

STATE OF OKLAHOMA
OFFICE OF MANAGEMENT AND ENTERPRISE SERVICES
GAAP CONVERSION MANUAL

M. LESSOR CONVERSION PACKAGE

June 2021

I. PURPOSE AND OBJECTIVES

The ACFR presents certain receivables and required disclosures for leases to non-state entities. This conversion package will gather information from state agencies to identify leases of state property to individuals, businesses, or non-state agencies. Do not include any leases where the lessee is another state agency.

From a lessor's perspective there are two classifications of leases, operating leases, and direct financing leases. A lease agreement is classified as a direct financing lease when substantially all of the risks and benefits of ownership are assumed by the lessee. For accounting purposes, a direct financing lease is viewed as an installment sale of property rather than the rental of property. All other leases are classified as operating leases. Leases for equipment or for an "entire" building can be either direct financing leases or operating leases. Leases for building "space" are considered operating leases.

The state requires a fiscal funding or cancellation clause that permits governmental lessees to terminate the agreement on an annual basis if funds are not appropriated to make required payments. The fiscal funding or cancellation clause will not prohibit the lease agreements from being capitalized. All leases must be classified for financial reporting.

II. AGENCY ACTION REQUIRED

- A. Carefully read the key terms in Part III.
- B. The Lessor Summary form (summary) should reflect amounts as of close of business on June 30.
- C. Round all dollar amounts to the nearest whole dollar.
- D. All working papers are subject to audit by the State Auditor & Inspector (SA&I). The agency is required to keep a copy of the completed summary form and all associated working papers for three years after the completion of the SA&I audit.
- E. The person who completes and signs the summary form should keep a copy. OMES will contact this person if there are any questions.
- F. If needed, call your agency's financial reporting analyst for guidance.
- G. Return the completed summary form to your OMES financial reporting analyst by e-mail **no later than the due date shown on the form**. **If you can return it earlier, please do so.**
- H. If the summary form does not apply to your agency, check the box in the upper left portion of the summary, complete item (2) and return it to the OMES.

III. KEY TERMS

- A. Bargain Purchase is when the lessee's purchase price is sufficiently less than the fair value.
- B. Estimated Residual value is the estimated fair value of the property at the end of the lease term.

- C. Executory Costs are insurance, maintenance, taxes or other costs that may be included in a lease payment.
- D. Inception Date of the lease is the date the lease has been signed by all parties.
- E. Lease - A contract where the state receives periodic rental payments from a non-state entity.

Direct Financing Lease - A lease is to be classified as a direct financing lease if any one of the following four criteria is met:

1. The lease transfers ownership of the property to the lessee by the end of the lease term.
2. The lease contains a bargain purchase option.
3. The lease term is equal to 75 percent or more of the estimated economic life of the lease property.
4. The present value of the minimum lease payments equals or exceeds 90 percent of the fair value of the leased property.

AND both of the following are satisfied:

1. Collectability of the minimum lease payments is reasonably predictable; and
2. No important uncertainties surround the amount of the unreimbursable costs yet to be incurred by the lessor under the lease.

Operating Lease - If the above criteria are not met, it is classified as an operating lease.

- F. Lessor - The party that receives the periodic rental payments.
- G. Lessor's Implicit Interest Rate is the discount rate used in the lease. (This is the rate that was used in the amortization of the lease at inception).
- H. Lessee - The party that makes the periodic rental payments. For the purpose of this package it is only those entities outside of state government.
- I. Minimum Lease Payments are the periodic rental payment required in the terms of the lease.
- J. Unearned Income is the difference between the total lease receivable and the carrying value of the leased property.

IV. SPECIFIC INSTRUCTIONS

REMEMBER: Do not include leases to other state agencies.

The completion of the conversion package can be accomplished as follows:

- A. Obtain the lease document including the debt service schedule, if any, for each lease.
- B. Use Form M-2 to assist in determining if each lease is a direct financing lease or an operating lease. Existing leases normally will be the same as the previous year.

PLEASE NOTE: ALL CAPITAL LEASES MUST HAVE A DEBT SERVICE (AMORTIZATION) SCHEDULE ATTACHED.

- C. Complete the Lessor Summary Form - Form M-1
 1. Enter the agency ACFR code, name, and funds/accounts to be included on the summary.

2. Provide the name, title, phone number and date for each person who completes and approves this summary form. The finance officer or executive director should approve the form before sending it to the Deputy State Treasurer for Debt Management. Keep a copy of the form. When submitting the form via email it should come from the address of the approving officer. This will act as an implicit electronic signature verifying the form has been reviewed for validity, accuracy, and completeness.

OPERATING LEASES:

For steps 3. through 8. below, building space rental must be reported separately from other operating leases. Use the column on the left for building space rental and the column on the right for all other operating leases.

3. Enter the total amount of the operating lease payments that were due (or earned) during the fiscal year.
4. Enter the amount of line 3. that was actually received by June 30.
5. Subtract line 4. from line 3. This should be the amount of uncollected operating lease receivable as of June 30.
6. Enter the amount of line 5. that was collected in July and August of the following fiscal year.
7. Subtract line 6. from line 5. This should be the amount of operating lease receivable that will be collected after August of the following fiscal year.
8. Enter the amount of the operating lease payments that are "due to be received" (or earned) in each of the next five fiscal years. These amounts are known as "minimum future rentals." For building space rentals enter only the following year's rental payments. If this amount is not known, you may use a reasonable estimate.
9. Enter the total of the amounts in step 8 for operating leases other than building space rental.

DIRECT FINANCING LEASES:

For steps 10 through 16 below, the principal portion of the direct financing lease payments must be reported separately from the interest portion of the payments. Use the column on the left for principal and the column on the right for interest. Steps 17 through 20 do not distinguish between principal and interest. Use the column on the right to record these amounts.

10. Enter the total amount of the direct financing lease payments that were due (or earned) during the fiscal year.
11. Enter the amount of line 10 that was actually received by June 30.
12. Subtract line 11 from line 10. This should be the amount of uncollected direct financing lease receivable as of June 30.
13. Enter the amount of line 12 that was collected in July and August of the following fiscal year.
14. Subtract line 13 from line 12. This should be the amount of direct financing lease receivable that will be collected after August of the following fiscal year.
15. Enter the amount of the direct financing lease payments that are "due to be received" (or earned) in each of the next five fiscal years, and the total amount due in years thereafter. These amounts are known as "minimum lease payments."
16. Enter the totals of the principal amounts and interest amounts in step 15 above.

17. Enter the total executory costs included in the minimum lease payments listed in #16 above.
18. Enter the allowance for uncollectible amounts included in #16 above.
19. Enter the unearned income included in #16 above.
20. Enter the estimated residual value of leased property.

D. Working Papers

The agency should keep any documents that support data on the summary form. For example:

- * OMES Central Purchasing requisitions
- * Debt service schedules
- * Lease Worksheets
- * Lease Summary