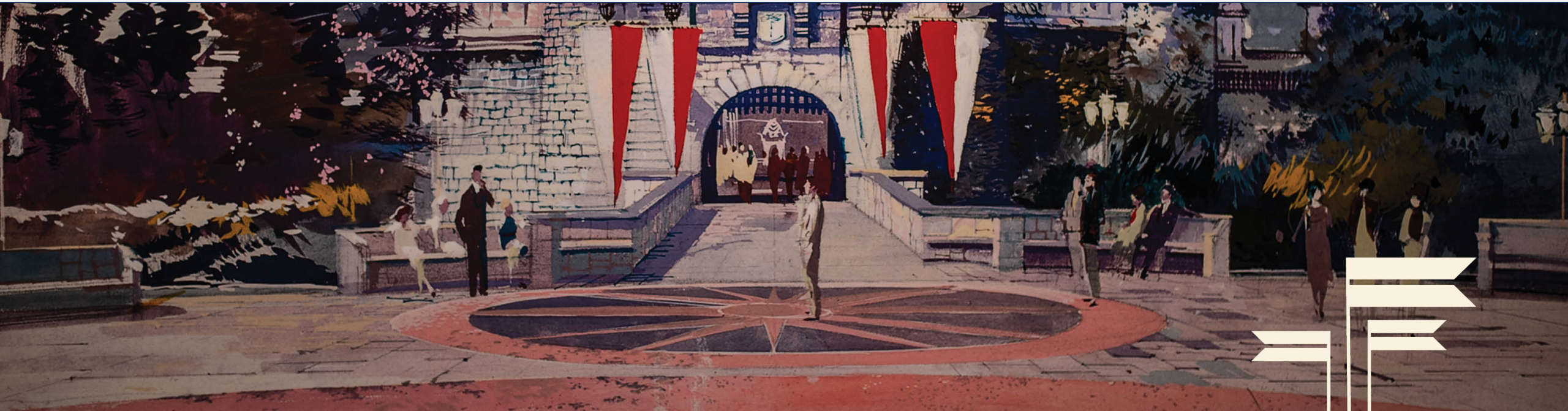




YESTERDAY, TOMORROW AND FINANCE
2020 CSMFO ANNUAL CONFERENCE
JANUARY 28-31, 2020
DISNEYLAND CA

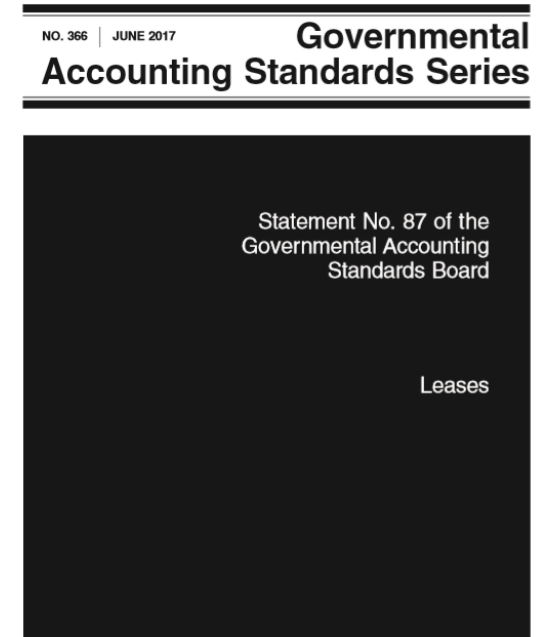


LEASE ACCOUNTING, PART DEUX



Today we will cover GASB 87 requirements:

- Lease definition, scope and transition
- Lease term and calculation
- Lease accounting and reporting
- Other provisions
- Lease policy considerations



First, High Level Overview

- GASB 87 replaces the former operating and capital leases model with a single model for lease accounting – “Lease Financing”
- Based on the foundational principle that leases are financings of the right to use an underlying asset.

Lease Definition

- A contract that conveys control of the right to use another entity’s nonfinancial asset (the underlying asset) as specified by the contract for a period of time in an exchange or exchange-like transaction (GASB 87, par.4)

A contract conveys **control** of the right to use the underlying asset when:

- The right to obtain the present service capacity from use of the underlying asset as specified in the contract, and
- The right to determine the nature and manner of use of the underlying asset.

Implementation Guide 4.1

- Q—A government obtains the right to use land, which has a market rent of \$100,000 per year, for \$1 per year. Should the government apply the requirements in Statement 87 to that transaction?
- A—No. The definition of a lease in paragraph 4 of Statement 87 specifies that the Statement should be applied only to exchange or exchange-like transactions. Paragraph 1 of Statement No. 33, Accounting and Financial Reporting for Nonexchange Transactions, classifies all transactions of state and local governments into two categories: (a) exchange and exchange-like and (b) nonexchange. The government's right to use land for \$1 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.

Implementation Guide 4.2

- Q—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 definition of a lease, is the government required to have uninterrupted control of the right to use the facility?
- A—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” (paragraph 5 of Statement 87). If the contract specifies that the government has control of those rights during three days of each week, the control criterion is met. 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 facility.

Implementation Guide 4.5

- Q—Do easements meet the definition of a lease?
- A—An easement provides the right to use a tangible asset, for example, land. Some easements meet the definition of a lease, while other easements do not. Paragraph 4 of Statement 87 states that, among other things, a lease is “for a period of time in an exchange or exchange-like transaction” (footnote reference omitted). Permanent easements, which last indefinitely without cancellation options, do not meet the period-of-time criterion. In addition, easements obtained for an amount that does not meet the description of exchange or exchange-like transactions in Statement 33, as amended, do not meet the exchange or exchange-like criterion.

