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|---|---|---|
| **Joint Policy:** | **Fixed Assets – Procurement /Contracts** | |
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# Fixed Assets - Acquisition Policy

## Executive Summary

This Policy is being issued jointly by the Office of the Comptroller (CTR) and the Operational Services Division (OSD). Unless otherwise specified, the following policies apply to the acquisition of fixed assets including durable commodities ("goods") by all branches of state government. Acquisition includes cash purchase, receipt of a donation, construction, rental, license, term lease, lease purchase (TELP) or eminent domain, regardless of funds used.

## Considerations

All acquisitions of fixed assets must be recorded in accordance with existing laws and policies of the Commonwealth. The procurement requirements for equipment, vehicles, furniture, computer software and other commodities by Executive and Non-Executive departments are issued by OSD under the **Procurement Information Center (PIC).**

See also, CTR's policy for **"Commodities and Services"** and state finance and contract requirements under **"State Finance Law and General Contract Requirements"**.

## Policy

### Acquisition of Fixed Assets.

The Commonwealth defines acquisition as the obtaining of a fixed asset. This acquisition can be done by, but is not restricted to, a cash purchase, receipt of a donation, construction, rental, license, term lease, lease purchase (TELP) or eminent domain, regardless of funds used. The Commonwealth owns an asset when the full title of the asset rests with the Commonwealth.

The cost of purchasing an asset includes all costs necessary to put that asset into existing use and location, including but not limited to freight, insurance and installation (i.e., ancillary costs.) These costs may include legal costs, eminent domain costs or environmental remediation. The custodial responsibilities of an asset will reside within a particular department. All GAAP fixed asset transactions must be entered in MMARS.

### Historical Costs

The cost of an asset will be recorded as the historical cost of the asset, unless otherwise mentioned. Historical Cost can be determined by the following:

- The amount of cash paid for the entire purchase of the asset.

- The fair market value of a donated asset at the time of donation.
- The sum total of all construction costs including design of an asset.

**Capitalization Thresholds**

**GAAP Fixed Assets**

GAAP Fixed Assets are defined as **singular assets** (including infrastructure) with the following characteristics:

- **All land**, regardless of cost. The cost at which a fixed asset is entered in MMARS is either the historical acquisition cost, or the appraised, fair market value at date of donation.
- **All works of art and historical treasures**, regardless of cost, acquired or donated to a department after July 1, 2001. The cost at which it is entered is either the historical acquisition cost or the appraised value at date of donation.
- **Vehicles, equipment, furniture, computer software, and all electrical and computer components** with a useful life in excess of one year and with an historical cost **in excess of $49,999.**
- **Buildings purchased or constructed** (and all other infrastructure assets such as dams, Boardwalks, Fishing, Boating and Shipping Piers, Beaches, Seawalls, Paved Bike Trails and Pedestrian Paths, Other Recreational Infrastructure, Dam and Lock Systems, Water Systems, Sewer Systems, Other Utilities) with an historical cost of **greater than $99,999**.
- **All road infrastructures** with an historical cost **in excess of $99,999.** per lane mile for road assets. These include interstate roads and bridges, arterial roads and bridges (major non-interstate roads), collector roads and bridges (major non-limited access roads), Local roads and bridges, parkways.
- **All computer software**, whether internally or externally developed, should be capitalized depending on its cost. It is important that software be inventoried for license purposes. Departments are subject to liability if they install non-purchased or non-licensed software. Therefore, departments should maintain close scrutiny on software that is installed on every computer. Software costs above $50,000, but below $1,000,000, are considered a GAAP fixed asset, and must be reported on the Fixed Assets component of MMARS, as Asset Type K. This software is depreciated over three years. Software costs above $1,000,000 are also a GAAP fixed asset, and should be recorded as Asset Type S. This software is depreciated over seven years.

All activities in these groups and other long-lived assets must be capitalized for GAAP purposes. All activity for infrastructure must be recorded in the Fixed Assets Subsystem, if the Commonwealth retains ownership of the infrastructure. If the infrastructure is deeded over to another government, authority or municipality, the activity is an expenditure as a grant. All costs, from initial design and permitting to point of in-service must be included in the cost of the infrastructure asset.

**Non-GAAP Fixed Assets**

Non-GAAP fixed assets are defined as **singular assets (**including infrastructure) with the following characteristics:

- **Vehicles, equipment, furniture, computer software, and all electrical and computer components** with (1) a useful life of more than one year and (2) with **an original cost between $1,000 and $49,999**
- **Buildings and other infrastructure** with an **original cost between $1,000 and $99,999**
- **Road infrastructure** with a **cost of less than $99,999 per lane mile** for roads and bridges.

- **Software** costs **<u>below $50,000</u>**. It is important that software be inventoried for license purposes. Departments are subject to liability if they install non-purchased or non-licensed software. Therefore, departments should maintain close scrutiny on software that is installed on every computer.

Non-GAAP Fixed Assets must be recorded in a Department's inventory and reconciled at least annually. This inventory can be either electronic or on paper, as long as it records the date of purchase, amount, description, location and disposition of an item. Non-GAAP Fixed Assets Inventory are subject to review in the audit process by the State Auditor's Office or the Commonwealth's independent auditors.

## ACQUISITION METHODS:

### Eminent Domain

Eminent domain is the governmental process of taking an asset it doesn't currently own from a private individual or other entity, in exchange for legally determined consideration. The asset taken is then used for a governmental function. The entire cost of eminent domain, including legal fees, should be included as part of the inclusive historical cost of the new asset being constructed.

