

18.1 Operating and Finance Leases

Policy Statement

It is the policy of the Province of Nova Scotia to record operating and finance leases in accordance with generally accepted accounting principles for the public sector.

Definitions

BARGAIN PURCHASE OPTION

A provision which allows the lessee, at its option, to purchase the leased property for a price which is sufficiently lower than the expected fair value of the property, at the date the option becomes exercisable. At the inception of the lease, exercise of the option appears to be reasonably assured.

EXECUTORY COSTS

Costs related to the operation of the leased tangible capital assets (e.g., insurance, maintenance cost, and property taxes).

FAIRVALUE

The amount of the consideration that would be agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act.

FINANCE LEASE

A lease that transfers to the lessee substantially all of the benefits and risks incidental to ownership of an asset. Title may or may not eventually be transferred.

INCEPTION OF THE LEASE

The earlier of the date of the lease agreement and the date of a commitment that is signed by the parties to the lease transaction and includes the principal terms of the lease. This is the effective date used for the classification of the lease.

IPSAS

International Public Sector Accounting Standards

LEASE

The conveyance, by a lessor to a lessee, of the right to use a tangible asset usually for a specified period of time in return for rent.

LEASED TANGIBLE CAPITAL ASSETS

A non-financial asset that has physical substance and a useful life extending beyond an accounting period, and is held under lease by a lessee for use, on a continuing basis, in the production or supply of goods and services. Under the terms of the lease substantially all of the risks and benefits incidental to ownership are, in substance, transferred to the government without necessarily transferring legal ownership.

OPERATING LEASE

A lease that does not transfer to the lessee substantially all the benefits and risks incidental to ownership of property.

PSAS

Public Sector Accounting Standards

PRESENT VALUE

The estimated worth today of the sum of future lease payments discounted back at a given rate of interest. Since the future value is discounted, the present value will be less than the future value.

Policy Objectives

The objective of this policy is to ensure operating and finance leases are properly classified and recorded appropriately and accurately.

Application

This policy applies to all leases of the Province's departments, agencies, boards, and commissions of the General Revenue Fund.

Policy Directives

A lease is classified as an operating or a finance lease based on accounting recommendations and guidelines of PSAS and IPSAS. It is necessary to look at the overall substance of the transaction in determining when substantially all the benefits and risks of ownership have been transferred to the lessee.

OPERATING LEASES

An operating lease is a lease in which, under the terms and conditions of the lease, the lessor does not transfer substantially all the benefits and risks incident to ownership of property to the lessee.

FINANCE LEASES

A finance lease is a lease in which, under the terms and conditions of the lease, substantially all of the benefits and risks incidental to ownership are, in substance, transferred to the lessee without necessarily transferring legal ownership.

From the point of view of the lessee, the benefits and risks of ownership would be transferred to the lessee when, at the inception of the lease, one or more of the following conditions are present:

- 1) There is reasonable assurance that the lessee will obtain ownership of the leased property by the end of the lease term. This condition would exist when the lease terms would result in ownership being transferred to the lessee by the end of the lease term or when the lease provides for a bargain purchase option.
- 2) The lease term is of such duration that the lessee will receive substantially all of the economic benefits expected to be derived from the use of the leased property over its life span. This condition would normally be met when the lease term is equal to a major portion (usually 75% or more) of the economic life of the leased property.
- 3) The lessor would be assured of recovering the investment in the leased property and of earning a return on the investment as a result of the lease agreement. This condition would exist if the present value of the minimum lease payments, excluding any portion thereof relating to executory costs, is equal to substantially all (usually 90% or more) of the fair value of the leased property, at the inception of the lease.

EMBEDDED LEASES

A lease is the conveyance, by a lessor to a lessee, of the right to use a tangible asset usually for a specified period of time in return for rent.

An arrangement may not take the legal form of a lease but may convey a right to use a tangible asset in return for a payment or series of payments. The evaluation of whether an arrangement contains an embedded lease should be based on the substance of the arrangement and requires an assessment of whether:

- a) fulfillment of the arrangement is dependent on the use of a specific tangible asset or assets; and
- b) the arrangement conveys a right to use the tangible asset or assets.

The classification of any embedded leases as operating or finance leases would still have to be performed in accordance with Public Sector Accounting Guideline 2 - Leased Tangible Capital Assets.

Policy Guidelines

OPERATING LEASES

Lease rental payments under an operating lease are expensed in the period in which the lease payments are payable to the lessor.

FINANCE LEASES

For a finance lease, the obligation is recorded when incurred in the amount of the present value of the minimum lease payments. As lease payments are made, the allocation between principal repayment and debt servicing costs is recorded. The capital lease repayment schedule is prepared at the beginning of the lease which will be used for recording and budgeting for the principal repayment amount and debt servicing costs in future fiscal years.

If the leased asset qualifies as a tangible capital asset under Chapter 14: Tangible Capital Assets, the asset is capitalized in the SAP Asset Management module in the amount of the present value of the minimum lease payments and the lease obligation is recorded as debt.

If the leased asset does not qualify as a tangible capital asset under Chapter 14: Tangible Capital Assets, the present value of the future lease payments is expensed and the lease obligation is recorded as debt.

Accountability

Departments are responsible for:

- assessing lease agreements to ensure the proper classification between operating and finance leases.
- assessing arrangements to determine whether arrangements are, or contain, leases.
- identifying their finance lease arrangements and advising Government Accounting

of finance lease obligations as they arise and are being considered.

- consulting with the Capital Markets Administration group at the Department of Finance to establish arrangements for payment processing and the recording of principal/debt servicing costs allocations.

Government Accounting is responsible for ensuring that any identified finance lease obligations and related debt servicing costs are initially assessed in an appropriate manner and accurately recorded in the Public Accounts of the Province. Government Accounting will prepare, or assist in the preparation of, the lease repayment schedules for purposes of allocating the lease payments to principal and debt servicing costs.

Capital Markets Administration is responsible for adjusting the general ledger accounts for the principal repayment portion of finance lease payments, recording the related debt servicing costs, and reconciling the outstanding finance lease obligations. Capital Markets Administration will provide required discount rates for the assessment of the finance lease repayment schedules.

Monitoring

Government Accounting will monitor the policy's performance and effectiveness.

References

Public Sector Accounting Guideline 2 - Leased Tangible Capital Assets
International Public Sector Accounting Standard 13 - Leases

Enquiries

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