



We've Seen the Future and It Looks Like ... Leases

By Michele Mark Levine

Here, we take a quick comparative look at GASB 87 and the SBITA and PPP EDs, and how the facts and circumstances differ despite the similarity of the accounting and financial reporting.

In May 2019, the Governmental Accounting Standards Board (GASB) issued an exposure draft (ED) of a proposed statement, *Subscription-Based Information Technology Arrangements* (SBITA ED); and in June 2019, GASB issued another ED, of a proposed statement, *Public-Private and Public-Public Partnerships and Availability Payment Arrangements* (PPP ED).¹ What stands out most about these proposals is that much of the accounting and financial reporting are directly tied by GASB to its Statement No. 87, *Leases* (GASB 87).

The underlying assumption of lease accounting and both of the EDs is that

specific kinds of contractual arrangements establish obligations that rise to the level of liabilities and rights that rise to the level of intangible assets, investing them with gravity far greater than the commitments and (generally unrecognized) contingencies that are the norm for executory agreements.² Here, we take a quick comparative look at GASB 87 and the SBITA and PPP EDs, and briefly consider the ways in which the facts and circumstances differ despite the similarity of the accounting and financial reporting. Exhibit 1 summarizes key terminology and provisions from GASB 87 and both EDs.

Exhibit 1: Selected Terminology and Provisions of GASB 87, SBITA ED, and PPP ED

	Leases (GASB 87)	SBITAs (Proposed)	PPPs (Proposed)
Parties	Lessor	SBITA vendor*	Transferor
	Lessee	Government	Operator
Control Rights Conveyed	Control of the right to use another entity's underlying asset	Control of right to use another party's underlying asset	Control of the right to <i>operate</i> or use an underlying asset
Purpose/Nature of Use	As specified in the contract	As specified in the contract	To provide public services
Subject/Underlying Assets	Nonfinancial asset	Hardware, software or IT infrastructure	Infrastructure or other nonfinancial asset
Intangible Right-to-Use Asset	Lease asset	SBITA asset	PPP intangible right-to-use asset

* No proposed accounting or financial reporting guidance is provided in the SBITA ED for governmental SBITA vendors, which are excluded from the scope of the proposal. This is different from the existing guidance for leases and the proposed guidance for PPPs, both of which address governments on either end of applicable transactions.

Exhibit 2: Capital Eligibility of Outlays for Activities Associated with SBITAs

Stage Name	Included Activities	Expense or Capitalize Outlays?
Preliminary Project Stage	Conceptual formulation and evaluation of alternatives, the determination of the existence of needed technology, and the final selection of alternatives for the SBITA	Expense
Initial Implementation Stage*	Designing the chosen path, such as configuration, coding, testing, and installation associated with the government's access to the underlying hardware or software. Other ancillary charges necessary to place the subscription asset into service also should be included in this stage. Data conversion is included in this stage only if it is necessary to make the subscription asset operational.	Capitalize if the following have been <i>completed</i> — but the subscription asset is not yet operational — prior to outlays for activities of this stage: <ol style="list-style-type: none"> 1. Determination of project objectives and nature and capacity of subscription asset. 2. Demonstration of technical feasibility. 3. Demonstration of government's intention, ability and effort to enter into SBITA. 4. Preliminary project stage activities. 5. Authorization and commitment by management to funding SBITA for at least the current fiscal year.
Post-Implementation	Maintenance, troubleshooting, and other activities associated with the government's ongoing access to the underlying hardware or software. All data conversion not necessary to make the subscription asset operation is included in this stage.	Expense

Training costs, regardless of which stage they are in, should be expensed as incurred.

* The initial implementation stage in the SBITA ED is very similar to the application development stage of internally generated computer software in current GASB standards (GASB Cod. Sec. 1400.145).

SBITAs and PPPs, as proposed, are clearly the progeny of leases, but the DNA of another parent can be seen in each of the exposure drafts as well. For SBITAs, the second parent is existing accounting and financial reporting guidance for internally generated computer software, which the SBITA ED heavily draws from in proposing guidance on the capitalization of implementation costs as part of a SBITA (intangible, right-to-use) asset.³ Examples of SBITAs, often referred to as cloud computing, include software-as-a-service (SaaS) contracts and their cousins, platform-as-a-service (PaaS) and infrastructure-as-a-service arrangements (IaaS). Exhibit 2 summarizes the capitalization guidance in the

