OFFICE OF THE NEW YORK STATE COMPTROLLER

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To: **Chief Fiscal Officers**

From: **Division of Local Government and School Accountability**

Subject: **Accounting and Financial Reporting for Leases as Required by GASB Statement No. 87**

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Purpose of Bulletin

The purpose of this bulletin is to provide accounting and financial reporting guidance for contracts that meet the definition of a lease and illustrate how local governments and school districts will need to account for and report these leases in the Annual Update Document (AUD) and the ST-3. More specifically, this bulletin will address the following:

- An overview of lease accounting.
- Calculations needed for lessees and lessors to measure leases.
- Accounting and reporting requirements for leases in the AUD and ST-3, for both governmental and proprietary funds.
- Lease contracts with multiple components and contract combinations.
- Lease modifications and terminations.
- Necessary disclosures in the notes to the financial statements, including the notes to the AUD.
- Lease variations.

It is important to note the accounting guidance covered in this bulletin is only for contracts which meet the definition of a lease. Please see our December 2020 Accounting Bulletin, *Lease Classification Changes as Required by GASB Statement No. 87*, for guidance on how to determine whether a contract meets the new lease definition and how to calculate the lease term.

Background

The Governmental Accounting Standards Board (GASB) issued Statement No. 87, Leases (Statement 87) to establish a single leasing model for accounting and reporting purposes. This guidance is intended to enhance the accountability, consistency and comparability of lease activities reported by governments.

Applicability in New York State

Statement 87 applies to all local governments, school districts and Boards of Cooperative Educational Services (BOCES) in New York State (NYS).

For local governments, school districts and BOCES that prepare annual financial statements in accordance with generally accepted accounting principles (GAAP), Statement 87 reporting requirements are effective for fiscal years beginning after June 15, 2021.[1] Local governments that do not complete GAAP-compliant financial statements must implement these new standards for AUD reporting purposes.

For the purposes of the AUD reporting, local governments with a fiscal year beginning after June 15, 2021 will be the first units required to file using the requirements set forth in this bulletin. School districts will be required to file the 2021-2022 fiscal year ST-3 using the requirements set forth in this bulletin. All other annual financial reports that are required to follow the Office of the State Comptroller's uniform system of accounts will also be required to file using the requirements of this statement for fiscal years beginning after June 15, 2021.

Changes in accounting of leases set forth in this bulletin should be applied retroactively by restating financial statements, if practicable, for all prior periods presented. If restating prior periods is not practicable, the cumulative effect of applying these changes should be reported as a restatement of beginning net position or fund balance.

Overview of Lease Accounting

The fundamental principle of Statement 87 is that leases are financings of the right to use an underlying asset. This statement eliminates the capital lease and operating lease classifications. For many lessors and lessees with capital leases, the accounting will, for the most part, remain the same. For those with operating leases, the accounting will significantly change. Operating leases previously only consisted of an inflow and outflow of resources. Information was not readily available in the financial statements displaying the long-term impact of the lease. Capital leases, however, were required to be accounted for as if they were acquisitions financed by debt. Statement 87 requires all contracts meeting the GASB's definition of a lease[2] to be accounted for the same way. In governmental funds, the accounting will be similar to capital leases under the previous leasing model. The lessee will recognize an expenditure and other financing source for the present value of all future lease payments at the commencement of the lease. The intangible right-to-use lease asset (lease asset) will be recorded in the schedule of non-current governmental assets and the outstanding liability of future lease payments will be recorded in the schedule of non-current governmental liabilities. Then subsequent payments are made like debt service payments by recording an expenditure for principal and interest equaling the lease payment within the fund and reducing the liability by the principal payment amount in the schedule of non-current governmental liabilities.

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[1] The effective date of this Statement was postponed by the issuance of GASB Statement No. 95, Postponement of the Effective Dates of Certain Authoritative Guidance.

[2] Exceptions include short-term leases, leases of assets held as investments, certain regulated leases, and leases that transfer ownership of the underlying asset.

In proprietary funds, the lessee will recognize a lease liability and a lease asset (capital asset) at the commencement of the lease. The lease liability will be reduced over time as payments are made, similar to most home mortgages. The lease asset will be amortized in a systematic and rational manner.[3]

For both governmental and proprietary funds, the lessor will recognize a lease receivable and deferred inflow of resources. As lease payments are received, the lease receivable will be reduced, and the deferred inflow of resources will be recognized as revenues. Proprietary funds will continue to depreciate the leased asset and accrue interest on lease payments.

Short-Term Leases

If a local government or school district determines a contract is a short-term lease[4] and is the lessee, they will recognize payments as expenditures or expenses based on the provisions of the lease contract. These expenditures should be charged to the functional unit the short-term lease is related to. For example, if a town leases space short-term for the assessor's office, it would be charged to A1355.4 Assessment Contractual Expenditures. If payments are made in advance, the lessee should recognize an asset (prepaid expenditure). If payments are due and will be paid in a subsequent reporting period, the lessee should report a liability.

