



GASB Statement No. 87, *Leases*

Deborah Beams, CPA

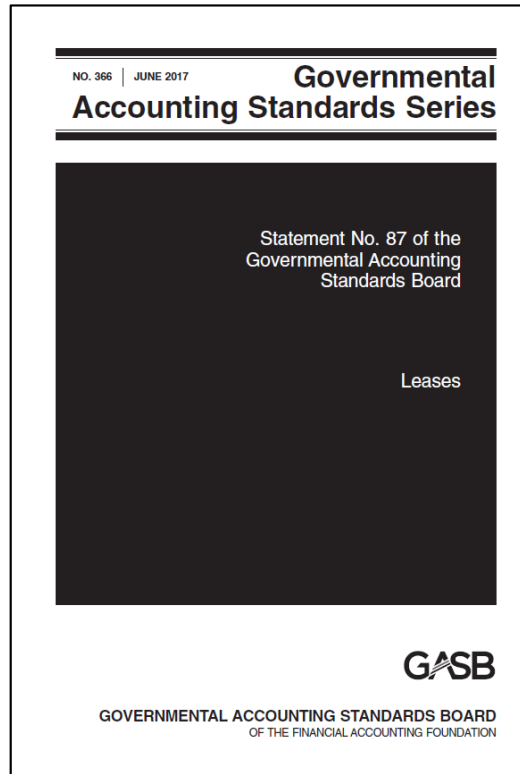
Supervising Project Manager

The views expressed in this presentation are those of Ms. Beams.
Official positions of the GASB are reached only after extensive due process and deliberations.

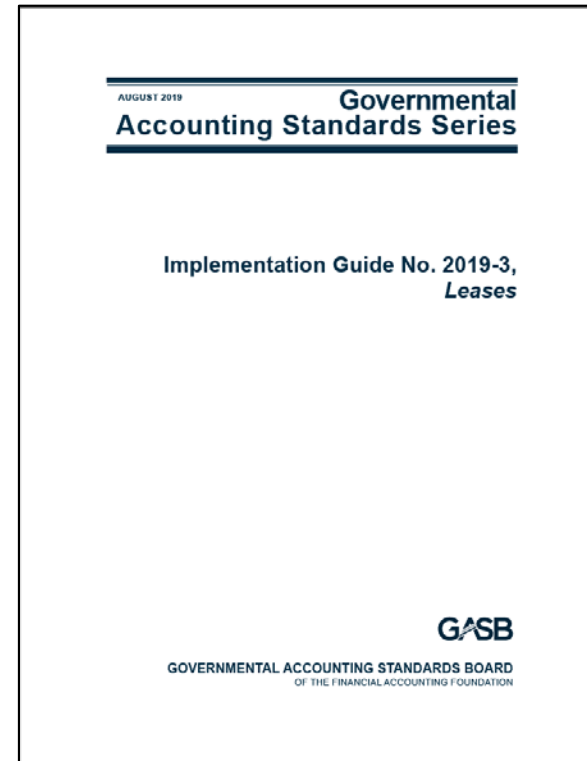
Overview

- Background
- Definition and scope
- Lease term
- Short-term leases
- Lessee accounting & reporting
- Lessor accounting & reporting
- Other provisions
- Effective date & transition

