

The logo for FORV/S, featuring the text "FORV/S" in a bold, white, sans-serif font. The background of the entire page is a vibrant red with a pattern of diagonal stripes in a slightly darker shade of red, creating a dynamic, geometric effect.

# FORV/S

## **GASB 87: Leases**

What You Need to Know

06/2022

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## Recent Activity

Since GASB issued Statement 87, *Leases*, in June 2017, there have been several updates and one effective date delay. This document has been refreshed to incorporate subsequent standard setting and implementation guidance issued by GASB<sup>1</sup>.

The guidance is now effective for fiscal years beginning after June 15, 2021, and subsequent reporting periods.



## Summary

Under current guidance, operating leases are reported without liability recognition even though the government often is committed to make payments on a long-term basis; the lessor records no receivable for its long-term right to receive payments. GASB Statement 87, *Leases*, establishes a uniform approach to accounting for and reporting leases based on the principle that all leases are—in substance—financings. Lease accounting is no longer based on the arrangement's classification as either capital or operating lease.

The new lease treatment will be similar to current guidance for capital leases. A lessee government will recognize a lease liability and intangible right-to-use (RTU) lease asset at the lease term's beginning. Rent expense under today's operating leases will be replaced with interest and amortization expenses. A lessee will recognize interest on the lease liability and amortization on the intangible lease asset over the lease term or—if shorter—the underlying asset's useful life. Because lease transactions under Statement 87 are considered a financing arrangement, lessees will present the intangible RTU lease asset as a capital asset and a lease liability for the future payments.

A lessor government is required to recognize a lease receivable and a deferred inflow of resources at the lease term's beginning. Lease revenue will be systematically recognized over the lease term with a corresponding reduction in deferred inflow of resources. Interest income on the lease receivable created by the financing arrangement will be recognized using the effective interest method. Lessors will not derecognize the underlying asset or calculate a residual value.

Lessees and lessors must disaggregate nonlease (service components) and contracts with multiple lease components. Regular reassessments of amounts recorded by the lessee and lessor as lease liabilities and lease receivables, respectively, are required under certain circumstances.

For lessees, the current operating lease category will be eliminated, along with potential opportunities to structure a lease for the desired financial statement effect. All leases will result in the recognition of interest and amortization expense, and all lease commitments will be recognized as liabilities unless one of the exceptions is met. In the cash flows statement, lease payments will be classified as financing outflows.

For lessors, derecognition of the underlying asset and calculation of the residual value are not required, and direct-financing and sales-type lease categories are eliminated under Statement 87.

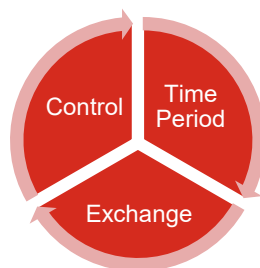
Both lessees and lessors must provide enhanced disclosures.

For help getting started, see "[Implementing GASB's Lease Guidance](#)."

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<sup>1</sup> This includes GASB Statement 93, *Replacement of Interbank Offered Rates*; GASB Statement 92, *Omnibus 2020*; GASB Statement 95, *Postponement of the Effective Date of Certain Authoritative Guidance*; GASB Statement 99, *Omnibus 2022*; *Implementation Guide 2019-3, Leases*; and *Implementation Guides 2020-1 and 2021-1*.

## Lease Definition



***“A contract that conveys control of the right to use another entity’s nonfinancial asset (the underlying asset) as specified in the contract for a period of time in an exchange or exchange-like transaction.” – GASB 87***

A nonfinancial asset is an asset not meeting the definition of a financial asset as defined in Statement 72, *Fair Value Measurement and Application*. Examples of nonfinancial underlying assets are buildings, land, vehicles, and equipment. In the updated definition, the term “contract” replaces “agreement” to require that a lease—whether written or verbal—be legally enforceable.

Contracts for services are not leases. Contracts conveying the right to use an underlying asset that includes a service component are discussed below in the [Multiple Lease Components](#) section.

*A contract should be evaluated for accounting as a lease based on the substance or the arrangement rather than the label on the contract. For example, a contract that transfers ownership of the underlying asset is a purchase regardless of whether it is labeled as a lease.*

## Control

The notion of control in the lease definition is applied to the contract’s specified RTU asset. A lessee has obtained control of the right to use the asset if the contract conveys to the lessee both the right to determine the underlying asset’s nature and manner of use and obtain the underlying asset’s present service capacity. Unlike current guidance, the new criteria do not limit a lease to contracts that convey “substantially all” of the present service capacity from the underlying asset’s use.

GASB Implementation Guide 2020-1 included the following example to illustrate the control concept:

*A city enters into an agreement that allows an organization to use one floor of a city building at a market rate. The contract states that the space is to be used only for a restaurant. Does the organization have control of the right to determine the nature and manner of use of the space?*

The organization has control of the right to determine the nature and manner of use of the space within the parameters of the contract (for a restaurant); therefore, the control criterion is met.

GASB Implementation Guide 2021-1 included the following example to illustrate the control concept:

*A city owns a fleet of equipment. The pieces of equipment are capital assets reported in an internal service fund. The internal service fund is used to report fleet management activity that provides other departments of the city (within the same legal entity) with the right to use the equipment on a cost-reimbursement basis. In the city's basic financial statements, should the agreements between the city's departments be reported as leases?*

No. In this circumstance, control is not conveyed to another legal entity; therefore, the agreements should not be reported as leases in the city's basic financial statements.

### **Examples – Control**

*Are cell phone tower or antenna placement agreements leases?*

Yes, if the agreement meets the lease definition and the control criterion. The control criterion generally is met if a cell phone tower or antenna placement agreement conveys control of the rights to use the land on which the tower is placed or the connection point to which the antenna is affixed.

*A government enters into a multiyear agreement for the right to use a facility. The government has exclusive use of the facility three days a week. Other parties use the facility on the other days. To meet the lease definition, is the government required to have uninterrupted control of the right to use the facility?*

No. In determining whether a contract conveys control of the right to use an underlying asset, a government should assess whether it has (a) the right to obtain the present service capacity from use of the underlying asset and (b) the right to determine the nature and manner of use of the underlying asset as specified in the contract. If the contract specifies the government has control of those rights during three days of each week, the control criterion is met. The requirement that the contract be for a period of time does not require uninterrupted usage.

## **Substitutions**

A lease conveys control of the right to use another entity's asset, which is distinct from the underlying asset. The RTU asset relates to the service capacity associated with an underlying asset, rather than the underlying asset itself. Substitution with an essentially identical asset allows the lessee to maintain control of the right to use the service capacity of another entity's underlying asset and does not violate the definition of a lease.

## **Easements**

An easement is a lease only if it meets the definition of a lease that includes a period-of-time criterion. The implementation guide notes that permanent easements do not meet the period-of-time criterion. In addition, easements obtained for a nominal amount would not meet the exchange or exchange-like criterion.

## **Exchange or Exchange-Like Transaction**

Implementation Guide 2021-1 clarifies that the assessment of whether the exchange or exchange-like transaction criteria is met should consider all values exchanged, including expected variable payments.

## **Bargain Leases**

The lease definition only applies to exchange or exchange-like transactions and would exclude contracts with nominal lease payments. A government's right to use land for \$1 per year, which has a market rent of \$100,000 per year, does not meet the description of an exchange or exchange-like transaction because each party does not receive or give up essentially equal value or not quite equal value. This type of arrangement represents a nonexchange transaction, e.g., a donation or grant, which is within the scope of Statement 33, *Accounting and Financial Reporting for Nonexchange Transactions*, and is not within Statement 87's scope.

## Materiality

Statement 87 does **not** include a quantitative threshold exception for lower-value leases. Under GASB's general materiality guidelines, if the underlying assets are insignificant—individually and in the aggregate—this statement's provisions may not apply. However, entities establishing a lease capitalization policy similar to that of capital assets are cautioned because the significance of asset capitalization is independent of the assessment of the significance of liability recognition.

## Scope Exclusions

Statement 87 carries forward several explicit scope exceptions from Statement 62, including contracts for rights to explore for natural resources, licensing contracts, and service concession arrangements, and expands the number of exclusions. Because leases will be reported on the statement of financial position, the implementation guide addresses several concerns raised by governments. GASB declined to provide an exception for assets under construction, historical works, and leases associated with certificates of participation.

Specific Scope Exclusions		
Intangible assets	Biological assets	Inventory
Service concessions	Conduit debt financings	Supply contracts

## Intangible Assets

This exclusion applies to the right to explore for or exploit natural resources (such as gas, mineral, and other nonregenerative resources), licensing contracts (such as motion pictures, videos, patents, and copyrights) and computer software.

### Subscription-Based Information Technology Arrangements

GASB Implementation Guide No. 2015-1 stated that licensing agreements for computer software should not be treated as leases. Because of the unique features and complexities of these transactions, GASB decided to explicitly exclude licensing contracts for computer software from Statement 87 (see "[New GASB Rules for Cloud Computing Costs](#)").

### Oil & Gas Exploration & Production

#### Example

*A government enters into a lease agreement that conveys control of the right to use a parcel of land to a company that engages in oil and gas exploration and production. Is this lease excluded from Statement 87?*

No. In this example, the company has control of the right to use the land itself. In contrast, if the government only provided the company with the right to explore for or exploit oil and gas but did not convey control of the right to use the land, that lease would be excluded from Statement 87. Although Statement 87 excludes "rights to explore for or to exploit natural resources such as oil, gas, and minerals," that exclusion applies **only** when the underlying asset in the lease is the right to explore for or exploit those resources.



## Grazing & Hunting

A government agreement that provides the exclusive right to use the government's land for five years during hunting season would be considered a lease. Because the lessee is the only party allowed to access and use the land during the hunting season each year during the term of the five-year agreement, the contract conveys control of the right to use the underlying asset (the land). The provision in the lease definition that the contract be for a period of time does not require uninterrupted control of the right to use the underlying asset.

Facts and circumstances are critical in determining if an agreement meets the lease definition. Consider an agreement that allows a rancher to use the government land for grazing and also allows access for compatible public recreation activities. The agreement further states that the government can construct roads and buildings, or otherwise alter the land, without the rancher's permission. This agreement would not be considered a lease since it does not convey the right to determine the nature and manner of use of the underlying asset because the rancher cannot prevent others from accessing, using, or altering the land.

