GASB Exposure Draft

January 25, 2016

Comments Due: May 31, 2016

Proposed Statement

of the Governmental Accounting Standards Board

Leases

This Exposure Draft of a proposed Statement of Governmental Accounting Standards is issued by the Board for public comment. Written comments should be addressed to:

Director of Research and Technical Activities
Project No. 3-24E

LEASES

Notice of Public Hearing and Request for Written Comments

PUBLIC HEARING

A public hearing is scheduled for June 29, 2016, beginning at 8:55 a.m. local time at the Doubletree by Hilton, San Francisco Airport, 835 Airport Boulevard, Burlingame, CA. Interested individuals or organizations may participate in the public hearing in person or by telephone. Details regarding participation will be provided after the GASB receives a notice of intent to participate.

Deadline for written notice of intent to participate in the public hearing: May 31, 2016

Basis for the public hearing. The GASB has scheduled the public hearing to obtain information from interested individuals and organizations about the issues discussed in this Exposure Draft. The hearing will be conducted by one or more members of the Board and its staff. Interested parties are encouraged to participate at the hearing and through written response.

Public hearing oral presentation requirements. Individuals or organizations that want to make an oral presentation in person or by telephone at the public hearing are required to provide, **by the deadline for notice of intent to participate (May 31, 2016),** a written notification of that intent and a copy of written comments addressing the issues discussed in this Exposure Draft. The notification and written submission should be addressed to the Director of Research and Technical Activities, Project No. 3-24E, and emailed to director@gasb.org or mailed to the address below. The notification should indicate a preference for participating in person or via telephone. The public hearing may be canceled if sufficient interest is not expressed by the deadline.

The Board intends to schedule all respondents who want to make oral presentations and will notify each individual or organization of the expected time of the presentation. The time allotted each individual or organization will be limited to about 30 minutes—10 minutes to summarize or elaborate on the written submissions, or to comment on the written submissions or presentations of others, and 20 minutes to respond to questions from those conducting the hearing.

Observers. Observers are welcome at the public hearing and are urged to submit written comments.

WRITTEN COMMENTS

Deadline for written comments: May 31, 2016

Requirements for written comments. Any individual or organization that wants to provide written comments but does not intend to participate in the public hearing should provide those comments by **May 31, 2016.** Comments should be addressed to the Director of Research and Technical Activities, Project No. 3-24E, and emailed to director@gasb.org or mailed to the address below.

OTHER INFORMATION

Public files. Written comments and transcripts of the public hearing will become part of the Board's public file. Written comments also are posted on the GASB's website. Copies of the transcript may be obtained for a specified charge.

Orders. This Exposure Draft may be downloaded from the GASB's website at www.gasb.org. For information on prices for printed copies, please contact the Order Department at the following address:

Governmental Accounting Standards Board
401 Merritt 7
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Norwalk, CT 06856-5116

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GASB publications also may be ordered at www.gasb.org.

Notice to Recipients of This Exposure Draft

The Governmental Accounting Standards Board (GASB) is responsible for establishing and improving standards of state and local governmental accounting and financial reporting to provide useful information to users of financial reports and to educate stakeholders—including issuers, auditors, and users of those financial reports—on how to most effectively understand and implement those standards.

The due process procedures that we follow before issuing our standards and other communications are designed to encourage broad public participation in the standards-setting process. As part of that due process, we are issuing this Exposure Draft setting forth a proposed Statement that would establish standards on leases.

We invite your comments on all matters in this proposed Statement. Because this proposed Statement may be modified before it is issued as a final Statement, it is important that you comment on any aspects with which you agree as well as any with which you disagree. To facilitate our analysis of comment letters, it would be helpful if you explain the reasons for your views, including alternatives that you believe the GASB should consider.

All responses are distributed to the Board and to staff members assigned to this project, and all comments are considered during the Board's deliberations leading to a final Statement. In deciding on changes in accounting and financial reporting standards, the GASB also takes into consideration the costs of preparing and reporting the information and its benefits to users of financial statements. When the Board is satisfied that all alternatives have adequately been considered, and modifications have been made as considered appropriate, a vote is taken on the Statement. A majority vote is required for adoption.

Summary

This proposed Statement addresses accounting and financial reporting for leases by state and local governments. It would establish 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 proposed Statement, a lessee would be required to recognize a lease liability and an intangible right-to-use lease asset. A lessor would be required to recognize a lease receivable and a deferred inflow of resources.

Definition of a Lease

A lease would be defined as a contract that conveys the right to use a nonfinancial asset (the underlying asset) 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 would be accounted for under the proposed leases guidance, unless specifically excluded.

Lease Term

The lease term would be defined as the period during which a lessee has a noncancelable right to use an underlying asset, plus the following periods, if applicable, covered by a lessee's option to:

a. Extend the lease if it is reasonably certain, based on all relevant factors, that the lessee will exercise that option
b. Terminate the lease if it is reasonably certain, based on all relevant factors, that the lessee will not exercise that option.

A fiscal funding or cancellation clause would be considered in determining the lease term only when it is reasonably certain that the clause will be exercised.

Lessees and lessors would reassess the lease term only if the lessee does either of the following:

a. Elects to exercise an option even though the lessor or lessee had previously determined that it was reasonably certain that the lessee would not exercise that option
b. Elects to not exercise an option even though the lessor or lessee had previously determined that it was reasonably certain that the lessee would exercise that option.

Lessee Accounting

A lessee would recognize a lease liability and a lease asset at the beginning of a lease, unless the lease is a short-term lease or transfers ownership of the underlying asset. The lease liability would be measured at the present value of payments expected to be made for the lease term. The lease asset would be measured at the amount of the initial measurement of the lease liability, plus any payments made to the lessor at or before the beginning of the lease and certain indirect costs.

A lessee would reduce the lease liability as payments are made and recognize an outflow of resources for interest on the liability. The lessee would 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 the financial statements would 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 would recognize a lease receivable and a deferred inflow of resources at the beginning of a lease, with certain exceptions (including a short-term lease or a lease that transfers ownership of the underlying asset). A lessor would not derecognize the asset underlying the lease. The lease receivable would be measured at the present value of lease payments expected to be received for the lease term. The deferred inflow of resources would be 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.

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

Contracts with Multiple Components and Contract Combinations

Generally, a government would account for the lease and nonlease components of a lease as separate contracts. If a lease involves multiple underlying assets, lessees and lessors generally would account for each underlying asset as a separate lease contract. To allocate consideration required under the contract to different components, lessees and lessors would use contract prices for individual components if reasonable based on observable stand-alone prices. Under certain circumstances, multiple components in a lease contract would be accounted for as a single lease unit. Contracts that are entered into at or near the same time with the same counterparty and meet certain criteria would be considered part of the same lease contract and would be evaluated in accordance with the guidance on contracts with multiple components.

Short-Term Leases

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

Lease Terminations and Modifications

An amendment to a lease contract would be considered a lease modification, unless the lessee's right to use the underlying asset decreases, in which case it would be a partial termination. A lease termination would be accounted for by reducing the carrying values of the lease liability and lease asset by a lessee, or the lease receivable and deferred inflow of resources by the lessor, with any difference being recognized as a gain or loss. A lease modification generally would be accounted for by remeasuring the lease liability and adjusting the related lease asset by a lessee, or remeasuring the lease receivable and adjusting the related deferred inflow of resources by a lessor.

Subleases and Leaseback Transactions

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

A transaction would qualify for sale-leaseback accounting only if it includes a qualifying sale. Otherwise, it is a borrowing. The sale and leaseback portions of a transaction would 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 would be reported as a deferred inflow of resources or a deferred outflow of resources and recognized over the term of the leaseback.

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

Effective Date and Transition

The requirements of this proposed Statement would be effective for reporting periods beginning after December 15, 2018. Earlier application is permitted.

Leases would 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 would not restate the assets underlying their existing sales-type or direct financing leases. Any residual assets for those leases would become the carrying values of the underlying assets.

How the Changes in This Proposed Statement Would Improve Financial Reporting

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

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 2 discusses the applicability of this Statement.

Proposed Statement of the Governmental Accounting Standards Board

Leases

January 25, 2016

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Proposed Statement of the Governmental Accounting Standards Board

Leases

January 25, 2016

INTRODUCTION

1. Governments enter into leases for many types of assets. The objective of this Statement is to better meet users' information needs for leases by improving accounting and financial reporting for leases. To achieve that objective, this Statement establishes a single model for lease accounting and financial reporting based on the foundational principle that leases within the scope of this Statement are financings of the right to use an underlying asset.

STANDARDS OF GOVERNMENTAL ACCOUNTING AND FINANCIAL REPORTING

Scope and Applicability of This Statement

2. 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.

3. For purposes of applying this Statement, a lease is defined as a contract that conveys the right to use a nonfinancial asset (the underlying asset) for a period of time in an exchange or exchange-like[1] transaction. 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.

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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.

4. 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.

5. This Statement does not apply to:

a. Lease contracts for intangible assets (including lease contracts concerning the 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) other than sublease contracts for intangible right-to-use lease assets
b. Leases of biological assets, including timber
c. 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*
d. 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.

6. 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 No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements,* paragraphs 211–220, 222–224, 226–238, 241–253, and 255–271, and footnotes 85–139 and 179; Statement No. 65, *Items Previously Reported as Assets and Liabilities*, paragraphs 16–18; and *Implementation Guide No. 2015-1*, Questions 2.27.5 and 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. 58, *Accounting and Financial Reporting for Chapter 9 Bankruptcies*, paragraph 8; Statement 62, paragraphs 5, 6, 113, 174, 221, 225, 239, 240, 254, 320, 351, 368–370, and 450, and footnote 12; Statement 65, paragraph 5;

[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)."

NCGA Interpretation 6, *Notes to the Financial Statements Disclosure,* paragraph 4; Interpretation No. 6, *Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements*, paragraphs 7, 9, 11, and 13; and Implementation Guide 2015-1, Questions 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.

7. The provisions of paragraphs 13–28 for lessee recognition and measurement, paragraphs 33–47 for lessor recognition and measurement, and paragraphs 63–68 for lease terminations and modifications apply to financial statements prepared using the economic resources measurement focus. The provisions of paragraphs 29 and 30 for lessee recognition and paragraph 48 for lessor recognition apply to financial statements prepared using the current financial resources measurement focus.