### Razing a Building

When a building is razed in order to clear the area for the construction of another building, the cost of razing the original building is recorded to land improvements. This will be entered in MMARS as an FA (Fixed Asset Acquisition or Betterment) document. The cost will then be associated with the parcel of land, not any future building. The disposal of the original building will be recorded in MMARS on an FD (Fixed Asset Disposal) document. When property has been purchased for the purpose of constructing a building, all costs incurred up to the *excavation of the new building* are considered land costs. Razing of old buildings and reshaping of the land are considered costs of the land, because these costs are necessary to get the land in condition for its intended purpose. Any proceeds obtained in the process of getting the land ready for its intended use, such as salvage of the old building or receipts from the sale of timber that has been cleared, are reductions in the cost of the land.

### Self-Constructed Assets and Historical Cost

Assets that are constructed should be priced at the total cost to build the asset. This includes both direct and indirect costs.

### Group Purchase of Assets

When two or more assets are purchased at the same time and the individual cost for each is known, the value of the assets will be the purchase cost plus any costs associated with putting those assets into use. However, if these additional costs are not directly assigned to a particular asset, these costs will be apportioned to the cost of all of the assets in a proportional manner. This will yield a cost for each unit, which will include the assets' direct costs, plus any ancillary costs incurred with putting the asset into service.

When two or more assets are obtained at one time and their individual costs are not readily known (i.e., land and building purchased as one), the individual costs are allocated to the assets based on their relative fair market values at the time of acquisition. These costs are simply a ratio of the initial acquisition cost vs. the relative fair market values.

### Considerations for the Acquisition of Durable Commodities

When deciding to acquire durable commodities, procuring departments and Procurement Management Teams (PMTs) should assess their requirements and weigh and compare their available options.

Departments must use one of the five acquisition methods identified below unless another method is legislatively authorized and/or approved by OSD or CTR.

1. **Rental** – Temporary short term use without ownership (limit 6 months) (Never a fixed asset).
2. **License** – Temporary use without ownership of intellectual property or software.
3. **Term Lease** – Temporary use without ownership for over 6 months. (These leases must be reviewed for categorization as capital or operating.)
4. **Outright Purchase** – Immediate ownership. (When the value of the commodity is $50,000 or greater, this is considered a Commonwealth fixed asset.)
5. **Tax Exempt Lease-Purchase (TELP)** – Purchase of commodity with financing and ultimate ownership. This should be reported as a capital lease. When the value of the commodity is $50,000 or greater, it is considered a Commonwealth fixed asset for which a Fixed Asset transaction (see below) must be entered at the time of acquisition.

## Fixed Asset Determination: When To Record Commodities As Fixed Assets

Regardless of the acquisition method, departments are responsible for recording fixed assets with a value of $50,000 or greater for equipment.

The Fixed Asset Subsystem is a component of MMARS whose purpose is to provide a uniform and fully automated vehicle to account for and report on GAAP (Governmental Generally Accepted Accounting Principles) fixed assets owned by the Commonwealth's departments. Departments must record GAAP fixed assets on the Fixed Asset Subsystem. This recording of these assets allows CTR to incorporate this information into the **Commonwealth's Annual Comprehensive Financial Report**.

Departments must also determine if a lease is a GAAP fixed asset, whether it is a capital lease or a term lease, and are responsible for any required reporting and proper coding of transactions in MMARS. The key steps in making this determination are as shown in the chart below.

| *Procurement Method* | *Value in Dollars/Useful Life* | *GAAP Reporting Category* | *FA (Fixed Asset Transaction) Yes or No* | *Object Code* |
|---|---|---|---|---|
| *TELP* | *> $50,000 For All Assets Except Buildings (Fixed Asset Type B) (>$100,000)* | *Capital* | *YES* | *L02-L13, U08* |
| *TELP* | *< $50,000* | *Capital* | *NO* | *L02-L13, U08* |
| *TERM LEASE* | *> $50,000 For All Assets Except Buildings (Fixed Assets Type B) (>$100,000) And A Transfer Of Ownership At The End Of The Lease* | *Capital* | *YES* | *L22-L33, U09* |
| *TERM LEASE* | *> $50,000 For All Assets Except Buildings (Fixed Asset Type B) (>$100,000) And A "Bargain Purchase Option" At The End Of The Lease* | *Capital* | *YES* | *L22-L33, U09* |
| *TERM LEASE* | *> $50,000 For All Assets Except Buildings (Fixed Assets Type B) (>$100,000) And A Lease Term$^3$75% Of The Asset's Useful Life* | *Capital* | *YES* | *L22-L33, U09* |
| *TERM LEASE* | *> $50,000 For All Assets Except Buildings (Fixed Assets Type B) (>$100,000) And A Present Value Of The Lease Payments$^3$90% Of The Assets Fair Market Value* | *Capital* | *Yes* | *L22-L33, U09* |

The purchase of durable commodities valued at equal to or greater than $50,000 (or as this amount is amended) are considered capital items and must be recorded as a Commonwealth asset as soon as the commodities are accepted. The following are considered capital items:

- All commodities acquired through outright purchase or TELP that are valued at equal to or greater than $50,000 or the current approved amount;
- Any **term lease** when the lease term is greater than 75% of the estimated economic life of commodity; and
- Any **term lease** when total payments (less maintenance cost) exceed 90% of the asset's fair market value.

