

# On the Horizon: Leases and Fiduciary Responsibilities

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*The views expressed in this presentation are those of Mr. Mead. Official positions of the GASB on accounting matters are determined only after extensive due process and deliberation.*



# Overview

- Reexamination of the guidance on leases
- Fiduciary responsibilities
- Other projects on the GASB's current technical agenda (time permitting)

# Accounting and Financial Reporting for Leases

# Leases Project Background

- Objective – reexamine issues associated with lease accounting
  - FASB/IASB project
  - Issuance of Concepts Statements
  - Evaluate standards that have been in effect for a sufficient length of time
- Pre-agenda research initiated April 2011
- Current technical agenda project added April 2013
  - Preliminary views issued November 2014
  - Exposure draft expected January 2016
  - Final Statement expected November 2016

# Tentative Board Decisions (TBDs) – Definition & Scope

- **Definition**
  - A contract that conveys the right to use an asset (the underlying asset) for a period of time in an exchange or exchange-like transaction.
  
- **Scope**
  - Continue existing scope exclusions
  - Expand exclusion to all leases of intangible assets
  - Exclude assets financed with outstanding conduit debt unless both the asset and conduit debt are reported by lessor

# TBDs – Single-Model Approach

- No classification of leases into operating/capital or other categories
- Underlying assumption that leases are financings
- Exceptions:
  - Short-term leases (more on that later)
  - Leases that transfer ownership or contain a bargain purchase option

# TBDs – Lease Term

- Includes noncancellable period, plus periods covered by a lessee's option to renew, *if the option is reasonably certain of being exercised*
- Excludes periods covered by a lessee's option to terminate, *if the option is reasonably certain of being exercised*
- Excludes periods for which lessee and lessor each have the option to terminate (cancellable periods)
- Fiscal funding/cancellation clauses evaluated as any other termination option
- Reassessed when an option is exercised or not exercised contrary to the previous expectation

# TBDs – Initial Reporting

	Assets	Liability	Deferred Inflow
<b>Lessee</b>	Intangible asset (right to use underlying asset)—value of lease liability plus prepayments and initial direct costs that are ancillary to place asset in use	Present value of future lease payments (incl. fixed payments, variable payments based on index or rate, reasonably certain residual guarantees, etc.)	NA
<b>Lessor</b>	<ul style="list-style-type: none"> <li>• Lease receivable (generally including same items as lessee liability)</li> <li>• Continue to report leased asset</li> </ul>	NA	Equal to lease receivable plus any cash received up front that relates to a future period

# TBDs – Initial Lessee Recognition & Measurement

- Recognize an intangible asset for the right to use the underlying asset and a liability for future payments
- Initial measurement of a lease liability includes:
  - Fixed payments to be made over the lease term
  - Variable payments based on an index or rate, using the rate in effect at beginning of lease
  - Variable payments that are in-substance fixed
  - Residual value guarantees reasonably certain of being required
  - Purchase options reasonably certain of being exercised
  - Termination penalties if based on the determination of the lease term, the termination option is reasonably certain of being exercised

# TBDs – Initial Lessee Recognition & Measurement (continued)

- Liability does not include lease payments that are dependent on a lessee's performance or usage of an underlying asset
- Lease liability payments would be discounted using the rate the lessor charges the lessee
  - If that rate cannot be readily determined, the lessee's incremental borrowing rate
- Initial measurement of a lease asset includes:
  - The value of the initial lease liability
  - Any prepayments (amounts paid for the lease prior to measuring the lease liability)
  - Initial direct costs if they are ancillary charges to place the leased asset into use

# TBDs – Initial Lessee Recognition & Measurement (continued)

- Lease incentives received should be reductions in the cost of lease assets
- Initial direct costs should be expensed unless they are necessary to place the leased asset into use

# TBDs – Initial Lessor Recognition & Measurement

- Recognize a lease receivable and deferred inflow of resources
- Do not derecognize the underlying asset and do not recognize a residual asset for all leases
- Exceptions to recognition and measurement:
  - Leases of investment property
  - Leases with characteristics of airport/airline agreements
- The leased asset is depreciated, unless a depreciable leased asset is required to be returned in its original or enhanced condition or the leased asset has an indefinite useful life