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

a. Paragraphs 9–12 define the lease term.
b. Paragraphs 13–32 provide lessee recognition, measurement, and disclosure guidance, including provisions in paragraph 14 for leases that transfer ownership.
c. Paragraphs 33–51 provide lessor recognition, measurement, and disclosure guidance, including provisions in paragraph 34 for leases that transfer ownership, provisions in paragraph 35 for leases of assets that are investments, and provisions in paragraph 36 for certain regulated leases, such as airport–airline agreements.
d. Paragraphs 52–59 address lease contracts with multiple components and contract combinations.
e. Paragraphs 60–62 address short-term leases.
f. Paragraphs 63–68 address lease terminations and modifications.
g. Paragraphs 69 and 70 address subleases.
h. Paragraphs 71–75 address sale-leaseback and lease-leaseback transactions.
i. Paragraph 76 addresses intra-entity leases.
j. Paragraph 77 addresses related-party leases.

Lease Term

9. 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, covered by a lessee's option to:

a. Extend the lease if it is reasonably certain, based on all relevant factors, that the lessee will exercise that option
b. Terminate the lease if it is reasonably certain, based on all relevant factors, that the lessee will not exercise that option.

Periods for which both the lessee and the lessor have an option to terminate the lease, or for which only the lessor has that option, are cancelable periods and are excluded from the lease term. Provisions that allow for termination of a lease due to (a) purchase of the underlying asset, (b) payment of all sums due, or (c) default on payments, are not considered termination options.

10. A fiscal funding or cancellation clause (a clause that allows governmental lessees to cancel a lease agreement, typically on an annual basis, if the government does not appropriate funds for the lease payments) should be considered in determining the lease term only when it is reasonably certain that the clause will be exercised.

11. At the beginning of a lease, the lessor and the lessee should assess all factors relevant to the likelihood that the lessee will exercise options, 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 lessee’s history of exercising renewal or termination options
d. The extent to which the lease is essential to the provision of government services.

12. Lessors and lessees should reassess the lease term only if the lessee does either of the following:

a. Elects to exercise an option even though the lessor or lessee had previously determined that it was reasonably certain that the lessee would not exercise that option
b. Elects to not exercise an option even though the lessor or lessee had previously determined that it was reasonably certain that the lessee would exercise that option.

Recognition and Measurement for Lessees

13. At the beginning of the lease term, a lessee should recognize a lease liability and an intangible right-to-use lease asset (hereinafter referred to as the lease asset), except as provided in paragraph 14 and paragraphs 60–62 (short-term leases).

Leases That Transfer Ownership

14. A lease contract that transfers ownership of the underlying asset to the lessee at or before the end of the lease and does not contain termination options (see paragraph 9) should be reported as a financed purchase of that asset.

Lease Liability

15. A lessee should measure the lease liability initially at the present value of payments expected to be made for the lease term. Measurement of the lease liability should include the following types of payments that might be required by a lease:

a. Fixed payments, less any lease incentives (such as a cash payment or reimbursement of moving costs) receivable from the lessor
b. Variable lease 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 beginning of the lease
c. Variable lease payments that are fixed in substance as described in paragraph 16
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 an option to terminate the lease or a fiscal funding or cancellation clause
g. Any other payments that are reasonably certain of being required based on an assessment of all relevant factors.

16. Variable payments based on future performance of the lessee or usage of the underlying asset should not be included. Rather, these variable payments should be recognized as an outflow of resources (for example, expense) in the resource flows statement in the period in which the obligation for those payments is incurred. However, any component of these variable payments that is fixed in substance should be included in the lease liability. An example would be a lease payment based on a percentage of sales but with a required minimum amount to be paid. That required minimum payment is fixed in substance.

17. The future lease payments should be discounted using the rate the lessor charges the lessee, which may be the interest rate implicit in the lease. If the rate cannot be readily determined by the lessee, the lessee's incremental borrowing rate (the estimated rate that would be charged for borrowing the lease payment amounts for 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 rate implicit in the lease.

18. At subsequent financial reporting dates, 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.

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[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.

19. The lessee should remeasure the lease liability at subsequent financial reporting dates if any of the following changes have occurred and 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 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 liability.
e. There is a change in the rate the lessor charges the lessee, if used as the initial discount rate.

20. If a lease liability is remeasured for any of the changes in paragraph 19, the liability also should be remeasured for any change in an index or rate used to determine variable lease payments if that change in the index or rate is expected to significantly affect the amount of the liability. A lease liability is not required to be remeasured solely for a change in an index or rate used to determine variable lease payments.

21. The lessee also should update the discount rate as part of the remeasurement if any of the following changes have occurred and 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.

22. 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.

23. If the discount rate is required to be updated based on the provisions in paragraph 21, the discount rate should be based on the revised rate the lessor charges the lessee at the time the discount rate is updated. If that rate cannot be readily determined, the lessee's estimated incremental borrowing rate should be used.

Lease Asset

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

a. The amount of the initial measurement of the lease liability (see paragraph 15)
b. Lease payments made to the lessor at or before the beginning of the lease, less any lease incentives received from the lessor
c. Initial direct costs that are ancillary charges necessary to place the lease asset into service.

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 an outflow of resources (for example, expense) in the period in which they are incurred.

25. The 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 26. 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.

26. If the 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 this circumstance, if the underlying asset is nondepreciable, such as land, the lease asset should not be amortized.

27. The lease asset generally should be adjusted by the same amount when the corresponding lease liability is remeasured based on paragraphs 19–23. However, if this 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).

28. 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 lease asset. The change in the manner or duration of use of the lease asset is an indicator that the lease asset may be impaired. The period for which the underlying asset has less usable capacity should be the relevant factor in determining the magnitude of the decline in service utility of the lease asset. If a lease asset is impaired, it 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

29. 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.

30. When a lease results in the reporting of a lease asset, 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.

Notes to Financial Statements—Lessees

31. 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 lease payments not included in the lease liability are determined
   (2) The existence, terms, and conditions of residual value guarantees provided by the lessee
b. The total amount of lease assets, and the related accumulated amortization, to be disclosed separately from other capital assets
c. The amount of lease assets by major classes of underlying assets, to be disclosed separately from other capital assets
d. The amount of outflows of resources recognized for the period for variable lease payments not previously included in the lease liability
e. The amount of outflows of resources recognized for the period for other payments, such as residual value guarantees or penalties, not previously included in 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 that have not yet begun
h. The components of any net impairment loss (gross impairment loss less change in lease liability) recognized on the lease asset during the period.

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

Recognition and Measurement for Lessors

33. At the beginning of the lease term, a lessor should recognize a lease receivable and a deferred inflow of resources, except as provided in paragraphs 34–36 and paragraphs 60–62 (short-term leases). Any initial direct costs incurred by the lessor should be reported as an outflow of resources (for example, expense) of the period.

Leases That Transfer Ownership

34. A lease contract that transfers ownership of the underlying asset to the lessee at or before the end of the lease, and does not contain termination options (see paragraph 9), should be reported as a financed sale of that asset.

Leases of Assets That Are Investments

35. If the underlying asset in a lease meets the requirements in Statement 72 to be reported as an investment, the lessor should not apply the recognition and measurement provisions of this Statement. The lessor should disclose the information in paragraph 49e of this Statement but is not required to make the other disclosures in paragraph 49.

Certain Regulated Leases

36. For leases for which external laws, regulations, or legal rulings (a) establish the costs that may be recovered through lease payments and (b) significantly limit the ability of the

lessor to set rates in excess of those costs, the lessor should not apply the general recognition and measurement provisions of this Statement. For example, the U.S. Department of Transportation regulates aviation leases between airports and airlines. For such leases, the lessor should recognize an inflow of resources (for example, revenue) based on the payment provisions of the contract and provide the disclosures in paragraph 51.

Lease Receivable

37. A lessor should measure the lease receivable initially at the present value of lease payments to be received for the lease term, reduced by any provision for uncollectible amounts. Measurement of the lease receivable should include the following types of payments that might be 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 beginning of the lease
c. Portions of variable payments that are fixed in substance (as described in paragraph 38)
d. Residual value guarantee payments that are fixed in substance (as described in paragraph 38).

38. Variable payments based on future performance of the lessee or usage of the underlying asset should not be included in the receivable. Those payments should be recognized as an inflow 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 lease receivable. For example, if a lease payment is based on a percentage of sales but has a required minimum payment, that required minimum payment is fixed in substance. Similarly, payment of a residual value guarantee is fixed in substance if it stipulates the underlying asset will be sold at the end of the lease term, with the lessee assuming a liability for any shortfall if the sales price is less than an agreed-upon minimum amount.

39. 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 when (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 when those options are exercised.

40. The future lease payments to be received should be discounted using the 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 rate implicit in the lease.

41. At subsequent financial reporting dates, the lessor should calculate the amortization of the discount on the receivable and report that amount as interest revenue for the period. It should be calculated so as to produce a constant periodic rate of return on the receivable.

Any payments received should be allocated first to the accrued interest receivable and then to the lease receivable.

42. The lessor should remeasure the lease receivable and update the discount rate at subsequent financial reporting dates if either of the following changes have occurred and are expected to significantly affect the amount of the receivable:

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

43. If a lease receivable is remeasured for either of the changes in paragraph 42, the receivable also should be remeasured for any change in an index or rate used to determine variable lease payments if that change in the index or rate is expected to significantly affect the amount of the receivable. A lease receivable is not required to be remeasured solely for a change in an index or rate used to determine variable lease payments.

44. If the discount rate is updated based on the provisions in paragraph 42, the receivable should be discounted using the revised rate.

Deferred Inflow of Resources

45. A lessor should measure the deferred inflow of resources at the initial value of the lease receivable, less any provision for uncollectible amounts (see paragraph 37), 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) in a systematic and rational manner over the term of the lease.

46. The deferred inflow of resources generally should be adjusted by the same amount as the change resulting from the remeasurement of the lease receivable as discussed in paragraphs 42–44.

Underlying Asset

47. 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 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.

Financial Statements Prepared Using the Current Financial Resources Measurement Focus

48. 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 (see paragraph 37), 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.

Notes to Financial Statements—Lessors

49. A lessor 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 the basis, terms, and conditions on which any variable lease payments not included in the lease receivable are determined
b. The carrying amount of assets on lease or held for leasing, by major classes of assets, and the amount of accumulated depreciation
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 leases, if the total is not displayed on the face of the financial statements
d. The amount of inflows of resources recognized in the reporting period for variable lease payments and other payments not previously included in the lease receivable, including inflows of resources related to residual value guarantees and termination penalties
e. 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.

50. In addition to the disclosures in paragraph 49, if a government's principal ongoing operations consist of leasing assets to other entities, the government should disclose a schedule of future lease payments that are included in the lease receivable, showing principal and interest, for each of the five subsequent years and in five-year increments thereafter.

51. A lessor with one or more regulated leases, as described in paragraph 36, 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 carrying amount of assets subject to exclusive use by one counterparty under agreements, by major class of assets, and the amount of accumulated depreciation
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 agreements, if the total is not displayed on the face of the financial statements
d. A schedule of expected future minimum payments under the agreement 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.

