

GASB Issues 2023 Implementation Guide – Lease & SBITA Updates

On June 5, 2023, GASB approved the release of its [2023 Implementation Guide](#) (IG), which primarily addresses unresolved questions on Statement 87, *Leases*, and Statement 96, *Subscription-Based Information Technology Arrangements* (SBITAs).

Background

At least annually, GASB issues an implementation guide to help governments adopt new accounting standards or provide guidance on existing standards. Implementation guides are authoritative Category B guidance in the GAAP hierarchy and are intended to clarify, explain, or elaborate on GASB statements.

Statement 87, Leases

Clarifications related to Statement 87 are effective for fiscal years beginning after June 15, 2023. For a detailed overview of Statement 87 requirements, see **FORsights™** article, "[GASB 87: Leases, What You Need to Know.](#)"

Statement 87, Leases
(as amended)

Fiscal Years Beginning After
June 15, 2021

Short-Term Leases

Existing Guidance

Statement 87 does not apply to short-term leases, defined as leases with a maximum possible term of 12 months or less at lease inception, including options to extend, regardless of their probability of being exercised. **The maximum possible term for short-term lease assessment assumes that all options to extend would be exercised and includes any notice periods.** Statement 99, *Omnibus 2022*, updated the wording on termination options and added language to prevent structuring and subsequent lease modifications to avoid recognition as follows:

- Periods for which **both the lessee and the lessor 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 should be excluded from the maximum possible term.
- A lease that previously had been determined to be short term and has been modified to extend the initial maximum possible term under the lease contract should be reassessed from lease inception. If the reassessed maximum possible term is greater than 12 months, the lease should no longer be considered a short-term lease. For a lease that is reclassified from a short-term lease, the lease term should be assessed beginning at the modification date to measure the lease receivable or liability.
- Termination provisions for payment defaults are not considered termination options for determining the lease term.

Clarifications

In the first scenario presented, a lease contract will remain in effect for three years unless terminated before then. The contract allows the lessee to terminate the lease for any reason with 60 days' notice. The contract allows the lessor to terminate the lease with 60 days' notice only if the lessee defaults on payments. The IG concludes that this is not a short-term lease. Although the lessee has an unconditional right to terminate, the lessor does not have an unconditional right to terminate because the lessor is allowed to terminate the lease only if the lessee defaults on payments. In this example, there are no periods for which both the lessee and lessor have an option to terminate and, therefore, no cancelable periods to exclude from the maximum possible term, which is three years.

In the second fact pattern, a lease has a noncancelable period of 36 months, and the lessee has an option to extend the lease for an additional 12 months. At lease commencement, **it is not reasonably certain that the lessee will exercise** that option. At the end of the noncancelable period, the lessee exercises the lease extension option. The IG clarifies that **exercising an extension option does not change the maximum possible term**. At lease commencement, the lease term is 36 months, and the maximum possible term is 48 months. When the lessee exercises the option to extend, the lease term is reassessed to be 12 months. However, the maximum possible term remains 48 months when the option is exercised.

A third question clarifies the two situations when a lease modification results in a short-term lease:

- If the lease was a short-term lease before the modification and the maximum possible term after the modification to extend the lease is 12 months or less, then the lease remains a short-term lease.
- Regardless of whether the lease was a short-term lease before the modification, if the modification meets the criteria to be accounted for as a separate lease¹ and the maximum possible term of that separate lease is 12 months or less, then the modification results in a separate short-term lease.

Lessee Issues

Interest Expense

In the example provided, a government leases a building with a 10-year lease term. At lease commencement, the government provides payment for the first three years and recognizes a liability for the present value of the payments for the remaining seven years, which will be paid starting in the lease's fourth year. The IG clarifies that interest expense represents the amortization of the discount on the lease liability and that the discount should be **amortized over the entire lease term**, including the first three years when the government is not making payments. The interest liability will continue to accrue until the government starts making payments in the fourth year.

Variable Leases – Foreign Currency Payments

In the fact pattern presented, a university enters into a building lease in Europe with payments of 5,000 euros per month. The university prepares its financial statements in U.S. dollars. The U.S. dollar payment amount is subject to change throughout the lease as exchange rates fluctuate. Are those lease payments variable payments that depend on an index or a rate? The IG clarifies that **the currency of lease payments does not affect whether those payments are considered fixed**. Because the contract requires a fixed payment amount in euros, the lease payments should be considered fixed payments. The change in expected U.S. dollar cash flows is a foreign currency transaction gain or loss, which should be reported in accordance with Statement 62.

¹ If the lease modification gives the lessee an additional lease asset by adding one or more underlying assets that were not included in the original lease, the additional portion of a modified lease should be accounted for as a new lease.

