

# GASB In Focus

## Preliminary Views on Leases for State and Local Governments

Leasing is an important activity for many state and local governments.

It can be an attractive financing option for obtaining certain necessary items—including vehicles, heavy equipment, and buildings—without having to actually purchase them.

Leasing also can offer greater flexibility to governments that do not need the assets for their entire useful lives, or to governments that do not wish, at least initially, to take on the burden of ownership. Some governments also lease assets of their own to others.

In order to more closely align the accounting and financial reporting of leases with the economic substance of these transactions, the Governmental Accounting Standards Board (GASB) has developed proposals that are incorporated into a Preliminary Views that was issued for public comment on November 20, 2014.

The Preliminary Views, *Leases*, presents the Board's current thinking on the issues associated with accounting for leases. The proposal is based on the foundational principle that all leases are financings of the right to use an underlying asset.

### Why is the GASB proposing improvements to accounting for leases?

The GASB periodically reexamines its guidance and considers whether that guidance continues to be appropriate given developments in the governmental environment and progress on the GASB's conceptual framework. The Leases project was undertaken at this particular time in part because the current leases standards are based primarily on private sector standards and those standards are currently being reexamined by the Financial Accounting Standards Board (FASB), the GASB's sister standards-setting organization.

### What benefits would the issuance of a final Statement on leases yield?

The Board's proposals in the Preliminary Views, if ultimately reflected in a final Statement, would:

- Provide financial statement users with better information to assess the nature and extent of a government's leasing activities and the impact of those activities on the financial statements
- Provide preparers and auditors with more consistent

and less complex guidance to follow when reporting leases, and

- Bring greater comparability between governments, as there would be a single classification for leases, with an exception for short-term leases (those lasting 12 months or less).

### How do state and local governments currently account for leases?

State and local governments currently classify leases as either capital or operating. Capital leases lead to lessees reporting long-term liabilities for future lease payments and lessors reporting long-term receivables. However, no long-term liabilities are recognized in the financial statements for operating leases, even though many represent long-term commitments by the lessee government to make payments. Likewise, no receivables are recognized when governments are lessors and have long-term rights to receive operating lease payments.

### What are the key issues being addressed?

A major area of consideration in the GASB project on lease accounting relates to the manner

in which leases are reflected in the financial statements to meet essential financial statement user needs.

The project is considering the following issues:

- What specific user needs exist regarding governmental leases and what decision-useful or accountability information is needed to meet those needs
- Whether current accounting and financial reporting standards are appropriate to meet those user needs
- If current standards are not found to be adequate, whether additional potential requirements should be considered
- Whether there should be a distinction between types of leases.

### What are the key provisions of the Preliminary Views?

In the Preliminary Views, the Board proposes a new accounting model for both lessees and lessors that would eliminate the current distinction between operating and capital leases.

Lessee governments would report the following in their financial statements for all leases except short-term leases:

- An intangible asset that represents the government's right to use the leased asset (rather than the leased asset itself)
- A corresponding liability for lease payments

- Amortization expense related to the leased asset (recognizing the asset amount as an expense over the term of the lease), and
- Interest expense related to the lease liability.

Government lessors would report the following in their financial statements for all leases except short-term leases:

- A receivable for the right to receive payments
- A corresponding deferred inflow of resources to reflect resources related to future periods
- Lease revenue (and a corresponding reduction in the deferred inflow) systematically over the term of the lease
- Interest revenue related to the receivable.

### How does this project relate to the FASB's leases project?

As previously noted, the existing GASB guidance on lease accounting is based on FASB guidance issued through November 1989. Because the FASB has an active lease accounting project under way, it made sense for the GASB to look at its existing lease-accounting guidance to consider whether changes are appropriate.

The Board is very much engaged in deliberating lease accounting issues viewed through the governmental lens, but is closely monitoring the FASB's leases project and the approaches the FASB has tentatively agreed upon

to date. The GASB and FASB project teams have been meeting periodically to discuss common project issues and tentative decisions made by the respective Boards.

It is important to note that the GASB and the FASB are independent standards-setting bodies and, therefore, may come to different conclusions. Members of each Board consider their respective environments (public and private sectors), conceptual frameworks, and experiences in developing proposed standards.

### What are the differences between this Preliminary Views and the FASB's proposal on leases?

While both the FASB and the GASB concur that all leases other than short-term leases should now be on the balance sheet of a lessee, they differ on how expenses should be recognized.

Under the guidance proposed by the FASB, some leases would be considered a rental arrangement rather than a financing. For these leases, there would be only one type of expense recognized by a lessee—the lease expense.

Under the GASB's Preliminary Views on lease accounting, and for a portion of leases under the FASB's purview, however, there would be two different expense components for a lessee: (1) an interest component based on the lease liability and (2) an amortization expense component based on the leased asset.

Additionally, the FASB has tentatively decided not to make significant changes to lessor accounting. The GASB has proposed to change lessor accounting so that it generally mirrors the accounting proposed for lessees.

### **How can the public share its views with the GASB?**

The deadline for providing comments to the GASB regarding its proposal on leases is March 6, 2015. Comments can be submitted by email to [director@gasb.org](mailto:director@gasb.org) or by mail

to GASB, 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116. Please refer to Project No. 3-24P.

The GASB also will be conducting public hearings in New York City, Dallas, and Los Angeles in April 2015. Individuals and organizations can participate in person or by telephone. Information about how to notify the GASB of an intention to participate can be found at the front of the Preliminary Views.

The Preliminary Views can be downloaded at [www.gasb.org](http://www.gasb.org).

**For more information about the project, please visit the GASB's website at [www.gasb.org](http://www.gasb.org).**

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