## Biological Assets

This exclusion applies to timber, living plants, and living animals.

### Cropland

While the use of land for farming may produce biological assets, the lease's underlying asset is the land, which is not a biological asset. A lease of cropland would not be excluded from Statement 87's scope.

### Zoos

A city-owned zoo that leases various animals (biological assets) for a specific period of time would be excluded from Statement 87's scope.

## Inventory

Because the lease of inventory normally involves a transfer of ownership rather than a lease, it is specifically excluded from Statement 87's scope.

## Service Concessions

Accounting guidance for service concessions is currently covered by Statement 60 (see "[GASB Updates Public-Private Partnership Accounting](#)" for changes to the guidance with the issuance of Statement No. 94, *Public-Private and Public-Public Partnerships and Availability Payment Arrangements*).

## Conduit Debt

Leases in which the underlying asset is financed with outstanding conduit debt are excluded from Statement 87's scope, unless the lessor reports both the underlying asset and conduit debt.<sup>2</sup> In June 2019, GASB issued Statement 91, *Conduit Debt Obligations*, which updates guidance for the accounting and reporting of conduit debt (see "[GASB Issues New Conduit Debt Rules](#)").

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<sup>2</sup> For purposes of Statement 87, conduit debt is debt issued in the government's name to finance the construction or acquisition of capital assets to be leased, which is secured by the lease payments. Issuers of conduit debt are not required under Interpretation No. 2, *Disclosure of Conduit Debt Obligations*, to recognize a liability for the debt. Likewise, the facilities constructed or acquired with the debt proceeds generally are not reported in the financial statements of issuers of conduit debt.

## Supply Contracts

Supply contracts, such as power purchase agreements, are intended to result in the purchase or sale of a commodity, such as natural gas or electricity, used in the normal course of operations. Such agreements normally do not convey the right to use the underlying asset but rather convey a right to the output generated by the underlying asset; therefore, they do not meet the lease definition. However, if a contract conveys control of the right to use the underlying asset for a period of time in addition to the right to the output generated by the underlying asset, the scope exception does not apply.

**Example** – A government enters into a contract with a private party wherein the private party will design and build a solar farm based on the government's specifications. The solar farm will be located on the government's property, but title to the solar equipment will be retained by the private party. The contract requires the government to purchase all the power generated from the solar farm and make payments solely based on the amount of power generated. The contract also requires the private party to dismantle and remove the solar farm at the contract's end. Does this contract result in a lease of solar equipment?

No. To meet the lease definition, a contract is required to convey control of the right to use the underlying asset. Two criteria must be met for a contract to convey control. In this example, the government has the right to obtain the present service capacity from the solar farm but does not have the right to determine the nature and manner of use. Therefore, the component of the contract that provides the government with the right to all the power generated by the solar farm does not convey control and does not meet the lease definition. However, the component of the contract that allows the private party to use the government's property may be a lease.

## Other Exclusions

### Contracts That Transfer Ownership

Contracts that transfer ownership of the underlying asset to the lessee and do not contain a termination option—or a fiscal funding or cancellation clause that is reasonably certain of being exercised—should be accounted for as financed purchases or sales. The presence of a bargain purchase option in a lease contract is not equivalent to a provision that transfers ownership of the underlying asset.

Implementation Guide 2021-1 clarifies that for contracts that need to be reported as financed purchases, a governmental buyer should look to guidance on capital assets and long-term debt or payables, depending on the financing terms. Governmental sellers should look to guidance on long-term receivables. A governmental seller should recognize a gain or loss on the sale of the capital asset in financial statements prepared using the economic resources measurement focus.

*A lease that contains a purchase option, including a bargain purchase option, should not be treated as a financed purchase or sale until that option is exercised.*

**Examples of Financed Purchases or Sales**

*A vendor installs equipment on a government's building to increase energy efficiency. The government will own the equipment at the end of the agreement, and the contract does not contain a termination option.*

This transaction should be reported as a financed purchase. If title to the equipment transfers to the lessee by the contract's end, the transaction is not accounted for as a lease for financial reporting purposes.

*A school district leases computers. At the end of the lease term, students are given the option to purchase their computer from the school district. Regardless of whether the students purchase their computers, the school district is required to purchase all computers from the lessor. The school district does not have a termination option.*

This arrangement should be reported as a financed purchase. Statement 87 states that one criterion of a financed purchase is that the contract transfers ownership of the underlying asset to the lessee by the end of the contract. In this example, the lessee is the school district, not the students. The sale of computers to the students is a separate transaction. The contract transfers ownership of the computers because the purchase by the school district is required.

## Lessor Scope Exceptions

In addition to the exceptions for short-term leases and leases that transfer ownership, Statement 87 provides an exemption to the lessor **recognition and measurement** requirements for leases of investment assets and certain regulated leases, but specific disclosure requirements are required for them.

Lessor Exceptions	
Investments	Certain regulated leases

### Leases of Investment Assets

If a lease's underlying asset meets the requirements in Statement 72, *Fair Value Measurement and Application*, to be reported as an investment measured at fair value, the lessor should not apply lease recognition and measurement. The lessor is only required to disclose the terms and conditions of lessee termination options or payment abatements if the lessor government has issued debt related to the investment asset for which the principal and interest payments are secured by the lease.

**Example – Investment Asset Lease**

*A state pension fund owns a building that is classified as an investment. The pension fund enters into a contract that conveys the right to use the building to a third party. Should that contract be accounted for as a lease?*

No. The state pension fund holds the building as an investment rather than a lease.

### Certain Regulated Leases

Leases that are subject to external laws, regulations, or legal rulings qualify for exemption from Statement 87's recognition and measurement requirements as long as they meet the following criteria:

- The lease rates cannot exceed a reasonable amount, with reasonableness being subject to determination by an external regulator
- Lease rates are similar for lessees that are similarly situated

- The lessor cannot deny potential lessees the right to enter into leases if facilities are available, provided that the lessee's use of the facilities complies with generally applicable use restrictions

Among the more common regulated leases are those between airports and air carriers (often referred to as airline use agreements) and other leases with similar characteristics are excluded from Statement 87's recognition and measurement requirements, primarily because they have characteristics different from normal financing arrangements and due to measurement challenges. Airport-airline lease agreements generally require payments that vary from period to period because of their cost-recovery nature, and many also contain revenue-sharing provisions.

A lease agreement for aeronautical use purposes, or a portion of a lease for aeronautical use purposes, likely will meet the criteria in GASB 87 for regulated leases. Federal Aviation Administration guidance distinguishes aeronautical use from nonaeronautical use as follows:

- Aeronautical use: "... any activity that involves, makes possible, is required for the safety of, or is otherwise directly related to the operation of aircraft. Aeronautical use includes services provided by air carriers related directly and substantially to the movement of passengers, baggage, mail and cargo on the airport. Persons, whether individuals or businesses, engaged in aeronautical uses involving the operation of aircraft, or providing flight support directly related to the operation of aircraft, are considered to be aeronautical users."
- Nonaeronautical use: Any activities not associated with the direct transport of passengers or cargo. Such activities generally involve the operation of facilities that do not need to be located at an airport, including airline headquarters and reservation centers; flight kitchens; hotels; public parking, rental car, and ground transportation facilities; terminal concessions, such as food and beverage purveyors; and retail, news, and gift shops. Lessors in a regulated lease should recognize inflows of resources, *e.g.*, revenue, based on the lease contract's payment provisions and provide certain financial statement disclosures as later outlined in this document.

A single contract may contain more than one lease. If a contract contains a lease component that meets the regulated lease criteria and a lease component that does not meet that criteria, the components should be separated in accordance with the multiple component guidance.

## Regulated Lease Disclosures

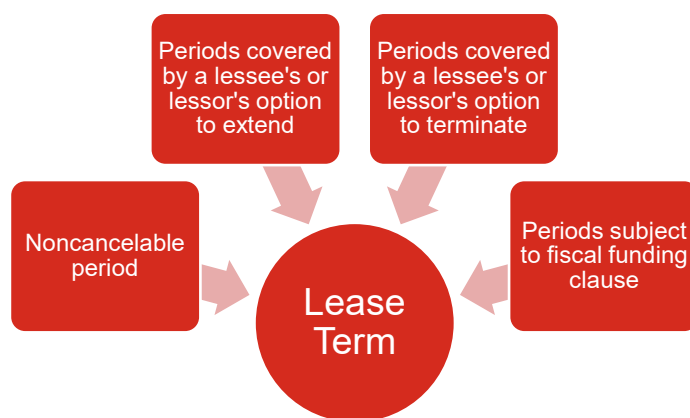
Disclosures for regulated leases meeting Statement 87's criteria are based on the general lessor disclosure requirements (discussed below) but modified to address the leases' uniqueness. Lessors with one or more regulated leases—other than short-term leases—are required to disclose the extent to which capital assets are subject to preferential or exclusive use by counterparties under agreements, by major asset class, and by major counterparty. For example, an airport could disclose the total number of terminal gates and the number of gates being leased by each major tenant under preferential or exclusive agreements.

A lessor also must disclose the existence, terms, and conditions of lessee options to terminate the lease or abate lease payments if the lessor government has issued debt for which the principal and interest payments are secured by the lease payments.

**Example – Regulated Leases**

*An airport leases gates under agreements that meet the definition of certain regulated agreements. Fifteen of the airport's gates are leased under exclusive use agreements to three airlines. Other airlines rent the airport's other nine gates on a per-use basis. The airport is required to disclose "the extent to which capital assets are subject to preferential or exclusive use by counterparties under agreements, by major class of assets, and by major counterparty." Is the airport required to disclose the carrying value of gates under exclusive use agreements?*

No. The airport could disclose the number of gates leased under exclusive use contracts by major counterparty and the number of gates rented on a per-use basis. Other methods of disclosure may include the percentage of gate square footage or the carrying amount of the gates leased under exclusive use agreements.

**Lease Term**

The lease term should reflect how long the lease is expected to be in effect. Assessment should be performed at lease commencement and begin with the period during which the lessee has a noncancelable right to use the underlying asset. The lease term commences when the lessee gains physical possession of the asset or attains access to use the underlying asset. For an asset under construction, the lease term begins when the certificate of occupancy is issued, even if payments are made during the construction period.

