GASB 87: You inventoried your leases, now what?
Practical steps for implementation and lessons learned

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Agenda

Introductions

Getting to know the new lease standard

Implementation considerations
- Lease Accounting & Reporting Technology
- Data and Abstraction
- Internal Controls
The City and County of San Francisco

- Established in 1850
- The only legal subdivision of the State of California with the governmental powers of both a city and a county
- Key public services provided by the City include:
  - Public safety and protection,
  - Public transportation,
  - Water and sewer,
  - Parks and recreation,
  - Public health,
  - Social services, and
  - Land-use and planning regulation
- Municipal budget for fiscal year 2019-20 was $12.3 billion with 55 city departments
- Population of 883,305 - a new Historical High for calendar year 2018
- Approximately 47 square miles, making it one of the most densely populated cities in America
Polling question #1

How familiar are you with the requirements and timelines of the new Governmental Accounting Standards Board (GASB) 87 standard?

• Very familiar, I am the organizational lead
• Very familiar, I am part of the transition team
• Very familiar
• Somewhat familiar
• Not at all familiar
• Don’t know/not applicable
Getting to know the new lease standard
Getting to know GASB 87—the “new lease standard”

A new lease accounting model is introduced by the following standard:

**GASB 87** is applicable to all **State and Local Government; Public Higher Education Institutions**

The new lease accounting model will result in **most leases being recorded on the balance sheet for lessees and lessors; a new requirement**

**For lessees:** Balance sheet impact is estimated as **seven times** the annual rent expense

Changes go **beyond accounting policy**, affecting systems, processes, controls, audit readiness, leasing, or procurement strategies and operations of many parts of the government
## Effective dates and adoption methodology

<table>
<thead>
<tr>
<th>Applicable to</th>
<th>GASB 87, Leases</th>
</tr>
</thead>
<tbody>
<tr>
<td>• State and Local Government; Public Higher Education Institutions</td>
<td></td>
</tr>
</tbody>
</table>

### Effective Date per guidance

| Reporting periods beginning after December 15, 2019[1] |

### Early adoption

| Encouraged |

### Adoption methodology

| Retroactive |

| Restate all prior periods presented |

### Effective date based on year-end

<table>
<thead>
<tr>
<th>Year-end</th>
<th>GASB 87 Effective Date</th>
</tr>
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<tbody>
<tr>
<td>December 31</td>
<td>January 1, 2020</td>
</tr>
<tr>
<td>March 31</td>
<td>April 1, 2020</td>
</tr>
<tr>
<td>June 30</td>
<td>July 1, 2020</td>
</tr>
<tr>
<td>September 30</td>
<td>October 1, 2020</td>
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[1] GASB issued an exposure draft proposing to amend the effective date to “fiscal years” starting after December 15, 2019 (vs. “reporting periods”). This amendment is pending due process, public comment, and Board deliberations, and is not considered authoritative until issued. Accordingly, dates provided throughout this presentation do not incorporate such changes; rather they reflect authoritative guidance currently disclosed in GASB 87.
Scope of GASB 87

Applicability
Establishes standards of accounting and financial reporting for leases by lessees and lessors. This Statement applies to financial statements of state and local governments as well as public higher education institutions.

GASB 87 lease definition
A contract 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.

Right to control
Contract must convey the right to control the identified asset through the entity’s right to (1) obtain the present service capacity of the underlying asset and (2) right to determine the nature and manner of use of the underlying asset.

Lease exclusions
This statement does not apply to leases of intangible assets leases, leases of biological assets, leases of inventory, service concession arrangements, leases involving conduit debt in certain circumstances, supply contracts, short-term leases, and contracts that transfer ownership. It is also not applicable if the lessee or lessor is included as a blended component of the primary government.

Short-term leases
Short-term leases (at commencement of the lease term, has a maximum possible term under the lease contract of 12 months or less), to be treated in a similar manner as current “operating leases.”

Transfer of Ownership
A contract that (a) transfers ownership of the underlying asset to the lessee by the end of the contract and (b) does not contain termination options, should be reported as a financed purchase/sale of the underlying asset.
Polling question #2

Which best describes the current state of your organization’s lease accounting implementation efforts?

- Advanced—We have completed lease accounting implementation
- Intermediate—We have started lease accounting implementation
- Planning—We have not started lease accounting implementation, but we plan to start implementation soon
- Lagging—We have not started lease accounting implementation or planning for it
- Don’t know/not applicable
Implementation considerations
Implementing the new lease accounting standards—why now?

