

40. Leasing

Preamble

One of the alternatives to borrowing in order to finance both revenue and capital expenditure is leasing. Two types of lease agreement exist: finance leases and operating leases. Finance leases are deemed to be "credit arrangements" and as such fall within the scope of controls over credit, whereas operating leases are exempted from being credit arrangements.

Regulations

- 40.1 Schools may only enter into OPERATING leases. Under the School Standards and Framework Act 1998, Schedule 10 Part 3, schools are only permitted to borrow with the written permission of the Secretary of State. Finance leases are borrowing. It is therefore illegal for schools to enter a Finance Lease without written permission of the Secretary of State. Whilst it is possible to apply to the DfE for such permission, advice is that such permission is very unlikely to be given. Schools therefore need to take extra care in selecting a lease.
- 40.2 As Headteacher, it is your responsibility to ensure that all new leases are sent to the correct Finance contact to be evaluated. You must not enter a lease until you have confirmation that the lease is an operating lease and not a finance lease. In addition you must complete the annual year-end lease return requested by Finance. Leases can sometimes be hidden within other contracts. If you enter into a contract that involves the use of an asset you must inform and consult your Finance contact.
- 40.3 Schools should note that instalments of leases **MUST NOT** be paid from Devolved Formula Capital grant under the terms of the grant.

Operating Leases

A lease is unlikely to be classified as an operating lease if it includes any of the following:

Classification of Leases per International Accounting Standard IAS 17

A lease is classified as a finance lease if it transfers substantially all the risks and rewards incident to ownership. All other leases are classified as operating leases. Classification is made at the inception of the lease.

Whether a lease is a finance lease or an operating lease depends on the substance of the transaction rather than the form. Situations that would normally lead to a lease being classified as a finance lease include the following:

- the lease transfers ownership of the asset to the lessee by the end of the lease term
- the lessee has the option to purchase the asset at a price which is expected to be sufficiently lower than fair value at the date the option becomes exercisable that, at the inception of the lease, it is reasonably certain that the option will be exercised
- the lease term is for the major part of the economic life of the asset, even if title is not transferred
- at the inception of the lease, the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset
- the lease assets are of a specialised nature such that only the lessee can use them without major modifications being made

Other situations that might also lead to classification as a finance lease are:

- if the lessee is entitled to cancel the lease, the lessor's losses associated with the cancellation are borne by the lessee
- gains or losses from fluctuations in the fair value of the residual fall to the lessee (for example, by means of a rebate of lease payments)
- the lessee has the ability to continue to lease for a secondary period at a rent that is substantially lower than market rent

Leases, which fail to meet these criteria, are finance leases and count towards the local authority's borrowing limits.

Before entering into leasing agreements schools are strongly advised to seek the advice of the local authority's Procurement Team to ensure that the terms of the lease are reasonable and that the equipment (e.g. photocopier) cannot be leased more cheaply through the central arrangements. Advice on the determination of leases as either 'finance' or 'operating' may be obtained from the school's finance adviser in EFS.

Although schools may enter into operating leases for equipment they need to take into account the recurring commitments in future years. It is suggested that the approval of the Governing Body should be obtained before any operating lease is entered into and that the aggregate commitment of all operating leases is reported to the Governing Body when approval is being sought to any new operating lease.