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Statement No. 87 of the Governmental Accounting Standards Board

Leases

GASB

GOVERNMENTAL ACCOUNTING STANDARDS BOARD
OF THE FINANCIAL ACCOUNTING FOUNDATION

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Summary

The objective of this Statement is to better meet the information needs of financial statement users by improving accounting and financial reporting for leases by governments. This Statement increases the usefulness of governments' financial statements by requiring recognition of certain lease assets and liabilities for leases that previously were classified as operating leases and recognized as inflows of resources or outflows of resources based on the payment provisions of the contract. It establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset. Under this Statement, a lessee is required to recognize a lease liability and an intangible right-to-use lease asset, and a lessor is required to recognize a lease receivable and a deferred inflow of resources, thereby enhancing the relevance and consistency of information about governments' leasing activities.

Definition of 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. Examples of nonfinancial assets include buildings, land, vehicles, and equipment. Any contract that meets this definition should be accounted for under the leases guidance, unless specifically excluded in this Statement.

Lease Term

The lease term is defined as the period during which a lessee has a noncancelable right to use an underlying asset, plus the following periods, if applicable:

a. Periods covered by a lessee's option to extend the lease if it is reasonably certain, based on all relevant factors, that the lessee will exercise that option
b. Periods covered by a lessee's option to terminate the lease if it is reasonably certain, based on all relevant factors, that the lessee will not exercise that option
c. Periods covered by a lessor's option to extend the lease if it is reasonably certain, based on all relevant factors, that the lessor will exercise that option

d. Periods covered by a lessor's option to terminate the lease if it is reasonably certain, based on all relevant factors, that the lessor will not exercise that option.

A fiscal funding or cancellation clause should affect the lease term only when it is reasonably certain that the clause will be exercised.

Lessees and lessors should reassess the lease term only if one or more of the following occur:

a. The lessee or lessor elects to exercise an option even though it was previously determined that it was reasonably certain that the lessee or lessor would not exercise that option.
b. The lessee or lessor elects not to exercise an option even though it was previously determined that it was reasonably certain that the lessee or lessor would exercise that option.
c. An event specified in the lease contract that requires an extension or termination of the lease takes place.

Short-Term Leases

A short-term lease is defined as a lease that, at the commencement of the lease term, has a maximum possible term under the lease contract of 12 months (or less), including any options to extend, regardless of their probability of being exercised. Lessees and lessors should recognize short-term lease payments as outflows of resources or inflows of resources, respectively, based on the payment provisions of the lease contract.

Lessee Accounting

A lessee should recognize a lease liability and a lease asset at the commencement of the lease term, unless the lease is a short-term lease or it transfers ownership of the underlying asset. The lease liability should be measured at the present value of payments expected to be made during the lease term (less any lease incentives). The lease asset should be measured at the amount of the initial measurement of the lease liability, plus any payments made to the lessor at or before the commencement of the lease term and certain direct costs.

A lessee should reduce the lease liability as payments are made and recognize an outflow of resources (for example, expense) for interest on the liability. The lessee should amortize the lease asset in a systematic and rational

manner over the shorter of the lease term or the useful life of the underlying asset. The notes to financial statements should include a description of leasing arrangements, the amount of lease assets recognized, and a schedule of future lease payments to be made.

Lessor Accounting

A lessor should recognize a lease receivable and a deferred inflow of resources at the commencement of the lease term, with certain exceptions for leases of assets held as investments, certain regulated leases, short-term leases, and leases that transfer ownership of the underlying asset. A lessor should not derecognize the asset underlying the lease. The lease receivable should be measured at the present value of lease payments expected to be received during the lease term. The deferred inflow of resources should be measured at the value of the lease receivable plus any payments received at or before the commencement of the lease term that relate to future periods.

A lessor should recognize interest revenue on the lease receivable and an inflow of resources (for example, revenue) from the deferred inflows of resources in a systematic and rational manner over the term of the lease. The notes to financial statements should include a description of leasing arrangements and the total amount of inflows of resources recognized from leases.

Contracts with Multiple Components and Contract Combinations

Generally, a government should account for the lease and nonlease components of a lease as separate contracts. If a lease involves multiple underlying assets, lessees and lessors in certain cases should account for each underlying asset as a separate lease contract. To allocate the contract price to different components, lessees and lessors should use contract prices for individual components as long as they do not appear to be unreasonable based on professional judgment, or use professional judgment to determine their best estimate if there are no stated prices or if stated prices appear to be unreasonable. If determining a best estimate is not practicable, multiple components in a lease contract should be accounted for as a single lease unit. Contracts that are entered into at or near the same time with the same counterparty and that meet certain criteria should be considered part of the same lease contract and should be evaluated in accordance with the guidance for contracts with multiple components.

Lease Modifications and Terminations

An amendment to a lease contract should be considered a lease modification, unless the lessee's right to use the underlying asset decreases, in which case it would be a partial or full lease termination. A lease termination should be accounted for by reducing the carrying values of the lease liability and lease asset by a lessee, or the lease receivable and deferred inflows of resources by the lessor, with any difference being recognized as a gain or loss. A lease modification that does not qualify as a separate lease should be accounted for by remeasuring the lease liability and adjusting the related lease asset by a lessee and remeasuring the lease receivable and adjusting the related deferred inflows of resources by a lessor.

Subleases and Leaseback Transactions

Subleases should be treated as transactions separate from the original lease. The original lessee that becomes the lessor in a sublease should account for the original lease and the sublease as separate transactions, as a lessee and lessor, respectively.

A transaction qualifies for sale-leaseback accounting only if it includes a sale. Otherwise, it is a borrowing. The sale and lease portions of a transaction should be accounted for as separate sale and lease transactions, except that any difference between the carrying value of the capital asset that was sold and the net proceeds from the sale should be reported as a deferred inflow of resources or a deferred outflow of resources and recognized over the term of the lease.

A lease-leaseback transaction should be accounted for as a net transaction. The gross amounts of each portion of the transaction should be disclosed.

Effective Date and Transition

The requirements of this Statement are effective for reporting periods beginning after December 15, 2019. Earlier application is encouraged.

Leases should be recognized and measured using the facts and circumstances that exist at the beginning of the period of implementation (or, if applied to earlier periods, the beginning of the earliest period restated). However, lessors should not restate the assets underlying their existing sales-type or direct financing leases. Any residual assets for those leases become the carrying values of the underlying assets.

How the Changes in This Statement Will Improve Accounting and Financial Reporting

This Statement will increase the usefulness of governments' financial statements by requiring reporting of certain lease liabilities that currently are not reported. It will enhance comparability of financial statements among governments by requiring lessees and lessors to report leases under a single model. This Statement also will enhance the decision-usefulness of the information provided to financial statement users by requiring notes to financial statements related to the timing, significance, and purpose of a government's leasing arrangements.

How the Board Considered Costs and Benefits in the Development of This Statement

One of the principles guiding the Board's setting of standards for accounting and financial reporting is the assessment of expected benefits and perceived costs. The Board strives to determine that its standards address significant user needs and that the costs incurred through the application of its standards, compared with possible alternatives, are justified when compared to the expected overall public benefit. The Board considered the costs of both the individual provisions in this Statement and the Statement as a whole. The Board is cognizant that the costs of implementing the changes required by this Statement may be significant. However, the Board believes that the expected benefits that will result from the information provided through implementation of this Statement, both initially and on an ongoing basis, are significant.

To reduce the cost of implementation, this Statement includes an exception for short-term leases, as described above, and exceptions for contracts that transfer ownership, leases of assets that are investments, and certain regulated leases. In response to stakeholder feedback, this Statement excludes supply contracts and leases of inventory. In addition, this Statement includes cost-reducing provisions regarding reassessment of the lease term, requiring governments to report multiple-component contracts as a single lease unit when determining a best estimate for allocating the contract price to individual components is not practicable, and not requiring lessors to derecognize underlying assets, among other provisions.

Unless otherwise specified, pronouncements of the GASB apply to financial reports of all state and local governmental entities, including general purpose governments; public benefit corporations and authorities; public employee retirement systems; and public utilities, hospitals and other healthcare providers, and colleges and universities. Paragraph 3 discusses the applicability of this Statement.

Statement No. 87 of the
Governmental Accounting
Standards Board

Leases

June 2017

GOVERNMENTAL ACCOUNTING STANDARDS BOARD
of the Financial Accounting Foundation
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Leases

June 2017

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Leases

June 2017

INTRODUCTION

1. Governments enter into leases for many types of assets. The previous guidance for leases has been in effect for many years. Under the previous guidance, leases were classified as either capital or operating depending on whether the lease met any of four tests. In many cases, the previous guidance resulted in reporting lease transactions differently than similar nonlease financing transactions.

2. The objective of this Statement is to better meet the information needs of financial statement users by improving accounting and financial reporting for leases; enhancing the comparability of financial statements between governments; and also enhancing the relevance, reliability (representational faithfulness), and consistency of information about the leasing activities of governments.

STANDARDS OF GOVERNMENTAL ACCOUNTING AND FINANCIAL REPORTING

Scope and Applicability of This Statement

3. This Statement establishes standards of accounting and financial reporting for leases by lessees and lessors. The requirements of this Statement apply to financial statements of all state and local governments.

4. For purposes of applying this Statement, 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[1] transaction.

5. To determine whether a contract conveys control of the right to use the underlying asset, a government should assess whether it has both of the following:

a. The right to obtain the present service capacity from use of the underlying asset as specified in the contract
b. The right to determine the nature and manner of use of the underlying asset as specified in the contract.

6. Leases include contracts that, although not explicitly identified as leases, meet the definition of a lease. This definition excludes contracts for services except those contracts that contain *both* a lease component and a service component.

7. As used in the definition of a lease, a nonfinancial asset is an asset that is not a financial asset as that term is defined in Statement No. 72, *Fair Value Measurement and Application.*[2] Examples of nonfinancial assets include land, buildings, vehicles, and equipment.

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[1]The scope of this Statement includes both exchange and exchange-like transactions. Footnote 1 of Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions,* states that the difference between exchange and exchange-like transactions is a matter of degree. In contrast to a "pure" exchange transaction, an exchange-like transaction is one in which the values exchanged, though related, may not be quite equal or in which the direct benefits may not be exclusively for the parties to the transaction. Nevertheless, the exchange characteristics of the transaction are strong enough to justify treating the transaction as an exchange for accounting recognition.

[2]A financial asset is defined in paragraph 86 of Statement 72 as, "Cash, evidence of an ownership interest in an entity, or a contract that conveys to one entity a right to do either of the following:

a. Receive cash or another financial instrument from a second entity
b. Exchange other financial instruments on potentially favorable terms with the second entity (for example, an option)."

8. This Statement does not apply to:

a. Leases of intangible assets, including rights to explore for or to exploit natural resources such as oil, gas, and minerals and similar nonregenerative resources; licensing contracts for items such as motion picture films, video recordings, plays, manuscripts, patents, and copyrights; and licensing contracts for computer software. In sublease transactions, however, this Statement does apply to the intangible right-to-use assets that are created by the original leases of tangible underlying assets.
b. Leases of biological assets, including timber, living plants, and living animals.
c. Leases of inventory.
d. Contracts that meet the definition of a service concession arrangement in paragraph 4 of Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements.*
e. Leases in which the underlying asset is financed with outstanding conduit debt, unless both the underlying asset and the conduit debt are reported by the lessor.
f. Supply contracts, such as power purchase agreements.

9. This Statement supersedes NCGA Statement 5, *Accounting and Financial Reporting Principles for Lease Agreements of State and Local Governments;* Statement No. 13, *Accounting for Operating Leases with Scheduled Rent Increases;* Statement No. 38, *Certain Financial Statement Note Disclosures,* paragraph 11; Statement 60, paragraph 7; Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements,* paragraphs 211–271, and footnotes 85–141; Statement No. 65, *Items Previously Reported as Assets and Liabilities,* paragraphs 7 and 16–18, and footnotes 6 and 7; and *Implementation Guide No. 2015-1,* Question Z.38.1. This Statement amends NCGA Statement 1, *Governmental Accounting and Financial Reporting Principles,* paragraphs 42 and 43; Statement No. 9, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting,* paragraph 37; Statement No. 14, *The Financial Reporting Entity,* paragraphs 58 and 76; Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments,* paragraphs 81, 116, and 117; Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries,* paragraphs 11 and 12; Statement No. 44, *Economic Condition Reporting: The Statistical Section,* paragraphs 23 and 45; Statement No. 51, *Accounting and Financial Reporting for Intangible Assets,* paragraph 3; Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments,* paragraph 74;

Statement No. 58, *Accounting and Financial Reporting for Chapter 9 Bankruptcies,* paragraph 8; Statement 62, paragraphs 3, 5, 6, 113, 135, 254, 320, 351, 368–370, and 450, and footnote 12; Statement 65, paragraph 5; Statement No. 66, *Technical Corrections—2012,* paragraph 2; NCGA Interpretation 6, *Notes to the Financial Statements Disclosure,* paragraphs 4 and 5; Interpretation No. 6, *Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements,* paragraphs 7, 9, 11, and 13; Implementation Guide 2015-1, Questions 2.27.5, 2.32.1, 5.72.1, 7.9.6, 7.30.2, 9.24.1, Z.42.9, Z.51.21, and Z.54.11; Implementation Guide No. 2016-1, *Implementation Guidance Update—2016,* Questions 5.2 and 5.35; and Implementation Guide No. 2017-2, *Financial Reporting for Postemployment Benefit Plans Other Than Pensions Plans,* Question 4.51.

10. The provisions of paragraphs 20–34 for lessee recognition and measurement, paragraphs 40–55 for lessor recognition and measurement, and paragraphs 71–79 for lease modifications and terminations apply to financial statements prepared using the economic resources measurement focus and, if applicable, to financial statements prepared using the current financial resources measurement focus. The provisions of paragraphs 35 and 36 for lessee recognition and paragraph 56 for lessor recognition only apply to financial statements prepared using the current financial resources measurement focus.

11. This Statement establishes guidance for the various aspects of lease transactions as follows:

a. Paragraphs 12–15 define the lease term.
b. Paragraphs 16–18 address short-term leases.
c. Paragraph 19 addresses contracts that transfer ownership.
d. Paragraphs 20–39 provide lessee recognition, measurement, and disclosure guidance.
e. Paragraphs 40–60 provide lessor recognition, measurement, and disclosure guidance, including provisions in paragraph 41 for leases of assets that are investments and provisions in paragraphs 42 and 43 for certain regulated leases, such as agreements between air carriers and airports.
f. Paragraphs 61 and 62 address lease incentives.
g. Paragraphs 63–70 address contracts with multiple components and contract combinations.
h. Paragraphs 71–79 address lease modifications and terminations.
i. Paragraphs 80 and 81 address subleases.
j. Paragraphs 82–87 address sale-leaseback and lease-leaseback transactions.

k. Paragraphs 88 and 89 address intra-entity leases.
l. Paragraphs 90 and 91 address leases between related parties.

Lease Term

12. The lease term is the period during which a lessee has a noncancelable right to use an underlying asset (referred to as the noncancelable period), plus the following periods, if applicable:

a. Periods covered by a lessee's option to extend the lease if it is reasonably certain, based on all relevant factors, that the lessee will exercise that option
b. Periods covered by a lessee's option to terminate the lease if it is reasonably certain, based on all relevant factors, that the lessee will *not* exercise that option
c. Periods covered by a lessor's option to extend the lease if it is reasonably certain, based on all relevant factors, that the lessor will exercise that option
d. Periods covered by a lessor's option to terminate the lease if it is reasonably certain, based on all relevant factors, that the lessor will *not* exercise that option.

Periods for which both the lessee and the lessor have an option to terminate the lease without permission from the other party (or if both parties have to agree to extend) are cancelable periods and are excluded from the lease term. For 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 the lessor have an option to terminate and, therefore, either could cancel the lease at any time. Provisions that allow for termination of a lease due to (1) purchase of the underlying asset, (2) payment of all sums due, or (3) default on payments, are not considered termination options.

13. A fiscal funding or cancellation clause allows governmental lessees to cancel a lease, typically on an annual basis, if the government does not appropriate funds for the lease payments. This type of clause should affect the lease term only if it is reasonably certain that the clause will be exercised.

14. At the commencement of the lease term, the lessee and the lessor should assess all factors relevant to the likelihood that the lessee or the lessor will exercise options identified in paragraphs 12a–12d, whether these factors are

contract based, underlying asset based, market based, or government specific. The assessment often will require the consideration of a combination of these interrelated factors. Examples of factors to consider include, but are not limited to, the following:

a. A significant economic incentive, such as contractual terms and conditions for the optional periods that are favorable compared with current market rates
b. A significant economic disincentive, such as costs to terminate the lease and sign a new lease (for example, negotiation costs, relocation costs, abandonment of significant leasehold improvements, costs of identifying another suitable underlying asset, costs associated with returning the underlying asset in a contractually specified condition or to a contractually specified location, or a substantial cancellation penalty)
c. The history of exercising options to extend or terminate
d. The extent to which the asset underlying the lease is essential to the provision of government services.

15. Lessees and lessors should reassess the lease term only if one or more of the following occur:

a. The lessee or lessor elects to exercise an option even though it was previously determined that it was reasonably certain that the lessee or lessor would not exercise that option
b. The lessee or lessor elects not to exercise an option even though it was previously determined that it was reasonably certain that the lessee or lessor would exercise that option
c. An event specified in the lease contract that requires an extension or termination of the lease takes place.

Short-Term Leases

16. A short-term lease is a lease that, at the commencement of the lease term, has a maximum possible term under the lease contract of 12 months (or less), including any options to extend, regardless of their probability of being exercised. For a lease that is cancelable by either the lessee or the lessor, such as a rolling month-to-month lease or a year-to-year lease, the maximum possible term is the noncancelable period, including any notice periods.

