*VOLUME 4, CHAPTER 26: "ASSETS UNDER CAPITAL LEASE"

SUMMARY OF MAJOR CHANGES

Changes are identified in this table and also denoted by blue font.

Substantive revisions are denoted by an asterisk (*) symbol preceding the section, paragraph, table, or figure that includes the revision.

Unless otherwise noted, chapters referenced are contained in this volume.

Hyperlinks are denoted by ***bold, italic, blue, and underlined font***.

This is the initial publication.

PARAGRAPH	EXPLANATION OF CHANGE/REVISION	PURPOSE
Various	This chapter contains updated policy for assets under capital lease based upon the policy contained in Volume 4, Chapter 6, dated June 2009. The existing policy in Volume 4, Chapter 6 related to assets under capital lease is no longer applicable.	Revision
Various	The Federal Accounting Standards Advisory Board issued a new accounting standard for leases, which may require substantive changes to the policy contained in this chapter. The effective date of this new standard is for reporting periods beginning after September 30, 2020. Until the new standard becomes effective, the guidance in this chapter must be followed.	Notification
1.2 (260102)	Added an "Authoritative Guidance" paragraph.	Addition
2.1 (260201)	Added additional language to the definition of bargain purchase option, capital lease, lease term, minimum lease payments, noncancelable and renewal or extension of leases. Added a definition for leasehold improvements and operating leases.	Addition
2.2 (260202)	Added a definition for the capital lease liability account; depreciation, amortization and depletion account; and for other losses from impairment of assets account.	Addition
2.3 (260203)	Clarified the use of net book value, fair value, and recorded cost when recording the cost of general property, plant, and equipment acquired under a capital lease, as well as, documentation requirements.	Revision

PARAGRAPH	EXPLANATION OF CHANGE/REVISION	PURPOSE
2.4 (260204)	Updated guidance for recognition responsibility, recognition timing, capitalization thresholds, and bulk acquisition through leases. Added additional guidance for recognition timing and accounting for real property outside of the United States. The changed capitalization thresholds are based on Office of Secretary of Defense memorandum dated September 20, 2013.	Revision/ Addition
2.5 (260205)	Clarified guidance that maintenance and repairs expended on leased assets are not considered capital improvements.	Revision
2.6 (260206)	Updated the guidance for "Depreciation/Amortization", including removing the salvage value threshold of ten percent.	Revision
2.7 (260207)	Added guidance for "Impairment" of lease based upon Statement of Federal Financial Accounting Standards 44.	Addition
2.8 (260208)	Added guidance for "Derecognition" of lease when a capital lease is terminated before expiration of the lease term.	Addition
3.1 (260301)	Added guidance for "Use of Canceled Treasury Account Symbol" to continue to reported capitalized leased assets using appropriations that subsequently have cancelled.	Addition
3.2 (260302)	Updated guidance for "Supporting Documentation", particularly associated with the derecognition of capital leases.	Revision
3.4 (260304)	Added additional guidance for "Deferred Maintenance and Repair", including reporting material amounts as Required Supplementary Information.	Addition
3.5 (260305)	Added guidance for "Reporting Requirements" related to disclosure of real property outside of the United States when real property is provided by a foreign government/host nation without reimbursement.	Addition

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*CHAPTER 26

ASSETS UNDER CAPITAL LEASE

1.0 GENERAL (2601)

1.1 Purpose (260101)

This chapter prescribes Department of Defense (DoD) accounting policy for assets under capital lease, which is a subset of General Property, Plant and Equipment (PP&E). Unless otherwise stated, this chapter is applicable to all DoD Components, including Working Capital Fund (WCF) activities. Budgetary accounting treatment of capital leases and lease purchases is found in the Office of Management and Budget Circular A-11, "Preparation, Submission, and Execution of the Budget," Appendix B and does not fall under the scope of this chapter.

*1.2 Authoritative Guidance (260102)

The accounting policy and related requirements prescribed by this chapter are in accordance with the applicable provisions of:

1.2.1. Federal Accounting Standards Advisory Board (FASAB) Statement of Federal Financial Accounting Concepts ***(SFFAC) 5***, "Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements";

1.2.2. FASAB ***SFFAC 6***, "Distinguishing Basic Information, Required Supplementary Information and Other Accompanying Information";

1.2.3. FASAB ***SFFAC 7***, "Measurement of the Elements of Accrual-Basis Financial Statements in Periods After Initial Recording";

1.2.4. FASAB Statement of Federal Financial Accounting Standards ***(SFFAS) 1***, "Accounting for Selected Assets and Liabilities";

1.2.5. FASAB ***SFFAS 3***, "Accounting for Inventory and Related Property";

1.2.6. FASAB ***SFFAS 4***, "Managerial Cost Accounting Standards and Concepts";

1.2.7. FASAB ***SFFAS 5***, "Accounting for Liabilities of The Federal Government";

1.2.8. FASAB ***SFFAS 6***, "Accounting for Property, Plant, and Equipment";

1.2.9. FASAB ***SFFAS 10***, "Accounting for Internal Use Software";

1.2.10. FASAB ***SFFAS 29***, "Heritage Assets and Stewardship Land";

1.2.11. FASAB ***SFFAS 40***, "Definitional Changes Related to Deferred Maintenance and Repairs: Amending Statement of Federal Financial Accounting Standards 6, Accounting for Property, Plant, and Equipment";

1.2.12. FASAB ***SFFAS 42***, "Deferred Maintenance and Repairs: Amending Statements of Federal Financial Accounting Standards 6, 14, 29 and 32;"

1.2.13. FASAB ***SFFAS 44***, "Accounting for Impairment Of General Property, Plant, and Equipment Remaining in Use";

1.2.14. FASAB ***SFFAS 50***, "Establishing Opening Balances For General Property, Plant and Equipment: Amending Statement of Federal Financial Accounting Standards (SFFAS) 6, SFFAS 10, SFFAS 23, and Rescinding SFFAS 35";

1.2.15. FASAB Technical Release ***(TR) 13***, "Implementation Guide for Estimating the Historical Cost of General Property, Plant and Equipment";

1.2.16. FASAB ***TR 14***, "Implementation Guidance on the Accounting for the Disposal of General Property, Plant & Equipment";

1.2.17. FASAB ***TR 15***, "Implementation Guidance for General Property, Plant, and Equipment Cost Accumulation, Assignment and Allocation";

1.2.18. ***DoD Directive 5110.4***, "Washington Headquarters Services (WHS)";

1.2.19. ***DoD Instruction (DoDI) 4165.14***, "Real Property Inventory (RPI) and Forecasting"; and

1.2.20. ***DoDI 5000.64***, "Accountability and Management of DoD Equipment and Other Accountable Property".

