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GASB 87: Are You Ready for the Changes Coming to Lease Accounting?

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The Governmental Accounting Standards Board (GASB) Statement No. 87 issued in June 2017 revises existing standards for leases and establishes a single model for lease accounting. The revision is based on the principle that leases are financings of the right to use an underlying asset.

Under previous guidance, leases could be presented as either capital leases or operating leases. The new guidance will increase comparability and usefulness of information and reduce complexity for preparers. GASB 87 aligns with leasing standards issued by the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB), and it will be effective for reporting periods beginning after Dec. 15, 2019. Early application of the new standard is encouraged.



New definition of a lease

GASB 87 introduces the new definition of a lease as a contract that conveys control of the right to use another entity's nonfinancial asset (an underlying asset such as buildings, land, vehicles, or equipment) as specified by the contract for a period of time in an exchange or exchange-like transaction. Control requires both the right to obtain the present service capacity from use of the underlying asset and the right to determine the nature and manner of use of the underlying asset. Control is not limited to contracts that convey substantially all of the present service capacity from use of the underlying asset.

The standard does not apply to leases for the following:

- Intangible assets such as mineral rights, patents and software, and copyrights
- Biological assets such as timber, living plants, and animals
- Inventory
- Service concession arrangements
- Assets financed with outstanding conduit debt, unless both the asset and the conduit debt are reported by the lessor
- Supply contracts such as typical power purchase agreements

However, if an entity leases an asset and it creates an intangible right-to-use asset under the new standard, subsequent subleasing of that asset would require application of GASB 87.

The lease term starts with the noncancelable period, plus periods covered by options either to extend the lease if the option is reasonably certain of being exercised or to terminate the lease if that is reasonably certain. The lease term excludes cancelable periods, and fiscal funding or cancellation clauses are ignored unless it is reasonably certain they will be exercised.

A short-term lease is one that, at the beginning of the lease, has a maximum possible term under the contract of no more than 12 months, including any options to extend. For short-term leases, lessees recognize lease payments as expenses in their reporting and lessors treat lease payments as revenue.

Changes under GASB 87

GASB 87 affects how lessees and lessors account for and report leases in their financial statements. The following exhibit provides a brief overview of the approaches for leases under the new standard:

Leases under GASB 87: an overview

	Lessees	Lessors
Recognition and measurement	<ul style="list-style-type: none"> • Recognize a lease liability for future lease payments and an intangible capital asset for the right to use the underlying asset • Report payables when due • Do not report capital assets 	<ul style="list-style-type: none"> • Recognize a lease receivable and deferred inflow of resources • Depreciate the underlying asset as normal • In governmental funds, report lease receivable and recognize deferred inflow of resources as revenue as available
Initial measurement	<ul style="list-style-type: none"> • Lease liability <ul style="list-style-type: none"> ◦ Includes fixed or variable payments, purchase options, and termination penalties of reasonable certainty • Right-to-use asset will generally be recorded at the same value as the lease liability 	<ul style="list-style-type: none"> • Lease receivable <ul style="list-style-type: none"> ◦ Includes fixed payments or variable payments, residual value guarantees, less provision for uncollectible amounts ◦ Discount the lease receivable using the rate charged to the lessee • Deferred inflow of resources – equal to the lease receivable plus any cash received upfront that relates to a future period • Continue to report leased capital asset
Subsequent recognition and measurement	<ul style="list-style-type: none"> • Lease liability <ul style="list-style-type: none"> ◦ Reduction for amortization on lease liability (interest expense) ◦ Remeasure when changes occur and adjust liability • Right-to-use asset <ul style="list-style-type: none"> ◦ Measure initially as the sum of initial lease liability, any prepayments, and initial direct costs ◦ Amortize subsequent recognition and measurement using a systematic and rational manner ◦ If underlying asset is impaired, consult Statement 42 guidance 	<ul style="list-style-type: none"> • Lease receivable <ul style="list-style-type: none"> ◦ Recognize amortization of the discount to produce a constant periodic rate of return on the receivable ◦ Allocate lease payments first to accrued interest receivable, then to the lease receivable ◦ Remeasure and update the discount rate if changes significantly affect the receivable amount; review index/rate used on variable payments • Deferred inflow of resources is recognized over the lease term • Leased asset is depreciated over useful life