Leases



Statement 87



Implementation Guide 2019-3

Background

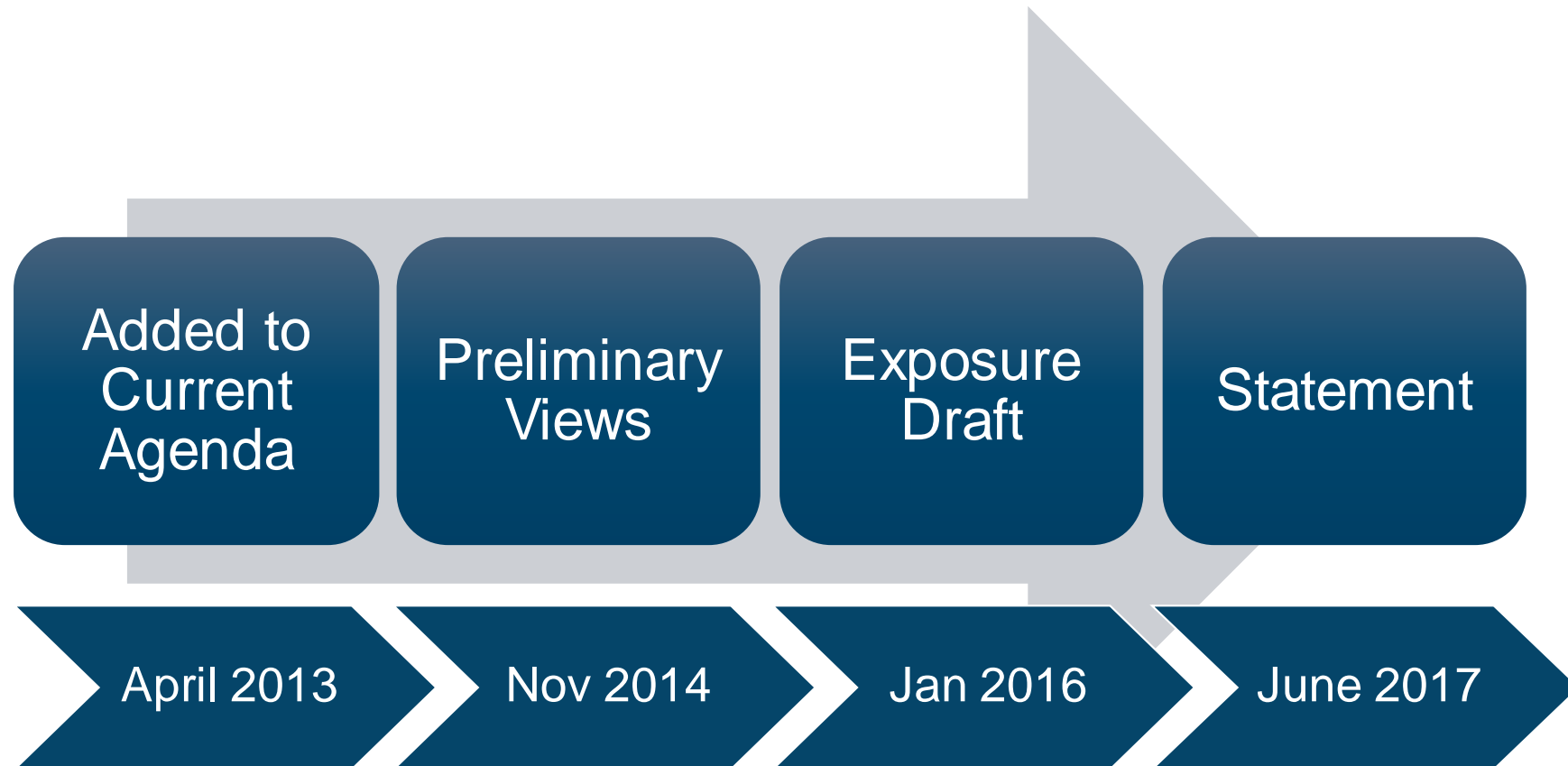
■ Why a new standard on leases?

- Existing standards in effect for decades
- Evaluate against conceptual framework
- Increase comparability and usefulness of information
- FASB and IASB joint project to update their lease standards

■ Why change lessor accounting?

- Symmetry with lessee
- Consistency with foundational principle

Background (continued)



Field test and public hearings after Preliminary Views

Background (continued)

- **Implementation Guide 2019–3, *Leases***
 - 77 questions and answers (authoritative)
 - 3 illustrations (nonauthoritative)
- **Implementation Guidance Update 2020**
 - Exposure Draft published early December
 - Proposed 13 new questions and answers on leases
 - Comments due January 31, 2020

Materiality

- GASB 87 contains the following box:

The provisions of this Statement need
not be applied to immaterial items.

- Subject to professional judgment
- Capitalization thresholds – Imp. Guide Q4.23
 - Consider quantitative and qualitative factors
 - Individually and in the aggregate
 - Assets and liabilities

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.
 - Contract – legal enforceability
 - Control of the right to use – discussed on later slides
 - Nonfinancial asset – not securities lending
 - Period of time – not perpetual (could be long)
 - Exchange or exchange-like transaction – give/receive equal value
- Implementation Guide:
 - Uninterrupted control not required to be a lease (Q4.2)
 - Easements may meet the definition if all parts met (Q4.5)

Definition of a Lease (continued)

- Control requires both of the following:
 - (1) the right to obtain the present service capacity from use of the underlying asset as specified in the contract, and
 - (2) the right to determine the nature and manner of use of the underlying asset as specified in the contract



Where is the line between being a lease
and not being a lease?

