



## Chapter 1

# GASB Statement No. 87, *Leases*

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### Learning objectives

- Identify how GASB Statement No. 87, *Leases*, affects accounting and reporting of leases by state and local governments acting as lessees.
- Identify how GASB Statement No. 87 affects accounting and reporting of leases by state and local governments acting as lessors.
- Recognize key terms identified in GASB Statement No. 87.
- Recognize how GASB Statement No. 87 affects accounting and reporting of lease modifications and terminations, subleases, and leasebacks by state and local governments.
- Determine the areas of GASB Statement No. 87 representing challenges for preparers of state and local government financial statements.

# Major areas of inquiry

GASB issued GASB Statement No. 87, *Leases*, in June 2017, effective for financial statements for periods beginning after December 15, 2019. GASB issued Statement No. 87 to make accounting and reporting of leases consistent with GASB Concepts Statement No. 4, *Elements of Financial Statements*, and to update lease accounting for the approaches considered by the Financial Accounting Standards Board (FASB) and International Accounting Standards Board (IASB).

Both preparers and auditors of state and local government financial statements have had a number of questions relating to the requirements of GASB Statement No. 87 as well as how to effectively implement the requirements of the standard. A number of these questions relate to the following:

- When is GASB Statement No. 87 applicable?
- How do the requirements of GASB Statement No. 87 affect accounting and financial reporting of leases by lessees and lessors?
- What additional disclosures are required by lessees and lessors?
- What is the impact on financial reporting in the first year of implementation?
- How may GASB Statement No. 87 affect the financial condition of state and local governments?
- What are the implementation challenges for state and local governments and their auditors?

# Background

Accounting for and financial reporting of leases by business entities and/or state and local governments has been the subject of much discussion by the relevant accounting standards-setting bodies since the early 1960s. In 1979 the National Council on Governmental Accounting (NCGA) published Statement 1, *Governmental Accounting and Financial Reporting Principles*, which stated that FASB Statement of Financial Accounting Standards (SFAS) No. 13, *Accounting for Leases* (published in 1976) was applicable to governmental units. Over the next 20 years, the FASB, NCGA, and GASB made relatively minor changes to lease accounting and financial reporting requirements.

In 2006, FASB and the IASB started a joint project to reexamine their guidance for leases which was the basis for the requirements in GASB Statement 62. The FASB and IASB project and the issuance of GASB Concepts Statement No. 4, *Elements of Financial Statements*, presented the GASB with an opportunity to reconsider lease accounting. In 2010, GASB issued GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, which incorporated into the GASB literature all statements and interpretations of FASB.<sup>1</sup> In 2011, GASB initiated pre-agenda research on leases that initially only focused on monitoring the developments of the FASB and IASB project.

In April 2013, GASB added a leases project to the current technical agenda in response to the significant changes to lease accounting being proposed by FASB and IASB. The GASB Board approved a Preliminary Views—*Leases*, in November 2014 and conducted outreach to stakeholders during and after the comment period. Also, during the comment period, a field test was conducted where participants were asked to apply the provisions of the Preliminary Views to some or all of their leases as either a lessee or a lessor.

After consideration of respondent comments and testimony on the proposals in the Preliminary Views, the board issued an exposure draft, *Leases*, in January 2016. Again, GASB conducted outreach to stakeholders during and after the comment period for the exposure draft.

A task force was assembled to provide feedback to GASB on issues discussed by the board as well as on the Preliminary Views, Exposure Draft, and final statement. Also, during this time, the Governmental Accounting Standards Advisory Council provided feedback to the board on key issues. After deliberating comments to the exposure draft, the board approved GASB Statement No. 87 for issuance in mid-2017.

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<sup>1</sup> Opinions of the Accounting Principles Board and Accounting Research Bulletins of the AICPA's Committee on Accounting Procedure were also incorporated into GASB literature with GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*.

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## Knowledge check

1. What is the objective of GASB Statement No. 87?
  - a. To make accounting for leases by state and local governments consistent with the accounting for leases by business entities.
  - b. To make accounting and reporting of leases consistent with GASB Concept Statement No. 4 and to update lease accounting for the approaches considered by FASB and IASB.
  - c. To establish accounting and reporting requirements for lessors.
  - d. To establish accounting and reporting requirements for lessees.

# Applicability of GASB Statement No. 87

GASB Statement No. 87 establishes standards of accounting and financial reporting for leases by lessees and lessors and is effective for fiscal years beginning after December 15, 2019. A *lease* is a contract conveying 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.

Certain leases and contracts are not accounted for under the requirements of GASB Statement No. 87. Leases for the following are not within the scope of the statement:

- 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.<sup>2</sup>
- Biological assets, including timber, living plants, and living animals
- Inventory
- Underlying asset financed with outstanding conduit debt, unless both the underlying asset and the conduit debt are reported by the lessor.

Contracts<sup>3</sup> relating to the following are also not within the scope of GASB Statement No. 87:

- Service concession arrangement as defined in paragraph 4 of Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements*
- Supply contracts, such as power purchase agreements.

GASB Statement No. 87 also makes distinctions between short-term leases and other leases.

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## Knowledge check

2. Which would be accounted for as a lease under the requirements of GASB Statement No. 87?
  - a. Lease with the right to explore offshore for and oil and gas reserves.
  - b. Contract to purchase fuel from a regional power company.
  - c. Lease of forest land for the purpose of harvesting timber.
  - d. Lease of buses to be used in providing public transportation.

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<sup>2</sup> In a sublease transaction, GASB Statement No. 87 does apply to the intangible right-to-use assets that are created by the original leases of tangible underlying assets.

<sup>3</sup> While contracts for services are not within the scope of GASB Statement No. 87, contracts having both a lease component and a service component are within the statement's scope.

# Terms and their application

GASB Statement No. 87 includes a number of terms that are defined and then expanded upon throughout the statement. These definitions represent those used in the statement even though they may have different meanings in other contexts. For example, the definition of a lease in GASB Statement No. 87 includes contracts if the contract meets the definition of a lease. Also, the legal definition of a lease (in any state) is likely not the same as the definition of a lease for purposes of GASB Statement No. 87.

## Lease

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.

