

**GASB 87, I WILL LEASE  
THIS STANDARD TO  
YOU FOR A MERE  
PITTANCE – MAKE ME  
AN OFFER**

**North Carolina  
Office of the  
State Controller**

JUNE 5, 2019

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**WHAT WE WILL CONSIDER**

- Discuss an overview of the single model for recording leases (capitalization)
- Discuss lessor considerations
- Analyze the importance of creating a lease inventory
- Identify issues related to defining leases, including separate components
- Analyze early auditor considerations

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## LEASES, SO WHAT – WHAT’S THE BIG DEAL???

### GOVERNMENTS ARE LESSEES

- **Global Change** (including FASB / International)
- **90,000+ governments may be effected, including Tribal Nations**
- **Existing GAAP largely from the 1970’s (if not before)**
  - **GASB-62 adopted mostly FASB-13 (GASB Cod Sec. L20)**

### GOVERNMENTS ARE LESSORS

- Airports
- Stadiums
- Casinos / entertainment venues
- Ports / marinas
- Utilities
- Institutions of Higher Education

**Governments may be both Lessees and Lessors!**

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## EXISTING GAAP FOR LEASES

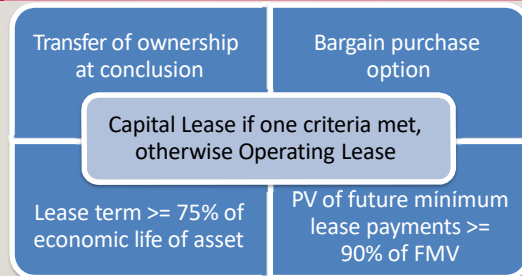
- GASB Codification Section L20 - Leases
  - NCGA Statement 5, *Accounting and Financial Reporting Principles for Lease Agreements of State and Local Governments*
  - GASB Statement 13, *Accounting for Operating Leases with Scheduled Rent Increases*
  - GASB Statement 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*

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## Current lease accounting

### ▶ LESSEE - DETERMINES TYPE OF LEASE – CAPITAL OR OPERATING



Lease Type	Accounting – accrual basis	Disclosure
Capital	Debit: capital assets Credit: long-term debt for PV of future minimum payments	Disclose future minimum payments
Operating	Expense payments as made	Disclose future minimum payments (if noncancelable)

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## EXISTING GAAP FOR LEASES

- Capital leases have the 'famous 4' that if one are hit, it's capitalized – akin to financed purchases -
  - The present value of the minimum lease payments is 90% (or more) of fair value at inception
  - Lease term is 75% (or more) of asset economic life
  - There is a bargain purchase option – often \$1
  - Ownership transfers at conclusion – cost is sometimes embedded in liability

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## EXISTING GAAP FOR LEASES

- All others are operating
- Disclosure:
  - Capital leases - minimum payments
  - Operating leases, expenses / expenditures
    - Noncancelable leases disclose minimum payments
- Problem – many operating leases in government are really noncancelable – current accounting does not meet GAAP definition of a liability (present obligation with little or no discretion to avoid)

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## 2017 TENNESSEE CAFR

For the Year(s) Ended June 30	Principal	Interest	Executory Costs	Governmental Activities Lease Obligation Payable
2018	\$ 1,495	\$ 1,162	\$ 772	\$ 3,429
2019	1,541	1,156	791	3,488
2020	1,576	1,145	811	3,532
2021	1,641	1,128	831	3,600
2022	1,693	1,104	852	3,649
2023-2027	8,969	4,556	4,590	18,115
2028-2029	2,479	654	1,796	4,929
<b>Total</b>	<b>\$ 19,394</b>	<b>\$ 10,905</b>	<b>\$ 10,443</b>	<b>40,742</b>
Less - interest				(10,905)
Less - executory costs				(10,443)
<b>Present value of net minimum lease payments</b>				<b>\$ 19,394</b>

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## 2017 TENNESSEE CAFR

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### A. Lease Obligations

**Operating lease obligations** — The state has entered into various operating leases for land, buildings and equipment. Most leases contain termination clauses providing for cancellation after 30, 60 or 90 days' written notice to lessors. In addition, most leases contain appropriation clauses indicating that continuation of the lease is subject to funding by the legislature. It is expected that in the normal course of business most of these leases will be replaced by similar leases. The state has also entered into various operating leases, which have non-cancelable lease terms. Below is a schedule of future minimum lease payments under these leases (expressed in thousands).

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## 2017 TENNESSEE CAFR

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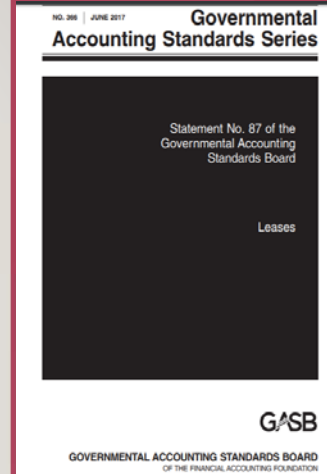
For the Year(s) Ended June 30	Noncancelable Operating Leases
2018	\$ 17,846
2019	15,787
2020	14,990
2021	12,517
2022	12,032
2023-2027	40,924
Total minimum payments required	\$ 114,096

Expenditures for rent under leases for the year ended June 30, 2017, amounted to \$79.7 million.

