GASB Exposure Draft

October 31, 2022

Comments Due: January 20, 2023

Proposed Implementation Guide

of the Governmental Accounting Standards Board

Implementation Guidance Update—2023

This Exposure Draft of a proposed Implementation Guide is issued by the GASB for public comment.
Written comments should be addressed to:

Director of Research and Technical Activities
Project No. 24-16g

IMPLEMENTATION GUIDANCE UPDATE—2023

WRITTEN COMMENTS

Deadline for submitting written comments: January 20, 2023

Written comments. We invite your comments on the implementation guidance in this proposed Implementation Guide.

Because this proposed Implementation Guide may be modified before it is cleared as a final Implementation Guide, it is important that you comment on any aspects with which you agree as well as any with which you disagree. To facilitate our analysis of comment letters, it would be helpful if you explain the reasons for your views, including alternatives that you believe the GASB should consider.

Any recommendations to address topics that are not included in this proposed Implementation Guide will not be included in the final Implementation Guide resulting from this project. However, those issues will continue to be monitored and may be considered for inclusion in a future guide.

Comments should be addressed to the Director of Research and Technical Activities, Project No. 24-16g, and emailed to director@gasb.org. Comments also may be submitted through an electronic input form.

OTHER INFORMATION

Public files. Written comments will become part of the GASB's public file and are posted on the GASB's website.

This Exposure Draft may be downloaded from the GASB's website at www.gasb.org.

Final GASB publications may be ordered at www.gasb.org.

Proposed Implementation Guide of the Governmental Accounting Standards Board

Implementation Guidance Update—2023

October 31, 2022

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INTRODUCTION

1. The objective of this Implementation Guide is to provide guidance that clarifies, explains, or elaborates on GASB Statements.

IMPLEMENTATION GUIDANCE

Applicability of This Implementation Guide

2. The requirements of this Implementation Guide apply to the financial statements of all state and local governments unless narrower applicability is specifically provided for in the pronouncement addressed by a question and answer.

3. This Implementation Guide amends Implementation Guide No. 2019-3, *Leases*, Question 4.16, and Implementation Guide No. 2021-1, *Implementation Guidance Update—2021*, Question 4.13.

New Questions and Answers

4. Questions and answers in this paragraph are new Category B guidance in the hierarchy of generally accepted accounting principles.

Leases

Short-Term Leases

4.1. Q—A lease contract states that it 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. Is this a short-term lease?

A—No. 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 on the condition that the lessee defaults on payments. Accordingly, there are no periods for which both the lessee and lessor have an option to terminate and, therefore, no cancellable periods to exclude from the maximum possible term, which is three years.

4.2. Q—A lease has a noncancellable period of 36 months, and the lessee has an option to extend the lease for an additional 12 months. At commencement of the lease, it is not reasonably certain that the lessee will exercise that option. At the end of the noncancellable period, the lessee exercises the option to extend the lease. Does exercising the option to extend result in a change to the maximum possible term?

A—No. In accordance with paragraph 16 of Statement No. 87, *Leases*, the maximum possible term at commencement includes all options to extend, regardless of their probability of being exercised. At the commencement of the lease, the lease term is 36 months, and the maximum possible term is 48 months. As a result, although the reassessed lease term is only 12 months from the exercise date, the maximum possible term remains 48 months when the option is exercised. In addition, although some lease modifications are accounted for as separate leases for which the maximum possible term would be assessed separately, exercising an existing option is not a lease modification in accordance with paragraph 71 of Statement 87.

4.3. Q—In what circumstances does a lease modification (as described in paragraph 71 of Statement 87) result in a short-term lease?

A—There are two circumstances in which a lease modification results in a short-term lease:

a. If the lease was a short-term lease before the modification and the maximum possible term after the modification to extend the lease (reassessed from inception as described in paragraph 12 of Statement No. 99, *Omnibus 2022*) is 12 months or less, then the lease remains a short-term lease.
b. Regardless of whether the lease was a short-term lease before the modification, if the modification meets the criteria in paragraph 72 of Statement 87 to be accounted for as a separate lease 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 Recognition and Measurement for Leases Other Than Short-Term Leases and Contracts That Transfer Ownership

4.4. Q—A government leases a building. The lease term is 10 years. At the commencement of the lease, 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 fourth year of the lease. Should the government recognize interest expense during the first three years of the lease?

