

GASB Statement No. 87, Leases



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- Effective for the fiscal year ending June 30, 2022
- Establishes a single model for lease accounting, eliminating the distinction of capital and operating leases
- Requires recognition of certain lease assets and liabilities for leases that were previously classified as operating leases
- Excludes short term leases – contract of 12 months (or less), including any options to extend
(regardless of the probability of being exercised)



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- Lessees and lessors will have similar accounting
 - Lessee is required to recognize a lease liability and an intangible right-to-use lease asset
 - Lessor is required to recognize a lease receivable and a deferred inflow of resources
- Implementation will require enhanced disclosures
- When reviewing existing leases, use facts and circumstances that exist at the beginning of the earliest period restated, NOT the commencement date of the lease
 - **For State Agencies, this would be 7/1/2021**



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SCO-560

- The form SCO-560 has been revised to include land and buildings and also to increase the amount of information obtained such that the lease can be properly recorded in the lease software by the Comptroller's Office.
- An SCO-560 will be required for all leases, not just new leases for the implementation period
 - Ensure all contracts are reviewed when completing the SCO-560 forms
- Note: there will be a separate form for Lessors



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- **Lease** – Defined as a contract that conveys control of the right to use a nonfinancial asset
- Nonfinancial assets include:
 - Land
 - Buildings
 - Vehicles
 - Equipment



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Scope

- A contract (e.g., an agreement between two or more parties that creates enforceable rights and obligations) 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.
 - **Control of the Right to Use**
 - The right to obtain the present service capacity from the use of the underlying asset
 - The right to determine the nature and manner of the underlying asset
 - **Includes:**
 - Subleases,
 - Contracts that are not specifically identified as a lease, but meet the definition of a lease (embedded leases), and
 - Lease component within a contract containing multiple components



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Scope Exceptions

- Leases of intangible assets, including
 - Leases to explore for or use non-regenerative resources
 - Licensing contracts for items such as motion picture films, video recordings, plays, manuscripts, patents, copyrights, and computer software
- Leases of biological assets, including timber, living plants, and animals
- Leases of inventory
- Contracts that meet the definition of a service concession arrangement
- Leases with the underlying asset financed with outstanding conduit debt, unless both the underlying asset and the conduit debt are reported by the lessor
- Supply contracts, such as power purchase agreements
- SBITA – Subscription based IT arrangements (covered by GASB 96, to be effective for the fiscal year ending June 30, 2023)



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Identifying Leases

- Land/Buildings – payments over multiple years even if the contract is not identified as a lease agreement
- Servers (cloud) – when and/or how are changes made (who approves)
- Embedded leases – Contracts that may not use the terms “lease” or “rent”:
 - Advertising agreements (e.g., Signage on land)
 - Service agreements (e.g., IT services)
 - Transportation agreements (e.g., University shuttle service)
 - Construction agreements



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Intra-entity/Inter-entity Leases

- Intra-entity leases
 - Leases between the primary government and component units (or between 2 component units) should be reported separately from other lease receivables/payables on the statement of net position.
- Inter-entity leases
 - Leases between the agencies/funds of the primary government
 - Not required to be reported at the CAFR level
 - Agencies who prepare departmental financial statements will be required to report inter-entity leases



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Short-term leases

- Maximum possible term at commencement date of 12 months or less (including any options to extend)
- The presence of lessee renewal options, extending past 12 months, regardless of their probability of being exercised, means the lease does not meet the definition of a short-term lease
- No recognition of lease liability or lease asset required
- Short term payments are expensed as incurred by lessees and recognized as revenue by lessors



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Recognition Threshold

- Using a recognition threshold is acceptable
- Governments should consider the quantitative and qualitative significance of the lease liability and lease asset in the application of a recognition threshold
- Do not evaluate the effect of non-recognition on a 'net' basis (lease asset - lease liability = net effect)
- Do not default to a threshold used for another non-GAAP policy (e.g., capitalization threshold for capital assets)
- Threshold will be reviewed at the contract level (if lease is for multiple pieces of equipment, the lease will be evaluated in its entirety)



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Lease Term - Lessee

The lease term starts with the noncancelable lease period.

Add additional periods if the Lessee has the option to:

- Extend the lease, if reasonably certain of being exercised
- Terminate the lease, if reasonably certain the lessee will **not** exercise that option,

Exclude additional periods:

- If both the Lessee and the Lessor must agree to extend
- If the Lessee and the Lessor BOTH have the option to terminate the lease without permission from the other party.
 - Example: A rolling month-to-month lease or a lease that continues into a holdover period until a new lease contract is signed, would not be enforceable if both the lessee and lessor have an option to terminate, and therefore, either could cancel the lease at any time.



