Purpose

We have been requested by Idaho Virtual Academy (IDVA) to provide an explanation of the impact that the Governmental Accounting Standards Board's Statement 87 (GASB 87) has regarding leases on the School's government-wide financial statements and certain financial metrics.

Background – What is GASB 87?

GASB 87 drastically changes the way leases are accounted for by entities who are subject to governmental accounting standards. It has very different criteria from prior years for what constitutes a lease, and it requires very different presentation for leases in the financial statements. The issue of lease criteria is irrelevant to this summary, but we will briefly explain the changes GASB 87 has on the financial statements.

Previously, if a lease was classified as an *operating lease* (until fiscal year 2022 IDVA's lease was classified as operating), the accounting was very simple. The lease was not included in the financial statements at all, except for a disclosure note in the financial statements explaining the brief terms of the lease as well as the total expense for the year.

Effect of GASB 87 on Government-Wide Financial Statements

Now with the implementation of GASB 87, for long-term leases (those whose terms exceed one year), the value of all future lease payments must be calculated and presented as a liability in the Statement of Net Position of the government-wide financial statements (page 5 of IDVA's audited financial statements). This *decreases* the net position of the School.

Conversely, GASB 87 requires calculation and presentation of an intangible asset representing the 'right to use' the asset being leased (facilities, in the case of IDVA). This intangible asset is also presented in the Statement of Net Position and *increases* the School's net position.

While both the asset and the liability decrease over time, they decrease at different rates. The asset is amortized (reduced) by an equal amount each year (called the straight-line method) until it is reduced to zero at the end of the lease term. Due to the effect of implicit interest, the liability decreases at a slower rate toward the beginning of the lease term, and at a faster rate toward the end as it is paid off (see example Figure 1 on the next page). This results in an artificially low net position toward the beginning of the lease term, and an artificially high net position toward the end of the term.

IDVA Metrics Analysis

The following is an analysis of two of the School's metrics we were asked to calculate with the effects of GASB 87 (as would be measured by the Idaho Public Charter School Commission), as well as without.

Metric: **Debt-to-Asset Ratio**
With GASB 87*: **1.01** (estimated, following method used for other schools by Commission)
Without GASB 87: **0.99**

Metric: **Total Margin**
With GASB 87**: **0.65%** (estimated, following method used for other schools by Commission)
Without GASB 87: -**0.01%**

*The debt-to-asset ratio is calculated from the Statement of Net Position on page 5 of the financial statements. It is calculated by dividing total liabilities (10,972,401) by total assets (10,838,023) and includes the lease-related asset and liabilities mentioned above. To calculate the ratio without the effects of GASB 87, we removed the current and long-term portions of the lease liability (324,403 and 313,909, respectively) from total liabilities, as well as the intangible asset (358,730 – book value calculations found on page 16) from total assets.

**Total margin is calculated by dividing the calculated change in net position (page 10 of the financial statements) by total revenues received by the School (page 9). The calculated change in net position is determined by removing the effects of the change in net pension liability on page 10 (add 280,515 to the ending net position of -155,047). To calculate the change in net position without the effects of GASB 87, we also subtracted the lease principal payment for the year (305,918) and added back the leased asset's amortization expense for the year (179,365). This resulted in a calculated change in net position of -$1,085 (depreciation exp.), leaving a total margin of -0.01%.

Figure 1.

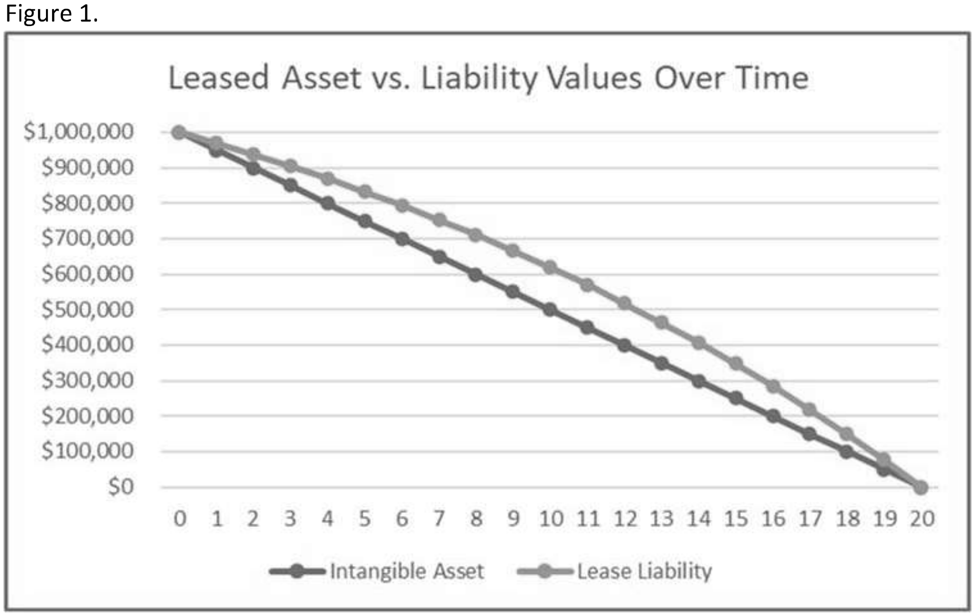

Chart represents the difference in value of a leased asset compared with that of its associated liability throughout the lease term. At first, the asset's net value decreases at a faster rate than the liability's, leaving a lower net position toward the beginning of the lease term. At year 12 the liability begins to decrease faster, increasing overall net position until they both zero out at year 20 and no longer affect net position. Example assumes a calculated present value of $1,000,000 and a 20-year lease life.