REVIEW OF THE MANAGEMENT AND USE OF STATE OWNED PASSENGER VEHICLES AND PRIVATELY OWNED VEHICLES USED AT STATE EXPENSE

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TO THE FISCAL COMMITTEE OF THE GENERAL COURT:

We have conducted a REVIEW OF THE MANAGEMENT AND USE OF STATE OWNED PASSENGER VEHICLES AND PRIVATELY OWNED VEHICLES USED AT STATE EXPENSE. Our review included an analysis of the historical costs associated with the acquisition and operation of the State owned passenger fleet. In addition, we reviewed the level of private mileage reimbursement that has been paid to State employees for the use of private vehicles while on State business.

Historical data was compiled from the annual Motor Vehicle reports which are filed with Administrative Services at the end of each fiscal year. These reports provide detailed cost data at the agency level on a per vehicle basis. Purchasing and retirement data was compiled from the Division of Plant and Property Management.

Our primary objectives were to evaluate the current policies surrounding State travel operations to determine if current practices provide maximum fleet performance at minimum expense.

This report results from our review of various aspects of motor vehicle operations and is intended solely to inform the Legislative Fiscal Committee of our findings from that review.

Office of the Legislative Budget Assistant
OFFICE OF THE LEGISLATIVE BUDGET ASSISTANT

August 20, 1984

EXECUTIVE SUMMARY

Controlling the cost of transporting people has become a more complicated and challenging responsibility as the size of the fleet increases and costs rise. Essentially, the policies governing the use of motor vehicles in the State of New Hampshire have not kept pace with these changing conditions. As a result of our study on the use of passenger vehicles we offer the following observations and recommendations.

CENTRALIZED FLEET MANAGEMENT AND OPERATIONS

The State currently operates under conditions which lack centralized management and direction. This has resulted in underutilization of the fleet, undeveloped management information systems, duplication and general mismanagement.

Our recommendations are twofold:

1) Establish a centralized interagency motor pool.

2) Create a position entitled Fleet Administrator empowered with complete authority to exercise control over the permanent assignment of State vehicles, a daily trip pool and the use of private vehicles. This position should be filled with a proven professional in the field of fleet management.

The remaining items discussed should be considered in establishing and maintaining a centralized interagency motor pool.

VEHICLE BREAKEVEN POINT

The recently published revision of the State Manual of Procedures, dated March 1984, changed the criteria for the breakeven point from 12,000 to 15,000 miles. Up until this publication the State has used 12,000 miles as the minimum annual mileage requirement a State vehicle must travel for efficient ownership. This mileage requirement has not been strictly enforced and individuals have received private mileage reimbursements in excess of 12,000 miles per year. We suggest the following:

1) 9,900 miles is a closer approximation of the true breakeven point between the cost to own a vehicle versus the cost to use private vehicles. This breakeven has been formulated using actual costs from fiscal years 1981 - 1983.

2) Closely monitor and control private mileage reimbursements on an individual basis to minimize the cost to the State and encourage maximum utilization of State owned vehicles.

FEE STRUCTURE

The cost to administer and operate the central fleet could be defrayed by the following fees:

- interagency billings for motor vehicle rental fees; and
- the collection of commuting mileage charges for all permanently assigned vehicles based on the distance between home and office.

MANAGEMENT INFORMATION SYSTEMS (MIS)

A well developed, comprehensive and functional management information system is crucial in providing management with the information to make well informed decisions. Sufficient financial and personnel resources should be devoted to its development.

FLEET MAINTENANCE

Safety, dependability, economy and performance are directly related to a preventative maintenance program. Vehicles should receive routine maintenance at regular intervals and they should be serviced whenever possible at State garages.

VEHICLE PROCUREMENT AND RETIREMENT

Policy makers should consider alternative procurement options. These include the purchase of used vehicles or the acquisition of the fleet on an installment basis through the execution of a lease-purchase agreement. Initial analysis appears to make further investigation of the lease purchase alternative worthwhile.

The retirement policies of State vehicles should be reevaluated in light of the increased operating costs that we have quantified as the vehicles age and the "rock bottom" salvage value the State receives at the State auction.

IDENTIFICATION OF POTENTIAL SAVINGS

We have identified the following potential savings which we feel are realistic estimates resulting from improved fleet management.

IDENTIFICATION OF POTENTIAL SAVINGS*
OVER AN ESTIMATED FIVE YEAR USEFUL LIFE PER VEHICLE

	PROJECTED SAVINGS	
	High	Low
IMPROVED PROCUREMENT		
• Manufacturers concessions	$ 1,500	$ 500
INCREASED SALVAGE VALUES	1,500	500
REDUCED OPERATING COSTS • Preventative Maintenance Program (.02 x 60,000 miles)	1,200	1,200
POTENTIAL SAVINGS PER VEHICLE	$ 4,200	$ 2,200
SAVINGS EXTENDED TO PASSENGER FLEET OF 600 VEHICLES	$ 2,520,000	$ 1,320,000

*These estimates assume retirement of the vehicles at 60,000 miles and an average fleet size of 600 passenger vehicles.

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INTRODUCTION

The administration of automotive fleets has been the focus of increasing attention and management concern as the costs associated with their operation and acquisition has escalated. Operating costs have increased for eight of the past ten years, only recently starting to level off as the cost of fuel has stabilized. Increased costs of acquisition have accompanied increased operating costs and future price increases appear likely.

Nationwide, fleet managers have reacted by continually downsizing their fleets to the extent that compacts now comprise over 70%[1] of the average fleet. New Hampshire has followed suit with the adoption of a policy that mandates the purchase of " sub-compacts unless there is a clear and convincing need to replace . . . with some other type of vehicle."[2] Never has the old adage "a penny saved" meant so much. That penny applied to a fleet size of 600 vehicles averaging 14,000 miles per year translates into savings of $84,000 a year.

