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Lease Accounting Policy

APPENDIX A

Accounting for Leases

Governmental Accounting Standards Board Statement No. 87, "Leases", establishes accounting and financial reporting standards for leases by lessees and lessors. For purposes of applying this standard, a lease is defined as 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 ("finance lease").

A contract conveys the right to use the underlying asset if it has both of the following:
- The right to obtain the present service capacity from use of the underlying asset as specified in the contract.
- The right to determine the nature and manner of use of the underlying asset as specified in the contract.

Leases include contracts that, although not explicitly identified as a lease, met the definition of a lease. This excludes contracts for services except contracts that contain both a lease component and a service component.

This standard does not apply to the following:

- Leases of intangible assets including rights to natural resources and licensing contracts (including licenses for patents, copyrights and computer software).
- Leases of biological assets including timber, living plants and living animals.
- Leases of inventory.
- Contracts that meet the definition of a service concession arrangement per Statement No. 60, "Accounting and Financial Reporting for Service Concession Arrangements".
- Leases in which the underlying asset is financed with outstanding conduit debt, unless both the underlying asset and the conduit debt are reported by the lessor.
- Supply contracts such as power purchase agreements.
- Leases of assets that are reported as an investment.

See GASB Statement No. 87 for additional guidance, including definitions of terms. Also see Capitalization Policy and Depreciation Policy.

Lease Term

The lease term is the period during which the lessee has a noncancelable right to use an underlying asset plus the following periods: periods covered by a lessee or lessor's option to extend the lease if it is reasonably certain that the lessee or lessor will exercise the option; and periods covered by a lessee or lessor's option to terminate the lease if it is reasonably certain that the lessee or lessor will not exercise the 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 of the parties have to agree to extend the lease) are cancelable periods and are excluded from the lease term.

The lease term commences when WVU gains physical possession of the asset or attains access to use the asset. If WVU has started making payments on the lease, the commencement/effective date will be defined as the start of the lease term as defined in the contract.

The lease term for those finance leases with an option to terminate by either party (without the permission of the other party) within twelve months (for example, where the lessor has the option to terminate the lease 180 days from the date from which notice is provided to the lessee) will be re-assessed on an annual basis (at the end of each fiscal year).

Most of WVU's leases contain a clause that states that WVU may cancel any purchase/order contract upon 30 days written notice to the vendor in addition to a clause that states that continuation of the purchase order/contract is contingent upon funds being appropriated by the Legislature or otherwise being made available. Under GASB No. 87, a fiscal funding clause that allows the lessee to cancel a lease if the government does not appropriate funds for the lease payments should affect the lease term only if it is reasonably certain that the clause will be exercised. Since it is considered unlikely that WVU would exercise these clauses, they have not been considered in determining the lease term.

IARA will exercise reasonable efforts to determine whether it is reasonably certain that an option to extend or terminate the lease will be exercised. These efforts will include consulting with the Leasing and Land Transactions unit in the General Counsel's Office (real estate leases), Procurement, Contracting and Payment Services, and the applicable department (for example, ITS). If necessary, IARA will assess other readily available information such as the history of exercising options to extend or terminate. If information is not available and IARA is unable to make this assessment, IARA will assume that any options to extend or terminate the lease are not reasonably certain to be exercised.

Evergreen Leases – For those leases that automatically renew at the end of the original lease term for another term of the same length or on a month-to-month basis, the lease will be re-evaluated at the end of the renewal term.

Short-Term Leases

A short-term lease is a lease that, at the beginning of the lease term, has a maximum possible term of 12 months or less including any options to extend, regardless of the probability of the option being exercised. For a lease that is cancelable by either the lessee or the lessor, such as a rolling month-to-month or year-to-year lease, the maximum possible term is the noncancelable period. The expense is recognized as payments are made, based on the provisions of the contract, for those leases for which WVU is the lessee. Revenue is recognized as payments are received for leases for which WVU is the lessor.

Example - student housing lease agreements.

Contracts that Transfer Ownership

A contract that transfers ownership of the underlying asset to WVU by the end of the contract and does not contain termination options is reported as a financed purchase of the underlying asset. This liability is classified as a note payable.

Capitalization Threshold

WVU will record all leases within the scope of this guidance that meet the requirements for capitalization and that exceed the capitalization threshold per WVU's capitalization policy for capital and intangible right-to-use assets (leased assets).

Lessee Accounting

Lease Liability – At the commencement of the lease term, a lease liability and an intangible right-to-use lease asset (capital asset) will be recognized. The liability will be initially measured at the present value of payments expected to be made during the lease term. Future lease payments will be discounted using the interest rate the lessor charges WVU, which may be an implicit interest rate. If the interest rate cannot be readily determined, WVU's incremental borrowing rate (average cost of borrowing) will be used.

Variable payments based on future performance or usage of the underlying asset will not be included in the calculation of the lease liability. Those payments will be recognized as an expense in the period in which the obligation for those payments is incurred.

