

## ► GASB 87: LEASES

GASB 87 is going to significantly change the government-wide statements for many governmental entities. Simply stated, a large majority of leases that are currently expensed are going to be required to be recorded on your government's financial statements. In this Clear Reliable Insight, we will walk you through what you need to know and how to prepare for this significant change to governmental financial statements.

### Why GASB 87?

Previous GASB literature was criticized for “creating an artificial distinction between capital and operating leases, which are viewed by many as having the same economic impact to the lessee. Most notably, both types of leases create a long-term obligation to make future payments, but lessees reported that obligation as a liability only for capital leases.”

### Basic Overview of GASB 87

The definition of a lease from GASB 87 is “a contract that conveys control of the right to use another entity's nonfinancial assets (the underlying asset) as specified in the contract for a period of time in exchange of exchange-like transactions.”

Both the lessee and lessor will be affected by this standard and will need to work together to ensure appropriate accounting for the leases.

#### — Lease Term

The lease term is defined as the period during which a lessee has a noncancelable right to use an underlying asset, plus the following periods, if applicable:

- Periods covered by a lessee's option to extend the lease if it is reasonably certain, based on all relevant factors, that the lessee will exercise that option.
- Periods covered by a lessee's option to terminate the lease if it is reasonably certain, based on all relevant factors, that the lessee will not exercise that option.
- Periods covered by a lessor's option to extend the lease if it is reasonably certain, based on all relevant factors, that the lessor will exercise that option.
- Periods covered by a lessor's option to terminate the lease if it is reasonably certain, based on all relevant factors, that the lessor will not exercise that option.

A fiscal funding or cancellation clause should affect the lease term only when it is reasonably certain that the clause will be exercised.

Lessees and lessors should reassess the lease term only if one or more of the following occur:

- The lessee or lessor elects to exercise an option even though it was previously determined that it was reasonably certain that the lessee or lessor would not exercise that option.

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- ▶ The lessee or lessor elects not to exercise an option even though it was previously determined that it was reasonably certain that the lessee or lessor would exercise that option.
- ▶ An event specified in the lease contract that requires an extension or termination of the lease takes place.

GASB 87 requires disclosures that are similar to those for capital leases under the prior lease standards.

### LESSEE

#### A GOVERNMENT LESSEE WILL PRESENT THE FOLLOWING NOTES TO FINANCIAL STATEMENTS:

- General description of leasing arrangements
- Total amount of lease assets (by major classes of underlying assets) and the related accumulated amortization
- Amount of outflows of resources recognized for the period for variable payments and other payments (such as residual value guarantees or penalties) not previously included in the measurement of the lease liability
- Principal and interest requirements to maturity for each of the next five fiscal years and in five-year increments thereafter
- Commitments under leases that have not yet begun (other than short-term leases)
- Components of any net impairment loss recognized on the lease asset during the period

### LESSOR

#### A GOVERNMENT LESSOR WILL PRESENT THE FOLLOWING NOTES TO FINANCIAL STATEMENTS:

- General description of leasing arrangements
- Total amount of inflows of resources (such as lease revenue and interest revenue), if not otherwise displayed on the face of the financial statements
- Amount of inflows of resources recognized for the period for variable payments and other payments (such as residual value guarantees or penalties) not previously included in the measurement of the lease receivable
- The existence, terms, and conditions of options by the lessee to terminate the lease or abate payments if the lessor government has issued debt for which the principal and interest payments are secured by the lease payments

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*The following are examples of what will now need to be recorded for all transactions that meet the definition of a lease and are not short-term in nature (less than 12 months):*

### Initial Reporting

	ASSETS	LIABILITY	DEFERRED INFLOW
<b>Lessee</b>	Intangible lease assets (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
<b>Lessor</b>	<ul style="list-style-type: none"> <li>- Lease receivable (generally includes same items as lessee's liability)</li> <li>- Continue to report the leased asset</li> </ul>	N/A	Equal to lease receivable plus any cash received up front that relates to future period

### Subsequent Reporting

	ASSETS	LIABILITY	DEFERRED INFLOW
<b>Lessee</b>	Amortize the intangible lease asset over shorter of useful life or lease term	Reduce by lease payments (less amount for interest expense)	N/A
<b>Lessor</b>	<ul style="list-style-type: none"> <li>- Depreciate leased asset (unless indefinite life or required to be returned in its original or enhanced condition)</li> <li>- Reduce receivable by lease payments (less amount needed to cover accrued interest)</li> </ul>	N/A	Recognize revenue over the lease term in a systematic and rational manner

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### The following leases are excluded from the scope of GASB 87:

- *Assets financed with outstanding conduit debt*
- *Biological assets, including timber, living plants, and living animals*
- *Intangible assets, including mineral rights, patents, software, copyrights*
- *Inventory*
- *Service concession arrangements*
- *Supply contracts*

### Potential Hurdles to Overcome

The most difficult part of the implementation phase will be the identification of all leases for your governmental entity. This means working together with all of your departments that enter into these contractual agreements and explaining the lease standard. It is important to stress that this identification is substance over form and that the exclusions used to classify a transaction as an operating lease no longer apply.

### How to Implement + How CRI Can Help

Luckily, there is still time for formulating your entity's plan. The lease standard goes into effect for periods beginning after June 15, 2021. We at CRI are ready to provide the assistance you need and have a multi- stage process that will ensure smooth implementation. Contact your CRI professional today to learn more!