Fleet management in todays environment must deal with "staggered vehicle introduction dates, high and fluctuating (interest) rates, an array of models from which to select, an uncertain resale market, rising operating costs and the choices of owning, leasing or just reimbursing drivers for business use of their personal vehicle."[3] With these choices in mind fleet administration has come to be recognized and "respected for the contributions that professional, sophisticated management can make to the bottom line."[4] To quote one administrator, "There are no simple solutions in the business of fleet administration - only intelligent choices".[5]

As an inspiration to meet the challenge we are facing in State government towards greater efficiency in fleet management, the following case is presented for your consideration. . . A fortune 100 company with a sterling reputation in fleet management has taken a fleet which has grown from 700 vehicles to 12,000 vehicles, servicing 100 field locations, with a total annual operating budget of $40 million, a capital budget of $60 million, a staff of <u>six</u> people and turned it into a profit center of $300 <u>per</u> vehicle as the vehicles are retired. . .[6] Proof positive - fleets can be managed and managed effectively!

SCOPE OF REVIEW

This review is limited to an analysis of general purpose passenger vehicles that are operated in the State of New Hampshire. It specifically excludes law enforcement vehicles, vans and pick-up trucks. It also excludes the vehicles that are located at the University of New Hampshire, Keene State College, Plymouth State College and the Fish and Game Commission. These locations account for approximately 500 passenger vehicles. Our review encompasses the remaining passenger fleet which numbered approximately 600 vehicles at the end of fiscal year 1984.

Our primary objective in undertaking this review of the policies and practices governing the use of motor vehicles was to ascertain whether the fleet is acquired, maintained, and distributed in the most efficient and least costly manner, in conjunction with private mileage reimbursement policies.

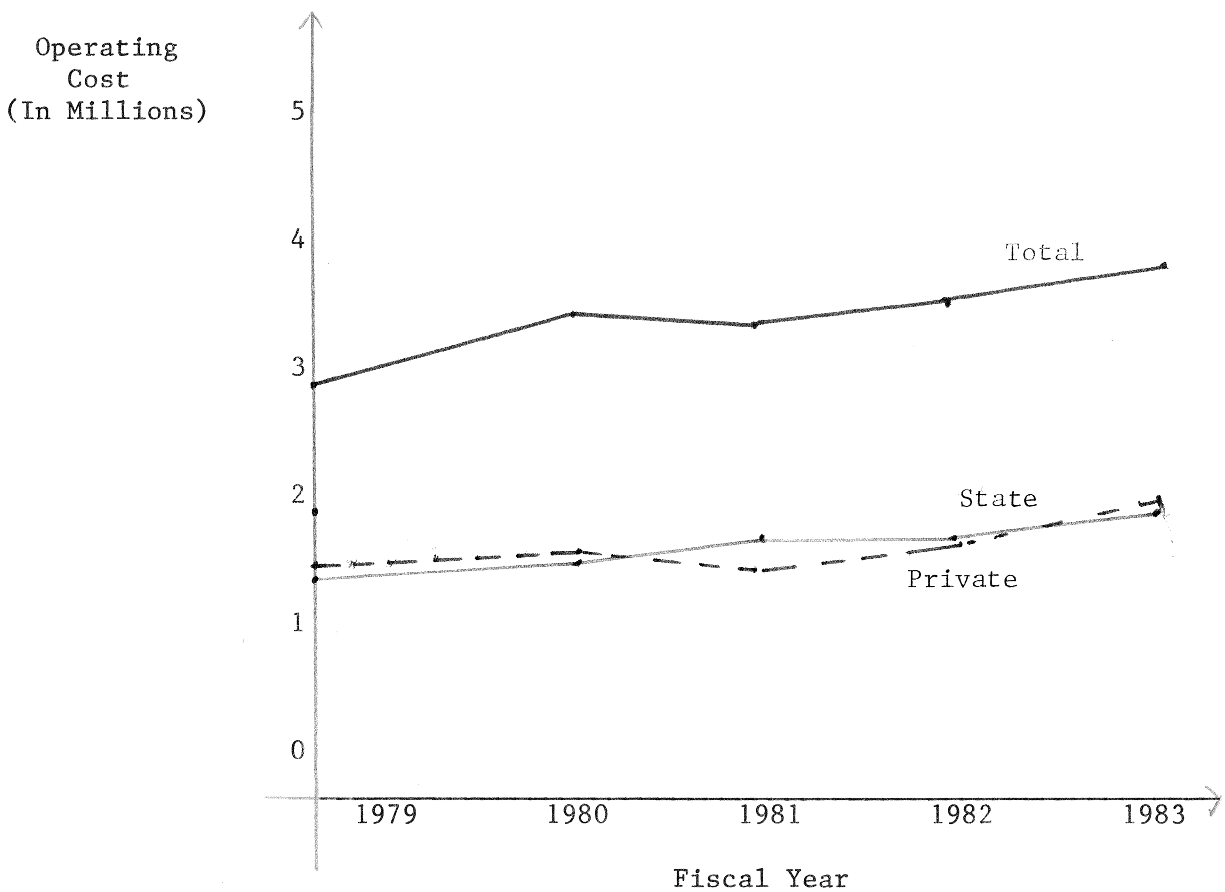
We have made inquires concerning fleet operations in other states, researched published and unpublished materials, and interviewed various individuals both in state government and the private sector. We analyzed historical cost data for passenger travel incurred on State business; both for State owned vehicles and privately owned reimbursements. Our analysis has led us to conclude that a centralized interagency motor pool could lead to substantial cost savings for the State. Given that conclusion we explored the advantages and disadvantages of establishing such a function, the needs and requirements for maintaining that function, and possible financing alternatives yet to be explored and/or employed by the State. Our report and recommendations follow.

HISTORICAL COST ANALYSIS

This report has been prepared in order to provide a framework from which future policy decisions and investments related to passenger travel can be analyzed. The State of New Hampshire has been faced with increasing costs associated with employee travel expense. These costs are incurred through the purchase of passenger vehicles, the operation and maintenance of the State fleet and reimbursement for privately owned vehicles used on State business. The cost related to the mix of State ownership and private mileage reimbursement since 1979 is reflected in Exhibit 1.

EXHIBIT 1

SUMMARY OF VEHICLE OPERATING COST
1979 - 1983



- - - - - - - - - Private Reimbursement
——————— State owned vehicles

Rates for private mileage reimbursement have increased over the years as reported in Exhibit 2.