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## GASB'S LEASE PROJECT OVERVIEW

- 2011 – added to research agenda
- 2013 – added to current agenda
- 2014 – preliminary views issued
- 2015 – field test / public hearings
- 2016 – exposure draft issued / public hearing
- 2017 – final standard released in June
- 2020 – Statement 87 effective 12/31/2020



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## GASB 87 CHANGES

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)

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## Definition of a Lease

A contract that conveys control of the right to use another entity's nonfinancial asset (the underlying asset) as specified by the contract for a period of time in an exchange or exchange-like transaction.

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## DEFINITION OF A LEASE

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

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## LEASES SCOPE EXCLUSIONS

### **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 (See GASB Statement 60)

Assets financed with outstanding conduit debt unless both the asset and conduit debt are reported by lessor

### **Supply contracts (such as typical power purchase agreements, which do not convey control of the right to use the underlying power generating facility)**

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## CONTRACTS THAT TRANSFER OWNERSHIP EXCEPTION

### **If a contract**

- Transfers ownership of the underlying asset to the lessee by the end of the contract **AND**
- Does not contain termination options (other than fiscal funding or cancellation clauses)

**This type of contract is not a lease and should be reported as a financed purchase**

These contracts are not subject to the measurement or financial reporting requirements of the Leases statement

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## CONTRACTS THAT TRANSFER OWNERSHIP EXCEPTION

“At the end of such term LESSEE shall acquire legal title to the Vehicles and terminate this Lease with respect thereto by paying to LESSOR all amounts that are due and unpaid hereunder and the remaining principal balance with respect to such Vehicles as shown on the Schedule relating thereto.”

**3. TERM AND RENT:** The Lease term shall commence as of the date that the Vehicles are delivered to LESSEE, or LESSEE's Agent (the "Commencement Date") and shall continue for the term shown on the attached Schedule relating thereto, unless Lessee notifies LESSOR that an Event of Non-appropriation (described below) has occurred or LESSEE exercises its option under Section 18. At the end of such term LESSEE shall acquire legal title to the Vehicles and terminate this Lease with respect thereto by paying to LESSOR all amounts then due and unpaid hereunder and the remaining principal balance with respect to such Vehicles as shown on the Schedule relating thereto. In lieu of such payment LESSOR hereby grants LESSEE the option to renew this Lease with respect to such Vehicles for the additional period as shown on the Schedule relating thereto, provided that the rate of interest applicable to such additional period shall be mutually agreed upon by LESSOR and LESSEE. LESSEE shall give written notice to LESSOR at least ninety (90) days prior to the end of the Lease term as to whether it will terminate this Lease and acquire the Vehicles or exercise its option to renew in accordance with this Section 3. LESSOR shall endeavor to give written notice to LESSEE at least sixty (60) days prior to the end of the Lease term if no such notice has been received from LESSEE. The rent under this Lease shall be payable in lawful money of the United States of America, from any and all legally available funds, and at the times and in the amounts as indicated on each attached Schedule. In lieu of cash, LESSOR will accept payment by check or wire transfer of immediately available funds only. Each payment will consist of a principal and interest component.

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## LEASE TERM – WHEN DOES IT START/END FOR FINANCIAL REPORTING PURPOSES?

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

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## LEASE TERM - EXAMPLE

### Step

1

Determine the noncancelable period

- Contract provides the government control of the right-to-use a bus for 3 years.
  - After three years, there is an option to extend for 2 years
  - After two years, the government can terminate the lease

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## LEASE TERM – EXAMPLE (CONT.)

### Step

1

Determine the noncancelable period – 2 years

### Step

2

Assess the options

- Contract provides the government control of the right-to-use a bus for 3 years.
  - After three years, there is an option to extend for 2 years
  - After two years, the government can terminate the lease

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## LEASE TERM – EXAMPLE (CONT.)

**Step**  
**1** **Determine the noncancelable period – 2 years**

**Step**  
**2** **Assess the options**  
Is it reasonably certain the termination option will be exercised by the government?

- **Contract provides the government control of the right-to-use a bus for 3 years.**

- After three years, there is an option to extend for 2 years
- After two years, the government can terminate the lease

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## LEASE TERM – EXAMPLE (CONT.)

**Step**  
**1** **Determine the noncancelable period – 2 years**

**Step**  
**2** **Assess the options**  
Is it reasonably certain the termination option will be exercised by the government? **NO**  
Is it reasonably certain the option to extend will be exercised by the government?

- **Contract provides the government control of the right-to-use a bus for 3 years.**

- After three years, there is an option to extend for 2 years
- After two years, the government can terminate the lease

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LEASE TERM – EXAMPLE (CONT.)

**Step 1 Determine the noncancelable period – 2 years**

**Step 2 Assess the options**  
 Is it reasonably certain the termination option will be exercised by the government? **NO**  
 Is it reasonably certain the option to extend will be exercised by the government? **YES**

- Contract provides the government control of the right-to-use a bus for 3 years.
  - After three years, there is an option to extend for 2 years
  - After two years, the government can terminate the lease

LEASE TERM – EXAMPLE (CONT.)

