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GASB 87 Leases

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December 17, 2021

GASB 87 Scope and Effective Date

- Effective date – reporting period beginning after June 15, 2021 (Originally December 15, 2019 - Postponed by GASB 95)
  - June 30, 2022
  - December 31, 2022
- How does this improve accounting and financial reporting?
  - Establishes a single model for lease accounting based on the principle that leases are financings of the right to use underlying asset

Current Lease Accounting

Lease Type Criteria

GASB codification L20

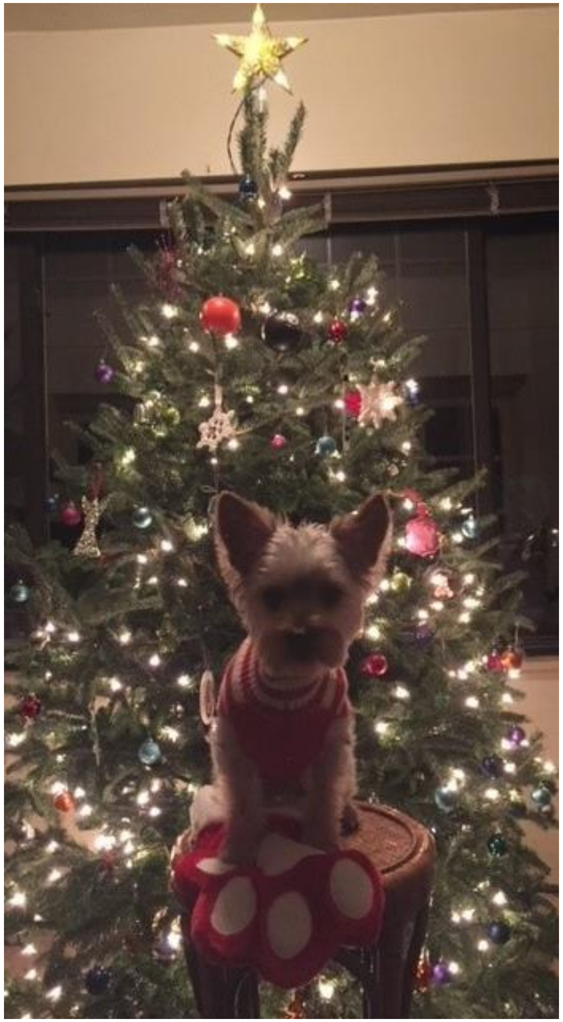
- Capital lease criteria
  - Lease transfers ownership by the end of the term
  - Lease contains a bargain purchase option
  - Lease is 75% or more of the estimated economic life of the leased property
  - Present value of the minimum lease payments equals 90% of the fair value of the property
- Operating leases
  - Anything not meeting the criteria of a capital lease

Capital Leases

- Value equal to the present value of the minimum lease payments or fair value of the asset leased (whichever is lower)
- Lease liability amortized
- Lease asset depreciated
  - Life of the asset or term of the lease depending the criteria met
- Disclose future minimum payments

Operating Leases

- No liability or asset recorded
- Lease payments are expensed
- Disclose future minimum payments
  - If long-term and noncancelable



Lease Accounting Under GASB 87

Definition of a Lease

- A contract that conveys control of the right to use another entity's nonfinancial asset as specified in a contact for a period of time in an exchange or exchange-like transaction.
- Nonfinancial Assets:
  - Buildings
  - Land
  - Vehicles
  - Equipment

Excluded from Scope of Statement 87

- Leases of intangible assets
- Leases of biological assets (timber, plants, animals)
- Contracts that meet the definition of a services concession arrangement
- Leases of assets financed with outstanding conduit debt
- Supply contacts

Contracts That Transfer Ownership

- Transfer of ownership of the underlying asset to the lessee by the end of the contract and:
  - Does not contain termination options
  - May contain a fiscal funding or cancellation clause that is not reasonably certain of being exercised
- Should be reported as a financed purchase (lessee) or sale of asset (lessor).

