# GASB 87: Leases

An in depth look into GASB's new lease standard

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Create Opportunities

# Objectives

- Recognize the scope and effective date of GASB Statement No. 87, “Leases”
- Demonstrate recognition, measurement and financial reporting requirements for lessee accounting
- Demonstrate recognition, measurement and financial reporting requirements for lessor accounting

# Background

## WHAT

– Revises existing lease standards on lease accounting and financial reporting (GASB 62)

## WHEN

– Effective for periods after December 15, 2019

## WHY

– Existing standards were dated

## WHO

– Governmental Lessees
  - ◊ Over 89,000 state and local governments, including states, counties, cities, ports, hospitals, universities, and special-purpose governments
  - ◊ Over 500 federally recognized tribal governments

– Governmental Lessors
  - ◊ ~ 390 primary commercial airports, sports stadiums, tribal casinos, ports and marinas. utilities' power poles

# Transition

- Apply retroactively
- Restate if practicable, cumulative effect if not
- Leases recognized and measured using the facts and circumstances that exist at the beginning of the period of implementation (hindsight)
- Lessors should not restate the assets underlying their existing sales-type or direct financing leases. Any residual assets for those leases would become the carrying values of the underlying assets

# Definition of a Lease

- A contract that conveys control of the right to use another entity's nonfinancial asset (underlying asset) as specified by the contract for a period of time in an exchange or exchange-like transaction
- Control requires both of the following:
  - (1) the right to obtain the present service capacity from use of the underlying asset, and
  - (2) the right to determine the nature and manner of use of the underlying asset
- Control applied to the right-to-use lease asset (a capital asset) “specified in the contract”
  - Control criteria NOT limited to contracts that convey substantially all of the present service capacity from use of the underlying asset
    - ◊ Right-to-use lease assets include rights to use underlying assets for portions of time, such as certain days each week or certain hours each day

# Exclusions from Scope

- Intangible assets (mineral rights, patents, software, copyrights) - except for the sublease of an intangible right-to use asset
- Biological assets (including timber, living plants, and living animals)
- Inventory
- Service concession arrangements (GASB 60)
- Assets financed with outstanding conduit debt unless both the asset and conduit debt are reported by lessor
- Supply contracts, such as power purchase agreements

***Scope exclusions are carried forward from GASB 62 because of the unique features and complexities associated with those types of transactions***

# Unified Reporting Model for Leases

- No classification of leases into operating/ capital or other categories
- Underlying assumption that leases are financings
- Exceptions (lessors and lessees)
  - Short-term leases
  - Leases that transfer ownership and do not contain termination options
- Exceptions for lessors
  - Leases of assets that are investments
  - Certain regulated leases (e.g. airport-airline agreements)

# Lease Term

- Starts with the noncancelable period, plus periods covered by lessees' and lessors' options to:
  - Extend the lease, if the option is reasonably certain of being exercised
  - Terminate the lease, if the option is reasonably certain of NOT being exercised
- Excludes "cancelable" periods
  - Periods for which lessee and lessor each have the option to terminate or both parties have to agree to extend
    - Rolling month-to-month leases
- Fiscal funding/cancelation clauses ignored unless *reasonably certain* of being exercised

Example: "The term of this Agreement begins on the date of delivery of the Equipment and ends on the later of the last day of the Minimum Lease Term ("Term") or the Extension Period (as herein defined). At the end of the Term, this Agreement is extended on a month-to-month basis until the Equipment is returned to the Lessor (the "Extension Period"). During the Extension Period the Lessor has the right to, on 30 days notice, increase the rate per month . . . . After the end of the Term either party can terminate this Agreement on 30 days written notice."

# Reassessment of the Lease

- Reassess the lease term only if one or more of the following occurs:
  - Lessee or lessor elects to exercise an option even though originally determined that the lessee or lessor would not exercise that option
  - Lessee or lessor elects to not exercise an option even though previously determined that the lessee or lessor would exercise that option
  - An event specified in the contract that requires an extension or termination of the lease takes place.

