

CHAPTER FOUR: ORGANIZATION, FUNCTIONS AND GENERAL PROVISIONS

SUBCHAPTER 4.05: Lease and Subscription Capitalization Policy

4.05.010 Purpose

The purpose of this policy is to establish the criteria and procedures for recognizing lease and subscription assets and liabilities on the balance sheet, as required by the Governmental Accounting Standards Board (GASB) Statements No. 87 and 96.

The policy applies to all lease and subscription agreements that contain lease or subscription components entered by The Town of Colma.

4.05.020 Definition

A lease is a contract, or part of a contract, that conveys the right to control the use of an identified asset (property, plant, or equipment) for a period in exchange for consideration. The lessee is the party that obtains the right to use the asset. The lessor is the party that owns the asset and makes it available for use by the lessee. GASB 87 is for capitalization of leases.

A subscription-based information technology arrangement (SBITAs) is a contract that gives the right to use another party's IT software for a set period of time. SBITAs is also known as GASB 96.

4.05.30 Capitalization

The Town of Colma will adopt a capitalization threshold of \$50,000 for leases and subscriptions with a term greater than 12 months. This means leases and subscriptions with an initial value of payments below \$50,000 will not be recognize on the balance sheet. This threshold was based on the materiality of leases and subscriptions recommended by The Town of Colma auditors.

If a lease or subscription is capitalized, The Town of Colma will recognize a right-of-use asset and a lease or subscription liability on the balance sheet at the commencement date of the contract or agreement. The right-of-use asset will be measured at the amount of the lease or subscription liability plus any initial direct costs incurred by the Town of Colma. The lease or subscription liability will be measured at the present value of the payments that are not paid at that date, discounted using the interest rate implicit in the lease or, if that rate cannot be readily determined, The Town of Colma incremental borrowing rate.

The Town of Colma will amortize the right-of-use asset over the lease or subscription term on a straight-line basis unless another systematic basis is more representative of the pattern of benefit. The Town of Colma will also recognize interest expense on the lease or subscription liability and reduce it by making payments.

The Town of Colma will present right-of-use assets and lease and subscription liabilities separately from other assets and liabilities on the balance sheet. Finance leases and subscriptions will be presented within property, plant and equipment and debt. Operating leases and subscriptions will be presented as separate line items. The Town of Colma will disclose information about its leases in the notes to the financial statements.

4.05.40 Procedure

The Town of Colma will follow these steps to implement this policy:

- Identify all existing and new contracts that contain leases/Subscriptions or potential leases/subscriptions.
- Evaluate whether each contract meets the definition of a lease under GASB 87 and whether it contains any embedded leases. Does the contract convey control of the right to use another entity's underlying asset? Is the underlying asset controlled for a period of time in an exchange or exchange like transaction? Does the contract transfer ownership of the underlying asset to the lessee by the end of the contract? Does the contract contain termination options? Does the contract contain a fiscal funding or cancellation clause that is reasonably certain of being exercised? Is the contract period over 12 months?
- Evaluate whether each contract meets the definition of a subscription under GASB 96. Does the subscription convey the right to use another party's IT software? Does the contract convey the right to use another party's IT software alone, or in combination with an underlying tangible capital asset? Is the contract a licensing arrangement that provides a perpetual license to use vendors software? Is the software controlled for a period of time in an exchange or exchange-like transaction? Is the contract period over 12 months?
- Apply the criteria for capitalizing leases/subscription to each identified lease/subscription and determine whether it should be recognized on the balance sheet or not based on the capitalization threshold.
- Measure and record right-of-use assets and lease and subscriptions liabilities at inception and subsequent periods for capitalized leases and subscriptions.
- Present and disclose leases in the financial statements according to GASB 87 for Leases and GASB 96 for subscriptions requirements.

This policy will be reviewed periodically for changes in facts and circumstances that may affect its appropriateness.