1250 Siskiyou Blvd, Ashland, Oregon 97520

T 541-552-6594 | **F** 541-552-6573

Number: 05.281

Accounting for Leases

Capital and Operating Leases

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Accounting for Leases

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.100 PROCEDURE STATEMENT

This policy sets forth system-wide standards for financial accounting and reporting of leases.

.110 PROCEDURE RATIONALE

OUS seeks to ensure that the policies and procedures related to financial accounting and reporting of leases are documented, communicated, clearly understood, and consistently applied.

.120 AUTHORITY

ORS 351.085 - Duties and Powers of Chancellor

OAR 580-040-0005 - Delegation and Assignment of Responsibility

IMD 6.001 - Finance and Business Affairs Accounting Policies - Assignment of Responsibility

FASB Statement No. 13 and subsequent FASB statements related to accounting for leases

GASB Statement No. 13, No. 34 and other GASB Statements related to accounting for leases

.130 APPROVAL AND EFFECTIVE DATE OF POLICY

Approved by the Associate Vice Chancellor for Finance & Administration/Controller, effective March 9, 2007. Additional clarifications and an additional section on the accounting for leasehold improvements were added effective December 15, 2008. Approved by the Vice President for Finance and Administration, effective July 1, 2015.

.140 KNOWLEDGE OF THIS PROCEDURE

All SOU institutional and personnel with financial management responsibilities and accounting and financial reporting responsibilities related to leases should be knowledgeable of this policy.

.150 DEFINITIONS

The financial accounting and reporting for leases requires a comprehensive understanding of a number of definitions. For ease in understandability, the definitions below are presented in order of major category.

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Accounting for Leases
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General Definitions:

Lease - A legal contract by which one party gives to another the use and possession of real or personal property for a specified time in exchange for periodic payments.

Lessee - The party who leases personal or real property from a lessor.

Lessor - The owner or owner's representative of the personal or real property that is leased to a lessor.

Inception Date - Effective date of the lease (the date the lessee has the right to occupy and/or use the property).

Non-cancelable - Terms of the lease make the possibility of cancellation by the lessee remote. (See Note 1)

Types of Leases: For financial accounting and reporting purposes, leases fall into one of two types:

Capital Lease - A lease of personal or real property which is non-cancelable, meets one or more of the four capitalization criteria in Section .200.A of this policy, and meets or exceeds the $5,000 capitalization threshold at the inception date of the lease.

Operating Lease - A lease of personal or real property that does not meet the criteria for a capital lease.

Lease Payments: Leases make reference to a number of different types of payments. Although different leases may use different terminology, the general types of lease payments are:

Rent - Periodic payments made in exchange for use of real or personal property. Rent comprises minimal rental payments and (if applicable) additional rental payments.

Minimal Rental Payments - Base fixed rent amount per period. The base fixed rent also includes scheduled rent increases that are detailed in the lease as of the inception date.

Additional Rent - Rent in addition to minimum rental payments. An example of additional rent includes the stated percentage of gross sales which would vary from period to period.

Executory Costs - These payments reimburse the lessor for certain costs related to the leased asset such as insurance, maintenance and tax expenses. Some lease agreements may refer to executory costs as "additional rent" or "additional costs."

Additional Costs - Components of rent, executory costs, tenant improvements, and/or other costs such as a required payment if the lessee fails to renew the lease at the expiration of the lease term.

Tenant Improvements - Expenditures by the lessee that add on to or improve the property being leased. Lease may refer to these as leasehold improvements

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Specific Lease Terms: The following terms are used to determine if the lease is a capital lease:

Bargain Purchase Option - An option that allows the lessee to purchase the leased property at the end of the lease for an amount that is significantly lower than the expected fair market value at the end of the lease.

Fair Market Value (FMV) - The price at which two unrelated and informed parties, each acting in their own best interest, agree to a transaction. Also referred to as an "arms-length transaction." Applied to leases, the fair market value of the property being leased would be the price for which it could be sold in an arm's-length transaction between unrelated parties.

Present Value (PV) - The current value of future cash payments, discounted at the appropriate interest rate. The interest rate used to calculate the PV is usually the financing rate in the lease. If the calculated PV is greater than the fair market value of the property being leased, the interest rate must be reduced so that the calculated PV equals the fair market value.

