

Governmental Audit Quality Center



GASB 87: Leases

What Preparers & Auditors Need to Know to be Ready for Implementation

A Governmental Audit Quality Center Web Event

Today's speakers



Stephen W. Blann,
CPA, CGFM, CGMA

Owner
Rehmann Robson, LLC



Chris Pembroke,
CPA

Shareholder
Crawford & Associates, P.C.

What we will cover

- 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



Panel discussion – Why is today’s topic important for governments and their auditors?



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*

5

Existing GAAP for leases

- Classification of leases (lessee perspective)
- Capital leases (meet one of four criteria)
 - Transfer of ownership at conclusion
 - Bargain purchase option
 - Lease term \geq 75% of economic life of asset
 - PV of future minimum lease payments \geq 90% of FMV
- Operating leases (all other leases)

6

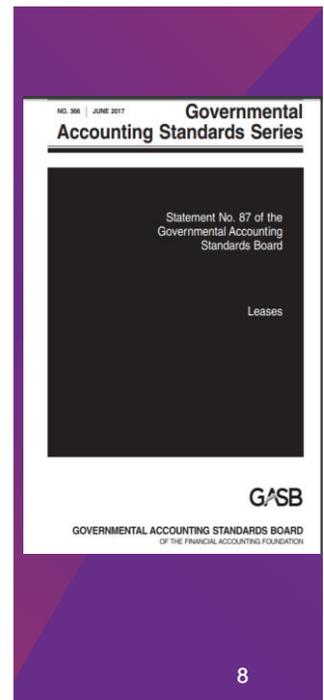
Existing GAAP for leases

- Accounting for leases (lessee perspective)
 - Capital leases
 - Debit capital assets and credit long-term debt for PV
 - Disclose future minimum payments
 - Operating leases
 - Expense payments as made (generally)
 - Disclose future minimum payments (if noncancelable)

7

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



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

Exceptions for lessors

- Leases of assets that are investments
- Certain regulated leases (e.g., airport-airline agreements)



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.

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

11

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)

12



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

13

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 16. 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 via transfer of immediately available funds only. Each payment will consist of a principal and interest component.

14

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

15

Lease term - example

Step



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

16

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

17

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

18

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

19

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

20

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
Total Lease Term	5 Years

- **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

21

Reassessment of lease term

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

<p>Lessee or lessor elects to exercise an option even though originally determined that the lessee or lessor would not exercise that option</p>	<p>Lessee or lessor elects to not exercise an option even though previously determined that the lessee or lessor would exercise that option</p>	<p>An event specified in the contract that requires an extension or termination of the lease takes place.</p>
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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

23

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

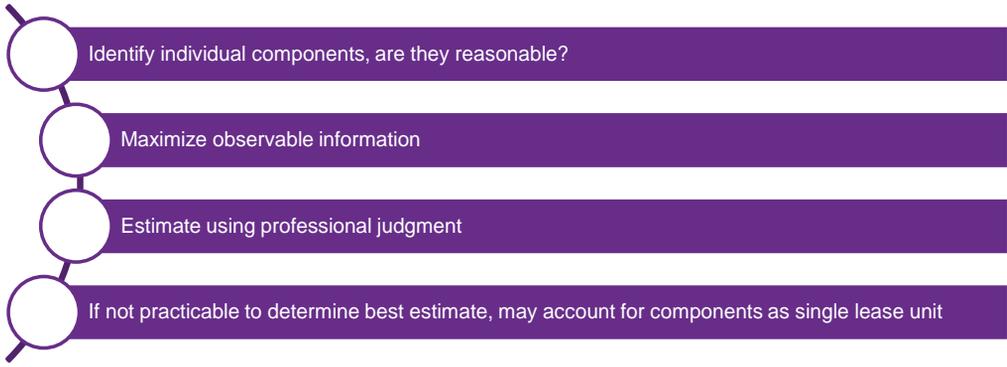
Are in differing major asset classes for disclosure

Consider **Contract Combinations** when reviewing Multiple Components

24

Contracts with multiple components

- Allocation process:



- No Policy provision in Standard

25

Panel discussion – How difficult do you think it will be for governments to estimate the lease term?



