



North Carolina Office of the State Controller

Financial Reporting Update

GASB 87 Effective for FY 2022

February 11, 2020

Update: July 1, 2020 – updated the effective date based on GASB 95; clarify Other Direct Costs capitalized in lease asset; Added FAQ to Appendix A, page 3 to address questions related to lease software procurement; Added Example 6 to Appendix C to address nuances with short term lease exception

Update: August 2021 – include newly issued implementation guidance since prior update; link to OSC discount rate procedural guidance and statewide accounting policy on leases; update references to Comprehensive Annual Financial Report (Annual Report); add Appendix D, revise Appendix A and Appendix B for newly published information.

In June 2017, the Governmental Accounting Standards Board (GASB) issued GASB Statement No. 87, *Leases*. This statement supersedes or amends parts of 15 existing statements. GASB 87 overhauls the accounting and financial reporting of leases for state and local governments by establishing a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying nonfinancial asset.

The objective of this statement is to improve the consistency of accounting and reporting for leases by requiring recognition of certain lease assets and liabilities for leases that previously were classified as operating leases. Under the new standard, leases previously classified as capital leases will be impacted also. GASB 87 will enhance the comparability, relevance, and reliability of information about the leasing activities of governments.

GASB 87 was originally effective for the fiscal year ending June 30, 2021. However, in May 2020, GASB issued GASB Statement No. 95, *Postponement of the Effective Dates of Certain Authoritative Guidance* (GASB 95). Based on the issuance of GASB 95, the implementation of GASB 87 is being delayed to the fiscal year ending June 30, 2022. GASB 87 will require a restatement of beginning balances for all periods presented (retroactive application). This statement will apply to all state and local governments with leasing arrangements as defined in the statement. This standard will have a significant impact on the entire State of North Carolina financial reporting entity, including the primary government (state agencies/departments) and its component units (universities, community colleges, other component units). The requirements in GASB 87 need not be applied to immaterial items.

Identifying Leases and Determining the Lease Term

Under pre-GASB 87 guidance, governments distinguished between operating and capital leases. Beginning in fiscal year 2021 and for all prior periods presented, there is no longer a distinction between operating and capital leases. All leasing arrangements as defined by GASB 87 will now be treated as financings of the right to use the leased asset.



GASB 87 defines a lease as a contract that conveys control of the right to use another entity's nonfinancial asset (the underlying asset, such as a vehicle, building, or equipment) as specified in the contract for a period of time in an exchange or exchange-like transaction. The contract must be legally enforceable. A contract conveys control of the right to use the underlying asset if it has both of the following:

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

Contracts for services are excluded, and contracts that contain both a lease component and a service component should separate and report only the lease component. There are several other exclusions from the scope of this definition. See the list of exclusions in Appendix A, Glossary of Useful Terms and Appendix B, Question 1c.

For further guidance on identifying leases, refer to **Appendix A: OSC Steps to Identifying Leases** and **Appendix B: OSC Decision Guide for Lease Identification**. Also refer to questions 4.1 – 4.11 in Implementation Guide No. 2019-3, *Leases*, for examples and common considerations related to the scope and applicability of GASB 87. See link below on page 7.

For arrangements that meet the GASB 87 definition of a lease, entities will be required to determine the lease term applicable to that lease, whether the entity is a lessee or a lessor in the arrangement. The lease term is the noncancelable period, plus periods covered by the lessee's and lessor's options to:

- Extend the lease, if reasonably certain of being exercised
- Terminate the lease, if reasonably certain of NOT being exercised

Periods for which both the lessee and lessor have an option to terminate or both parties have to agree to extend the lease are cancelable periods and are excluded from the lease term. Fiscal funding/cancellation clauses are ignored unless reasonably certain of being exercised.

A lessee or a lessor is 'reasonably certain' if they have evaluated relevant factors such as economic incentives or disincentives (cost to terminate, market rates for new leases, cancellation penalties, etc.), the history of exercising options to extend or terminate, and how essential the leased asset is to a government's operations. After evaluating these factors, an entity can be reasonably certain if there is a greater than probable chance that one of the above options will or will not be exercised. In certain cases, lease terms should be reassessed. For example, if a lessee exercises an option that it was previously uncertain about, the lease term should be adjusted.

GASB 87 specifically exempts short-term leases from the provisions of the standard. A short-term lease is one that has a maximum possible term under the contract, including options to extend, of 12 months or less as determined at the beginning of the lease. Options to terminate the lease are excluded. A short-term lease should be accounted for as expenses for the lessee upon payment and revenues for the lessor upon receipt of the payment, similarly to how operating leases were recognized under previous guidance.



For examples of lease term determinations, see **Appendix C: Lease Term Examples**. Also refer to questions 4.12 – 4.20 in Implementation Guide No. 2019-3, *Leases*, for further guidance and clarification. See link below on page 7.

General Reporting Requirements - Lessee

A government can be either a lessee or a lessor in a leasing arrangement. In this section, we discuss the general reporting requirements for lessees.

One major change that will affect both lessees and lessors with existing capital leases is that the lessee will NOT recognize and depreciate the underlying capital asset in the lease. For leases within the scope of GASB 87, a lessee should initially recognize a lease liability and an intangible right to use asset. The intangible right to use asset (lease asset) is a capital asset. The right to use asset is distinct from the underlying asset itself (vehicle, building, etc.), which will continue to be reported on the lessor's books.

Lessees should measure the lease liability at the present value of future minimum lease payments. Initial measurement of the lease liability should include the following:

- Fixed payments
- Variable payments that depend on an index or rate
- Variable payments that are fixed in substance
- Payments for residual value guarantees
- Exercise price of a purchase option if the lessee is reasonably certain to exercise the option
- Payments for early termination of the lease
- Lease incentives receivable from the lessor (this decreases the payment)
- Any other payments that are reasonably expected of being required based on an assessment of all relevant factors.

