GASB 87 - Leases

<u>South Carolina Association of CPAs – Fall Fest</u>

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GASB 87 - Leases

- Effective for periods beginning after December 15, 2019
  - December 31, 2020 or June 30, 2021 or September 30, 2021
- Amends GASB 62 lease guidance (which was from FASB Statement 13)
- The existing standards had been in effect for decades without review to determine if they remain appropriate and continue to result in useful information; FASB and IASB conducted a joint project to update their lease standards; opportunity to increase comparability and usefulness of information and reduce complexity for preparers
  - GASB 87 is predominately consistent with new FASB lease accounting requirements

*Prior **Lessor** Classification of Leases*

Types of leases:

1. Sales-Type Leases
2. Direct Financing Leases
3. Leveraged Leases
4. Operating leases (all other leases)

GASB 87 - Leases

Prior Lessee Classification of Leases

Two primary classification of leases

A. Capital leases (meet one of four criteria)

1. Transfer of ownership at conclusion
2. Bargain purchase option
3. Lease term ≥ 75% of economic life of asset
4. PV of future minimum lease payments ≥ 90% of FMV

B. Operating leases (all other leases)

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Prior Lessee Accounting of Leases

A. Capital leases

1. Journal Entry

Debit: Capital Assets	XXX	
Credit: Long-term debt*		XXX

**At present value of future minimum lease payments*

2. Disclosure – Future minimum payments

B. Operating leases – Expense the payments as made

1. Disclosure – Future minimum payments if noncancelable

New Standard

Definition of a Lease

- Standard is applied to any contract that meets the definition of a lease:

"A lease is a contract that conveys control of the right to use another entity's nonfinancial asset for a period of time in an exchange or exchange-like transaction."

Definition of a Lease (continued)

- **Conveying 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

Definition of a Lease (continued)

- **Nonfinancial Asset**
  - An asset that is not a financial asset as that term is defined by GASB 72
    - Financial – Cash, evidence of ownership interest in an entity, or a contract that conveys right to receive cash from a second entity or exchange other financial instruments (option). These are excluded from the scope of GASB 87
    - Non-financial asset examples are land, buildings, vehicles, and equipment.

Definition of a Lease (repeat)

- Standard is applied to any contract that meets the definition of a lease:

"A lease is a contract that conveys control of the right to use another entity's nonfinancial asset for a period of time in an exchange or exchange-like transaction."

- Substance Over Form
  - Leases include contracts that may not be called leases – but still meet the definition provided – and vice versa

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 (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)

Leases Scope Exclusions (continued)

- This Statement also does ***not*** apply to contracts/leases that **transfer ownership** -

A lease contract that transfers ownership of the underlying asset to the lessee at or before the end of the contract and does not contain termination options should be reported as a financed purchase of that asset.

- Can contain a fiscal funding clause (if not reasonably certain of being exercised) and still quality for exclusion (i.e. can still be accounted for as a purchase)

Examples – Are these Leases?

- Contract to utilize a car for 3 years
- Contract to utilize software for 3 years
- Contract to utilize cafeteria under parameters of costs to be charged
- Contact to manage convention center
- Contract to utilize a building for the next 40 years with no transfer of ownership
- Contract to utilize a building for the next 40 years with transfer of ownership

Overview of Reporting Model for Leases

- 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 (see prior slide)
- Exceptions for lessors
  - Leases of assets that are investments (under GASB 72 definition)
  - Certain regulated leases (e.g., airport-airline agreements)

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Lease Term

- **Lease Term** – The period during which a lessee has a non-cancelable right to use an underlying asset, plus the following periods, if applicable, covered by a lessee's or lessor's option to:

    - Extend the lease - if it is *reasonably certain* of being exercised

    - Terminate the lease - if it is *reasonably certain* of not being exercised

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Lease Term (continued)

- Periods for which the lessee and lessor each have an option to terminate the lease without permission from the other party are **cancelable periods** and are **excluded** from the lease term
  - Cancelable periods also include periods when both parties agree to extend the lease (i.e. – rolling or month-to-month leases)
- Provisions that allow for termination of a lease due to (a) purchase of the underlying asset, (b) payment of all sums due, or (c) default on payments are not considered termination options
- A fiscal funding or cancellation clause generally is NOT a termination provision and should be considered a termination clause in determining lease term only when it is reasonably certain that the clause will be exercised.