Implementation Guide 4.8

- Q—Are cell phone tower or antenna placement agreements leases?
- A—If the agreements meet the definition of a lease in paragraph 4 of Statement 87, including the control criterion, then such agreements are leases. The control criterion generally is met if a cell phone tower or antenna placement agreement conveys control of the right to use the land on which the tower is placed or the connection point to which the antenna is affixed.



SPEAKER PRESENTATION

YESTERDAY, TOMORROW AND FINANCE
2020 CSMFO ANNUAL CONFERENCE
JANUARY 28-31, 2020
DISNEYLAND CA

Exclusions

- Intangible assets, such as mineral rights, patents, software and copyrights, except for the sublease of an intangible right-to-use assets
- Biological assets, including timber, living plants, and living animals
- Inventory
- Contracts that meet the definition of a service concession arrangement (GASB 60)
- Assets financed with outstanding conduit debt, unless both the underlying asset and the conduit debt are reported by the lessor
- Supply contracts, such as power purchase agreements



Exceptions

- Lessee
 - ✓ Short-term lease (maximum possible term of 12 months or less)
 - Lease payments recognized as expense by the lessee and recognized as revenue by the lessor
 - ✓ Contracts that transfer ownership
 - The transaction should be reported as a financed purchase of the underlying asset by the lessee and sale of the asset by the lessor.

Implementation Guide 4.18

- Q—A government enters into a lease with a 6-month noncancellable period and an option to extend for another 12 months after the noncancellable period. The government is not reasonably certain that it will exercise the option to extend and, therefore, assesses the lease term as six months. Is this agreement a short-term lease under Statement 87?
- A—No. Paragraph 16 of Statement 87 states that a short-term lease “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.” Therefore, the lessee should report a lease liability and a lease asset; however, the lease term would be only six months.

Implementation Guide 4.21

- Q—A vendor installs equipment in 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. For financial reporting purposes, should this transaction be reported as a lease or a financed purchase?
- A—This transaction should be reported as a financed purchase. If title to the equipment transfers to the lessee by the end of the contract, the transaction is not accounted for as a lease for financial reporting purposes. Rather, the transaction is a financed purchase, as discussed in paragraph 19 of Statement 87.

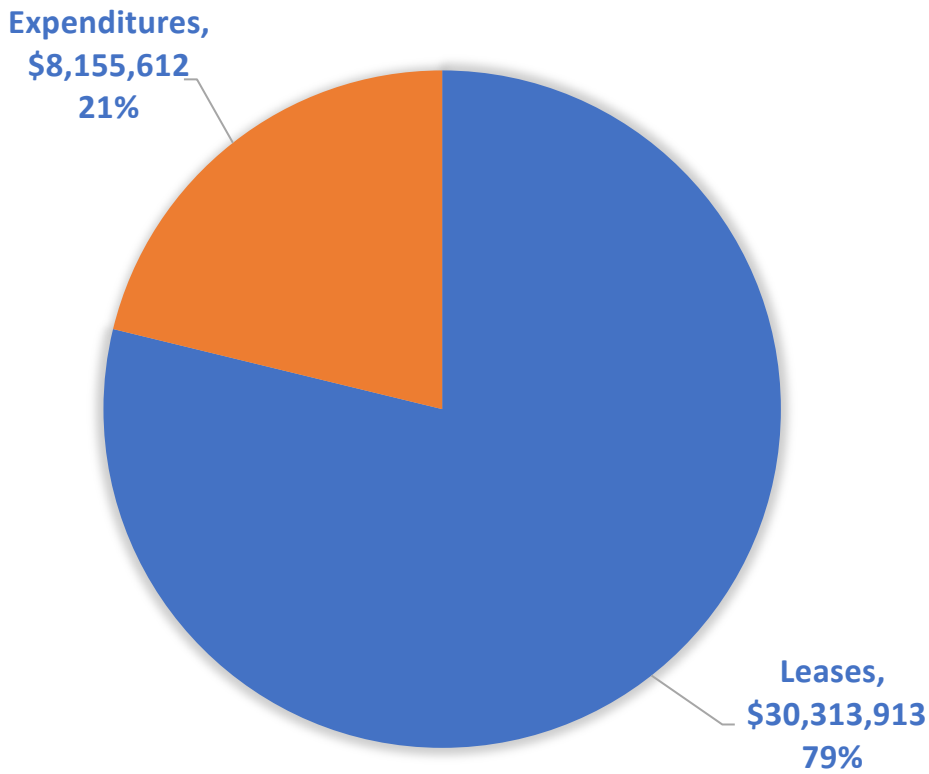
Exceptions, continued

- Lessor
 - ✓ Investments
 - If the underlying asset meets the requirements of GASB 72, then it should be reported as an investment measured at fair value.
 - ✓ Certain regulated leases
 - Lessors should recognize revenue based on the payment provisions of the lease contract and provide disclosures.
 - Examples: the U.S. Department of Transportation and the Federal Aviation Administration regulate aviation leases between airports and air carriers and other aeronautical users.