Lease Term

- The period during which a lessee has a noncancelable right to use an underlying asset, plus:
  - Periods covered by a lessee's or lessor's option to extend the lease if it is reasonably certain
  - Periods covered by a lessee's or lessor's option to terminate the lease if it is reasonably certain
  - Period for which both the lessee and lessor have an option to terminate without permission from the other party (or if both have to agree to extend) are cancelable periods and are excluded from the lease term (rolling month-to-month lease)

Reassessment of the Lease Term

- Only if one or more occur
  - The lessee or lessor elects an option that was not previously determined to be exercised
  - An event specified in the lease contracts that requires an extension or termination of the lease takes place

Short-term Leases

Term

- Maximum possible term under the lease contract of 12 months including options to extend
- Leases cancelable by either party such as month-to-month or year-to-year leases
  - Maximum possible term is the noncancelable period (including notice periods)

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Recognition

- Lessees
  - Lease payments are recognized as an expense
  - Asset for payments made in advance or liability for payments due
- Lessors
  - Lease payments are recognized as revenue
  - Liability for payments made in advance or asset for payments owed

Long-term Leases

Lease Liability

Measurement

- Measured at the present value of payments expected to be made during the lease term
- The discount rate used for measurement should be the interest rate the lessor charges the lessee
- If an interest rate is not determined by the lessee, the estimated incremental borrowing rate should be used

Future Payments Included in the Measurement of the Lease Liability

- Fixed payments
- Variable payments that depend on an index
- Variable payments that are fixed in substance
- Amounts that are reasonably certain of being required to be paid
- The exercise price of the purchase option if it is reasonably certain that the lessee will exercise the option
- Payments for penalties for terminating the lease
- Lease incentives receivable from the lessor

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Future Payments NOT Included in the Measurement of the Lease Liability

- Variable payments based on future performance or usage of the underling asset
  - Expensed in the period the payment is incurred
  - If any component of the variable payment is fixed in substance, then should be included in the measurement

Adjustment to the Lease Liability

- Change in the lease term
- Likelihood of purchase option being exercised has changed
- Change in the estimated amount of payments
- Change in variable payments that were contingent on the performance or use of the asset become fixed

Adjustment to the Lease Liability (Continued)

- Change in discount rate
  - Change in interest rate charged by lessor
  - Change in the index or rate used to determine variable payments that significantly affects the amount of the liability
  - Not required to remeasure for change in incremental borrowing rate

Lease Asset (Right to Use Asset)

Measurement

- Measured as the sum of the following:
  - The amount of the initial measurement of the liability
  - Lease payments made to the lessor at or before the commencement of the lease term, less any incentives
  - Initial direct costs to place the leased asset into service

Amortization

- Systematic and rational manner over the shorter of:
  - Lease term
  - Useful life of the asset
- Recorded as amortization expense and can be combined with depreciation

Amortization (Continued)

- If a purchase option is reasonably certain of being exercised:
  - Amortize over the life of the asset
  - If nondepreciable (land), than the lease asset should not be amortized

Adjustments to the Lease Asset

- Same factors as the lease liability
- If value of asset is reduced to zero, remaining liability is removed and recognized as a gain
- Impairment of asset
  - Change in time the asset can be used
  - Decline in service utility of the asset

Financial Statement Presentation

Economic Resources Measurement Focus - Lessee

- Lease Asset
  - Present value of the lease payments
  - Amortize over life of lease/asset
- Lease Liability
  - Present value of the lease payments
  - Amortize over life of the lease

Current Financial Resources Measurement Focus - Lessee

- Inception
  - Other financing sources
    - Proceeds of lease
  - Capital outlay
    - Purchase of lease asset
- Ongoing
  - Debt service
    - Lease payment

Economic Resources Measurement Focus - Lessor

- Lease Receivable
  - Present value of the lease payments
  - Amortized over the life of the lease
- Deferred Inflows of Resources
  - Equal to the lease receivable
  - Amortize and recognize as revenue over the term of the lease
- Lease Asset
  - Do not derecognize

