

# GASB Statement 87, Leases: Common Implementation Questions

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There is no time left to procrastinate on preparing to implement GASB Statement 87. If this is your first introduction to the new lease standard, please refer to [Christopher Heinfeld's 2021 article for a basic introduction to the GASB pronouncement](#).

Below are some key items and commonly asked questions to be aware of as you go to record the lease transactions, prepare the financial statement footnotes, and review said items before your annual audit gets started.

## What are the biggest changes?

In **most** situations, *but not all*, the following will occur: previously reported capital leases will now be reported as financed purchases and previously reported operating leases will now be reported as leases. This means that previously classified operating leases will now be reported on the Fund Financials and Government-Wide Financial Statements. A restatement to the beginning financial statement balances is going to be dependent on the impact of GASB 87 on each government and should be made on a case by case basis.

There is an exception for short-term leases. The short-term exception (or relief from the new standard) defines short-term leases as a contract with a maximum possible term, including any options to extend (regardless of whether the options will be exercised), of 12 months or less; these contracts do not need to be accounted for as leases. Thus, if an agreement is for the right to use the nonfinancial asset for only 3 months each year for 3 years (a maximum possible term of 9 months), the maximum possible term of the

agreement is less than 12 months, and the agreement meets the short-term exception requirements. See 4.7 in Implementation Guide 2021-1. This is key when also reviewing current agreements that end in the year of implementation. The GASB Statement 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.” Thus, in instances in which a lease is in place for less than 12 months during the period of implementation, with no options to extend, the lease should be considered a short-term lease.

#### What if I have an Internal Service Fund that “owns” assets the Government utilizes?

The definition of a lease requires the conveyance of control of the right to use another entity’s nonfinancial asset. Thus, in instances in which an internal service fund is used to provide other departments/governmental funds the right to use an asset on a cost-reimbursement basis, the agreements should not be reported as a lease in the basic financial statements. See 4.4 in Implementation Guide 2021-1.

#### What incremental borrowing rate do I utilize?

For lessor arrangements, determining the incremental borrowing rate (IBR) has not been crystal clear. Unlike FASB, the GASB lease guidance does not offer a practical expedient to apply an appropriate discount rate to a portfolio of similar leases. Under GASB guidance, each lease could have a different discount rate, which needs to be supported with appropriate documentation. Below is an example framework to calculate a government’s incremental borrowing rate:

#### **Base Rate + Financing Adjustments + Lease-Specific Adjustments = Incremental Borrowing Rate**

**1) Base Rate:** The first step is to establish an appropriate base rate, which will then be updated for financing adjustments and lease specific adjustments. The starting point may be based on debt already outstanding (a recent line of credit or short term loan). For governments without outstanding debt or debt that is not publicly traded, a risk-free rate may be the only starting point.

**2) Financing Adjustments:** A government would need to adjust the base rate to reflect credit-specific factors such as the overall level of indebtedness or if the lease results in a change to leverage ratio, which would warrant a higher incremental borrowing rate.

**3) Lease-Specific Adjustments:** These would include the term of the lease agreements. Generally, the longer the term, the higher the rate. Also considered would be the timing of payments – such as any prepayments or if the payment amount decreases/increases over time. Other lease-specific factors can be addressed here.

#### How different will my Financial Statements and Footnotes look?

If the government is the lessor, the arrangements will require a leases receivables, deferred inflow of resources, additional interest revenue, and new lease revenues to be reported in the fund financials. If the government is the lessee and has a transaction that meets the lease criteria (which again is separate from a financed purchase), there will be a new line item classified as a 'leased asset'. Previously recorded capital assets resulting from previous capital leases (now financed purchases) can remain in the capital asset category.

The notes to the financial statements will also require updates related to GASB 87 implementation. For financed purchase arrangement, the disclosures are similar (but not exactly the same) as previous capital lease disclosures. Lease arrangement disclosures will be similar to financed purchase but will require one major addition: The amount of leased (right-to-use) assets by major classes of underlying assets and the total amount of leased (right-to-use) assets and related accumulated amortization. The capital asset disclosure will also have to be updated to reflect the new items. Refer to paragraphs 37, 38, 57, and 58 in the GASB statement for the specific list of required disclosures.

#### What are my auditors going to ask for?

The government's responsibility for the internal control over leases should be imbedded in overall debt management. With that in mind, maintaining documentation and support for specific determinations throughout the implementation should be maintained. What procedures has the government performed to ensure completeness in implementation? Document, document, document!

This article may not address all questions your organization may have. You can refer to the GASB implementation guides, Q&A, other external resources available online, or reach out to your auditors for guidance.

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