



LEWIS THOMASON

GASB87-Leases

Overview and Changes

Chris W. McCarty



GASB87-Leases.

What are they, and what's new?

Disclaimer

- This slide show covers potential legal changes in GASB87, rather than accounting changes / principles.
- I am an attorney, not an accountant.



- **GASB87 is Statement No. 87 from the Governmental Accounting Standards Board.**
- **It specifically addresses “leases” and how state and local governmental entities (including schools) are to account for leases—as lessees or lessors—on financial statements.**



Principles

- According to GASB87, the “objective of the Statement is to better meet the information needs of financial statements used by improving accounting and financial reporting for leases; enhancing the comparability of financial statements between governments; and also enhancing the relevance, reliability (representational faithfulness), and consistency of information about the leasing activities of governments.”
GASB87-Leases, at Paragraph 2.



Effective Dates

- GASB87 was originally proposed and released in 2017.
- Originally, the effective date of the guidance was to be December 15, 2019. GASB87-Leases, at Paragraph 92.
- However, for reasons we all remember too well in 2020, the effective date was postponed.
- In May 2020, the effective date for the guidance was postponed and the new effective date fell on June 15, 2021.
- The guidance will affect *fiscal years* beginning after this date.



Scope

- The Statement applies to financial statements for all state and local governments, and establishes standards of accounting for leases—as lessee or lessor—in such statements.



