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MOM-SFSD-POL-SAB - Accounting for Leases as a Lessee (336)-Draft

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I. Purpose

This policy provides guidance related to the financial transactions and reporting of lease assets and liabilities, through the use of the SABHRS Lease Administration (LA) module under the provisions of GASB Statement No. 87.

II. Scope

This policy applies to all state agencies and component units, excluding community colleges.

III. Lease Criteria

Note: All potential lease agreements should be evaluated and recorded based only on the terms that were effective on the first day of the fiscal year of implementation onward. For example, for the fiscal year ending 6/30/2022, agreements that existed prior to 7/1/2021 should be treated as if they commenced 7/1/2021.

A. Identifying a Lease

A lease is a contract or agreement that conveys control of the right to use another entity's nonfinancial asset (the underlying asset) as specified in the contract for a period of time in an exchange or exchange-like transaction. Leases include contracts that, although not explicitly identified as leases, meet the definition of a lease. This definition excludes contracts for services except those contracts that contain both a lease component and a service component. A decision tree is available in Appendix A to aide in evaluating a contract for the presence of a lease.

Contracts that are entered into at or near the same time with the same counterparty should be considered part of the same contract if either of the following criteria is met:

1. The contracts are negotiated as a package with a single objective
2. The amount of consideration to be paid in one contract depends on the price or performance of the other contract

Contracts may contain multiple components, such as a contract that contains both a lease component and a nonlease component. If a contract that contains both a lease component (such as the right to use a building) and a nonlease component (such as maintenance services for the building), the lease and the nonlease components should be accounted for as separate contracts unless they are combined as described in Section VIII (Allocation of Payments for Contracts with Multiple Components).

If a lease involves multiple underlying assets and the assets have different lease terms, the lessee and the lessor should account for each underlying asset as a separate lease component. In addition, the lessee should account for each underlying asset as a separate lease component if the underlying assets are in different major classes of assets (Land, Building, Equipment, or Other). This provision does not apply if a combination is necessary under the guidance in Section VIII (Allocation of Payments for Contracts with Multiple Components).

To determine whether a contract conveys control of the right to use the underlying asset, a government should assess whether it has both of the following:

1. The right to obtain the present service capacity from use of the underlying asset as specified in the contract
2. The right to determine the nature and manner of use of the underlying asset as specified in the contract.

These rights don’t necessarily have to be available to a lessee for an uninterrupted period of time, as long as both rights are present for time periods specified in the contract, the condition is met. Additionally, the contract may contain a provision that allows for the substitution of the underlying asset. Such a provision should not affect a lease determination if the service capacity derived from the use of the asset remains unchanged.

Nonfinancial Assets

A nonfinancial asset is an asset that is not a financial asset. A financial asset, which is excluded from lease consideration, is defined as cash, evidence of an ownership interest in an entity, or a contract that conveys to one entity a right to do either of the following:

1. Receive cash or another financial instrument from a second entity
2. Exchange other financial instruments on potentially favorable terms with the second entity (for example, an option)

Examples of nonfinancial assets include land, buildings, vehicles, and equipment.

Exchange and Exchange-Like Transactions

A “pure” exchange transaction occurs when each party receives and gives up essentially equal values. The difference between exchange and exchange-like transactions is a matter of degree. In contrast to a "pure" exchange transaction, an exchange-like transaction is one in which the values exchanged, though related, may not be quite equal or in which the direct benefits may not be exclusively for the parties to the transaction. Nevertheless, the exchange characteristics of the transaction are strong enough to justify treating the transaction as an exchange for accounting recognition.

B. This policy does not apply to:

1. Leases between State Agencies that are not defined as Component Units of the State and listed in MOM-SFSD-POL-SAB-Annual Comprehensive Financial Report (371) Section VI(B)(2). (For leases between State Agencies that are not defined as Component Units, account for the lease payments as directed in MOM-SFSD-POL-SAB-Interfund Activities (345) Section XI)
2. Leases of intangible assets, including rights to explore for or to exploit natural resources such as oil, gas, and minerals and similar nonregenerative resources; licensing contracts for items such as motion picture films, video recordings, plays, manuscripts, patents, and copyrights; and licensing contracts for computer software. In sublease transactions, however, this policy does apply to the intangible right-to-use assets that are created by the original leases of tangible underlying assets
3. Leases of biological assets, including timber, living plants, and living animals.
4. Leases of inventory
5. Supply contracts, such as power purchase agreements
6. Contracts that meet the definition of a service concession arrangement. A service concession arrangement exists if all of the following criteria are met:

   a. The transferor conveys to the operator the right and related obligation to provide public services through the use and operation of a capital asset in exchange for significant consideration, such as an up-front payment, installment payments, a new facility, or improvements to an existing facility

b. The operator collects and is compensated by fees from third parties.

