asset in which ownership of the asset transfers by the end of the contract would be reported as a financed purchase of the asset.

An APA that is related to operations would be accounted for as flows of resources (for example, expense) in the period to which the payments relate.

Transferor Reporting

For all P3s, recognize:

- Receivable for installment payments to be received, if any
- Deferred inflow of resources for the assets recognized, including payments received from the operator at or before start of the P3 term

If underlying P3 asset is a new asset or an existing asset that has been improved...

- ...and the P3 is an SCA: also recognize the capital asset at acquisition value when placed into operation
- ...and the P3 is not an SCA: also recognize a receivable for the capital asset, measured at operator's estimated carrying value as of the future date of the transfer in ownership

Operator Reporting

For all P3s,
recognize:

- Liability for installment payments to be made, if any

If underlying P3 asset is (a) existing asset or improvement or (b) new asset and the P3 is an SCA...

- ...also recognize an intangible right-to-use asset

If underlying P3 asset is a new asset and the P3 is not an SCA...

- Also recognize the underlying P3 asset until ownership is transferred
- And a liability for the underlying P3 asset, measured at the estimated carrying value as of the future date of the transfer

Questions?