

GASB Statement 87

Leases

(Implementation Guide)

INTRODUCTION

1. The objective of this Implementation Guide is to provide guidance that clarifies, explains, or elaborates on the requirements of Statement No. 87, *Leases*.

IMPLEMENTATION GUIDANCE

Applicability of This Implementation Guide

2. The requirements of this Implementation Guide apply to the financial statements of all state and local governments.

3. Paragraphs C2 and C4 of this Implementation Guide include provisions to remove from the *Codification of Governmental Accounting and Financial Reporting Standards* and from the *Comprehensive Implementation Guide*, respectively, the transition-related questions and answers in this Implementation Guide at the conclusion of the transition period for this Implementation Guide.

New Questions and Answers

4. Questions and answers in this paragraph address issues related to accounting and financial reporting for leases in accordance with the requirements of Statement 87.

Scope and Applicability of Statement 87

4.1. Q—A government obtains the right to use land, which has a market rent of \$100,000 per year, for \$1 per year. Should the government apply the requirements in Statement 87 to that transaction?

A—No. The definition of a lease in paragraph 4 of Statement 87 specifies that the Statement should be applied only to exchange or exchange-like transactions. Paragraph 1 of Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*, classifies all transactions of state and local governments into two categories: (a) exchange and exchange-like and (b) nonexchange. The government's right to use land for \$1 does not meet the description of an exchange or exchange-like transaction because each party does not receive or give up essentially equal value or not quite equal value.

4.2. Q—A government enters into a multiyear agreement for the right to use a facility. The government has exclusive use of the facility three days a week. Other parties use the facility on the other days. To meet the definition of a lease, is the government required to have uninterrupted control of the right to use the facility?

A—No. In determining whether a contract conveys control of the right to use an underlying asset, a government should assess whether it has (a) the right to obtain the present service capacity from use of the underlying asset and (b) the right to determine the nature and manner of use of the underlying asset "as specified in the contract" (paragraph 5 of Statement 87). If the contract specifies that the government has control of those rights during three days of each week, the control criterion is met. The provision in the lease definition that the contract be for a period of time does not require uninterrupted control of the right to use the facility.

4.3. Q—A government enters into a five-year agreement that provides another entity with the right to use the government's land. The other entity plans to use the land for hunting and is the

only party that is allowed to access and use the land during hunting season each year for the term of the agreement. Is the hunting rights agreement a lease?

A—Yes. Because the lessee is the only party allowed to access and use the land during the hunting season each year during the term of the five-year agreement, the contract conveys control of the right to use the underlying asset (the land). The provision in the lease definition that the contract be for a period of time does not require uninterrupted control of the right to use the underlying asset.

- 4.4. Q—A government enters into an agreement that allows a rancher to use the government's land for grazing. The agreement states that the rancher is required to allow access to the land for compatible public recreation activities. In addition, the agreement states that the government can construct roads and buildings, or otherwise alter the land, without permission from the rancher. Does the grazing rights agreement meet the definition of a lease?

A—No. The agreement does not convey the right to determine the nature and manner of use of the underlying asset because the rancher cannot prevent others from accessing, using, or altering the land. (See also Questions 4.3 and 4.11.)

- 4.5. Q—Do easements meet the definition of a lease?

A—An easement provides the right to use a tangible asset, for example, land. Some easements meet the definition of a lease, while other easements do not. Paragraph 4 of Statement 87 states that, among other things, a lease is "for a period of time in an exchange or exchange-like transaction" (footnote reference omitted). Permanent easements, which last indefinitely without cancellation options, do not meet the period-of-time criterion. In addition, easements obtained for an amount that does not meet the description of exchange or exchange-like transactions in Statement 33, as amended, do not meet the exchange or exchange-like criterion.

- 4.6. Q—To obtain access to additional power during the warmest months of the year, a government enters into a contract with a private party wherein the government has control of a portion of a power plant, specifically, a steam turbine, from March through October for three years. The government obtains exclusive rights to the present service capacity and to determine the nature and manner of use of the steam turbine. The government makes fixed payments and variable payments that are based on actual usage and output. Does this contract include a lease?