# Short Term Leases

## Definition and Exception

- A short-term lease is one that, at the beginning of the lease, has a “maximum possible term” under the contract, including any options to extend, of 12 months or less
- Practicality exception for short-term leases
- For a lease that is cancelable either by the lessee or lessor, such as month-to-month or year-to-year leases, the maximum possible term is the noncancelable period including any notice period

## Accounting

- **LESSEE** — lease payments recognized as expenses/expenditures based on the payment provisions of the contract
  - No recognition of assets or liabilities associated with the right to use the underlying asset for short-term leases
- **LESSOR** — lease payments recognized as revenue based on the payment provisions of the contract
  - No recognition of receivables or deferred inflows associated with the lease
- No resource flows recognized during rent holiday periods
- No required disclosures

# Lessee Accounting and Reporting

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# Initial and Subsequent Reporting - Lessee

| | Assets | Liability | Deferred Inflow |
|---|---|---|---|
| **Initial Reporting** | Intangible asset (right to use underlying asset)—value of lease liability plus prepayments and initial direct costs that are ancillary to place asset in use | Present value of future lease payments (incl. fixed payments, variable payments based on index or rate, reasonably certain residual guarantees, etc.) | N/A |
| **Subsequent Reporting** | Amortize the intangible asset over shorter of useful life or lease term | Reduce by lease payments (less amount for interest expense) | N/A |

# Recognition and Measurement - Lessee

- Recognize a liability for future lease payments and an intangible capital asset for the right to use the underlying asset (the “lease asset”)
- In governmental funds:
  - Report payables when due
  - Don’t report capital assets

**Lease liability = present value of payments expected to be made during the lease term.**

# Initial Measurement - Lessee

- Initial measurement of a lease liability includes:
  - Fixed payments (less lease incentives receivable from lessor)
  - Variable payments based on an index or rate (such as CPI), using the rate as of the beginning of lease
  - Variable payments that are fixed in substance
  - Residual value guarantees *reasonably* certain of being required
  - Purchase options *reasonably* certain of being exercised
  - Termination penalties, if lease term reflects lessee exercising termination options/fiscal funding clauses
  - Any other *reasonably* certain payments
- Lease liability does not include lease payments that are dependent on a lessee's performance or usage of an underlying asset
- Lease liability payments discounted using the rate the lessor charges the lessee (may be implicit) or, if that rate cannot be readily determined, the lessee's incremental borrowing rate

# Subsequent Measurement - Lessee



- Lease liability reduced for actual payments less amortization of discount on lease liability (interest expense)

EXAMPLE

| | | |
|---|---|---|
| Interest Expense | $5,000 | |
| Lease Liability | $20,000 | |
| Cash | | $25,000 |

*(To record cash payment, interest expense, and reduction of liability.)*

- Remeasure lease liability when certain changes occur (if expected to significantly affect liability measurement)
- If liability remeasured
  - Adjust liability for change in variable payments index/rate
  - Update discount rate when certain other judgments change
- Adjustments to the lease liability generally should adjust the lease asset by the same amount
  - Exception if adjustment is greater than carrying value of asset, difference is recognized in the flows statement

# Lease Asset - Lessee



## Lessee's right-to use asset

- Initially measure lease asset as the sum of:
  - a. Initial lease liability
  - b. Any prepayments (amounts paid for the lease prior to measuring the lease liability)
    - i. Less any incentives received from the lessor
  - c. Initial direct costs that are necessary ancillary charges to place the leased asset into use
    - i. Other initial direct costs (e.g., insurance, legal, administrative) should be expensed

# Lease Asset – Lessee, cont'd



## Lease asset subsequent recognition and measurement

- Lease asset amortized (e.g., amortization expense) using a systematic and rational manner over the shorter of the useful life of the underlying asset or the lease term
  - Lease asset amortization may be combined with depreciation expense for other capital assets
  - If the lease has a purchase option which is reasonably certain of being exercised, amortize over the useful life of the underlying asset as if the lessee owns the underlying asset, using the lessee's depreciation policy, unless non-depreciable.
- Lease asset generally adjusted by the same amount as lease liability.
  - If this change reduces the carrying value of the lease asset to zero, any remaining amount is a gain
  - If the underlying asset becomes impaired, apply capital asset impairment guidance of Statement 42 to the right-to- use lease asset

# Exercise 1 – Temporary Building Lease (Lessee)

- ✓ Lease starts 1/01/21 for 60 months; $1,000 monthly payment due 1st of each month
- ✓ After 60 months, on month-to-month basis until building is returned
- ✓ During month-to-month period rate can be adjusted upward based on CPI with 30 days' notice to Lessee
- ✓ If building is declared a total loss Lessee will pay $39,000 equipment value, at which time Lessee will become the owner
- ✓ Lessee pays Lessor $2,000 initial set-up cost ($400 freight, $1,600 block and level labor) and will pay $1,700 dismantle cost ($400 freight, $1,300 labor to knock down) at end of lease
- ✓ Discount rate (provided by Lessor) is 3%

# Exercise 1 – Calculations (Lessee)

Present value of $1,000 monthly payments for 5 years (60 months):

= PV Rate = .0025 (3% per year / 12 months to get rate per month)

NPer (number of periods) = 60

Pmt (monthly payment) = $1,000

FV (future value) = 0

Type = 1 if payments are made at beginning of period, 0 if made at end of period

= $55,791

Total (for both the intangible asset and lease liability)

$55,791 + $2,000 set-up cost = $57,791

What about $1,700 dismantle fee?