As used in the definition of a lease, a *nonfinancial asset* is the underlying asset and is not a financial asset as defined in GASB Statement No. 72, *Fair Value Measurement and Application*, as amended. Examples include land, buildings, vehicles, and equipment.

When determining if a contract conveys the right to control the use of the underlying asset, a government should assess whether it has both of the following:

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

Under the definition of a lease, leases of nonfinancial assets at amounts well below the fair value of the underlying asset would not likely meet the definition of an exchange or exchange-like transaction. For example, a government leasing one of its buildings on its own land to the local Chamber of Commerce for one dollar a year for 20 years is neither an exchange nor exchange-like transaction. As such, it does not meet the definition of a lease and is not required to be accounted for as such under GASB Statement No. 87.

## Lease term


The period during which a lessee has a noncancelable right to use an underlying asset (referred to as the noncancelable period), plus the following periods, if applicable:

- Periods covered by a lessee's option to extend the lease if it is reasonably certain, based on all relevant factors, that the lessee will exercise that option
- Periods covered by a lessee's option to terminate the lease if it is reasonably certain, based on all relevant factors, that the lessee will not exercise that option
- Periods covered by a lessor's option to extend the lease if it is reasonably certain, based on all relevant factors, that the lessor will exercise that option
- Periods covered by a lessor's option to terminate the lease if it is reasonably certain, based on all relevant factors, that the lessor will not exercise that option.

Fiscal funding or cancellation clauses do not affect the least term unless it is reasonably certain the clause will be exercised. The ability of the government lessee to cancel a lease simply by not appropriating funds for the lease payment(s) does not change the noncancelable aspect of the lease.

*Cancelable leases* are those where (a) both the lessee and lessor have an option to terminate the lease without permission of the other party or (b) both parties have to agree to extend the lease. Cancelable leases are excluded from the scope of GASB Statement No. 87.

However, a lease may have both a noncancelable period and a cancelable period. In these circumstances, the period of time for which the lease is cancelable is excluded from the lease term. For example, a lease for office space has a five-year term after which the lease converts to a month-to-month lease. During the rolling month-to-month cancelable period, either the lessee or lessor may opt to terminate the lease without permission of the other party. The lease term in this example, for purposes of applying the requirements of GASB Statement No. 87, is five years.

Key point	
	A lease must convey control of the right to use the lease asset throughout the lease term. Control includes the right to obtain the present service capacity of the lease asset as well as the right to determine the nature and manner of use of the lease asset.

At the commencement of the lease the lessee and lessor should assess all factors relevant to the likelihood either party will exercise any termination options. Consideration should be given to whether the factors are based on the contract, underlying asset, or market or if they are government specific. Consideration of multiple interrelated factors may be necessary. GASB Statement No. 87 lists the following factors lessees and lessors should consider:

- A significant economic incentive
  - Examples include contractual terms and conditions for the optional periods that are favorable compared with current market rates
- A significant economic disincentive
  - Such as costs to terminate the lease and sign a new lease which could include
    - Negotiation costs
    - Relocation costs
    - Abandonment of significant leasehold improvements
    - Costs of identifying another suitable underlying asset
    - Costs associated with returning the underlying asset in a contractually specified condition or to a contractually specified location
    - Substantial cancellation penalty
- History of exercising options to extend or terminate
- Extent to which the asset underlying the lease is essential to the provision of government services.

GASB Statement No. 87 also enumerates when lessees and lessors should reassess the lease term. The lease term should be reassessed by both the lessee and lessor if one or more of the following occur:

- Lessee or lessor elect to exercise an option even though it was previously determined that it was reasonably certain the lessee or lessor would not exercise the option

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

### Short-term lease

Lease that, at the commencement of the lease term, has a maximum possible term under the lease contract of 12 months or less. This includes any option to extend regardless of the probability of the option being exercised. The *maximum possible term* under a cancellable month-to-month or year-to-year lease is the noncancelable period including any notice period.

Lessees recognize short-term lease payments as an expense/expenditure (outflow of resources) based on the payment provisions of the lease contract. The lessee should recognize an asset if payments are made in advance or a liability for rent due if payments are to be made subsequent to the reporting period. The lessee should not recognize an outflow of resources during any rent holiday period

A lessor should recognize short-term lease payments as revenue (inflows of resources) based on the payment provisions of the lease contract. The lessor should recognize a liability if payments are received in advance or an asset for rent due if payments are to be received subsequent to the reporting period. The lessor should not recognize an inflow of resources during any rent holiday period.

#### Key point



Upon the effective date of GASB Statement No. 87, leases will no longer be accounted for as operating or capital leases. State and local governments will account for leases as right to use assets having either a short or long lease term.

## Knowledge check

3. In addition to the noncancelable period stated in a lease contract, which would also be considered part of the lease term?
  - a. Periods covered by a lessor's option to terminate the lease if it is reasonably possible, based on all relevant factors, that the lessor will not exercise that option.
  - b. Periods covered by a lessor's option to extend the lease if it is reasonably possible, based on all relevant factors, that the lessor will exercise that option.
  - c. Periods covered by a lessee's option to extend the lease if it is reasonably possible, based on all relevant factors, that the lessee will exercise that option.
  - d. Periods covered by a lessee's option to terminate the lease if it is reasonably certain, based on all relevant factors, that the lessee will not exercise that option.

# Overview of requirements of GASB Statement No. 87

GASB Statement No. 87 establishes a single model for lease accounting based on the principle that leases are financings of the right to use an underlying asset. In most cases, implementation of this statement will result in governmental lessees and lessors accounting for the same lease transaction in a way that mirrors how the other party accounts for it. This section provides an overview of the major and most relevant accounting and reporting requirements for lessees and lessors required by GASB Statement No. 87. Readers are cautioned to read the actual statement in its entirety (including the Background and Basis for Conclusions sections) to understand all of the requirements of the statement. GASB Statement No. 87 is available at [www.gasb.org](http://www.gasb.org).

In August 2019, GASB issued Implementation Guide 2019-3, *Leases*, to assist state and local governments in applying the requirements of the standard. Information as to how to acquire Implementation Guide 2019-3 is available at [www.gasb.org](http://www.gasb.org).