Lessor Issues

Recognition of Inflows of Resources

Statement 87 requires that the deferred inflow of resources related to a lease be recognized as inflows of resources (for example, revenue) over the lease term. The IG highlights existing guidance to help with classification of the inflows. Statement 34, *Basic Financial Statements—and Management’s Discussion and Analysis—for State and Local Governments*, requires governments to establish a policy that defines operating revenues in a way that is appropriate to the nature of the activity being reported. That policy should be consistent with the objective of distinguishing between operating and nonoperating revenues and expenses, which is to provide a reporting format that displays the extent to which an enterprise’s operating expenses were covered by revenues generated by its principal ongoing operations. Whether revenue recognized from the deferred inflow of resources related to a lease is operating revenue or nonoperating revenue depends on the following:

- The purpose of the lease
- The nature of the activity being reported as a business-type activity or in an enterprise fund
- The government’s policy defining operating revenue

Clarification on Implementation Guide 2019-3

The IG updates wording in question 4.16 to change from “cancellable periods” to “periods covered by the lessee’s option to terminate” in the fact pattern. It does not change the conclusion that in determining whether it is reasonably certain that the lessee will not exercise the termination option, the lessee should assess all factors relevant to the likelihood that the lessee will not exercise the option, including significant economic disincentives such as cancellation penalties.

Statement 96, SBITA

The below updates are effective for fiscal years beginning after June 15, 2023. Statement 96 defines a SBITA, establishes that a SBITA would result in a right-to-use (RTU) asset and a corresponding liability, provides capitalization criteria, and requires new note disclosures. For a detailed review of the Statement’s requirements, see [“GASB 96 – What You Need to Know.”](#)



Statement 96, SBITA
(as amended)

Fiscal Years Beginning After
June 15, 2022

Perpetual License

Existing Guidance

Statement 96, as issued, had an explicit scope exclusion for licensing arrangements that provide a perpetual license to governments to use a vendor’s computer software. These arrangements would follow Statement 51, *Accounting and Financial Reporting for Intangible Assets*, as amended.

Clarification

The IG clarifies that **a licensing agreement for a vendor's computer software that automatically renews until canceled is not a perpetual license**. A provision under which a licensing agreement automatically renews until canceled is an option to terminate the agreement at each renewal date. An agreement that includes a termination option is not a purchase, whereas a perpetual license is a purchase in which a government is granted a permanent right to use the vendor's computer software.

Software as a Service

The IG clarifies that Software as a Service, Platform as a Service, and Infrastructure as a Service contain a combination of IT software and tangible capital assets. Despite these labels, each model contains IT software used in combination with tangible capital assets. A government must assess if the arrangement meets the SBITA definition:

“For purposes of applying this Statement, a SBITA is 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.”

Subscription Term

Existing Guidance

The SBITA subscription term includes the period during which a government has a noncancelable right to use the underlying IT assets and includes periods covered by an option to extend (if it is reasonably certain that either party—the government or the SBITA vendor—will exercise that option) or to terminate (if it is reasonably certain either party will not exercise that option). Statement 99 clarifies that a provision that gives a party the right to terminate the contract only in certain circumstances or upon the occurrence of certain events, such as the action or inaction of the other party, would not be considered an termination option in determining the SBITA term. For example, provisions that allow for the termination due to a violation of SBITA terms and conditions, such as a default on payments, are not considered termination options.

At the commencement of the subscription term, a government should recognize a subscription liability and an intangible RTU asset. **The commencement of the subscription term occurs when the initial implementation stage is completed**, at which time the government has obtained control of the right to use the underlying IT assets and, therefore, the subscription asset is placed into service.

Clarification

In the scenario presented, a government enters into a six-year SBITA contract with no extension or termination options and begins making semiannual subscription payments to the SBITA vendor immediately after the contract takes effect. The initial implementation stage is not completed until the end of the second year after the contract takes effect. In this case, the subscription term is four years. The initial implementation stage is completed at the end of the contract's second year. The subscription term commences at the beginning of the third year and ends at the conclusion of the sixth year when the SBITA contract ends.

Statement 100, Accounting Changes & Error Corrections

Distinguishing between a change in accounting principle and a change in estimate can be difficult, but the distinction is critical to applying the correct guidance. To address these issues, Statement 100, *Accounting Changes and Error Corrections*, defines the following categories and the prescribed accounting for each:

- Changes in accounting principles
- Changes in accounting estimates
- Changes to or within the financial reporting entity
- Corrections of errors in previously issued financial statements

For additional details, see "[GASB Updates Rules on Accounting Changes & Error Corrections](#)."

The IG clarifies what constitutes a change to or within the financial reporting entity. Under the scenario presented, a government closes out a major capital projects fund and moves the remaining resources to the general fund upon the completion of a capital project. Even though the capital projects fund will no longer be included in the government's financial reports in future periods, it does not constitute a change to or within the financial reporting entity in this case, because the fund's removal does not result from a movement of continuing operations. The movement of remaining resources to the general fund should be reported as interfund activity in accordance with Statement 34, as amended.

These changes would be applied simultaneously with the adoption of Statement 100.

Statement 100, Accounting Changes & Error Corrections

Fiscal Years Beginning After June 15, 2023

Conclusion

For some governments, implementing these Statements will be complex and likely will require significant hours to implement correctly. **FORVIS** can help educate your team, provide implementation tools, and assist with analysis and documentation. If you would like assistance complying with the new guidance, contact one of our professionals.

Our public sector accounting, audit, and consulting experience and resources can help you stay compliant, stretch your dollar, and plan for the future. Learn more about our services below and let us know how we can assist you. For more information, visit forvis.com.

Contributors

Amy Shreck

Partner

amy.shreck@forvis.com

Anne Coughlan

Director

anne.coughlan@forvis.com