

BUDGET LETTER

SUBJECT: LEASES – NEW ACCOUNTING POLICY	NUMBER: 21-02
REFERENCES: GASB 87, LEASES	DATE ISSUED: January 28, 2021
	SUPERSEDES:

TO: Agency Secretaries
Department Directors
Departmental Budget, Accounting, and Procurement Officers
Department of Finance Budget and Accounting Staff

FROM: DEPARTMENT OF FINANCE

This Budget Letter notifies departments of new accounting and reporting requirements for leases effective for fiscal year 2021-22 and onward. The change in policy is needed to comply with Governmental Accounting Standards Board Statement No. 87 ([GASB 87](#)) – Leases.

State Administrative Manual (SAM) section 8632, Installment Purchase/Capital Lease Contracts, defines the criteria for capital leases. The current policy uses two categories of leases, capital and operating. Under the new policy, the two categories will be replaced by a single model for lease accounting based on the principle that leases are the means to finance the right to use an underlying asset. Below is the policy summary and departmental guidelines to apply the new standards on existing and new leases beginning July 1, 2021.

NEW POLICY

The new policy does not distinguish between capital and operating lease categories. It eliminates operating leases and requires all contracts that meet the definition of a lease to be accounted for as assets and liabilities. A lessee will recognize a lease liability and an intangible right-to-use leased asset (the lease is the asset as opposed to the asset itself). A lessor will recognize a lease receivable and deferred inflow of resources.

Definition of Lease

The new definition of a lease is a contract that conveys control of the right to use another entity's nonfinancial 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. A contract that meets this definition should be accounted for using the new policy unless specifically excluded. Departments should exclude these lease types from their review.

- Leases of intangible assets.
- Leases of biological assets.
- Contracts that meet the definition of a service concession.
- Leases in which the underlying assets are financed with outstanding conduit debt.
- Supply contracts, such as power purchase agreements.

Departments will analyze existing and new contracts and agreements to determine if they meet the new lease definition. The new policy requires departments to evaluate contracts in the following three categories. Each category is described below in detail.

- Leases (new definition)
- Short Term Lease
- Financed Purchases

Leases (New Definition)

All lease contracts that do not fall into one of the other two categories, short term leases or financed purchases, are treated with the new single-model approach. Lessees will recognize a lease liability and intangible right to use the leased asset. Lessors will record a lease receivable and deferred inflow of resources.

Short Term Lease

A short term lease is 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. The accounting of a short term lease is similar to the current accounting for operating leases. Lessee lease payments will be recognized as operating expenses, while amounts a lessor receives will be recognized as lease revenue.

Financed Purchases

Financed purchases are lease contracts that transfer ownership of the underlying asset to the lessee by the end of the contract and do not contain termination options. The contract may contain a fiscal funding or cancellation clause that is not reasonably certain of being exercised. The accounting of such contracts is similar to the current accounting for capital leases. The lessee is considered the owner of the asset. The leased asset will be recorded as an asset and depreciated; the lease liability will be recorded and reduced as lease payments are made.

FISCAL YEAR 2021-22 IMPLEMENTATION OF POLICY

Departments are required to comply with the new lease policy in their year-end financial reports submitted to the State Controller's Office (SCO) beginning with fiscal year 2021-22. This policy applies to both new and existing leases and contracts.

Reporting of Existing Leases

The new policy is effective beginning July 1, 2021. Departments will measure and recognize existing leases based on the facts and circumstances of each lease contract as of July 1, 2021, not at the inception of the lease.

SCO has published pre-implementation guidelines to assist departments in the preparation of implementing the policy. Departments should review the guidance on the SCO's [website](#) and begin to evaluate existing leases and contracts to determine if they meet the new definition as described above. Departmental accounting, procurement, and asset management staff should review, complete, and submit the pre-implementation guidance worksheets to the SCO within the given timeframes.

Publication of Updated Policies

The Department of Finance, Fiscal Systems and Consulting Unit (FSCU) is developing the updated policies for SAM. FSCU will notify departments of the availability of the updated policies by early June.

If you have questions regarding this BL, please contact the FSCU Hotline at (916) 324-0385 or FSCUHotline@dof.ca.gov. If you have questions regarding the SCO's pre-implementation guidance, please contact the SCO at (916) 324-9789 or sardstatepolicy@sco.ca.gov.

/s/ Thomas Todd

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