A—Yes. This contract conveys control of the right to use the underlying asset (a steam turbine) as specified in the contract for a period of time in addition to the right to the output generated by the underlying asset. The contract pertains to the control of the steam turbine and meets the definition of a lease in paragraph 4 of Statement 87. The lease includes fixed payments and variable payments based on actual usage and output.

- 4.7. Q—A government enters into a contract with a private party wherein the private party will design and build a solar farm based on the government's specifications. The solar farm will be located on the government's property, but title to the solar equipment will be retained by the private party, who will determine the nature and manner of its use. The contract requires the government to purchase all of the power generated from the solar farm and make payments based solely on the amount of power generated. The contract also requires the

private party to dismantle and remove the solar farm at the end of the contract. Does this contract result in a lease of solar equipment?

A—No. To meet the definition of a lease, a contract is required to convey control of the right to use the underlying asset. Paragraph 5 of Statement 87 provides two criteria that should be present for a contract to convey control. In this example, the government has the right to obtain the present service capacity from the solar farm but does not have the right to determine the nature and manner of use. Therefore, the component of the contract that provides the government with the right to all of the power generated by the solar farm does not convey control and does not meet the definition of a lease. However, the component of the contract that allows the private party to use the government's property may be a lease. (See also Question 4.8 regarding equipment placed on government property and Question 4.30 regarding the removal of assets.)

4.8. Q—Are cell phone tower or antenna placement agreements leases?

A—If the agreements meet the definition of a lease in paragraph 4 of Statement 87, including the control criterion, then such agreements are leases. The control criterion generally is met if a cell phone tower or antenna placement agreement conveys control of the right to use the land on which the tower is placed or the connection point to which the antenna is affixed.

4.9. Q—A contract allows the vendor to replace the underlying asset with an essentially identical asset. Does that substantive right of substitution affect the evaluation of whether the contract conveys control of the right to use the asset?

A—No. A lease conveys control of the *right to use* another entity's asset. That right is distinct from the underlying asset. That is, the right-to-use asset relates to the *service capacity* associated with an underlying asset, rather than the underlying asset itself. Substitution with an essentially identical asset allows the lessee to maintain control of the right to use the service capacity of another entity's underlying asset and is consistent with the definition of a lease in paragraph 4 of Statement 87.

4.10. Q—A government enters into a lease agreement that conveys control of the right to use a parcel of land to a company that engages in oil and gas exploration and production. Is this lease excluded from Statement 87?

A—No. In this example, the company has control of the right to use the land itself. In contrast, if the government only provided the company with the right to explore for or to exploit oil and gas but did not convey control of the right to use the land, that lease would be excluded from Statement 87. Although paragraph 8a of Statement 87 excludes "rights to explore for or to exploit natural resources such as oil, gas, and minerals," that exclusion applies only when the underlying asset in the lease is the right to explore for or to exploit those resources.

4.11. Q—A government owns land that it leases to another entity for use as cropland. Is this lease excluded from Statement 87 as a lease of biological assets?

A—No. Leases of biological assets are excluded from the requirements of Statement 87 by paragraph 8b. Although the use of land for farming may produce biological assets, the underlying asset of the lease is the land, which is not a biological asset. Therefore, this lease would not be excluded from the scope of Statement 87.

Lease Term

4.12. Q—A developer builds and leases a building to a government. The government is required to make payments during the three-year construction period. The government does not have

access to the building until a certificate of occupancy is issued at the end of the construction period. When does the lease term begin?

A—The lease term begins when the certificate of occupancy is issued because that is when the government gains access to the building. Paragraph 12 of Statement 87 states that the lease term commences when the lessee has a noncancellable right to use the underlying asset. Paragraph 5 of Statement 87 further explains that control of the right to use the underlying asset is the right to obtain the present service capacity from its use and the right to determine the nature and manner of its use. Thus, the lease term commences when the lessee gains physical possession of the asset or attains access to use the underlying asset. (See also Question 4.32.)

