

STATE OF SOUTH CAROLINA
OFFICE OF THE COMPTROLLER GENERAL

GAAP CLOSING PROCEDURES MANUAL

OPERATING LEASES CLOSING PACKAGE

REFERENCE	3.19
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PURPOSE AND OBJECTIVES

This closing package focuses on rental agreements and operating leases between your agency and non-State vendors. It does not concern itself with:

- o Capital leases or installment purchases (see State Treasurer's Lease Reporting Package for definitions). Report information regarding capital leases and installment purchases to the State Treasurer's Office in accordance with the State Treasurer's Lease Reporting Package.
- o Leases where the State is the lessor (see KEY TERMS).

The State prepares its financial statements in accordance with Generally Accepted Accounting Principles (GAAP). GAAP requires that the State disclose in its Notes to Financial Statements at June 30 the future minimum lease payments (see KEY TERMS) under noncancelable operating leases (see KEY TERMS) with initial or remaining terms at June 30 exceeding one year. In addition to total rental expenditures for the current year, future minimum rentals are presented for each of the five succeeding fiscal years and in five year increments thereafter. Payments for contingent rentals (See KEY TERMS) are required to be disclosed as a separate line item.

AGENCY ACTION REQUIRED

- o Important: With the exception of copiers leased under the 1999 contract, your agency is responsible for completing Lease Register forms for all leases in accordance with the State Treasurer's Lease Reporting Package. **Note that for audit purposes, you must retain a completed Lease Register, including Item 11, for each lease your agency has entered into.** The State Treasurer requires that you complete a Lease Register at the beginning of the lease term, before making the first lease payment. This helps to ensure that you properly classify each lease as a capital lease or an operating lease in accordance with generally accepted accounting principles. Consult the State Treasurer's Office staff if you have questions regarding lease classification.
- o Using the State Treasurer's Lease Reporting Package, determine which of your agency's leases and rental agreements are operating leases (see the KEY TERMS section below). Your determination should be based on the answers to Item 11 on the Lease Register (GAAP Form 3.19.2).

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- o Determine whether the Operating Leases Closing Package applies to your agency. It does if your agency's total noncancelable operating lease (see KEY TERMS) obligation at June 30 for all future years is more than \$200,000. (Leases in effect at June 30 include lease agreements signed on or before June 30. Your agency's obligation begins when both parties sign the lease agreement, whether the lease payments begin before or after June 30. Do not include any leases where the lessor is a State agency.)
- o If the Operating Leases Closing Package applies to your agency, read this closing package, paying special attention to the definitions of key terms.
- o Choose Method A, B, or C to report detailed data to the Comptroller General's Office regarding noncancelable operating leases in effect at June 30:
 - Method A: Make photocopies of only those Lease Register pages (prepared in accordance with the State Treasurer's Lease Reporting Package) that include noncancelable operating leases in effect at June 30 with a remaining term at June 30 exceeding one year. Leases in effect at June 30 include lease agreements *signed* on or before June 30. Your agency's obligation begins when both parties sign the lease agreement, whether the lease payments begin before or after June 30.
 - Method B: Complete a separate Lease Register (GAAP Form 3.19.2) for the Comptroller General's Office that includes only the items other than Item 11 for each noncancelable operating lease in effect at June 30 with a remaining term at June 30 exceeding one year. Leases in effect at June 30 include lease agreements *signed* on or before June 30. Your agency's obligation begins when both parties sign the lease agreement, whether the lease payments begin before or after June 30. (See the last pages of this closing package for further instructions.)
 - Method C: Use a computer printout or other alternative format in place of Methods A or B to document details of all noncancelable operating leases in effect at June 30 with a remaining term at June 30 exceeding one year. Leases in effect at June 30 include lease agreements *signed* on or before June 30. Your agency's obligation begins when both parties sign the lease agreement, whether the lease payments begin before or after June 30. If you select this option, you must include all items except Item 11 shown on the Lease

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Register as described on the last pages of this closing package.

- o On the Lease Register pages or alternative documentation prepared under Method A, B, or C as described above, complete Question 14.

The amounts reported on Question 14 for all applicable leases will be reported on the Operating Leases Summary Form (GAAP Form 3.19.1), Part V.

- o Regardless of whether you used Method A, B, or C, please observe the following:
 - Show your agency's three-character STARS agency code on each page of documentation.
 - Do not include any leases where the lessor is a State agency.
- o Finally, after receiving the necessary computer printout from the Comptroller General's Office in early August (see Exhibit 3.19 (E)), reconcile the printout amounts to your agency's records and complete the Operating Leases Summary Form (GAAP Form 3.19.1). Every agency submitting an Operating Leases Closing Package is required to reconcile the printout amounts to the agency's records and to report any discrepancy of over \$5,000 to the Comptroller General.
- o Return the following materials to the Comptroller General's Office no later than August 31:
 - Copies of the detailed documentation for operating leases prepared in accordance with Method A, B, or C as described above.
 - The completed Operating Leases Summary Form (GAAP Form 3.19.1).

If you can return the materials earlier, please do so. Please do not return documentation of your reconciliation between your agency's records and the computer printout the Comptroller General's Office sent you. Instead, retain this documentation for audit purposes.

KEY TERMS

Bargain Purchase Option. A bargain purchase option is a provision allowing the lessee, at his option, to purchase the leased property for

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a price that is sufficiently lower than the expected fair value of the property at the date the option becomes exercisable that exercise of the option appears to be reasonably assured.

Bargain Renewal Option. A bargain renewal option is a provision allowing the lessee, at his option, to renew the lease for a rent sufficiently lower than the fair rental of the property at the date the option becomes exercisable that exercise of the option appears to be reasonably assured.

Cancelable Lease. A lease agreement is cancelable if it includes specific language permitting the lessee to cancel the agreement for virtually any reason after providing the lessor adequate notice. However, a lease that permits cancellation only in certain restrictive situations such as the following is considered noncancelable:

- o Only upon the occurrence of some remote contingency.
- o Only if the General Assembly fails to appropriate adequate funds (this is often called a "fiscal funding clause").
- o Only with the permission of the lessor.
- o Only if the lessee enters into a new lease with the same lessor.
- o Only upon payment by the lessee of a penalty in an amount such that continuation of the lease appears reasonably assured.

