CIRCULAR

STATE OF NEW JERSEY
DEPARTMENT OF THE TREASURY

NO.: 22-02-OMB	ORIGINATING AGENCY: OFFICE OF MANAGEMENT AND BUDGET	
EFFECTIVE DATE: IMMEDIATE	EXPIRATION DATE: INDEFINITE	SUPERSEDES: N/A
SUBJECT: APPLICATION OF GOVERNMENT ACCOUNTING STANDARDS BOARD'S GUIDELINES CONCERNING LEASE RECOGNITION AND ACCOUNTING (GASB 87)		
ATTENTION: DIRECTORS OF ADMINISTRATION, FISCAL OFFICERS, FACILITIES DIRECTORS, AND CHIEF INFORMATION OFFICERS/IT DIRECTORS		
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This Circular contains important information regarding Governmental Accounting Standards Board Statement No. 87 (GASB 87), which provides guidelines on the recognition and accounting for leases. Ongoing updates are being made to the Land and Building Asset Management (LBAM) system to ensure compliance with GASB 87 requirements. As in previous years, the State will require the reporting of all leases that satisfy capital asset thresholds. For more information regarding capital asset reporting thresholds for leased assets, please refer to Circular 19-11-OMB. It is encouraged that all agencies obtain and read a copy of GASB 87 by visiting the GASB website. All questions pertaining to this Circular and associated training should be directed to Chris Beitz, OMB Financial Reporting at (609) 292-3175.

Summary of GASB 87:

The objective of GASB 87 is to better meet the informational needs of financial statement users by improving accounting and financial reporting for leases by governments. GASB 87 defines a lease as a contract that conveys control of the right to use another entity's nonfinancial asset, such as buildings, land, vehicles, and equipment. It establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset. To determine if a government has the right to use an underlying asset it must have the right to obtain service capacity and to determine the manner of use of the asset. Under previous guidance, leases were classified as either capital or operating based on certain criteria. GASB 87 eliminates this distinction and one of the following classifications are used: short-term leases, contracts that transfer ownership, and all other leases. Additionally, lease modifications that do not qualify as a separate lease would require remeasuring the lease liability and adjusting the asset.

I. Policies

Departments must report all leased assets that fall within the scope of GASB 87 beginning in Fiscal Year 2022. Failure to report all activity will affect the ability of the Office of Legislative Services, Office of the State Auditor, and OMB to complete the Annual Comprehensive Financial Report (formerly Comprehensive Annual Financial Report).

A. Lease Identification

Recent year-end capital asset Circulars have advised agencies to document specific lease information, including lease terms, potential renewals, lease options, payment information, and the parties involved. This practice should be in place for all leases, as well as, agreements not previously defined and reported as leases.

Agreements not previously defined and reported as leases could include, but are not limited to, multi-function photocopiers, security equipment, audio-visual equipment, and other commonplace items utilized by State offices. Each agency's LBAM unit/personnel should coordinate with their fiscal offices to obtain contract information for these types of items that satisfy the reporting threshold. Agreements should be valued in the aggregate. For example, if your department leases several copiers, the reporting threshold consideration should be based on the combined cost of all copiers. Agencies are required to enter the asset record for leased assets into LBAM. The lease agreement must then be forwarded to OMB where the lease will be entered and linked to the asset in LBAM. Please see Section E for further details.

Types of agreements that are excluded under GASB 87 include leases of intangible assets (patents, software, copyrights), leases of biological assets (timber, living plants, living animals), leases of inventory, service concession agreements, certain financed assets, and supply contracts (power purchase agreements).

B. Classification

As previously stated, GASB 87 eliminates the classification of capital and operating leases. Under previous guidance, the State would expense operating leases and report capital leases on its balance sheet. With the elimination of capital and operating leases, additional leases will now be on the State's financial statements. When evaluating agreements, there are three classifications to consider: short-term leases, contracts that transfer ownership, and all other leases.

Short-term leases have a maximum possible term of 12 months or less at the commencement of the lease term. This includes any options to extend, regardless of their probability of being exercised. These types of leases will be reported in a similar manner as to how operating leases were treated.

Contracts that transfer ownership are those that transfer ownership of the underlying asset by the end of the contract and they do not contain any termination options. These should be reported as a financed activity.

All other leases are long-term leases, which have terms greater than 12 months at the commencement of the lease term. These leases should be reported in a similar manner to how capital leases traditionally have been.