Current Financial Resources Measurement Focus - Lessor

- Inception
  - Lease receivable
  - Deferred inflow of resources
- Ongoing
  - Reduction of the receivable upon lease payment
  - Recognition of revenue and reduction of deferred inflow or resources

Example Journal Entries

Office Space

- Terms
  - Total lease payments - $100,000
  - 5 years
  - Interest rate 4.5% (incremental borrowing rate)
- Present value
  - $80,000 Principal
  - $20,000 Interest

Office Space – Lessee

- Inception - Accrual
  - Debit - Right to use asset $80,000
  - Credit - Lease Liability $80,000
- Inception – Mod. Accrual
  - Debit - Capital outlay $80,000
  - Credit - Lease Proceeds $80,000

Office Space - Lessee

- Annual Entries – Accrual
  - Lease Asset
    - Debit – Amortization $16,000
    - Credit - Right to use asset $16,000
  - Lease Liability
    - Debit – Lease Liability $16,000
    - Debit – Interest Expense $4,000
    - Credit – Cash $20,000

Office Space - Lessee

- Annual Entries – Mod. Accrual
  - Lease Liability
    - Debit – Debt Service, Principal $16,000
    - Debit – Debt Service, Interest $4,000
    - Credit – Cash $20,000

Office Space – Lessor

- Inception – Accrual and Mod. Accrual
  - Debit – Lease Receivable $80,000
  - Credit – Deferred Inflows of Resources $80,000

Office Space – Lessor

- Annual Entries – Accrual and Mod. Accrual
  - Debit Cash $20,000
  - Credit Lease Receivable $16,000
  - Credit Interest Income $4,000
  - Debit Deferred Inflows of Resources $16,000
  - Credit Lease Revenue $16,000

Notes to Financial Statements - Lessees

Description of the Leasing Arrangement

- Basis and terms of the lease
- Conditions of variable payments not included in the measurement of the liability
- Terms and conditions of guarantees provided by the lessee not included in the measurement of the liability

Lease Assets

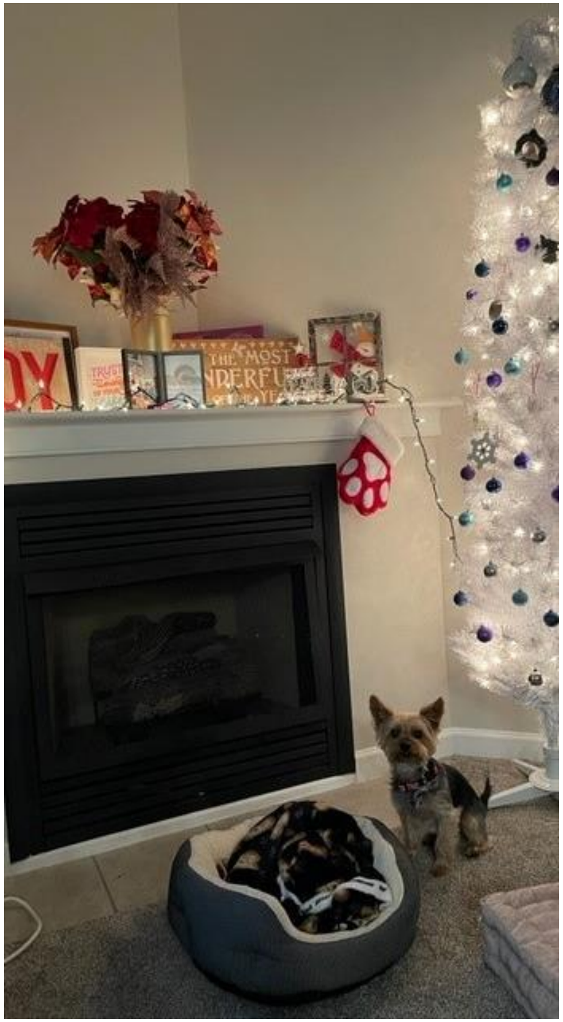
- Total amount of the lease asset
- Accumulated amortization
- Major classes of underlying assets