Lessees

17. A lessee should recognize short-term lease payments as outflows of resources (for example, expense) based on the payment provisions of the lease contract. The lessee should recognize an asset if payments are made in advance or a liability for rent due if payments are to be made subsequent to the reporting period. The lessee should not recognize an outflow of resources during any rent holiday period (for example, one or more months free).

Lessors

18. A lessor should recognize short-term lease payments as inflows of resources (for example, revenue) based on the payment provisions of the lease contract. The lessor should recognize a liability if payments are received in advance or an asset for rent due if payments are to be received subsequent to the reporting period. The lessor should not recognize an inflow of resources during any rent holiday period (for example, one or more months free).

Contracts That Transfer Ownership

19. A contract that (a) transfers ownership of the underlying asset to the lessee by the end of the contract and (b) does not contain termination options (see paragraph 12), but that may contain a fiscal funding or cancellation clause that is not reasonably certain of being exercised (see paragraph 13), should be reported as a financed purchase of the underlying asset by the lessee or sale of the asset by the lessor.

Lessee Recognition and Measurement for Leases Other Than Short-Term Leases and Contracts That Transfer Ownership

20. At the commencement of the lease term, a lessee should recognize a lease liability and an intangible right-to-use lease asset (a capital asset hereinafter referred to as the lease asset), except as provided in paragraphs 16–18 (short-term leases), and paragraph 19 (contracts that transfer ownership).

Lease Liability

21. A lessee initially should measure the lease liability at the present value of payments expected to be made during the lease term. Measurement of the lease liability should include the following, if required by a lease:

a. Fixed payments
b. Variable payments that depend on an index or a rate (such as the Consumer Price Index or a market interest rate), initially measured using the index or rate as of the commencement of the lease term
c. Variable payments that are fixed in substance (as discussed in paragraph 22)
d. Amounts that are reasonably certain of being required to be paid by the lessee under residual value guarantees
e. The exercise price of a purchase option if it is reasonably certain that the lessee will exercise that option
f. Payments for penalties for terminating the lease, if the lease term reflects the lessee exercising (1) an option to terminate the lease or (2) a fiscal funding or cancellation clause
g. Any lease incentives (as discussed in paragraphs 61 and 62) receivable from the lessor
h. Any other payments that are reasonably certain of being required based on an assessment of all relevant factors.

22. Variable payments based on future performance of the lessee or usage of the underlying asset should not be included in the measurement of the lease liability. Rather, those variable payments should be recognized as outflows of resources (for example, expense) in the period in which the obligation for those payments is incurred. However, any component of those variable payments that is fixed in substance should be included in the measurement of the lease liability.

23. The future lease payments should be discounted using the interest rate the lessor charges the lessee, which may be the interest rate implicit in the lease. If the interest rate cannot be readily determined by the lessee, the lessee's estimated incremental borrowing rate (an estimate of the interest rate that would be charged for borrowing the lease payment amounts during the lease term) should be used. Lessees are not required to apply the guidance for imputation of interest in paragraphs 173–187 of Statement 62 but may do so as a means of determining the interest rate implicit in the lease.

24. In subsequent financial reporting periods, the lessee should calculate the amortization of the discount on the lease liability and report that amount as an outflow of resources (for example, interest expense) for the period. Any payments made should be allocated first to the accrued interest liability[3] and then to the lease liability.

25. The lessee should remeasure the lease liability at subsequent financial reporting dates if one or more of the following changes have occurred at or before that financial reporting date, based on the most recent lease contract before the changes,[4] and the changes individually or in the aggregate are expected to significantly affect the amount of the lease liability since the previous measurement:

a. There is a change in the lease term.
b. An assessment of all relevant factors indicates that the likelihood of a residual value guarantee being paid has changed from reasonably certain to not reasonably certain, or vice versa.
c. An assessment of all relevant factors indicates that the likelihood of a purchase option being exercised has changed from reasonably certain to not reasonably certain, or vice versa.
d. There is a change in the estimated amounts for payments already included in the measurement of the lease liability (except as provided in paragraph 26).
e. There is a change in the interest rate the lessor charges the lessee, if used as the initial discount rate.
f. A contingency, upon which some or all of the variable payments that will be made over the remainder of the lease term are based, is resolved such that those payments now meet the criteria for measuring the lease liability under paragraph 21. For example, an event occurs that causes variable payments that were contingent on the performance or use of the underlying asset to become fixed payments for the remainder of the lease term.

26. If a lease liability is remeasured for any of the changes in paragraph 25, the liability also should be adjusted for any change in an index or rate used to determine variable payments if that change in the index or rate is expected to

[3]In the statement of cash flows, payments allocated to the accrued interest liability should be classified as financing activities as provided in Statement 9.

[4]Changes arising from amendments to a lease contract should be accounted for under the provisions of paragraphs 71–79 for lease modifications and terminations.

significantly affect the amount of the liability since the previous measurement. A lease liability is not required to be remeasured solely for a change in an index or rate used to determine variable payments.

27. The lessee also should update the discount rate as part of the remeasurement if one or both of the following changes[5] have occurred and the changes individually or in the aggregate are expected to significantly affect the amount of the lease liability:

a. There is a change in the lease term.
b. An assessment of all relevant factors indicates that the likelihood of a purchase option being exercised has changed from reasonably certain to not reasonably certain, or vice versa.

28. A lease liability is not required to be remeasured, nor is the discount rate required to be reassessed, solely for a change in the lessee's incremental borrowing rate.

29. If the discount rate is required to be updated based on the provisions in paragraph 27, the discount rate should be based on the revised interest rate the lessor charges the lessee at the time the discount rate is updated. If that interest rate cannot be readily determined, the lessee's estimated incremental borrowing rate at the time the discount rate is updated should be used.

Lease Asset

30. A lessee initially should measure the lease asset as the sum of the following:

a. The amount of the initial measurement of the lease liability (see paragraph 21)
b. Lease payments made to the lessor at or before the commencement of the lease term, less any lease incentives (as discussed in paragraphs 61 and 62) received from the lessor at or before the commencement of the lease term
c. Initial direct costs that are ancillary charges necessary to place the lease asset into service.

[5]See footnote 4.

Any initial direct costs that would be considered debt issuance costs under paragraph 12 of Statement No. 7, *Advance Refundings Resulting in Defeasance of Debt,* should be recognized as outflows of resources (for example, expense) in the period in which they are incurred.

31. A lease asset should be amortized in a systematic and rational manner over the shorter of the lease term or the useful life of the underlying asset, except as provided in paragraph 32. The amortization of the lease asset should be reported as an outflow of resources (for example, amortization expense), which may be combined with depreciation expense related to other capital assets for financial reporting purposes.

32. If a lease contains a purchase option that the lessee has determined is reasonably certain of being exercised, the lease asset should be amortized over the useful life of the underlying asset. In that circumstance, if the underlying asset is nondepreciable, such as land, the lease asset should not be amortized.

33. A lease asset generally should be adjusted by the same amount as the corresponding lease liability when that liability is remeasured based on paragraphs 25–29. However, if that change reduces the carrying value of the lease asset to zero, any remaining amount should be reported in the resource flows statement (for example, a gain).

34. The presence of impairment indicators (described in paragraph 9 of Statement 42) with respect to the underlying asset may result in a change in the manner or duration of use of the lessee's right-to-use asset. Such a change in the manner or duration of use of the lessee's right-to-use asset may indicate that the service utility of that lease asset is impaired. The length of time during which the lessee cannot use the underlying asset, or is limited to using it in a different manner, should be compared to its previously expected manner and duration of use to determine whether there is a significant decline in service utility of the lease asset. If a lease asset is impaired, the amount reported for the lease asset should be reduced first for any change in the corresponding lease liability. Any remaining amount should be recognized as an impairment.

Financial Statements Prepared Using the Current Financial Resources Measurement Focus

35. If a lease is expected to be paid from general government resources, the lease should be accounted for and reported on a basis consistent with governmental fund accounting principles.

36. An expenditure and other financing source should be reported in the period the lease is initially recognized. The expenditure and other financing source should be measured as provided in paragraphs 21–23. Subsequent governmental fund lease payments should be accounted for consistent with principles for debt service payments on long-term debt.

Notes to Financial Statements—Lessees

37. A lessee should disclose the following about its lease activities (which may be grouped for purposes of disclosure), other than short-term leases:

a. A general description of its leasing arrangements, including (1) the basis, terms, and conditions on which variable payments not included in the measurement of the lease liability are determined and (2) the existence, terms, and conditions of residual value guarantees provided by the lessee not included in the measurement of the lease liability
b. The total amount of lease assets, and the related accumulated amortization, disclosed separately from other capital assets
c. The amount of lease assets by major classes of underlying assets, disclosed separately from other capital assets
d. The amount of outflows of resources recognized in the reporting period for variable payments not previously included in the measurement of the lease liability
e. The amount of outflows of resources recognized in the reporting period for other payments, such as residual value guarantees or termination penalties, not previously included in the measurement of the lease liability
f. Principal and interest requirements to maturity, presented separately, for the lease liability for each of the five subsequent fiscal years and in five-year increments thereafter
g. Commitments under leases before the commencement of the lease term
h. The components of any loss associated with an impairment (the impairment loss and any related change in the lease liability, as discussed in paragraph 34).

38. A lessee also should provide relevant disclosures for the following transactions, if applicable:

a. Sublease transactions (see paragraph 81)
b. Sale-leaseback transactions (see paragraph 85)
c. Lease-leaseback transactions (see paragraph 87).

39. A lessee is not required to disclose collateral pledged as a security for a lease (under paragraph 113 of Statement 62) if that collateral is solely the asset underlying the lease.

Lessor Recognition and Measurement for Leases Other Than Short-Term Leases and Contracts That Transfer Ownership

40. At the commencement of the lease term, a lessor should recognize a lease receivable and a deferred inflow of resources, except as provided in paragraphs 16–18 (short-term leases), paragraph 19 (contracts that transfer ownership), paragraph 41 (leases of assets that are investments), and paragraphs 42 and 43 (certain regulated leases). Any initial direct costs incurred by the lessor should be reported as outflows of resources (for example, expense) for the period.

Leases of Assets That Are Investments

41. If the underlying asset in a lease meets the requirements in Statement 72 to be reported as an investment measured at fair value, the lessor should not apply the recognition and measurement provisions of this Statement. The lessor should disclose the information in paragraph 57d of this Statement but is not required to make the other disclosures in paragraph 57.

Certain Regulated Leases

42. Certain leases are subject to external laws, regulations, or legal rulings. For example, the U.S. Department of Transportation and the Federal Aviation Administration regulate aviation leases between airports and air carriers and other aeronautical users. Lessors should not apply the provisions in paragraphs 44–59 of this Statement to leases that meet the provisions of paragraph 43.

43. Lessors should recognize inflows of resources (for example, revenue) based on the payment provisions of the lease contract and provide the disclosures in paragraph 60 for leases for which external laws, regulations, or legal rulings establish all of the following requirements:

a. Lease rates cannot exceed a reasonable amount, with reasonableness being subject to determination by an external regulator.
b. Lease rates should be similar for lessees that are similarly situated.
c. The lessor cannot deny potential lessees the right to enter into leases if facilities are available, provided that the lessee's use of the facilities complies with generally applicable use restrictions.

Lease Receivable

44. A lessor initially should measure the lease receivable at the present value of lease payments expected to be received during the lease term, reduced by any provision for estimated uncollectible amounts. Measurement of the lease receivable should include the following, if required by a lease:

a. Fixed payments
b. Variable payments that depend on an index or a rate (such as the Consumer Price Index or a market interest rate), initially measured using the index or rate as of the commencement of the lease term
c. Variable payments that are fixed in substance (as discussed in paragraph 45)
d. Residual value guarantee payments that are fixed in substance (as discussed in paragraph 46)
e. Any lease incentives (as discussed in paragraphs 61 and 62) payable to the lessee.

45. Variable payments based on future performance of the lessee or usage of the underlying asset should not be included in the measurement of the lease receivable. Rather, those variable payments should be recognized as inflows of resources (for example, revenue) in the period to which those payments relate. However, any component of those variable payments that is fixed in substance should be included in the measurement of the lease receivable.

46. Amounts to be received under residual value guarantees (that are not fixed in substance) should be recognized as a receivable and an inflow of resources if (a) a guarantee payment is required (as agreed to by the lessee and lessor) and (b) the amount can be reasonably estimated. Amounts to be received for

the exercise price of a purchase option or penalty for lease termination should be recognized as a receivable and an inflow of resources (for example, revenue) when those options are exercised.

47. The future lease payments to be received should be discounted using the interest rate the lessor charges the lessee, which may be the interest rate implicit in the lease. Lessors are not required to apply the guidance for imputation of interest in paragraphs 173–187 of Statement 62 but may do so as a means of determining the interest rate implicit in the lease.

48. In subsequent financial reporting periods, the lessor should calculate the amortization of the discount on the lease receivable and report that amount as an inflow of resources (for example, interest revenue) for the period. Any payments received should be allocated first to the accrued interest receivable and then to the lease receivable.

49. The lessor should remeasure the lease receivable at subsequent financial reporting dates if one or more of the following changes have occurred at or before that financial reporting date, based on the most recent lease contract before the changes,[6] and the changes individually or in the aggregate are expected to significantly affect the amount of the lease receivable since the previous measurement:

a. There is a change in the lease term.
b. There is a change in the interest rate the lessor charges the lessee.
c. A contingency, upon which some or all of the variable payments that will be received over the remainder of the lease term are based, is resolved such that those payments now meet the criteria for measuring the lease receivable under paragraph 44. For example, an event occurs that results in variable payments that were contingent on the performance or use of the underlying asset becoming fixed payments for the remainder of the lease term.

50. If a lease receivable is remeasured for any of the changes in paragraph 49, the receivable also should be adjusted for any change in an index or rate used to determine variable payments if that change in the index or rate is expected

[6]Changes arising from amendments to a lease contract should be accounted for under the provisions of paragraphs 71–79 for lease modifications and terminations.

to significantly affect the amount of the receivable since the previous measurement. A lease receivable is not required to be remeasured solely for a change in an index or rate used to determine variable payments.

51. The lessor also should update the discount rate as part of the remeasurement if one or both of the following changes[7] have occurred and the changes individually or in the aggregate are expected to significantly affect the amount of the lease receivable:

a. There is a change in the lease term.
b. There is a change in the interest rate the lessor charges the lessee.

52. If the discount rate is updated based on the provisions in paragraph 51, the receivable should be remeasured using the revised discount rate.

Deferred Inflow of Resources

53. A lessor initially should measure the deferred inflow of resources as follows:

a. The amount of the initial measurement of the lease receivable (see paragraph 44)
b. Lease payments received from the lessee at or before the commencement of the lease term that relate to future periods (for example, the final month's rent), less any lease incentives (as discussed in paragraphs 61and 62) paid to, or on behalf of, the lessee at or before the commencement of the lease term.

54. A lessor subsequently should recognize the deferred inflow of resources as inflows of resources (for example, revenue) in a systematic and rational manner over the term of the lease. The deferred inflow of resources generally should be adjusted by the same amount as any change resulting from the remeasurement of the lease receivable as discussed in paragraphs 49–52.

[7]See footnote 6.

Underlying Asset

55. A lessor should not derecognize the asset underlying the lease. A lessor should continue to apply other applicable guidance to the underlying asset, including depreciation and impairment. However, if the lease contract requires the lessee to return the asset in its original or enhanced condition, a lessor should not depreciate the asset during the lease term.

Financial Statements Prepared Using the Current Financial Resources Measurement Focus

56. In financial statements prepared using the current financial resources measurement focus, a lessor should recognize a lease receivable and a deferred inflow of resources to account for a lease. A lessor should measure the deferred inflow of resources at the initial value of the lease receivable (see paragraph 44), plus the amount of any payments received at or before the commencement of the lease term that relate to future periods (for example, the final month's rent). A lessor subsequently should recognize the deferred inflow of resources as inflows of resources (for example, revenue), if available, in a systematic and rational manner over the term of the lease.

Notes to Financial Statements—Lessors

57. A lessor should disclose the following about its lease activities (which may be grouped for purposes of disclosure), other than short-term leases and certain regulated leases:

a. A general description of its leasing arrangements, including the basis, terms, and conditions on which any variable payments not included in the measurement of the lease receivable are determined
b. The total amount of inflows of resources (for example, lease revenue, interest revenue, and any other lease-related inflows) recognized in the reporting period from leases, if that amount cannot be determined based on the amounts displayed on the face of the financial statements
c. The amount of inflows of resources recognized in the reporting period for variable and other payments not previously included in the measurement of the lease receivable, including inflows of resources related to residual value guarantees and termination penalties

d. The existence, terms, and conditions of options by the lessee to terminate the lease or abate payments if the lessor government has issued debt for which the principal and interest payments are secured by the lease payments.

58. A lessor also should provide relevant disclosures for the following transactions, if applicable:

a. Leases of assets that are investments (see paragraph 41)
b. Certain regulated leases (see paragraph 60)
c. Sublease transactions (see paragraph 81)
d. Sale-leaseback transactions (see paragraph 85)
e. Lease-leaseback transactions (see paragraph 87).

59. In addition to the disclosures in paragraphs 57 and 58, if a lessor's principal ongoing operations consist of leasing assets to other entities, the government should disclose a schedule of future payments that are included in the measurement of the lease receivable, showing principal and interest separately, for each of the five subsequent fiscal years and in five-year increments thereafter.

