Commonwealth of the Northern Mariana Islands (CNMI)

Department of Finance

GASB 87

POLICIES AND PROCEDURES

TABLE OF CONTENTS:

SECTION 1: PURPOSE

GASB Statement No. 87 – *Leases* aims to enhance the accounting and financial reporting of lease agreements by governmental entities. It provides a unified approach to recognizing and disclosing lease obligations, thereby improving the clarity, consistency, and usefulness of financial information presented in governmental financial statements.

Historically, leases were classified as either operating or capital, resulting in inconsistencies in reporting and limiting comparability across entities. GASB 87 replaces this dual-model framework with a single lease accounting model, recognizing all leases as financings of the right to use an underlying asset.

Under this new model, lessees are required to recognize:

- A lease liability for the present value of future lease payments, and
- A corresponding right-of-use (ROU) asset representing the right to utilize the leased property during the lease term.

This Standard Operating Procedure (SOP) establishes the internal process for identifying, reviewing, and processing lease agreements that fall within the scope of GASB 87 and are greater than or equal to the organization's capitalization threshold of $5,000. It ensures that qualifying leases are evaluated, accounted for, and reported in compliance with governmental accounting standards.

By recognizing lease obligations and assets on the balance sheet, GASB 87 improves transparency and strengthens accountability. The standard provides stakeholders—including taxpayers, elected officials, auditors, and financial analysts—with a clearer picture of a government’s financial commitments and resource usage, ultimately supporting better decision-making and fiscal oversight.

Section 1.1. Background

GASB 87 introduces a single, consistent model for reporting leases, based on the idea that leases are a way of financing the right to use an asset, not just rental agreements. This means that instead of treating leases as simple expenses, they are now recognized as financial obligations.

Under this model, government agencies/departments must report:

· A lease liability for future payments

· A right-of-use (ROU) asset representing the right to use the leased item

This change improves transparency, helps stakeholders better understand financial commitments, and makes it easier to compare lease information across agencies. Overall, it supports more accurate financial reporting and better decision-making.

Section 1.2 Applicable Statues

GASB Statement No. 87, Leases

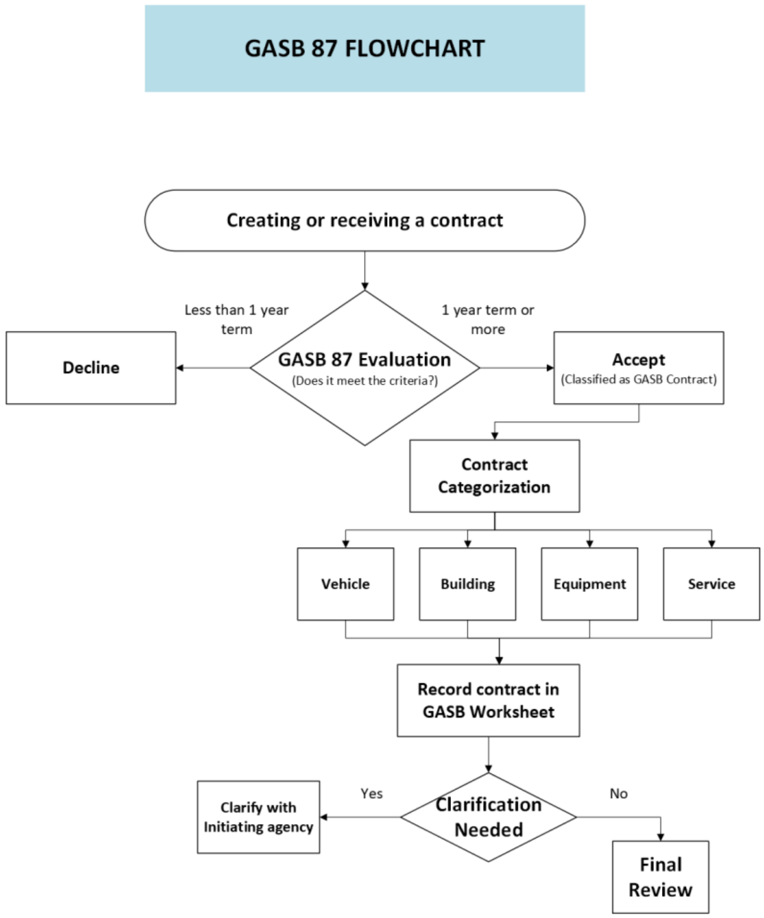
Section 1.3 Definition and Acronym

Acronym	Meaning
GASB	- Governmental Accounting Standards Board
ROU Asset	- Right-of-Use Asset
NPV	- Net Present Value
LEASE TERMS	- period during which a lessee has a noncancelable right to use an underlying asset
LESSEE	- refers to the party that leases from another
LESSOR	- refers to the party that leases to another