Payments Not Included in the Measurement of the Liability

- Variable payments not included in the measurement
- Guarantees
- Termination penalties

Other

- Principal and interest required for each of the five subsequent years and in five-year increments thereafter
- Commitments before commencement of the lease
- Any loss associated with an impairment of the asset and related change to the lease liability



Notes to Financial Statements - Lessors

General

- Basis and terms of the lease
- Total lease and interest revenue recognized in the reporting period
- Amount of payments not included in the measurement of the lease receivable
- Terms and conditions of options by the lessee to terminate the lease

Leasing as a Principal Activity

- Future payments of lease receivable
  - Principal and interest separately
  - Each of five subsequent years and in five-year increments thereafter

Lessee Footnote Example – Policy

Leases

The Township is a lessee for a noncancellable lease of playground equipment. The Township recognizes a lease liability and an intangible right-to-use lease asset (lease asset) in the government-wide financial statements. The Township recognizes lease labilities with an initial, individual value of $5,000 or more.

At the commencement of a lease, the Township initially measures the lease liability at the present value of payments expected to be made during the lease term. Subsequently, the lease liability is reduced by the principal portion of lease payments made. The lease asset is initially measured as the initial amount of the lease liability, adjusted for lease payments made at or before the lease commencement date, plus certain initial direct costs. Subsequently, the lease asset is amortized on a straight-line basis over its useful life.

Key estimates and judgments related to leases include how the Township determines (1) the discount rate it uses to discount the expected lease payments to present value, (2) lease term, and (3) lease payments.

- The Township uses the interest rate charged by the lessor as the discount rate. When the interest rate charged by the lessor is not provided, the Township generally uses its estimated incremental borrowing rate as the discount rate for leases.
- The lease term includes the noncancellable period of the lease. Lease payments included in the measurement of the lease liability are composed of fixed payments and purchase option price that the Township is reasonably certain to exercise.

The Township monitors changes in circumstances that would require a remeasurement of its lease and will remeasure the lease asset and liability if certain changes occur that are expected to significantly affect the amount of the lease liability.

Lease assets are reported with capital assets and lease liabilities are reported with long-term debt on the statement of net position.

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Lessee Footnote Example

Leases

During 2022, the Township entered into a three-year noncancelable lease agreement as lessee for the use of playground equipment. An initial lease liability was recorded in the amount of $27,232 during 2022. As of December 31, 2022, the value of the lease liability was $18,594. The Township is required to make annual payments of $10,000. The lease has an interest rate of 5%. The equipment has a ten-year estimated useful life. The value of the right-to-use asset as of the end of the current fiscal year was $27,232 and had accumulated amortization of $9,077.

The future principal and interest lease payments as of December 31, 2022, were as follows:

Fiscal Year Ending December 31,	Principal	Interest	Total
2023	$ 9,070	$ 930	$ 10,000
2024	9,524	476	10,000
Totals	$ 18,594	$ 1,406	$ 20,000

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Lessor Footnote Example - Policy

Leases

The Township is a lessor for a noncancellable lease of a building. The Township recognizes a lease receivable and a deferred inflow of resources in the government-wide and governmental fund financial statements.

At the commencement of a lease, the Township initially measures the lease receivable at the present value of payments expected to be received during the lease term. Subsequently, the lease receivable is reduced by the principal portion of lease payments received. The deferred inflow or resources is initially measured as the initial amount of the lease receivable, adjusted for lease payments received at or before the lease commencement date. Subsequently, the deferred inflow or resources is recognized as revenue over the life of the lease term.

Key estimates and judgments include how the Township determines (1) the discount rate it uses to discount the expected lease receipts to present value, (2) lease term, and (3) lease receipts.

- The Township uses its estimated incremental borrowing rate as the discount rate for leases.
- The lease term includes the noncancellable period of the lease. Lease receipts included in the measurement of the lease receivable is composed of fixed payments from the lessee.