# TBDs – Initial Lessor Recognition & Measurement (continued)

- Initial measurement of a lease receivable includes:
  - Fixed payments to be made over the lease term
  - Variable payments based on an index or rate, using the rate in effect at beginning of lease
  - Variable payments that are in-substance fixed
  - Residual value guarantees that are in-substance fixed
- Receivable does not include variable lease payments that are dependent on a lessee's performance or usage of an underlying asset
- Residual value guarantees recognized as a receivable when the amount of the payment has been decided but not yet paid

# TBDs – Initial Lessor Recognition & Measurement (continued)

- Purchase option payments or termination penalties recognized when exercised
- Initial measurement of the deferred inflow of resources include the receivable amount plus any cash received up front

# TBDs – Subsequent Reporting

	Assets	Liability	Deferred Inflow
Lessee	Amortize over shorter of useful life or lease term	Reduce by lease payments (less amount of interest expense)	NA
Lessor	<ul style="list-style-type: none"> <li>• Depreciate leased asset (unless indefinite life or required to be returned in its original or enhanced condition)</li> <li>• Reduce receivable by lease payments (less payment needed to cover accrued interest)</li> </ul>	NA	Recognize revenue over the lease term on a systematic and rational basis

# TBDs – Subsequent Lessee Recognition & Measurement

- Lease liability remeasured by recording amortization of discount on liability (interest expense) and reducing liability for actual payments less amortization
- Lease asset amortized (amortization expense) using a systematic and rational basis over the shorter of the useful life of the underlying asset or the lease term
  - If the lease transfers ownership or if a purchase option is determined to be reasonably certain of being exercised, amortize as if the lessee owns the underlying asset, using the lessee's depreciation policy

# TBDs – Subsequent Lessee Recognition & Measurement (continued)

- Reassessment of a lease liability when certain judgments change
- If liability reassessed, also reassess discount rate when certain other judgments change
- Adjustments to the lease liability generally should adjust the lease asset by the same amount
  - Exception: if adjustment is greater than carrying value of asset, difference is recognized in the flows statement

# TBDs – Subsequent Lessor Recognition & Measurement (continued)

- Recognize revenue over the lease term on a systematic and rational basis
- Discount rate used to determine the present value of the lease receivable would be the rate the lessor charges the lessee
- Remeasure the lease receivable by calculating the amortization of the discount on the lease receivable and reducing the lease receivable by the actual lease payment amount less the amortization of the discount

# TBDs – Subsequent Lessor Recognition & Measurement (continued)

- Reassess the discount rate when the lease term is changed or certain other judgments change
- An adjustment to the receivable for a change in lease term would be recognized as an adjustment to the related deferred inflow of resources

# TBDs – Lessee Disclosures

- A general description of leasing arrangements, including the basis, and terms and conditions, on which variable lease payments are determined and the existence, and terms and conditions, of residual value guarantees provided by the lessee
- Total amount of assets recorded under leases, and the related accumulated amortization, disclosed separately from owned assets
- Lease assets disaggregated by major classes of underlying assets
- The total variable lease payments actually incurred during the reporting period

# TBDs – Lessee Disclosures

- Payments made in excess of contractual requirements, such as residual value guarantees or penalties
- A maturity analysis of future minimum lease payments that shows payments for each of the first five years and five-year increments thereafter, with the payments shown undiscounted and total interest summed for all years
- Lease commitments, other than short-term leases, for which the lease term has not begun
- Components of any net impairment loss

# TBDs – Lessor Disclosures

- A general description of leasing arrangements
- The basis, and terms and conditions, on which variable lease payments are determined
- The carrying amount of property on lease or held for leasing by major classes of property and the amount of accumulated depreciation
- The total amount of revenue recognized in the reporting period related to leases
- The lease revenue related to variable lease payments and other payments not included in the measurement of the lease receivable, including revenue related to residual guarantees and termination penalties