Contracts with Multiple Components

52. Lessors and lessees 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.

53. If a lessor or lessee 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 56b or paragraph 56c.

54. If a lease involves multiple underlying assets, the lessor and the lessee should account for each underlying asset as a separate lease component if the assets have different lease terms. 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 31c. The provisions of this paragraph should be applied unless the contract meets the exception in paragraph 56b or paragraph 56c.

55. To allocate the consideration required under the contract to the different components, lessors and lessees should first use any prices for individual components that are included in the contract if they are reasonable based on other observable stand-alone prices. Stand-alone prices are those that would be paid or received if the same or similar assets were leased 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. These discounts may be taken into account when determining whether individual component prices are reasonable. For example, if the individual component prices are each discounted by the same percentage from normal market prices, those component prices would be considered reasonable.

56. If a contract does not include prices for individual components, or if those prices are not reasonable based on other observable stand-alone prices, lessors and lessees should do the following:

a. If observable stand-alone prices are readily available for *all* components, a government should allocate the consideration based on the relative values of the observable stand-alone prices.
b. If observable stand-alone prices are readily available for *some* (but not all) components, a government should allocate the observable stand-alone price to each component for which it is readily available. A government may (1) estimate the allocation of the remaining consideration to the remaining components or (2) account for the remaining components as a single lease unit.
c. If observable stand-alone prices are not readily available for *any* of the components, a government may (1) estimate the prices for each component or (2) account for the entire contract as a single lease unit.

57. When multiple components are accounted for as a single lease unit, as provided for in paragraphs 56b and 56c, 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

58. Contracts that are entered into at or near the same time with the same counterparty should be considered part of the same lease 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.

59. If multiple contracts are determined to be part of the same lease contract, that lease should be evaluated in accordance with the guidance on contracts with multiple components in paragraphs 52–57.

Short-Term Leases

60. A short-term lease is a lease that, at the beginning of the lease, has a maximum possible term under the contract of 12 months or less, including any options to extend, regardless of its probability of being exercised. For a lease that is cancelable by either the lessee or the lessor, such as a month-to-month lease or a year-to-year lease, the maximum possible term is the noncancelable period, including any notice periods. For a lease that is cancelable only by the lessee, the maximum possible term should be evaluated under the requirements of the lease term as defined in paragraph 9.

Lessees

61. A lessee should recognize short-term lease payments as outflows of resources (for example, expense) based on the payment provisions of the contract. The lessee should not apply the recognition and measurement requirements of paragraphs 13–28 but 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. The lessee should not recognize an outflow of resources during any rent holiday period (for example, one or more months free).

Lessors

62. A lessor should recognize short-term lease payments as an inflow of resources (for example, revenue) based on the payment provisions of the contract. The lessor should not apply the recognition and measurement requirements of paragraphs 33–47 but 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. The lessor should not recognize an inflow of resources during any rent holiday period (for example, one or more months free).

Lease Terminations and Modifications

63. 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 (see paragraphs 19 and 42), and adding or removing an underlying asset. An amendment to a lease contract should be considered a lease modification unless the lessee's right to use the underlying asset decreases. If the lessee's right to use the underlying asset decreases (for example, the lease term is shortened or the number of underlying assets is reduced), that change should be accounted for as a partial lease termination.

64. If a lease modification gives the lessee an additional right to use an underlying asset that was not included in the original lease and is reasonably priced compared to its stand-alone price (in the context of that particular contract), both the lessee and the lessor should account for that additional portion of the modified lease as a new lease, separate from the original portion of the lease.

Lease Terminations

Lessees

65. A lessee generally should account for the full or partial termination of a lease 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 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.

Lessors

66. A lessor should account for the full or partial termination of a lease by reducing the carrying values of the lease receivable and related deferred inflow of resources, and recognizing a gain or loss for the difference. 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.

Lease Modifications

Lessees

67. 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). Additionally, if the change is the result of a refunding of debt (whether tax-exempt or taxable) by the lessor in which the perceived economic advantages of the refunding are passed through to the lessee, the lessee should account for the change as provided in paragraph 221 of Statement 62.

Lessors

68. 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, if the change relates to payments for the current period, the change should be recognized in the resource flows statement for the current period (for example, revenue). Additionally, if the change is the result of a refunding of related debt (whether tax-exempt or taxable), the lessor should account for the change as provided in paragraph 225 of Statement 62.

Subleases

69. 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.

70. The original lessee (and now the lessor in a 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 the original lease.

Sale-Leaseback Transactions

71. 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 transaction should include a qualifying sale (see paragraphs 287–323 of Statement 62) in order 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 by both the seller-lessee and the buyer-lessor.

72. The sale and leaseback 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 to be recognized in the resource flows statement over the term of the lease. However, if the leaseback 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.

73. A sale-leaseback transaction is considered to have off-market terms if there is a significant difference between (a) the sales 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. The following are examples of off-market terms:

a. A transaction has a sale price and lease payments that are both significantly higher than market.
b. A transaction has a sale price that is significantly higher than market but the lease payments are at or below market.
c. A transaction has a sale price that is significantly lower than market.

74. A seller-lessee should disclose the terms and conditions of sale-leaseback transactions in addition to the disclosures required of a lessee (paragraph 31). A buyer-lessor should provide the disclosures required of a lessor (paragraph 49).

Lease-Leaseback Transactions

75. 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 gross amounts of the lease and the leaseback.

Intra-Entity Leases

76. 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 payment between component units should be reported as inflows of resources and outflows of resources.

Leases between Related Parties

77. Accounting for leases between related parties should recognize the substance of the transaction (following the reporting requirements of this Statement) rather than merely its legal form. For example, if the lease contract is written to meet the definition of a short-term lease but the related parties have a mutual understanding that the agreement will stay in effect for several more years, that lease should not be accounted for as a short-term lease.

EFFECTIVE DATE AND TRANSITION

78. The requirements of this Statement are effective for reporting periods beginning after December 15, 2018. Earlier application is permitted.

79. 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 the financial statements should disclose the nature of the restatement and its effect. Also, the reason for not restating prior periods presented should be disclosed.

80. Leases should be recognized and measured using the facts and circumstances that exist 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 exist 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.

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 Lessees,* 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 Governmental Accounting Standards Board (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. 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 raised the question of whether the GASB also should consider reexamination of its lease requirements. 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. Because of the significant changes to lease accounting then 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. Because of the issuance of Concepts Statement No. 4, *Elements of Financial Statements,* the GASB was able to reexamine the leases guidance in light of definitions of financial statement elements (including assets and liabilities) that were not in place when that guidance was established.

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, and 15 individuals or organizations testified at public hearings held in April 2015.

A5. The GASB conducted outreach to stakeholders during and after the comment period for the Preliminary Views, 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.

A6. 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 and Exposure Draft. In addition, further feedback was provided by members of the Governmental Accounting Standards Advisory Council (GASAC) at several of its meetings.

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 beginning 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. The foundational principle that leases are financings forms the basis for the lessee and lessor accounting models in this Statement.

B3. In developing the foundational principle, the Board considered whether there are inherently different types of leases in the governmental environment. The guidance in Statement 62 was based on the notion that some leases are essentially financed purchases of the underlying asset (classified as capital leases) and other leases (classified as operating leases) are not. Therefore, the accounting approach for a lease was dependent on that classification. The classification of a lease as capital or operating 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 bright-line nature often resulted in very similar leases being accounted for in different ways.

B4. Some respondents to the Preliminary Views disagreed with the foundational principle that leases are financing arrangements and, instead, believe that there are different types of leases and that the accounting should acknowledge that distinction. 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 Statement 62) often are treated differently for calculating debt covenants or statutory debt limits and that eliminating that distinction in financial reporting may cause 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, however, they all contain the element of financing (as described in paragraph B2). As a result, 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 distinguish between certain leases such that a different accounting approach for each type could be needed.

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 inception of the lease* 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. The definition of a lease in this Statement is primarily based on the definition included in Statement 62. One modification to that definition is the replacement of the term *agreement* with the more precise and limiting term *contract.* This change was made to require that a lease be legally enforceable (see paragraph B22 for discussion of fiscal funding clauses). 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 securities lending and similar activities would not be subject to this Statement.

B8. A contract should not be accounted for as a lease unless it meets the definition of a lease in this Statement, even if the language in the contract or its title refer to it as a lease. Conversely, a contract that meets the definition of a lease should be accounted for as a lease even if the language of the contract or its title *does not* refer to it as a lease. The Board believes that the accounting should be based on the substance of the arrangement rather than the label on the contract.

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) and that it should be accounted for according to the provisions 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 on nonexchange transactions in Statement 33 does not specifically address leases and that professional judgment will be needed to determine the appropriate accounting.

Leases 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. These scope exclusions are carried forward in this Statement because of the 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 the transactions. However, consideration of the entirety of those transactions is outside the scope of the Leases project. Additionally, the GASB specifically addressed service concession arrangements in Statement 60.

B12. A common type of licensing contract is for computer software. While not explicitly mentioned in Statement 62 as an example of a licensing contract that is excluded from the scope of the leases guidance, Question Z.51.21 in *Implementation Guide No. 2015-1* states that licensing agreements for computer software should not be treated as leases. However, some respondents to the Preliminary Views questioned whether the Leases project would impact the guidance in the Implementation Guide. Therefore, this Statement explicitly excludes licensing contracts for computer software.

B13. Some respondents to the Preliminary Views requested that the Board consider excluding leases of all intangible assets, rather than just those specifically listed in Statement 62. The Board considered that proposal and decided to expand the scope exclusion to all intangible assets because leases of other intangible assets often involve transactions as multi-faceted as those listed in Statement 62, such as those that involve natural resource exploration and intellectual property licenses.

B14. The Preliminary Views also proposed that leases that contain bargain purchase options be accounted for as financed purchases. This view was based on the assumption that governments normally would exercise these 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. Therefore, the Board proposed that the substance of those leases be considered a financed purchase of the underlying asset. Some respondents to the Preliminary Views disagreed with that premise because some governments do not exercise bargain purchase options for a variety of reasons, even when 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 bargain purchase option should be treated as any other purchase option included in a lease.

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. The Board decided that it was not appropriate for a lessor government to recognize a lease receivable (and deferred inflow of resources) associated with conduit debt unless it reports both the debt and the related capital asset. Additionally, the Board believes that it is not appropriate to require note disclosures unless both the debt and the related capital asset are reported because the disclosures would not provide context for amounts recognized in the financial statements.

Lease Term

Noncancelable Period

B17. 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 agreement, 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.

Renewal and Termination Options

B18. Many leases include clauses that allow a lease to be renewed or extended at the option of the lessee. Likewise, many leases include clauses that allow the lessee the option of terminating or cancelling the lease at or after a certain point in time. The Board considered whether renewal periods 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 renewal options (even when all parties understand the intent is to renew) 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 renewal options and termination options (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.