Interest Rate - The lower of the financing rate in the lease or the lessee's incremental borrowing rate, which is the realistic rate of interest that the lessee would have paid if it had borrowed funds to buy the asset under similar terms. OUS estimates the lessee's incremental borrowing rate at two (2) percentage points above the rate paid by the Oregon Short Term Fund (OSTF). OSTF interest rates are found on the Office of State Treasurer website at: http://www.ost.state.or.us/About/OSTF/RateChanges.asp

Lease Term - The lease term includes the non-cancelable term of the lease, plus the following;

- All periods for which failure to renew the lease imposes a penalty on the lessee
- All periods covered by renewal or extension options:
    - during which the lessee guarantees the lessor's debt on the leased property
    - up to the date a bargain purchase option is exercisable
    - That are at the lessor's option

Minimum Lease Payments - If the lease contains a bargain purchase option, minimum lease payments include only the minimum rental payments over the lease term and the payment called for in the bargain purchase option. Otherwise, minimum lease payments include the following:

- Minimum rental payments called for by the lease over the lease term
- Any guarantee of residual value at the expiration of the lease term
- Payments that the lessee must or can be required to make upon failure to renew or extend the lease at the expiration of the lease term

Minimum lease payments do not include executory costs or additional rental payments.

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Allocation of Capital Lease Payments: The following terms are used for allocating capital lease payments between principal and interest:

Effective Interest Method - A method for determining the portion of the capital lease payments to be allocated to principal and interest expense. The amount allocated to interest expense is the outstanding principal balance at the beginning of the payment period multiplied by the interest rate. The portion of the payment not allocated to interest expense reduces the outstanding principal balance. Appendix .700.A of this policy provides an example of the use of the effective interest rate method in a capital lease amortization schedule.

Service Life: The following terms are used for amortizing the cost of the capital lease over multiple financial reporting periods:

Guaranteed Residual Value - 1) The certain or determinable amount the lessor has the right to require the lessee to pay to purchase the leased property, or 2) the amount the lessee or the third-party guarantor guarantees the lessor will realize at the end of the lease.

Residual Value - The price at which a fixed asset is expected to be sold at the end of its service life. Residual value is also referred to as salvage or scrap value.

Service Life - Length of time an asset is expected to last. Service life is used to calculate annual depreciation expense and is dictated by the applicable asset type in Banner Fixed Assets. For some capital leases and leasehold improvements, the default service life of the asset type must be changed to the remainder of the lease term.

Other: The following are additional terms associated with the financial accounting and reporting of leases:

Leasehold Improvement - Addition or improvement made to leased property. The improvements are attached to property not owned by the lessee. The lessee has the right to use the leasehold improvement for the remaining term of the lease.

Sale and Leaseback - Occurs when the institution sells an asset and then enters into a lease agreement to lease the asset back.

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.160 RESPONSIBILITIES

Responsibilities related to accounting for leases include the following:

A. SOU Business Services Accounting\Controller's Office

Developing accounting and reporting policies related to leases.

Reporting lease disclosures in financial statements.

B. Institutions

Determining correct classification of capital versus operating lease.

Recording leases correctly in Banner FIS and Fixed Assets.

Completing and submitting required year-end reports to the Controller's Division

.200 UNIVERSITY AS LESSEE

A. Criteria for Capital vs Operating Lease

In general, a capital lease transfers the risks and benefits of ownership to the lessee either through actual title transfer at the end of the lease or because the lease covers a significant portion of the expected life of the leased property. Operating leases are generally for substantially less than the expected life of the leased property and/or contain cancellation clauses so that the institution is not committed to a long term payment stream.

For financial accounting and reporting purposes, the lease is a "capital lease" if:

a) The fair market value of the property at the inception of the lease meets or exceeds the capitalization threshold of $5,000,

b) The lease is non-cancelable, and

c) The lease meets one or more of the following four criteria:

1) The lease transfers ownership of the property to the lessee by the end of the lease term.

2) The lease contains a bargain purchase option.

3) The lease term is equal to or greater than 75% of the estimated service life of the leased property (e.g., lease is six years, estimated life is eight years.)

