
ACCOUNTING FOR LEASES: GASB 87



2021 WASBO Annual Conference

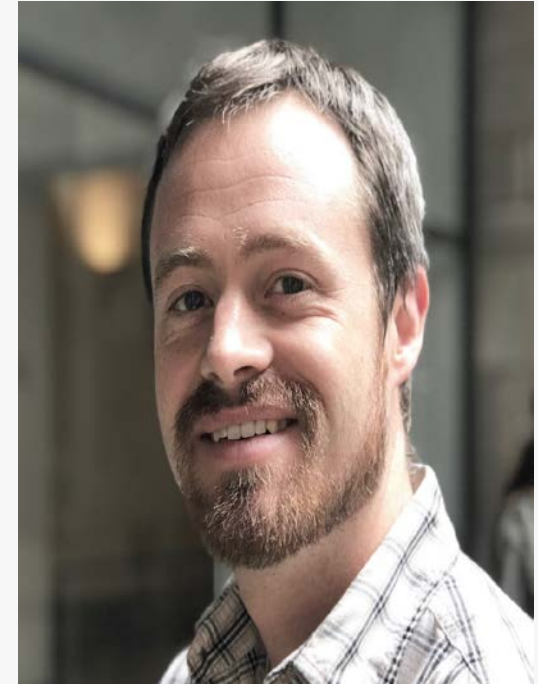
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GASB 87 Accounting for Leases

Today's Topics

- Prepare for Lease Accounting
- Definitions
- Types of Leases
- Cash Basis Accounting and Reporting
- Modified Accrual Accounting for Leases
- The Interest Rate
- Illustrated Example for Modified Accrual Lease Accounting



Prepare for Lease Accounting

- GASB 87 guidance becomes effective: September 1, 2021
- This is for the 2021-22 School Year.
- The guidance applies retroactively to all your leases.
- Operating and capital leases will become:
Leases or Leases With Option to Purchase



Prepare for Lease Accounting

- It is highly recommended that school districts **PREPARE NOW** for new lease accounting.
 - Identify leases and contracts which apply.
 - Create a list for review.
 - Document key provisions:
 - Such as the lease term, extensions, termination provisions, payment provisions, and an implied interest rate.



Prepare for Lease Accounting

Just because the word “lease” isn’t in the agreement, doesn’t mean it doesn’t meet the definition of a lease under GASB 87.

And not all “leases” meet the definition of the new standard.

It’s the substance of the agreement that you must analyze – and document.



GASB 87 Lease Types

- Accounting treatment depends upon the Lease Type:
 1. Short-Term Leases
 2. Contracts that Transfer Ownership
 3. The Single-Model Approach

Definitions

A Lease:

- “A lease is defined as 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.”



Definitions

Right to Use:

- The right to obtain the present service capacity from use of the underlying asset and the right to determine the nature and manner of its use.
- Right to use an asset for a specified period of time.
- The right to use does not mean uninterrupted access.
 - One lessee may have a multi-year, facility use agreement for a room 3 days a week; while another lessee uses the same room one day a week.

Definitions

Lease Term:

- The period during which a lessee has a non-cancelable right to use an underlying asset.
 - Plus periods covered by the lease and periods covered by the lessee's or lessor's option to terminate the lease.
- Fiscal funding/cancelation clauses are ignored unless reasonably certain to be exercised.



Definitions

Exclusions:

- Certain activities are excluded from lease guidelines under GASB 87.
 - Intangible Assets – Such as Patents and Software
 - There are Exceptions to the Exclusions
 - Biological Assets – Such as Timber
 - Service Concession Arrangements
 - Supply Contracts
 - Subscription-Based Information Technology Arrangements
 - (SBITAs) GASB 96 Coming Soon



Definitions

Lessee:

- The school district acquires the right to use another entity's nonfinancial asset(s) (i.e., tenant)
- Examples:
 - The school district leases parking space from the county for its Bus Fleet.
 - The school district leases copiers from a vendor.