EXHIBIT 2

SUMMARY OF PRIVATE MILEAGE REIMBURSEMENT
1979 - 1983

Fiscal Year	Reimbursement Rate	Private Mileage Reimbursement Dollars	Number of Miles Travelled
1979	.15	$ 1,477,084	9,847,227
1980	.17	1,670,994	9,829,376
1981	.17	1,484,717	8,733,629
1982	.23	1,749,008	7,604,383
1983	.25	1,977,788	7,911,152

BREAKEVEN POINT

Up until March 1984, the State has followed a general policy that sets 12,000 miles as the point where the State breaks even between the cost of ownership versus reimbursement for the use of private vehicles. The 12,000 mile limitation has not been strictly enforced and we have found several instances where individuals are receiving reimbursement for mileage well in excess of 12,000 miles. Conversely, many agencies have vehicles assigned to them that do not meet the 12,000 annual mileage accrual. This occurred in over 20% of the fleet during fiscal year 1983. These vehicles are underutilized and could be more effectively used elsewhere. We further submit that a closer approximation of the true breakeven point is 9,868 miles based on the following assumptions:

AVERAGE PURCHASE PRICE	= \$7,500
USEFUL LIFE	= 5 years
AVERAGE OPERATING COST	= \$.098/mile
PRIVATE MILE REIMBURSEMENT RATE	= \$.250/mile

$$\text{BREAKEVEN} = \frac{\text{Fixed cost} + \overset{\text{Annual}}{\text{Operating cost}}}{\text{Reimbursement Rate}}$$

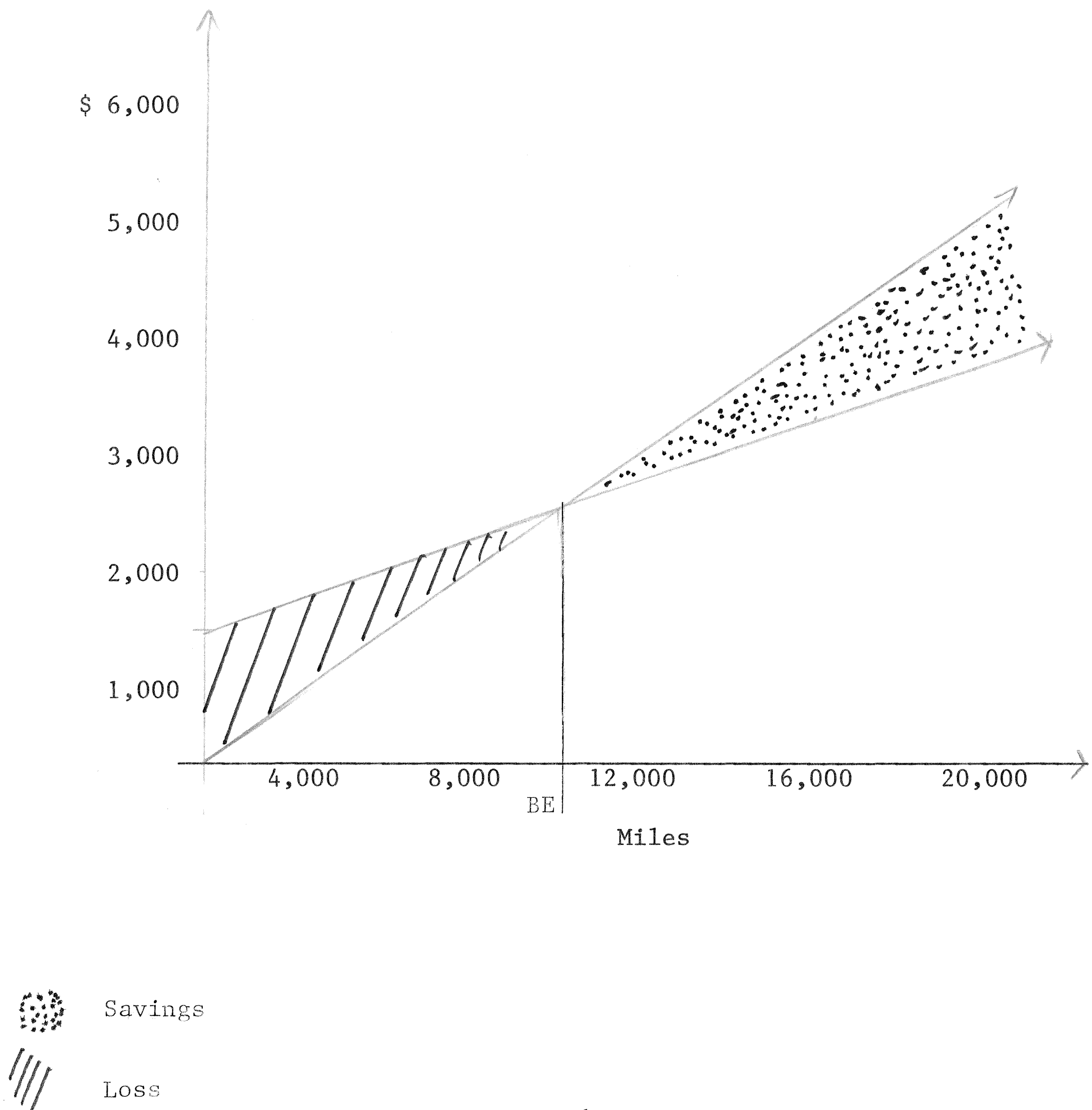
$$.25n = 1500 + .098n$$

$$n = 9868$$

The Breakeven occurs when private reimbursement x annual miles driven = depreciation + (operating cost x annual miles driven). (Exhibit 3)

EXHIBIT 3

BREAKEVEN ANALYSIS



OPERATING COSTS

Through an analysis of reported operating costs and capital expenditures, we have determined that it costs the State an average of 13.5 cents per mile to own and operate a fleet vehicle. The components of this cost are displayed in Exhibit 4. Our calculations were compiled from data that was reported to Administration and Control in fiscal year 1983. It has been stratified by model year. Operating costs increase directly with the age of the vehicles evidenced by the results of our analysis and presented in Exhibit 5. We estimate that in fiscal year 1983 alone, it cost the State approximately $100,000 more to operate vehicles that predate the 1980 model year than it would cost to travel the same number of miles in newer vehicles.

