




County of Riverside
OFFICE OF THE AUDITOR-CONTROLLER
 STANDARD PRACTICE MANUAL

SECTION: 5		SUBJECT: CAPITAL LEASES
POLICY NUMBER: 511		CATEGORY: CAPITAL ASSET POLICIES
REVISED DATE: 07/01/17	APPROVED BY: 	

PURPOSE: To establish standard guidelines for the proper accounting of capital leases.

SCOPE: Applies to County departments, agencies, special districts and authorities that are governed by Riverside County Board of Supervisors.

POLICY: Capital leases must be recorded in compliance with GAAP and Governmental Accounting Standards Board (GASB) Statement No. 62 – *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements.*

PROCEDURES: This policy includes information on the criteria to determine a capital lease and the process and documentation needed to record the capital lease in the PeopleSoft financial system.

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Capital Lease Determination

A lease agreement is classified as a capital lease when substantially all of the risks and benefits of ownership are transferred to and assumed by the lessee. A capital lease is viewed as financing related to the acquisition of a capital asset, regardless of the form of the rental, lease, or other financing agreement. A capital lease is required to be recorded **if any one** of the four following criteria is a characteristic of the lease transaction / agreement per GASB 62:

1. The lease transfers ownership (title) of the asset to the lessee by the end of the lease term.
2. The lease contains a *bargain purchase option*.
 - a. *Bargain purchase option* is a provision allowing the lessee, at his/her option, to purchase the leased asset for a price which is sufficiently lower than the expected fair value (FV) of the asset at the date the option becomes exercisable and that exercise of the option appears, at the inception of the lease, to be reasonably assured. Fair value is defined as the price for which the asset could be sold in an arm's-length transaction between unrelated parties.
3. The lease term is equal to 75% or more of the estimated economic life of the leased asset. However, if the beginning of the lease term falls within the last 25% of the total estimated economic life of the leased property, this criterion shall not be used for purposes of classifying the lease.
4. The present value at the beginning of the lease term of the minimum lease payments, excluding that portion of the payments representing executory costs such as insurance and maintenance to be paid by the lessor, including any gain thereon, equals or exceeds 90 percent of the excess of the fair value of the leased property to the lessor at the inception of the lease over any related investment tax credit retained by and expected to be realized by the lessor. However, if the beginning of the lease term falls within the last 25 percent of the total estimated economic life of the leased property, including earlier years of use, this criterion should not be used for purposes of classifying the lease. A lessor should compute the present value of the minimum lease payments using the interest rate implicit in the lease. A lessee should compute the present value of the minimum lease payments using its incremental borrowing rate, unless (1) it is practicable to obtain the implicit rate computed by the lessor and (2) the implicit rate computed by the lessor is less than the lessee's incremental borrowing rate. If both of those conditions are met, the lessee should use the implicit rate.

General Note: *Executory costs are costs such as insurance, routine maintenance, and other costs associated with keeping the asset in service. Executory costs are considered period costs, rather than part of the acquisition cost of the asset. Leases not meeting the criteria of a capital lease, as described above, shall be classified as operating leases.*

To assist users in applying the above tests in determining if a transaction should be recorded as a capital lease; users are encouraged to use a standard spreadsheet model, such as the "Capital Lease Test.xls," found on the "Report & Publication" page of the Auditor Controller Office (ACO) website <http://www.auditorcontroller.org/ReportsPublications.aspx>

Lease Involving Real Estate

If land is the singular item of property leased and the criterion 1 or 2 noted above under the heading "*Capital Lease Determination*" is met, the lessee should account for the lease as a capital lease, otherwise, as an operating lease.

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Lease Involving Land and Building

If land and a building are part of a lease and criterion 1 or 2 noted above under the heading “*Capital Lease Determination*” is met, the land and building should be separately capitalized by the lessee.

Lease Involving Equipment as Well as Real Estate

Leases involving real estate and equipment, the portion of the minimum lease payments applicable to the equipment element of the lease should be estimated by whatever means are appropriate in the circumstances, and should be accounted for separately according to its classification.

Lease Involving Only Part of a Building

If the fair value of the leased property is objectively determinable, the lessee should classify and account for the lease according to the provisions noted above under “*Leases Involving Land and Buildings*”.

If the fair value of the leased property is not objectively determinable, the lessee should classify the lease according to the criterion 3 noted above under the heading “*Capital Lease Determination*” using the estimated economic life of the building in which the leased premises are located. If that criterion is met, the leased property should be capitalized as a unit and amortized accordingly.

Recording a Capital Lease

The present value of minimum lease payments at the inception of the capital lease must be recorded as an asset and liability in PeopleSoft. When determining the present value of the lease payments, the lessee should use its incremental borrowing rate. However, the lessee should use the lessor’s implicit interest rate to determine the present value of the lease payments if:

- 1) The lessee can determine the lessor’s implicit interest rate and
- 2) The lessor’s implicit interest rate is less than the lessee’s incremental borrowing rate.

The lessee’s incremental borrowing rate is the estimated interest rate the lessee would have had to pay if the leased property had been purchased by the lessee and financed over the period covered by the lease.

