Leases

2 Types of Leases

- Covered in MOM 335 and 340
  - New capital lease example in MOM 335 (XIV.C, 5-7)
- Operating Lease
  - Lessee uses property then returns it
  - Benefits/drawbacks of ownership remain with lessor
- Capital Lease
  - Lessee uses all or nearly all of the property's useful life
  - Benefits/drawbacks of ownership transfer to lessee

Determination of Lease Type

- Bright-line standard for determination
- If <u>any</u> of the four are met, then the lease must be accounted for as a capital lease:
  1. Title transfers to lessee by the end of the lease
  2. Lease contains a bargain purchase option for lessee
  3. Lease term > 75% of property's useful life
  4. Present value of payments > 90% FMV of property (use Excel template in MOM 335/340)

Installment Purchases

- Property which is paid for over time
- Title transfers to lessee at the inception of the agreement
- Transaction is accounted for as a capital lease

Capital Lease

- Should be added to AM in the month of inception
- If the lease was not added, the asset should be added to AM
  - Requires two more manual entries
- Entry detail can be found in MOM 335 and 340
- Interest is included in capital lease payments

Capital Lease Entries

1. Inception of the lease agreement (governmental funds only)
2. Add lease to AM
3. Annual depreciation
4. Lease principal and interest payment
5. Reduce lease obligation by principal payments
6. Adjust liability amount to be paid in following fiscal year (principal portion only, reverse next FY)
7. Accrue interest payable at FYE (reverse next FY)

Capital Lease Example

- Scenario
  - Agency enters into a 5 year lease in a governmental fund (modified accrual)
  - Monthly payments of $250 are made at the beginning of each month of the contract beginning 01/01/2012
  - The interest rate provided by lessor is 7.3%
  - Lease was <u>not</u> added to AM during the month of inception

Capital Lease Example (cont.)

Macro from MOM 335 XIV C 5 or MOM 340 XIII A

State of Montana

Capital Lease Amortization Schedule

Enter Values	
Number of Total Payments	60.0
Interest Rate (x.xx%)	7.30%
Payment Amount (enter as a negative because payment is going out; if a portion of your payment is for executory costs such as maintenance, taxes, or insurance, then exclude that portion from the amount you input here.)	$ (250.00)
Future Value - Leave as 0	$ -
Executory Costs (enter as a positive number; input 0 if no part of your payment goes towards executory costs.)	$ -
Date of First Payment (m/d/yyyy)	1/1/2012
Number of Payments per Year	12
Enter 1 if payment is up front, or 0 if payment is at the end of the service period.	1

Print Schedule

Clear Input

$ 149.34

Present Value
$ 12,611.96

Date of Payment	Payment #	Maintenance Fee	Payment Amount	Interest	Principal	Balance
1/1/2012	1	$ -	$ 250.00	$ -	$ 250.00	$ 12,361.96
2/1/2012	2	$ -	$ 250.00	$ 75.20	$ 174.80	$ 12,187.16
3/1/2012	3	$ -	$ 250.00	$ 74.14	$ 175.86	$ 12,011.30
4/1/2012	4	$ -	$ 250.00	$ 73.07	$ 176.93	$ 11,834.37
5/1/2012	5	$ -	$ 250.00	$ 71.99	$ 178.01	$ 11,656.36
6/1/2012	6	$ -	$ 250.00	$ 70.91	$ 179.09	$ 11,477.27
7/1/2012	7	$ -	$ 250.00	$ 69.82	$ 180.18	$ 11,297.09
8/1/2012	8	$ -	$ 250.00	$ 68.72	$ 181.28	$ 11,115.81
9/1/2012	9	$ -	$ 250.00	$ 67.62	$ 182.38	$ 10,933.43
10/1/2012	10	$ -	$ 250.00	$ 66.51	$ 183.49	$ 10,749.95

Capital Lease Example (cont.)

- Use Macro contained in MOM 335/MOM 340
- Entry 1: Inception of lease (manual entries)
  - Actuals Ledger
    - Debit 63xxx – Expenditure—Non Bgtd $12,612
    - Credit 583300 – Inception of Lease—Non Bgtd $12,612
  - Entitywide Ledger
    - Debit 583300 – Inception of Lease—Non Bgtd $12,612
    - Credit 63xxx – Expenditure—Non Bgtd $12,612

Capital Lease Example (cont.)

- Entry 2: Add lease to AM
  - Lease can only be done in month of inception
  - If missed, asset must be added to AM separately:
  - Entitywide Ledger (generated automatically by AM when asset is added)
    - Debit 17xx – Fixed Asset account $12,612
    - Credit 63xxx or 64xxx – Capital Exp $12,612
  - Entitywide Ledger (manual entry)
    - Debit 63xxx or 64xxx – Capital Exp $12,612
    - Credit 2104 – Lease Obligation $12,612

Capital Lease Example (cont.)

- Entry 3: Record depreciation, monthly
  - Automatically generated by AM whether the lease, or just the asset, was added to AM
  - Entitywide Ledger
    - Debit 62805 – NB Depreciation Exp $210
    - Credit 17xx – Accumulated Depreciation $210

Capital Lease Example (cont.)

