

Implement GASB 87 Leases

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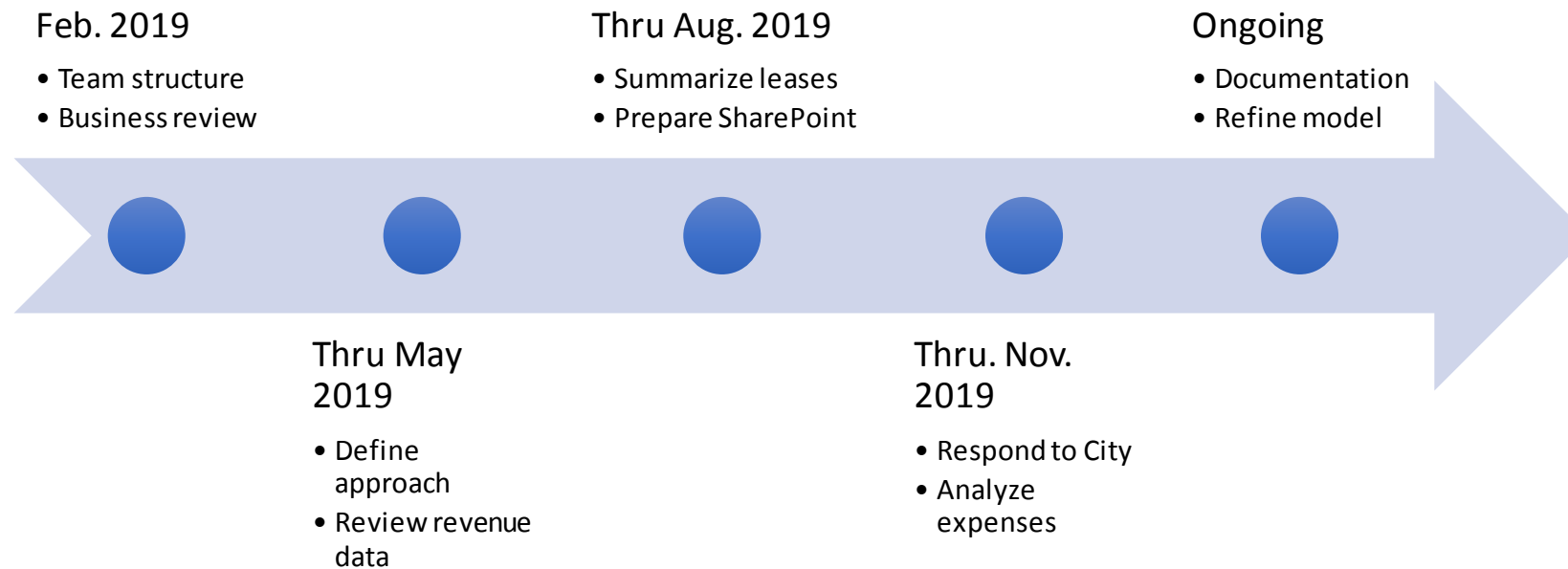
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Approach to GASB 87 Implementation is similar at most airports



SFO is able to deal with challenges by starting in early 2019



Decentralized lease management forms a major challenge for GASB 87 Implementation