60. A lessor with one or more regulated leases, as described in paragraphs 42 and 43, should disclose the following about those lease activities (which may be grouped for purposes of disclosure), other than short-term leases:

a. A general description of its agreements
b. The extent to which capital assets are subject to preferential or exclusive use by counterparties under agreements, by major class of assets and by major counterparty
c. The total amount of inflows of resources (for example, lease revenue, interest revenue, and any other lease-related inflows) recognized in the reporting period from these agreements, if that amount cannot be determined based on the amounts displayed on the face of the financial statements
d. A schedule of expected future minimum payments under these agreements for each of the subsequent five years and in five-year increments thereafter
e. The amount of inflows of resources recognized in the reporting period for variable payments not included in expected future minimum payments
f. The existence, terms, and conditions of options by the lessee to terminate the lease or abate lease payments if the lessor government has issued debt for which the principal and interest payments are secured by the lease payments.

Lease Incentives

61. As used in this Statement, lease incentives are (a) payments made to, or on behalf of, the lessee, for which the lessee has a right of offset with its obligation to the lessor, or (b) other concessions granted to the lessee. A lease incentive is equivalent to a rebate or discount and includes assumption of a lessee's preexisting lease obligations to a third party, other reimbursements of lessee costs, rent holidays, and reductions of interest or principal charges by the lessor.

62. Lease incentives reduce the amount that a lessee is required to pay for a lease. Lease incentives that provide payments to, or on behalf of, a lessee at or before the commencement of a lease term are included in initial measurement by directly reducing the amount of the lease asset (see paragraph 30). Lease incentive payments to be provided after the commencement of the lease term should be accounted for by lessees and lessors as reductions of lease payments for the periods in which the incentive payments will be provided. Those payments should be measured by lessees consistently with the lessee's lease liability (paragraphs 21–29) and by lessors consistently with the lessor's lease receivable (paragraphs 44–52). Accordingly, lease incentive payments to be provided after the commencement of the lease term are included in initial measurement and any remeasurement if they are fixed or fixed in substance, whereas variable or contingent lease incentive payments are not included in initial measurement.

Contracts with Multiple Components

63. Lessees and lessors may enter into contracts that contain multiple components, such as a contract that contains both a lease component and a nonlease component, or a lease that contains multiple underlying assets.

64. If a lessee or lessor enters into a contract that contains both a lease component (such as the right to use a building) and a nonlease component (such as maintenance services for the building), the government should account for the lease and nonlease components as separate contracts unless the contract meets the exception in paragraph 67.

65. If a lease involves multiple underlying assets and the assets have different lease terms, the lessee and the lessor should account for each underlying asset as a separate lease component. In addition, the lessee should account for each

underlying asset as a separate lease component if the underlying assets are in different major classes of assets for disclosure purposes under paragraph 37c. The provisions of this paragraph should be applied unless the contract meets the exception in paragraph 67.

66. To allocate the contract price to the different components, lessees and lessors first should use any prices for individual components that are included in the contract, as long as the price allocation does not appear to be unreasonable based on the terms of the contract and professional judgment, maximizing the use of observable information; for example, using readily available observable stand-alone prices. Stand-alone prices are those that would be paid or received if the same or similar assets were leased individually or if the same or similar nonlease components (such as services) were contracted individually. Some contracts provide discounts for bundling multiple leases or lease and nonlease components together in one contract. Those discounts may be taken into account when determining whether individual component prices do not appear to be unreasonable. For example, if the individual component prices are each discounted by the same percentage from normal market prices, the discount included in those component prices would not appear to be unreasonable.

67. If a contract does not include prices for individual components, or if any of those prices appear to be unreasonable as provided in paragraph 66, lessees and lessors should use professional judgment to determine their best estimate for allocating the contract price to those components, maximizing the use of observable information. If it is not practicable to determine a best estimate for price allocation for some or all components in the contract, a government should account for those components as a single lease unit.

68. If multiple components are accounted for as a single lease unit as provided for in paragraph 67, the accounting for that unit should be based on the primary lease component within that unit. For example, the primary lease component's lease term should be used for the unit if the lease components have different lease terms.

Contract Combinations

69. Contracts that are entered into at or near the same time with the same counterparty should be considered part of the same contract if either of the following criteria is met:

a. The contracts are negotiated as a package with a single objective.
b. The amount of consideration to be paid in one contract depends on the price or performance of the other contract.

70. If multiple contracts are determined to be part of the same contract, that contract should be evaluated in accordance with the guidance for contracts with multiple components in paragraphs 63–68.

Lease Modifications and Terminations

71. The provisions of a lease contract may be amended while the contract is in effect. Amendments modify the provisions of the lease contract. Examples of amendments to lease contracts include changing the contract price, lengthening or shortening the lease term, and adding or removing an underlying asset. An amendment should be considered a lease modification unless the lessee's right to use the underlying asset decreases, in which case the amendment should be considered a partial or full lease termination. By contrast, exercising an existing option, such as an option to extend or terminate the lease as discussed in paragraphs 15a and 15b, is subject to the guidance for remeasurement.

Lease Modifications

72. The lessee and lessor should account for an amendment during the reporting period resulting in a modification to a lease contract as a separate lease (that is, separate from the most recent lease contract before the modification) if both of the following conditions are present:

a. The lease modification gives the lessee an additional lease asset by adding one or more underlying assets that were not included in the original lease contract.

b. The increase in lease payments for the additional lease asset does not appear to be unreasonable based on (1) the terms of the amended lease contract and (2) professional judgment, maximizing the use of observable information (for example, using readily available observable stand-alone prices).

Lessees

73. Unless a modification is reported as a separate lease as provided in paragraph 72, a lessee should account for a lease modification by remeasuring the lease liability. The lease asset should be adjusted by the difference between the remeasured liability and the liability immediately before the lease modification. However, if the change reduces the carrying value of the lease asset to zero, any remaining amount should be reported in the resource flows statement (for example, a gain).

74. If prior to the expiration of the lease term a change to the provisions of a lease results from a debt refunding by the lessor, including an advance refunding, in which the perceived economic advantages of the refunding are passed through to the lessee, the change should be accounted for as follows:

a. If a change to the provisions of a lease results from a debt refunding by the lessor, including an advance refunding that results in a defeasance of debt, the lessee should adjust the lease liability to the present value of the future lease payments under the revised lease using the effective interest rate applicable to the revised lease contract. The resulting difference should be reported as a deferred outflow of resources or a deferred inflow of resources. The deferred outflow of resources or the deferred inflow of resources should be recognized as an adjustment to an outflow of resources (for example, as an increase or decrease to interest expense) in a systematic and rational manner over the remaining life of the old debt or the life of the new debt, whichever is shorter.
b. If (1) the provisions of a lease are changed in connection with an advance refunding by the lessor that results in a defeasance of debt and (2) the lessee is obligated to reimburse the lessor for any costs related to the refunded debt that have been or will be incurred (such as an unamortized discount or a call premium), the lessee should recognize those costs in a systematic and rational manner over the remaining life of the old debt or the life of the new debt, whichever is shorter.

Lessors

75. Unless a modification is reported as a separate lease as provided in paragraph 72, a lessor should account for a lease modification by remeasuring the lease receivable. The deferred inflow of resources should be adjusted by the difference between the remeasured receivable and the receivable immediately before the lease modification. However, to the extent that the change relates to payments for the current period, the change should be recognized as an inflow of resources (for example, revenue) or an outflow of resources (for example, expense) for the current period.

76. If prior to the expiration of the lease term a change to the provisions of a lease results from a debt refunding by the lessor, including an advance refunding, in which the perceived economic advantages of the refunding are passed through to the lessee, the change should be accounted for as follows:

a. If a change to the provisions of a lease results from a debt refunding by the lessor, including an advance refunding that results in a defeasance of debt, the lessor should adjust the lease receivable to the present value of the future lease payments based on the interest rate applicable to the revised lease contract and also should adjust the deferred inflows of resources. The adjustment to the deferred inflow of resources should be recognized as inflows of resources or outflows of resources (for example, gain or loss) over the remaining life of the old debt or the life of the new debt, whichever is shorter.
b. If a change to the provisions of a lease results from an advance refunding that results in a defeasance of debt, the lessor also should systematically recognize, as inflows of resources (for example, revenue), any reimbursements to be received from the lessee for costs related to the refunded debt (such as an unamortized discount or a call premium) over the remaining life of the old debt or the life of the new debt, whichever is shorter.

Lease Terminations

77. The lessee and lessor should account for an amendment during the reporting period resulting in a decrease in the lessee's right to use the underlying asset (for example, the lease term is shortened or the number of underlying assets is reduced) as a partial or full lease termination.

Lessees

78. A lessee generally should account for the partial or full lease termination by reducing the carrying values of the lease asset and lease liability, and recognizing a gain or loss for the difference. However, if the lease is terminated as a result of the lessee purchasing an underlying asset from the lessor, the lease asset should be reclassified to the appropriate class of owned asset.

Lessors

79. A lessor should account for the partial or full lease termination by reducing the carrying values of the lease receivable and related deferred inflow of resources, and recognizing a gain or loss for the difference. However, if the lease is terminated as a result of the lessee purchasing an underlying asset from the lessor, the carrying value of the underlying asset should be derecognized and included in the calculation of any resulting gain or loss.

Subleases

80. A sublease involves three parties: the original lessor, the original lessee (who also is the lessor in the sublease), and the new lessee. The original lessor should continue to apply the general lessor guidance. The government that is the original lessee and becomes the lessor in the sublease should account for the original lease and the sublease as two separate transactions, as a lessee and a lessor, respectively. Those two separate transactions should not be offset against one another. The new lessee should apply the general lessee guidance.

81. The original lessee (now the lessor in the sublease) should include the sublease in its disclosure of the general description of lease arrangements. Its lessor transactions related to subleases should be disclosed separately from its lessee transactions related to original leases.

Sale-Leaseback Transactions

82. Sale-leaseback transactions involve the sale of an underlying asset by the owner and a lease of the property back to the seller (original owner). A sale-leaseback should include a transaction that qualifies as a sale (see para-

graphs 287–319 and 321–323 of Statement 62) to be eligible for sale-leaseback accounting. A sale-leaseback transaction that does not include a qualifying sale should be accounted for as a borrowing activity by the seller-lessee and a lending activity by the buyer-lessor.

83. The sale and lease portions of a sale-leaseback transaction should be accounted for in financial statements prepared using the economic resources measurement focus as two separate transactions—a sale transaction and a lease transaction—except that the difference between the carrying value of the capital asset that was sold and the net proceeds from the sale should be reported as a deferred inflow of resources or a deferred outflow of resources and subsequently recognized in the resource flows statements in a systematic and rational manner over the term of the lease. However, if the lease portion of the transaction qualifies as a short-term lease, any difference between the carrying value of the capital asset that was sold and the net proceeds from the sale should be recognized immediately.

84. A sale-leaseback transaction is considered to have off-market terms if there is a significant difference between (a) the sale price and the estimated fair value of the asset or (b) the present value of the contractual lease payments and the estimated present value of what the lease payments for that asset would be at the market price, whichever of the two differences is more readily determinable. That difference should be reported based on the substance of the transaction (for example, as a borrowing, a nonexchange transaction, or an advance lease payment) rather than as part of the sale-leaseback transaction.

85. A seller-lessee should disclose the terms and conditions of sale-leaseback transactions in addition to the disclosures required of a lessee in paragraph 37. A buyer-lessor should provide the disclosures required of a lessor in paragraph 57.

86. For entities that elect to apply the regulated operations guidance of Statement 62, and that meet the criteria in paragraphs 476–500 of that Statement, as amended, the difference between (a) the amount of inflows of resources or outflows of resources (for example, revenue or expense) recognized for a transaction that is accounted for as a sale-leaseback and (b) the amount of inflows of resources or outflows of resources included in allowable cost for rate-making purposes should be recognized as a separate regulatory-created asset or regulatory-created deferred inflow of resources, as appropriate.

Lease-Leaseback Transactions

87. In a lease-leaseback transaction, an asset is leased by one party (first party) to another party and then leased back to the first party. The leaseback may involve an additional asset (such as leasing a school building that has been constructed by a developer on land owned by and leased back to a school district) or only a portion of the original asset (such as leasing back only one floor of a building to the owner). A lease-leaseback transaction should be accounted for as a net transaction. Both parties to a lease-leaseback transaction should disclose the amounts of the lease and the leaseback separately in the notes to financial statements.

Intra-Entity Leases

88. When the lessee or lessor is included as a blended component unit of the primary government, the reporting requirements of this Statement do not apply. Instead, when the lessor is a blended component unit, the debt and assets of the lessor should be reported as if they were the primary government's debt and assets. For example, the capital assets leased from a blended component unit would be reported as capital assets, and related debt would be reported as a long-term liability in the reporting entity's government-wide financial statements. The debt service activity of the lessor would be reported as a debt service activity of the reporting entity. With respect to leases with or between blended component units, for which eliminations are required, these eliminations should be made before the financial statements of the blended component units are aggregated with those of the primary government. The remaining cash payments between component units should be reported as inflows of resources and outflows of resources.

89. Lease arrangements between the primary government and discretely presented component units (or between discretely presented component units) should be treated in the same manner as any other lease under the provisions of this Statement. However, related receivables and payables should not be combined with other amounts due to or due from discretely presented component units or with lease receivables and payables with organizations outside the reporting entity.

Leases between Related Parties

90. In the separate financial statements of the related parties, the classification and accounting should be the same as for similar leases between unrelated parties, except in cases in which it is clear that the terms of the transaction have been significantly affected by the fact that the lessee and lessor are related. In such cases, the classification and accounting should be modified as necessary to recognize the substance of the transaction rather than merely its legal form. For example, if the lease contract is structured to meet the definition of a short-term lease but the related parties have a mutual understanding that the lease contract will stay in effect for several more years, that lease should not be accounted for as a short-term lease. The nature and extent of leasing transactions with related parties should be disclosed.

91. In financial statements for which an interest in an investee is accounted for using the equity method, any inflow of resources or outflow of resources (for example, gain or loss) on a leasing transaction with the related party should be accounted for in accordance with the principles set forth in paragraphs 202–210 of Statement 62 and paragraph 77 of Statement 72.

EFFECTIVE DATE AND TRANSITION

92. The requirements of this Statement are effective for reporting periods beginning after December 15, 2019. Earlier application is encouraged.

93. Changes adopted to conform to the provisions of this Statement should be applied retroactively by restating financial statements, if practicable, for all prior periods presented. If restatement for prior periods is not practicable, the cumulative effect, if any, of applying this Statement should be reported as a restatement of beginning net position (or fund balance or fund net position, as applicable) for the earliest period restated. In the first period that this Statement is applied, the notes to financial statements should disclose the nature of the restatement and its effect. Also, the reason for not restating prior periods presented should be disclosed.

94. 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.

However, lessors should not restate the assets underlying their existing sales-type or direct-financing leases. Any residual assets for those leases should become the carrying values of the underlying assets.

The provisions of this Statement need not be applied to immaterial items.

This Statement was issued by unanimous vote of the seven members of the Governmental Accounting Standards Board.

David A. Vaudt, *Chairman*
Jan I. Sylvis, *Vice Chairman*
James E. Brown
Brian W. Caputo
Michael H. Granof
Jeffrey J. Previdi
David E. Sundstrom

Appendix A

BACKGROUND

A1. Accounting for leases has been the subject of much discussion by various standards-setting bodies. Guidance provided by the Accounting Principles Board in 1964 in Opinion No. 5, *Reporting of Leases in Financial Statements of Lessee,* helped shape Financial Accounting Standards Board (FASB) Statement No. 13, *Accounting for Leases.* FASB Statement 13 was published in 1976 and has formed the basis for the existing model used by many different standards setters. For state and local governments, the National Council on Governmental Accounting (NCGA) Statement 1, *Governmental Accounting and Financial Reporting Principles,* published in 1979, stated that FASB Statement 13 was applicable to governmental units. Some modifications were made to accounting for leases in the governmental environment through NCGA Statement 5, *Accounting and Financial Reporting Principles for Lease Agreements of State and Local Governments,* and GASB Statement No. 13, *Accounting for Operating Leases with Scheduled Rent Increases.* The GASB codified the requirements of FASB Statement 13, as amended, as of November 30, 1989, as GASB guidance with the issuance of Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements.*

A2. In 2006, the FASB and the International Accounting Standards Board (IASB) started a joint project to reexamine their guidance for leases. In June 2007, the GASB issued Concepts Statement No. 4, *Elements of Financial Statements.* Because the FASB's leases guidance (as of November 30, 1989) is the basis for the GASB requirements in Statement 62, the FASB and IASB project presented an opportunity for the GASB to reconsider lease accounting in light of (a) definitions of financial statement elements (including assets and liabilities) that were not in place when the GASB leases guidance was established and (b) the research and approaches considered by the FASB and IASB. In 2011, the GASB initiated pre-agenda research on leases. The pre-agenda research initially focused on monitoring the developments of the FASB and IASB project.

A3. Considering the GASB conceptual framework and the significant changes to lease accounting being proposed by the FASB and IASB, the Board added a leases project to the current technical agenda in April 2013. The addition of the project is consistent with the GASB's strategic objective to periodically undertake reexamination projects on pronouncements that have been effective for a sufficient length of time.

A4. In November 2014, the Board approved a Preliminary Views, *Leases.* The Preliminary Views proposed accounting and financial reporting requirements for both lessees and lessors based on the foundational principle that leases in the scope of the project are financings of a right to use an underlying asset. Thirty-eight responses to the Preliminary Views were received from organizations and individuals, and 15 organizations or individuals testified at public hearings held in April 2015.

A5. After consideration of respondent comments and testimony on the proposals in the Preliminary Views, the Board issued an Exposure Draft, *Leases,* in January 2016. The Exposure Draft continued to propose a single reporting approach for all leases based on the foundational principle that leases in the scope of the project are financings of a right to use an underlying asset. The Board received 71 written responses to the Exposure Draft from organizations and individuals. In addition, 11 organizations or individuals testified at a public hearing held in June 2016.