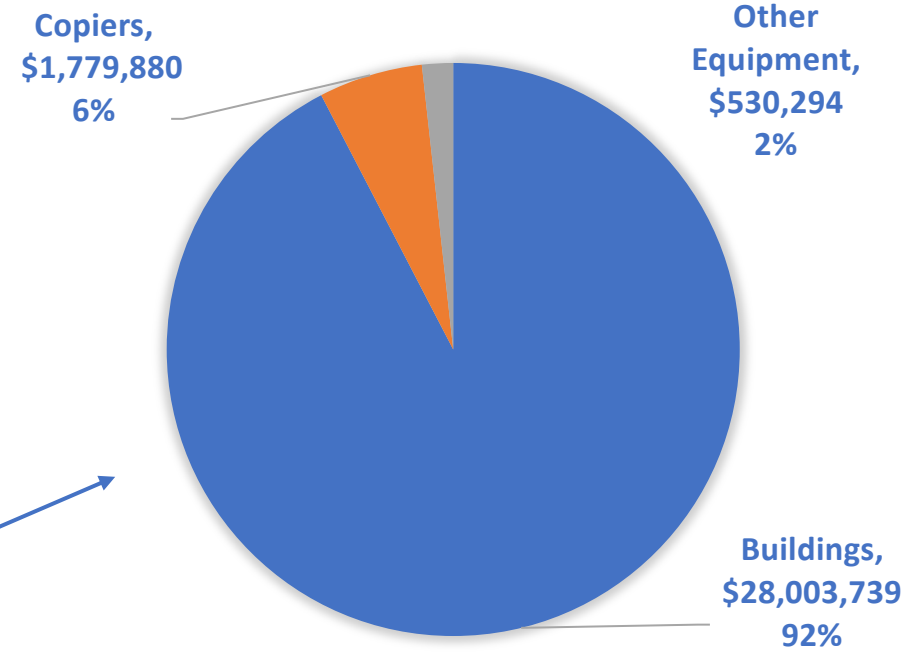
Implementation Guide 4.45

- Q—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 the pension fund account for the contract as a lease?
- A—No. Because the state pension fund holds the building as an investment, in accordance with paragraph 41 of Statement 87, it should not apply the recognition and measurement provisions of that Statement.

County of Alameda Population of Lease Expenditure Accounts



County of Alameda GASB 87 Lease Population





SPEAKER PRESENTATION

YESTERDAY, TOMORROW AND FINANCE
2020 CSMFO ANNUAL CONFERENCE
JANUARY 28-31, 2020
DISNEYLAND CA

Transition

- Apply retroactively, restate if practicable, otherwise cumulative effect should be reported as a restatement of beginning net position for the earliest period presented.
- Leases should be recognized and measured using the facts and circumstances that exist at the beginning of the period of implementation.
- Lessor should not restate the assets underlying their existing sales-type or direct-financing leases. Any residual assets for those leases should become the carrying values of the underlying assets



Implementation Guide 4.76

- Q—For leases that were reported as operating leases prior to the implementation of Statement 87, should a government determine what the lease asset would have been on the date of implementation if it initially had been recognized and amortized in prior periods as a lease under the provisions of Statement 87?
- A—No. Paragraph 94 of Statement 87 states that 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 and amortized in prior periods as a lease under the provisions of Statement 87. The lease liability should be measured using the remaining lease term and discount rate as of the beginning of the earliest period restated. The right-to-use 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 the lease liability would be the same.

Lease Term

When does the lease start and end?

- Starts with the noncancellable period, plus periods covered by lessees' and lessors' options to:
 - Extend the lease, if the option is *reasonably certain* of being exercised
 - Terminate the lease, if the option is *reasonably certain* of NOT being exercised
- Excludes "cancelable" periods
 - Periods for which lessee and lessor each have the option to terminate or both parties have to agree to extend
 - ✓ For example, rolling month-to-month leases
- Fiscal funding/cancelation clauses only if *reasonably certain* of being exercised

Lease Term, continued

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

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

Implementation Guide 4.13

- Q—A lease contract has a noncancellable period of five years and specifies that at the end of the five years, both the lessor and lessee have the right to cancel the lease or may continue the lease, using the same terms on a month-to-month basis. Is the month-to-month holdover period included in the initial assessment of the lease term?
- A—No. During the holdover period, the lessee has not contracted for a noncancellable right to use an underlying asset, and the lessor is not required to continue providing the asset. That is, the holdover period is cancellable by either party and, therefore, is excluded from the lease term, as defined in paragraph 12 of Statement 87.

Implementation Guide 4.14

- Q—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 5 years at a 30 percent discount, affect the lessee's initial assessment of the lease term?
- A—Paragraph 14 of Statement 87 requires that, at the commencement of the lease term, a government assess all factors relevant to the likelihood that the lessee or the lessor will exercise lease extension or termination options identified in paragraphs 12a–12d of that Statement. 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 that it is reasonably certain that the option will be exercised, the lease term would be 25 years.

Lessee Lease Liability – Initial Measurement

Lease liability is measured at the present value of payments expected to be made during the lease term and includes:

- Fixed lease payments
- Variable payments that depend on an index or rate (initially measured using index/rate at commencement of the lease term)
- Variable payments that are fixed in substance (excluding payments dependent on lessee's future performance or usage of underlying asset ... those should be expensed as incurred)
- Residual value guarantees
- Exercise price of a purchase option
- Payment for penalties for terminating the lease
- Any lease incentives receivable from the lessor
- Any other reasonably certain payments

Discount using the interest rate lessor charges lessee; otherwise, the lessee's incremental borrowing rate.

Implementation Guide 4.23

- Q—A government adopts a capitalization threshold and expenses acquisitions, including lease assets, that fall below that threshold. Can the government apply a similar threshold to lease liabilities?
- A—Lease liabilities that are significant, either individually or in the aggregate, should be recognized. Authoritative pronouncements do not provide specific guidance related to a determination of capitalization threshold amounts. However, governments often establish capitalization thresholds. (See Question 7.9.8 of Implementation Guide No. 2015-1.) When applying a capitalization threshold to leases, lessees should consider the quantitative and qualitative significance of the lease liability, in addition to the significance of the lease asset in accordance with the guidance provided in Question 7.4.1 of Implementation Guide 2015-1, as amended.

Implementation Guide 4.26

- Q—Lease payments for a five-year lease are indexed to the Consumer Price Index (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 the CPI during the preceding year. The CPI at the commencement of the lease is 251. How should the initial lease liability be calculated?
- A—Paragraph 21b of Statement 87 requires that variable payments that depend on an index or a rate initially be measured using the index or rate as of the commencement of the lease term. If lease payments are indexed to the CPI, the payments to be included in the initial measurement of the lease liability should be based on the CPI at the commencement of the lease. If the CPI is 251 at the commencement of the lease, 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 the CPI. Therefore, the lease liability should be measured 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 outflows of those periods. (See Illustration B3 in nonauthoritative Appendix B.)

