



State of Arizona Accounting Manual

Topic 90 Special Topics
Section 36 **Installment Purchases**

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INTRODUCTION

There are a number of ways in which the acquisition of both personal and real property can be financed over time. State agencies may, for instance, use a capital lease for such acquisitions. SAAM 2545 contains information related to the identification of and accounting for a capital lease and the ways in which a capital lease is distinguished from an operating lease.

An arrangement called an installment purchase agreement is also used by entities that are not constituent parts of Arizona Government as a means of financing the acquisition of property. State agencies, in accordance with the limitations imposed by Article IX, Section 5 of the Constitution of the State of Arizona, may not enter into installment purchase agreements.

Under the terms of an installment purchase agreement, the buyer pays the seller the full purchase price by making a series of partial payments over time. The payments typically include stated or imputed interest. The buyer takes title to the property at the inception of the agreement (this is an important characteristic that distinguishes an installment purchase agreement from a capital lease, under the terms of which title transfers to the lessee, often at a bargain price, at the end of the contract). Under the terms of an installment purchase agreement, the seller retains a security interest in, but not title to or ownership of, the property until all of the scheduled payments have been made.

Under both operating leases and capital leases, since ownership has not been transferred to the lessee, if the lessee should default in making the scheduled payments, the leased property is returned to the lessor; the lessee, while possibly subject to termination and recovery fees, is not responsible for the balance of the payments for the remaining term of the lease.

Under an installment purchase agreement, the seller (or financier) is entitled to receive whatever remains unpaid under the contract. The seller (or financier) may repossess the property. However, the purchaser is still obligated for any balance due under the contract after the seller (or financier) has made a reasonable attempt to mitigate damages. It is the existence of this residual contingent liability and the possibility that, collectively, such arrangements may result in more than three hundred fifty thousand dollars (\$350,000) of debt that contravene Arizona's Constitution.

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POLICY & PROCEDURES

1. State agencies may not enter into installment purchase agreements.
2. Any contracts employing periodic payments to finance the acquisition of assets must be submitted to in-house legal counsel or the Office of the Arizona Attorney General for review.

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