

INTRO

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 - MBA, University of Utah
 - BS, Accounting, **Brigham Young University**
 - Started Public Accounting in 2002
 - There are NO jokes about governmental lease accounting!...go figure

THE PROBLEM

- Though leases are similar to loans, companies have long been permitted to exclude most leases from their balance sheets. As a result, investors looking at a company's financial statements may have struggled to calculate its true financial obligations.
- The old joke = What is $2 + 2$?...whatever you want it to be
 - Estimated \$2 TRILLION in leases; 85% of which are off balance sheet
 - Lack of transparency and comparability

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“Our books are balanced. 50% of our numbers are real and 50% are made up.”

LEASE ACCOUNTING (CURRENTLY)

- GASB Statement No. 13, *Accounting for Operating Leases with Scheduled Rent*
 - Operating and Capital Leases determination
 - Operating: no assets or liabilities are reported; minimal disclosures
 - Capital: treated similar to a financed capital asset purchase; minimal disclosure
 - DOES NOT provide a single model for reporting governmental leasing agreements
 - Lack of comparability
 - Lack of consistency

LEASE ACCOUNTING (EXPOSURE)

- In January 2016, GASB issued an exposure draft, *Leases*
 - Highlights:
 - Definition of a Lease
 - Lease Term
 - Lessee Accounting
 - Lessor Accounting
 - Lease Terminations / Modifications
 - Exclusions
 - Effective Date (currently, a game of kick-the-can)
 - April 14, 2017 issued the final statement – cannot get minutes yet

LEASE ACCOUNTING (EXPOSURE)

- Leases, Defined -

- Lease:
 - A contract that conveys the **right to use** another entity's **nonfinancial asset** (the underlying asset) for a period of time in an **exchange or exchange-like transaction**. **Intangible right to use lease asset is a capital asset**
- Examples of nonfinancial assets include:
 - Buildings, land, vehicles, and equipment.
 - Contracts that, although not explicitly identified as leases, meet the definition of a lease (Rental Agreement)
- Exclusions:
 - Short-term (<12 months) lease agreements
 - Lease for intangible assets (Computer Software)
 - **Supply Contracts and Inventory**

LEASE ACCOUNTING (EXPOSURE)

- Lease Term -

- A lessee has a **noncancelable right to use an underlying asset**, plus the following **by a lessee's option** to:
 - WILL exercise option to extend (included in term)
 - WILL NOT exercise option to terminate (excluded from term)
 - For example, clause that allows governmental lessees to cancel a lease agreement that is expected to be exercised
 - **Purchases of the underlying asset, accelerated payoffs, or default on payments, are not considered termination options.**

LEASE ACCOUNTING (EXPOSURE)

- Lease Term (Continued) -

- Reassessment of term should occur only if the **lessee does** either of the following:
 - Elects **to** exercise an option even though was reasonably certain that the lessee would not exercise that option
 - Elects to **not** exercise an option even though was reasonably certain that the lessee would exercise that option.

LEASE ACCOUNTING (EXPOSURE)

- Lessee Accounting -

- Recognize a **lease liability** and a **lease asset** at the beginning of a lease, unless the lease is a short-term (12 months) or transfers ownership.
- Note disclosures would include a description of leasing arrangements, the amount of lease assets recognized, and a schedule of future lease payments to be made.

LEASE ACCOUNTING (EXPOSURE)

- Lessee Accounting -

- Lease Liability -
 - Measured at the **present value of payments expected to be made** for the lease term.
 - Payments include: fixed payments (add), lease incentives (reduce), variable payments (CPI-based)
 - Reduce the lease liability as payments are made and recognize **an outflow of resources for interest on the liability** (including imputed interest)

LEASE ACCOUNTING (EXPOSURE)

- Lessee Accounting -

- Lease Asset -
 - Measurement should be based on the measurement of the associated lease liability, which is consistent with the accounting for most capital assets at historical cost and because they arise from the same transaction
 - **Amortize the lease asset** over the **SHORTER** of the lease term or the useful life of the underlying asset.

LEASE ACCOUNTING (EXPOSURE)

- Lessee Accounting -

- Expense Recognition
 - **As a lease is a financing**, requires that a lessee recognize interest expense related to the amortization of the discount on the lease liability.
 - Recognize amortization expense related to the lease asset, (a 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 with other interest and depreciation or amortization expense amounts; NOT with operating expenses

LEASE ACCOUNTING (EXPOSURE)

- Lessee Accounting -

- Expense Recognition (Continued)
 - Amortization should be guided by the specific lease, NOT by the depreciation policy of other owned assets
 - May have shorter lives (lease term)
 - Right to use is an intangible asset distinct from asset leased

LEASE ACCOUNTING (EXPOSURE)

- Fund Accounting, Lessee -

- If a lease agreement is expected to be financed from general government resources, the lease should be accounted for and reported on a basis consistent with governmental fund accounting principles.
- The amount of the asset should be reflected as an expenditure and other financing source. Subsequent governmental fund lease payments should be accounted for consistent with principles for general obligation debt.

LEASE ACCOUNTING (EXPOSURE)

- Lessor Accounting -

- Recognize a **lease receivable** and a **deferred inflow of resources** at the beginning of a lease, unless the lease is a short-term lease or transfers ownership.
- **Any initial direct costs as an expense**
- Notes disclosures would include a description of leasing arrangements and the total amount of revenue recognized from leases.