For real property leases, the State's standard property lease agreement normally is considered noncancelable. Suppose, however, that several such leases in the past have satisfied a particular condition listed in the agreement's cancellation clause and, as a result, you actually canceled them. Based on your past experience, therefore, you believe that your agency's current property leases are cancelable (because you believe that the probability of future cancellations under this particular condition is greater than remote). Treat such a lease as cancelable only if you have regularly canceled a large proportion of such leases and you have documented this fact well; otherwise, treat it as noncancelable.

The Lease Register (GAAP Form 3.19.2) for a cancelable lease should indicate "Y" (Yes) for Question 13. (Also see definitions of Lease Agreement, Lessee, Lessor, and Noncancelable Lease below.)

For Capital Leases only: GAAP states that fiscal funding or cancellation clauses should not prohibit lease agreements from being capitalized. Therefore, if a cancelable lease meets all other capitalization criteria, the likelihood of the lease being canceled

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must be evaluated. If the probability of cancelation is remote, the lease should be capitalized.

Contingent Rental. Contingent rentals are the increases or decreases in lease payments that result from changes occurring subsequent to the inception of the lease in factors (other than the passage of time) on which the lease payments are based. Lease payments that depend on a factor directly related to the future use of leased property, such as machine hours of use or sales volume during the lease term, are contingent rentals. Contingent rentals are excluded from future minimum lease payments. Payments for copiers leased under the State's 1999 contract are contingent rentals; copy overage charges under the 1995 contract also are contingent rentals.

Estimated Economic Life of Leased Property. The estimated economic life of leased property is the estimated remaining period during which the property is expected to be economically usable by one or more users, with normal repairs and maintenance, for the purpose for which it was intended at the inception of the lease. This may be determined by asking the vendor.

Executory Costs. Executory costs are costs such as insurance, maintenance, and taxes the lessee must pay in connection with leased property. Because these costs would not be capitalized, they must be excluded from the minimum lease payments to determine lease classification (i.e., excluded from lease register Questions 8b and 11.4--refer to the section COMPLETING THE LEASE REGISTER). Executory costs that are part of the minimum lease payment (see definition below) to the lessor are excluded from the present value calculation but included as part of the future obligation in Part 14 of the lease register.

Beginning in fiscal year 2001-2002, executory costs included as part of the minimum lease payment for operating leases are to be included on Section V of the Summary Form. Do not break out any executory costs separately.

Fair Market Value. An asset's fair market value is the price at which the asset would change hands between a willing buyer and a willing seller where both have knowledge of all relevant facts. The fair market value of the property will usually be its normal selling price, reflecting any volume or trade discounts that may be applicable. The fair market value of leased property may be obtained from the vendor at the inception of the lease.

Fair Market Value of Rental. The fair market value of a rental is the rental payment stream that would be agreed upon between a willing

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lessor and a willing lessee where both have knowledge of all relevant facts. Determination of the fair market value encompasses factors such as the value of the leased property, effort necessary for the lessor to provide contracted services, and inflation. (Also see definitions of Lessee and Lessor below.)

Fiscal Funding Clause. A fiscal funding clause in a lease agreement provides that the State may cancel the lease if the General Assembly fails to appropriate adequate funds. A fiscal funding clause in itself does not make a lease cancelable. Unless there is also a general cancellation clause requiring only advance notification to the lessor, a lease containing a fiscal funding clause is considered noncancelable.

Implicit Interest Rate. The interest rate that the State uses to determine both the obligation and the initial carrying value of a leased asset should be the same as the rate used by the lessor if it is known or if it can be determined from the conditions of the contract. This would be the **implicit interest rate**. If the rate is not known and not determinable, the State's incremental borrowing rate is used.

Incremental Borrowing Rate. The incremental borrowing rate is a 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 property. The State's borrowing rate can be obtained from the State Treasurer's Office.

Lease Agreement. A lease agreement is a written document in which a lessor gives property rights to a lessee for a specific period of time. For example, rental agreements are lease agreements. (Also see definitions of Lessee and Lessor below.)

Lease Term. The fixed noncancelable term of the lease plus the following:

- o All periods covered by bargain renewal options (See Definition).
- o All periods for which failure to renew leases imposes a penalty on the lessee in such amount that a renewal appears to be reasonably assured.
- o All periods covered by ordinary renewal options during which a guarantee by the lessee of the lessor's debt directly or indirectly related to the leased property is expected to be in effect or a loan from the lessee to the lessor directly or

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indirectly related to the leased property is expected to be outstanding.

- o All periods covered by ordinary renewal options preceding the date as of which a bargain purchase option is exercisable.
- o All periods representing renewals or extensions of the lease at the lessor's option.

Lessee. The lessee is the "consuming" party in a leasing arrangement.

Lessor. The lessor is the "vending" party in a leasing arrangement.

Minimum Lease Payments. The minimum lease payment is the minimum payment that the lessee must pay to the lessor during the fiscal year as specified in the lease agreement, excluding contingent rental payments. Some lease agreements may specify executory costs as a part of the minimum payment the lessee must make to the lessor. Executory costs that are included as part of the minimum payment to the lessor are excluded from the present value calculation for determining if a lease is operating or capital, but are included in Part V of the Operating Leases Summary Form and in Item 14 of the Lease Register.

For copiers leased under both the 1995 and 1999 contract, you are asked in Section IV of the Summary Form if you split the costs of the minimum lease payments between object codes 0403 (for 1995 copiers) or 0408 (for 1999 copiers), 0303 (Copying Equipment Supplies), and 0203 (Copying Equipment Service). The cost should be split as follows for copiers leased under the 1999 contract:

Contingent Rental Payments	0408	67%
Copying Equipment Service	0203	21%
Copying Equipment Supplies	0303	12%

The split should be as follows for copiers leased under the 1995 contract:

Rent-Copying Equipment	0403	67%
Copying Equipment Service	0203	21%
Copying Equipment Supplies	0303	12%

You may make these splits as you make the payments on the copiers; however, it may be more convenient for you to make the splits for the entire fiscal year on a single voucher submitted before the end of fiscal month 13.