Disclosures	<ul style="list-style-type: none"> • General description of leasing arrangements for each lease • Total amount of assets recorded under leases and related accumulated amortization • Lease assets disaggregated by major classes of underlying assets • Variable lease payments recognized in the period but not previously included as liability • Maturity analysis of future lease payments • Lease commitments not yet begun • Components of any net impairment loss 	<ul style="list-style-type: none"> • General description of leasing arrangements including basis, terms, and conditions on which variable lease payments not included in the lease receivable are determined • Total inflows recognized in reporting period • Lease inflows related to variable lease payments recognized in the period but not previously included • If government's principal ongoing operations consist of leasing to other entities, disclose maturity analysis of all future lease payments included in lease receivables
Lease modifications	<ul style="list-style-type: none"> • Remeasure lease liability on the effective date and adjust the right-to-use asset by the difference between the modified liability and the amount before the modification; if asset is reduced to \$0, report any additional reduction as a gain 	<ul style="list-style-type: none"> • Remeasure lease receivable on the effective date and adjust the deferred inflow of resources by the difference between the modified receivable and amount before the modification
Lease terminations	<ul style="list-style-type: none"> • Reduce or remove the lease asset and liability; recognize the difference as a gain or loss • If lessee purchases the underlying asset, adjust lease liability to reflect payments yet to be made 	<ul style="list-style-type: none"> • Reduce or remove the lease receivable and related deferred inflow of resources; recognize the difference as a gain or loss • If lessor sells the underlying asset, derecognize the underlying asset and include calculation for gain or loss

Other accounting and reporting provisions

When making the transition to GASB 87, keep in mind the following accounting and reporting considerations:

- Lease incentives reduce the amount the lessee has to pay. Payments provided at or before the inception of the lease should be reported as a reduction of the lessee's lease asset. Payments provided after the inception of the lease should be reported as reductions in payments for the appropriate period.
- Contracts with multiple components should be separated into lease and nonlease components, or multiple lease components. Allocate considerations to multiple underlying assets in instances of differing lease terms or differing major classes for disclosure.
- Combination contracts entered into at or near the same time with the same counterparty should be considered part of the same lease contract if the contracts are negotiated as a package with a single objective or if the amount of consideration to be paid in one contract depends on the price or performance of the other contracts. Combined contracts are subject to multiple-components guidance.



Other lease transactions that might affect lessors include:

- **Subleases.** Subleases should be treated as transactions separate from the original lease.
- **Sale-leasebacks.** For sale-leasebacks, qualifying sales are required. Account for them as two separate transactions, and if the terms are substantially off-market, report based on the substance of the transaction.
- **Lease-leasebacks.** Account for lease-leasebacks as a net transaction and disclose the gross amounts of the lease and the leaseback.
- **Intra-entity leases.** In the case of leases with or between blended component units, eliminate internal leasing activity before financial statements are aggregated. Treat leases with or between discretely presented components as normal leases, but present receivables and payables separately.
- **Related-party leases.** For related-party leases, recognize the substance of the transaction if it differs significantly from the legal form and disclose the nature and extent of related-party leases. Use the equity method for stock investments.

Making the transition to GASB 87

Implementation of GASB 87 will require lessees and lessors to identify, inventory, and review their existing lease agreements. Subsequently, they must also determine modifications to their presentation and disclosure in financial statements in future years.

Before implementing GASB 87, it is critical to understand the requirements of the new standard, gather information, evaluate the impact, select a transition approach, and design the solution. After these initial steps, organizations can effectively implement and monitor the solution. The implementation process can be broken down into five steps.

First, appoint a champion. An implementation champion can spearhead the process and make sure it goes as smoothly as possible. This individual should be able to organize large, complex projects, have enough available time to complete the implementation, and have access to the resources needed to be successful.

Second, create a task force.

Responsibilities of the task force include identifying current policies and procedures affected by the change; reviewing impact on debt covenants; documenting internal controls to verify proper accounting and financial reporting; determining repository locations for lease terms; and identifying necessary information for implementation and ongoing reporting.

Third, inventory the lease population.

This process can be time-consuming, as lease contracts are likely spread across the organization in several different departments, divisions, and locations. Additionally, as part of this process, organizations should identify and review contracts with embedded leases because they might not have been originally identified as leases. Further complicating this step is the fact that many organizations have multiple systems in place that record leases and use software programs that are not compatible or linked for proper analysis and reporting.

Fourth, consider change management.

Organizations must consider any types of changes that would lead to new measurements or accounting for leases, such as period changes, refinance arrangements, and incorporation of leasehold improvements into existing agreements. Entities should also identify any triggering events that could prompt re-evaluation of lease accounting, such as impairment, changes in lease term, or significant changes in assumptions.

Fifth, communicate with stakeholders.

Entities must provide visibility and transparency to stakeholders, educate them on the impact of the lease standard, and manage expectations for the new presentation of the former operating leases. External stakeholders such as rating agencies and lenders should be identified and included in communications about accounting changes, including the impact on debt ratios that could result from the addition of a large number of new liabilities formerly recorded only in footnotes as operating leases.

A head start

Because implementation of GASB 87 is a complex process, many organizations are approaching it well in advance of its effective date. By following the steps above, the implementation of the new standard can be achieved successfully.



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