Lease Term — Example

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

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

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Lease Term — Example

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

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

Lease Term — Example

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

Lessee options		Lessor options		Term
Terminate	Extend	Terminate	Extend	
Uncertain	n/a	Uncertain	n/a	4 years
Uncertain	n/a	**Reasonably Certain**	n/a	4 years
Reasonably Certain	n/a	Uncertain	n/a	4 years
Reasonably Certain	n/a	**Reasonably Certain**	n/a	4 years

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

Reassessment of Lease Term

- Reassess the lease term only if *one or more* of the following occurs:

a. Lessee or lessor elects to exercise an option even though originally determined that the lessee or lessor would *not* exercise that option

b. Lessee or lessor elects to *not* exercise an option even though previously determined that the lessee or lessor would exercise that option

c. An event specified in the contract that requires an extension or termination of the lease takes place.

Short-Term Lease Accounting 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

Short-Term Lease Accounting Exception (cont.)

- Accounting for Short-term Leases:
  - LESSEE — lease payments recognized as expenses/expenditures based on the payment provisions of the contract
    - No recognition of assets or liabilities associated with the right to use the underlying asset for short-term leases
  - LESSOR — lease payments recognized as revenue based on the payment provisions of the contract
    - No recognition of receivables or deferred inflows associated with the lease
  - No resource flows recognized during rent holiday periods
  - No required disclosures

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Short-Term Lease Accounting Example

- City leases office space for 12 months with possible extension on a month-to-month basis although cancellation in this period can occur with 30 day notice by either party. Rent is $1,000 per mo.
- City would record each month's rent payment as:

	Db	Cr
Rent Expense	$ 1,000	
Cash		$ 1,000

- Accrual and Modified Accrual Accounting is the same.
- Any prepayment or lack of payment would create a prepaid or accrual.

All Others – Overview of Initial Reporting

	ASSETS	LIABILITY	DEFERRED INFLOW
Lessee	Intangible asset (right to use underlying asset) – value of lease liability plus prepayments and initial direct costs that are ancillary to place asset in use, less any incentives	Present value* of future lease payments (including fixed payments, variable payments based on index or rate, reasonably certain residual guarantees, etc.	N/A
Lessor	• Lease receivable (generally including same items as lessee liability) • Continue to report leased asset	N/A	Equal to lease receivable plus any cash received up front that relates to a future period
* To calculate the PV, the lessee would use a discount rate that reflects the rate the lessor charges the lessee, (may be the rate implicit in the lease). If that cannot be determined, the lessee would use the incremental borrowing rate.			

All Others – Overview of Subsequent Reporting

	ASSETS	LIABILITY	DEFERRED INFLOW
Lessee	Amortize the intangible asset over shorter of useful life or lease term. Amortization expense may be combined with depreciation expense related to other capital assets for reporting purposes.	Reduce by lease payments (less amount for interest expense)	N/A
Lessor	• Depreciate leased asset (unless indefinite life or required to be returned in its original or enhanced condition) • Reduce receivable by lease payments (less payment needed to cover accrued interest)	N/A	Recognize revenue over the lease term in a systematic and rational manner

LESSEE

Recognition & Measurement

LESSEE—Recognition & Measurement

- Recognize a liability for future lease payments (the "lease liability") and an intangible capital asset for the right to use the underlying asset (the "lease asset")
    - Full accrual accounting

- In governmental funds (modified accrual)
  – Report payables when due
  – Don't report lease (capital) assets

LESSEE—Lease Liability Initial Measurement

- Initial measurement of a lease liability includes:
  - Fixed payments (less any lease incentives receivable from the lessor in the future – not lease incentives to paid at inception)
  - Variable payments based on an index or rate (such as CPI), using the rate as of the beginning of lease
  - Variable payments that are fixed in substance
  - Residual value guarantees *reasonably certain* of being required
  - Purchase options *reasonably certain* of being exercised
  - Termination penalties, if lease term reflects lessee exercising termination options/fiscal funding clauses
  - Any other *reasonably certain* payments

LESSEE—Lease Liability Initial Measurement (cont.)