Use judgment.

Definition of a Lease (continued)

- Implementation Guide:
 - Rancher must allow access and use by others
 - Does not convey control, not a lease (Q4.4)
 - Right of substitution of essentially identical asset
 - Does not affect evaluation of control (Q4.9)
- Proposed Implementation Guide Update:
 - Restrictions in the contract (Q4.7)
- What about the following?
 - Advertising?
 - Taxi access fees?
 - Landing fees?
 - Common Use Terminal Gate fees?

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 (Statement 60)



Arrangements associated with conduit debt obligations (Statement 91)



Supply contracts (such as power purchase agreements that do not convey control of the right to use the underlying generating facility)

Scope Exclusions (continued)

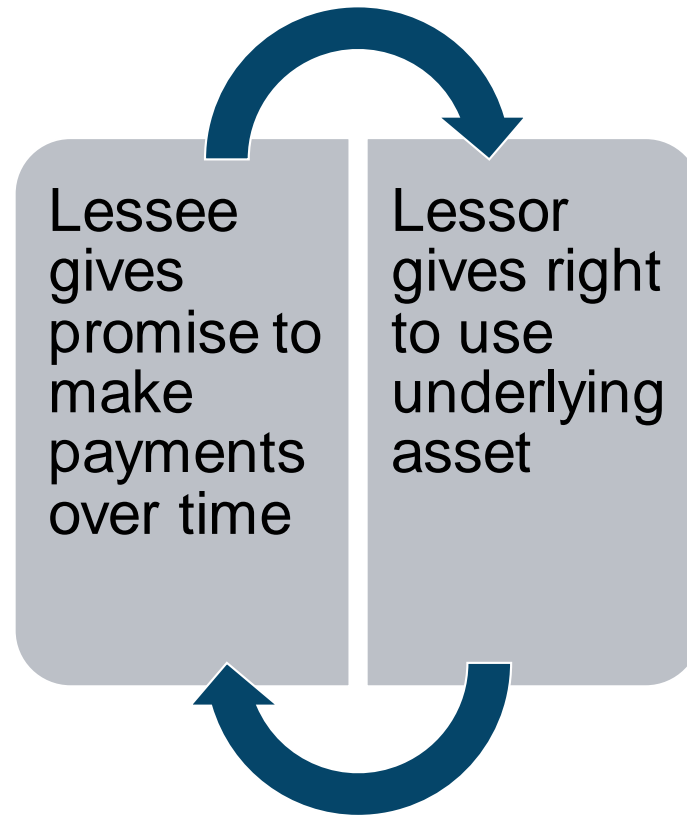
- Currently
 - Computer software licenses are excluded
 - IT hardware leases are included
- Subscription-Based Information Technology Arrangements project
 - Same definition as lease but underlying IT hardware or software
 - New exclusion to Statement 87 for IT hardware leases
 - Similar treatment to lease (liability and intangible asset)
 - Tentative effective dates:
 - IT hardware – same as leases (begin after 12/15/19)
 - Remainder – begin after 6/15/21
 - Final statement expected early June 2020

Scope Exclusions (continued)

- Currently
 - Service concession arrangements are excluded
 - Other public-private partnerships may be included
- Public Private Partnerships and Availability Payment Arrangements project
 - Service concession arrangements still excluded
 - Other public-private partnerships follow 87 if meet lease definition
 - Guidance for public-private partnerships that don't meet lease definition
 - Similar treatment to lease (receivable and deferred inflow)
 - Proposed effective date for years beginning after 6/15/21
 - Final statement expected March 2020

Foundational Principle

- Leases are financings
- At commencement:

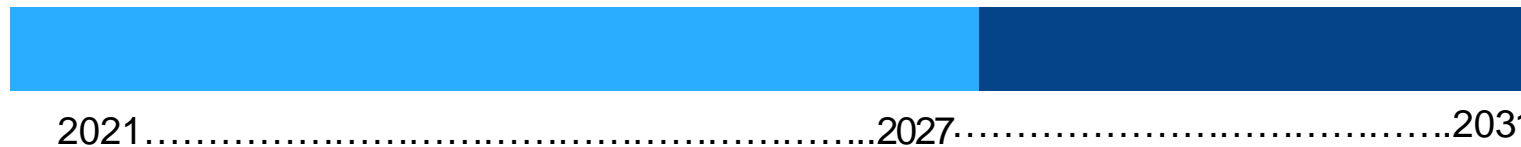


Unified Reporting Model for Leases

- No classification of leases into operating/capital or other categories
- Exceptions (lessors and lessees)
 - Short-term leases
 - Contracts 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

