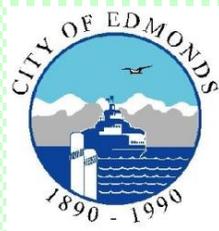


# **City of Edmonds**



## **Policy on Accounting for Leases**

**November 19, 2019**

**Resolution # XXXX**

# City of Edmonds Policy on Accounting for Leases

## Policy Statement

This policy establishes accounting treatment of lease agreements entered into by the City, both as a lessee and as a lessor. There are three types of lease classifications: short-term leases, lease contracts that transfer ownership, and all other leases. The proper lease classification is important because it determines the City's accounting and reporting requirements in compliance with GASB Statement No. 87.

## Reason for Policy

When the right to the use of property in exchange for a payment occurs, Generally Accepted Accounting Principles require the lessee to record the lease as an asset. This policy establishes uniform thresholds and procedures for all City departments when recording leases.

## Who Must Comply

All City departments must comply. This policy applies to all active leases, regardless of the date the lease was entered into.

## Procedures

1. **Understand rules for lease accounting.** All leases other than short term leases must be recorded as assets to the lessee. These leases are recorded on the balance sheet and depreciated over time.
2. **Apply lease term threshold.** Any item with a lease term of twelve months or less is a short-term lease and cannot be capitalized. Treat all leases with terms of twelve months or less as operating leases.
3. **Apply cash payment thresholds.** Apply the following thresholds when determining when to capitalize an equipment or facility lease. Note that thresholds should be applied by lease schedule; lease agreements can be for a building, an individual asset, a group of assets, and can fall under the terms of a City-wide master lease agreement. To be aligned with the City's thresholds for capitalization of assets,
  - A. An equipment lease of twelve months or longer with a present value of \$5,000 or more at the inception of the lease must be capitalized.
  - B. An infrastructure lease of twelve months or longer with a present value of \$50,000 or more at the inception of the lease must be capitalized.
  - C. A lease of twelve months or longer for replacement of components to the Wastewater Treatment Plant with a present value of \$100,000 or more at the inception of the lease must be

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capitalized.

D. For all non-short-term leases, the department must send a copy of the lease agreement to the Finance Director.

### **4. Record capital leases properly.**

A. Initial setup: the Finance Department will record the entry to establish the capital lease asset and the related liability at the inception of the lease. This is an important step to ensure all of the City's financial obligations are properly valued for financial reporting purposes.

B. Making lease payments: lease payments are the responsibility of the department. These payments should follow City payment policies and guidelines for processing and approving payments and are initially coded to lease expense.

C. Amortization of the lease liability: The lease liability is reduced throughout the life of the lease using the effective interest method. On at least an annual basis, the Finance department is responsible for creating journal entries (for each lease) which reverse the payment coding and reclassify it to the appropriate amortization and interest BARS codes, as well as reducing the liability. Lease payments are allocated between the calculated lease liability amortization and interest expense. Under this method, interest expense decreases and the liability amortization amount increases over time.

**5. Account for all leases timely.** The accounting for leases other than short-term leases should be recorded at the lease inception date and must be recorded no later than year end.

**6. Account for executory costs correctly:** Executory costs include such things as utilities, repairs, maintenance, insurance, common area expenses, and taxes paid for the leased asset during its economic life. These are considered period costs and therefore must be expensed as incurred. These expenditures may be the responsibility of either the lessee or lessor, depending on the lease terms.

**7. Maintain supporting documentation.** For any lease with a lease term greater than twelve months, the Finance Department must keep the following documentation on file for the life of the leased asset plus an additional six years:

A. The master lease agreement,

B. Supporting documentation for any additional assumptions used in calculating the present value of the lease, and

C. A schedule of payments showing amortization of the lease-related liability.

**8. Make required disclosures for year-end lease reporting:** the Finance Department is responsible for ensuring that all calculations and Note disclosures are made in accordance with the requirements of GASB 87.

**9. Account for leases where Edmonds is the lessor.** Accounting for leases where the City is

## Attachment A

the lessor follows the same rules outlined above, except that the City is on the other side of the transactions.

### **Responsibilities and Contacts**

Department directors are responsible for ensuring that their department abides by this policy and the accompanying procedures. Departments must notify the Finance Director of leases as they arise throughout the year and no later than year-end in order to properly calculate and disclose lease commitments as part of the year-end financial reporting process. As with other expenses, the Departments are responsible for making all applicable payments.

The Finance Department is responsible for recording the initial setup of the capital lease asset and liabilities, for amortizing the lease liability, and for recording depreciation of the lease asset.

### **Definitions**

Short-term lease: this lease has the potential length of the maximum possible noncancellable term of 12 months or less. If after considering the effects of potential extensions (regardless of their likelihood of being exercised) the lease agreement specifies a noncancellable term of 12 months or less, the lease is deemed a short-term lease.

Contracts that transfer ownership: Lease contracts that transfer ownership are treated as sales of the asset (by the lessor) and a purchase of the asset on credit (by the lessee). This type of lease cannot contain termination options and the underlying contract transfers ownership of the asset to the lessee by the end of the contract. The GASB allows contracts to contain fiscal funding or cancellation clauses and be treated as a sale as long as it is reasonably certain the clauses will not be exercised.

All other leases: Any other contract or agreement that conveys a right of use of property in exchange for payment will be characterized much like the former "capital lease" under the prior standard (FASB 13).

### **Effective Date**

This policy is effective beginning January 1, 2020.