- The new lease accounting standards represent the most pervasive change introduced by the GASB in many years
- Implementation efforts will likely take well over a year for reporting entities with significant volume of leases
- Effective and timely implementation is recommended for:
  - Obtaining an audit opinion free of material weaknesses or significant deficiencies;
  - Ensuring bond/credit ratings (where applicable) are not jeopardized;
  - Enhancing ability to make key operational decisions (e.g., lease vs buy, property management/maintenance) and managing real estate footprint;
  - Minimizing manual labor required to maintain compliance and establishing a sustainable process that frees up valuable resources for meaningful tasks
Critical steps in your path toward achieving compliance

Preparation is a necessity when considering the areas of impact.

- Read and get to know the new lease standards
- Develop a plan with milestones
- Foster organizational collaboration
Develop a plan with milestones

Phase 1: Assessment
Sample steps:
• Identify key stakeholders
• Create governance, project management office structure, and policy
• Identify relevant contract population and evaluate potential leases
• Identify systems involved in tracking related contract data

Phase 2: Planning
Sample steps:
• Complete technology vendor selection and blueprint technology solution
• Develop data migration plan, basic tool configuration and training
• Design adequate controls
• Refine policy decisions
• Draft updates to process flows/controls

Phase 3: Implementation
Sample steps:
• Install selected system
• Perform lease abstraction
• Migrate data from existing system
• Upload data into lease accounting solution
• Complete data sanitization and normalization
• Perform validation testing (systems and data)
• Develop pro-forma statements, reconciliations, etc.
• Prepare supporting package for auditors
• Produce & validate restated comparative statements

Timeline estimates are provided for reporting entities with less than 5,000 leases. Timelines may vary significantly based on volume/complexity of leases, condition of existing lease tracking processes, system selected, etc.
Lessons learned from public company lease implementations

Finding leases may not be straightforward

- Not every lease is labeled a “lease agreement” and identifying embedded leases can involve considerable time and judgment as many of these contracts may not have been identified as leases in the past.
- Leases may be tracked and maintained in disparate systems, databases, and systems and by different groups of individuals.
- Stakeholders within functions outside of real estate/facilities will likely need to be trained on “what is a lease” to support in identifying contracts with embedded leases.
- Locating and compiling the entire population of leases may take several months to complete.

Implementation considerations:
- Start with identifying the individuals who have the best knowledge of contracts signed.
- Obtain leadership endorsement for the project.
- Undertake careful planning upfront to identify a complete population of leases and to establish appropriate procedures as new and modified leases are executed.
- Take a close look at all operations, identifying areas where embedded leases are more likely to exist.
Polling question #3

Will the amount of time and effort your organization’s lease accounting team expends on implementation change in the next 12 months?

• Yes—increase
• No change
• Yes—decrease
• Don’t know/not applicable
My leases are inventoried, now what?

You have already completed initial steps in the assessment phase, such as:

✔ Identified key stakeholders
✔ Assessed systems and tools
✔ Inventoried leases by gathering all leases and have considered:
  ➢ “Contracts” that may be leases
  ➢ Leases that were in Bob’s desk drawer
  ➢ Leases that are embedded in other documents or contracts

Now what?

There are some operational challenges and key considerations entities should consider as they move from the assessment phase to the planning and implementation phases.
Operational challenges
Key considerations for GASB 87 implementation

Lease Accounting & Reporting Technology
The new requirement creates the need for accurate lease data and new calculations. Entities need to create a comprehensive technology roadmap with considerations for modifying the existing system, moving to a new system or implementing a bridge solution.

Data and Abstraction
Lease agreements require a high volume of data and this data can reside across multiple decentralized locations. In addition, the data be inaccurate or non-reflective of the new lease accounting standard data requirements.

Internal Controls
Due to the increased relevance of new leasing on the financial statements, entities may face additional scrutiny from auditors and regulators regarding the design and effectiveness of controls related to lease accounting.
Lease accounting & reporting technology

✓ Technology solution should be selected early
✓ As you review your current lease technology capabilities, the following functional requirements should be considered:

**Abstraction** technology to support efficient data gathering for large volumes of leases.

**Storage** of electronic lease documents and related data fields.

**Reporting** capabilities to perform necessary calculations and create required disclosures.

**Operational** considerations including key event notifications, “what if” analyses, workflow management, and data analytics.