4) The present value (PV) of minimum lease payments equals or exceeds 90% of the fair value of the leased property (e.g., PV of future minimum lease payments is $9,000, fair market value of property is $10,000.)

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Criteria 3 and 4 are not applicable if the lease term begins during the final 25% of the property's economic life.

If a lease does not meet the above criteria a., b., and c., it should be treated as an operating lease.

B. Capital Lease Authorization

A capital lease is essentially a financing arrangement for the acquisition of personal or real property. ORS 283.085 to 283.092 requires approval of the Department of Administrative Services for financing arrangements in excess of $100,000.

C. Real Estate Leases

Land Only

Leases involving only land are capitalized if either criteria A.c.1. or A.c.2. above are met. If neither of those criteria is met, the lease is classified as an operating lease. The more restrictive criteria are due to the non-depreciable nature of land.

Land and Building

When a lease includes land and building, the capitalization criteria is more complicated. If criteria A.c.1. or A.c.2. above are met, the entire lease is capitalized; however, the land and building must be capitalized separately. The present value of the minimum lease payments is allocated between the land and the building in proportion to their fair market values (FMV) at the inception of the lease. The FMV must be determined by the university based on an appraisal and/or the lease.

If neither criteria A.c.1. or A.c.2. are met, an allocation is made between land and building based on relative fair values before applying criteria A.c.3. and A.c.4. If the fair value of the land component is less than 25% of the total, the total value of the lease is treated as entirely applicable to the building. If either criteria A.c.3. or A.c.4. are met, the entire lease is capitalized.

If the land component is 25% or greater, the land and building are treated separately. The land portion is accounted for as an operating lease. Criteria A.c.3. and A.c.4. are applied to the building based on the portion of the lease allocated to the building. If either criterion is met, the building portion is accounted for as a capital lease. If neither criteria A.c.3. or A.c.4. is met, the entire lease is accounted for as an operating lease.

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D. Accounting for a Capital Lease

Capital leases are considered a form of debt financing and must be accounted for as such.

Recording a Capital Lease

Each capital lease requires an amortization schedule. The amortization schedule uses the effective interest method to break-out the minimum lease payments into principal and interest expense. The interest rate used in the amortization schedule must result in the following two conditions:

At inception date, the present value of the minimum lease payments is less than or equal to the fair market value of the property to be leased.

The principal balance at the end of the lease term is $0.

If the interest rate stated in the lease agreement does not result in the above two conditions, the interest rate in the amortization schedule must be revised to an implicit interest rate that will satisfy the above two conditions.

The present value of minimum lease payments at the inception of the capital lease is recorded as an asset and liability in Banner FIS. Since the capital lease is considered a form of financing and not descriptive of the property itself, the property being leased is recorded as a capital asset based on asset type (e.g., equipment, building, etc.) in the Banner Fixed Assets system.

Recording the capital lease as an asset in Banner Fixed Assets automatically debits the applicable asset account in Banner FIS with an offsetting credit to account code "E1001 NIP Change in Fixed Assets." The credit to account code E1001 in Banner FIS must then be reclassified to a capital lease liability. See Appendix .700.A for sample accounting entries for a capital lease.

Accounting for Capital Lease Payments

As lease payments are made during the year, principal, interest and executory costs need to be separated out in accordance with the amortization schedule that uses the effective interest method to allocate between the interest expense and principal payment of the capital lease liability. The principal, interest and executory costs should be charged to the appropriate operating ledger expense account codes. Throughout the year or by the end of each fiscal year, the capital lease payable liability must be adjusted for the amount of principal paid during the year.

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Amortization of Capital Lease

Capital leases are amortized due to the right to use the leased property without owning or having title to the property. Because the annual financial statements incorporate capital leases into the property, plant, and equipment caption (not intangible assets), the amortization of capital leases are included with depreciation expense and accumulated depreciation in the OUS accounting records.

The amortization period is generally the term of the lease. But if the lease contains provision for transferring ownership or a bargain purchase option, then the amortization period is the service life of the asset type.

A capital lease for which we do not expect to obtain ownership should technically not be amortized below its guaranteed residual value. However, accommodating this requirement would conflict with OUS's general depreciation policy of no salvage value. Given that few capital leases entered into by OUS, if any, contain guaranteed residual values, OUS accounting policy is not to consider salvage value in the amortization of capital leases.