A—Yes. In accordance with paragraph 24 of Statement 87, interest expense represents the amortization of the discount on the lease liability. That discount should be amortized over the entire lease term, including the first three years during which the government is not making payments. The interest liability will continue to accrue until the government starts making payments in the fourth year.

4.5. Q—A public university enters into a lease of a building in Europe for its study abroad program. The lease requires the university to make payments of 5,000 euros per month. The university prepares its financial statements in U.S. dollars. Because the lease payment is required to be made in euros, the amount of the payment in U.S. dollars 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?

A—No. The currency in which lease payments are made does not affect whether those payments are considered fixed. As such, because the contract requires a fixed payment amount in euros, the lease payments should be considered fixed payments for the purpose of applying paragraph 21 of Statement 87. The increase or decrease in expected U.S. dollar cash flows is a foreign currency transaction gain or loss, which should be reported in accordance with paragraphs 165–172 of Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*.

Lessor Recognition and Measurement for Leases Other Than Short-Term Leases and Contracts That Transfer Ownership

4.6. Q—Paragraph 54 of Statement 87 requires that the deferred inflow of resources related to a lease be recognized as inflows of resources (for example, revenue) over the term of the lease. If reported as revenue, should a business-type activity or enterprise fund report those inflows of resources as operating revenue?

A—Paragraph 102 of Statement No. 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. As discussed in Question 7.73.4 in *Implementation Guide No. 2015-1*, 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. Therefore, whether revenue recognized from the deferred inflow of resources related to a lease is operating revenue or nonoperating revenue depends on (a) the purpose of the lease, (b) the nature of the activity being reported as a business-type activity or in an enterprise fund, and (c) the government's policy defining operating revenue.

Other Implementation Guidance

Statement No. 96, Subscription-Based Information Technology Arrangements

4.7. Q—Is a licensing agreement for a vendor's computer software that automatically renews until cancelled a licensing agreement that provides a perpetual license?

A—No. A provision under which a licensing agreement automatically renews until cancelled is an option to terminate the agreement at each renewal date. An agreement that includes an option to terminate 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. Therefore, a licensing agreement for a vendor's computer software that automatically renews until cancelled does not provide a perpetual license.

4.8. Q—A government enters into a six-year subscription-based information technology arrangement (SBITA) contract with no options to extend or terminate the contract 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. What is the subscription term?

A—The subscription term is four years. The initial implementation stage is completed at the end of the second year of the contract. Therefore, in accordance with paragraphs 9 and 15 of Statement 96, 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 No. 100, Accounting Changes and Error Corrections

4.9. Q—Upon completion of a capital project during the year, a government closes out a major capital projects fund and moves remaining resources to the general fund. Does this circumstance constitute a change to or within the financial reporting entity?

A—No. Even though the capital projects fund will no longer be included in the government's financial reports in future periods (that is, the fund will be removed for financial reporting purposes), it does not constitute a change to or within the financial reporting entity in accordance with paragraph 9a of Statement 100 because, in this case, the removal of the fund does not result from a movement of continuing operations. Instead, that movement of remaining resources to the general fund should be reported as interfund activity in accordance with paragraph 112 of Statement 34, as amended.

Amendment to Previously Issued Question and Answer

5. The question and answer in this paragraph amends a question and answer in a previously issued Implementation Guide.

Leases

Question 4.16 in Implementation Guide 2019-3

5.1. Q—A lease contract allows only the lessee to unilaterally terminate the lease at any time but also provides for cancellation penalties. The cancellation penalties are so great that it is reasonably certain that the lessee will not terminate the lease. Should the periods covered by the lessee's option to terminate be excluded from the lease term?

A—No. Paragraph 12 of Statement 87 requires that periods covered by *either* a lessee or a lessor option to terminate the lease be included in the lease term if it is reasonably certain, based on all relevant factors, that the lessee or lessor will not exercise the option. In determining whether it is reasonably certain that the lessee will not exercise the option to terminate the lease, the lessee (or in the case in which the government is the lessor—the lessor) should assess all factors relevant to the likelihood that the lessee will not exercise the option. Those factors include significant economic disincentives, such as cancellation penalties, as discussed in paragraph 14 of Statement 87. (See also Question 4.29 in Implementation Guide 2019-3.)