Lease Term - Example	
Noncancelable period	Years 1 – 2
+ Period covered by option to terminate when it is NOT certain to be exercised	Year 3
+ Period covered by Option to Extend when it is reasonably certain to be exercised	Year 4 – 5
<b>Total Lease Term</b>	<b>5 Years</b>

- Contract provides the government control of the right-to-use a bus for 3 years.
  - After three years, there is an option to extend for 2 years
  - After two years, the government can terminate the lease

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## LEASE TERM

- For *financial reporting*, when does the lease start and end?
  - 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

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## LEASE TERM — EXAMPLE I

- 5 year lease with lessee-only option to cancel at 4

Lessee options		Lessor options		Term
Terminate	Extend	Terminate	Extend	
Uncertain	n/a	n/a	n/a	5 years
<b>Reasonably Certain</b>	n/a	n/a	n/a	4 years

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## LEASE TERM — EXAMPLE 2

- 5 year lease with lessee option to extend to 6 and lessor option to cancel at 4

Lessee options		Lessor options		Term
Terminate	Extend	Terminate	Extend	
n/a	Uncertain	Uncertain	n/a	5 years
n/a	Uncertain	<b>Reasonably Certain</b>	n/a	4 years
n/a	<b>Reasonably Certain</b>	Uncertain	n/a	6 years
n/a	<b>Reasonably Certain</b>	<b>Reasonably Certain</b>	n/a	4 years

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## LEASE TERM — EXAMPLE 3

- 5 year lease with lessee and lessor options to cancel at 4

Lessee options		Lessor options		Term
Terminate	Extend	Terminate	Extend	
Uncertain	n/a	Uncertain	n/a	4 years
Uncertain	n/a	<b>Reasonably Certain</b>	n/a	4 years
<b>Reasonably Certain</b>	n/a	Uncertain	n/a	4 years
<b>Reasonably Certain</b>	n/a	<b>Reasonably Certain</b>	n/a	4 years

- Cancelable after 4th year because both lessee and lessor can cancel

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## REASSESSMENT OF LEASE TERM

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.

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## SHORT-TERM LEASE 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

**No Balance Sheet Impact**

**No disclosures required**

**Flows statements reflect the activity based on contract provision**

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## CONTRACTS WITH MULTIPLE COMPONENTS

- Separate contracts into lease and nonlease components or multiple lease components
- Allocate consideration to multiple underlying assets if:

Service components of contract

Differing lease terms, or

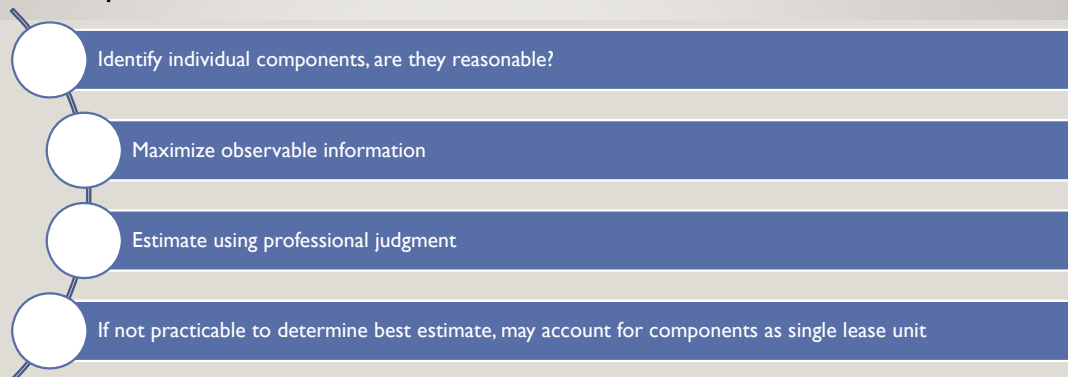
Are in differing major asset classes for disclosure

Consider **Contract Combinations** when reviewing Multiple Components

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## CONTRACTS WITH MULTIPLE COMPONENTS

### Allocation process:



No Policy provision in Standard

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## IMPLEMENTATION GUIDE

- 7.9.8. Q—Should a government's capitalization policy be applied only to individual assets or can it be applied to a group of assets acquired together? Consider a government that has established a capitalization threshold of \$5,000 for equipment. If the government purchases 100 computers costing \$1,500 each, should the computers be capitalized? •
- A—Authoritative pronouncements do not address the manner in which a capitalization policy should be established and applied. Capitalization policies adopted by governments include many considerations such as finding an appropriate balance between ensuring that all significant capital assets, collectively, are capitalized and minimizing the cost of record keeping for capital assets. It may be appropriate for a government to establish a capitalization policy that would require capitalization of certain types of assets whose individual acquisition costs are less than the threshold for an individual asset. Computers, classroom furniture, and library books are assets that may not meet the capitalization policy on an individual basis, yet might be considered material collectively.

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## LESSEE

## RECOGNITION & MEASUREMENT

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## INITIAL & SUBSEQUENT REPORTING

	Party	Assets	Liabilities	Deferred Inflow of Resources
Initial Reporting	Lessee	Intangible asset (lease liability + prepayments + initial direct costs placing asset into use)	Present value of future lease payments (fixed, variable, including guarantees etc.)	None
	Lessor	Lease receivable, capital asset remains on books	Should be none	Lease receivable + cash that relates to future period (e.g. last month's rent)
Subsequent Reporting	Lessee	Amortize intangible over shorter of useful life or term of lease	Reduce by lease payments (effective interest)	None
	Lessor	Depreciate capital asset unless required to be returned in original or better condition Reduce receivable, taking into account accrued interest	Should be none	Recognize revenue in effective interest method (systematic & rational)