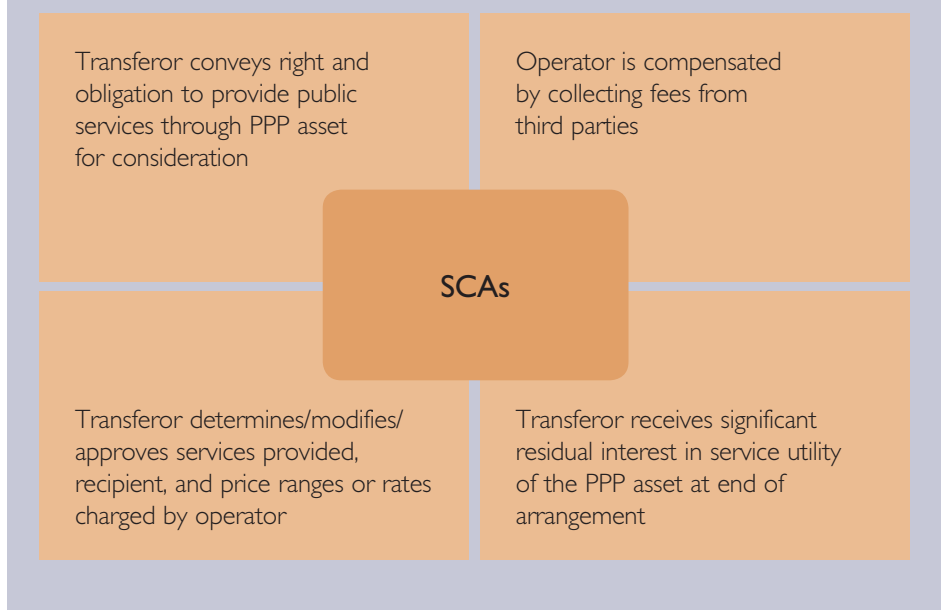
proposed ED, which are based on stages that essentially mirror those for internally generated computer software.

Service concession arrangements (SCAs) accounting is the second parent to the PPP ED, which proposes to supplant it.⁴ The PPP ED encompasses a broader array of arrangements than SCAs, however, and also defines and provides guidance on another new entrant to the acronym array, availability payment arrangements (APAs). APAs are defined primarily to distinguish them from, and exclude them from, the accounting and reporting for PPPs.⁵ Like SCAs, a fundamental element of any PPP is that a government is using the arrangement as a way to provide public services using

capital assets. Exhibit 3 summarizes the proposed SCA requirements, which have changed very little from the existing guidance.⁶

PPPs, however, are not limited to arrangements in which the underlying asset is owned by the government that is contracting for the provision of the public services, and that government transferor may have more or less control over the operation of the underlying asset (such as regarding the services provided and their pricing) than under the rules for SCAs. The method of compensating the operator may also differ, as those PPPs that are SCAs must — and other PPPs may — provide that the operator is compensated through payments by third-party users rather

Exhibit 3: Proposed Criteria for SCAs in PPP ED



than by the transferor. Both parties' accounting and financial reporting for PPPs is dependent on the source of the underlying asset (an *existing asset* of the transferor, such an existing asset of the transferor *with improvements made by the operator*, or a *new asset* acquired or constructed by the operator) as well as whether or not the PPP is also a lease and/or is also an SCA.

Substantial similarities include that all three (leases, SBITAs and PPPs) have — or propose — the following provisions:

- Use of present values of future payments as the basis for measuring long-term liabilities (lessees, governments in SBITAs, operators) or receivables (lessors and transferors).
- Remeasurement of those liabilities or receivables under similar circumstances.
- Recognition of intangible right-to-use assets (lessees, governments in SBITAs, operators) and deferred

inflows of resources (lessors and transferors).

- Periods covered by arrangements (the arrangement term) = noncancelable period + periods covered by one party's (unilateral) option to extend, if extension is reasonably certain + periods covered by one party's option to terminate, if termination is reasonably certain *not* to occur.
- Combination of multiple arrangements entered into between the same parties in a similar timeframe

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and for similar purposes, where the provisions of the agreements may be interdependent.

- Similar recognition and measurement for arrangement modifications and terminations.
- Separation of components — and recognition of multiple arrangements — if a single agreement includes, for example, underlying assets of significantly different types or for different terms, or includes both capital asset use and service components (more on this in a moment).
- Similar note disclosures, including capital asset disclosures of right-to-use assets and schedules of principal and interest payments similar to long-term debt but exempt from the disclosures specific to liabilities meeting the definition of debt (GASB Statement No. 88).

