

Leasing of Equipment

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Functional Sub group Corporate Administration - Purchasing

Summary Leasing of Equipment

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Applies to Area Health Services/Chief Executive Governed Statutory Health Corporation, Board Governed Statutory Health Corporations, Affiliated Health Organisations - Non Declared, Divisions of General Practice, NSW Ambulance Service, NSW Dept of Health, Public Health Units, Public Hospitals

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Director-General

This Policy Directive may be varied, withdrawn or replaced at any time. Compliance with this directive is **mandatory** for NSW Health and is a condition of subsidy for public health organisations.

CIRCULAR

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LEASING OF EQUIPMENT

This Circular supersedes Departmental Circular No. 84/244 and Information Bulletins 95/11 and 95/39.

BACKGROUND

For some time consideration has been given to the need for a leasing facility to be provided for both major and minor equipment.

Provided there is a market for secondhand equipment which allows leasing companies to eventually dispose of the leased equipment and thus provide competitive lease rates, a lease arrangement could be beneficial. It could provide:-

- * Access to equipment not affordable on a capital purchase basis.
- * The opportunity to convert to new technology as it occurs during the term of the lease.

The policy advised in this circular has been developed following consultation with and consideration of comments provided by Area Health Services.

CONSIDERATIONS

Basic considerations in leasing equipment are:-

1. Any arrangement must be an operating lease, not a finance lease. State Government policy does not condone finance leasing, and finance leases can only be approved on a specific case basis by the Treasurer. (Definitions of a finance lease and an operating lease are attached, as well as criteria for classification).

Distributed in accordance with circular list(s):

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All approved lease proposals must contain a certification by the Chief Executive Officer and Director of Finance that the proposal is an operating lease in accordance with Accounting Standard AAS 17.

2. Those involved in considering financing proposals through leasing are to ensure compliance with the provisions of relevant legislation and policy, and that adequate documentation of financing proposals, evaluation of alternatives and decision-making are retained for accountability purposes.
3. The Director of Finance is to certify that on a current and forward years basis funds exist to cover the lease payments, and is to provide details of the source of these funds and indicate that any impact on the Net Cost of Services result or other financial management requirements of the Health Service can be appropriately managed.

PROVISION OF LEASE FACILITIES:

C There are various methods of providing the leasing facility, the main ones being:-

1. A central lease facility arranged by tender and available either on a structured take up arrangement or on ad hoc take up.
2. Supplier financed lease.
3. Third party finance arranged by the supplier.
4. Third party finance arranged by tender for specific project.

C A central lease facility would be suitable for program purchasing, where it is reasonably certain that a particular number will be required within a particular period. The cost of finance would increase considerably if there is uncertainty as to the type and mix of equipment and the possible take up value. This method needs further examination, but looks suitable mostly for structured statewide procurement.

C Supplier financed and third party (arranged by supplier) leases are convenient, as they can be arranged in the same tender as the equipment. However generally the most economic source of funds would run in the order:-

- * Tendered
- * Third party arranged by supplier
- * Supplier.

C The method of procurement, ie quotations, tenders, should be in line with the requirements for procurement at various expenditure levels indicated in the Purchasing and Supply Manual.

PROBITY ISSUES:

- C Basic equity of access to the total process is the main consideration. The major decision is, however, how to approach the call for tenders and resultant evaluation.
- C In general, the best results are achieved by tendering the lease facility separate to the equipment acquisition. This is desirable both for commercial and probity reasons.
- C A further option is to call tenders for the supply of equipment under a lease option. This does, of course, restrict tenders somewhat, as suppliers can only tender if they can offer a lease option, either self funded or third party funded.
- C At the present time some tenderers are submitting lease options of various types as an alternative tender to an acquisition option. However based on value for money it would not be possible for a lease proposition to be assessed superior to a straight out purchase, unless there is a consumables commitment attached which subsidises the lease cost.
- C Therefore prior to calling tenders a decision needs to be made as to whether the items are to be subject to straight out purchase or a lease arrangement, and tenders then called accordingly.
- C If for any reason the one tender calls for either a purchase or a lease option, tender documentation and evaluation methodology should clearly indicate the position.