Section 1.4 Effective Date

The GASB 87 procedures will be effective **July 18, 2025**. Implementation activities were initiated for Fiscal Year 2022 (FY22) to ensure timely compliance and readiness.

Section 1.5 Flowchart



SECTION 2: UNDERSTANDING GASB 87 LEASE GUIDELINES

Section 2.1 GASB Overview

The implementation of GASB Statement 87, which governs lease accounting, requires a structured and thorough documentation process to ensure compliance and accuracy. The procedure for documenting responsibilities involves several key steps and considerations, outlined as follows:

When creating or receiving a contract, it undergoes a GASB 87 Evaluation to determine its classification. If the contract term is less than one year, it is declined and excluded from GASB 87 classification. However, if the term is one year or more including the option to extend, the contract is accepted and categorized as a GASB contract.

Next, the contract proceeds to Contract Categorization, where it is classified under one of the following categories: Vehicle, Building, Equipment, or Service. Once categorized, the details of the contract are recorded in the GASB Worksheet for proper tracking and compliance.

Examples of Leased Assets Under GASB 87

Under GASB 87, a lease is defined as a contract that conveys control of the right to use a non-financial asset for a period of time in exchange for consideration. The following are common categories of leased assets recognized as Right-of-Use (ROU) assets:

Buildings and Land:

Governments often lease office space, warehouses, or other buildings. These leases are recorded as ROU assets under GASB 87.

Equipment:

Leases of equipment like computers, machinery, or other specialized gear are also within the scope of GASB 87.

Vehicles:

Cars, trucks, buses, and other vehicles used by government agencies are commonly leased and recognized as ROU assets.

Real Estate:

While often included under buildings, more broadly, any real estate leased by a government entity is subject to GASB 87.

Other Non-financial Assets:

The definition of a lease under GASB 87 encompasses a broad range of non-financial assets, meaning that any contract meeting the definition of a lease for such assets must be accounted for under GASB 87

Step 1: Identify Lease Agreements

All agency/departments must review contracts or agreements involving the use of tangible property to determine whether the arrangement meets GASB 87 criteria.

Step 2: Prepare and Submit Lease Package

Agency/Departments must submit the following documents to the Department of Finance – Accounting Division:

- Fully executed lease agreement
- Description and location of the leased asset
- Lease term, including start and end dates and any renewal options
- Total expected payments and payment schedule
- Fund certification (if applicable)
- Contact information for department liaison

Step 3: Finance Review and Classification

The Department of Finance - Procurement Services will:

- Evaluate the submission for compliance with GASB 87
- Determine the lease term, discount rate, lease liability, and right-of-use asset
- Record the lease in the accounting system

Step 4: Annual Monitoring and Updates

Departments/Agencies must:

- Review Munis to determine whether the previous year's contracts are still active or have been terminated. All contract numbers, along with the relevant GASB information, have been recorded in the worksheet.
- Notify the Department of Finance - Procurement Services of any changes, renewals, terminations, or modifications to the lease
- Provide updated documentation when applicable

The Procurement Services will keep records and update accordingly for proper reporting.

*The underlying assets include capital assets (land), buildings, vehicles, and equipment.

If any clarification is required during this process, the matter is referred to the initiating agency for resolution. Once all issues are clarified, or if no clarification is needed, the contract undergoes a Final Review to complete the process.

GASB Statement 87, Leases - How to Implement

Section 2.2 Defining Lease Under GASB 87

A lease is a contract that transfers the right to use another entity's asset (the underlying asset) for a specific period of time in an exchange or exchange-like transaction. (A transaction is exchange or exchange-like when each party in the contract receives or gives up essentially equal value.)

Underlying assets include capital assets (land), buildings, vehicles, and equipment.

GASB 87 Does Not Apply to:

- Contracts that transfer ownership of an underlying asset to the lessee by the end of the contract and have no termination options. These should be reported as a financed purchase of the underlying asset by the lessee, or sale of the asset by the lessor. For example, a lease-purchase contract.