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## Requirements for lessees

### Leases other than short-term leases and leases and contracts that transfer ownership

A lessee should recognize a lease liability and an intangible right-to-use lease asset (a capital asset hereinafter referred to as the lease asset) at the commencement of the lease term. Exceptions to this are

- short-term leases (discussed previously), and
- contracts transferring ownership of the lease asset to the lessee at the end of the lease contract (discussed later in this chapter).

### Lease liability

At inception, the lessee should measure the lease liability at the present value of payments expected to be made during the lease term. Measurement of the lease liability should include the following, if required by a lease:

- Fixed payments
- Variable payments that depend on an index or a rate initially measured using the index or rate as of the commencement of the lease term
- Variable payments that are fixed in substance (not based on future performance or usage)<sup>4</sup>
- Amounts reasonably certain of being required to be paid by the lessee under residual value guarantees
- Exercise price of a purchase option if it is reasonably certain the lessee will exercise that option

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<sup>4</sup> Variable payments based on future performance of the lessee or usage of the underlying asset should be recognized as expenses (outflows of resources) in the period in which the obligation for the payments is incurred.

- Payments for penalties for terminating the lease, if the lease term reflects the lessee exercising either
  - an option to terminate the lease or
  - a fiscal funding or cancellation clause
- Any lease incentives (discussed later in this chapter) receivable from the lessor
- Any other payments reasonably certain of being required based on an assessment of all relevant factors

All future minimum lease payments should be discounted using the interest rate the lessor charges the lessee, which may be the interest rate implicit in the lease. If the interest rate cannot be readily determined by the lessee, the lessee's estimated incremental borrowing rate (an estimate of the interest rate that would be charged for borrowing the lease payment amounts during the lease term) should be used. Lessees are not required to apply the guidance for imputation of interest in paragraphs 173–187 of Statement 62 but may do so as a means of determining the interest rate implicit in the lease.

In subsequent financial reporting periods, the lessee should calculate the amortization of the discount on the lease liability and report the amount as interest expense/expenditure (outflow of resources) for the period. Any payments made should be allocated first to the accrued interest liability and then to the lease liability.

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## Knowledge check

4. Which would **not** be included in the initial measurement of a lease liability?
- a. Fixed payments.
  - b. Variable payments that are fixed in substance.
  - c. Exercise price of a purchase option if it is probable the lessee will exercise that option.
  - d. Lease incentives due from the lessor.

The lessee is required to remeasure the lease liability at subsequent financial reporting dates if one or more of the following changes have occurred at or before that financial reporting date. In addition, any such changes<sup>5</sup>, individually and in the aggregate, should be expected to significantly affect the amount of the lease liability since the previous measurement.

- Change in the lease term
- An assessment of all relevant factors indicates the likelihood of a residual value guarantee being paid has changed from reasonably certain to not reasonably certain, or vice versa
- 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
- Change in the estimated amounts for payments already included in the measurement of the lease liability (except for changes in an index or rate used to determine variable payments)
- Change in the interest rate the lessor charges the lessee, if used as the initial discount rate

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<sup>5</sup> Changes arising from amendments to a lease contract are accounted for as lease modifications and terminations that are discussed later in this chapter.

- A contingency, upon which some or all of the variable payments to be made over the remainder of the lease term are based, is resolved such that the payments now meet the criteria for measuring the lease liability as discussed previously.

A remeasured lease liability should also be adjusted for any change in an index rate, or other rate, used to determine variable payments if the change in such rate is expected to significantly affect the amount of the liability. By itself, a change in an index or other rate used to determine variable payments does not require remeasurement of a lease liability. Remeasurement of a lease liability is also not required, nor is reassessment of the discount rate required, solely due to a change in the lessee's incremental borrowing rate.

However, the discount rate should also be updated as part of the remeasurement in certain circumstances. When remeasurement of a lease liability is required and changes in the discount rate are expected to significantly affect the amount of the lease liability (either individually or in the aggregate), the discount rate should be updated if one or both of the following changes occur:

- There is a change in the lease term
- 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.

If the discount rate is required to be updated (based on the provisions noted previously) the discount rate should be updated using the revised interest rate the lessor charges the lessee at the time of such update. The lessee's estimated incremental borrowing rate at the time the discount rate is updated should be used if the lessor's interest rate cannot be readily determined.

## **Lease asset**


Initially a lease asset is measured as the sum of the following:

- Amount of the initial measurement of the 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
- Ancillary initial direct costs necessary to place the lease asset into service
  - Any initial direct costs considered debt issuance costs under paragraph 12 of GASB Statement No. 7, *Advance Refundings Resulting in Defeasance of Debt*, should be recognized as expenses/expenditures (outflows of resources) in the period in which they are incurred.

A lease asset should be amortized in a systematic and rational manner over the shorter of the lease term or the useful life of the underlying asset. However, if a lease includes a purchase option the lessee is reasonably certain to exercise, the lease asset should be amortized over its useful life unless the underlying asset is nondepreciable (land for example). Amortization is reported as amortization expense (an outflow of resources) which may be combined with depreciation expense relating to capital assets for financial reporting purposes.

When a lease liability is remeasured and adjusted, the corresponding lease asset generally should be adjusted by the same amount. However, if the change reduces the carrying value of the lease asset to

zero, any excess remeasurement adjustment amount should be reported as a gain or loss in the statement of activities or statement of revenues, expenses, and changes in net position.

Key point	
	To minimize the potential for significant gains or losses resulting from remeasurement of the lease liability, lessees may wish to consider amortizing the lease asset in an amount equal to the amortization of the lease liability (principal portion). Assuming there is no difference between the initial lease asset and initial lease liability, such an amortization method would result in the carrying value of the lease asset being equal to the carrying value of the lease liability. GASB Statement No. 87 requires the amortization method to only be "systematic and rational."

The presence of impairment indicators (described in paragraph 9 of GASB Statement 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*) with respect to the underlying asset may result in a change in the manner or duration of use of the lessee's right-to-use asset. Such a change may indicate the service utility of the lease asset is impaired. The length of time during which the lessee cannot use the underlying asset or is limited to using it in a different manner, should be compared to its previously expected manner and duration of use to determine whether there is a significant decline in service utility of the lease asset. If a lease asset is impaired, the amount reported for the lease asset should be reduced first for any change in the corresponding lease liability. Any remaining amount should be recognized as an impairment using the requirements of GASB Statement No. 42.