When the lease is complete, if the leased property is returned to the lessor, the capital lease and its accumulated depreciation records are updated to "disposed" status in Banner Fixed Asset records and the institution's accounting records. If, at the end of the lease, the institution exercises the bargain purchase option or title to the asset is otherwise transferred to the institution, the capital lease and accumulated depreciation should not be "disposed" in the institution's accounting records.

See Appendix .700 for examples of accounting entries.

E. Financial Reporting Requirements for Capital Leases

In the notes to the annual financial statements, OUS is required by GAAP to disclose, in total, both the capitalized cost and accumulated depreciation of capital leases, the range of interest rates, the latest lease expiration date, and provide a schedule of the future minimum lease payments (excluding executory costs).

At fiscal year-end institutions are required to submit two schedules to the Chancellor's Office Controller's Division: a Capital Lease Liability schedule (FS.2.b) of debt amortization for each capital lease and a Capitalized Lease Asset schedule (FS.2.c) of the capitalized cost and accumulated depreciation of capital leases.

Refer to the annual closing of the books instructions for the requested format of the reports.

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F. Accounting for an Operating Lease

Operating leases are not recorded as assets or liabilities in Banner FIS general ledger accounting records. Operating lease payments are treated strictly as current year expenses and recorded in FIS as such. An institution may enter into an operating lease with "scheduled rent increases". The two most common reasons for periodic operating lease payment increases require different accounting treatment:

Inducements to Lease: The lease payments may be artificially low in the beginning of a lease to induce the lessee to sign the lease. If this is the case, operating lease expense needs to be evenly distributed over the life of the lease based on the straight-line method. An Operating Lease Liability must be accrued during the years of low lease payments. The liability is then decreased during the years of higher lease payments.

Economic: The lease payments may increase due to an increase in the appraised value of the property or because the lease payments are tied to the Consumer Price Index or inflation. If this is the case, payments should be expensed as they are made and there is no need to attempt to calculate or account for future increases before they occur.

Property leased pursuant to an operating lease is not required to be recorded in Banner Fixed Assets. An institution may choose to record property from operating leases in Banner Fixed Assets for insurance coverage purposes. If one enters a property pursuant to an operating lease in Banner Fixed Assets, one must select options that do not result in recording it as an asset in Banner FIS.

See Appendix .700 for examples of accounting entries.

G. Financial Reporting Requirements for Operating Leases

OUS is required by GAAP to disclose total current year, total prior year and total future minimum lease payments relating to the non-cancelable portion of operating leases in the notes to the annual financial statements. To meet these reporting requirements, institutions are required to maintain a schedule of all operating leases and the expected non-cancelable future payments of those operating leases, including any scheduled rent increase, if known. This listing is required to be submitted to the Chancellor's Office Controller's Division as a part of the annual closing of the books. Refer to Operating Lease Liability schedule FS.2.a.

The "non-cancelable portion of an operating lease" relates to the time period required for cancellation by the lessee. If a lease requires one month notice for cancellation, one month's worth of future expense would be reported in the notes to the financial statements at year-end. If a lease requires one year notice for cancellation, 12 months' worth of future expense would be reported in the notes to the financial statements at year-end. If the lease is considered non-cancelable, future expenses for the life of the lease would be reported.

Refer to the annual closing of the books instructions for the requested format of the reports.

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H. Accounting for Leasehold Improvements

Leasehold improvements are additions or improvements made to lease property. The improvements become part of or are attached to property not owned by the lessee. The institution (lessee) has the right to use the leasehold improvement for the remaining term of the lease. Leasehold improvements typically refer to improvements made to buildings or land (real property) that an institution currently occupies through an operating lease.

For accounting purposes, leasehold improvements are capitalized and amortized in the OUS accounting records if all of the following occur:

- The leasehold improvement will last more than one year.
- The remaining term of the lease is also more than one year.
- The cost of the leasehold improvement equals or exceeds the $5,000 capitalization threshold.
- The cost of the leasehold improvement is charged to and paid by the institution (lessee) and not by the lessor (or owner represented by the lessor) of the leased property.
- The cost of the leasehold improvement does not reduce current or future lease payments of the institution (lessee).
- The institution has the right to use the leasehold improvement for the remaining term of the lease.