- Lease liability does not include lease payments that are dependent on lessee's performance or usage of 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
- If the underlying asset becomes impaired, apply capital asset impairment guidance of Statement 42 to the right-to-use lease asset

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## LESSEE – BUS LEASE EXAMPLE

**The government has a long-standing process of leasing its buses.**

- On January 1, 2021, the government enters into a contract for five buses. The contract states the term is 5 years, with monthly payments of \$2,000 due every 1st of the month. Lessor provided the borrowing rate of 6%.
- After three years, the government may cancel the contract.
- After the fifth year, the purchase price for each bus is \$12,000.
- The government regularly leases buses and has historically utilized the buses for the full term of the contract and have never terminated early. The contract does not provide the lessor an option to terminate. At the date of the contract, the government does not have any intent to terminate early. At the end of the lease, the government intends to return the buses, there is no transfer of ownership provision.

✓ **Does this meet the definition of a lease?**



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## LESSEE – BUS LEASE EXAMPLE (CONT.)

**The government has a long-standing process of leasing its buses.**

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✓ **Does this meet the definition of a lease? YES**



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## LESSEE – BUS LEASE EXAMPLE (CONT.)

### Identifying the Lease Term

	Lessee options		Lessor options	
	Terminate	Extend	Terminate	Extend
<b>Year 1</b>	N/A	N/A	N/A	N/A
<b>Year 2</b>	N/A	N/A	N/A	N/A
<b>Year 3</b>	N/A	N/A	N/A	N/A
<b>Year 4</b>	Reasonably certain will not exercise	N/A	N/A	N/A
<b>Year 5</b>	Reasonably certain will not exercise	N/A	N/A	N/A

What is the term of the lease?

Should the purchase price be considered in the lease liability?



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## LESSEE – BUS LEASE EXAMPLE (CONT.)

### Identifying the Lease Term

	Lessee options		Lessor options	
	Terminate	Extend	Terminate	Extend
<b>Year 1</b>	N/A	N/A	N/A	N/A
<b>Year 2</b>	N/A	N/A	N/A	N/A
<b>Year 3</b>	N/A	N/A	N/A	N/A
<b>Year 4</b>	Reasonably certain will not exercise	N/A	N/A	N/A
<b>Year 5</b>	Reasonably certain will not exercise	N/A	N/A	N/A

What is the term of the lease? **5 YEARS**

Should the purchase price be considered in the lease liability? **NO**



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## LESSEE – BUS LEASE EXAMPLE (CONT.)

### Assumptions for Lease Liability calculation:

Buses are delivered on January 1, 2021, date of 1st payment.

Payment schedule 5 years, assuming a 6% interest rate.

Purchase price, not certain of being exercised (exclude)

Present value of \$2,000 monthly payments for 5 years (60 months):

- Rate = (6% per year / 12 months to get rate per month)
- Nper (number of payments) = 60
- Pmt (monthly payment) = 2,000
- FV (future value) = 0
- Type = 1 if payments are made at beginning of period, 0 if payments are made at end of period

$$=PV(6\%/12,60,-2000,0,0)$$



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## LESSEE – BUS LEASE EXAMPLE (CONT.)

### Assumptions for Lease Liability calculation:

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- FV (future value) = 0
- Type = 1 if payments are made at beginning of period, 0 if payments are made at end of period

$$=PV(6\%/12,60,-2000,0,0)$$



**Present Value = \$103,451**

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## LESSEE – BUS LEASE EXAMPLE (CONT.)

### Annualized Payment Schedule

	Principal	Interest	Total Payment
<b>2021</b>	18,290	5,710	24,000
<b>2022</b>	19,419	4,581	24,000
<b>2023</b>	20,616	3,384	24,000
<b>2024</b>	21,888	2,112	24,000
<b>2025</b>	<u>23,238</u>	<u>762</u>	<u>24,000</u>
	<b>103,451</b>	<b>16,549</b>	<b>120,000</b>

Year 1	Amortization	20,690
Year 2	Amortization	20,690
Year 3	Amortization	20,690
Year 4	Amortization	20,690
Year 5	Amortization	<u>20,691</u>
		<b>103,451</b>



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### LESSEE – BUS LEASE EXAMPLE (CONT.)

<b>Governmental Fund - Initial Journal Entry</b>	<b>Debit</b>	<b>Credit</b>
Capital outlay	103,451	
Other financing sources - lease proceeds		103,451
<i>To record capital expenditure and related proceeds from lease of buses</i>		
<b>Entity-wide - Initial Journal Entry</b>	<b>Debit</b>	<b>Credit</b>
Other financing sources - lease proceeds	103,451	
Lease liability – due within one year		18,290
Lease liability – due beyond one year		85,161
Intangible lease asset - vehicles	103,451	
Capital outlay		103,451
<i>To record intangible asset and related liability from lease of buses</i>		



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### LESSEE – BUS LEASE EXAMPLE (CONT.)

<b>Enterprise funds - Initial Journal Entry</b>	<b>Debit</b>	<b>Credit</b>
Intangible lease asset - vehicles	103,451	
Lease liability – due within one year		18,290
Lease liability – due beyond one year		85,161



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## LESSEE – BUS LEASE EXAMPLE (CONT.)