The liability will be re-measured at subsequent reporting dates if one or more of the following changes have occurred at or before the financial reporting date:

- There is a change in the lease term.
- 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.
- 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.
- There is a change in the estimated amounts for payments already included in the measurement of the lease liability (except for a change in the index or rate used to determine variable payments).
- There is a change in the interest rate the lessor charges the lessee, if used as the initial discount rate.
- A contingency, upon which some or all of the variable payments will be based, is resolved such that those payments now meet the criteria for measuring the lease liability.

The discount rate will be updated as part of the re-measurement of the liability if one or both of the following changes have occurred and the changes individually or in the aggregate are expected to significantly affect the amount of the liability:

- There is a change in the lease term.
- 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.

If the discount rate is required to be updated, the discount rate will be based on the revised interest rate charged by the lessor at the time the discount rate is updated. If this rate cannot be readily determined, the incremental borrowing rate will be used.

If the lease payments are made by an external party (such as the WVU Foundation), capital grants and gifts revenue is recognized.

Lease Asset – The asset will initially be measured as the sum of the following:

- The amount of the initial measurement of the lease liability.
- Lease payments made to the lessor at or before the commencement of the lease term less any lease incentives received from the lessor at or before the commencement of the lease term.
- Initial direct costs necessary to place the asset in service.

The lease asset will be amortized over the shorter of the lease term or the useful life of the asset and reported as amortization expense. If the lease contains a purchase option that is reasonably certain of being exercised, the asset will be amortized over the useful life of the asset. If the asset is non-depreciable, it will not be amortized.

If the liability is re-measured, the asset will be adjusted by the same amount. If the change reduces the carrying amount of the asset to zero, any remaining amount will be reported as a gain.

If a leased asset is impaired, the amount reported for the leased asset will be reduced by any change in the corresponding lease liability. Any remaining amount will be recognized as an expense.

Lessor Accounting

Lease Receivable – At the commencement of the lease term, a lease receivable and a deferred inflow of resources will be recognized. The receivable will be initially measured at the present value of payments expected to be received during the lease term. Future lease payments will be discounted using the interest rate WVU charges the lessee, which may be an implicit interest rate. If the interest rate cannot be readily determined, WVU's incremental borrowing rate (average cost of borrowing) will be used.

Variable payments based on future performance or usage of the underlying asset will not be included in the calculation of the lease liability. Those payments will be recognized as revenue in the period to which the payments relate.

The receivable will be re-measured at subsequent reporting dates if one or more of the following changes have occurred at or before the financial reporting date:

- There is a change in the lease term.
- There is a change in the interest rate the lessor charges the lessee
- A contingency, upon which some or all of the variable payments will be based, is resolved such that those payments now meet the criteria for measuring the lease receivable.

The discount rate will be updated as part of the re-measurement of the receivable if one or both of the following changes have occurred and the changes individually or in the aggregate are expected to significantly affect the amount of the receivable:

- There is a change in the lease term.
- There is a change in the interest rate the lessor charges the lessee.

If the discount rate is required to be updated, the receivable should be re-measured using the revised discount rate.

Underlying Asset – If the lease contract requires that the lessee return the asset in its original or enhanced condition at the end of the lease term, the underlying asset should not be depreciated during the lease term. If the underlying asset is not readily identifiable in the lease contract and/or the fixed assets system, it is not practicable to allocate the cost of the asset, and the cost of the underlying asset is immaterial, the underlying asset will continue to be depreciated (for example, cell tower leases).

Deferred Inflow of Resources – The deferred inflow of resources should be measured as follows:

- The amount of the initial measurement of the lease receivable.
- Lease payments received from the lessee at or before the commencement of the lease term that relate to future periods (for example, the final month's rent) less any lease incentives paid to or on behalf of the lessee at or before the commencement of the lease term.

The deferred inflow of resources will be recognized as revenues over the lease term. The deferred inflow of resources will be adjusted by the same amount for any change resulting from the re-measurement of the lease receivable.

WVU will not de-recognize the asset underlying the lease and will continue to apply applicable guidance such as the guidance for depreciation. If the lease requires the lessee to return the asset in its original or enhanced condition, WVU will not depreciate the asset during the lease term.

Contracts with Multiple Components

Contracts that contain multiple components, such as a lease component (the right to use a building, for example) and a non-lease component (maintenance services for a building, for example) will be accounted for as separate contracts. If a lease involves multiple underlying assets and the assets have different lease terms, each asset will be accounted for as a separate lease component. If the underlying assets are in different major classes of assets, each asset will be accounted for as a separate lease component. WVU's capitalization policy will determine the assets to be accounted for as part of the lease component (assets with an individual price above the capitalization threshold) and the non-lease component (assets with an individual price below the capitalization threshold).

If a contract does not include prices for individual components and if it is not practicable to determine a best estimate for allocation, WVU will account for those components as a single lease unit. If multiple components are accounted for as a single unit, accounting for that unit will be based on the primary lease component within the unit.

