

OREGON ACCOUNTING MANUAL		Number 15.60.30.PR
Oregon Department of Administrative Services State Controller's Division		Effective Date July 1, 2001
Chapter	Accounting and Financial Reporting	.1 OF .4
Part	Capital Assets	
Section	Capital Leases	Approval Signature on file at SCD

Authority NCGA Statement No. 5
FASB Statement No. 13
GASB Statement No. 34

Criteria for Recording a Capital Lease

- .101 An asset and a liability should be recorded in an agency's accounting records as a **capital lease** when the present value of the minimum future lease payments is \$5,000 or more and any *one* of the following conditions in (a) through (d) *and* the condition in (e) are met:
- Ownership of the leased **real property** or **personal property** will be transferred to the agency at the end of the lease. In this case, record the liability as a lease-purchase contract payable, general ledger account 1715.
 - The lease contains a **bargain purchase option**. A bargain purchase option exists when the lessee can exercise a provision in the lease to buy the asset sometime during the term of the lease at a price considerably lower than the fair market value of the asset. Also, if there was reasonable assurance or it was the agency's intention at the start of the lease that a purchase option would be exercised, the lease would be considered a capital lease. In this case, record the liability as a lease-purchase contract payable, general ledger account 1715.
 - Lease terms are 75% or more of the real or personal property's useful life. The length of the contract would have to be at least 75% of the actual life of the asset. This would be the case if, for example, an agency has a lease contract for a motor vehicle that extends for 48 months and the agency estimates the useful life of the vehicle at 60 months. In this case, the term of the lease runs for 80% of the normal life of the asset, meeting the criteria. If the term of the lease had been less than 45 months, the lease would not have qualified under this criteria since 45 months is 75% of the useful life of the asset. In addition, if the beginning of a lease term falls within the last 25% of the total estimated useful life of the leased asset, including earlier years of use, the lease is considered an operating lease. Record the liability as an obligation under capital lease, general ledger account 1716.
 - The net present value of future minimum lease payments at the inception of the lease are 90% or more of the fair market value of the real or personal property. A calculation is made for both the lessee's **incremental borrowing rate** and for the lessor's **implicit interest rate**. The present value amounts are then compared to the fair market value of the asset. If the present value amount of either of the calculations exceed 90% of the fair market value, the lease should be classified as a capital lease. Report the liability as an obligation under capital lease, general ledger account 1716.
 - In addition to one of the items above, the lease must not have a cancellation clause in the contract to be considered a capital lease. If the lease contract has a cancellation clause, it

cannot be considered a capital lease and should be reported as an operating lease. A true cancellation clause allows the lessee to terminate at any time for any reason. A clause specifying the cancellation of the lease due to nonappropriation of funds does not eliminate the possibility that the lease is a capital lease. If the chances of the lease being canceled due to nonappropriation are considered to be remote (normally true in the State), the lease must fail all other criteria before considering it an operating lease.

- .102 If the lease does not meet any *one* of the above criteria in .101 (a) through (d) *and* the condition in (e), the lease should be recorded as an **operating lease** in the agency's accounting records. See **OAM 15 80 00** on Commitments for more information on operating leases.

Accounting Transactions

- .103 When a lease meets the criteria of a capital lease, an asset and liability should be recorded in the accounting records.
- a. If property has been leased by a **proprietary fund** or a **fiduciary fund**, the asset, liability and other related entries will be accounted for within the accounts of that fund.
 - b. If property has been leased using resources from **governmental funds** (for general government purposes), the asset will be capitalized and the liability will be recorded in the **government-wide reporting fund**. Payments to reduce the liability will be in the governmental fund that originated the liability. A **debt service fund** is not to be used to record payments on this type of liability unless legally mandated through an appropriation.
- .104 The entry to record a capital lease and the corresponding liability in either a proprietary fund or the government-wide reporting fund is as follows:

TC 466 Establish asset and liability for capital lease

DR 0863 Capital Leased Property	xxx	
DR 3074 Change in Capital Assets	xxx	
CR 3018 Invested in Capital Assets		xxx
CR 1715 Lease-Purchases Contracts Payable		xxx
or CR 1716 Obligations Under Capital Lease		

- .105 To reduce the liability when a principal payment is made, record:

TC 459 Reduce liability due to payment made

DR 1715 Lease-Purchases Contracts Payable	xxx	
or DR 1716 Obligations Under Capital Lease		
CR 3600 GAAP Expenditure Offset-Capital Outlay		xxx

- .106 When capital leased property is disposed of, record an entry as follows:

TC 535 Disposition of capital leased property

DR 0871 Accumulated Amortization-Capital Leased Property	xxx	
CR 0863 Capital Leased Property		xxx

If the capital leased property has any unamortized balance, the follow entry is made:

TC 537 Remove unamortized balance of capital leased asset

DR 3200 GAAP Revenue Offset-Gain(loss) on Disposition	xxx	
DR 3018 Invested in Capital Assets	xxx	
CR 0863 Capital Leased Property		xxx
CR 3074 Change in Capital Assets		xxx