c. The transferor determines or has the ability to modify or approve what services the operator is required to provide, to whom the operator is required to provide the services, and the prices or rates that can be charged for the services

d. The transferor is entitled to significant residual interest in the service utility of the facility at the end of the arrangement

C. Contracts that Transfer Ownership

A contract that transfers ownership of the underlying asset to the lessee by the end of the contract and does not contain termination options should be reported as a financed purchase of the underlying asset by the lessee (See “Financed Purchases” in MOM-SFSD-POL-SAB-Capital Assets (335))

Provisions that allow for termination of a lease due to the following are not considered termination options:

1. Purchase of the underlying asset
2. Payment of all sums due
3. Default on payments
4. A fiscal funding or cancellation clause that is not reasonably certain of being exercised

D. Easements

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. A lease is for a period of time in an exchange or exchange-like transaction. 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 below description of exchange or exchange-like transactions do not meet the exchange or exchange-like criterion.

IV. Short-Term Leases

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. For a lease that is cancelable by either the lessee or the lessor, such as a rolling month-to-month lease or a year-to-year lease, the maximum possible term is the noncancelable period, including any notice periods.

A lessee should recognize short-term lease payments as operating expenses. The lessee should recognize a prepaid expense if payments are made in advance or a liability for rent due if payments are to be made subsequent to the reporting period. The lessee should not recognize an outflow of resources during any rent holiday period (for example, one or more months free).

Note: It is possible for a lease to exist with a term of less than 12 months and not be identified as a short-term lease because identification of a short-term lease is based on the maximum possible term of the contract without consideration of the “reasonably certain” factors discussed in Section VI (Lease Term).

V. Lease Threshold

A. Threshold Calculation

For consideration of the lease threshold every possible payment to the lessor specified in the agreement (excluding amounts specifically identified for nonlease components) should be totaled regardless of the probability of the payments being made. Variable payments should be calculated as follows

1. Variable payments that depend on an index rate should be calculated using the index rate in effect at the commencement of the lease
2. All other variable payments should be calculated based on the portion of the payments that are fixed in substance and are not based on future performance

In addition, payments not paid to the lessor, that are identified as ancillary charges necessary to place the leased asset into service, should be added to the total. Lease incentives, that are certain to occur, may be subtracted from this calculation. For contracts with multiple components the guidance in Section VIII (Allocation of Payments for Contracts with Multiple Components) should be applied. This means that the payments for provisions within the contract that would be identified as separate leases should be considered independently. If the calculation is less than the amount below, lease accounting is not required and lease payments to the lessor should be treated as operating expenses as they occur.

Lessee Lease Threshold	$100,000

If a modification to the terms occurs in the same fiscal year the original agreement was signed, which does not qualify as a new lease as described in Section IX (Allocation of Payments for Contracts with Multiple Components), the threshold analysis should be reperformed using the process described above with all payments (as modified). If a modification occurs subsequent to the fiscal year the original contract was signed and does not qualify as a new lease as described in Section IX (Allocation of Payments for Contracts with Multiple Components), the threshold analysis should be considered based only on payments to be made subsequent to the modification date.

For standalone financial statements this threshold should be evaluated and reduced if determined necessary for fair presentation of the financial statements.

B. Federal Funds

If a lease is not accounted for as a lease due to the lease threshold, care should still be taken to ensure compliance with the allowable cost principle described in the Uniform Guidance provision in §200.465(e) Rental costs of real property and equipment.

C. Below Threshold Purchase Option

If a purchase option is exercised for a lease that was not recorded because it fell below the Lessee Lease Threshold, MOM-SFSD-POL-SAB-Capital Assets (335) should be applied to the asset using the cost of the purchase option as the purchase price.