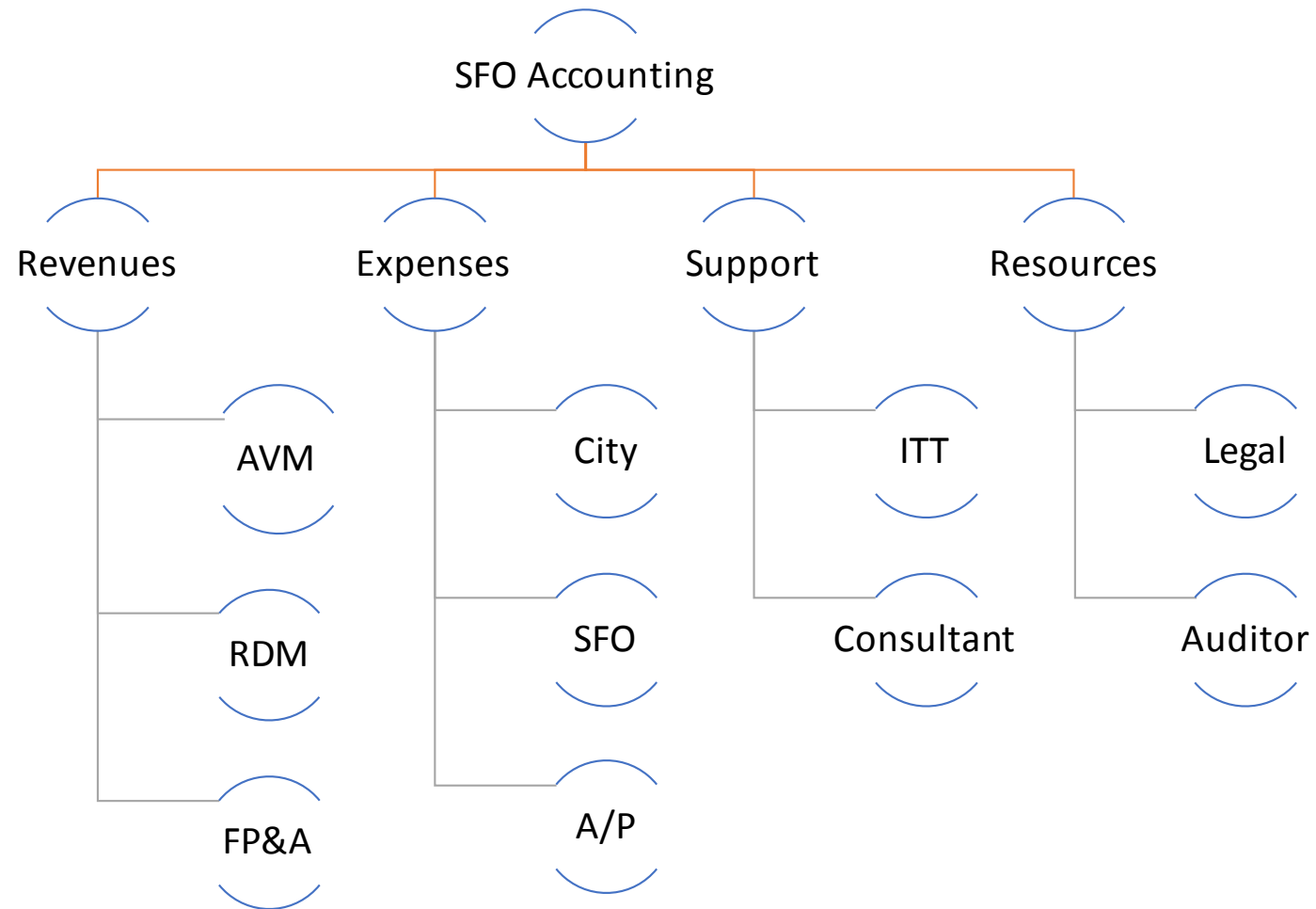
Revenues

- Leases
 - Aviation Management (AVM)
 - Revenue Development Management (RDM)
- Permits
 - Ground Transportation
 - IT
 - Security access
 - AVM and RDM
- Other exceptions (MOUs)

Expenses

- Agreements
 - City procurement: city-wide contracts
 - SFO contract management: professional services
 - Tech Market: IT related services
- Purchase orders without agreements
- Direct purchases

SFO GASB 87 Lease Team Structure



Two-step rental payment structure causes ongoing logistic issue

Sample Timeline

3/1/19

- SFO executes a lease with lessee
- Lease effective date

6/1/19

- SFO transfers space to lessee
- Lease commencement date

12/1/19

- Lessee starts operation and pays rent
- Rent commencement date

Implications

- The lessee gains full control of the space on the lease commencement date, which is the date recognized by GASB 87
- However, when SFO executes the lease, the lease commencement date and rent commencement date are unknown
 - Staff must go back to the lease and stamp both dates
 - The lease has no payment in FY 2019, so doesn't show in revenues
 - Assumptions made on 7/1/19 need to be revised

Step 1: Identify All Agreements

Revenues

- Two approaches can be used to identify revenue agreements:
- Analyzing revenue details from accounting system
- Discussing with key departments to identify internal files, such as lease master
- Additional conversation with key staff is also recommended
- An airport needs to demonstrate to the auditor that it has established a systematic approach, rather than identifying a set of selected leases