If the average operating costs of 13.5¢ per mile is compared with the private mileage reimbursement rate of 25¢ per mile it is evident that a policy that encourages the use of fleet vehicles would generate substantial savings for the State of New Hampshire. If just one half of the private mileage that was travelled in fiscal year 1983 could be eliminated through the use of fleet vehicles, the State would realize a net savings of $350,000 after accounting for all costs associated with State ownership.

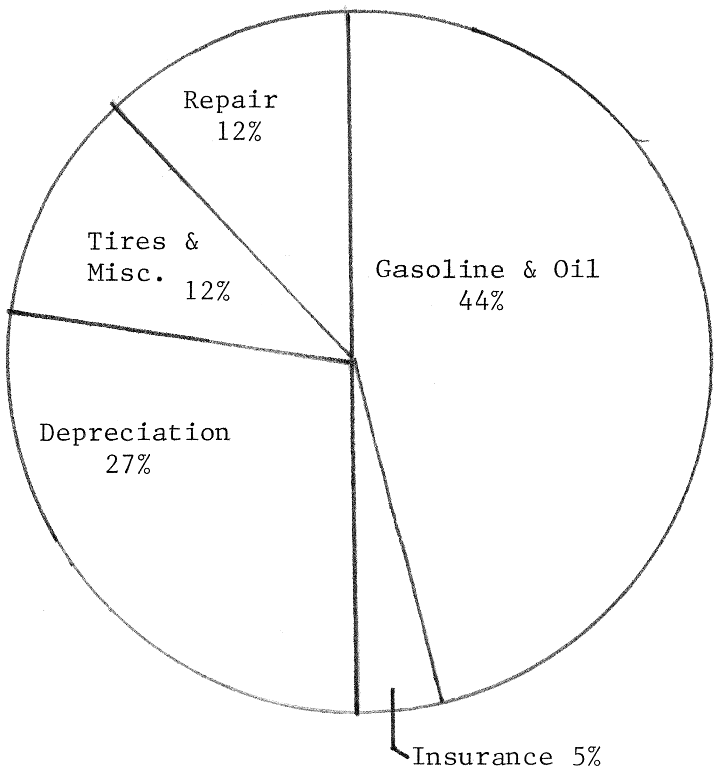
These savings could most effectively be realized through the introduction of a centralized interagency motor pool with the authority to exercise control over the permanent assignment of State vehicles, a daily trip pool and the use of private vehicles. A central fleet has been successful in a number of other states and municipalities. We have reviewed several of their operations and have incorporated many of the practices which contribute to their success.

To summarize, New Hampshire is faced with inefficient use of its passenger fleet, as evidenced by underutilization of its existing fleet, compounded by the high level of private reimbursement. In addition, recurrent delays in the replacement of fleet vehicles has resulted in an inferior and rapidly deteriorating fleet as illustrated in the fleet profile. (Exhibit 6) This condition can be remedied through judicious use of the limited financial resources that are available and serious consideration of alternatives to current practices and policies.

The remainder of this report is devoted to a discussion of the advantages, disadvantages and operations of a centralized interagency motor pool. The report concludes with a discussion of alternative financing options focusing on the increased use of lease financing by the public sector.

