

ACCOUNTING INTERPRETATION NO. 10

Subject: Accounting for Leases

Lease-purchase agreements may be in the form of capital or operating leases. A capital lease is, for the most part, viewed as an installment purchase of property rather than the rental of property. An operating lease does not involve the purchase of property and payments represent the rental expenditures. Capital leases exist if ANY of the following conditions are met:

- (a) The lease transfers ownership of the property to the lessee by the end of the lease term.
- (b) The lease contains a bargain purchase option.
- (c) The lease term is equal to 75% or more of the estimated economic life of the leased property.
- (d) The sum of the principal lease payments equal 90% of the fair value of the asset.

Once it has been determined that a capital lease exists, then the following entries would be required:

- | | | | |
|----|---|----|--|
| 1. | Equipment (Account No. 166) | xx | |
| | Investments in General Capital Assets (Account No. 253) | xx | |

To capitalize the present value of the minimum lease payments in the General Capital Asset Accounts.

- | | | | |
|----|--|----|----|
| 2. | Expenditure (400 accounts) | xx | |
| | Other Financing Source (Account No. 370) | xx | |
| | or | | |
| | Expenditure | xx | |
| | Cash (Downpayment) | | xx |
| | Other Financing Source | | xx |

At the start of the lease, the present value of the minimum lease payments must be recognized as an expenditure against the budget and as an other financing source. The expenditure category used should relate to the type of asset acquired.

- | | | | |
|----|---|----|----|
| 3. | Amount to be Provided (Account No. 185) | xx | |
| | Other Long-Term Liabilities (Account No. 235) | | xx |

This entry is necessary to recognize the liability in the General Long-Term Liabilities Accounts. The amount capitalized should be the present value of the minimum lease payments.

- | | | | |
|----|-------------|----|----|
| 4. | Expenditure | xx | |
| | Cash | | xx |

To record the periodic payments in future periods. The expenditure account to recognize these payments to service the debt should be account "800 Debt Services."

If the lease is an operating lease, the lease would be recorded as follows:

Expenditures - Rent	xx	
Cash (Vouchers Payable)		xx

To record the operating lease at the inception of the lease.