- For financial reporting purposes, when does the lease start and end?
 - Start with the **noncancelable period**



- Plus periods covered by options to:
 - **Extend lease**, if reasonably certain of being exercised
 - **Terminate lease**, if reasonably certain of *not* being exercised
- Excludes cancelable periods
 - Periods for which lessee and lessor both have option to extend or terminate (such as rolling month-to-month leases)
- *Reasonably certain* not defined

Lease Term (continued)

- Renewal and termination options in a lease contract

Probability assessment performed	<ul style="list-style-type: none">• Only lessee has option to renew (lessor cannot refuse)• Only lessee has option to terminate• Only lessor has option to renew (lessee cannot refuse)• Only lessor has option to terminate
Always excluded (no probability)	<ul style="list-style-type: none">• Lessee and lessor both have to agree to renew• Lessee and lessor each have option to terminate

- Fiscal funding and cancellation clauses are ignored unless reasonably certain of being exercised

Lease Term — Example 1

- 3-year lease with lessee option to extend for another 2 years
- Reasonably certain that lessee will extend
- Lease term = 5 years

Lease Term — Example 2

- 7-year lease
- Lessee and lessor can each cancel after year 3
- Reasonably certain neither lessee nor lessor will cancel
- Lease term = 3 years
- See also Implementation Guide Q4.15

Lease Term — Example 3

- 5-year lease, becomes month-to-month after that
- Month-to-month means either side can cancel
- Lease term = 5 years
- See also Implementation Guide Q4.13

Lease Term (continued)

- Factors to consider in initial probability assessment
 - Significant economic incentive (e.g. favorable rent rate)
 - Significant economic disincentive (e.g. cancellation penalty, relocation costs)
 - History of exercising options
 - Extent to which asset is essential to provision of services

Lease Term (continued)

- Reassessment of lease term
 - Option exercised when initially determined reasonably certain it would not be
 - Option not exercised when initially determined reasonably certain it would be
 - Event specified in contract occurs requiring extension or termination
- Probability assessment at initial commencement only
 - Proposed Implementation Guidance Update Q4.10
 - Initial determination not reasonably certain to extend
 - Later becomes reasonably certain
 - Lease term reassessed only when exercised

Short-Term Leases

Definition	At beginning of lease, <i>maximum possible term</i> under the contract is 12 months or less
Maximum possible term	<ul style="list-style-type: none">• Includes any lessee-only options to extend• Includes any lessor-only options to extend<ul style="list-style-type: none">• Regardless of probability• If contract has cancelable periods, use noncancelable period, including any notice periods
Cancelable periods	<ul style="list-style-type: none">• Periods for which lessee and lessor both have option to extend or terminate

Short-Term Leases (continued)

■ Implementation Guide:

- Six-month noncancellable plus 12-month option not reasonably certain of being exercised?
 - Not a short-term lease but lease term would be six months (Q4.18)
- Maximum possible term when only lessee has option to cancel?
 - Include all optional periods (Q4.19)

■ Proposed Implementation Guidance Update:

- Three-year lease but either party can cancel with 60 days notice (Q4.11)
- History of entering into a new 12-month lease every year (Q4.13)

Short-Term Leases (continued)

Lessee accounting	<ul style="list-style-type: none">• Recognize expenses based on the terms of the contract• Do not recognize assets or liabilities associated with the right to use the underlying asset
Lessor accounting	<ul style="list-style-type: none">• Recognize lease payments as revenue based on the payment provisions of the contract• Do not recognize receivables or deferred inflows
Disclosures	<ul style="list-style-type: none">• None

Contracts That Transfer Ownership

- Contracts that:
 - Transfer ownership of the underlying asset to the lessee
 - Do not contain termination options (unless fiscal funding clause not reasonably certain of being exercised)
- Do not follow leases guidance
- Report as a financed purchase (lessee) or sale (lessor)

Initial Reporting

	Assets	Liability	Deferred Inflow
Lessee	Intangible lease 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 for the lease term	NA
Lessor	<ul style="list-style-type: none"> • Lease receivable (present value of future payments) • Continue to report the leased asset 	NA	Equal to lease receivable plus any cash received up front that relates to a future period