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Lease Term - Lessor

The lease term starts with the noncancelable lease period.

Add additional periods if the Lessor has the option to:

- Extend the lease, if reasonably certain of being exercised
- Terminate the lease, if reasonably certain the lessee will **not** exercise that option,

Exclude additional periods:

- If both the Lessee and the Lessor must agree to extend
- If the Lessee and the Lessor BOTH have the option to terminate the lease without permission from the other party.



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Lease Term

- What does reasonably certain mean?
 - Reasonably certain is a high threshold of probability that must be met to include optional lessee payments in the measurement of lease assets and lease liabilities
 - Lessee has a compelling economic reason to exercise the renewal or purchase option (or not to exercise a termination option)
 - Consider all economic factors relevant to the assessment
 - Market-based factors, Contract-based factors, Asset-based factors, Government-specific factors



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Components of a Lease

Leases may contain multiple lease components

- **Step 1: Identify separate lease components**
 - If lease components have different lease terms, they must be accounted for separately
 - If underlying assets are in different major classes of assets for disclosure purposes, they must be accounted for separately
- **Step 2: Identify any non-lease components**
 - Non-lease components must be accounted for separately
 - An example would be a service contract or common area maintenance
- **Step 3: Allocate the contract price**
 - Use prices for individual components that are included in the contract, as long as not unreasonable
 - If contract doesn't include separate prices for individual components or they seem unreasonable, use judgement to best estimate the allocation for each component



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Lease Payments

Lease payments include:		
Payment Type	Lessee	Lessor
Fixed payments	X	X
Variable payments fixed in substance	X	X
Variable payments that depend on an index or rate	X	X
Residual value guarantees ¹	X	X
Purchase options ²	X	
Termination penalties ²	X	
(Lease incentives) ³	X	X
Any other payments ²	X	

¹ For lessees, RVGs are included if reasonably certain of being required. For lessors, they are included if fixed in substance

² Included only if reasonably certain to be exercised/required

³ Lease incentive receivable by the lessee (payable by the lessor) after lease commencement are ordinarily a reduction (offset) in the calculation of total lease payments



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Lease Payments

- Fixed lease payments
 - Fixed payments – Contractually fixed and not subject to any variability
 - Variable payments that are fixed in substance – May be described as variable but are “in-substance fixed” because contract terms ensure payment of a fixed amount is unavoidable
 - Lease incentives –
 - Payments made to, or on behalf of, the lessee, for which the lessee has a right of offset with its obligation to the lessor
 - Other concessions granted to the lessee
 - Lease incentives that are fixed and are to be provided after the commencement date are deducted from the fixed lease payments in the measurement of the lease liability



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Lease Payments

- Variable lease payments
 - Variable lease payments that depend on an index or rate are included (e.g., increases/decreases based on the Consumer Price Index (CPI))
 - Use the index or rate at commencement date. Forward rates and forecasting techniques are not considered
 - When initially measuring the lease payments, the current index or rate is assumed to stay in effect
 - Variable lease payments based on future performance or usage are not included, even if they are highly certain!
 - If variable lease payments are not included in the calculation of the lease liability, they are expensed as incurred



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Discount Rate

- Expect further guidelines from GASB to be forthcoming
- At this time, recommend using a discount rate based on one of the following:
 - Stated rate in the lease agreement
 - Incremental Borrowing Rate (IBR)
 - The Comptroller's office currently calculates the IBR considering both taxable and tax-exempt bonds



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Initial Indirect Costs

- Lessees
 - Initial direct costs that are “ancillary charges necessary to place the lease asset into service” are included as part of the lease asset
 - All other indirect costs are expensed as incurred, including potential legal fees and debt issuance costs
- Lessors
 - Any initial direct costs incurred by the lessor are expensed as incurred.



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Accounting for a Lease – Initial Reporting

	Lessee	Lessor
Assets	Intangible right-to-use lease asset = Lease liability plus prepayments and any ancillary costs to place the asset to use	Lease receivable = Present value of expected lease payments over the lease term Continue to report the asset
Liability	Lease liability = Present value of expected lease payments over the lease term	N/A
Deferred Inflow	N/A	Equals the lease receivable plus any cash received up front that pertains to a future period



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Lessee Accounting Example

Equipment Lease Information

- 5 – year non-cancellable lease of equipment (no optional renewal periods for lessee or lessor)
- A refundable security deposit of \$25,000 and the first lease payment required at lease signing (before commencement date)
- Annual payment of \$75,000 due in advance
- Purchase option of \$250,000 that lessee is reasonably certain to exercise upon lease commencement date (15 year useful life)
- Lessee incurs \$15,000 of initial direct costs to place equipment into service