26

LESSEE Recognition & Measurement

Leases overview—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	Present value of future lease payments (incl. fixed payments, variable payments based on index or rate, reasonably certain residual guarantees, etc.)	N/A
LESSOR	<ul style="list-style-type: none"> 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

- 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

Leases overview—subsequent reporting

	Assets	Liability	Deferred Inflow
LESSEE	Amortize the intangible 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 payment needed to cover accrued interest) 	NA	Recognize revenue over the lease term in a systematic and rational manner

- Exception if adjustment is greater than carrying value of asset, difference is recognized in the flows statement
- If the underlying asset becomes impaired, apply capital asset impairment guidance of Statement 42 to the right-to-use lease asset

29

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?**



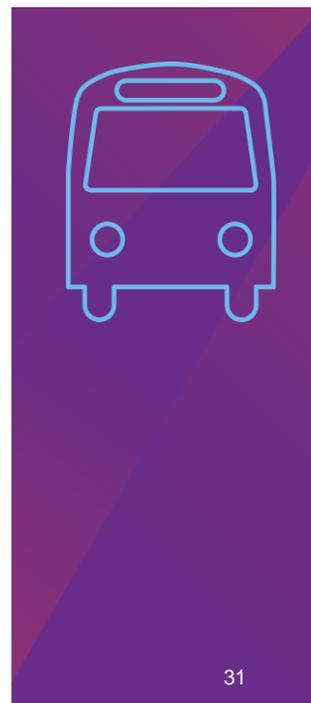
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LESSEE – bus lease example (cont.)

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



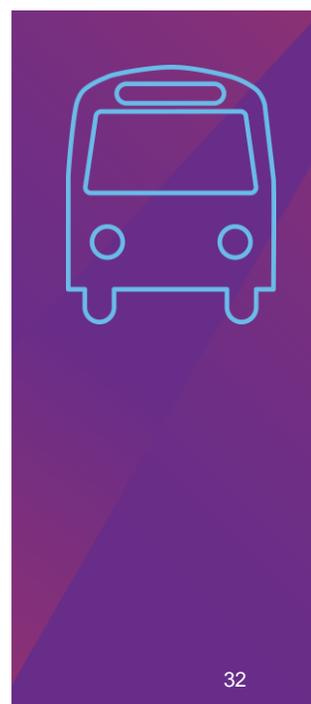
LESSEE – bus lease example (cont.)

Identifying the Lease Term

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



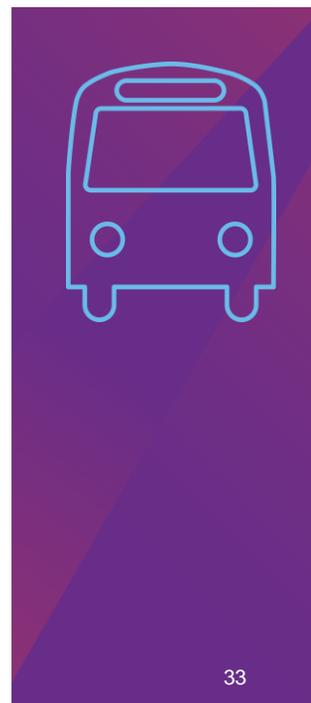
LESSEE – bus lease example (cont.)

Identifying the Lease Term

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



LESSEE – bus lease example (cont.)

Assumptions for Lease Liability calculation:

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

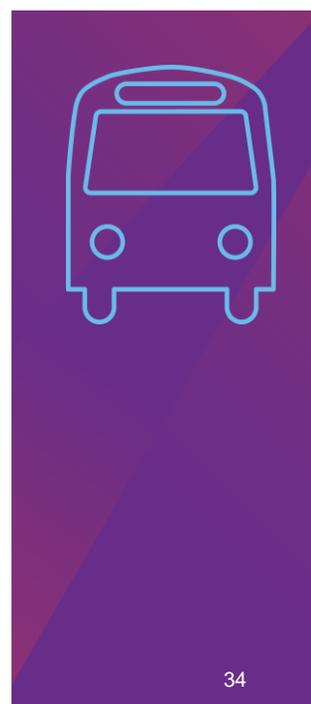
Payment schedule 5 years, assuming a 6% interest rate.

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

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



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.

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- 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

35

LESSEE – bus lease example (cont.)