DEPARTMENT ROLES:

- 1) Departments are responsible for recording all capital leases immediately once all supporting documentation is available and has been received by the department.
- 2) Capital assets acquired via a capital leased must be entered into the PeopleSoft Asset Management Module by selecting the appropriate “category” when entering the assets related to the capital lease.
 - a. A copy of the lease agreement and amortization/lease payment schedule must accompany the completed *Acquisition, Betterment & Capital Leases*, Form AM-5, and must be submitted to the ACO.
- 3) At the end of the fiscal year, proprietary funds shall reclassify its year-to-date lease principal expenses to the appropriate liability accounts. This method ensures budgetary control during the year, while properly reporting principal disbursements as reductions to liabilities for year-end reporting purposes.
- 4) During the annual asset certification, all capital lease asset must be certified; land does not need to be certified.
- 5) Complete AM-5 Form must be submitted to the Auditor-Controller with all supporting documentation, within 15 days after it has been entered in the AM module, **except** at year end it should be submitted within 24 hours.

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CAPITAL BUDGET EXPENSE CODES

The acquiring department is responsible for assigning the appropriate account number when entering into a capital lease agreement. Individuals should be certain to use the correct account number in all circumstances.

County of Riverside Expenditure Accounts as of March 1, 2016	
New Code	Description
	<i>Interest On Oth Long-Term Debt</i>
533740	Capital Lease-Interest
533770	Cap Lease - Bldg Interest Pmt
533780	Cap Lease - Equip Interest Pmt
533790	Cap Lease - Veh Interest Pmt
533800	Cap Lease - Land Interest Pmt

County of Riverside Expenditure Accounts as of July 1, 2017	
New Code	Description
	<i>Interest On Oth Long-Term Debt</i>
533740	Capital Lease-Interest
533770	Cap Lease - Bldg Interest Pmt
533780	Cap Lease - Equip Interest Pmt
533790	Cap Lease - Veh Interest Pmt
533800	Cap Lease - Land Interest Pmt

County of Riverside Liability Accounts as of July 1, 2017	
Account	Description
	Capital lease obligations
283100	Capital Lease Obligation
283101	Capital Lease Obligation Bldgs
283102	Capital Lease Obligation Equip
283103	Capital Lease Obligation Vehic
283104	Capital Lease Obligation Land

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AUDITOR-CONTROLLER’S ROLES:

- 1) Review and verify AM-5 form and transactions recorded in system to ensure accuracy and adequate documentation to support the transaction.
- 2) Process transactions in PeopleSoft Financial System.

RECORDS MANAGEMENT ROLES:

Department

Retain all capital lease agreement supporting documentation for at least 7 years as it relates to capital assets information reported and submitted to the Auditor-Controller.

Auditor-Controller

The Auditor-Controller is the official Department of Record for all AM Forms and its supporting documentation that are submitted to us. The documentation is filed in accordance with the County’s General Records Retention policy which states to keep the current year plus the 7 past years.

SECURITY ROLES:

In order to perform the functions discussed above the following roles must be requested:

Department:

Capital Asset Processor – this role will allow you to:

- Add capital/noncapital asset information
- Update some capital asset information

Auditor Controller:

Asset Reviewer Auditor-Controller Only – this role will allow you to:

- Adjust, re-categorize, transfer, and dispose capital assets/noncapital asset information
- Review and process transactions
- Run capital and lease asset reports

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CAPITAL ASSETS FORM

Acquisition, Betterment & Capital Leases

OFFICE OF THE AUDITOR-CONTROLLER
 Complete and return to the Auditor-Controller's Office, Mail Stop #1050.

**SPM FORM
AM-5**

"*" Indicates optional field **ASSET ID:** _____

DEPARTMENT			BUSINESS UNIT		
FUND	DEPT ID	PROGRAM *	CLASS *	BGT PER	PROJ/GRANT *
CATEGORY	ACCOUNT	COST			
BOOK	FINANCING CODE	LOCATION			
ACQUISITION DATE			IN SERVICE DATE		
VENDOR CODE:			VENDOR NAME		
MANUFACTURER	SERIAL NUMBER	MODEL			
ASSET DESCRIPTION:					
DEPRECIATION METHOD		USEFUL LIFE (in months)	SALVAGE AMOUNT		
PURCHASE AUTHORIZATION			VOUCHER		
For Betterments Only:					
BETTERMENT DESCRIPTION					
TOTAL BETTERMNT VALUE					
For Capital Leases Only:					
LEASE ID#			LIABILITY AMOUNT (PRIN)		
ATTACH THE FOLLOWING AND CHECK THE BOX FOR EACH ATTACHMENT PROVIDED:					
<input type="checkbox"/>	P.O. s,	<input type="checkbox"/>	Property schedules,	<input type="checkbox"/>	Amortization schedules,
<input type="checkbox"/>	CAPITAL LEASE TEST.XLS		<input type="checkbox"/>	Financing agreements,	

Prepared by: _____ Phone: _____

Date: _____ Dept: _____

Distribution: Department and Capital Asset Section of the ACO

Standard Practice Manual – AM-5

January 2006 (This form replaces GEN FORM 34)
 Capital Assets Form (pending approval)

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