Section 2.3 Understanding Lease Terms

Lease terms are determined after a full analysis of the contract, including factors surrounding the contract. Do not assume that the contract lease term is the same as the standard lease term.

The lease term includes:

- The noncancelable period;
- Periods covered by lessee's or lessor's option to terminate that you don't expect them to exercise; and
- Periods covered by lessee's or lessor's option to extend the lease term that you do expect them to exercise.

Note: If you're reasonably certain the lessee or lessor will exercise a fiscal funding clause, use the date you expect them to exercise the option to determine the end-of-lease term.

Section 2.4 Noncancelable Lease Period

The noncancelable period is when neither the lessee nor the lessor can terminate the contract.

Example

A Government agency/department contract with Agnus Industries has a termination clause allowing the tenant the right to cancel after 90 days. The noncancelable period is the first 90 days.

Section 2.5 Early Termination Period

Leases may include an early termination option after 30, 60 or 90 days' notice. When this option is available, the termination period occurs after the notice timeframe.

Example
A Government agency/department enters into a five-year contract with KD Industrial Company for office space. After one year, the agency/department can give 60 days' notice to terminate the lease. The noncancelable period is 14 months. A termination option covers the remaining 46 months. The agency/department must determine if it is reasonably certain that they won't exercise this option.

Section 2.6 Lease Extension

Leases may contain an option to extend the lease for a set amount of time.

Example
A government agency/department enters a five-year contract with ABC Corporation for office space. This lease has two four-year renewal options. If the agency/department decides it's reasonably certain it will exercise the first extension, but not reasonably certain it will exercise the second, the lease term is nine years.

Section 2.7 Use of Underlying Assets

The lease term is when a lessee has a non-cancelable right to use an underlying asset, plus the following periods of coverage (if applicable):

- Lessee's option to extend the lease if it's reasonably certain the lessee will exercise that option.
- Lessee's option to terminate the lease if it's reasonably certain the lessee won't exercise that option.
- Lessor's option to extend the lease if it's reasonably certain the lessor will exercise that option.
- Lessor's option to terminate the lease if it's reasonably certain the lessor won't exercise that option.

The lease term excludes cancelable periods, when both the lessee and the lessor can terminate without permission from the other party.

Note: The following are not considered termination options: Provisions that allows for termination of a lease due to (1) purchase of the underlying asset, (2) payment of all sums due, or (3) default on payments.

Examples of Cancelable Periods

- Rolling, month-to-month lease; or
- Lease that continues into a holdover period until a new lease is signed.

Section 2.8 Fiscal Funding Clause

Fiscal funding or cancellation clauses allow lessees to cancel a lease if the government doesn't appropriate funds for payments. This typically occurs on an annual basis. A cancellation clause only affects the lease term if it's reasonably certain the clause will be exercised.

Review all contracts to see if this clause exists. If it does, you must document your determination of reasonably certain or not reasonably certain.

Section 2.9 Making a "Reasonably Certain" Determination

"Reasonably certain" means that it is highly likely—beyond just possible or probable—that a government will exercise or not exercise an option, such as a renewal, termination, or purchase option. Each agency must apply its circumstances to GASB-required relevant factors to determine if a lease meets the threshold of "reasonably certain." Relevant factors include:

- **Market-based factors,** such as a whether contract terms and conditions for the optional periods are favorable compared with current market rates.
- **Contract-based factors,** such as significant economic deterrents, including costs to terminate an existing lease and sign a new one. Types of costs include 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.
- **Asset-based factors,** such as whether the asset underlying the lease is necessary for providing government services.
- **Government-specific factors,** such as the cost or timeliness of the procurement process or the likelihood to appropriate funds based on historical experience.
- **Capital Threshold,** the minimum value ($5,000) for a lease to be capitalized as an asset under GASB 87.

When is it used?

In both GASB 87 and GASB 96, this term is used when evaluating:

- Renewal options
- Termination options
- Purchase options
- Cancellation clauses

You must assess whether it is reasonably certain that the entity:

- Will renew a lease or subscription
- Will not terminate early
- Will exercise a purchase option at the end of the term

SECTION 3: GASB 87 Applicable Lease Types

Section 3.1 Payable Leases

Payable leases require the government agency/department, as lessee, to recognize a lease liability and an intangible right-to-use lease asset.