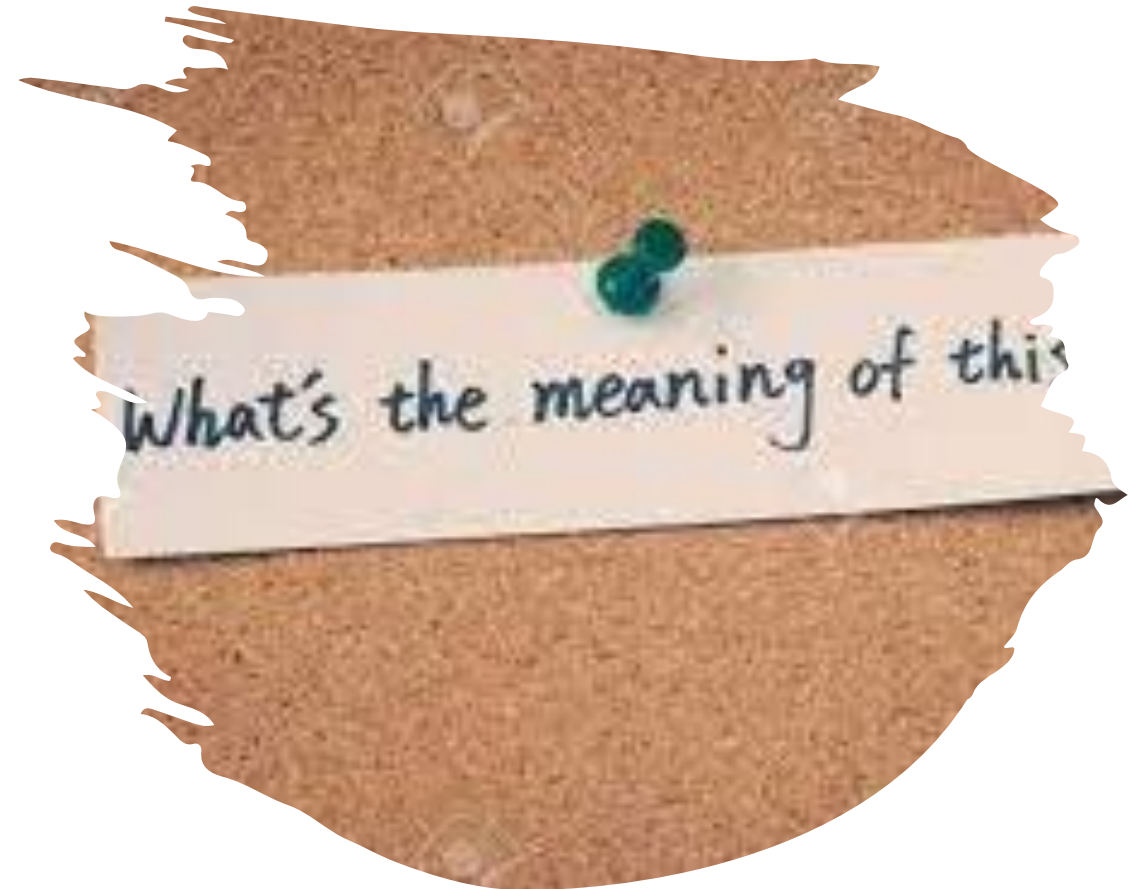
Application

- The changes in GASB87 are to be applied retroactively. GASB87-Leases, at Paragraph 93.
- Thus, schools must restate financial statements, if practicable, for prior periods presented. If it is not practical to do so, the reason for not restating prior periods presented should be disclosed by the entity.
- For leases being restated, the leases should be recognized and measured using the facts and circumstances that existed at the beginning of the earliest period restated.



What does this mean for Schools?

- Effectively, schools are now required to account for leases in a different way than they have previously, and need to reclassify leases they are currently a party to.
- Under previous guidance, governments and schools classified leases as either capital or operating leases. GASB87-Leases, at Paragraph 1.
- Going forward, under GASB87, there will be no such distinction, and the definition of leases could, in effect, be broader than in previous standards (in some cases).





LEWIS THOMASON

WHICH CONTRACTS AND LEASES QUALIFY

Definition of a “Lease”



- “For purposes of applying this Statement, a lease is defined as 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.” GASB87-Leases, at Paragraph 4 (emphasis added).
- This definition also includes “contracts that, although not explicitly identified as leases, meet the definition of lease.” GASB87-Leases, at Paragraph 6.
- This definition excludes “contracts for services except those contracts that contain *both* a lease component and a service component.” GASB87-Leases, at Paragraph 6.

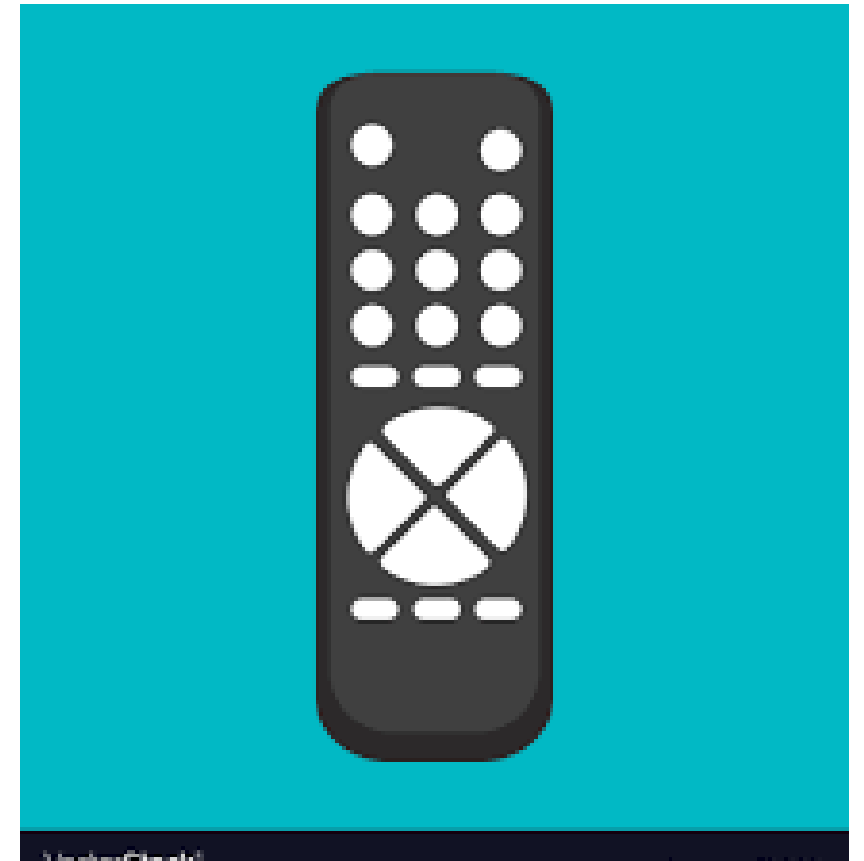


Term

- The term of a lease or contract is not explicitly part of the definition of lease.
- But, in effect, the term of a lease or contract matters for classifying a contract as a lease.
- “Short-term leases” are leases with a term of 12 months or less, including options to extend. GASB87—Leases, at Paragraph 16.
- These are not recognized as a “lease” on financial statements.