Leasehold improvements that do not meet the above criteria are expensed.

Leasehold improvements do not include:

- Moveable equipment or furniture because they are not attached to the property being leased and the institution has title to them.
- Expenditures for improvements in exchange for reductions in current or future rent payments. Improvements made by the lessee in lieu of rent payments should be recorded as rent payments. Improvements in lieu of rent payments for a period that goes beyond the current fiscal year should be prorated between rent payments and prepaid expense over the entire period for which rent payments are waived.

Leasehold improvements to real property leased by OUS institutions that will be capitalized should be accounted for in fund type 81 – unexpended plant funds.

Capitalized leasehold improvements are included in the fixed asset captions of the financial statements. They are recorded as capital assets in Banner FIS based on the nature of the underlying property (e.g., building, land improvements, etc.).

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The term "leasehold improvement" is not descriptive of the property itself; therefore, when recording leasehold improvements in Banner Fixed Assets, the asset type and account code (e.g., building, land improvements, etc.) must indicate the nature of the underlying property (e.g., building, land improvement, etc.).

Record user attribute code "LH" in the banner fixed asset record to separately identify a leased asset as a leasehold improvement in the banner fixed assets system."

An institution may choose to record non capitalized leasehold improvements in the Banner Fixed Assets system for insurance coverage purposes. When entering non capitalized leasehold improvements in Banner Fixed Assets, one must select options that do not result in recording it as an asset in Banner FIS.

Capitalized leasehold improvements are amortized because we have the right to use the leasehold improvement but do not own or have title to the property. Because leasehold improvements are reported with property, plant, and equipment (not with intangible assets), the amortization of leasehold improvements is recorded as depreciation expense and accumulated depreciation in the OUS accounting records.

The amortization period for leasehold improvements is as follows:

Lease Type	Amortization Period
Leasehold improvements to operating leases, or Leasehold improvements to capital leases without provision for transfer of ownership or bargain purchase option.	Shorter of the remaining term of the lease or the service life of the asset type associated with the leasehold improvement.
Leasehold improvements to capital leases with provision for transfer of ownership or bargain purchase option.	Shorter of the remaining service life of the asset type of the capital lease, or the service life of the asset type associated with the leasehold improvement.

When leasehold improvements are recorded in Banner Fixed Assets, the amortization life is defaulted to the service life of the asset type associated with the kind of improvement. The service life should be changed to the amortization period required in the above table.

At the end of the lease, if the leased property is returned to the lessor, the leasehold improvement and its accumulated depreciation records are updated to "disposed" status. If, at the end of the lease, the institution exercises the bargain purchase option or title to the asset is otherwise transferred to the

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institution, the leasehold improvement and accumulated depreciation should remain on the institution's accounting records.

I. Leasehold Improvement Bonds and Capital Construction

Real property leasehold improvements that are paid for by the institution are essentially capital construction projects and must comply with rules, regulations and policies for capital construction, including complying with system wide limits and legislative approval requirements.

If leasehold improvements are to be financed with bonds, the term of the bonds can't be longer than the original lease term. The original lease term does not include any renewal or extension options.

J. Financial Reporting Requirements for Leasehold Improvements

Leasehold improvements are not separately disclosed in the annual financial statements or notes to the financial statements. Nevertheless, potential financial reporting needs related to leasehold improvements include the following:

- To separately identify leasehold improvements in Banner Fixed Assets.
- To record leasehold improvements in the correct real property asset category (e.g., buildings, land improvements) for financial reporting purposes.
- To amortize leasehold improvements over the appropriate period of time.
- To ensure that asset records and accumulated depreciation records of leasehold improvements are updated to "disposed" status at end of lease term or, if capitalized lease purchase, updated to "disposed" when the asset is disposed of.

.210 UNIVERSITY AS LESSOR

An institution may enter into an operating lease as the lessor when leasing an asset to either an outside entity or another OUS institution. It would be unusual for an institution to be the lessor in a capital lease. If your institution is contemplating such a transaction, please contact the OUS Controller's Division.