Variable payments that are dependent on a lessee's future performance or usage of the underlying asset should not be included in the lease liability. These variable payments should be expensed when the obligation for payment is incurred. However, if any component of these variable payments is fixed, they should be included in the lease liability.

Future lease payments should be discounted using the interest rate the lessor charges the lessee or the implicit rate. If the interest rate is not readily determinable, the lessee's estimated incremental borrowing rate should be used.

The lease asset should be measured as the sum of the initial lease liability plus prepayments made at or before the commencement of the lease term less lease incentives received plus initial direct costs that are ancillary charges necessary to place the lease asset in service. An example of an initial direct cost that would be capitalized is transportation charges for bringing the asset to its intended location where it will be placed into service. Other initial direct costs include, but are not limited to, legal, administration, or negotiation fees.

Initial recognition will include a restatement of beginning balances in the year of implementation, so entities are required to calculate lease liabilities and assets as of July 1, 2021 in order to



comply with GASB 87. Entities will need to examine their existing capital and operating leases to determine whether they will continue to meet the definition of a leasing arrangement under GASB 87. For existing leases that meet the definition, all lease calculations should be made as if the commencement date of the lease is the earliest period presented. For most entities, this will be July 1, 2021.

In subsequent periods, the lessee will amortize the interest (i.e. discount) on the lease liability and report that amount as interest expense. Payments should be allocated first to interest payable and then to the amortization of the lease liability. The lease asset should be amortized over the shorter of the lease term or the useful life of the underlying asset. If a lease contains a purchase option and it is reasonably certain that it will be exercised, the lease asset should be amortized over the useful life of the asset.

Financial statements prepared using the current financial resources measurement focus, i.e., Governmental Funds (General Fund, Special Revenue Funds, Capital Project Funds, and Permanent Funds), should report an expenditure and other financing source in the period the lease is initially recognized. These should be measured in accordance with the requirements for measuring the lease liability. In subsequent periods, payments should be accounted for as principal and interest expenditures. Amortization of interest should not be recognized in the fund level financial statements.

The lease liability should be remeasured if certain changes have occurred at or before the financial reporting date and the changes are expected to significantly affect the amount of the lease liability. Generally, the lease asset should be adjusted by the same amount as the lease liability.

GASB 87 requires notes to the financial statements for lease activities, other than short-term leases as follows:

- a. General description of its leasing arrangements, including (1) the basis, terms, and conditions on which variable payments not included in the measurement of lease liability are determined and (2) the existence, terms, and conditions of residual value guarantees provided by the lessee not included in the measurement of the lease liability
- b. The total amount of lease assets, and the related accumulated amortization, disclosed separately from other capital assets
- c. The amount of lease assets by major classes of underlying assets, disclosed separately from other capital assets
- d. The amount of expense/expenditure recognized in the reporting period for variable payments and other payments (such as residual value guarantees or termination penalties) not previously included in the measurement of the lease liability
- e. 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
- f. Commitments under leases before the commencement of the lease term
- g. The components of any impairment loss associated with the underlying asset, including the amount of impairment loss and any related change in the lease liability
- h. Additional disclosures are required for lessees that have sublease, sale-leaseback, and/or lease-leaseback transactions. See GASB 87, paragraphs 81, 85, and 87 for further information (See link below on page 7).



For further clarification, guidance and examples, please refer to questions 4.23 – 4.42 of Implementation Guide No. 2019-3, *Leases*. See link below on page 7.

General Reporting Requirements – Lessor

In many ways, the reporting requirements of the lessor are the mirror image of the requirements for lessees.

Lessors should initially recognize a lease receivable and a deferred inflow of resources. Lessors should measure the lease receivable at the present value of lease payments expected to be received, less amounts deemed uncollectible. Initial measurement of the lease receivable should include the following:

- Fixed payments
- Variable payments that depend on an index or rate
- Variable payments that are fixed in substance
- Residual value guarantee payments that are fixed in substance
- Any lease incentives payable to the lessee (this decreases the lease receivable)

Variable payments that are dependent on a lessee's future performance or usage of the underlying asset should not be included in the lease receivable. These variable payments should be recognized as revenue in the period to which those payments relate. However, if any component of these variable payments is fixed, they should be included in the lease receivable.

Future lease payments to be received should be discounted using the interest rate the lessor charges the lessee or the implicit rate.

The deferred inflow of resources should be measured as the sum of the initial lease receivable plus lease payments received at or before the commencement of the lease term that apply to a future period, such as the final month's rent, less any lease incentives paid to the lessee.

If the underlying asset in a lease is reported as an investment in accordance with GASB Statement No. 72, *Fair Value Measurement and Application*, the lessor should not apply the recognition and measurement provisions of GASB 87. The note disclosure requirement in GASB 87, paragraph 57d, should be applied. For example, if a lease is entered for the purpose of subleasing solely for profit, GASB Statement 72 would apply and not GASB 87. There are also different requirements for certain regulated leases, such as aviation leases.

Initial recognition will include a restatement of beginning balances in the year of implementation, so entities are required to calculate lease receivables and deferred inflows of resources as of July 1, 2021 in order to comply with GASB 87. Entities will need to examine their existing leases to determine whether they will continue to meet the definition of a leasing arrangement under GASB 87. For existing leases that will continue to meet the definition, all lease calculations should be made as if the commencement date of the lease is the earliest period presented. For most entities, this will be July 1, 2021.



A lessor should not derecognize the asset underlying the lease. The lessor should continue to depreciate the capital asset and continue to apply other applicable guidance.