B19. The determination of the likelihood of a renewal or termination option being exercised applies only if that option pertains to the lessee alone. If either the lessee or the lessor has the option to cancel a lease (or if both parties have to agree to renew), an enforceable contract does not exist beyond that point. For example, a month-to-month or rolling lease, or a lease that continues into a holdover period until a new contract is signed, would not be enforceable because either the lessee or lessor could cancel the lease at any time. When a lease contains a lessor-only option to terminate the lease, the Board believes that the difficulty for a lessee to evaluate the likelihood of that option being exercised outweighs the potential benefits of including the extra periods in the lease term.

B20. The Board considered several potential probability thresholds for including a period covered by a renewal or termination option in the lease term, including *more likely than not*, *probable*, *virtually certain,* and when there is *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. Some respondents disagreed with the use of that threshold because the term *probable* has different interpretations in practice and would result in a lack of comparability. Other respondents believe that probable is not a high enough threshold to justify including renewal periods in the lease term. In redeliberations, the Board decided to use *reasonably certain* as the threshold for including periods covered by renewal or termination options in the lease term. 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 is more consistent with the term *reasonably assured* that was used in the determination of a lease term under Statement 62.

B21. The Board also discussed the factors a government should consider when determining the likelihood that a renewal or termination option will be exercised. Although the Board acknowledges that having a significant economic incentive is 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 this assessment at the beginning of the lease based on information received about the lessee's plans during the lease negotiations.

Fiscal Funding Clauses

B22. Many governmental lease contracts include fiscal funding or cancellation clauses. These clauses allow governmental lessees to terminate a lease agreement, typically on an annual basis, if the government does not appropriate funds for the lease payments. Many times, laws or regulations require inclusion of a fiscal funding or cancellation clause, but the government, acting in good faith when it enters into the lease agreement, does not intend or expect to exercise the clause. The Board considered how those types of clauses should be treated in assessing the lease term and concluded that a fiscal funding clause should be evaluated in the same manner as other termination options. That is, it would not be considered in determining the lease term unless it is reasonably certain that the option will be exercised (funds will not be appropriated).

Reassessments

B23. The Board 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 that have numerous leases. Additionally, a *lessor* may not have access to the relevant information about a 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 were appropriate in certain circumstances.

B24. The Board concluded that a government should reassess the lease term only if the lessee either (a) *elects* to exercise an option even though it was originally determined that the lessee would not exercise that option or (b) *elects* to not 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 beginning of a lease that the lessee would exercise a renewal option, but the lessee does not exercise that option by the exercise date, the lease term should be reassessed. The Board believes that the lease term should be updated when the lessee elects to exercise an option or not to exercise an option contrary to the initial determination of the lease term. The Board believes this 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 communicates its election, both the lessee and lessor would know whether an option will or will not be exercised and, therefore, would be in a position to reassess the lease term, if necessary.

Recognition and Measurement for Lessees

B25. This Statement requires lessees to recognize and measure transactions within its scope as leases, except for leases that transfer ownership of the underlying asset and do not contain termination options. Leases that transfer ownership of the underlying asset should be accounted for as financed purchases rather than as leases. The Board determined that the substance of a lease that transfers ownership is a purchase of the underlying asset with payments financed over time. Therefore, assuming there is no possibility of termination before the transfer occurs, such a contract would follow guidance for acquisitions of capital assets with related long-term liabilities instead of the guidance for leases. Provisions that allow for termination of a lease due to fiscal funding or cancellation clauses, purchase of the underlying asset, payment of all sums due, or default are not considered termination options and, therefore, do not disqualify the transactions from being treated as a financed purchase.

Lease Liability

Recognition

B26. This Statement requires lessees to recognize a lease liability for leases other than those outside the scope of this Statement, leases that transfer ownership of the underlying asset to the lessee, and 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. 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

B27. The Board concluded that the lease liability should be measured at the present value of future lease payments to be made for the lease term, which represent the obligations of the lessee under the contract. The present value calculation is consistent with the notion that a lease is a financing transaction and recognizes the cost of the financing.

B28. 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. Any 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.

B29. Variable payments that depend on an index or rate have a baseline measurement at the beginning of the lease, 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 current index or rate could be assumed to stay in effect when initially measuring the future payments.

B30. 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 beginning of the lease 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. Without the baseline measurement with which to start, the Board decided that variable payments that depend on future performance or usage 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 these 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.

B31. 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. Several alternatives were considered for the threshold for when those contingent payments would be included in the measurement of the lease liability, including *more likely than not, expected to be payable, probable,* and when *a significant economic incentive is present.* In the Preliminary Views, the Board proposed to use a threshold of probable for those payments for consistency with (a) the contingency literature from Statement 62 and (b) the proposed use of probable in assessing the lease term. However, consistent with its reasons for changing the use of probable in assessing the lease term (see paragraph B20), the Board also decided to change the threshold for including contingent payments in the determination of the lease liability to *reasonably certain.*

B32. The Board considered whether to provide guidance on selecting the discount rate to be used for making the present value calculation of the lease liability. The lease 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 from that provided by the existing standards would not be desirable. The rate that the lessor charges the lessee, which may be the interest rate implicit in the lease, was selected as the most preferable because it is the rate at which the transaction is made. However, consistent with Statement 62, the Board concluded that if the rate implicit in the lease is not readily determinable, the lessee's incremental borrowing rate is an acceptable alternative. The lessee's incremental borrowing rate is the estimated rate that would have been charged for borrowing the lease payment amounts for the lease term, which could vary from the lessee's rate for general obligation debt depending on, for example, the amount and duration of the lease.

B33. The Board also considered but rejected the use of a risk-free rate because leases are not risk free. The Board also considered a discount rate based on a municipal bond index. However, it determined that the rate that 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 agreement and is a better representation of the actual transaction than a more generic market rate.

Remeasurement

B34. The Board concluded that a lease liability should be remeasured in certain circumstances to reflect changes in the lease or the estimates incorporated into the liability measurement. This Statement specifies several conditions under which the lease payment amounts likely have changed because of changes to the lease agreement or 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 would trigger a potential remeasurement of the liability. However, in response to concerns of 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 in paragraph 19. That modification of the requirement 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.

B35. 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 circumstances requiring reassessment of the discount rate are those that change the nature of the lease agreement and, thus, the rate implicit in the lease—a change in the lease term and a change in the assessment of the exercise of a purchase option. The Preliminary Views proposed that a significant change in the index or rate used to determine variable lease payments would prompt reassessment of the discount rate. That provision was not carried forward to be consistent with the Board's other decisions regarding remeasurement of the liability.

Lease Asset

Recognition

B36. 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 beginning of a lease, 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 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. The lease asset is the right to use the underlying asset rather than the underlying asset itself.

Measurement

B37. 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 represents the amount to be paid for the lease asset. 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.

B38. The measurement of the lease asset includes any lease payments made at or before the beginning of the lease. 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. Any lease incentives received from the lessor are equivalent to rebates or discounts of the acquisition cost and, accordingly, reduce the amount capitalized.

B39. 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, described in paragraph 12 of Statement No. 7, *Advance Refundings Resulting in Defeasance of Debt,* 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 (including structuring fees paid to a special-purpose entity) 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 capitalizing 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.

B40. 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 for a profit). In those circumstances, the lease asset would be measured in accordance with the investments guidance in Statement 72, rather than the guidance in this Statement. The Board believes that meeting the definition of an investment changes the character of, for example, a sublease 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

B41. Consistent with the treatment of changes in capital leases under Statement 62, paragraph 27 of this Statement requires that when a lease liability is remeasured, the corresponding lease asset be adjusted by the same dollar amount (except in cases of impairment, which is discussed in paragraphs B43 and B44, and in cases in which the adjustment would cause the asset to be reported as a negative amount). As noted in its Preliminary Views, the Board believes that modifications to the lease liability generally result in a change in the amount the lessee will be paying for its intangible asset. Therefore, while acknowledging that adjusting the lease asset for a change in the lease liability results in the lease asset no longer being measured at adjusted historical cost, the Board believes that such an adjustment is nevertheless appropriate.

B42. Recognizing that not all changes to a lease liability relate to a change in the value of the lease asset, the Board provided an exception in its Preliminary Views. The Board proposed 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. In the interest of maintaining consistency and in response to concerns expressed by respondents to the Preliminary Views, the Board decided to remove the exception and instead require that this change in the lease liability be accompanied by a corresponding change in the lease asset.

Impairment

B43. 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.

B44. If the lease asset is impaired, there often will be a change to the corresponding lease liability (for example, rent payments may not be required for the time the underlying asset is unusable). The Board believes the change to the lease asset for a change in the lease liability (see paragraph B41) should be made first because the impairment affects both amounts. Any remaining amount would be reported as an impairment. However, disclosure is required of the total impairment amount and the adjustment to the lease liability so that those amounts are not obscured by recognition of only a net impairment loss.

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

B45. 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

B46. 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 recognizes 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 are classified in Statement 62. However, the Board believes that presentation would be inconsistent with the foundational principle that a lease is a financing.

B47. The Board considered whether amortization 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 that lease asset may have a shorter useful life (lease term) than the useful life of the underlying asset. Nevertheless, if the lease contains a purchase option that is reasonably certain of being exercised, the lessee would amortize the lease asset over the estimated useful life of the underlying asset, unless the underlying asset is nondepreciable, such as land.

B48. 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. A calculation that results in a constant total lease expense (interest plus amortization) could be considered systematic and rational in some cases.

Notes to Financial Statements for Lessees

B49. The disclosures required for lessees in paragraph 31 include a general description of their leasing arrangements, carrying forward in most cases an existing requirement in Statement 62. The Board supplemented the information in that disclosure with details about variable payments and residual value guarantees not included in the lease liability. The Board believes that this information is essential to the financial statement users' understanding 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.

B50. To provide users with information that will allow them to assess the extent to which the lessee's capital assets are leased rather than owned, lessees are required to disclose the total amount of lease assets and the related accumulated amortization, separately from owned capital assets. This disclosure should disaggregate the information by major classes of underlying assets.

B51. The Board concluded that the disclosure of the schedule of future lease payments should be based on paragraphs 10 and 11 in Statement No. 38, *Certain Financial Statement Note Disclosures*. The Board decided that principal and interest components of the payments should be shown separately for each of the next five years and in five-year increments thereafter as is disclosed for future debt service requirements. This conclusion is consistent with the foundational principle that leases are financings.

B52. The requirement to disclose commitments for leases that have not yet begun is consistent with other disclosure requirements for obligations and commitments that have not met the criteria to be recognized as liabilities in financial statements.