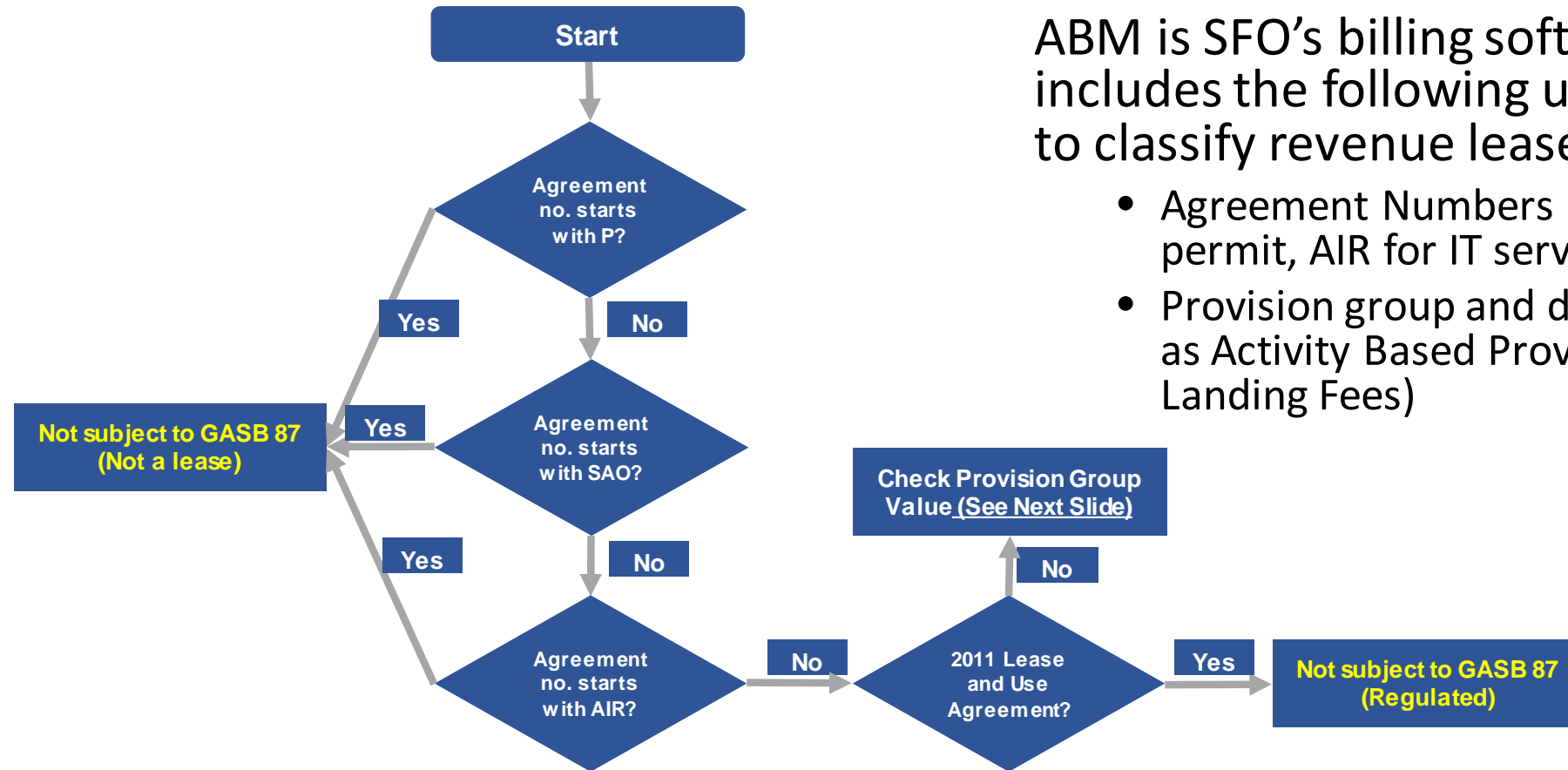
Expenses

- Similarly, accounting data are key sources for identifying expense agreements
- In addition to rental expenses, most service agreements need to be examined due to the concept of embedded leases
- If an airport obtains service capacity and determines the manner and use of an asset, the agreement may have an embedded lease. An example is a contract to obtain shuttle bus services, where an airport determines the route and frequency.

