# Leases under GASB Statement 87
## Implementation Considerations

COLORADO Department of Education

## BACKGROUND INFORMATION

In June 2017, the Governmental Accounting Standards Board (GASB) issued Statement No. 87 – Leases. The objective of this Statement is to better meet the information needs of financial statement users by improving accounting and financial reporting for leases by governments.

This Statement increases the usefulness of governments' financial statements by requiring recognition of certain lease assets and liabilities for leases that previously were classified as operating leases and recognized as inflows of resources or outflows of resources based on the payment provisions of the contract. It establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset.

Under this Statement, a lessee is required to recognize a lease liability and an intangible right-to-use lease asset, and a lessor is required to recognize a lease receivable and a deferred inflow of resources, thereby enhancing the relevance and consistency of information about governments' leasing activities.

The requirements of this Statement are effective for reporting periods beginning after December 15, 2019, or FY2020-2021. Earlier application is encouraged. It is important to know that the standard is to be applied retroactively; existing leases are to be recognized and measured based on the facts and circumstances of the lease in the period of implementation of Statement No. 87, not inception of the lease.

In August 2019, GASB issued an implementation guide No. 2019-3 for Leases. This guide may be helpful to entities trying to implement Statement No. 87 now in order to gauge the direction the GASB was proposing for the accounting and reporting of leases under GASB Statement No. 87.

## NEW DEFINITION OF A LEASE

The Statement defines a lease contract as "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.

A $1 per month rent would be a <u>non-exchange</u> transaction.

Currently reported 'operating' leases that meet the new definition and are greater than 1 year would be reported under the new standard, dropping the word "operating".

## CAPITAL LEASE = CAPITAL FINANCING ACTIVITIES

Capital leases (that transfer ownership) would be reported as capital financing activities instead of being called leases. This will impact the terminology and footnote disclosure of such activities after implementation of GASB Statement No.

### Considerations:

- Take a complete inventory of all lease agreements, both as lessor and lessee
- Look for existing agreements not currently being recognized or disclosed as leases to ensure completeness
- Evaluate all current leases and contracts to determine if they meet the GASB #87 definition of a lease.
- Review the details of each lease contract, looking for nonlease components and determining the interest rate charged
- Assess all leases greater than twelve months.
- Contact legal counsel and explain the new terms for accounting purposes.
- Review debt limits and capitalization thresholds for possible impacts
- Calculate the present value of the lease to be reported.
- Prepare the details of the lease agreement for disclosure, including a schedule of future lease payments if the lessee.
- Seek input from the district's external auditor

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For school districts and with Federal reporting requirements, school districts must continue to isolate the general obligation (GO) voter approved debt from the other debt reported.

## EXCLUDED FROM GASB #87 TREATMENT

The Statement excludes the following items from its application:

- Leases for intangibles (including computer software)
    - Except for sublease of intangible right-to-use leased asset
- Leases for biological assets
- Leases for inventory
- Leases where underlying asset financed with conduit debt
    - Except for underlying asset and conduit debt reported by lessor
- Service concession agreements
- Supply contracts – electric power purchase agreements
- Short-term leases (maximum term 12 months or less)
- Contracts that transfer ownership of the underlying asset to the lessee

## LEASE TERM

The period during which the lessee has:

- Noncancelable right to use underlying asset
- Plus periods where
    - Lessee or Lessor option to extend (if exercise is reasonably certain)
    - Lessee or Lessor option to terminate (if *not* exercising is reasonably certain), includes fiscal funding clauses

## LEASES OF THE LESSEE GOVERNMENT

For the Lessee governments – the government-wide statements would report an intangible lease asset that represents the lessee's right to use the leased asset and a long-term liability for the lease.

The long-term lease payable would be measured as the present value of the payments under the provisions of the lease.

The intangible right-to-use lease asset would equal the lease liability plus any prepayments and certain initial direct costs.

Subsequent to reporting the lease – the asset will be amortized over the shorter of the useful life or lease term , and the liability will be reduced by lease payments (less amount of interest expense).

Under modified accrual treatment for governmental funds, at the commencement of the lease, report a capital outlay – lease expenditure, as well as, an other financing source – lease proceeds. Ensure that this activity is addressed in the budget process for the initial year of the lease to avoid experiencing an over expenditure of the budget appropriation for the fund that reports this activity.

For disclosure purposes, a description of leasing arrangements, the amount of lease assets, and a schedule of future lease payments with principal and interest listed separately and with the first five years in detail and 5 year increments thereafter are required.