EXHIBIT 4

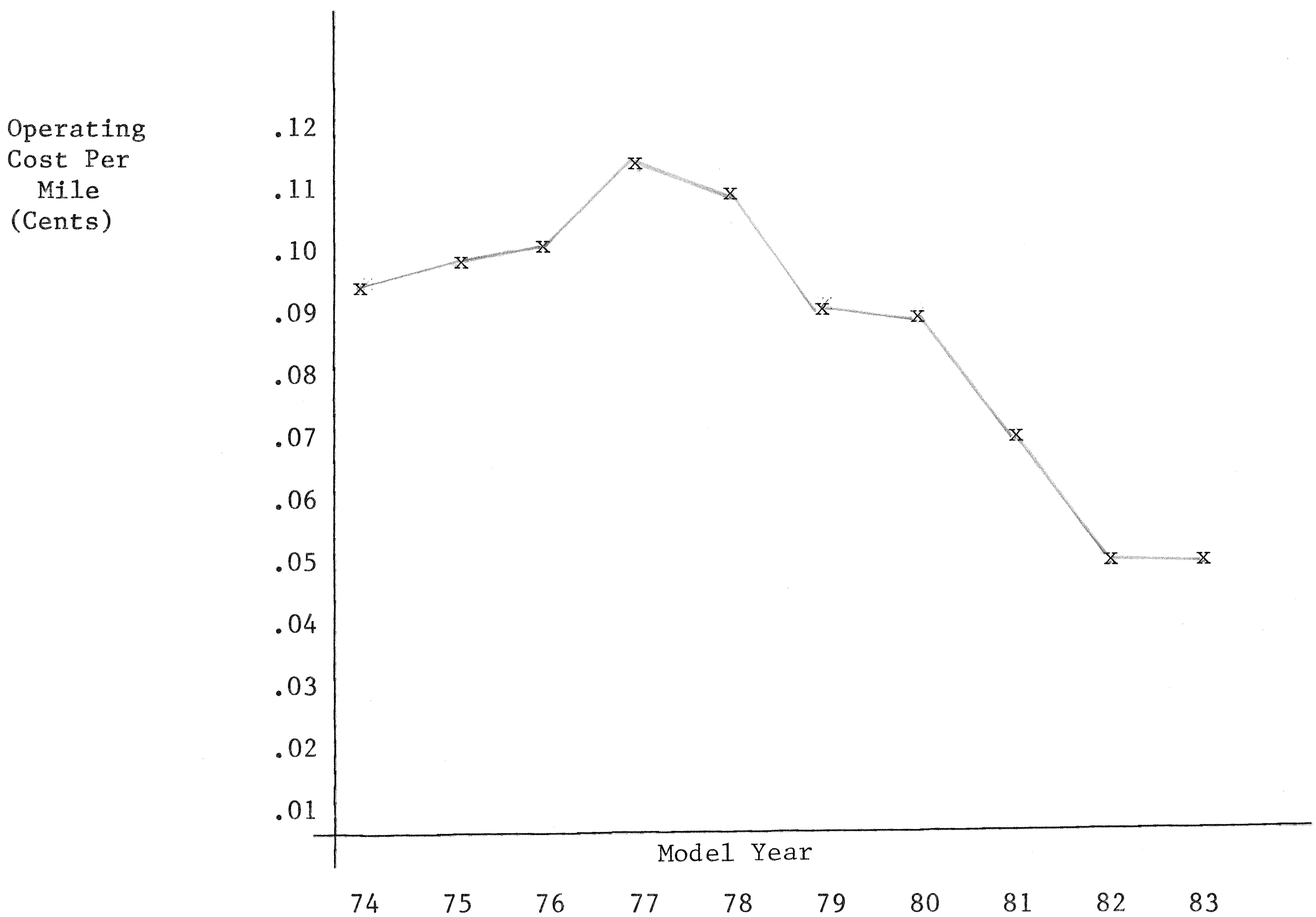
COST COMPONENTS OF STATE OWNERSHIP



Average Cost Components Per Mile

Gasoline	.058
Oil	.001
Tires & Misc.	.016
Repairs	.016
Insurance	.007
Total Operating Costs	.098
Average Depreciation Cost Per Mile	.037
TOTAL COST OF OWNERSHIP AND OPERATION	.135

OPERATING COSTS (CENTS PER MILE) STRATIFIED BY MODEL YEAR
FOR THE YEAR ENDING JUNE 30, 1983



Operating Cost Per Mile

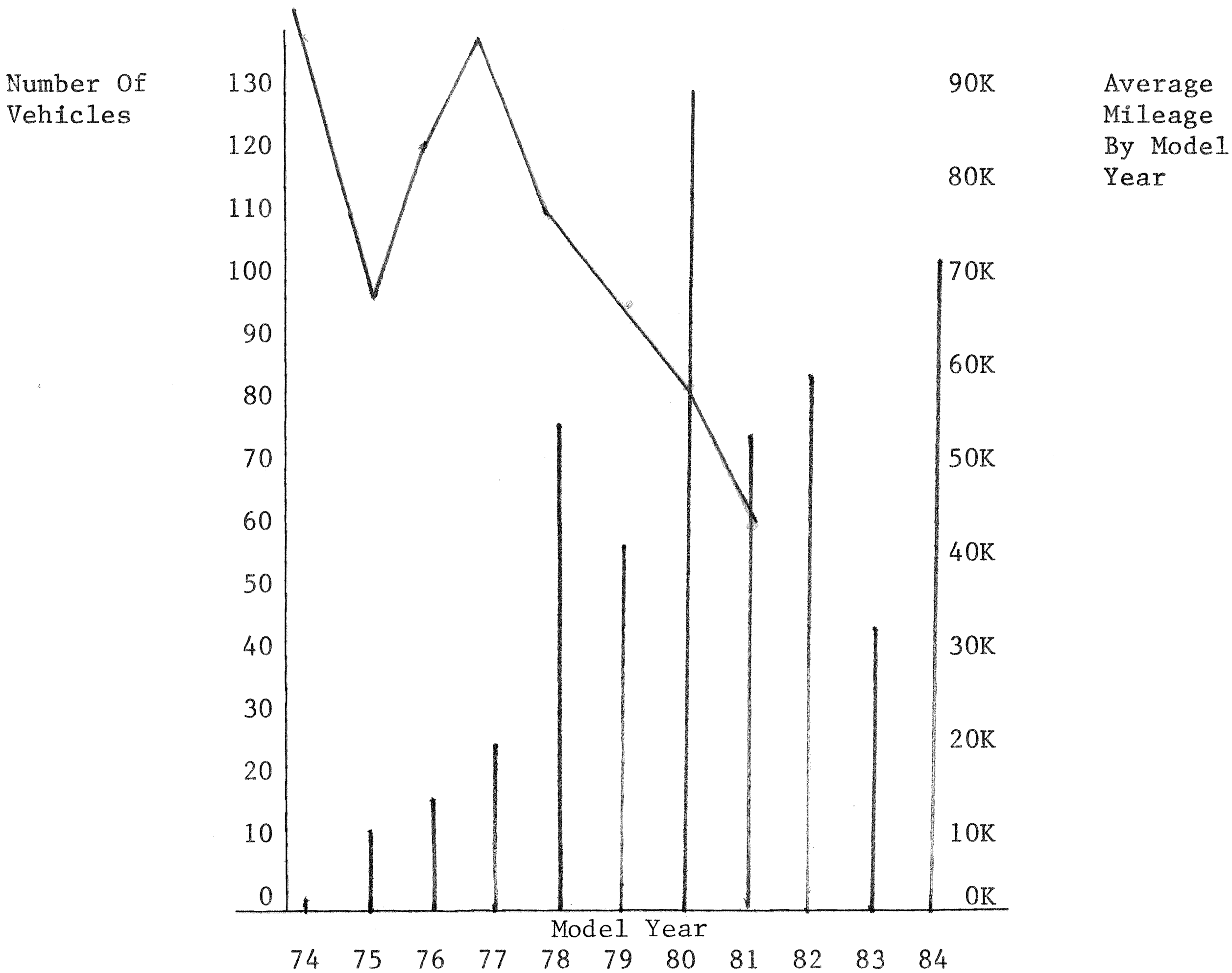
.093	.099	.103	.114	.110	.090	.088	.071	.050	.050

EXHIBIT 6

FLEET PROFILE

NUMBER OF PASSENGER VEHICLES BY MODEL YEAR (BAR GRAPH)

AVERAGE MILEAGE BY MODEL YEAR (LINE GRAPH)



Number Of Vehicles	1	10	16	25	78	53	126	70	80	39	104	Total 602
Average Mileage (Thousands)	93	68	83	90	76	66	57	40	N/A	N/A	N/A	

CENTRALIZED INTERAGENCY FLEET OWNERSHIP AND MANAGEMENT

ADVANTAGES

The advantages of a centralized motor pool are numerous and varied. Overall, they tend to provide greater flexibility and more uniform utilization of the fleet. This results in the ability to reduce fleet size by at least ten percent (10%).[7] Effective trip pools can significantly reduce the number of permanent assignments, a major cause of "overfleet". Also:

Improved Safety - Fleet vehicles can be regularly maintained on a fixed timetable,

Improved User Flexibility - The central pool can facilitate immediate access, immediate replacement and immediate cost termination according to the users need.