# Exercise 1 – Journal Entries - January 1 (Lessee)

- **Governmental funds**

| | | |
|---|---|---|
| Dr. Building rental expenditure | $57,791 | |
| Cr. Other Financing Sources | | $57,791 |
| *(To record capital expenditures and related financing from lease or temporary building)* | | |
| Dr. Redemption of principal | $2,000 | |
| Cr. Cash | | $2,000 |
| *(To record payment of set-up cost for leased temporary building)* | | |

# Exercise 1 – Journal Entries - January 1 (Lessee)

- **Government-wide and proprietary funds**

| | | |
|---|---|---|
| Dr. Leased buildings | $57,791 | |
| Cr. Lease liability | | $57,791 |
| *(To record capital asset and related liability from lease or temporary building)* | | |

| | | |
|---|---|---|
| Dr. Lease liability | $2,000 | |
| Cr. Cash | | $2,000 |
| *(To record payment of set-up cost for leased temporary building)* | | |

# Exercise 1 - Twelve monthly payments (Lessee)

1. Set up an interest amortization schedule for each month

2. Divide the $1,000 monthly payment into interest and principal

   (Debit redemption of principal and interest expenditure and credit cash)

3. Total amounts for the first year:

| | |
|---|---|
| Redemption of principal | $10,613 |
| Interest | 1,387 |
| Total | $12,000 |

(excluding $2,000 set-up payment)

# Exercise 1 - Twelve monthly payments (Lessee)



## Governmental funds

| | | |
|---|---|---|
| Dr. Redemption of principal | $10,613 | |
| Dr. Interest expenditure | $1,387 | |
| Cr. Cash | | $12,000 |
| *(To record 12 monthly lease payments for first year)* | | |

## Government-wide and proprietary funds

| | | |
|---|---|---|
| Dr. Leases payable | $10,613 | |
| Dr. Interest expense | $1,387 | |
| Cr. Cash | | $12,000 |
| *(To record 12 monthly lease payments for first year)* | | |

# Exercise: Journal Entries to Convert Governmental Funds to Government-wide (Lessee)

| | | |
|---|---|---|
| Dr. Other financing sources | $57,791 | |
| Cr. Lease liability | | $57,791 |
| *(To reclassify building lease payable)* | | |

| | | |
|---|---|---|
| Dr. Leased buildings | $57,791 | |
| Cr. Building rental expenditure | | $57,791 |
| *(To reclassify right to use leased building)* | | |

| | | |
|---|---|---|
| Dr. Redemption of principal | $12,613 | |
| Cr. Lease liability | | $12,613 |
| *(To reclassify monthly lease payments and set up cost)* | | |

# Exercise: Journal Entries – December 31 (Lessee)

## Government-wide and proprietary funds



| | | |
|---|---|---|
| Dr. Amortization expense | $11,558 | |
| Cr. Accumulated amortization | | $11,558 |
| *(To record amortization of right to use leased building [57,791/5])* | | |

| | | |
|---|---|---|
| Dr. Interest expense | $113 | |
| Cr. Interest payable | | $113 |
| *(To accrue December interest on leased temporary building)* | | |

# Lessee - Disclosures



1. A general description of leasing arrangements, including
   a. Basis, terms, and conditions, on which variable lease payments are determined
   b. Existence, terms, and conditions, of residual value guarantees provided by the lessee

2. Total amount of assets recorded under leases, and the related accumulated amortization, disclosed separately from other capital assets
3. Lease assets disaggregated by major classes of underlying assets, disclosed separately from other capital assets
4. Variable lease payments recognized during the period but not previously included in the lease liability
5. Other payments recognized during the period but not previously included in the lease liability (such as residual
value guarantees or penalties)
6. A maturity analysis of all future lease payments
   a. Payments for each of the first five years
   b. Payments in five-year increments thereafter
   c. Show principal and interest separately
7. Lease commitments, other than short-term leases, for which the lease term has not yet begun
8. Components of any net impairment loss (gross impairment loss less change in lease liability)