2.0 ACCOUNTING FOR ASSETS UNDER CAPITAL LEASE (2602)

*2.1 Definitions (260201)

A lease conveys the use of an asset or part of an asset (such as part of a building) from one entity, the lessor, to another, the lessee, for a specified period of time in return for rent or other compensation. Leases can be either capital or operating leases as described in this chapter. The asset being leased under a lease, which meets the criteria of a capital lease, is capitalized and depreciated. The asset being leased under a lease that does not meet the criteria of a capital lease is classified as an operating lease, the asset is not capitalized and lease payments are expensed over the term of the lease.

2.1.1. Bargain Purchase Option. A bargain purchase option is a provision allowing the lessee 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, and where exercise of the option appears, at the inception of the lease, to be reasonably assured.

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

2.1.3. Capital Lease. Capital leases are leases that transfer substantially all the benefits and risks of ownership to the lessee. Lessees must classify a lease as a capital lease if, at its inception, one or more of the following four criteria are met:

2.1.3.1. The lease transfers ownership of the property to the lessee by, or at, the end of the lease term;

2.1.3.2. The lease contains an option to purchase the leased property at a bargain price (refer to the definition in subparagraph 260201.A);

2.1.3.3. The lease term (as defined in subparagraph 260201.H) is equal to or greater than 75 percent of the estimated economic life of the leased property; or

2.1.3.4. The present value of rental and other minimum lease payments, excluding that portion representing executory costs to be paid by the lessor, equals or exceeds 90 percent of the fair value of the leased property. The lessee must compute the present value of the minimum lease payments using the Treasury Instrument interest rate ***Resource Center*** (bill, note or bond) for the beginning of the month when the lease started, which matches the term of the lease. For example, the interest rate for an 8.5-year capital lease would be the average of the interest rates for a 7-year Treasury Note and a 10-year Treasury Note unless:

2.1.3.4.1. It is practicable for the lessee to learn the interest rate implicit in the lease computed by the lessor; and

2.1.3.4.2. The implicit rate computed by the lessor is less than the Treasury Instrument Rate.

2.1.3.5. The criteria cited in subparagraphs 260201.C.3 and 260201.C.4, do not apply if the beginning of the lease term falls within the last 25 percent of the total estimated economic life of the leased property. While leases/occupational agreements with the General Services Administration (GSA) typically do not meet the capital lease criteria, if a GSA lease does meet the criteria cited in subparagraph 260201.C it should be capitalized.

2.1.3.6. If a lease does not meet at least one of the four criteria cited in subparagraphs 260201.C.1 through 260201.C.4, it should be classified as an operating lease. Operating leases of General PP&E are leases in which the entity does not assume the risks of ownership of the asset. Multi-year service contracts and multi-year purchase contracts for expendable commodities are not capital leases. Multi-year purchase contracts for expendable commodities are not capital leases. Multi-year service contracts that do not include provisions for exclusive use of assets (either through identification of specific assets, segregation of services provided from other customers or exclusive use of an asset) are not capital leases.

2.1.4. Contingent Rentals. Contingent rentals are rentals on which the amounts are dependent on some factor other than the passage of time, such as a store lease where contingent rentals are based on a percentage of sales in excess of stipulated amounts or under certain data processing equipment leases based on hours of use in excess of stipulated minimums. Contingent rentals are not part of the minimum lease payments and are expensed as incurred over the term of the lease.

2.1.5. Estimated Economic Life. Estimated economic life 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, without limitation by the lease term.

2.1.6. Fair Value. Fair value is an unbiased, equitable or just value based on the cost of a similar item or the price that an impartial buyer would be willing to pay for the item or a similar item.

2.1.7. Interest Rate Implicit in the Lease. The interest rate implicit in the lease is the discount rate that, when applied to the minimum lease payments (less executory costs and the unguaranteed residual value), causes the aggregate present value at the beginning of the lease term to be equal to the fair value of the leased property at the inception of the lease.

2.1.8. Lease Term. The lease term is the fixed noncancelable term of the lease including:

2.1.8.1. All periods, if any, covered by bargain renewal options;

2.1.8.2. All periods, if any, for which failure to renew the lease imposes a penalty on the lessee in such amount that a renewal appears, at lease inception, to be reasonably assured;

2.1.8.3. All periods, if any, covered by ordinary renewal options during which any of the following conditions exist:

2.1.8.3.1. 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

2.1.8.3.2. A loan from the lessee to the lessor directly or indirectly related to the leased property is expected to be outstanding.

2.1.8.4. All periods, if any, covered by ordinary renewal options preceding the date as of which a bargain purchase option is exercisable;

2.1.8.5. All periods, if any, representing renewals or extensions of the lease at the lessor's option; and

2.1.8.6. The lease term should not be assumed to extend beyond the date a bargain purchase option becomes exercisable.

2.1.9. Leasehold Improvements. A leasehold improvement is an improvement to leased land, to include easements and right-of-ways, buildings, structures, and linear structures utilized by the United States Federal Government.

2.1.10. Materiality. Materiality, as defined by the SFFAS 1, is the degree to which omitting or misstating information about the item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement.

2.1.11. Minimum Lease Payments. Minimum lease payments are the payments that the lessee is obligated to make or can be required to make in connection with the leased property. Minimum lease payments exclude:

2.1.11.1. Contingent rentals

2.1.11.2. Any guarantee by the lessee of the lessor's debt and the lessee's obligation to pay (apart from rental payments) executory costs such as insurance, maintenance, and taxes in connection with the leased property.