## LEASES OF THE LESSOR GOVERNMENT

For the Lessor governments – the government-wide statements would report a receivable for the right to receive payments, initially measured based on the present value of future lease payments to be received.

A corresponding deferred inflow of resources, measured at the initial value of the lease receivable, to reflect that the receivable relates to future periods.

Lease revenue (and a corresponding reduction in the deferred inflows of resources) systematically over the term of the lease, including recognizing interest revenue related to the receivable.

The same treatment is reported for both government-wide and under modified accrual treatment for governmental funds.

For disclosure purposes, a description of leasing arrangements and the total amount of lease revenue for the current year is required.

## LEASE CONTRACTS WITH MULTIPLE COMPONENTS

For a contract with lease and nonlease components, separate the lease components from the nonlease components and treat as separate contracts.

For multiple underlying assets in the same lease and assets that have different lease terms, treat each underlying asset as a separate component. Allocate contract price to each component using reasonableness and professional judgment to determine the prices for each component in the contract and use stand-alone prices for similar assets. If cannot determine an allocation, treat as a single-lease unit.

## CONTRACT COMBINATIONS

The criteria for treating such combinations as a single contract relate to:

- Determining if the contracts were entered into at or near the same time with the same counterparty and one of the following applies (1) negotiated as a package with a single objective, or (2) consideration paid in one contract depends on the price or performance of the other contract.
- If not, evaluate as a contract with multiple components.

## LEASE MODIFICATIONS

For amendments to the lease contracts, would normally be considered a modification – if right to use is reduced. This would equal a partial termination.

The treatment of lease modifications would be as a separate lease, or would be a remeasurement of the existing lease.

Would treat as a separate lease if both the following exist: (1) Lessee receives one or more underlying assets not part of original lease and (2) the increased payments for additional assets are not unreasonable. If both are not met, then treat as a remeasurement.

## REMEASUREMENT

For the lessee – remeasure the lease liability and adjust the lease asset for the difference between the remeasured liability and the liability before the lease modificaition.

For the lessor – remeasure the lease receivable and adjust the deferred inflow of resources for the difference between the remeasured receivable and the receivable before the remeasurement.

## TERMINATIONS

When the Lessee's right to use the asset is reduced for a shortened lease term or a reduction in the number of assets, the lessee would reduce the lease liability and asset and the difference would be reported as gain/loss. For the lessor, reduce lease receivable and deferred inflow of resources, with the difference reported as gain/loss.

## SUBLEASE

For a sublease arrangement, treat as a separate transaction, as the lessee is now also the lessor. No offset of transactions for the original lessee, the right to use asset and liability (original lease), and for the receivable and deferred inflow of resources (sublease)

## INTRA-ENTITY LEASE ACTIVITY

When the lessee or lessor is included as a blended component unit of the primary government, the reporting requirements of this Statement do not apply. Instead, when the lessor is a blended component unit, the debt and assets of the lessor should be reported as if they were the primary government's debt and assets. The debt service activity of the lessor would be reported as a debt service activity of the reporting entity.

With respect to leases with or between blended component units, for which eliminations are required, these eliminations should be made before the financial statements of the blended component units are aggregated with those of the primary government.

## CHART OF ACCOUNT CHANGES

On June 8, 2018, various changes to the chart of accounts (COA) were presented to the Financial Policies and Procedures Advisory Committee (FPP Committee). These included changes to Appendix L for Leases, to the various fund codes being impacted, and also changes to the object, source and balance sheet codes. These chart of account changes must be implemented for FY2020-2021, but are optional prior to that fiscal year for any district that wishes to early implement GASB Statement No. 87.

## Where can I learn more?

- Visit the School Finance website at https://www.cde.state.co.us/cdefinance
- Contact Kirk Weber, Financial Accounting Technical Advisor at weber_k@cde.state.co.us
- GFOA Advisory: Accounting for Leases at https://www.gfoa.org/accounting-leases
- GASB Statement No. 87 at https://www.gasb.org/cs/ContentServer?c=Document_C&cid=1176169170145&d=&pagename=GASB%2FDocument_C%2FDocumentPage
- GASB Implementation Guide No. 2019-3, Leases at
- https://www.gasb.org/cs/ContentServer?c=Document_C&cid=1176173189687&d=&pagename=GASB%2FDocument_C%2FDocumentPage
- A CliftonLarsonAllen LLP tool for GASB 87 Lease Determination is at http://www.cde.state.co.us/cdefinance/gasb87_lease_tool