Governmental Accounting Standards Board Statement 87 Summary

WI Department of Public Instruction, School Financial Services Team
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Summary

The Governmental Accounting Standards Board (GASB) issued Statement No. 87 with the objective of improving accounting and financial reporting for leases by governments. It establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset.

The statement is effective for Wisconsin school districts beginning in fiscal year 2021-2022. The statement must be applied to existing leases with recognition and measurement using the facts and circumstances as of the beginning of the period of implementation. Earlier implementation is allowed.

Lease Definition

A lease is defined as **<u>a contract that conveys control of the right to use another entity's nonfinancial asset</u>** (the underlying asset) as specified in the contract for a period of time in an exchange or exchange-like transaction. Examples of nonfinancial assets include buildings, land, vehicles, and equipment. Right to use is defined as the right to obtain the present service capacity from use of the underlying asset and the right to determine the nature and manner of it use. Any contract (whether it says lease or not) that meets this definition should be accounted for under the lease guidance, unless specifically excluded in this Statement.

Transactions Excluded From Lease Definition

1. Short-term contract – 12 months or less (**<u>including</u>** possible extension periods, regardless of probability of exercising) – treated like temporary rent
2. Contracts that transfer ownership of the underlying asset by the end of the contract and does not contain termination options– treated like capital debt financing instead of a lease
3. Non-exchange transactions, such as $1 rentals
4. Leases of intangible assets – GASB Statement No. 96 addresses computer software. Applicable FY23.
5. Lease of biological assets, including timber. Land is not excluded.
6. Leases of inventory
7. Service concession agreements – use GASB Statement No. 60
8. Leases where the underlying asset is financed by conduit debt
9. Supply contracts, including commodities and utilities

Lease Term Determination

The lease term is determined by the period during which the lessee has:

1. Non-cancelable right to use underlying asset (period that does not include any possible terminations or extensions)
2. **<u>Plus</u>** periods when:
   a. Either lessee **<u>or</u>** lessor option to extend (if exercise is reasonably certain)
   b. Either lessee **<u>or</u>** lessor option to terminate (if not exercising is reasonably certain)
3. Periods are considered cancelable and should **<u>not</u>** be included in the lease term when:
   a. **<u>Both</u>** lessee and lessor have to agree to extend
   b. **<u>Both</u>** lessee and lessor have an option to terminate without permission from the other party

Lease Modifications and Remeasurement

Annually, leases will need to be evaluated to determine if there is a lease modification. Modifications to a lease could be considered a termination, partial termination, separate lease, or a remeasurement. A remeasurement could include:

1. Lessee or Lessor exercises an option originally determined it was not reasonably certain to exercise.
2. Lessee or Lessor does not exercises an option originally determined it was reasonably certain to exercise.
3. Any event in the contract that requires an extension or termination of the lease

Lease Contracts with Multiple Components

For contracts with lease and non-lease components, the lease components need to be separated from the non-lease components and treated separately. Services are non-lease components. For example, a copier lease could have a lease component related to the right to use the copier and a non-lease component related to maintenance, toner, per page, or any other "usage" costs. These non-lease components need to be recorded separately from the copier lease component as an operational expense in the period incurred.

For Leases with multiple different types of assets, each asset must be treated as a separate lease.

Grouping, Capitalization, Materiality

Similar assets with the same lease terms can be grouped together. Capitalization policies and materiality can be considered, but also have to consider there is no capitalization policy related to the corresponding lease liability that will be recorded on the government-wide financial statements. Additionally, lease assets should be considered in the aggregate, not just individually.

Governmental Fund Lease Transactions

For lessee governments, the governmental funds report an expenditure based on the non-financial asset being leased and an other financing source at the commencement of the lease, initially measured at the present value of the lease payments. Ensure that this activity is addressed in the budget process for the initial year of the lease to avoid experiencing an over expenditure of the budget appropriation for the fund that reports this activity. Over the life of the lease, principal and interest expenditures are recorded to the appropriate accounts as payments are made.

For lessor governments, the governmental funds report a receivable for the right to receive payments, initially measured based on the present value of future lease payments to be received. A corresponding deferred inflow of resources, measured at the initial value of the lease receivable, is recorded to reflect that the receivable relates to future periods. Lease revenue and a corresponding reduction in the deferred inflows of resources are recorded systematically over the term of the lease, including recognizing interest revenue related to the receivable.

Additional information on governmental fund accounting transactions and template journal entries will be released once the WUFAR changes are finalized.

Disclosures

For a lessee's disclosures, a description of leasing arrangements, the amount of lease assets, and a schedule of future lease payments with principal and interest listed separately and with the first five years in detail and 5 year increments thereafter are required.

For a lessor's disclosures, a description of leasing arrangements and the total amount of lease revenue for the current year are required.