# TBDs – Lessor Disclosures

- A maturity analysis of the lease receivable, presenting the undiscounted cash flows to be received on an annual basis for a minimum of each of the first five years and aggregated totals in five-year increments thereafter, reconciled to the lease receivable
- The existence, and terms and conditions, of options by the lessee to terminate a lease if the lessor government has issued debt for which the principal and interest payments are secured by lease payments

# TBDs – Short-Term Lease Exception

- A short-term lease is one that, at the beginning of the lease, has maximum possible term under the contract, including any options to extend, of 12 months or less
- The maximum possible term for a cancellable lease defined as the noncancellable period, including any notice periods
- Leases that transfer ownership not qualify for the short-term lease exception, even if they meet the other criteria
- Accounting requirement for all leases that qualify

# TBDs – Short-Term Lease Exception

- Lessees not be required to recognize assets or liabilities associated with the right to use the underlying asset for short-term leases
  - Lease payments recognized as expenses/expenditures based on the terms of the contract
- Lessors not required to recognize receivables or deferred inflows associated with the lease
  - Lease payments recognized as revenue based on the terms of the contract

# TBDs – Lease Terminations

## ■ Lessees

- For lease terminations (other than from the lessee's purchase of the underlying asset), lessees remove the lease asset and obligation, and recognize the difference as a gain or loss to account for the termination of a lease.
- For terminations associated with the lessee's purchase of the underlying asset, record the difference between the purchase price and the carrying amount of the lease liability as an adjustment to the carrying amount of the asset

## ■ Lessors

- Remove the lease receivable and related deferred inflow of resources, and recognize any difference as a gain or loss to account for a termination of a lease

# TBDs – Lease Modifications

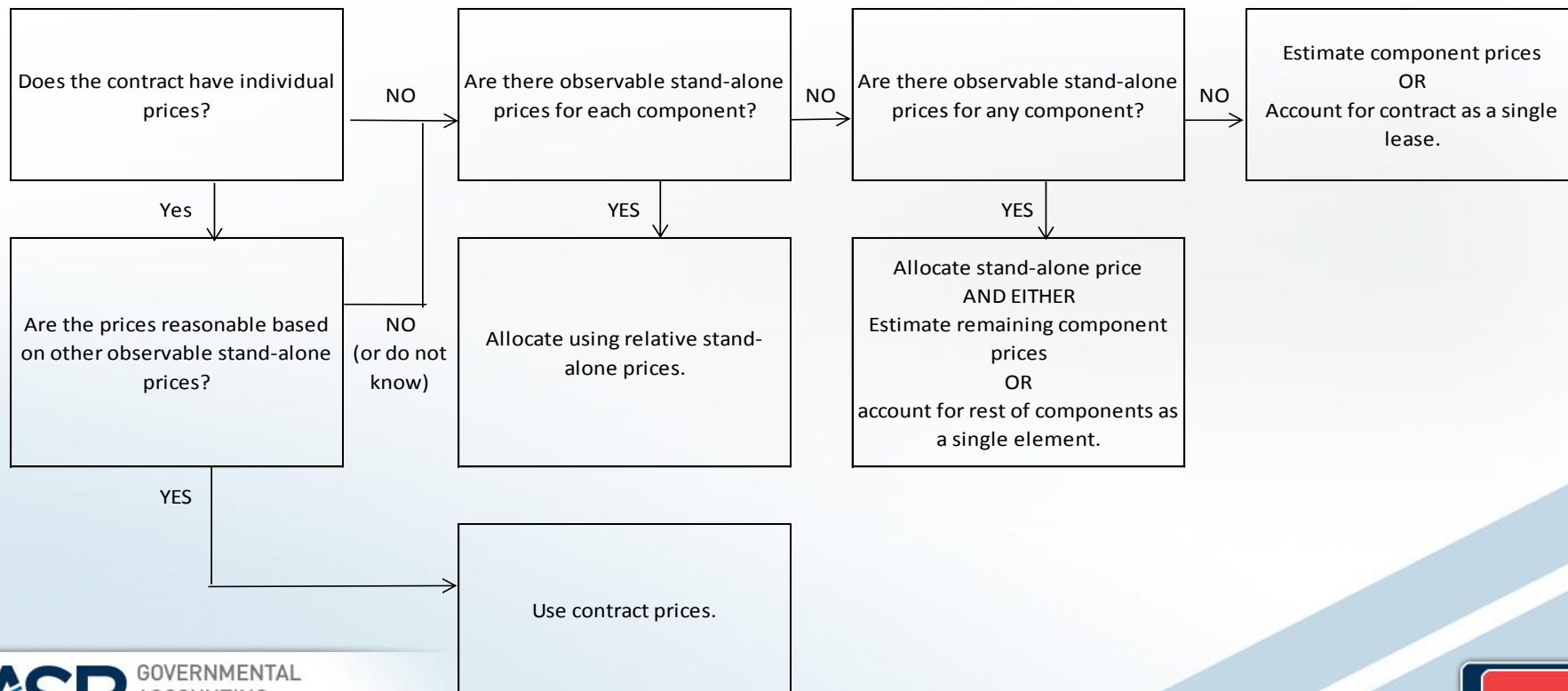
- A change in the lease contract considered a modification of the original lease if the lessee keeps the same right of use
- A change in the lease contract considered a new lease (and the original lease terminated) if the lessee loses part of its right of use
- Lessors
  - Remeasure the lease liability on the effective date of modification and assess the need for an updated discount rate
  - Adjust the right-of-use asset by the difference between the modified liability and the liability immediately before the modification