# Lessee – Capital Asset Note Disclosure

| | Beginning Balance | Increases | Decreases | Ending Balance |
|---|---|---|---|---|
| Capital assets not being depreciated | | | | |
| Land | $ 12,038,276 | $ - | $ (4,280) | $ 12,033,996 |
| Construction in progress | 31,222,996 | 12,890,833 | (30,025,559) | 14,088,270 |
| Total capital assets not being depreciated | 43,261,272 | 12,890,833 | (30,029,839) | 26,122,266 |
| | | | | |
| Other capital assets | | | | |
| Buildings and improvements | 240,126,741 | 30,072,509 | (1,949,759) | 268,249,491 |
| Equipment and fixtures | 26,200,540 | 2,239,879 | (31,254) | 28,409,165 |
| Leased buildings | 636,731 | 57,791 | - | 694,522 |
| Leased equipment and fixtures | 5,005,414 | - | - | 5,005,414 |
| Total other capital assets at historical cost | 271,969,426 | 32,370,179 | (1,981,013) | 302,358,592 |
| Less accumulated depreciation for | | | | |
| Buildings and improvements | (67,806,215) | (7,317,012) | 1,579,277 | (73,543,950) |
| Equipment and fixtures | (18,380,429) | (2,365,552) | 31,254 | (20,714,727) |
| Less accumulated amortization for Leased assets | (1,938,346) | (1,105,860) | - | (3,044,206) |
| Total accumulated depreciation and amortization | (88,124,990) | (10,788,424) | 1,610,531 | (97,302,883) |
| Other capital assets, net | 183,844,436 | 21,581,755 | (370,482) | 205,055,709 |
| Capital assets, net | $ 227,105,708 | $ 34,472,588 | $ (30,400,321) | $ 231,177,975 |

# Lessee – Lease Liability Note Disclosure

| Year Ending Dec. 31 | Principal Payments | Interest Payments | Total |
|---|---|---|---|
| 2022 | $ 1,522,550 | $ 141,188 | $ 1,663,738 |
| 2023 | 1,343,745 | 111,951 | 1,455,696 |
| 2024 | 1,375,985 | 81,825 | 1,457,810 |
| 2025 | 1,421,848 | 50,151 | 1,472,000 |
| 2026 | 11,807 | 163 | 11,970 |
| 2027-2031 | XXX | XXX | XXX |
| | $ 5,675,936 | $ 385,278 | $ 6,061,214 |

# LESSOR Accounting and Reporting

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# Initial and Subsequent Reporting - Lessor

| | Assets | Liability | Deferred Inflow |
|---|---|---|---|
| **Initial Reporting** | • Lease receivable (generally including same items as lessee liability)<br>• Continue to report leased asset | N/A | Equal to lease receivable plus any cash received up front that relates to a future period |
| **Subsequent Reporting** | • Depreciate leased asset (unless indefinite life or required to be returned in its original or enhanced condition)<br>• Reduce receivable by lease payments (less payment needed to cover accrued interest | N/A | Recognize revenue over the lease term in a systematic and rational manner |

# Lessor – Recognition and Measurement

- Recognize a lease receivable and deferred inflow of resources
- Do not derecognize the underlying asset and do not
- recognize a residual asset
  - Depreciate underlying asset as normal, unless required to be returned in its original or enhanced condition or has an indefinite useful life
- In governmental funds, report lease receivable and deferred
- inflow of resources
  - Recognize deferred inflow of resources as revenue when "available"

# Lessor - Initial Measurement



- Initial measurement of a lease receivable includes:
  - Fixed payments
  - Variable payments that depend on an index or rate (such as CPI) (Use the rate as of beginning of lease)
  - Variable payments that are fixed in substance (Exclude variable lease payments that are dependent on a lessee's performance or usage of an underlying asset
  - Residual value guarantees that are fixed in substance
  - Less provision for uncollectible accounts
- Discount the lease receivable using the rate the lessor charges the lessee
  - Interest rate may be implicit in the lease
- Initially excludes the following
  - Residual value guarantees that are not fixed in substance should be recognized as a receivable when: (1) Payment is required, and (2) Amount can be reasonably estimated
- Purchase option payments or termination penalties
  - Recognized when exercised

# Lessor – Deferred Inflow of Resources

- Deferred Inflow of Resources — Initial Measurement
  - Receivable amount, plus
  - Any cash received up front that relates to future periods (e.g., final month's rent)

- Recognize revenue in a systematic and rational manner over the term of the lease

# Lessor – Subsequent Recognition  Measurement

- Recognize amortization of the discount on the lease receivable (interest revenue) to produce a constant periodic rate of return on the receivable
- Lease payments allocated first to accrued interest receivable and then to the lease receivable
- Remeasure the lease receivable and update the discount rate when one or more of the following occur and are expected to significantly affect the receivable amount:
  - a. There is a change in lease term, or
  - b. There is a change in the rate the lessor charges the lessee
  - c. A contingency is resolved making variable payments fixed
- If remeasured, also remeasure for changes in an index/rate used to determine variable lease payments
- If the discount rate is updated, the receivable should be adjusted using the revised rate
- The deferred inflow of resources generally adjusted by the same amount as the lease receivable