**Sample: Is this a capital or operating lease?**

Lessor Company and Commonwealth agency ABC sign a lease agreement dated January 1, 20xx, that calls for the Lessor Company to lease equipment to ABC beginning on January 1, 20xx. The lease agreement has the following terms and conditions:

1. The term of the lease is for five years, and the lease agreement is noncancelable, requiring equal rental payments of $25,981.62 at the beginning of each year (annuity due basis).
2. The equipment has a fair market value at the inception of the lease of $100,000, an estimated economic life of five years, and no salvage value.
3. ABC pays all the ancillary costs directly to vendors of the Commonwealth, except for property taxes of $2,000 per year, which are the responsibility of Lessor.
4. The lease contains no renewal options and the equipment reverts to Lessor at the termination of the lease.
5. Because of circumstances, Lessor's discount rate is 10% - set by the Lessor.
6. The Commonwealth depreciates on a straight-line basis.

**Capital or operating lease?**

This is a capitalized lease because of two factors (one is all that is needed).

1. The lease term is equal to the equipment's economic life of five years and
2. The present value of the lease payments exceeds 90% of the fair market value of the property of $100,000. This is computed as follows:

| | | |
|---|---|---|
| Minimum Lease Payment | $25,981.62 - $2,000 property taxes | = $23,981.62 |
| Term | | x 5 |
| **Total Lease Payments** | | **=$119,908.10** |
| **Capitalized Amount** | Present Value of $23,981.62 x PV Factor 10% / 5 years | |
| | (computed in Excel) | **=$100,000.00** |
| | **90% of Fair Market** | **=$ 90,000.00** |
| | **It is a capitalized lease.** | |

**Procurement Considerations for Acquisition of a Durable Commodity.**

The following sections outline considerations for the following acquisition methods for durable commodities:

| | |
|---|---|
| **1. Rentals** | **Temporary Short-Term Use Without Ownership (Limit 6 Months) (Never a Fixed Asset) (May qualify as Incidental Purchase.** |
| **2. Licenses –** | **Temporary Use Without Ownership** |
| **3. Term Lease** | **Temporary Use Without Ownership (Longer than 6 Months).** |
| **4. Outright Purchase** | **Outright Purchase With Immediate Ownership** |
| **5. Tax Exempt Lease Purchase (TELP)** | **Tax Exempt Lease Purchase - Purchase of Commodity With Financing and Ultimate Ownership.** |

**When Departments Should Consider Temporary Use of a Commodity (Rental or Term Lease)**

Departments may consider rental or term leases when some or all of the following criteria are met:

- The department has a **short term** or **temporary need** for a commodity;
- The department will need the commodity for a temporarily funded program or project, a pilot project, or the department does not know how long commodity will be needed;
- The department does not want or need to own the commodity or to classify it as a Commonwealth asset;
- The department needs to have the ability to upgrade or replace the commodity with newer or different models, new or different technology in order to react to rapidly changing technology or internal departmental needs;
- The durability of the commodity will not provide a long-term useful life, normally longer than 36 months. For some IT commodities, longer than 18 months;
- The commodity cannot be recycled, passed down or circulated to other areas of a department when new commodities are needed, and would have to be declared surplus;
- The disposal of a commodity will be costly or lead to a potential environmental hazard;
- The commodity cannot be easily modified or upgraded with parts, but would have to be completely replaced with a new commodity;
- The benefits of temporary use of the commodity outweigh the benefits of ownership;
- The department has sufficient funds (and anticipates future funds) to pay for the temporary use of the commodity; If the anticipated **PERIOD** of the term of the lease is ***greater than 75% of estimated economic or "useful" life*** of the commodity, the department should consider an outright purchase or a TELP as opposed to a term lease. If a term lease is done, this commodity must also be recorded as a fixed asset. This is because the department is paying for the majority of the value of the commodity which qualifies this as a purchase;
- If the anticipated **VALUE** of total term lease payments (less maintenance costs) is ***greater than 90% of the commodity's fair market value***, the department should consider an outright purchase or TELP as opposed to a term lease. If a term lease is done, this commodity must also be recorded as a fixed asset. This is because the department is paying for the majority of the value of the commodity that qualifies it as purchase.

**Rentals - Temporary Short-Term Use Without Ownership (Limit 6 Months)**

A rental is an ideal arrangement for departments that have a one-time need or a short-term requirement for a commodity. For example, a department may need to rent 200 chairs for a conference or special ceremony, or a video camera for a special taping. These commodities are needed temporarily or for the specific or unusual event, and it is not practical or reasonable to purchase or lease the commodity.

**Note:** The total rental cost for several single days or for several days may qualify as an incidental purchase and an RFR may not be required.

Term rentals are longer than a one-time rental, or extend over a short period of time (not to exceed 6 months) and require periodic payments to the rental company contractor. The title to a rented commodity is held by the rental company.

In contrast with most lease contracts, maintenance and repair responsibility for a rented commodity remains with the rental company contractor. A department should expect a rented commodity to be functional and in commodity working condition and should immediately notify the rental company if the commodity is not performing as expected.

Departments are encouraged to negotiate the rental payments with the rental company contractor, and should not enter into a rental that contains penalty clauses (which exceed the actual rental fee) for exceeding the rental term. Departments should execute, on a timely basis, a rental amendment (provided it does not exceed a total aggregate of 6 months) if the department anticipates needing the use of the commodity for longer than the rental term.

