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# FISCAL POLICIES MANUAL

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## CAPITAL LEASE EXAMPLE

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### INTRODUCTION

This document presents an example of a capital lease. The terms of the lease are defined as well as the criteria for determining if it is a capital lease, the roles of the agency and of the State Controller's Office, and an amortization schedule based on the example.

### TERMS OF THE EXAMPLE LEASE

The lease term is for 36 months starting January 1, 2006. The contract requires payments of \$ 334.22 to be paid at the beginning of each month. Of the \$ 334.22 payment, \$ 30.00 is for maintenance.

The lessor stated that they would normally sell the copier for \$10,500. In other words, \$10,500 is the fair market value of the copier. The State of Idaho's economic life policy states that the life of a copier is seven years.

At the end of the lease the photocopier will revert back to the lessor. The contract does not offer any bargain purchase option. The lessor did not provide a rate of return they want on the lease (implicit rate) so we will use an interest rate the State could get if the State would go out to get a loan to buy this photocopier, also known as the incremental rate. For this example the incremental rate is 6%.

NOTE: If the implicit rate of the lessor cannot be determined or approximated you will have to obtain the incremental rate. The incremental rate must be obtained from the Treasure's Office. If you need assistance in obtaining an incremental rate contact the Controller's Office, Bureau of Reporting and Review.

### STEP 1: CAPITAL LEASE CRITERIA

Go through the four capital lease criteria to see if the terms qualify this lease as a capital lease.

1. Is there a transfer of ownership at the end of the lease? (No.)
2. Is there a bargain purchase option? (No.)
3. Is the lease term greater than 75% of the asset's useful life? ( $3/7 = 42.3\%$  which is  $< 75\%$ , so No).
4. Is the present value of minimum lease payments at the inception of the lease greater than 90% of the asset's fair market value? (Yes. See details below)

- a. [Click here to download and open a MS Excel template](#) used to calculate the present value of a series of payments and to get an amortization schedule. You can save this as a template (*Save as type:...*) on your PC.  
Note: This template will not work if the payment amount varies during the lease term. In this case, you need to create your own template or spreadsheet. You may call the Controller's Office for assistance.
- b. Enter the terms of the example lease.
- c. After entering the terms, the calculator will show that the principal is \$10,050.  $\$10,050 / \$10,500 = 95.7\%$  and therefore greater than 90%. **Also, the present value \$10,050 is greater than \$5,000; therefore, this lease must be reported in the lease payable closing package.**

This lease is a capital lease because it meets the fourth criteria.

## STEP 2: AGENCY AND STATE CONTROLLER RESPONSIBILITIES

Since this is a capital lease, the state needs to record an asset and a liability in its financial statements. For each payment, proper allocation between principal and interest must be made.

### Agency responsibilities

- Enter the photocopier on the agency's own fixed asset system or on the State Controller's Fixed Asset System (FAS) as a capital asset with an ownership code of L at the amount of \$10,050.
- For each payment properly allocate amounts for principal and interest according to your Amortization chart.

Example of payment: Payment # 5:

Office Equipment – Capital Lease (TC 230 with subobject 6915)	\$259.34
Interest Expense – (TC 230 with Subobject 5962)	\$ 44.88
Maintenance Expense –(TC 230 with Subobject 5225)	\$ 30.00
Cash	\$ 334.22

- Complete a capital lease payable closing package at fiscal year end. If this capital lease is new this year, submit the amortization schedule that you used.

### Controller's Responsibilities at year-end:

- At year-end, ensure the proper amount is recorded for the liability on the financial statements – both a current portion and non-current portion.
- At year-end, double check the agency's separation of principal and interest according to amortization schedule based upon lease terms.
- At year-end, record the depreciation expense in financial statements.

Amortization Schedule example done in Microsoft Excel.