- Entry 4: Lease principal and interest payment
  - Manual entry is always required
  - Actuals Ledger
    - Month 1:
      - Debit 69301 – Lease Principal $250
      - Debit 6930x – Lease Interest $0*
      - Credit 1104 – Cash $250
    - Month 2:
      - Debit 69301 – Lease Principal $175
      - Debit 6930x – Lease Interest $75*
      - Credit 1104x – Cash $250

*Taken from Macro

Capital Lease Example (cont.)

- Entry 5: Reduce lease obligation by principal payments
  - Since the lease was <u>not</u> added to AM (only the asset), this must be a manual entry
  - Entitywide Ledger
    - Year 1:
      - Debit 2104 – Lease Obligation $1,135
      - Credit 69301A – Principal Lease—Non Bgtd $1,135
    - Year 2:
      - Debit 2104 – Lease Obligation $2,236
      - Credit 69301A – Principal Lease—Non Bgtd $2,236

Capital Lease Example (cont.)

- Entry 6: Adjust liability amount to be paid in following fiscal year (principal only)
  - Must be reversed next fiscal year
  - Entitywide Ledger
    - Year 1:
      - Debit 2104 – Lease Obligation $2,236
      - Credit 2124 – Lease Pay—Due within 1 yr. $2,236*
    - Year 2:
      - Debit 2104 – Lease Obligation $2,405
      - Credit 2124 – Lease Pay—Due within 1 yr. $2,405*

*Taken from Macro

Capital Lease Example (cont.)

- Entry 7: Accrue interest payable
  - Must be reversed next fiscal year
  - Entitywide Ledger
    - Years 1-5:
      - Debit 6930x – Interest Expense $0
      - Credit 2116 – Accrued Interest Payable $0
    - No interest is accrued because payments are made upfront
      - Entire payment is made before services are received, therefore no expense is accrued

Capital Lease Disclosures

- All leases must be added to lease template sent to DOA – SAD (Ingrid for FY12)
- All assets acquired through capital lease that are still in use must be listed beneath current leases
  - Even if the asset is fully depreciated
- Before sending, check that:
  1. Certain SABHRS accounts net to zero
  2. Capital lease schedule agrees to SABHRS

Capital Lease Disclosures (cont.)

- Check 1: SABHRS accounts net to zero when the Actuals and Entitywide Ledgers are combined
  - Review your trial balance: General Ledger > General Reports > Trial Balance – Fund
  - Inception: 583300 (for governmental funds only)
  - Lease principal:
    - 69301/69301A
    - 69303/69303A
    - 69401/69401A
    - 69403/69404
    - Review entries 4 and 5 if these accounts do not net to 0

Capital Lease Disclosures (cont.)

- Check 2: Capital lease schedule agrees to SABHRS
  - Review ledger activity: General Ledger > Review Financial Information > Ledger
  - Account 2124 = principal balance for year 2013
    - Review entry 6 if this does not agree
  - Account 2104 = principal balance for years 2014 and beyond
    - Review entries 5 and 6 if this does not agree
  - Account 583300 in the Actuals Ledger = principal balance for all years (FY 2011 thru end of lease)
    - Governmental funds only
    - Review entry 1 if this does not agree

Lease Schedule Preparation Tips

- Lease schedule template link is on State Accounting Bureau's website: http://accounting.mt.gov/accounting.mcpx
- Lease memo (same location) has full instructions

Schedule Preparation Tips (cont.)

- Capital lease common errors
  - Incomplete data fields
    - Asset ID, Historical Cost and Accumulated Depreciation fields are left blank
      - This information can by found here: Asset Management > Depreciation > Review Depreciation Info > Asset Depreciation, Depreciation tab
        - Must choose Fiscal Year 2012 and Period 12
        - Click Calculate NBV
        - Cost and Accumulated Depreciation are shown on the left
    - Fund field is either blank or listed as “various”
      - If more than one fund, must show allocation

Schedule Preparation Tips (cont.)

- Capital lease common errors (cont.)
  - Dates don't agree
    - Every lease must have an expiration date
    - Ensure expiration date agrees with the final payment in the principal and interest section
  - Small leases are not listed
    - Capital asset threshold: $5k/equipment or $25k/buildings
    - No capital lease threshold
    - When asset value is < the capital asset threshold:
      - Indicate "Expensed" under Asset ID
      - Record full amount in Historical Cost and Accumulated Depreciation fields

Schedule Preparation Tips (cont.)

- Capital lease common errors (cont.)
  - Principal amounts do not agree with SABHRS
    - Principal amount listed under FY 2013 must agree to account 2124
    - Principal amounts listed in all but FY 2013 must agree to account 2104
  - Assets remaining from expired leases not listed
    - All assets still in use, even if fully depreciated, must be listed

Schedule Preparation Tips (cont.)

- Operating lease common errors
  - Incomplete data fields
  - Dates don’t agree
- Quick checks
  - Ask division staff about any new purchases or agreements that may constitute a lease
  - Compare current year’s to prior year’s schedule

Lease Questions

- Please review this year's lease memo and use lease template on our website
- Please review MOMs 335 and 340
- Use Macro in MOM 335/340 for capital leases
- Capital lease interest
  - BOI's average STIP yield, found here: http://www.investmentmt.com by using the STIP link.
- Still have questions, call me: x3975