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GOVERNMENTAL ACCOUNTING STANDARDS BOARD (GASB) STATEMENT NO. 87 LEASES (LESSEE PERSPECTIVE)

Executive Summary

- Issued in June 2017, GASB 87 requires all governmental entities to recognize an intangible lease asset called a right-to-use asset and a lease liability for the majority of leases lasting longer than one year.
- Payments made will be recognized as reductions to the liability, while the lease asset is amortized over the lease term or its useful life, whichever is shorter.
- Additional enhanced disclosures should now include a description of leasing arrangements, the amount of assets recognized and a schedule of future payments.
- This update does not apply to leases less than 12 months in duration or instances in which the contract transfers ownership of the underlying asset.
- This update is effective for reporting periods beginning after December 15, 2019 and is to be implemented retroactively by restating all prior periods, if practicable.

Why is this being issued?

Key theme: GASB 87 creates a single model for lease accounting, based on the foundational principle that leases are effectively financing the right to use an asset.[1]

The primary purpose of this amendment is to overhaul current lease accounting for governmental entities and establish a common means of lease classification leading to greater comparability among governmental entities. This change should assist state and local governments in making more informed and strategic decisions.

Who is impacted?

This statement applies to the financial reports of all state and local governmental entities.[2]

Key Provisions

GASB 87 represents a significant change to the current way of classifying and accounting for leases. Under legacy leasing guidance, leases were classified as operating leases unless they met a set of qualifying circumstances, in which case the leases were classified as capital leases. Capital leases were capitalized on the statement of net position, while operating leases were recorded as rent expense on the statement of activities. The accounting for operating leases caused certain information to be withheld from the financial statements, often described as off-balance sheet financing.

Leases with terms exceeding 12 months and leases that do not contain transfer of ownership provisions are recorded on the statement of net position as a right-to-use asset and an offsetting lease liability upon commencement of the lease. If a contract transfers ownership at the end of the lease, the contract is accounted for as a financed purchase of the asset. Lease measurement under GASB 87 is performed by calculating the present value of payments that are expected to be made over the term of the lease. This new lease accounting methodology effectively eliminates most off-balance sheet financing. Subsequent accounting for leases under GASB 87 requires the reduction of the lease liability using the effective interest method, with a reduction to the liability as well as the recording of any interest expense. Additionally, the lease asset must be amortized over the shorter of the lease term or the useful life of the asset. Enhanced disclosures are now also required, some of which will include a description of any leasing arrangements, the amount of assets recognized and a schedule of future payments to be made.[3]

Comparison to Financial Accounting Standards Board (FASB) Accounting Standards Update (ASU) No. 2016-02 (Topic 842), Leases

In February 2016, the Financial Accounting Standards Board (FASB) issued ASU 2016-02 to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet while also disclosing key information about leasing transactions. Under GASB 87, state and local governments record a right-to-use asset upon commencement of the lease, similar to ASC 842. Both standards provide a short-term lease exemption.

One of the most significant differences between the two standards is the classification of leases. Leases classified as capital and operating leases under legacy guidance are recorded as financing leases on the Statement of Net Position under GASB 87, whereas ASU 2016-02 retains the operating lease and capital lease classification. Lease liabilities are classified as long-term operating liabilities under ASU 2016-02, whereas under GASB 87, lease liabilities are long-term financings. As such, under GASB 87, all cash flows made for lease activities are to be classified as financing activities, whereas under ASU 2016-02 cash flows made for lease activities are to be classified as operating activities for the interest portion and financing for the principal portion.[4]

Endnotes

[1] GASB Statement No. 87, Leases
[2] ibid
[3] ibid
[4] ibid

Our Thoughts On

Lease accounting is experiencing significant changes regardless of which standard-setting body an entity is beholden. The guidance issued under both of these standards (GASB 87 and FASB ASU 2016-02) allows for more transparent and representative financial statements and disclosures for users. Legacy lease accounting guidance for governmental entities was aligned closely with FASB legacy leasing guidance. Going forward, GASB is aligning itself closer to the International Accounting Standards Board leasing standard, International Financial Reporting Standard 16, Leases which prescribes a single model approach to lease classification. State and local governments will benefit from the enhanced information provided under GASB 87, but implementation may prove to be both time-consuming and costly and should not be delayed. To assist in the transition, GASB released an implementation guide (No. 2019-3) in August 2019.

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