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A. Operating Lease with Entity Outside of OUS

1. Accounting Requirements

No entries are made in Banner FIS at the inception of the operating lease. Accounting transactions in Banner FIS are limited to recording the periodic revenue of the operating lease. If maintenance or other costs are billed to the lessee, they should be accounted for in the proper income account codes. Institutions are required to maintain a record of all operating leases to provide information for the notes to the annual financial statements.

2. Financial Reporting Requirements

In the notes to the annual financial statements, OUS is required by GAAP to disclose operating lease receivables. To meet these reporting requirements, institutions are required to submit a schedule of future lease receivables for all non-cancelable operating leases, including current year lease rental income.

Institutions are also required to provide certain information relating to land, property or equipment that is leased out. The information should include type of asset being leased, capitalized cost of the leased asset, accumulated depreciation on the leased asset and a description of the leasing arrangement.

At fiscal year-end institutions are required to submit this information in two schedules to the Chancellor's Office Controller's Division: Operating Lease - Minimum Future Rentals schedule (FS.13.a) and Operating Lease Receivables - Leased Asset Information schedule (FS.13.b).

Refer to the annual closing of the books instructions for the requested format of the reports.

B. Operating Lease between OUS Institutions

1. Accounting Requirements

No entries are made in Banner FIS at the inception of the operating lease. Accounting transactions in Banner FIS are limited to recording the periodic revenue or expense of the operating lease. Institutions are required to maintain a record of all operating leases to provide information for the notes to the annual financial statements.

2. Financial Reporting Requirements

In order for operating leases between institutions to be eliminated from the financial statements, institutions are required to submit a schedule of such leases at year-end as part of the closing of the books. Both the lessee and lessor institutions need to report the lease.

The lessor institution needs to report the type of asset being leased, capitalized cost of the leased asset, accumulated depreciation on the leased asset, a description of the leasing arrangement, the institution the asset is leased to, and lease income for the year.

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The lessee institution needs to report a brief description of the leased asset, the institution the asset is leased from and lease expense for the year.

Refer to the annual closing of the books instructions for the requested format of the reports.

.220 SALE AND LEASEBACK

A sale and leaseback occurs when an institution sells an asset and then enters into a lease agreement to lease the asset back. If your institution is contemplating a sale/leaseback transaction, please contact the OUS Controller's Division. The four capitalization criteria in Section .200.A must be applied to the leaseback in order to determine if it is a capital or operating lease.

<u>A. Accounting for Sale/Leaseback Transactions</u>

The sale of the asset could result in a gain or loss; however, the leaseback of the same asset must be considered in the accounting of the gain or loss. The institution has the same asset and therefore, any gain or loss on the sale should be deferred.

If the leaseback is an operating lease, the deferred gain or loss should be recognized proportionally to the lease payments. If the lease is a capital lease, the deferred gain or loss should be recognized proportionally to lease depreciation.

There are two exceptions to the rule of deferring a gain or loss. The institution may record the gain or loss on the sale immediately if, in the leaseback, it retains usage of a substantially smaller portion (10% or less) of the total asset. Also, a loss is recognized immediately if the asset's fair value at the time of the sale is less than its undepreciated cost. In this case, the amount of the loss to be recognized is the difference between the undepreciated cost of the asset and its fair value.

See Appendix .700 for examples of accounting entries.

<u>B. Reporting Requirements for Sale/Leaseback</u>

Involving Personal Property

For sale/leaseback transactions involving only personal property, the institution should include the lease information in the appropriate schedule for either a capital or operating lease.

Involving Real Property

For sale/leaseback transactions involving real property, there are additional reporting requirements. Institutions must report to the Chancellor's Office Controller's Division, a description of terms of sale/leaseback transaction, including future commitments, obligations, and other provisions that require or result in the institution's continuing involvement. OUS must disclose in the notes to the financial statements, the obligations for future minimum lease payments.

Refer to the annual closing of the books instructions for the requested format of the reports.

