

# GASB Statement No. 87, Leases – The Basics

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The time to begin implementing the new standard for leases is here! Hopefully you have stayed informed on the guidance issued, either by reviewing the GASB Statement, attending presentations, and/or reading related implementation guides. However, if you have not, this article is a great overview to get you caught up.

To begin, GASB Statement No. 87 changed the definition of a lease; the standard replaced the previous capital and operating lease definitions and requirements with a single lease definition: *a contract that conveys control of the right to use another entity's nonfinancial asset (the underlying asset) as specified in the contract for a period of time in an exchange or exchange-like transaction.* In short, the key elements of this definition include: control of the asset, for a period of time, and in an exchange or exchange-like transaction. According to the standard, *control* requires both the right to obtain the present service capacity of the asset, and the right to determine the nature and manner of use of the asset. However, *control* may or may not be the complete and unlimited use of the asset. Additionally, the contract would need to be for a specific time period, and not in perpetuity. Lastly, the contract would need to include terms in which the right to use the asset was compensated at essentially equal or not quite equal value.

As with other GASB standards, there are exclusions and an exception:

*Exclusions* include biological assets (e.g., timber, living plants, living animals), intangible assets (e.g., patents, software, copyrights), inventory, services concessions arrangements,

supply contracts, and underlying assets financed with conduit debt. The one *exception* (or relief from the new standard) relates to short-term leases. The 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. Consider the following example that does not meet the exception requirements: a six-month noncancelable lease, with an option to renew for 12 months after the noncancelable period; as the maximum possible term is 18 months, the contract should be reported as a lease under the new standard.

Under previous GASB guidance, contracts that transferred ownership were classified as capital leases. However, under the new GASB statement, a contract that transfers ownership of the underlying asset to the lessee by the end of the contract and does not contain termination options (other than fiscal funding causes) is not considered a lease; these contracts should be reported or reclassified as a financed purchase (or similar).

With an effective date for periods beginning after June 15, 2021, it is time to start researching any potential contracts your entity has that will qualify as a lease under GASB Statement No. 87. We strongly encourage all entities to compile a list of contracts (from the lessor and lessee perspective), and determine whether a lease exists under the new GASB statement. The list of contracts could be compiled in a spreadsheet and include the following columns:

- contract number
- contract entities
- contract description
- evaluation conclusion of the contract as a lease or not
- effective date
- noncancelable term
- end of contract
- renewable terms
- entity with the option to renew
- whether the option is reasonably certain to be exercised
- termination terms
- entity with the option to terminate
- whether the termination option is reasonably certain to not be exercised
- payment frequency
- payment amount

Through this process, management should evaluate and research the contracts and agreements, to determine whether a lease, financed purchase, or other arrangement exists.

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