The government agency/department measures lease liability as the present value of payments expected to be made during the lease term and is centrally calculated.

GASB Coordinator/Specialist calculates lease liability when agencies provide the following information:

- Fixed payments;
- Variable payments that depend on an index or a rate (Consumer Price Index or *market interest rate), initially measured using the index or rate at the end of the lease term;
- Variable payments fixed in substance;
- Amounts reasonably certain of being required to be paid by the lessee under residual value guarantees;
- The exercise price of a purchase option if it's reasonably certain that the lessee will exercise that option;
- Payments for penalties for lease termination, including:
    - lease terms with an option for the lessee to terminate the lease;
    - fiscal funding clause; or
    - cancellation clause.
- Lease incentives* receivable from the lessor;
- Other payments reasonably certain of being required based on an assessment of all relevant factors.

*Lease incentives are (a) 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 (b) other concessions granted to the lessee.

* The market interest rate can be obtained by contacting a financial institution or bank to determine the interest rate the government would be charged to borrow for a similar term and amount.

GASB Coordinator/Specialist calculates the lease asset when agencies provide the following information:

- Amount of the initial measurement of the lease liability.
- Lease payments made to the lessor at or before the end of the lease term, less any lease incentives received from the lessor at or before the end of the lease term
- Initial direct costs that are ancillary charges required to place the lease asset into service. (Examples may include delivery and installations costs.)

Section 3.2 Revenue Leases

Revenue leases require the Government Entity/Agency, as lessor, to recognize a lease receivable and a deferred inflow of resources.

GASB Coordinator/Specialist calculates the lease receivable when agencies provide the following information:

- Fixed payments;
- Variable payments that depend on an index or a rate (Consumer Price Index or market interest rate), initially measured using the index or rate at the end of the lease term;
- Variable payments fixed in substance;
- Residual value guarantee payments fixed in substances; and
- Lease incentives.

GASB Coordinator/Specialist calculates the deferred inflow of resources when agencies provide the following information:

- Lease payments made to the lessor at or before the end of the lease term, less any lease incentives received from the lessor at or before the end of the lease term.

Section 3.3 Subleases

A sublease is a property rental agreement by a tenant to a third-party for a portion of the tenant's existing lease contract.

Example
A government agency/department leases a floor in a building in from Conklin Inc. and rents a room to another entity. The government agency/department is then both a lessee and a lessor and must report both to the Department of Finance - Procurement Services.

Section 3.4 Sale-leasebacks

A sale-leaseback is the sale of a property with an agreement that it will then be leased back. Only a sale transaction qualifies for sale-leaseback accounting.

Example
A government agency/department sells a piece of property. The sale includes a contractual agreement that the agency/department will lease the property back from KAL Ltd. The agency/department must report the lease to the Department of Finance – Procurement Services.

Section 3.5 Lease-leasebacks

A lease-leaseback is the lease of property to a tenant with the agreement that the property will then be leased back from that same party (usually with an asset or service attached).

Example
A government agency/department owns a piece of land and leases it to a private company, Yund Inc. The agreement obligates Yund Inc. to build an office and lease it back to the agency/department. The agency/department must report both leases to the Department of Finance – Procurement Services.

Section 3.6 Software as Leases Subject to GASB 87 and Reporting Subscriptions

Contracts that include licenses involving the right to use software under a subscription arrangement are subject to GASB Statement No. 96 (SBITA).

Under GASB 96, a Subscription-Based Information Technology Arrangement (SBITA) applies when a government enters into a contract that:

1. Grants the government control over the right to use the vendor’s software,
2. Is provided through a subscription model (e.g., SaaS or cloud-based access),
3. Has a noncancelable term of more than 12 months, and
4. Involves exchange or exchange-like consideration (i.e., payment in return for use).

If a license meets these conditions, the arrangement must be accounted for under GASB 96, which requires recognizing a subscription asset and a corresponding subscription liability on the government’s financial statements.

Example
An agency has a 3-year contract with Mezz Ltd. for Microsoft 365 Government Subscription, which includes

Access to Microsoft 365 Government (G3) suite – includes Outlook, Word, Excel, Teams, SharePoint, and OneDrive. GASB 96/SBITA applies and must be reported.