Subsequent Reporting

	Assets	Liability	Deferred Inflow
Lessee	Amortize the intangible lease asset over shorter of useful life or lease term	Reduce by lease payments (less amount for interest expense)	NA
Lessor	<ul style="list-style-type: none"> • Depreciate leased asset (unless indefinite life or required to be returned in its original or enhanced condition) • Reduce receivable by lease payments (less amount needed to cover accrued interest) 	NA	Recognize revenue over the lease term in a systematic and rational manner

Initial Measurement - Lease Payment Types

Payment Type	Lessee Liability	Lessor Receivable
Fixed payments	Include	Include
Variable – index or rate	Include using rate at commencement	Include using rate at commencement
Variable – performance or usage	Exclude	Exclude
Variable – fixed in substance	Include	Include
Lease incentives	Include amounts receivable from lessor	Include amounts payable to lessee

Initial Measurement - Lease Payment Types (continued)

Payment Type	Lessee Liability	Lessor Receivable
Residual value guarantees	Include if reasonably certain	Include if fixed in substance
Purchase option exercise price	Include if reasonably certain	Exclude (separate when exercised)
Termination penalties	Include if lease term reflects	Exclude (separate when exercised)
Other payments	Include if reasonably certain	Exclude

Initial Measurement - Discount Rate

- Lessee

- Rate lessor charges the lessee
 - May be interest rate implicit in the lease
- If not readily determinable, use lessee's incremental borrowing rate

- Lessor

- Rate lessor charges the lessee
 - May be interest rate implicit in the lease
 - Option to apply imputation guidance Statement 62

Initial Measurement - Discount Rate (continued)

- Lessor (continued)
 - Proposed Implementation Guidance Update Q4.17
 - Stated rate
 - Estimate implicit rate
 - Including lessee's incremental borrowing rate or published market rates
 - If those not practicable, lessor's incremental borrowing rate

Subsequent Recognition & Measurement

- Lessee:

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

Interest Expense		\$4,000	
Lease Liability		\$18,000	
	Cash (or accounts payable)		\$22,000

- Lease asset amortized

Amortization Expense		\$15,000	
	Lease Asset		\$15,000

Subsequent Recognition & Measurement

- Lessor:

- Lease receivable reduced for actual payments less amortization of discount (interest revenue)

Cash (or accounts receivable)		\$22,000	
	Lease Receivable		\$18,000
	Interest Revenue		\$4,000

- Lease revenue recognized from deferred inflow

Deferred Inflow of Resources		\$15,000	
	Lease Revenue		\$15,000

Subsequent Recognition & Measurement (continued)

- Remeasure lease liability or receivable (if expected to significantly affect liability measurement)

Event	Lessee	Lessor
Change in lease term	X	X
Change in likelihood of residual value guarantee	X	
Change in likelihood of purchase option	X	
Change in estimated amounts for payments already included	X	
Change in interest rate lessor charges	X	X
Contingency resolved for variable payments	X	X

Subsequent Recognition & Measurement (continued)

- If liability or receivable remeasured
 - Adjust liability or receivable for change in variable payments index/rate
 - Update discount rate when certain other judgments change
 - Lessee: change in lease term or likelihood of purchase option
 - Lessor: change in lease term or interest rate charged to lessee

Lessee's Lease Asset

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

Lessee's Lease Asset (continued)

- Subsequent recognition and measurement
 - Amortized using a systematic and rational manner
 - Over the shorter of the useful life of the underlying asset or the lease term
 - 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.
 - Amortization expense *may* be combined with depreciation expense for other capital assets

Lessee's Lease Asset (continued)

- If lease liability remeasured, lease asset generally adjusted by the same amount
 - Until lease asset reduced to zero
 - Any remaining amount is gain
- Apply impairment guidance of Statement 42 to the right-to-use lease asset

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

Lessee Disclosures (continued)

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)

Lessor's Deferred Inflow of Resources

- Initial Measurement:
 - Initial receivable amount
 - Plus any cash received up front that relates to future periods (e.g., final month's rent)
 - Less any lease incentives paid before commencement
- Recognize revenue in a systematic and rational manner over the lease term
- If receivable remeasured, generally adjust deferred inflow by same amount

Lessor's Underlying Asset

- Do not derecognize
 - Board considered derecognition
 - Would represent giving up of right-to-use the asset
 - Significant practical challenges
- Continue normal capital asset treatment
 - Except do not depreciate if required to be returned in original or enhanced condition