2.1.12. Noncancelable. Noncancelable means the lease is cancelable only on the occurrence of a remote contingency or with the permission of the lessor. Funds that are not appropriated by the Congress in future years to cover the lease are considered a remote contingency. If the lessee enters into a new lease with the same lessor, the term of the new lease would be considered noncancelable. In addition, a lease term would be considered noncancelable if the lessee incurs a penalty in such amount that continuation of the lease appears, at inception, reasonably assured.

2.1.13. Operating Leases. Operating leases are leases that meet all of the following criteria. (If the criteria is not met, the lease is to be considered a capital lease or a lease-purchase, as appropriate.)

2.1.13.1. Ownership of the asset remains with the lessor during the term of the lease and is not transferred to the Government at or shortly after the end of the lease term;

2.1.13.2. The lease does not contain a bargain price purchase option;

2.1.13.3. The lease term does not exceed 75 percent of the estimated economic life of the asset;

2.1.13.4. The present value of the minimum lease payments over the life of the leases is less than 90 percent of the fair value of the asset at the beginning of the lease term;

2.1.13.5. The asset is a general purpose asset rather than being for a special purchase of the Government and is not built to the unique specification of the Government as a lease; and

2.1.13.6. There is a private sector market for the asset.

2.1.14. Renewal or Extension of Leases. The renewal or extension of a lease refers to the continuation of a lease agreement beyond the original lease term, including a new lease under which a lessee continues to use the same property. Renewals or extensions do not include modifications of any of the terms in the original arrangement before the end of the term of the original arrangement.

*2.2 Relevant USSGL Accounts (260202)

The DoD USSGL accounts are specified on the Office of the Deputy Chief Financial Officer Standard Financial Information Structure website for the DoD Standard Chart of Accounts (including point accounts) and the Transaction Library. USSGL accounts most commonly used in accounting for capital leases include:

2.2.1. Assets Under Capital Lease (Account 181000). The Assets Under Capital Lease account is used to record general equipment assets and real property assets acquired under capital lease and properly capitalized according to the guidance in subparagraphs 260201.C and 260204.D.1.

2.2.2. Accumulated Depreciation on Assets Under Capital Lease (Account 181900). The Accumulated Depreciation on Assets Under Capital Lease account accumulates the annual/periodic depreciation expense for assets under capital lease.

2.2.3. Leasehold Improvements (Account 182000). The Leasehold Improvement account is used to record the value of capitalized improvements to leased general equipment and leased real property.

2.2.4. Accumulated Amortization on Leasehold Improvements (Account 182900). The account, Accumulated Amortization on Leasehold Improvements, is used to accumulate the periodic amortization expense for leasehold improvements.

2.2.5. Capital Lease Liability (Account 294000). The Capital Lease Liability account is used to record the present value of liabilities for general equipment assets and real property assets acquired under a lease agreement that meets the test for capitalizing the assets.

2.2.6. Depreciation, Amortization, and Depletion (Account 671000). This account is used to recognize the expense resulting from the process of allocating costs of an asset (tangible or intangible) over the period of time benefited or the asset's useful life.

2.2.7. Other Losses from Impairment of Assets (Account 729200). The loss from the partial impairment of General Property, Plant and Equipment including assets under capital lease, but excluding internal use software.

*2.3 Acquisition/Valuation (260203)

2.3.1. Recorded Cost. When acquiring a General PP&E asset under a capital lease, the recorded cost must be recognized in accordance with paragraph 260204. The recorded cost of General PP&E under capital lease is the basis for computing depreciation/amortization (if applicable). This paragraph defines and prescribes the use of net book value, fair value, and recorded cost when recording the cost of General PP&E items acquired under capital lease.

2.3.1.1. Net Book Value. Net book value is the recorded cost of a General PP&E asset, less its accumulated depreciation/amortization.

2.3.1.2. Fair Value. Fair value is an unbiased, equitable or just value based on the cost of a similar item or the price that an impartial buyer would be willing to pay for the item or a similar item.

2.3.1.3. Amount to Record. The recorded cost of General PP&E items under a capital lease is the present value of the rental and other minimum lease payments during the lease term, excluding that portion of the payments representing executory cost such as insurance, maintenance and taxes paid to the lessor. If the present value amount, however, exceeds the fair value of the leased property at the inception of the lease, the amount recorded should be the fair value. If the executory cost portion of the minimum lease payments cannot be determined, the amount must be estimated.

2.3.2. Documentation. When recording the acquisition of a General PP&E item under capital lease in the accountable property system of record (APSR) and/or accounting system, the item must be assigned a dollar value (i.e., recorded cost) as detailed in this chapter. The dollar value must be supported by appropriate documentation, including the executed lease agreement. The DoD Component entering into a lease must have the lease agreement available for determining the capitalization of the leased item. Guidance on supporting documentation can be found in paragraph 260302.

*2.4 Recognition (260204)

2.4.1. All General PP&E items acquired by DoD Components under a capital lease must be recognized for accountability and financial reporting purposes. Recognition requires the proper accounting treatment (expense or capitalization with depreciation/amortization) and the reporting of capitalized amounts and accumulated depreciation/amortization on the appropriate DoD Component's financial statements.

2.4.2. Recognition Responsibility. The DoD Component that procures a General PP&E item by entering into a capital lease will be the DoD Component that must initially record the item. In the event where a DoD Component other than the initial lessee uses and benefits from the leased asset, the recognition responsibility of the leased asset must be reevaluated. The subsequent recognition responsibility of a General PP&E item under capital lease is determined based on the type of asset being leased. Refer to the appropriate chapter in this Volume for additional guidance.

2.4.3. Recognition Uncertainty. It is important that the overall accounting records of the DoD and the Federal Government are not duplicative.

2.4.3.1. In situations where doubt exists as to which DoD Component should record an item, the DoD Components involved must reach agreement with the other applicable DoD Component(s) or Federal agencies as to which entity will record the item.

2.4.3.2. If the DoD Components cannot reach an agreement, the matter must be referred to the Office of the Deputy Chief Financial Officer, Office of the Under Secretary of Defense (Comptroller) for resolution. Requests for resolution must be accompanied by adequate supporting documentation to assist in resolution of the matter and be submitted through the Financial Management and Comptroller of the submitting Military Department or Defense Agency.