### Leases in governmental funds

Leases expected to be paid from general government resources should be accounted for and reported on a basis consistent with governmental fund accounting principles. In the period such a lease is initially measured, an expenditure and other financing source should be reported at an amount equal to the lease liability. Subsequent lease payments from governmental funds should be accounted for consistent with principles for debt service payments on long-term debt. That is, the lease payment should be reported as expenditures for principal and interest.

### Disclosures

For other than short-term leases<sup>6</sup>, a lessee should disclose the following relating to its lease activities (these items may be grouped for purposes of disclosure):

- General description of its leasing arrangements, including
  - basis, terms, and conditions on which variable payments not included in the measurement of the lease liability are determined

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<sup>6</sup> GASB Statement No. 87 does not require disclosure of any information relating to short-term leases other than recognizing payments as expenses/expenditures, advance payments of rent as assets, and payments due subsequent to the reporting period as liabilities.

- existence, terms, and conditions of residual value guarantees provided by the lessee not included in the measurement of the lease liability
- Total amount of lease assets, and the 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
- Amount of expenses/expenditures (outflows of resources) recognized in the reporting period for variable payments not previously included in the measurement of the lease liability
- Amount of expenses/expenditures (outflows of resources) recognized in the reporting period for other payments, such as residual value guarantees or termination penalties, not previously included in the measurement of the lease liability
- 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 commencement of the lease term
- Components of any loss associated with an impairment (the impairment loss and any related change in the lease liability).

A lessee also should provide relevant disclosures for the following transactions (these lease transactions are discussed later in this chapter), if applicable:

- Sublease transactions
- Sale-leaseback transactions
- Lease-leaseback transactions

A lessee is not required to disclose collateral pledged as a security for a lease (under paragraph 113 of Statement 62) if the collateral is solely the asset underlying the lease.

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## Knowledge check

5. Which is **not** required to be disclosed by the lessee relating to its leasing arrangements?
- a. Commitments under leases after the commencement of the lease term.
  - b. General description of its leasing arrangements.
  - c. Amount of lease assets by major classes of underlying assets, disclosed separately from other capital assets.
  - d. 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.

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## Requirements for lessors

### Leases other than short-term leases and leases and contracts that transfer ownership

A lessor should recognize a lease receivable and a deferred inflow of resources at the commencement of the lease term. The following are exceptions to this:

- Short-term leases (discussed previously in this chapter)
- Contracts transferring ownership of the lease asset to the lessee at the end of the lease contract (discussed later in this chapter)
- Leases of assets that are investments (discussed below) and
- Certain regulated leases (disclosed below).

Initial direct costs incurred by the lessor should be reported as expenses/expenditures (outflows of resources).

### **Leases of assets that are investments**

The provisions of GASB Statement No. 87 do not apply to the recognition and measurement of leases where the underlying asset is recognized as an investment (as defined in GASB Statement No. 72) by the lessor. In such cases, the lessor reports the underlying asset at fair value as required in GASB Statement No. 72.

### **Certain regulated leases**

Lessors should not apply the requirements of GASB Statement No. 87 relating to a lease receivable, the corresponding deferred inflow of resources, and the underlying asset if a lease is subject to external laws, regulations, or legal rulings.<sup>7</sup> With respect to these “regulated leases,” lessors disclose only certain unique information about the leasing arrangement if external laws, regulations, or legal rulings establish all of the following requirements:

- Lease rates cannot exceed a reasonable amount, with reasonableness being subject to determination by an external regulator.
- Lease rates should be similar for lessees that are similarly situated.
- Lessor cannot deny potential lessees the right to enter into leases if facilities are available, provided the lessee’s use of the facilities complies with generally applicable use restrictions.

When a lease is a regulated lease, lessors should recognize revenue (inflows of resources) based on the payment provisions of the lease contract. In addition, lessors with one or more regulated leases are required to disclose the following about their regulated lease activities<sup>8</sup> (which may be grouped for purposes of disclosure), other than short-term leases:

- General description of its regulated lease agreements
- Extent to which capital assets are subject to preferential or exclusive use by counterparties under regulated lease agreements, by major class of assets and by major counterparty
- Total amount of revenues (inflows of resources such as lease revenue, interest revenue, and any other lease-related revenues) recognized in the reporting period from regulated lease agreements (if the amount cannot be determined based on the amounts displayed on the face of the financial statements)

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<sup>7</sup> For example, the U.S. Department of Transportation and the Federal Aviation Administration regulate aviation leases between airports and air carriers and other aeronautical users.

<sup>8</sup> Other than short-term leases as defined in GASB Statement No. 87.

- Schedule of expected future minimum payments under regulated lease agreements for each of the subsequent five years and in five-year increments thereafter
- Amount of revenues (inflows of resources) recognized in the reporting period for variable payments not included in expected future minimum payments
- Existence, terms, and conditions of options by the lessee to terminate the regulated 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.

### Key point



In a regulated lease arrangement, external laws, regulations, or legal rulings establish rates and limit what a lessor can do in some circumstances. This lack of control imposed on the lessor creates a leasing arrangement significantly different from a non-regulated lease arrangement. The accounting and financial reporting requirements of GASB Statement No. 87 recognize these differences.

### Lease receivable

At inception, the lessor should measure the lease receivable at the present value of payments expected to be received during the lease term. Amounts expected to be received should be reduced for any provision for estimated uncollectible amounts. Measurement of the lease receivable should include the following, if required by a lease:

- Fixed payments
- Variable payments that depend on an index or a rate initially measured using the index or rate as of the commencement of the lease term
- Variable payments that are fixed in substance (not based on future performance or usage)<sup>9</sup>
- Residual value guarantee payments that are fixed in substance (not based on future performance or usage)<sup>10</sup>
- Any lease incentives (discussed later in this chapter) payable to the lessee.

All future minimum lease payments should be discounted using the interest rate the lessor charges the lessee, which may be the interest rate implicit in the lease. Like lessees, lessors are not required to apply the guidance for imputation of interest in paragraphs 173–187 of Statement 62 but may do so as a means of determining the interest rate implicit in the lease.