VI. Lease Term and Asset Life

A. Lease Term

The lease term commences when the lessee gains physical possession of the asset or attains access to use the underlying asset. The lease term is the period during which a lessee has a noncancelable right to use an underlying asset (referred to as the noncancelable period), plus the following periods, if applicable:

1. Periods covered by a lessee's option to extend the lease if it is reasonably certain, based on all relevant factors, that the lessee will exercise that option
2. Periods covered by a lessee's option to terminate the lease if it is reasonably certain, based on all relevant factors, that the lessee will not exercise that option
3. Periods covered by a lessor's option to extend the lease if it is reasonably certain, based on all relevant factors, that the lessor will exercise that option
4. Periods covered by a lessor's option to terminate the lease if it is reasonably certain, based on all relevant factors, that the lessor will not exercise that option

Periods for which both the lessee and the lessor have an option to terminate the lease without permission from the other party (or if both parties have to agree to extend) are cancelable periods and are excluded from the lease term. For example, a rolling month-to-month lease, or a lease that continues into a holdover period until a new lease contract is signed, would not be enforceable if both the lessee and the lessor have an option to terminate and, therefore, either party could cancel the lease at any time.

Provisions that allow for termination of a lease due to the following are not considered termination options.

1. Purchase of the underlying asset
2. Payment of all sums due
3. Default on payments
4. A fiscal funding or cancellation clause that is not reasonably certain of being exercised

At the commencement of the lease term, an assessment should be performed of all factors relevant to the likelihood that the lessee or the lessor will exercise options that may affect the lease term, whether these factors are contract based, underlying asset based, market based, or government specific. The assessment often will require the consideration of a combination of these interrelated factors. Examples of factors to consider include, but are not limited to, the following:

1. A significant economic incentive, such as contractual terms and conditions for the optional periods that are favorable compared with current market rates
2. A significant economic disincentive, such as costs to terminate the lease and sign a new lease (for example, negotiation costs, relocation costs, abandonment of significant leasehold improvements, costs of identifying another suitable underlying asset, costs associated with returning the

underlying asset in a contractually specified condition or to a contractually specified location, or a substantial cancellation penalty)
3. The history of exercising options to extend or terminate
4. The extent to which the asset underlying the lease is essential to the provision of government services

The lease term should be reassessed annually, see Section IX, (Lease Remeasurement).

B. Asset Useful Life

The lease asset will generally be amortized on a straight-line basis over the span of the lease term unless one of the following conditions are met:

1. The useful life of the underlying asset is less than the lease term
2. The lease contains a purchase option that the lessee has determined is reasonably certain of being exercised

If either of these conditions are present, the lease asset will be amortized over the useful life of the underlying asset which will require overwriting the default "Estimated Life" for the asset when it is established in LA. If the underlying asset is land, which is non depreciable, and a purchase option is reasonably certain to be exercised, the indefinite useful life will be established by using the G49 (Lease Land – Non Depr) Profile ID for governmental funds and the P49 (Land – Non Derp) profile ID for proprietary funds.

VII. Lease Payments

A. Lease Liability and Asset

At the commencement of the lease term, a lessee should recognize a lease liability and an intangible right-to-use lease asset (a capital asset hereinafter referred to as the lease asset), except short-term leases and contracts that transfer ownership. The present values of the lease liabilities and lease asset will be calculated by entering the following payments into LA using the the appropriate payment type or option as described in the LA Manual.

A lessee initially should measure the lease liability at the present value of payments expected to be made to the lessor during the lease term. Measure of lease liability should include the following:

1. Fixed Payments
2. Variable payments that depend on an index or a rate, initially measured using the index or rate as of the commencement of the lease term.
3. Variable payments that are fixed in substance
4. Amounts that are reasonably certain of being required to be paid by the lessee under residual value guarantees
5. Exercise price of a purchase option if it is reasonably certain that the lessee will exercise that option
6. Payments for penalties for terminating the lease
7. Any lease incentives
8. Any other payments that are reasonably certain of being required based on an assessment of all relevant factors

Estimates may be used for payments that meet the above requirements but for which a price will be identified at a future date (for example, extensions that are reasonably certain to occur). Variable payments based on future performance of the lessee or usage of the underlying asset (for example, percentage of sales) should not be included in the measurement of the lease liability. Rather, variable payments should be recorded as an operating expense in the period in which the obligation for those payments is incurred. However, any component of those variable payments that is fixed in substance should be included in the measurement of the lease liability.

