LEASES – APPLICATION

GASB 87, *Leases*, issued June 2017, effective for reporting periods beginning after June 15, 2021; earlier application is encouraged

This Statement requires reporting certain lease liabilities that currently are not reported. The accounting is based on the substance of the arrangement rather than the label on the contract. The terms *capital lease* and *operating lease* are discontinued.

Leases – Leases are financings of the right to use an underlying asset. Under this Statement, a lessee is required to recognize a lease liability and an intangible right-to-use lease asset. A lessor is required to recognize a lease receivable and a deferred inflow of resources.

A *lease* is a contract that conveys the right to use a nonfinancial asset (the underlying asset) for a period of time in an exchange or exchange-like transaction. Examples of nonfinancial assets include buildings, land, vehicles, and equipment. Any contract that meets this definition is accounted for as a lease, unless specifically excluded, such as:

- A short-term lease is defined as a lease that, at the beginning of the lease, has a maximum possible term under the contract of 12 months or less, including options to extend, regardless of its probability of being exercised. Lessees and lessors should recognize short-term payments as expenditures/expenses or revenues, respectively, based on the payment provisions of the contract.

- Contracts that transfer the right to use an asset that require only a nominal amount, such as one dollar per year, are nonexchange transactions and should be accounted for according to the provisions of GASB 33.

- Licensing agreements for computer software should not be treated as leases.

- Leases that transfer ownership before or at the end of the lease and do not contain termination options are accounted for as financed purchases rather than as leases. The substance of a lease that transfers ownership is a purchase of the underlying asset with payments financed over time. Therefore, assuming there is no possibility of termination before the transfer occurs, such a contract follows guidance for acquisition of capital assets with related long-term liabilities instead of guidance for leases. Provisions that allow for termination of a lease due to fiscal funding or cancellation clauses, purchase of the underlying asset, payment of all sums due, or default are not considered termination options and, therefore, do not disqualify the transactions from being treated as a financed purchase.

The *lease term* is the period during which a lessee has a noncancelable right to use an underlying asset, plus the following periods, if applicable, covered by a *lessee's* option to:

- Extend the lease if it is reasonably certain that the lessee will exercise that option
- Terminate the lease if it is reasonably certain that the lessee will not exercise that option.

Fiscal funding clauses should be evaluated in the same manner as other termination options. That is, it is not considered in determining the lease term unless it is reasonably certain that the option will be exercised (funds will not be appropriated).

The lease term is to be reassessed only when it is reasonably certain that the lessee changes its determination to exercise or not to exercise an option.

Lessee Accounting – A lease liability and a lease asset is recognized as the beginning of a lease, unless the lease is a short-term lease or transfers ownership of the underlying asset.

The *lease liability* is the present value of payments expected to be made for the lease term.

The *lease asset* is the amount of the lease liability, plus any payments made to the lessor at or before the beginning of the lease and certain indirect costs less any lease incentives received from the lessor. The lease asset is the right to use the underlying asset rather than the underlying asset itself.

The lessee reduces the lease liability as payments are made and recognize an expense for interest on the liability. The lessee amortizes the lease asset (usually straight-line) over the shorter of the lease term or the useful life of the underlying asset. The notes to the financial statements are to include a description of leasing arrangements, the amount of lease assets recognized, and a schedule of future lease payments to be made.

Lessor Accounting – A lessor recognizes a lease receivable and a deferred inflow of resources at the beginning of a lease, with certain exceptions (including a short-term lease or a lease that transfers ownership of the underlying asset). A lessor continues to recognize the asset underlying the lease. The lease receivable is the present value of lease payments expected to be received for the lease term. The deferred inflow of resources is the value of the lease receivable plus any payments received at or prior to the beginning of the lease that relate to future periods.

A lessor recognizes interest revenue on the lease receivable and revenue from the amortization of the deferred inflow of resources over the term of the lease. The notes to the financial statements are to include a description of the leasing arrangements and the total amount of revenue recognized from the leases.

Lease Terminations and Modifications – A lease termination is accounted for by reducing the carrying values of the lease liability and lease asset by the lessee, or the lease receivable and deferred inflow of resources by the lessor, with any difference being recognized as a gain or loss. A lease modification is accounted for by remeasuring the lease liability and adjusting the related lease asset by the lessee, or remeasuring the lease receivable and adjusting the related deferred inflow of resources by the lessor.

Subleases and Leaseback Transactions – Subleases are treated as transactions separate from the original lease. A sale-leaseback transaction is accounted for as a separate sale and lease transactions, except that any difference between the carrying value of the capital asset that was sold and the net proceeds from the sale is reported as a deferred inflow/outflow of resources and recognized over the term of the leaseback. A lease-leaseback transaction is accounted for as a net transaction. The gross amounts of each portion of the transaction are disclosed.