A6. The GASB conducted outreach to stakeholders during and after the comment periods for the Preliminary Views and for the Exposure Draft, including a webinar for the benefit of financial statement users. Also, the GASB conducted a field test during the comment period for the Preliminary Views, in which participants were asked to apply the provisions of the Preliminary Views to some or all of their leases as either a lessee or a lessor. Some participants chose to do both. Field test participants provided information that addressed whether the provisions of the Preliminary Views were understandable and operational, and they estimated costs to implement the proposed requirements in the Preliminary Views.

A7. The Board assembled a task force for the project composed of members broadly representative of the GASB's stakeholders. The task force members provided feedback on issues discussed by the Board and on the drafts of the Preliminary Views, Exposure Draft, and final Statement. In addition, further feedback was provided by members of the Governmental Accounting Standards Advisory Council (GASAC) at several of its meetings throughout the Board's due process.

Appendix B

BASIS FOR CONCLUSIONS

Introduction

B1. This appendix discusses factors considered significant by Board members in reaching the conclusions in this Statement. It includes discussion of the alternatives considered and the Board's reasons for accepting some and rejecting others. Individual Board members may have given greater weight to some factors than to others.

Foundational Principle

B2. The accounting and financial reporting guidance for leases in this Statement is based on the foundational principle that leases are financings. In a lease transaction, a lessee receives the legal right to use an underlying asset (the asset that is subject to the lease, such as a vehicle or building) at the commencement of the lease term. In exchange, the lessee promises to make payments over time for the right to use that underlying asset. Therefore, the lessee has financed the acquisition of that legal right. Conversely, a lessor receives payments over time for transferring to the lessee the legal right to use the underlying asset.

B3. In developing the foundational principle, the Board considered whether there are inherently different types of leases in the governmental environment. The guidance in NCGA Statement 5 and Statement 62 was based on the notion that some leases essentially are financed purchases of the underlying asset (classified as capital leases) and other leases (classified as operating leases) are not. The approach to accounting for a lease was dependent on that classification. The capital or operating lease classification depended on whether the lease met any of four tests. Those tests were intended to determine whether most of the risks and benefits of ownership of the underlying asset were transferred to the lessee. If so, the lease essentially was a financed purchase of the asset and would be accounted for as a capital lease. Those tests have been criticized because their application in many cases resulted in reporting lease transactions differently than similar nonlease financing transactions.

B4. Some respondents to the Exposure Draft disagreed with the foundational principle that leases are financing arrangements. Instead, they believe that there are different types of leases and that the accounting should acknowledge those distinctions. In their view, a lease of equipment for its entire useful life is different from a lease of office space in a building for a few years. Some respondents also were concerned that capital and operating leases (the terminology used in NCGA Statement 5 and Statement 62) often are treated differently for calculating debt covenants or statutory debt limits. In their view, eliminating that distinction in financial reporting could cause some governments to not be in compliance with those covenants or limits.

B5. The Board acknowledges that there are many varieties of leases. Despite the differences that may be present in the details of individual lease agreements in the governmental environment, they all contain the element of financing (as described in paragraph B2). Therefore, the Board believes that a single approach that accounts for leases based on that common financing element should be required. The Board considered another potential method for classifying leases into different types that would be based on whether the lessee consumes substantially all of the economic benefits derived from the underlying asset. The Board also considered whether leases could be classified based on the purpose of the lease or the intent of the government for entering into the arrangement. However, any of those classifications would result in a different accounting approach for similar transactions and would reduce comparability.

B6. The Board also discussed whether some or all leases should be treated as executory contracts for accounting and financial reporting purposes. An executory contract requires performance by one party over the term of the contract, in exchange for payments made by the other party as performance occurs. The guidance in Statement 62 for operating leases was based on the notion that those leases should be accounted for as executory contracts. However, the Board believes that performance pursuant to a lease contract does not occur over the term of the contract. Rather, the lessor has satisfied the obligation *at the commencement of the lease term* when the lessee is granted the right to use the underlying asset, consistent with the provisions established in Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements.*

Scope and Applicability

Definition of a Lease

B7. This Statement defines a lease 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" (paragraph 4; footnote omitted). That definition primarily is based on the definition included in Statement 62, with modifications to clarify its application. One modification is the replacement of the term *agreement* with the more precise and limiting term *contract.* This change was made to require that a lease, whether written or verbal, be legally enforceable. (See paragraph B24 for discussion of fiscal funding or cancellation clauses.) The Board also added the notion of *control* and noted that a lease conveys control of the *right to use* the asset of a different legal entity (the underlying asset) rather than control of the underlying asset itself, which is retained by the lessor. The addition of the notion of control focuses on concerns of respondents to the Exposure Draft about differentiating leases from other types of contracts, such as supply contracts. Supply contracts, such as those that are power purchase agreements, normally convey access to the output of assets, rather than control of the right to use the asset. The definition also is expanded to apply to nonfinancial assets rather than only capital assets. The broader definition allows for the possibility of other types of assets to be leased. However, the Board excluded financial assets from the definition so that, for example, securities lending and similar activities would not be subject to this Statement.

B8. The Board believes that a contract should be evaluated for accounting as a lease based on the substance of the arrangement rather than the label on the contract. For example, a contract that transfers ownership of the underlying asset is a purchase regardless of whether it is labeled as a lease.

B9. The definition of a lease in this Statement also specifies that a lease should be an exchange or exchange-like transaction. Some governmental contracts that transfer the right to use an asset require only a nominal amount, such as one dollar per year, to be exchanged for the right to use the underlying asset. The Board believes that the substance of that type of arrangement represents a nonexchange transaction (such as a donation or grant), which is addressed within the scope of Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions.*

B10. Some respondents to the Preliminary Views questioned the exclusion of nonexchange transactions from the definition of a lease, citing concerns about how to account for those transactions. The Board acknowledges that the existing guidance for nonexchange transactions in Statement 33 does not specifically address the right to use nonfinancial assets in nonexchange transactions, such as the free use of office space. The Board noted that those nonexchange transactions, although not in the scope of this Statement, are expected to be addressed as part of the GASB's project on revenue and expense recognition.

Arrangements Excluded from This Guidance or Considered for Exclusion

B11. Statement 62 identified several lease-like arrangements that are not subject to its leases guidance, including contracts for the rights to explore for natural resources, licensing contracts, and service concession arrangements. Those scope exclusions are carried forward in paragraph 8 because of the unique features and complexities associated with those types of transactions. The Board believes the lease-like portion of those transactions should not be addressed without consideration of the entirety of each transaction. However, consideration of the entirety of those transactions is outside the scope of this Statement. Additionally, the GASB specifically addressed the accounting for service concession arrangements in Statement 60.

B12. A common type of licensing contract is for computer software. Question Z.51.21 in *Implementation Guide No. 2015-1* stated that licensing agreements for computer software should not be treated as leases. However, some respondents to the Preliminary Views questioned whether the proposed leases standards would impact the guidance in the Implementation Guide. Again, because of the unique features and complexities of these transactions, the Board decided to explicitly exclude licensing contracts for computer software from this Statement. Those contracts are expected to be studied further as part of the GASB's separate pre-agenda research activity addressing information technology arrangements, including cloud computing.

B13. Paragraph 8a excludes intangible assets from the scope of this Statement, except for an intangible right-to-use asset that becomes the underlying asset in a sublease arrangement. The Board believes that intangible assets present issues that differ from those of tangible nonfinancial assets and, accordingly, should not be addressed in this Statement. However, in a sublease

transaction, the original lessee is subleasing its *intangible* right to use the underlying *tangible* nonfinancial asset. Therefore, the intangible right-to-use asset being leased in a sublease is included in the scope of this Statement.

B14. This Statement requires that leases that transfer ownership of the underlying asset to the lessee be accounted for as financed purchases or sales. Some respondents to the Exposure Draft argued that a lease that contains a bargain purchase option or one in which it is reasonably certain that a purchase option would be exercised also should be accounted for as a financed purchase or sale. Those respondents believe that governments normally would exercise bargain purchase options, even if only to resell the asset (presumably for a gain), and it is likely that such an option would not be in the contract unless the government expected to exercise it. Similarly, if purchase of the underlying asset is reasonably certain, they believe that the substance of the lease is a financed purchase or sale. The Board considered the merits of those comments but continues to believe that some governments do not exercise bargain purchase options for a variety of reasons, even if it appears to be economically advantageous to do so. For example, the government may not do so because of the time and effort required for compliance with procurement requirements. Those considerations persuaded the Board that the presence of a bargain purchase option in a lease contract is not equivalent to a provision that transfers ownership of the underlying asset. Therefore, the Board concluded that a lease that contains any purchase option, including a bargain purchase option, should not be treated as a financed purchase or sale until that option is exercised.

B15. The Board considered whether there should be a scope exclusion for leases associated with certificates of participation. Some leases form the revenue stream that supports repayment of the certificates of participation debt. The Board believes that the association of lease payments with certificates of participation does not affect the substance of the lease transaction; therefore, the Board concluded that there should not be an exclusion for such leases.

B16. A government may issue conduit debt in its name to finance the construction or acquisition of capital assets for another entity, with the other entity agreeing to repay the debt. That arrangement may have some of the characteristics of a lease. However, issuers of conduit debt are not required under Interpretation No. 2, *Disclosure of Conduit Debt Obligations,* to recognize a liability for the debt. In addition, the facilities constructed or acquired with the proceeds of the debt often are not reported in the financial statements of issuers of conduit debt. Due to accounting complexities associated with those arrange-

ments, the Board concluded that leases in which the underlying asset is financed with outstanding conduit debt should not be included in the scope of this Statement, unless both the underlying asset and the conduit debt are reported by the lessor. The Board has initiated a separate pre-agenda research activity to reexamine accounting and financial reporting for conduit debt.

B17. Some respondents to the Exposure Draft requested additional modifications to the scope of this Statement. As discussed in paragraph B7, the Board added an exclusion for supply contracts. The Board also added an exclusion for leases of inventory because the use of inventory normally involves a transfer of ownership rather than a lease. Some respondents to the Exposure Draft requested that the scope also exclude historical works of art and assets under construction. The Board decided not to exclude those arrangements because they do not have the same complexities found in other transactions that were excluded from the scope of this Statement.

B18. Some respondents to the Exposure Draft requested clarification regarding the treatment of cloud computing contracts. As previously noted, those contracts are expected to be studied further as part of the pre-agenda research activity addressing information technology arrangements, including cloud computing. The Board noted that under this Statement, evaluations include whether contracts (a) convey control of the right to use another entity's underlying asset, (b) are service contracts, or (c) include both lease and service components. Similarly, some respondents requested clarification on the treatment of contracts for cell phone tower placement; connection points for antennae; and grazing, hunting, and farming rights. The Board believes that the definition of a lease provides sufficient guidance for determining whether those contracts are leases.

Lease Term

Noncancelable Period

B19. The determination of the lease term begins with the noncancelable period. Because the definition of a lease focuses on legally enforceable rights and obligations associated with a lease contract, the lease term has the same focus. The noncancelable period is included in the lease term because it is the period for which the lessee and lessor are legally obligated without the possibility of cancellation.

Options to Extend or Terminate

B20. Many leases include options to extend, such as a five-year lease that the lessee can extend to six years. Likewise, many leases include options to terminate the lease at or after a certain point in time, such as a five-year lease that the lessee can terminate at the end of the fourth year. The Board considered whether periods covered by an option to extend and periods after a potential termination date should be included in the lease term. Limiting the lease term to only the noncancelable period could lead to opportunities to structure leases with short noncancelable periods and many options to extend (even when all parties understand the intent is to extend) or with an early termination option (even when all parties understand there is no intent to terminate). Therefore, the Board concluded that the lease term should include certain periods covered by options to extend or terminate the lease (determined by the likelihood of those options being exercised) so that the lease term reflects how long the lease is expected to be in effect.

B21. The Exposure Draft proposed that only a *lessee's* options to extend or terminate a lease should be considered in determining the lease term. A respondent disagreed with excluding consideration of lessor-only options from the lease term because, if a lessor-only option to extend was exercised, the lessee would have little or no discretion to avoid the contractual lease payments before the end of the lease term. Similarly, if the lessee is reasonably certain that a lessor-only option to terminate would be exercised, inclusion of the subsequent period would overstate the lease term. The Board noted that although lessor-only options may be difficult in certain circumstances for a lessee to evaluate, those options would have the same enforceability as lessee options if exercised. Based on those considerations, the Board concluded that the most conceptually consistent approach for determining the lease term is to consider both lessee and lessor options to extend or terminate a lease contract.

B22. The Board initially considered several probability thresholds for including a period covered by an extension or termination option in the lease term, including *more likely than not, probable, virtually certain,* and *a significant economic incentive to exercise the option.* In the Preliminary Views, the Board proposed using a threshold of *probable* for consistency with guidance in Statement 62 for recognition of a liability arising from a contingency. In response to concerns expressed by respondents to the Preliminary Views, the Board decided to propose *reasonably certain* in the Exposure Draft as the threshold for including periods in the lease term covered by options to extend or terminate.

The Board believes that the term *reasonably certain,* although also requiring the use of professional judgment, is a higher threshold and is less speculative than *probable.* Additionally, it essentially retains the threshold of *reasonably assured* in the prior leases guidance in Statement 62.

B23. The Board also discussed the factors a government should consider when determining the likelihood that an extension or termination option will be exercised. Although the Board acknowledges that having a significant economic incentive may be a good indicator that an option will be exercised, governments do not always make decisions solely for economic reasons. Therefore, a government should consider all relevant factors, including but not limited to economic factors, in determining the likelihood that an option will be exercised. The Board also believes that a lessor should be able to make that assessment at the commencement of the lease term based on information received about the lessee's plans during the lease negotiations.

Fiscal Funding or Cancellation Clauses

B24. Many governmental lease contracts include fiscal funding or cancellation clauses. Those clauses allow governmental lessees to end a lease, typically on an annual basis, if the government does not appropriate funds for the lease payments. Laws or regulations often require inclusion of a fiscal funding or cancellation clause, but the government, acting in good faith when it enters into the lease, does not intend or expect to exercise that clause. Therefore, the Board concluded that a fiscal funding or cancellation clause should not affect the lease term unless it is reasonably certain that the clause will be exercised (that is, funds will not be appropriated).

Reassessments

B25. The Board initially considered requiring reassessment of the lease term if there is a change in the relevant factors that led to the initial determination of whether it was reasonably certain that a lessee would exercise options to extend or terminate a lease. The Board was concerned, however, that such a reassessment process could be costly, especially for governments with many leases. The Board also initially was concerned about the lessor's ability to evaluate the lessee's circumstances to make the reassessment. Alternatively, the Board considered using a triggering event approach so that reassessment would be required only in certain specific and obvious circumstances. However, the Board was again influenced by the potential costliness of that approach

based on concerns about lessors not knowing whether a triggering event has occurred. At the other end of the spectrum, the Board considered whether a government should *ever* be required to reassess the lease term but determined that reassessments are appropriate in certain circumstances.

B26. The Exposure Draft proposed that a government be required to reassess the lease term only if the government either (a) *elects* to exercise an option even though it was originally determined that the lessee would not exercise that option or (b) *elects* not to exercise an option even though it was originally determined that the lessee would exercise that option. For example, if it were considered reasonably certain at the commencement of the lease term that the lessee would exercise an option to extend but the lessee does not exercise that option by the exercise date, the lease term should be reassessed. In response to concerns raised by respondents to the Exposure Draft, the Board concluded that the lease term should be updated when the lessee or lessor elects to exercise an option or not to exercise an option contrary to the initial determination of the lease term. The Board believes that requirement imposes less of a burden on preparers because there will be little or no judgment involved and there is no requirement for ongoing reassessments. When a lessee or lessor communicates its intention to exercise or not exercise an option, both the lessee and lessor would know whether an option will be exercised and, therefore, would be able to reassess the lease term, if necessary.

B27. Another criterion (proposed by some respondents) requires a government to reassess the lease term of the most recent lease contract before the change when an event specified in the lease contract that requires an extension or termination of the lease takes place. The Board agreed to add that criterion in paragraph 15c because it is consistent with the underlying principle of the two reassessment criteria in paragraphs 15a and 15b. All three criteria are based on the principle that the lease term should not be reassessed until an event occurs or an action is taken. That is, probability is not considered in determining whether the lease term should be remeasured. The Board believes the additional criterion will not require the level of judgment necessary to evaluate probability and, therefore, will not add significant implementation effort.

B28. Some respondents proposed additional criteria that they believe should require the lease term to be reassessed. An additional criterion offered by some respondents would have required a government to evaluate the likelihood that a significant event or a significant change in circumstances, within the control of management, would occur that directly affects whether the government is reasonably certain (a) to exercise or not to exercise an option to extend or

terminate the lease or (b) to purchase the underlying asset. That proposed criterion would have introduced a probability consideration to the criteria for reassessment in paragraphs 15a and 15b. The Board decided that, for the reasons described in the preceding paragraphs, the proposed criterion should not be added.

Short-Term Leases

Definition of a Short-Term Lease

B29. A short-term lease is defined as a lease that has a maximum possible term of 12 months (or less), including any options to extend, regardless of their probability of being exercised. The use of *maximum possible term* in the definition removes the effect of potential options to extend or terminate the lease on the classification of a lease as short term. Maximum possible term assumes that all options to extend would be exercised and inherently would exclude all options to terminate. The Board was concerned that basing the definition of a short-term lease on the assumption that options to extend would not be exercised would allow for structuring leases to avoid the requirements of the general accounting and financial reporting guidance for leases in this Statement. For example, at the commencement of the lease term, a lessee determines that it is not reasonably certain that an extension option would be exercised, and accordingly, it does not include that option in the lease term. If the lessee later exercises that option and the term extends beyond 12 months, the lease would have to be recognized at that time. The Board believes that the monitoring effort and the resultant reclassification would have negated the cost relief provided by the short-term exception.