2.4.4. Recognition Timing. Recording of a General PP&E item under capital lease for financial reporting purposes must occur at lease inception.

2.4.4.1. Lease inception is the date of the lease agreement. A lease agreement must be in writing, signed by the parties in interest to the transaction, and should specifically set forth the principal provisions of the transaction. For leasehold improvements, the date it should be recorded is the date the leasehold improvement is placed in service.

2.4.4.2. For General PP&E assets under capital lease acquired by an external third party contractor on behalf of a DoD Component, the lease agreement must be executed by an authorized DoD contracting officer. The assets must be recorded upon signing of the lease and delivery or constructive delivery of the leased asset, whether to the contractor performing the service or to the DoD Component. Delivery or constructive delivery will be based on the terms of the contract regarding delivery, receipt, and acceptance. The leased asset should either be capitalized in the appropriate USSGL account or, if the leased asset does not meet the lease criteria for capitalization and the capitalization threshold, such items must be recorded in the appropriate expense account.

2.4.5. Capitalization Thresholds. A capitalization threshold is the amount that determines the financial reporting of an asset or expensing its cost.

2.4.5.1. The capitalization threshold for General PP&E items acquired under capital lease, with the exception of real property items, is:

2.4.5.1.1. $1 million for the Department of Air Force and the Department of Navy general funds;

2.4.5.1.2. $1 million for the Office of the Director of National Intelligence General PP&E; and

2.4.5.1.3. $250 thousand for all other DoD Component’s (including Department of the Army) General Fund and WCF.

2.4.5.2. The capitalization threshold for real property items acquired under capital lease for all DoD Components is $250 thousand.

2.4.5.3. General PP&E items under capital lease with a recorded cost that equals or exceeds the applicable capitalization threshold, must be capitalized as an asset in the appropriate DoD Component's accounting records and depreciated/amortized over its lease term. Leasehold improvements should be depreciated/amortized over the lesser of its estimated economic life or the remaining lease term. General PP&E items under capital lease, with a recorded cost below the applicable capitalization threshold must be accounted for as an operating lease with no balance sheet recognition, with the exception of General PP&E items acquired as part of a qualifying bulk acquisition as described in subparagraph 260204.H.

2.4.5.4. For General PP&E items acquired under capital lease, which meet or exceed the appropriate capitalization threshold, the lessee must recognize both a capital lease asset and a capital lease liability at lease inception.

2.4.6. Allocation of Lease Payments. A portion of each lease payment must be allocated to interest expense, and the balance should be applied to reduce the lease liability using the effective interest rate method. (Interest is calculated on the balance of the lease obligation for each period, and the remainder of the payment is applied as a reduction of the lease obligation.) The periodic payment amount allocated to interest expense must be computed based on the interest rate used to compute the present value of minimum lease payments, unless the lease is recorded at fair value.

2.4.7. Leases with Residual Guarantee or Penalty. Leases with a residual guarantee by the lessee or a penalty for failure to renew the lease at the end of the lease term, generally should result in a liability balance that will equal the amount of the guarantee or penalty at the end of the lease term. If a renewal or other extension of the lease term or a new lease under which the lessee continues to lease the same property renders the guarantee or penalty inoperative, the asset and the liability under the lease should be adjusted. The adjustment must be the amount equal to the difference between the present value of the future minimum lease payments under the revised agreement and the present balance of the liability. The present value of future minimum lease payments under the revised lease agreement should be computed using the rate of interest used to record the lease initially. Other renewals and extensions of lease terms should be considered new agreements.

2.4.8. Bulk Acquisitions Through Leases. For capitalization purposes, a bulk acquisition is defined as the acquisition of like items as part of multiple leases with a single lessor within a fiscal year. Acquisitions through multiple leases with a single lessor during separate fiscal years are to be considered separately within each fiscal year. To determine proper recognition of bulk acquisitions through leases, the acquisition cost of all like items leased under multiple leases with a single lessor within a fiscal year must be totaled, and the resulting total must be considered against the lease criteria for capitalization and the capitalization threshold prescribed by subparagraphs 260201.C and 260204.E respectively.

2.4.9. Accounting for Real Property Outside of the United States. As used in this chapter, "United States" means the 50 States of the United States, the District of Columbia, and the commonwealths, territories, and possessions of the United States. In carrying out their mission, operations and objectives, there are circumstances in which DoD Components occupy and use real property facilities and/or general equipment outside of the United States for which there is not a lease agreement. When a DoD Component occupies an asset and/or uses general equipment outside of the United States but the DoD did not fund its acquisition, the DoD Component will recognize such facilities and/or general equipment on its financial statements as assets under a capital lease only if a specific agreement with the host nation/foreign government exists. The agreement must include a requirement that the DoD Component pay minimum regular payments for its use. The agreement must meet one of the criteria for a capital lease as specified in SFFAS 6, paragraph 20:

Table 26-1. Capital Lease Criteria

Capital Lease Criteria	Application
The lease transfers ownership of the property to the lessee by the end of the lease term.	Not likely for foreign owned real property.
The lease contains an option to purchase the leased property at a bargain price.	Not likely for foreign owned real property.
The lease term is equal to or greater than 75 percent of the estimated economic life of the leased property.	Not likely for foreign owned real property. The specified term of the agreement with the host nation/foreign government will substitute for the lease term for this analysis. Terms specified in these agreements are typically less than 75 percent of a real property asset's estimated economic life.
The present value of rental and other minimum lease payments, excluding that portion of the payments representing executory costs, equals or exceeds 90 percent of the fair value of the leased property.	Not likely for foreign owned real property. The payments to the host nation/foreign government established in the agreement will substitute for lease payments for this analysis. If minimum payments established in the agreement cover multiple items, only the proportional amount paid for the subject asset should be considered for this analysis.
Note: The last two criteria are not applicable when the beginning of the lease term falls within the last 25 percent of the total estimated economic life of the leased property.	

2.4.9.1. If a lease agreement (as contrasted with another type of agreement with the host nation/foreign government) exists, the other provisions of this chapter would apply.

2.4.9.2. See also reporting requirements for disclosure of real property outside the United States at subparagraph 260305.B.

