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EFFICIENCY

The hire value way to purchase

Dwindling capital means leasing equipment may improve care quality and finances, say Louise Hamilton and Bob Dredge

In times of plenty, financing rules made outright purchase the most obvious source of new investment. Now, with capital likely to become an increasingly scarce resource, any preconceptions that leasing equipment is too expensive or too challenging need to be reconsidered if the NHS is to gain access to the equipment and technology essential to deliver both quality services and cost efficiencies.

In this difficult economic climate, relying on buying equipment outright is unlikely to be a realistic or maintainable strategy.

Since the 2011-12 NHS allocations were announced in the operating framework last

December, much attention has been focused on the revenue position. The Department of Health asserted that total primary care trust allocations will increase, on average, by 3 per cent. However, both the King's Fund and the Institute for Fiscal Studies have come to the view that the promise of real terms growth can be challenged.

In addition, the £20bn of efficiency savings needed to deal with the cost impact of demographic and technological advances looms large.

Little attention has been given to the position for capital – the funds required for the many innovations necessary to improve quality and efficiency.

Capital allocations have also been growing by substantial sums. Indeed the capital vote was underspent in five of the last six years and was still increasing by 6 per cent as recently as 2010.

Reduced capital

However, this looks set to change. The DH stated in the operating framework that there will be no automatic capital allocations for primary care trusts, that any capital will be sanctioned by the strategic health authority, and any underspend not carried forward. The spending review and 2011 budget have clearly reduced the availability of capital for the NHS for the years to come.

Internally generated funds,

equipment, compared with the real cost of owning the equipment for the same period.

It is worth noting that, under the Treasury's clear line of sight project, capital charges will be removed from central government accounts. We will have to wait and see how this impacts on the NHS. However, early indications are that while new public dividend capital will not be available, the net impact on financing of capital is likely to be unchanged as other capital charge equivalents remain.

There are specific tests that can help to clarify if a lease is an operating lease. Until recently the



Buying equipment outright may not be sustainable

'Real value for money comes from adopting a longer term, planned approach'

the accumulated surpluses of foundation trusts, have been a source of capital financing over recent years. However, with foundation trusts reportedly facing average reductions to their budgets of 6.3 per cent, it is unlikely that much will be available for reinvestment.

Constrained activity

While in theory every patient is paid for at full costs under payment by results, the actual tariff for 2011 has been reduced by an average of 1.5 per cent. The ability to recover this margin by undertaking additional activity is now constrained by both the imposition of a marginal rate tariff on additional activities

and in many cases an affordability cap imposed by PCTs in many of the 2011 contracts.

In this environment finance directors must be looking for any legitimate source of funds that can enable them to sustain the volume and quality of the services they deliver.

When advances in technology tend to outpace the effective life of the equipment, leasing can be a sensible and effective choice as opposed to capital purchase if looked at early enough in the procurement process, as part of a longer term business strategy.

The NHS often has a dual strategy of attaining best value and the cheapest price for

ABOVE BOARD: ACCOUNTING RULES

Leases can cause problems for accountants who wish to know if the value of the asset is, or is not, to appear on their balance sheet. For this to happen they will need to demonstrate that they have agreed to an operating lease, as opposed to a finance lease.

Different leases are accounted for in different ways. Many shorter leases, called operating leases, typically lasting three to five years, are treated as rentals, so in the accounts simply show the cost of the lease payments.

For longer leases, called finance leases, the trust would show an estimate of the value of the

equipment in its own books. Instead of reporting the actual lease payments, the accounts would then show three calculated amounts: depreciation; interest charges; and capital charges, which, when calculated correctly, are normally relatively small (these three combined are broadly equivalent to the annual lease payments). These calculated amounts for finance leases come out of trusts' capital budgets.