<sup>9</sup> Variable payments based on future performance of the lessee or usage of the underlying asset should be recognized as revenues (inflows of resources) in the period to which the payments relate.

<sup>10</sup> Residual value guarantee amounts not fixed in substance should be recognized as a receivable and revenue (inflow of resources) if an agreed-upon guarantee payment is required 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 revenue (inflow of resources) when the options are exercised.

In subsequent financial reporting periods, the lessor should calculate the amortization of the discount on the lease receivable and report the amount as interest revenue (inflow of resources) for the period. Any payments received should be allocated first to the accrued interest receivable and then to the lease receivable.

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## Knowledge check

6. Which would **not** be included in the initial measurement of a lease receivable?
- Fixed payments.
  - Variable payments that are fixed in substance.
  - Exercise price of a purchase option if it is probable the lessee will exercise that option.
  - Lease incentives due to the lessee.

The lessor is required to remeasure the lease receivable at subsequent financial reporting dates if one or more of the following changes have occurred at or before that financial reporting date. In addition, any such changes<sup>11</sup>, individually and in the aggregate, should be expected to significantly affect the amount of the lease receivable since the previous measurement.

- Change in the lease term
- Change in the interest rate the lessor charges the lessee
- A contingency, upon which some or all of the variable payments to be received over the remainder of the lease term are based, is resolved such that the payments now meet the criteria for measuring the lease receivable as discussed previously.

A remeasured lease receivable should also be adjusted for any change in an index rate, or other rate, used to determine variable payments if the change in such rate is expected to significantly affect the amount of the receivable. By itself, a change in an index or other rate used to determine variable payments does not require remeasurement of a lease receivable.

However, the discount rate should be updated as part of the remeasurement in certain circumstances. When remeasurement of a lease receivable is required and changes in the discount rate are expected to significantly affect the amount of the lease receivable (either individually or in the aggregate), the discount rate should be updated if one or both of the following changes occur:

- There is a change in the lease term
- There is a change in the interest rate the lessor charges the lessee.

If the discount rate is required to be updated (based on the provisions noted previously) the discount rate should be updated using the revised discount rate.

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<sup>11</sup> Changes arising from amendments to a lease contract are accounted for as lease modifications and terminations which are discussed later in this chapter.

## Deferred inflow of resources

Initially, a lessor should measure the deferred inflow of resources corresponding to the lease receivable as follows:

- Amount of the initial measurement of the lease receivable
- Lease payments received from the lessee at or before commencement of the lease term relating to future periods (for example, the final month's rent), less any lease incentives (discussed later in this chapter) paid to, or on behalf of, the lessee at or before commencement of the lease term.

In subsequent periods, a lessor should recognize the deferred inflow of resources as revenue (an inflow of resources) in a systematic and rational manner over the term of the lease. When a lease receivable is remeasured, the corresponding deferred inflow of resources generally should be adjusted by the same amount.

## Underlying asset

A lessor does not derecognize the asset underlying the lease. As such, a lessor should continue to apply other applicable guidance to the underlying asset, including depreciation and impairment. If the lease contract requires the lessee to return the asset in its original or enhanced condition, a lessor should not depreciate the asset during the lease term.

Under existing guidance in GASB Statement No. 62, some lessor governments derecognized underlying assets for sales-type or direct-financing leases. In many cases, these leases involved a transfer of ownership of the underlying asset to the lessee. GASB Statement No. 87 does not require lessors to determine the value of these previously derecognized underlying assets. For any previously derecognized assets, any residual asset included in the net investment in the lease under Statement 62 becomes the new carrying value of the underlying asset.

## Leases in governmental funds

In financial statements of governmental funds, a lessor should recognize a lease receivable and a deferred inflow of resources to account for a lease. The deferred inflow of resources is initially measured at the initial value of the lease receivable, plus the amount of any payments received at or before the commencement of the lease term relating to future periods (for example, the final month's rent). In subsequent periods, a lessor should recognize the deferred inflow of resources as revenue (an inflow of resources), if available, in a systematic and rational manner over the term of the lease.

## Disclosures<sup>12</sup>

For other than short-term leases<sup>13</sup> and certain regulated leases (discussed in a previous section of this chapter), a lessor should disclose the following relating to its lease activities other than leases of assets that are investments (these items may be grouped for purposes of disclosure):

- General description of its leasing arrangements, including the basis, terms, and conditions on which any variable payments not included in the measurement of the lease receivable are determined
- Total amount of revenues (inflows of resources such as lease revenue, interest revenue, and any other lease-related revenues) recognized in the reporting period from leases, if the amount cannot be determined based on amounts displayed on the face of the financial statements
- Amount of revenues (inflows of resources) recognized in the reporting period for variable and other payments not previously included in the measurement of the lease receivable, including revenues (inflows of resources) relating to residual value guarantees and termination penalties.

Lessors should disclose the following for all lease activities including leases of assets that are investments:

- 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.

A lessor also should provide relevant disclosures for the following transactions, if applicable:

- Leases of assets that are investments (discussed previously in this chapter)
- Certain regulated leases (discussed previously in this chapter)
- Sublease transactions (discussed later in this chapter)
- Sale-leaseback transactions (discussed later in this chapter)
- Lease-leaseback transactions (discussed later in this chapter)

If a lessor's principal ongoing operations consist of leasing assets to other entities, the government should also disclose (in addition to the disclosures noted previously) a schedule of future payments that are included in the measurement of the lease receivable. Future payments should be presented separately for principal and interest for each of the five subsequent fiscal years and in five-year increments thereafter.

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<sup>12</sup> Disclosures relating to regulated leases are discussed in a previous section of this chapter.

<sup>13</sup> GASB Statement No. 87 does not require disclosure of any information relating to short-term leases other than recognizing payments as expenses/expenditures, advance payments of rent as assets, and payments due subsequent to the reporting period as liabilities.

