

State of Iowa – Lease Accounting (GASB 87) – FAQ

A. State of Iowa Policy:

1. Q: Where can I find the State of Iowa's **lease policies** for lessee and lessor accounting?

A: The Lease Policy – Lessee & Lease Policy – Lessor are on the DAS website (scroll to the bottom of the page): <https://das.iowa.gov/state-employees/state-accounting/manuals-forms-reference-materials/reference-material>

2. Q: My department entered into a three-year lease for office space in January 2024 and the lease asset and lease liability were reported in the FY2024 GAAP Package based on the information calculated using the GASB 87 – Lease Liability Template for FY2024 provided by the GAAP Team. Where should my department obtain the information for reporting this lease in the FY2025 GAAP package?

A: As a general rule, the department should continue to report information calculated in the FY2024 GASB 87 – Lease Liability Template, **unless there are significant changes that have occurred to the lease**. Examples of changes that *might* be considered significant include amendments to the underlying assets that are being leased, a renegotiation of the lease term, etc.

3. Q: In FY2023, my department entered into a lease contract that had an initial five-year period with two one-year renewal options (a maximum possible term of seven years). When the lease was initially evaluated for reporting in the GAAP package in FY2023, my department determined it was not likely to exercise either of the renewal options. As a result, my department calculated the lease asset and lease liability based on a five-year term in FY2023. On February 1, 2025, my department determined the two one-year renewal options will be exercised. How should I reflect this change to my lease term in the FY2025 GAAP package?

A: Exercising an existing option to extend a lease that had previously not been included in the department's lease term should be handled as a *remeasurement*. First, treat the original lease (both the asset and liability) as an early termination, disposing of the asset, amortization, and liability (principal) as of the date the department made the decision the options would be exercised (February 1, 2025). The GAAP Package worksheets used for reporting the lease assets and liabilities both have early termination sections you must complete.

Second, using the current fiscal year's lease liability calculator and estimated incremental borrowing rate (or the system your department uses to calculate and track leases), calculate a new lease liability from the point where the department decided it would exercise the options through the end of those options.

From the question above, the new lease term is the date the decision was made (February 1, 2025) through the lease end date in FY2030. The newly calculated lease liability and lease asset should be added to the GAAP Package, in the same manner as any new lease.

4. Q: My department entered into a four-year lease for office space and the lease term ends on June 30, 2025. The new office space lease begins on July 1, 2025 and has a five-year term. Should my department delete the four-year office space lease in the FY2025 GAAP package or the FY2026 GAAP package? Additionally, in what fiscal year should my department add the five-year office space lease to the GAAP package?

A: The four-year lease should not be deleted until July 1, 2025 because it is an asset of the department through June 30, 2025; therefore, it should be deleted in the FY2026 GAAP package. Theoretically, at June 30, 2025, the lease asset will have a net book value of zero (it should be fully amortized because the lease term ends on

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June 30, 2025), and the lease liability balance should also be zero. The five-year lease should be an addition to lease assets and lease liabilities in the FY2026 GAAP package.

5. Q: My department entered into a three-year lease for office space. The lease contract includes (a) \$2,000 monthly charge for office space rental, and (b) \$150 monthly charge for **common area maintenance (CAM)**, for a total monthly payment of \$2,150. Should the CAM portion of the total monthly payment be included in the rent amount for determining the lease liability and lease asset?

A: Common area maintenance (CAM) charges should be excluded from the lease liability and lease asset calculation; therefore, only the \$2,000 monthly charge for rental of the office space should be included when determining the lease liability and lease asset.

B. Scope and Applicability of GASB 87:

1. Q: My department entered into a contract with a landowner for the right to use 50 acres of farm land for **one dollar** per year for 10 years. Does this transaction meet the definition of a lease, per GASB 87?

A: Per paragraph 4, GASB 87 applies to *exchange and exchange-like transactions*. An exchange or exchange-like transaction is one where both parties receive or give up equal (or almost equal) values. A contract for the right to use 50 acres of land for one dollar does not meet the definition of an exchange or exchange-like transaction. Consequently, this contract should not be reported as a lease in the department's GAAP package.

2. Q: My department routinely enters into contracts for **easements** with land owners. Does an easement for the right to use land meet the definition of a lease, per GASB 87?