If the local government or school district is the lessor, they will recognize payments as revenues when they are received, based on the provisions of the lease contract. These revenues should be recorded in the pre-existing rental revenue account codes. Payments received early should be recorded as a liability (688 Other Liabilities). If payments are due but will be received in a subsequent reporting period, the lessor should report an asset.

Contracts that Transfer Ownership

If a contract transfers ownership of the underlying asset to the lessee at the end of the term and does not contain termination options, it should be accounted for in accordance with our December 2015 accounting bulletin, *Installment Purchase Contracts*.

Lessee Calculations

Lease Liability

If the local government or school district is the lessee in a contract, they will need to calculate the lease liability at the commencement of the lease term. The lease liability equals the present value of the payments expected to be made during the lease term, as shown in the following graphic:

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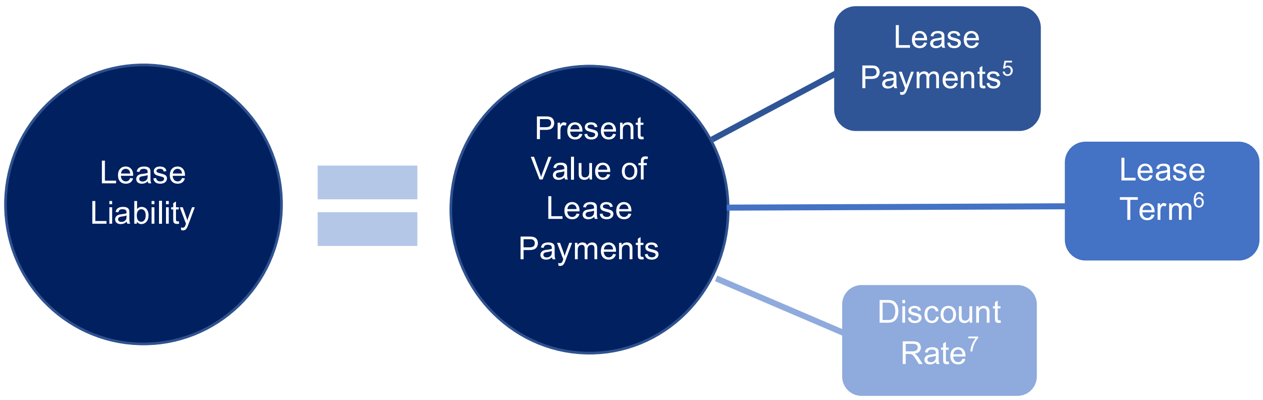
[3] This does not necessarily mean the same amount must be amortized in each period. The amortization method must be logical, consistently applied, and objective and acceptable to another unbiased accountant.
[4] See our December 2020 Accounting Bulletin, *Lease Classification Changes as Required by GASB Statement No. 87*, for information on short-term leases.



An example of how to calculate the present value of the payments expected to be made during a lease term can be found in Appendix B.

Lease Asset

In addition to the lease liability, the lessee will also need to calculate the lease asset at or before the commencement of the lease term. This is equal to the amount of the lease liability calculated previously plus:

1. Lease payments made to the lessor at or before the commencement of the lease term, less any lease incentives.[8] For example, the lessee pays $10,000 prior to the start of the lease as a down payment to lower the amount of future lease payments.
2. Initial direct costs that are ancillary charges necessary to place the lease asset into service. For example, the lessee pays the lessor $2,000 for delivery and installation of the equipment being leased.

Remeasurement

The lessee should remeasure the lease liability at subsequent reporting dates if one or more of the following changes have occurred at or before the financial reporting date and the changes individually or in the aggregate are expected to significantly affect the amount of the lease liability since the previous measurement:

- A change in the lease term.
- A residual value guarantee being paid has changed from reasonably certain to not reasonably certain, or vice versa.
- A purchase option being exercised has changed from reasonably certain to not reasonably certain, or vice versa.

[5] See Appendix A for a breakdown of the lease payments that should be included in the lease liability.
[6] Please see pg. 3 of our December 2020 Accounting Bulletin, *Lease Classification Changes as Required by GASB Statement No. 87*, for the definition of "lease term."
[7] Paragraph 23 of Statement 87 states, "The future 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." This rate will vary depending on the lessee's credit rating as well as the asset type, commencement date and term of the lease.
[8] Lease incentives are (a) 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 (b) other concessions granted to the lessee.

- A change in the estimated amounts for payments already included in the measurement of the lease liability.
- A change in the interest rate the lessor charges the lessee,[9] if used as the initial discount rate.
- A contingency, upon which some or all of the variable payments that will be made over the remainder of the lease term are based, is resolved and those payments now meet the criteria for measuring the lease liability.

If a lease is remeasured due to any of the above changes in the lease contract, the liability should also be adjusted for any change in an index or rate used to determine variable payments if the change is expected to significantly affect the liability. However, a change in this index or rate by itself is **not** sufficient to cause a lease liability to be remeasured.

The discount rate used should also be updated as a part of the remeasurement if the lease term changes or if the likelihood of a purchase option being exercised has changed from reasonably certain to not reasonably certain, or vice versa. This new discount rate should be based on the revised interest rate the lessor charges the lessee. If this is not available, the lessee's estimated incremental borrowing rate should be used during remeasurement.