- 4.13. Q—A lease contract has a noncancellable period of five years and specifies that at the end of the five years, both the lessor and lessee have the right to cancel the lease or may continue the lease, using the same terms on a month-to-month basis. Is the month-to-month holdover period included in the initial assessment of the lease term?

A—No. During the holdover period, the lessee has not contracted for a noncancellable right to use an underlying asset, and the lessor is not required to continue providing the asset. That is, the holdover period is cancellable by either party and, therefore, is excluded from the lease term, as defined in paragraph 12 of Statement 87.

- 4.14. Q—How does a bargain renewal option, such as a 20-year lease at a market rate with a lessee option to renew the lease for an additional 5 years at a 30 percent discount, affect the lessee's initial assessment of the lease term?

A—Paragraph 14 of Statement 87 requires that, at the commencement of the lease term, a government assess all factors relevant to the likelihood that the lessee or the lessor will exercise lease extension or termination options identified in paragraphs 12a–12d of that Statement. Relevant factors include significant economic incentives and disincentives, such as the cost of exercising the renewal option and the expected condition and maintenance requirements for the underlying asset during the extension period. In this example, if the governmental lessee determines that it is reasonably certain that the option will be exercised, the lease term would be 25 years.

- 4.15. Q—A lease contract allows either party to unilaterally terminate the lease at any time but also provides for cancellation penalties. The cancellation penalties are so great that it is reasonably certain that neither party will terminate the lease. Should the cancellable periods be excluded from the lease term?

A—Yes. Paragraph 12 of Statement 87 requires that periods for which *both* the lessee and the lessor have an option to terminate the lease without permission from the other party be excluded from the lease term as cancellable periods. The presence of cancellation penalties does not affect that conclusion. Even if, as in this example, both parties are reasonably certain that the lease will not be terminated, the cancellable periods should be excluded from the lease term.

- 4.16. Q—A lease contract allows only the lessee to unilaterally terminate the lease at any time but also provides for cancellation penalties. The cancellation penalties are so great that it is reasonably certain that the lessee will not terminate the lease. Should the cancellable periods be excluded from the lease term?

A—No. Paragraph 12 of Statement 87 requires that periods covered by *either* a lessee or a lessor option to terminate the lease be included in the lease term if it is reasonably certain, based on all relevant factors, that the lessee or lessor will not exercise the option. In

determining whether it is reasonably certain that the lessee will not exercise the option to terminate the lease, the lessee (or in the case in which the government is the lessor—the lessor) should assess all factors relevant to the likelihood that the lessee will not exercise the option. Those factors include significant economic disincentives, such as cancellation penalties, as discussed in paragraph 14 of Statement 87. (See also Question 4.29.)

Short-Term Leases

- 4.17. Q—A government enters into a 12-month noncancellable lease in which the lessee has options to renew for 12 months at a time, up to 49 times. Is this agreement a short-term lease under Statement 87?

A—No. According to paragraph 16 of Statement 87, the maximum possible term of a short-term lease is required to be 12 months or less, including any options to extend. The presence of lessee renewal options, regardless of their probability of being exercised, means this lease does not meet the definition of a short-term lease.

- 4.18. Q—A government enters into a lease with a 6-month noncancellable period and an option to extend for another 12 months after the noncancellable period. The government is not reasonably certain that it will exercise the option to extend and, therefore, assesses the lease term as six months. Is this agreement a short-term lease under Statement 87?

A—No. Paragraph 16 of Statement 87 states that a short-term lease “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.” Therefore, the lessee should report a lease liability and a lease asset; however, the lease term would be only six months.

- 4.19. Q—A city enters into a lease with a lessor for 16 months. The city can cancel the lease at any time after six months. The lessor does not have the option to cancel the lease. For purposes of determining whether this lease is a short-term lease, what is the maximum possible term of this lease?

