

OFFICE OF THE NEW YORK STATE COMPTROLLER

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To: Chief Financial Officers
From: Division of Local Government and School Accountability
Subject: Lease Classification Changes as Required by GASB Statement No. 87

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Purpose of Bulletin

The purpose of this bulletin is to inform local government and school district officials of the upcoming new requirements regarding the classification of leases for accounting and reporting purposes, as required by the Governmental Accounting Standards Board (GASB) [Statement No. 87, Leases](#) (Statement 87). This bulletin explains the GASB's new definition of a lease (including outlining the types of leases that are excluded by this new standard) and an explanation of what a lease term is per Statement 87.

A subsequent accounting bulletin will be issued by our office in 2021 that will provide more detailed accounting and reporting guidance on Statement 87, as well as how to account for and report leases in the Annual Update Document (AUD), the ST-3, and other annual financial reports that are required to follow the Office of the State Comptroller's uniform system of accounts.

Background

Historically, leases were categorized as either capital or operating leases. The capital or operating lease classification depended on whether a 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 they were, then the lease was essentially considered a financed purchase of the asset and accounted for as a capital lease. All other leases were considered operating leases. For governmental funds, capital leases were accounted for in essentially the same manner as the purchase of an asset through long-term debt issuance. Principal and interest payments were recognized as expenditures in the accounting period they became due and the remainder of the lease obligation would be recorded in the Schedule of Non-Current Governmental Liabilities (W). The net present value of the outstanding obligation was used as the account balance. Operating lease payments would be charged as expenditures over the lease term as they became payable so a liability was never recognized.

In June 2017, the GASB issued Statement 87 which established a single lease accounting model based on the principle that leases are financings of the right to use an underlying asset. Under Statement 87, a lessee is required to recognize a lease liability and an intangible right-to-use lease asset, and a lessor is required to recognize a lease receivable and a deferred inflow of resources.

This new standard broadens the scope of the contracts that will qualify as leases and will likely substantially increase the number of leases now required to be reported by local governments and school districts. It also requires reporting of leases where local governments or school districts are the lessor.

Due to these changes, local governments and school districts will need to re-examine all of their contracts¹ to determine if they qualify as a lease under this new standard.

Applicability to Local Governments and School Districts in New York State

Statement 87 applies to all local governments and school districts in New York State (NYS). For local governments and school districts that prepare annual financial statements in accordance with generally accepted accounting principles (GAAP), Statement 87 reporting requirements are effective for fiscal years beginning after June 15, 2021.² Local governments that do not complete GAAP-compliant financial statements must implement these new standards for AUD reporting purposes.

For the purposes of the AUD reporting, local governments with a fiscal year beginning after June 15, 2021 will be the first units required to file using the requirements set forth in this bulletin. School districts will be required to file the 2021-2022 fiscal year ST-3 using the requirements set forth in this bulletin. All other annual financial reports that are required to follow the Office of the State Comptroller's uniform system of accounts will also be required to file using the requirements of this statement for fiscal years beginning after June 15, 2021.

Statement 87 Highlights

New Lease Definition

Statement 87 defines a lease as “a contract that conveys control of the right to use another entity’s nonfinancial asset³ (the underlying asset) as specified in the contract for a period of time in an exchange or exchange-like transaction.”⁴ This Statement also includes subleases, sale-leaseback transactions and lease-leaseback transactions, but it excludes contracts for services except those contracts that contain both a lease component and a service component. Specifically, local governments and school districts may enter into contracts that contain both a lease component and a nonlease component, or a lease that contains multiple underlying assets. An example could be an IT equipment lease with a related maintenance services component. For contracts with a lease and nonlease component, each component should be accounted for as separate contracts, unless it is not practicable to separate and estimate the costs of those services. For contracts with multiple underlying assets with different lease terms or if the assets are in different major classes of assets, each of the assets should be accounted for as a separate lease component.

¹ It is important to note that some contracts that are not explicitly called leases may qualify as leases under the requirements of this new standard.

² The effective date of this Statement was postponed by the issuance of Statement 95, [Postponement of the Effective Dates of Certain Authoritative Guidance](#).

³ A nonfinancial asset is “an asset that is not a financial asset (e.g., land, buildings, vehicles, and equipment).”

⁴ “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.” Essentially, a transaction is exchange or exchange-like when each party in the contract receives or gives up essentially equal value.

Furthermore, per Statement 87, a contract “conveys control of the right to use the underlying asset” when the government has the right to both of the following:

- (a) Obtain the present service capacity from use of the underlying asset as stated in the contract, and
- (b) Determine the nature and manner of use of the underlying asset as stated in the contract.

Statement 87, however, **does not apply to:**

- Leases of intangible assets, including rights to explore or exploit natural resources; licensing contracts for items such as video recordings, patents and copyrights; and licensing contracts for computer software.
- Leases of biological assets, including timber, living plants and living animals.
- Leases of inventory.
- Contracts that meet the definition of a service concession arrangement.
- 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.
- Supply contracts, such as purchase power agreements.
- A lease with a term of 12 months or less (short-term leases).

Additionally, if ownership of the underlying asset transfers to the lessee at the end of the lease term and there are no termination options, then the lease should be accounted for as a financed purchase of the underlying asset by the lessee and a sale of the asset by the lessor. An example would be a lease-purchase contract.

Lease Term

The lease term is the period a lessee has a noncancelable right to use an underlying asset, plus any options to extend/terminate if the lessee or lessor are reasonably certain⁵ they will/will not exercise those options, respectively. See the chart below:

		Lessee				Lessor		
		Periods covered by a lessee's option to extend the lease if reasonably certain lessee will exercise that option	+	Periods covered by a lessee's option to terminate the lease if reasonably certain lessee will not exercise that option		+	Periods covered by a lessor's option to extend the lease if reasonably certain lessor will exercise that option	+
Non-cancelable Lease Period	+				+			

⁵ Reasonably certain requires the use of professional judgement, which per Statement 87, “is a higher threshold and less speculative than probable.”

Any periods of the lease in which both the lessee and lessor have an option to terminate without permission from the other party are cancelable periods and are excluded from the lease term. Examples include a rolling month-to-month lease or a lease that continues into a holdover period until a new lease contract is signed. Provisions that allow for the termination of a lease due to (1) purchase of the underlying asset, (2) payment of all sums due, or (3) default on payments, are **not** considered termination options. Additionally, fiscal funding or cancellation clauses will not affect the lease term unless it is reasonably certain the clause will be exercised.

It is the responsibility of the local government or school district who is administering the lease to determine reasonable certainty. Examples of factors to consider when determining reasonable certainty include, but are not limited to, the following:

- A significant economic incentive, such as contractual terms and conditions for the optional periods that are favorable compared with current market rates.
- 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).
- The history of exercising options to extend or terminate.
- The extent to which the asset underlying the lease is essential to the provision of government services.

The Office of the New York State Comptroller (OSC) has created a [Reasonably Certain Template](#) that local governments and school districts may use to document determinations of reasonable certainty relating to leases. This template is not an OSC accounting and financial reporting requirement and does not need to be submitted to OSC.

Additional Information

GASB prepared [Implementation Guide 2019-3, Leases](#), to clarify, explain and elaborate on the requirements of Statement 87. This guide addresses many specific examples which local governments and school districts may find helpful in making determinations about which contracts qualify as lease agreements and the lease term.

Local governments and school districts, as applicable, should also discuss their specific leasing situations with their certified public accountants and municipal attorneys.

If you have questions pertaining to leases as described in this bulletin, please contact the New York State Comptroller's [regional office that serves your local government or school district](#).