Step 2. Classify Leases

- In this step, an airport attempts to classify all agreements based on accounting data, and exclude those categories not subject to GASB 87
 - Examples for revenue exclusions: all agreements issued by ground transportation unit, because those are for airport access only, i.e., taxi firms can't dictate lane striping
 - Examples for expense exclusions: all financial services agreements issued by accounting/finance, because those are not tied to physical assets
- For remaining agreements, this step aims to:
 - Exclude agreements that are not leases
 - Not conveying right of control of the underlying asset
 - Exclude leases that are not GASB 87 leases
 - Regulated
 - Short-term
 - Non-exchange
 - Exclude revenue categories that are not subject to GASB 87
 - Variable payment provision
 - Monthly fees

SFO uses the following procedure to analyze revenue data



ABM is SFO's billing software and includes the following useful data to classify revenue leases:

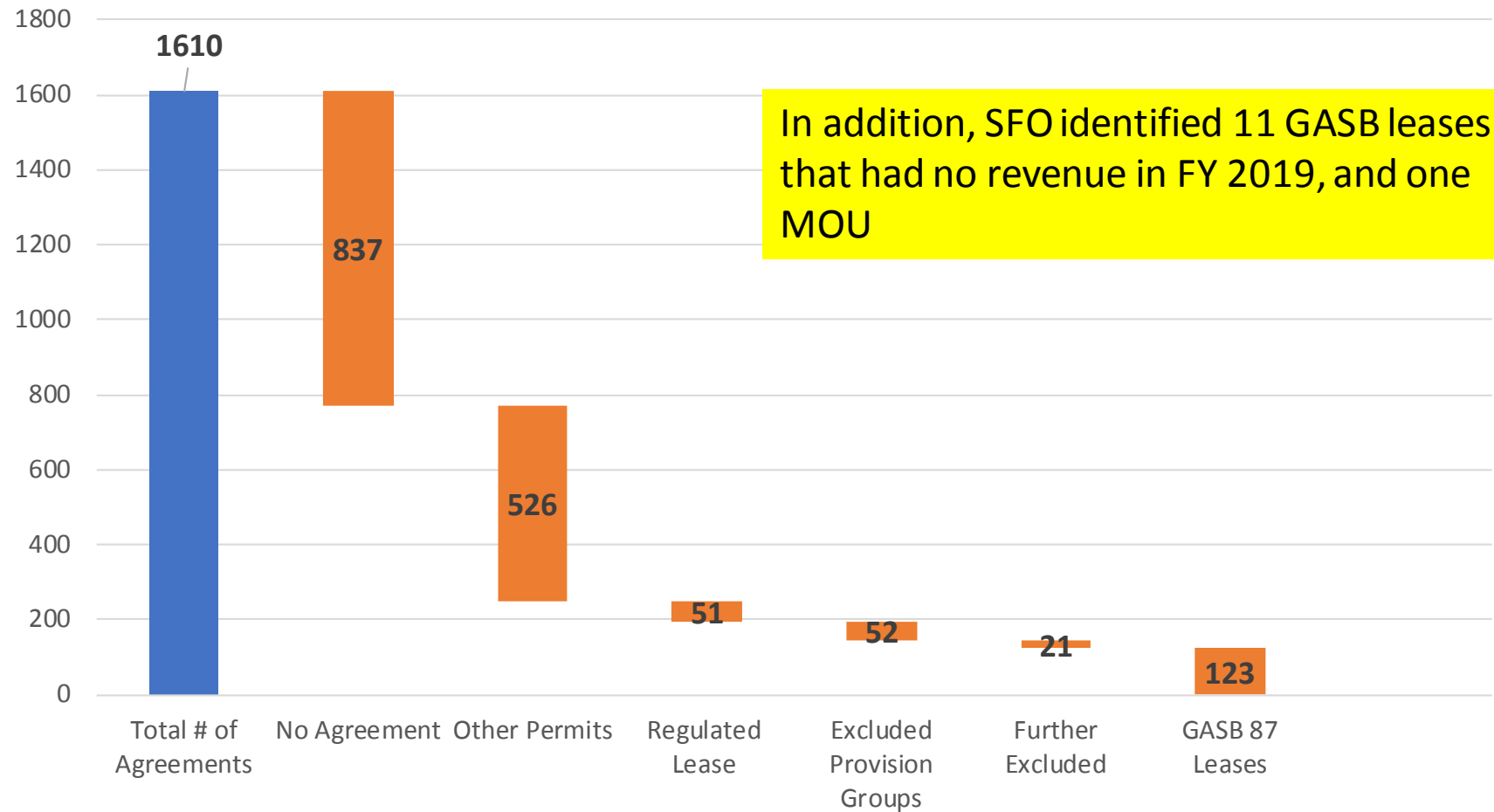
- Agreement Numbers (P for permit, AIR for IT services, etc.)
- Provision group and details (such as Activity Based Provisions -> Landing Fees)