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	<u>23,238</u>	<u>762</u>	<u>24,000</u>
	103,451	16,549	120,000

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>
		103,451

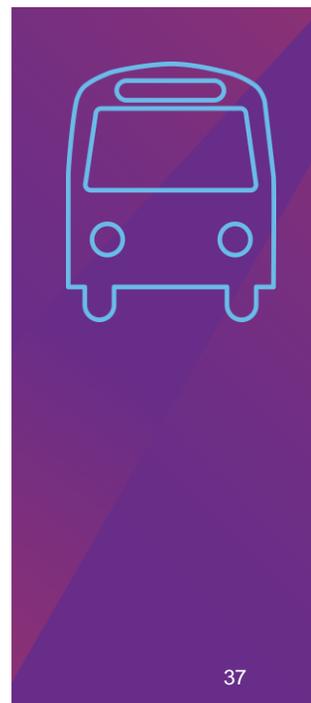


36

LESSEE – bus lease example (cont.)

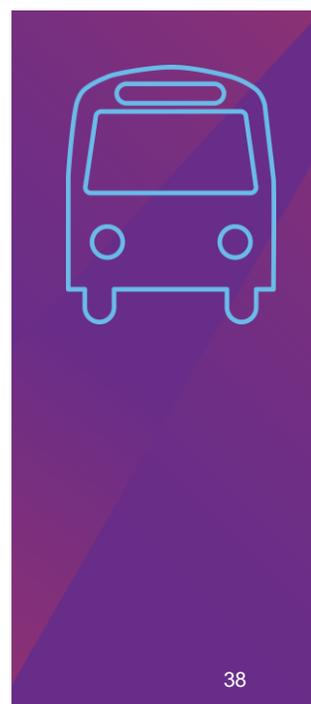
Governmental Fund - Initial Journal Entry	Debit	Credit
Capital outlay	103,451	
Other financing sources - lease proceeds		103,451
<i>To record capital expenditure and related proceeds from lease of buses</i>		

Entity-wide - Initial Journal Entry	Debit	Credit
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>		



LESSEE – bus lease example (cont.)

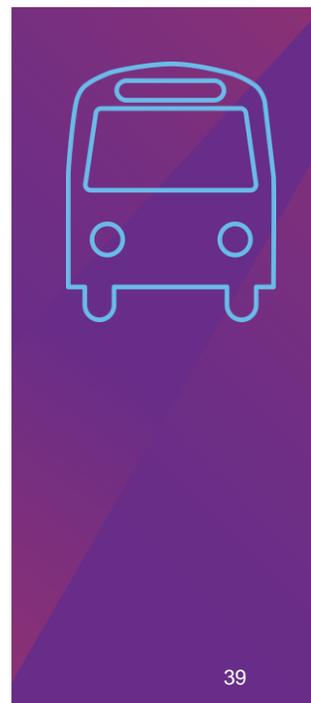
Enterprise funds - Initial Journal Entry	Debit	Credit
Intangible lease asset - vehicles	103,451	
Lease liability – due within one year		18,290
Lease liability – due beyond one year		85,161



LESSEE – bus lease example (cont.)

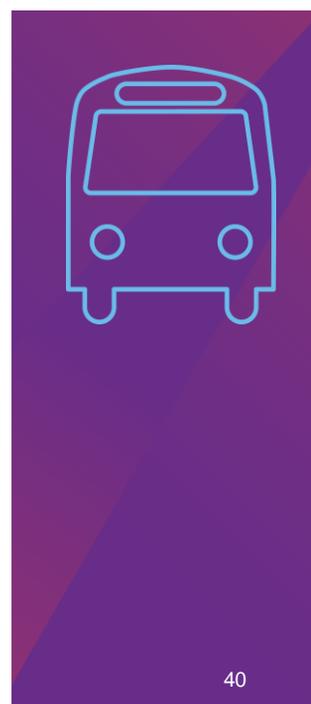
Governmental Fund - Year 1 Journal Entry	Debit	Credit
Interest expense	5,710	
Lease principal payment expenditure	18,290	
Cash		24,000
<i>To record 12 monthly lease payments for first year</i>		

Entity-wide - Year 1 Journal Entries	Debit	Credit
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>		



LESSEE – bus lease example (cont.)