<b>Governmental Fund - Year 1 Journal Entry</b>	<b>Debit</b>	<b>Credit</b>
Interest expense	5,710	
Lease principal payment expenditure	18,290	
Cash		24,000
<i>To record 12 monthly lease payments for first year</i>		

<b>Entity-wide - Year 1 Journal Entries</b>	<b>Debit</b>	<b>Credit</b>
Lease liability – due within on year	18,290	
Lease principal payment expenditure		18,290
Amortization expense	20,690	
Accumulated amortization		20,690
<i>To eliminate fund level activity for first year</i>		



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## LESSEE – BUS LEASE EXAMPLE (CONT.)

<b>Enterprise funds - Year 1 Journal Entry</b>	<b>Debit</b>	<b>Credit</b>
Lease liability – due within one year	18,290	
Interest expense	5,710	
Cash		24,000
<i>To record 12 monthly lease payments for first year</i>		
Amortization expense	20,690	
Accumulated amortization		20,690
<i>To record annual amortization expense</i>		



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## LESSEE – BUS LEASE EXAMPLE (CONT.)

### Enterprise funds and Entity-wide Year 1 Journal Entry

	Debit	Credit
Lease liability – due beyond one year	19,419	
Lease liability – due within one year		19,419

*To adjust due within one year liability*

Consider need for accrued  
interest based on payment  
schedule.



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## LESSEE – BUS LEASE EXAMPLE (CONT.)

### Governmental Fund - Year 2 Journal Entry

	Debit	Credit
Interest expense	4,581	
Lease principal payment expenditure	19,419	
Cash		24,000

*To record 12 monthly lease payments for second year*

### Entity-wide - Year 2 Journal Entries

	Debit	Credit
Lease liability – due within one year	19,419	
Lease principal payment expenditure		19,419
Amortization expense	20,690	
Accumulated amortization		20,690

*To eliminate fund level activity for second year*



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## LESSEE – BUS LEASE EXAMPLE (CONT.)

<b>Enterprise funds - Year 2 Journal Entry</b>	<b>Debit</b>	<b>Credit</b>
Interest expense	4,581	
Lease liability – due within one year	19,419	
Cash		24,000
<i>To record 12 monthly lease payments for second year</i>		
Amortization expense	20,690	
Accumulated amortization		20,690
<i>To record annual amortization expense</i>		



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## LESSEE – BUS LEASE EXAMPLE (CONT.)

<b>Enterprise funds and Entity-wide Year 2 Journal Entry</b>	<b>Debit</b>	<b>Credit</b>
Lease liability – due beyond one year	20,616	
Lease liability – due within one year		20,616
<i>To adjust due within one year liability</i>		

**Consider need for accrued interest based on payment schedule.**



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## LESSEE – BUS LEASE EXAMPLE (CONT.)

### Three years remaining on bus lease

#### End of year 2 balances

Lease liability – due within one year	\$ 20,616
Lease liability – due beyond one year	<u>45,126</u>
Total	65,742
Vehicle - leased asset	\$ 103,451
Accumulated amortization - Vehicle - leased asset	<u>(41,380)</u>
Vehicle NBV	62,071



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## LESSEE—DISCLOSURES

- a. A general description of leasing arrangements, including:
  1. Basis, terms, and conditions, on which variable lease payments are determined
  2. Existence, terms, and conditions of residual value guarantees provided by the lessee
- b. Total amount of assets recorded under leases, and the related accumulated amortization, disclosed separately from other capital assets
- c. Lease assets disaggregated by major classes of underlying assets, disclosed separately from other capital assets
- d. Variable lease payments recognized during the period but not previously included in the lease liability

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## LESSEE—DISCLOSURES

- e. Other payments recognized during the period but not previously included in the lease liability (such as residual value guarantees or penalties)
- f. A maturity analysis of all future lease payments
  - Payments for each of the first five years
  - Payments in five-year increments thereafter
  - Show principal and interest separately
- g. Lease commitments, other than short-term leases, for which the lease term has not yet begun
- h. Components of any net impairment loss (gross impairment loss less change in lease liability)

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## LESSEE – BUS LEASE DISCLOSURE EXAMPLE - “GENERAL DESCRIPTION DISCLOSURE”

“The government is leasing five buses for five years, starting January 1, 2021, with monthly payments of \$2,000 with an interest rate of 6%.”

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LESSEE – BUS LEASE DISCLOSURE EXAMPLE (CONT.)

<b>Capital Assets – Year 2</b>	<b>Beginning Balance</b>	<b>Additions</b>	<b>Deletions</b>	<b>Ending Balance</b>
Capital assets not being depreciated				
Land	\$ 1,000,000	\$ -	\$ -	\$ 1,000,000
Total Capital Assets not being depreciated	1,000,000	-	-	1,000,000
Capital assets being depreciated / amortized				
Building	5,000,000	500,000	-	5,500,000
Equipment	400,000	36,000	10,000	426,000
Leased Building (Intangible asset)	500,000	100,000	-	600,000
<b>Leased Vehicles (Intangible asset)</b>	<b>103,451</b>	<b>-</b>	<b>-</b>	<b>103,451</b>
Total capital assets being depreciated / amortized	6,003,451	636,000	10,000	6,629,451
Less: Accumulated depreciation for				
Building	3,300,000	110,000	-	3,410,000
Equipment	340,800	28,400	10,000	359,200
Less: Accumulated amortization for				
Leased building	20,000	20,000	-	40,000
<b>Leased vehicles</b>	<b>20,690</b>	<b>20,690</b>	<b>-</b>	<b>41,380</b>
Total depreciation and amortization	3,681,490	179,090	10,000	3,850,580
Net capital assets being depreciated and amortized	2,321,961	456,910	-	2,778,871
Total, net of accumulated depreciation	\$ 3,321,961	\$ 456,910	\$ -	\$ 3,778,871



Impact on Net Investment in Capital Assets

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LESSEE – BUS LEASE DISCLOSURE EXAMPLE (CONT.)