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Lessee Accounting Example

Lease Payment Summary

- **Lease payments include:**

Fixed payments	\$300,000	(\$75,000 x 4 years)*
<u>Purchase option</u>	<u>\$250,000</u>	
Total lease payments	\$550,000	

*Initial payment was paid before commencement date so not included in the lease liability calculation



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Lessee Accounting Example

Initial measurement of lease liability

- Assume the discount rate was not provided in the lease agreement, will use the IBR of 3.5%
- Lease liability = the present value of expected payments
- Payment Dates

Payment Date	Amount
At signing*	\$75,000
Beg of year 2	\$75,000
Beg of year 3	\$75,000
Beg of year 4	\$75,000
Beg of year 5	\$75,000
End of year 5	\$250,000

*Initial payment was paid before commencement date so not included in the lease liability calculation

- Present value = \$485,974



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Lessee Accounting Example

Initial measurement of lease asset

- The lease asset is the sum of:

Initial measurement of lease liability	\$485,974
Initial direct costs	\$15,000
Prepaid lease payments at or before commencement	<u>\$75,000</u>
Total	\$575,974

- **Note: ASSET ≠ LIABILITY**



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Lessee Accounting Example

Initial measurement journal entries

- At lease signing

Dr. Lease deposit	\$25,000		
Dr. Prepaid lease	\$75,000		
Cr. Cash		\$100,000	
- Prior to lease commencement to record initial direct costs

Dr. Prepaid asset	\$15,000		
Cr. Cash		\$15,000	
- At lease commencement

Dr. Lease Asset	\$575,974		
Cr. Lease Liability		\$485,974	
Cr. Prepaid Lease		\$75,000	
Cr. Prepaid asset		\$15,000	



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Accounting for a Lease – Subsequent Reporting

	Lessee	Lessor
Assets	Amortize lease asset over the shorter of the useful life of asset or lease term	Depreciate leased asset Reduce lease receivable by lease payments (less payments for interest)
Liability	Reduce lease liability by lease payments (less interest expense recognized)	N/A
Deferred Inflow	N/A	Recognize revenue over the lease term in a systematic and rational matter



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Accounting for a Lease – Modified Accrual

- If the lease is expected to be paid from general government resources, it should be accounted for and reported on a basis consistent with governmental fund accounting principles –
 - An expenditure or other financing source is reported in the period the lease is initially recognized and is measured using the guidance for measuring the lease liability
 - Subsequent government fund lease payments are accounted for consistent with the principles for debt service payments on long-term debt.
- For State agencies, accounting will be similar to the current capital lease accounting



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Disclosures – Lessees

- General description of leasing arrangements
- Total amount of lease assets and related accumulated amortization
- Amount of lease assets by major classes of underlying assets
- Amount of variable payments not previously included in liability
- Amount of other payments not previously included in liability
- Principal and interest requirements to maturity
- Lease commitments not yet begun
- Components of any impairment loss and any related change in lease liability



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- General description of leasing arrangements including basis, terms, and conditions on which variable lease payments not included in lease receivable are determined
- Total inflows recognized in reporting period
- Lease inflows related to variable lease payments recognized in the period but not previously included
- Existence, terms, and conditions of lessee options to terminate lease or abate payments if lessor has issued debt which is secured by lease payments
- Relevant disclosures should be provided for the following if applicable:
 - Leases of assets that are investments
 - Certain regulated leases
 - Sublease transactions
 - Sale-leaseback transactions
 - Lease-leaseback transactions



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GASB Statement No. 87, Leases SCO-560 – Accounting for Leases/Lessee

Key Changes

- **Noncancelable lease period**
- **Lessor/Lessee option to terminate lease**
- **Lessor/Lessee option to renew lease**
- **Detailed breakout of all types of payments**
 - **Fixed payments**
 - **Variable payments**
 - **Purchase options, termination penalties, etc.**



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Implementation – Final Thoughts

- State agencies as lessees and lessors will need to identify and review their existing lease agreements
 - Agencies need to establish procedures that identify when new leases are entered into and when existing leases are modified
 - Increased communication between accounting staff and those who enter into lease agreements will be necessary
 - Review existing contracts with potential embedded leases
- Recommend preparing a schedule of **ALL** contracts to document initial review. (Auditors will likely require to determine completeness)
- Start completing the new SCO-560 form beginning 7/1/2021 so that these can be entered into our lease software
- **DO NOT wait until 2022 to start submitting information**