A—The maximum possible term is 16 months. Paragraph 16 of Statement 87 states that for a lease that is cancellable by “either the lessee or the lessor,” the maximum possible term is the noncancellable period. The intent of the provision is that the lessee and the lessor *both* have a right to cancel. Paragraph 12 of Statement 87 defines cancellable periods as periods for which both the lessee and the lessor have an option to terminate the lease without permission from the other party. Because only the lessee has the right to cancel in this scenario, the maximum possible term would be the 16 months that the lease could last and, therefore, it is not a short-term lease.

- 4.20. Q—A government signs a contract for a lease beginning January 1, 20X2, and ending December 31, 20X2. During the negotiations of that contract, a second contract with the same counterparty for a lease of the same asset also was being negotiated. Near the same time that the first contract was signed, the government signs the second contract with a term beginning January 1, 20X3, and ending December 31, 20X3. The amount of consideration in each contract is independent of the other contract. Can the government account for both contracts as short-term leases?

A—Although each contract individually would meet the definition of a short-term lease, the government should consider the requirements for contract combinations in paragraphs 69 and 70 of Statement 87. If those contracts were negotiated as a package with a single objective (the intent was to lease the asset for two years, even though the structure is two single-year lease contracts), then those contracts would be considered part of the same contract (a two-year lease) and would not be a short-term lease.

Contracts That Transfer Ownership

- 4.21. Q—A vendor installs equipment in a government's building to increase energy efficiency. The government will own the equipment at the end of the agreement, and the contract does not contain a termination option. For financial reporting purposes, should this transaction be reported as a lease or a financed purchase?

A—This transaction should be reported as a financed purchase. If title to the equipment transfers to the lessee by the end of the contract, the transaction is not accounted for as a lease for financial reporting purposes. Rather, the transaction is a financed purchase, as discussed in paragraph 19 of Statement 87.

- 4.22. Q—A school district leases computers. At the end of the lease term, students are given the option to purchase their computers from the school district. Regardless of whether the students purchase their computers, the school district is required to purchase all computers from the lessor. The school district does not have a termination option. Should this arrangement be reported as a lease or a financed purchase of the computers by the school district?

A—This arrangement should be reported as a financed purchase. Paragraph 19 of Statement 87 states that one criterion of a financed purchase is that the contract transfers ownership of the underlying asset to the lessee by the end of the contract. In this example, the lessee is the school district, not the students. The contract transfers ownership of the computers because the purchase by the school district is required. The sale of computers to the students is a separate transaction.

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

Lease Liability

- 4.23. Q—A government adopts a capitalization threshold and expenses acquisitions, including lease assets, that fall below that threshold. Can the government apply a similar threshold to lease liabilities?

A—Lease liabilities that are significant, either individually or in the aggregate, should be recognized. Authoritative pronouncements do not provide specific guidance related to a determination of capitalization threshold amounts. However, governments often establish capitalization thresholds. (See Question 7.9.8 of *Implementation Guide No. 2015-1*.) When applying a capitalization threshold to leases, lessees should consider the quantitative and qualitative significance of the lease liability, in addition to the significance of the lease asset in accordance with the guidance provided in Question 7.4.1 of *Implementation Guide 2015-1*, as amended.

- 4.24. Q—A government enters into a lease with another government that includes an optional extension period of three years, exercisable only by the lessee. The payment amounts for the optional period will be negotiated at the time the option is exercised. The lessee has an ongoing relationship with the lessor and is reasonably certain that it will exercise its option to extend. Therefore, the optional renewal period is included in the lease term in accordance with paragraph 12a of Statement 87. How should the lessee measure the lease liability if the payment amount for the optional period is not specified in the contract?