Interest Rate 6%

Date	Payment #	Maintenance Fee	Payment Amount	Interest	Principal	Balance
						\$10,050.00
1/1/2006	1	\$ 30.00	\$ 304.22		\$ 304.22	\$ 9,745.78
2/1/2006	2	\$ 30.00	\$ 304.22	\$ 48.73	\$ 255.49	\$ 9,490.29
3/1/2006	3	\$ 30.00	\$ 304.22	\$ 47.45	\$ 256.77	\$ 9,233.52
4/1/2006	4	\$ 30.00	\$ 304.22	\$ 46.17	\$ 258.05	\$ 8,975.47
5/1/2006	5	\$ 30.00	\$ 304.22	\$ 44.88	\$ 259.34	\$ 8,716.13
6/1/2006	6	\$ 30.00	\$ 304.22	\$ 43.58	\$ 260.64	\$ 8,455.49
7/1/2006	7	\$ 30.00	\$ 304.22	\$ 42.28	\$ 261.94	\$ 8,193.54
8/1/2006	8	\$ 30.00	\$ 304.22	\$ 40.97	\$ 263.25	\$ 7,930.29
9/1/2006	9	\$ 30.00	\$ 304.22	\$ 39.65	\$ 264.57	\$ 7,665.72
10/1/2006	10	\$ 30.00	\$ 304.22	\$ 38.33	\$ 265.89	\$ 7,399.83
11/1/2006	11	\$ 30.00	\$ 304.22	\$ 37.00	\$ 267.22	\$ 7,132.61
12/1/2006	12	\$ 30.00	\$ 304.22	\$ 35.66	\$ 268.56	\$ 6,864.05
1/1/2007	13	\$ 30.00	\$ 304.22	\$ 34.32	\$ 269.90	\$ 6,594.15
2/1/2007	14	\$ 30.00	\$ 304.22	\$ 32.97	\$ 271.25	\$ 6,322.90
3/1/2007	15	\$ 30.00	\$ 304.22	\$ 31.61	\$ 272.61	\$ 6,050.30
4/1/2007	16	\$ 30.00	\$ 304.22	\$ 30.25	\$ 273.97	\$ 5,776.33
5/1/2007	17	\$ 30.00	\$ 304.22	\$ 28.88	\$ 275.34	\$ 5,500.99
6/1/2007	18	\$ 30.00	\$ 304.22	\$ 27.50	\$ 276.72	\$ 5,224.28
7/1/2007	19	\$ 30.00	\$ 304.22	\$ 26.12	\$ 278.10	\$ 4,946.18
8/1/2007	20	\$ 30.00	\$ 304.22	\$ 24.73	\$ 279.49	\$ 4,666.69
9/1/2007	21	\$ 30.00	\$ 304.22	\$ 23.33	\$ 280.89	\$ 4,385.80
10/1/2007	22	\$ 30.00	\$ 304.22	\$ 21.93	\$ 282.29	\$ 4,103.51
11/1/2007	23	\$ 30.00	\$ 304.22	\$ 20.52	\$ 283.70	\$ 3,819.81
12/1/2007	24	\$ 30.00	\$ 304.22	\$ 19.10	\$ 285.12	\$ 3,534.69
1/1/2008	25	\$ 30.00	\$ 304.22	\$ 17.67	\$ 286.55	\$ 3,248.14
2/1/2008	26	\$ 30.00	\$ 304.22	\$ 16.24	\$ 287.98	\$ 2,960.16
3/1/2008	27	\$ 30.00	\$ 304.22	\$ 14.80	\$ 289.42	\$ 2,670.74
4/1/2008	28	\$ 30.00	\$ 304.22	\$ 13.35	\$ 290.87	\$ 2,379.88
5/1/2008	29	\$ 30.00	\$ 304.22	\$ 11.90	\$ 292.32	\$ 2,087.56
6/1/2008	30	\$ 30.00	\$ 304.22	\$ 10.44	\$ 293.78	\$ 1,793.77
7/1/2008	31	\$ 30.00	\$ 304.22	\$ 8.97	\$ 295.25	\$ 1,498.52
8/1/2008	32	\$ 30.00	\$ 304.22	\$ 7.49	\$ 296.73	\$ 1,201.80
9/1/2008	33	\$ 30.00	\$ 304.22	\$ 6.01	\$ 298.21	\$ 903.58
10/1/2008	34	\$ 30.00	\$ 304.22	\$ 4.52	\$ 299.70	\$ 603.88
11/1/2008	35	\$ 30.00	\$ 304.22	\$ 3.02	\$ 301.20	\$ 302.68
12/1/2008	36	\$ 30.00	\$ 304.22	\$ 1.51	\$ 302.71	\$ (0.02)
		\$ 1,080.00	\$ 10,951.92	\$ 901.90	\$ 10,050.02	