# TBDs – Lease Modifications (continued)

- Lessors
  - Remeasure the lease receivable on the effective date of modification and assess the need for an updated discount rate
  - Adjust the deferred inflow of resources by the difference between the modified receivable and the receivable immediately before the modification

# TBDs – Leases with Multiple Components

- Separate contracts into lease and nonlease components or multiple lease components
- Allocate consideration to multiple components:



# TBDs – Contract Combinations

- Contracts entered into at or near the same time with the same counterparty should be considered
- Contract combination required if one or both of the following criteria are met:
  - The contracts are negotiated as a package with a single objective
  - The amount of consideration to be paid in one contract depends on the price or performance of the other contract
- Combined contract then subject to multiple component guidance

# Additional TBDs

## ■ Subleases

- Subleases be accounted for as transactions separate from the original lease, with the information about subleases as one of the items to be included in the general description of lease arrangements
  - Lessor transactions related to subleases should be disclosed separately from the original lessee transactions

## ■ Related party leases

- Related party leases be recognized based on the substance of the transaction, when substance is significantly different from form

## ■ Leases with blended component units

- Eliminations for internal leasing activity take place before the financial statements are aggregated

# Additional TBDs

- **Sale-Leasebacks**
  - Qualifying sale required
  - Any gain or loss on sale portion deferred over term of leaseback
  - Adjust for any off-market terms
    - Excess as additional financing
    - Deficiency as prepayment of rent
  - Disclose terms and conditions
  - If fail to have qualifying sale, treat as a borrowing
- **Lease-Leasebacks**
  - Recognize net lease liability and asset or net lease receivable and deferred inflow
  - Disclose gross components

# TBDs – Effective Date and Transition

- **Effective Date**

- Effective for periods beginning after December 15, 2018
  - Two years after final Statement expected to be issued
  - Earlier application would be allowed

- **Transition Provisions**

- Leases recognized and measured using the facts and circumstances that exist at the beginning of the period of implementation
- Lessors would not restate the assets underlying their existing sales-type or direct financing leases
  - Any residual assets for those leases would become the carrying values of the underlying assets

# Fiduciary Responsibilities

# Why Address Fiduciary Responsibilities?

- Existing authoritative standards do not define what is meant by *fiduciary responsibility*
- Inconsistent use of private-purpose trust funds and agency funds
- Concerns about how governments engaged only in business-type activities should report their fiduciary activities
- Perceived need by users for a flows statement for agency funds