B53. Some respondents to the Preliminary Views suggested that the proposed disclosures may become overly lengthy, especially if the government has a large number of leases. 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

B54. The assets and liabilities resulting from application of this Statement also are subject to disclosure requirements found in other Statements. These include the disclosure of changes in capital assets and long-term liabilities in Statement 34 and related party disclosures in Statement No. 56, *Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards.* The Board believes that those disclosure requirements apply to leases and do not need to be repeated in this Statement. Similarly, the requirement in Statement No. 9, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting*, to report information about noncash transactions (such as acquiring a lease asset with a lease liability) also apply and, therefore, is not repeated in this Statement.

B55. Statement 62 requires disclosure of assets pledged as security for loans. The Board believes that requirement also applies to assets pledged as security for lease liabilities. However, the Board concluded that that disclosure need not be made because it is generally implicit in the understanding of a lease that the underlying asset itself is the only security for a lease obligation.

B56. The Board considered, but decided not to require, several other potential disclosures relating to amounts recognized in the financial statements, including significant assumptions and judgments used in accounting for leases, the numerical discount rate or average of rates used to discount the future lease payments, the amount of initial direct costs capitalized, all lease-related expenses and cash flows, categorization of lease renewal options by their likelihood, and the portion of the liability that relates only to the noncancelable period of the lease. However, 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.

B57. The Board also considered and rejected disclosures about amounts *not* recognized in the financial statements, including a schedule of future payments for nonlease components included in a contract that contains a lease, the fair value of a lease liability, why the government chose to lease rather than buy the underlying asset, and 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

B58. 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 determined that symmetry between the lessee and lessor accounting models is an important consideration in establishing accounting and financial reporting standards. Some respondents to the Preliminary Views questioned the need to modify existing lessor accounting and suggested that the Board retain the model provided in Statement 62. The Board acknowledges that there are fewer concerns with the lessor model in Statement 62 but believes that it should be reviewed in the interest of doing 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.

B59. As discussed in paragraph B25, the Board believes that the substance of a lease that transfers ownership is a purchase of the underlying asset rather than a financing of an intangible right-to-use asset. As discussed in paragraph B40, the Board believes that underlying assets that meet the definition of an investment should be measured as an investment. Therefore, this Statement provides an exception from its general lessor recognition and measurement requirements for leases that transfer ownership and for leases for which the underlying asset is investment property. The Board notes 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.

B60. This Statement also provides an exception from its general lessor recognition and measurement requirements for leases for which external laws, regulations, or legal rulings (a) establish the costs that may be recovered through lease payments and (b) significantly limit the ability of the lessor to set rates in excess of those costs. This exclusion addresses the unique characteristics of aviation leases between airports and airlines and other leases with similar characteristics. Federal laws, regulations, and related court decisions specify allowable costs for aviation leases and also generally prohibit lease payments in excess of those costs. Based on these external laws, regulations, and legal rulings, many airport–airline lease agreements are structured so that the airport shares revenue from concessions or other sources with the airlines, which may reduce the airlines' lease costs to less than the airport's actual costs of providing the underlying assets. Other airport–airline agreements include settlement (or true-up) provisions that may require airlines to make up for revenue shortfalls caused by underutilization or other causes, such as bankruptcy of other airlines. Because of these unique characteristics, the Board believes that the nature of these lease agreements is different from a normal financing of a right to use an underlying asset. The Board notes that these lease agreements almost always require payments that vary from period to period because of the cost-recovery nature of the agreement and, in many instances, contain revenue-sharing provisions. Therefore, for these 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 36.

B61. This Statement requires that all lessors recognize initial direct costs as expenses of the period. This is consistent with the reporting for initial direct costs associated with other types of transactions in Statement No. 65, *Items Previously Reported as Assets and Liabilities*.

Lease Receivable

Recognition

B62. This Statement requires lessors to recognize a lease receivable for leases other than those that transfer ownership, leases of assets that are investments, certain regulated leases, short-term leases, and leases outside 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 that right 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

B63. The Board concluded that a lease receivable should be measured at the present value of future lease payments to be made for 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 payable. Residual value guarantees that are fixed payments in substance also are included in the measurement of the lease receivable because those amounts also are a guaranteed minimum that the lessor will receive.

B64. Other types of payments, such as those arising from purchase options and residual value guarantees (that are not fixed payments in substance), may be contingent upon future events. The Board acknowledges the different treatment of those possible payments in the lessee's lease payable 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. But 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.

B65. The Board's decision to provide guidance on selecting the discount rate to be used for making the present value calculation is discussed in paragraph B32. The Board believes that the rate the lessor charges the lessee is the appropriate discount rate because it is the rate incorporated into the transaction. The Board also believes that 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 were set using a method that does not involve an interest rate (for example, comparison of market rents for similar pieces of real estate). 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. Additionally, in some cases, the discount rate used in the lease may be in other documentation (for example, a fact sheet) even if it is not in the lease contract itself. However, in response to stakeholder concerns, the Board decided to note that the guidance on imputing interest in Statement 62 may assist some governments in determining the discount rate to use, though governments are not required to consult that guidance for the purposes of this Statement.

Remeasurement

B66. 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 B34. However, changes in amounts that are included in a lessee's liability (if they are reasonably certain), but are not included in a lessor's receivable, would not cause remeasurement of the lessor's receivable. The basis for the provisions for reassessing the discount rate are the same as discussed for reassessment by a lessee in paragraph B35.

Deferred Inflow of Resources

B67. 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 up 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. In addition, when the lessor and lessee are both part of the same reporting entity, symmetry in accounting prevents distortion of the total government's financial position.

B68. The Preliminary Views proposed that a change in lease receivable due to a change in an index or rate used to determine variable payments that is attributable to the current period would be reported in the resource flows statement for the period. The Board decided instead to require lessors to report that change in the lease receivable with a corresponding change in the deferred inflow of resources, for the same reasons discussed in paragraphs B41 and B42 regarding remeasurement of the lessee's payable amount.

Underlying Asset

B69. 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 problems that were not prevalent under the former guidance, which resulted in many leases being classified as operating 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 would likely 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.

B70. Some respondents to the Preliminary Views expressed concern about recognizing both a lease receivable and the underlying asset, suggesting that it inflates 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.

B71. 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 agreement 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 the similar provisions in Statement 60.

Lessor Obligations

B72. The Board considered whether a lessor has obligations during the lease term that should 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 beginning of the lease. 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 52–57 (discussed in paragraphs B86–B92).

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

B73. The Board concluded that a lessor should recognize a lease receivable and a deferred inflow of resources for the portion of the receivable 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

B74. 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, need not also be addressed as part of the leases guidance in this Statement.

Leveraged Leases

B75. 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 for Lessors

B76. Lessors are required to disclose a general description of their leasing arrangements for the same reasons described in paragraph B49 for the corresponding disclosure by lessees. However, general disclosure about residual value guarantees is not specifically required for lessors because they are not allowed to derecognize the underlying asset.

B77. Lessors are required to disclose the carrying amount of assets on lease or held for leasing and the related accumulated depreciation. The Board believes it is important to distinguish between assets that are available for the government's own use and those that are not available because the right to use those assets has been or will be granted to others through leasing arrangements.

B78. 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.

B79. 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.

B80. 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 these types of governments.

B81. Some respondents to the Preliminary Views expressed the view that the totality of the proposed disclosures may be excessive. The Board considers the disclosures for lessors in this Statement to be essential and expects that preparers will aggregate disclosures when appropriate and consider materiality in compiling the information necessary to meet the disclosure requirements.

Other Considerations for Notes to Financial Statements

B82. The assets and liabilities resulting from a lessor's application of this Statement also are subject to disclosure requirements found in other Statements, including related party disclosures found in Statement 56, disclosure of asset valuation allowances required by Statement 62, and disclosure of noncash transactions required by Statement 9. The Board believes that those disclosure requirements apply to leases and do not need to be repeated in this Statement.

B83. The Board considered several other potential disclosures relating to amounts recognized in the financial statements but declined to impose any additional requirements. The Board notes 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

B84. Leases of investment assets are excluded from the recognition and measurement provisions of this Statement (see paragraph B59). 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 these 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 involved to the lessor, even if the underlying asset is classified as an investment.

B85. 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 B60). 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 these leases, there is no requirement to disclose principal and interest payments included in a lease receivable.

Contracts with Multiple Components

B86. A single lease contract may cover the leases of multiple underlying assets or include nonlease components (such as maintenance of the underlying asset). Additionally, a contract may provide for the lease of an asset that is excluded from the scope of this Statement (for example, an intangible asset). Statement 62 provided limited guidance for contracts with multiple components, discussing only the separation of lease assets composed of land and a building; it did not discuss separation of lease and service components. However, at that time, most leases were classified as operating leases and were accounted for in substantially the same manner as service contracts. Because of the fundamental changes to lease accounting in this Statement, the question of whether contracts with multiple components should be separated for financial reporting purposes becomes more important.

B87. The Board considered whether this Statement should provide guidance on separation of contracts with multiple components. In theory, the reporting for leases contracts with multiple underlying assets or with a service component should be the same as if the components were in separate contracts. The Board decided that lessees and lessors should separate lease contracts involving multiple underlying assets into multiple lease components if they have different lease terms because they are essentially separate leases. The Board also decided that lessees should separate lease contracts involving different underlying asset classifications into multiple lease components because lessees are required to disclose leases by major underlying asset classification. The Board recognizes the potential cost and complexity of separating multiple components of a contract but believes that separation should be required so that the financial statements faithfully represent the substance of the transaction.

B88. One potential way to lessen the cost to preparers of separating contracts is to allow governments to make an accounting policy election not to do so. If the election were made, the government would account for the entire contract as one lease. Under the lessee and lessor models in this Statement, that could result in capitalizing service contracts (with a corresponding liability for services that have not been provided) and recognizing interest expense or revenue on those components. For lessees, it also could result in recognizing material asset values in an incorrect underlying asset class. The Board believes that the benefit of eliminating the potential for significant inconsistencies in reporting services provided through a lease contract versus services provided through a separate service contract outweighs the potential cost of separating the nonlease components. The Board also believes that classifying multiple assets included in a lease contract in the appropriate underlying asset class will reduce (a) timing differences in recognition of lease-related expenses and revenues and (b) the misclassification of asset classes. Additionally, allowing an accounting policy election would reduce comparability as different governments may make different elections.

Allocation of Consideration

B89. This Statement requires allocation to the individual components of a lease contract based on the proportionate observable stand-alone prices as if the individual components had been contracted for separately. Some contracts with multiple components provide individual prices for each component. If those prices are reasonable based on observable stand-alone prices, the government can use them without any further analysis. Reasonableness should be evaluated in relation to stand-alone prices when discounts are provided for bundling lease and nonlease components (such as services) or bundling multiple underlying assets. However, if the individual prices stated in the contract are artificially skewed to either the lease or nonlease component, they should not be used because they would not be comparable to the prices for each component if they had been contracted for separately.

