



national treasury

Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

CLASSIFICATION CIRCULAR 4 OF 2008/09

CLASSIFICATION OF LEASE AGREEMENTS IN THE STANDARD CHART OF ACCOUNTS

Purpose

The purpose of this classification circular is to provide guidance to all government financial practitioners on the economic classification of lease payments in the budget and in BAS using the new SCOA accounts and segments. In addition the circular clarifies the link between the economic classification and the disclosure requirements in the annual financial statements.

This circular does not elaborate on the difference between operating and finance leases, users should refer to the Guide for the Preparation of Annual Reports (Disclosure Notes) for guidance on how to distinguish between these two forms of lease agreements.

Definitions

A **finance lease** is a lease that transfers substantially all the risks and rewards of ownership of an asset. Title may or may not eventually be transferred.

In substance, the lessee purchases an asset by way of a financing arrangement between itself (the lessee) and the lessor. Refer to Practice Note 5 of 2006/07 issued by the Office of the Accountant-General for specific rules regarding this type of transaction.

An **operating lease** is a lease other than a finance lease.

Discussion

The classification of the lease (i.e. operating or finance lease) must be made at the inception of the lease agreement. The economic classification of the lease payments made over the period of the lease will depend on the type of lease agreement entered into by the department. The tables below illustrate the economic classification in the "old" SCOA (i.e. pre 1 April 2008) and the "new" SCOA (i.e. post 1 April 2008).

As mentioned above and illustrated in the table, the lessee to a finance lease purchases the asset. The payment is therefore classified as a transaction of a capital nature. However if the lease was an operating lease the lessee would merely be paying for the use of the goods.

In short, finance lease transactions should be funded from the department's capital budget whereas payments in terms of operating lease agreements are funded from the current (operating) budget of the department.

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Classification of transactions in the financial system:

Prior to 1 April 2008:

Item	Objective segment	Project segment
Operating lease		
OPERATING LEASE (departments post the transaction to the relevant category of asset that has been leased)	Relevant "CURRENT" programme leasing the asset	The use of the project segment is not a requirement. It may however be used to keep track of the lessor or contract number.
Finance lease		
OPERATING LEASE* (departments post the transaction to the relevant category of asset that has been leased)	Relevant "CAPITAL" programme leasing the asset	The use of the project segment is not a requirement. It may however be used to keep track of the lessor or contract number.
INT PAID:FINANCE LEASES (interest portion of installment)	Relevant "CURRENT" programme leasing the asset	The use of the project segment is not a requirement. It may however be used to keep track of the lessor or contract number.

* although the non-posting level is called "OPERATING LEASE" the posting level items may be used to record operating lease expenditure. Alternatively the entity may use the items under payments for capital assets.

From 1 April 2008:

Item	Asset category	Project segment
Operating lease		
LEASE PAYMENTS	Relevant category of asset leased	NO PROJECTS (STAND ALONE ITEM) CUR
Finance lease		
LEASE PAYMENTS (capital portion of installment)	Relevant category of asset leased	NO PROJECTS (STAND ALONE ITEM) CAP
INT PAID:FINANCE LEASES (interest portion of installment)	Relevant category of asset leased	NO PROJECTS (STAND ALONE ITEM) CUR

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The examples below illustrate the classification, presentation and disclosure of transactions relating to both operating and finance lease.

Example - operating lease:

The lease term is for 24 months starting 1 April 2006 for a photo copier machine. The contract requires payments of R334.22 to be paid at the beginning of each month.

The payment made on 1 May 2006 is recorded as follows:

Using "old" SCOA accounts

Segment	Account	Amount
Item	LEASE: OFFICE EQUIPMENT	334.22
Objective	CORPORATE SERVICES CURRENT	
Project	NO PROJECTS	
TOTAL payment		334.22

Using "new" SCOA accounts

Segment	Account	Amount
Item	LEASE PAYMENTS	334.22
Asset category	OFFICE EQUIPMENT	
Project	NO PROJECTS (STAND ALONE ITEM) CUR	
TOTAL payment		334.22

NOTE: for the purpose of this example amounts have not been rounded to the nearest R1,000 in the extracts below

[Extract] Presentation in the expenditure estimates (budget statement)