Enterprise funds - Year 1 Journal Entry	Debit	Credit
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>		



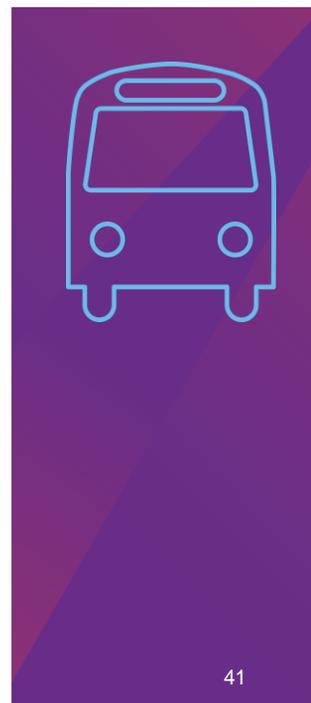
LESSEE – bus lease example (cont.)

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.



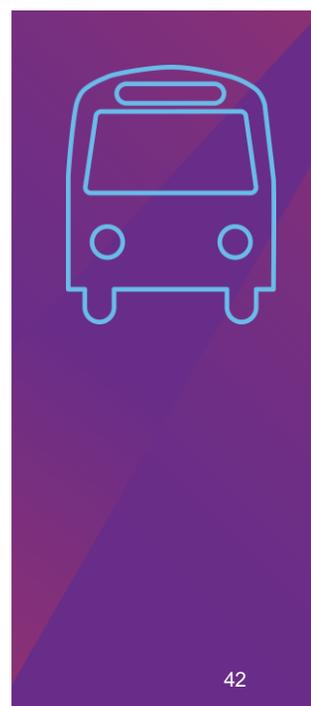
LESSEE – bus lease example (cont.)

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

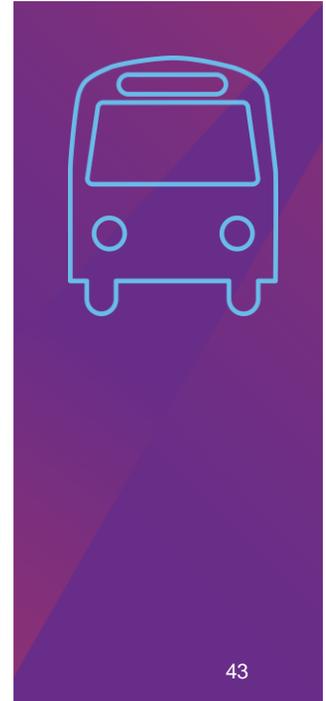
Entity-wide - Year 2 Journal Entries	Debit	Credit
Lease liability – due within one year	19,419	
Lease principal payment expenditure		19,419
Amortization expense	20,690	
Accumulated amortization		20,690

To eliminate fund level activity for second year



LESSEE – bus lease example (cont.)

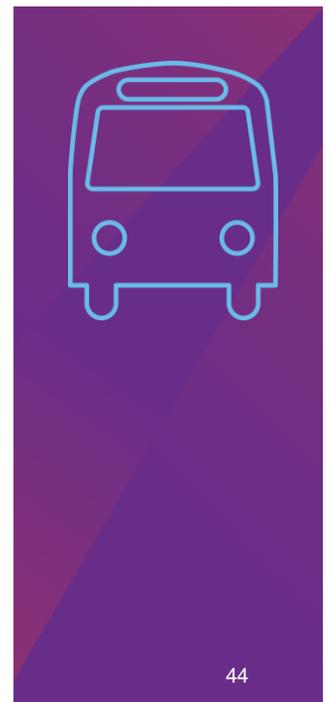
Enterprise funds - Year 2 Journal Entry	Debit	Credit
Interest expense	4,581	
Lease liability – due within one year	19,419	
Cash		24,000
<i>To record 12 monthly lease payments for second year</i>		
Amortization expense	20,690	
Accumulated amortization		20,690
<i>To record annual amortization expense</i>		



LESSEE – bus lease example (cont.)

Enterprise funds and Entity-wide Year 2 Journal Entry	Debit	Credit
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.

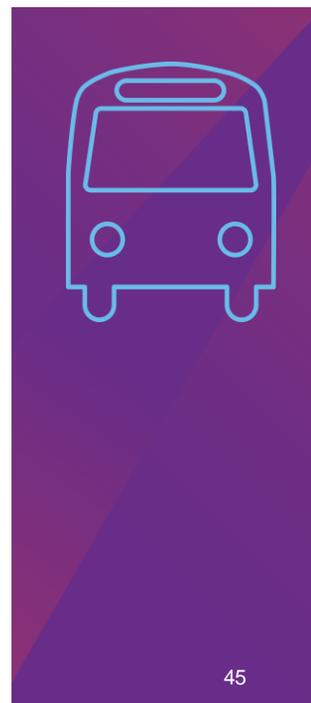


LESSEE – bus lease example (cont.)