B30. Some respondents to the Exposure Draft argued that 12 months is too short to provide meaningful cost relief because, they assert, few leases would qualify for the exception as proposed. These respondents suggested extending the definition to two, three, or five years. After considering those comments, the Board reaffirmed its decision that 12 months is the most appropriate length of time upon which to base the definition of a short-term lease. Twelve months generally is consistent with many governments' budgetary and financial reporting cycles and is used in classifying assets and liabilities as current and noncurrent in a classified statement of net position. The Board also considered that the financing component would be much less significant in lease contracts of 12 months or less.

Accounting for Short-Term Leases

B31. The Board considered whether there should be an election to apply the short-term exception to the reporting requirements. It concluded that establishing the short-term exception as a requirement rather than an accounting policy election would enhance comparability among governments. The Board believes that comparability would be reduced if governments could choose whether to apply the short-term exception.

B32. The guidance for reporting short-term leases in this Statement is intended to provide cost relief by not requiring lessees or lessors to apply the overall recognition and measurement provisions of this Statement. Allowing lessees and lessors to recognize only outflows and inflows of resources based on the payment provisions of the lease contract eliminates the need for preparers to calculate amounts for assets and liabilities with useful lives or maturities of less than one year. That approach is not equivalent to cash-basis recognition, as governments still would be required to recognize assets and liabilities for payments paid or received before or after the reporting period.

Notes to Financial Statements for Short-Term Leases

B33. The Board proposed in the Preliminary Views that a lessee be required to disclose the amount of outflows (for example, expenses or expenditures) recognized during the reporting period related to short-term leases to provide information about the volume of a government's short-term lease activity. Some respondents to the Preliminary Views commented that a requirement to identify short-term lease outflows of resources would negate the cost relief offered by the short-term exception. Those respondents argued that the cost of identifying short-term leases and tabulating the amount for disclosure would be comparable to the costs of applying the recognition and measurement provisions. The Board agreed with those arguments and decided not to include a disclosure requirement for short-term lease outflows in this Statement.

Recognition and Measurement for Lessees

Lease Liability

Recognition

B34. This Statement requires lessees to recognize and measure transactions as leases, including recognition of a lease liability, except for (a) leases outside the scope of this Statement, (b) contracts that transfer ownership of the underlying asset to the lessee and do not contain termination options (but may contain fiscal funding or cancellation clauses that are not reasonably certain of being exercised), and (c) short-term leases. Liabilities are defined in Concepts Statement 4 as present obligations to sacrifice resources that the government has little or no discretion to avoid. It further states that the event that created the liability has already occurred. For example, the Board believes that the lessee taking possession of the underlying asset or gaining access to use the underlying asset is an event that creates such an obligation. The lessee already has received the right to use the underlying asset and has a present obligation to make the payments in exchange for that right. Unless the lessee renegotiates the lease, the lessee has little or no discretion to avoid the contractual lease payments (or termination penalties) before the end of the lease term.

Measurement

B35. The Board concluded that the lease liability should be measured at the present value of future lease payments expected to be made during the lease term, which represent the obligations of the lessee under the lease contract. The present value calculation is consistent with the notion that a lease is a financing transaction and recognizes the cost of the financing.

B36. There are several different types of payments that might be required under a lease contract. Fixed payments are established as specific dollar amounts in the lease contract, and the lessee is obligated to make them. As discussed in paragraph 62, lease incentives receivable from the lessor reduce the lease liability because they are components of the same transaction with the same counterparty and, thus, the payable and receivable can be offset. Variable payments are sometimes required and may depend on an index or rate (for example, Consumer Price Index or a commodity index), or on future

performance or usage by the lessee (for example, a percentage of sales or machine hours used). However, because of the variability and unpredictability of those payments, their measurement requires more judgment and estimation than fixed payments.

B37. Variable payments that depend on an index or rate have a baseline measurement at the commencement of the lease term, using the current index or rate and, therefore, are included in the measurement of the lease liability. The Board considered whether future variable payments that depend on an index or rate should be measured using expected changes in that index or rate. However, the Board decided that the potential cost of developing such expectations outweighed the expected benefit of a more representationally faithful liability amount. Therefore, the Board concluded that the current index or rate could be assumed to stay in effect when initially measuring the future payments.

B38. Variable payments that depend on future performance of the lessee or usage of the underlying asset by the lessee do not have a baseline measurement at the commencement of the lease term and, therefore, are excluded from the measurement of the liability. There may be expectations of the levels of future performance or usage, but estimating those amounts may not be practical because they are dependent upon events or transactions that have not occurred. The Board decided that variable payments that depend on future performance of the lessee or usage of the underlying asset by the lessee should not be included in the measurement of the lease liability. However, the Board concluded that any minimum guarantee amount or other portions of those variable payments that are fixed in substance can be reliably measured and, therefore, should be included in the lease liability because they are not dependent upon events or transactions that have not occurred.

B39. Other types of payments, such as those arising from purchase options and residual value guarantees, may be contingent upon future events. The Board concluded that such payments should be included in the measurement of the lease liability if it is reasonably certain that payments arising from those options or guarantees will be required. As discussed in paragraph B22, several alternatives were considered to establish a threshold for whether options should be included in the determination of the lease term. Those same alternatives were considered for determining whether to include contingent payments in the measurement of the lease liability. Consistent with its reasons for using a threshold of *reasonably certain* when assessing the lease term, the Board decided to apply the same threshold for including contingent payments in the determination of the lease liability.

B40. The Board considered whether to provide guidance for selecting the discount rate to be used for making the present value calculation of the lease liability. The previous leases guidance in Statement 62 included provisions for determining the discount rate to be applied to a lease liability, and the Board agreed that reducing the level of guidance for this issue would not be desirable from a consistency standpoint. The Board concluded that the interest rate the lessor charges the lessee, which may be the interest rate implicit in the lease, is preferable because it is the rate at which the transaction is made. However, consistent with Statement 62, the Board also concluded that if the interest rate implicit in the lease is not readily determinable, the lessee's estimated incremental borrowing rate is an acceptable alternative.

B41. The Board also considered but rejected the use of a risk-free interest rate for discounting because leases are not risk free. The Board also considered a discount rate based on a municipal bond index. However, it determined that the interest rate the lessor charges the lessee or the lessee's estimated incremental borrowing rate is more specific to the transaction and the parties to the lease and is a better representation of the actual transaction than a more generic market rate.

Remeasurement

B42. The Board concluded that a lease liability should be remeasured in certain circumstances to reflect changes under the lease contract or the estimates incorporated into the liability measurement under the lease contract, such as a change in the probability of exercising an option. This Statement specifies several conditions under which the lease payment amounts likely have changed because of changes to the estimates used in determining the liability. This Statement also requires that the liability be remeasured if any of those changes are expected to significantly affect the amount of the lease liability. The Preliminary Views proposed that a change in the index or rate used to determine variable lease payments require a potential remeasurement of the liability. However, in response to concerns of some respondents to the Preliminary Views, the Board decided to require remeasurement of variable lease payments only if the liability is already required to be remeasured under paragraph 25 of this Statement. That modification was made because the frequency of changes in an index or rate used to determine variable lease payments could place a significant burden on preparers to evaluate the significance of the change each time an index or rate changed.

B43. Certain circumstances also trigger reassessment of the discount rate used to measure the lease liability. The Board considered not requiring an update to the discount rate after initial determination but noted that there could be situations in which an update is warranted because the updated measurement would provide more relevant information. The Preliminary Views proposed that a significant change in the index or rate used to determine variable lease payments require reassessment of the discount rate. That proposed requirement was not carried forward to be consistent with the Board's other decisions regarding remeasurement of the liability.

B44. Some stakeholders raised the issue of contingent rentals subsequently becoming noncontingent. For example, a concessionaire's lease may require a nominal payment in the first year and fixed payments in subsequent years based on a percentage of first-year sales. To more accurately report significant changes to the lease liability, and the lease asset, the Board added a requirement that remeasurement occur when a contingency, upon which some or all of the variable payments are based, is resolved such that those payments now meet the criteria for inclusion in the measurement of the lease liability.

Reporting Cash Flows

B45. Some respondents to the Exposure Draft requested additional guidance for the classification of leases in the statement of cash flows. The Board noted that Question 5.2 in Implementation Guide No. 2016-1, *Implementation Guidance Update—2016,* as amended, provides guidance on that topic. The Codification Instructions in Appendix C of this Statement provide conforming amendments to that question in the Implementation Guide.

Lease Asset

Recognition

B46. This Statement requires lessees to recognize a lease asset to correspond with the lease liability. Assets are defined in Concepts Statement 4 as resources with present service capacity that the government presently controls. At the commencement of the lease term, the lessee obtains the right to use the underlying asset by either gaining physical possession of the asset or attaining access to use the underlying asset. The lease asset is the right to use the underlying asset rather than the underlying asset itself. The right to use makes

the underlying asset a resource to the lessee and gives the lessee access to the underlying asset's present service capacity. Therefore, the Board believes that this right meets the definition of an asset.

Measurement

B47. The Board concluded that the initial measurement of the lease asset should be based on the measurement of the associated lease liability. The Board considered whether the lease asset should be measured independently of the lease liability (for example, on a fair value basis) but decided against that approach. Capital assets generally are measured at historical cost, which is the amount paid for those assets. The lease liability generally represents the amount to be paid for the lease asset, except as noted in paragraph 30. Therefore, basing the measurement of the lease asset on the lease liability is consistent with the accounting for most capital assets at historical cost. Additionally, it recognizes the relationship between the liability and the asset because they arise from the same transaction.

B48. The measurement of the lease asset includes any lease payments made at or before the commencement of the lease term. Those payments are not included in the lease liability but are part of the cost of the lease asset. Therefore, those amounts should be added to the amount derived from the lease liability so that the lease asset is measured at its total cost. Accordingly, any lease incentive payments received from the lessor at or before the commencement of the lease term reduce the amount capitalized, as discussed in paragraph 62.

B49. Ancillary charges necessary to place an asset into service are capitalized as part of the cost of that asset under paragraph 18 of Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments.* Debt issuance costs other than insurance, described in paragraph 12 of Statement No. 7, *Advance Refundings Resulting in Defeasance of Debt,* as amended, are recognized as an expense or expenditure of the period in which they are incurred. To be consistent with those provisions, the Board decided that initial direct costs associated with a lease (for example, structuring fees such as legal and administrative costs) should be accounted for as if they were paid in a financed purchase of a capital asset. The Board considered accounting for all initial direct costs the same way (either capitaliz-

ing or expensing all of them) as a matter of practicality, but it believes that governments are accustomed to making these determinations and, therefore, would not have significant difficulty in applying this provision.

B50. Statement No. 72, *Fair Value Measurement and Application,* defines an investment and provides accounting guidance for assets that meet that definition. In some circumstances, an asset recognized under a lease could meet the definition of an investment (for example, if the lease is entered into for the purpose of subleasing solely for profit). The Board believes that meeting the definition of an investment changes the character of, for example, a lease receivable; measurement of that receivable as an investment is appropriate even though it arises from an arrangement that otherwise would be accounted for as a lease.

Remeasurement

B51. Paragraph 33 of this Statement requires that when a lease liability is remeasured, the corresponding lease asset be adjusted by the same dollar amount (except when the adjustment would cause the asset to be reported as a negative amount, and in cases of impairment, which is discussed in paragraph B52). The Board believes that changes in the value of the lease liability typically coincide with changes in the value of the lease asset, but not necessarily by the same amount. The Board acknowledges that adjusting the lease asset by the same amount may result in the asset being reported at an amount different from historical cost or fair value. Nevertheless, the Board believes that the expected benefits of requiring separate remeasurement of the lease asset are not sufficient to justify the perceived costs of that remeasurement. The Board also considered that, if a change in the lease liability results from a change in an index or rate that is attributable to the current period, the change in the liability should be reported in the resource flows statement for the period rather than as an adjustment to the related asset. However, in the interest of maintaining consistency, the Board rejected that exception and instead decided to require that this change in the lease liability also be accompanied by a corresponding change in the lease asset.

Impairment

B52. The Board considered whether an exception to Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries,* should be made for lease assets. That consideration led

to the Board's conclusion that a lease asset, although intangible, could experience a significant and unexpected decline in service utility such that impairment should be recognized. The decline in service utility of the intangible right to use an underlying asset often is a result of a decline in the service utility of the underlying asset itself. For example, if a leased building is damaged by a flood, the value of the lessee's right to use the building is similarly affected. Because a lease asset arises from the right to use an underlying asset for a length of time, the service utility of that lease asset is associated with a measure of time. The Board noted that if the lease asset is impaired, there often will be a change to the corresponding lease liability (for example, payments may not be required for the time the underlying asset is unusable).

Lessee Recognition in Financial Statements Prepared Using the Current Financial Resources Measurement Focus

B53. This Statement carries forward without significant change the accounting for leases in governmental funds in NCGA Statement 5, as amended. The Board believes that guidance remains sufficient for use in financial statements prepared using the current financial resources measurement focus.

Expense Recognition

B54. Consistent with the foundational principle that a lease is a financing, this Statement requires that a lessee recognize interest expense related to the amortization of the discount on the lease liability. A lessee also should recognize amortization expense related to the lease asset, representing the decrease in the useful life of the right to use the underlying asset over the lease term. The interest expense and amortization expense are reported in the resource flows statements with other interest and depreciation or amortization expense amounts. The Board considered whether the interest and amortization expenses related to a lease could be combined and reported as a single rent expense amount, so that the expense could be classified as an operating expense, consistent with the manner in which expenses for operating leases were classified in Statement 62. However, the Board believes that presentation would be inconsistent with the foundational principle that a lease is a financing.

B55. The Board considered whether amortization of the lease asset should be guided by a government's depreciation policy for owned assets. That alternative was ultimately rejected, however, because the lease asset is an intangible

asset that is distinct from the underlying asset being leased, and the period for which the lessee has the right to use the underlying asset may be shorter than the useful life of the underlying asset itself.

B56. The Board concluded that amortization of the lease asset should be calculated in a systematic and rational manner to be consistent with depreciation and amortization of other capital assets. Amortization in a systematic and rational manner does not necessarily mean the same amount would be amortized in each period. For example, a calculation that results in a constant total lease cost (the total of the separately determined interest and amortization) could be considered systematic and rational in some cases.

Notes to Financial Statements—Lessees

B57. The disclosures required for lessees in paragraph 37 include a general description of their leasing arrangements. The Board enhanced the information that was previously required to be disclosed by Statement 62 with details about variable payments and residual value guarantees not included in the lease liability. The Board believes that this information is essential for a financial statement user to understand that the lessee may be required to pay more for use of the lease asset than the amount recognized as a lease liability. In that same regard, to provide information to users about the full cost of leases, lessees are required to disclose the amount of expense recognized in the period for variable lease payments and other payments not previously included in the lease liability.

B58. Some respondents to the Exposure Draft suggested that the proposed disclosures may be overly lengthy for governments with many leases. In addition, some respondents stated that the extent of the disclosures could affect their ability to negotiate competitive future lease arrangements. The Board considers the disclosures for lessees in this Statement to be essential and believes that preparers will aggregate disclosures when appropriate and consider the significance of the lease transactions in compiling the information necessary to meet the disclosure requirements.

Other Considerations for Notes to Financial Statements

B59. The Board considered, but decided not to require, several other potential disclosures relating to amounts recognized in the financial statements, including (a) significant assumptions and judgments used in accounting for leases,

(b) the numerical discount rate or average of rates used to discount the future lease payments, (c) the amount of initial direct costs capitalized, (d) all lease-related expenses and cash flows, (e) the existence of options to extend or terminate the lease, (f) categorization of options to extend by their likelihood, and (g) the portion of the liability that relates only to the noncancelable period of the lease. The Board rejected those potential disclosures because they were not considered to provide essential information, were not required for similar transactions that do not meet the definition of a lease, or were not cost beneficial.

B60. The Board also considered and rejected disclosures about amounts *not* recognized in the financial statements, including (a) a schedule of future payments for nonlease components included in a contract that contains a lease, (b) the fair value of a lease liability, (c) why the government chose to lease rather than buy the underlying asset, and (d) leases for which the government is paying a below-market rate. Again, the Board decided not to require these disclosures because they were not considered to provide essential information, were not required for similar transactions that do not meet the definition of a lease, or were not cost beneficial.

Recognition and Measurement for Lessors

B61. The Board believes that governmental lessees and lessors should account for the same transaction in a way that mirrors how the other party accounts for it. Consequently, the Board concluded that the lessee and lessor accounting models should be symmetrical to the extent appropriate. Some respondents to the Exposure Draft suggested that the Board retain the lessor model provided in Statement 62, though it lacked symmetry with the lessee model. The Board acknowledges that there are fewer concerns with the lessor model in Statement 62 but believes that it was necessary to reconsider that model in a complete reexamination of lease accounting. Pursuant to that review, the Board determined that a new lessor accounting model should be developed in the governmental environment for symmetry with the lessee model based on the foundational principle that leases are financings.

B62. As discussed in paragraph B14, the Board believes that the substance of a lease that transfers ownership is a sale of the underlying asset rather than a financing of an intangible right-to-use asset. In addition, as discussed in paragraph B50, the Board believes that underlying assets that meet the definition of an investment should be measured in accordance with guidance for invest-

ments. Therefore, in addition to an exception for short-term leases, this Statement also provides exceptions to its general lessor recognition and measurement requirements for leases that transfer ownership, and leases for which the underlying asset is investment property. The Board noted that investment property generally is reported at fair value, which may be determined using a valuation technique that considers the present value of future lease payments to be received. A lessor's reporting of a separate lease receivable for the leased investment property essentially would be duplicating the value of those future lease payments.