A maturity analysis of all future lease payments  
Payments for each of the first five years

- Payments in five-year increments thereafter
- Show principal and interest separately

Future Lease Payment Maturity Schedule			
	Principal	Interest	Total Payment
<b>2023</b>	\$ 20,616	\$ 3,384	\$ 24,000
<b>2024</b>	21,888	2,112	24,000
<b>2025</b>	23,238	762	24,000
<b>2026</b>	-	-	-
<b>2027</b>	-	-	-
<b>2028 - 2032</b>	-	-	-
	<b>\$ 65,742</b>	<b>\$ 6,258</b>	<b>\$ 72,000</b>

Combine with building lease payment schedule for financial statement presentation

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## LESSEE – BUS LEASE EXAMPLE, EXPANDED

### Multiple contract components

- What if the lease agreement requires the government to pay an additional \$500 per quarter for maintenance, including oil change, tune ups, etc. for each bus?
- Should that be included in the lease liability?
- Does \$500 per quarter for five buses seem reasonable?
- Is it identifiable in the contract?



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## LESSEE – BUS LEASE EXAMPLE, EXPANDED (CONT.)

### Multiple contract components

- What if the lease agreement requires the government to pay an additional \$500 per quarter for maintenance, including oil change, tune ups, etc. for each bus?
- Should that be included in the lease liability? **NO**
- Does \$500 per quarter for five buses seem reasonable? **YES**
- Is it identifiable in the contract? **YES**



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## LESSEE – ACTIVITY BUS EXAMPLE, EXPANDED (CONT.)

### Multiple contract components

<b>Governmental Fund - Year 1 Journal Entry</b>	<b>Debit</b>	<b>Credit</b>
Interest expense	5,710	
Lease principal payment expenditure	18,290	
Maintenance expense	2,000	
Cash		26,000
<i>To record 12 monthly lease payments for first year</i>		
<b>Entity-wide - Year 1 Journal Entries</b>		
Lease liability	18,290	
Lease principal payment expenditure		18,290
Amortization expense	20,690	
Accumulated amortization		20,690
<i>To eliminate fund level activity for first year</i>		



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## LESSEE – ACTIVITY BUS EXAMPLE, EXPANDED (CONT.)

### Multiple contract components

<b>Enterprise funds - Year 1 Journal Entry</b>	<b>Debit</b>	<b>Credit</b>
Lease liability	18,290	
Interest expense	5,710	
Maintenance fees	2,000	
Cash		26,000
<i>To record 12 monthly lease payments for first year</i>		



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## LESSEE – BUS LEASE EXAMPLE, EXPANDED (CONT.)

### Additional payment factors in contract

- What if the lease agreement requires the government to pay \$50 per month, per bus for mileage, plus \$1 dollar per mile for every mile over 500 miles each month.
  - What should be included in the lease liability?
  - Is a piece of the contract “fixed in substance”?
  - Is a piece of the contract excluded from the lease liability?



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## LESSEE – BUS LEASE EXAMPLE, EXPANDED (CONT.)

### Additional payment factors in contract

Monthly payment = \$2,000

Additional monthly fixed payment for mileage = \$50

Monthly variable payment for mileage = \$1/ per mile for every mile over 500 miles each month.

- What additional payments should be included in lease liability?
  - Payments that are fixed in substance are included in the liability
- Is a piece of the contract “fixed in substance”?
  - Yes, the monthly charge of \$50 should be included
- Is a piece of the contract excluded from the lease liability?
  - Yes, the mileage fee is not based on an index or rate, it is based on the lessee’s usage of the underlying asset.



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LESSEE – BUS LEASE EXAMPLE, EXPANDED (CONT.)

	Monthly	Fixed in Substance	Variable	Total			
Monthly payment	\$2,000	+	\$50	+	0	=	\$2,050
Variable payment	\$1/ mile over 500 per bus						

Annualized Payment Schedule			
	Principal	Interest	Total Payment
2021	18,748	5,852	24,600
2022	19,904	4,696	24,600
2023	21,132	3,468	24,600
2024	22,435	2,165	24,600
2025	23,819	781	24,600
	<b>106,038</b>	<b>16,962</b>	<b>123,000</b>



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LESSEE – BUS LEASE EXAMPLE, EXPANDED (CONT.)

Additional payment factors in contract

In the first month, the cumulative amount of mileage over 500 per bus was 750 miles

Governmental Fund - Year 1 Journal Entry	Debit	Credit
Interest expense	5,852	
Lease principal payment expenditure	18,748	
Mileage expenditure	750	
Cash		25,350
<i>To record 12 monthly lease payments for first year and mileage expenditure</i>		



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## LESSEE – BUS LEASE EXAMPLE, EXPANDED (CONT.)

### Additional payment factors in contract

In the first month, the cumulative amount of mileage over 500 per bus was 750 miles

Enterprise funds - Year 1 Journal Entry	Debit	Credit
Lease liability	18,748	
Interest expense	5,852	
Mileage expense	750	
Cash		25,350
<i>To record 12 monthly lease payments for first year</i>		



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## LESSEE – BUS LEASE EXAMPLE, EXPANDED (CONT.)