C. Lease Terms

Per GASB 87, the lease term is the period during which a lessee has a noncancelable right to use an underlying asset plus the period an option to extend the lease has been deemed reasonably certain to be executed. "Reasonably certain" is defined as the likelihood the State executes a term in the contract based on precedence set during similar situations. For example, if the State would normally exercise a purchase option for a particular type of lease, it's reasonable to expect the purchase option would be executed in a similar contract. If a party has an option to terminate, but it is deemed reasonably certain the termination option will not be executed, this period should also be considered part of the lease term. If the lessee and lessor both have the option to terminate a renewal period without permission from the other party, that renewal period is excluded from the terms of the lease regardless of probability.

- For example, the Department of the Treasury engages in a two-year lease to occupy an office building in Trenton. Provided additionally in the lease agreement are two five-year options to extend the lease in which there is a reasonable certainty those two five-year options will be executed. Under these terms, the lease would be entered into LBAM as a twelve-year lease, which will be classified in LBAM as long-term.

- In a separate example, the Department of the Treasury enters into an equipment lease for a noncancelable six-month period, along with two six-month optional renewal periods that are deemed reasonably certain to be executed. Under GASB 87, this would be considered an 18-month lease and would also be considered long-term. However, if the lease term had a six-month non-cancelable period with no options to extend, this would be classified by GASB 87 as short-term.

- As mentioned above, if it is deemed reasonably certain that any lease termination option will not be executed, this should be reflected in the lease term. For example, if an agency enters into a five-year lease with the final year of the lease containing a lease termination option that is deemed reasonably certain not to be executed, then the lease term should be classified as five years.

D. Lease Modifications and Contingencies.

GASB 87 requires an increased level of measurement for the outflows of resources for leasing activity that agencies engage in. It also addresses how government entities should remeasure lease agreements where a significant change has occurred. There are certain components of a lease which cannot be included in the payment structure of a lease when it is entered in LBAM. Fixed payments, payments based on a rate that is present at the inception of the lease, and other payments that are reasonably certain to be paid should be included when a lease is initially entered into LBAM. However, performance-based payments and usage payments will not be included in the payment structure of a lease. These payments cannot be reasonably determined as to whether they will be expensed at the time a lease is entered. Therefore, LBAM has been modified in order for those payments to be entered and recorded in the reporting year in which they are expensed. Termination penalties and variable payments whose rate is not available at the inception of the lease are examples of the types of payments that will be recognized as outflows of resources in a given reporting period once entered onto the lease record.

Leases are measured both by the terms of the agreement as well the payment liability for the right to use an underlying asset. During the course of a lease agreement, certain factors that were deemed reasonably certain may change and thus require a remeasurement of a lease. One factor that could cause a lease remeasurement is a purchase option previously deemed likely to be executed and has not been. Changes to initial or current lease terms can result in changes to the lease liability. If changes occur, please contact OMB Financial Reporting as instructed under agency reporting responsibilities.

E. Agency Reporting Responsibilities

As noted in Circular 19-11-OMB, when agencies lease an asset, they must send the lease contract, the fair market value of the leased asset, and LBAM location of the leased asset to OMB Financial Reporting. Agencies should develop procedures to properly document all leases entered into. This documentation process includes accounting for lease terms and potential renewals for all leases, including lease agreements previously not reported in LBAM, such as photocopiers and other multifunction devices. Agencies' LBAM personnel are responsible for entering the asset record, designated as leased, into LBAM. OMB Financial Reporting will then enter the lease information for the asset through the modified lease module in LBAM. Lease contracts and the associated information for leases can be sent to leases.lbam@treas.nj.gov. As mentioned, agencies should include the LBAM identification number of the leased asset record in the email along with the contract, fair market value, and location. Agencies do not need to re-enter leased asset records already present in LBAM. OMB Financial Reporting will re-enter lease records for those assets already present in LBAM according to the new standard. If an agency enters into an arrangement that might contain components which could constitute a lease, please contact OMB Financial Reporting for assistance in reaching that determination.

During the course of a lease agreement, agencies must contact OMB should any of the following contingencies or commitments in the lease agreement occur during a subsequent fiscal year from when a lease is signed:

1. A residual value guaranteed payment is to be paid under the terms of the lease.
2. A termination penalty payment is determined to be paid under the terms of the lease.
3. A variable payment amount is determined to be paid under the terms of the lease.
4. A purchase option for a leased asset that was determined reasonably likely to be executed has since been determined to not be executed.
5. A purchase option that was determined likely to not be executed has since been determined to be executed.
6. Any change in the terms of a lease agreement should be reported to OMB.

Although these payments cannot be factored into the payment structure of a lease at its inception, it is necessary to report these payments as outflows of resources during the fiscal year in which they are incurred.

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