The Township monitors changes in circumstances that would require a remeasurement of its lease and will remeasure the lease receivable and deferred inflows of resources if certain changes occur that are expected to significantly affect the amount of the lease receivable.

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Lessor Footnote Example

Leases

During 2022, the Township began leasing two floors of one of its buildings to a third party. The lease is for four years, and the Township will receive monthly payments of $10,000. The Township recognized $112,733 in lease revenue and $8,198 in interest revenue during 2022 related to this lease. As of December 31, 2022, the Township's receivable for lease payments was $349,131. Also, the Township has a deferred inflow of resources associated with this lease that will be recognized as revenue over the lease term. As of December 31, 2022, the balance of the deferred inflow or resources was $338,200.

Lessee Adoption Footnote Example

GASB Statement No. 87, "*Leases,*" better meets the information needs of financial statement users by improving accounting and financial reporting for leases by governments. The provisions of this statement have been adopted and incorporated into these financial statements. As a result of this implementation, Organization recognized on January 1, 20XX a lease liability of $XXXX, which represents the present value of the remaining operating lease payments and a right-of-use asset of $XXXX, which represents the operating lease liability of $XXXX adjusted for accrued rent of $XXXX and unamortized initial direct costs of $XXXX. The difference between the lease assets and lease liabilities was recorded as an adjustment to net assets.

Other Items to Consider

Lease Incentives

- Payments to or on behalf of the lessee by the lessor
- Considered a rebate or discount to the lease obligation
- Include in the initial measurement
  - Applied as a reduction in lease payments for the period in which the incentive payment will be provided

Contracts with Multiple Components

- Account for agreements that contain lease and non-lease components separately
  - If separate amounts are not included in the agreement, use professional judgement
  - If not practical to determine, treat as a single lease unit
- Account for agreements that contain multiple underlying assets that have different lease terms separately

Lease Modifications

- Treat as a separate lease if the following are present:
  - The modification gives the lessee an additional lease asset by adding additional underlying asset(s)
  - Increase in lease payments does not appear unreasonable based on the terms of the amended lease contract
- Otherwise remeasure the current lease

Lease Termination

- Decrease in the lessee's right to use the underlying asset
  - Shortened term
  - Decrease in the number of underlying assets
  - Include partial or full lease termination
- Reduce lease asset and liability and report gain/loss for difference
- If termination is result of purchase, then reclass asset

Other Lease Arrangements

- Subleases
- Sales-leaseback transactions
- Lease-leaseback transactions

Implementation and Practical Considerations

Implementation

- Implemented retroactively by restatement, if practical for all periods presented
  - Little impact on statement of activities
- Do not apply to immaterial items
  - Consider the underlying asset leased

Implementation

- Gather information for all outstanding leases and evaluate the terms and conditions and identify:
  - Length of lease
  - Interest rate to apply
  - Useful life of the asset

Implementation

- Compile information for disclosure
  - Roll forward of leases
  - Future payments schedule
  - Roll forward of leased assets by category
  - Any other payments made/received

Practical Considerations

- Assess lease agreements
  - Are terms month-to-month or less than 12 months?
  - Does the lease include cancelable terms?
- Evaluate what is material to the users of the financial statements
- Evaluate current capitalization policies and thresholds

Other Implementation Considerations

- Lease may be recorded across multiple funds

- May result in a fund having fund balance when the fund previously has not.

Comparison to FASB ASC 842

- GASB makes no distinction between operating and finance leases
- GASB contains stricter rules for short term lease qualification
- Differences in lessor options to extend or terminate the lease are considered
- GASB does not allow option to capitalize short term leases
- FASB allows accounting policy elections to simplify lease accounting
- Differences in transitional provisions

GASB Implementation Guide 2019-03

Scope and Applicability of Statement 87

4.1. Q—A government obtains the right to use land, which has a market rent of $100,000 per year, for $1 per year. Should the government apply the requirements in Statement 87 to that transaction?