IARA will exercise reasonable efforts in separating the lease component and the non-lease component and the underlying assets. These efforts will include consulting with the Leasing and Land Transactions unit in the General Counsel's Office (real estate leases), Procurement, Contracting and Payment Services, and the applicable department (for example, ITS); reviewing similar contracts and/or leasing arrangements, and reviewing any other documentation that is available.

Non-lease components, including assets with an individual price below the capitalization threshold and other components, such as maintenance and utilities, will be accounted for in accordance with WVU's policies and the applicable accounting guidance for those transactions.

Lease Modifications and Terminations

Lease Modifications - Examples of lease amendments include changing the contract price, changing the lease term, and adding or removing assets. Exercising an existing option, such as an option to extend or terminate the lease, may be subject to re-measurement.

An amendment is treated as a separate lease if one or more assets were added to the contract **and** the increase in lease payments does not appear to be unreasonable.

Lessee - Unless a modification is reported as a separate lease, the lease liability is re-measured and the lease asset is also adjusted. If the change reduces the carrying amount of the asset to zero, any remaining amount is reported as a gain.

Lessor - Unless a modification is reported as a separate lease, the lease receivable is re-measured, and the deferred inflow of resources is also adjusted. The change related to payments for the current period will be recognized as revenue or expense in the current period.

If a lease is amended after the expiration of the lease term, for accounting purposes the commencement date of the amendment will be assumed to be the last day of the current lease term.

Lease Terminations - If the right to use the asset decreases, the amendment is treated as a partial or full lease termination (for example, the number of underlying assets is reduced, or the lease term is shortened).

Lessee – The carrying value of the asset and the lease liability will be reduced and a gain or loss will be recognized for the difference. If the lease is terminated due to the purchase of the underlying asset, the asset will be reclassified to the appropriate class of capital asset.

Lessor – The carrying value of the lease receivable and the related deferred inflow of resources will be reduced and a gain or loss will be recognized for the difference. If the lease is terminated due to purchase of the underlying asset, the asset should be retired.

IARA will exercise reasonable efforts to resolve any discrepancies between the lease agreement and actual payments/receipts. In order to resolve any discrepancies or other issues, the provisions of the lease agreement will take precedence.

Public Private Partnerships

Contracts that meet the definition of a public-private partnership or availability payment arrangement are excluded from the lease accounting requirements. These contracts fall under the accounting requirements of GASB No. 94, "Public-Private and Public-Public Partnerships and Availability Payment Arrangements".

Public-private and public-public partnerships are arrangements in which the transferor contracts with an operator to provide public services by conveying control of the right to operate or use a nonfinancial asset for a period of time. Availability payment arrangements are arrangements in which an operator is compensated for activities that may include designing, constructing, financing, maintaining or operating an underlying financial asset for a period of time. The payments are based entirely on the asset's availability for use (for example, construction milestones or the physical condition of the asset) rather than on revenues or other measures of demand.

Subleases that are part of WVU's public private partnerships (PPPs) may meet the definition of a lease. If so, the accounting and financial reporting guidance for leases should be applied if (a) existing assets of WVU are the only underlying PPP assets, (b) improvements are not required to be made by the developer to those existing assets as part of the PPP arrangement, and (c) the PPP does not meet the definition of an service concession arrangement.

Service Concession Arrangements

Some PPPs are service concession arrangements (SCAs). An SCA is a PPP arrangement in which all of the following are met:

a. WVU conveys the right to the developer (operator) the right and related obligation to provide public services through the use and operation of an underlying PPP asset in exchange for significant consideration.
b. The operator collects and is compensated by fees from third parties.
c. WVU determines or has the ability to modify or approve which services the operator is required to provide, to whom the operator is required to provide the services, and the rates to be charged for the services.
d. WVU is entitled to significant residual interest in the service utility of the underlying PPP asset at the end of the arrangement.

For PPPs that meet the definition of an SCA, the accounting and financial reporting guidance for SCA's is applied (GASB No. 60, "Accounting and Financial Reporting for Service Concession Arrangements").

Subscription-based IT Arrangements

Contracts that convey control of the right to use another party's IT software, alone or in combination with tangible capital assets for a period of time (subscription-based information technology arrangements (SBITAs) are excluded from the lease accounting requirements. The accounting for these contracts fall under GASB No. 96, "Subscription-Based Information Technology Arrangements". These include contracts for remote access to software applications or cloud data storage (such as Software as a Service (SaaS), Platform as a Service (PaaS) and Infrastructure as a Service (IaaS). See Subscription-Based IT Arrangements Accounting Policy.

Contracts that convey control of the right to use another party's combination of information technology software and tangible capital assets that meet the definition of a lease, in which the software component is insignificant when compared to the cost of the tangible capital asset (for example, a smart copier that is connected to an IT system), will be subject to the accounting requirements for leases.

Licensing arrangements that provide a perpetual license to use another party's computer software are subject to the accounting requirements of GASB No. 51, "Accounting and Financial Reporting for Intangible Assets". See Capitalization Policy and Depreciation Policy.