B63. This Statement also provides an exception to its general lessor recognition and measurement requirements for certain regulated leases that meet the criteria in paragraph 43. This exclusion addresses aviation leases between airports and air carriers (often referred to as airport–airline agreements) and other leases with similar characteristics. Federal laws, regulations, and related court decisions require that fees imposed on aeronautical users of airports be fair and reasonable. The U.S. Department of Transportation is required to make determinations on the reasonableness of terms in response to complaints filed with the Department. Federal laws, regulations, and related court decisions also prohibit airports from unjustly discriminating against aeronautical users and require airports to apply a consistent methodology in establishing fees for similarly situated aeronautical users. A practical effect is that airports cannot prevent air carriers from entering into leases if facilities are available, provided that the lessee's use of the facilities complies with applicable aeronautical use restrictions.

B64. Because of the characteristics of those regulated leases, the Board believes that the nature of those lease agreements is different from a normal financing of a right to use an underlying asset. The Board also noted that those lease agreements almost always require payments that vary from period to period because of the cost-recovery nature of the agreements and that, in many instances, they contain revenue-sharing provisions. Therefore, for those types of agreements, the Board believes it is most appropriate to recognize lease revenue based on the provisions of the agreement even if those provisions result in irregular recognition from, for example, a rent holiday. This exception does not apply to leases that do not meet the criteria in paragraph 43, such as most leases of terminal space to restaurants and other non-aviation-related vendors at airports. The Board believes that those leases are not substantively different from other nonregulated leases, such as leases of vendor stalls at government-owned sports stadiums.

B65. The Exposure Draft proposed that the exception for certain regulated leases be based on legal requirements (a) establishing the costs that may be recovered through lease payments and (b) significantly limiting the ability of the lessor to set rates in excess of those costs. Although those criteria describe some leases between airports and air carriers, respondents to the Exposure Draft noted that airports and air carriers may voluntarily agree to rates in excess of costs, as long as those rates are applied consistently between similarly situated air carriers. Respondents also noted some instances in which legal requirements allow lease rates to recover more than cost, such as for debt service coverage. The Board consulted with subject matter experts to refine the Exposure Draft's proposed provisions so that the criteria would apply to all regulated aviation leases at airports.

Lease Receivable

Recognition

B66. This Statement requires lessors to recognize a lease receivable for leases within the scope of this Statement. The lease contract gives the lessor the right to receive payments in exchange for the lessee's right to use the underlying asset. The Board believes the lessor's right to receive payments meets the definition of an asset in Concepts Statement 4. Assets are defined as resources with present service capacity that the government presently controls. The right to receive payments is a resource that can be drawn upon, and the lessor presently controls that right.

Measurement

B67. This Statement requires a lease receivable to be measured at the present value of future lease payments expected to be made during the lease term. The receivable includes fixed payments, variable payments that depend on an index or rate, and variable payments that are fixed in substance. Those components of the lease receivable are symmetrical with components of the lessee's lease liability.

B68. Other types of payments, such as those arising from purchase options and residual value guarantees (that are not fixed in substance), may be contingent upon future events. The Board acknowledges the different treatment of those possible payments in the lessee's lease liability and the lessor's lease receivable and that the payments may be recognized in a lessor's receivable

later than when they are recognized in a lessee's liability. The Board considered including those payments in the calculation of the lease receivable when it was reasonably certain that the payments would be made. The Board concluded that to do so would be tantamount to recognition of a contingent asset, which conflicts with the guidance in paragraph 112 of Statement 62.

B69. The Board's decision to provide guidance for selecting the discount rate to be used for making the present value calculation is discussed in paragraph B40. The Board believes that the interest rate the lessor charges the lessee is the most appropriate discount rate because it is the rate incorporated into the transaction, and the lessor would have the information to determine that rate. Some respondents to the Preliminary Views questioned that presumption, citing examples of leases in which lease payments are set using a method that does not involve an interest rate (for example, comparison of market rents for similar pieces of real estate). Nevertheless, the Board believes that a discount rate can be imputed on any future payment stream, even if it was not explicitly factored into the determination of the payment amounts.

Remeasurement

B70. The provisions for remeasurement of a lease receivable are similar to those for remeasurement of a lessee's lease liability, which are discussed in paragraph B42. However, changes in amounts included only in a lessee's liability attributable to the exercise of a purchase option or a residual value guarantee would not cause remeasurement of the lessor's receivable. The basis for requiring a lessor's reassessment of the discount rate is the same as for reassessment by a lessee, as discussed in paragraph B43.

B71. Some respondents raised the issue of contingent rentals subsequently becoming noncontingent. For the reasons discussed in paragraph B44, the Board added a requirement that remeasurement occur when a contingency, upon which some or all of the variable payments that will be received over the remainder of the lease term are based, is resolved such that those payments meet the criteria for remeasuring the lease receivable.

Deferred Inflow of Resources

B72. This Statement requires lessors to recognize a deferred inflow of resources to correspond to the lease receivable. A deferred inflow of resources is defined in Concepts Statement 4 as an acquisition of net assets by the

government that is applicable to a future reporting period. The Board believes that recognizing a lease receivable is an acquisition of net assets and that the lease payments included in the lease receivable relate to future reporting periods. Thus, the lessor is required to recognize revenue as the service capacity of the underlying asset is used by the lessee over future reporting periods. This conclusion is consistent with the reporting requirements in Statement 60. That Statement requires governments to report deferred inflows of resources associated with capital assets for many service concession arrangements.

Underlying Asset

B73. When the lessor gives the lessee the right to use the underlying asset, the lessor relinquishes its right to use that asset. Under Statement 62, when a lessor recognized a lease receivable for a lease that qualified as a capital lease, the lessor also derecognized the underlying asset. For this Statement, the Board considered derecognition of the underlying asset but concluded that doing so would present significant issues that were not prevalent under the former guidance, because that guidance resulted in many leases being classified as operating rather than capital leases. For example, if only a portion of a building is leased to another party, the lessor would derecognize only a portion of the historical cost of the building. The amount recognized as a lease receivable likely would not be equivalent to the portion of the historical cost that would be derecognized because the underlying asset is valued at historical cost rather than the present value of the right to use that asset.

B74. Some respondents to the Exposure Draft expressed concern about recognizing both a lease receivable and the underlying asset, suggesting that it would inflate the government's total assets. As mentioned in the preceding paragraph, the Board considered derecognizing some or all of the underlying asset but concluded that relinquishing the right to use an asset, which it still owns, does not diminish the historical cost recognized for that asset. The Board believes that recognizing the lease receivable with the corresponding deferred inflow of resources does not inflate the lessor's statement of net position because, at initial measurement, those two accounts generally decrease and increase net position by the same amounts.

B75. The underlying asset in a lease generally would continue to be accounted for in accordance with other applicable guidance, including depreciation and impairment. However, if the lease contract requires the lessee to return the

asset in its original or enhanced condition, the lessor would not depreciate the asset during the lease term because the service capacity of that asset would be at least the same at the end of the lease as it was at the beginning and, accordingly, it would not be appropriate to recognize a reduction through depreciation. This conclusion also is consistent with similar provisions in Statement 60.

Lessor Obligations

B76. The Board considered whether a lessor has obligations during the lease term that would result in recognition of a liability rather than a deferred inflow of resources. The Board concluded that a lessor has satisfied the principal obligation under a lease after the lessor has made the underlying asset available to the lessee at the commencement of the lease term. Leases may include language requiring the lessor to not interfere with the lessee's "quiet enjoyment" of the use of the asset and perhaps other assurances. Those provisions restraining the lessor's activities are not easily quantifiable and do not potentially require the lessor to sacrifice resources, which is essential for recognition of a liability. Service and other nonlease obligations that are included in the same contract would be separated under the multiple component guidance in paragraphs 63–68 (discussed in paragraphs B89–B91).

Lessor Recognition in Financial Statements Prepared Using the Current Financial Resources Measurement Focus

B77. The Board concluded that a lessor should recognize a lease receivable for the present value of lease payments and a deferred inflow of resources for the portion of that amount that is not available (as defined for governmental funds). The Board believes that, under the current financial resources measurement focus of governmental funds, lease receivables should be accounted for no differently than other receivables.

Participation by Third Parties

B78. This Statement supersedes the lessor guidance in Statement 62 for when the underlying asset in the lease is sold or the lease is assigned to a third party, because much of that guidance was related to determining whether a sale had occurred. However, that determination should be made when an asset is sold, regardless of whether there is a lease in place. The Board believes that the

guidance in paragraphs 282–349 of Statement 62 for sales of real estate is sufficient to address leased asset situations and, accordingly, additional guidance need not be included in this Statement.

Leveraged Leases

B79. This Statement supersedes the lessor guidance for leveraged leases in Statement 62. A leveraged lease is one that involves a creditor providing long-term financing to the lessor for the acquisition of the underlying asset. Under Statement 62, a lessor in a leveraged lease offsets the lease receivable with the associated debt. The Board believes that offsetting is not appropriate because a right of offset for those two amounts does not exist. Furthermore, because leveraged leases are uncommon in the governmental environment, the Board concluded that it is not necessary to specifically address leveraged leases in this Statement.

Notes to Financial Statements—Lessors

B80. Lessors are required to disclose a general description of their leasing arrangements for the same reasons described in paragraph B57 for the corresponding disclosure by lessees. However, general disclosure about residual value guarantees is not specifically required for lessors because the underlying assets are not derecognized.

B81. The Board decided to not carry forward the proposed requirement in the Exposure Draft for lessors to disclose the carrying amount of assets on lease or held for leasing and the related accumulated depreciation. That disclosure was required under the prior model because operating leases were not recognized in the financial statements. Under the lessor model in this Statement, however, lessors recognize a lease receivable and related deferred inflows of resources for all leases. Therefore, the Board believes that the potential benefit of that disclosure would no longer justify its expected cost.

B82. The total amount of revenue from leases is disaggregated in the resource flows statements (interest revenue is reported separately from other lease-related revenue). The Board believes that disclosure of the total amount of revenue from leasing activities, including variable lease payments and other payments not previously included in the lease receivable, is essential to financial statement users to understand the relative significance of leases on the lessor's financial statements.

B83. Some governments issue debt to finance the construction or acquisition of assets that will be leased. That debt often is secured by the lease payments. In that case, this Statement requires disclosure of any lessee options to terminate the lease or provisions to abate lease payments during periods when, for example, the underlying asset is damaged and cannot be used by the lessee. The Board believes that disclosure of such termination options and abatement provisions is essential in those situations because their presence creates a risk that the lessee will not make some or all payments and jeopardize the security of the underlying debt.

B84. This Statement carries forward the requirement in Statement 62 to disclose a schedule of future lease payments included in the lease receivable. However, it limits that disclosure to governments whose principal ongoing operations consist of leasing assets to other entities. It expands the disclosure to include all payments beyond the initial five years and requires principal and interest amounts to be shown separately. The Board believes that disclosure will provide users with essential information about future cash flows included in the lease receivable for those types of governments.

Other Considerations for Notes to Financial Statements

B85. The Board considered several other potential disclosures relating to amounts recognized in the financial statements, including the existence of options to extend or terminate the lease, but declined to establish any additional requirements. The Board noted that either (a) disclosure is not required for similar balances and transactions relative to nonleasing activities or (b) sufficient information already is available in other disclosures.

Notes to Financial Statements for Investment Leases and Certain Regulated Leases

B86. Leases of investment assets are excluded from the recognition and measurement provisions of this Statement (see paragraph B62). Nevertheless, the Board considered whether those leases also should be exempted from disclosure requirements. Outreach to financial statement users indicated that the disclosures required for investments generally would be sufficient for those types of transactions and, as a result, the Board did not extend all of the lessor

disclosure requirements to leases of investment assets. However, the disclosure of lessee termination options for leases that secure debt payments was considered essential because of the risk to the lessor, even if the underlying asset is classified as an investment.

B87. This Statement establishes separate disclosures for aviation leases between airports and airlines, and other leases with similar characteristics, due to the unique characteristics of those leases (as discussed in paragraph B63). The disclosures are based on the general lessor disclosure requirements, modified as needed to address the different nature of the leases. For example, because a lease receivable is not reported for those leases, there is no requirement to disclose principal and interest payments included in a lease receivable. Also, considering respondent comments on the Exposure Draft, the Board modified the previously required disclosure of the carrying amount of assets on lease or held for leasing to, instead, require disclosure of the extent to which capital assets are subject to preferential or exclusive use by counterparties under agreements, such as airport–airline agreements. That changes the focus of the disclosure from (a) assets not available for use by a lessor to (b) risks from lease concentration with specific lessees. For example, an airport could disclose the total number of terminal gates at an airport and the number of gates being leased by each major tenant under preferential or exclusive agreements. Based on discussions with subject matter experts, the Board believes that disclosure of lease counterparty concentration risk provides more useful information. The Board also believes that for aviation leases between airports and airlines, the extent to which capital assets are subject to preferential or exclusive use by counterparties also is more relevant than information about assets not available for use by a lessor.

Lease Incentives

B88. A respondent to the Exposure Draft raised an issue as to whether leasehold improvements would be lease incentives. The Board noted that leasehold improvements typically are provided by the lessee. In that case, a leasehold improvement is not an incentive received from the lessor. Nevertheless, some lease contracts may require the lessor to pay for leasehold improvements. In that case, the payment for a leasehold improvement may be an example of a lease incentive payment to or on behalf of the lessee if, for example, it provides additional assets to the lessee without additional cost. The

determination would be based on the facts and circumstances of the leasehold improvement. To specifically address this type of situation, the Board added explicit guidance in paragraphs 61 and 62 to clarify the accounting for lease incentives.

Contracts with Multiple Components

B89. The Board considered whether this Statement should provide guidance for separating contracts with multiple components. In theory, the reporting for lease contracts with multiple underlying assets or with a service component should be the same as if the components were in separate contracts. The Board recognizes the potential cost and complexity of separating multiple components of a contract but believes that separation generally should be required so that the financial statements faithfully represent the substance of the transaction.

B90. Some respondents to the Exposure Draft expressed concerns over the expected costs of and difficulties in separating multiple components. The Board recognizes that there are incremental costs associated with separating multiple components and allocating the contract price to those components. However, the Board believes that not doing so for multiple underlying assets may misstate both the nature of lease assets and the related liabilities. Furthermore, not separating lease components from nonlease components would result in capitalizing a period expense and recognizing a liability for services that have not been provided. The Board also believes that once new policies are established and new systems are put in place, separation of multiple components could become a manageable routine. The Board believes that the benefit of eliminating potentially significant inconsistencies between reporting services provided through a lease contract and services provided through a separate service contract outweighs the potential cost of separating the nonlease components.

B91. The Board considered allowing governments to elect not to separate contract components. That election would have provided for an optional accounting policy, rather than a requirement to separate contract components. If such an election were made, the government would account for the entire contract as one lease. However, to enhance comparability among governments and for the other reasons discussed in the preceding paragraphs, the Board reaffirmed its earlier decision not to allow a policy election.

Allocation of the Contract Price

B92. Some contracts with multiple components provide individual prices for each component, whereas other contracts provide only a single payment amount for all the components. To allocate the contract price for multiple components in a lease contract, the Exposure Draft proposed requiring that the lessee and lessor use individual prices included in the contract, if those contract prices are reasonable based on observable stand-alone prices for leasing the same or similar assets or contracting for the same or similar services. The Exposure Draft provided alternative allocation methods if the contract did not stipulate prices for individual components or if those prices were not reasonable.

B93. Some respondents were concerned that the Exposure Draft proposal would have required governments to obtain observable stand-alone prices to provide positive evidence corroborating the reasonableness of individual contract prices. Those respondents argued that the assurance derived from obtaining that evidence would not justify the expected significant costs of and difficulty in obtaining it. They also asserted that it would be impractical to obtain observable stand-alone prices in every instance of multiple-component contracts, given the volume of leases entered into by many governments and the prevalence of multiple-component contracts, which are common for equipment and real estate leases. The Board was influenced by those concerns and consequently agreed to modify the language in paragraph 66 to instead provide for a determination that individual contract prices do not appear to be unreasonable, thus avoiding the implication that governments are required to obtain stand-alone prices to provide positive evidence of reasonableness. Notwithstanding that decision, the Board believes that readily available stand-alone prices likely provide the best indication that contract prices do not appear to be unreasonable and, accordingly, paragraph 66 emphasizes that governments should maximize their use to support a judgment that individual contract prices do not appear to be unreasonable.

B94. The Exposure Draft also provided that if there are no contract prices for individual components or if those prices are not reasonable, lessees and lessors should seek readily available observable stand-alone prices for individual components to allocate the contract price. The Exposure Draft further stated that if observable stand-alone prices are not readily available for some or all of the components, a government may choose between (a) making an estimate to allocate the remaining contract price or (b) treating the remaining

components as a single lease unit, based on the primary lease component. Some respondents observed that, given the expected difficulty in obtaining individual stand-alone prices, many governments would choose to treat the remaining components as a single lease rather than make an allocation based on estimates. They contended that such a consequence would be contrary to the Board's objective in seeking separation of contract components, as discussed in paragraphs B89 and B90. The Board agreed that such an outcome was not optimal and, therefore, modified the provisions in paragraph 66 to provide governments with the flexibility to use other reasonable and more cost-beneficial methods to allocate consideration, while also emphasizing that the use of readily available observable stand-alone prices should be maximized in determining their best estimate.

B95. The Board considered that a potential disadvantage of using estimates to allocate the contract price would be inconsistency among the best estimates developed by different governments for contracts with similar components. However, the Board noted that the primary objective of separating the contract price into multiple components—especially separating prices between lease and nonlease components—is to ensure that financial reporting faithfully represents the substance of those multiple-component contracts. The Board concluded that allowing governments to use their best estimates to allocate the contract price would simplify the allocation process and provide significant cost relief to governments, while still achieving a faithful representation of those transactions. However, the Board acknowledges that there may be circumstances in which it is not practicable for governments to make estimates for price allocation due to the unique nature of leases specifically designed for the leasing parties, specific provisions stipulated in certain lease contracts, or other unique circumstances. Therefore, the Board continues to believe it is appropriate to provide additional cost relief by requiring governments to report multiple-component contracts as a single lease unit if determining a best estimate is not practicable.

