



ACCOUNTING POLICY AND PROCEDURES (APP) MANUAL

TOPIC: Section 8 – Capital Assets 3.0	EFFECTIVE DATE: 06/24/1991
TITLE: Capital and Operating Leases	REVISION DATE: 05/04/2019
AUTHORIZED BY: Deputy Director, Bureau of Fiscal Services	

BACKGROUND

The State of Wisconsin issues a Comprehensive Annual Financial Report (CAFR) based on Generally Accepted Accounting Principles (GAAP). Recognized as the official source of GAAP for state and local governments, the Governmental Accounting Standards Board (GASB) continually establishes and improves standards of accounting and financial reporting for those governments. In December 2010, the GASB issued Statement No. 62 that incorporated the applicable provisions of pre-November 30, 1989 statements issued by the Financial Accounting Standards Board (FASB) into their state and local government accounting and financial reporting standards. That codification included Statement of Financial Accounting Standards #13, Accounting for Leases, issued by the FASB. It requires leases to be classified in the financial statements as either capital or operating leases.

A lease is defined as an agreement between a lessor and a lessee that conveys to the lessee the right to use property or equipment for a specified period of time for stipulated cash payments (lease payments). Typically, the Department of Health Services (DHS) is the lessee, leasing equipment and real estate from lessors.

Note that the terms "lease" and "rental" are synonymous for the purpose of implementing this procedure. The lease document conveying the right to use the property/equipment may also be referred to as a service agreement, or memorandum of understanding (MOU). All lease and/or rental transactions should be reported to the Bureau of Fiscal Services (BFS) unless specifically excluded below.

EXCLUSIONS

The payments described below should not be classified as lease payments:

1. Leases/Rentals for copiers and minor equipment
2. Leases/Rentals with a total term of one year or less
3. Payments in accordance with maintenance agreements

Questions on whether a transaction should be included or excluded should be directed to the Capital Asset Accountant in the BFS – Cost Allocation and Financial Reporting (CAFR) Section.

PROCEDURES

A distinction is made in the reporting requirements between the institutions (mental health institutes, developmentally disabled centers, and secure treatment centers), the Bureau of Information Technology Services (BITS), and the remaining organizations within the DHS.

Institutions, BITS

Each organization mentioned above shall appoint a lease coordinator. The lease coordinator shall submit on a quarterly basis, by the 5th working day after the close of the quarter, the following information to BFS/CAFR:

- A Lease Transmittal Notice: Please note that Lease Transmittal information (F-80455) should be submitted quarterly to BFS **whether or not any new leases have been initiated**.
- The lease documents and/or information pertaining to each lease, as outlined in the “**Type of Leases and Their Reporting Requirements**” section. Documentation and information is required to be submitted when any one of the following situations occurs:
 - A new lease is initiated during the quarter.
 - An existing lease is extended or renewed in the quarter.
 - An existing lease has not been previously reported.
 - An existing lease has been cancelled
 - A new purchase order is issued for an existing lease.
- Revisions to the coordinator's name and telephone number

Other Organizations

Lease activity recorded in STAR for all other organizations will be reviewed by BFS/CAFR. Relevant data will be obtained from DHS files for completion of Lease Data Sheets and spreadsheets compiling information for reporting lease activity in the CAFR with two exceptions:

First, organizations not listed above are required to provide BFS/CAFR with the Hard Disk Drive Erasure/Cleansed Confirmation Form for all relevant equipment removed by the vendor (See Section II below).

Second, Organizations that negotiated a real estate lease directly with a lessor, versus having DOA negotiate on their behalf; need to follow the reporting requirements outlined in Section II C below.

Types of Leases and Their Reporting Requirements

- I. Generally, a lease will fall into one of four categories outlined below.
 - A. Equipment leases negotiated through State Procurement Operational Bulletins.
 - B. Real Estate (land and/or buildings) Leases negotiated through the Department of Administration (DOA).
 - C. All other leases not included in category "A" or "B" above, where the division is the lessee.
 - D. All leases where the organization is the *lessor* (a state or a non-state agency rents property or equipment from the organization). Report lease agreements with other organizations within the department, other state agencies, or non-state agencies.
- II. A description of each lease type and the reporting requirements for each lease type is outlined in the following paragraphs.
 - A. Equipment leases negotiated through State Procurement Contracts.

For leases in category A the following information should be sent to the BFS/CAFR: A copy of the purchase order, or the purchase request if the transaction is processed as a direct pay, along with the Operating Lease Agreement: F-80456. Those documents are not required for photocopiers and minor equipment such as postage meters. They are required for mailing machines, chemistry analyzers, and other major equipment leases, however.