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Net Minimum Lease Payment. The *net* minimum lease payment is the minimum lease payment **net of any executory costs** included as part of the minimum lease payment that the lessee must make to the lessor. The net minimum lease payments are reported on line 8b of the Lease Register. The net minimum lease payment is used only for the present value calculation for determining whether a lease is capital or operating.

Example: Suppose that on June 30, 2001, your agency leased a mail machine requiring monthly payments of \$100. Assume the following: the term of the lease is 5 years, the first payment was made on July 1, 2001, the fair market value of the leased property is \$7,500, the machine has an estimated economic life of 7 years, and executory costs make up 10% of the lease payment.

The following table illustrates the minimum lease payment and the net minimum lease payment computations:

Minimum monthly lease payment:	\$100
Monthly executory costs:	\$ 10
Net minimum monthly lease payment:	\$ 90

Refer to Exhibit 3.19 (B) to see how these amounts are reported in lines 8, 8a, and 8b.

On the Operating Leases Summary Form (GAAP Form 3.19.1), your agency would report the following as the future annual obligation in Section V:

Minimum lease payment per year: \$1,200 (\$100 x 12 months)

Note that the **minimum lease payment**, and not the net minimum lease payment, is used for future obligation calculations. The net minimum lease payment is used only for the present value calculation.

Refer to page 2 of Exhibit 3.19 (A), agency lease ID #1, to see how line items for this particular lease would be completed on an Operating Leases Summary Form (GAAP Form 3.19.1).

Net Lease Payment Per Period. The net lease payment per period is the annual net minimum lease payment amount divided by the number of payments required to be made per year. The net lease payment per period **excludes all executory costs, whether the executory costs are a part of the minimum lease payment you make to the vendor or whether the executory costs are apart from the minimum lease payment.** The net lease payment per period also excludes contingent rentals (see

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definition above). Payments during any lease renewal periods also are excluded from the calculation. For example, the net lease payment per period does **not** include taxes, insurance, maintenance, or usage charges for copy machines. The net lease payment per period is used to complete the lease register and determine proper lease classification. (Refer to the section COMPLETING THE LEASE REGISTER, item (8)).

Noncancelable Lease. A noncancelable lease is any lease that is not a cancelable lease. The Lease Register (GAAP Form 3.19.2) for a noncancelable lease should indicate "N" (No) for Question 13. (See definition of Cancelable Lease above.)

Operating Lease. An operating lease is any lease or rental agreement that does not meet the criteria for being a capital lease. (These criteria are fully explained in the State Treasurer's Lease Reporting Package.) Operating leases do not substantially transfer benefits and risks of ownership to the lessee. Instead, an operating lease merely authorizes a lessee to use a lessor-owned asset.

For this closing package, please report only operating leases where the lessor is a non-State party. That is, do not report operating leases where a State agency is lessor.

Reportable Operating Leases. Agencies must report on this closing package all operating leases that are between a State agency and a non-State entity, are noncancelable, and at June 30 had a remaining term of greater than one year. Lease agreements *signed* by both parties and having a remaining term greater than one year are reportable, whether the lease payments begin before or after June 30.

Example 1: If at June 30, 2002, your agency has a noncancelable operating lease and the term of the lease ends on June 30, 2003, this lease is **not** reportable because the remaining term at June 30, 2002, is not greater than one year.

Example 2: Your agency and the lessor both sign a five-year noncancelable operating lease agreement on June 15, 2002, and the first payment of the lease is due on July 15, 2002. This lease **is** reportable because it is considered to be in effect at June 30 (the lease is in effect as of June 15, the date both parties signed it) and has a remaining term at June 30, 2002, greater than one year.

Rent Holiday. Some leases give the lessee a rent holiday--i.e., a period of rent reduction in the first few months or years of the lease. A rent holiday usually is designed to ease the lessee's short-term cash flow requirements or to otherwise provide financing for the lessee. A reduced payment at the end of a lease term is not a rent holiday.

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Scheduled Rent Increases. Scheduled rent increases are increases that are fixed in the lease agreement, take place with the passage of time, and are not contingent on future uncertain events.

ACCOUNTING PRINCIPLES AND POLICIES

The State prepares its financial statements in accordance with Generally Accepted Accounting Principles (GAAP). GAAP requires that the State:

- o Disclose in its Notes to Financial Statements at June 30 the future "minimum lease payments" (see KEY TERMS) for operating leases having both of the following characteristics:
 - Noncancelable (see KEY TERMS).
 - Initial or remaining term at June 30 longer than one year.

These amounts are presented for each of the next five years and in five year increments thereafter.

- o Disclose in its Notes to Financial Statements the total rental expenditure recorded for the current fiscal year. The State's policy is to obtain this figure directly from STARS.
- o Disclose in its Notes to Financial Statements at June 30 the amount expended for contingent rentals for the current fiscal year.
- o Record Accounts Payable associated with operating leases at June 30 if lease payments due during one fiscal year are not paid until the next fiscal year (see Section 3.12, Accounts Payable Closing Package).

GAAP requirements regarding operating leases appear in:

- o Governmental Accounting Standards Board (GASB) Codification Sections 2300.106, L20.103 through L20.108, and L20.125.
- o Governmental Accounting Standards Board (GASB) Statement 13, "Accounting for Operating Leases with Scheduled Rent Increases."
- o Governmental Accounting Standards Board (GASB) Statement 38, "Certain Financial Statement Note Disclosures," paragraph 10.
- o Financial Accounting Standards Board (FASB) Statement 13, "Accounting for Leases" as revised and interpreted.

GAAP requirements for rent holidays, leasing part of a building, and scheduled rent increases are as follows:

- o Rent Holidays.