*2.5 Improvements/Enhancements (260205)

2.5.1. The costs to improve (leasehold improvements) a General PP&E item under lease (capital or operating) must be capitalized when (1) the costs of the improvement increase the item's capability, size, and/or extends its useful life and (2) the cost of the improvement equals or exceeds the applicable capitalization threshold (see subparagraph 260204.E), regardless of funding source.

2.5.2. When leasehold improvements meet or exceed DoD capitalization criteria (see subparagraphs 260204.E and 260205.A), such improvements must be capitalized and amortized over the lesser of the remainder of the lease period or the improvement's useful life.

2.5.3. Maintenance and repair costs expended on leased assets are not considered capital improvements, regardless of whether the cost equals or exceeds the applicable capitalization threshold. In SFFAS 42, the FASAB defines maintenance and repairs as activities directed toward keeping fixed assets in an acceptable condition. Maintenance and repair activities include preventative maintenance; replacement of parts, systems, or components; and other activities needed to preserve or maintain assets. Maintenance and repair activities also include cyclic work done to prevent damage that would be more costly to restore than to prevent (e.g., painting). A roof or a heating and air conditioning system that is replaced due to the failing of the existing asset must be classified as a repair and must be expensed, even if the replacement incorporated a better quality and longer life shingle or a more efficient heating and air conditioning unit.

2.5.4. Although maintenance and repairs are generally expensed in the period incurred, certain replacements of parts, systems, or components may or may not be an improvement for accounting purposes. Crucial to the determination of whether a replacement must be recognized as a repair or an improvement is the intent behind the replacement. Repair by replacement occurs when parts, systems, or components have failed, are in the incipient stages of failing, or are no longer performing the functions for which they were designated. Replacements falling into this category must be expensed. If the replacement was undertaken to improve an item that was in good working order, then the replacement must be recognized as an improvement.

*2.6 Depreciation/Amortization (260206)

2.6.1. The recorded cost of assets under capital lease and leasehold improvements, which have been capitalized in accordance with the guidance prescribed by this chapter, must be depreciated/amortized. Such capitalized amounts, as well as associated amounts of accumulated depreciation/amortization and depreciation/amortization expense, must be reflected in DoD financial statements.

2.6.2. For leased General PP&E, depreciation/amortization is the systematic and rational allocation of the recorded cost of an asset over the lease term. The depreciation/amortization recovery period (useful life) to be used to depreciate personal or real property acquired by a capital lease is the lease term regardless of the recovery period designated for the type of property. For example, if a capital lease is used to acquire a fire truck and the lease term is seven years and the DoD estimated recovery period for a truck is five years, then the fire truck would be depreciated over seven years. In the same example, if the lease period were only four years, the fire truck would be fully depreciated over four years.

Table 26-2. Depreciation/Amortization Period for Assets Under Capital Lease

Asset	Recovery Period	Lease Term	Depreciation Period
Truck	5	4	4
Truck	5	7	7

2.6.2.1. The salvage value, also known as the residual or scrap value, is the amount that would be expected to be obtained from selling an asset at the end of its useful life, but only when such proceeds (from recycle, resale, or salvage) are permitted to be retained and used by the DoD Component. Salvage value is only applicable to assets under capital lease if the asset meets the criteria in subparagraphs 260201.C.1 and 260201.C.2.

2.6.2.2. The depreciable/amortizable basis of an asset is the recorded cost reduced by the asset's salvage value.

2.6.3. In the case of leased General PP&E assets, the event that triggers the calculation of depreciation is the beginning of the lease term. In the case of capitalized leasehold improvements, the event that triggers amortization is when the improvement is placed into service.

2.6.4. The recorded cost of leased General PP&E assets and capitalized leasehold improvements must be depreciated/amortized using the straight-line method of depreciation/amortization.

2.6.4.1. Straight-line depreciation/amortization expense for the capitalized lease is calculated as the depreciable/amortizable basis (recorded cost less salvage value as described in subparagraph 260206.B.1) divided equally among accounting periods during the lease term.

2.6.4.2. Straight-line depreciation/amortization expense for leasehold improvements is calculated as the depreciable/amortizable basis (recorded cost of the leasehold improvement) divided equally among accounting periods during the remaining lease term or the useful life of the leasehold improvement, whichever is less.

2.6.5. An asset under capital lease must be retained in the APSR, as well as the accounting records, and reflect both its recorded cost and accumulated depreciation/amortization until the end of the lease term or disposition of the asset.

2.6.6. WCF activities are required to depreciate/amortize General PP&E assets under capital lease in accordance with the guidance in this chapter without regard to whether such assets are procured through a WCF activity's Capital Purchase/Investment Program budget or whether depreciation/amortization for such assets is included in rates charged to customers. The recognition of General PP&E assets under capital lease and the depreciation/amortization of such assets by WCF activities therefore may be different for financial statement reporting purposes than the depreciation/amortization amounts used for WCF rate development and budget presentation. Depreciation/amortization for all General PP&E assets under capital lease of WCF activities must be recognized as an expense on the Statement of Net Cost, reflected in the Statement of Changes in Net Position, included in accumulated depreciation/amortization amounts on the Balance Sheet, and reported in the "Defense Working Capital Fund Accounting Report [Accounting Report (Monthly) 1307]. Depreciation/amortization recorded on General PP&E assets under capital lease, which was not acquired nor will be replaced through use of Defense WCF resources, must be classified as non-recoverable for rate setting purposes and reported appropriately on the AR (M) 1307. Defense WCF rates charged to customers are based on guidance in Volume 2B and Volume 11B.

*2.7 Impairment (260207)

2.7.1. Description. SFFAS 44 defines impairment as a significant and permanent decline in the service utility of General PP&E or expected service utility of construction in progress that results from events or changes in circumstances that are not considered normal and ordinary.

2.7.1.1. See subparagraph 260207.B.2 for a guidance on determining the significance and permanence of a service utility decline.

2.7.1.2. The service utility of General PP&E is the usable capacity that, at acquisition, was expected to provide service. The current usable capacity of General PP&E may be less than its original usable capacity due to the normal or expected decline in useful life or to impairing events or changes in circumstances, such as physical damage, obsolescence, enactment or approval of laws or regulations, or other changes in environmental or economic factors, or changes in the manner or duration of use.

