

THE PPC GOVERNMENTAL UPDATE

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Getting Ready to Implement GASBS No. 87, *Leases*



Quick Recap

In June 2017, the GASB issued Statement No. 87, *Leases*, to improve accounting and financial reporting for governments with leases. It establishes a single approach for reporting leases, which is to say, it removes the distinction between an operating and a capital lease and is consistent with the approach taken by the FASB in its recent standard for nongovernmental entities.

GASBS No. 87 is based on the premise that leases are essentially financing arrangements for the use of a nonfinancial asset. As such, lessees record an asset representing the right to use an asset for a period of time and a liability for the lease payments. Accordingly, lessors recognize a lease receivable and a corresponding deferred cash inflow for the lease payments.

Scope and Applicability

GASBS No. 87 applies to the financial statements of all state and local governments, both as lessees and lessors. It applies to any contract that meets

the definition of a lease, as stated in the Statement. However, it does not include contracts for services unless it contains *both* a lease component and a service component.

Practical Consideration:

The Statement does not apply to leases of the following: intangible assets, biological assets, inventory, service concession contracts, supply contracts, or certain leases with assets financed with outstanding conduit debt.

GASBS No. 87 provides guidance for the following aspects of lease transactions:

- Lease term
- Short-term leases (12 months or less, including options to extend)
- Contracts that transfer ownership
- Recognition, measurement, and disclosure
- Lease incentives
- Contracts with multiple components and contract combinations

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- Modifications and terminations
- Subleases
- Sale-leaseback and lease-leaseback
- Intra-entity leases
- Related-party leases

Accounting Recap for the Lessee

Excluding short-term leases, the initial measurement of the lease liability is equal to the present value of payments expected to be made during the lease term. Payments include fixed payments, variable payments if they are dependent on an index or rate such as CPI, amounts reasonably required under residual value guarantees, the exercise price of reasonably certain purchase options, termination penalties under certain conditions, lease incentives receivable from the lessor, and any other payment reasonably certain of payment. The discount rate should be the rate implicit in the agreement or, if not readily determinable, the lessee's incremental borrowing rate.

The initial measurement of the lease asset is the sum of the initial lease liability, the lease payments made prior to lease commencement, and the initial direct costs necessary to place the asset in service. In addition, the lease asset should be amortized over the shorter of either the lease term or the useful life of the underlying asset and reported as an amortization expense.

Disclosure

The following are just some of the disclosures that lessees should make for leases other than short-term leases:

- General description of lease terms
- The total amount of lease assets and related accumulated amortization (presented separately from other capital assets)
- Leased assets by major class (presented separately from other capital assets)
- Variable payments not previously included in the measurement of the lease liability
- Other payments such as residual value guarantees or termination penalties not previously included in the measurement of the lease liability
- Principal and interest requirements, presented separately, for the lease liability for each of the five subsequent fiscal years and in five-year increments thereafter
- Commitments before lease term commencement
- Impairment losses, including its components

Additional disclosures are required for sublease, sale-leaseback, and lease-leaseback transactions.

Accounting Recap for the Lessor

Under GASBS No. 87, a lessor government is required to recognize a lease receivable and a deferred inflow of resources at the commencement of the lease term. This recognition does not apply to short-term leases, contracts that transfer ownership, leases of assets that are investments, or certain regulated leases. The initial direct costs incurred by the lessor should be reported as outflows of resources (expenditure/expense) during the period.

The initial measurement of the lease receivable is equal to the present value of lease payments expected to be received during the lease term. Payments include fixed payments, variable payments if they are dependent on an index or rate such as CPI, amounts reasonably required under residual value guarantees, variable payments that are fixed in substance, residual value guarantee payments that are fixed in substance, and any lease incentives payable to the lessee. The discount rate should be the interest rate the lessor charges the lessee.

The initial measurement of the deferred inflow of resources should be the amount of the lease receivable plus any payments received at or before the commencement of the lease term that relates to future periods, less any lease incentives paid to the lessee at or before the commencement of the lease term.

The interest revenue is recognized over the lease term based on the amortization of the discount on the lease receivable.

For governments with existing sales-type or direct-financing leases, any residual assets for those leases should become the carrying values of the underlying assets.

A lessor does not derecognize the asset underlying the lease.

Disclosure

The following are just some of the disclosures that lessors should make for leases:

- General description of leasing arrangements
- Variable payments not included in lease receivables
- Lessee termination options
- Total lease-related inflows of resources—for example, lease revenue, interest revenue, etc.
- General description of regulated leasing arrangements
- Schedule of expected future minimum lease payments
- Related-party leases

Disclosure should also be made for leases of assets that are investments; sublease, sale-leaseback, or lease-leaseback transactions; or certain regulated leases.

Practical Consideration:

Contract provisions, such as purchase options, rate changes, and other lease conditions during the term of the lease, may impact how the lease is recorded.