Lessee Accounting

- A LESSEE should recognize a lease liability and an intangible right-to-use lease asset (capital asset) at the commencement of the lease term, unless the lease is a short-term lease or it transfers ownership of the underlying asset.
- Lease liability should be measured at the present value of payments expected to be made during the lease term (less any lease incentives.)
- Lessee should reduce the lease liability as payments are made and recognize an outflow of resources (expense) for interest on the liability.
- Lease asset (see next slide)
- Notes to the financial statements should include description of leasing terms, amount of lease assets recognized and a schedule of future lease payments to be made among other detailed disclosures (see paragraphs 37 – 39 of GASB 87).

Lessee Accounting, continued

Lease asset is measured as the sum of the following:

- The amount of the initial lease liability
- Lease payments made to the lessor at or before commencement of the lease term less any lease incentives received from the lessor at or before commencement of the lease term
- Initial direct costs that are ancillary charges necessary to place the lease asset into service
- Initial direct costs that are debt issuance costs should be expensed as incurred.
- Amortize in a systematic and rational manner over shorter of lease term or useful life of the underlying asset. Report as an outflow (e.g., amortization expense.) Can be combined with depreciation expense for financial reporting purposes.

Lessor Accounting

- A LESSOR should recognize a lease receivable and a deferred inflow of resources at the commencement of the lease term, with certain exceptions for leases of assets held as investments, certain regulated leases, short-term leases and leases the transfer ownership of the underlying asset.
- Lease receivable should be measured at the present value of lease payments expected to be received during the lease term
- Lease deferred inflow of resources should be measured at the value of the lease receivable plus any payments received at or before the commencement of the lease term that relate to future periods.
- Lessor should recognize interest revenue on the lease receivable and an inflow of resources (revenue) from the deferred inflows of resources in a systematic and rational manner over the lease term.
- Lessor should not derecognize the asset underlying the lease.
- Notes to the financial statements should include description of leasing terms and the total amount of inflows of resources recognized from leases among other detailed disclosures (see paragraphs 57 – 60 of GASB 87).



SPEAKER PRESENTATION

YESTERDAY, TOMORROW AND FINANCE
2020 CSMFO ANNUAL CONFERENCE
JANUARY 28-31, 2020
DISNEYLAND CA

Lease Liability Example #1 – Calculation of Implicit Rate

Assume the following facts:

- Fair value of leased equipment = \$18,000
- Initial direct costs incurred = \$1,000
- Lease payments required = \$6,000 annually
- Lease term = 4 years



Lease Liability Example #1 – Calculation of Implicit Rate

B6		✕ ✓ <i>fx</i>		=IRR(B1:B5)
	A	B	C	
1	Present Value at Inception	\$ 19,000	Consists of \$18,000 fair value + \$1,000 direct costs	
2	Year 1 payment	\$ (6,000)		
3	Year 2 payment	\$ (6,000)		
4	Year 3 payment	\$ (6,000)		
5	Year 4 payment	\$ (6,000)		
6		10.047%		
7				

Lease Liability Example #1 – Resulting Amortization Table

Year	Beg Value	Interest	Payment	End Value
1	\$ 19,000	\$ 1,909	\$ (6,000)	\$ 14,909
2	\$ 14,909	\$ 1,498	\$ (6,000)	\$ 10,407
3	\$ 10,407	\$ 1,046	\$ (6,000)	\$ 5,452
4	\$ 5,452	\$ 548	\$ (6,000)	\$ -

Lease Liability Example #2 – Equipment Lease (Lessee)

Assume the following facts:

- Government enters in a 5 year lease for capital equipment (60 months) on April 1
- Monthly payments of \$1,000 are due on 1st of every month. Total monthly payments = \$60,000. First payment due on April 1
- Government has the option to purchase equipment for \$2,000 at end of lease term that is reasonably certain they will exercise. Payment must be made 30 days before end of lease term.
- Government incurs transportation costs of \$2,500 to get equipment ready to place into service.
- Government estimates the useful life of the equipment at 7 years (84 months)
- Annual interest rate charged on lease = 3%
- Government's fiscal year-end is December 31

Lease Liability Example #2 – STEP 1: Calculate the Lessee Lease Liability

Lease liability = present value of future payments expected to be made over lease term (present value of monthly payments + present value of \$2,000 purchase payment at end)

- Present value of \$1,000 monthly payments = \$55,791

Rate = Interest rate per period (3%/12)

Nper = Total number of payment periods

Pmt = Payment made each period

Fv = Future value

Type = 1 (payment made at beginning of period)



The screenshot shows the 'Function Arguments' dialog box for the PV function. The arguments are as follows:

Argument	Value	Result
Rate	0.0025	= 0.0025
Nper	60	= 60
Pmt	-1000	= -1000
Fv		= number
Type	1	= 1

The dialog box also displays the formula result: **Formula result = \$55,791**. Below the arguments, there is a description: 'Returns the present value of an investment: the total amount that a series of future payments is worth now.' and a note: 'Rate is the interest rate per period. For example, use 6%/4 for quarterly payments at 6% APR.'