In addition to the payments noted above, payments entered in LA as "Initial Direct Costs" should include:

1. Lease payments made to the lessor at or before the commencement of the lease term, and any lease incentives received from the lessor at or before the commencement of the lease term
2. Initial direct costs that are ancillary charges necessary to place the lease asset into service (for example, freight and transportation charges, site preparation costs, and certain professional fees).

Any initial direct costs that would be considered debt issuance costs should be, expensed in the period in which they are incurred.

B. Lease Incentives

Lease incentives are:

1. Payments made to, or on behalf of, the lessee, for which the lessee has a right of offset with its obligation to the lessor, or
2. Other concessions granted to the lessee

A lease incentive is equivalent to a rebate or discount and includes assumption of a lessee's preexisting lease obligations to a third party, other reimbursements of lessee costs, rent holidays, and reductions of interest or principal charges by the lessor.

Lease incentives reduce the amount that a lessee is required to pay for a lease. Lease incentives that provide payments to, or on behalf of, a lessee at or before the commencement of a lease term are included in initial measurement by directly reducing the amount of the lease asset. These should be recorded as a "Lease Incentive" payment type in LA as directed by the LA Manual.

Lease incentive payments, to be provided after the commencement of the lease term, should be accounted for as reductions of lease payments for the periods in which the incentive payments will be provided. These payments should be included in the initial measurement and any remeasurement if they are fixed or fixed in substance. In such cases the incentive should be incorporated into calculations to reduce a "Base Rent" payment type in LA or to reduce an applicable option.

Variable or contingent lease incentive payments are not included in the initial measurement and should be treated as a reduction of lease payments as they occur. This will require a lease remeasurement under the "change in the estimated amounts for payments already included in the measurement of the lease liability" provision of Section IX (Lease Remeasurement).

C. Payments and Incentives at or Prior to Commencement

Lease payments to a lessor prior to the commencement of a lease (when the lessee gains physical possession of the asset or attains access to use the underlying asset) should be accounted for as prepaid expenses as directed in MOM-SFSD-POL-SAB-Fiscal Year-end Procedures (375). At the commencement of a lease, prepaid expenses should be reversed and recorded to 63411(Non-IT) or 63412(IT). These payments should be added as "Add Initial Direct Cost" or "Add Prepaid Rent" using the "Add Lease Payments" tool in in LA, as directed in the LA Manual.

Due to system constraints for LA, the following adjustment is required as part of establishing the lease in LA when the "Add Initial Direct Cost" or "Add Prepaid Rent" payment types are used.

Entitywide Ledger (Governmental Funds), Actuals Ledger (Proprietary Funds)			
Debit	63413	NB Lease Offset - AM	$10,000
Credit	62502	NB ROU Lease Principal	$10,000

Lease Incentives received prior to the commencement of the lease should be subtracted from any prepaid expenses recorded for the lease. If lease incentives received prior to commencement of the lease exceed prepaid expenses record for the lease, the excess should be recorded to Account 2590 (Pre-Commence Lease Incentive). At the commencement of the lease, the Account 2590 balance should reversed and the incentive should be recorded as a negative entry to 63411(Non-IT) or 63412(IT).

D. Nonlease Expenses

Reoccurring charges for nonlease components of a lease agreement (such as janitorial charges or utilities) may also be added to LA using the "Add Miscellaneous Rent" and "Add Operating Expense" lease payments options as described in the LA Manual.

The Account for the Accounting Distribution of these payment types should be "69502" otherwise improper entries will be posted by Asset Management (AM). If voucher integration is used, the account code on the voucher should be updated to a nonlease account after the voucher is generated by LA.

E. Discount Rate

The future lease payments should be discounted using the interest rate the lessor charges the lessee, which may be the interest rate implicit in the lease. If the interest rate is not stated in the contract, the lessee's estimated incremental borrowing should be used. For lease purposes, the State of Montana's incremental borrowing rates is the rate for the Montana Board of Investments INTERCAP loan program that is in effect on July 1 of the fiscal year the lease commences. The INTERCAP rate will be updated in SABHRS annually as the default rate for a lease identified as the "Borrowing Rate Percent." Another rate may be used by adding it as the "Interest Rate Percent."