B90. Many contracts require only one total payment amount for all of the components of the contract. For these contracts, the use of observable stand-alone prices provides an objective, external basis for making the allocation and helps promote consistency among governments. However, these prices are required to be used only if they are readily available. The Board does not believe that governments should be required to go to great lengths to obtain such prices.

B91. 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 consideration or (b) treating the remaining components as a single lease unit, based on the primary lease component. The Board believes that these options provide some cost relief while also allowing for consistency with any components for which there are reasonable contract prices or readily available observable stand-alone prices.

B92. Respondents to the Preliminary Views expressed some concerns about the potential cost involved in separating contracts with multiple components. Some suggested approaches for excluding certain contracts from that requirement. One suggestion was to exclude 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. Another suggestion was to provide criteria to 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 observable stand-alone prices. 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 to having to determine observable stand-alone prices.

Contract Combinations

B93. To avoid the need to separate multiple components of a contract, some governments might instead choose to enter into a separate contract for each component. Generally, making that choice would produce appropriate results, but the Board is concerned that those contracts could be structured in such a way as to artificially inflate a nonlease component price and deflate a lease component price. Additionally, some governments might seek to take advantage of the short-term lease exception (see paragraphs B96–B101) by simultaneously signing a series of consecutive one-year contracts. Because of these concerns, the Board decided that certain contracts should be combined and considered as a single lease and then be disaggregated by applying the requirement to separate multiple components. While that process may often produce the same accounting result as if the contracts had not been combined, the allocation to multiple components would normalize any disproportionate prices between the contracts.

B94. 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 these criteria would indicate that the substance of the contracts is a single lease and, therefore, the contracts should be accounted for as such. The first criterion—whether there is evidence that the contracts are negotiated as a package—could be assessed by examining the procurement process that was followed. Meeting the second criterion—whether consideration to be paid in one contract depends on the price or performance of the other contract—would be evident from the contracts themselves.

B95. The Preliminary Views included a presumption that contracts entered into at or near the same time with the same counterparty would not be considered parts of the same lease. That presumption could have been rebutted if the contracts met either of the criteria described in paragraph B94. Some respondents questioned the need to state that presumption and recommended that the guidance start with a more neutral stance. The Board agreed that stating that presumption does not change the outcome that would result from applying the criteria for combination and, therefore, did not carry forward that presumption.

Short-Term Leases

Definition of a Short-Term Lease

B96. A short-term lease is defined as having 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 obviates the effect of potential renewal options on the classification of a lease as short term. Renewal options would have been considered if the Board instead based the definition of a short term lease on the lease term. However, the Board was concerned that including renewal options would allow for structuring leases to obtain specific accounting outcomes. For example, if it was not considered reasonably certain at inception of a lease that a renewal option would be exercised and was accordingly not included in the determination of the lease term, the lease would have to be recognized later if the option was exercised and the term extended beyond one year. In addition, the Board believes that the monitoring effort and the resultant reclassification would negate the cost relief provided by the short-term exception.

B97. If a transaction that meets the definition of a lease does not have a specified ending date, the maximum possible term cannot be determined. As discussed in paragraph B19, the Board believes that a contract that is cancelable by either the lessee or the lessor is not legally enforceable beyond any noncancelable period or notice period. If governments are unable to determine the lease term beyond the noncancelable period, calculation of a lease payable and lease receivable beyond the noncancelable period is not possible. The Board concluded that leases that have no specified ending date beyond a noncancelable period of 12 months or less should be reported in a manner similar to short-term leases.

B98. The Preliminary Views proposed that the maximum term for a short-term lease not exceed 12 months. Some respondents to the Preliminary Views argued that 12 months is too short to provide meaningful cost relief because, they contended, few leases would qualify for the exception as proposed. Some respondents suggested extending the definition to two, three, or five years. After considering these comments, the Board again decided that 12 months was the most appropriate length of time upon which to base the definition of a short-term lease. Twelve months is generally consistent with a government's budgetary and financial reporting cycles and is used in reporting assets and liabilities in a classified statement of net position. The Board also considered that in lease arrangements for 12 months or less, the financing component would be much less significant. Accordingly, the Board decided to retain the limit of a short-term lease at 12 months, as proposed in the Preliminary Views.

Accounting for Short-Term Leases

B99. The Board considered whether governments should be required or permitted 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 were allowed to choose whether to report leases as short term.

B100. The reporting of short-term leases in this Statement is intended to provide some measure of cost relief from the overall recognition and measurement provisions for lessees and lessors. Allowing lessees and lessors to simply recognize expense/expenditures and revenue based on the payment provisions of the contract eliminates the need for preparers to calculate amounts for assets and liabilities with useful lives or maturities of less than one year. This approach is not equivalent to cash-basis recognition, as governments would still be required to recognize assets and liabilities for payments paid or received before or after the period to which they apply.

Notes to Financial Statements for Short-Term Leases

B101. The Board proposed in the Preliminary Views that a lessee be required to disclose the amount of expense or expenditure recognized during the reporting period related to short-term leases. This would 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 expense would negate the cost relief offered by the short-term exception. They argued that the cost of identifying short-term leases and tabulating the expense total for disclosure would be comparable to the costs of applying the recognition and measurement provisions. The Board was persuaded by these arguments and decided not to include a disclosure requirement for short-term lease expense in this Statement.

Other Potential Exceptions

B102. 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 concerns in particular about the burden of applying these 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 would not apply.

B103. 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 stakeholders raised concerns may not be covered by the exception. For example, some computers might be considered core, whereas others might be considered noncore.

B104. Some stakeholders questioned whether governments would be permitted to set policy thresholds for capitalization of their 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 insignificant, individually and 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.

B105. If a government has many similar leases, it may choose to account for them as a portfolio rather than as individual items. For example, the government might use the likelihood of renewal options being exercised for a portfolio of leases as a whole, rather than each individual lease. The Board believes this would be an acceptable approach because the result would not be significantly different and would save some time and effort in the calculations. However, the Board did not specifically include that provision in the Statement because it could be interpreted as establishing a precedent to use a portfolio approach in other areas of financial reporting, for which it may not be appropriate.

Lease Terminations and Modifications

B106. Lease contracts often are modified during the lease term. The parties may agree to extend a lease when there was no renewal provision, 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 original contract. This Statement provides guidance on accounting for lease terminations and modifications because the Board believes the accounting for a lease should reflect changes in the provisions of the lease contract.

B107. The Board believes that an amendment to a lease contract that diminishes (but does not fully end) the lessee's right to use the underlying asset should 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 those cases, the lessee's right to use the underlying assets is diminished and that portion of the lease should be treated as terminated. In contrast, other amendments to a lease contract, including a reduction in payment amounts, are modifications rather than terminations. This is 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 the same as those in Statement 62.

B108. When a lease is fully or partially terminated, the lessee no longer has the same right to use the underlying asset. Therefore, the Board believes it is appropriate for 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. Therefore, the Board believes that it is appropriate for the lessee to reduce the carrying value of the lease liability, and for the lessor to reduce the carrying value of the related lease receivable, so that the balances reflect only the payments still required. The lessor also would reduce the deferred inflow of resources so that the appropriate amount of lease revenue would be recognized in the current period. 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.

B109. The accounting for a lease termination that results from the lessee's purchase of the underlying asset would be different from that of other terminations. Even though the lease contract ends, the lessee continues to have the right to use the underlying asset because that right is embedded in its ownership. Therefore, the Board believes that it is no longer appropriate to classify the asset as a lease asset. The liability also should be reduced so that it represents only those payments yet to be made. A corresponding adjustment should be made to the purchased asset because it affects the cost of the asset.

Subleases

B110. This Statement requires that subleases be accounted for as separate transactions from the original leases. 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. The Board views the original lease and sublease as two separate transactions because they are entered into with different parties. (A lease and sublease with the same party would be a lease-leaseback, per paragraph 75, and is discussed in paragraph B119.) Existing literature does not provide for offsetting of transactions with different parties; the Board does not believe an exception is appropriate in this context.

B111. 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 B110, 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

B112. This Statement requires that in order to apply the provisions of sale-leaseback accounting, the sale in a sale-leaseback transaction should be a qualifying sale under the provisions for sales of real estate in Statement 62. The sales of real estate guidance includes 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 if a sale has occurred, regardless of whether a leaseback is involved.

B113. 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, the Board decided 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 practical reasons.

Sale-Leaseback Transactions with Off-Market Terms

B114. This Statement contains specific provisions for when a sale-leaseback has off-market terms. The Board considered whether to include such provisions, as accounting for most other types of transactions does not have exceptions for when a transaction price is significantly above or below the market price. However, the Board believes that the substance of sale-leaseback transactions with off-market terms is different from such transactions with market terms. Therefore, the Board decided that the need to reflect the substance of the transaction outweighed concerns about the cost and complexity of identifying and calculating the difference between market and off-market terms.

B115. The determination of whether terms are off-market can be made by comparing either the sale price or the contractual lease payments to their corresponding market rates. The interdependence and direct relationship between the sale price and the leaseback payments indicates that measuring either one of the differences based on the market rates would signal whether the transaction is off-market. Further, both the fair value of the underlying asset and the market rate for lease payments may not always be readily available or accessible to a government when it enters into a sale-leaseback transaction.

B116. If a transaction has a sale price and lease payments that are both higher than market, this indicates that the seller-lessee is receiving cash both for the asset and as a borrowing. If the sale price is higher than market but lease payments are at or below market, the implication is that the seller-lessee is receiving a grant or other type of nonexchange revenue. If a transaction has a sale price that is lower than market, this indicates an advance lease payment in substance.

Notes to Financial Statements for Sale-Leaseback Transactions

B117. The Board believes that disclosure of the terms and conditions of a sale-leaseback is beneficial for users of the seller-lessee's financial statements in understanding 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 Transactions without a Qualifying Sale

B118. A sale-leaseback transaction that does not have a qualifying sale is accounted for as a financing because the substance of the transaction is a borrowing rather than the 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 this requirement is not necessary because if the seller-lessee enters into a sublease agreement, it would become a lessor for the sublease transaction and follow the lessor guidance, including applicable disclosures.

Lease-Leaseback Transactions

B119. 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, the Board believes a right of offset exists and it is appropriate for each party to recognize only a net amount. The Board also 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

B120. 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 between units 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 with Related Parties

B121. Leases with related parties are subject to the requirements in Statement 56 to report the substance of the transaction, if significantly different from its form. The Board considered whether to provide an exception to that requirement 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. (Disclosures for leases with related parties are discussed in paragraphs B54 and B82.)