Generally, a department may not rent a commodity for longer than 6 months or negotiate options to renew. Although rental companies will negotiate longer-term rentals, these rentals are generally not cost-effective. Therefore, if the department is unsure whether the rental will exceed 6 months, or the department is nearing the 6-month period, the department should negotiate a short-term lease for the anticipated period, rather than a rental. Leases are generally significantly less expensive than rentals for periods exceeding 6 months. Thus, for a department to realize the best value and execute the most practical contract, a department should know their exact requirements for the commodity and negotiate the best pricing structure.

Many commodities may be rented. Although the latest model or newest technology may be available for rental, it is likely that the equipment will not be brand new (the rental company may have rented the same equipment to other users).

In the rare event that a department wishes to purchase the rented commodity, it may be possible to negotiate this purchase at fair market value. However, this option should be treated as a separate outright purchase procurement (if the value does not qualify as an incidental purchase and the item is not on a statewide contract).

**Licenses – Temporary Use Without Ownership**

A license is essentially the same as a lease. Most licenses are acquired by paying a fee for the use of software or the use of other intellectual property that does not fall under the normal categories of durable commodities. Most departments pay a fee or royalty for the right (exclusive or non-exclusive) to use the software, intellectual property or equipment.

A license continues for the period of the contract or until the license is revoked by the contractor. Title and ownership of the software or equipment remain with the contractor and title will never pass to the department. Licenses may contain restrictions on the department's use, distribution or modifications to the software or equipment and may have limited warranties.

*Note:* Prior to contract execution, information technology license language should be reviewed by the PMT's information technology staff to ensure that the language is not unduly restrictive, and by the department's legal staff to ensure that it does not conflict with the *Commonwealth Terms and Conditions,* the *Standard Contract Form,* and the RFR terms and that it does not contain terms unfavorable to the department.

If the license is for proprietary software, legal counsel should focus on the elements addressed in the Information Technology Division's publication *Negotiating a Proprietary Software License*, posted at ITD's website at [www.mass.gov/itd](http://www.mass.gov/itd) under "Policy, Standards and Legal" (Click on "Legal", and then "Software Licensing and Development"). For further assistance with information technology licensing, department counsel should contact either the Information Technology Division's General Counsel or their respective secretariats. Departments should also seek assistance from the relevant OSD PMT when acquiring a license.

**Term Lease - Temporary Use Without Ownership (Longer than 6 Months). (See also #4 Tax Exempt Lease Purchase – Purchase of** Commodity **with Financing and Ultimate Ownership.)**

The term lease (also known as lease or operational lease) may be a feasible option for procuring departments that have a longer term need (longer than 6 months), **but do not need or intend to purchase the** commodity. For example, a term lease may be practical when the commodity or equipment changes rapidly with advances in technology. Generally, the following are some characteristics of term leases:

- A lease gives the department the use of the commodity for a specified period;
- Lease payments are usually less than a rental for the same period of time;
- Procuring departments are usually required to maintain and service the commodity, either as part of the lease payment or under s separate maintenance contract;
- Leases may offer automatic upgrades or replacement with new models during or at the end of the term of the lease;
- Title and ownership remain with the contractor and will not be transferred to the department as part of the lease.

**Specific instances in which term leasing is a desirable option**

Term leasing can be a beneficial alternative when there is:

- A project of undetermined duration;
- A limited duration project funded by capital funds (in which TELP is not an option);
- A need for rapid technological change;
- A significant financial or environmental cost associated with the disposal of the commodity;
- Downsizing, relocating or re-organizing within a department;
- A need to be flexible and to respond quickly to changing department needs;

The use of term leasing requires that:

- Departments have a clear and internally approved commodity use business plans (see the next guideline);
- Departments understand the **"useful life"** of their equipment according to their business strategy (furniture has a different useful life than desktop computers). This is important because many leasing companies may offer leases for a period equal to or longer than the useful life of the equipment. (This happens often with information technology equipment, which has a much shorter life than furniture.) A department that enters into a lease for a period equal to or greater than the useful life would in essence by paying the full value of a purchase of the commodity, without gaining any equity or purchase rights, which would not be a prudent use of resources. Also, the department would be required to record this commodity as a fixed asset. **Leases should always be negotiated for LESS that the 75% of the useful life of the equipment;**
- Departments understand the **"fair market value"** of the commodity to be leased. This is important because many leasing companies may offer leases for a total lease amount that equals or is greater than the total value of the commodity. A department that enters into a lease for an

amount equal to or greater than the value of the commodity would in essence be paying the full value of a purchase of the commodity, without gaining any equity or purchase rights. Also, the department would be required to record this commodity as a fixed asset. **Leases should always be negotiated for LESS than the 90% of the value of the** commodity **of the equipment;**

- Funding must be secured at the beginning of the lease, and maintained throughout the lease term, to assure payment throughout the lease term;
- The contract plan addresses the disposal of commodities, in accordance with appropriate regulations, at the end of a lease so that the commodities may be replaced, upgraded or returned to the leasing contractor without any disruption of service.

**The time frame for a term lease should depend on the anticipated useful life of the** commodity

In the information technology arena, for example, term leases beyond three years are not recommended. TELPs or outright purchases are not recommended since these methods should only be used when the useful life of the equipment is extensive.

Flexibility is considered one benefit of leasing a commodity. The preferred structure of a lease should be considered by a department. Once the lease is completed and all payments are made the commodity is returned to the contractor.