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## Knowledge check

7. Which is required to be disclosed by the lessor relating to all of its leasing arrangements other than leases of assets that are investments and regulated lease arrangements?
- Amount of lease assets by major classes of underlying assets, disclosed separately from other capital assets.
  - Total amount of revenues (inflows of resources such as lease revenue, interest revenue, and any other lease-related revenues) recognized in the reporting period from leases, if the amount cannot be determined based on amounts displayed on the face of the financial statements.
  - 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.
  - Future payments included in the lease receivable with principal and interest presented separately for each of the five subsequent fiscal years and in five-year increments thereafter.

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## Requirements for lessees and lessors

### Contracts that transfer ownership

In certain circumstances, lease contracts are required to be accounted for as a financed purchase or sale of the underlying asset by the lessee and lessor, respectively. GASB Statement No. 62 required lessors to account for this and similar type leases as sales-type or direct-financing leases. Lessors should not restate the assets underlying their existing sales-type or direct-financing leases in the period of implementation. Any residual assets for those leases should become the carrying values of the underlying assets.

Circumstances requiring the lease to be accounted for as a financed purchase or sale include lease contracts that

- transfer ownership of the underlying asset to the lessee by the end of the contract, and
- do not contain termination options but may include a fiscal funding or cancellation clause that is not reasonably certain of being exercised.

### Key point



Lessors are not required to derecognize a right-to-use capital asset leased to a lessee unless the lease contract transfers ownership to the lessee at the end of the contract. A lessor continues to report the underlying asset with all other tangible capital assets if the lease contract does not transfer ownership to the lessee. When a lease contract transfers ownership, the lessor and the lessee account for the lease contract as a sale and financed purchase, respectively.

## Lease incentives

Lease incentives reduce the amount that a lessee is required to pay for a lease.

In the context of GASB Statement No. 87, *lease incentives* are

- payments 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.

A lease incentive is equivalent to a rebate or discount and includes

- assumption of a lessee's preexisting lease obligations to a third party,
- other reimbursements of lessee costs,
- rent holidays, and
- reduction of interest or principal charges by the lessor.

Lease incentives providing payments to, or on behalf of, a lessee are recognized based on when the incentives are to be provided. The various accounting treatments are discussed below.

- Incentives provided at or before the commencement of a lease term — include in initial measurement by directly reducing the amount of the lease asset.
- Lease incentive payments to be provided after the commencement of the lease term — reduce lease payments for the periods in which the incentive payments will be provided. The payments should be measured by lessees consistently with the lessee's lease liability and by lessors consistently with the lessor's lease receivable.
  - Fixed or fixed in substance lease incentive payments — include in initial measurement and any remeasurement
  - Variable or contingent lease incentive payments — do not include in initial measurement.

Leasehold improvements provided by the lessee would not be an incentive received from the lessor. However, some lease contracts may require the lessor to pay for leasehold improvements. Depending on the facts and circumstances of the lease arrangement, this situation may be an incentive payment to or on behalf of the lessee. For example, a lessor providing additional assets to the lessee without additional cost could be an incentive based on the facts and circumstances of the leasehold improvement.

## Contracts with multiple components

Lease contracts may include both a lease component and a nonlease component, or a lease may involve multiple underlying assets. For example, a monthly lease payment for a copier may include the lease component as well as nonlease components for maintenance, copier supplies, and property insurance.

In these types of lease contracts, the government should account for the lease and nonlease components as separate contracts unless (a) prices for the individual components are not included in the contract or (b) the prices appear to be unreasonable. When prices appear unreasonable, professional

judgment should be used to estimate the component prices using observable information (for example, readily available stand-alone prices<sup>14</sup>).

When leases involve multiple underlying assets with assets having different lease terms, the lessee and the lessor should account for each underlying asset as a separate lease component. In addition, the lessee should account for each underlying asset as a separate lease component if the underlying assets are in different major classes of assets for disclosure purposes. This requirement does not apply if separate asset prices are not provided in the lease contract or if prices provided are unreasonable.

Lessees and lessors should allocate the contract price to the different components using any prices for individual components included in the lease contract as long as they do not appear to be unreasonable. Some contracts provide discounts for bundling multiple leases or lease and nonlease components together in one contract. Those discounts may be taken into account when determining whether individual component prices do not appear to be unreasonable.

Multiple components are accounted for as a single lease unit when it is not practicable for the government to make estimates for price allocation. In such cases, the accounting for the unit should be based on the primary lease component within the unit. Circumstances in which it might not be practicable to make estimates for price allocation include the following:

- The lease may be uniquely designed for the leasing parties
- Specific provisions stipulated in certain lease contracts
- Other unique circumstances.

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## Knowledge check

8. Which is **not** a characteristic of a lease incentive?
- a. Lease incentives increase the amount a lessee is required to pay for a lease.
  - b. Lease incentives are payments made to or on behalf of the lessee for which the lessee has a right of offset with its obligation to the lessor.
  - c. Lease incentive payments provided after the commencement of the lease term are not included in the initial measurement.
  - d. Lease incentive payments provided before the commencement of the lease term are included in the initial measurement.

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<sup>14</sup> Stand-alone prices are those that would be paid or received if the same or similar assets were leased individually or if the same or similar nonlease components (such as services) were contracted individually.

## Contract combinations

Contracts entered into at or near the same time with the same counterparty should be considered part of the same contract if either of the following criteria is met:

- 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.

Multiple contracts determined to be part of the same contract should be evaluated in accordance with the guidance for contracts with multiple components discussed previously.

## Lease modifications

During the term of a lease contract various provisions may be amended which modify the lease contract. An amendment is considered a lease modification unless the lessee's right to use the underlying asset decreases. In these cases, the amendment is considered a partial or full lease termination.

Amendments resulting in a modification to a lease contract made during the financial reporting period should be accounted for as a separate lease by both the lessee and lessor if the following conditions are present:

- Lease modification gives the lessee an additional lease asset by adding one or more underlying assets that were not included in the original lease contract
- Increase in lease payments for the additional lease asset does not appear to be unreasonable based on (1) the terms of the amended lease contract and (2) professional judgment, maximizing the use of observable information.

A lessee should account for a lease modification by remeasuring the lease liability unless a modification is required to be reported as a separate lease as noted previously. The lease asset should be adjusted by the difference between the remeasured liability and the liability immediately before the lease modification. If the change reduces the carrying value of the lease asset to zero, any remaining amount should be reported in the statement of activities/statement of revenues, expenses, and changes in net position.