Excluding certain provision groups allows SFO to narrow the scope of analysis

Provision Group	Decision	Reason
Activity Based Provision	Not subject to GASB 87	Variable payment (% rental)
Airline Statistics	Not subject to GASB 87	Regulated lease
BART Rent	Subject to GASB 87	
General Provisions	Subject to GASB 87	
Government Rental Space	Subject to GASB 87	Some are non-exchange and will be excluded
Information Technology Services	Not subject to GASB 87	Not a lease (adjustment, only 3 ITT agreements)
Minimum Annual Guaranty	Subject to GASB 87	
Monthly Fees	Not subject to GASB 87	Not a lease (maintenance fee, cleaning fee, etc.)
Nonterminal Rental Space	Subject to GASB 87	
Other Fees	Not subject to GASB 87	Not a lease
Terminal Rental Space	Not Subject to GASB 87	Review airline vs. nonairline
Utility Services	Not subject to GASB 87	Not a lease
Blank	Not subject to GASB 87	Miscellaneous

Details under excluded groups are reviewed nevertheless, since this is the first year of implementation.

Based on FY 2019 accounting data, SFO identified 123 GASB 87 revenue leases



Analyzing expense data is more challenging

Challenges

- Unlike revenue leases that are generally similar, expense agreements are all different
- All expenses under an agreement are typically included as one line item, unlike revenues, which are recorded under provisions
- The concept of embedded lease requires SFO to examine most expense agreements
- There are fixed term, infinite quantity contracts such as equipment rental

Approach

- **Collaboration of multiple departments:**
 - A/P
 - City procurement
 - SFO contract management
 - IT
 - Other departments
- **Analytical questions**
 - Does an agreement involve equipment or other asset?
 - If yes, does SFO own the asset?
 - If no, does SFO determine the manner and use of the asset?
- More than two dozen agreements are identified for further review

Step 3. Review Lease Details

For the leases needed to be examined, the following information will be extracted:

- Information to determine lease term
 - Lease commencement date, rent commencement date, expiration date, term of the lease, options to extend or cancel
- Information to determine rent amount
 - Fixed payments, variable payments that are fixed in substance, payment escalation clause, residual value guarantee, lease incentives, payments received in advance, initial direct cost such as delivery and installation fee (Guide Illustration B1)
- Information to determine additional exclusion criteria
 - Underlying asset type, whether the lease transfers ownership
- Other information to determine if a lease needs special treatment under GASB 87
 - Whether a lease is between related parties, lease-leaseback transaction

Steps 4 and 5. Select software/model, and monitor

Software/Model

- When software solutions are available, SFO will evaluate options
- One concern is whether those software solutions can be integrated into existing accounting software
- Nevertheless, SFO plans to use an Excel version as an interim solution before a commercial software is adopted
- Initial lease asset will be calculated, and crosscheck with actual payments throughout the year

Monitoring

- Evaluating FY 2019 historical results is straightforward, but ongoing monitoring is complicated
 - New leases, which could be generated from two departments
 - Changes in lease assumptions: commencement date and renewal option
 - Changes in leased space and other amendments
 - Discount rate and other factors for potential re-measurement

Steps 6. Review preliminary results

Revenues

- The Commission estimates that the lease asset as of July 1, 2018 is approximately \$784 million. Numbers are surely to change after discount rate discussion.
- Duty free contract accounts for more than half of the lease asset, due to long term and comparatively high minimum annual guarantee
- Lease asset is expected to go much higher after the Commission awards the next batch of rental car contracts, which are month-to-month now

Expenses

- The Commission estimates that the lease liability is less than \$1 million
- This amount is lower than expected, because many copier agreements have variable terms and amounts, which are being reviewed
- The Commission is also waiting to see industry treatment regarding construction contracts

Some interesting issues we have encountered

- Leases
 - Antenna?
 - Embedded leases: Stericycle
- Regulated leases
 - ACI-NA whitepaper: using office for ticket reservation center does not fall under regulated leases
 - Some judgements are required:
 - TSA office
 - FBI/DEA office
 - Postal service
 - Easement
- Payment
 - Fair market value is considered fixed in substance
 - How about terminal rental rate that is recalculated annually?
- Discount rate
 - Lessor's incremental borrowing rate: reasonable to evaluate future payments
 - Lessor's historical borrowing rate: reasonable to reflect cost recovery and cost of assets to be recovered

Questions?

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