If it is a lease for a copier, multifunction device or similar equipment that replaces existing equipment, the hard drive of the device being replaced must be erased by the vendor and the vendor must provide signature verification of such erasure using a Hard Disk Drive Erasure/Cleansed Confirmation Form (F-00587). That form must be included with your quarterly report. The same applies for all equipment that is removed without being replaced.

B. Real Estate (land and/or buildings) Leases negotiated through DOA.

This category is only for leases negotiated by the Department of Administration (DOA) for state agencies where a private vendor, not affiliated with the state, leases real estate to a state agency. Please provide a listing detailing the name of the lessor and the address of the leased space.

Real estate leases included in this category should be assumed to be operating leases, unless BFS/CAFR informs the organization otherwise. BFS/CAFR will inform organizations of any leases classified as capital leases based on a DOA review of the leases involved and the proper costs to be included in the capital asset records. Those assets acquired in a capital lease transaction must be added to the organization's capital asset records.

This category DOES NOT include real estate leases where the organization negotiates a lease directly with the lessor. That type of lease should be reported in accordance with category "C" below.

C. All other Leases not included in category "A" or "B" above, where the organization is the lessee.

Leases in category C generally originate when an organization leases property or equipment directly from a vendor.

Leases included in this category should be assumed to be operating leases, unless BFS/CAFR informs the organization otherwise. BFS/CAFR will inform organizations of any leases classified as capital leases based on their review of the leases and the proper costs to be included in their capital asset records. Those assets acquired in a capital lease transaction must be added to the capital asset records.

For leases in category C the information to be sent to BFS/CAFR will depend on whether the lease was or was not coordinated through the DES Office of Facilities, Safety, and Risk Management (OFSRM). For real estate leases where the Division/Institution worked with OFSRM staff when negotiating the lease terms with the lessor, send a list detailing the name of each lessor along with the address of the leased space. For all other Category C leases the following information should be sent to BFS/CAFR: Signed lease documents, purchase orders, a copy of the purchase requisition if the transaction is processed as a direct pay, and other related lease information along with the Lease Agreement Summary: F-80457 .

To properly classify DHS negotiated leases, specific information, as listed below, must be outlined in the lease document or detailed in an appendix attached to the lease document. The appendix must be referenced in the lease document or signed as a separate document by the same individuals signing the lease document. (See Attachment 1 for a glossary of lease terms).

- Name of Lessor
- Transfer of Ownership: does title pass to state?
- State Purchasing Bulletin Number (if applicable)

- Asset Description
- Lease period
- Lease cancellation provisions
- Lease payments: amount (specify annual, quarterly or monthly basis)
- Payment date(s)
- Renewal terms: payments, time period and likelihood of exercising option
- Penalty for failure to renew or extend lease amount and terms
- Purchase option: amount, date option to be exercised, and likelihood of exercising option
- Executory Costs: type and value
- Fair market value of each item
- Economic life
- Lessor's implicit interest rate
- Residual Value: amount – guaranteed or not guaranteed
- Contingent rental terms

- D. All Leases where the Division/Institution is the LESSOR (a state or a non-state agency rents property and/or equipment FROM a DHS Division/Institution). Report lease agreements with other organizations within the Department, other state agencies or non-state agencies.

Leases included in this category are assumed to be operating leases, unless BFS/CAFR informs the organization otherwise. BFS/CAFR will inform organizations of any leases classified as capital leases based on their review of the leases and the proper costs to be excluded from their capital inventory. Those assets leased out in a capital lease transaction must be removed from the organization's capital inventory.

For leases in Category D the information to be sent to BFS/CAFR will depend on whether the lease was or was not coordinated through the DES Office of Facilities, Safety and Risk Management (OFSRM). For property leases where the Division/Institution worked with OFSRM staff when negotiating the lease terms with the lessee, send a list detailing the name of each lessee. For all other Category D leases the following information should be sent to BFS/CAFR: Signed lease documents, purchase orders, purchase request if the transaction is processed as a direct pay, and other related lease information along with the Lease Agreement Summary: F-80457 .

To properly classify **DHS negotiated leases**, specific information, as listed below, must be outlined in the lease document or in an appendix attached to the lease document. The appendix must be referenced in the lease document or signed as a separate document by the same individuals signing the lease document. (See Attachment 1 for a glossary of lease terms.)