# Exercise: Temporary Building Lease (Lessor)

- Lease starts 1/01/21 for 60 months; $1,000 monthly payment due 1st of each month
- After 60 months, on month-to-month basis until building is returned
- During month-to-month period rate can be adjusted upward based on CPI with 30 days' notice to Lessee
- If building is declared a total loss Lessee will pay $39,000 equipment value, at which time Lessee will become the owner
- Lessee pays Lessor $2,000 initial set-up cost ($400 freight, $1,600 block and level labor) and will pay $1,700 dismantle cost ($400 freight, $1,300 labor to knock down) at end of lease
- Discount rate (provided by Lessor) is 3%

# Exercise: Journal Entries – (Lessor)



## January 1

| | | |
|---|---|---|
| Dr. Lease receivable | $57,791 | |
| Cr. Deferred inflow or resources | | $57,791 |
| *(To record receivable and related deferred inflow from leasing)* | | |

| | | |
|---|---|---|
| Dr. Cash | $2,000 | |
| Cr. Lease receivable | | $2,000 |
| *(To record set-up fee)* | | |

## For first twelve monthly payments

| | | |
|---|---|---|
| Dr. Cash | $12,000 | |
| Cr. Lease receivable | | $10,613 |
| Cr. Interest income | | $1,387 |
| *(To record receipt of first 12 monthly lease payments)* | | |

# Exercise: Journal Entries – (Lessor) (cont'd)



## December 31

| | | |
|---|---|---|
| Dr. Deferred inflow of resources | $11,558 | |
| Cr. Lease income | | $11,558 |
| *(To record lease income)* | | |

| | | |
|---|---|---|
| Dr. Depreciation expense | $5,000 | |
| Cr. Accumulated depreciation | | $5,000 |
| *(To record annual depreciation on underlying asset)* | | |

| | | |
|---|---|---|
| Dr. Interest receivable | $113 | |
| Cr. Interest income | | $113 |
| *(To accrue December interest on lease receivable)* | | |

# Exclusions from lessor scope

The following transactions do not apply to general lessor recognition and measurement guidance (but still required to provide certain disclosures)

Leases of tangible that are investments (No lease receivable reported for leased investment assets because investments are reported at fair value)

Certain regulated leases (e.g. airport – airline agreements) Airport-airline agreements have features that don't operate like financings

# Lessor - Disclosures



## Lease activities may be grouped for disclosure purposes

1. A general description of leasing arrangements
   - The basis, terms, and conditions on which variable lease payments not included in the lease receivable are determined
2. The total amount of inflows recognized in the reporting period related to leases, if not displayed on face of financials
3. The lease inflows related to variable lease payments and other payments not previously included in the lease receivable
   - Include inflows related to residual value guarantees and termination penalties
4. If lease payments secure lessor's debt:
   - The existence, terms, and conditions of options by the lessee to terminate a lease or abate lease payments

A lessor should provide relevant disclosures for the following transactions, if applicable:

- Leases of assets that are investments (see paragraph 41)
- Certain regulated leases (see paragraph 60)
- Sublease transactions (see paragraph 81)
- Sale-leaseback transactions (see paragraph 85)
- Lease-leaseback transactions (see paragraph 87).

# Lessor - Disclosures



If government's principal ongoing operations consist of leasing to other entities:

- Disclose maturity analysis of all future lease payments included in lease receivable
  - Payments for each of the first five years
  - Payments in five-year increments thereafter
  - Show principal and interest separately

Similar disclosures required for certain regulated leases (for example, airport-airline agreements)

a. A general description of its agreements
b. The extent to which capital assets are subject to preferential or exclusive use by counterparties under agreements, by major class of assets and by major counterparty
c. The total amount of inflows of resources (for example, lease revenue, interest revenue, and any other lease-related inflows) recognized in the reporting period from these agreements
d. A schedule of expected future minimum payments under these agreements for each of the subsequent five years and in five-year increments thereafter
e. The amount of inflows of resources recognized in the reporting period for variable payments not included in expected future minimum payments
f. The existence, terms, and conditions of options by the lessee to terminate the lease or abate lease payments if the lessor government has issued debt for which the principal and interest payments are secured by the lease payments.