LEASE ACCOUNTING (EXPOSURE) - Lessor Accounting (Continued) -

- Lease Receivable
 - Measured at the **present value of lease payments expected to be received** for the lease term, less provision for uncollectible amounts.
 - Payments include: fixed payments (add), residual value guarantees (add), variable payments (CPI-based)
- Recognize **interest revenue on the lease receivable** over the term of the lease.
- Remeasure if there is a change in the term or rate

LEASE ACCOUNTING (EXPOSURE) - Lessor Accounting (Continued) -

- Deferred Inflows of Resources
 - Measured at the **value of the lease receivable** PLUS any payments received at or prior to the beginning of the lease that relate to future periods.
- Recognize **interest revenue** on the deferred inflow of resources over the term of the lease.

LEASE ACCOUNTING (EXPOSURE)

- Lessor Accounting (Continued) -

- Underlying Asset
 - Should not derecognize
 - Should continue to apply other applicable guidance to the underlying asset, **including depreciation and impairment**. However, if the lease agreement requires the lessee to return the asset in its original or enhanced condition, a lessor should **NOT** depreciate the asset during the lease term.

LEASE ACCOUNTING (EXPOSURE)

- Fund Accounting, Lessor -

- In governmental fund financial statements, lease receivables and deferred inflows of resources should be used to account for leases.
- A lessor should measure the deferred inflow of resources at the initial value of the lease receivable, less any provision for uncollectible amounts, plus the amount of any payments received at or prior to the beginning of the lease that relate to future periods (for example, the final month's rent).
- A lessor subsequently should recognize the deferred inflow of resources as an inflow of resources (for example, revenue), if available, in a systematic and rational manner over the term of the lease.

LEASE ACCOUNTING (EXPOSURE)

- Accounting Summary -

Initial Reporting of the Lease			
	Assets	Liability	Deferred Inflow
Lessee	Intangible asset (right to use leased asset)—value of lease liability plus prepayments and initial direct costs that are ancillary to place asset in use	Present value of future lease payments (including fixed payments, variable payments based on index or rate, probably residual guarantees)	Not Applicable
Lessor	<ul style="list-style-type: none"> • Lease receivable (generally including same items as lessee liability) • Continue to report leased asset 	Not Applicable	Equal to lease receivable plus any cash received up front related to future periods

LEASE ACCOUNTING (EXPOSURE)

- Accounting Summary -

Subsequent Reporting of the Lease			
	Assets	Liability	Deferred Inflow
Lessee	Amortize over shorter of useful life or lease term	Reduce by lease payments (less amount of interest expense)	Not Applicable
Lessor	<ul style="list-style-type: none"> • Depreciate leased asset (unless indefinite life or required to be returned in its original or enhanced condition) • Reduce receivable by lease payments (less payment needed to cover accrued interest) • Amortize discount over term of the receivable 	Not Applicable	Recognize revenue over the lease term on a systematic and rational basis

LEASE ACCOUNTING (EXPOSURE)

- Terminations/Modifications -

- A lease contract may be amended while it is in effect. Examples of amendments include:
 - a change in consideration, a lengthening or shortening of the lease term, and adding or removing an underlying asset
- An amendment to a lease contract should be considered a lease modification or a partial lease termination.
- If a lease modification gives the lessee an additional right to use an asset not included in the original lease, both the lessee and the lessor should account for that additional portion of the modified lease as a new lease

LEASE ACCOUNTING (EXPOSURE)

- Terminations/Modifications -

- Lessee
 - **Partial Term.** Account for by reducing the carrying values of the lease asset and lease liability, and recognizing a gain or loss for the difference
 - **Asset Purchased.** If terminated as a result of purchasing the underlying asset from the lessor, the lease asset should be reclassified to the appropriate class of owned asset.
 - The lease liability should be changed to reflect only those payments yet to be made, and that change should be reflected in the cost of the purchased asset

LEASE ACCOUNTING (EXPOSURE)

- Terminations/Modifications -

- Lessor
 - **Partial Term.** Account for by reducing the carrying values of the lease receivable and deferred inflow of resources, and recognizing a gain or loss for the difference
 - **Asset Purchased.** If terminated as a result of purchasing the underlying asset from the lessor, the lease asset should be derecognized and included in the calculation of any resulting gain or loss.

LEASE ACCOUNTING (EXPOSURE)

- Exclusions -

- Short-term Lease (12 months or less) and Cancellable Period Agreements
- Lessees
 - Should recognize short-term lease payments as an expense
 - Should recognize an **asset** if payments are made in advance of the period to which they relate, or a **liability** for rent due if payments are to be made subsequent to that period
 - Should **not** recognize an outflow of resources during any rent holiday period (for example, one or more months free)

LEASE ACCOUNTING (EXPOSURE)

- Exclusions (Continued) -

- Lessors
 - Should recognize short-term lease payments as an revenue
 - Should recognize a **liability** if payments are received in advance of the period to which they relate, or an **asset** for rent due if payments are to be received subsequent to that period
 - Should **not** recognize an inflow of resources during any rent holiday period (for example, one or more months free)

LEASE ACCOUNTING (EXPOSURE)

- Effective Date -

- Anticipated effect date of AFTER December 15, 2019 (**December 31, 2020** and **June 30, 2021**)
- Early implementation is permitted for the bored and crazy! 😊

LEASE ACCOUNTING (EXPOSURE)

- How to Prepare -

- Scope – do I have an understanding of all leases
 - Gather all contracts that explicitly leases
 - Gather all contracts that are not explicitly leases
 - What leases will or may be a lease?
- How will increase liabilities and assets affect your financial condition?
 - Bond rating? Talk to Agencies now
- Implementation could be time-consuming – plan early and use your network for assistance