Regulated Lease Exception

- Certain regulated leases do not apply the general lessor recognition and measurement guidance
- External laws establish:
 - Lease rates cannot exceed a reasonable amount, with reasonableness being subject to determination by an external regulator
 - Lease rates should be similar for lessees that are similarly situated
 - Lessor cannot deny potential lessees the right to enter into leases if facilities are available

Lessor Disclosures

1. General description of leasing arrangements
2. Total amount of inflows recognized in the reporting period related to leases
3. Lease inflows related to payments not previously included in the lease receivable
4. Lessee termination options if lease payments secure debt
5. If principal ongoing operations are leasing, schedule of expected future minimum payments

Lessor Disclosures (continued)

- Certain regulated leases
 - General description of agreements
 - Extent to which capital assets are subject to preferential or exclusive use
 - Total amount of inflows recognized in the period
 - Schedule of expected future minimum payments
 - Amount of inflows recognized in the period for variable payments not included in minimum payments
 - Lessee termination options if lease payments secure debt
- Implementation Guide Q4.55
 - Possible ways to meet the “preferential or exclusive use” requirement

Other Accounting & Reporting Provisions

Lease Incentives

- Lease Incentives—reduce the amount lessee has to pay
 - a) Payments made to, or on behalf of, the lessee, for which there is a right of offset
 - b) Other concessions
- Payments provided before inception of lease
 - Lessee
 - Reduce any prepayments or be a liability (Imp Guide Q4.56)
 - At inception, reduction of lease asset
 - Lessor
 - Recognize asset (Imp Guide Q4.57)
 - At inception, reduce deferred inflow of resources

Lease Incentives

- Payments provided at inception of lease
 - Lessee
 - Direct reduction of lease asset
 - Lessor
 - Direct reduction of deferred inflow of resources
- Payments provided after inception of lease
 - Reductions of payments for period provided
 - Lessee
 - Reduces lease liability (and lease asset)
 - Lessor
 - Reduces lease receivable (and deferred inflow)

Contracts with Multiple Components

- Separate contracts into lease and nonlease components or multiple lease components
- Separate multiple underlying assets if:
 - Differing lease terms, or
 - Are in differing major asset classes for disclosure (lessee only)
- Also separate regulated components from nonregulated components (Implementation Guide Q4.46)

Contracts with Multiple Components

- Allocation process

1. Use any component prices in the contract if do not appear unreasonable



2. If no component prices or prices unreasonable, use best estimate of separate prices



3. If not practicable to estimate, account for all components as single lease unit

Contract 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:
 - a. The contracts are negotiated as a package with a single objective
 - b. 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
- Amendment is lease modification unless lessee's right to use underlying asset decreases
 - Partial or full termination if lessee's right to use underlying asset decreases

Lease Modifications

- 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 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
- If change results from the lessor refunding related debt and passing savings on to the lessee, see remeasurement guidance in paragraph 74

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

Lease Terminations 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
- 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 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 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 lease)
- 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 offset)
- 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
 - Report leases as normal in standalone financial statements (Imp Guide Q4.75)
- 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 leases with equity method investees
- Disclose the nature and extent of related-party leases

Effective Date

- Reporting periods* beginning after December 15, 2019
 - Earlier application encouraged
- * Proposed change to “fiscal years” in Omnibus 20XX Exposure Draft
 - Would allow governments that do interim GAAP reports to wait until first full fiscal year to implement
- No further change to effective date expected

Transition

- Apply retroactively
 - Restate prior years if practicable, cumulative effect if not
- Recognized and measured *using the facts and circumstances that exist at the beginning of the period of implementation* (hindsight)
 - As if the lease term commenced on that date
- 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

Transition Example 1

- Existing operating lease of equipment (lessee) at \$15,000 per month
- 5-year lease, implementation at beginning of year 4
- Lessee renewal option of 1 more year, reasonably certain it will
- Lease term is 3 years (years 4-5 of original lease plus 1 year renewal)
- Recognize lease asset for present value of \$540,000
- Use discount rate appropriate for a 3-year borrowing of \$540,000

Transition Example 2

- Existing operating lease of land (lessor) at \$50,000 per month
- 10-year lease, eight months left at implementation
- Becomes a short-term lease (maximum possible term is eight months)
- No receivable to recognize
- Recognize revenue as payments received