Operating lease transactions with rent holidays should be measured using either of the following methods:

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- On a straight-line basis over the lease term.
- Based on the estimated "fair market value of the rental" (See KEY TERMS).

For rent holiday situations, therefore, the Comptroller General's Office will attempt to compute an implicit interest rate (see KEY TERMS). In this case, the implicit rate is the rate at which the present values of the lessee's payment stream and the lessor's fair-market-value lease revenue stream are equal. If an implicit rate cannot be computed (such as when the fair market value of the rental cannot be determined), the Comptroller General's Office will use the straight-line basis over the lease term to measure the operating leases with rent holidays.

- o Part of a Building. If the fair value of the leased property is not objectively determinable, use only the economic life criterion. That is, if you are leasing a part of a building for less than 75% of the estimated economic life of the entire building and cannot objectively determine the fair value of the leased property, classify the lease as operating. If you are leasing the building for longer than 75% of the estimated economic life of the building, classify the lease as capital.

Example: Suppose that on June 30, 2001, your agency signs a noncancelable real property lease for office space as part of a building that requires monthly payments of \$8.00 per square foot, including \$1.00 per square foot for taxes, insurance, and maintenance (i.e., for executory costs). Assume the following: the term of the lease is 16 years, the first payment is made on July 1, 2001, there is no bargain purchase option, there is no title transfer, the fair market value of the leased property is not known, and the building has an economic life of 30 years.

If your agency rented a total of 5,000 square feet, the following table illustrates the minimum lease payment and the net minimum lease payment computations:

Minimum monthly lease payment:	\$40,000 (\$8 x 5,000)
Monthly executory costs:	\$ 5,000 (\$1 x 5,000)
Net minimum monthly lease payment:	\$35,000 (\$7 x 5,000)

Refer to Exhibit 3.19 (C) to see how these amounts are reported in lines 8, 8a, and 8b.

Because you do not know the fair value of the leased property, you are not required to calculate the present value to determine if the lease is capital or operating. In this case, only the

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economic life criterion applies. Because the building has an economic life of 30 years and you are leasing the office space 16 years, which is less than 75% of the economic life, this is an operating lease.

On the Operating Leases Summary Form (GAAP Form 3.19.1), your agency would report the following as the future annual obligation in Section V:

Minimum lease payment per year: \$480,000 (\$40,000 x 12 months)

Note that the minimum lease payment, and not the net minimum lease payment, is used for the calculation of the future obligation. The net minimum lease payment is used only for the present value calculation.

Refer to page 2 of Exhibit 3.19 (A), agency lease ID #2, to see how line items for this particular lease would be completed on an Operating Leases Summary Form (GAAP Form 3.19.1).

o Scheduled Rent Increases.

Operating leases with scheduled rent increases (see KEY TERMS) will be measured based on the provisions of the lease agreement if all of the following conditions are met:

- The lease agreement specifies scheduled rent increases over the lease term.
- These increases are intended to cover the anticipated effects of property value appreciation or increases in costs due to factors such as inflation.
- The lease payments, including scheduled rent increases, are reasonably associated with the present and anticipated "fair market value of the rental" (see KEY TERMS).

That is, expenditures on leases with scheduled rent increases will be recorded in the year when due rather than on a straight-line basis.

Measurement of scheduled rent increases also will be based on provisions of the lease agreement if the lease payments are required to be made on a systematic and rational basis representative of the time pattern in which the leased asset is available for lessee use.

Example: Suppose that on June 30, 2001, your agency signs a noncancelable real property lease for office space as part of a building that requires monthly payments of \$1,000 per month for rent, including \$50 per month executory costs. Assume the following: the term of the lease is 6 years, the monthly payment

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amount increases to \$1,100 on July 1, 2004, the first payment is made on July 1, 2001, there is no bargain purchase option, there is no title transfer, the fair market value of the leased property is not known, and the building has an economic life of 20 years. Refer to Exhibit 3.19 (D) to see how these amounts are reported in lines 8, 8a, and 8b.

Because you do not know the fair value of the leased property, you are not required to calculate the present value to determine if the lease is capital or operating. In this case, only the economic life criterion applies. Because the building has an economic life of 20 years and you are leasing the office space for 10 years, which is less than 75% of the economic life, this is an operating lease.

On the Operating Leases Summary Form (GAAP Form 3.19.1), your agency would report the following as the future obligation by year in Section V:

Minimum lease payments to be reported for future years:

FYE June 30, 2003	\$12,000
FYE June 30, 2004	\$12,000
FYE June 30, 2005	\$13,200
FYE June 30, 2006	\$13,200
FYE June 30, 2007	\$13,200

Note that the **minimum lease payment**, and not the net minimum lease payment, is used for calculation of the future obligation.

Refer to page 2 of Exhibit 3.19 (A), agency lease ID #3, to see how line items for this particular lease would be reported on the Operating Leases Summary Form (GAAP Form 3.19.1).

WORKING PAPERS

All working papers are subject to audit, even if your agency does not submit a closing package. Every agency should keep:

- o Copies of each lease or rental agreement.
- o Copies of the completed Operating Leases Summary Form (GAAP Form 3.19.1).
- o Copies of completed Lease Registers (GAAP Form 3.19.2) or other acceptable detailed lease documentation prepared in accordance with Method A, B, or C as described beginning on page 2 of this closing package.

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- o A copy of the computer printout that the Comptroller General's Office provided, showing STARS expenditure object 04xx amounts (see Exhibit 3.19 (E)).
- o Documentation of the reconciliation of the printout amounts to your agency's records.
- o Copies of Lease Registers completed at the lease inception, with all questions completed.
- o Working papers that support each amount on the completed forms, including documentation that supports the fair market value and economic life of the property.