The lease asset will generally be adjusted by the same amount as the lease liability.

Lessor Calculations

Lease Receivable

If the local government or school district is the lessor in a contract, they will need to calculate the lease receivable at the commencement of the lease term. Similar to the lease liability, the lease receivable[10] equals the present value of the payments expected to be received during the lease term,[11] reduced by any provision for estimated uncollectible amounts.

Deferred Inflow of Resources

In addition to the lease receivable, the lessor will also need to calculate the deferred inflow of resources at the commencement of the lease term. This is equal to the amount of the lease receivable plus any lease payments related to future periods (e.g., last month's rent), less any lease incentives paid to, or on behalf of, the lessee at or before the commencement of the lease term.

Remeasurement

The lessor should remeasure the lease receivable at subsequent reporting dates if one or more of the following changes have occurred at or before the financial reporting date and the changes individually or in the aggregate are expected to significantly affect the amount of the lease receivable since the previous measurement:

- Change in lease term.
- A change in the interest rate the lessor charges the lessee.

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[9] A change in the incremental borrowing rate alone is not enough to warrant remeasurement.

[10] See Appendix A for a breakdown of the lease payments that should be included in the lease receivable.

[11] The future lease receipts should be discounted using the interest rate the lessor charges the lessee, which may be the interest rate implicit in the lease. Lessors are **not** required to apply the guidance in GASB Statement No. 62 paragraphs 173-187 to calculate of an interest rate but may do so as a means of determining the implicit interest rate.

- A contingency, upon which some or all of the variable payments that will be made over the remainder of the lease term are based, is resolved and those payments now meet the criteria for measuring the lease receivable.

If a lease is remeasured due to any of the above changes in the lease contract, the receivable should also be adjusted for any change in an index or rate used to determine variable payments if the change is expected to significantly affect the receivable. However, a change in this index or rate by itself is **not** sufficient to cause a lease receivable to be remeasured.

The discount rate used should also be updated as a part of the remeasurement if the lease term changes or if there is a change in the interest rate the lessor charges the lessee. This new discount rate should be based on the revised interest rate the lessor charges the lessee.

Lessee Accounting and Reporting for the AUD and ST-3

Governmental Funds

When a local government or school district is the lessee and accounts for lease transactions in governmental funds, it will recognize an expenditure and other financing source, in the amount of the lease liability (as calculated using previous information), at the commencement of the lease. The expenditure will be recorded in pre-existing account codes and the other financing source will be reported in new account code **5788 – Leases**. Non-lease components, such as costs to place the asset into service, insurance and services provided, should be recorded as expenditures using pre-existing account codes. The asset being leased should be added to the schedule of non-current capital assets in the appropriate asset class. The lease liability should be recorded in new account code **W682 – Lease Liability,** in the schedule of non-current governmental liabilities. The lease asset should be recorded in the schedule of non-current governmental assets using one of the new account codes listed in Appendix C.

The lease payments should be amortized using the lease liability and interest rate stated in the lease contract, or the estimated incremental borrowing rate used by the lessee.

The lease payments will be reported using new account codes **9788.6 – Leases, Principal** and **9788.7 – Leases, Interest**.

Sample governmental fund journal entries to assist local governments and school districts implement Statement 87 with respect to being a lessee can be found in Appendix D of this bulletin.

Proprietary Funds

When a local government is the lessee and accounts for lease transactions in a proprietary fund, it will recognize a lease liability and lease asset (as calculated using previous information) at the commencement of the lease. Please see Appendix C for the new asset, accumulated amortization, liability and amortization expense codes available in the proprietary funds for AUD reporting.

Statement 87 also requires the lease asset to be amortized in a systematic and rational manner[12] over the shorter of the lease term or the useful life of the underlying asset. To determine the useful life of an asset, the OGS Capital Asset Policy and Procedures Manual may be referenced,

[12] This does not necessarily mean the same amount must be amortized in each period. The amortization method must be logical, consistently applied, and objective and acceptable to another unbiased accountant.

specifically Appendix E: Capital Asset Profile IDs. Local governments have discretion to choose an amortization method they deem acceptable. This may result in different amounts being amortized in each period. However, we expect most local governments and school districts will choose to use the straight-line method, which will result in the same amount being amortized each period of the lease term.

Sample proprietary fund journal entries to assist local governments implement Statement 87 with respect to being a lessee can be found in Appendix E of this bulletin.

Lessor Accounting and Reporting for the AUD and ST-3

Governmental Funds

When a local government or school district is the lessor and accounts for lease transactions in governmental funds, it will recognize a lease receivable and deferred inflow of resources, (calculated using previous information) at the commencement of the lease. The lease receivable will be reported in new account code **454 – Leases Receivable**.