### Lease Termination For LESSEES

What if in year 4, the government gave notice that they would be terminating the lease in year 4 after the year 4 payments were made?

Annualized Payment Schedule			
	Principal	Interest	Total Payment
2021	18,290	5,710	24,000
2022	19,419	4,581	24,000
2023	20,616	3,384	24,000
2024	21,888	2,112	24,000
2025	23,238	762	24,000
	<b>103,451</b>	<b>16,549</b>	<b>120,000</b>



Back to the original Bus Lease example

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## LEASE MODIFICATIONS

### For 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

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## LESSEE – BUS LEASE EXAMPLE, EXPANDED (CONT.)

### Lease Termination For 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

<b>Entity-wide - Year 4 Journal Entries</b>	<b>Debit</b>	<b>Credit</b>
Lease liability	23,238	
Intangible lease asset - vehicles		20,691
Gain on termination of lease		2,547

*To record the termination of the lease in Year 4*

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## STATEMENT OF NET POSITION - LESSEE

	Current Guidance	Proposed Guidance
Underlying tangible capital asset	Yes	No
Right to use underlying tangible capital asset	No	Yes
Lease payable	Yes	Yes

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## STATEMENT OF NET POSITION - LESSOR

	Current Guidance	Proposed Guidance
Lease receivable	Yes	Yes
Underlying capital asset	No	Yes

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## COMMON LEASED ASSETS



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# LESSOR

## RECOGNITION & MEASUREMENT

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### INITIAL & SUBSEQUENT REPORTING

	Party	Assets	Liabilities	Deferred Inflow of Resources
Initial Reporting	Lessee	Intangible asset (lease liability + prepayments + initial direct costs placing asset into use)	Present value of future lease payments (fixed, variable, including guarantees etc.)	None
	Lessor	Lease receivable, capital asset remains on books	Should be none	Lease receivable + cash that relates to future period (e.g. last month's rent)
Subsequent Reporting	Lessee	Amortize intangible over shorter of useful life or term of lease	Reduce by lease payments (effective interest)	None
	Lessor	Depreciate capital asset unless required to be returned in original or better condition Reduce receivable, taking into account accrued interest	Should be none	Recognize revenue in effective interest method (systematic & rational)

- 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

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## LESSOR - EXCEPTIONS

- Two main transactions do not apply the general lessor recognition and measurement guidance (but still required to provide certain disclosures)
  - Leases of tangible assets 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



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## LESSOR - DISCLOSURES

Lease activities may be grouped for disclosure purposes

- a. A general description of leasing arrangements
  - The basis, terms, and conditions on which variable lease payments not included in the lease receivable are determined
- b. The total amount of inflows recognized in the reporting period related to leases, if not displayed on face of financials

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## LESSOR - DISCLOSURES

- c. 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
- d. 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

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



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## 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

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## LESSOR – OFFICE SPACE EXAMPLE

- Lease between a Primary Government (State X) and a discretely presented component unit (DPCU) (governmental in stand-alone financial statements) in which both have 6/30 fiscal year ends.
- State X's current rental agreement has expired and is electing to relocate to a new larger space offered by the DPCU. As part of the agreement the DPCU has to install entry security access at each entrance within the first month of the agreement. The cost of the installation is \$2,500.00
- The agreement begins on 7/01/2021. The term is for one year with an option to extend each year for the next four years by the lessee.
- With prior agreements, State X has elected the options to extend and current indications are that State X will exercise the options for future agreements.



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## LESSOR – OFFICE SPACE EXAMPLE (CONT.)

- The agreement calls for a monthly payment due on the 1st of each month for an amount of \$1,962
- The agreement does not provide a stated interest rate.
- The DPCU, during the implementation of GASB Statement No. 72, determined the building and space being leased was a capital asset at that time.



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LESSOR – OFFICE SPACE EXAMPLE (CONT.)

Identifying the Lease term

	Lessee options		Lessor options	
	Terminate	Extend	Terminate	Extend
<b>Year 1</b>	Reasonably certain will	N/A	N/A	N/A
<b>Year 2</b>	Reasonably certain will	N/A	N/A	N/A
<b>Year 3</b>	Reasonably certain will	N/A	N/A	N/A
<b>Year 4</b>	Reasonably certain will	N/A	N/A	N/A
<b>Year 5</b>	Reasonably certain will	N/A	N/A	N/A



Requires evaluation of both parties when there are lessee/lessor options.

- What is the term of the lease?

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LESSOR – OFFICE SPACE EXAMPLE (CONT.)

Identifying the Lease term

	Lessee options		Lessor options	
	Terminate	Extend	Terminate	Extend
<b>Year 1</b>	Reasonably certain will	N/A	N/A	N/A
<b>Year 2</b>	Reasonably certain will	N/A	N/A	N/A
<b>Year 3</b>	Reasonably certain will	N/A	N/A	N/A
<b>Year 4</b>	Reasonably certain will	N/A	N/A	N/A
<b>Year 5</b>	Reasonably certain will	N/A	N/A	N/A



- What is the term of the lease? **Five Years**

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## LESSOR – OFFICE SPACE EXAMPLE (CONT.)

The rental begins on July 1, 2021 and that is the date the first payment is due.

