

# GASB Exposure Draft Commentary

## Leases Implementation Guide

### California State Controller's Office

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Letter of Comment No. 026  
File Reference: Leases2-IG87  
Date Received: 04/30/2019

#### **Purpose:**

The objective of this Exposure Draft is to provide guidance that clarifies, explains, or elaborates on the requirements of Governmental Accounting Standards Board Statement No. 87, *Leases* (GASB 87). Consistent with GASB 87, the requirements of the proposed implementation guide are effective for reporting periods beginning after December 15, 2019. Therefore, they would be applicable to the State's CAFR for the year ended June 30, 2021. The Exposure Draft provides questions and answers to address issues related to accounting and financial reporting for leases in accordance with the requirements of GASB 87. It also provides illustrative examples.

#### **Impact to the State:**

The impact of GASB 87 will be significant to the State's financial statements. It requires the implementation of a new reporting process, and it will change the amounts and types of accounts listed in the State's financial statements. It will also require changes to the State's note disclosures.

#### **Response to the Exposure Draft:**

The California State Controller's Office (SCO), State Government Reporting Policy Section of the State Accounting and Reporting Division reviewed the Exposure Draft of the Implementation Guide for its applicability to the State's financial statements. In particular, the review examined whether there were any opportunities for clarification or elaboration within the Implementation Guide that may benefit the State in the future.

Regarding paragraph 4.35, the SCO has concerns that by not capitalizing lease payments as assets until the lease commences could result in misleading full-accrual fund balance fluctuations. While it is understandable that a lease asset in principle should not exist until the lease commences, it seems most appropriate that the prepayments should be recorded as deferred outflows until the commencement of the lease. However, in practice the approach in paragraph 4.35 appears to involve the expensing of prepayments, which reduces the fund balance, followed by the capitalization of those expenses when the lease commences, which requires increasing the fund balance again by the amount of the prepayments. This seems like an unnecessary year-to-year fluctuation to full-accrual fund

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balances when the economic activity has not changed — the government is paying towards a lease asset that it will be required to capitalize at some point. The SCO therefore requests that the Board specifically addresses how such transactions will be accounted for in practice.

Concerning paragraph 4.61, the SCO requests that the Board elaborate on what the journal entries for the \$10,000 in installation costs would be. Since the \$10,000 is paid over the life of the lease, increasing the lease asset by the present value of the \$10,000 in payments seems appropriate, but it seems unclear what the credit journal entry should be for the present value, if the Board states that the installation costs are not included in the measurement of the lease liability. The SCO would like to know if the credit entry would be a deferred inflow of resources.

Concerning paragraph 4.79, the SCO could benefit from further elaboration. The SCO interprets paragraph 4.79 to read that an operating lease does not require a retroactive reclassification as a lease with an amortized lease asset and liability, but rather should be capitalized and accrued as a lease asset and liability based on the present values of all lease payments going forward from the implementation date. Consequently, there would be no requirement to restate any fund balances because the treatment of the operating lease as a lease asset and liability would not be retroactive. The SCO would like clarification whether this is correct, because retroactively applying GASB 87 to determine the effects on fund balance would require significantly more work than to reclassify leases based only on the lease payments going forward.

Furthermore, the SCO requests clarification regarding what discount rate to use for the recording of all lease assets and liabilities during the implementation year. The SCO is unsure whether it should record all leases at the discount rate of the implementation year or whether it needs to go back and determine the discount rates of all leases according to their lease commencement years, even though the lease assets and liabilities would not be retroactively recorded. It would be helpful if the Board could clearly address this matter.

The SCO would also like to point out that during the implementation year it is likely that the large recognition of lease assets and liabilities will result in significantly higher than average capital outlays and financing sources for the modified accrual fund statements. If the leases are not retroactively reported, then it seems all leases during implementation year will require capital outlay and financing source journal entries. Since these entries have no net effect on the fund balance and

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may have a misleading effect on users of the financial statements concerning current year lease activity, the SCO believes there should not be any recording of capital outlays or other financing sources for leases that commenced prior to the implementation date. The SCO requests that the Board specifically address the impact of GASB 87 implementation on the fund statements.

The SCO would like to thank the Board for the opportunity to comment on the Exposure Draft of the Leases Implementation Guide. It appreciates the Board's commitment and effort towards the updating the standards of governmental financial reporting, and hopes the Board finds these comments to be constructive and beneficial.