B96. As previously noted, some respondents to the Exposure Draft expressed concerns about the practicality and potential cost of separating contracts with multiple components. Some suggested excluding components if they are insignificant to the contract. The Board believes such an exclusion should be considered under the general materiality guidelines and, as a result, it is not necessary to explicitly address it in this Statement. Others suggested that the Statement exclude a contract from the separation requirements if the components are rarely contracted for separately. The Board sees little advantage to that approach compared to the effort required to determine the best estimates

for contract price allocation. To qualify for such an exclusion, a government would have to research the frequency with which the components are contracted for separately, which the Board believes would require a comparable amount of effort.

Contract Combinations

B97. Contracts entered into at or near the same time with the same counterparty would be subject to combination for financial reporting purposes if either of two criteria is met. The Board believes that meeting either of those criteria would indicate that the substance of the contracts is a single lease and, therefore, the contracts should be accounted for as such.

Other Potential Exceptions

B98. The Board considered several other potential exceptions to the overall recognition and measurement provisions that, similar to the short-term exception, could provide some cost relief to preparers. Some stakeholders raised specific concerns about the burden of applying those provisions to leases of assets, such as copy machines and small computer equipment, that are often leased in high volume but at low per-asset cost. The Board considered providing an explicit exception for "small ticket" items but concluded that it would be inappropriate for the Board to prescribe a dollar limit that could apply to all governments. If such assets are considered to be insignificant, individually and in the aggregate, the provisions of this Statement may not apply.

B99. Some stakeholders questioned whether a government would be permitted to set a policy establishing thresholds for capitalization of its leases, similar to those commonly used for capital assets. The Board views capitalization policies as methods to operationalize materiality; that is, those policies allow governments to specify amounts that they consider to be significant, individually or in the aggregate. The Board believes that a policy similar to those that establish capitalization thresholds could be used for leases. However, establishing such a policy is within the province of management and, accordingly, is not addressed in this Statement. The Board noted, however, that the assessment of the significance of liabilities is independent of capitalization policies.

B100. Another potential exception would have been to apply this Statement only to leases of a government's core assets, excluding leases of assets that are considered to be "noncore." However, the Board chose not to pursue this

exception because of the difficulty in defining core and noncore assets in a way that would be comparable among governments. Additionally, the types of assets about which some respondents raised concerns may not be covered by the exception. For example, some computers might be considered core, whereas others might be considered noncore.

Lease Modifications and Terminations

B101. Lease contracts often are modified during the lease term. The parties may agree to extend a lease when there is no option to extend, payment amounts could be revised, or another underlying asset might be added. Sometimes a lessee and lessor might agree to terminate a lease prior to its scheduled end date, even if such a provision was not included in the most recent lease contract before the modification. This Statement provides guidance for accounting for lease terminations and modifications because the Board believes the accounting for a lease should reflect changes in the provisions of the prior lease contract.

B102. This Statement requires that an amendment to a lease contract that diminishes (but does not terminate) the lessee's right to use the underlying asset be accounted for as a partial lease termination. For example, shortening the lease term or reducing a lease from four vehicles to three is a partial termination. In contrast, other amendments to a lease contract, including a reduction in payment amounts, are modifications rather than terminations. The Board believes that this guidance is appropriate because the lessee retains the same right to use the underlying asset, even if the lessee will be paying less for that right going forward. The provisions in this Statement for lease modifications are similar to prior guidance in Statement 62.

B103. This Statement requires that the additional portion of a modified lease be accounted for as a new lease, separately from the current portion of the lease, when two conditions are met. The first condition, as proposed in the Exposure Draft, would have required that a lease modification give the lessee an additional lease asset either by lengthening the lease term or by adding one or more underlying assets that were not included in the original lease. The Board decided that a modification that lengthens the lease term does not grant an additional lease asset; it merely changes an attribute of the lessee's existing lease asset. The second condition, as proposed in the Exposure Draft, would have required that the lease payments for the additional portion in a modified lease be reasonably priced compared to its stand-alone price. In light of the

revisions the Board made to the requirements regarding the allocation of the contract price to multiple components discussed in paragraphs B92 and B93, the Board concluded that it was appropriate to similarly modify that condition in paragraph 72b. That is, if lease payments for the additional lease asset appear to be unreasonable based on (a) the terms of the amended contract and (b) professional judgment, the modification amends the terms and conditions of the existing lease rather than creating a new lease.

B104. When a lease is fully or partially terminated, the lessee no longer has the same right to use the underlying asset. Therefore, this Statement requires a lessee to remove the carrying value, or a portion thereof, of the intangible lease asset that represents that right to use. An early termination often relieves the lessee of its obligations to make future lease payments, although there may be some final payments or termination penalties required. An early lease termination could be the result of factors that could indicate impairment of the underlying asset, and the applicable guidance in Statement 42 would apply.

B105. The guidance for lease modifications resulting from a debt refunding by the lessor, including an advance refunding, in which the perceived economic advantages of the refunding are passed through to the lessee was originally provided by Statement 62. That guidance has been modified for this Statement to align those provisions with the basic principles established in this Statement.

Subleases

B106. Sometimes a government will enter into a lease for an underlying asset and, either simultaneously or at a later date, sublease that underlying asset (or a portion of it) to another party. This Statement requires that subleases be accounted for as separate transactions from the original leases. The Board views the lease and sublease as two separate transactions entered into with different parties and, accordingly, concluded that there is no basis for offsetting the lease payable and receivable amounts. (A lease and sublease with the same party would be a lease-leaseback per paragraph 87 and is discussed in paragraph B113.)

B107. Outreach to users indicated that a general description of sublease arrangements would be essential to financial statement users for understanding the nature of the government's overall leasing activities. Consistent with the view discussed in paragraph B106, transactions of a lessee as a lessor in a sublease are required to be reported separately from the lessee transactions.

Statement 62 required disclosure of sublease payments to be received. This Statement does not require that disclosure because the payments to be received from subleases would be included in the lease receivable and the note disclosure of future lease payments required for lessors. The Board does not believe that sublease payments are sufficiently different from other lease payments to require separate disclosure.

Sale-Leaseback Transactions

B108. This Statement requires that a sale-leaseback include a transaction that qualifies as a sale under the guidance for sales of real estate in Statement 62. The sales-of-real-estate criteria include the provision that an option or requirement for a seller to repurchase the asset would preclude sale treatment. The Board believes that a qualifying sale should occur for a transaction to be accounted for as a sale-leaseback and that the sales-of-real-estate criteria should be used to determine whether a sale has occurred, regardless of whether a leaseback is involved.

B109. Statement 62, as amended, provided that recognition of a gain or loss on the sale in a sale-leaseback transaction depends on the extent to which the seller-lessee retains use of the property. Determining what portion of the gain or loss to recognize at the time of the sale depended on interpretation of the terms *minor portion* and *substantially all.* To simplify that process, this Statement requires that any difference between the carrying value of the capital asset that was sold and the net proceeds from the sale should be deferred by the seller-lessee over the term of the leaseback, regardless of how much use of the property the seller-lessee retains. A leaseback that qualifies as a short-term lease also is excluded for the same reasons short-term leases are excluded.

Sale-Leaseback Transactions with Off-Market Terms

B110. This Statement contains specific provisions for when a sale-leaseback has off-market terms. The Board believes that the substance of sale-leaseback transactions with off-market terms is different from similar transactions with market terms and that the benefits of recognizing the substance of the transaction outweigh concerns about the possible cost and complexity of identifying and calculating the difference between market and off-market terms.

Notes to Financial Statements for Sale-Leaseback Transactions

B111. The Board believes that disclosure of the terms and conditions of a sale-leaseback is essential for users of the seller-lessee's financial statements to understand the transaction, including any commitments made or further involvement of the seller-lessee in carrying out the transaction. The Board considered requiring disclosure of gains or losses arising from sale-leaseback transactions but does not believe these gains or losses are substantially different enough from those arising from other capital asset disposals to warrant a separate disclosure requirement.

Sale-Leaseback without a Transaction That Qualifies as a Sale

B112. The Board concluded that a sale-leaseback that does not include a transaction that qualifies as a sale is accounted for as a financing because the substance of the transaction is a borrowing rather than a sale of an asset. Such a transaction would be subject to existing standards for long-term liabilities, including disclosures; therefore, the Board does not believe such requirements need to be repeated in this Statement. Statement 62 requires a seller-lessee in a failed sale-leaseback to disclose any sublease payments receivable. The Board decided that requirement is not necessary because if the seller-lessee enters into a sublease, it would become a lessor for the sublease transaction and follow the lessor guidance, including applicable disclosures.

Lease-Leaseback Transactions

B113. In a lease-leaseback transaction, each party is both a lessor and a lessee. Because each portion of the transaction is with the same counterparty, a right of offset exists. The Board believes that disclosure of the gross amounts of the lease and leaseback would provide users with essential information about the magnitude of each portion of the transaction.

Intra-Entity Leases

B114. This Statement does not change the guidance for intra-entity leases established in NCGA Statement 5, as referenced in Statement No. 14, *The Financial Reporting Entity.* The Board believes that guidance is a specific application of the general guidance for transactions within a financial reporting entity. However, the Board decided to provide guidance for eliminations with or between blended component units in this Statement so that the eliminations will be reported consistently among governments. The Board believes these eliminations reduce complexity in the financial statements without sacrificing essential information to financial statement users.

Leases between Related Parties

B115. Leases between related parties are subject to the requirements in Statement No. 56, *Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards,* to report the substance of the transaction, if significantly different from its form. This Statement carries forward related application guidance for leases between related parties previously included in Statement 62. The Board considered whether to provide an exception to the requirements in those Statements for leases because of the emphasis in this Statement on legally enforceable rights and obligations stemming from a lease contract. However, the Board believes that the substance of a lease arrangement with a related party should be the basis for financial statement recognition because of the potential for structuring a lease contract in a manner that might distort the substance of the transaction.

Considerations Related to Benefits and Costs

B116. The overall objective of financial reporting by state and local governments is to provide information to assist users (the citizenry, legislative and oversight bodies, and investors and creditors) in assessing the accountability of governments and in making economic, social, and political decisions. One of the principles guiding the Board's setting of standards for financial reporting is the assessment of the expected benefits and perceived costs. The Board strives to determine that its standards (including disclosure requirements) address a significant user need and that the costs incurred through the application of its standards, compared with possible alternatives, are justified when compared to the expected overall public benefit.

B117. Present and potential users are the primary beneficiaries of improvements in financial reporting. Persons within governments who are responsible for keeping accounting records and preparing financial statements, as well as managers of public services, also benefit from the information that is collected and reported in accordance with GASB standards. The costs to implement the standards are borne primarily by governments and, by extension, their citizens and taxpayers. Users also incur costs associated with the time and effort required to obtain and analyze new information to meaningfully inform their assessments and decisions.

B118. The Board's assessment of the expected benefits and perceived costs of issuing new standards is unavoidably more qualitative than quantitative because no reliable and objective method has been identified for quantifying the value of improved information in financial statements. Furthermore, it is difficult to accurately measure the costs of implementing new standards until implementation has taken place. Nonetheless, the Board undertakes this assessment based on the available evidence regarding expected benefits and perceived costs with the objective of achieving an appropriate balance between maximizing benefits and minimizing costs.

B119. The Board gathered information on the expected benefits of improving the existing leases standards primarily through input from financial statement users on the project task force and GASAC, and research with users related to disclosure requirements. The feedback indicated that users are interested in (a) the future payment commitments of a lessee, (b) the revenue stream that a lessor is expected to receive, and (c) the longer term impact of leases on the resources of the government. The Board believes that the recognition and disclosure requirements of this Statement are responsive to the needs expressed by the users.

B120. Information that the Board considered regarding the perceived costs came primarily from input from financial statement preparers on the project task force and GASAC, due process comments received on the Preliminary Views and Exposure Draft in comment letters and public hearing testimony, and results from a field test. Participants in the field test provided the Board with their estimates of the initial costs to implement the proposed standards and the recurring annual costs in subsequent years.

B121. The Board considered the anticipated costs in two categories: general costs of applying the standards and costs of applying particular provisions. For general costs of applying the standards, the Board anticipates that a majority of

governments will incur some costs in adopting this Statement because many governments have a significant number of leases. Based on feedback received from stakeholders, those costs likely will result from reviewing existing lease agreements, staff training, and system changes. Many of those costs will increase with the number of significant leases that a government has and the complexity of those arrangements. For example, it may take more effort to account for a lease contract with options to extend and multiple components than a lease without those elements. Respondent comments related to costs and benefits raised concerns about the overall effort and resources needed to implement the proposed guidance, to test for subsequent compliance, and to monitor leases for changes that would result in adjustments to the amounts recognized in financial statements. Some respondents also raised concerns regarding the limited resources of governments, especially smaller ones, to assess a significant volume of leases. Although this Statement does not require regular reassessments, some circumstances require updates or changes to the amounts recognized. Overall, the treatment in this Statement is very similar to the previous guidance for capital leases in Statement 62, which should help mitigate some of the costs of implementation. Additionally, as discussed elsewhere in this Basis for Conclusions, the Board made several decisions in the interest of reducing costs. These include, but are not limited to, the provisions regarding:

a. The short-term lease exception, including not requiring disclosures related to short-term leases by either lessees or lessors
b. Not requiring a lessor to derecognize the underlying asset or calculate a residual value
c. Allocation of the contract price to multiple components of a lease that allows the stated contract prices to be used if they do not appear to be unreasonable
d. Allocation of the contract price to multiple components that allow best estimates to be used for allocation if no separate prices are included in the contract or if stated prices appear to be unreasonable
e. The requirement to treat an entire multiple-component contract as a single lease unit if determining a best estimate is not practicable
f. The general exclusion from recognition and measurement requirements of leases of underlying assets that are held as investments
g. Not requiring lessors to disclose the carrying amount (and accumulated depreciation) of assets on lease or held for leasing by major classes of assets (except for certain regulated leases).

In addition, the transition provisions discussed in paragraphs B124 and B125 are intended to mitigate costs of implementation.

B122. The Board considered the aggregate expected benefits and perceived costs associated with the entirety of the requirements in this Statement. The Board is cognizant that the costs of implementing the changes required by this Statement may be significant. However, the Board believes that the expected benefits that would result from the information provided through implementation of this Statement, both initially and on an ongoing basis, are significant and justify the perceived costs.

Effective Date and Transition

B123. The provisions of this Statement are effective for reporting periods beginning after December 15, 2019. The Board believes that this effective date allows adequate time for financial statement preparers to plan for the transition and implementation of the provisions of this Statement. The Exposure Draft proposed an earlier effective date. However, some respondents to the Exposure Draft requested an extension of that effective date. The Board acknowledges that implementation will be more challenging for governments with many leases. The Board believes that the extension of the effective date, which is one year later than proposed in the Exposure Draft, will reduce the burden on preparer governments by providing additional time to analyze existing lease contracts and gather information for reporting and disclosure requirements; implement internal controls; update information technology systems; work with grant providers to address changes in lease reporting; and address potential changes in statutes and policies, debt limits, and compliance with debt covenants. The Board believes the effective date provides sufficient time for implementation if governments do not delay in beginning their implementation process.

B124. This Statement requires that leases be recognized and measured using the facts and circumstances that existed at the beginning of the period of implementation. The Board believes that it would not be practical to require governments to return to the commencement of each lease term and determine what the balances would have been if this Statement had been in effect from that time. Therefore, the adjustments should be made based on the remaining lease payments as of the beginning of the period of implementation or the beginning of any earlier periods restated. The Board considered requiring prospective application only to new leases entered into after the effective date. Although prospective implementation could have made transition easier, the

Board is concerned about the usefulness of information provided when lease transactions are accounted for under different models. Additionally, it could be many years before all existing leases accounted for under Statement 62 have expired.

B125. Some lessor governments previously derecognized underlying assets in accordance with the guidance in Statement 62 for sales-type or direct-financing leases. The Board believes that it is not meaningful for those lessors to determine what the value of the underlying asset would be at the time of implementation and recognize it. Therefore, if any residual asset had been included in the net investment in the lease under Statement 62, that amount should become the new carrying value of the underlying asset. In many cases, those leases involve a transfer of ownership, and the lessor will not retain ownership of the asset at the end of the lease.

B126. This Statement encourages early application. The Board considered whether comparability among governments could suffer if some governments chose early application. However, the benefits of early application include better information provided to financial statement users and the ability of other governments to learn from the experience of the early adopters. The Board believes that these benefits outweigh the potential for comparability issues in the interim.

B127. The provisions of this Statement should be applied retroactively by restating financial statements, if practicable, for all prior periods presented. The phrase *if practicable* has been used in other GASB standards in a similar context as used in this Statement with respect to transition provisions that require restating the financial statements for all prior periods presented. The Board believes that reasonable efforts should be employed before a government determines that restatement of all prior periods presented is not practicable. In other words, *inconvenient* should not be considered equivalent to *not practicable.*

Appendix C

CODIFICATION INSTRUCTIONS

C1. The instructions that follow update the June 30, 2016 *Codification of Governmental Accounting and Financial Reporting Standards* for the effects of this Statement. Only the paragraph number of the Statement is listed if the paragraph will be cited in full in the Codification.

* * *

[In all sections, update cross-references.]

* * *

GENERALLY ACCEPTED ACCOUNTING PRINCIPLES AND LEGAL COMPLIANCE **SECTION 1200**

.115 [In subparagraph (c), replace *paragraphs .108–.110* with *paragraph .110*.]