- Lease liability does <u>not include</u> lease payments that are dependent on a lessee's performance or usage of an underlying asset
- Lease liability payments should be <u>discounted</u> 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

LESSEE—Lease Asset Initial Measurement

- Lessee's right-to-use lease asset
  - Initially measure lease asset as the sum of:
    a. Initial lease liability
    b. Any prepayments (amounts paid to the lessor prior to measuring the lease liability)
      - Less any lease incentives *received* from the lessor at/or before commencement of the lease
    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 - including those that could be considered to be issuance costs) should be expensed

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LESSEE— Initial Measurement

- Practical Considerations
  - Like all GASB standards – The provisions of this statement need not be applied to immaterial items
    - Is the calculated asset and/or liability material to your financial statements?
    - Use of capital asset capitalization threshold policy?
      - » i.e. if the asset determined with the initial measurement is under your capitalization threshold, it is likely that the transaction (both asset and liability) would be immaterial and therefore can just be expensed as paid
    - Consider discussing with your auditor if you conclude immaterial

LESSEE— Initial Measurement Example 1

<u>Lease of a Copy Machine</u>

Lease Payment per month	$100 per month
Lease Term	2 years

What is the amount of the lease asset (no consideration of discount)?

What is the amount of the lease liability (no consideration of discount)?

What is the entry to record the initial lease at inception?

LESSEE— Initial Measurement Example 1 - Answer

Lease of a Copy Machine

Lease Payment per month $100 per month

Lease Term 2 years

What is the amount of the lease asset (no consideration of discount)?

$2,400 ($100 * 24 months)

What is the amount of the lease liability (no consideration of discount)?

$2,400 ($100 * 24 months)

What is the entry to record the initial lease at inception?

Probably no entry – amount is most likely immaterial

LESSEE— Initial Measurement Example 2

Lease of a Vehicle

Lease Payment per month	$500 per month
Lease Term	2 years

What is the amount of the lease asset (no consideration of discount)?

What is the amount of the lease liability (no consideration of discount)?

What is the entry to record the initial lease at inception?

LESSEE— Initial Measurement Example 2 - Answer

Lease of a Vehicle

Lease Payment per month $500 per month

Lease Term 2 years

What is the amount of the lease asset (no consideration of discount)?

$12,000 ($500 * 24 months)

What is the amount of the lease liability (no consideration of discount)?

$12,000 ($100 * 24 months)

What is the entry to record the initial lease at inception?

	Db	Cr
Lease Asset	$ 12,000	
Lease Liability		$ 12,000

LESSEE—Present Value Considerations

- Lease liability payments should be discounted to present value using the rate the lessor charges the lessee
  - Rate may be implicit or,
  - if that rate cannot be readily determined, the lessee's incremental borrowing rate
- Present value means that we should think about this as if we are borrowing money from a bank. Given that we are not paying for use of the asset all up front, then we are, in essence, financing the purchase of the use of the asset and must charge some of our payment to interest (a cost of financing)

LESSEE—Present Value Considerations

- Interest rate may be stated in your lease agreement and interest may be calculated/identified
  - In this case the principal balance at beginning of lease is the present value of the lease payments – payments will be stated in the agreement and broken out between principal and interest.
  - Common in debt / borrowings. Not as common in leases

LESSEE—Present Value Considerations

- If there is not an explicitly stated rate, then rate may be implicit
  - This is when you can calculate the rate knowing the payment stream and the value/cost of the access to the asset you are purchasing

Annual Payment	$ 1,000	(known)
Value of Equipment	$ 5,000	(known)
Interest Rate	5.47%	(determined)

Year	Total Payment	Interest	Principal	Balance
				$ 5,000
1	$ 1,000	$ 274	$ 727	4,274
2	1,000	234	766	3,507
3	1,000	192	808	2,699
4	1,000	148	852	1,847
5	1,000	101	899	948
6	1,000	52	948	(0)

LESSEE—Present Value Considerations

- If implicit rate can not be determined, then you can utilize your incremental borrowing rate
  - This rate is an estimate of the rate that would be charged for borrowing a similar amount during the lease term

Annual Payment	$ 1,000	(known)
Value of Equipment	$ 5,158	(determined)
Interest Rate	4.50%	(estimated)