When lease payments are received, the lessor will reduce the lease receivable by the principal amount received. The deferred inflow of resources will be recognized as a current period revenue using new account code **2421 – Lease Payments Collected**. This recognition should happen in a systematic and rational manner over the lease term. Similar to the amortization expense for proprietary funds mentioned previously, local governments and school districts have discretion in which method they can use to recognize the deferred inflow of resources as current period revenue. We, however, expect that most local governments and school districts will choose to use the straight-line method.

Sample governmental fund journal entries to assist local governments and school districts implement Statement 87 with respect to being a lessor can be found in Appendix F of this bulletin.

Proprietary Funds

A local government acting as the lessor and accounting for the transaction in a proprietary fund will account for the lease the same as in governmental funds with two key differences:

- The lessor should continue to recognize and depreciate the capital assets as they were before the lease. The lessor will only stop depreciating the asset during a lease when the lease contract requires the lessee to return the asset in its original or enhanced condition.
- The lessor will recognize accrued interest receivable and interest income at the end of each fiscal year for the subsequent fiscal year, instead of the period in which they receive the lease payment.

Sample proprietary fund journal entries to assist local governments implement Statement 87 with respect to being a lessor can be found in Appendix G of this bulletin.

Contracts with Multiple Components and Contract Combinations

Local governments and school districts may enter into contracts containing multiple components, including a lease component and a non-lease component or a contract with multiple underlying assets. For contracts with multiple components, each component should be accounted for separately. For example, if a contract includes the leasing of a building and maintenance services for the building, these two components should be accounted for separately. Leases for multiple underlying assets with different lease terms or belonging to different major asset classes should also be accounted for separately.

Additionally, local governments and school districts should treat contracts entered into at or near the same time as a single contract if either of the following criteria is met:

- The contracts are negotiated as a package with a single objective.
- The amount of consideration to be paid in one contract is dependent on the price or performance of the other contract.

To allocate the price to each separate component, any stated prices within the contract, if available, should be used if it does not appear unreasonable based on the terms of the contract and professional judgment. If components of the contract were discounted because they are bundled, the discount may be applied if it does not appear unreasonable. If the price for each component is not explicitly stated in the contract, or if the prices appear to be unreasonable, then professional judgment, along with any observable information,[13] should be used to estimate the allocation price of each component within the contract.

If the local government or school district is unable to practicably determine the best estimate for multiple components within the contract, the components should be accounted for as a single lease. If contracts are combined into a single lease, the accounting for that lease should be based on the terms of the primary lease component.

Lease Modifications and Terminations

A lease amendment during the reporting period should be considered a new lease (by both the lessee and lessor) if both of the following conditions are present:

- The lessee receives an additional lease asset by adding one or more underlying assets which were not included in the original lease contract, and
- The increase in payments for the additional lease asset does not appear unreasonable based on the terms of the amended contract and professional judgment.

If the lease is amended, but does not meet the above conditions, the modification will be accounted for by remeasurement. Lessees will remeasure the lease liability, and the lease asset will be adjusted by the difference between the remeasured liability and the liability immediately before remeasurement. Lessors will remeasure the lease receivable, and the deferred inflow of resources will be adjusted by the difference between the remeasured receivable and the receivable immediately before remeasurement.

If the provisions of a lease contract change because of a debt refunding by the lessor, including an advance refunding that results in a defeasance of debt, the lessee and lessor should adjust the lease liability, lease receivable and deferred inflow of resources to the present value of the future lease payments in accordance with the revised contract. The lessee will report the difference as a deferred outflow or inflow of resources that will be recognized as an adjustment to an outflow of resources (for example, an increase or decrease to interest expense) in a systematic and rational manner over the remaining life of the old debt or the life of the new debt, whichever is shorter. The lessor's adjustment to the deferred inflow of resources should be

[13] Observable information could include using stand-alone prices, which are the prices that would be paid if the assets were leased or bought separately.

recognized as inflows or outflows of resources (e.g., gain or loss) over the remaining life of the old debt or the life of the new debt, whichever is shorter.

If the provisions of a lease contract change in connection to an advance refunding by the lessor that results in defeasance of debt and the lessee is obligated to reimburse the lessor for any costs related to the refunded debt (e.g., unamortized discount or call premium), the lessee should recognize those costs in a systematic and rational manner over the remaining life of the old debt or the life of the new debt, whichever is shorter. The lessor should systematically recognize, as inflows of resources, any reimbursements received from the lessee for costs related to the refunded debt over the remaining useful life of the old debt or the life of the new debt, whichever is shorter.

If a lease amendment during the reporting period decreases the lessee's right to use the underlying asset, it should be accounted for as a partial or full lease termination. Lessees should generally account for this by reducing the carrying value of the lease asset and lease liability, recognizing a gain or loss for the difference. Lessors should generally account for this by reducing the carrying value of the lease receivable and related deferred inflow of resources, recognizing a gain or loss for the difference.

If the lease is terminated due to the lessee purchasing the underlying asset, the lessee should reclassify the lease asset to the appropriate class of owned assets. The lessor will derecognize the asset and recognize any gain or loss.