A—Paragraph 12a of Statement 87 requires that periods covered by a lessee option to extend the lease be included in the lease term if it is reasonably certain, based on all relevant

factors, that the lessee will exercise that option. Payments for that optional period should be included in the lease liability, even if the amount is estimated. In many cases, a government will not be reasonably certain of renewal without having an estimate of the payment amount or range of amounts. In this example, the payments may be estimated based on the lessee and lessor's ongoing relationship and professional judgment, maximizing the use of observable information. For example, if appropriate, the estimate may be based on the last known payment amount.

- 4.25. Q—A lease contract for copy machines requires that a minimum amount be paid for toner and paper regardless of whether these supplies are obtained. Should some portion of the minimum amount to be paid for supplies be included in the measurement of the lease liability?

A—As discussed in paragraphs 66 and 67 of Statement 87, if the amount that the lessee is required to pay for supplies does not appear to be unreasonable, regardless of whether supplies are obtained, the government should account for the supplies separately from the lease and therefore not include that amount in the measurement of the lease liability. If the amount appears to be unreasonable, professional judgment may be needed to determine whether some or all of the minimum amount is, in substance, a fixed lease payment that should be included in the measurement of the lease liability under paragraph 21c of Statement 87.

- 4.26. Q—Lease payments for a five-year lease are indexed to the Consumer Price Index (CPI). The lease payments for the first year are \$5,000 per month, which is the market rate based on the current CPI, and payments for subsequent years will increase or decrease based on the change in the CPI during the preceding year. The CPI at the commencement of the lease is 251. How should the initial lease liability be calculated?

A—Paragraph 21b of Statement 87 requires that variable payments that depend on an index or a rate initially be measured using the index or rate as of the commencement of the lease term. If lease payments are indexed to the CPI, the payments to be included in the initial measurement of the lease liability should be based on the CPI at the commencement of the lease. If the CPI is 251 at the commencement of the lease, a government would assume it will stay at 251 throughout the lease, which would result in consistent lease payments for initial measurement of the lease liability because the subsequent years' payments are based on the change in the CPI. Therefore, the lease liability should be measured at the present value of \$5,000 per month for 60 months. Any variation from \$5,000 paid in future periods will be recognized as outflows or reductions of outflows of those periods. (See Illustration B3 in nonauthoritative Appendix B.)

- 4.27. Q—A government enters into two leases. The first lease requires monthly lease payments based on a fixed percentage of sales or \$10,000, whichever is more. The second lease includes a choice to pay either (a) a fixed monthly payment of \$30,000 or (b) \$100 per hour of equipment use with a monthly minimum payment of \$10,000. The choice is made by the lessee at the beginning of each month. Which payment amounts from the two leases should be included in the lease liability?

A—The minimum payment of \$10,000 should be included for both leases. Paragraph 21c of Statement 87 requires that the lease liability include "variable payments that are fixed in substance." For both leases, the minimum amount that is required to be paid (\$10,000) is fixed in substance and therefore should be included in the lease liability.

- 4.28. Q—A school district leases buses for two years and is required to make variable payments based on the number of miles driven. There is no minimum payment requirement stated in the lease agreement. The school district is reasonably certain of the minimum number of miles that will be driven based on established routes. Paragraph 21h of Statement 87

requires that a lease liability include "any other payments that are reasonably certain of being required based on an assessment of all relevant factors." Should the lease liability include the reasonably certain variable lease payments?

A—No. Paragraph 22 of Statement 87 requires that variable payments based on future performance of the lessee or usage of the underlying asset not be included in the measurement of the lease liability. Because those payments are covered in paragraph 22, they should not be included in the measurement of the lease liability in accordance with paragraph 21h, even if they are reasonably certain of being required. Rather, those variable payments should be recognized as outflows of resources in the period(s) in which the obligation for those payments is incurred. (See also Question 4.39.)

- 4.29. Q—Paragraph 21f of Statement 87 states that measurement of the lease liability should include "payments for penalties for terminating the lease, if the lease term reflects the lessee exercising (1) an option to terminate the lease or (2) a fiscal funding or cancellation clause." Does *term* refer to a provision of the contract or does it refer to the lease term as defined in paragraphs 12–15 of Statement 87?