A: Per paragraph 4, GASB 87 a lease must be for a *period of time* in an *exchange or exchange-like transaction*. Some land easements will meet the definition of a lease, while other land easements will not. The department first must evaluate whether the easement in question was received in an exchange or exchange-like transaction. If the transaction meets the definition of exchange or exchange-like, then the department must determine if the result of the transaction is a permanent easement or a non-permanent easement. Permanent easements, which last indefinitely without cancellation options, do not meet the period-of-time criteria, and therefore do not meet the definition of a lease per GASB 87. Therefore, permanent easements should not be reported as a lease in the department's GAAP package. A non-permanent easement received in an exchange or exchange-like transaction meets the definition of period of time per GASB 87; the department should follow the State of Iowa's Lease Policy – Lessee to determine if the contract meets all lease reporting requirements and thresholds for inclusion in the department's GAAP package as a lease.

If the department determines it has a permanent easement, it should evaluate the easement to determine if it meets the definition of an intangible asset as defined in GASB 51, paragraph 2 (as amended by GASB 87). Intangible assets possess all of the following characteristics: (a) lack of physical substance, (b) nonfinancial nature, and (c) initial useful life extending beyond a single reporting period. The department should follow the State of Iowa's Intangible Assets Policy to determine if the contract meets reporting requirements and thresholds for inclusion in the department's GAAP package as an intangible asset.

3. Q: My department has several **cell phone tower placement agreements**. Does this type of agreement meet the definition of a lease, per GASB 87?

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A: This type of agreement may or may not meet the definition of a lease per GASB 87. The department must determine whether each agreement conveys *control of the right to use the underlying asset* (the land) on which the towers are placed. To determine if the agreement conveys control of the right to use the land, the department must have both (1) the right to obtain the present service capacity from use of the land as specified in the agreement, and (2) the right to determine the nature and manner of use of the land as specified in the agreement. If the control criteria are met, the department should follow the State of Iowa's Lease Policy – Lessee to determine if the agreement meets all lease reporting requirements and thresholds for inclusion in the department's GAAP package as a lease.

4. Q: My department has a number of **antenna placement agreements**. Does this type of agreement meet the definition of a lease, per GASB 87?

A: This type of agreement may or may not meet the definition of a lease per GASB 87. The department must determine whether each agreement conveys *control of the right to use the underlying asset* (the connection point) to which the antenna is affixed. To determine if the agreement conveys control of the right to use the connection point, the department must have both (1) the right to obtain the present service capacity from use of the connection point as specified in the agreement, and (2) the right to determine the nature and manner of use of the connection point as specified in the agreement. If the control criteria are met, the department should follow the State of Iowa's Lease Policy – Lessee to determine if the agreement meets all lease reporting requirements and thresholds for inclusion in the department's GAAP package as a lease.

5. Q: My department has a contract with a vendor to lease a copier. The contract allows the vendor to replace the copier with an **essentially identical** copier. Does this **right of substitution** impact the decision on whether the contract conveys control of the right to use the asset (the copier)?

A: No, a vendor's right to substitute an essentially identical copier does not impact whether the department has control of the right to use the copier because a lease conveys control of the right to use another entity's asset. The right to use the asset is distinct from the underlying asset itself. Under lease accounting (assuming all other GASB 87 criteria are met), the department recognizes a right-to-use asset, which relates to the service capacity associated with the underlying asset, rather than the underlying asset itself. Often times a contract for the right to use an asset is for a shorter period of time than the life of the tangible asset. If the department has a contract for a lease of a copier and that contract includes this type of right of substitution, the right of substitution does not affect the control criteria and the department should follow the State of Iowa's Lease Policy – Lessee to determine if the contract meets all other lease reporting requirements and thresholds for inclusion in the department's GAAP package as a lease.

C. Lease Term:

1. Q: My department has a noncancelable 3-year lease. At the conclusion of the 3-year noncancelable period, both the lessor and my department have the right to cancel the lease, or the lease may continue on a **month-to-month** basis using the same payment terms. Should my department include the optional month-to-month time in our initial assessment of the lease term?