EFFECTIVE DATE AND TRANSITION

6. Questions 4.1–4.8 and 5.1 are effective for fiscal years beginning after June 15, 2023, and all reporting periods thereafter. Earlier application is encouraged if the pronouncement addressed by the question and answer has been implemented. Changes, if any, adopted at transition to conform to the provisions in Questions 4.1–4.8 and 5.1 in this Implementation Guide should be reported as a change in accounting principle in accordance with Statement 100, including the display and related disclosure requirements, as applicable. If Questions 4.1–4.8 or 5.1 are implemented prior to Statement 100, changes, if any, adopted at transition to conform to the provisions in those questions should be applied retroactively by restating financial statements, if practicable, for all prior periods presented. If restatement for prior periods is not practicable, the cumulative effect, if any, of applying this Implementation Guide should be reported as a restatement of beginning net position (or fund balance or fund net position, as applicable) for the earliest period restated. In the first period that this Implementation Guide is applied, the notes to financial statements should disclose the nature of the restatement and its effect. Also, if prior periods presented were not restated, the reason for not restating prior periods presented should be disclosed.

7. Question 4.9 should be applied simultaneously with the requirements of Statement 100, which are effective for accounting changes made in fiscal years beginning after June

15, 2023, and all reporting periods thereafter. If Statement 100 has been implemented prior to the issuance of this Implementation Guide, Question 4.9 is effective for fiscal years beginning after June 15, 2023, and all reporting periods thereafter, with earlier application encouraged.

The requirements in this Implementation Guide need not be applied to immaterial items.

Appendix A

BACKGROUND

A1. In June 2015, the GASB issued Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments.* As a result of that Statement, GASB Implementation Guides were elevated to Category B in the hierarchy of generally accepted accounting principles. Since that time, the GASB has cleared additional implementation guidance to assist its stakeholders by clarifying, explaining, or elaborating on the requirements of its Statements.

A2. New questions and answers are included in this Implementation Guide to address (a) issues raised by the GASB's stakeholders through inquiries posed to the GASB and (b) issues identified by the GASB in anticipation of questions that will arise during implementation of GASB pronouncements.

A3. In addition to new questions and answers, this Implementation Guide includes amendments to previously issued implementation guidance to address an issue identified by the GASB subsequent to the clearance of that guidance.

Appendix B

AMENDMENT TO PREVIOUSLY ISSUED QUESTION AND ANSWER—MARKED FOR CHANGES

B1. This appendix presents in marked form the substantive amendments that are proposed in paragraph 5 of this Implementation Guide. Text that is proposed to be added is <u>underlined</u>, and text that is proposed to be deleted is ~~struck out~~. Editorial modifications are not marked.

Leases

Question 4.16 in Implementation Guide 2019-3

5.1. Q—A lease contract allows only the lessee to unilaterally terminate the lease at any time but also provides for cancellation penalties. The cancellation penalties are so great that it is reasonably certain that the lessee will not terminate the lease. Should the ~~cancellable~~ periods <u>covered by the lessee's option to terminate</u> be excluded from the lease term?

A—No. Paragraph 12 of Statement 87 requires that periods covered by *either* a lessee or a lessor option to terminate the lease be included in the lease term if it is reasonably certain, based on all relevant factors, that the lessee or lessor will not exercise the option. In determining whether it is reasonably certain that the lessee will not exercise the option to terminate the lease, the lessee (or in the case in which the government is the lessor—the lessor) should assess all factors relevant to the likelihood that the lessee will not exercise the option. Those factors include significant economic disincentives, such as cancellation penalties, as discussed in paragraph 14 of Statement 87. (See also Question 4.29 in Implementation Guide 2019-3.)

Appendix C

CODIFICATION INSTRUCTIONS

Codification of Governmental Accounting and Financial Reporting Standards—June 2023 Update

C1. The instructions that follow update the June 30, 2022 *Codification of Governmental Accounting and Financial Reporting Standards* (Codification) for the provisions of this Implementation Guide. Only the question number from this Implementation Guide is listed if the question and answer will be cited in full in the Codification.