F. Voucher Coding

Vouchers for payments related to a lease should use the coding below. Payments may include several items that were not included in the lease liability, or reoccurring operating expenses recorded in SABHRS. If vouchers are generated by LA, the voucher coding should be reviewed for proper allocation. Coding for nonlease payments will always need to be updated on LA generated vouchers. In addition, any payments that are necessary along with the items on an LA generated voucher will require a separate manual voucher.

1. Non-IT Underlying Asset

63411	Payments made at or prior to the commencement of the lease that are initial direct costs or ancillary to putting the asset into service.
69501	Payments to lessor included in the lease liability (an interest adjustment will take place during fiscal year end)
62520	Variable lease payments not included in the lease liability
62XXX	Payments for non-lease components (examples include utility charges, janitorial service, or copier "per page" charges) should be recorded to an appropriate operating expense account
62521	Early termination fees not included in the lease liability
62522	Residual value guarantee payments not included in the lease liability

2. IT Underlying Asset

63412	Payments made at or prior to the commencement of the lease that are initial direct costs or ancillary to putting the asset into service.
69504	Payments to lessor included in the lease liability for IT assets (an interest adjustment will take place during fiscal year end)
62520A	Variable lease payments not included in the lease liability
62XXX	Payments for non-lease components (examples include utility charges, janitorial service, or copier "per page" charges) should be recorded to an appropriate operating expense account
62521A	Early termination fees not included in the lease liability
62522A	Residual value guarantee payments not included in the lease liability

VIII. Allocation of Payments for Contracts with Multiple Components

To allocate the contract price to the different components, lessees first should use any prices for individual components that are included in the contract, as long as the price allocation does not appear to be unreasonable based on the terms of the contract and professional judgment, maximizing the use of observable information; for example, using readily available observable stand-alone prices. Stand-alone prices are those that would be paid or received if the same or similar assets were leased individually or if the same or similar nonlease components (such as services) were contracted individually. Some contracts provide discounts for bundling multiple leases or lease and nonlease components together in one contract. Those discounts may be taken into account when determining whether individual component prices do not appear to be unreasonable. For example, if the individual component prices are each discounted by the same percentage from normal market prices, the discount included in those component prices would not appear to be unreasonable.

If a contract does not include prices for individual components, or if any of those prices appear to be unreasonable, lessees should use professional judgment to determine their best estimate for allocating the contract price to those components, maximizing the use of observable information. If it is not practicable to determine a best estimate for price allocation for some or all components in the contract, a government should account for those components as a single lease unit.

If multiple components are accounted for as a single lease unit, the accounting for that unit should be based on the primary lease component within that unit. For example, the primary lease component's lease term should be used for the unit if the lease components have different lease terms. The following characteristics, among others, may be indicative of a primary component:

1. The component performs a function that is the government's primary objective in entering into the contract
2. The component's fair value is substantial relative to the fair values of the other components
3. The lease term of the component is longer than the lease terms of the other components
4. The component's benefit to the government is substantial relative to the benefits of the other components

IX. Lease Remeasurement

Every active lease with optional provisions should be evaluated annually, using the guidance below to determine if remeasurement of the lease liability is necessary. It is recommended that the checklist below, also found in Appendix B, be completed and added as an attachment to each lease in LA.

A.	The lessee or lessor has elected to exercise an option even though it was previously determined that it was reasonably certain that the lessee or lessor would not exercise that option?		Yes/ No
B.	The lessee or lessor has elected not to exercise an option even though it was previously determined that it was reasonably certain that the lessee or lessor would exercise that option?		Yes/ No