A—No. The definition of a lease in paragraph 4 of Statement 87 specifies that the Statement should be applied only to exchange or exchange-like transactions. Paragraph 1 of Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*, classifies all transactions of state and local governments into two categories: (a) exchange and exchange-like and (b) nonexchange. The government's right to use land for $1 does not meet the description of an exchange or exchange-like transaction because each party does not receive or give up essentially equal value or not quite equal value.

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Scope and Applicability of Statement 87

4.2. Q—A government enters into a multiyear agreement for the right to use a facility. The government has exclusive use of the facility three days a week. Other parties use the facility on the other days. To meet the definition of a lease, is the government required to have uninterrupted control of the right to use the facility?

A—No. In determining whether a contract conveys control of the right to use an underlying asset, a government should assess whether it has (a) the right to obtain the present service capacity from use of the underlying asset and (b) the right to determine the nature and manner of use of the underlying asset "as specified in the contract" (paragraph 5 of Statement 87). If the contract specifies that the government has control of those rights during three days of each week, the control criterion is met. The provision in the lease definition that the contract be for a period of time does not require uninterrupted control of the right to use the facility.

Scope and Applicability of Statement 87

4.5. Q—Do easements meet the definition of a lease?

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

Scope and Applicability of Statement 87

4.10. Q—A government enters into a lease agreement that conveys control of the right to use a parcel of land to a company that engages in oil and gas exploration and production. Is this lease excluded from Statement 87?

A—No. In this example, the company has control of the right to use the land itself. In contrast, if the government only provided the company with the right to explore for or to exploit oil and gas but did not convey control of the right to use the land, that lease would be excluded from Statement 87. Although paragraph 8a of Statement 87 excludes "rights to explore for or to exploit natural resources such as oil, gas, and minerals," that exclusion applies only when the underlying asset in the lease is the right to explore for or to exploit those resources.

Lease Term

4.13. Q—A lease contract has a noncancellable period of five years and specifies that at the end of the five years, both the lessor and lessee have the right to cancel the lease or may continue the lease, using the same terms on a month-to-month basis. Is the month-to-month holdover period included in the initial assessment of the lease term?

A—No. During the holdover period, the lessee has not contracted for a noncancellable right to use an underlying asset, and the lessor is not required to continue providing the asset. That is, the holdover period is cancellable by either party and, therefore, is excluded from the lease term, as defined in paragraph 12 of Statement 87.

Short-Term Leases

4.18. Q—A government enters into a lease with a 6-month noncancellable period and an option to extend for another 12 months after the noncancellable period. The government is not reasonably certain that it will exercise the option to extend and, therefore, assesses the lease term as six months. Is this agreement a short-term lease under Statement 87?

A—No. Paragraph 16 of Statement 87 states that a short-term lease "has a maximum possible term under the lease contract of 12 months (or less), including any options to extend, regardless of their probability of being exercised." Therefore, the lessee should report a lease liability and a lease asset; however, the lease term would be only six months.

Contracts That Transfer Ownership

4.21. Q—A vendor installs equipment in a government's building to increase energy efficiency. The government will own the equipment at the end of the agreement, and the contract does not contain a termination option. For financial reporting purposes, should this transaction be reported as a lease or a financed purchase?

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

4.22. Q—A school district leases computers. At the end of the lease term, students are given the option to purchase their computers from the school district. Regardless of whether the students purchase their computers, 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 by the school district?

A—This arrangement should be reported as a financed purchase. Paragraph 19 of Statement 87 states that one criterion of a financed purchase is that the contract transfers ownership of the underlying asset to the lessee by the end of the contract. In this example, the lessee is the school district, not the students. The contract transfers ownership of the computers because the purchase by the school district is required. The sale of computers to the students is a separate transaction.

Lease Liability

4.23. Q—A government adopts a capitalization threshold and expenses acquisitions, including lease assets, that fall below that threshold. Can the government apply a similar threshold to lease liabilities?

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

Lease Liability

4.28. Q—A school district leases buses for two years and is required to make variable payments based on the number of miles driven. There is no minimum payment requirement stated in the lease agreement. The school district is reasonably certain of the minimum number of miles that will be driven based on established routes. Paragraph 21h of Statement 87 requires that a lease liability include "any other payments that are reasonably certain of being required based on an assessment of all relevant factors." Should the lease liability include the reasonably certain variable lease payments?

