GASB 87 – LEASES
State of California
Statewide Implementation
and Business Solutions

I. GASB 87 OVERVIEW

In June 2017, the Government Accounting Standards Board (GASB) issued Statement No. 87, *Leases*. GASB Statement No. 87 (GASB 87) increases the usefulness of governmental financial statements by requiring recognition of certain lease assets and liabilities for all leases, including those that previously were classified as operating leases and recognized as income by lessors and expenditures by lessees. GASB 87 replaces the previous lease accounting methodology and establishes a single model for lease accounting based on the foundational principle that leases are a financing of the right to use an underlying asset.

GASB 87 defines a lease as a contract that conveys control of the right to use another entity's nonfinancial asset as specified in the contract for a period of time in an exchange or exchange-like transaction. GASB 87 applies to all contracts meeting this definition of a lease, unless specifically excluded.

GASB 87 specifically excludes the following from lease accounting guidelines:

- Leases of intangible assets
- Leases of biological assets
- Leases of inventory
- Service concession arrangements (as specified in GASB Statement No. 60)
- Leases of assets financed with outstanding conduit debt
- Supply contracts
- Leases of assets that are investments
- Certain leases subject to external laws, regulations, or legal rulings

GASB 87 requires a different accounting treatment for each of the following three categories of contracts:

1. **Short-term leases**: Defined as a lease that, at the commencement of the lease term, has a maximum possible term under the lease contract of 12 months (or less), including any options to extend, regardless of their probability of being exercised. For a lease that is cancelable by either the lessee or the lessor, the maximum possible term is the amount of time either party is required to notify the other party of the cancellation (notice period). Lessees and lessors should recognize short-term lease payments as outflows of resources or inflows of resources, respectively, based on the payment provisions of the lease contract.
2. **Contracts that transfer ownership** (referred to as "**financed purchases**" hereinafter): Defined as a contract that transfers ownership of the underlying asset to the purchaser by the end of the contract and does not contain termination options. The contract may contain a fiscal funding or cancellation clause that is not reasonably certain of being exercised. Note that the mere inclusion of a bargain purchase option does not qualify as a transfer of ownership—the ownership transfer must not contain termination options.
3. **Leases other than short-term leases and contracts that transfer ownership** (referred to as **Right to Use (RTU) leases**" hereinafter): All other leases that do not meet the definition of short-term leases or contracts that transfer ownership.

GASB 87 is effective for the State of California Annual Comprehensive Financial Report (ACFR) for the fiscal year ending June 30, 2022.

LESSEE ACCOUNTING

1) GASB 87 requires a lessee government to recognize a lease liability and an intangible asset representing the lessee's right to use the leased asset at the commencement of the lease.

2) GASB 87 requires the lessee government to measure its lease liability as the present value of all payments expected to be made during the lease term.

3) Variable payments based on future performance of the lessee or usage of the underlying asset should be expensed as incurred, and not included in the measurement of the lease liability.

4) The lease asset should be measured at the amount of the initial measurement of the lease liability, plus any payments made to the lessor at or before the commencement of the lease term.

5) The lessee should assess each lease liability annually for changes in the terms of the lease, interest rate, impairment of the underlying leased asset, or other factors that may impact the expected lease payments. Lease amendments and other modifications could necessitate remeasuring the lease liability.

6) The lessee government will generally report amortization expense for the lease asset over the shorter of the term of the lease or the useful life of the underlying asset. This amortization expense may be reported with depreciation expense for capital assets. *(Please note that per 2 Code of Federal Regulations 200.1, RTU Lease assets are not capital assets. Therefore, RTU Lease asset amortization expense cannot be included in depreciation schedules submitted to the federal government.)*

7) The lessee will calculate the amortization of the discount on each lease liability in subsequent financial reporting periods, and report that amount as interest expense.

8) The lessee government's financial statement footnote disclosures will include the following:
   - A general description of leasing arrangements.
   - The total amount of lease assets recognized.
   - Related accumulated amortization, disclosed separately from other capital assets.
   - Amount of lease assets by major classes of underlying assets, disclosed separately from other capital assets.
   - Principal and interest requirements to maturity, for the lease liability for each of the five subsequent fiscal years, and in five-year increments thereafter.

- A description of variable payments and other payments not included in the lease liability, and the expense recognized in the reporting period for these payments.
- Impairment losses and any significant related changes in the lease liability.

LESSOR ACCOUNTING

1) GASB 87 requires the lessor government to recognize a lease receivable at the present value of lease payments anticipated to be received during the lease term, reduced by any provision for estimated uncollectible amounts.