Although the accounting for longer leases is more complicated, it is important to remember that what matters is the real cost of the lease over the expected life of the

guidance was that of the standard statement of accounting principles (SSAP 21). Put simply, if it could be demonstrated that 90 per cent or less of net present value remains with the lessor then it was an operating lease. However, since the requirement of the NHS to comply with international accounting standards (IAS 17) things are less clear.

IAS 17 defines a finance lease as a lease that transfers substantially the entire risks and rewards incidental to the ownership of the asset. Operating leases are any other lease (ie, not financing).

IAS17 does not have a simple

90 per cent rule. There is still a test to establish if the net present value of the lease payment covers, substantially, all of the value of the asset. An assessment of the type of lease is now based on of qualitative tests, summarised in the table.

Table based on Audit Commission briefing note on identifying and accounting for leases. Each lease will need to be separately assessed and sufficient evidence must be available to justify the assessment, and satisfy any auditor. It is likely an approach that scores and weights each factor may be appropriate to reach a decision on the type of lease. This has already been accepted by some NHS auditors.

TEST	ANSWER	IMPACT
Does the lease transfer ownership to the lessee by the end of the term?	No	Operating lease indicated
Does the lessee have an option to buy the asset at a sufficiently favourable price that it is reasonably certain it will be exercised?	No	Operating lease indicated
Is the lease term for the major economic life of the asset?	<50% of expected life	Operating lease indicated
At the start of the lease does the present value of the minimum payments amount to substantially all of the fair value of the asset?	<80% of fair value	Operating lease indicated
Are the assets of such a specialised nature such that only the lessee can use them without modification?	No	Operating lease indicated
If the lessee can cancel the lease, does the lessee bear the cost of the lessor's losses?	No	Operating lease indicated
Do gains or losses in any fluctuation of the fair value of the asset accrue to the lessee?	No	Operating lease indicated
Does the lessee have an option to continue the lease for a second period at a rent which is substantially below the market rent?	No	Operating lease indicated

goods and services. However, the two are often incompatible. Many trusts have historically opted for the cheapest offering obtained by public tender, as they feel they cannot justify spending more. By opting for the cheapest price, trusts can often leave themselves exposed to greater costs further down the line, if or when vital equipment fails to perform efficiently.

Real value for money comes from adopting a longer term, planned approach. A key benefit of leasing is the ability to spread the cost of attaining the best equipment. These costs can be repaid over the whole income generating working life of the equipment, funded through revenue budgets rather than waiting in a long queue for available capital funds.

Extended life cycle

Strategic procurement planning will help trusts to make rational justifications for choosing higher end, higher value equipment, because it will outlast and outperform cheaper alternatives. Spending more at the time of purchase can make a considerable difference, as that additional investment can translate into several years longer working life of the equipment. Consideration of whole life cycle costs is a crucially important factor when choosing both the equipment and the lease finance used to procure it.

Trusts will often have specific details of the equipment they believe they can afford, rather than a generic specification of what they need to deliver the best clinical services. This is a mindset that needs to change, because if you consider the option of leasing at the outset there can be better outcomes.

It is essential not to think in terms of capital outlays, or owning equipment, but of the clinical and financial benefits of replacing an ageing inventory with high performing leased equipment with consistently high levels of uptime.



Leasing may make it viable to procure higher end equipment

‘It is essential not to think of capital outlays, or owning equipment, but of the clinical and financial benefits’

A well planned equipment procurement programme can help to ensure high service levels, lower running costs and optimum patient care.

Care priority

All the indications are that providers will increasingly be paid for the quality of service provided by each hospital and therefore better equipment will equal better income. Despite strong disagreements and passionate arguments for and against the Health Bill, no matter what form the proposed new legislation finally takes, one thing all sides agree on is that patient care simply must not suffer as a result.

The ability to plan for an

equipment replacement programme, and use opportunities to upgrade and add to equipment inventory via revenue budgets, at fixed known costs, makes leasing a valuable tool that trusts can use, alongside other finance options, to address the significant cost and efficiency challenges facing the NHS. ●

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