The noncancelable period then is adjusted for periods covered by lessee and lessor options to extend or terminate the lease if it is **reasonably certain** options to extend will be exercised—and options to terminate will not be exercised—considering all relevant factors, including significant economic disincentives, such as a cancellation penalty.

Periods for which the lessee **and** the lessor each have an option to cancel the lease without permission from the other party—or if both parties must agree to extend—are cancelable periods excluded from the lease term. The presence of cancellation penalties does not affect this conclusion. Rolling month-to-month leases—or leases that continue into a holdover period until a new lease contract is signed—would not be enforceable, and such leases should be excluded from the lease term.

Statement 99, *Omnibus 2022*, further clarifies the treatment of purchase options as follows:

- An option to terminate is an unconditional right that exists within the lease contract. A provision that gives a lessee or lessor the right to terminate the lease only in certain circumstances or upon the occurrence of certain events, such as the action or inaction of the other party to the lease contract, should not be considered an option to terminate the lease for purposes of determining the lease term. For example, provisions that allow for the termination of a lease due to a violation of lease terms and conditions, such as a default on payments, are not considered options to terminate the lease.

- If a lessee has the option to purchase the underlying asset during the lease term and the contract is not a contract that transfers ownership, the lease term should exclude the period, if any, after the date at which the option is reasonably certain to be exercised.

Because governments do not always make decisions solely for economic reasons, all relevant factors—contracts-based, underlying asset-based, market-based, and government-specific—should be considered in determining the likelihood of whether an option will be exercised. Examples of factors to consider include—but are not limited to—the following:

- A significant economic incentive, such as contractual terms and conditions for the optional periods that are favorable compared to current market rates
- A significant economic disincentive, such as termination costs
- The history of exercising options to extend or terminate
- The extent to which the asset underlying the lease is essential to the provision of governmental services

## Reasonably Certain

The threshold of “reasonably certain” essentially retains the threshold of “reasonably assured” in current lease guidance and will require the use of professional judgment. This is a higher threshold than “probable.” The requirement to evaluate lessor options from the same threshold perspective as lessee options is based on the premise that both parties’ options have the same enforceability if exercised.

The likelihood of whether lessor-only options might be exercised may be difficult for a lessee to evaluate and vice versa for lessee-only options. Lessors are encouraged to assess the lease term based on information received about the lessee’s plans—including funding arrangements—during lease negotiations.

## Fiscal Funding Clauses

A fiscal funding or cancellation clause allows governmental lessees to cancel a lease—typically on an annual basis—if the government does not appropriate funds for the lease payments. Laws and regulations often require inclusion of a fiscal funding or cancellation clause in lease agreements, even though the government, acting in good faith at lease commencement, does not intend or expect to exercise the clause. The clause would affect the lease term only when it is reasonably certain the clause will be exercised.

### **Example – Bargain Renewal Option**

*How does a bargain renewal option, such as a 20-year lease at a market rate with a lessee option to renew the lease for an additional five years at a 30 percent discount, affect the lessee’s initial assessment of the lease term?*

At the lease term’s commencement, a government must assess all factors relevant to the likelihood that the lessee or lessor will exercise lease extension or termination options. Relevant factors include significant economic incentives and disincentives, such as the cost of exercising the renewal option and the expected condition and maintenance requirements for the underlying asset during the extension period. In this example, if the governmental lessee determines it is reasonably certain that the option will be exercised, the lease term would be 25 years.

## Reassessment

The lease term must be reassessed when the lessee or lessor exercises an option or elects not to exercise an option contrary to the lease term's initial determination, or when an event specified in the contract that requires a lease extension or termination occurs. Lease terms are not remeasured based on changes in the probability of an event or action occurring.

## Short-Term Leases

Statement 87 does not apply to short-term leases, defined as leases with a maximum possible term of 12 months or less at lease inception, including options to extend, regardless of their probability of being exercised. The **maximum possible** term for short-term lease assessment assumes that all options to extend would be exercised and includes any notice periods. Statement 99, *Omnibus*, updates the wording on termination options and added language to prevent structuring and subsequent lease modifications to avoid recognition as follows:

- Periods for which both the lessee and the lessor have an option to terminate the lease without permission from the other party (or if both parties have to agree to extend) are cancelable periods and should be excluded from the maximum possible term.
- A lease that previously had been determined to be short term and has been modified to extend the initial maximum possible term under the lease contract should be reassessed from lease inception. If the reassessed maximum possible term is greater than 12 months, the lease should no longer be considered a short-term lease. For a lease that is reclassified from a short-term lease, the lease term should be assessed beginning at the modification date to measure the lease receivable or liability.
- Termination provisions for payment defaults are not considered termination options for determining the lease term.

Implementation Guide 2021-1 makes this clarification:

- The length of a contract when there is an interrupted control, *i.e.*, a seasonal contract, does not affect the assessment of the maximum possible term. The maximum term should be based on the period when the government has control of the right to use the asset.

Examples of contracts that do **not** meet the requirements for a short-term lease:

- A 12-month lease with the lessee having an option to renew for 12 months at a time up to 49 times
- A lease with a six-month noncancelable period and an option to extend for one year that is not reasonably certain to be exercised
- A 16-month lease that is cancelable after six months by the lessee

For short-term leases, lessees and lessors will only recognize outflows and inflows of resources based on the lease contract's payment provisions (with the recognition of assets and liabilities for payments paid or received before or after the reporting period). No outflow or inflow of resources is recognized during any free-rent (rent holiday) period.



GASB's 2020 Implementation Guide included the following examples for short-term leases:

*A governmental housing authority enters into a 12-month residential lease contract that states the lessee may renew. If the lessee decides to renew, the housing authority and the lessee will enter into a separate lease contract at a later date for the subsequent 12-month period. Is the existing 12-month residential lease contract a short-term lease under Statement 87?*

Yes. A short-term lease has a maximum possible term under the contract of 12 months or less, including any options to extend. Although the lease contract states that the lessee may renew, the lessee does not have a unilateral right to extend the existing contract because the housing authority and the lessee would enter into a new contract for the subsequent 12 months. Therefore, the maximum possible term under the existing contract is 12 months, and the lease is a short-term lease.

*A government enters into a three-year lease contract. However, both the lessee and the lessor have a right to cancel at any time with 60 days' advance notice. For purposes of determining whether this lease is a short-term lease, what is the maximum possible term?*

The maximum possible term is 60 days. In this example, there is no noncancelable period other than the notice period. Therefore, the maximum possible term is only the notice period of 60 days, and the lease is a short-term lease.

*A city leases boat slips in its marina to boat owners. Each lease is for 12 months and does not contain an option to extend. A certain boat owner has signed a new lease every year for the past 20 years, and the city expects her to continue to do so. Is this a short-term lease?*

Yes. Whether a lease is a short-term lease depends on the terms of the contract. The history of new leases being signed every year and the likelihood of a new lease being signed next year are not relevant for making the determination of whether a lease is a short-term lease.

## Multiple Lease Components

Within the general principle of materiality, governments should separate contracts into lease and nonlease components or multiple leases if the underlying assets have different lease terms. Lessors and lessees should allocate the contract price to multiple components of a lease by first using individual component prices as stated in the contract, as long as the price allocation does not seem unreasonable based on the contract terms. Professional judgment should be used to determine the reasonableness of contract price allocation, maximizing the use of observable information such as readily observable standalone prices.

If a contract does not include separate prices for individual components or if the stated prices appear to be unreasonable, lessors and lessees should use professional judgment to determine their **best estimate** for the allocation of the contract price to each component, maximizing the use of observable information. If it is not practicable for governments to make a best estimate for price allocation for some or all contract components, e.g., due to the unique nature of leases specifically designed for the leasing parties, specific provisions stipulated in certain lease contracts, or other circumstances, a government should account for multiple-component contracts as a single lease unit based on the primary lease component. The determination of the primary component will require professional judgment maximizing the use of observable information. GASB's Lease Implementation Guide provides the following characteristics that may be indicative of a primary component:

- The component performs a function that is the government's primary objective in entering into the contract.
- The component's fair value is substantial relative to the fair values of the other components.
- The component's lease term is longer than the lease terms of the other components.
- The component's benefit to the government is substantial relative to the benefits of the other components.



An explicit exception to the lease allocation guidance is not provided for contracts with insignificant nonlease components, though general materiality considerations apply. However, if components are material, governments are required to separate them.

*Setting a policy not to separate components is not allowed under Statement 87.*

#### **Example – Installation Costs**

*A government leases equipment that the lessor will install for an additional \$10,000. The lease contract requires the government to pay the lessor for installation of the equipment in the subsequent reporting period. Should the government record the installation costs as part of the lease liability or as a separate liability?*

Initial direct costs are **not** included in the lease liability's measurement. Installation costs generally are considered a nonlease component. Because the \$10,000 is a payment for installation costs and not a payment for the right to use the equipment, it is not considered a lease payment and should be accounted for as a separate liability. However, if the installation costs are ancillary charges necessary to place the lease asset into service, they should be included in the lease asset's initial measurement.

#### **Example – Maintenance**

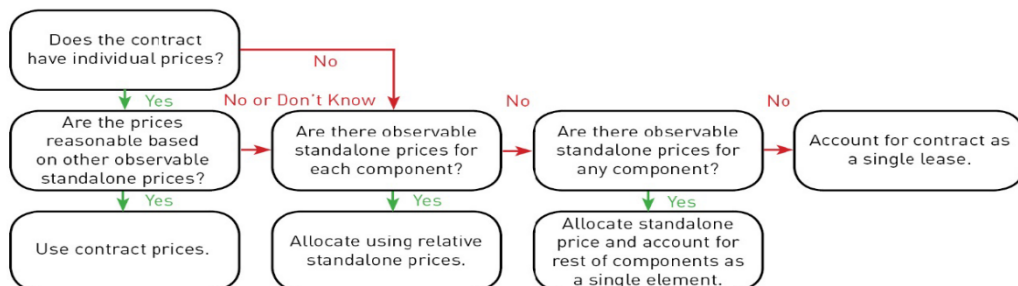
*A government leases two floors of an eight-floor building. Part of the lease payments covers the government's share of utilities and janitorial costs for maintaining a lobby that all tenants share. Should the utilities and janitorial costs for the lobby be included in the government's lease liability?*

If the government is able to separate and estimate the costs for those services, the costs should **not** be included in the government's lease liability. If the lease contract does not specify the amount (in dollars or percentage), the government could request that information from the landlord. In addition, local real estate professionals may have statistics such as average charges per square footage. However, if the government is unable to separate the costs and estimate them, the janitorial services and utility costs for the lobby should be included in the government's lease liability.