GENERAL INSTRUCTIONS--OPERATING LEASES SUMMARY FORM (GAAP FORM 3.19.1)

- o At the inception of a lease, use the State Treasurer's Lease Reporting Package to determine which of your agency's leases and rental agreements are operating leases (see the KEY TERMS section above). Your determination should be based on the answers to Section 11 on the Lease Register (GAAP Form 3.19.2).
- o Determine whether you need to complete the Operating Leases Summary Form (GAAP Form 3.19.1). You must do so if your agency had one or more noncancelable operating leases (see KEY TERMS) in effect at year-end with remaining term at June 30 exceeding one year. Your agency's total noncancelable operating lease obligation at June 30 for all future years is more than \$200,000. Leases in effect at June 30 include lease agreements *signed* on or before June 30. Your agency's obligation begins when both parties sign the lease agreement, whether the lease payments begin before or after June 30. Do not include any leases where the lessor is a State agency.
- o If the Operating Leases Closing Package applies to your agency, read this closing package paying special attention to the definitions of key terms.
- o Choose Method A, B, or C to report detailed data to the Comptroller General's Office regarding noncancelable operating leases in effect at June 30:
 - Method A: Make photocopies of only those Lease Register pages (prepared in accordance with the State Treasurer's Lease Reporting Package) that include noncancelable operating leases in effect at June 30 with a remaining term at June 30 exceeding one year. Leases in effect at June 30 include lease agreements *signed* on or before June 30. Your agency's obligation begins when both parties sign the lease agreement, whether the lease payments begin before or after June 30.

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- Method B: Complete a separate Lease Register (GAAP Form 3.19.2) for the Comptroller General's Office that includes only the items other than Item 11 for each noncancelable operating lease in effect at June 30 with a remaining term at June 30 exceeding one year. Leases in effect at June 30 include lease agreements *signed* on or before June 30. Your agency's obligation begins when both parties sign the lease agreement, whether the lease payments begin before or after June 30. (See the last pages of this closing package for further instructions.)
- Method C: Use a computer printout or other alternative format in place of Methods A or B to document details of all noncancelable operating leases in effect at June 30 with a remaining term at June 30 exceeding one year. Leases in effect at June 30 include lease agreements *signed* on or before June 30. Your agency's obligation begins when both parties sign the lease agreement, whether the lease payments begin before or after June 30. If you select this option, you must include all items except Item 11 shown on the Lease Register as described on the last pages of this closing package.
 - o On the Lease Register pages or alternative documentation prepared under Method A, B, or C as described above, complete Question 14.

Enter the amounts reported on Question 14 for all applicable leases on the Operating Leases Summary Form (GAAP Form 3.19.1), Part V.

- o Regardless of whether you used Method A, B, or C, please observe the following:
 - Show your agency's three-character STARS agency code on each page of documentation.
 - Do not include any leases where the lessor is a State agency.
- o Finally, complete the Operating Leases Summary Form (GAAP Form 3.19.1).
 - Round all dollar amounts on the Form to the nearest whole dollar.
 - Complete only one Form covering all funds.
 - Enter data on the Form only for leases where the lessor (see KEY TERMS) is a non-State vendor.
 - Enter data only for operating leases (see KEY TERMS), not capital leases.

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- Be sure that the detailed operating lease information you provide in accordance with Method A, B, or C is consistent with data you provide on the Operating Leases Summary Form (GAAP Form 3.19.1).
- o Return the completed Operating Leases Summary Form (GAAP Form 3.19.1), along with copies of the supporting details prepared in accordance with Method A, B, or C to the Comptroller General's Office no later than August 31. If you can return the materials earlier, please do so.
 - o The person who prepares the detailed lease documentation and the Operating Leases Summary Form (GAAP Form 3.19.1) should keep a copy. The Comptroller General's Office will call this person if there are questions.
 - o Exhibits 3.19 (A) through (D) show a sample completed Operating Leases Summary Form (GAAP Form 3.19.1) and the supporting Lease Register (GAAP Form 3.19.2). Detailed instructions for completing the Forms follow the exhibits. Exhibit 3.19 (E) is a sample computer printout showing certain 04xx object code expenditures for a fiscal year of the sample agency.

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**STATE OF SOUTH CAROLINA
OPERATING LEASES SUMMARY FORM
FOR THE FISCAL YEAR ENDED JUNE 30, 2002 (1)**

2002
EXHIBIT 3.19 (A)
Page 1 of 2

Agency: (2) A99 Sample Agency
Code Name

Prepared: (3) 8/29/02 By: J.P. Junior Title: Accountant Phone: 734-1234
Date Employee Name

Approved: (3) 8/29/02 By: I.M. Senior Title: Director of Accounting Phone: 734-2345
Date Employee Name

I. CURRENT FISCAL YEAR

If your agency's records do not reconcile to the printout of operating lease expenditures and the net amount of the difference is \$5,000 or more in total, indicate the net amount of the difference and an explanation of the difference (use a negative number to show that your agency's expenditures are lower than the printout amount and a positive number to show that your agency's expenditures are higher than the printout amount).

Net difference \$ (7,000) (4) Explanation 0413 expenditures to be reclassified as 0415 (5)

II. LEASES WITH SCHEDULED RENT INCREASES

Does your agency have any operating leases with scheduled rent increases (see Key Terms) which are intended to cover anticipated property value appreciation or increases in costs due to factors such as inflation OR where the lease payments, although increasing, are made on a systematic and rational basis representative of the time pattern in which the leased asset is available for your agency's use? (Please mark one.)

(6) Yes No

If "Yes," identify the particular leases involved by listing the Agency Lease ID Number(s) from the Lease Register below:

Agency Lease ID Number 3 (7)

Agency Lease ID Number _____

Agency Lease ID Number _____

III. LEASES WITH RENT HOLIDAY PROVISIONS

Does your agency have any operating leases with "rent holiday" (see Key Terms) provisions? (Please mark one.)

(8) Yes No

If "Yes," identify the leases involved by listing the Agency Lease ID Number(s) from the Lease Register below:

Agency Lease ID Number _____ (9)

Agency Lease ID Number _____

IV. COPIERS

For copiers for which executory costs are a part of the minimum lease payment, did your agency split charges between (a) the lease payment object codes (0403 and 0408) and (b) object codes 0203 (Equipment Service) and 0303 (Supplies)?