Notes to the Financial Statements (Including the AUD)

Lessee

The lessee should disclose the following:

- A general description of its leasing arrangements, including:
    - The basis, terms and conditions on which variable payments not included in the measurement of the lease liability are determined.
    - The existence, terms and conditions of residual value guarantees provided by the lessee not included in the measurement of the lease liability.
- The total amount of lease assets (by major class), and the related accumulated amortization. These assets should be disclosed separately from other capital assets.
- The amount of lease assets by major classes of underlying assets, disclosed separately from other capital assets.
- The amount of outflows of resources recognized in the reporting period for variable payments not previously included in the measurement of the lease liability.
- The amount of 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 the leases (before the commencement of the lease term).
- The components of any net impairment loss recognized on the lease asset during the period.

- Relevant disclosures for:
    - Sublease transactions
    - Sale-leaseback transactions
    - Lease-leaseback transactions.

It should be noted that collateral pledged as a security for a lease (per paragraph 113 of GASB Statement No. 62) is **not** required to be disclosed if that collateral is solely the asset underlying the lease.

Lessor

The lessor should disclose the following:

- A 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.
- The total amount of inflows of resources recognized in the reporting period from leases, if that amount cannot be determined based on the amounts displayed on the face of the financial statements.
- The amount of inflows of resources recognized in the reporting period for variable and other payments not previously included in the measurement of the lease receivable, including inflows of resources related to residual value guarantees and termination penalties.
- The existence, terms and conditions of options by the lessee to terminate the lease or abate payments if the lessor has issued debt for which the principal and interest payments are secured by the lease payments.
- Relevant disclosures for:
    - Leases of assets that are investments
    - Certain regulated leases that meet the criteria of paragraph 43 of the Statement (which may include agreements between air carriers and airports)
    - Sublease transactions
    - Sale-leaseback transactions
    - Lease-leaseback transactions.

Other Lease Transactions The majority of this bulletin focused on the basics of lessee/lessor accounting under Statement 87. Additional analysis will be required for subleases, sale-leasebacks, lease-leasebacks, intra-entity leases, and leases between related parties. These transactions are briefly outlined in Appendix H and Statement 87 provides specific guidance on the treatment of these types of transactions.

Additional Information

GASB prepared the following Implementation Guides to clarify, explain and elaborate on the requirements of Statement 87:

- Implementation Guide No. 2019-3, Leases
- Implementation Guide No. 2020-1, Implementation Guidance Update - 2020
- Implementation Guide No. 2021-1, Implementation Guidance Update - 2021

These guides address many specific examples which local governments and school districts may find helpful in when categorizing, accounting and reporting for leases.

If you have questions pertaining to the accounting guidance described in this bulletin, please contact the State Comptroller's regional office that serves your local government.

Appendix A – Payments to Include in the Lease Calculations

Payment Types	Definitions and Examples	Include in Lease Liability Calculation	Include in Lease Receivable Calculation
Fixed Payments.	Contractually fixed and not subject to any variability.	✓	✓
Variable payments that depend on an index or a rate.	Payments are based on set common rates or an index, such as the Consumer Price Index or a market interest rate. These are initially measured using the rate at the commencement of the lease.	✓	✓
Variable payments that are fixed in substance. Variable payments based on future performance or usage of the underlying asset, however, are not included.	If there is a component of variable payments that is fixed in substance, that amount should be included. For example, a contract for a vehicle states you will be charged $.50 per mile driven or $500 a month, whichever is greater. The minimum payment of $500 is a fixed-in-substance payment while the $.50 per mile is based on usage, and therefore, not included.	✓	✓
Amounts reasonably certain of being required to be paid by the lessee under residual value guarantees.	A residual value guarantee is a guarantee made by the lessee to the lessor that the value of the underlying asset will be at least a specific amount at the end of the lease.	✓	✓
The exercise price of a purchase option if it is reasonably certain that the lessee will exercise that option.	A town, for example, enters into a five-year lease agreement for a vehicle with a purchase option of $10,000 at the end of the lease. The town is reasonably certain that they will purchase the vehicle, so $10,000 should be included in the lease payment calculation.	✓	
Payments for penalties for lease termination if it's reasonably certain that the lessee will exercise that option.	If the lease term reflects a lessee exercising (1) an option to terminate the lease or (2) a fiscal funding or cancellation clause, then any penalty associated with that termination option should be included in the lease payments.	✓	
Lease incentives **receivable** from the lessor (for lease liability calculation) OR **payable** to the lessee (for lease receivable calculation).	These are equivalent to a rebate or discount and may include assumption of a lessee's preexisting lease obligations, rent holidays, other reimbursements of lessee costs, and reductions of interest or principal charges by the lessor.	✓	✓
Other payments that are reasonably certain of being required based on an assessment of all factors.		✓	

Appendix B – Example of Present Value of Lease Payments

The following example is intended to demonstrate how to calculate the present value of the payments expected to be made during a lease term. This example assumes a present value calculator is used to compute the present value.

A county enters into a contract to lease a fleet of vehicles. The contract states the term is five years, with monthly payments of $1,500 due the first of every month. The lessor did not provide an interest rate, so the county uses their estimated incremental rate of 5%.