- If the anticipated TERM of the term lease is ***greater than 75% of estimated economic value or useful life*** this commodity must be recorded as a fixed asset because the department is paying for most of the value of the commodity (qualifying it as purchase).
- If the anticipated VALUE of total term lease payments (less maintenance cost) is ***greater than 90% of the*** commodity***'s fair market value*** this commodity must be recorded as a fixed asset because the department is paying for most of the value of the commodity (qualifying it as a purchase).

**Negotiating options as part of a lease**

A department may not negotiate an option to purchase under a term lease. Options to purchase (also referred to as buy-out options) significantly inflate lease costs (and are therefore inappropriate). **A department must evaluate, before acquiring a** commodity**, whether it is best value to lease the** commodity**.**

Also, departments should not negotiate other options as part of a term lease, e.g., options to upgrade, refresh or replace equipment. These types of options generally build in additional monthly costs and require the department to purchase something in advance that it may never receive (in violation of state finance law). Instead, departments have the ability to negotiate upgrades, refresh or replace a commodity at any time during the lease term. Even if this language is not specified in a RFR, the department will always have the opportunity to negotiate with a contractor.

**Can a department reconsider its choice and choose to buy a** commodity **during or at the completion of the term lease?**

Yes, with certain restrictions.

- If the department determines **during the lease period** that it should have purchased the commodity, and the department has sufficient funds for an outright purchase, it may negotiate the fair market value purchase of the commodity with the contractor.
- If the department determines **during the lease period** that is should have purchased the commodity, and the department does not have sufficient funds for an outright purchase, it should

re-negotiate the term lease as a TELP. TELP payments (unlike lease payments) contribute to the purchase of the commodity, thereby reducing the overall cost to the department.

- If the department determines **<u>at the end of the lease period</u>** that it should have purchased the commodity, <u>and</u> the department has sufficient funds for an outright purchase, it may negotiate the fair market value purchase of the commodity with the contractor. However, the purchase should be treated as a completely separate transaction and may not be built in as an option under the original lease.

## <u>Terminating a Term Lease</u>

Departments must be very careful when considering terminating a term lease. Term leases are unlike rental or other contracts that are terminable at will and without cause or penalty. Similar to a TELP, the cancellation of a term lease may result in severe penalties if the department decides to terminate prior to the end of the lease. Therefore, departments may not terminate a lease easily and should be very careful to ensure that the commodity to be leased is essential to department operations for the period of the lease

A leasing contractor factors in the value of the commodity and the associated financing cost for the period leased. As such, the full negotiated amount of the lease is not just the monthly or quarterly value of the lease while it is at the department, but the full amount of the investment that the leasing company seeks to recoup, irrespective of the length of the lease. The full amount of the lease is then broken down into multiple payments for the convenience of the department to be paid over a specified period of time.

The leasing company expects to recoup the full amount of the lease even if the department wants to terminate the lease early. Therefore, a department seeking to terminate a lease early without cause will often be faced with three options, (1) an acceleration of payments (the leasing company wants to recoup all remaining leasing payments); (2) negotiating a buyout of the commodity at the fair market value of the commodity; (3) negotiating a settlement of some amount less than the remaining lease payments. Departments should seek guidance from their fiscal and legal staffs when deciding to terminate a lease.

Terminating leases due to downsizing or budget cuts is not automatic. Termination for lack of appropriation applies only to circumstances in which the department has no funding that could be used for paying the lease. In situations in which an appropriation or allotments have been reduced and equipment is no longer needed, the department is still obligated to make lease payments and must attempt to locate another department that is willing to assume the lease and possession of the equipment, or negotiate the termination of the lease with the contractor and return of the equipment. Leased equipment is owned by the leasor and can not be surplused.

## <u>When Departments Should Consider Purchasing a Commodity (Either Outright Purchase or TELP)</u>

Departments should consider an outright purchase or TELP when some or all of the following criteria are met:

- The department has a **definite long term or permanent need** for the commodity. Departments SHOULD NOT consider the purchase of a commodity if the need is temporary or if the department cannot determine the needed duration;
- The department wants to **own** the commodity and classify it as a Commonwealth asset;
- The commodity is not likely to be quickly outdated by advances in technology and will continue to be usable by the department for a longer period than 36 months;
- The durability of the commodity will provide a long-term useful life, normally longer than 36 months; for some IT commodities, longer than 18 months;
- The commodity can be recycled, passed down or circulated to other areas of a department when new commodities are needed rather than considering it as a surplus item;

- The commodity can be easily modified or upgraded with parts, rather than having to be replaced with a new commodity;
- The benefits of ownership of the commodity outweigh the burdens of ownership, such as ongoing maintenance, repairs and final disposition;
- The department has sufficient funds to purchase the commodity **(outright purchase)**;
- The department does not have sufficient funds for an outright purchase, but it anticipates having funding in the future to purchase the commodity over time (**Tax Exempt Lease Purchase – TELP**).

**Note: Commodities purchased through outright purchase or TELP will be considered Commonwealth fixed assets and should be recorded as part of the department's Fixed Asset Management Plan**.

## <u>Outright Purchase With Immediate Ownership</u>

A department uses an outright purchase when the department has determined that it is most advantageous to buy the commodity rather than just purchase the temporary use of the commodity and the department has sufficient funds available to purchase the commodity. Departments wishing to purchase a commodity, but lacking sufficient funds for an outright purchase, should consider a Tax Exempt Lease Purchase (TELP).