Lease Liability Example #2 – STEP 1: Calculate the Lessee Lease Liability, continued

Present value of \$2,000 purchase payment at end = \$1,725

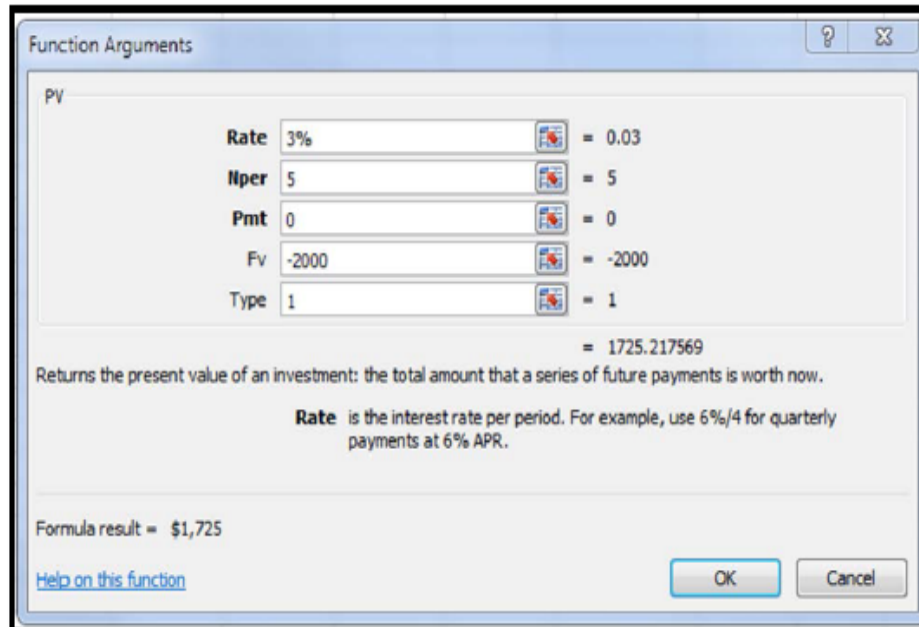
Rate = Interest rate per period (3% annual)

Nper = Total number of payment periods
(5 years)

Pmt = Payment made each period

Fv = Future value

Type = 1 (payment made in last month of
lease)



Function Arguments

PV

Rate	3%	= 0.03
Nper	5	= 5
Pmt	0	= 0
Fv	-2000	= -2000
Type	1	= 1

= 1725.217569

Returns the present value of an investment: the total amount that a series of future payments is worth now.

Rate is the interest rate per period. For example, use 6%/4 for quarterly payments at 6% APR.

Formula result = \$1,725

[Help on this function](#)

OK Cancel

Present value of lease liability to recognize is \$55,791 + \$1,725 = \$57,516

Lease Liability Example #2 – STEP 2: Calculate Amortization of Discount on Lease Liability

The \$1,000 monthly payment is based on the present value of \$60,000 due over the 60 months of the lease. Since the lessee government is also liable for the \$2,000 purchase option due on the 60th month, the total lease liability to amortize at inception is \$57,516.

$$\$56,516 \times .0025$$

Payment - Interest

The final \$3,000 payment represents the \$1,000 payment due for the 60th month, plus the \$2,000 purchase option due at the end of the lease term.

amortization of lease payments					
Annual interest rate	3.00%				
monthly rate	0.0025				
periods	60				
Payment per year	12				
Amount	\$ 55,791				
Payment	\$ 1,000	=PMT(.0025,60,-55791,0,1)			
Payment Number	Payment	Interest	Principal	Balance	
				\$ 57,516	
1	\$ 1,000	\$ -	\$ 1,000	56,516	
2	1,000	141	859	55,657	
3	1,000	139	861	54,796	
4	1,000	137	863	53,933	
5	1,000	135	865	53,068	
6	1,000	133	867	52,201	
7	1,000	131	869	51,332	
8	1,000	128	872	50,460	
9	1,000	126	874	49,586	
59	1,000	10	990	2,993	
60	3,000	7	2,993	-	

Lease Liability Example #2 – STEP 3: Calculate the Intangible Right-To-Use Lease Asset

	\$ 57,516	lease liability
+	<u>2,500</u>	transportation costs to place asset into service
	\$60,016	intangible right-to-use lease asset to record

Lease Liability Example #2 – STEP 4: Calculate Amortization of Intangible Right-To-Use Lease Asset

Amortize asset in rational and systematic manner over the shorter of the life of the underlying leased asset or the lease term, unless there is a purchase option that is reasonably certain to be exercised. Then, amortize over the useful life of the underlying asset.

amortization of lease asset		
Lease asset value	\$	60,016
Useful life (months)		84
Monthly amortization	\$	714
Annual amortization	\$	8,568
Month Number	Amortization	Balance
		\$ 60,016
1	\$ 714	59,302
2	714	58,588
3	714	57,874
4	714	57,160
5	714	56,446
6	714	55,732
7	714	55,018
8	714	54,304
9	714	53,590

Lease Liability Example #2 – STEP 5: General Ledger Entries If Lease Is Paid From General Fund

Journal entries – April 1

General fund

DR	Expenditures – capital outlay	\$57,516	
	CR	Other financing source- inception of lease	\$57,516

To record capital expenditure and related financing from lease of equipment

DR	Expenditures – capital outlay	\$ 2,500	
	CR	Cash	\$ 2,500

To record expenditure for transportation costs to place asset into service

Lease Liability Example #2 – STEP 5: General Ledger Entries If Lease Is Paid From General Fund, continued

Journal entries – monthly lease payments

General fund

As of December 31 – Total of 9 months lease payments

DR	Expenditures – debt service principal	\$7,930	
DR	Expenditures – debt service interest	\$1,070	
	CR	Cash	\$9,000

To record monthly lease payments based on amortization of lease payments schedule.