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.230 IRS FILING REQUIREMENTS FOR LEASE/PURCHASE AGREEMENTS

Each year, OUS is required to report to the IRS all leases entered into during the previous calendar year for which the OUS may ultimately acquire an interest in the property. This can be either through a bargain purchase option or title transfer. For IRS reporting purposes, the OUS capitalization threshold of $5,000 does not apply. Financing agreements must have a stated interest rate and the cost of purchasing the asset should be less than the estimated economic value of the asset at the termination of the lease/purchase (Bargain Purchase Option.) Individual leases of less than $100,000 can be aggregated and reported on IRS Form 8038-GC "Informational Return for Small Tax-Exempt Governmental Bond Issues and Installment Sales." The filing deadline for this form is February 15th. Individual lease purchase agreements entered into during the year that equal or exceed $100,000 must be reported separately on IRS Form 8038-G "Information Return for Tax-Exempt Governmental Obligations." The reporting deadline for this form is on or before the 15th day of the 2nd calendar month after the close of the calendar quarter in which the lease is entered into. (i.e., if a qualifying lease is entered into on July 10th, it must be reported to the IRS by November 15th.) If an institution enters into a lease/purchase agreement that meets these reporting requirements, the lease must be reported to the Chancellor's Office Controller's Division, Debt Manager within 30 days of the lease inception.

For purposes of these IRS forms, the "entered into date" for a lease or installment purchase is defined as "the date interest starts to accrue."

See Appendix .700.D for specific data to be reported and requested reporting format.

.690 CONTACT INFORMATION

Direct questions about this policy to the following offices:

Subject	Contact
General questions from institutional personnel	Service Center
General questions from institutional central administration and Chancellor's Office personnel	Business Services - Controller's Division

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.695 HISTORY

03/09/07 - Approved

12/15/08 - Updated

Policy Last Updated 12/15/08

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APPENDIX

.700 ACCOUNTING EXAMPLES

Note: It is understood that there are a number of ways to accomplish the desired end result in accounting for leases. So long as the institution's accounting records properly record lease payable liability, annual interest, and executory costs at year end, each institution may set its own accounting procedures for leases.

A. Capital Leases

There are a number of steps involved in accounting for a capital lease. They include:

- Recording the capital lease in Banner Fixed Assets.
- Capitalizing the fixed asset.
- Entering a JV in FIS to reclassify the equity associated with the asset to a capital lease payable liability.
- Making periodic lease payments of principal, interest and executory costs.
- Recording depreciation on the capitalized lease.
- Removing accumulated depreciation and asset from the accounting records if the institution does not retain ownership of the asset at the end of the lease.

The following example illustrates the accounting entries for a capital lease:

Example of Capital Lease Accounting Entries (LINK BROKEN…PROVIDE EXAMPLES)

B. Operating Leases

Accounting for an operating lease is fairly straight forward in that each lease payment is a current year expense as it occurs. If a lease contains scheduled rent increases, the institution must spread the expense evenly over the life of the lease. This may result in the institution recording a liability or a prepaid, depending on the situation.

The following example illustrates the accounting entries for an operating lease:

Example of Operating Lease Accounting Entries (LINK BROKEN…PROVIDE EXAMPLES)

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Accounting for Leases
Capital and Operating Leases

C. Leasehold Improvements

The following example illustrates the accounting entries for capitalizing and amortizing a leasehold improvement:

Example of Leasehold Improvements Accounting Entries (LINK BROKEN…PROVIDE EXAMPLES)

D. Sale/Leaseback

There are a number of steps involved in accounting for a sale/leaseback. They include:

Disposing of the fixed asset.

Recording deferred gain or loss on sale unless either of the two exceptions in Section .220.A is met.

Determining if the leaseback is a capital or operating lease and recording it appropriately.

The following example illustrates the accounting entries for a sale/leaseback:

Example of Sale and Leaseback Accounting Entries

E. IRS Lease/Purchase Reporting

For purposes of reporting lease/purchase agreements to the IRS, please provide the following information to the Chancellor's Office Controller's Division, Debt Manager:

- Lessor's Name
- Type of property being leased
- Lease Inception Date
- Lease Issue Price (principal amount of property being leased)

The following is an example of the data to be submitted:

Example of IRS Lease/Purchase Reporting (LINK BROKEN…PROVIDE EXAMPLES)

Appendix Last Updated: 12/15/08

Footnotes:

1) Leases pertaining to governments often have a cancellation ("non-appropriation") clause for circumstances in which the lease would be cancelable if the legislature or other funding authority does not appropriate the funds necessary for the governmental unit to fulfill its obligations under the lease agreements. If this occurrence is considered a "remote contingency," the lease should be considered non-cancelable.