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



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

- 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)

47

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%.”



48

LESSEE – bus lease disclosure example (cont.)

Capital Assets – Year 2	Beginning Balance	Additions	Deletions	Ending Balance
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
Leased Vehicles (Intangible asset)	103,451	-	-	103,451
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
Leased vehicles	20,690	20,690	-	41,380
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

49

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
2023	\$ 20,616	\$ 3,384	\$ 24,000
2024	21,888	2,112	24,000
2025	23,238	762	24,000
2026	-	-	-
2027	-	-	-
2028 - 2032	-	-	-
	\$ 65,742	\$ 6,258	\$ 72,000

Combine with building lease payment schedule for financial statement presentation

50

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?



51

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? **YES**
- Does \$500 per quarter for five buses seem reasonable? **YES**
- Is it identifiable in the contract? **YES**



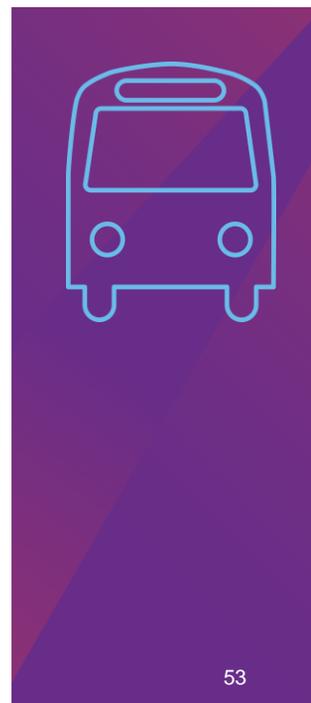
52

LESSEE – bus lease example, expanded (cont.)

Multiple contract components

Governmental Fund - Year 1 Journal Entry	Debit	Credit
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>		

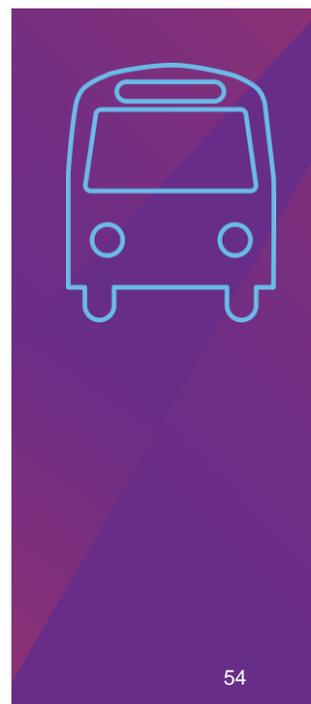
Entity-wide - Year 1 Journal Entries	Debit	Credit
Lease liability	18,290	
Lease principal payment expenditure		18,290
Amortization expense	20,690	
Accumulated amortization		20,690
<i>To eliminate fund level activity for first year</i>		



LESSEE –bus lease example, expanded (cont.)

Multiple contract components

Enterprise funds - Year 1 Journal Entry	Debit	Credit
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>		



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?



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.

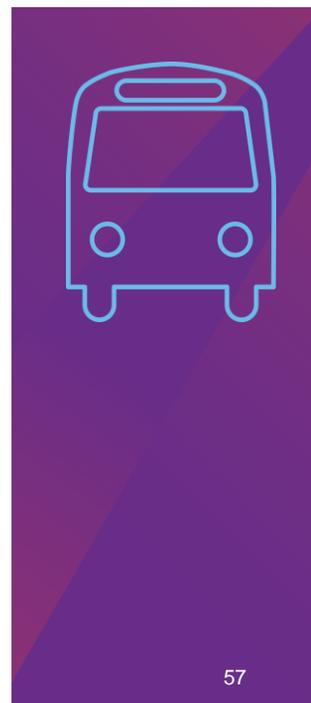
- What additional payments should be included in lease liability?
 - Payments that are fixed in substance are included in the liability
- Is a piece of the contract “fixed in substance”?
 - Yes, the monthly charge of \$50 should be included
- Is a piece of the contract excluded from the lease liability?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