SPEAKER PRESENTATION

YESTERDAY, TOMORROW AND FINANCE
2020 CSMFO ANNUAL CONFERENCE
JANUARY 28-31, 2020
DISNEYLAND CA

Lease Liability Example #2 – STEP 6: Government-Wide Conversion

DR	Intangible right-to-use lease asset	\$60,016	
	CR Expenditures – capital outlay		\$60,016
To recognize intangible right-to-use lease asset			
DR	Other financing source – inception of lease	\$57,516	
	CR Lease liability		\$57,516
To recognize lease liability			



Lease Liability Example #2 – STEP 6: Government-Wide Conversion, continued

DR	Lease liability	\$7,930	
	CR	Expenditures – debt service principal	\$7,930

To recognize monthly lease payments for principal

DR	Amortization expense	\$6,426	
	CR	Intangible right-to-use lease asset	\$6,426

To amortize intangible right-to-use lease asset over the useful life of the underlying asset

Lease Liability Example #3 – Property Lease

Assume the following facts:

- Lease of 2nd floor of building for County Public Health
- Initial lease term of 10 years through FY13-14, amendment to extend the lease term for an additional 10 years through FY23-24
- Original agreement included janitorial costs paid by lessor, costs were transferred to lessee in June 2005 and are listed separately in the monthly base rent
- County pays base monthly rent, which is escalated annually by 3%
- Parking is included with nonexclusive and exclusive parking. County receives 4 exclusive parking spaces per 1,000 square feet of rentable area
- Common area maintenance provided by lessor, costs are clearly separated in the base monthly rent

Lease Liability Example #3 – Amortization Schedules

Lease Liability Amortization Schedule

Starting with year of GASB 87 implementation

Balance as of June 30:	Cash Payments	Interest Expense	Liability Reduction	Liability Balance
2020				\$ 1,498,914.23
2021	\$ 394,412.70	\$ 44,967.43	\$ 349,445.27	1,149,468.96
2022	406,245.16	\$ 34,484.07	\$ 371,761.09	777,707.87
2023	418,432.51	\$ 23,331.24	\$ 395,101.27	382,606.59
2024	394,084.79	\$ 11,478.20	\$ 382,606.59	-
	<u>\$ 1,613,175.16</u>			

Lease Asset Amortization Schedule

Starting with year of GASB 87 implementation

Balance as of June 30:	Amortization Expense	Asset Balance
2020		\$ 1,498,914.23
2021	(382,701.51)	1,116,212.72
2022	(382,701.51)	733,511.22
2023	(382,701.51)	350,809.71
2024	(350,809.71)	-

Notes: Inflation rate 3.0%
Discount rate 3.0%

Lease Liability Example #3 – Journal Entries

Governmental Fund

Dr. Lease expenditure (capital outlay)	\$ 1,498,914.23	
Cr. Lease issued (other financing source)		\$ 1,498,914.23

To record the lease agreement at the present value of the minimum lease payments

Dr. Lease expenditure	\$ 349,445.27	
Dr. Interest expenditure	\$ 44,967.43	
Cr. Cash		\$ 394,412.70

To record the lease payments made during fiscal year 2020/21



SPEAKER PRESENTATION

YESTERDAY, TOMORROW AND FINANCE
2020 CSMFO ANNUAL CONFERENCE
JANUARY 28-31, 2020
DISNEYLAND CA

Lease Liability Example #3 – Journal Entries, continued

Government-Wide Conversion

Dr. Capital asset (Right-of-use building)	\$ 1,498,914.23	
Cr. Lease expenditure (capital outlay)		\$ 1,498,914.23
Dr. Lease issued (other financing source)	\$ 1,498,914.23	
Cr. Lease liability		\$ 1,498,914.23

To record the right-of-use building and related lease liability

Dr. Amortization expense	\$ 382,701.51	
Cr. Accumulated amortization		\$ 382,701.51

To record amortization of the right-of-use building equal to one-tenth of the building's lease value for the fiscal year 2020/21

Dr. Lease liability	\$ 349,445.27	
Cr. Lease expenditure		\$ 349,445.27

To record the principal portion of lease payments as a reduction of the lease liability



Lease Incentives

Lease Incentives—reduce the amount lessee has to pay

- Payments made to, or on behalf of, the lessee, for which there is a right of offset
- Other concessions

Payments provided at or before inception of lease reported as

- Direct reductions of lessee's lease asset

Payments provided after inception of lease reported as

- Reductions of payments for period provided
- Reduces PV of lease liability (and lessor's receivable)

Implementation Guide 4.57

- Q—A governmental lessor makes incentive payments to a lessee to relieve the lessee's existing obligation to another lessor. The payments are made prior to the commencement of the lease term. How are such payments reported by the governmental lessor?
- A—The governmental lessor should recognize an asset at the time the payments are made. Paragraph 53b of Statement 87 provides that lease incentives paid at or before the commencement of the lease term should reduce the lessor's initial measurement of the deferred inflow of resources. In this case, at the commencement of the lease, the asset should reduce the deferred inflow of resources.

Contracts with Multiple Components

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

Implementation Guide 4.58

- Q—A government leases equipment that will be installed by the lessor for an additional \$10,000. The lease contract requires that the government 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?
- A—Initial direct costs are not included in the measurement of the lease liability. Installation costs generally are considered a nonlease component. Because the payments (totaling \$10,000) are for installation costs and not for the right to use the equipment, the payments are not considered lease payments under paragraph 21 of Statement 87 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 initial measurement of the lease asset in accordance with paragraph 30c of Statement 87. (See Illustration B1 in nonauthoritative Appendix B.)

Implementation Guide 4.60

- Q—A government leases two floors of an eight-floor building. A 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?
- A—Based on paragraph 64 of Statement 87, if it is practicable for the government to separate and estimate the costs for those services, the costs should not be included in the government's lease liability. For example, if the lease contract itself does not specify the amount (in dollars or percentage), the government could request that information from the landlord. Additionally, local real estate professionals may have statistics such as average charges per square footage. However, if it is not practicable for the government to separate the costs and estimate them, based on the provisions in paragraph 67 of Statement 87, the janitorial services and utility costs for the lobby should be included in the government's lease liability.



