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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
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
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
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
Disclosures and schedules required

- Contracts that transfer ownership
- Non-short-term leases

No disclosure requirement for short-term lease outflows
Definition of a “Lease”

- “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 and rights to use the asset
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
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
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
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
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.
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
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
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
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
Disclosures

- General description of the leasing arrangement
- Total inflows of resources recognized
Lease Term

- 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
### Lease Payments

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

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

<table>
<thead>
<tr>
<th>Transaction date</th>
<th>Lessee</th>
<th>Lessor</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td><strong>Transaction date</strong></td>
<td><strong>Lessee</strong></td>
</tr>
<tr>
<td>1/1/2017</td>
<td>Lease liability 33,617</td>
<td>Deferred inflow 33,617</td>
</tr>
<tr>
<td></td>
<td>Lease asset 33,617</td>
<td>Lease receivable 33,617</td>
</tr>
<tr>
<td>2/1/2017</td>
<td>Interest expense 126</td>
<td>Interest income 126</td>
</tr>
<tr>
<td></td>
<td>Lease liability 874</td>
<td>Lease income 874</td>
</tr>
<tr>
<td></td>
<td>Cash 1,000</td>
<td>Cash 1,000</td>
</tr>
<tr>
<td>2/1/2017</td>
<td>Amortization expense 934</td>
<td>Deferred inflow 874</td>
</tr>
<tr>
<td></td>
<td>Accum amortization 934</td>
<td>Lease receivable 874</td>
</tr>
</tbody>
</table>

### Assumptions:

- **Term:** 36 months
- **Interest rate (Lessee cost of funds):** 4.50%
- **Monthly lease payment:** $1,000
- **Lessor does not derecognize underlying capital asset**
Key Impacts of the New Lease Model

- 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
Key Impacts of the New Lease Model

- 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.