Definitions

Lessor:

- The district conveys the right to use its nonfinancial assets to another entity (i.e., landlord).
- Examples:
 - The school district leases a surplus elementary school to a university.
 - The district leases surplus land rights to a communication service provider for a cell tower.

Short Term Leases

GASB 87 defines short-term leases entirely on the length of the maximum possible noncancellable lease term.

- Short-term is generally defined as 12 months or less.
- A lease term of less than 12 months is not automatically a short-term lease.
- All future options to extend are considered, regardless of probability.
 - Ref: (GASB87, Par. 16) (Implementation Guide 2019-3; 4.18)



Short Term Leases

Accounting Transactions and Financial Reporting

- Accounting treatment has not changed
- The lease payments are recorded as revenues or expenditures based on the payment provisions of the contract.
- Short-term leases require no additional note disclosures.



Contracts that Transfer Ownership

- Formerly “Capital Leases”
- Accounted for as Purchase Contracts
- To the Lessor: These contracts are treated as a financed sale of the asset.
- To the Lessee: These contracts are treated as a purchase of the asset on credit.
- The contract does not contain a termination option.



Contracts that Transfer Ownership

- The contract can directly specify that ownership of the underlying asset is transferred to the lessee by the end of the lease.
- Accounting and reporting for contracts that transfer ownership is the same as the single-model approach.

The Old Criteria: Capital verses Operating Leases

- Four Criteria distinguished a Lease as Capital.
- If a lease met any of the criteria, it was a capital lease and accounted for as a purchase contract.
- Transfers ownership by the end of the lease term.
- Contains a bargain purchase option.
- 75 percent or more of the estimated economic life.
- PV of minimum lease payments equals at least 90 percent of the fair value of the lease property.



The Old Criteria: Capital verses Operating Leases

- The four criteria were difficult to measure.
- Capital leases require the recognition of an other financing source and expenditure.
- Operating Leases do not.

- GASB 87 says: **we've had enough of that.** From now on, all lease accounting guidance will take a single approach.



The Single-Model Approach

- All leases that do not fall into the first two categories are treated with the single-model approach.
 - They are not Short-Term Leases.
 - They are not Contracts that Transfer Ownership
 - They are just “Leases”.
- The accounting treatment is the same as Contracts that Transfer ownership.



Cash Basis Accounting – The Lessee

At the acquisition of the lease, the Cash-Basis District books the **total amount of the contractual liability**: For illustration purposes, we will create a contract for \$60,000; with payments of \$1,000 per month for 5 years.

GL	Sub-Ledger	Account Title	DR	CR
530	NCES 973X	Equipment X	60,000	
965	Rev-9500	Long-Term Financing		60,000

To Recognize the Acquisition of a Lease

Cash Basis Accounting – The Lessee

- A monthly payment on a lease – cash basis:

GL	Sub-Ledger	Account Title	DR	CR
530	NCES 744X	Lease of X	1,000	
241	n/a	Warrants Outstanding		1,000

To Record the lease payments.

Cash Basis Accounting – The Lessor

Lease payments are recorded as revenue when cash is received.

GL	Sub-Ledger	Account Title	DR	CR
230	n/a	Cash	1,000	
960	Rev-2700	Lease Income		1,000

To Recognize Lease Revenue when received.

Cash Basis Financial Reporting Requirement for Leases

- On the Schedule of Long-Term Liabilities (SLTL):
 - Report the Year End contractual liability remaining for lease payments.
 - Cash Basis: Plug your ears when we talk about Modified Accrual...
- Disclosure in the Notes to the Financials.
 - We are working on a new Lease Note Template for disclosure requirements.
 - Keep information about the Description of the Contract, Monthly Payments, and the Schedule of Payments.



Accounting For Leases

Modified Accrual Accounting



Interest Rates, Discount Rates, and Borrowing Rates

- The terms mean the same thing... generally.
- It is the rate the lessor charges the lessee.
- The rate is often not stated in lease agreements.
- The rate must be determined; because it used to calculate the present value (PV) of the contract.



Other Interest Rate Terminology

Stated Interest Rate:

It is an interest rate that is written into the contract.