SPEAKER PRESENTATION

YESTERDAY, TOMORROW AND FINANCE
2020 CSMFO ANNUAL CONFERENCE
JANUARY 28-31, 2020
DISNEYLAND CA

Contract Combinations

- Contracts entered into at or near the same time with the same counterparty should be considered part of the same lease contract if either of the following criteria is met:
 - The contracts are negotiated as a package with a single objective
 - The amount of consideration to be paid in one contract depends on the price or performance of the other contract
- Combined contract then subject to multiple components guidance



Implementation Guide 4.63

- Q—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 the specifications of each agreement. The lease contracts do not provide information about the government's objective(s). Can the government's procurement processes be used to determine whether there is a single objective?
- A—Yes. Paragraph 69a of Statement 87 requires that contracts that are entered into at or near the same time with the same counterparty be 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 objective(s), the government's procurement processes provide sufficient information to determine the government's objective(s) for entering into the lease agreements.

Lease Modifications and Terminations

Result from ***amendments*** to lease contract, not from exercising options in that contract

- **MODIFICATIONS**

Considered lease modification unless lessee's right to use underlying asset decreases

- **TERMINATIONS**

Considered partial or full lease termination if lessee's right to use underlying asset *decreases*



SPEAKER PRESENTATION

YESTERDAY, TOMORROW AND FINANCE
2020 CSMFO ANNUAL CONFERENCE
JANUARY 28-31, 2020
DISNEYLAND CA

Lease Modifications and Terminations, continued

Examples of amendments:

- Change in consideration
- Lengthening or shortening the lease term
- Adding or removing an underlying asset

Examples of a lessee's right to use an underlying asset decreasing:

- Lease term is shortened
- Number of underlying assets is reduced



Implementation Guide 4.65

- Q—While a lease contract is in effect, the provisions of the contract are amended to change the number of vehicles included in the contract. Are additions and subtractions of underlying assets in a lease accounted for as a lease modification or a lease termination?
- A—A lease amendment that adds an underlying asset to the contract is a lease modification (for example, increasing the lease from three vehicles to four). A lease modification should be accounted for as either a separate lease (if it meets the criteria in paragraph 72 of Statement 87) or a remeasurement of the existing lease. Alternatively, a lease amendment that removes an underlying asset from the contract (for example, decreasing the lease from three vehicles to two) should be accounted for as a partial lease termination.

Implementation Guide 4.66

- Q—A 10-year lease contract includes an option to extend the lease for 5 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 cancellable period and, therefore, it has been excluded from the lease term. If, during the lease term, the lessor and the lessee agree to extend the contract for five years, should this be accounted for as a lease modification or as a new lease?
- A—Because both parties have to agree to the optional five-year period, it is considered cancellable and, therefore, not subject to the lease term reassessment guidance in paragraph 15 of Statement 87. However, once the lessor and the lessee agree to exercise the option to extend, the five-year period becomes noncancellable and should be accounted for as a lease modification. Paragraph 71 of Statement 87 states that lengthening a lease term while the contract is in effect is an amendment that should be considered a lease modification, unless it is due to a reassessment of the lease term under paragraph 15.



SPEAKER PRESENTATION

YESTERDAY, TOMORROW AND FINANCE
2020 CSMFO ANNUAL CONFERENCE
JANUARY 28-31, 2020
DISNEYLAND CA

Accounting for Lease Modifications

- Report as **new lease** by both lessor and lessee *if*
 - New assets are added and
 - Not unreasonably priced
- Otherwise, **remeasure** as discussed on following slides





SPEAKER PRESENTATION

YESTERDAY, TOMORROW AND FINANCE
2020 CSMFO ANNUAL CONFERENCE
JANUARY 28-31, 2020
DISNEYLAND CA

Accounting for Lease Modifications - Lessee

- Remeasure the lease liability on the effective date of modification
 - Assess the need for an updated discount rate
- Adjust the right-of-use asset by the difference between the modified liability and the liability immediately before the modification
 - If asset reduced to \$0, any additional reduction is reported as a gain
- If change results from the lessor refunding related debt and passing savings on to the lessee, see remeasurement guidance in paragraph 74





SPEAKER PRESENTATION

YESTERDAY, TOMORROW AND FINANCE
2020 CSMFO ANNUAL CONFERENCE
JANUARY 28-31, 2020
DISNEYLAND CA

Accounting for Lease Modification - Lessor

- Remeasure the lease receivable on the effective date of modification
 - Assess the need for an updated discount rate
- Adjust the deferred inflow of resources by the difference between the modified receivable and the receivable immediately before the modification
 - However, to the extent any change relates to payments for the current period, recognize in current period flows statement (for example, revenue)
- If change results from refunding related debt and passing savings on to the lessee, see remeasurement guidance in paragraph 76



Implementation Guide 4.67

- Q—Three years into a 4-year lease, a school district modifies its lease from 200 computers to 230 computers due to an increase in enrollment, changing the remaining lease liability from \$200,000 to \$202,500. The school district has determined that the increase in the lease payments appears to be unreasonable because it is very low when compared to the value of the additional underlying assets. How should the school district account for the amendment to the lease?
- A—Because the school district has determined that 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 the condition in paragraph 72b of Statement 87 is not present. Paragraph 73 of Statement 87 states that unless a modification is reported as a separate lease as provided by paragraph 72, 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.

Implementation Guide 4.68

- Q—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 remainder of the lease. 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?
- A—Paragraph 75 of Statement 87 states that unless a modification is reported as a separate lease as provided in paragraph 72, a lessor should account for a lease modification by remeasuring the lease receivable. Thus, the lease receivable should decrease by \$230,000, which represents the difference between the receivable before the lease modification and the remeasured receivable. Additionally, 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.