Many commodities are available on statewide contracts and can be obtained quickly and efficiently. Commodities that are not on statewide contract and cannot be purchased through an incidental purchase (because the total value of the procurement is higher than the department's incidental purchase limit or the object code incidental purchase limit) should be procured in accordance with the procurement regulations, policies and procedures applicable to the department. For executive departments (Procurement Level III) an Request for Response (RFR) must be used. The RFR or other solicitation should be drafted to identify the commodity(s) required and obtain the best value for the department's available funds. The RFR should identify the department's goals for using the commodity and ask bidders to identify all available options, so that bidders can effectively match the department with the commodity and accessories that most closely meet these needs.

Depending on the type of commodity to be procured, the RFR should include a maintenance component, either in a warranty for repair or replacement, or for needed on-call maintenance and repairs. This section of the RFR may solicit separate responses (just for maintenance and repairs) from bidders other than the contractor selected for the purchase of the equipment. Coupling the purchase and maintenance under one RFR will eliminate the need for a separate maintenance RFR and contract.

## <u>Tax Exempt Lease Purchase - Purchase of Commodity with Financing and Ultimate Ownership. (See also Term Lease – Temporary Use without Ownership - Longer than 6 Months.)</u>

### <u>Factors to Consider for Tax Exempt Lease Purchase</u>

The term "lease purchase" is synonymous with purchase (if the commodity's value is equal to or greater than $50,000 or other approved value, the commodity is considered a fixed asset of the Commonwealth and must be recorded). Lease purchase is also synonymous with Tax Exempt Lease Purchase (TELP), i.e., whenever a department considers buying a commodity with financing, it enters into a Tax Exempt Lease Purchase (TELP). There are no leasing options under a lease-purchase.

All lease purchases entered into by a department must be TELPs absent a statutory or other legal prohibition. A TELP provides financing for the commodity purchase over time. The TELP financier pays an equipment contractor immediately for the full cost of the commodity. The department then pays the TELP financier over a specified period of time. Upon completion of payments, the title to the commodity is transferred to the department. Tax exempt refers to the benefits a TELP financier receives from the tax-exempt status of the Commonwealth. A TELP financier can sell tax-exempt bonds to finance the purchase of the commodity that is much less expensive and more easily sold than taxable bonds. This provides Commonwealth departments with a much lower interest rate for the TELP payments.

A department may consider using a **Tax Exempt Lease Purchase (TELP)** when:

- the department has determined that it is most advantageous to buy a commodity rather than purchase the temporary use of the commodity, i.e., no anticipated trade-in is planned;
- the commodity is essential to the operations of the department;
- the department does not have sufficient funds currently available to purchase the commodity outright, and
- the department anticipates and commits to having sufficient continuing funding available over the term of the TELP to pay the cost of the commodity and the financing costs. **(Note: Capital funds may not be used for TELP financing.)**

**Note:** A TELP financing company is not a merchant dealing in the commodity being purchased, and **will not provide upgrade and swapping options that a lease may provide**. Other than for maintenance and warranty issues, the department's relationship with the equipment contractor terminates when the TELP financier makes full payment to the contractor for the equipment at the beginning of the TELP term.

Departments should remain aware that a TELP is a mechanism for financing the **purchase** of a commodity. Title for the commodity remains with the TELP financing company until all payments are made by the department.

TELP contracts may include the provision of service and maintenance or may require that separate contracts provide for this upkeep, depending upon the procurement and the contractor. Service and maintenance costs are additional and may be available through the TELP contractor as part of the TELP contract as a convenience, **however these costs may not be financed as part of the TELP payments, but must be paid separately.**

TELP cancellations usually result in severe penalties and the loss of all equity built up in the commodity. In addition, termination of a TELP can have a severe impact on the Commonwealth's bond rating. ***The termination or cancellation of a TELP should be carefully considered and used only in very extreme circumstances and may not be made without prior written authorization by the office of the Comptroller and the Fiscal Affairs Division.*** Usually the only way that a TELP can be terminated, without penalty, is when the legislature fails to appropriate funds for that contract (the elimination of a line item) and there are no other available sources of funds that are authorized for that purpose.

If the TELP contract is encumbered in an account in which funding is reduced, other discretionary contracts (contracts terminable without cause which do not have automatic severe penalty clauses associated with termination), department expenditures and even staff **must be terminated or reduced in order to ensure sufficient funds to cover the TELP payments.** This priority of obligations is required since the TELP contractor pays the equipment contractor immediately for the full cost of the commodity and is allowing the department to repay this amount over the term of the TELP. Therefore, the department is obligated to repay this amount and associated financing costs.

**An Outline of the TELP Acquisition Process**

A TELP acquisition method allows a department to purchase the commodity and finance the cost of the commodity over time. The TELP process is outlined briefly as follows:

- All anticipated TELP purchases must be reviewed in advance by the Executive Office for the Administration and Finance, Fiscal Affairs Division (FAD). Departments must submit a request to FAD outlining the type, quantity and anticipated value of the commodity(ies) including the sources of funding identified for all future TELP payments;
- Commodities and equipment must be procured in accordance with the procurement regulations, policies and procedures applicable to the department. The department may select the commodity

either from a current statewide contract, or the department may conduct a solicitation for the commodity (in which the RFR states the department intends to finance the commodity), provided the statewide TELP does not meet a department's need;