A—In paragraph 21f of Statement 87, *term* refers to the lease term as defined in paragraphs 12–15 of that Statement. If the lease term was calculated to reflect the lessee terminating the lease, whether through a termination option or a fiscal funding or cancellation clause, the measurement of the lease liability should include all penalties that are expected to be incurred.

- 4.30. Q—A lessee installs physical assets on leased land and is required by the lease contract to remove those assets and restore the land to pre-lease condition at the end of the lease. Should the lessee include the obligation to remove the assets in the lease liability or should the lessee report an asset retirement obligation (ARO) under Statement No. 83, *Certain Asset Retirement Obligations*?

A—If the lessee is directly responsible for the restoration work, the lessee should report an ARO in accordance with Statement 83, separate from the lease liability. Paragraph 21h of Statement 87 requires that the lease liability include any other payments that are reasonably certain of being required based on an assessment of all relevant factors. However, that requirement does not include payments that are reasonably certain of being required from the lessee to parties other than the lessor, nor does it include payments that are not in exchange for the right to use the underlying asset.

- 4.31. Q—A government leases a fleet of vehicles for half of the vehicles' estimated useful lives. The lease term is 30 months. The lease does not specify the discount rate. Total monthly lease payments over the term of the lease are \$1.1 million, and the fair value of the vehicles at the commencement of the lease is \$2 million. May the fair value of the vehicles be used in determining the implicit discount rate of the lease?

A—Yes. Discounting the lease payments at the rate the lessor charges the lessee, explicitly or implicitly, arrives at the fair value of the right to use the vehicles, which is not necessarily equivalent to the fair value of the vehicles. Using the \$2 million fair value of the vehicles at the commencement of the lease to determine the implicit discount rate in a lease may be appropriate if the government has determined that, considering the facts and circumstances of the agreement, the fair value of the vehicles approximates the fair value of the lessee's right to use the vehicles at that time. If those values differ because the lease term is less than the entire useful life of the vehicles, the fair value of the right to use the vehicles for the lease term may be estimated using professional judgment, maximizing the use of observable information. In this example, the government has estimated that the fair value of the right to use the vehicles is \$1 million because the length of the lease term is half of the vehicles' estimated useful lives. The government assumes the fair value of the *right to use the vehicles*

decreases ratably over the lease term because the service capacity of the vehicles remains the same throughout the lease term, even though the fair value of the *vehicles* decreases faster at the beginning of the lease term. Therefore, the interest associated with the lease is \$100,000, and the discount rate is approximately 7.5 percent.

Lease Asset

- 4.32. Q—A government makes payments related to a building lease during a construction period before gaining access to the building. Can payments made during the construction period be reported as a lease asset at the time they are paid?

A—No. Payments made before commencement of the lease term should be reported as prepayments (assets), not as a lease asset. At the commencement of the lease term, the lessee obtains the right to use the underlying asset by either gaining physical possession of the asset or attaining access to use the underlying asset. The lease asset is the right to use the underlying asset rather than the underlying asset itself. The right to use makes the underlying asset a resource to the lessee and provides the lessee with access to the underlying asset's present service capacity. Therefore, at the commencement of the lease term, the prepayments should be reclassified as part of the initial measurement of the lease asset, as provided in paragraph 30b of Statement 87. (See also Question 4.12.)

- 4.33. Q—Can composite or group methods be used to amortize lease assets?

A—Yes. If a government has many similar leases, it may choose to amortize the lease assets as a group rather than individually. Similarly, if a collection of dissimilar leases comprises, for example, a network subsystem, composite amortization may be applied to the lease assets of the subsystem. However, assets should not be grouped in a way that would prevent the government from meeting the requirements in paragraph 37 of Statement 87. (See also Questions 7.15.3 and 7.15.4 in Implementation Guide 2015-1.)