Self Sustained Cost Center - Rental rates can be charged to the agencies that use the vehicles at a level which will sustain continued operations of the fleet.

Elimination of Commuting Mileage - Our current reporting requirements are not sufficient to extract the exact level of commuting mileage that currently exists in our fleet. The requirement that the traveling employee pick-up and drop-off a fleet vehicle at a central location will eliminate commuting expense, which we estimate to be between $70,000 - $140,000 per year. (10% to 20% of annual operating costs)[8]

The State will ultimately benefit by the introduction of professional fleet management and improved fleet cost accounting control.

DISADVANTAGES

Perhaps the greatest disadvantage to a central fleet pool will be employee/user resistance that usually accompanies change. There is a very real economic impact to some State employees who have had the use of State vehicles for commuting purposes. The best means of overcoming this resistance is for fleet management to react in an efficient, responsive and flexible manner in order to accommodate the demands with which it will be confronted.

FLEET OPERATIONS

The current condition of State travel operations is one of decentralization, duplication, fragmentation and mismanagement. In part, this condition exists due to the fact that no one is assigned responsibility for the State owned fleet in its entirety. Secondly, the individuals that are charged with fleet management responsibilities, are often times done so in conjunction with other duties which take priority. As a result, a major cost center with accumulated costs of over $20 million since 1979 is essentially unmanaged on a statewide level. The following sections focus on six main areas associated with effective fleet management. They include a discussion of the role of a fleet administrator, the formation of an interagency trip pool, management information systems and cost control, fleet maintenance and vehicle procurement.

ROLE OF THE FLEET ADMINISTRATOR

Second only to the firm commitment and resolve of policy makers, a professional fleet administrator is vital to achieve efficient operations. The success of centralized operations rests primarily in his or her hands. The following job description is reprinted from the October 1980 issue of Dun's Business Month as a guide to describe the comprehensive nature and level of responsibility which we feel accompanies this position:[9]

Function: To develop, recommend and/or institute policies, procedures and controls which provide a framework for effective administration of the (company) fleet, its procurement, periodic replacement and economic operation. Also, administer the automobile tire program. This position requires a knowledge and understanding of basic technical aspects of automobile procurement, operations and disposition. The nature of the position and changing conditions place a premium on the qualities of initiative, flexibility and adaptability.

Recommendations to Management:

- On timing, type and number of vehicles to be procured,
- Manner of procurement after study of leasing vs. buying, and
- Use of alternate methods of vehicle disposal.

Within General Guidelines:

- Control expenditures against annual capital program for vehicle replacement,
- Initiate and modify comprehensive procedures and guidelines for headquarters and field units,
- Review dealer chargebacks to establish validity. Reject or negotiate where applicable,
- Select dealers in the issuance of bids and purchase orders,
- Review makes and model, performance and resale values as a basis for recommendation on future replacement,
- Initiate transfer and sale of surplus vehicles in a manner which minimizes non-operating expenses, and
- Determine whether vehicles involved in accidents should be repaired or disposed of as unsafe to drive.

Principal Accountabilities:

- Initial accountability, subject to overall management approval, of timing, type and number of vehicles to be procured and sold,
- Initiation of studies and recommendations with the objective of maximum vehicle performance and service while maintaining minimum operating expense.

CENTRALIZED INTERAGENCY TRIP POOL

Currently, State-owned motor vehicles are allocated to a specific agency or department for their exclusive use. Interagency use of motor vehicles does not occur. A central dispatch location where assignments are made on a daily, weekly, or monthly basis would facilitate improved fleet management and usage. Employees traveling on official business would be required to pick-up and return the fleet vehicle to the central dispatch location.

An essential preliminary procedure in the formation of a central trip pool is the reevaluation of permanently assigned vehicles against predetermined criterion. The criterion should be narrowly defined to encourage pool usage and discourage permanent assignments, except when a permanent assignment is a decided advantage to both the individual and to the State. In addition, the use of private vehicles should be restricted unless prior approval by the fleet administrator has been granted. The use of private vehicles should not be permitted if a fleet vehicle is available. The cost savings generated by implementing the procedures mentioned above will be substantial since the cost to operate a State vehicle is 13.5 cents per mile as opposed to the private reimbursement rate of 25 cents per mile.

The size of the central trip pool required to fulfill the State's travel needs, which is currently provided by both State owned and private vehicles, must be continually evaluated as the central pool becomes functional. Careful scrutiny of existing assignments should result in a substantial number of State vehicles available for reassignment to the central pool. We anticipate the need for additional vehicles to cover the travel which is currently provided by private vehicles. This additional acquisition, however, will be to the State's economic advantage as previously discussed.

MANAGEMENT INFORMATION SYSTEMS AND COST ACCOUNTING CONTROL

The application of a management information system is crucial to the successful operation of a central fleet. Economic survival of the program is contingent on management's ability to make informed decisions based on accurate and timely information. Before the pool can become operational the following accounting systems will have to be established:

- Inventory control - vehicles and parts,
- Interagency billing system,
- Revolving working capital accounts,
- Maintenance tracking system,
- User and trip logs, and
- Shop operations accounting - repair orders and purchases.

MAINTENANCE

A preventive maintenance program should be initiated to maintain an acceptable level of fleet performance. Safety, dependability, economy and performance are directly related to a vehicle's maintenance program. Fleet management should be charged with the responsibility of maintaining State owned vehicles to ensure that the maintenance schedule is reasonable and adhered to.