Debt Limitations

Review state and local laws and agreements to determine any potential impact on compliance with debt limitations and bond covenants now that all leases lasting more than a year are reported by lessees as long-term liabilities.

WUFAR Account Changes

Related WUFAR account changes will be added to this technical assistance document when WUFAR Revision #36 is finalized.

Pertinent Implementation Guide Items

Implementation Guide 2019-003, Leases (IG) provides authoritative guidance that clarifies, explains, or elaborates on the requirements of Statement No. 87, Leases in the form of questions and answers. Additionally, Appendix B of the IG provides non-authoritative illustrations related to Statement No. 87.

Below are summaries of IG question and answers important for school business office staff:

4.1 Q – A government obtains the right to use land for $1 per year. Is this a lease?
A – No. To meet the definition of a lease, the transaction must be exchange or exchange-like.

4.2 Q – The government has exclusive use of the facility three days a week. Can this contract be considered a lease?
A – Yes. Uninterrupted control is not required to be a lease.

4.9 Q – Does a contract that allows the substitution of the underlying asset with an essentially identical asset affect whether the contract conveys control of the right to use the asset?
A – No. Substitution of essentially identical assets does not affect evaluation of control.

4.13 Q – Is a month-to-month holdover period at the end of the lease included in the lease term?
A – No. The holdover period is cancellable by either party and, therefore, is excluded from the lease term.

4.15 Q – A lease contract gives both parties the right to cancel but it's reasonably certain neither will terminate. Should the cancellable periods be excluded from the lease term?
A – Yes. If both parties have an option to terminate without permission from the other party, the cancellation period is not included in lease term, regardless of probability.

4.16 Q – A lease contract gives only the lessee the right to cancel and it's reasonably certain the lessee will not terminate. Should the cancellable periods be excluded from the lease term?
A – No. If either the lessee or lessor have the option to terminate, the cancellation period is included in the lease term if it is reasonably certain the termination will not be exercised.

4.18 Q – A lease contract has a six-month noncancellable period and a 12 month option to extend that is not reasonably certain of being exercised. Is this a short-term lease?
A – No. Short-term leases have a maximum possible term of 12 months, including any options to extend, regardless of their probability of being exercised. The lease term would be 6 months.

4.20 Q – During contract negotiations occurring at a similar time, a government signs two separate lease contracts for consecutive years with the same lessor for a lease of the same assets. The amount of consideration in each contract is independent of the other contract. Can the government account for both contracts as short-term leases?

A – If the intent was to lease the asset for two years, even though the structure is two single-year lease contracts, then those contracts would be considered a two-year lease and would not be a short-term lease.

4.22 Q – A school district leases computers. At the end of the lease term, the school district is required to purchase all computers from the lessor. The school district does not have a termination option. Should this arrangement be reported as a lease or a financed purchase of the computers?
A – This arrangement should be reported as a financed purchase.

4.23 Q – Can a capitalization threshold be used?
A – Yes, but consider significance of both asset and liability, individually and in aggregate.

4.28 Q – A bus lease requires variable payments based on the number of miles driven with no minimum payment required. The minimum number of miles that will be driven is reasonably certain. Should the lease liability include the reasonably certain variable lease payments?
A –No. Variable payments based on future performance of the lessee or usage of the underlying asset are not included in the measurement of the lease liability.

For the full wording of the question and answers as well as questions and answers that are not included in this document, we suggest reviewing the IG. A link can be found in the resources section of this document.

Resources

Governmental Accounting Standards Board Statement No. 87
GASB Implementation Guide 2019-003, Leases
Contact your auditor for potential additional resources and tools.

Potential Next Steps for WI School Districts

- Further familiarize yourself with the requirements of GASB Statement 87. See resources section.
- Consider working with your auditor up front on the implementation of the standard and the determination of the information that needs to be compiled. They may have additional resources or firm specific forms that may expedite the process.
- Gather all contracts potentially considered a lease agreement under new definition.
    - May take a significant amount of time and is necessary before doing any other steps.
    - Contract does not need to say lease.
    - Include all contracts regardless of how they were treated in the past.
    - Include contracts providing others the right to use district assets as district may be a lessor.
    - Contracts likely exist throughout the district (beyond the business office).
    - Reviewing recurring payments or receipts may help locate contracts to analyze but is not an all-inclusive method to finding contracts.
- Consider creating an inventory of all contracts that might meet the definition of a lease. The inventory may include the following contract information:
    - Description of contract
    - Underlying asset
    - Length of contract
    - Options for extensions and/or terminations by both lessee and lessor, if any
    - Service components, if any
    - All principal and interest payments required.

- Consider the need to develop new district policies and procedures, as necessary
    - Determine materiality thresholds for capitalization. Work with auditor to determine what is appropriate. Remember items below the threshold may be material in aggregate.
    - Develop a framework that addresses “reasonably certain” criteria.
    - Develop procedures to collect and review contracts that may be considered leases from throughout the District going forward.