A—No. Paragraph 22 of Statement 87 requires that variable payments based on future performance of the lessee or usage of the underlying asset not be included in the measurement of the lease liability. Because those payments are covered in paragraph 22, they should not be included in the measurement of the lease liability in accordance with paragraph 21h, even if they are reasonably certain of being required. Rather, those variable payments should be recognized as outflows of resources in the period(s) in which the obligation for those payments is incurred. (See also Question 4.39.)

Lease Asset

4.32. Q—A government makes payments related to a building lease during a construction period before gaining access to the building. Can payments made during the construction period be reported as a lease asset at the time they are paid?

A—No. Payments made before commencement of the lease term should be reported as prepayments (assets), not as a lease asset. At the commencement of the lease term, the lessee obtains the right to use the underlying asset by either gaining physical possession of the asset or attaining access to use the underlying asset. The lease asset is the right to use the underlying asset rather than the underlying asset itself. The right to use makes the underlying asset a resource to the lessee and provides the lessee with access to the underlying asset's present service capacity. Therefore, at the commencement of the lease term, the prepayments should be reclassified as part of the initial measurement of the lease asset, as provided in paragraph 30b of Statement 87. (See also Question 4.12.)

GASB Implementation Guide 2021-01

Definition of a Lease

4.4. Q—A city owns a fleet of equipment. The pieces of equipment are capital assets reported in an internal service fund. The internal service fund is used to report fleet management activity that provides other departments of the city (within the same legal entity) with the right to use the equipment on a cost-reimbursement basis. In the city's basic financial statements, should the agreements between the city's departments be reported as leases?

A—No. The definition of a lease in paragraph 4 of Statement 87, in part, requires conveyance of control of the right to use another entity's underlying asset. In this circumstance, control is not conveyed to another legal entity; therefore, the agreements should not be reported as leases in the city's basic financial statements.

Definition of a Lease

Q—A government enters into a multiyear contract that provides another entity with the right to use the government's facility for retail sales. The contract states that the entity is required to make periodic variable payments based on an established percentage of retail sales (that is, they are variable based on future performance of the lessee) in addition to insignificant periodic fixed payments. Are the variable payments based on future sales included in the assessment of whether the contract is an exchange or exchange-like transaction for purposes of meeting the definition of a lease?

A—Yes. The definition of a lease in paragraph 4 of Statement 87 requires the contract to be an exchange or exchange-like transaction. Although paragraph 45 of Statement 87 provides that the measurement of the lease receivable should not include variable payments based on future performance of the lessee, the assessment of whether the contract meets the definition of a lease should precede the measurement of the lease receivable. For that reason, the assessment of whether the right to use the government's facility is provided in an exchange or exchange-like transaction should consider all values exchanged, which includes the expected variable payments. Significant variable payments that are not included in the measurement of the lease receivable are required by paragraph 57c of Statement 87 to be disclosed if the contract meets the definition of a lease, even if the lease receivable is insignificant.

Lease Term - Reassessment

4.6. Q—A government enters into a 72-month lease as a lessee. However, both the government and the lessor have a right to cancel at any time, without permission from the other party, with 24 months' advance notice. Therefore, the initial lease term is 24 months because the remaining 48 months are cancellable periods at the commencement of the lease. At the end of the government's reporting period, neither the government nor the lessor has exercised its right to cancel. Should the government reassess the lease term?

A—Yes. The effect of excluding cancellable periods from the lease term, as required by paragraph 12 of Statement 87, is the same as if it were reasonably certain that a lessee or lessor option to cancel would be exercised. (Therefore, it also is *not* reasonably certain that the option to cancel would *not* be exercised, and consequently, the period covered by the termination option is not included in the initial determination of the lease term in accordance with paragraph 12b of Statement 87.) In that situation, paragraph 15b of Statement 87 requires reassessment of the lease term if the lessee or lessor elects not to exercise an option even though it was previously determined that it was reasonably certain that the option would be exercised. In the example in this question, as long as neither party provides notice exercising its right to cancel, the remaining lease term at any point during the first 48 months of the lease would be 24 months. Therefore, the government should reassess the lease term at the end of the first reporting period and subsequent reporting periods, as applicable.

