GASB 87, *Leases*
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GASB 87, *Leases*

- **What**: Establishes a single approach to accounting for and reporting leases
- **Why**: Principle that leases are financings of the right to use an underlying asset
- **When**: Effective for reporting periods beginning after December 15, 2019; earlier application is encouraged
    - For June 30 year ends – fiscal year 2021

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GASB 87, *Leases*

- Guidance for lease contracts for nonfinancial assets
- Exclusions:
  - Nonexchange transactions
  - Lease of intangible assets
- Exceptions for:
  - Short-term leases
  - Financial purchases
  - Assets that are investments
  - Certain regulated leases

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GASB 87, *Leases*

- Also addresses accounting for:
  - Lease terminations and modifications
  - Sale-leaseback transactions
  - Non-lease components embedded in lease contracts (such as service agreements)
  - Leases with related parties

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GASB 87, *Leases, Major Changes*

- Classifications
- Leases beyond 12 months will have a balance sheet impact
  - Lessee will recognize a lease liability and an intangible asset for the right to use the leased asset, and the
  - Lessor will recognize a lease receivable, a deferred inflow of resources
  - Lessor will continue to depreciate and account for the lease asset

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GASB 87, *Leases Disclosure*

- Disclosures and schedules required
  - Contracts that transfer ownership
  - Non-short-term leases
- No disclosure requirement for short-term lease outflows

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Definition of a "Lease"

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- "A contract that conveys control of the right to use another entity's nonfinancial asset (the underlying asset) as specified in the contract for a period of time in an exchange or exchange-like transaction."
- Entity has both the ability <u>and</u> rights to use the asset

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3 Categories of Leases

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- Currently (pre GASB 87) classified as either “operating” or “capital”
- GASB 87 will sort lease agreements into three categories:
  - Short-term leases
  - Contracts that transfer ownership
  - All other leases

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Short-Term Lease

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- ***Maximum possible term of 12 months or less***, including any options to extend
- If cancelable by either the lessee or the lessor, (i.e. month-to-month or year-to-year) maximum possible term is the non-cancelable period, including notice periods
- Lessee recognizes short-term lease payments as expenses

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Contracts that Transfer Ownership

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- Lease contracts where ownership transfers to the lessee by the end of the contract
- Lessee reports as a financed purchase
- Lessor reports as sale of the asset

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Lessee Accounting – Other Leases

- Recognize a lease liability and an intangible asset - right to use asset
  - Liability is the present value of the payments covered by the contract, value will be reduced as payments are made
  - Asset equals the initial measurement of the liability, value will be reduced through periodic amortization

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Lessee Accounting – Other Leases

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- Lease liabilities are long-term debt, and lease payments are capital financing outflows in the cash flow statement
- In the full accrual activity statements, lessees no longer report rent expense
- Instead report interest expense on the liability and amortization expense related to the asset

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Lessee Accounting – Other Leases

- Amortization expense for using the lease asset (similar to depreciation) over the shorter of:
  - The term of the lease or
  - Useful life of the underlying asset
- Interest expense on the lease liability

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Lessee Accounting – Other Leases

- Note disclosures about the lease:
  - General description of the leasing arrangement
  - Amount of lease assets recognized, and
  - Schedule of future lease payments to be made

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Lessor Accounting

- Recognize a lease receivable and a deferred inflow of resources
- Continue to report the leased asset in its financial statements
- Recognize lease revenue from amortizing the deferred inflow over the lease term
- Recognize interest revenue on the lease receivable

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Lessor Accounting

- The new rules exclude leases associated with investment assets carried at fair value (e.g., investment rental property),
- These will continue to be accounted for as they are today

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Lessor Accounting - Disclosures

- Disclosures
  - General description of the leasing arrangement
  - Total inflows of resources recognized

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Lease Term

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- Non-cancelable portion of the lease
- Plus those periods the lessee and lessor are reasonably certain will remain in the lease, includes periods where:
  - Lessee or lessor is able to extend to the lease and is reasonably certain to do
  - Lessee or lessor is able to but is reasonably certain not to terminate the lease
- Fiscal funding/cancellation clauses should not be taken into consideration unless the clause is reasonably certain of being exercised

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Lease Payments

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Lessee's Lease Liability	Lessor's Lease Receivable
Fixed payments	Fixed payments
Variable payments based on a rate or index	Variable payments based on a rate or index
Variable payments that are in-substance fixed payments	Variable payments that are in-substance fixed payments
Lease incentives received from the lessor	Lease incentives paid to the lessee
Amounts that are reasonably certain to be paid by the lessee under a residual value guarantee	Residual value guarantee payments that are fixed in substance
Exercise price of a purchase option the lessee is reasonably certain to exercise	
Payments for lease termination penalties if applicable	
Any other payments that are reasonably certain to be paid	

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Discount Rate

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- Rate charged by the lessor
- When lessee can’t determine that rate, the lessee should use its incremental borrowing rate (cost of funds)

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Lease Accounting

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Example Entries

Transaction date	Lessee			Lessor		
1/1/2017	Lease liability		33,617	Deferred inflow		33,617
	Lease asset	33,617		Lease receivable	33,617	
2/1/2017	Interest expense	126		Interest income		126
	Lease liability	874		Lease income		874
	Cash		1,000	Cash	1,000	
2/1/2017	Amortization expense	934		Deferred inflow	874	
	Accum amortization		934	Lease receivable		874

Assumptions:	
Term:	36 months
Interest rate (Lessee cost of funds):	4.50%
Monthly lease payment:	$1,000
Lessor does not derecognize underying capital asset	

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Key Impacts of the New Lease Model

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- Right-of-use assets may amortize more quickly than the liabilities, negatively impacting net position
- Lessees report lease liabilities as long-term debt, concerns about compliance with restrictive debt covenants

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Key Impacts of the New Lease Model

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- Lessees will report interest expense on the liability and amortization expense related to the asset, front-loading the expense recognition
- In cash flow statements, lease payments classified as capital financing activity by lessees

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