To calculate the present value, the following must be known: the interest rate, number of payments, monthly payment, future value, and whether payments are made at the beginning or end of the period.

<u>Using the information from above:</u>

- Rate: 5%/12 months = .004167
- Number of payments: 5 years x 12 months = 60 payments
- Monthly payment = $1,500
- Future value[14] = $0
- Payments are due the first of every month

Inputting each of these items into a present value calculator, the present value of the lease payments in this example is $79,817.25. Under Statement 87, this would also be the total amount of the lease liability.

[14] When determining the present value of lease payments, the future value will always be zero.

Appendix C – New AUD Account Codes

Governmental Funds[15]

Account Code	Account Name
454	Leases Receivable
2421	Lease Payments Collected
5788	Leases
9788.6	Leases, Principal
9788.7	Leases, Interest

Enterprise Funds

Account Code	Account Name
121	Intangible Lease Asset – Land
122	Intangible Lease Asset – Buildings
124	Intangible Lease Asset – Machinery and Equipment
127	Intangible Lease Asset – Other
131	Accumulated Amortization, Intangible Lease Asset – Land[16]
132	Accumulated Amortization, Intangible Lease Asset – Buildings
134	Accumulated Amortization, Intangible Lease Asset – Machinery and Equipment
137	Accumulated Amortization, Intangible Lease Asset – Other
682	Lease Liability
1996.4	Amortization
9788.7	Leases, Interest

Statement of Non-Current Governmental Assets and Liabilities

Account Code	Account Name
K121	Intangible Lease Asset – Land
K122	Intangible Lease Asset – Buildings
K124	Intangible Lease Asset – Machinery and Equipment
K127	Intangible Lease Asset – Other
K132	Accumulated Amortization, Intangible Lease Asset – Buildings
K134	Accumulated Amortization, Intangible Lease Asset – Machinery and Equipment
K137	Accumulated Amortization, Intangible Lease Asset – Other
W682	Lease Liability

[15] Active in all governmental funds except the debt service fund.
[16] If a lessee is reasonably certain a purchase option will be exercised in a lease in which the underlying asset is non-depreciable, the asset should not be amortized.

Appendix D – Sample Journal Entries

Lessee – Governmental Funds

The following sample journal entries are intended to demonstrate how Statement 87 affects the individual governmental fund financial statements filed by a local government as part of its AUD. These sample journal entries are based on the following assumptions:

- Village "A" enters into a contract to lease 10 police cars for five years.
- Village "A" will make annual payments of $20,000 starting at the commencement of the lease.
- The lessor charges an annual interest rate of 5%.
- The present value of these payments (using a present value calculator) equals $90,919.

The amortization table below shows the amount allocated to principal and interest for each payment during the lease term.

Amortization of Lease Payments

Interest Rate 5%				Outstanding Balance
Year	**Principal**	**Interest**	**Total Payment**	$90,919
1	$20,000	$0	$20,000	$70,919
2	$16,454	$3,546	$20,000	$54,465
3	$17,277	$2,723	$20,000	$37,188
4	$18,141	$1,859	$20,000	$19,048
5	$19,048	$952	$20,000	$0

1) To record the capital outlay and other financial source at the commencement of the lease.

Account	Debit	Credit
A3120.2 Police, Equip & Cap Outlay	$90,919	
A5788 Leases		$90,919

2) To record the leased asset in the schedule of non-current governmental assets and the present value of outstanding lease payments as a liability in the schedule of non-current governmental liabilities:

Account	Debit	Credit
K124 Intangible Lease Asset - Machinery and Equipment	$90,919	
K129 Total Non-Current Governmental Assets		$90,919
W129 Total Non-Current Governmental Liabilities	$90,919	
W682 Lease Liability		$90,919

3) To record the first lease payment at the commencement of the lease[17]:		
Account	**Debit**	**Credit**
A9788.6 Leases, Principal	$20,000	
A200 Cash		$20,000

4) To reduce the outstanding liability in the schedule of non-current governmental liabilities by the amount of principal paid:		
Account	**Debit**	**Credit**
W682 Lease Liability	$20,000	
W129 Total Non-Current Governmental Liabilities		$20,000

5) To record the lease payment in Year Two:		
Account	**Debit**	**Credit**
A9788.6 Leases, Principal	$16,454	
A9788.7 Leases, Interest	$ 3,546	
A200 Cash		$20,000

6) To reduce the outstanding liability in the schedule of non-current governmental liabilities by the amount of principal paid:		
Account	**Debit**	**Credit**
W682 Lease Liability	$16,454	
W129 Total Non-Current Governmental Liabilities		$16,454

Entries five and six would be made each subsequent year based on the amortized lease payment amounts until the end of the lease term.

[17] Lease payments due at the commencement of the lease **do not** include interest, and, therefore, principal is reduced by the full lease payment.