In subsequent periods, the lessor will amortize the interest (i.e. discount) on the lease receivable and report that amount as a revenue. Interest should be amortized using the effective interest method, per Implementation Guide 2019-3 Question 4.49. Payments received should be allocated first to interest receivable and then to the amortization of the lease receivable. The deferred inflow of resources should be systematically recognized as revenue over the lease term. Financial statements prepared using the current financial resources measurement focus, i.e., Governmental Funds, should recognize the deferred inflow of resources as revenue, if available, systematically over the lease term. Revenue is considered available if it is collected within 31 days after year-end.

The lease receivable should be remeasured if certain changes have occurred at or before the financial reporting date and the changes are expected to significantly affect the amount of the lease receivable. Generally, the deferred inflow of resources should be adjusted by the same amount as the lease receivable.

GASB 87 requires notes to the financial statements for lease activities, other than short-term leases and certain regulated leases as follows:

- a. General description of its leasing arrangements, including the basis, terms, and conditions on which any variable payments not included in the measurement of the lease receivable are determined
- b. The total amount of revenue recognized in the reporting period from leases, if not already displayed separately on the face of the financial statements
- c. The amount of revenue recognized in the reporting period for variable and other payments not previously included in the measurement of the lease receivable, including revenues related to residual value guarantees and termination penalties
- d. The existence, terms, and conditions of options by the lessee to terminate the lease or abate payments if the lessor government has issued debt for which the principal and interest payments are secured by the lease payments
- e. Additional disclosures are required for lessors that have regulated lease, sublease, sale-leaseback, and/or lease-leaseback transactions. See GASB 87 paragraphs 60, 81, 85, and 87 for further detail (See link below on page 7).

Additional note disclosures are required if a lessor's principal ongoing operations consist of leasing assets to other entities or if the lessor has regulated leases.

For further clarification, guidance and examples, please refer to questions 4.43 – 4.55 of Implementation Guide No. 2019-3, *Leases*. See link below on page 7.

General Reporting Requirements – Other Topics Addressed

GASB 87 discusses several related topics, such as reporting for lease modifications and terminations, subleases, sale-leaseback transactions, lease-leaseback transactions, intra-entity leases, leases between related parties, and more. Below are the topics considered most likely to apply to state entities during the implementation year of this standard:



- **Intra-Entity Leases:**
 - Leases between a primary government and its blended component unit should be eliminated at the reporting entity level. If the blended component unit has separately issued financial statements, the blended component unit should report the lease activity in its standalone financial statements.
 - Leases between a primary government and its discretely presented component unit, such as a university or community college, should be reported separately and should **not** be eliminated.
 - If the underlying asset is fully owned by the State of North Carolina and the “lease” exists for the purpose of reimbursing costs between one state entity and another, the requirements of GASB 87 do not apply. For example, payments made or received for Motor Fleet vehicles do **not** fall under the definition of a lease per GASB 87.
 - Leases within departments or between agencies in the primary government (e.g. a lease between the Dept. of Administration and the Dept. of Public Safety) do **not** fall under the definition of a lease per GASB 87. Leases are the right to use a different legal entity’s nonfinancial asset.

- **Contracts with Multiple Components:** These are contracts that may contain both a lease and a non-lease component, or those leases that contain multiple underlying assets.
 - Lease and Non-Lease Component – the lease and non-lease component should be accounted for as separate contracts. In cases where there are no stated prices for the separate components (such as leasing a building and also paying for the associated utilities, which can vary in price), lessees and lessors are permitted to determine their best estimate for allocating the contract price to those components. If a best estimate cannot be determined, the lease can be accounted for as a single lease. The accounting for the lease should be based on the primary lease component.
 - Multiple Underlying Assets – contracts for multiple underlying assets with different lease terms should be accounted for as separate contracts.

For further clarification, guidance, and examples, please refer to questions 4.56 - 4.75 of Implementation Guide No. 2019-3, *Leases*. Link below.

To gain additional understanding of GASB 87, please refer to the following resources:

- The GASB webpage from which you can access a PDF file of GASB 87 as well as other GASB pronouncements – [GASB Pronouncements](#)
- [Implementation Guide No. 2019-3, Leases](#)
- [Implementation Guide No. 2020-1](#) (Questions 4.6-4.17, effective fiscal year 2023)
- [Implementation Guide No. 2021-1](#) (Questions 4.4-4.21, effective fiscal year 2023 and Question 4.22 effective fiscal year 2022)
- Appendix A: OSC Steps to Identifying Leases
- Appendix B: OSC Decision Guide for Lease Identification
- Appendix C: Lease Term Examples
- [Appendix D: NCAS Chart of Account Changes](#)
- [OSC GASB 87 Lease Inventory Template](#)
- [105.7 – Statewide Accounting Policy - Leases](#)



- [GASB 87 Discount Rate Procedural Guidance](#)

GASB 87 Implementation Considerations

OSC expects the implementation of this statement to require a significant expenditure of time, effort, and resources for all state entities leading up to the fiscal year 2022 implementation date and thereafter. It is important for state entities to begin the process of identifying, examining, and maintaining their leasing contracts now to comply with reporting requirements for GASB 87. The change in reporting requirements for leases will require entities to examine current reporting for existing and potential leases to determine whether they meet the new requirements of GASB 87.

In an effort to assist state entities with this implementation and to gain an understanding of the nature of leasing arrangements throughout the State to implement further policy, OSC sent the Lease Inventory Template to primary government agencies on May 17, 2019 (link provided above). Primary government agencies were required to submit certain portions of this template to OSC on December 2, 2019 for leases held as of June 30, 2019. This template was provided to component units as a convenience to build a GASB 87-compliant inventory of their leasing arrangements but is not required to be submitted to OSC. ALL entities throughout the State should update and maintain their respective lease inventories on at least an annual basis.