A: No, because both parties have the right to cancel during the month-to-month period (meaning the month-to-month period is not noncancelable), it should not be included in the department's initial assessment of the lease term. Another way to explain this is that your department has not contracted for a noncancelable right

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to use the underlying asset, nor is the lessor required to continue providing the asset to your department. As a result, the lease term in this case would be 3 years.

2. Q: When evaluating a lease contract that can be unilaterally terminated by both parties at any time, how does the existence of **cancellation penalties** (whether significant or insignificant) impact the calculation of the **lease term**?

A: Do not include the cancellable period in the lease term when a contract can be terminated by both parties at any time, even if the contract has significant cancellation penalties and there is reasonable certainty that neither party will exercise the termination right. In the situation where both parties can terminate the contract at any time, that period of time should always be excluded from the lease term.

3. Q: My department is the lessee in a lease contract that can only be unilaterally terminated by my department, how does the existence of **cancellation penalties** (whether significant or insignificant) impact the calculation of the **lease term**?

A: GASB 87, paragraph 12, requires the department to evaluate the likelihood that the termination option will be exercised by the department. If the department determines it is reasonably certain, based on all relevant factors, that the department will not exercise the termination option, the department should include the cancellable periods in the calculation of the lease term. On the other hand, if the department determines it is reasonably certain, based on all relevant factors, that the department will exercise the termination option, the department should exclude the cancellable periods in the calculation of the lease term.

D. Short-Term Leases:

1. Q: My department is the lessee in a lease contract for office space. The contract is noncancelable for 12 months, and the department has the **option to renew** the contract for 12-months at a time, up to 9 times. My department determined it is not likely to exercise any of the 9 options to renew the contract. Does this contract meet the GASB 87 definition of a **short-term lease**?

A: No, GASB 87, paragraph 16 states that a short-term lease is a lease that at commencement of the lease term, the lease has a maximum possible term of 12 months (or less), including any options to extend, regardless of the likelihood the options will be exercised. The maximum possible term is calculated to be 10 years. The lessee's probability for exercising the option does not impact whether the lease is classified as a short-term lease; it does, however, impact the calculation of the lessee's lease term for valuing the lease asset and related lease liability.

2. Q: My department has a 24-month office space lease that the department has the right to cancel at any time after six months. The lessor does not have an option to cancel the lease at any time. Does the 18-month period in which my department can cancel the lease meet the GASB 87 definition of a **noncancelable period**, or does this lease meet the GASB 87 definition of a **short-term lease**?

A: This lease is not a short-term lease. This lease has a maximum possible term of 24 months because the 18-month period for which your department can cancel the lease, but the lessor cannot cancel the lease, does not meet the definition of a cancellable period. While GASB 87, paragraph 16 states that for a lease that is cancellable by "**either** the lessee or the lessor," the maximum possible term is the noncancelable period, GASB Implementation Guide question 4.19 states, the intent is that when the lessee and the lessor **both** have a right

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to cancel the lease, that period is defined as cancellable. The noncancelable period in this example is 24 months, which results in this lease not meeting the definition of a short-term lease.

3. Q: My department has a 24-month office space lease that the department and the lessor have the right to cancel at any time after six months. Should we include the 18-month period in which my department and the lessor both have the option to cancel the lease in the calculation of the maximum possible term for determining whether this lease meets the **short-term lease** exception in paragraph 16 of GASB 87?

A: No, both the department and the lessor can cancel the lease at any time after six months, which makes the maximum possible term six months. This lease is a short-term lease.

E. Contracts that Transfer Ownership:

1. Q: My department contracts to lease laptops for use by the students enrolled at its two schools. At the end of the lease term, the students have the option to purchase their laptops from the department. The department is required to purchase the laptops from the lessor, regardless of whether the students choose to purchase their laptops. Further, the department does not have an option to terminate the lease contract. Does this contract meet the definition of a lease or a financed purchase?

A: This is a financed purchase, not a lease. GASB 87, paragraph 19 states that a contract that (a) transfers ownership of the underlying asset to the lessee by the end of the contract and (b) does not contain termination options, should be reported as a financed purchase. The department should report the related asset(s) on the Capital Assets pages (if capitalization thresholds are met) and the related liability on the Financed/Installment Purchases pages of the GAAP package.