Appendix E – Sample Journal Entries

Lessee – Proprietary Funds

The following sample journal entries are intended to demonstrate how Statement 87 affects the individual proprietary fund financial statements filed by a local government as part of its AUD. These sample journal entries are based on the following assumptions:

- Village "B" enters a contract to lease 10 vehicles for its water fund (an enterprise fund) for five years.
- Village "B" will make annual payments of $20,000 starting at the commencement of the lease.
- The lessor charges an annual interest rate of 5%.
- The present value of these payments (using a present value calculator) equals $90,919.

The amortization table below calculates the annual amortization expense using the straight-line method.

Amortization of the Lease Asset

Year	Amount
1	$18,184
2	$18,184
3	$18,184
4	$18,184
5	$18,184

1) To record the lease asset and lease liability at the commencement of the lease.

Account	Debit	Credit
EW124 Intangible Lease Asset – Machinery and Equipment	$90,919	
EW682 Lease Liability		$90,919

2) To record the lease payment made at the commencement of the lease.

Account	Debit	Credit
EW682 Lease Liability	$20,000	
EW200 Cash		$20,000

3) To record the amortization of the lease asset and accrual of interest payable at the end of Year One:

Account	Debit	Credit
EW1996.4 Amortization	$18,184	
EW9788.7 Leases, Interest	$3,546	
EW134 Accumulated Amortization, Intangible Lease Asset - Machinery and Equipment		$18,184
EW651 Accrued Interest Payable		$3,546

4) To record the lease payment made at the start of year two:		
Account	**Debit**	**Credit**
EW682 Lease Liability EW651 Accrued Interest Payable EW200 Cash	$16,454 $3,546	 $20,000

Entries three and four would be made in each subsequent year, based on the amounts in the lease payment and lease asset amortization tables, until the end of the lease term.

Appendix F – Sample Journal Entries

Lessor – Governmental Funds

The following sample journal entries are intended to demonstrate how Statement 87 affects the individual governmental fund financial statements filed by a local government as part of its AUD. These sample journal entries are based on the following assumptions:

- Town "C" enters into a contract to lease office space for three years.
- Town "C" will receive monthly payments of $3,000 at the end of each month.
- Town "C" charges an annual interest rate of 4%.
- The present value of these payments (using a present value calculator) equals $101,612.

The amortization table below shows the amount allocated to principal and interest for each payment during the lease term.

Amortization of Lease Receipts

Monthly Interest Rate .033% (4%/12 = monthly rate)				Outstanding Balance
Month	**Principal**	**Interest**	**Total Payment**	$101,612
1	$2,661	$339	$3,000	$98,951
2	$2,670	$330	$3,000	$96,281
3	$2,679	$321	$3,000	$93,602
4	$2,688	$312	$3,000	$90,914
5	$2,697	$303	$3,000	$88,217
6	$2,706	$294	$3,000	$85,511

Monthly Recognition of Deferred Inflow of Resources

($101,612 present value / 36 monthly payments)

Month	Amount
1	$2,823
2	$2,823
3	$2,823
4	$2,823
5	$2,823
6	$2,823

1) To recognize the lease receivable and deferred inflow of resources at the commencement of the lease.		
Account	**Debit**	**Credit**
A454 Leases Receivable	$101,612	
A691 Deferred Inflow of Resources		$101,612

2) To record the receipt of the first month's lease payment and recognize the deferred inflow of resources as revenue.		
Account	**Debit**	**Credit**
A200 Cash	$3,000	
A2401 Interest and Earnings		$339
A454 Leases Receivable		$2,661
A691 Deferred Inflow of Resources	$2,823	
A2421 Lease Payments Collected		$2,823

These entries would be made for all subsequent payments received for the term of the lease.

Appendix G – Sample Journal Entries

Lessor – Proprietary Funds

The following sample journal entries are intended to demonstrate how Statement 87 affects the individual proprietary fund financial statements filed by a local government as part of its AUD. These sample journal entries are based on the following assumptions:

- Town "D" enters into a contract to lease a building for three years. The building is reported in the sewer enterprise fund.
- Town "D" will receive monthly payments of $3,000 at the beginning of each month.
- Town "D" charges an annual interest rate of 4%.
- The present value of these payments (using a present value calculator) equals $101,951.
- The lessee is not required to return the building to the town in its original or enhanced condition. The town depreciates the building at $10,000 annually.

The amortization table below shows the amount allocated to principal and interest for each payment during the lease term.

Amortization of Lease Receipts

Monthly Interest Rate .033% (4%/12 = monthly rate)				Outstanding Balance
Month	**Principal**	**Interest**	**Total Payment**	$101,951
1	$3,000	$0	$3,000	$98,951
2	$2,670	$330	$3,000	$96,281
3	$2,679	$321	$3,000	$93,602
4	$2,688	$312	$3,000	$90,914
5	$2,697	$303	$3,000	$88,217
6	$2,706	$294	$3,000	$85,511

Monthly Recognition of Deferred Inflow of Resources

($101,951 present value / 36 monthly payments)

Month	Amount
1	$2,832
2	$2,832
3	$2,832
4	$2,832
5	$2,832
6	$2,832

1) To recognize the lease receivable and deferred inflow of resources at the commencement of the lease.		
Account	**Debit**	**Credit**
ES454 Leases Receivable	$101,951	
ES691 Deferred Inflow of Resources		$101,951