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
	106,038	16,962	123,000

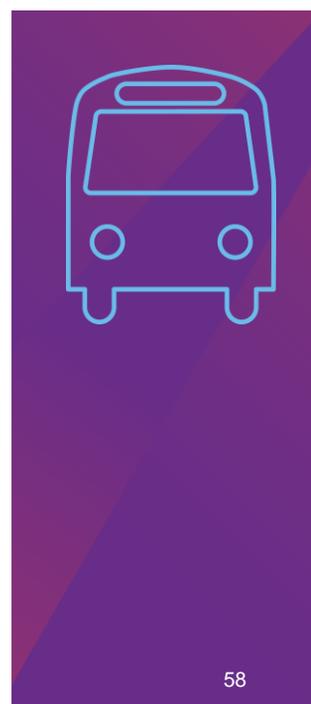


LESSEE – bus lease example, expanded (cont.)

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>		

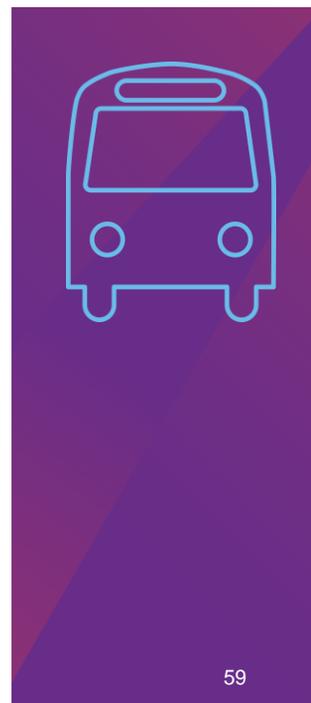


LESSEE – bus lease example, expanded (cont.)

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>		

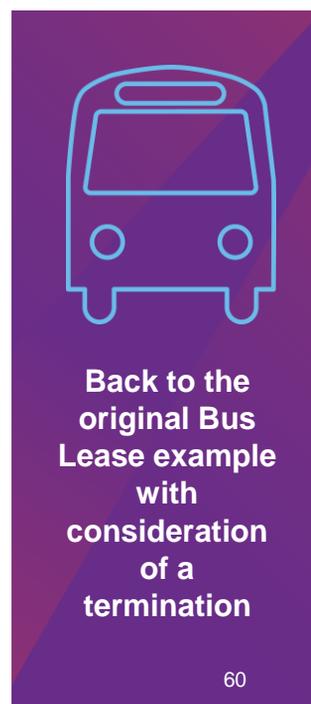


LESSEE – bus lease example, expanded (cont.)

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
	103,451	16,549	120,000



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

61

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

Entity-wide - Year 4 Journal Entries	Debit	Credit
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

62

Panel discussion – How do you expect most governments
will handle the practical debits/credits of leases?



63

LESSOR
Recognition & Measurement

Leases overview—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	Present value of future lease payments (incl. fixed payments, variable payments based on index or rate, reasonably certain residual guarantees, etc.)	N/A
LESSOR	<ul style="list-style-type: none"> 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

- 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

65

Leases overview—subsequent reporting

	Assets	Liability	Deferred Inflow
LESSEE	Amortize the intangible 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 payment needed to cover accrued interest) 	NA	Recognize revenue over the lease term in a systematic and rational manner

- Discount the lease receivable using the rate the lessor charges the lessee
- Interest rate may be implicit in the lease

66

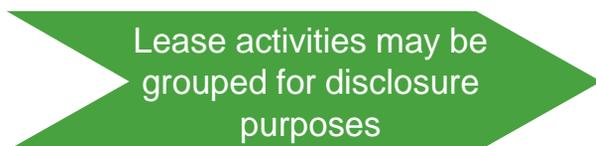
LESSOR - exceptions

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



LESSOR - disclosures



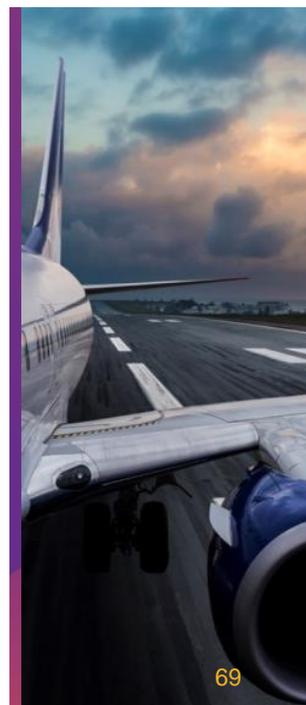
- a. A general description of leasing arrangements
 - The basis, terms, and conditions on which variable lease payments not included in the lease receivable are determined
- b. The total amount of inflows recognized in the reporting period related to leases, if not displayed on face of financials