Governmental Funds (General Fund, Special Revenue Funds, Capital Projects Funds, and Permanent Funds). The lessee will not report the lease liability and lease asset on the Balance Sheet. The liability will be reported in GASB 5200 Long Term Debt Account Group and the lease asset will be reported in the Fixed Asset System. Additionally, the amortization of interest and the intangible asset will not be reported in the Governmental Fund financial statements. Adjustments will be made in the State's [Annual Report](#) in the government-wide financial statements. The Statement of Revenues, Expenditures, and Changes in Fund Balances will be impacted as discussed in the lessee section above for Governmental Funds. The lessee will not recognize restatements in the financial statements. The restatement, if applicable, will be reported in the State's [Annual Report](#) in the government wide financial statements. The lessor will report the lease receivable and deferred inflow of resources on the Balance Sheet as discussed in the lessor section above. The lessor will recognize restatements in the financial statements, as applicable. Note disclosures will be required for lessees and lessors as noted above. OSC will provide additional reporting information for leases in Governmental Funds.

Proprietary Funds (Enterprise Funds, Internal Service Funds, and Component Units, such as Universities and Community Colleges). The Statements of Net Position, Statements of Revenues, Expenses, and Changes in Net Position, Statements of Cash Flows, and the Notes to the Financial Statements will be impacted. Restatements of beginning net position also will be required. At a government-wide level, leasing activities within legally separate business-type activities will be eliminated. For example, at the government-wide level, a lease between two universities or a lease between a university and its own component unit would be eliminated for Annual Report purposes. Note disclosures will be required for lessees and lessors as noted above. OSC will provide additional information for leases in Proprietary Funds.

Further, entities should review any existing bond/debt covenants, agreements, laws, etc. to ensure continued compliance after the GASB 87 implementation. If the term "capital lease" is used, this will need to be modified. Consider the implications of simply removing the word "capital" as the number of leases that will be reported will increase significantly. Other implementation considerations should include discussions of potential changes to internal controls and processes for identifying, entering into, and reporting leasing arrangements to



prevent and detect material misstatements or omissions for standalone and Annual Report financial disclosures.

Thank you for your time and attention to this important change. OSC will continue to provide updates as the standard is implemented. Additional implementation guidance will be issued as it is developed for statewide chart of account changes, policy updates, specific journal entry examples for lessees and lessors, interest rates, and other items. Questions regarding this specific update should be directed to Shivani Jani at 919-707-0525 or Shivani.Jani@osc.nc.gov.

Appendix A:

OSC Guide to Identifying Leases under GASB 87

The purpose of this document is to provide a guide to staff throughout the State in (1) identifying leases at their organization and (2) creating a central repository (i.e. an inventory) of leasing contracts with relevant information to aid in the implementation and reporting requirements for GASB 87, *Leases*. This document should be read in conjunction with completing the required elements of the GASB 87 Lease Inventory Template, sent to all state entities on May 17, 2019. A copy of the Lease Inventory Template can be found [here](#).

Current reporting guidance promulgated by the Governmental Accounting Standards Board (GASB) states that leases are either operating or capital. The issuance of GASB Statement 87, *Leases*, establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset. GASB 87 is effective for the fiscal year ended June 30, 2022, including a restatement of beginning net position as of July 1, 2021.

The new standard requires each agency to examine its existing leasing and other contracts in their entirety to determine how they will be reported under the new guidance. **GASB 87 will require significant time, up-front effort and coordination within each agency. Staff should be maintaining their lease repositories on an ongoing basis starting now.** This will require ongoing coordination among various business units or departments, such as Purchasing and Procurement, depending on the extent of decentralization of leasing contracts and the procurement process. The following is a general step-by-step guide for the identification of leases at your agency.

Step 1: Read GASB 87 and GASB Implementation Guide 2019-3, *Leases*

Begin by reading [GASB 87, *Leases*](#). Also refer to the [Implementation Guide 2019-3, *Leases*](#), which provides examples and clarification on the requirements contained within GASB 87.

[Implementation Guide 2020-1](#) and [Implementation Guide 2021-1](#) also provide sections of further guidance specific to leases (scroll to Page 7 of this FRU for effective dates and specific paragraphs).

Step 2: Identify Leases at Your Organization

2a: **Examine your Procurement Process and Form a Leases Workgroup.** Examine your agency's process for entering into contracts. If several departments are involved in this process, form a leases workgroup to ensure that all types of current and potential leasing contracts can be identified. A leases workgroup should include members of the accounting team (Controller's Office) and any other business units/departments within your agency that have the authority to engage in contracts with parties both internal and external to the State. Gather all real property leases that are currently held with the State Property Office for your organization. ***At least one member of the accounting/Annual Reporting team at your agency should be involved in this process*.**

Appendix A

2b: Examine Existing and Known Leases. Begin the process of identifying leases by gathering contracts that are already reported as operating or capital leases. Examine your general ledger accounts for capital leases payable, rental expense, and rental income to ensure you are considering all existing and recorded leasing arrangements. **Use Appendix B: OSC Decision Guide for Lease Identification to help you identify if you have a leasing arrangement under GASB 87.** If the contract meets the definition of a lease under GASB 87, add it to the Lease Inventory Template on the correct tab depending on whether your agency is the lessee or lessor in the contract. **Focus on identifying and adding your largest dollar value leases first.** Convert any hard-copy lease agreements to electronic and readable/searchable (pdf) format, and keep those documents in a central electronic drive/location. Do not include any leases or arrangements that should be excluded from GASB 87. See the FAQ and Glossary of Useful Terminology below and the Decision Guide tab in the template for leases that do not apply.

2c: Evaluate Other Contracts for Embedded Leases. Not every lease is labeled a “lease agreement,” and identifying embedded leases can involve considerable time and judgment as many of these contracts may not have been identified as leases in the past. Embedded leases are components within contracts that allow for the use of an asset, with the user having control over the right to use that asset. Such contracts (or components of such contracts) may be defined as leases under GASB 87 even if the contract does not use the word ‘lease’. One way to conduct a review of potential embedded leases is to analyze your agency’s payments made to outside vendors, and research what the vendor contracts underlying those payments contain.