Considerations Related to Benefits and Costs

B122. 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 accounting and financial reporting is the assessment of expected benefits and the 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.

B123. 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 conformity 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 information to meaningfully inform their assessments and decisions.

B124. The Board's assessment of the expected benefits and the 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 actually 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.

B125. 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.

B126. 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 in comment letters and public hearing testimony, and results from the 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.

B127. 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, these costs likely will result from reviewing existing lease agreements, staff training, and system changes. Many of these 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 renewal options and multiple components than a lease without those elements. Stakeholders also expressed concern about monitoring leases for changes that would result in adjustments to the amounts recognized in financial statements. 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 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 the provisions regarding reassessment of lease term, not requiring a lessor to estimate the portion of an underlying asset that would be derecognized, and the short-term lease exception.

B128. 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 the Statement, both initially and on an ongoing basis, are significant.

Effective Date and Transition

B129. The provisions of this Statement are effective for reporting periods beginning after December 15, 2018. The Board believes that the requirements of this Statement should become effective soon enough to provide better information to financial statement users without unnecessary delay. However, the Board acknowledges that implementation will be more challenging for governments that have a large number of leases. Even though the Preliminary Views did not include a proposed effective date, some respondents took the opportunity to express their desire for a lengthy implementation period. The Board believes the effective date provides sufficient time if governments do not delay in beginning their implementation process.

B130. This Statement requires that leases be recognized and measured using the facts and circumstances that exist at the beginning of the period of implementation. The Board believes that it would not be practical to require governments to return to the beginning of each lease 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. While 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.

B131. 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 would become the new carrying value of the underlying asset. In many cases, these leases involve a transfer of ownership or bargain purchase option, and the lessor will not retain ownership of the asset at the end of the lease.

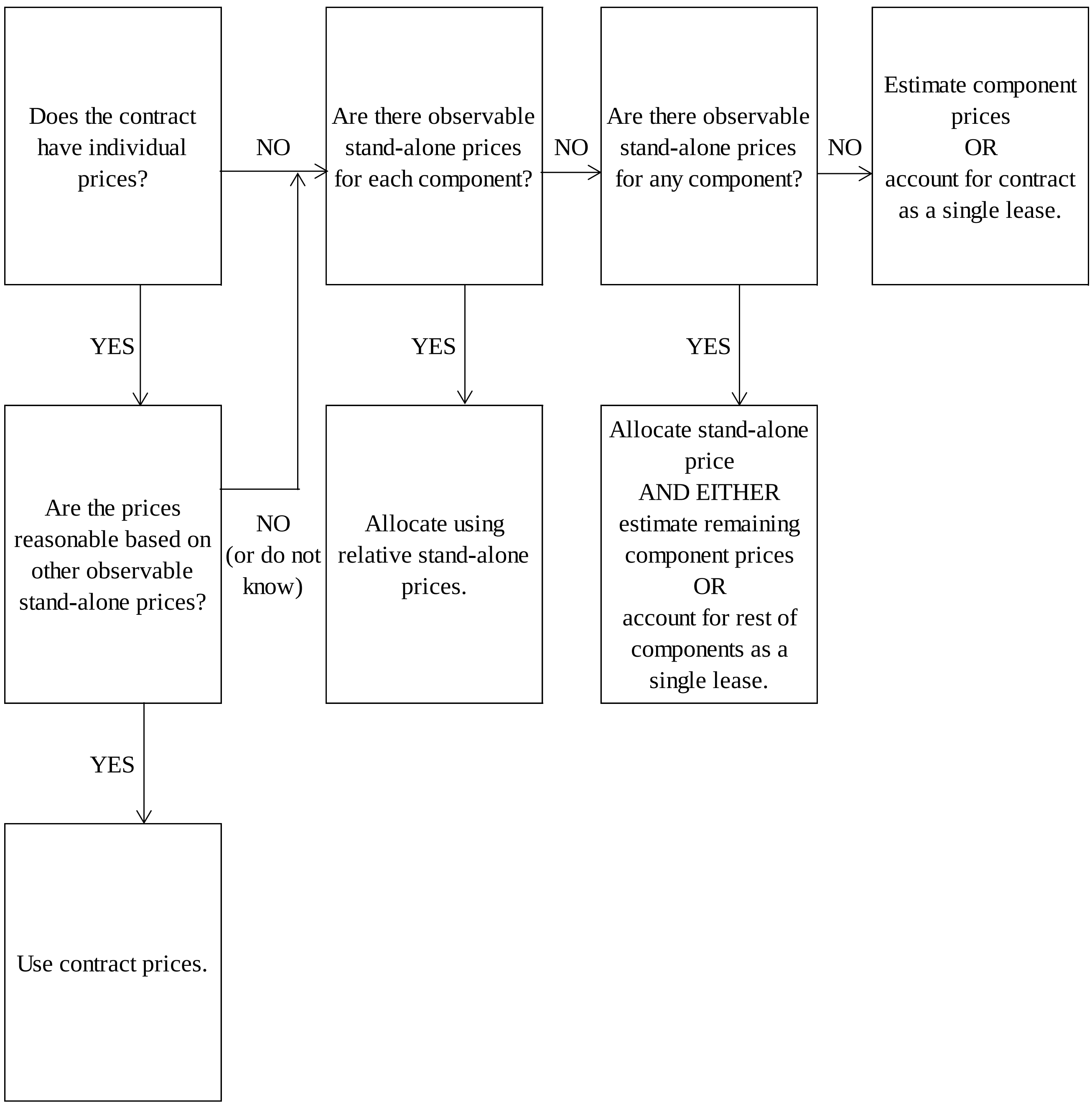
B132. This Statement permits early application. The Board considered encouraging early application. However, the Board noted that it may not be possible for all governments to determine what information was available in earlier periods, in order to retroactively apply the provisions. The Board also considered 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.

B133. If this Statement is applied early, its provisions 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

FLOWCHART FOR ALLOCATION OF CONSIDERATION TO MULTIPLE COMPONENTS

C1. The following flowchart is intended to aid in the application of the provisions for contracts with multiple components of this Statement. The flowchart is nonauthoritative and does not cover all aspects of the Statement. It should not be used in place of the Statement itself.



Appendix D

CODIFICATION INSTRUCTIONS

D1. The instructions that follow update the June 30, 2015 *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 .107*.]

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REPORTING CAPITAL ASSETS — **SECTION 1400**

Sources: [Add GASB Statement XX.]

.120 [Delete *capital*.] [GASBS 62, ¶5, as amended by GASBS XX, ¶13]

.121 [Revise the second sentence as follows:] Paragraph .115 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 interest expense. [GASBS 62, ¶6, as amended by GASBS XX, ¶18]

.139 [Delete *capital*.] [GASBS 51, ¶3, as amended by GASBS 72, ¶64 and GASBS XX, ¶13]

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

Capital Assets Acquired through Leases

.156 Paragraphs .121–.129, .132, and .144 of Section L20 provide guidance on reporting assets acquired through leases.

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

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[x]Paragraph .125 of Section L20 provides additional guidance for assessing impairment of lease assets. [GASBS 42, ¶11, as amended by GASBS XX, ¶28]

.187 [Add the following footnote at the end of the first sentence:]

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[x]Paragraph .125 of Section L20 provides additional guidance for measuring impairment of lease assets. [GASBS 42, ¶12, as amended by GASBS XX, ¶28]

.719-7 [Delete *paragraphs .103–.515 of*.] [GASBIG 2015-1, QZ.51.21, as amended by GASBS XX, ¶5]

.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 XX, ¶13]

.745-2 [Delete *under a capital lease*.] [GASBIG 2015-1, QZ.42.9, as amended by GASBS XX, ¶13]

* * *

REPORTING LIABILITIES SECTION 1500

Sources: [Add GASB Statement XX.]

.102 [Delete *capital and operating*.] [NCGAS 1, ¶42, as amended by NCGAS 4, ¶14, NCGAI 9, ¶12, GASBS 6, ¶13 and ¶23, GASBS 10, ¶53, GASBS 16, ¶6, GASBS 18, ¶7, GASBS 27, ¶17, GASBS 47, ¶3, GASBS 49, ¶9, GASBS 62, ¶34–¶43 and ¶96–¶113, GASBS 63, ¶8, GASBS XX, ¶13, and GASBI 1, ¶13; GASBS 34, ¶6 and GASBS 34, ¶81 as amended by GASBS XX, ¶13; GASBS 34, ¶30, ¶82, ¶92, and ¶108, as amended by GASBS 63, ¶8]

.103 [Delete *capital and operating*.] [NCGAS 1, ¶43, as amended by NCGAS 4, ¶14, NCGAI 9, ¶12, GASBS 6, ¶17, GASBS 16, ¶13, GASBS 17, ¶6, GASBS 18, ¶10, GASBS 27, ¶16, GASBS 47, ¶3, GASBS 49, ¶9 and ¶24, GASBS 62, ¶34–¶43 and ¶96–¶113, GASBS 63, ¶8, GASBS XX, ¶13, and GASBI 1, ¶10 and ¶12; GASBS 34, ¶82, as amended by GASBS 63, ¶8]

.106 [In the last sentence of footnote 2, replace *rental* with *the lease payment*.] [GASBS 62, fn12, as amended by GASBS XX, ¶ 45]

.117 [Delete *capital*.] [GASBI 6, ¶9, as amended by GASBS 47, ¶3, GASBS 49, ¶9 and ¶24, and GASBS XX, ¶13]

.119 [Delete *capital*.] [GASBI 6, ¶11, as amended by GASBS 47, ¶3, GASBS 49, ¶24, and GASBS XX, ¶13]

.122 [In the third sentence, delete *capital*.] [NCGAS 1, ¶70 and ¶72, as amended by GASBS 34, ¶82; GASBS 6, ¶16; GASBI 6, ¶13, as amended by GASBS XX, ¶13]

* * *

BASIS OF ACCOUNTING SECTION 1600

.118 [Delete *capital*.] [GASBI 6, ¶9, as amended by GASBS 47, ¶3, GASBS 49, ¶9 and ¶24, and GASBS XX, ¶13]

.120 [Delete *capital*.] [NCGAS 1, ¶72; GASBI 6, ¶13, as amended by GASBS XX, ¶13]

* * *

CLASSIFICATION AND TERMINOLOGY SECTION 1800

.113 [In footnote 3, replace *rental* with *the lease payment*.] [GASBS 62, fn12, as amended by GASBS XX, ¶45]

[In heading above paragraph .128, delete *capital*.]