Unless a lease modification is required to be reported as a separate lease as noted previously, a lessor should account for a lease modification by remeasuring the lease receivable. The deferred inflow of resources should be adjusted by the difference between the remeasured receivable and the receivable immediately before the lease modification. To the extent the change relates to payments for the current period, the change should be recognized as revenue (inflow of resources) or an expense (outflow of resources) for the current period.

## Key point



Lease amendments modify the terms of a lease contract. Examples of lease amendments include changing contract prices, lengthening or shortening the lease term, and adding or removing an underlying asset.

### Lease terminations

The lessee and lessor should account for an amendment during the reporting period resulting in a decrease in the lessee's right to use the underlying asset as a partial or full lease termination.

A lessee generally should account for the partial or full lease termination by reducing the carrying values of the lease asset and lease liability and by recognizing a gain or loss for the difference. If the lease is terminated as a result of the lessee purchasing an underlying asset from the lessor, the lease asset should be reclassified to the appropriate class of owned asset.

A lessor should account for the partial or full lease termination by reducing the carrying values of the lease receivable and related deferred inflow of resources and by recognizing a gain or loss for the difference. If the lease is terminated as a result of the lessee purchasing an underlying asset from the lessor, the carrying value of the underlying asset should be derecognized and included in the calculation of any resulting gain or loss.

### Subleases

Sublease transactions involve the following three parties:

- Original lessor
- Original lessee (becomes the lessor in the sublease)
- New lessee

Accounting and reporting by the parties to a sublease transaction is as follows:

- Original lessor
  - Continues to apply general lessor guidance
- Original lessee/new lessor
  - Accounts for original and sublease as lessee and lessor, respectively
    - Transactions should not be offset against each other
  - Includes sublease in disclosure of general description of lease arrangements
    - Lessor transactions relating to subleases should be disclosed separately from original lessee transaction
- New lessee
  - Applies general lessee guidance

## Leaseback transactions

Leaseback transactions may involve a sale-leaseback transaction or a lease-leaseback transaction. Sale-leaseback transactions are accounted for as two separate transactions, whereas lease-leaseback transactions are accounted for as a net transaction.

### Sale-leaseback transactions

A *sale-leaseback* transaction involves the sale of an underlying asset by the owner and a lease from the new owner of the asset back to the original owner. These transactions should qualify as a sale under paragraphs 287-319 and 321-323 of GASB Statement No. 62. If the transaction does not qualify as a sale, it is accounted for as a borrowing activity by the seller/lessee and a lending activity by the buyer/lessor.

In financial statements prepared using the economic resources measurement focus, the sale and lease portions of a sale-leaseback transaction should be accounted for as a sale transaction and a lease transaction. The difference between the carrying value of the capital asset sold and the net proceeds from the sale should be reported as a deferred inflow of resources or a deferred outflow of resources. These deferred resource flows are recognized in the statement of activities or the statement of revenues, expenses, and changes in net position in a systematic and rational manner over the term of the lease.

If the lease portion of the transaction qualifies as a short-term lease, any difference between the carrying value of the capital asset sold and the net proceeds from the sale should be recognized immediately. A seller-lessee should disclose the terms and conditions of sale-leaseback transactions in addition to other lease-related disclosures required of a lessee in GASB Statement No. 87. A buyer-lessor should provide the lease-related disclosures required of a lessor in GASB Statement No. 87.

### Lease-leaseback transactions

A *lease-leaseback* transaction involves a lease asset where the original lessee leases the underlying asset to another party and who then leases it back to the original lessee. The leaseback may involve an additional asset or only a portion of the original asset. A lease-leaseback transaction should be accounted for as a net transaction and both parties should disclose the amounts of the lease and the leaseback separately in the notes to financial statements.

## Intra-entity leases

### Blended component units

When the lessee or lessor is included as a blended component unit of the primary government, the reporting requirements of GASB Statement No. 87 do not apply. Instead, 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.

With respect to leases with or between blended component units, for which eliminations are required, these eliminations should be made before the financial statements of the blended component units are

aggregated with those of the primary government. The remaining cash payments between component units should be reported as inflows of resources and outflows of resources.

### **Discretely presented component units**

Lease arrangements between the primary government and discretely presented component units (or between discretely presented component units) should be treated in the same as any other lease under the provisions of GASB Statement No. 87. However, related receivables and payables should not be combined with other amounts due to or due from discretely presented component units or with lease receivables and payables with organizations outside the reporting entity.

### **Leases between related parties**

In the separate financial statements of the related parties, the classification and accounting should be the same as for similar leases between unrelated parties. An exception to this is in cases where it is clear the terms of the transaction have been significantly affected by the fact the lessee and lessor are related. In such cases, the classification and accounting should be modified as necessary to recognize the substance of the transaction rather than merely its legal form.

The nature and extent of leasing transactions with related parties should be disclosed. In financial statements for which an interest in an investee is accounted for using the equity method, any inflow of resources or outflow of resources (for example, gain or loss) on a leasing transaction with the related party should be accounted for in accordance with the principles set forth in paragraphs 202–210 of GASB Statement 62 and paragraph 77 of GASB Statement 72.

# Financial reporting

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## Upon initial implementation

GASB Statement No. 87 is effective for periods beginning after December 15, 2019. When the requirements of the statement are first applied, changes resulting from these requirements should be applied retroactively by restating financial statements, if practicable, for all prior periods presented. Governmental entities presenting comparative statements in the year of implementation will need to restate all prior year statements presented.

If restatement for prior periods is not practicable, the cumulative effect of applying the requirements of GASB Statement No. 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. The reason for not restating prior periods presented should also be disclosed. In the first period the requirements of the statement are applied, notes to the financial statements should disclose the nature of any restatement and its effect.

Leases should be recognized and measured using the facts and circumstances existing at the beginning of the period of implementation. If applied to earlier periods, leases should be recognized and measured using the facts and circumstances existing at the beginning of the earliest period restated. However, lessors 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.

### Key point



The board believes reasonable efforts should be employed before a government determines restatement of all prior periods presented is not practicable. In the basis for conclusions section, paragraph 127 states inconvenient should not be considered equivalent to not practicable.