Step 3: Analyze and Document Key Lease Terms, Evaluate Bond and Other Debt Covenants, Make Necessary Changes to Internal Controls and Processes

Analyze your lease agreements further, **focusing on your largest dollar value leases first.** The Lease Inventory Template contains key elements for the calculation of liabilities, assets, and deferred inflows of resources per GASB 87. Maintaining this information on a per lease basis will be essential to the accurate and complete reporting of leases statewide and for your entity. Note that lease agreements may not contain all the necessary data to comply with the new lease standards, such as fair values and discount rates. **See [105.7 – Statewide Accounting Policy – Leases](#) for further guidance on capitalization thresholds for primary government entities. Also see [OSC GASB 87 Discount Rate Procedural Guidance](#) for more information on how to determine interest rates for leasing arrangements.**

Those entities that are statutorily permitted to issue debt in their own name should examine their bond and other debt covenants to determine how a lease liability will affect the requirements contained therein.

GASB 87 introduces additional considerations around an entity’s internal control structure. In order to ensure accurate and complete reporting of leases, there will be an increased focus on internal controls related to identification of leasing transactions, ongoing maintenance of leasing information, and robust management review of leasing information for financial reporting at an agency level.

FAQ and Glossary of Useful Terminology*

*Note: The [Implementation Guide 2019-3, Leases](#) contains further examples, illustrations, and clarification on terminology.

Why is New Leasing Guidance Necessary?

New guidance is needed because the existing leasing standards have been in effect for decades without being changed or reconsidered. They do not take the definitions of assets and liabilities as defined by the GASB into consideration. Previous standards have been criticized for creating an artificial distinction between capital and operating leases, when the economic impact is the same for the lessee.

Is OSC acquiring a statewide contract for lease software?

No. OSC recommends individual state entities consider procuring lease maintenance software if that entity has a large volume of leases (for example, greater than 15 leases). Due to the ongoing maintenance required in developing amortization schedules for each lease, accounting for lease additions, terminations, and modifications, as well as many other moving parts to the overall lease liability and lease asset calculations, entities with a large volume of leases or very decentralized operations should consider procurement of a lease maintenance software to ensure compliance with GASB 87.

What is a "Lease" under GASB 87?

Entities enter into leasing arrangements within the normal course of business. With the new standard, a lease is defined as a contract that conveys control of the right to use another entity's nonfinancial asset (the underlying asset) as specified in the contract for a period of time in an exchange or exchange-like transaction. Examples of nonfinancial assets include buildings, land, vehicles, and equipment.

What arrangements are NOT subject to GASB 87?

GASB 87 does NOT apply to:

- a.) Leases of intangible assets, biological assets, and inventory (e.g. software subscriptions, animals/plants, and finished goods inventory)
- b.) Service concession arrangements
- c.) Leases in which the underlying asset is financed with conduit debt
- d.) Supply contracts; such contracts convey access to output of assets, not control of right to use asset
- e.) Leases of financial assets reported as investments
- f.) Short term leases, as defined in GASB 87 paragraph 16 (see definition below)
- g.) Contracts that transfer ownership of the underlying asset at the end of the lease term (such contracts are considered financed purchases)

Short-term lease - (outside scope of GASB 87) – a lease that, at the commencement of the lease term, has a maximum possible term under the lease contract of 12 months or less, including any options to extend – regardless of their probability of being exercised. Options to terminate the lease are excluded.

Appendix A

For a lease that is cancellable by either the lessee or the lessor, such as a rolling month-to-month lease or a year-to-year lease, the maximum possible term is the noncancelable period, including any notice periods. For example, if an agency has a year-to-year lease on a machine but must give at least 90-days notice to cancel the lease, the lease term is the 12-month non-cancellable period, PLUS the notice period of 90 days. As such, the total lease term is 15 months and would not be considered a short-term lease. However, in this example, if there is no required notice period, the lease term would be 12 months, and as such a short-term lease is not subject to the requirements of GASB 87. See Questions 4.17-4.20 in the [Implementation Guide 2019-3, Leases](#) for additional examples.

Lease term - the period during which a lessee has a non-cancellable right to use an underlying asset.

Lease-leaseback transaction - an asset is leased by one party (first party) to another party and then leased back to the first party.

Sublease - a lease by a lessee of part or all leased assets to another person but with the original lessee retaining rights or interest under the original lease.

Sale-leaseback transaction – involves the sale of an underlying asset by the owner, and a lease of the property back to the seller.

Fiscal Funding/Cancellation Clause - A government agency may place a fiscal funding clause in a lease, which states that the government agency has the option to break the lease if it does not receive the money to make the lease payment through the appropriation process. The fiscal funding clause provides the government agency with a safety measure that eliminates the risk that it will have to pay high cancellation fees.

Incremental Borrowing Rate – The rate that, at the inception of the lease, the lessee would have incurred to borrow over a similar term, the resources necessary to purchase the leased asset.

Present Value - The discounted value of a future amount or amounts of cash, assuming a given rate of interest.

Regulated Lease - Leases that are subject to external laws, regulations, or legal rulings. For example, the U.S. Department of Transportation and the Federal Aviation Administration regulate aviation leases between airports and air carriers and other aeronautical users.

Appendix B: OSC Decision Guide for Lease Identification

Note: This decision chart does not replace reading GASB 87 and related implementation guidance. This chart is meant as a non-authoritative guide for the most common decisions to be made when identifying whether a contract contains a lease. Links to GASB 87 and related implementation guidance are provided below.

Instructions: For each contract that is currently reported as an operating or capital lease, OR for any contract that may contain a leasing component, go through this Decision Guide to verify whether you have a lease that needs to be reported under GASB 87.

1a. Is there a contract in existence for a specified period of time with another entity?

