NATIONAL FEDERATION
of MUNICIPAL ANALYSTS

NEW GOVERNMENTAL LEASE ACCOUNTING STANDARDS (GASB 87)

Summary: The Government Accounting Standards Board (GASB) has published its new lease accounting standards for governments following GASB accounting standards (GASB Lease Rules). The new GASB Lease Rules were issued in June 2017 and will be effective for reporting periods beginning after December 15, 2019. In the GASB's view, leases are all assumed to be capital financings of the underlying assets with only a narrow range of short-term equipment and motor vehicle leases treated as an "operating lease." Consequently, GASB no longer contemplates the subjective determination/distinction between an "operating lease" and a "capital lease;" GASB now assumes all leases are "capital leases" except for the specific exceptions noted. GASB 87 will now require recognition of assets and liabilities for all leases (with some limited exceptions) whether or not they previously were accounted for as an operating or a capital lease. The following is a summary breakdown of the GASB Lease Rules for both governmental lessees and lessors:

If the government is the "Lessee":

- Recognize a lease liability and a lease "asset":
    - The lease liability is measured as the present value of future lease payments under the expected term of the lease (including any expected renewals).
    - The lease asset (an intangible asset) should initially equal the lease liability plus any payments made to the lessor at or before the commencement of the term.
        - Amortized over the shorter of the lease term (plus any expected renewal terms) and the asset's useful life (as determined by the government).
- The lease liability is reduced over time as lease payments are made in a manner similar to most home mortgages.
    - A portion of those lease payments are comprised of a current interest expense
    - The remainder is reflected as reduction of the lease liability.
- Notes should include a description of each material lease transaction (with some details on the allocation of fiscal burdens/benefits under the lease, e.g., "triple net lease"), the total amount of leases recognized, and a schedule of future lease payments to be made similar to current debt note disclosures.

If the government is the "Lessor":

- Recognize a lease receivable and an offsetting deferred inflow of resources representing the future lease payments. The underlying leased asset remains on the lessor's balance sheet at its cost basis.
    - Lease receivable measured at the present value of lease payments expected to be received.
    - The deferred inflow of resources will equal the value of the lease receivable plus any payment received at or before the lease term.

- The lessor should recognize interest revenue on the lease receivable and an inflow of resources (for example, lease payment revenue) from the deferred inflows of resources.
- Financial statement notes should include a description of each material leasing arrangement (with some details arrangements on the allocation of fiscal burdens/benefits under the lease, e.g., "triple net lease"), and the total amount of inflows of resources recognized from leases in the reporting period.

Historical Treatment of Leases: The pre-GASB 87 approach to lease accounting required a somewhat subjective determination of whether a lease was classified as a "capital lease" or an "operating lease." That lease classification was based on any one of four tests that assessed which party, the lessee or the lessor, bore the benefits and risks of ownership. Historically, that lease classification was somewhat subjective and certainly varied from government to government. In addition, there was not much note disclosure required regarding the terms of the lease and leased assets, or the basis for the determination if the lease was an "operating lease" or a "capital lease." Another criticism of the previous GASB methodology was that governmental lease accounting did not capture in its entirety the economic substance of the lease transaction nor fully reflect the allocation of burdens and benefits of the lease transaction. The new GASB lease standards address those deficiencies and also treat both third party lease transactions and "inter-governmental" lease transactions under the same set of accounting rules.

Impact of New GASB Lease Rules on NFMA Members & Financial Statement Analysis: The GASB Committee believes the implementation of GASB 87 will provide for a more straightforward, uniform, and complete accounting of a government's "lease" transactions on its government and enterprise fund statements. In addition, the financial statement notes will provide more and better information on the underlying lease transactions.

Exceptions That Are Intended to Reduce Implementation Costs: In an effort to reduce the cost of implementing the new GASB Lease Rules, limited exceptions to the single, "capital lease" approach will remain for short-term government leases. Short-term leases are leases that have a maximum term of twelve months even when including any options to extend irrespective of the probability of extensions. Governmental lessees and lessors should recognize payments on those short-term leases as outflows of resources or inflows of resources, respectively, just as was done previously for governmental operating leases.

There are other exceptions, too. For contracts that transfer ownership of a governmental asset, the transaction should be reported as a financed purchase or sale by the lessee and lessor, respectively, of the underlying asset. Finally, leases of assets that are investments and certain leases of specialty/regulated assets (e.g., a lease between airports and carriers) may differ from the new GASB Lease Rules.