2.7.1.3. Normal and ordinary events or circumstances are those that fall within the expected useful life of the General PP&E such as standard maintenance and repair requirements. Events or circumstances that are not considered normal are those where, at the time the General PP&E was acquired, the event or change in circumstance would not have been expected to occur during the useful life of the General PP&E or, if expected, was not sufficiently predictable to be considered in estimating the General PP&E's useful life.

2.7.2. Identification of Potential Impairment Loss. The determination of whether General PP&E under capital lease remaining in use is impaired is a two-step process, which includes (1) identifying potential impairment indicators and (2) testing for impairment.

2.7.2.1. Step 1 - Identify Indicators of Potential Impairment. Indicators of potential impairment can be identified and brought to DoD Component's attention in a variety of ways, such as procedures related to deferred maintenance and repair (DM&R). Although DoD Components are not required to establish additional or separate procedures beyond those that may already exist, they should evaluate existing processes and internal controls to determine if they are sufficient to reasonably assure the identification of potential impairment indicators and implement appropriate additional processes and internal controls if necessary. Once identified, however, indicators are not conclusive evidence that a measurable or reportable impairment exists. DoD Components should carefully consider the surrounding circumstances to determine whether a test of potential impairment is necessary given the circumstances. Some common indicators of potential impairment include:

2.7.2.1.1. Evidence of physical damage;

2.7.2.1.2. Enactment or approval of laws or regulations, which limit or restrict General PP&E usage;

2.7.2.1.3. Changes in environmental or economic factors;

2.7.2.1.4. Technological changes or evidence of obsolescence (however, if obsolete General PP&E continues to be used, the service utility expected at acquisition may not be diminished);

2.7.2.1.5. Changes in the manner or duration of use of General PP&E;

2.7.2.1.6. Construction stoppage or contract termination; and

2.7.2.1.7. General PP&E idled or unserviceable for excessively long periods.

2.7.2.2. Step 2 - Impairment Test. Identified General PP&E should be tested for impairment by determining whether these two factors are present: (i) the magnitude of the decline in service utility is significant and (ii) the decline in service utility is expected to be permanent.

2.7.2.2.1. Significant declines in service utility are those that cause costs (including operational and maintenance costs) to be disproportionate to the new expected service utility. The determination of whether or not an item is significant is a matter of professional judgment and is distinct from materiality considerations. Such judgments should be based on the relative costs of providing the service before and after the decline, the percentage decline in service utility, or other considerations.

2.7.2.2.2. The decline in service utility is considered permanent when the DoD Component has no reasonable expectation that the lost service utility will be replaced or restored; that is, the DoD Component expects that the General PP&E will remain in service so that its remaining service utility will be utilized. In contrast, a reasonable expectation that the lost service utility will be replaced or restored may exist when the DoD Component has: (1) specific plans to replace or restore the lost service utility of the General PP&E, (2) committed or obligated funding for remediation efforts, or (3) a history of remediating lost service utility in similar cases or for similar General PP&E.

2.7.3. Determining the Appropriate Measurement Approach. Impairment losses on General PP&E assets under capital lease that will continue to be used by the entity should be estimated using a measurement approach that reasonably estimates the portion of net book value associated with the diminished service utility of the General PP&E. A measurement method would not be considered appropriate if it would result in an unreasonable net book value associated with the remaining service utility of the General PP&E. Conversely, a reasonable measurement method may result in no impairment loss to be recorded. Regardless of the method used, recognition of impairment loss should be limited to the asset's net book value at the time of impairment. Widely recognized methods for measuring impairment include:

2.7.3.1. Replacement Approach. Impairment of General PP&E with physical damage generally may be measured using a replacement approach. This approach uses the estimated cost to replace the lost service utility of the General PP&E at today's standards (i.e., at current market prices and in compliance with current statutory, regulatory, or industry standards) to identify the portion of the historical cost of General PP&E that should be written-off due to impairment. It may be appropriate to apply the ratio of estimated cost to replace the diminished service utility over total estimated cost to replace the General PP&E, to the net book value of General PP&E to determine the impairment amount.

2.7.3.2. Restoration Approach. Uses the estimated cost to restore the diminished service utility of the General PP&E, but does not include any amounts attributable to improvements and additions to meet today's standards.

2.7.3.3. Service Unit Approach. Impairment of General PP&E that are affected by enactment or approval of laws or regulations or other changes in environmental factors or are subject to technological changes or obsolescence generally may be measured using a service unit approach. This approach compares the service units provided by the General PP&E before and after the impairment, to isolate the historical cost of the service utility that cannot be used due to the impairment, to determine the impairment amount.

2.7.3.4. Deflated Depreciated Current Cost Approach. Impairment of General PP&E that are subject to a change in manner or duration of use generally may be measured using a deflated depreciated current cost approach. Under this approach, a current cost for a General PP&E to replace the current level of service is estimated. This estimated current cost is then depreciated/amortized to reflect the fact that the General PP&E is not new, and is then subsequently deflated to convert it to historical cost dollars. A potential impairment loss results if the net book value of the General PP&E exceeds the estimated historical cost of the current service utility (i.e., deflated depreciated current cost).

2.7.3.5. Cash Flow Approach. Recognizes an impairment loss only if the net book value (a) is not recoverable and (b) exceeds the higher of its net realizable value (NRV) or value-in-use estimate.

2.7.3.5.1. The net book value of General PP&E is not recoverable if it exceeds the sum of the undiscounted cash flows expected to result from the use and eventual disposition of the General PP&E.

2.7.3.5.2. NRV is the estimated amount that can be recovered from selling, or any other method of disposing, of an item less estimated costs of completion, holding, and disposal. SFFAC 7 describes value in use as the present value of future cash flows that an entity expects to derive from an asset, including cash flows from use of the asset and eventual disposal.

2.7.3.5.3. If the net book value is not recoverable, the impairment loss is the amount by which the net book value of the General PP&E exceeds the higher of its NRV or value in use estimate. No impairment loss exists if the net book value is less than the higher of the General PP&E's NRV or value in use estimate.