APPROVAL LEVELS:

1. Prior to any new lease commitment being entered into which either:-
 - a. Involves a capital equipment cost in excess of \$500,000, or
 - b. Involves a payment in any one year in excess of \$100,000, a business case must be forwarded to the Finance Division of the Department for consideration. Where the equipment being procured has a functional relationship to another Division of the Department, it should be submitted via that Division.

For the purposes of these restrictions an acquisition should not be split into its components nor divorced from the overall project to avoid the approval requirements.

2. Where a Health Service wishes to have a delegation in excess of the above levels, application can be made to the Department seeking increased levels. Such application will be considered on a case by case basis and must demonstrate:-

- * ability to operate within Net Cost of Services allocations (SP&T and Special Projects excluded)
- * ability to operate within the limit of Government Cash Payments.
- * ability to repay any loans to the Department
- * ability to manage cash at bank .

Applications are to be forwarded to the General Manager, Finance and Commercial Services

3. It should be noted that Treasury Circular 98/7 requires that all proposals for operating leases with a contract threshold amount of \$1 million or more be submitted to Treasury for assessment, prior to any in-principle decision being made on whether to proceed or any tender document being issued. The threshold relates to the capital equipment cost or the extent of the take up under one facility.

NSW GOVERNMENT IT MASTER LEASING FACILITY

The Department of Public Works and Services has established an IT Master Leasing & Asset Management Facility for use by NSW Government organisations.

All new operating leases that are IT in nature should be funded under the Master Leasing Facility. Any claims for exemption from this requirement must be submitted through the Department to Treasury.

Use of the Facility does not absolve an agency from observing all current requirements relating to investment in IT equipment. In particular, it is expected that all agencies follow procedures consistent with the applicable guidelines issued by the Office of Information Technology. Projects being funded through the Facility should, therefore be consistent with agencies' IT strategic plans and be included in overall capital strategic plans.

Agencies should undertake a full evaluation using Treasury's Financial Appraisal Guidelines prior to deciding to use the Facility. This evaluation should compare the viability of purchasing the asset against the lease option.

The Facility also contains a sale and leaseback option.

Where an agency wishes to sell an asset to a financing provider and then lease back this same asset the following requirements will apply:

- Approval to follow this approach must be sought from the Treasury through the Department;
- The agency must be able to demonstrate the cost effectiveness of a sale and leaseback by undertaking a detailed financial analysis;
- If the agency wishes to retain the proceeds from the sale it will need to demonstrate that it can fund future lease payments from within existing forward estimates;
- The agency will need to reach agreement with the Treasury on how the proceeds from the sale are to be utilised.

GENERAL:

- C When calling for tenders other than a basic leasing facility the information requested from suppliers should be sufficient to clearly establish:-
 - * The basic cost of the equipment items supplied.
 - * The additional cost due to the leasing arrangement.
 - * The provider of the lease finance (supplier or third party).
 - * The validity of the arrangement as an operating lease.
 - * The cost of any associated consumables.
 - * The cost of, and any requirement to commitment to, maintenance.
- C It should be ensured that contracts arranged do not place an obligation for ongoing commitment past the initial contract period.