SECTION 4 OTHERS

Section 4.1 Variable Payment Types for Payable and Revenue Leases

Fixed in Substance: payments have a minimum payment.

- Example: A government agency/department signs a contract with Conklin Printer Supplies. The contract states the department/agency pays $0.01 a page or $500 a month, whichever is greater. The minimum payment of $500 is a fixed substance payment.

Based on an Index or Rate: payments are based on set common rates or an index, such as the Consumer Price Index or bank rates.

- Example: A government agency/department signs a contract with Abigail Inc. for office space. The rent is $3,000 per month and increases annually with the Consumer Price Index or bank rates. The variable payments include the $3,000 monthly rent, plus the Consumer Price Index or bank rate as of the lease end-date.

Based on Usage or Future Performance: payments that depend on future performance, such as reaching a certain threshold or usage.

- Example: A government agency/department signs a contract with Schneible Industries to rent an excavator for $50 per hour. Each excavator rented in the past 10 years was used for over 500 hours per year. A new construction project requires double the amount of excavator work needed over the course of the contract. The variable payment amount to be included in the measurement is $0 since payments are based on disincentives future usage.

Section 4.2 Worksheet Guide

Asset Classes tab - Must be updated to reflect the major asset categories utilized by your entity.
These categories will be used to track intangible assets that are required to be recognized
from lease and similar agreements.

We recommend that recognized intangible assets be tracked within your capital asset module under their appropriate categories—such as Leased Building, Leased Equipment, etc.—to ensure the accuracy of information required for disclosure purposes.

For amortization:

- Use the shorter of the estimated life of the underlying asset or the lease term unless your entity is reasonably certain of exercising a purchase option.
- If a purchase option will be exercised, apply the asset life established by your capitalization policy.

Once an agreement is evaluated and determined to be recognizable:

- Ensure all applicable data is completed in the worksheet.
- Select **"Yes"** under "Lease is material."
    - This will generate a corresponding Amortization tab, named based on Column A.
- An amortization schedule will need to be developed for each agreement identified.

Once the agreement has been evaluated and identified as needing to be recognized an amortization schedule will need to be developed for each agreement. (Ensure all data is filled out and Select "Yes" - lease is material – this will generate an amortization tab named based on Column A)

a. This tab will also allow for additional input for other amounts to be included (ex. Lessee reasonably certain of exercising purchase option - can include $ of option in schedule)
b. if changes need to occur - delete the tab and update information on tab "Inventory"; once updated reselect "Yes" on materiality column. This will generate the tab again.

Compliance

All agencies/departments are responsible for complying with this SOP. Failure to properly identify and report qualifying leases may result in audit findings and inaccurate financial reporting.

Information regarding columns

A. **Agreement Number/Description** – Enter the Lease number and Master Agreement Number/& brief description
B. **Agreement Effective Date** – Enter the date that the lease begins.
C. **Lessee/Lessor** – Indicate whether you are the lessee or lessor in the lease agreement.

a. **Lessor** – the party granting a lease to someone else; receives payment for granting the right to use an asset to the lessee.

b. **Lessee** – the party being granted the right to use an asset by the lessor

D. **Governmental/BTA/ISF**

E. **Underlying Asset Type** – Select the asset type being leased (Intangible, Service, Investment, Land, Building, Vehicle, Infrastructure, or Equipment).

F. **Control/Right to Use** – Select yes or no – whether or not the contract conveys control to the lessee of the right to use the lessor's asset as specified in the contract for a period of time in an exchange or exchange-like transaction.

a. Control does not have to be uninterrupted and while the agreement may have conditions on use that does not limit your entities control of service capacity of the agreement.

G. **Max Lease Term Greater than 12 Months** – Select whether or not the maximum lease term is greater than 12 months

a. Options to extend should be considered in the lease term whether or not they are expected to be exercised.

H. Lease Term Perpetual -

I. **Exchange or Exchange-like transaction** –Consideration exchanged are equal or similar value

J. **Transfer of Ownership** – If title transfers by the end of the contract without a termination option; enter Yes

K. **Lease Determination –** This column will automatically populate based on your previous response in the worksheet.

L. **Agreement Term** – Enter the total term of the lease agreement, not including any options to extend or terminate the lease.

Columns M through R you are evaluating the terms and options for the LESSEE (the party that is being granted the right to use the underlying asset).