***Note:** Answer "no" if this is a lease between agencies or departments of the State (e.g. between DPS and DOT).

(GASB 87, para. 4)

YES (Go to Question 1b.)

NO (This contract does not contain a lease.)

1b. Is there an identified non-financial asset?

(GASB 87, para. 7)

YES (Go to Question 1c.)

NO (This contract does not contain a lease.)

1c. Does the contract meet any of the exclusions for GASB 87?

(See Chart Below)

GASB 87 does NOT apply to:

- a.) Leases of intangible assets, biological assets, and inventory [GASB 87, para. 8] (e.g. software subscriptions, animals/plants, and finished goods inventory)
- b.) Service concession arrangements [GASB 87, para. 8]
- c.) Leases in which the underlying asset is financed with conduit debt [GASB 87, para. 8]
- d.) Supply contracts; such contracts convey access to output of assets, not control of the right to use the asset [GASB 87, para. 8]
- e.) Leases of financial assets reported as investments [GASB 87, para. 41]
- f.) Short term leases, as defined in GASB 87 paragraph 16 (See Links Below)
- g.) Contracts that transfer ownership at the end of the lease term [GASB 87, para. 19] (such contracts are considered financed purchases)

YES (This contract does not contain a GASB 87 lease.)

NO (Go to Question 1d.)

Appendix B

1d. Does the contract specify that equal or near-equal value is exchanged for the user's right to use the asset?

(GASB 87, para. 4)

_____ (Go to Question 2a.)
YES

_____ (This contract does not contain a lease.)
NO

2a. Does the user of the asset have the right to obtain the present service capacity from use of the underlying asset throughout the period of use?

(GASB 87, para. 5)

_____ (Go to Question 2b.)
YES

_____ (This contract does not contain a lease.)
NO

2b. Does the user have the right to determine the nature and manner of use of the underlying asset as specified in the contract?

(GASB 87, para. 5)

_____ *Primary Government Agencies: This contract may contain a lease. Go to Question 3.*
YES *Component Units: This contract contains a lease if it meets your entity's capitalization threshold for leases.*

_____ (This contract does not contain a lease.)
NO

3. *Primary Government Agencies Only* - Does this lease arrangement meet the capitalization threshold set forth in OSC Statewide Accounting Policy 105.7, Leases?

[OSC Statewide Accounting Policy 105.7](#)

_____ *This contract contains a lease.*
YES *Must report for statewide accounting and reporting purposes.*

_____ *Immaterial for reporting purposes. Expense payments as they are made.*
NO

Helpful Links:

[Implementation Guide 2019-3. Leases](#)

[GASB 87](#)

Appendix C:
How to Determine Your Lease Term - Examples

Example 1

Fact Pattern: A 5-year lease, and the lessee is able to cancel the lease after 4 years.

	Lessee		Lessor		Lease Term (Noncancelable Period)
	Terminate	Extend	Terminate	Extend	
Certainty Level of Being Exercised (Uncertain or Reasonably Certain)	<i>Uncertain</i>	<i>na</i>	<i>na</i>	<i>na</i>	5 years
	<i>Reasonably Certain</i>	<i>na</i>	<i>na</i>	<i>na</i>	4 years

Example 2

Fact Pattern: A 5-year lease, and the lessee is able to extend the lease 3 more years after Year 4.

	Lessee		Lessor		Lease Term (Noncancelable Period)
	Terminate	Extend	Terminate	Extend	
Certainty Level of Being Exercised (Uncertain or Reasonably Certain)	<i>na</i>	<i>Uncertain</i>	<i>na</i>	<i>na</i>	5 years
	<i>na</i>	<i>Reasonably Certain</i>	<i>na</i>	<i>na</i>	7 years

Example 3

Fact Pattern: A 5-year lease. Lessee is able to extend the lease to 6 years, Lessor is able to cancel after 4 years.

	Lessee		Lessor		Lease Term (Noncancelable Period)
	Terminate	Extend	Terminate	Extend	
Certainty Level of Being Exercised (Uncertain or Reasonably Certain)	<i>na</i>	<i>Uncertain</i>	<i>Uncertain</i>	<i>na</i>	5 years
	<i>na</i>	<i>Reasonably Certain</i>	<i>Reasonably Certain</i>	<i>na</i>	4 years
	<i>na</i>	<i>Uncertain</i>	<i>Reasonably Certain</i>	<i>na</i>	4 years
	<i>na</i>	<i>Reasonably Certain</i>	<i>Uncertain</i>	<i>na</i>	6 years

Example 4

Fact Pattern: A 5-year lease. Both the Lessee and the Lessor can cancel after 4 years without permission from the other party.

	Lessee		Lessor		Lease Term (Noncancelable Period)
	Terminate	Extend	Terminate	Extend	
Certainty Level of Being Exercised (Uncertain or Reasonably Certain)	<i>Uncertain</i>	<i>na</i>	<i>Uncertain</i>	<i>na</i>	4 years
	<i>Reasonably Certain</i>	<i>na</i>	<i>Reasonably Certain</i>	<i>na</i>	4 years
	<i>Uncertain</i>	<i>na</i>	<i>Reasonably Certain</i>	<i>na</i>	4 years
	<i>Reasonably Certain</i>	<i>na</i>	<i>Uncertain</i>	<i>na</i>	4 years

*Note - the entire lease is cancelable after 4 years by either party. As such, the noncancelable period is 4 years, not 5.

Appendix C

Example 5

Fact Pattern: A 6-month lease. Option to extend for an additional 6 months, and the lessee or lessor can cancel after 6 months.