Technology changes may be a longer lead time activity which may necessitate a temporary solution to facilitate data capture and pro forma reporting.
Three general categories of technology solutions

<table>
<thead>
<tr>
<th>Enterprise solutions</th>
<th>Integrated lease management</th>
<th>Other point/niche lease solutions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Enterprise solutions represent modules or capabilities integrated in an ERP suite.</td>
<td>Category consists of integrated software such as IWMS,* which helps optimize the use of resources, including real estate, infrastructure, and facilities.</td>
<td>Products designed to help address specific business problems (lease administration, lease accounting, facility management, etc.)</td>
</tr>
</tbody>
</table>

*IWMS – Integrated Workplace Management Systems
Lessons learned from public company lease implementations

Systems and processes may require more attention than expected and desired

- The new lease standard requires significantly more data and calculations to produce accounting journal entries and disclosures.
- Most companies acquired new lease technology solutions or modified existing systems for lease accounting. Many have discovered that it often takes longer than expected for a new tool to be fully operational.
- System and process challenges could delay the overall implementation.
- Internal processes and requirements for systems that need to be approved for use can significantly impact the implementation timeline.

Implementation considerations:

- **Begin the system implementation process** including understanding your business requirements, vendor demos, and selection process.
- Consider effective project management practices to efficiently use project resources and to manage timeline risk, particularly in areas such as:
  - business requirements development
  - application integration
  - system testing
  - user training
Polling question #4

Which poses the largest challenge to your entity’s lease accounting implementation efforts in the next 12 months?

• No software solution is ready to handle the unique needs of my type of organization

• Government budget processes are making it tough to procure software solutions or other resources needed

• Lack of resources or bandwidth to take on lease accounting implementation work

• Lack of centralized leadership and operations, due to multiple organizations rolling-up into one agency or entity

• The need to restate one year of financials, if we issue comparative financials

• Don’t know/not applicable
Data abstraction – Planning

The following summarizes several of the initial steps involved in abstracting data for GASB 87 compliance purposes.

- Build abstraction templates fully compliant with GASB 87 accounting, reporting, and disclosure requirements
- Identify capabilities of existing technology (e.g., optical character recognition) and potential benefits
- Build an abstraction roadmap, communicate to stakeholders
- Perform a data gap analysis to assess existing lease data against abstraction template
- Establish project leadership, milestones, governance (quality reviews, abstraction guidelines, approvals, etc.) and resource requirements
Data abstraction – Planning

Common challenges to proactively consider

- The reporting and disclosure requirements of the new lease accounting standard result in an increase in electronic data needs and a long lead time to abstract and validate data.
- Factors to consider may include:

- High volume of data fields
- Information isn’t all in one agreement
- Different arrangements in different countries
- Multiple currencies and languages
- Data housed in disparate systems
- Contracts open to interpretation
- Internal controls
- Judgment requirements

During the implementation period, your operations will not cease. You will enter into new leases, and existing leases will be modified or terminated.
## Data abstraction – Planning

### Preparing for lease abstraction

#### PRE-ABSTRACTION CHECKLIST

<table>
<thead>
<tr>
<th>Question</th>
<th>Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>What is my total lease portfolio?</td>
<td>How many...</td>
</tr>
<tr>
<td></td>
<td>- Real Estate leases, non-real estate leases, MSAs with Leased Assets?</td>
</tr>
<tr>
<td></td>
<td>- English leases versus foreign language leases?</td>
</tr>
<tr>
<td></td>
<td>- Simple leases (fewer than 15 pages), or more complex leases?</td>
</tr>
<tr>
<td>What format are my lease documents in?</td>
<td>Hard copies or electronic?</td>
</tr>
<tr>
<td>Are my leases in a centralized location?</td>
<td>Who is able to access this location?</td>
</tr>
<tr>
<td>Is my lease file complete?</td>
<td>Are the latest lease, amendments, renewal documents compiled and saved in the centralized location?</td>
</tr>
<tr>
<td>Do we have a lease inventory?</td>
<td>The lease inventory file should include names of all of the documents that are in-scope for abstraction</td>
</tr>
<tr>
<td>Have I made a decision and documented my accounting policy elections?</td>
<td>Election of Package of Three practical expedients?</td>
</tr>
<tr>
<td>Have I collected all of the relevant Non-Contract Sourced Data (“NCSD”) for fields not present in the underlying lease agreement?</td>
<td>Examples include: region, business unit ID, lease incentives, fair market values, discount rates</td>
</tr>
<tr>
<td>Have I selected the tool into which my leases are being abstracted?</td>
<td>Does my existing tool have accounting capabilities, or do I need to migrate into a new tool?</td>
</tr>
</tbody>
</table>
Data abstraction – Execution
Illustrative workflow

Entities should consider a project team and determine a method by which they will inventory, organize, normalize, and gather data from lease contracts. The following illustrates a potential process for meeting the requirements of GASB 87, Leases.

