

Determining an Appropriate Discount Rate

GASB 87, Leases, and GASB 96, SBITAs

GASB Statement 87 states that 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 cannot be readily determined by the lessee or lessor, the estimated incremental borrowing rate should be used.

GASB Statement 96 states that future subscription payments should be discounted using the interest rate the SBITA vendor charges the government, which may be the interest rate implicit in the SBITA. If the interest rate cannot be readily determined by the government, the government's estimated incremental borrowing rate should be used.

For statewide financial reporting purposes, state entities within the primary government should first use the explicit rate that is stated in their leasing and subscription contracts. In the absence of a stated interest rate, entities should attempt to calculate the implicit interest rate (an internal rate of return). If an implicit rate cannot be determined, the incremental borrowing rate should be used to discount future lease and subscription payments.

The incremental borrowing rate is an estimate of the interest rate that would be charged for borrowing the lease and subscription payment amounts during the lease and SBITA term. It is a measure that is often based on the quality of the borrower (i.e., the rate includes a factor for risk of the borrower), the length of the borrowing, as well as what the borrowed funds will be used for, in addition to other macroeconomic factors including the prevailing interest rate environment.

All agencies/entities within the State's financial reporting entity should make appropriate efforts to determine and document the interest rates used for their lease and subscription agreements, if not explicitly stated in such agreements. In choosing the right incremental borrowing rate, agencies/entities should consider whether this rate comes from a rate-setting body (such as a bank) as well as whether that rate can be supported and justified given the forms of debt that are currently issued by the agency/entity. For example, in the absence of a stated interest rate in the lease and subscription agreement and documentation that an internal rate of return cannot be calculated, an agency/entity may decide to use the [prime bank loan rate](#) as determined by the U.S. Federal Reserve, or an agency/entity may decide to discuss specific borrowing rates with their banking institution.

All decisions regarding interest rate determinations for leasing and subscription agreements should be documented and maintained by the individual state agency/entity.

Future Considerations for Leases and SBITAs

OSC highly recommends new lease and subscription agreements be negotiated in such a manner that an explicit interest rate is contained within the contract. This would require accounting and business offices within state agencies to communicate with their procurement and contracting departments to ensure that contract terms meet financial reporting needs and include the most accurate measure of discounting for leasing and subscription arrangements (i.e., a stated interest rate).

Related Documents (Memos/Forms)

[105.7 – Statewide Accounting Policy - Leases and SBITAs](#)

Revision History

6/16/2021 – Established policy, effective July 1, 2021.

2/24/2023 – Established policy for SBITAs, effective July 1, 2022