## **Multiple Concurrent Contracts**

Contracts entered into at or near the same time with the same counterparty are subject to combination for financial reporting purposes only if the contracts are negotiated as a package with a single objective, or the consideration to be paid in one contract depends on the other contract's price or performance. The use of a master vendor agreement does not require that the underlying contracts be accounted for as part of the same contract unless the contracts are entered into at or near the same time and at least one of the other criteria is met. If multiple contracts are determined to be part of the same contract, lessors and lessees are required to evaluate the newly combined contract in accordance with the guidance for multiple lease components, noted above. The reporting for lease contracts with multiple underlying assets and lease contracts with a nonlease service component should be the same—as if the components were in separate contracts.

This will be a key management judgment that will require supporting documentation.

**Contracts with Multiple Components****Example – Multiple Contracts**

*A government solicits bids for a fleet of public safety vehicles and leases the assets from the lowest qualified bidder. A separate lease agreement is used for each vehicle. The leases are entered into over the course of several months as the police and fire departments review each agreement's specifications. The lease contracts do not provide information about the government's objectives. Can the government's procurement processes be used to determine whether there is a single objective?*

Yes. Contracts that are entered into at or near the same time with the same counterparty are considered part of the same contract if negotiated as a package with a single objective. In this situation, in the absence of explicit information in the contracts about the government's objectives, the government's procurement processes provide sufficient information to determine the government's objective for entering into the lease agreements.

**Discount Rate (Lessee & Lessor)**

This will be a significant area of judgment. Lessees must discount lease payments using the interest rate at which the transaction is made, *i.e.*, the rate the lessor charges the lessee, which may be the rate implicit in the lease. Consistent with current guidance, if the lease's implicit interest rate is not readily determinable, the lessee's estimated incremental borrowing rate should be used. Determining the incremental borrowing rate entails estimating the interest rate the lessee would be charged for borrowing the lease payment amounts during the lease term.

The standard notes that lessors have information to determine the interest rate they charge the lessee—including implicit rates—and should use this rate to discount the future lease payments. Many government contracts do not include a stated interest rate. As originally issued, GASB 87 provided an alternative to an "implicit interest rate" for lessees, but no such alternative or guidance was provided to lessors.

GASB's 2020 Implementation Guide extended relief to lessors. If there is no stated rate (or if the stated rate is not the rate the lessor charges the lessee), the lessor should determine whether the rate implicit in the lease can be estimated. Lessors may apply the guidance for imputation of interest in Statement 62, "the prevailing rates for similar instruments of issuers with similar credit ratings will normally help determine the appropriate interest rate. ..." Lessors should use professional judgment to determine their best estimate for the interest rate, maximizing the use of observable information; for example, using the lessee's estimated incremental borrowing rate or published market rates for similar instruments. If there is no stated rate (or if the stated rate is not the rate the lessor charges the lessee) and the implicit rate cannot be determined, the lessor may presume (unless there is persuasive evidence to the contrary) that it is recovering its cost associated with interest cost and use the lessor's own incremental borrowing rate as the discount rate.

To calculate an implicit interest, a market value for the related asset is required. For some asset types, equipment or office space in a downtown building, market data is not too difficult to obtain. For other specialized asset types, the market value will be more challenging, e.g., transit, ports, or airport agreements for space inside a government-owned terminal or land and facilities with access to runways. A valuation specialist might be needed to apply a cost, income, or market approach—or some combination of these approaches—to arrive at a lease's supportable implicit rate.

For additional insights into the discount rate calculation, see [“What's the Discount Rate for Government Leases?”](#)

### **Examples – Discount Rate**

*A contract conveys the right to use a building for 30 years and the attached parking garage for 15 years. Should the discount rate be separately assessed for each component?*

Yes. Lease contracts involving multiple underlying assets must be accounted for as separate lease components if the underlying assets have different lease terms. The reporting of two components instead of one may affect the agreement's implicit discount rate. The lessee's implicit incremental borrowing rate may differ between the two components because of differences in lease terms.

*A government leases a fleet of vehicles for half of their estimated useful lives. The lease term is 30 months. The lease does not specify the discount rate. Total lease payments over the lease term are \$1.1 million, and the fair value of the vehicles at the lease's commencement is \$2 million. May the fair value of the vehicles be used in determining the lease's implicit discount rate?*

Yes. Discounting the lease payments at the rate the lessor charges the lessee—explicitly or implicitly—arrives at the fair value of the intangible right to use the vehicles, which is not necessarily equivalent to the fair value of the vehicles. Using the \$2 million fair value of the vehicles at the lease's commencement to determine the lease's implicit discount rate may be appropriate if the government has determined that—considering the agreement's facts and circumstances—the vehicle's fair value approximates the fair value of the lessee's right to use the vehicles. If those values differ because the lease term is less than the entire useful life of the vehicles, the fair value of the right to use the vehicles for the lease term may be estimated using professional judgment, maximizing the use of observable information. In this example, the government has estimated that the fair value of the right to use the vehicles is \$1 million because the length of the lease term is half of the vehicles' estimated useful lives. The government assumes the fair value of the right to use the vehicles decreases ratably over the lease term because the service capacity of the vehicles remains the same throughout the lease term, even though the fair value of the vehicles decreases faster at the lease term's beginning. Therefore, the interest associated with the lease is \$100,000, and the discount rate is approximately 7.5 percent.

## Lessee Accounting

### Lease Liability

- Present value of lease payments expected to be made during the lease term

### RTU Asset

- Lease liability +
- Lease payments to lessor at or before commencement of the lease term, less lease incentives +
- Initial direct costs to place lease asset in service

## Initial Measurement

### Lease Liability

For all leases, except for short-term leases and contracts that transfer ownership of the underlying asset to the lessee and do not contain termination options, the lessee will record a lease liability. The lease liability should be measured at the present value of future lease payments expected to be made during the lease term and include the following:

- Fixed payments – payments established at specific amounts in the lease contract for which the lessee is obligated to make
- Variable payments that depend on an index or rate—such as the Consumer Price Index (CPI) or a market interest rate—initially measured using the index or rate as of the lease term's commencement and assumed to stay in effect throughout the lease term
- Variable payments that are fixed in substance
- Amounts that are reasonably certain of being required to be paid by the lessee under residual value guarantees (RVG)
- The exercise price of a purchase option if it is reasonably certain that the lessee will exercise that option
- Payments for penalties for terminating the lease if the lease term reflects the lessee exercising (1) an option to terminate the lease or (2) a fiscal funding or cancellation clause
- Any lease incentives receivable from the lessor
- Any other payments that are reasonably certain of being required based on an assessment of all relevant factors

### Lease Term for Measuring the Lease Liability

The lease term for measuring the lease liability does not refer to the contract's provisions but rather the term described above, which includes all reasonably certain options to extend or terminate a lease. If a lease term reflects a lessee termination, then the lease liability measurement should include all expected penalties.

## Variable Payments

Variable payments that depend on the lessee's future performance or usage of the underlying asset do not have a baseline measurement at lease term commencement and are excluded from the initial liability, e.g., copier lease payments contingent on copier usage or rental car payments dependent on miles incurred. However, any minimum guarantee amounts or other portions of variable payments that are fixed in substance, i.e., they can be readily measured, should be included in the lease liability.

### **Example – CPI-Based Variable Payment**

*Lease payments for a five-year lease are indexed to the CPI. The lease payments for the first year are \$5,000 per month, which is the market rate based on the current CPI, and payments for subsequent years will increase or decrease based on the change in CPI during the preceding year. The CPI at the lease's commencement is 251. How should the initial lease liability be calculated?*

Variable payments that depend on an index or rate initially are measured using the index or rate as of the lease term's commencement. If the CPI is 251 at lease commencement, a government would assume it will stay at 251 throughout the lease, which would result in consistent lease payments for initial measurement of the lease liability because the subsequent years' payments are based on the change in CPI. The lease liability should be calculated at the present value of \$5,000 per month for 60 months. Any variation from \$5,000 paid in future periods will be recognized as outflows or reductions of those periods.

### **Example – Usage-Based Variable Payment**

*A lease contract for copy machines requires that a minimum amount be paid for toner and paper regardless of whether these supplies are obtained. Should some portion of the minimum amount to be paid for supplies be included in the lease liability's measurement?*

If the amount the lessee is required to pay for supplies does not appear to be **unreasonable**, regardless of whether supplies are obtained, the government should account for the supplies separately from the lease and, therefore, not include the amount in the lease liability measurement. If the amount appears to be unreasonable, professional judgment may be needed to determine whether some or all of the minimum amount is, in substance, a fixed lease payment that should be included in the lease liability's measurement.

### **Example – Fixed In-Substance Payments**

*A government enters into two leases. The first lease requires monthly lease payments based on a fixed percentage of sales or \$10,000, whichever is more. The second lease includes a choice to pay either (a) a fixed monthly payment of \$30,000 or (b) \$100 per hour of equipment use with a monthly minimum payment of \$10,000. The lessee makes the choice at the beginning of each month. Which payments from the two leases should be included in the lease liability?*

The lease liability must include "variable payments that are fixed in substance." For both leases, the minimum amount that is required to be paid (\$10,000) is fixed in substance and should be included in the lease liability.

## Purchase Options & RVGs

Other types of payments, such as those arising from the lessee's exercise of a purchase option or RVG, may be contingent on future events. Such payments should be included in the lease liability's measurement if it is reasonably certain that the option will be exercised or the RVG payment will be required.

*The same “reasonably certain” threshold applies to contingent payments for determination of the lease liability as used when assessing the lease term. For example, lease termination penalties are included in a lease liability’s initial measurement if the lease term reflects it is reasonably certain a lessee will exercise a lease termination option or fiscal funding or cancellation clause.*

## Lease Incentives

A lease incentive is a payment made to—or on behalf of—the lessee for which the lessee has a right of offset with its obligation to the lessor or other concessions granted to the lessee. These incentives include assumption of or agreement to pay a lessee’s pre-existing, third-party lease obligations; other reimbursements of lessee costs; rent holidays; and reductions of interest or principal charges by the lessor. A lessor-provided leasehold improvement is another example of a lease incentive payment if, for example, it provides additional assets to the lessee without additional cost.