Note that, for both lessors and lessees, there are different rules for financial statements prepared using the current financial resources measurement focus and those financial statements prepared using the economic resources measurement focus.

PPC's Guide to Preparing Governmental Financial Statements contains detailed information on GASBS No. 87. In addition, *PPC's Guide to Audits of Local Governments* contains several practice aids to assist in auditing the implementation of GASBS No. 87.

Getting Ready for the New Standard

Governments may have a substantial number of leases. Typically, the administration of those leases is decentralized across the organization, making it more challenging to determine which leases may be subject to the new accounting standard and financial reporting requirements. Therefore, it is vital for government accounting staff and audit firms to properly prepare for GASBS No. 87. All governments should have started planning for the implementation of the new standard. Additionally, evaluate communication between departments that initiate lease agreements and the accounting department and ensure that policies and procedures are appropriate and communicated promptly. The list of critical considerations below has been developed to provide guidance.

- Develop a plan that may include:
 - Identifying a project oversight team.
 - Identifying critical issues.
 - Estimating the approximate time it will take to complete the implementation.
- Identify who maintains the information on the leases.
- Ensure completeness by identifying other existing agreements not currently recognized as leases.
- Review the detail of all lease contracts and other agreements. It may be helpful to create a schedule with essential data, such as lease term, lease payment, interest rates, and renewal dates.
- Evaluate systems and internal controls. Ensure the financial system's chart of accounts can support recording assets, liabilities, and expenses under the new standard.

- Communicate with all interested parties how the new leasing standard will affect the overall financial reporting process.

Hopefully, this high-level outline can guide you to prepare and fully implement the new standard from start to finish.

Effective Date

GASBS No. 87 is effective for reporting periods beginning after June 15, 2021, and all reporting periods thereafter, as amended.



GAQC Releases Practice Aid and Tools for Single Audits

The AICPA Governmental Audit Quality Center (GAQC) recently released several tools in an effort to assist auditors and auditees in navigating the growing complexities and prevalence of audits performed under OMB's *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Due to the unprecedented level of federal funding awarded to various types of entities, including for-profit entities, nonprofit organizations, and local governments, in response to the COVID-19 pandemic, there will be a significant increase in the number of entities that are subject to single audit requirements.

PRF General and Targeted Distributions Practice Aid

There are many areas of complexity and confusion surrounding the U.S. Department of Health and Human Services (HHS) Provider Relief Fund (PRF), several of which have been topics of recent articles in this newsletter. Because many healthcare organizations have complex ownership structures, including parent-subsidiary relationships, many questions have arisen as it relates to the reporting entity unit(s) undergoing the HHS audit requirements. For example, when management elects to have the audit cover less than the consolidated entity, linking PRF reporting requirements through the HHS reporting portal to the Schedule of Expenditures or Federal Awards or the Schedule of HHS Awards becomes increasingly confusing and problematic.

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In response to these questions, the GAQC released a nonauthoritative practice aid, *Audit Scope Considerations for Provider Relief Fund General and Targeted Distributions in Parent-Subsidiary Relationships*. The practice aid includes background information on HHS audit requirements and how those requirements relate to reporting portal requirements and audit scope, as well as a parent-subsidiary decision tree to illustrate different scenarios and impact on the scope of the audit.

Single Audit Tool for Auditors

The GAQC also released a checklist, *Tips for Auditors Taking on Single Audits*, to address several considerations for auditors that may be inexperienced in performing engagements under the Uniform Guidance or are performing these engagements for the first time. Topics of the checklist include:

- Engagement acceptance
- Independence considerations
- Internal control and compliance testing
- Major program determination
- Required reporting

As a reminder, audit firms should carefully consider whether they are able to meet the requirements to perform single audits. If the audit firm is not confident that they can meet the requirements, the GAQC recommends that they partner with a firm with the appropriate expertise before accepting the engagement.

Single Audit Tool for Auditees

In addition, the GAQC released a checklist for auditees, *Tips for Organizations Subject to Single Audit Requirements*, for the benefit of entities that are

expending federal funding and subject to single audit requirements for the first time. Topics in this checklist include:

- Knowing when a single audit is required
- Understanding relevant compliance requirements
- Establishing and maintaining effective internal controls
- Evaluating and monitoring compliance with statutes, laws, and regulations
- Selecting an audit firm
- Other resources

These GAQC resources are free for AICPA members and can be accessed from the GAQC website or through the following links.

Practical Consideration:

- GAQC practice aid—*Audit Scope Considerations for Provider Relief Fund General and Targeted Distributions in Parent-Subsidiary Relationships*: www.aicpa.org/resources/download/prf-targeted-general-distributions-in-parent-subsidiary-relationships
- GAQC checklist—*Tips for Auditors Taking on Single Audits*: www.aicpa.org/resources/download/single-audit-tips-for-auditors
- GAQC checklist—*Tips for Organizations Subject to Single Audit Requirements*: www.aicpa.org/resources/download/tips-for-organizations-subject-to-single-audit-requirements