1. Communicate, to all key stakeholders, approved data gathering strategy to identify and collect source documents.

2. Perform initial data abstraction into a spreadsheet in a format compatible with choice of lease accounting solution and GASB 87 requirements.

3. Complete first level of lease level data review. Run validation parameters and completeness assessment procedures, confirm key interpretations with appropriate stakeholders.

4. Upload lease contracts to a centralized repository. This may include manual and automated loading depending on source system. Track questions or missing documents in Issue Log and ensure timely resolution.

5. Perform reconciliation procedures to support accuracy and completeness of data and address any data gaps or accounting issues.

6. Design centralized procedures to ensure completeness, accuracy, validity of data abstraction going forward.

7. Continue to abstract lease data and maintain the lease portfolio (e.g., new leases, mods, terminations).

Data gathering is one area in which substantial time may be needed for compliance.

Current state

GASB 87: You inventoried your leases, now what?
Practical steps for implementation and lessons learned
Lessons learned from public company lease implementations

Accounting judgments and estimates can be complex and call for alignment between various stakeholders

- Determination of the key accounting estimates will likely involve multiple inputs and judgments, (e.g., determination of the lease term or discount rate).
- Accounting estimates and judgments necessary may be different for each type of contract and require accounting to become familiar with certain operations aspects.

Implementation considerations:

- **Review sample contracts early** for all identified portfolios in order to identify points that may require extensive accounting evaluation.
- **External and internal auditors should be on the implementation journey**, starting from the beginning.
Lessons learned from public company lease implementations

Required lease data can be a challenge to abstract, migrate, and maintain

- Many lease agreements contain complex terms and conditions that could impact accounting conclusions.
- Some lease agreements have numerous amendments, making identification of the appropriate source document for relevant data fields a further source of complexity.
- Lease agreements may not be stored in repositories that are consolidated and consistently structured.
- Lease agreements do not contain all of the necessary data necessary to comply with the new lease standards (e.g., discount rate and fair market values).
- Abstraction of lease and lease data could take an average of **4-12 months** to complete.

Implementation considerations:
- **Don’t underestimate** what it takes to collect, organize, and maintain lease data
- Seek to **achieve efficiencies** by:
  - developing robust plans
  - implementing data quality checks and controls
  - leveraging technology in combination with suitably trained and skilled data specialists
Internal control considerations
Integrating operational enhancements as part of the transition journey

The new lease standard introduces additional considerations around an entity's internal control structure:

- Increased focus around internal controls by regulators and other stakeholders
- New balances and disclosures subject to internal controls
- Complexity of requirements of the new lease accounting standard

Other internal control considerations:
- Data and access management
- Technology/processing
- Talent
- Service organizations
# Internal control considerations

## Lease cycle

### Transition
- Control environment
- Risk assessment
- Completeness of initial opening balance sheet
- Controls during comparative reporting period

### Lease Origination
- Controls around lease classification
  - Embedded leases
  - Short-term leases
  - Immaterial leases
  - Leases that transfer ownership

### Lease Modification
- Leases commonly are modified, renewed, extended, cancelled
  - Timely identification of modifications
  - Tracking, reviewing, and approving changes
- Version controls

### Reporting and Disclosures
- Significantly increased disclosure requirements
- Many of the disclosure requirements are data intensive
  - Weighted average calculations, variable lease payments, etc.
  - Consider source and controls over the data

### Information Technology Controls
- Controls over source data and interfaces/data transfer
- General IT controls including access controls, segregation of duties
- Change management controls related to lease calculations
- Appropriate user acceptance testing
- Audit trails

### Outsourced Service Provider Controls
- Many organizations use outsourced service providers to assist in the management of parts or all of their lease portfolio
  - Consider internal controls performed by the service provider
  - Appropriate monitoring mechanisms over reporting from the service provider
Polling question #5

Has your organization considered ways to strategically leverage new data, technology, or processes as part of the lease transformation.

• Yes, we are looking at ways to leverage
• No, we are focused on the transformation
• Don’t know/not applicable
Question and answer
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