Accounting for lease incentives is based on whether incentives are received at or before lease inception or after lease inception. Lease incentives before lease commencement directly reduce the lessee’s recorded initial lease asset amount. Payments after lease commencement should be accounted for by both the lessee and lessor as reductions of lease payments in the year the payments will be provided. Only lease incentive payments that are fixed or fixed in-substance are included in the initial measurement and subject to remeasurement; variable or contingent lease incentive payments are not included in initial measurement.



**Example – Lease Incentives—Lessee**

*Lease incentive payments provided by a lessor before a lease term's commencement are included in the lease asset's initial measurement. How are such payments reported by the lessee until the lease asset is recognized at lease commencement?*

Lease incentives received by a lessee before lease commencement would reduce any lease prepayments made by the lessee and be reclassified to the lease asset at lease commencement. If there are no lease prepayments, the advance incentives would result in a liability until the lease term's commencement. At that time, the lease incentives would be reclassified to a reduction of the lease asset.

*Implementation Guide 2021-1 includes the following examples of lease incentive accounting:*

**Example 1**

***A governmental lessee has six months remaining on an office space lease. A third party offers to pay the government's remaining obligation to the pre-existing lessor as an incentive for the government to enter into a new lease for office space owned by that third party. The government will terminate the pre-existing lease, and the third party will pay the pre-existing lessor in one payment before the commencement of the new lease. How should the government account for that incentive?***

*When the pre-existing lease is terminated, the pre-existing lease asset and lease liability should be reduced. The pre-existing lease asset should be reduced to zero because the government no longer has the right to use that office space. However, the government should continue to report the pre-existing lease liability until the payment to the pre-existing lessor is made. The government should recognize a loss for the amount of the reduction in the pre-existing lease asset. When the third party makes the payment to the pre-existing lessor, the government should derecognize its pre-existing lease liability and recognize a liability for advance incentives. When the new lease term commences, the incentive received should reduce the new lease asset.*

**Example 2**

***A government leases retail space to a lessee. The contract requires the governmental lessor to make certain improvements to the space—wiring and plumbing—which are part of the government's asset. The improvements will be owned by the governmental lessor, and the governmental lessor is not reimbursed by the lessee. Should the improvements be considered lease incentives for the purpose of measuring the lease receivable?***

*No. In this example, the requirement that the lessor pay for certain improvements does not reduce the lease payments expected to be received during the lease term. The lessor should account for the improvements separately from the lease and should not include the improvements as lease incentives in the measurement of the lease receivable.*

**Lease Asset**

Initial measurement of the intangible right-of-use asset is based on the lease liability's initial measurement, adjusted for certain prepayments, incentives, and direct costs. A lessee should add lease payments made **at or before** lease commencement to the leased asset's initial measurement. Payments made during an asset's construction cannot be recognized as a leased asset at the time they are paid—lease recognition occurs at lease commencement. Such amounts should be reported as a prepaid asset. A lessee should reduce the amount capitalized by the amount of lease incentive payments received from the lessor at or before lease inception. Initial direct costs incurred to place a lease asset into service should be accounted for as if they were paid in a financed purchase of a capital asset. That means ancillary charges such as legal and administrative structuring fees should be added to the lease asset measurement. Initial direct costs that would be considered debt issuance costs under paragraph 12 of Statement No. 7, *Advance Refundings Resulting in Defeasance of Debt*, should be recognized as outflows of resources, e.g., expense/expenditure, in the period incurred.

## Subsequent Years' Recognition & Measurement

### Interest Expense

- Calculated as amortization of discount on a lease liability

### Amortization Expense

- Systematic & rational manner
- Shorter of lease term or useful underlying asset
- May be combined with depreciation expenses for reporting

Consistent with the principle that a lease is a financing, a lessee must recognize amortization expense on the lease asset, representing the decrease in useful life of the right to use the underlying asset. Amortization should be calculated in a systematic, rational manner over the shorter of the lease term or the underlying asset's useful life, consistent with depreciation and amortization of other capital assets. While many governments will choose a straight-line method, other patterns of amortization could be acceptable. Governments can choose to use a composite or group amortization method for similar leases.

For leases with bargain purchase options reasonably certain of being exercised, the lessee should amortize the lease asset over the underlying asset's useful life. However, if the underlying asset is nondepreciable, e.g., land, the lease asset should not be amortized.

For reporting purposes, interest and amortization expense may be combined with other interest and depreciation or amortization expense amounts on capital assets, respectively.

*Lease expenses for today's operating leases will no longer be classified as a single rent expense but will instead be recorded as separate interest and amortization components.*



**Examples – Amortization**

*A government leases land and amortizes the lease asset because it is not reasonably certain that it will purchase the land. If the government subsequently becomes reasonably certain that it will purchase the land, should the lease asset be remeasured to the amount of the initial measurement before the lease asset was amortized?*

No. If a lease contract includes a purchase option and the lessee determines it is reasonably certain of being exercised, the lease asset is amortized over the underlying asset's useful life, unless the underlying asset is nondepreciable. The government should cease amortizing the lease asset as of the date the government becomes reasonably certain that it will purchase the underlying asset. (The government should not reclassify the lease asset as land until the purchase occurs.) The lessee also should determine whether exercising the purchase option is expected to significantly affect the lease liability amount. A lease asset generally should be adjusted by the same amount as the corresponding lease liability when that liability is remeasured. A lessee must remeasure the lease liability when an assessment of all relevant factors indicates the likelihood of a purchase option being exercised has changed from reasonably certain to not reasonably certain or vice versa.

*What if the underlying asset were a depreciable asset such as equipment?*

The government would continue to amortize its lease asset once it becomes reasonably certain it will purchase a depreciable underlying asset. The government should amortize the lease asset over the underlying asset's remaining useful life, if different from the lease term. In addition, the asset value that is amortized may change if the lease liability is adjusted for the change in likelihood of the purchase option being exercised.

**Remeasurement**

The lease liability should be remeasured at subsequent reporting dates if one or more of the following occurs, presuming the changes individually or in the aggregate are expected to significantly affect the lease liability since the last measurement:

- The lease term changes<sup>3</sup>
- Based on an assessment of all relevant factors, the likelihood of an RVG being paid or purchase option being executed changes from "reasonably certain" to "not reasonably certain" or vice versa
- The estimated remaining payments change from the amount included in the lease liability measurement
- The rate the lessor charges the lessee changes, if used as the initial discount rate
- Remeasurement is required when a contingency—upon which some or all of the variable payments expected to be made over the lease term's remainder are based—is resolved such that those payments meet the criteria for inclusion in the lease liability, *i.e.*, an event occurs causing variable payments contingent on the underlying asset's performance or use has occurred, causing the payments to become fixed or fixed in substance
- Statement 99, *Omnibus 2022*, clarifies that a lease receivable should not be remeasured solely for a change in an index, or a rate used to determine variable payments.
- Implementation Guide 2021-1 clarifies that remeasurement is only required when a contingency, upon which some or all of the variable payments over the remainder of the lease term are based, is resolved. A

<sup>3</sup>Changes to the lease term or the likelihood of a purchase option being executed requires a lessee to update the discount rate when the changes—individually or in the aggregate—are expected to significantly affect the recorded lease liability. The discount rate should be based on the revised rate the lessor charges the lessee or—if not readily determinable—the lessee's estimated incremental borrowing rate at the time of update.

contingency resolved for only one year but not for the remainder of the lease term would not require remeasurement.

If remeasurement is triggered, the liability also must be adjusted for changes to the index or rate used to determine variable payments, if the change is expected to significantly affect the previous measurement's liability amount. Changes in an index or rate used to measure variable payments do not—in and of themselves—require liability reassessment. The lessee is not required to remeasure the lease liability or reassess the discount rate solely because of changes in its incremental borrowing rate.

Lessees should adjust the lease asset by the same amount as the corresponding lease liability, except if the lease asset's carrying value is reduced to zero. If this occurs, any remaining amount should be reported in the resource flows statement as a gain.

### Impairment

In accordance with Statement 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*, a capital asset is considered impaired when its service utility has significantly and unexpectedly declined. Lease asset impairment generally links to impairment of the lessee's right to use the underlying asset caused by its impaired service utility. A significant decline in the underlying lease asset's service utility may be determined by assessing changes in the length of time during which the underlying asset can be used (duration of use) or in the way the underlying asset can be used (manner of use), compared to its previously expected duration and manner of use. If a lease asset is impaired, it should be reduced first for any change in the corresponding lease liability, and any remaining amount should be recognized as an impairment.

#### **Example – Impairment**

*At the end of year nine of a 10-year lease, a flood damages a leased building. Before the flood, the lessee reported a lease asset—net of amortization—of \$275,000 and a lease liability of \$300,000. Because of the damage, the lessor reduces the lessee's remaining payments by \$20,000, and the lessee determines the lease asset's remaining service utility is only \$100,000. How should the lessee report the impairment?*

The lessee should reduce the lease liability and lease asset by \$20,000 for the reduction to the lessor's remaining payments. The lessee also should reduce the lease asset by an additional \$155,000 and record an impairment of \$155,000 to reflect the remaining decrease in the lease asset's service utility. However, if the change in the lease liability had been sufficient to reduce the lease asset's carrying value to zero, any remaining reduction of the lease liability should be reported as an inflow in the resource flows statement, e.g., a gain.

## Lessor Accounting

### Leveraged Leases

Statement 87 supersedes Statement 62's guidance on accounting for leveraged leases—leases that involve a creditor providing long-term financing to the lessor for the underlying asset's acquisition—and situations when the underlying lease asset is sold or the lease is assigned to a third party. For leveraged leases, no replacement guidance is given in Statement 87 primarily because they are uncommon in governments. For underlying asset sale or assignment, a lessor's determination of whether a sale has occurred should be made regardless of whether a lease is in place.