* * *

[Update cross-references throughout.]

* * *

ANNUAL COMPREHENSIVE FINANCIAL REPORT SECTION 2200

Sources: [Add GASBIG 2023-X.]

.752-6 [At the end of the answer, add the following sentence:] (See also Question .752-7.) [GASBIG 2021-1, Q4.13, as amended by GASBIG 2023-X, Q4.6]

[Insert new Question .752-7 as follows:]

.752-7 [GASBIG 2023-X, Q4.6]

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ADDITIONAL FINANCIAL REPORTING CONSIDERATIONS SECTION 2250

Sources: [Add GASBIG 2023-X.]

[Insert new Question .710-1 as follows:]

.710-1 [GASBIG 2023-X, Q4.9]

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LEASES SECTION L20

Sources: [Add GASBIG 2023-X.]

.702-5 [Replace Question .702-5 with GASBIG 2023-X, Q5.1.] [GASBIG 2019-3, Q4.16, as amended by GASBIG 2023-X, Q5.1]

[Insert new Questions .703-9–.703-11 as follows:]

.703-9–.703-11 [GASBIG 2023-X, Q4.1–Q4.3]

[Insert new Question .707-2 as follows:]

.707-2 [GASBIG 2023-X, Q4.4]

[Insert new Question .708-4 as follows; renumber subsequent questions.]

.708-4 [GASBIG 2023-X, Q4.5]

.715-4 [At the end of the answer, add the following sentence:] (See also Question .715-5.) [GASBIG 2021-1, Q4.13, as amended by GASBIG 2023-X, Q4.6]

[Insert new Question .715-5 as follows; renumber subsequent questions.]

.715-5 [GASBIG 2023-X, Q4.6]

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SUBSCRIPTION-BASED INFORMATION TECHNOLOGY ARRANGEMENTS **SECTION S80**

Sources: [Add GASBIG 2023-X.]

[Insert new headings .701–.724 mirroring headings from Standards section; except under headings .701 (Scope and Applicability of This Statement) and .703 (Subscription Term), insert *No questions assigned.* under each new heading.]

[Insert new Question .701-1 under Scope and Applicability of This Statement heading:]

.701-1 [GASBIG 2023-X, Q4.7]

[Insert new Question .703-1 under Subscription Term heading:]

.703-1 [GASBIG 2023-X, Q4.8]

* * *

Comprehensive Implementation Guide—June 2023 Update

C2. The instructions that follow update the June 30, 2022 *Comprehensive Implementation Guide* for the provisions of this Implementation Guide. Only the question number from this

Implementation Guide is listed if the question and answer will be cited in full in the *Comprehensive Implementation Guide.*

* * *

[Update cross-references throughout.]

* * *

[Insert the following new content:]

7.73.7. [GASBIG 2023-X, Q4.6]

12.17.9–12.17.11. [GASBIG 2023-X, Q4.1–Q4.3]

12.21.2. [GASBIG 2023-X, Q4.4]

12.26.4. [GASBIG 2023-X, Q4.5]

[Under heading 12.72, revise the text as follows:]

See also Question 7.73.6 for a discussion of classification of interest revenue related to leases if the principal ongoing operation of a business-type activity or enterprise fund is leasing property to other entities and Question 7.73.7 for a discussion of classification of revenue recognized from the deferred inflow of resources related to a lease.

[After Question Z.91.3, insert new headings Z.96 and Z.100 and questions and answers as follows:]

Z.96 Statement No. 96, *Subscription-Based Information Technology Arrangements*

Z.96.1–Z.96.2. [GASBIG 2023-X, Q4.7–Q4.8]

Z.100 Statement No. 100, *Accounting Changes and Error Corrections*

Z.100.1. [GASBIG 2023-X, Q4.9]

* * *

[Revise the following questions as indicated:]

7.73.6. [At the end of the answer, add the following sentence:] (See also Question 7.73.7.) [GASBIG 2021-1, Q4.13, as amended by GASBIG 2023-X, Q4.6]

12.13.3. [Replace Question 12.13.3 with GASBIG 2023-X, Q5.1.] [GASBIG 2019-3, Q4.16, as amended by GASBIG 2023-X, Q5.1]

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