

**BROOME COUNTY
DEPARTMENT OF
AUDIT AND CONTROL**

LEASE ANALYSIS

September 2004

Alex J. McLaughlin, Comptroller

September 28, 2004

Jeffrey P. Kraham, County Executive:

The Department of Audit and Control has conducted an analysis of Broome County's leases. The principle objective was to ascertain the extent to which management has implemented the recommendations outlined in our June 2002 report on leases.

The results of our analysis indicate that while management has implemented some of the recommendations for improvements in our June 2002 report, other of our recommendations have not been implemented. Specifically, no analysis of financing alternatives is being performed and some improvements are required in the County's lease accounting procedures.

Sincerely,

Alex J. McLaughlin
Comptroller

cc: Daniel A Schofield, Chairman of the Legislature
Members of the Legislature
Louis P. Augostini, Clerk of the Legislature
Jerome Z. Knebel, Commissioner of Finance
Richard R. Blythe, Purchasing Director
Kenneth E. Badger, Budget & Research Director

Lease Analysis Overview Narrative

We have analyzed various Broome County lease agreements. The purpose of our analysis was to evaluate the suitability of leasing as a financing vehicle for County acquisitions, and to determine the extent to which County managers have implemented the recommendations for improvements included in our June 2002 report on leases.

Our 2002 report revealed that the County had no formal policy to require an evaluation of financing alternatives, and that frequently the County had entered into lease agreements with a prohibitively high cost of capital. We also observed at the time, that the County did not have effective procedures in place to ensure that leases were properly accounted for.

For purposes of this analysis, we developed a master list of lease agreements entered into since the June 2002 release of our last report. From that list, we selected a sample of leases for detailed examination.

For the leases selected, we reviewed the applicable contracts, noting the lease term and the timing and amount of payments. We also noted any special conditions that applied, such as overuse fees, maintenance costs, late fees, guaranteed residual value, bargain purchase, etc.

For each lease, we calculated the implicit interest rate. The implicit rate of interest is the financing cost incorporated into the lease payment by the lessor.

The lifetime cost of lease payments included in our sample was in excess of \$4.3 million.

Prior Audit

June 2002.

AUDIT FINDINGS, RECOMMENDATIONS AND RESPONSES

FINDING 1: THE COUNTY STILL HAS NO POLICY IN PLACE REQUIRING AN EVALUATION OF FINANCING ALTERNATIVES FOR LEASE PROPOSALS

The County has still not developed and implemented a policy to require that financing alternatives for lease proposals are considered.

As a result, the County has entered into property and equipment leases that are much more expensive than it would be to purchase similar items.

In one case, the County has leased office space for \$273,750 per year for 15 years. The market value of the leased property is \$621,720. Over the term of the lease, even after taking into consideration the time value of money, the County will pay \$2.8 million more to lease this property than it would have cost to buy it (or something comparable).

In other cases, the County has entered into leases for equipment that include interest rates of 4.5% to nearly 6%. Our own cost of capital, had we chosen to sell debt as a financing alternative, was less than 2% at the time the leases were entered into.

RECOMMENDATION:

We recommend that the County implement a policy requiring that a lease vs. purchase analysis be prepared and submitted to the appropriate authority (the Broome County Legislature and/or the Board of Acquisition and Contracts) as support for all proposed lease agreements.

MANAGEMENT RESPONSE:

Management was provided with an opportunity to comment on this report, but did not.

FINDING 2: LEASE CAPITALIZATION POLICIES ARE NOT FULLY COMPLIANT WITH FINANCIAL ACCOUNTING STANDARDS BOARD REQUIREMENTS.

Since our last examination (June 2002), a formal Lease Analysis Procedure has been developed and implemented by the Finance department for the review of leases for purposes of determining the classification of leases (capital or operating). The procedures, however, should be modified to comply fully with the requirements of the Financial Accounting Standards Board's (FASB) statement number 13.

The requirement regarding lease term versus useful life needs to be set at 75%, not 90% and it should be noted in the procedures that both this requirement and the requirement referring to the percentage of the present value of the minimum lease payments versus fair value of the property are not applicable to properties within the last 25% of their useful lives.

RECOMMENDATION:

We recommend that the Department of Finance revise its lease accounting procedures to fully reflect the requirements of FASB 13.

MANAGEMENT RESPONSE:

Management was provided with an opportunity to comment on this report, but did not.

FINDING 3: PROCEDURES IMPLEMENTED BY FINANCE TO IDENTIFY LEASE AGREEMENTS DO NOT EFFECTIVELY CAPTURE ALL SUCH AGREEMENTS

During the course of our examination, we reviewed files maintained by the Law Department in order to identify contracts entered into after June 2002 for use in determining our audit sample. We compared this list to the Broome County Lease Agreement Additions document provided by the Finance department. There were three (3) contracts in the Law Department's File that were not on the list maintained by Finance.

Leases not captured for analysis can distort the true capital structure of the organization.

RECOMMENDATION

We recommend the finance department improve procedures to ensure that all leases are captured.

MANAGEMENT RESPONSE

Management was provided with an opportunity to comment on this report, but did not.