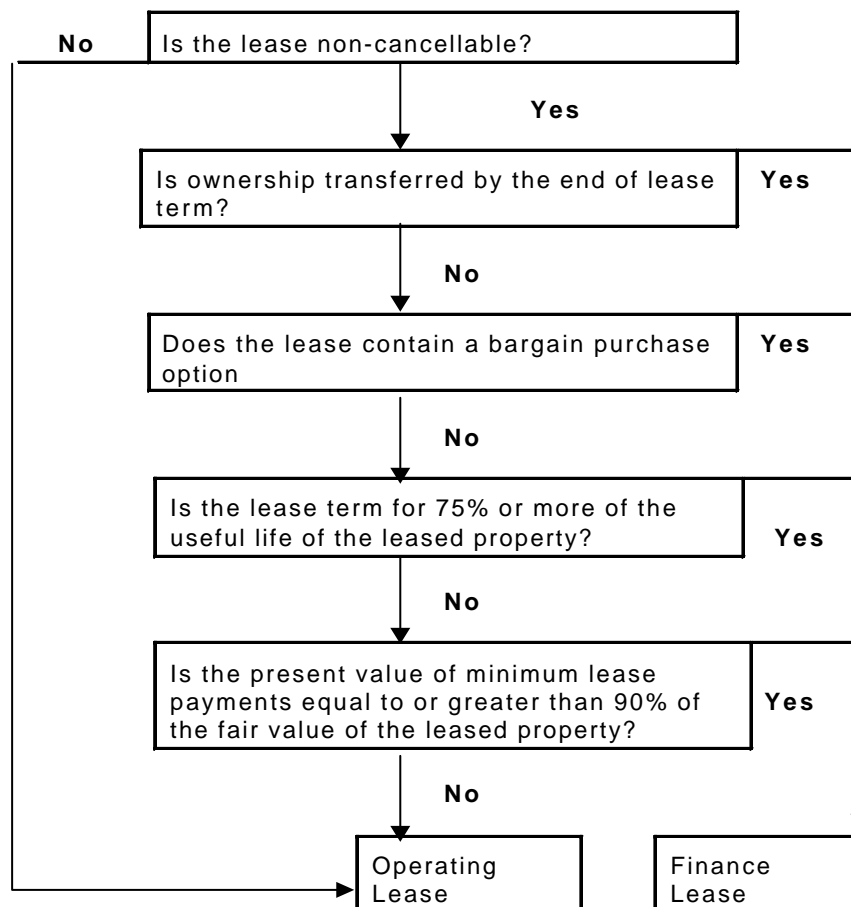
Michael Reid
Director-General

ATTACHMENT

LEASING

CLASSIFICATION OF A LEASE

A lease is a finance lease if it effectively transfers substantially all the risks and benefits incident to ownership. The following chart gives examples of situations in which a lease could normally be classified as a finance lease by a lessee and lessor. The examples do not necessarily reflect all possible situations in which a lease may be classified as a finance lease, nor should a lease necessarily be classified as a finance lease by virtue of the route followed on these charts. The substance of the transaction determines the classification.



LEASING

(INFORMATION BASED ON ACCOUNTING STANDARD AAS 17)

Definitions:-

1. **“Finance lease”** means a lease which effectively transfers from the lessor to the lessee substantially all the risks and benefits incident to ownership of the leased property.
2. **“Operating lease”** means a lease under which the lessor effectively retains substantially all the risks and benefits incident to ownership of the leased property.
3. **“Non-cancellable lease”** means a lease which -
 - (i) can be cancelled only with the permission of the lessor or upon the occurrence of some remote contingency; or,
 - (ii) the lessee, upon cancellation, would be committed to enter into a further lease for the same or equivalent property with the same lessor or a third party related to the lessor; or,
 - (iii) provides that the lessee, upon cancellation, would incur a penalty of a magnitude that, in normal circumstances, could be expected to discourage cancellation.

Guidelines for Lease Classification:-

The following criteria are presented as guidelines to assist in classifying leases.

1. The effective passing, from lessor to lessee, of substantially all of the risks and benefits incident to ownership could normally be assumed where the following criteria are satisfied:-
 - a. The lease is non cancellable; and,
 - b. Either of the following tests is met:
 - (i) the lease term is for 75 per cent or more of the useful life of the lease property; however, if the beginning of the lease term falls within the last 25 per cent of the total useful life of the leased property, including earlier years of use, this criterion would not be appropriate for purposes of classifying the lease; or,
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- (ii) the present value, at the beginning of the lease term, of the minimum lease payments equals or exceeds 90 per cent of the fair value of the leased property to the lessor at the inception of the lease. (The discount rate to be used in calculating the present value, is the the interest rate implicit in the lease).
- 2. In order to discount the minimum lease payments to their present value as at the beginning of the lease term, the lessee will need to know or be able to ascertain the interest rate implicit in the lease. Where the lessee knows the fair value of the leased property at the inception of the lease and is able to make a reasonable estimate of their dual value, the implicit interest rate can be readily computed. However, in certain circumstances the lessee may not know the fair value of the leased property or be able to estimate reasonably the residual value. In these circumstances the lessee will need to estimate the interest rate implicit in the lease