Maintenance should be performed whenever practical at State operated garages at regular intervals. Currently, maintenance records are not maintained and in many cases, no maintenance schedules exist for State owned vehicles. Improved maintenance will result in a higher resale value for all State vehicles. The State realized $38,650 in salvage value on 60 vehicles in fiscal year 1983, an average of $644 per vehicle. A stringent maintenance program should increase this extremely low resale value, to somewhere between $1,000 - $1,200 per vehicle. A recent study by the National Association of Fleet Administrators points out that a well maintained vehicle can result in the reduction of overall expenses of over $3,000 per vehicle. Refer to Exhibit 7 for more details.

EXHIBIT 7

OPERATING COSTS -- WELL-MAINTAINED VS. NON-MAINTAINED[10]

	Well-Maintained		Non-Maintained	
Acquisition Cost	$ 10,000.		$ 10,000.	
Operating Costs (60,000 Miles)	$ 8,780.		$ 9,970.	
Tax & Ins. Reg.	1,600.		1,600.	
Fuel	5,100.	@ 8½$/mile	5,500.	@ .091¢/mile
Oil	300.		160.	
Tune-up	400.		100.	
Brakes	500.		750.	
Tires	500.		700.	
Transmission (transmission overhaul)	60.		800.	
Shocks (includes suspension work)	120.		240.	
Alignment	80.		60.	
Cleaning	120.		60.	
Total Cost	$ 18,780.		$ 19,970.*	
Resale Value	$ 7,000.		$ 5,000.	
Net Cost	$ 11,780.		$ 14,970.	
Difference			$ 3,190.	

Proper Maintenance Reduces Overall Cost of Vehicle
By Over $3,000. Per Vehicle.

Figures based on AAA, DOT, IRS studies and personal studies over the past three years. These figures are average and rounded off.

Figures do not include expenses of unusual nature such as accident or casualty loss.

*Cost may be increased by repairs required to restore vehicle to marketable condition ±$1,000.

VEHICLE PROCUREMENT

NEW VEHICLES PURCHASES

Three main options of vehicle procurement discussed below include the purchase of new vehicles, the purchase of used vehicles and leasing. The State currently purchases its motor vehicle fleet through a central purchasing agent located at the Division of Plant and Property Management. The purchase procedures include a competitive bid invitation once a year. Subsequently, purchases are made sporadically during the year at the request of State agencies. Purchases of new passenger vehicles have increased from approximately $421,931 in fiscal year 1981 to $766,845 in fiscal year 1984.

The implementation of a central trip pool would enable the State to purchase new vehicles in bulk from the manufacturer. This type of direct purchase can lead to a concession of $500 to $1,500 per vehicle. As a result we could expect to realize annual savings ranging from $60,000 to with the purchase of 120 vehicles up to $720,000 with the purchase of 600 vehicles.

USED VEHICLES

The purchase of used vehicles is a widely accepted procurement option which is usually done through a leasing company or rental agency. Leasing companies generally provide for a 12 month or 12,000 mile warranty and immediate delivery of their used vehicles. The cost of purchasing a used vehicle is usually discounted by at least $1,000 in comparison to a new car. The key element here is to compare the "life cycle cost" of new vehicles versus used vehicles.

LEASING

The third option related to vehicle procurement is discussed in the next section entitled the LEASE PURCHASE DECISION.

THE LEASE-PURCHASE DECISION

The decision to lease versus purchase or lease versus borrow should be separate and distinct from the investment decision. The justification to acquire the asset or to make the investment must be favorable before it makes sense to evaluate the best means to finance the investment. To illustrate this concept, the following diagram applies:

Increasingly, state and local governments have turned to leasing as a viable means to finance the assets which are necessary to provide public service. The growth of leasing by the public sector is explained by a variety of factors which include:

- The ability to acquire assets and spread the cost over several years, generally coinciding with useful life,
- Lease purchase is an economical intermediate-term financing tool for assets that have useful lives which are too short to justify bond financing yet are too expensive to fund in any given fiscal year.
- Under IRS Code Section 103(a)(1) it is possible for leasing companies to offer financing at reduced rates due to the tax free status of lease payments.
- Leasing may be attractive when compared to high interest rates in the bond market or the refusal of the voters to approve new bond issues.
- Policy makers may opt to limit capital expenditures to major capital improvements or to preserve the funds for investment purposes.
- With the acquisition of new equipment, maintenance costs are reduced on aging equipment.

TYPES OF LEASES

There are a number of different leasing arrangements and types of leases that are available and commonly used. They range from a simple true lease to complicated lease structures that involve fractional interests that are marketed to multiple investors. The reader is referred to Financial Accounting Standards Board Statement No.13, National Council on Governmental Accounting No.5 and the applicable IRS regulations for additional information and classification of leases.

TAX-EXEMPT LEASE AGREEMENTS

Because of existing Federal tax regulations, the type of lease which has been widely used in the public sector is the lease-purchase agreement or tax-exempt lease. The term tax-exempt lease comes from the tax-exempt treatment of the interest portion of the lease payment that is granted to lessors by the Federal government under certain conditions when the lessee is a "state, a territory or possession of the United States; or an 'on behalf of' issuer of any state or local governmental unit".[11] Tax exempt treatment of the interest payment to the lessor enables the lessor to offer lower lease terms to governmental units than it can to commercial lessees. The conditions which must exist to qualify for tax exempt treatment under the IRS Code are as follows:

- The lease-purchase agreement must be an obligation issued pursuant to the issuer's borrowing power.

- The interest portion of the lease-purchase payment must be identified.

- The agreement must be structured as a conditional sale or installment purchase as opposed to a true lease.

There are several reasons why the State of New Hampshire might consider a lease-purchase agreement as a means to finance a portion of its motor vehicle fleet. Since the average useful life of a vehicle is likely to be between five and six years, bond financing may not be an appropriate alternative both from the standpoint of the term of the bond and the type of asset being financed. Like many other governmental entities, competing demands for limited financial resources has resulted in a backlog of capital requests for motor vehicles. As reflected in Exhibit 6, one half of the current fleet exceeds the 60,000 mile guideline at which point a vehicle can be replaced according to the New Hampshire Code of Administrative Rules ADM 305.06(B) (Appendix A). Approximately 300 vehicles predate the 1981 model year. They have accumulated an average of 76,000 miles per vehicle. According to our calculations it costs the State almost twenty-five percent more to operate these vehicles. Replacement of passenger vehicles has averaged 78 vehicles per year over over the past four years. This rate of replacement is not sufficient to support a reliable central fleet operations. We recommend that consideration be given to an accelerated replacement program to such an extent that effective central fleet operations results. We have obtained lease rates for three separate lease-purchase programs and have performed a lease purchase analysis in each case.