Year	Total Payment	Interest	Principal	Balance
				$ 5,158
1	$ 1,000	$ 232	$ 768	4,390
2	1,000	198	802	3,588
3	1,000	161	839	2,749
4	1,000	124	876	1,873
5	1,000	84	916	957
6	1,000	43	957	0

This can also be done in excel with formula **=NPV(rate, range of cells)**

LESSEE—Subsequent Recording

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

Lease Liability	xx,xxx	
Interest Expense	xxx	
Cash		xx,xxx

LESSEE—Subsequent Recording

- Lease asset should be amortized (e.g., amortization expense) using a systematic and rational manner over the shorter of the useful life of the underlying asset or the lease term
  - Lease asset amortization *may* be combined with depreciation expense for other capital assets
  - 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 (not the lease term), using the lessee's depreciation policy, unless non-depreciable.

Amortization Expense	xx,xxx	
Lease Asset		xx,xxx

LESSEE—Subsequent Remeasurement

- Remeasure lease liability when certain changes occur (if expected to significantly affect liability measurement)
  - Such as change in lease term, changes in likelihood of purchase option being exercised, etc.
- If liability remeasured
  - Adjust liability for change in variable payments index/rate
  - Update discount rate when certain other judgments change
- Adjustments to the lease liability generally should adjust the lease asset by the same amount
  - Exception if adjustment is greater than carrying value of asset, difference is recognized in the flows statement

LESSEE—Subsequent Remeasurement (cont.)

- If the underlying lease asset becomes impaired, apply capital asset impairment guidance of Statement 42 to the right-to-use lease asset

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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

LESSEE—Disclosures (continued)

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)

LESSOR

Recognition & Measurement

LESSOR—Overview of Recognition & Measurement

- Recognize a lease receivable and deferred inflow of resources
- *Do not derecognize (remove) 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
- In governmental funds (modified accrual), report lease receivable (full amount – same as accrual accounting above) and offsetting deferred inflow of resources
  - Recognize deferred inflow of resources as revenue when "available"

LESSOR—Exceptions

- The following transactions do not apply the general lessor recognition and measurement guidance (but still required to provide certain disclosures)
  - Leases of tangible, leased assets that are investments
    - Definition of investment under GASB 72
    - 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

LESSOR—Initial Measurement

- Initial measurement of a lease receivable includes:
  - Fixed payments (less any lease incentives payable to the lessee in the future– not lease incentives to be paid at inception)
  - Variable payments that depend on an index or rate (such as CPI)
    - Use the rate as of beginning of lease
  - Variable payments that are fixed in substance
    - Exclude variable lease payments that are dependent on a lessee's performance or usage of an underlying asset
  - Residual value guarantees that are fixed in substance
  - Less provision for uncollectible amounts

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LESSOR—Initial Measurement (cont.)

- Discount the lease receivable using the rate the lessor charges the lessee
  - Interest rate may be implicit in the lease
- Initially excludes the following
  - Residual value guarantees that are not fixed in substance should be recognized as a receivable when:
    a. Payment is required, and
    b. Amount can be reasonably estimated
  - Purchase option payments or termination penalties
    - Recognized when exercised

LESSOR—Deferred Inflow of Resources

- Initial Measurement of the Deferred Inflow of Resources includes:
  - Receivable amount, plus
  - Any cash received up front that relates to future periods (e.g., final month's rent)

LESSOR—Subsequent Recording

- Lease Receivable
  - Recognize amortization of the discount on the lease receivable (interest revenue) to produce a constant periodic rate of return on the receivable
  - Lease payments (receipts of cash) allocated first to accrued interest receivable and then to the lease receivable
- Deferred Inflow of Resources
  - Recognize revenue over the lease term on a systematic and rational manner over the lease term

LESSOR—Subsequent 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:

  a) There is a change in lease term, or

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

  c) 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

LESSOR—Disclosures

- Lease activities may be grouped for disclosure purposes
- Disclosures required of Lessor:

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
   - Includes lease/rent revenue, interest income

LESSOR—Disclosures (continued)

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)

LESSOR—Disclosures (continued)