2) To record the receipt of the first month's lease payment and recognize the deferred inflow of resources as revenue.		
Account	**Debit**	**Credit**
ES200 Cash	$3,000	
ES454 Leases Receivable		$3,000
ES691 Deferred Inflow of Resources	$2,832	
ES2421 Lease Payments Collected		$2,832

3) To record the receipt of the second month's lease payment and recognize the deferred inflow of resources as revenue.		
Account	**Debit**	**Credit**
ES200 Cash	$3,000	
ES2401 Interest and Earnings		$330
ES454 Leases Receivable		$2,670
ES691 Deferred Inflow of Resources	$2,832	
ES2421 Lease Payments Collected		$2,832

These entries continue for the rest of the year based on the amortization of lease receipts.

4) At the end of the fiscal year, the town will record the annual depreciation of the building and accrue interest receivable for the last month of the year which will be received on the first day of the next fiscal year.		
Account	**Debit**	**Credit**
ES1994.4 Depreciation	$10,000	
ES112 Accumulated Depreciation, Buildings		$10,000
ES381 Accrued Interest Receivable	$230	
ES2401 Interest and Earnings		$230

5) To record the receipt of the lease payment in the second fiscal year and recognize the deferred inflow of resources as revenue.		
Account	**Debit**	**Credit**
ES200 Cash	$3,000	
ES381 Accrued Interest Receivable		$230
ES454 Leases Receivable		$2,770
ES691 Deferred Inflow of Resources	$2,832	
ES2421 Lease Payments Collected		$2,832

Appendix H – Other Lease Transactions

Subleases

A sublease transaction occurs when the lessee in a contract becomes the lessor in a new lease contract for the same underlying asset they are currently leasing. The lessor of the original contract will continue to apply the general lessor guidance discussed in this bulletin. The new lessor (original lessee) should account for both the original lease **and** the sublease as they are two separate transactions. These two transactions should **not** offset. The new lessee should apply the general lessee guidance starting on pg. 3 of this document.

The original lessee should include the sublease in its disclosure of the general description of lease arrangements. Its lessor transactions related to subleases should be disclosed separately from its lessee transactions related to the original lease.

Sale-Leaseback Transactions

A sale-leaseback transaction occurs when an underlying asset is sold[18] and the new owner leases the asset back to the original owner. In general, a sale-leaseback transaction will be accounted for as two separate transactions, a sale and a lease. However, the difference in carrying value of the capital asset sold and the net proceeds from the sale should be reported as a deferred inflow/outflow of resources and recognized 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 asset that was sold and the net proceeds from the sale should be recognized immediately.

A sale-leaseback transaction is considered to have off-market terms if there is a significant difference between either the sale price and estimated fair value of the asset, or the present value of lease payments and estimated present value of what lease payments would be at market price. The difference should be reported based on the substance of the transaction rather than as part of the sale-leaseback transaction.

A seller-lessee should disclose the terms and conditions of the sale-leaseback transactions in addition to the disclosures required of a lessee. A buyer-lessor should provide the disclosures required of a lessor.

Lease-Leaseback Transactions

A lease-leaseback transaction occurs when an asset is leased by one party (original lessor) to another party, then leased back to the original lessor. The leaseback may involve additional assets that were not included in the original lease (e.g., leasing a school building constructed by

[18] This must include a transaction that qualifies as a sale, as discussed in GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, paragraphs 287-319 and 321-323. If a qualifying sale does not occur, this transaction should be accounted for as a borrowing transaction by the seller-lessee and as a lending transaction by the buyer-lessor.

a developer on land owned by and leased back to a school district) or a portion of the original asset (e.g., leasing back only one floor of a building to the owner).

Lease-leaseback transactions should be accounted for as a net transaction because each part of the transaction is with the same counterparty. Both parties involved should disclose gross amounts of the lease and leaseback in notes to the financial statements.

Intra-Entity Leases

If a local government or school district enters into a lease as a blended component unit[19] (whether as a lessee or lessor), the reporting requirements of Statement 87 do not apply. If the blended component unit is the lessor, then the primary government will report the debt and assets of the lessor as if they were its own. Additionally, debt-service activity by the lessor would be reported by the primary government.

Leases with or between blended component units will require eliminations for internal leasing activity that must take place before the financial statements of the blended component unit are aggregated with the financial statements of the primary government. These transactions will be treated as regular leases, except related receivables and payables should be presented separately from all other receivable and payables (including any amounts due to/due from).

Leases Between Related Parties

Leases between related parties will be accounted for as if they were leases between unrelated parties unless it is **clear** the terms of the transaction have been significantly affected by the fact the lessee and lessor are related. In this case, the classification and accounting should be modified, as necessary, to recognize the substance of the transaction over the legal form. The nature and extent of these types of leasing transactions should be disclosed.

[19] Blended component units are defined in our 2012 Accounting Bulletin, *The Financial Reporting Entity – as Updated by GASB Statement* 61.