2.7.3.6. Lower of (a) Net Book Value or (b) Higher of NRV or Value-in-Use Approach. General PP&E impaired from either construction stoppages or contract terminations, which are expected to provide service, should be reported at their recoverable amount; the lower of (a) the General PP&E's net book value or (b) the higher of its NRV or value-in-use estimated. Impaired General PP&E under capital lease, which are not expected to provide service, should be accounted for in accordance with paragraph 260208.

2.7.4. Recognizing and Reporting Impairment Losses. The loss from impairment, if any, should be recognized and reported in the Statement of Net Cost in the period in which the DoD Component concludes that the impairment is both (1) a significant decline in service utility and (2) expected to be permanent. Such losses may be included in program costs or costs not assigned to programs. A general description of the General PP&E for which an impairment loss is recognized, the nature (e.g., damage or obsolescence) and amount of the impairment and the financial statement classification of the impairment loss must be disclosed in the notes to the financial statements in the period the impairment loss is recognized.

2.7.5. Recoveries. The impairment loss must be reported net of any associated recovery, when the recovery and loss occur in the same fiscal year. Recoveries reported in subsequent fiscal years must be reported as revenue or other financing source as appropriate. The amount and financial statement classification of recoveries should be disclosed in the notes to the financial statements.

2.7.6. Remediating Previously Reported Impairments. The costs incurred to replace or restore the lost service utility of impaired General PP&E remaining in use must be accounted for in accordance with applicable standards (i.e., recognized according to the nature of the costs incurred and the appropriate capitalization threshold).

2.7.7. Diminished Service Utility Without Recognized Impairment Loss. If the future service utility has been adversely affected but the impairment test determines that a loss does not need to be recognized, a change to the estimates used in depreciation/amortization calculations (such as estimated useful life and salvage value) should be considered.

*2.8 Derecognition (260208)

A lease modification is a termination of a capital lease before the expiration of the lease term. The lease modification must be accounted for by the lessee by removing the asset and obligation, with a gain or loss recognized for the difference. Supporting documentation required for derecognition is listed in subparagraph 260302.A.2.

3.0 ADDITIONAL CONSIDERATIONS (2603)

*3.1 Use of Canceled Treasury Account Symbol (TAS) (260301)

3.1.1. The Department of Treasury's Governmentwide Treasury Account Symbol Adjusted Trial Balance System (GTAS) is a data collection system that replaces the reporting functionalities of Federal Agencies Centralized Trial-Balance System I and II, Intragovernmental Fiduciary Confirmation System, and Intragovernmental Reporting and Analysis System as the primary means for Components to report their trial balance data to the Department of Treasury. Capitalized assets must be reported in GTAS when purchased and after the original purchasing TAS has expired and canceled. Treasury's GTAS provides a "cancelled" or "C" TAS on the GTAS Super Master Account File (SMAF) for each fund family represented on the SMAF to allow Components to continue to report capitalized leased assets using appropriations that subsequently have cancelled. The system generated "C" TAS has three components: the three-digit agency identifier, availability type "C", and a four-digit main account.

3.1.2. All DoD Components must use the "C" availability type TAS to report capitalized assets. Assets may be moved to a C TAS at any time from the purchase date to the date the original purchasing fund cancels.

3.1.3. To transfer an asset to a C TAS:

3.1.3.1. Use USSGL account transaction E510 to transfer out the asset from the purchasing fund account.

3.1.3.2. Use USSGL account transaction E606 to transfer in the asset into the appropriate C TAS.

*3.2 Supporting Documentation (260302)

Entries to record financial transactions in accounting system general ledger accounts and/or the accountable property records and/or systems must:

3.2.1. Be supported by source documents that reflect all transactions affecting the DoD Component's investment in assets under capital lease.

3.2.1.1. All acquisitions, whether by capital lease, purchase, transfer from other agencies, donation, or other means, must be supported as of the date the DoD Component takes custody of the asset. The documents listed in Table 26-3, where applicable, must be readily available to support the changes in asset value or physical attributes as a result of a new acquisition or leasehold improvement.

Table 26-3. Supporting Documentation for Assets Under Capital Lease Acquisition

Evidence	Examples*
Unique Identification	Assignment of unique identifier
Project Approval	Such as, but not limited to a Work Order
Obligation on Behalf of the Government	Such as, but not limited to: 1. For leases, or lease modifications: • Statement of Work; • Dollar Amount of Lease; • Location; • Source of Funds; • Parties to the Lease agreement; and • Signature Page [Signature of All Parties]. 2. Approved Work Order.
Payment Submitted	Such as, but not limited to, approved last invoice reflecting the total amount submitted for payment to date.
Acceptance	Such as, but not limited to: 1. DoD ***(DD) Form 250***, Material Inspection and Receiving Report; 2. ***GSA Form 1334***, Request for Transfer of Excess Real and Related Personal Property; 3. ***DD Form 1354***, Transfer and Acceptance of DoD Real Property (interim or final), with associated source documentation retained by the responsible party; 4. Signed lease for leased property; 5. Executed Occupancy agreement; and 6. Transfer letter and documents for transferred assets.
* The supporting documentation examples included in Table 26-3 could also be applicable to operating leases.	

3.2.1.2. All derecognition of capital leases must be supported as of the date the lessee is no longer liable for the lease obligation. The execution of certain derecognition events will generate financial or administrative accountability transactions. These documents, where applicable, must be readily available to support derecognition:

3.2.1.2.1. “Declaration of excess” document;

3.2.1.2.2. Original lease document;

3.2.1.2.3. Approval documentation for derecognition;

3.2.1.2.4. Lease modification (e.g., for early termination of lease);

3.2.1.2.5. Document to support any improvements made to the assets under capital lease;

3.2.1.2.6. Transfer documents for transferred assets or as otherwise stated.

3.2.1.3. Documents that support the recorded cost of General PP&E assets under capital lease must be retained by the DoD Component in accordance with the requirements contained in Volume 1, Chapter 9 or as otherwise stated. Documentation (original documents and/or hard and electronic copies of original documentation) must be maintained in a readily available location during the applicable retention period to permit the validation of information pertaining to the asset such as the lease term, lease date and cost of leasehold improvements. The documentation must also be linked to the appropriate unique identifier(s). Supporting documentation may include, but is not limited to, the documentation as outlined in this subparagraph.