# Implementation challenges

As can be seen from the previous sections, GASB Statement No. 87 has the potential to significantly affect state and local governments operations and financial condition. A summary of the practice areas most affected by GASB Statement No. 87 includes the following:

- Understand the requirements of the statement
- Communicate with elected officials and other stakeholders
- Identify existing leases
- Determine if identified leases terminate before the effective date of the statement
- Allocate human and financial resources
- Measure lease liabilities and lease assets
- Measure lease receivables and corresponding deferred inflows of resources
- Determine the effect of recording leases on financial condition, debt covenants, and debt limits

The issues relating to the initial implementation of GASB Statement No. 87 will vary from one government to the next depending on the type of leases involved, the complexity of existing lease arrangements, and the extent to which a government uses lease arrangements. Therefore, the following general discussion of implementation issues and how to mitigate them will affect state and local governments and their auditors differently.

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## Understand the requirements and communicate with elected officials and other stakeholders

Preparers and auditors of government financial statements will need to be familiar with the requirements of GASB Statement No. 87. In addition, it may be necessary to educate staff, elected officials, and other stakeholders.

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## Identify existing leases and determine if identified leases terminate before the effective date of the statement

Upon implementation, it is extremely important for state and local governments to identify all of their leasing arrangements. The process of identifying lease arrangements may be more challenging for governments with a decentralized lease function. Once leases have been identified, it will be necessary to determine which leases terminate prior to the effective date of the statement and which leases do not. In addition, all operating leases will need to be reviewed to determine if the initial term and expected renewals exceed 12 months. During the identification process, governments may wish to place a moratorium on entering into new lease arrangements or to require all new leases to be processed through the accounting or finance function.

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## Allocate human and financial resources

Much of the information needed to initially implement and annually apply the requirements of GASB Statement No. 87 will likely be the responsibility of a government’s accounting and finance personnel. It is unlikely these personnel will have the time or staff needed to initially identify all existing lease arrangements. In subsequent years, governments may wish to consider a formal lease function to administer and monitor lease arrangements.


It may be necessary for some governments to hire contract staff to assist in identifying lease arrangements and in implementing the requirements of GASB Statement No. 87. It is imperative that a government budget adequate time and financial resources to obtain the information required to properly implement and annually apply the statement. Ideally, these amounts would be included in the annual budget for, at a minimum, the fiscal year in which the government will be required to implement GASB Statement No. 87.

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## Measure lease liabilities and lease assets

Lessees should recognize and measure lease contracts using the facts and circumstances existing at the beginning of the period the statement is implemented. Upon initial implementation of GASB Statement No. 87, a number of calculations will be necessary to determine the amounts to recognize as lease liabilities and lease assets. Each lease will need to be reviewed and evaluated to determine if any options exist in the lease and if it is reasonably certain the government will or will not exercise such options. In addition, lease agreements may or may not state the interest rate implicit in the lease which will require staff to make inquiries of lessors and/or to determine the government’s estimated incremental borrowing rate.

Timing of any internally or externally prepared analyses or other information will need to be determined early in the initial implementation process and every year thereafter. The earlier this date can be determined the more time accounting and finance staff will have to prepare the information needed to properly implement GASB Statement No. 87.

Key point	
	Governments are required to use their estimated incremental borrowing rate if the rate the lessor charges the lessee or the implicit rate in the lease is not known. A government’s estimated incremental borrowing rate may be different for lease assets accounted for in governmental activities than in business-type activities.

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## **Measure lease receivables and corresponding deferred inflows of resources**

Lessors should recognize and measure lease contracts using the facts and circumstances existing at the beginning of the period the statement is implemented. Lessors will need to review all existing operating, direct financing, and sales-type lease agreements to determine how they need to be accounted for and reported under the requirements of GASB Statement No. 87. Upon initial implementation a number of calculations may be necessary to determine the amounts to recognize as lease receivables and deferred inflows of resources for leases currently reported as operating leases. Each lease will need to be reviewed and evaluated to determine if any options exist in the lease and if it is reasonably certain the government will or will not exercise such options. In addition, lease agreements may or may not state the interest rate implicit in the lease which will take time to determine. This will likely prove challenging for lease arrangements previously accounted for as operating leases.

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## **Determine the effect of recording leases on financial condition, debt covenants, and debt limits**

Timing of any internally or externally prepared analyses or other information will need to be determined early in the initial implementation process and every year thereafter. The earlier this date can be determined the more time accounting and finance staff will have to prepare the information needed to properly implement GASB Statement No. 87.

Governments may also need to design and implement controls and update their information technology and financial management systems to effectively manage and report lease arrangements in years subsequent to initial implementation.

A governmental lessee may have a significant lease liability resulting from applying the requirements of GASB Statement No. 87 to short-term and other leases rather than the current accounting for leases as operating or capital leases. Additional debt and reporting interest expense may affect a government's compliance with debt limits and debt covenants. In these cases, financial statement preparers and their auditors will need to determine what effect, if any, implementation and ongoing application of GASB Statement No. 87 will have on the government's financial statements as soon as possible.

It is also possible lease-related amounts reported in the financial statements of a government may affect how a credit analyst views the government's credit risk. Governments may want to discuss the potential impact of the requirements of GASB Statement No. 87 with bond trustees and credit analysts, as well as their elected officials, as soon as possible.

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## Knowledge check

9. As discussed in this section what is **not** an implementation challenge state and local governments may face when implementing GASB Statement No. 87?
- a. Identify existing leases.
  - b. Determining if identified leases terminate before the effective date of the statement.
  - c. Effect of recording leases on total net position.
  - d. Measure lease receivables and corresponding deferred inflows of resources.

# Summary

This chapter discusses the requirements of GASB Statement No. 87 relating to accounting and financial reporting of leases by governmental lessees and lessors. The chapter discusses key terms established with GASB Statement No. 87 and provides an overview of the measurement, accounting, and reporting requirements for leases by lessees and lessors. Additionally, the chapter discusses the disclosures required by lessees and lessors relating to leases as well as potential issues associated with initial and subsequent measurement and reporting of lease-related transactions.