# Other Accounting & Reporting Provisions

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# Lease Incentives

- Lease Incentives—reduce the amount lessee has to pay
  - Payments made to, or on behalf of, the lessee, for which there is a right of offset
  - Other concessions
- Payments provided at or before inception of lease reported as
  - Direct reductions of lessee's lease asset
- Payments provided after inception of lease reported as
  - Reductions of payments for period provided
  - Reduces PV of lease liability (and lessor's receivable)

# Contracts with Multiple Components

- Separate contracts into lease and nonlease components or multiple lease components
- Allocate consideration to multiple underlying assets if:
  - Differing lease terms, or
  - Are in differing major asset classes for disclosure
- Allocation process:
  - First — use any prices for individual components if price allocation not unreasonable based on contract terms and professional judgment (maximizing observable information)
  - If no prices or if not reasonable, use best estimate based on professional judgment (maximizing observable information)
  - If not practicable to determine best estimate, may account for components as single lease unit

# Contracts Combinations



- Contracts entered into at or near the same time with the same counterparty should be considered part of the same lease contract if either of the following criteria is met:
  - The contracts are negotiated as a package with a single objective
  - The amount of consideration to be paid in one contract depends on the price or performance of the other contract
- Combined contract then subject to multiple components guidance

# Lease Modifications & Terminations

- Result from amendments to lease contract, not from exercising options in that contract

**MODIFICATIONS**

- Considered lease modification unless lessee's right to use underlying asset decreases

**TERMINATIONS**

- Considered partial or full lease termination if lessee's right to use underlying asset decreases

Report as **new lease** by both lessor and lessee if
- New assets are added and
- Not unreasonably priced
Otherwise, **remeasure** as discussed on following slides

# Lease Modifications – Lessees

- Remeasure the lease liability on the effective date of modification
  - Assess the need for an updated discount rate
- Adjust the right-of-use asset by the difference between the modified liability and the liability immediately before the modification
  - If asset reduced to $0, any additional reduction is reported as a gain
- If change results from the lessor refunding related debt and passing savings on to the lessee, see remeasurement guidance in paragraph 74

# Lease Modifications – Lessors

- Remeasure the lease receivable on the effective date of modification
  - Assess the need for an updated discount rate
- Adjust the deferred inflow of resources by the difference between the modified receivable and the receivable immediately before the modification
  - However, to the extent any change relates to payments for the current period, recognize in current period flows statement (for example, revenue)
- If change results from refunding related debt and passing savings on to the lessee, see remeasurement guidance in paragraph 76

# Lease Terminations – Lessees

- For partial/full lease terminations (other than purchases), lessees reduce/remove the lease asset and obligation
- Recognize the difference as a gain or loss
- If the lessee purchases the underlying asset, reclassify to the appropriate asset class
    - Adjust lease liability to reflect the payments yet to be made; reflect adjustment in cost of the purchased asset

# Lease Terminations – Lessors

- For partial/full lease terminations (other than sales), lessors reduce/remove the lease receivable and related deferred inflow of resources
- Recognize the difference as a gain or loss
- If the lessor sells the underlying asset, derecognize underlying asset
  - Include in the calculation of any gain or loss

# Subleases

- Accounted for as transactions separate from the original lease
  - Do not offset original lease liability and sublease receivable
- Disclosures for original lessee (now the lessor)
  - Include subleases in the general description of lease arrangements
  - Lessor transactions related to subleases should be disclosed separately from the original lessee transactions

# Sale-Leasebacks

- Qualifying sale required (otherwise it is a borrowing)
- Accounted for as two separate transactions—a sale transaction and a lease transaction—except that:
    - Any gain or loss on sale portion deferred and recognized over term of leaseback (but immediately recognize if leaseback is short-term
- If terms are significantly off-market, report based on the substance of the transaction, for example:
    - Borrowing, Nonexchange transaction, Advance lease payment
- Disclose terms and conditions of sale-leaseback

# Lease-Leasebacks



- Example: A school district leases land to a developer. The developer builds a school and leases the school and land back to the school district.
    - Accounted for as a net transaction (because of right of setoff)
    - Disclose (both parties)
        - Gross amounts of the lease and the leaseback

# Intra-Entity Leases

- Leases with/between blended component units
  - Eliminations for internal leasing activity take place before the financial statements are aggregated
- Leases with/between discretely-presented component units
  - Treat like normal leases, but
- Present receivables and payables separately

# Leases between Related Parties

- Recognize substance of the transaction, when substance is significantly different from legal form
  - For example, a short-term lease is long-term if parties have an understanding that lease will be extended several years
- Use equity method for investments in stock
- Disclose the nature and extent of related-party leases