3.2.2. Include sufficient information indicating the physical quantity, location, and unit cost of the General PP&E assets under capital lease. The accountable property records must be designed to be of maximum assistance in making procurement and utilization decisions, including decisions related to identifying potential excess General PP&E that may be available for reuse, transfer to other DoD Components, or made available for disposal in accordance with current DoD regulations and other regulatory requirements.

3.2.3. Enable periodic, independent verification of the accuracy of the accounting and accountable property records through periodic physical counts/inventories of General PP&E assets under capital lease (existence and completeness -- "book to floor and floor to book"). Such periodic inventories also must include reconciling the APSR and accounting systems with the general ledger accounts and physical counts. Personal hand receipt self-validations are not acceptable for meeting the independent verification of physical inventory requirements. See DoDI 5000.64 (excluding real property) and DoDI 4165.14 for real property.

3.2.4. Identify and classify General PP&E that was capitalized, recorded in the APSR and accounting system, and reported in the financial statements.

3.2.5. Be based on the same documents, to ensure that entries to the accounting and accountable property records are the same. This will ensure that the property accountability records are integrated and subsidiary to the accounting system and those records can be reconciled with the accounting system.

3.2.6. Include all General PP&E possessed by the Department (to include DoD leased property held by contractors).

3.2.7. Provide information to identify and account for leased General PP&E, regardless of whether the General PP&E was acquired by a capital lease or operating lease or whether the value of the General PP&E exceeds DoD capitalization thresholds.

3.2.8. Provide information to identify and account for improvements to General PP&E assets under capital lease.

3.3 Physical Inventories of General PP&E (260303)

DoD Components must perform periodic physical inventories of General PP&E including assets under capital lease in accordance with DoDI 5000.64 (equipment and other accountable property) or DoDI 4165.14 (real property).

*3.4 DM&R (260304)

3.4.1. In SFFAS 42, the FASAB defines DM&R as maintenance and repairs that were not performed when they should have been or were scheduled to be and which are put off or delayed to a future period.

3.4.1.1. For purposes of this policy, maintenance and repairs are activities directed toward keeping fixed assets in an acceptable condition. Maintenance and repairs include preventive maintenance; replacement of parts, systems, or components; and other activities needed to preserve or maintain the asset in acceptable condition.

3.4.1.2. Maintenance and repairs exclude activities aimed at expanding the capacity or capability of an asset or otherwise upgrading it to serve needs different from or significantly greater than its current use.

3.4.2. Amounts for DM&R may be measured using condition assessment surveys, life-cycle cost forecasts, or other methods that are similar to the condition assessment survey or life-cycle costing methods.

3.4.2.1. Condition assessment surveys are periodic physical inspections of General PP&E to determine their current condition and estimated cost to correct any deficiencies.

3.4.2.2. Life-cycle costing is an acquisition or procurement technique that considers operating, maintenance, and other costs in addition to the acquisition cost of assets. Since it results in forecasts of maintenance and repairs expense, these forecasts may serve as a basis against which to compare actual maintenance and repairs expense to arrive at an estimate of DM&R.

3.4.3. DoD Components should determine what condition standards are acceptable and which DM&R measurement methods to apply. Once determined, condition standards and measurement methods must be consistently applied unless the DoD Component determines that changes are necessary. Changes deemed necessary by the DoD Component must be accompanied by an explanation documenting the rationale for the change(s) and any related impact the change(s) will have on the DM&R estimates.

3.4.4. DM&R must be measured for capitalized and non-capitalized General PP&E (including assets under capital lease), fully depreciated General PP&E, Heritage Assets, and Stewardship Land. In addition, DM&R must be measured for inactive and/or excess General PP&E to the extent that it is required to maintain the General PP&E in acceptable condition (e.g., to comply with existing laws and regulations or to preserve value pending disposal). In addition, DM&R must measure funded maintenance and repairs that have been delayed for a future period as well as unfunded maintenance and repairs.

3.4.5. DoD Components must report material amounts of DM&R as Required Supplementary Information (RSI) to the financial statements (see Volume 6B, Chapter 12). At a minimum, the Components must present the following information as RSI:

3.4.5.1. Estimates of the beginning and ending balances of DM&R for each major category of General PP&E asset under capital lease;

3.4.5.2. A summary of the DoD Component's maintenance and repairs policies and a brief description of how they are applied (i.e., method of measuring DM&R);

3.4.5.3. Policies for ranking and prioritizing maintenance and repair activities;

3.4.5.4. Factors the DoD Component considers in determining acceptable condition standards;

3.4.5.5. Whether DM&R relates solely to capitalized General PP&E or also to amounts relating to noncapitalized or fully depreciated General PP&E under capital lease;

3.4.5.6. Capitalized General PP&E for which the DoD Component does not measure and/or report DM&R and the rationale for the exclusion; and

3.4.5.7. If applicable, explanation of any significant changes to (a) DM&R amounts from the prior year and (b) the policies and factors subject to the reporting requirements established in subparagraphs 260304.E.1 through 260304.E.6.

*3.5 Reporting Requirements (260305)

3.5.1. DoD Components with leased General PP&E should reference a note on the Balance Sheet that discloses information about the reported assets. See Volume 6B for the specific reporting requirements.

3.5.2. Disclosure of Real Property Outside of the United States

DoD Components must disclose in the notes to the financial statements those instances where they are using real property provided by a foreign government/host nation without reimbursement by DoD to the foreign government/host nation, as applicable, that:

3.5.2.1. The DoD Component is utilizing real property provided by and owned by a foreign government/host nation in its operations outside of the United States without reimbursement by DoD to the foreign government/host nation and that there are no amounts recorded in the financial statements related to these properties.

3.5.2.2. The general nature of the agreement with the foreign government/host nation. It is not intended or recommended that the geographic location of the foreign government/host nation be disclosed.

3.6 Environmental Liabilities/Cleanup Costs (260306)

The lease agreement must clearly identify the party responsible for environmental liabilities/cleanup costs. The accounting policy for environmental liabilities/cleanup costs pertaining to General PP&E is contained in Chapter 13.