	Lessee		Lessor		Lease Term (Noncancelable Period)
	Terminate	Extend	Terminate	Extend	
Certainty Level of Being Exercised (Uncertain or Reasonably Certain)	<i>Not applicable - this is a short term lease with a maximum possible term of 12 months or less, including any options to extend or terminate, regardless of whether either party is reasonably certain they will extend.</i>				

Example 6 ****NEW Example Added, July 2020****

Fact Pattern: A 6-month lease. Lessee option to extend for additional 7 months.

	Lessee		Lessor		Lease Term (Noncancelable Period)
	Terminate	Extend	Terminate	Extend	
Certainty Level of Being Exercised (Uncertain or Reasonably Certain)	<i>na</i>	<i>Reasonably Certain</i>	<i>na</i>	<i>na</i>	13 months*
	<i>na</i>	<i>Uncertain</i>	<i>na</i>	<i>na</i>	6 months*

***Note: This example does NOT meet the short term lease exception requirement.** This is because the short term exception includes any options to extend, regardless of how reasonably certain the lessee is to exercise the option.

NC Office of the State Controller - APPENDIX D, Part 1
New Accounts Added to Implement GASB Statement 87, Leases
 Effective for fiscal year 2022

	New NCAS Account #	Full Account Title Account Classification Definition	NCAS Account Title (25 Char) Financial Statement Caption DSS Financial Statement Rollup
1	115300	Lease Receivable Receivable (Current Asset) Definition: This account represents the present value of lease payments expected to be received within one year of the balance sheet date by a lessor in a leasing arrangement, reduced by any provision for estimated uncollectible amounts. This account is for use by governmental and proprietary lessors, including component units of the State.	LEASE RECEIVABLE rolls to new caption "Lease Receivable" in the Assets section on the balance sheet (11G/11P).
2	125300	Lease Receivable-Noncurrent Receivable (Noncurrent Asset) Definition: This account represents the present value of lease payments expected to be received at least one year or more subsequent to the balance sheet date by a lessor in a leasing arrangement, reduced by any provision for estimated uncollectible amounts. This account is for use by proprietary lessors, including component units of the State.	LEASE RECEIVABLE-NONCURRE rolls to new caption "Lease Receivable, Noncurrent" in the Noncurrent Assets section of the classified balance sheet for proprietary funds (DSS 11P).
3	127001	Right to Use Lease Asset - Land and Permanent Easements Capital Assets Definition: This account represents the value of the intangible Right to Use lease asset for leased land and permanent easements accounted for under GASB Statement 87, Leases. The value in this account should include all capitalizable costs applicable under GASB Statement 87, Leases. See OSC Statewide Accounting Policy 105.7 and the GASB 87 Financial Reporting Update for further details.	RTU-LAND rolls to new caption under "Capital Assets" on the DSS 11P/11G.
4	127101	Right to Use Lease Asset - Buildings Capital Assets Definition: This account represents the value of the intangible Right to Use lease asset for leased permanent structures accounted for under GASB Statement 87, Leases. The value in this account should include all capitalizable costs applicable under GASB Statement 87, Leases. See OSC Statewide Accounting Policy 105.7 and the GASB 87 Financial Reporting Update for further details.	RTU-BUILDINGS rolls to new caption under "Capital Assets" on the DSS 11P/11G.

NC Office of the State Controller - APPENDIX D, Part 1
New Accounts Added to Implement GASB Statement 87, Leases
 Effective for fiscal year 2022

	New NCAS Account #	Full Account Title Account Classification Definition	NCAS Account Title (25 Char) Financial Statement Caption DSS Financial Statement Rollup
5	127350	Right to Use Lease Asset - Machinery & Equipment Capital Assets Definition: This account represents the value of the intangible Right to Use lease asset for leased machinery and equipment accounted for under GASB Statement 87, Leases. This account includes leases for furniture, general equipment, motor vehicles, and motorized equipment. The value in this account should include all capitalizable costs applicable under GASB Statement 87, Leases. See OSC Statewide Accounting Policy 105.7 and the GASB 87 Financial Reporting Update for further details.	RTU-MACHINERY & EQUIPMENT rolls to new caption under "Capital Assets" on the DSS 11P/11G.
6	127295	Right to Use Lease Asset - General Infrastructure Capital Assets Definition: This account represents the value of the intangible Right to Use lease asset for leased general infrastructure accounted for under GASB Statement 87, Leases. The value in this account should include all capitalizable costs applicable under GASB Statement 87, Leases. See OSC Statewide Accounting Policy 105.7 and the GASB 87 Financial Reporting Update for further details.	RTU-GENL INFRASTRUCTURE rolls to new caption under "Capital Assets" on the DSS 11P/11G.
7	127970	Accumulated Amortization - Right to Use Land Capital Assets, Depreciable	ACCUM AMORT-LAND rolls to new caption under "Accumulated Depreciation" within the Depreciable Capital Assets parent category on DSS 11P/11G.
8	127971	Accumulated Amortization - Right to Use Buildings Capital Assets, Depreciable	ACCUM AMORT-BUILDINGS rolls to new caption under "Accumulated Depreciation" within the Depreciable Capital Assets parent category on DSS 11P/11G.
9	127972	Accumulated Amortization - Right to Use Machinery & Equipment Capital Assets, Depreciable	ACCUM AMORT-MACH & EQUIP rolls to new caption under "Accumulated Depreciation" within the Depreciable Capital Assets parent category on DSS 11P/11G.
10	127973	Accumulated Amortization - Right to Use General Infrastructure Capital Assets, Depreciable	ACCUM AMORT-GENL INFRASTR rolls to new caption under "Accumulated Depreciation" within the Depreciable Capital Assets parent category on DSS 11P/11G.