Does a contract “convey control”

- To determine whether a contract conveys control as contemplated by GASB87, schools and governments are to use a 2-pronged test. GASB87-Leases, at Paragraph 5.
- 1) Does the contract have a right to obtain the present service capacity from use of the underlying asset as specified in the contract?
- 2) Does the contract have a right to determine the nature and manner of use of the underlying asset as specified in the contract?



Nonfinancial Assets



- “Nonfinancial assets” are assets that are not a financial asset as defined by GASB72-Fair Value Measurement and Application.
- So, “nonfinancial assets” are anything that is not “Cash, evidence of an ownership interest in an entity, or a contract that conveys to one entity a right to do either of the following: a. Receive cash or another financial instrument from a second entity; b. Exchange other financial instruments on potentially favorable terms with the second entity (for example, an option).” GASB87-Leases, at p. 2., n. 2.
- Examples of “nonfinancial assets” include: land, buildings, vehicles, and equipment.

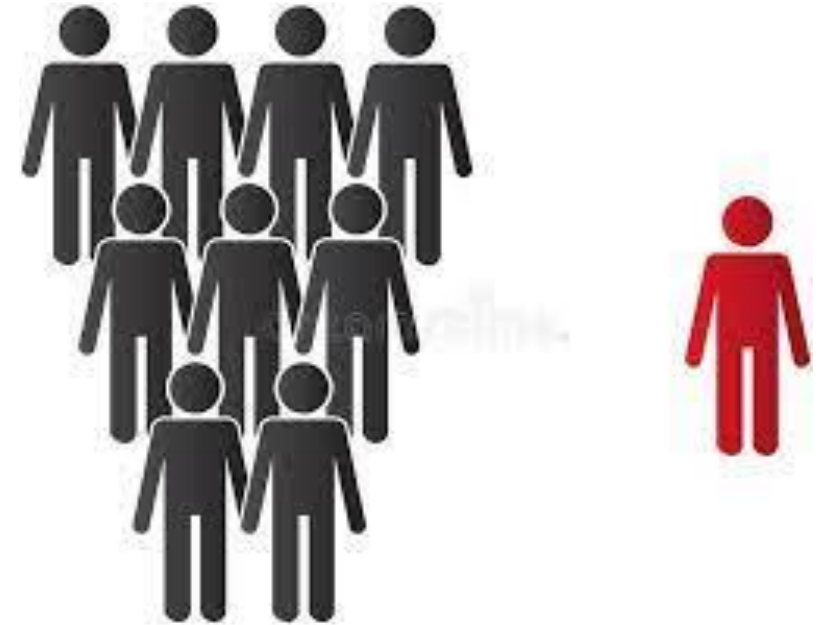
Exchange or Exchange-Like Transaction

- GASB87 included both exchange and exchange-like transactions, but not nonexchange transactions.
- The terms exchange and exchange-like transactions are defined in GASB33.
- Exchange transactions are those in which each party receives and gives up essentially equal values.
- Exchange-like transactions are those in which a government gives (or receives) value without directly receiving (or giving) equal value in exchange.
- GASB33 describes the difference as follows: “The difference between exchange and exchange-like transactions is a matter of degree. In contrast to a ‘pure’ exchange transaction, an exchange like transaction may not be exclusively for the parties to the transaction. Nevertheless, the exchange characteristics of the transaction are strong enough to justify treating the transaction as an exchange for accounting recognition.” GASB33—Accounting and Financial Reporting for Nonexchange Transactions, at p. 1, n.1