[*Got it.*]

When entering into contractual obligations in the future...
request that the contract include a stated interest rate.



Other Interest Rate Terminology

- **Implicit Interest Rate:**
 - An interest rate that is understood by the lessor and lessee to be charged in the contract.
 - If you know the Present Value, Lease Term, and Payments: The interest rate is implicit in the lease.



Other Interest Rate Terminology

- **Incremental Borrowing Rate (IBR):**
- An interest rate that is an “approximation” of a rate that would be charged in a similar transaction between similar parties.
- A known, current interest rate the school district is being charged in other like contracts.
 - *Refer to other contracts that include known interest rates.*
 - *Don't rely on generic Bond interest rates.*



Define your Interest Rates and Present Values

- Even though GASB 87 does not take effect until next year, the guidance applies retroactively to all your current leases.
- You must calculate the present value of a lease by applying the interest rate in effect at the inception of the lease.
- If you entered into a lease contract on July 1, 2017, use the interest rate in effect on that date.
- This is work you can do now; you want it out of the way.



Document Your Methodology

- Document your methods and sources used to determine the interest rate for each lease agreement.
- Keep your work... it should be retained.
- It is advisable to have a written policy on how the district created reasonable interest rates.



Document Your Methodology

- We have a Present Value Tool. (There is hope)
- A special thanks to our friends at **Piper Sandler Companies** who understood the need and built a prototype, Present Value Tool in Excel, for us to use.
- We hope to make the Tool available on the OSPI website soon.



An Illustration on Lease Accounting for Modified Accrual

- In a lease, you are provided with the lease term (5 Years) and the monthly payment amount (\$1,000).
- You know the Total Contractual Lease payments to be is \$60,000.
- ($\$1,000 * 12 * 5 = \$60,000$)
- You need to create a payment spreadsheet to allocate each payment between interest and principal.

An Illustration on Lease Accounting for Modified Accrual

- You must have an interest rate to calculate the Present Value.
- For our illustration, we will use an annual rate of 3.0% (.03)
- 12 monthly payments, the interest rate factors as (.0025)
- $(.03 / 12 = .0025)$
- (.0025 is the interest rate per period.)



The Present Value Equation Illustration

- Assumptions:
 - \$1,000 down payment
 - \$1,000 per month lease payments
 - 60 months
 - **\$60,000 total**
- Using the Present Value function tool in Excel.
- *(You can do this now, in Excel, without the PV Tool we are building.)*



Present Value Function in Excel

=PV(rate, nper, pmt, [fv], [type])

- **Rate** Required. The interest rate per period
- **Nper** Required. The total **number of payment** periods in a lease.
- **Pmt** Required. The payment made each period and cannot change over the life of the lease.
- **Fv** Optional, The future value, or a cash balance you want to attain after the last payment is made (**usually 0**).
- **Type** Optional, The number 0 or 1 indicates when payments are due. 0 end of the period. 1 at the beginning of the period.



Present Value Function in Excel

=PV(rate, nper, pmt, [fv], [type])

- **Rate** .0025 (.03/12 months = .0025)
- **Nper** 60 months
- **Pmt** Monthly payment of \$1000 (Note that this is a negative number.)
- **Fv** Cash balance at end of lease \$0
- **Type** 1 indicates payments at the start of the period
- The PV function in Excel is:
 - =PV(.0025,60,-1000,0,1) = \$55,791

Modified Accrual Accounting – The Lessee

- At the acquisition of lease, the modified accrual district calculates and records the **present value (PV) of the contractual liability**:

GL	Sub-Ledger	Account Title	DR	CR
530	NCES 973X	Equipment X	55,791	
965	Rev-9500	Long-Term Financing		55,791

To Recognize the Acquisition of a Lease

Modified Accrual Accounting – The Lessee

Create a payment spreadsheet to allocate each payment between interest and principal.