(10) Yes No

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COMPLETING THE OPERATING LEASES SUMMARY FORM (GAAP FORM 3.19.1)

REF	EXPLANATION
(1)	Enter the fiscal year for which this Form applies.
(2)	Enter the agency name and three-character STARS agency code.
(3)	Complete all information regarding preparation of this Form. The Finance Director or Executive Director should approve the Form before sending it to the Comptroller General's Office.

PART I--CURRENT FISCAL YEAR: Complete this section only if the reconciliation between your agency's operating lease expenditures under STARS expenditure object codes 0401 through 0416 (excluding 0415, Rental--State-Owned Real Property) and the computer printout the Comptroller General's Office sent you indicates that adjustments of at least \$5,000 need to be made to expenditures in STARS.

- (4) Enter the net amount of any adjustment totaling \$5,000 or more to be made to STARS. Enter net reductions in expenditures as negative numbers and net increases in expenditures as positive numbers. Do not include any amounts for STARS expenditure object 0415, "Rent--State-Owned Real Property."
- (5) Describe the adjustment and its purpose in words. If additional information is required, someone from the Comptroller General's Office will contact the closing package preparer.

PART II--LEASES WITH SCHEDULED RENT INCREASES: Please answer the indicated questions regarding scheduled rent increases.

- (6) Check "Yes" or "No" to indicate whether your agency has any operating leases with scheduled rent increases (see KEY TERMS) with the following characteristics:
- o Lease was in effect at the end of the current fiscal year and had a remaining term longer than one year at that date.
 - o Either:
 - The increases are intended to cover the anticipated effects of property value appreciation or increases in costs due to factors such as inflation.

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EXPLANATION

Unless you have been splitting charges for the payments you make each month under the 1995 agreement, you should also submit a journal voucher before the close of FM 13 to reclassify the cost as follows:

Rent-Copying Equipment	0403	67%
Copying Equipment Service	0203	21%
Copying Equipment Supplies	0303	12%

If you either split the charges on a monthly basis or submitted a year-end voucher to reclassify the annual cost, answer "Yes" to the question.

PART V--FUTURE MINIMUM LEASE PAYMENTS FOR NONCANCELABLE OPERATING LEASES WITH INITIAL OR REMAINING TERM EXCEEDING ONE YEAR:

- (11) Enter the appropriate fiscal year indicators. Begin with the next fiscal year after the fiscal year just completed. For example, if the closing package is being completed for fiscal year 2002, the future years' minimum payments would begin with the fiscal year ended June 30, 2003. Enter the next five fiscal years separately, and then enter five year increments thereafter.

- (12) Enter the agency lease identification number and the amount of the future-year minimum lease payments (see KEY TERMS) reported in Question 14 of the Lease Register (or other supporting detailed operating lease documentation you submit) for each of your agency's noncancelable operating leases in effect at June 30 with a remaining term at June 30 exceeding one year. Leases in effect at June 30 include lease agreements *signed* on or before June 30. Your agency's obligation begins when both parties sign the lease agreement, whether the lease payments begin before or after June 30. You may make additional copies of this form if needed to list all applicable leases.

- (13) For each indicated future fiscal period, add up the lease payments for operating leases reported in Part V and enter the amounts on the total line of the Summary Form.

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EXHIBIT 3.19 (B)

_____ Capital

_____ X _____ Operating

LEASE REGISTER

1	Agency Code			<i>A99</i>
2	Agency Name			<i>Sample Agency</i>
3	Description			<i>Mail Machine</i>
4	Agency Lease ID Number			<i>1</i>
5	Lessor/Lender Name			<i>Pitney-Bowes</i>
6	Total Lease Payment			<i>6,000.00</i>
7	Payment Interval			<i>Monthly</i>
8	Minimum Lease Payment per Period			<i>100</i>
8a	Executory Costs Per Period			<i>10</i>
8b	Net Minimum Lease Payment per Period (line 8 less line 8a)			<i>90</i>
8c	Lease Term			<i>60 months</i>
9	Beginning Payment Date			<i>07/01/01</i>
9a	Ending Payment Date			<i>06/01/06</i>
10	Prepay or Arrears?			<i>Prepay</i>
11	GAAP Criteria:			
11.1	Title Transfer?			<i>NO</i>
11.2	Bargain Purchase Option?			<i>NO</i>
11.3	Lease Term			<i>60 months</i>
11.3a	Estimated Economic Life			<i>84 months</i>
11.3b	Estimated Economic Life x 75%			<i>63 months</i>
11.3c	Is the Lease Term (line 11.3) greater than or equal to the Estimated Economic Life X 75%? (line 11.3b)			<i>NO</i>
11.4	Net Minimum Lease Payment Per Period			<i>90</i>
11.4a	Incremental Borrowing Rate			<i>4.38%</i>
11.4b	Incremental Borrowing Rate Per Period			<i>0.37%</i>
11.4c	Number of Payments			<i>60</i>
11.4d	Enter the Present Value			<i>4,859</i>
11.4e	Fair Market Value			<i>7,500</i>
11.4f	Fair Market Value x 90%			<i>6,750</i>
11.4g	Is the Present Value (line 11.4d) greater than or equal to the Fair Market Value X 90%? (line 11.4f)			<i>NO</i>
12	Capital or Operating?			<i>Operating</i>
13	Lease Cancelable?			<i>NO</i>
14	Future Minimum Lease Payments:			
	Fiscal Year 2003	\$ 1,200	FY 2008-2012	\$ -
	Fiscal Year 2004	\$ 1,200	FY 2013-2017	\$ -
	Fiscal Year 2005	\$ 1,200	FY 2018-2022	\$ -
	Fiscal Year 2006	\$ 1,200	FY 2023-2027	\$ -
	Fiscal Year 2007	\$ -	FY 2028-2032	\$ -
(Report any liability that goes beyond FY 2032 on a separate form.)				