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)



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



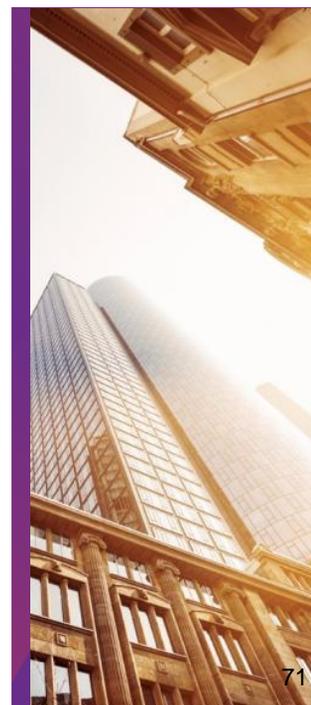
Lessor – office space example

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.



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.



LESSOR – office space example (cont.)

Identifying the Lease term

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

- What is the term of the lease?



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

73

LESSOR – office space example (cont.)

Identifying the Lease term

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

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



74

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



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



LESSOR – office space example (cont.)

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

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



77

LESSOR – office space example (cont.)

Year 1 Journal Entry	Debit	Credit
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>		

Year 1 Journal Entry	Debit	Credit
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.

78

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
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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

79

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

80

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



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.



LESSOR – Office space example, expanded (cont.)

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



Considerations for Implementation

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

85

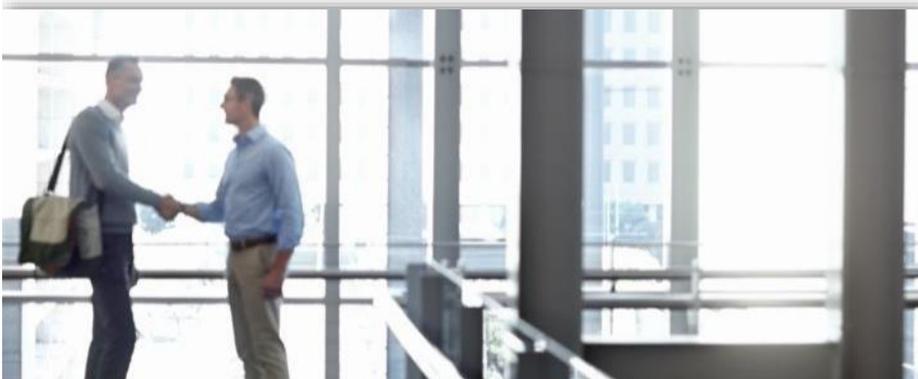
Identifying the rate charged

From the lessee perspective

From the lessor perspective

%

86



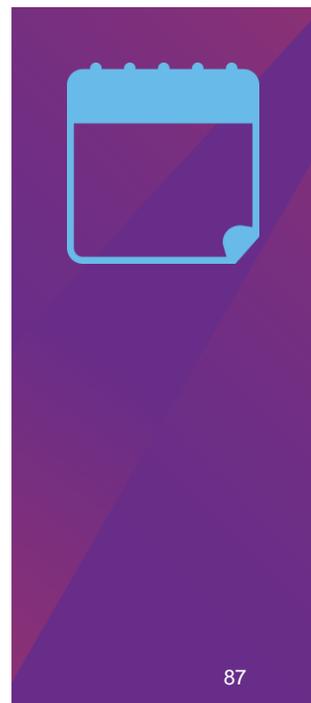
Effective date & transition

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



Implementation ideas



Other accounting and reporting provisions

Lease Incentives

Subleases

Sale-Leasebacks

Lease-Leasebacks

Intra—Entity Leases

Leases Between
Related Parties

Stay tuned to the forthcoming
Leases Implementation Guide
www.gasb.org

89

Questions?

90

Panel discussion – What are the most important participant takeaways from today’s presentation?



91

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92



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Thank you

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