PPPs may seem, at first blush, to be the most unlike the others (leases and SBITAs), predominantly in that the purpose of a PPP must include the provision of public service. Other significant differences include that the ownership of the underlying asset may rest with either party during the term of the arrangement and the more limited sense in which an operator may control an underlying asset (controlling, possibly, only the *operation* of that asset rather than the broader control of its *use*).

However, SBITAs are the exception in that, as a practical matter, they are the *least closely* connected to one or more specific, *tangible capital assets*.⁷ While GASB has proposed that a lease agreement may provide for the right of substitution of an underlying asset by a lessor, it would have to be an identical

asset.⁸ For a SBITA, on the other hand, it is conceivable — and even expected — that as technology advances, not only will new versions of software be used by vendors providing cloud computing services to governments, but new generations of hardware as well.⁹ Moreover, the same underlying hardware and software in a SBITA may be used concurrently by multiple customers of a SBITA vendor. This again is in contrast to leases, where GASB has proposed that a lessee must be the only party able to “access and use” and must be able to “prevent others from accessing, using or altering” the underlying asset.¹⁰

As the names software-as-a-service, platform-as-a-service, and infrastructure-as-a-service imply, the service components, rather than the use of either the underlying software or hardware, are often the predominant character of the arrangements. While cloud computing arrangements may be a viable substitute for ownership of underlying assets, similar to the way in which a real property or equipment lease is, cloud computing arrangements are intended not merely to stand in for such assets, but to obviate the need for much in-house staffing and expertise to maintain the IT operations as well, and to mitigate some of the risk of technological obsolescence that arises with ownership. In this way, the SBITA is substantively different from leases and PPPs.

Moreover, as mentioned above, treating service elements of arrangements as completely distinct from the rights to use underlying capital assets is characteristic of all three types of arrangements. Thus, the SBITA accounting and financial reporting is rooted in the

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assumption that service components can be separately identified and that the subscription payments can be reliably allocated between asset use and services in a way that is reflective of their relative economic value. But such componentization is, as a practical matter, usually far from obvious.

The difficulty of distinguishing the service and asset-use components of SBITAs, as well as the somewhat tenuous connection to specific underlying hardware and software, may call into question the reliance on the conceptual framework of leases for these arrangements. Nonetheless, a key result of this approach — the capitalization and resulting deferral of implementation costs that will benefit a government over the full term of a cloud computing agreement — appears both conceptually and practically sound.

The forgoing musing notwithstanding, please note that GFOA has not yet taken a position on the SBITA or PPP EDs, nor developed comments to be shared with GASB. The comment period for the SBITA ED ends August 23, 2019 and the comment period for the PPP ED ends September 13, 2019. ■

Notes

1. More complete discussions of the SBITA and PPP EDs can be found in the May 2019 and June 2019 issues of GFOA's *GAAFR Review* newsletter, respectively.

2. This statement is from the perspective of the user (lessee, government, operator) of the underlying assets.
3. If a SBITA is like a lease, capitalizable implementation costs can be analogized to leasehold improvements. Current guidance on internally-generated software is found in Governmental Accounting Standards Board *2018-2019 Codification of Governmental Accounting and Financial Reporting* (GASB Cod.) Section (Sec.) 1400, “Reporting capital assets,” paragraphs .144 — .150, sourced from GASB Statement No. 51.
4. Current SCA guidance is found in GASB Cod. Sec. S30, “Service Concession Arrangements.”
5. APAs are arrangements “in which a government compensates an operator for activities that may include designing, constructing, financing, maintaining, or operating an underlying infrastructure or other nonfinancial asset for a period of time in an exchange or exchange-like transaction. The payments by the government are based entirely on the asset’s availability for use rather than on tolls, fees, or similar revenues or other measures of demand” (PPP ED, paragraph 7). Depending on the structure and content of an APA, the PPP ED proposes that it will be accounted for either as a financed acquisition of the underlying capital asset or as a service contract.
6. The current requirement that the public service must relate to the primary function of the underlying asset (GASB Cod. Sec. S30, footnote 2) is not proposed to be carried forward in the PPP ED.
7. Even a lease-back or other sub-lease arrangement, where the underlying asset is itself an intangible right-to-use lease asset, is clearly identified with the specific, tangible capital asset that underlies the initial lease.
8. See forthcoming leases implementation guidance from GASB. Question 4.4 of GASB’s Exposure Draft, Proposed Implementation Guide, *Leases* (GASB Leases IG ED).
9. It is notable that governments in SBITA may not even know when hardware upgrades are made by SBITA vendors.
10. GASB Leases IG ED, question 4.10 and 4.11.

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