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OFFICE OF THE COMPTROLLER GENERAL**

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OPERATING LEASES CLOSING PACKAGE

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EXHIBIT 3.19 (C)

_____ Capital

_____ X _____ Operating

LEASE REGISTER

1	Agency Code	<i>A99</i>	
2	Agency Name	<i>Sample Agency</i>	
3	Description	<i>Office Space</i>	
4	Agency Lease ID Number	<i>2</i>	
5	Lessor/Lender Name	<i>Keenan</i>	
6	Total Lease Payment	<i>2,400,000.00</i>	
7	Payment Interval	<i>Monthly</i>	
8	Minimum Lease Payment per Period	<i>40,000</i>	
8a	Executory Costs Per Period	<i>5,000</i>	
8b	Net Minimum Lease Payment per Period (line 8 less line 8a)	<i>35,000</i>	
8c	Lease Term	<i>16 years</i>	
9	Beginning Payment Date	<i>07/01/01</i>	
9a	Ending Payment Date	<i>06/01/17</i>	
10	Prepay or Arrears?	<i>Prepay</i>	
11	GAAP Criteria:		
11.1	Title Transfer?	<i>NO</i>	
11.2	Bargain Purchase Option?	<i>NO</i>	
11.3	Lease Term	<i>16 years</i>	
11.3a	Estimated Economic Life (in months)	<i>30 years</i>	
11.3b	Estimated Economic Life x 75%	<i>22.5 years</i>	
11.3c	Is the Lease Term (line 11.3) greater than or equal to the Estimated Economic Life X 75%? (line 11.3b)	<i>NO</i>	
11.4	Net Minimum Lease Payment Per Period	<i>N/A</i>	
11.4a	Incremental Borrowing Rate	<i>Part</i>	
11.4b	Incremental Borrowing Rate Per Period	<i>of</i>	
11.4c	Number of Payments	<i>Building</i>	
11.4d	Enter the Present Value	↓	
11.4e	Fair Market Value		
11.4f	Fair Market Value x 90%		
11.4g	Is the Present Value (line 11.4d) greater than or equal to the Fair Market Value X 90%? (line 11.4f)	↓	
12	Capital or Operating?	<i>Operating</i>	
13	Lease Cancelable?	<i>NO</i>	
14	Future Minimum Lease Payments:		
	Fiscal Year 2003	\$ 480,000	FY 2008-2012 \$ 2,400,000
	Fiscal Year 2004	\$ 480,000	FY 2013-2017 \$ 2,400,000
	Fiscal Year 2005	\$ 480,000	FY 2018-2022 \$ -
	Fiscal Year 2006	\$ 480,000	FY 2023-2027 \$ -
	Fiscal Year 2007	\$ 480,000	FY 2028-2032 \$ -
	(Report any liability that goes beyond FY 2032 on a separate form.)		

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EXHIBIT 3.19 (D)

_____ Capital

_____ Operating

LEASE REGISTER

1	Agency Code			<i>A99</i>
2	Agency Name			<i>Sample Agency</i>
3	Description			<i>Office Space</i>
4	Agency Lease ID Number			<i>3</i>
5	Lessor/Lender Name			<i>Keenan</i>
6	Total Lease Payment			<i>75,600.00</i>
7	Payment Interval			<i>Monthly</i>
8	Minimum Lease Payment per Period			<i>SRI</i>
8a	Executory Costs Per Period			<i>SRI</i>
8b	Net Minimum Lease Payment per Period (line 8 less line 8a)			<i>SRI</i>
8c	Lease Term			<i>6 years</i>
9	Beginning Payment Date			<i>07/01/01</i>
9a	Ending Payment Date			<i>06/01/07</i>
10	Prepay or Arrears?			<i>Prepay</i>
11	GAAP Criteria:			
11.1	Title Transfer?			<i>NO</i>
11.2	Bargain Purchase Option?			<i>NO</i>
11.3	Lease Term			<i>6 years</i>
11.3a	Estimated Economic Life (in months)			<i>20 years</i>
11.3b	Estimated Economic Life x 75%			<i>15 years</i>
11.3c	Is the Lease Term (line 11.3) greater than or equal to the Estimated Economic Life X 75%? (line 11.3b)			<i>NO</i>
11.4	Net Minimum Lease Payment Per Period			<i>N/A</i>
11.4a	Incremental Borrowing Rate			<i>Part</i>
11.4b	Incremental Borrowing Rate Per Period			<i>of</i>
11.4c	Number of Payments			<i>Building</i>
11.4d	Enter the Present Value			↓
11.4e	Fair Market Value			
11.4f	Fair Market Value x 90%			
11.4g	Is the Present Value (line 11.4d) greater than or equal to the Fair Market Value X 90%? (line 11.4f)			
12	Capital or Operating?			<i>Operating</i>
13	Lease Cancelable?			<i>NO</i>
14	Future Minimum Lease Payments:			
	Fiscal Year 2003	\$ 12,000	FY 2008-2012	\$ -
	Fiscal Year 2004	\$ 12,000	FY 2013-2017	\$ -
	Fiscal Year 2005	\$ 13,200	FY 2018-2022	\$ -
	Fiscal Year 2006	\$ 13,200	FY 2023-2027	\$ -
	Fiscal Year 2007	\$ 13,200	FY 2028-2032	\$ -
(Report any liability that goes beyond FY 2032 on a separate form.)				

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OFFICE OF THE COMPTROLLER GENERAL
OPERATING LEASE PAYMENTS
FY 02 FM 01 - 13

EXHIBIT 3.19 (E)
DAOFO01B
07/30/2002 11:19

AGENCY	MAMI	AMOUNT
A99	0401	328.21
A99	0403	806.20
A99	0413	19,256.00
A99	O416	72.00
AGENCY TOTAL		20,462.41

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COMPLETING THE LEASE REGISTER (GAAP FORM 3.19.2)

REF	EXPLANATION
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NOTE: Refer to the State Treasurer's Capital Lease Reporting Package for further information when completing the Lease Register.