# Implementation considerations



| Analyze existing lease contracts | Implement internal controls | Update information technology | Address potential changes |
|---|---|---|---|
| **Gather information/create an inventory for reporting and disclosure requirements from all departments** | **Verify and or implement internal controls are operating effectively to identify leases** | **Consider upgrading technology in order to track and monitor existing leases and future leases to efficiently extract information** | **Address potential changes in statutes and policies, debt limits and compliance with debt covenants that could be impacted** |

# Consider Technology to Manage Leases


Spreadsheets, especially to amortize the lease asset and schedule the principal and interest payments

Save lease documents as OCR (searchable) .pdf files and bookmark key lease provisions

Document imaging software
- Scan and index lease documents in one central place

Debt management software
- Automatically generates amortization schedules
- CAFR reporting
- Automatically creates journal entries

Data analytics to identify monthly disbursements in the same amounts

# Implementation Guide

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# Question 4.4



Q—A government enters into an agreement that allows a rancher to use the government's land for grazing. The agreement states that the rancher is required to allow access to the land for compatible public recreation activities. In addition, the agreement states that the government can construct roads and buildings, or otherwise alter the land, without permission from the rancher. Does the grazing rights agreement meet the definition of a lease?

A—No. The agreement does not convey the right to determine the nature and manner of use of the underlying asset because the rancher cannot prevent others from accessing, using, or altering the land. (See also Questions 4.3 and 4.11.)

# Question 4.5



Q—Do easements meet the definition of a lease?

A—An easement provides the right to use a tangible asset, for example, land. Some easements meet the definition of a lease, while other easements do not. Paragraph 4 of Statement 87 states that, among other things, a lease is “for a period of time in an exchange or exchange-like transaction” (footnote reference omitted). Permanent easements, which last indefinitely without cancellation options, do not meet the period-of-time criterion. In addition, easements obtained for an amount that does not meet the description of exchange or exchange-like transactions in Statement 33, as amended, do not meet the exchange or exchange-like criterion.

# Question 4.8

Q—Are cell phone tower or antenna placement agreements leases?

A—If the agreements meet the definition of a lease in paragraph 4 of Statement 87, including the control criterion, then such agreements are leases. The control criterion generally is met if a cell phone tower or antenna placement agreement conveys control of the right to use the land on which the tower is placed or the connection point to which the antenna is affixed.

# Question 4.17

Q—A government enters into a 12-month noncancellable lease in which the lessee has options to renew for 12 months at a time, up to 49 times. Is this agreement a short-term lease under Statement 87?

A—No. According to paragraph 16 of Statement 87, the maximum possible term of a short-term lease is required to be 12 months or less, including any options to extend. The presence of lessee renewal options, regardless of their probability of being exercised, means this lease does not meet the definition of a short-term lease.

# Question 4.18



Q—A government enters into a lease with a 6-month noncancellable period and an option to extend for another 12 months after the noncancellable period. The government is not reasonably certain that it will exercise the option to extend and, therefore, assesses the lease term as six months. Is this agreement a short-term lease under Statement 87?

A—No. Paragraph 16 of Statement 87 states that a short-term lease "has a maximum possible term under the lease contract of 12 months (or less), including any options to extend, regardless of their probability of being exercised." Therefore, the lessee should report a lease liability and a lease asset; however, the lease term would be only six months.

# Question 4.23

Q—A government adopts a capitalization threshold and expenses acquisitions, including lease assets, that fall below that threshold. Can the government apply a similar threshold to lease liabilities?

A—Lease liabilities that are significant, either individually or in the aggregate, should be recognized. Authoritative pronouncements do not provide specific guidance related to a determination of capitalization threshold amounts. However, governments often establish capitalization thresholds. (See Question 7.9.8 of Implementation Guide No. 2015-1.) When applying a capitalization threshold to leases, lessees should consider the quantitative and qualitative significance of the lease liability, in addition to the significance of the lease asset in accordance with the guidance provided in Question 7.4.1 of Implementation Guide 2015-1, as amended.

# Question 4.30



Q—A lessee installs physical assets on leased land and is required by the lease contract to remove those assets and restore the land to pre-lease condition at the end of the lease. Should the lessee include the obligation to remove the assets in the lease liability or should the lessee report an asset retirement obligation (ARO) under Statement No. 83, Certain Asset Retirement Obligations?