Economic classification	Adjusted appropriation	Medium-term expenditure estimate		
	2006/07	2007/08	2008/09	2009/10
Current payments				
Compensation of employees	xxx	xxx	xxx	Xxx
Goods and services				
<i>of which</i>				
<i>operating leases</i>	4,011	4,011	-	-
Interest and rent on land				
Payments for capital assets				
Buildings and other fixed structures	-	-	-	-
Machinery and equipment	-	-	-	-
	xxx	xxx	xxx	xxx

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[Extract] Presentation in the Statement of Financial Performance

	2006/07	2005/06
Current payments		
Compensation of employees	xxx	xxx
Goods and services	4,011	-
Interest and rent on land		
Payments for capital assets		
Buildings and other fixed structures	-	-
Machinery and equipment	-	-
	xxx	xxx

Disclosure at the end of the 2006/07 financial year (in the disclosure notes)

2006/07	Land	Buildings and other fixed structures	Machinery and equipment	Total
Not later than 1 year	-	-	4,011	4,011
Later than 1 year and not later than 5 years	-	-	-	-
Later than five years	-	-	-	-
Total present value of lease liabilities	-	-	4,011	4,011

Calculated:
 $334.22 \times 12 = 4,010.64$
 to be paid in 2007/08

Example – finance lease:

The lease term is for 36 months starting 1 April 2006 for a photo copier machine. The contract requires payments of R334.22 to be paid at the beginning of each month. The photo copier's market value is R10,500. Assume that the interest rate implicit in the lease agreement is 6 %. The net present value is R11,041. This figure is calculated as follows:

Function Arguments

PV

Rate = 0.005

Nper = 36

Pmt = 334.22

Fv = 0

Type = 1

= -11041.0818

Returns the present value of an investment: the total amount that a series of future payments is worth now.

Type is a logical value: payment at the beginning of the period = 1; payment at the end of the period = 0 or omitted.

Formula result = -11041.0818

[Help on this function](#)

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The lease amortization schedule for the 2006/07 financial year is as follows:

Date	Payment	Interest	Capital	Balance
				11,041.08
1/4/2006 1	334.22		(334.22)	10,706.86
1/5/2006 2	334.22	53.53	(280.69)	10,426.18
1/6/2006 3	334.22	52.13	(282.09)	10,144.09
1/7/2006 4	334.22	50.72	(283.50)	9,860.59
1/8/2006 5	334.22	49.30	(284.92)	9,575.67
1/9/2006 6	334.22	47.88	(286.34)	9,289.33
1/10/2006 7	334.22	46.45	(287.77)	9,001.56
1/11/2006 8	334.22	45.01	(289.21)	8,712.34
1/12/2006 9	334.22	43.56	(290.66)	8,421.68
1/01/2007 10	334.22	42.11	(292.11)	8,129.57
1/02/2007 11	334.22	40.65	(293.57)	7,836.00
1/03/2007 12	334.22	39.18	(295.04)	7,540.96
TOTAL	4,010.64	510.52	-3,500.01	

The lease amortization schedule for the 2007/08 financial year is as follows:

Date	Payment	Interest	Capital	Balance
1/04/2007 13	334.22	37.70	(296.52)	7,244.45
1/05/2007 14	334.22	36.22	(298.00)	6,946.45
1/06/2007 15	334.22	34.73	(299.49)	6,646.96
1/07/2007 16	334.22	33.23	(300.99)	6,345.98
1/08/2007 17	334.22	31.73	(302.49)	6,043.49
1/09/2007 18	334.22	30.22	(304.00)	5,739.48
1/10/2007 19	334.22	28.70	(305.52)	5,433.96
1/11/2007 20	334.22	27.17	(307.05)	5,126.91
1/12/2007 21	334.22	25.63	(308.59)	4,818.32
1/01/2008 22	334.22	24.09	(310.13)	4,508.20
1/02/2008 23	334.22	22.54	(311.68)	4,196.52
1/03/2008 24	334.22	20.98	(313.24)	3,883.28
TOTAL	4,010.64	352.96	-3,657.68	

The lease amortization schedule for the 2007/08 financial year is as follows:

Date	Payment	Interest	Capital	Balance
1/04/2008 25	334.22	19.42	(314.80)	3,568.48
1/05/2008 26	334.22	17.84	(316.38)	3,252.10
1/06/2008 27	334.22	16.26	(317.96)	2,934.14
1/07/2008 28	334.22	14.67	(319.55)	2,614.59
1/08/2008 29	334.22	13.07	(321.15)	2,293.44
1/09/2008 30	334.22	11.47	(322.75)	1,970.69
1/10/2008 31	334.22	9.85	(324.37)	1,646.32
1/11/2008 32	334.22	8.23	(325.99)	1,320.33
1/12/2008 33	334.22	6.60	(327.62)	992.72
1/01/2009 34	334.22	4.96	(329.26)	663.46
1/02/2009 35	334.22	3.32	(330.90)	332.56
1/03/2009 36	334.22	1.66	(332.56)	(0.00)
TOTAL	4,010.64	127.36	-3,883.28	

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Total capital	11,041.08 (value of asset**)
Total interest paid	<u>990.84</u>
Total installments paid (4,010.64 x 3yrs)	12,031.92

**Refer to the Guide for the Preparation of Annual Reports (Disclosure Notes) for guidance the value of the asset.

The payment made on 1 May 2006 in terms of the new SCOA is recorded as follows:

Segment	Account	Amount
Allocation of capital portion		
Item	LEASE PAYMENTS	280.69
Asset category	OFFICE EQUIPMENT	
Project	NO PROJECTS (STAND ALONE ITEM) CAP	
Allocation of interest portion		
Item	INT PAID:FINANCE LEASES	53.53
Asset category	NON ASSET RELATED	
Project	NO PROJECTS (STAND ALONE ITEM) CUR	
TOTAL payment		334.22

NOTE: for the purpose of this example amounts have not been rounded to the nearest R1,000 in the extracts below

[Extract] Presentation in the expenditure estimates (budget statement)

Economic classification	Adjusted appropriation	Medium-term expenditure estimate		
	2006/07	2007/08	2008/09	2009/10
Current payments				
Compensation of employees	xxx	xxx	xxx	Xxx
Goods and services				
<i>of which</i>				
<i>operating leases</i>	-	-	-	-
Interest and rent on land	511	353	127	-
Payments for capital assets				
Buildings and other fixed structures	-	-	-	-
Machinery and equipment	3,500	3,658	3,883	-
	<u>xxx</u>	<u>xxx</u>	<u>xxx</u>	<u>xxx</u>

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[Extract] Presentation in the Statement of Financial Performance

	2006/07	2005/06
Current payments		
Compensation of employees	xxx	xxx
Goods and services	xxx	xxx
Interest and rent on land	511	
Payments for capital assets		
Buildings and other fixed structures	-	-
Machinery and equipment	3,500	-
	xxx	xxx

Disclosure at the end of the 2006/07 financial year

2006/07	Land	Buildings and other fixed structures	Machinery and equipment	Total
Not later than 1 year	-	-	3,658	3,658
Later than 1 year and not later than 5 years	-	-	3,883	3,883
Later than five years	-	-	-	-
Total present value of lease liabilities	-	-	7,541	7,541

The total of the "capital portion" in the amortization schedule.

NOTE: departments are not at present required to "capitalise" any assets acquired in terms of a finance lease in their asset registers. Should this requirement change in the future detailed guidance will be provided in the Guide for the Preparation of Annual Reports issued annually by the Office of the Accountant-General (National Treasury).

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Effective date and transitional provisions

This Classification Circular applies to all lease agreements entered into after 1 April 2008. With regard to lease agreements already in existence on 1 April 2008 the following applies:

- For the **2006/07** financial year: no amendments should be made to these figures, the department should indicate in the notes if the classification differs from this circular;
- For the **2007/08** financial year: departments must account and disclose the lease according to the budget allocation. A discussion should be included in the note where the classification differs to this circular;
- For the **2008/09** financial year: the allocation of expenditure should be made in accordance with this circular. The adjustments budget process should be used to amend the budget of the department if the funds were not initially classified in accordance with this circular.

The effective date for implementation of this circular is the date on this circular, unless otherwise stated. Please contact the SCOA Technical Committee via the **SCOA call center at (012) 315 5311** or by sending a concise mail to scoa@treasury.gov.za if further clarity or discussion is required regarding the changes highlighted above.

SCOA Technical Committee

Date: 10 June 2008