This Statement is effective for reporting periods beginning after June 15, 2021. It applies to earlier periods presented (the beginning of the earliest period restated).

Initial measurement of lease transaction:

| | Assets | Liability | Deferred Inflow |
|---|---|---|---|
| Lessee | Intangible lease asset (right to use underlying asset)—value of lease liability plus initail indirect costs that are ancillary to place asset in use | Present value of future lease payments, variable payments based on index or rate, reasonably certain residual guarantees, etc.) | Not applicable |
| Lessor | • Lease receivable (generally includes same items as lessee's liability)<br>• Continue to report leased asset | Not applicable | Equal to lease receivable plus any cash received up front that relates to a future period |

Subsequent lease activity:

| | Assets | Liability | Deferred Inflow |
|---|---|---|---|
| Lessee | Amortize the intangible lease asset over shorter of useful life or lease term | Reduce by lease payments (less amount for interest expense) | Not applicable |
| Lessor | • Reduce receivable by lease payments (less amounts needed to cover accrued interest)<br>• Depreciate leased asset (unless indefinite life or required to be returned in its original or enhanced condition) | Not applicable | Recognize revenue over the lease term in a systematic and rational manner |

Assume the following facts regarding a district's lease, beginning July 1, 2019:

1. 10-year lease of a building, with an option to extend for an additional 5 years.
2. Lease payments are $50,000 per year during the initial term and $55,000 per year during the optional period, all payable in arrears.
3. The district incurs initial direct costs (for improvements) of $65,000.
4. The district receives a $50,000 lease incentive at the beginning of the lease.
5. At the beginning of the lease, the district concludes that is it not reasonably certain to exercise the option.
6. The district's incremental borrowing rate at the beginning of the lease is 5%.

The present value of the 10 remaining payments is $386,087. The lease asset is measured at $401,087 (the initial lease liability + initial direct costs – lease incentive).

Payment Schedule

| | Date | Payment | Interest | Principal | Balance |
|---|---|---|---|---|---|
| | 7/1/2019 | | | | 386,087 |
| 1 | 6/30/2020 | 50,000 | 19,304 | 30,696 | 355,391 |
| 2 | 6/30/2021 | 50,000 | 17,770 | 32,230 | 323,161 |
| 3 | 6/30/2022 | 50,000 | 16,158 | 33,842 | 289,319 |
| 4 | 6/30/2023 | 50,000 | 14,466 | 35,534 | 253,785 |
| 5 | 6/30/2024 | 50,000 | 12,689 | 37,311 | 216,474 |
| 6 | 6/30/2025 | 50,000 | 10,824 | 39,176 | 177,298 |
| 7 | 6/30/2026 | 50,000 | 8,865 | 41,135 | 136,162 |
| 8 | 6/30/2027 | 50,000 | 6,808 | 43,192 | 92,971 |
| 9 | 6/30/2028 | 50,000 | 4,649 | 45,351 | 47,619 |
| 10 | 6/30/2029 | 50,000 | 2,381 | 47,619 | - |
| | | 500,000 | 113,913 | 386,087 | |

At the end of Year 1, the lease liability is $355,391 and the lease asset is $360,978.

Amortization Schedule

| | Date | Amortization | Balance |
|---|---|---|---|
| | 7/1/2019 | | 401,087 |
| 1 | 6/30/2020 | 40,109 | 360,978 |
| 2 | 6/30/2021 | 40,109 | 320,869 |
| 3 | 6/30/2022 | 40,109 | 280,761 |
| 4 | 6/30/2023 | 40,109 | 240,652 |
| 5 | 6/30/2024 | 40,109 | 200,543 |
| 6 | 6/30/2025 | 40,109 | 160,435 |
| 7 | 6/30/2026 | 40,109 | 120,326 |
| 8 | 6/30/2027 | 40,109 | 80,217 |
| 9 | 6/30/2028 | 40,109 | 40,109 |
| 10 | 6/30/2029 | 40,109 | 0 |
| | | 401,087 | |

Note that total interest expense and total amortization expense over the term of the lease is $515,000 ($113,913 interest + $401,087 amortization).