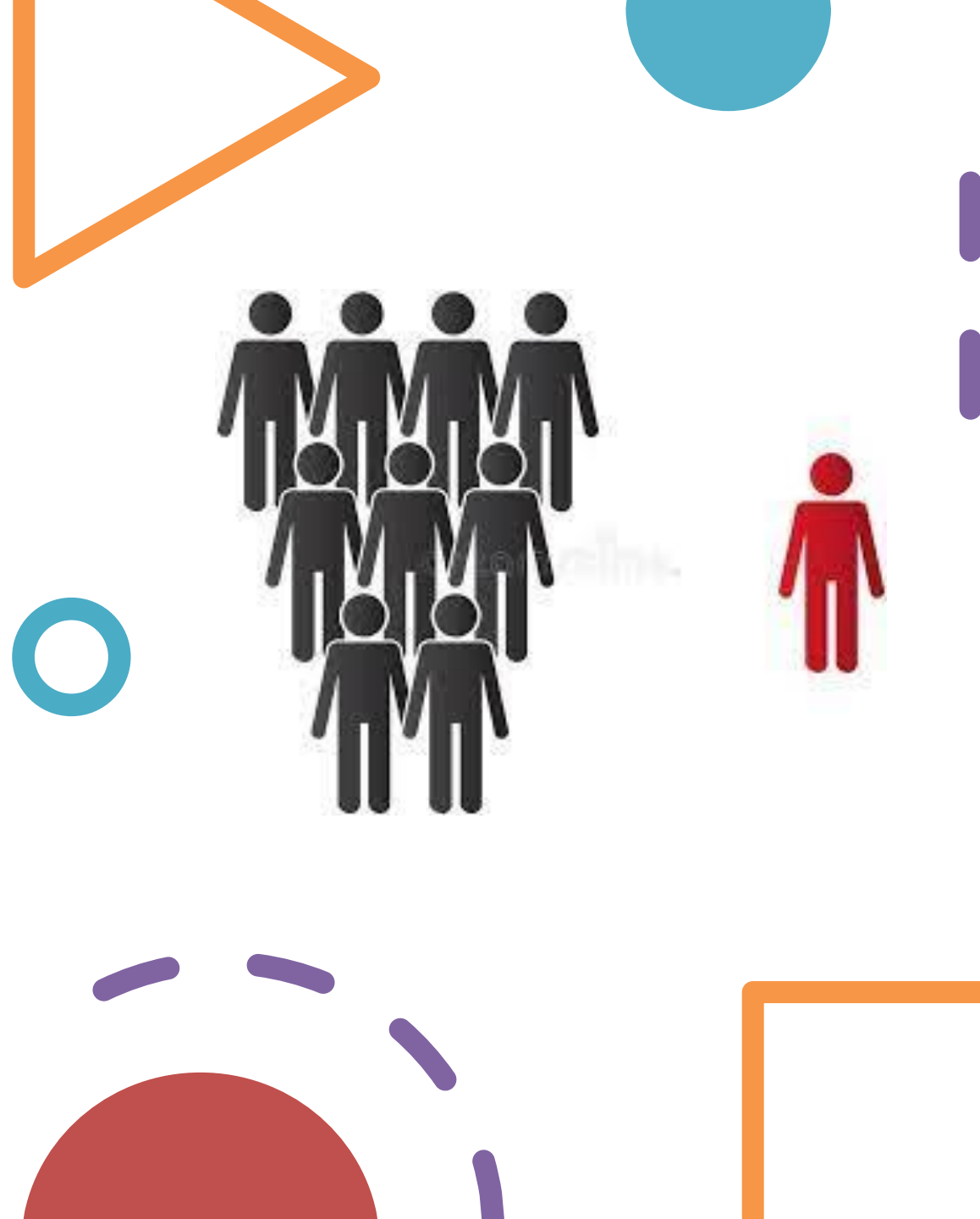
Leases and Contracts Excluded from Definition

- Leases of intangible assets, including rights to explore for or to exploit natural resources such as oil, gas, and minerals and similar nonregenerative resources; licensing contracts for items such as motion picture films, video recordings, plays, manuscripts, patents, and copyrights; and licensing contracts for computer software. In sublease transactions.
- Leases of biological assets, including timber, living plants, and living animals.
- Leases of inventory.
- Contracts that meet the definition of a service concession arrangement in Paragraph 4 of Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements*.
- Leases in which the underlying asset is 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.



Leases and Contracts Excluded from Definition Cont.

- “Short Term Leases”, as defined by Paragraph 16 in GASB87-Leases. (Leases of 12 months or less.)
- “Contracts That Transfer Ownership,” as defined by Paragraph 19 in GASB87-Leases.
- “Intra-Entity Leases,” as defined by Paragraphs 88-89.



Definitions are Important

- Going forward, the definition of lease in GASB87 will be important for accounting compliance in schools and governments.
- Even more important will be evaluating what contracts and leases will qualify under the definition and need to be appropriately noted in financial statements.





LEWIS THOMASON

EXAMPLES...