.128 [Replace *capital lease* with *lease*.] [GASB 34, ¶80; GASBS XX, ¶13]

.743-1 [Delete *capital*.] [GASBIG 2015-1, QZ.54.11, as amended by GASBS XX, ¶13]

* * *

COMPREHENSIVE ANNUAL FINANCIAL REPORT SECTION 2200

.180 [In footnote 33, replace *rental* with *the lease payment*.] [GASBS 62, fn12, as amended by GASBS XX, ¶45]

.715-11 [Replace *capital lease* with *lease*.] [GASBIG 2015-1, Q7.30.2, as amended by GASBS XX, ¶13]

* * *

NOTES TO FINANCIAL STATEMENTS SECTION 2300

.106 [In subparagraph (j), replace paragraph references with *.128, .129, .146, .147, and .148*. In subparagraph (l), insert *and lease assets* following *capital assets*.] [NCGAS 1, ¶158; NCGAI 6, ¶4, as amended; GASBS 34, ¶113, ¶114, ¶117–¶120, and ¶123, as amended by GASBS 62, ¶4; GASBS 34, ¶115, ¶116, ¶121, and ¶122, as amended by GASBS 62, ¶4 and GASBS 63, ¶8; GASBS 38, ¶6, ¶7, ¶9, ¶10, ¶14, and ¶15; GASBS 45, ¶24 and ¶25; GASBS 54, ¶23 and ¶24; GASBS 56, ¶8–¶11, as amended by GASBS 63,

¶8; GASBS 56, ¶12–¶14; GASBS 62, ¶90–¶95, ¶106–¶109, ¶112, ¶113, ¶201, ¶223, ¶231, ¶239, ¶255, ¶256, and ¶270; GASBS XX, ¶31, ¶32, ¶49, ¶50, and ¶51]

.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 XX, ¶31]

.118 [Replace *capital assets* with *capital assets, with lease assets presented separately,*.] [GASBS 34, ¶117, as amended by GASBS XX, ¶31]

* * *

CASH FLOWS STATEMENTS **SECTION 2450**

.132 [Replace *an asset* with *a lease asset* and delete *capital* before *lease*.] [GASBS 9, ¶37, as amended by GASBS XX, ¶13]

[Delete Question .707-15.]

.714-2 [Replace the fourth and fifth 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 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 XX, ¶13]

* * *

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

.118 [Replace *capital lease* with *lease* throughout.] [GASBS 14, ¶58, as amended by GASBS XX, ¶13]

* * *

STATISTICAL SECTION **SECTION 2800**

.122 [Delete *capital*.] [GASBS 44, ¶23, as amended by GASBS XX, ¶13]

.503 [Delete *capital*.] [GASBS 44, ¶45, as amended by GASBS XX, ¶13]

.506 [Delete *capital*.] [GASBS 44, ¶45, as amended by GASBS XX, ¶13]

.714-1 [Delete *capital*.] [GASBIG 2015-1, Q9.24.1, as amended by GASBS XX, ¶13]

* * *

CLAIMS AND JUDGMENTS **SECTION C50**

Sources: [Add GASB Statement XX.]

[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 XX, ¶32]

[26]A lessee is not required to disclose collateral pledged for a lease if that collateral is solely the asset underlying the lease. [GASBS XX, ¶32]

* * *

INTEREST COSTS—IMPUTATION **SECTION I30**

.102 [At the end of subparagraph (g), insert *unless specifically required*.] [GASBS 62, ¶174, as amended by GASBS XX, ¶76]

* * *

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

.110 [In the first and fourth sentences, delete *capital*.] [GASBS 14, ¶76, as amended by GASBS XX, ¶13]

* * *

LEASES **SECTION L20**

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

[Replace current paragraphs .101–.515 with the following:]

Scope and Applicability of This Section

.101 This section establishes standards of accounting and financial reporting for leases by lessees and lessors. The requirements of this section apply to financial statements of all state and local governments. For purposes of applying this section, a lease is defined as a contract that conveys the right to use a nonfinancial asset (the underlying asset) for a period of time in an exchange or exchange-like[1] transaction. Leases include contracts that, although not explicitly identified as leases, meet the definition of a lease. This definition does not include contracts for services except those contracts that contain both a lease component and a service component. [GASBS XX, ¶2 and ¶3]

[1][GASBS XX, fn1]

.102–.103 [GASBS XX, ¶4–¶5, including footnote]

.104–.164 [GASBS XX, ¶7–¶67, including headings and footnote]

.165 If prior to the expiration of the lease term a change in the provisions of a lease results from a refunding by the lessor of debt, 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 in the provisions of a lease results from a refunding by the lessor of debt, 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 agreement. 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 a component of 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 the provisions of a lease are changed in connection with an advance refunding by the lessor of debt that results in a defeasance of debt at the date of the advance refunding and the lessee is obligated to reimburse the lessor for any costs related to the debt to be refunded that have been or will be incurred, such as unamortized discount or a call premium, the lessee should accrue those costs by the "interest" method (see paragraphs .101–.115 of Section I30) over the remaining life of the old debt or the life of the new debt, whichever is shorter.

[GASBS 62, ¶221, as amended by GASBS 65, ¶7, GASBS 65, ¶15, and GASBS XX, ¶67; GASBS 65, ¶7]

.166 [GASBS XX, ¶68, including heading]

.167 If prior to the expiration of the lease term a change in the provisions of a lease results from a refunding by the lessor of debt, 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 in the provisions of a lease results from a refunding of debt, including an advance refunding that results in a defeasance of debt, the lessor should adjust the balance of the lease receivable to the present value of the future lease payments based on the interest rate applicable to the revised lease agreement and also should adjust the deferred inflow of resources. The adjustment to the deferred inflow of resources should be recognized as a 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 in the provisions of a lease results from an advance refunding that results in a defeasance of debt, the lessor should systematically recognize, as revenue, any reimbursements to be received from the lessee for costs related to the debt to be refunded, 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.

[GASBS 62, ¶225, as amended by GASBS XX, ¶68]

.168–.173 [GASBS XX, ¶69–¶74, including headings]

.174 The difference between the amount of revenue or expense recognized for a transaction that is accounted for as a sale-leaseback and the amount of revenue or expense included in allowable cost for rate-making purposes should be capitalized or accrued as a separate regulatory-created asset or liability, as appropriate, if that difference meets the criteria of Section Re10, "Regulated Operations." [GASBS 62, ¶254, as amended by GASBS XX, ¶71–¶73]

.175 [GASBS XX, ¶75, including heading]

Intra-Entity Leases

.176 If under the criteria of Section 2100, "Defining the Financial Reporting Entity," the lessor is reported as part of the primary government for financial reporting purposes, the criteria of this section do not apply. Instead, the lessor's debt and assets should be reported as a form of the primary government's debt and assets. For example, the leased general capital assets would be reported as general capital assets in the government-wide statement of net position, and related debt would be reported as a general long-term liability in the government-wide statement of net position. The debt service activity of the lessor would be reported as a debt service activity of the primary government. 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 payment between component units should be reported as inflows of resources and outflows of resources. [GASBS 14, ¶58, as amended by GASBS 34, ¶80 and ¶82, GASBS 63, ¶8; GASBS XX, ¶76]

.177 Lease arrangements between the primary government and discretely presented component units (or between those component units) should be treated in the same manner as any other lease agreement of a state or local government. These agreements, therefore, should be considered long-term contracts for accounting and financial reporting purposes and afforded the appropriate lease treatment. However, related receivables and payables should not be combined with other amounts due to/from component units or with lease receivables and payables with organizations outside the reporting entity. [GASBS 14, ¶58; GASBS XX, ¶13]

Leases between Related Parties

.178 Except as noted below, leases between related parties should be classified in accordance with the criteria in paragraphs .105 and .106. Insofar as the separate financial statements of the related parties are concerned, the classification and accounting should be the same as for similar leases between unrelated parties, except in cases where 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 written to meet the definition of a short-term lease but the related parties have a mutual understanding that the agreement 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. [GASBS 62, ¶239, as amended by GASBS XX, ¶77]

.179 In financial statements for which an interest in an investee is accounted for using the equity method, any gain or loss on a leasing transaction with the related party should be accounted for in accordance with the principles set forth in paragraphs .109–.116 and .145 of Section I50. [GASBS 62, ¶240, as amended by GASBS XX, ¶77]

* * *

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 .130 of Section L20, "Leases." [GASBS 62, ¶450, as amended by GASBS XX, ¶33]

* * *

REAL ESTATE — SECTION R30

.141 [Replace *paragraphs .159–.171* with *paragraphs .171–.175*.] [GASBS 62, ¶320, as amended by GASBS XX, ¶71–¶74]

.171 [Replace subparagraph (b) with the following: *Initial direct costs of leases (see Section L20).*] [GASBS 62, ¶351, as amended by GASBS XX, ¶13]

.188 [Delete footnote 35 and renumber subsequent footnotes; delete *operating*.] [GASBS 62, ¶368, as amended by GASBS XX, ¶13]

.189 [Delete *operating* throughout.] [GASBS 62, ¶369, as amended by GASBS XX, ¶13]

.190 [Insert a new second sentence as follows:] Lease revenue should be recognized in accordance with the provisions of paragraphs .142–.143 of Section L20. [GASBS 62, ¶370; GASBS XX, ¶45 and ¶46]

* * *

BANKRUPTCIES **SECTION Bn5**

[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 XX, ¶65 and ¶67]

* * *

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

.708-1 [Delete *capital*.] [GASBIG 2015-1, Q5.72.1, as amended by GASBS XX, ¶13]

* * *

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 XX, ¶71–¶73]

* * *

D2. The instructions that follow update *Implementation Guide No. 2015-1* for the effects of this Statement. That Guide, as modified, will be incorporated into the *Comprehensive Implementation Guide.*

* * *

[Update cross-references throughout.]

* * *

[Delete current Question 2.27.5.]

2.32.1. [Replace the fourth and fifth 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 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 XX, ¶13]

5.72.1. [Delete *capital*.] [GASBIG 2015-1, Q5.72.1, as amended by GASBS XX, ¶13]

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 XX, ¶13]

7.30.2. [Replace *capital lease* with *lease*.] [GASBIG 2015-1, Q7.30.2, as amended by GASBS XX, ¶13]

9.24.1. [In the answer, delete *capital.*] [GASBIG 2015-1, Q9.24.1 as amended by GASBS XX, ¶13]

[Delete Question Z.38.1.]

Z.42.9. [In the second question, delete *under a capital lease.*] [GASBIG 2015-1, QZ.42.9, as amended by GASBS XX, ¶6]

Z.51.21. [Replace *Statement 62, paragraphs 211–271, as amended,* with *Statement No. XX, Leases,*; replace *Statement 62* with *Statement XX*.] [GASBIG 2015-1, QZ.51.21, as amended by GASBS XX, ¶5]

Z.54.11. [Delete *capital*.] [GASBIG 2015-1, QZ.54.11, as amended by GASBS XX, ¶13]

* * *