## Initial Measurement

### Lease Receivable

- Fixed payments
- Variable payments based on index or rate
- Variable payments fixed in substance
- RVG fixed in substance
- Lease incentive due to lessee

### Underlying Asset

- No change in accounting
- Not derecognized

### Lease Receivable

A lessor initially should measure the lease receivable at the present value of lease payments expected to be received during the lease term, reduced by any provision for estimated uncollectible amounts. Measurement of the lease receivable should include the following:

- Fixed payments
- Variable payments that depend on an index or rate, initially measured using the index or rate as of the lease term's commencement
- Variable payments that are fixed in substance
- RVG payments that are fixed in substance
- Any lease incentives payable to the lessee

Other types of payments, such as those arising from purchase options and RVGs that are not fixed in substance—but contingent on future events—are **not included** in the lessor's initial measurement. Instead, a lessor should record a lease receivable and recognize inflows of resources, e.g., revenue, at the time a not-fixed-in-substance RVG's guarantee payment is required—as agreed to by the lessee and lessor—and the amount can be reasonably estimated. Amounts to be received for the exercise price of a purchase option or penalty for lease termination should be recognized as a receivable and an inflow of resources, e.g., revenue, when those options are exercised.

### Variable Payments

Variable payments based on the lessee's future performance or the leased asset's usage should **not be included** in the lease receivable's measurement. Those variable payments should be recognized as inflows of resources, e.g., revenue, in the period to which those payments relate. Examples include variable payments based on a percentage of airport terminal restaurant sales or vendor stall sales at government-owned sports stadiums.

**Example – Variable Payments**

*A government leases retail space to a vendor for three years. The first year's principal portion is \$100,000 (minimum annual guarantee). The principal portion in the second year depends on first-year sales. If the first year's sales exceed \$1 million, the minimum annual guarantee for the second year is \$110,000. If the first year's sales were less than \$1 million, the minimum annual guarantee for the second year is \$100,000, and the minimum annual guarantee for the third year is \$90,000. What amounts should be included in the lessor's lease receivable at the lease's commencement?*

The lease receivable should include the variable payments that are fixed in substance and not dependent on the lessee's future performance. In this example, the payments that would be made if the lessee were to have zero in sales each year should be included in the lease receivable at the lease's commencement because the lease payments grow with increased sales. The individual payments to be included in the calculation of the lease receivable total \$290,000 (first year – \$100,000, second year – \$100,000, and third year – \$90,000).

**RVG**

Certain components of the lease receivable—fixed payments, variable payments that depend on an index or rate or are fixed in substance—are symmetrical with components of the lessee's lease liability.

**Example – RVG**

*In addition to fixed payments, a lease contract includes provisions for variable payments based on future performance and for an RVG that did not initially meet the criteria for recognition in the lease receivable. If those variable payments and RVG subsequently meet the criteria for recognition, should the amounts be added to the existing lease receivable or reported as separate receivables?*

When the variable payments and RVG meet the criteria for recognition, the amounts should be considered separate receivables, and an inflow of resources should be recognized in the period to which those payments relate. Variable payments based on future performance and RVGs that are not fixed in substance should not be included in the lease receivable's initial measurement. Remeasurement of the lease receivable is not required when those payments meet the recognition criteria.

**Deferred Inflow of Resources**

Lessors should recognize a deferred inflow of resources corresponding to the lease receivable's initial measurement, plus lease payments received from the lessee at or before lease commencement that relate to future periods, e.g., the final month's rent, less any lease incentives paid to—or on behalf of—the lessee at or before lease commencement. The underlying asset is not derecognized.

**Lease Incentives**

A lease incentive is a payment made to—or on behalf of—the lessee, for which the lessee has a right of offset with its obligation to the lessor—equivalent to a rebate or discount—or is in the form of other lessee concessions. These incentives include assumption of a lessee's pre-existing, third-party lease obligations; other reimbursements of lessee costs; rent holidays; and reductions of interest or principal charges by the lessor. A lessor-provided leasehold improvement is another example of a lease incentive payment if, for example, it provides additional assets to the lessee without additional cost.

The accounting for lease incentives is based on whether they are received at or before lease inception or after lease inception. Payments to be provided after lease commencement should be accounted for by the lessor as reductions of lease payments in the year the payments will be provided. Only lease incentive payments that are fixed or fixed in substance are included in the initial measurement and subject to remeasurement; variable or contingent lease incentive payments are not included in initial measurement.

## Leasehold Improvements

Some lease contracts may require the lessor to pay for leasehold improvements. The payment for a leasehold improvement may be an example of a lease incentive payment to or on behalf of the lessee if, for example, it provides additional assets to the lessee without additional cost. The determination would be based on the facts and circumstances of the leasehold improvement.

### **Example – Lease Incentives—Lessor**

*A governmental lessor makes incentive payments to a lessee to relieve the lessee's existing obligation to another lessor. The payments are made before the lease term's commencement. How are such payments reported by the governmental lessor?*

The governmental lessor should recognize a prepayment (asset) when the payments are made. Lease incentives paid at or before the lease term's commencement should reduce the lessor's initial measurement of the deferred inflow of resources. In this case, at the lease's commencement, the asset should reduce the deferred inflow of resources.

*Statement 87 is based on the premise that a lessor's relinquishing the right to use an asset, which it still owns, does not diminish the asset's historical cost recognized. Unlike the current treatment for capital leases under Statement 62, lessors will not derecognize the underlying asset under Statement 87.*

## Subsequent Years' Recognition & Measurement

### Lease Revenue

- Inflow over lease term
- Systematic & rational method

### Interest Revenue (on the Lease Receivable)

- Interest rate method

## Lease Revenue/Deferred Inflow

Statement 87 requires lessors to recognize a deferred inflow of resources to correspond to the lease receivable. A deferred inflow of resources is defined in Concepts Statement 4 as an acquisition of net assets by the government that is applicable to a future reporting period. GASB believes that recognizing a lease receivable is an acquisition of net assets and that the lease payments included in the lease receivable relate to future reporting periods. Thus, the lessor is required to recognize revenue as the service capacity of the underlying asset is used by the lessee over future reporting periods.

Revenue is recognized over the lease term with interest revenue and other lease-related revenue separately reported in the resource flows statement. Unlike lessees that amortize over the shorter of the lease term or the useful life, a lessor must use the lease term for the deferred inflow. In alignment with lessee accounting, payments received should be allocated first to the accrued interest receivable—current year's amortization of the lease receivable's discount using the effective interest method—and then to the lease receivable. In alignment with lessee accounting, a lessor should recognize inflows of resources, e.g., revenue, in a systematic and rational manner over the lease term for the deferred inflow.

### Interest Revenue/Lease Receivable

The lease receivable must be amortized using the interest method, which results in a constant rate of interest when applied to the amount outstanding at the beginning of any given period.

### Underlying Asset

The underlying asset in a lease should continue to be accounted for in accordance with other applicable guidance, including depreciation and impairment, except if the lease contract requires the lessee to return the asset in its original or enhanced condition. In this circumstance, the lessor would **not** depreciate the asset during the lease term because the service capacity of that asset would be assessed at an amount at least the same at the end of the lease as it was at the beginning, and it would not be appropriate to recognize a reduction through depreciation.

### Remeasurement

The provisions for remeasurement of a lease receivable are similar to those for remeasurement of a lessee's lease liability. Remeasurement should occur at subsequent financial reporting dates when there is a change in the lease term or interest rate charged to the lessee or when a contingency existing at lease commencement is resolved and variable payments meet the criteria for measuring the lease receivable. The changes—individually or in the aggregate—must be expected to significantly affect the lease receivable amount since the previous measurement.

If the lease receivable is being remeasured, it should be adjusted for a change in the index or rate used to determine variable payments if the change is expected to significantly affect the receivable amount since the previous measurement. A lease receivable is not required to be remeasured solely for a change in an index or rate used to determine variable payments.

### Discount Rate

The discount rate should only be updated—and receivable remeasured—if there is a change in the lease term or interest rate the lessor charges the lessee, provided the changes individually or in the aggregate are expected to significantly affect the lease receivable amount. At that time, the receivable should be remeasured using the revised rate.

The deferred inflow of resources balance generally should be adjusted by the same amount as any changes resulting from remeasurement of the lease receivable.

*Remeasurement is common in a concessionaire's lease requiring a nominal payment in the first year and fixed payments in subsequent years based on a percentage of first-year sales.*

### Example – Lessor Remeasurement

*Halfway through a 10-year lease, a lessor remeasures the lease receivable from \$500,000 to \$10,000, due to a reduction in the lease term. The related deferred inflow of resources balance at that date was \$480,000. How does the remeasurement of the lease receivable affect the measurement of the remaining deferred inflow of resources?*

The deferred inflow of resources generally should be adjusted by the same amount as the corresponding lease receivable when the receivable is remeasured. However, if that change reduces the carrying value of the deferred inflow of resources to zero, any remaining amount should be reported as an outflow in the resource flows statement, e.g., a loss. Accordingly, the lessor should reduce the lease receivable by \$490,000 and the deferred inflow of resources by \$480,000 and record an outflow of \$10,000.



## Disclosures

Disclosure requirements have been enhanced under Statement 87 to provide information about the full cost of leases. New requirements are **bolded**.

### Lessee

A lessee should disclose the following about its lease activities (which may be grouped for purposes of disclosure), other than short-term leases:

- A general description of its leasing arrangements, including (1) the basis, terms, and conditions on which variable payments not included in the lease liability measurement are determined and (2) the existence, terms, and conditions of RVGs provided by the lessee not included in the lease liability's measurement
- The total amount of lease assets—and the related accumulated amortization—disclosed separately from other capital assets
- The amount of lease assets by major classes of underlying assets, disclosed separately from other capital assets
- **The amount of outflows of resources recognized in the reporting period for variable payments not previously included in the lease liability's measurement**
- **The amount of outflows of resources recognized in the reporting period for other payments, such as RVGs or termination penalties, not previously included in the lease liability's measurement**
- Principal and interest requirements to maturity—presented separately—for the lease liability for each of the five subsequent fiscal years and in five-year increments thereafter
- Commitments under leases before the lease term's commencement
- The components of any loss associated with an impairment (the impairment loss and any related change in the lease liability)

Disclosures also are required for lease commitments on upcoming leases, sublease, sale-leaseback, and lease-leaseback transactions.

Amortization expense for lease assets can be combined with depreciation expense in the required disclosure by function.