Short-term Leases

4.7. Q—A government enters into a three-year contract for the right to use a piece of equipment. Because the government only needs the equipment on a seasonal basis, the contract states that the government only has the right to use the equipment from January through March for each of those three years. Based on the contract, the government has control of the right to use the equipment during those three months each year and does not have an option to extend the right to use the equipment. Is this contract a short-term lease under Statement 87?

A—Yes. According to paragraph 16 of Statement 87, the maximum possible term of a short-term lease is 12 months or less, including any options to extend. If there is interrupted control, the length of the contract is not the maximum possible term. In accordance with paragraph 4 of Statement 87, a contract is required to convey control of the right to use an underlying asset to meet the definition of a lease. Therefore, the maximum possible term should be based on the period during which the government has control of the right to use the piece of equipment. In this example, the maximum possible term is nine months.

Lessee Recognition and Measurement

4.11. Q—A government leases office space and is one of several tenants in the building. In addition to fixed payments, the government is required to make payments to reimburse the lessor for a pro rata share of the lessor's taxes and insurance. The additional monthly payment amounts are stated in the lease based on the lessor's estimate of taxes and insurance at the beginning of each year of the lease term. Annually, the lessor provides a reimbursement or requests an additional payment from the government to account for the difference between the actual and estimated pro rata share of taxes and insurance. Should the additional monthly payments be included in the measurement of the lease liability?

A—No. If a contract specifies that a lessee pays for a share of the lessor's taxes and insurance, whether estimated or actual, those payments are considered nonlease components of the contract, which should be accounted for separately from lease components. Therefore, those payments are not lease payments and should not be included in the measurement of the lease liability. Instead, those payments should be recognized as outflows of resources (for example, expense) in the periods in which the obligation for those payments is incurred.

Lease Incentives

4.18. Q—A government leases retail space to a lessee. The contract requires the governmental lessor to make certain improvements to the space, for example, to the wiring and plumbing, which are part of the government's asset. The improvements will be owned by the governmental lessor, and the governmental lessor is not reimbursed by the lessee. Should the improvements be considered lease incentives for the purpose of measuring the lease receivable?

A—No. Paragraph 62 of Statement 87 states that "lease incentives reduce the amount that a lessee is required to pay for a lease." In the example in this question, the requirement that the lessor pay for certain improvements does not reduce the lease payments expected to be received during the lease term. The lessor should account for the improvements separately from the lease and should not include the improvements as lease incentives in the measurement of the lease receivable.

Effective Date and Transition

4.22. Q—A government implements Statement 87 at the beginning of its fiscal year on July 1, 2021, and does not present prior periods in its financial statements. At that time, the government has a lease in place that started January 1, 2019, and ends December 31, 2021. The lease does not contain any options to extend. At the initial implementation date, should the lease be considered a short-term lease?

A—Yes. Paragraph 94 of Statement 87 states that "leases should be recognized and measured using the facts and circumstances that existed at the beginning of the period of implementation. If applied to earlier periods, leases should be recognized and measured using the facts and circumstances that existed at the beginning of the earliest period restated." For leases that are already in effect at transition, a government should consider the beginning of the period of implementation or the beginning of the earliest period restated, whichever is earlier, as the commencement of the lease term, even if the actual lease started before that date. Therefore, in this example, because prior periods are not presented, the maximum possible term at the commencement of the lease term (that is, the date the Statement is first implemented) is six months, and the lease should be reported as a short-term lease.

Example Lease Schedules

Questions?

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Sources: Governmental Accounting Standards Board Statement No. 87, *"Leases".*
GASB Implementation Guide No. 2019-3
GASB Implementation Guide No. 2021-1