Payment schedule, assumes a 4% interest rate.

Present value of \$1,962 monthly payments for 5 years (60 months):

- Rate = (4% per year / 12 months to get rate per month)
- Nper (number of payments) = 60
- Pmt (monthly payment) = 1,962
- FV (future value) = 0
- Type = 1 if payments are made at beginning of period, 0 if payments are made at end of period

**Present Value = \$106,890**



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## LESSOR – OFFICE SPACE EXAMPLE

Amortization table – Measurement of the lease receivable based on the fixed payments outlined in the agreement

Annualized Payment Schedule			
	Principal	Interest	Total Payment
<b>2021</b>	19,995	3,549	23,544
<b>2022</b>	20,440	3,104	23,544
<b>2023</b>	21,273	2,271	23,544
<b>2024</b>	22,140	1,404	23,544
<b>2025</b>	<u>23,042</u>	<u>502</u>	<u>23,544</u>
	<b>106,890</b>	<b>10,830</b>	<b>117,720</b>



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## LESSOR – OFFICE SPACE EXAMPLE (CONT.)

<b>Initial Journal Entry</b>	<b>Debit</b>	<b>Credit</b>
Lease receivable	106,890	
Deferred inflow of resources		106,890
<i>To record receivable and related deferred inflow (7/1)</i>		

<b>Initial Journal Entry</b>	<b>Debit</b>	<b>Credit</b>
Expenditure/expense	2,500	
Cash		2,500
<i>To record direct cost associated with the agreement (Year 1 July)</i>		



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## LESSOR – OFFICE SPACE EXAMPLE (CONT.)

<b>Year 1 Journal Entry</b>	<b>Debit</b>	<b>Credit</b>
Cash	23,544	
Interest Income		3,549
Lease Receivable		19,995
<i>To record receipt of 12 monthly lease payments for first year (systematic/rational manner)</i>		

<b>Year 1 Journal Entry</b>	<b>Debit</b>	<b>Credit</b>
Deferred inflow of resources	19,995	
Interest Receivable	290	
Lease Revenue		19,995
Interest Revenue		290
<i>To record systematic recognition of revenue; and accrued interest (6/30)</i>		



**Lessor continues reporting the tangible asset and the recognition of depreciation.**

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## LESSOR - REMEASUREMENT

**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:**

There is a change in lease term

There is a change in the rate the lessor charges the lessee

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

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## LEASE MODIFICATIONS

### For 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

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## LEASE TERMINATIONS

### For 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

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## LESSOR – OFFICE SPACE EXAMPLE, EXPANDED

- During June 2022; State X, as a result of a shortfall in revenue, required state agencies to relocate any staff located outside of a state owned facility; provided space is available for relocation.
- The DPCU unit has been notified by State X that the state agency located in its office space will relocate for the next fiscal year and is exercising their option to terminate effective 7/1/2022. Based on the termination option agreement, since advance notice was provided, no payment will be required at 7/1.



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## LESSOR – OFFICE SPACE EXAMPLE, EXPANDED (CONT.)



<b>Year 2 Journal Entry</b>	<b>Debit</b>	<b>Credit</b>
Deferred inflow of resources	86,895	
Lease Receivable		86,895
<i>To record termination of lease</i>		

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## CONSIDERATIONS FOR IMPLEMENTATION

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## MATERIALITY CONSIDERATIONS

Asset value and liability value

What if the underlying assets do not meet the government's capitalization threshold?

- IG question on this 7.9.8 – directing governments to capitalize the collective amount if material in total
  - Draft IG - Leases question

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## IDENTIFYING THE RATE CHARGED

From the lessee perspective

From the lessor perspective



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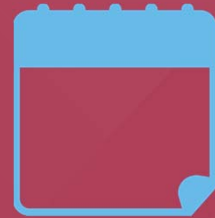
## EFFECTIVE DATE & TRANSITION

Effective for periods beginning after December 15, 2019

- Earlier application encouraged

### 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



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## IMPLEMENTATION IDEAS

Start reviewing existing leases as soon as possible

Implement IC to identify leases & lease modifications

Update accounting systems for new information needs

Consider impact on capitalization policy

Consider impact on reporting lease liabilities on:

- Debt limitations
- Bond covenants
- Grant agreements

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## OTHER ACCOUNTING AND REPORTING PROVISIONS

Lease Incentives

Subleases

Sale-Leasebacks

Lease-Leasebacks

Intra—Entity Leases

Leases Between Related Parties

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## LEASES IMPLEMENTATION GUIDE EXPOSURE DRAFT TOPICS

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- 80 Questions, 3 - Illustrations
- Scope and Applicability
- Lease term
- Short-term leases
- Contracts that transfer ownership
- Lessee recognition and measurement (other than short-term leases and ownership transfers)
- Notes – lessees
- Lessor recognition and measurement (other than short-term leases and ownership transfers)

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## LEASES IMPLEMENTATION GUIDE EXPOSURE DRAFT TOPICS

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- Notes – lessors
- Incentives
- Multiple components
- Combinations
- Modifications and terminations
- Sale – leaseback transactions
- Lease – leaseback transactions
- Intra-entity leases
- Transition and effective date

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## QUESTIONS?

YES I DO. LET ME GET THIS  
STRAIGHT, I AM GOING TO HAVE  
TO RECALCULATE AND RECLASSIFY  
50, 100, 500, 1000 LEASES?

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