- (1) Enter the three-character STARS agency code.
- (2) Enter your agency's name.
- (3) Enter a brief description of the leased property (e.g. Copier, Office Space).
- (4) Enter an agency reference number for the lease agreement. This may be the purchase order number, contract number or a number you make up. The only requirement is that the number for each lease remain the same for each fiscal year the lease is reported.
- (5) Enter the name of the lessor (see KEY TERMS).
- (6) Enter the total dollar amount that is to be paid to the lessor over the lease term, **including** executory costs (see KEY TERMS).
 For example: Lease Term = 3 years
 Payment = \$50.00 per month
 Total lease amount = \$50.00 x 12 mo/yr x 3 yr = \$1,800.00

 Do not include contingent rentals (such as overage charges for photocopying machines).
- (7) Enter the appropriate time interval for which lease payments are due (e.g. Y = Yearly, Q = Quarterly, S = Semi-annually, M = Monthly).
- (8) Enter the minimum lease payment the agency is required to make per the lease agreement each time a payment is due. The amount that you pay each month includes any executory costs (see KEY TERMS) that are payable to the lessor as part of the minimum lease payment. This is the amount you will use for calculation of the future obligation. Do not include any contingent payments, such as overages for copying machines. Enter *SRI* for a lease with a scheduled rate increase.

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(11.2) Enter YES or NO depending upon whether the lease agreement contains a bargain purchase option (see KEY TERMS). If YES, the lease is a capital lease.

(11.3) Enter the lease term (see KEY TERMS).

(11.3a) Enter the estimated economic life of the leased property (see KEY TERMS).

(11.3b) Multiply the number from (11.3a) by 75% and enter the result.

(11.3c) Enter YES if 75% of the economic life (11.3b) is less than or equal to the lease term (11.3). If YES, the lease is a capital lease.

Enter NO if 75% of the economic life (11.3b) is greater than the lease term (11.3).

(11.4) Enter the net minimum lease payment per period. This should be the same as the amount on line 8b.

(11.4a) Enter the implicit interest rate (see KEY TERMS) if (a) the rate can be determined and (b) it is lower than the incremental borrowing rate (see KEY TERMS). Otherwise, enter the incremental borrowing rate.

(11.4b) Enter the rate above per period. NOTE: If the payments are not made on an annual basis, you must convert the rate to the interest rate per period. (For example, suppose you make monthly payments and the annual interest rate is 7.5%. Divide 7.5 by 12 months to get the interest rate per period of 0.625%).

(11.4c) Enter the number of periods or the number of payments that the agency is committed to pay.

For example, on a 5-year agreement with monthly payments, the number of periods or number of payments would be 60.

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GENERAL INSTRUCTIONS--OPERATING LEASE CLOSING PACKAGE REVIEWER CHECKLIST (GAAP FORM 3.19.3)

- The purpose of the Reviewer Checklist is to help your agency perform an effective review of the completed closing package forms **before** you submit them to the Comptroller General's Office. An effective review is essential to minimizing closing package errors. As such, it is an important internal control. **Completion of this Checklist is required.**
- **Retain the completed checklist for audit along with your other working papers; do not return it to the Comptroller General's Office.**
- Your agency's Finance Director, Executive Director, or another reviewer should complete the Reviewer Checklist. The reviewer **must** be someone other than the preparer.
- Each question on the Reviewer Checklist is designed so that a "No" answer indicates a potential problem. Generally, when the reviewer responds "No," he/she should return the closing package form to the preparer to be corrected and resubmitted. If you believe that a "No" answer to a particular question is unavoidable or acceptable in your unique situation, however, attach an explanation to the completed checklist and retain it with the completed checklist.
- This checklist is not all-inclusive. It is designed only to detect the most frequent types of errors. It may not identify all possible errors.
- Exhibit 3.19 (F) shows a sample completed Reviewer Checklist (GAAP Form 3.19.3).

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STATE OF SOUTH CAROLINA
OPERATING LEASE CLOSING PACKAGE
REVIEWER CHECKLIST
FISCAL YEAR 2002

EXHIBIT
3.19 (F)
Page 1 of 1

Reviewer's Signature:	<i>I. M. Senior</i>
Date Last Review Step Was Completed:	<i>August 29, 2002</i>
REVIEW STEP	YES/NO
Is the reviewer of the operating lease closing package someone other than the person who prepared it?	<i>Yes</i>
Did the preparer and reviewer <i>sign</i> the operating lease closing package (not just type or rubber-stamp their names)?	<i>Yes</i>
Did the preparer and reviewer show their titles and telephone numbers?	<i>Yes</i>
Can all amounts reported on the operating lease closing package be traced back to official agency accounting records or to working papers?	<i>Yes</i>
Do the completed closing package forms reflect implementation of all changes in closing package instructions for this year, if any, that apply to your agency?	<i>Yes</i>
Are differences between the closing package amounts reported in the current-year and those reported last year either (1) small or (2) explained (as to reasons) in working papers retained for audit purposes?	<i>Yes</i>
Have you attached to the Operating Leases Summary Form, a lease register, or alternate documentation for <u>each</u> noncancelable operating lease effective on June 30 with a remaining term at June 30 exceeding one year?	<i>Yes</i>
Did you complete all the information except Part II on the attached lease registers (or agency prepared forms with the same information)? Note: For audit purposes, you must complete the <u>entire</u> lease register for <u>every</u> lease at its inception.	<i>Yes</i>
Did you reconcile your agency's rental expenditures to the STARS report provided to your agency?	<i>Yes</i>
Have you reported on the Operating Leases Summary Form all noncancelable operating leases effective on June 30 that have a remaining lease term of more than one year from June 30?	<i>Yes</i>
Did you recalculate the amounts reported in Parts I and V of the Operating Leases Summary Form? Do the amounts per fiscal year on Question 14 and all attached lease registers (or similar agency prepared forms) agree to the amounts reported on the Operating Leases Summary Form Part V?	<i>Yes</i>
Did you recalculate the totals for each fiscal year and five year increments reported on the Operating Leases Summary Form Part V?	<i>Yes</i>
For copier leases, did you properly allocate the minimum lease payments and contingent rental payments among STARS expenditure object codes 0203, 0303, 0403, and 0408?	<i>Yes</i>