- Once the commodities are selected, the department can then select from one of the three options available for TELP financing. The options, which are discussed more fully below, are:
    - The Commonwealth TELP (administered by the Information Technology Division)
    - The Statewide TELP contract (requires quotes from all statewide contractors)
    - A contractor TELP (from the contractor supplying the commodity under an RFR)
- The TELP arrangement is finalized upon the department's acceptance of the commodity and completion of the required paperwork of the TELP (Commonwealth of Massachusetts – Fiscal Affairs Division Tax Exempt Lease Purchase Authorization Form, Statewide Tax Exempt Lease Purchase Quotation Form, Acceptance Certificate, Acceptance Certificate Payment Schedule, Tax Exempt Lease Purchase Agreement, Essential Use Letter and Certificate of Appropriation);
- The TELP contractor (financier) gets the benefit of the Commonwealth's tax exempt status and therefore can offer better financing rates to departments;
- A department makes TELP payments (principal and interest costs only) periodically (monthly, quarterly, annually or semi-annually) spreading the acquisition cost over a longer period of time (24, 36, 48, 60 or more months), depending on the type of commodity, its useful life and the total cost;

Note: Maintenance, personnel or other costs that may not be financed should be invoiced and paid separately from TELP payments.

- TELP payments are unconditional and a department may not terminate a TELP arrangement except for non-appropriation of funds, which is not overspending of a budget, but usually occurs only when a department is dissolved or has its funding cut severely;
- TELP payments must be made through the MMARS Recurring Payment System on time in order to avoid adverse consequences to the Commonwealth's financial status;
- Departments gain possession and use of the commodity or equipment immediately and the title remains with the TELP contractor until all of the TELP payments have been made; and
- Title to the commodity transfers to the department at the end of the TELP term.

**The Commonwealth TELP (Administered by the Information Technology Division)**

The Information Technology Division (ITD) manages the Commonwealth TELP statewide contract on behalf of departments. Financing a purchase utilizing the Commonwealth TELP may provide the following advantages to departments:

- ITD assists departments through the entire TELP process;
- The Commonwealth TELP is a commodity option for smaller TELP purchases provided the total acquisition costs of the equipment is at least $50,000;
- The Commonwealth TELP contractor cannot refuse to provide financing to a department, unlike the statewide TELP or contractor TELP financiers who may refuse to provide financing for certain types of equipment or smaller dollar purchases;
- The Commonwealth TELP interest rate is set as part of the contract according to the Commonwealth's credit rating, and is updated quarterly to reflect market changes;
- Departments save administrative costs because they do not need to competitively solicit TELP interest rates or negotiate a financing contract with a third-party financier;

- Departments know the interest rate and total financing cost, and may budget the procurement accordingly (or the selection of the commodity from a statewide contract); and
- TELP payments under the Commonwealth TELP are set up on the quarterly Recurring Payment System on MMARS and paid quarterly in arrears.

Departments seeking to utilize the Commonwealth TELP for a commodity purchase can contact ITD:

Information Technology Division
One Ashburton Place, 8th Floor
Boston, MA 02108

**Statewide TELP Contract**

The statewide TELP contract is a commodity option for purchase of a commodity meeting the following requirements:

- The commodity or equipment to be purchased has a total acquisition cost of greater than $50,000.
- The commodities are information technology equipment, telecommunication, motor vehicles, energy/water conservation equipment, office automation equipment, photocopy/duplication equipment or other equipment or commodities authorized by OSD as appropriate for TELP.
- The department obtains competitive TELP quotes from ALL of the approved statewide TELP contractors to obtain the best TELP financing rates.
- The department establishes the TELP payment schedule in accordance with one of the approved MMARS "REST" tables in the Recurring Payment System (monthly, quarterly, semiannual or annually).

The Financial Services Procurement Management Team has developed a comprehensive statewide *TELP Handbook* to assist departments step-by-step through the process of obtaining TELP financing which is available on Comm-PASS at: comm-pass.com.

**Contractor TELPs**

The third TELP financing option is a contractor TELP. Similar to the third party financing available using the Commonwealth TELP contractor through ITD or the statewide TELP contract, some contractors may also offer TELP financing as part of commodity purchases. A contractor financed tax-exempt lease purchase (or contractor TELP) may be considered advantageous for the following reasons:

- It is convenient for the department since a contractor TELP provides "one-stop shopping" for both the purchase of the commodity and the financing of TELP payments;
- Departments may be able to negotiate better commodity pricing through a full service equipment contractor since the contractor will realize the benefit of the equipment purchase as well as the interest payments for the financing of payment.

**Certain restrictions apply when considering using a contractor TELP:**

1. Commodity contractors on statewide contract can only provide TELP financing for their listed commodities if a TELP option has been approved under the statewide contract (for example, the statewide contract for photocopiers has a TELP option). If the TELP financing option has not been approved under the statewide contract, the departments must obtain TELP financing through either the Commonwealth TELP (ITD) or the statewide TELP contract.
2. RFRs for commodity purchases with a TELP option may only be drafted and awarded to contractors that provide BOTH the commodity AND the financing as a single "one-stop shop" entity. **RFRs may not be done to seek third party financing** (in which the commodity is obtained from the contractor but the TELP financing is provided by a separate entity from the contractor). This is prohibited since the statewide TELP contract has already approved qualified third party financiers

for TELP. Contractors that seek to offer contractor TELP financing under an RFR <u>must</u> agree to the same terms and conditions outlined in the statewide TELP contract concerning providing TELP financing, which should be included in the RFR for the commodity purchase. Please see the Comm-PASS for the statewide contract for TELP services. (comm-pass.com)

3. Contractor TELP payments MUST be scheduled in accordance with one of the approved MMARS tables in the Recurring Payment System (monthly, quarterly, semi-annual or annually).
4. Contractor TELPs do no always offer the best interest rates, and departments are encouraged to compare the quotes offered under a contractor TELP with the statewide TELP contract or the Commonwealth TELP to determine if the contractor TELP is the best value for the commodity purchase. A higher interest rate (and higher TELP payments) may not justify the convenience offered under a contractor TELP.