- 4.34. Q—A government leases land and amortizes the lease asset because it is not reasonably certain that it will purchase the land. If the government subsequently becomes reasonably certain that it will purchase the land, should the lease asset be remeasured to the amount of the initial measurement before the lease asset was amortized?

A—No. If a lease contract includes a purchase option and the lessee determines that it is reasonably certain of being exercised, paragraph 32 of Statement 87 requires that the lease asset be amortized over the useful life of the underlying asset, unless the underlying asset is nondepreciable. If the government is not reasonably certain at the commencement of the lease that it will purchase the land but later becomes reasonably certain, the government should cease amortizing the lease asset as of the date that the government becomes reasonably certain that it will purchase the underlying asset. (The government should not reclassify the lease asset as land until the purchase occurs.) However, the lessee should determine whether exercising the purchase option is expected to significantly affect the amount of the lease liability. A lease asset generally should be adjusted by the same amount as the corresponding lease liability when that liability is remeasured based on paragraphs 25–29 of Statement 87. Paragraph 25c of that Statement requires the lessee to remeasure the lease liability when 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.

- 4.35. Q—A government leases equipment and amortizes the lease asset because it is not reasonably certain that it will purchase the equipment. If the government subsequently

becomes reasonably certain that it will purchase the equipment, should the lease asset be remeasured to the amount of the initial measurement before the lease asset was amortized?

A—No. The government should continue to amortize its lease asset—in this case, equipment—once it becomes reasonably certain that it will purchase a depreciable underlying asset. However, the government should amortize the lease asset over the remaining useful life of the underlying asset, if different from the lease term. Additionally, the asset value that is amortized may change if the lease liability is adjusted for the change in likelihood of the purchase option being exercised, as described in the answer to Question 4.34.

- 4.36. Q—At the end of year 9 of a 10-year lease, a flood damages a leased building. Before the flood, the lessee reported a lease asset, net of amortization, of \$275,000, and a lease liability of \$300,000. Because of the damage, the lessor reduces the lessee's remaining payments by \$20,000, and the lessee determines that the remaining service utility of the lease asset is only \$100,000. How should the lessee report the impairment?

A—Paragraph 34 of Statement 87 states that the lease asset should be reduced first for any change in the corresponding lease liability, with any remaining amount of the decrease in the lease asset's service utility being recognized as an impairment. Accordingly, the lessee should reduce the lease liability and lease asset by \$20,000 for the reduction of remaining payments due to the lessor. The lessee also should reduce the lease asset by an additional \$155,000 and record an impairment of \$155,000 to reflect the remaining decrease in service utility of the lease asset. However, if the change in the lease liability had been sufficient to reduce the carrying value of the lease asset to zero, any remaining reduction of the lease liability should be reported as an inflow in the resource flows statement (for example, a gain) as discussed in paragraph 33 of Statement 87.

Notes to Financial Statements—Lessees

- 4.37. Q—Can amortization expense for lease assets be combined with depreciation expense in the required disclosure by function?

A—Yes. Paragraph 117d of Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, requires disclosure of amounts of depreciation expense "charged to each of the functions in the statement of activities." If the lease amortization expense is applicable to multiple functions in the statement of activities, it should be charged to those functions accordingly. Therefore, lease amortization expense by function should be disclosed and may be combined with depreciation expense in the required disclosure by function.

- 4.38. Q—Does a lessee's ability to group lease activities for the purpose of disclosure also apply to disclosures in other paragraphs, such as disclosures of sublease transactions required by paragraph 81 of Statement 87?

A—Yes. The grouping provisions in paragraph 37 of Statement 87 apply to disclosures in which a grouping option is not specifically addressed in other disclosure requirements.

- 4.39. Q—A government makes lease payments based solely on the use of leased equipment. Future payments are variable based on usage of the underlying asset; therefore, the government does not record a lease asset and a lease liability. Is the government required to disclose the lease?

A—Yes. The lessee should apply the lease disclosure requirements in paragraphs 37–39 of Statement 87, as applicable, unless the lease meets the short-term lease exception.