Example 1

- On April 1, 2023, a school enters into a contract for a facility lease (a building). The contract states that the term is for **5 years**, with monthly payments of \$4,000.00 due by the 5th day of every month.
- Is it a lease under GASB87—Leases?
- **YES**
- Non-financial asset, conveys control, exchange or exchange-like, longer than 12 months.



Example 2

- On January 1, 2023, a school enters into a contract with a dealership to use 5 school buses. The contract states the term is for 3 years, with monthly payments of \$2,000.00 due every 1st day of the month.
- Is it a lease under GASB87—Leases?
- **YES**
- Non-financial asset, conveys control, exchange or exchange-like, longer than 12 months.



Example 3

- On July 1, 2023, a school renews an existing contract for an athletic practice facility lease for the 3rd time. The contract states the term is for 3 years, with monthly payments of \$5,000.00 due by the 15th of every month.
- Is it a lease under GASB87—Leases?
- **YES**
- Non-financial asset, conveys control, exchange or exchange-like, longer than 12 months.



Example 4

- On December 1, 2023, a school enters into a contract for land use with a farmer owning a 40-acre parcel neighboring the school. The contract states that the term is for 5 years, with yearly payments of \$1.00 due on January 5th of each year of the term.
- Is it a lease under GASB87—Leases?
- **Likely not**
- Non-financial asset, conveys control, longer than 12 months, BUT not exchange or exchange-like.



LEWIS THOMASON

HOW SHOULD SCHOOLS RECOGNIZE LEASES?

Guidance in GASB87

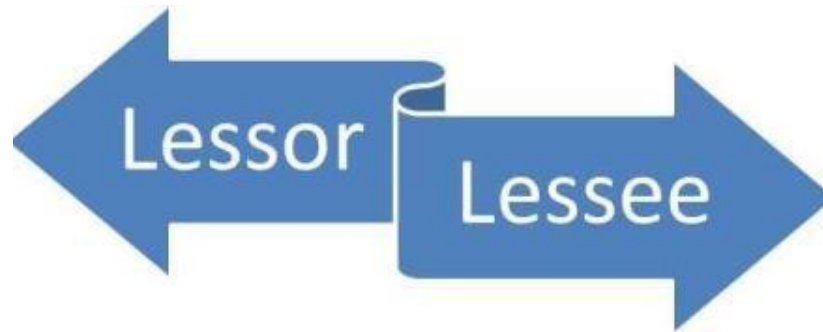
- GASB87 provides voluminous and pointed guidance for how entities should account for leases and contracts qualifying as leases as both lessee and lessor over the life of a lease.
- This presentation is not going to cover all of this guidance or delve into details in this guidance.
- An index of where guidance can be found in the Statement can be found in Paragraph 11 of GASB87.





LEWIS THOMASON

ACCOUNTING LEASES GENERALLY



Lessees

- Lessees should recognize a lease liability and the intangible right-to-use lease asset beginning from the commencement of the lease term.
- Generally, the lease liability is measured at the present value of payments expected to be made during the lease term minus any lease incentives. Lease assets are measured as the sum of 1) the amount of the initial measurement of the lease liability; 2) lease payments made at or before the least term commences; and 3) certain direct costs necessary to place the lease asset into service.
- Financial statements for lessees should also disclose aspects of the lease activities spelled out in Paragraph 37.

Lessors

- Lessors should recognize a lease receivable and deferred inflow of resources (except in a few instances) beginning from the commencement of the lease term.
- Generally, the lease receivable is measured as at the present value of lease payments expected to be received during the lease term, reduced by any provision for estimated uncollectible amounts.
- Generally, deferred inflow of resources is initially measured as the amount of the initial measurement of the lease receivable plus any payments received at or before the commencement of the lease term that relate to future periods.
- Initial direct costs incurred by the lessor should be reported as outflows of resources.
- Financial statements for lessors should also disclose aspects of lease activities spelled out in Paragraph 57.





Measuring Components and Adjusting Over Lease Term

- Detailed explanations of how to measure the various lease components and adjust accounting over the life of the lease are provided throughout the guidance.
- Schools will need to measure from the commencement of leases and adjust over the life of leases on their financial statements appropriately going forward.



LEWIS THOMASON

Questions?

Chris W. McCarty
CMcCarty@LewisThomason.com
865.546.4646

KNOXVILLE | MEMPHIS | NASHVILLE

*The contents of this presentation are for informational purposes and should not be considered legal advice.
This presentation does not establish an attorney-client relationship.*