C.	An event specified in the lease contract has occurred that requires an extension or termination of the lease takes place?		Yes/ No
D.	An assessment of all relevant factors indicates that the likelihood of a residual value guarantee being paid has changed from reasonably certain to not reasonably certain, or vice versa?		Yes/ No
E.	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? (A change to the useful life of the lease asset may be necessary)		Yes/ No
F.	There is a change in the estimated amounts for payments already included in the measurement of the lease liability (Not including a change in index rate used to determine variable payments)?		Yes/ No
G.	There is a change in the interest rate the lessor charges the lessee, if used as the initial discount rate?		Yes/ No
H.	A contingency, upon which some or all of the variable payments that will be made over the remainder of the lease term are based, is resolved such that those payments now meet the criteria for measuring the lease liability, as defined in Section VII (Lease Payments) of MOM 336? For example, an event occurs that causes variable payments that were contingent on the performance or use of the underlying asset to become fixed payments for the remainder of the lease term.		Yes/ No
I.	"Yes" answered for any of the above? If "No," Liability Remeasurement is not required, if yes proceed to J.		Yes/ No
J.	There is a change in the index rate used to calculate variable payments. If yes, recalculate the variable payment as part of the amendment.		Yes/ No

A "Yes" answer to any of the above will require the lease to be updated using the amendment process described in the LA Manual. If the incremental borrowing rate was used as the discount rate, the rate should be updated as part of this process if:

1. There is a change in the lease term
2. 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

X. Lease Modifications and Terminations

The provisions of a lease contract may be amended while the contract is in effect. Amendments modify the provisions of the lease contract. Examples of amendments to lease contracts include changing the contract price, lengthening or shortening the lease term, and adding or removing an underlying asset. An amendment should be considered a lease modification unless the lessee's right to use the underlying asset decreases, in which case the amendment should be considered a partial or full lease termination.

Exercising an option to extend or terminate a lease, which already exists in active contracts or amendments, is not a modification and should be evaluated using the guidance in Section IX, (Lease Remeasurement).

The lessee should account for an amendment during the reporting period resulting in a modification to a lease contract as a separate lease (that is, separate from the most recent lease contract before the modification) if both of the following conditions are present:

1. The lease modification gives the lessee an additional lease asset by adding one or more underlying assets that were not included in the original lease contract
2. The increase in lease payments for the additional lease asset does not appear to be unreasonable based on (1) the terms of the amended lease contract and (2) professional judgment, maximizing the use of observable information (for example, using readily available observable stand-alone prices)

Unless a modification is reported as a separate lease, a lessee should account for a lease modification by remeasuring the lease liability. The remeasurement of the lease liability should apply the appropriate discount rate for when the modification became effective. Additionally, the lessee should apply the guidance in Section VI (Lease Term), and Section VII (Lease Payments), to calculate the changes to the payments and term of the lease of the lease. The modification should be added to LA following the lease amendment instructions in the LA Manual.

1. If the modification results in the purchase of the underlying asset, the procedures in Section XI (Lease Asset Purchase) should be applied
2. If the modification is the result of an impairment to the underlying asset impairment, the procedures in Section XII (Lease Asset Impairment) should be applied

Debt Refunding

If prior to the expiration of the lease term a change to the provisions of a lease results from a debt refunding by the lessor, including an advance refunding, such transactions should be evaluated on a case-by-case basis with consultation from the State Accounting Bureau.

XI. Lease Asset Purchase

If a lease purchase option is exercised, one of the following procedures should be applied.

Note: if the asset value calculated below does not meet the capitalization thresholds for the asset type as defined in MOM-SFSD-POL-SAB-Capital Assets (335) or if the useful life of the asset remaining after the lease term is less than one year complete only these steps:

1. Expire the lease and the ROU asset as of the day the option was exercised
2. Record any payments that were included in the lease liability to 69501 and any additional payments to an appropriate 62XXX expenditure account

A. Purchase Option Included in Liability

If the cost of exercising the option was fully or partially included in the lease liability.

1. Expire the lease and ROU Asset as of the day the option was exercised.

   a. If the purchase payment amount is less than the amount included in the liability, first amend the lease to reflect the reduced amount
   b. If the purchase payment amount is more than amount included in the liability, expire the lease and record the original amount in account 69501 on the payment voucher and the additional amount in an appropriate for the asset 63XXX or 64XXX account.