2) The lessor government will recognize a deferred inflow of resources at the initial value of the lease receivable, plus the amount of any payments received at or before the commencement of the lease term that relate to future periods (i.e. the final month's rent).

3) The lessor government will continue to report the asset underlying the lease in its financial statements. The lessor should continue to apply applicable accounting guidance to the asset, including depreciation and impairment.

4) The lessor should assess each lease receivable annually for changes in the terms of the lease, interest rate, impairment of the underlying leased asset, or other factors that may impact the expected lease payments. Lease amendments and other modifications could necessitate remeasuring the lease receivable.

5) The lessor will report lease revenue, systematically over the term of the lease, corresponding with the reduction of the deferred inflow.

6) The lessor will calculate the amortization of the discount on each lease receivable in subsequent financial reporting periods, and report that amount as interest revenue.

7) The future lease payments to be received should be discounted using the interest rate the lessor charges the lessee, which may be the interest rate implicit in the lease.

8) The lessor government's financial statement footnote disclosures will include the following:
   - A general description of the leasing arrangements.
   - The total amount of revenue recognized from the leases.
   - A description of variable payments and other payments not included in the measurement of the lease receivable. This includes revenue related to residual value guarantees and lease termination penalties.
   - If the lease payments serve as security for debt issued by the lessor government, the existence, terms, and conditions of options for the lessee to terminate the lease or abate lease payments.

- If material, the lessor government should disclose a schedule of future payments that are included in the lease receivable, showing principal and interest requirements to maturity, for each of the five subsequent fiscal years, and in five-year increments thereafter.

OTHER SIGNIFICANT PROVISIONS

1) *Lease Term* - The lease term is defined as the period during which a lessee has a noncancelable right to use an underlying asset, plus the following periods:
   - Periods covered by the lessee's option to extend the lease when reasonably certain the lessee will exercise this option
   - Periods covered by the lessee's option to terminate the lease when reasonably certain the lessee will not exercise this option
   - Periods covered by the lessor's option to extend the lease when reasonably certain the lessor will exercise this option
   - Periods covered by the lessor's option to terminate the lease when reasonably certain the lessor will not exercise this option

   Periods where both the lessee and the lessor have an option to terminate or extend the lease without permission from the other party are cancelable periods and are excluded from lease term.

   Lease term should be reassessed if only one or more of the following occur:
   - Lessee or lessor elects to exercise an option even though previously determined that it was reasonably certain they would not exercise that option.
   - Lessee or lessor elects not to exercise an option even though it was previously determined that it was reasonably certain they would exercise that option.
   - Event specified in the lease contract that requires an extension or termination takes place.

2) *Lease Modifications* – A lease amendment or modification should be accounted for as a separate lease by both the lessee and the lessor if it adds one or more underlying assets that were not included in the original lease contract; and the increase in lease payments for the additional lease asset does not appear to be unreasonable.

3) *Lease Terminations* – An amendment which results in a decrease of the lessee's right to use the underlying asset is considered to be a full or partial termination.
   - A lessee should reduce the carrying values of the lease liability and related asset, and recognize a gain or loss for the difference.
   - A lessor should reduce the carrying values of the lease receivable and related deferred inflow of resources, and recognize a gain or loss for the difference.

4) *Intra-Entity Leases* – Activity between a primary government and its component units should be accounted for as follows:

- For intra-entity leases between blended component units, the reporting elements of GASB 87 do not apply. The capital assets, related debt, and debt service activity of the lessor should be reported in the financial statements of the primary government.
- Eliminations for leases between blended component units should be made before the financial statements of these entities are aggregated with those of the primary government. The remaining cash payments between component units should be reported as inflows and outflows of resources.
- Lease arrangements between the primary government and discretely presented component units should be discretely presented in a manner consistent with GASB 87. Related receivables and payables should not be combined with other Due To/Due From amounts, or with activity from organizations outside of the reporting entity.

5) *Additional Disclosures* – Both a lessor and a lessee government should provide additional relevant financial statement disclosures for the following transactions, if applicable:
   - Related party leases.
   - Leases of assets that are investments.
   - Certain regulated leases.
   - Sublease transactions.
   - Sale-leaseback transactions.
   - Lease-leaseback transactions.

GASB Literature and Resources (Ctrl + Click to follow link)

- GASB Statement No. 87, *Leases*
- GASB Implementation Guide No. 2019-3, *Leases*
- GASB Implementation Guide No. 2020-1, *Implementation Guidance Update—2020*
- GASB Implementation Guide No. 2021-1, *Implementation Guidance Update—2021*