Date	Payment	Interest	Principal	Balance
				55,791.49
9/1/2021	1,000.00	-	1,000.00	54,791.49
10/1/2021	1,000.00	136.98	863.02	53,928.47
11/1/2021	1,000.00	134.82	865.18	53,063.29
12/1/2021	1,000.00	132.66	867.34	52,195.95

Formula: =CUMIPMT(.0025,60,**55791.49**,2,2,1)*-1



Modified Accrual Accounting – The Lessee

- When monthly payments are made, record an expenditure for debt principal and interest.

GL	Sub-Ledger	Account Title	DR	CR
530	AA84; NCES 7832	Principal	863.02	
530	AA83; NCES 7835	Interest	136.98	
601		Accounts Payable		1,000.00
To Record the monthly lease payment.				

- Provide the payment schedule to you AP person.



Modified Accrual Accounting – **The Lessor**

Lessor:

- The district conveys the right to use its nonfinancial assets to another entity (i.e., landlord).
- Examples:
 - The school district leases a surplus elementary school to a university.
 - The district leases surplus land rights to a communication service provider for a cell tower.



Modified Accrual Accounting – **The Lessor**

For F-196 Modified Accrual, a lessor should recognize the Present Value of a lease receivable and a deferred inflow of resources at the start of the lease term.

GL	Sub-Ledg	Account Title	DR	CR
345		Leases—Receivable	55,791	
755		Deferred Inflow— Leases		55,791

To Record the Present Value of the Lease Contract at the start of the lease term.



Modified Accrual Accounting – **The Lessor**

- When monthly payments are received, record Interest Income and the reduction of the Receivable.

GL	Sub-Ledg	Account Title	DR	CR
230		Cash	1,000.00	
345		Lease—Receivable		863.02
960	Rev-2450	Other Interest Income		136.98

To Recognize the October Lease Payment Received.

Modified Accrual Accounting – The Lessor

- Lease Income is recognized by the straight-line amortization of Deferred Inflow—Leases: $(55,791.49 / 60 \text{ months} = 929.86 \text{ per month.})$

GL	Sub-Ledg	Account Title	DR	CR
755		Deferred Inflow— Leases	929.86	
960	Rev— 2700	Lease Income		929.86

To Recognize Lease Income and Adjust Deferred Inflows.

Modified Accrual Accounting – **The Lessor**

Create a payment spreadsheet to track your lease.

Date	Payment	Interest Income	Principal Reduction	Receivable Balance	Lease Income	Def'd Inflow
				55,791.49		55,791.49
9/1/21	1,000.00	-	1,000.00	54,791.49	929.86	54,861.63
10/1/21	1,000.00	136.98	863.02	53,928.47	929.86	53,931.77
11/1/21	1,000.00	134.82	865.18	53,063.29	929.86	53,001.91
12/1/21	1,000.00	132.66	867.34	52,195.95	929.86	52,072.06



Modified Accrual Financial Reporting Requirement for Leases

- On the Schedule of Long-Term Liabilities (SLTL):
 - Report the **present value** of the future lease **principal**.
- Disclosure in the Notes to the Financials.
 - Working on a new Lease Note Template for disclosure requirements. Keep in mind the Description of the contract, Monthly Payments, and schedule of payments.



Utilize Reference Materials

- GASB 87 Guidance
- The GASB Implementation Guide (2019-03)
- The 2021–22 School District Accounting Manual
- Attend WASBO Classes and Presentations
- The State Auditor’s website for information on Lease Accounting.
- The Blue Book
- The GFOA website



Leases in Summary

- Communicate with your Administrators and Purchasing Director.
- It is highly recommended that school districts **PREPARE NOW** for new lease accounting.
 - Identify leases and contracts which apply.
 - Build your spreadsheet now.
 - Document key provisions:
 - Such as the lease term, extensions, termination provisions, payment provisions, and an implied interest rate.



Leases in Summary

- Just because the word “lease” isn’t in the agreement, doesn’t mean it doesn’t meet the definition of a lease under GASB 87.
- And not all “leases” meet the definition of the new standard.
- It’s the substance of the agreement that you must analyze – and document.



GASB 87 Accounting for Leases

We hope this presentation is a benefit to you.

If you have questions, let us know.
The Q&A will be provided soon.

Thank you