2. Add the asset to AM as the appropriate asset type using the remaining value of the ROH asset at the date the option was exercised for the remaining life of the asset.

   a. The remaining value of the ROH asset should be the amount of "loss" recorded to account 62808B in the AM RET entry
   b. If the purchase payment was more than the amount included in the liability, the additional amount should be added to the value of the asset
   c. The following adjustment is required if to reverse the loss created from retiring the ROU asset

Entitywide Ledger (Governmental Funds), Actuals Ledger (Proprietary Funds)			
Debit	63198/64298	NB Full Accrual Equip Offset/ NB Full Accr Build Offset	$10,000
Credit	62808B	NB Lease Change Loss	$10,000

B. Purchase Option Not Included in Liability

If the cost of exercising the option was not included in the lease liability.

1. Expire the lease and ROU Asset as of the day the option was exercised
2. Add the asset to AM as the appropriate asset type for the amount of the purchase payment over the remaining life of the asset

   a. The remaining life of the asset is the period typically associated with the asset type less the time between the commencement of the lease and the date the option was exercised

3. Record the payment to the appropriate, for the asset, 63XXX or 64XXX account

XII. Lease Asset Impairment

The presence of impairment indicators with respect to the underlying asset may result in a change in the manner or duration of use of the lessee's right-to-use asset. Common indicators of impairment include:

1. Evidence of physical damage, such as for a building damaged by fire or flood, when the level of damage is such that restoration efforts are needed to restore service utility

2. Enactment or approval of laws or regulations or other changes in environmental factors, such as new water quality standards that a water treatment plant does not meet (and cannot be modified to meet)
3. Technological development or evidence of obsolescence, such as that related to a major piece of diagnostic or research equipment (for example, a magnetic resonance imaging machine or a scanning electron microscope) that is rarely used because newer equipment provides better service
4. A change in the manner or expected duration of use of a capital asset, such as closure of a school prior to the end of its useful life
5. Construction stoppage, such as stoppage of construction of a building due to lack of funding

Such a change in the manner or duration of use of the lessee's right-to-use asset may indicate that the service utility of that lease asset is impaired. The length of time during which the lessee cannot use the underlying asset or is limited to using it in a different manner, should be compared to its previously expected manner and duration of use to determine whether there is a significant decline in service utility of the lease asset. If a lease asset is impaired, the amount reported for the lease asset should be reduced first for any change in the corresponding lease liability through the lease modification process in Section X (Lease Modifications and Terminations). Any remaining amount should be recognized as an impairment.

XIII. Special Lease Liability Types

A. Subleases

If a leased asset is subleased to another entity, the original lease should continue to be accounted for as prescribed in this policy. The new lease should be treated as a separate transaction using the guidance in MOM-SFSD-POL-SAB-Accounting for Leases as a Lessor (337).

B. Sale-Leaseback Transactions

Sale-leaseback transactions involve the sale of an underlying asset by the owner and a lease of the property back to the seller (original owner). Such transactions should be evaluated on a case-by-case basis with consultation from the State Accounting Bureau.

C. Lease-Leaseback Transactions

In a lease-leaseback transaction, an asset is leased by one party (first party) to another party and then leased back to the first party. Such transactions should be evaluated on a case-by-case basis with consultation from the State Accounting Bureau.

XIV. Leases between Related Parties

In the separate financial statements of the related parties, the classification and accounting should be the same as for similar leases between unrelated parties, except in cases in which it is clear that the terms of the transaction have been significantly affected by the fact that the lessee and lessor are related. In such cases, the classification and accounting should be modified as necessary to recognize the substance of the transaction rather than merely its legal form. For example, if the lease contract is structured to meet the definition of a short-term lease but the related parties have a mutual understanding that the lease contract will stay in effect for several more years, that lease should not be accounted for as a short-term lease. The nature and extent of leasing transactions with related parties should be disclosed. The State Accounting Bureau should be consulted on a case-by-case basis when lease agreements potentially involve related parties.

XV. Fiscal Year-end Entries

After the close of the Lease Administration Module and Prior to the close of the General Ledger, the State Accounting Bureau will record adjusting entries, based on LA balances, which will reclassify a portion of amounts recorded as lease principal payments to lease interest (69503). Additionally, for modified accrual funds, entries will be recorded in the Actuals Ledger and the Entitywide Ledger to record Capital Outlay Expenditures (Account 63413) and Other Financing Source Revenue (Account 583300) as required by GAAP. For all funds, an adjustment will be made in the Actuals or Enititywide Ledger, depending on Fund Type to identify the current portion of the lease liability in Account 2124B.

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