*Preparers may aggregate disclosures when appropriate and consider a lease transaction's significance in compiling the information necessary to meet the disclosure requirements. GASB did not provide guidance regarding where to place and how to structure lease disclosures in the notes to the financial statements. Preparers should continue to use professional judgment to determine how to present the disclosure requirements in a manner that is useful and understandable to users.*

### Lessor

Like lessees, lessors are required to disclose more information about the effect on current resources arising from leasing activities than Statement 62 requires. A lessor should disclose the following about its lease activities (which may be grouped for purposes of disclosure), other than short-term leases and certain regulated leases:

- A general description of its leasing arrangements, including the basis, terms, and conditions on which any variable payments not included in the lease receivable's measurement are determined
- **The total amount of inflows of resources—for example, lease revenue, interest revenue, and any other lease-related inflows—recognized in the reporting period from leases, if that amount cannot be determined based on the amounts displayed on the face of the financial statements**

- **The amount of inflows of resources recognized in the reporting period for variable and other payments not previously included in the measurement of the lease receivable, including inflows of resources related to RVGs and termination penalties**
- 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

General disclosure about RVGs is not specifically required for lessors because the underlying assets are not derecognized.

Statement 87 also expands on the current requirement to disclose the future minimum lease payments to be received for each of the five succeeding years to also include a schedule of future minimum lease payments in five-year increments thereafter, with principal and interest separately presented. However, only lessors whose principal ongoing operations consist of leasing assets to other entities and lessors with certain regulated leases are required to prepare this disclosure.

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 are required for all leases, including leases of investment assets and certain regulated leases.

Lessors also should apply the relevant disclosures for certain regulated leases; investment leases subject to Statement 72; and sublease, sale-leaseback, and lease-leaseback transactions.

*Disclosing a schedule of future lease payments included in the lease receivable is only required for governments whose principal ongoing operations consist of leasing activities.*

## Lease Modifications & Terminations

Lease accounting should reflect changes to the lease contract's provisions. Certain changes under the lease contract or estimates incorporated into the contract's measurement require remeasurement of a lessee's liability or a lessor's lease receivable if the change is expected to significantly affect the amount recorded. Lease modifications and terminations, however, are not changes **under** the original lease contract. Instead, they are **amendments to** the original lease contract while the contract is in effect—which may require recording a new and separate lease.

In a lease modification, the lessee retains the same right to use the underlying asset, even if the lessee will be paying less for that right going forward. Example lease modifications include an agreement by both parties to extend a lease when there is no option to extend, revise payment amounts, or add an underlying asset. If the lessee's right to use the underlying asset decreases, the amendment is instead considered a partial or full lease termination.

### **Example – Lease Termination or Modification?**

*A 10-year lease contract includes an option to extend the lease for five years if both the lessor and lessee agree. Because both parties have to agree to extend, paragraph 12 of Statement 87 refers to this as a cancelable period and, therefore, it has been excluded from the lease term. If, during the lease term, the lessor and lessee agree to extend the contract for five years, should this be accounted for as a lease modification or a new lease?*

Because both parties have to agree to the optional five-year period, it is considered cancelable and, therefore, not subject to the lease term reassessment guidance. However, once the lessor and lessee agree to exercise the five-year option, it becomes noncancelable and should be considered a lease modification, unless it is due to a reassessment of the lease term.



*Statement 93, Replacement of Interbank Offered Rates, creates an exemption from modification guidance for contract amendments solely to replace the London Interbank Offered Rate (LIBOR) for variable rate payments (see “GASB Finalizes LIBOR Transition Relief”).*

## Lease Modification Accounting

Lease modification accounting is similar to prior guidance in Statement 62. If the lease modification gives the lessee an additional lease asset by adding one or more underlying assets that were not included in the original lease, the additional portion of a modified lease should be accounted for as a new lease. However, if lease payments for the additional lease asset appear to be **unreasonable** based on the amended contract's terms and the use of professional judgment, the modification should be accounted for as an amendment of the existing lease.

All other lease modifications—such as lengthening the lease term—result in lease term reassessment rather than reporting as a separate lease. Lessees will remeasure the lease liability (and corresponding asset), and lessors will remeasure the lease receivable (and corresponding deferred inflow of resources), in accordance with Statement 87's remeasurement guidance.

### Example – Lease Modifications—Lessees

#### Lessees

*Three years into a four-year lease, a school district modifies its lease from 200 computers to 230 computers due to an enrollment increase, changing the remaining lease liability from \$200,000 to \$202,500. The school district has determined the increase in lease payments appears to be **unreasonable** based on the **value of the additional underlying assets**. How should the school district account for the amendment to the lease?*

Because the school district has determined the increase in the lease payments appears to be unreasonable, the school district should account for this as a lease modification but not as a separate lease. Because this is not reported as a separate lease, a lessee should account for a lease modification by remeasuring the lease liability. The lease asset should be adjusted by the difference between the remeasured liability and the liability immediately before the lease modification. Thus, the lease asset should be increased by \$2,500, which represents the difference between the remeasured liability and the liability immediately before the lease modification.

### Example – Lease Modifications—Lessor

#### Lessors

*A government leases one floor of an office building to a private party for several years. In the middle of the lease, a significant downturn in the local real estate market occurs. The government and the lessee renegotiate the rental payments for the lease's remainder. The lease receivable—present value of lease payments expected to be received during the remaining lease term—before the amendment was \$500,000, and after it was \$270,000. How should the government account for the lease modification?*

Unless a modification is reported as a separate lease, a lessor should account for a lease modification by remeasuring the lease receivable. The lease receivable should decrease by \$230,000, which represents the difference between the receivable before the lease modification and the remeasured receivable. In addition, the deferred inflow of resources should decrease by \$230,000. However, to the extent that the change in the lease receivable relates to payments for the current period, the change should be recognized as a decrease in revenue.

**Implementation Guide 2021-1 provided the following examples:**

**Example 1**

**A governmental lessee and a governmental lessor enter into a contract with a lease term beginning in 20X1. In 20X3, the lessee and lessor modify the provisions of the lease contract, and the changes that result from that amendment will take effect in 20X5. When should the lessee and lessor account for the amendment?**

The lessee and lessor should account for the amendment in 20X3, when the provisions of the contract are modified.

**Example 2**

**A school district remeasures a lease liability as a result of a lease modification. Does that remeasurement require reassessment of the discount rate?**

Yes, a lease modification requires remeasurement of the lease liability, which in the context of a lease modification is the same as reperforming an initial measurement. Therefore, the school district should recalculate the lease liability, including reassessing the discount rate.

**Example 3**

**A government leases equipment with a noncancellable period of five years and no options to extend. While the lease contract is in effect, the provisions of the contract are amended to lengthen the noncancellable period from five years to eight years. Because that modification does not add one or more underlying assets and is not accounted for as a separate lease, the lessee is required to remeasure the lease liability. How should the lease liability be remeasured?**

A change arising from an amendment to a lease contract should be accounted for in accordance with the provisions for lease modifications—the lessee should reassess the lease term and recalculate the lease liability for the amended lease contract in accordance with the provisions for initial measurement.

## Modifications Resulting from a Lessor's Debt Refunding

The guidance for lease modifications resulting from a lessor's debt refunding (including an advanced refunding) in which the refunding's perceived economic advantages are passed through to the lessee has been modified from Statement 62—the accounting differences between capital and operating leases have been removed.

A lessor should account for the changed lease provisions resulting from a debt refunding by adjusting the lease receivable to the present value of the future minimum lease payments using the interest rate in the revised lease contract, with a corresponding adjustment to deferred inflows of resources.

Lessees should adjust their lease liability to the present value of the future lease payments under the revised lease using the effective interest rate applicable to the revised lease contract. The difference should be reported as a deferred outflow of resources (deferred loss) or a deferred inflow of resources (deferred gain) to be amortized as a component of interest expense/expenditure in a systematic, rational manner over the remaining life of the old or new debt, whichever is shorter. If the advanced refunding results in a defeasance of debt, the lessee should recognize costs it is obligated to reimburse to the lessor, e.g., unamortized discount or a call premium, also in a systematic, rational manner over the remaining life of the old or new debt, whichever is shorter.

## Partial & Full Lease Termination Accounting

An amendment that diminishes—but does not terminate—the lessee's right to use the underlying asset should be accounted for as a partial lease termination, not a modification. This includes shortening the lease term or reducing a lease from, for example, four vehicles to three. Alternatively, the lessee and lessor might agree to a full termination prior to a lease's scheduled end date, even if such a provision was not included in the most recent lease contract.

If a lease is fully or partially terminated, the lessee no longer has the same right to use the underlying asset and is required to remove the carrying value—or a portion thereof—of the intangible lease asset representing the lost right to use. The corresponding lease liability also is reduced with gain or loss recognition for the difference.

Accordingly, a lessor should reduce the carrying value of the lease receivable and deferred inflow of resources for the partial or full termination and recognize a gain or loss for the difference. Derecognition of the underlying asset due to the lessee purchasing the asset should be considered in the lessor's gain or loss calculation.

#### **Example – Lessee Partial Termination**

*Two years into a 10-year lease, the lease term is reduced to five years. At the time of the amendment, the lease liability's carrying value is \$80,000, and the lease asset's carrying value is \$76,000. How should the lessee account for the partial termination of the lease?*

The lessee should account for the amendment as a decrease in the right to use the underlying asset. If the lessee determines the remeasured liability is \$50,000, the lease liability and the lease asset should each be reduced by \$30,000.

#### **Example – Lessor Full Termination**

*Two years into a 10-year lease, the remaining lease agreement is canceled. The lease receivable's carrying value is \$80,000, and the related deferred inflow of resources is \$76,000. How should the lessor account for the lease's full termination?*

Once the lease is terminated, the lease receivable's carrying value and the related deferred inflow of resources should be eliminated. A loss of \$4,000 should be recognized in financial statements that apply the economic resources measurement focus. In financial statements that apply the current financial resources measurement focus, another financing use should be recognized.

## **Sale-Leaseback Transactions**

Sale-leaseback transactions involve the sale of an underlying asset by the owner and a lease of the property back to the seller (original owner). A sale-leaseback transaction is a transaction that qualifies as a sale under the guidance for real estate sales in Statement 62. In a change from current guidance, any difference between the carrying value of the capital asset that was sold and the sale's net proceeds must be reported as a deferred inflow or deferred outflow of resources by the seller-lessee over the leaseback's term, regardless of how much of the asset's use the seller-lessee retains. The deferral should be recognized in the resource flows statements in a systematic, rational manner over the lease term. If the transaction's lease portion qualifies as a short-term lease, the gain or loss should be immediately recognized. If the transaction does not include a qualifying sale, it should be accounted for as a financing because the transaction's substance is a borrowing/lending activity (rather than an asset sale).