## Internal Controls

There are two accounting/management paths depending on ownership:

1. If the asset is acquired under the ownership of the Commonwealth:
   - Funds for the asset should be budgeted and expended in the appropriate account, subsidiary and object codes for each equipment/assets;
   - The asset should be procured by the department according to 801 CMR 21.00, as amended;
   - The asset should be encumbered and paid for through the state accounting system (MMARS);
   - The asset should receive the proper management treatment by the department that includes inventory/fixed asset management, maintenance management, and surplus property management, and comply with the department's Internal Control Plan. The method of control and inventory of software is an integral part of a department’s internal controls.

   If the asset will be made available for use by a contractor, this arrangement must be documented in the contract, management systems, etc. and include provisions for its return when the contract expires.
2. If the asset is acquired under the ownership of the contractor or grantee pursuant to a contract or grant:
   - Funds for the asset should be budgeted and expended in the appropriate account, subsidiary and object code for such contracts/grants in accordance with the department's Internal Control Plan
   - The asset should be procured, paid for and managed in accordance with the contractor/grantee policies and procedures and other internal controls.

## Departments need to have a business plan for internal commodity needs

The business plan should address the following:

- What are the department needs, technically or otherwise? Consideration must be given to the strategic direction of the Commonwealth and the needs of the department.
- How does the department plan to get there?
- In the information technology area, which operating systems and applications software products does the department plan to use?
- How is the business plan going to be supported (internally or externally)?
- Should commodities be purchased outright, financed (TELP) or term leased? Should the acquisition methods be combined?
- How does the department protect against technical obsolescence; how often does the department need to upgrade or replace the commodity?

- How does the department plan to replace the commodity when the lease ends?
- Have disposal costs and requirements been considered?
- Are the plans and goals realistic? Does the department have a plan to properly handle a downsize, consolidation or other funding cut so that leasing and TELP obligations are fulfilled?

## Departments must have a formal asset management program

Similar to tracking fixed assets of Commonwealth owned commodities or those financed through TELP (especially on a large scale) an asset management program must be in place to track and control the leased inventory. Since ownership remains with the leasing contractor, the department must carefully track the location of all leased commodities. While leasing is a flexible tool, tight control and planning are mandatory. Using information technology as an example, benefits include:

- Automation of system updates reduces the cost of hardware and software deployment;
- Effective planning of system updates reduces the cost of hardware and software deployment;
- Department has the ability to track the commodity inventory, especially in time of reorganization and downsizing;
- Downtime of equipment is minimized resulting in higher productivity and lower costs;
- Departments can strike a balance between hardware deployment, the retirement of equipment, and the use and integration of newer technologies. Departments must know where all leased commodities are located because the department may be subject to severe penalties if leased commodities are lost.

## Traditional funding mechanisms and sources need to be re-examined

- A multi-year commitment is critical both to a department and a contractor before entering into a lease;
- Appropriation of funds must be secured both for the current year and out-year budget commitments;
- The type of funds should be considered;
- Restrictions related to various funding sources must be considered

## Information Sources

Related Policies

- Key State Finance Law Compliance Appointments and Responsibilities
- Department Head Signature Authorization and Electronic Signature for MMARS Documents
- Contracts Policies
- Accounts Payable Policies
- Records Management Policies
- OSD Procurement Information Center (PIC)

Legal Authority –

- Expenditure Classification Handbook;
- M.G.L. c. 7A (Office of the Comptroller); M.G.L. c. 29 (State Finance Law);
- M.G.L. c. 110F (Uniform Electronic Transactions Act);
- 801 CMR 21.00
- M.G.L. c. 29, § 29D (Debt Collection); M.G.L. c. 29, § 29E (Revenue Maximization);
    - M.G.L. c. 30, § 27 (Revenue Receipt); M.G.L. c. 10, § 17B (Revenue Receipt); Massachusetts Constitution Article LXIII Section 1 (Revenue Receipt);
- M.G.L c. 7, § 22 (OSD – Commodities and Services); M.G.L. c. 30, §. 51; (OSD – Commodities and Services) M.G.L. c. 30, §. 52; (OSD – Commodities and Services)
- M.G.L. c. 15A and M.G.L. c. 73 (state and community colleges);

- M.G.L. c. 75 (UMASS); General or special laws governing expenditures;
- Massachusetts Executive Orders (Level III – Executive Only);
- Administrative Bulletins(Level III – Executive Only);
- Comptroller regulations (815 CMR 2.00  10.00);
- M.G.L. c. 29, § 66  (State Finance Law Violations)

- Attachments –
  Fixed Assets Types & Useful Lives Chart
  Fixed Asset Cycle Illustration

- Links - None
- Contacts –  CTR Help Desk

**Revisions**

- November 1, 2005 - Updates to reflect joint issuance of policy with OSD concurrent with launch of Procurement Information Center (PIC).
- November 1, 2006 – Removed language referencing Knowledge Center and updated relevant links to Mass.gov/osc portal site.