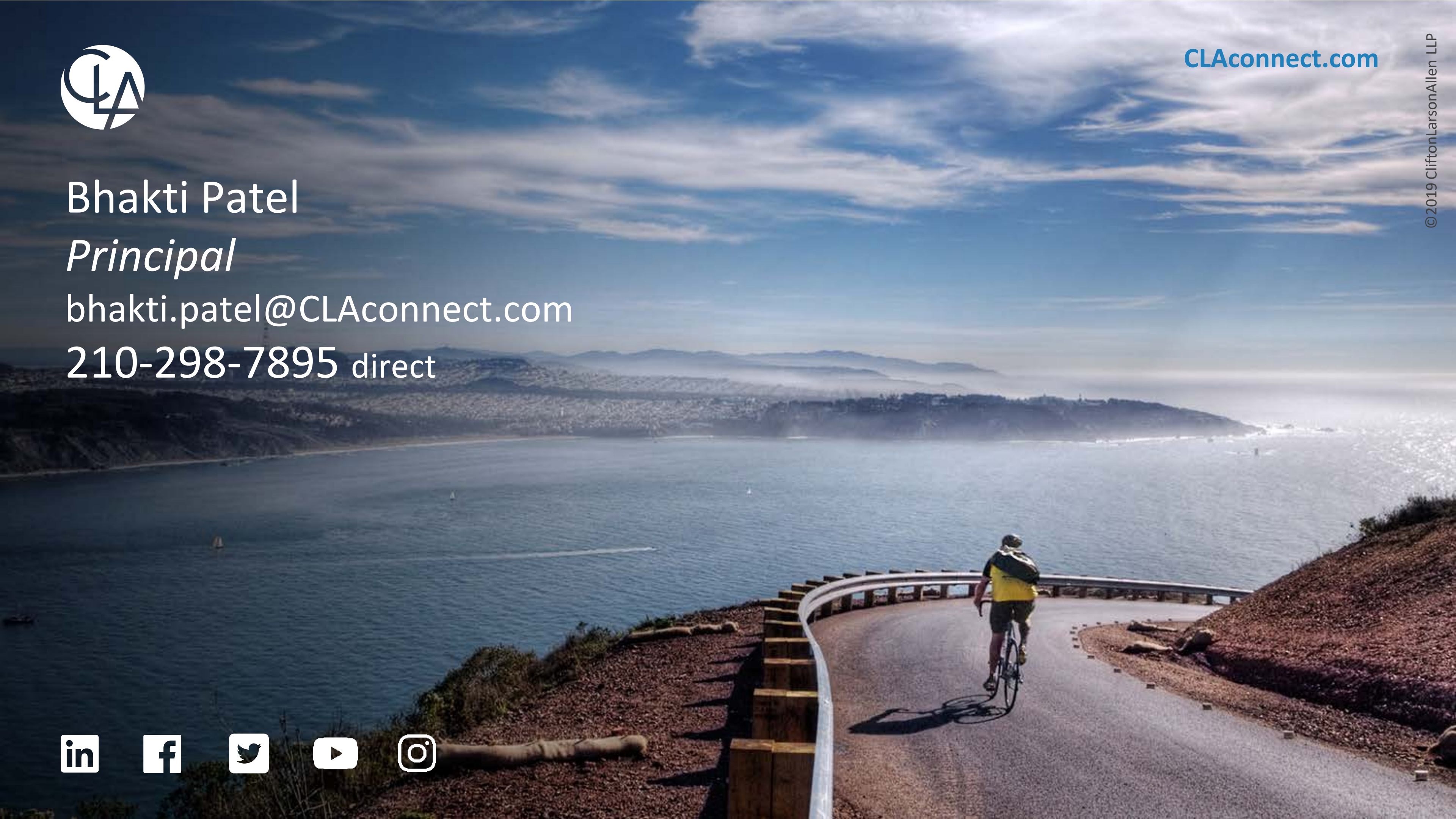
A—If the lessee is directly responsible for the restoration work, the lessee should report an ARO in accordance with Statement 83, separate from the lease liability. Paragraph 21h of Statement 87 requires that the lease liability include any other payments that are reasonably certain of being required based on an assessment of all relevant factors. However, that requirement does not include payments that are reasonably certain of being required from the lessee to parties other than the lessor, nor does it include payments that are not in exchange for the right to use the underlying asset.

# Question 4.53



Q—How should the lessor assess impairment of an underlying asset when the rights to that asset are controlled by the lessee and the lessor does not have physical access to the underlying asset?

A—Absent any indication of impairment from the lessee, or other impairment information known to the lessor, the lessor should not recognize any impairment of the underlying asset, in accordance with the provisions of Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries,* as amended. Paragraph 8 of Statement 42 states that "the events or changes in circumstances affecting a capital asset that may indicate impairment are prominent—that is, conspicuous or known to the government. Absent any such events or changes in circumstances, governments are not required to perform additional procedures to identify potential impairment of capital assets beyond those already performed as part of their normal operations."



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