For the year ending June 30, 2020, the district would account for the lease as follows:

| | dr. | cr. |
|---|---|---|
| **Initial measurement** | | |
| Governmental Fund: | | |
| Cash | | (15,000) |
| Expenditure - lease | 401,087 | |
| Other financing use - lease | | (386,087) |
| | | |
| **At end of Year 1** | | |
| Governmental Fund: | | |
| Cash | | (50,000) |
| Expenditure - lease | 50,000 | |
| | | |
| Government-wide financial statements: | | |
| Lease asset | 401,087 | |
| Accumulated amortization - lease asset | | (40,109) |
| Lease liability | | (355,391) |
| Expenditure - lease | | (451,087) |
| Other financing use - lease | 386,087 | |
| Interest expense | 19,304 | |
| Lease amortization | 40,109 | |

**Sample Disclosures – Lessee**

Note 1 – Summary of Significant Accounting Policies

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

At the commencement of a lease, the District 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 District determines (a) the discount rate it uses to discount the expected lease payments to present value, (b) lease term, and (c) lease payments.

- The District uses the interest rate charged by the lessor as the discount rate. When the interest rate charged by the lessor is not provided, the District 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 District is reasonably certain to exercise.

The District 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 other capital assets and lease liabilities are reported with long-term liabilities on the statement of net position.

**X. LEASE PAYABLE**

During the current fiscal year, the District entered into a five-year lease agreement as lessee for the acquisition and use of playground equipment. An initial lease liability was recorded in the amount of $386,087 during the year ended June 30, 2020. As of June 30, 2020, the value of the lease liability was $355,391. The District is required to make monthly principal and interest payments of $50,000. The lease has an interest rate of 5%. In addition, the District will purchase the equipment for $2,000 at the end of the lease term. The equipment has a ten-year estimated useful life. The value of the right-to-use asset as of June 30, 2020 was $360,978 and had accumulated amortization of $40,109.

The future principal and interest lease payments as of June 30, 2020, were as follows:

| Year Ending June 30, | Principal | Interest | Total |
|---|---|---|---|
| 2021 | $ 32,230 | $ 17,770 | $ 50,000 |
| 2022 | 33,842 | 16,158 | 50,000 |
| 2023 | 35,534 | 14,466 | 50,000 |
| 2024 | 37,311 | 12,689 | 50,000 |
| 2025 | 39,176 | 10,824 | 50,000 |
| 2026-2029 | 177,298 | 22,702 | 200,000 |
| Totals | $ 355,391 | $ 94,609 | $ 450,000 |

## X. CAPITAL ASSETS

* Need to separate right-to-use assets (leased assets) from other categories in cost and accumulated depreciation in the capital asset activity table.

## X. LONG-TERM LIABILITIES

***** Need to add a row to the debt schedule for leases payable

### From the 2020 GFOA General Purpose Disclosure Checklist - Lessee

If the government is a **lessee** in a lease contract, are following disclosures made, if applicable?

(1) General description of the lease? This would include any variable payments or residual value guarantees not included in the lease liability.

(2) Total amount of underlying lease assets by major classes and the related accumulated depreciation?

(3) Total amount of payments made for variable and other payments (i.e. residual value guarantees, termination penalties) not included in the lease liability?

(4) Principal and interest payments to be made, presented separately, for each of the next five years individually and in five-year increments thereafter?

(5) Any commitments under leases before the lease term commences?

(6) Any impairment losses and any related change in lease liability?

(7) If the government lessee subleases the underlying asset, is a description of the sublease included in the general description of the lease? (Note: the lessor transactions should be disclosed separately from lessee transactions).

(8) If the government is a seller-lessee in a sales lease back transaction, has the government disclosed the terms and conditions of sale-leaseback, in addition to items 1-6 above?

(9) If the government is in a lease-leaseback transaction, has the government disclosed the amounts of the lease and the leaseback separately in the notes to financial statements?

**Ice Cream School District**
**Cell Tower Leases**
**June 30, 2021**

| Location | Lease | Lease Start | Term (Yrs.) | Annual Payment | Term Increases | Year Ending June 30, 2017 | 2018 | 2019 | 2020 | 2021 |
|---|---|---|---|---|---|---|---|---|---|---|
| **Terminated in 2021:** | | | | | | | | | | |
| Vanilla Elementary School | Sprint 1 | 10/1/2017 | 4 + 4 | 10,000 | 10% | - | 10,000 | 10,000 | 10,000 | 10,000 |
| **Continuing in 2021:** | | | | | | | | | | |
| Cookie Dough Elementary School | Verizon 1 | 8/1/2016 | 5 + 5 | 18,000 | 15% | 18,000 | 18,000 | 18,000 | 18,000 | 18,000 |
| Chocolate Swirl Elementary School | T-Mobile 1 | 6/30/2018 | 5 | 12,000 | | - | 12,000 | 12,000 | 12,000 | 12,000 |
| Rocky Road Middle School | AT&T 1 | 10/1/2018 | 4 + 4 + 4 | 15,000 | 10% | - | - | 15,000 | 15,000 | 15,000 |
| Mint Chocolate Chip High School | Verizon 2 | 10/31/2018 | 5 + 5 | 18,000 | 15% | - | - | 18,000 | 18,000 | 18,000 |
| Maple Nut District Offices | Sprint 2 | 8/1/2019 | 4 + 4 | 10,000 | 10% | - | - | - | 10,000 | 10,000 |
| Coconut Joy High School | Verizon 3 | 3/1/2020 | 5 + 5 | 9,000 | 15% | - | - | - | 9,000 | 9,000 |
| **New in 2021:** | | | | | | | | | | |
| Neapolitan High School | Vivint 1 | 4/1/2021 | 4 | 12,000 | | - | - | - | - | 12,000 |
| **Totals at 6/30/2020** | | | | | | | | | **92,000** | **92,000** |
| **Totals at 6/30/2021** | | | | | | | | | | **94,000** |