A seller-lessee is required to disclose a sale-leaseback transaction's terms and conditions, including, for example, any commitments made or further involvement of the seller-lessee in carrying out the transaction, in addition to the general lessee disclosure requirements. A buyer-lessor would provide the [general lessor disclosure](#) requirements. Sale-leaseback transactions with off-market terms should be reported based on the transaction's substance rather than as part of the sale-leaseback transaction, e.g., as a borrowing, a nonexchange transaction, or an advance lease payment.

## **Regulated Operations**

Entities that elect to apply the regulated operations guidance in Statement 62—and meet Statement 62's related criteria—are required to follow separate sale-leaseback recognition guidance. The difference between the amount of resource inflows or outflows, e.g., revenue or expense, in the sale-leaseback transaction and the amount of inflows or outflows included in allowable cost for rate-making purposes should be recognized as a separate regulatory-created asset or deferred inflow of resources.

**Examples – Sale-Leaseback Transactions**

*The difference between the carrying value of a capital asset that was sold and the net proceeds of the sale in a sale-leaseback transaction is reported as a deferred inflow of resources or a deferred outflow of resources and subsequently recognized in the resource flows statements. Should the amount of inflows or outflows of resources recognized in subsequent years be considered part of the sale transaction or lease transaction?*

The recognition of the deferred inflow of resources or deferred outflow of resources should be considered a component of the sale transaction because this amount represents the overall gain or loss on the asset's sale.

*A government sells a building to a third party and leases a different but equivalent building from the same party. As part of the consideration for the building sale, the government receives rent concessions for the leased building. Is this a sale-leaseback transaction?*

No. A sale-leaseback transaction involves the sale and leaseback of the same underlying asset. Because the sale and the lease relate to two different underlying assets, the sale and the lease should be recorded as two separate transactions. The rent concessions should be recorded as part of the consideration for the sale rather than as a lease incentive and should not affect the lease's initial recording.

**Lease-Leaseback Transactions**

In a lease-leaseback transaction, each party is both a lessor and a lessee. Because each portion of the transaction is with the same counterparty, a right of offset exists, and the transaction should be recorded net—even if the leaseback involves an additional asset or only a portion of the original asset. Both parties are required to disclose the gross amounts of the lease and leaseback to provide users with information about the magnitude of each portion of the transaction.

**Examples – Lease-Leaseback Arrangements**

*A government leases an office building to a private party and determines that, as a lessor, its initial lease receivable and related deferred inflow of resources are \$3 million. The government leases back one floor of the building to house its finance department and determines that, as a lessee, its initial lease liability and related lease asset are \$700,000. How should the lease-leaseback transaction be reported?*

Lease-leasebacks must be reported as net transactions. In a lease-leaseback transaction, each party is both a lessor and a lessee. Because each portion of the transaction is with the same counterparty, a right of offset exists. The lease liability and the lease receivable should be offset and reported as either a net lease liability or net lease receivable. Similarly, the lease asset and deferred inflow of resources should be offset. In this example, the government should report a lease receivable (net of the leaseback) and a deferred inflow of resources (net of the leaseback) of \$2.3 million.

*A government leases land to a contractor on which the contractor will build a new school and lease both the land and school back to the government. The government makes advance lease payments to the contractor during construction. How should the government report the lease during the construction period?*

Prior to the new building being made available to the government, the lease of the land to the contractor should be reported as a standalone lease. Any lease payments made to the contractor prior to the new building being made available should be reported as a prepayment. Once the new building is made available to the government, the lease and the prepayment should be accounted for as a lease-leaseback transaction.

## Subleases

A sublease is accounted for as a transaction separate from the original lease, except for a lease-leaseback transaction such that the right of offset exists. That means a lessee's transactions as the sublease lessor in a sublease are required to be reported separately from the lessee transactions. The lessee as the sublease lessor also should include the sublease separately in its lessor and lessee disclosures.

The current requirement for separate disclosure of sublease payments to be received is not required under Statement 87 (payments to be received from subleases will be included in the lease receivable and the sublease lessor's note disclosure of future lease payments).

*A transaction that relieves the original lessee of its obligation under the lease is a lease termination rather than a sublease.*

## Intra-Entity Leases

The provisions for reporting leases within the same financial reporting entity have been carried forward with clarifying edits so that elimination will be consistently reported among governments. That means when the lessee or lessor is included as a blended component unit, the lessor's debt and assets should be reported as if they were the primary government's debt and assets. Capital assets leased from a blended component unit should be reported as capital assets, and related debt would be reported as a long-term liability in the reporting entity's governmentwide financial statements.

Each entity would continue to apply Statement 87 in any separate financial statements, but eliminations for leases with or between blended component units should be made before the separate financial statements are aggregated with the primary government. Any remaining cash payments between component units are reported as inflows, outflows, or resources.

Leases between the primary government and discretely presented component units—or between discretely presented component units—are subject to Statement 87's general provisions. Related receivables and payables should not be combined with other amounts due to or from the discretely presented component unit or with lease receivables and payables with organizations outside the reporting entity.

### **Example – Intra-Entity Lease**

*A county building authority is a blended component unit of a county. The building authority acquires and constructs public capital assets to lease them to the county. Should the leases with the county be eliminated as intra-entity leases in the reporting entity's financial statements?*

Yes. 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. However, the building authority should report the leases in its standalone financial statements.

## Related-Party Leases

Leases between related parties are subject to requirements in Statement 56, *Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards*, requiring the parties to report the transaction's substance if significantly different from its form. Disclosure of the nature and extent of related-party leasing transactions is required. In all other aspects, the classification and accounting should be the same as for similar leases between unrelated parties. Although the emphasis in Statement 87 is on legally enforceable rights and obligations stemming from a lease contract, financial statement preparers should recognize the substance of a lease arrangement with a related party if significantly different than its form.

## Transition

Statement 87's provisions should be retroactively applied by restating the financial statements, if practicable, for all prior periods presented. Reasonable efforts should be employed before a government determines restatement of all prior periods presented is not practicable, and "inconvenient" should not be considered a baseline for not restating. If restatement is not practical, the cumulative effect of applying Statement 87, if any, should be reported as a restatement of beginning net position—or fund balance or fund net position—for the earliest period restated.

Leases should be recognized and measured using the facts and circumstances that existed at the beginning of the implementation period, or the beginning of the earliest period restated. Lessor governments that previously derecognized underlying assets in accordance with Statement 62's guidance for sales-type or direct-financing leases are not required to determine the underlying asset's value at the time of implementation and recognize it. Instead, any residual asset included in the net investment in the lease recorded under Statement 62 should become the underlying asset's new carrying value.

In the first restatement period, the notes to the financial statements should disclose the restatement's nature and effect and the reason for not restating prior periods, as applicable.

Earliest Period Presented		
Year-End	Comparative-Year Presentation	Single-Year Presentation
June 30	July 1, 2020–June 30, 2021	July 1, 2021–June 30, 2022
September 30	October 1, 2020–September 30, 2021	October 1, 2021–September 30, 2022
December 31	January 1, 2021–December 31, 2021	January 1, 2022–December 31, 2022



**Example – Transition—Operating Lease**

*For leases that were reported as operating leases prior to Statement 87's implementation, should a government determine what the lease asset would be on the implementation date if it initially had been recognized as a capital lease and amortized in prior periods?*

No. Leases should be measured using the facts and circumstances that existed at the beginning of the period of implementation. The government is not required to estimate what the lease asset would have been if it initially had been recognized as a capital lease and amortized in prior periods. The RTU asset should be measured based on the lease liability at that date and no restatement of beginning net position would be required because the lease asset and lease liability would be the same.

**Example – Transition—Capital**

*In a period prior to Statement 87's implementation, a government entered into a capital lease with an interest rate of 5 percent and recorded a capital asset and liability of \$45,600. At the beginning of the earliest period restated, the capital asset's carrying value is \$20,900, and the liability (principal outstanding) is \$21,500. The government determines the liability at that date should be \$22,500 under Statement 87 due to a change in the lease term's assessment. For leases that were reported as capital leases prior to Statement 87's implementation, can the government use the capital lease asset's carrying value at the beginning of the earliest period restated as the measure of the lease asset?*

Leases should be measured using the facts and circumstances that exist at the beginning of the implementation period. This allows for use of the existing capital lease asset's carrying value, adjusted to the lease liability's new carrying value under Statement 87. The government should report a \$1,000 increase of the lease liability to \$22,500 due to the lease term's reassessment. The lease asset should be increased by the same amount (\$1,000), to \$21,900. The \$600 difference should be included in the restatement of beginning net position.

**Conclusion**

For some governments, Statement 87's adoption will be complex and likely will require significant hours to implement correctly. **FORVIS** can help educate your team, provide implementation tools, and assist with analysis and documentation. If you would like assistance complying with the new guidance, contact one of our professionals.

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## Appendix – Lessee Reporting of a Building Lease with a Lease Incentive

A utility enters into a lease for a building for a noncancelable term of 10 years. Fixed payments of \$15,000 are due at the beginning of each year. At the end of the first year, the utility is entitled to a rebate (a lease incentive) of \$5,000. The discount rate is 6 percent.

### Accounting & Financial Reporting

#### Lease Liability

The lease incentive is treated as a reduction of the lease payments. Because the incentive is provided at the end of year one, it was determined the incentive was a reduction of the second year's payment and would be factored into the present value of lease payments for that year, in accordance with paragraph 62 of Statement 87. The calculation of the initial lease liability is as follows:

Year	Payment	Present Value	Incentive	Present Value	Total
1	\$15,000	\$15,000	\$ -	\$-	\$15,000
2	15,000	14,151	(5,000)	(4,717)	9,434
3	15,000	13,350	-	-	13,350
4	15,000	12,594	-	-	12,594
5	15,000	11,881	-	-	11,881
6	15,000	11,209	-	-	11,209
7	15,000	10,574	-	-	10,574
8	15,000	9,976	-	-	9,976
9	15,000	9,411	-	-	9,411
10	15,000	8,878	-	-	<u>8,878</u>
		Initial lease liability			<u>\$ 112,308</u>

#### Lease Asset

The lease incentive would reduce the lease asset by the same amount as the lease liability.