M. **Termination Option** – Does the LESSEE have the option to terminate the lease agreement?

N. **Reasonably Certain** – Is the LESSEE reasonably certain to exercise the termination option? (Remember - High Level of Certainty

a. In order to evaluate whether or not exercising an option is "reasonably certain", you should:

i. Consider how this option has been handled in the past

ii. Consider the economic impact of the option

iii. Consider the importance of the underlying asset to operations

O. **Year to Exercise** – Identify the year in which the LESSEE is reasonably certain to exercise their option to terminate.
P. **Option to Extend** – Does the LESSEE have the option to extend the lease?
Q. **Reasonably Certain** – Is it reasonably certain that the LESSEE is going to exercise the option to extend? (Use same criteria as column M)
R. **Years to Extend** – Enter the number of years that the LESSEE is reasonably certain to extend the contract beyond the original lease term

Columns S through X, you are evaluating the terms and options for the LESSOR (the party that granted the lessee the right to use the underlying asset)

S. **Termination Option** – Does the LESSOR have the option to terminate the lease agreement?
T. **Reasonably Certain** – Is the LESSOR reasonably certain to exercise the termination option?
   a. In order to evaluate whether or not exercising an option is "reasonably certain", you should:
      i. Consider how this option has been handled in the past
      ii. Consider the economic impact of the option
      iii. Consider the importance of the underlying asset to operations
U. **Year to Exercise** – Identify the year in which the LESSOR is reasonably certain to exercise their option to terminate.
V. **Option to Extend** – Does the LESSOR have the option to extend the lease?
W. R**easonably Certain** – Is it reasonably certain that the LESSOR is going to exercise the option to extend? (Use same criteria as column M)
X. **Years to Extend** – Enter the number of years that the LESSOR is reasonably certain to extend the contract beyond the original lease term.

Columns W through AA are automatically populated based on your previous responses in the worksheet. No action is required for these columns.

AD. Payment Frequency – Indicate whether payments against the lease are made weekly, monthly, quarterly, or annually.

AE. Payment – Indicate whether the payment is made at the beginning or end of the period (If the lease payments are made monthly, are they paid at the beginning or end of the month, etc.)

AF. Payment Periods – This column is going to automatically populate with the total number of lease payments to be made based on your previous selections. Verify that this number is correct.

AG. **Multiple Components –** Answer whether or not the lease has multiple components. These can include:

- **a.** The lease could have multiple underlying assets
- **b.** The lease could have non-lease components such as maintenance costs

AH. Describe – If you entered "Yes" in column AG for multiple components (Yes/No), describe all other components that the lease agreement has.

AI. **Fixed/Insubstance Fixed Payments** – Enter the total amount of the lease payment that is fixed or fixed in substance.

AJ. **Variable Payments to Track for Note Disclosure –** Answer whether or not there are variable amounts paid against the lease (maintenance, paper for a copier, etc.)

AK. Describe – If you answered "Yes" in column AI, describe the variable payments associated with the lease.

AL. Interest Rate – Indicate whether the interest rate is stated in the lease agreement or if it will be implied from another comparable source.

AM. If Imputed, Describe – If you selected imputed in column AM, describe where the imputed rate is coming from.

AN. Rate – Enter the interest rate of the lease agreement.

AO. Present Value – This column will automatically populate based on your previous selections.

AP. Preparer Consideration of Materiality (Yes=material, no = not material) – The threshold for materiality recognition has been set at $5,000 for both lessee and lessor transactions. If you answered "Yes" a separate tab will generate for each lease you determine you want to record.

AQ. Accumulation of Immaterial Agreements – This column will automatically populate based on your previous selections.

AR. Account Number/Fund - Enter funding account number(s)

SECTION 5: REVISION/VERSION HISTORY

** This GASB 87 policy and procedure will be periodically reviewed and updated to reflect changes in regulations or organizational requirements.*

Revision History

Originator:	Department of Finance, Office of the Secretary
Effective Date:	07/18/25
Approved By:	Tracy B. Norita, Secretary of Finance
Approval Signature:	TNorita
Procedure Purpose:	To ensure that we consistently identify, measure, record, and report leases according to the GASB Statement 87 and to comply with Generally Accepted Accounting Standards.

Version History:

Version Number	Version Date	Description of Change	Point of Contact
Version 1.0	*07/18/25*	*Initial Release*	*SOF Team*