SPEAKER PRESENTATION

YESTERDAY, TOMORROW AND FINANCE
2020 CSMFO ANNUAL CONFERENCE
JANUARY 28-31, 2020
DISNEYLAND CA

Lease Terminations for Lessees

- For partial/full lease terminations (other than purchases), lessees reduce/remove the lease asset and obligation
- Recognize the difference as a gain or loss
- If the lessee purchases the underlying asset, reclassify to the appropriate asset class
 - Adjust lease liability to reflect the payments yet to be made; reflect adjustment in cost of the purchased asset



Implementation Guide 4.69

- Q—Two years into a 10-year lease, the lease term is reduced to 5 years. At the time of the amendment, the carrying value of the lease liability is \$80,000, and the carrying value of the lease asset is \$76,000. How should the lessee account for the partial termination of the lease?
- A—According to paragraph 78 of Statement 87, the lessee should account for the partial termination by reducing the carrying values of the lease liability and the lease asset. For example, if, in accordance with paragraph 25 of Statement 87, the lessee determines that the remeasured liability is \$50,000, the lease liability and the lease asset each should be reduced by \$30,000.

Lease Terminations for Lessors

- For partial/full lease terminations (other than sales), lessors reduce/remove the lease receivable and related deferred inflow of resources
- Recognize the difference as a gain or loss
- If the lessor sells the underlying asset, derecognize underlying asset
 - Include in the calculation of any gain or loss

Implementation Guide 4.70

- Q—Two years into a 10-year lease, the remaining lease agreement is cancelled. The carrying value of the lease receivable is \$80,000, and the related deferred inflow of resources is \$76,000. How should the lessor account for the full termination of the lease?
- A—According to paragraph 79 of Statement 87, once the lease is terminated, the carrying value of the lease receivable 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, an other financing use should be recognized.

Subleases

- Accounted for as transactions separate from the original lease
 - Do not offset original lease liability and sublease receivable
- Disclosures for original lessee (now the lessor)
 - Include subleases in the general description of lease arrangements
 - *Lessor* transactions related to subleases should be disclosed separately from the original lessee transactions

Sale-Leasebacks

- Qualifying sale required (otherwise it is a borrowing)
- Accounted for as two separate transactions—a sale transaction and a lease transaction—except that
 - Any gain or loss on sale portion deferred and recognized over term of leaseback (but immediately recognize if leaseback is short-term lease)
- If terms are significantly off-market, report based on the substance of the transaction, for example:
 - Borrowing, nonexchange transaction, advance lease payment
- Disclose terms and conditions of sale-leaseback



SPEAKER PRESENTATION

YESTERDAY, TOMORROW AND FINANCE
2020 CSMFO ANNUAL CONFERENCE
JANUARY 28-31, 2020
DISNEYLAND CA

Off-Market Terms

Examples of off-market terms:

- A transaction has a sale price and lease payments that are both significantly higher than market
- A transaction has a sale price that is significantly higher than market but the lease payments are at or below market
- A transaction has a sale price that is significantly lower than market



Implementation Guide 4.72

- Q—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?
- A—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, therefore, should not affect the initial recording of the lease.



SPEAKER PRESENTATION

YESTERDAY, TOMORROW AND FINANCE
2020 CSMFO ANNUAL CONFERENCE
JANUARY 28-31, 2020
DISNEYLAND CA

Lease-Leasebacks

- Example: A school district leases land to a developer. The developer builds a school and leases the school and land back to the school district.
- Accounted for as a *net* transaction (because of right of setoff)
- Disclose (both parties)
 - Gross amounts of the lease and the leaseback



Implementation Guide 4.73

- Q—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 \$3,000,000. 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?
- A—Paragraph 87 of Statement 87 requires that lease-leasebacks 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 a net lease receivable. Similarly, the lease asset and the 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 \$2,300,000.

Implementation Guide 4.74

- Q—A government leases land to a contractor on which the contractor will build a new school and lease both the land and the 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?
- A—Prior to the new building being made available to the government, the lease of the land to the contractor should be reported as a stand-alone 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. (See also Questions 4.12 and 4.32.)



SPEAKER PRESENTATION

YESTERDAY, TOMORROW AND FINANCE
2020 CSMFO ANNUAL CONFERENCE
JANUARY 28-31, 2020
DISNEYLAND CA

Intra-Entity Leases

- Leases with/between blended component units
 - Eliminations for internal leasing activity take place before the financial statements are aggregated
- Leases with/between discretely-presented component units
 - Treat like normal leases, but
 - Present receivables and payables separately



Implementation Guide 4.75

- Q—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 financial statements of the reporting entity?
- A—Yes. Paragraph 88 of Statement 87 states that “. . . 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 stand-alone financial statements, as applicable.



SPEAKER PRESENTATION

YESTERDAY, TOMORROW AND FINANCE
2020 CSMFO ANNUAL CONFERENCE
JANUARY 28-31, 2020
DISNEYLAND CA

Leases Between Related Parties

- Recognize substance of the transaction, when substance is significantly different from legal form
 - For example, a short-term lease is long-term if parties have an understanding that lease will be extended several years
- Disclose the nature and extent of related-party leases





SPEAKER PRESENTATION

YESTERDAY, TOMORROW AND FINANCE
2020 CSMFO ANNUAL CONFERENCE
JANUARY 28-31, 2020
DISNEYLAND CA

Lease Policy Considerations

Leases Between Related Parties

- Create new policy or modify existing policies
- Clarify role of the Finance Department and other departments
- Communicate requirements to other departments to ensure compliance
- Establish proper thresholds to limit scope and evaluate materiality





SPEAKER
PRESENTATION

YESTERDAY, TOMORROW AND FINANCE
2020 CSMFO ANNUAL CONFERENCE
JANUARY 28-31, 2020
DISNEYLAND CA

Questions?

Let's Talk.