- Name of lessee
- Transfer of ownership: does title pass to lessee?
- Asset description
- Lease period
- Lease cancellation provisions
- Lease payments: amount (specify annual, quarterly or monthly basis)
- Payment date(s)
- Renewal terms: payments, time period and likelihood of exercising option
- Penalty for failure to renew or extend lease – amount and terms

- Purchase option: amount, date option to be exercised, and likelihood of exercising option
- Executory Costs: type and value
- Fair market value (cost) of each item
- Economic life
- Residual Value: amount – guaranteed or not guaranteed
- Contingent rental

ATTACHMENT

Glossary of Lease Terms

FORMS

Lease Transmittal Notice, [F-80455](#)

Operating Lease Agreement, [F-80456](#)

Lease Agreement Summary, [F-80457](#)

[DOA GAAP Conversion Manual](#)

Hard Disk Drive Erasure/Cleansed Confirmation, [F-00587](#)

CONTACTS

[Capital Asset Accountant](#)

ATTACHMENT**GLOSSARY OF LEASE TERMS**

Bargain purchase option. A bargain purchase option is a lessee's option to purchase the leased property at a bargain price that makes the exercise of the option almost certain.

Bargain renewal option. A bargain renewal option is a lessee's option to renew the lease at a bargain rental price that makes the exercise of the option almost certain.

Contingent rental. Contingent rentals are those which cannot be determined at the inception of the lease because they depend on future factors or events. Contingent rentals can either increase or decrease lease payments. Examples are rental payments based on future sales, future machine hours, and future interest rates.

Estimated economic life. The estimated remaining period during which the property, with normal repairs and maintenance, is expected to be economically usable by one or more users for the purpose for which it was intended at the inception of the lease without limitation by the lease term.

Executory costs. Costs such as insurance, maintenance, and taxes. If paid by a lessor any lessor's profit on those costs is considered the same as executory costs.

Fair rental. Fair rental is the rental rate for similar property under similar lease terms and conditions.

Fair market value. Fair value is the price the leased property could be sold for between unrelated parties in an arm's length transaction.

Inception date. The date that a lease agreement or a written commitment is signed provided the property being leased is constructed or acquired by the lessor. (This is not the same date as the beginning of the lease term.)

Estimated residual value. Estimated residual value is the estimated fair value of the leased property at the end of the lease term. The estimated residual value shall not exceed the amount estimated at the inception of the lease.

Incremental borrowing rate. The rate that, at the inception of the lease, the lessee would have incurred to borrow, over a similar term, the funds necessary to purchase the leased asset.

Fiscal funding clause. A clause in a lease agreement providing that the lease is cancelable if the legislature or other funding authority does not appropriate the funds necessary for the government unit to fulfill its obligations under the lease agreement.

Implicit interest rate. The interest rate implicit in the lease is the discount rate that when applied to certain items results in an aggregate present value equal to the fair value of the leased property at the beginning of the lease term, less any investment credit expected to be realized and retained by the lessor.

Lessee minimum lease payments. Normal minimum lease payments include:

1. The minimum rent called for during the lease term.
2. Any payment(s) or guarantee(s) that the lessee must make or is required to make concerning the leased property at the end of the lease term (residual value) including:
 - a. Any amount stated to purchase the leased property.
 - b. Any amount stated to make up any deficiency from a specified minimum.
 - c. Any amount payable for failure to renew or extend the lease at the expiration of the lease term.

3. The following should be excluded in determining the minimum lease payments:
 - a. A guarantee by the lessee to pay the lessor's debt on the leased property.
 - b. The lessee's obligation (separate from the rental payments) to pay executory costs (insurance, taxes, etc.) in connection with the leased property.
 - c. Contingent rentals.

Lessor's minimum lease payments. The minimum lease payments to a lessor are the sum of:

1. The minimum lease payments under the lease terms.
2. Any guarantee by a third party, unrelated to the lessee and lessor, of the residual value or rental payments beyond the lease term, providing such guarantor is financially capable of discharging the potential obligation.

Lease term. The lease term shall include all of the following time periods:

1. Any fixed non-cancelable term.
2. Any period(s) covered by a bargain purchase option.
3. Any period(s) in which penalties are imposed in an amount that at the inception of the lease reasonably assures the renewal of the lease by the lessee.
4. Any period(s) covered by ordinary renewal options during which a guarantee by the lessee of the lessor's debt that is directly or indirectly related to the leased property is expected to be in effect or a loan from the lessee to the lessor that is directly or indirectly related to the leased property is expected to be outstanding.
5. Any period(s) covered by ordinary renewal options preceding the date on which a bargain purchase option is exercisable.
6. Any period(s) representing renewals or extensions of the lease at the lessor's option.