| **Estimated Method of Accounting for Cell Tower Leases Using NPV:** | Dr. | Cr. |
|---|---|---|
| **Balances at 6/30/2020:** | | |
| Asset - Leases Receivable | 572,198 | |
| Deferred Inflow of Resources - Related to Leases | | (572,198) |
| **Transaction in 2021:** | | |
| Asset - Leases Receivable | | (75,740) |
| Deferred Inflow of Resources - Related to Leases | 75,740 | |
| Asset - Cash | 104,000 | |
| Revenue - Interest (1510) | | (22,888) |
| Revenue - Leases (1910) | | (81,112) |
| **Balances at 6/30/2021:** | | |
| Asset - Leases Receivable | 496,458 | |
| Deferred Inflow of Resources - Related to Leases | | (496,458) |

## Sample Disclosures - Lessor

Note 1 – Summary of Significant Accounting Policies

**Leases** – The District is a lessor for noncancelable leases of cell tower sites. The District recognizes a lease receivable and a deferred inflow of resources in the government-wide and governmental fund financial statements.

At the commencement of the leases, the District 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 of 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 of resources is recognized as revenue over the life of the lease term.

Key estimates and judgements include how the District determines (a) the discount rate it uses to discount the expected lease receipts to present value, (b) lease term, and (c) lease receipts.

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

The District monitors changes in the circumstances that would require a remeasurement of its leases 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.

**X. LEASE RECEIVABLE**

The District leases sites to third parties for cell tower operations under lease terms ranging from 4 to 12 years. The district will receive annual payments ranging from $9,000 to $18,000. For the year ended June 30, 2021, the District recognized lease revenue of $81,112 and interest revenue of $22,888. At June 30, 2021, the District reports a lease receivable and an equal deferred inflow of resources related to leases of $496,458.

**From the 2020 GFOA General Purpose Disclosure Checklist - Lessor**

If the government is a **lessor** in a lease contract, are following disclosures made, if applicable?

(1) General description of the lease? This would include any variable payments or residual value guarantees not included in the lease receivable.

(2) Total amount received, principal and interest, from leases, if the amount cannot be determined from the financial statements.

(3) Total amount of payments received for variable and other payments (i.e. residual value guarantees, termination penalties) not included in the lease receivable?

(4) The 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?

(5) If leasing is one of the government's principal operations, has it disclosed principal and interest to be received, presented separately, for each of the next five years individually and in five-year increments thereafter?

(6) If the government is leasing an asset reported as investment, did it only disclosure item 4 above?

(7) If the government lessee subleases the underlying asset, did it make the disclosures listed above for government lessor? (Note: the lessor transactions should be disclosed separately from lessee transactions).

(8) If the government is a seller-lessee in a sales lease back transaction, has the government disclosed the terms and conditions of sale-leaseback, in addition to items 1-6 above?

(9) If the government is in a lease-leaseback transaction, has the government disclosed the amounts of the lease and the leaseback separately in the notes to financial statements?

Recommendation for Utah School Districts:

- Compile lease contracts and information. Identify lease terms, payments, initial direct costs (ancillary charges necessary to place an asset into service; does not include debt issuance costs), and lease incentives.
- Implement the new standard by July 1, 2021. (If comparative information is desired for the MD&A or individual fund financial statements, begin to measure leases under the new standard on July 1, 2020.)
- For leases financed with general governmental resources, governmental funds will reflect the amount of the lease asset as an expenditure and other financing source. *Accordingly, the budget should also reflect these amounts.*
- In governmental fund financial statements, lease receivables and deferred inflows of resources are recorded by the lessor.
- Disclose lease assets and related accumulated amortization (by major classes of underlying assets) separately from other capital assets.
- Disclose the principal and interest components of lease liabilities separately from other long-term liabilities for each of the next five years and in five-year increments thereafter.