- .107 For capital leases meeting criteria (a) and (b) in .101 above (lease-purchase contracts payable), expenditures for payments on a capital lease entered into for general government purposes are reflected in **R*STARS** as capital outlay (for principal amount) and debt service (for interest expenditure). For governmental fund financial statement reporting purposes, capital outlay expenditures recorded during the year are reclassified to debt service principal expenditures. The expenditures are eliminated for reporting in the government-wide financial statements.
- .108 For capital leases meeting criteria (c) and (d) in .101 above (obligations under capital lease), expenditures for payments on a capital lease entered into for general government purposes are reflected as capital outlay expenditures. For governmental fund financial statement reporting purposes, capital outlay expenditures recorded during the year are reclassified to debt service principal and interest expenditures, as applicable. The principal expense is eliminated for reporting in the government-wide financial statements.
- .109 In the year a new lease purchase is incurred by governmental funds, an entry is made by SARS during financial statement compilation to record a capital outlay expenditure and an other financing source to properly report leases incurred on the operating statement. Needed information is obtained from agency year end disclosure forms.
- .110 For capital leases meeting criteria (a) and (b) in .101 above (lease-purchase contracts payable), expenses for payments on proprietary fund capital leases are reflected as capital outlay (for principal amount) and debt service (for interest expense). Through the use of GAAP offsets, expenses for principal payments are eliminated against the change in liability.
- .111 For capital leases meeting criteria (c) and (d) in .101 above (obligations under capital lease), expenses for payments on proprietary fund capital leases are reflected as capital outlay expenses. Through the use of GAAP offsets, expenses for principal payments are eliminated against the change in liability.
- .112 For capital leases meeting criteria (a) and (b) in .101 above (lease-purchase contracts payable), use the estimated useful life of the asset to record amortization of the capital lease. For capital leases meeting criteria (c) and (d) in .101 above (obligations under capital lease), amortization would be recorded based on the length of the lease, not the useful life of the asset. Refer to **OAM 15 60 20** on Depreciation and Amortization of capital assets for guidance on amortization.

Financial Statement Reporting

- .113 In proprietary funds, capital leased property is reported as part of Buildings, Property and Equipment within the capital assets category on the proprietary fund statement of net assets. Both lease-purchase contracts payable and obligations under capital lease are reported as part of Obligations Under Capital Lease in the proprietary fund statement of net assets. Because the statement of net assets is presented in the classified format, agencies should reclassify the current portion of the liability into general ledger account 1280, Lease-Purchase Contracts Payable-Current, and general ledger account 1281, Obligations Under Capital Lease-Current, as applicable, at fiscal year end. This reclassification will allow the current and noncurrent portions of the liability to be appropriately reported on the face of the statement of net assets.

- .114 In the government-wide reporting fund, capital leased property is reported as part of Buildings, Property and Equipment within the capital assets category on the government-wide statement of net assets. Both lease-purchase contracts payable and obligations under capital lease are reported as part of Obligations Under Capital Lease in the government-wide statement of net assets. Because the statement of net assets is presented in the classified format, agencies should reclassify the current portion of the liability into general ledger account 1280, Lease-Purchase Contracts Payable-Current, and general ledger account 1281, Obligations Under Capital Lease-Current, as applicable, at fiscal year end. This reclassification will allow the current and noncurrent portions of the liability to be appropriately reported on the face of the statement of net assets.
- .115 Amortization expense in proprietary funds is reported in the statement of revenues, expenses and changes in fund net assets as a separate line item within operating expenses. Accumulated amortization is reported as a contra account to capital assets on the proprietary fund statement of net assets.
- .116 Amortization expense in the government-wide reporting fund is reported in the statement of activities in the applicable function for governmental or business-type activities. Accumulated amortization for general capital assets is reported as a contra account to capital assets on the government-wide statement of net assets.

Disclosure Requirements

- .117 Agencies should complete year end disclosure forms applicable to capital leases to allow SARS to disclose required information in the notes to the State’s financial statements. Agencies that issue audited financial statements should include required capital lease disclosures in the notes to their financial statements.
- .118 A listing of the minimum future lease payments for five years and after, in the aggregate, should be presented in the notes to the financial statements for both governmental and business-type activities as in the following example:

Year Ended	Business-Type	Governmental
<u>June 30</u>	<u>Activities</u>	<u>Activities</u>
2003	\$4,800	\$9,600
2004	4,800	9,600
2005	4,800	7,200
2006	4,800	7,200
2007	2,700	7,200
Thereafter	<u>7,200</u>	<u>4,800</u>
Total future minimum lease payments	29,100	45,600
Less amounts representing interest	<u>9,700</u>	<u>16,800</u>
Present value of net minimum lease payments	<u>\$19,400</u>	<u>\$28,800</u>