* * *

REPORTING CAPITAL ASSETS **SECTION 1400**

.120 [Replace *capital lease* with *lease*.] [GASBS 62, ¶3 and ¶5, as amended by GASBS 87, ¶20 and ¶30]

.121 [Revise the second sentence as follows:] Paragraph .121 of Section L20 provides that, during the term of a lease, a portion of each payment that relates to the lease liability should be recorded as an outflow of resources (for example, interest expense). [GASBS 62, ¶6, as amended by GASBS 87, ¶24]

.139 [Replace *capital lease* with *lease*.] [GASBS 51, ¶3, as amended by GASBS 69, ¶40, GASBS 72, ¶64, and GASBS 87, ¶20]

[Revise paragraph .156, including heading as follows:]

Capital Assets Obtained through Leases

.156 Paragraphs .127–.136, .138, and .151 of Section L20 provide guidance on reporting assets obtained through leases.

.186 [Add the following footnote at the end of the first sentence of subparagraph (a); renumber subsequent footnotes:]

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[33]Paragraph .131 of Section L20 provides additional guidance for assessing impairment of lease assets. [GASBS 42, ¶11, as amended by GASBS 87, ¶34]

.187 [Add the following footnote at the end of the first sentence; renumber subsequent footnotes:]

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[34]Paragraph .131 of Section L20 provides additional guidance for measuring impairment of lease assets. [GASBS 42, ¶12, as amended by GASBS 87, ¶34]

.719-8 [Delete *paragraphs .103–.515 of*.] [GASBIG 2015-1, QZ.51.21, as amended by GASBS 87, ¶8]

.735-1 [In the last sentence in the answer, replace *assets under a capital lease* with *a lease asset under a lease*.] [GASBIG 2015-1, Q7.9.6, as amended by GASBS 87, ¶20]

.745-2 [Delete *under a capital lease*.] [GASBIG 2015-1, QZ.42.9, as amended by GASBS 87, ¶20]

* * *

REPORTING LIABILITIES **SECTION 1500**

.102 [Replace *capital and operating leases* with *leases*; in sources, remove GASBS 13, ¶7, from amending sources of NCGAS 1, ¶42, and add GASBS 87, ¶20, as an amending source of NCGAS 1, ¶42 and GASBS 34, ¶81.]

.103 [Replace *capital and operating leases* with *leases*; in sources, remove GASBS 13, ¶9, from and add GASBS 87, ¶20, ¶35, and ¶36, to the amending sources of NCGAS 1, ¶43.]

.106 [In the last sentence of footnote 2, replace *rental* with *the lease payment*.] [GASBS 62, fn12, as amended by GASBS 87, ¶53]

.117 [Replace *capital leases* with *leases*; in sources, add GASBS 87, ¶20, as an amending source of GASBI 6, ¶9.]

.119 [Replace *capital leases* with *leases*; in sources, add GASBS 87, ¶35 and ¶36 as an amending source of GASBI 6, ¶11.]

.122 [In the third sentence, replace *capital leases* with *leases*.] [NCGAS 1, ¶70 and ¶72, as amended by GASBS 34, ¶82; GASBS 6, ¶16; GASBI 6, ¶13, as amended by GASBS 87, ¶35 and ¶36]

* * *

BASIS OF ACCOUNTING **SECTION 1600**

.118 [Replace *capital leases* with *leases*; in sources, add GASBS 87, ¶20 as an amending source of GASBI 6, ¶9.]

.120 [Replace *capital leases* with *leases*.] [NCGAS 1, ¶72; GASBI 6, ¶13, as amended by GASBS 87, ¶20]

* * *

CLASSIFICATION AND TERMINOLOGY **SECTION 1800**

Sources: [Delete NCGA Statement 5; add GASB Statement 87.]

[In footnote 3, replace *rental* with *the lease payment*.] [GASBS 62, fn12, as amended by GASBS 87, ¶53]

[In heading above paragraph .128, replace *Capital Lease* with *Lease*.]

.128 [Replace with ¶36.] [GASBS 87, ¶36]

.743-1 [Replace *capital lease* with *lease*.] [GASBIG 2015-1, QZ.54.11, as amended by GASBS 87, ¶20]

* * *

[In footnote 33, replace *rental* with *the lease payment*.] [GASBS 62, fn12, as amended by GASBS 87, ¶53]

.715-11 [Replace *capital lease* with *lease* and *capital leases* with *leases*.] [GASBIG 2015-1, Q7.30.2, as amended by GASBS 87, ¶20]

* * *

NOTES TO FINANCIAL STATEMENTS SECTION 2300

Sources: [Add GASB Statement 87.]

.106 [In subparagraph (j), replace paragraph references with *.134, .135, .136, .153, .154, .155, and .156*. In subparagraph (l), replace *capital assets* with *capital assets, including lease assets*. In sources, add NCGAI6, ¶5, as amended; remove GASBS 62, ¶223, ¶231, ¶239, ¶355, ¶256, and ¶270; and replace GASBS 34 sources with the following:] GASBS 34, ¶116, as amended by GASBS 62, ¶4, GASBS 63, ¶8, and GASBS 87, ¶37; GASBS 34, ¶117, as amended by GASBS 62, ¶4 and GASBS 87, ¶37

.117 [Revise the second sentence as follows:] The information disclosed should be divided into major classes of capital assets, with lease assets presented separately, and major classes of long-term liabilities, as well as between those associated with governmental activities and those associated with business-type activities. [GASBS 34, ¶116, as amended by GASBS 63, ¶8 and GASBS 87, ¶37]

.118 [Replace *capital assets* with *capital assets, with lease assets presented separately,*.] [GASBS 34, ¶117, as amended by GASBS 87, ¶37]

* * *

CASH FLOWS STATEMENTS SECTION 2450

.133 [In current paragraph .132, renumbered for the effects of Statement No. 84, *Fiduciary Activities,* replace *an asset* with *a lease asset* and replace *capital lease* with *lease*.] [GASBS 9, ¶37, as amended by GASBS 87, ¶20]

[Revise Question .707-16 as follows:]

.707-16 Q—How should lease activities be classified in the statement of cash flows?

A—Most leases result in the lessee recording an intangible lease asset, which is a type of capital asset. The capital and related financing activities category is directly affected by capitalization policies. (See paragraph 63 of the Basis for Conclusions of Statement 9.) If a lease results in a lessee recognizing a lease asset, the cash flows (including the interest portion) should be included in the capital and related financing activities category as an outflow in the lessee's statement of cash flows. A lessor should normally classify the inflows in the lessor's statement of cash flows consistent with how the underlying asset is classified on the statement of net position, that is, as an investing or capital and related financing activity. The lease transaction is a financing of a nonfinancial asset. The timing of the cash flows does not coincide with the date of the financing, but the cash flows are, nevertheless, payments for the right to use the nonfinancial asset. (See the discussion of noncash disclosures in Question .714-2 of this section.)

Cash flows resulting from a short-term lease, on the other hand, usually should be classified with operating activities. The lessee's cash payments always should be presented as an operating activities outflow. The lessor's cash receipts normally should be presented as an operating activities inflow; however, Question .707-3 discusses factors that should be evaluated to determine whether lease revenue may be classified as an investing activities inflow. (See Examples B, C, E, H, and I in nonauthoritative paragraph .901 of this section.)

[GASBIG 2015-1, Q2.27.5, as amended by GASBS 87, ¶16, ¶20, ¶40, and ¶55, and GASBIG 2016-1, Q5.2]

.714-2 [Replace the last two sentences of subparagraph (b) of the answer with the following:] For example, when an enterprise fund enters into a lease for a building, a noncash transaction occurs because a liability for a lease obligation and a lease asset for the right to use the building are recorded in the statement of net position.

[Revise the third sentence of subparagraph (c) of the answer as follows:] For example, a lease transaction typically meets the definition of a capital and related financing activity.

[In the last paragraph of the answer, replace *obtaining a capital asset by entering into a capital lease* with *obtaining a lease asset by entering into a lease*.] [GASBIG 2015-1, Q2.32.1, as amended by GASBS 87, ¶20]

* * *

REPORTING ENTITY AND COMPONENT UNIT PRESENTATION AND DISCLOSURE **SECTION 2600**

.118 [Replace *capital lease* with *lease* throughout. In the second sentence, replace *paragraph .149* with *paragraph .184*, and in the third sentence, replace *paragraph .150* with *paragraph .185*.] [GASBS 14, ¶58, as amended by GASBS 87, ¶88 and ¶89]

* * *

STATISTICAL SECTION **SECTION 2800**

.122 [Replace *capital leases* with *leases*.] [GASBS 44, ¶23, as amended by GASBS 87, ¶20]

.503 [Replace *capital leases* with *leases*.] [GASBS 44, ¶45, as amended by GASBS 87, ¶20]

.506 [Replace *capital leases* with *leases*.] [GASBS 44, ¶45, as amended by GASBS 87, ¶20]

.714-1 [Replace *capital leases* with *leases*.] [GASBIG 2015-1, Q9.24.1, as amended by GASBS 87, ¶20, and GASBIG 2016-1, Q5.35]

* * *

CLAIMS AND JUDGMENTS **SECTION C50**

Sources: [Add GASB Statement 87.]

[Revise paragraph .168 as follows:]

.168 [In the first sentence, delete *long-term leases*; insert new footnote 26 following *commitments,*.] [GASBS 62, ¶113, as amended by GASBS 87, ¶39]

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[26]A lessee is not required to disclose collateral pledged for a lease if that collateral is solely the asset underlying the lease. [GASBS 87, ¶39]

* * *

DEBT EXTINGUISHMENTS AND TROUBLED DEBT RESTRUCTURING **SECTION D20**

.126 [Replace sources with the following:] [GASBS 62, ¶135 as amended by GASBS 87, ¶3–¶8 and ¶10–¶91]

* * *

DERIVATIVE INSTRUMENTS **SECTION D40**

.171 [Replace *paragraph .127* with *paragraphs .134–.136*.] [GASBS 53, ¶74 as amended by GASBS 87, ¶37–¶39]

* * *

ACCOUNTING FOR PARTICIPATION IN JOINT VENTURES AND JOINTLY GOVERNED ORGANIZATIONS **SECTION J50**

.110 [In the first sentence, replace *capital leases* with *leases*; in the fourth sentence replace *capital lease* with *lease*.] [GASBS 14, ¶76, as amended by GASBS 87, ¶20]

* * *

LEASES **SECTION L20**

Source: [Remove all sources; add GASB Statement 87.]

[Replace entire section, including the effects of Statement 84, with the following:]

Scope and Applicability of This Section

.101–.106 [GASBS 87, ¶3–¶8, including footnotes]

.107–.188 [GASBS 87, ¶10–¶91, including headings and footnotes]

* * *

LENDING ACTIVITIES **SECTION L30**

[Replace paragraph .117 with the following:]

.117 The provisions of paragraphs .105–.109 should apply to lessors in determining the net amount of *initial direct costs* as that term is used in paragraph .137 of Section L20, "Leases." [GASBS 62, ¶450, as amended by GASBS 87, ¶40]

* * *

REAL ESTATE **SECTION R30**

.141 [Replace *paragraphs .159–.171* with *paragraphs .178–.182*.] [GASBS 62, ¶320, as amended by GASBS 87, ¶82–¶86]

.171 [Replace subparagraph (b) with the following: *Initial direct costs of leases (see Section L20).*] [GASBS 62, ¶351, as amended by GASBS 87, ¶20 and ¶40]

.188 [Delete footnote 35 and renumber subsequent footnotes; replace *operating leases* with *leases*.] [GASBS 62, ¶368, as amended by GASBS 87, ¶40]

.189 [Delete *operating* throughout.] [GASBS 62, ¶369, as amended by GASBS 87, ¶40]

.190 [Insert a new second sentence as follows:] Lease revenue should be recognized in accordance with the provisions in paragraphs .149 and .150 of Section L20. [GASBS 62, ¶370; GASBS 87, ¶53 and ¶54]

* * *

BANKRUPTCIES **SECTION Bn5**

[In heading above paragraph .107, replace *Capital Leases* with *Leases*. Replace paragraph .107 with the following:]

.107 If the provisions of a lease are modified in a way that changes the amount of the remaining lease liability and the modification either (a) does not give rise to a new agreement or (b) does give rise to a new agreement but such agreement also meets the definition of a lease, then the present balances of the lease asset and the lease liability should be adjusted by an amount equal to the difference between the lease liability under the revised or new agreement and the carrying amount of the pre-petition lease liability. The lease liability under the revised or new agreement should be computed using the rate of interest used to record the lease initially. A termination of a lease should be accounted for by removing the lease asset and lease liability, with a gain or loss recognized for the difference. [GASBS 58, ¶8, as amended by GASBS 87, ¶73, ¶74, and ¶78]

* * *

PENSION PLANS ADMINISTERED THROUGH TRUSTS THAT MEET SPECIFIED CRITERIA—DEFINED BENEFIT **SECTION Pe5**

.708-1 [Replace *capital lease* with *lease*.] [GASBIG 2015-1, Q5.72.1, as amended by GASBS 87, ¶20]

* * *

REGULATED OPERATIONS **SECTION Re10**

[Delete paragraphs .118 and .119; renumber subsequent paragraphs.]

.118 [In current paragraph .120, replace *by the deposit method or as a financing under paragraphs .150–.171 of Section L20* with *as a sale-leaseback*.] [GASBS 62, ¶254, as amended by GASBS 87, ¶82–¶84]

* * *

C2. The instructions that follow update paragraph C1 of Implementation Guide No. 2017-2, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans,* for the effects of this Statement.

* * *

POSTEMPLOYMENT BENEFIT PLANS (OTHER THAN PENSION PLANS) ADMINISTERED THROUGH TRUSTS THAT MEET SPECIFIED CRITERIA—DEFINED BENEFIT **SECTION Po50**

.711-1 [Replace *capital lease* with *lease*.] [GASBIG 2017-2, Q4.51, as amended by GASBS 87, ¶20]

* * *

C3. The instructions that follow update the June 30, 2016 *Comprehensive Implementation Guide* for the effects of this Statement.

* * *

[Revise Question 2.27.5 as follows:]

2.27.5. Q—How should lease activities be classified in the statement of cash flows?

A—Most leases result in the lessee recording an intangible lease asset, which is a type of capital asset. The capital and related financing activities category is directly affected by capitalization policies. (See paragraph 63 of the Basis for Conclusions of Statement 9.) If a lease results in a lessee recognizing a lease asset, the cash flows (including the interest portion) should be included in the capital and related financing activities category as an outflow in the lessee's statement of cash flows. A lessor normally should classify the inflows in the lessor's statement of cash flows consistent with how the underlying asset is classified on the statement of net

position, that is, as an investing or capital and related financing activity. The lease transaction is a financing of a nonfinancial asset. The timing of the cash flows does not coincide with the date of the financing, but the cash flows are, nevertheless, payments for the right to use the nonfinancial asset. (See the discussion of noncash disclosures in Question 2.32.1 in Implementation Guide 2015-1.)

Cash flows resulting from a short-term lease, on the other hand, usually should be classified with operating activities. The lessee's cash payments always should be presented as an operating activities outflow. The lessor's cash receipts normally should be presented as an operating activities inflow; however, Question 4.9 discusses factors that should be evaluated to determine whether lease revenue may be classified as an investing activities inflow. (See Examples B, C, E, H, and I in nonauthoritative Appendix B2-1 in Implementation Guide 2015-1.)

[GASBIG 2015-1, Q2.27.5, as amended by GASBS 87, ¶16, ¶20, ¶40, and ¶55, and GASBIG 2016-1, Q5.2]

2.32.1. [Replace the last two sentences of subparagraph (b) of the answer with the following:] For example, when an enterprise fund enters into a lease for a building, a noncash transaction occurs because a liability for a lease obligation and a lease asset for the right to use the building are recorded in the statement of net position.

[Revise the third sentence of subparagraph (c) of the answer as follows:] For example, a lease transaction typically meets the definition of a capital and related financing activity.

[In the last paragraph of the answer, replace *obtaining a capital asset by entering into a capital lease* with *obtaining a lease asset by entering into a lease*.] [GASBIG 2015-1, Q2.32.1, as amended by GASBS 87, ¶20]

5.72.1. [Replace *capital lease* with *lease*.] [GASBIG 2015-1, Q5.72.1, as amended by GASBS 87, ¶20]

7.9.6. [In the last sentence in the answer, replace *assets under a capital lease* with *a lease asset under a lease*.] [GASBIG 2015-1, Q7.9.6, as amended by GASBS 87, ¶20]

7.30.2. [Replace *capital lease* with *lease*.] [GASBIG 2015-1, Q7.30.2, as amended by GASBS 87, ¶20]

9.24.1. [Replace *capital leases* with *leases*.] [GASBIG 2015-1, Q9.24.1 as amended by GASBS 87, ¶20 and GASBIG 2016-1, Q5.35]

[Delete Question Z.38.1.]

Z.42.9. [Delete *under a capital lease*.] [GASBIG 2015-1, QZ.42.9, as amended by GASBS 87, ¶20]

Z.51.21. [Replace *Statement 62, paragraphs 211–271, as amended,* with *Statement No. 87, Leases,*; replace *Statement 62* with *Statement 87*.] [GASBIG 2015-1, QZ.51.21, as amended by GASBS 87, ¶8]

Z.54.11. [Replace *capital lease* with *lease*.] [GASBIG 2015-1, QZ.54.11, as amended by GASBS 87, ¶20]

* * *

C4. The instructions that follow update paragraph C4 of Implementation Guide 2017-2 for the effects of this Statement.

* * *

8.112.1. [Replace *capital lease* with *lease*.] [GASBIG 2017-2, Q4.51, as amended by GASBS 87, ¶20]

* * *