# TBDs – Focus on Control

- Identifying when a school district has a fiduciary responsibility:
  - A school district must have control to have a fiduciary responsibility for assets
  - However, a school district's control over assets is insufficient alone to making a determination about whether or not a district has a fiduciary responsibility for assets

# TBDs – Focus on Control

- A school district *controls* assets in a fiduciary capacity if those assets:
  - Are used by the school district (or its assignee) to provide benefits to specified or intended beneficiaries *and either of the following is true*
    1. The district holds the assets *or*
    2. The district has the ability to administer or direct the
      - a. Use
      - b. Exchange *or*
      - c. Employed the present service capacity of the assets in any other way that provides benefits

# TBDs – When Is an Activity Fiduciary?

- An activity is a fiduciary activity of a government if the school districts controls the assets of the activity, the assets of the activity are not derived from the district's own-source revenue as defined in Statement No. 44, *Economic Condition Reporting: The Statistical Section*, and one of the following criteria are met:
  - The assets result from a pass-through grant for which the district does *not* have administrative or direct financial involvement
  - The assets are administered in accordance with a trust agreement or equivalent arrangement in which the district itself is *not* a beneficiary
  - The assets are to be used for the benefit of individuals that are *not* required to be residents or recipients of the district's goods and services as a condition of being a beneficiary, *or*
  - The assets are to be used for the benefit of organizations or other governments that are *not* part of the financial reporting entity or recipients of the district's goods and services.

# TBDs – Component Units

- Does the potential component unit meet the definition of a component unit in Statement 14?
  - Yes: the control criteria does *not* have to be met but one of the four criteria must be met for the component unit to be considered a fiduciary component unit.
  - No: the control and own-source revenue criteria and one of the four criteria must be met to be reported as a fiduciary activity

# TBDs – Pension and OPEB Arrangements

- If the resources held for pension or OPEB arrangements...
  - ...and the arrangement is within the scope of other GASB guidance or proposals: The guidance within the scope of this existing guidance or proposals would be followed
  - ...but the arrangement is *not* within the scope of other GASB guidance or proposals: Further consideration is needed to draw a conclusion about where the resources would be reported
    - If the resources are (1) held in a trust or equivalent arrangement and (2) not available to the government for another purpose, then the activity would be reported in a fiduciary fund

# TBDs – Fiduciary Fund Types

- Revised definitions for pension (and other employee benefit) trust funds, investment trust funds, and private-purpose trust funds, focusing on the resources that should be reported within each
- The revised definition of a private-purpose trust fund makes explicit that a trust agreement or equivalent arrangement should be present for an activity to be reported in the fund
- A new fund type—*custodial funds*—is proposed to report fiduciary activities for which there is no trust agreement or equivalent arrangement.
  - This fund type would include funds currently reported as agency funds

# TBDs – Changes in Fiduciary Net Position

- School districts engaged in fiduciary activities would present additions disaggregated by source (investment income and costs if applicable) and deductions disaggregated by type (administrative costs if applicable) in a statement of changes in fiduciary net position for all fiduciary funds with the following exception:
  - Custodial funds held for a period of 3 months or less can report one total for additions and one total for deductions as long as the descriptions are sufficient to provide for the nature of the transactions

# Project Timeline

Pre-Agenda Research Initiated	April 2010
Project Added to Current Agenda	August 2013
Preliminary Views Issued	November 2014
Comment Period Ended	March 2015
Exposure Draft Expected	December 2015
Final Statement Expected	October 2016

# Other Projects on the Current Technical Agenda

1. Asset Retirement Obligations
2. Blending Requirements for Certain Component Units
3. Irrevocable Split-Interest Agreements
4. Pension Issues
5. External Investment Pools
6. Financial Reporting Model Reexamination, including Recognition Concepts (covered in a separate session)
7. Implementation Guidance Update
8. Implementation Guide to Statements 74 & 75 (OPEB)