- 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

Other Accounting and 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
  c) Include rebates, discounts, free rent (rent holiday), assumption of lessee's pre-existing lease, reimbursement of lessee costs (such as leasehold improvements)
- Payments provided at or before inception of lease reported as
  – Direct reductions of lessee's lease asset
- Payments provided after inception of lease reported as
  – Reductions of payments for period provided (if applicable)
  – Reduces PV of lease liability (and lessor's receivable)

Lease Incentives – Example (Free Rent)

6 year lease		
1st year free rent		
Annual Report each of remaining 5 years		$ 10,000
Total payments to be made		$ 50,000

Initial Entry (wo condering PV)	Db	Cr
Lease Asset	$ 50,000	
Lease Liability		$ 50,000
Subsquent Recognition (Year 1)		
Rent / Depreciation Expense	$ 8,333	
Lease Asset		$ 8,333
Subsquent Recognition (Year 2 - 6)		
Lease Liability	$ 10,000	
Cash		$ 10,000
Rent / Depreciation Expense	$ 8,333	
Lease Asset		$ 8,333

Lease Incentives – Example (Leaseholds)

6 year lease		
Payments made by Lessor for leashold improvements		$ 8,000
(at time of the lease inception)		
Annual Rent for each of 6 years		$ 10,000
Total payments to be made		$ 60,000

Initial Entry (wo condering PV)	Db	Cr
Lease Asset	$ 52,000	
Leasehold Improvements (cap asset)	$ 8,000	
Lease Liability		$ 60,000
Subsquent Recognition (All 6 years)		
Lease Liability	$ 10,000	
Cash		$ 10,000
Rent / Depreciation Expense	$ 10,000	
Lease Asset		$ 8,667
Leashold improvements (capital asset)		$ 1,333

Contracts with Multiple Components

- Separate contracts into lease and nonlease components or multiple lease components
- Allocate consideration to multiple underlying assets if:
  - Differing lease terms, or
  - Are in differing major asset classes for disclosure
- Allocation process:
  - First — use any prices for individual components if price allocation not unreasonable based on contract terms and professional judgment (maximizing observable information)
  - If no prices or if not reasonable, use best estimate based on professional judgment (maximizing observable information)
  - If not practicable to determine best estimate, may account for components as single lease unit

Contracts with Multiple Components

- Discussion Examples
  - Contract for use of software (non-lease) plus use of hardware (lease)?
  - Lease to use a building (lease) plus contract for maintenance of building (non-lease)
  - Others?

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
- **MODIFICATIONS**
  - Considered lease modification unless lessee's right to use underlying asset decreases
- **TERMINATIONS**
  - Considered partial or full lease 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

LESSEES - Lease Modifications

- 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

LESSORS - Lease Modifications

- 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

LESSEES - Lease Terminations

- 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

LESSORS - Lease Terminations

- 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

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Subleases

- Accounted for as transactions <u>separate</u> from the original lease
  - Do not offset original lease liability and sublease receivable
  - Lessee will now also be a lessor
- 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

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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, e.g.:
  - 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 setoff)
- 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
  - Reporting requirements of this standard do not apply
  - Debt and assets of the lessor should be reported as if they were the primary government's debt and assets

Intra-Entity Leases (continued)

- Leases with/between <u>discretely-presented component units</u>
  - Treat like normal leases (follow same accounting described in this presentation, but
    - Present receivables and payables separately
  - Most of these transactions we see involve the transfer of ownership and this standard would not apply (see previous discussion). These should probably now be called contracts (and not leases)

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 investments in stock
- Disclose the nature and extent of related-party leases

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 <u>at the beginning of the period of implementation</u>* (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

Implementation Plan

What to do to Prepare?

- Inventory current agreements
  - Which ones fall under this standard?
  - Which ones will still be in place during the implementation year?
  - Consider terms – anything need clarification?
  - Any impact on debt convents or other financial policies (fund balance) with addition of the liabilities?

What to do to Prepare (continued)?

- Develop system of internal control to ensure all agreements moving forward are considered
  - How decentralized is your contracting process?
  - How ensure you will consider all of them?
- For new agreements entered until the implementation year
  - Review to ensure you have information to perform proper accounting (break out non-lease components)

Questions ???

GASB 87 - Leases

South Carolina Association of CPAs – Fall Fest

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Mauldin & Jenkins

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