Transition Example 3

- Existing capital lease (lessee) liability is \$21,500 and asset is \$20,900 (Implementation Guide Q4.77)
- Remainder of lease term measured under GASB 87 and liability should be \$22,500

Transition Example 3 (continued)

- Lease asset should equal lease liability (no prepayments or initial direct costs)
- Adjust existing asset and liability with remainder as restatement:

Lease Asset			\$1,600	
	Lease Liability			\$1,000
	Net Position			\$600

- Lease asset also to be reclassified as intangible

Transition Example 4

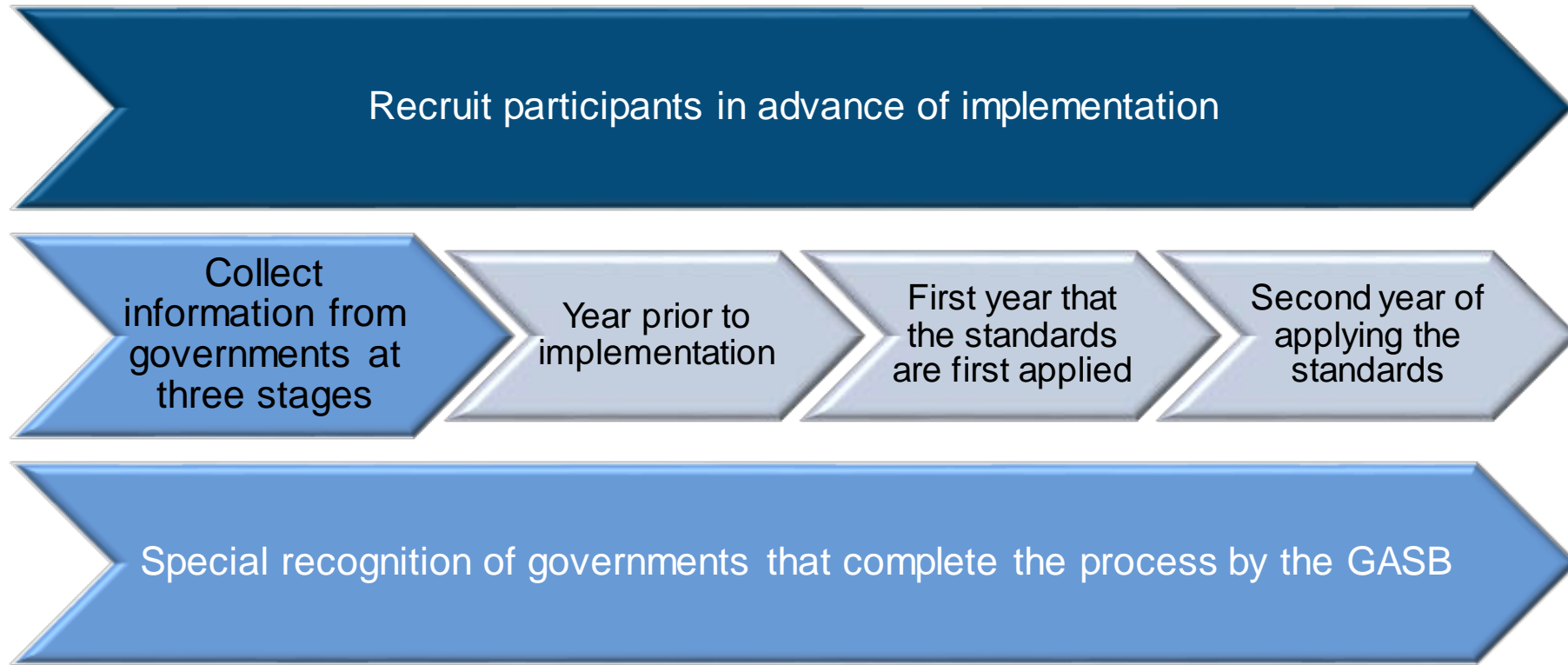
- Existing sale-type lease (lessor) with net investment in lease of \$31,000
- New lease receivable measured at \$30,000
- Do not re-recognize underlying asset

Lease Receivable			\$30,000	
Net Position			\$31,000	
	Net Investment in Lease			\$31,000
	Deferred Inflow			\$30,000

Website Resources



New PIR Process



Volunteer on the GASB website to participate in the PIR for Statement 87

Questions?

Visit www.gasb.org