NC Office of the State Controller - APPENDIX D, Part 1
New Accounts Added to Implement GASB Statement 87, Leases
Effective for fiscal year 2022

	New NCAS Account #	Full Account Title Account Classification Definition	NCAS Account Title (25 Char) Financial Statement Caption DSS Financial Statement Rollup
11	229208	Deferred Inflows of Resources for Lease Agreements Deferred Inflows of Resources Definition: For deferred inflows of resources defined by GASB Statement 87, Leases. Amounts reported in this account are amortized over the lease term. This account is for use by governmental and proprietary lessors, including component units of the State.	DEF INFLOWS LEASE AGMTS rolls to new caption under "Deferred Inflows of Resources" on the DSS 11P/11G.
12	437128	Lease Interest Revenue Nonoperating Misc. Revenue (11P) / Misc. Revenue (11G) Definition: This account represents interest revenue related to leases accounted for under GASB 87, Leases. This account is for use by governmental and proprietary lessors, including component units of the State.	LEASE INTEREST rolls to new caption under "nonoperating revenues" on the DSS 53P and "miscellaneous revenue" on the DSS 52G
13	534140	Right to Use - Land and Permanent Easements Property, Plant & Equipment Expense/Expenditure Definition: This account represents capitalizable costs during the fiscal year related to lease agreements for land and permanent easements accounted for under GASB Statement 87, Leases. This account is for use by governmental and proprietary funds, including component units of the State of North Carolina. These costs must be capitalized as part of the 127001 Right to Use Lease Asset at year end.	RTU-LAND AND PERM EASE rolls to new caption under 'Supplies and Materials' on the DSS 53P and "Capital Outlay" on the DSS 52G. *This 534XXX account for proprietary funds should be zero at year end*
14	534240	Right to Use - Buildings Property, Plant & Equipment Expense/Expenditure Definition: This account represents capitalizable costs during the fiscal year related to lease agreements for permanent structures accounted for under GASB Statement 87, Leases. This account is for use by governmental and proprietary funds, including component units of the State of North Carolina. These costs must be capitalized as part of the 127101 Right to Use Lease Asset at year end.	RTU-BUILDINGS rolls to new caption under 'Supplies and Materials' on the DSS 53P and "Capital Outlay" on the DSS 52G. *This 534XXX account for proprietary funds should be zero at year end*
15	534425	Right to Use - General Infrastructure Property, Plant & Equipment Expense/Expenditure Definition: This account represents capitalizable costs during the fiscal year related to lease agreements for general infrastructure accounted for under GASB Statement 87, Leases. This account is for use by governmental and proprietary funds, including component units of the State of North Carolina. These costs must be capitalized as part of the 127295 Right to Use Lease Asset at year end.	RTU-GENL INFRASTRUCTURE rolls to new caption under 'Supplies and Materials' on the DSS 53P and "Capital Outlay" on the DSS 52G. *This 534XXX account for proprietary funds should be zero at year end*
16	534560	Right to Use - Machinery and Equipment Property, Plant & Equipment Expense/Expenditure Definition: This account represents capitalizable costs during the fiscal year related to lease agreements for machinery and equipment accounted for under GASB Statement 87, Leases. This account is for use by governmental and proprietary funds, including component units of the State of North Carolina. These costs must be capitalized as part of the 127350 Right to Use Lease Asset at year end.	RTU-MACH & EQUIP rolls to new caption under "Supplies and Materials" on the DSS 53P and "Capital Outlay" on the DSS 52G. *This 534XXX account for proprietary funds should be zero at year end*

NC Office of the State Controller - APPENDIX D, Part 2
Existing Accounts Modified to Implement GASB Statement 87, Leases
Effective for fiscal year 2022

	OSC Action	NCAS Account #	Old Account Title; Account Classification Old F/S Caption; Old Definition	New NCAS Account Title Acct classification F/S caption; Definition
1	Caption Title Change, Modify Description	214100	Capital Leases Payable Current Liabilities Old F/S Caption: Capital Leases Payable Old Definition: This account is used to record the principal payments related to a capital lease due in the current period.	<u>New Account Title:</u> LEASE LIABILITY <u>Acct. Classification:</u> Current Liabilities <u>F/S Caption:</u> Lease Liability <u>New Definition:</u> This account is used to record the principal payments related to a lease due in the current period.
2	Caption Title Change, Modify Description	224100	Capital Leases Payable Noncurrent Liabilities Old F/S Caption: Capital Leases Old Definition: This account is used to record the principal payments related to a capital lease due at a future date at least one year or more subsequent to the balance sheet date.	<u>New Account Title:</u> LEASE LIABILITY-NONCURREN <u>Acct. Classification:</u> Noncurrent Liabilities <u>F/S Caption:</u> Lease Liability <u>New Definition:</u> This account is used to record the principal payments related to a lease due at a future date at least one year or more subsequent to the balance sheet date. This is the value of the lease liability as calculated per GASB Statement 87 requirements, and is reduced by the current portion each year.
3	Caption Title Change.	437213	Proceeds - Capital Leases Other Financing Source Old F/S Caption: Other Debt Issued Old Definition: none.	<u>New Account Title:</u> PROCEEDS-LEASES <u>Acct. Classification:</u> Other Financing Source <u>F/S Caption:</u> Other Debt Issued <u>New Definition:</u> For use by governmental funds only.
4	Caption Title Change.	535313	Capital Lease Principal Payments Other Expenses & Adjustments Old F/S Caption: Principal Retirement Old Definition: none	<u>New Account Title:</u> LEASE PRINCIPAL PAYMENTS <u>Acct. Classification:</u> Other Expenses & Adjustments <u>New F/S Caption:</u> Principal Retirement <u>New Definition:</u> none
5	Caption Title Change.	535323	Capital Lease Interest Other Expenses & Adjustments Old F/S Caption: Interest and Fees (52G) or Debt Interest (53P) Old Definition: none	<u>New Account Title:</u> LEASE INTEREST PAYMENTS <u>Acct. Classification:</u> Other Expenses & Adjustments <u>New F/S Caption:</u> Interest and Fees (52G) or Debt Interest (53P) <u>New Definition:</u> none