COST CALCULATIONS: METHODS

We have evaluated the lease purchase decision using two different methodologies. In the first instance we have converted the up front purchase price of the asset into a stream of uniform annual costs over the useful life of the asset. This is referred to as the equivalent annual worth method.[12] In the second instance we have converted the future lease payments to their present value[13] for comparison to the purchase price. Each method points to the lease-purchase agreement as the least costly alternative. To explain why a leasing arrangement can be less costly than an outright purchase it is necessary to explain the fundamentals of the time value of money. Generally speaking, most people do not value the same amount of money paid at different points in time equally. The time value of money is explained by three basic factors:

1) The element of risk or uncertainty increases as events move further into the future. People demand compensation in return for the acceptance of increased uncertainty in the form of interest payments.

2) People tend to value immediate consumption more so than future consumption. Again people expect to be compensated for the foregone use of their money today.

3) Lastly, in inflationary periods, inflation diminishes the purchasing power of todays money. The expectation of inflation drives up interest rates which has a significant impact on the future value of money relative to the value of money today.

These three factors all explain why money paid out today is worth more than money paid in the future. Since a lease-purchase agreement involves a series of payments in the future, in return for the use of assets today, one must equalize the difference in the timing of payments to draw proper comparisons. This is accomplished by applying factors which discount or compound cash flows and converts them to comparable bases of value. The resultant numbers can then be compared to determine which option represents the lowest cost.

THE IMPORTANCE OF ASSUMPTIONS

In every instance when one is converting cash flows for comparison, assumptions play an integral part in the analysis. Care should be taken to use reasonable estimates. Sensitivity analysis should be performed on key assumptions to determine which assumptions have the greatest impact on results. We have used the following assumptions:

Expected useful life:	5 years
Lease term:	5 years
Interest rate:	10,12,13 and 14%: The interest rate that most closely reflects the rate of return that could be earned on an amount equal to the purchase price of the asset over its useful life, is the rate that generates the most accurate comparison.

The specific lease rates, terms and purchase price which we have used in our analysis where obtained from a leader in lease financing nationwide. Bear in mind, that these analyses are presented simply to illustrate how a lease versus purchase decision is analyzed. The actual purchase price, concessions, interest rates and lease rates would be fixed at the time the lease/purchase agreement is signed. Of course, all elements of the agreement are negotiable. Bids should be solicited from various vendors before drawing to a final conclusion.

Our results are summarized in the tables below:

SUMMARY OF AVERAGE PURCHASE PRICE PER VEHICLE

Replacement Program (# Of Vehicles)	Fiscal Year 1984 Actual Average	Lease Purchase Terms Estimated Average Purchase Price: Without Concessions	With Concessions
120	$ 7,374*	$ 6,900	$ 6,400
300	N/A	6,900	5,900
600[14]	N/A	6,900	5,713

*Actual average purchase price for vehicles purchased in fiscal year 1984 (104 vehicles).

LEASE ALTERNATIVE
SUMMARY OF SAVINGS

MONTHLY SAVINGS
(REFERENCE EXHIBIT 8)

Replacement Program

Number of Vehicles	At Assumed Interest Rates Of			
	10%	12%	13%	14%
Without Manufacturers Concessions				
120	$ 440	$ 1,281	$ 1,702	$ 2,129
300	1,293	3,395	4,448	5,515
With Manufacturers Concessions				
120	$ 408	$ 1,188	$ 1,579	$ 1,975
300	1,105	2,903	3,804	4,715

TOTAL SAVINGS OVER USEFUL LIFE
(REFERENCE EXHIBIT 9)

	10%	12%	13%	14%
Without Manufacturers Concessions				
120	$ 14,720	$ 49,902	$ 66,668	$ 82,911
300	45,934	133,494	175,221	215,646
600	95,528	238,544	306,750	373,165
With Manufacturers Concessions				
120	$ 13,662	$ 46,294	$ 61,845	$ 76,911
300	39,270	114,140	149,820	184,386
600	87,704	205,023	261,367	316,233

MOTOR VEHICLES REPLACEMENT PROGRAMS
EQUIVALENT MONTHLY WORTH ANALYSIS

	Interest Factors			
Replacement Program Without Manufactures Concessions	10% .0212283	12% .022244	13% .0227529	14% .023268
120 Vehicles				
Monthly cost to purchase $828,000 x Factor	17,577	18,418	18,839	19,266
Monthly cost to lease	17,137	17,137	17,137	17,137
Expected monthly savings to lease	440	1,281	1,702	2,129
300 Vehicles				
Monthly cost to purchase $2,070,000 x Factor	43,943	46,045	47,098	48,165
Monthly cost to lease	42,650	42,650	42,650	42,650
Expected monthly savings to lease	1,293	3,395	4,448	5,515
Replacement Program With Manufactures Concessions				
120 Vehicles				
Monthly cost to purchase $768,000 x Factor	16,303	17,083	17,474	17,870
Monthly cost to lease	15,895	15,895	15,895	15,895
Expected monthly savings to lease	408	1,188	1,579	1,975
300 Vehicles				
Monthly cost to purchase $1,770,000 x Factor	37,574	39,372	40,273	41,184
Monthly cost to lease	36,469	36,469	36,469	36,469
Expected monthly savings to lease	1,105	2,903	3,804	4,715

EXHIBIT 9

MOTOR VEHICLES REPLACEMENT PROGRAMS -- PRESENT VALUE ANALYSIS

	Present Value of Lease Payments at Interest Rates of			
Replacement Program Without Manufactures Concessions	10%	12%	13%	14%
120 Vehicles				
Capital Investment	$ 828,000	$ 828,000	$ 828,000	$ 828,000
40 Chevettes 40 Cavaliers 40 Celebrities				
Present value lease payments ($17,137 x 60 months)	813,280	778,098	761,332	745,089
Savings to lease	$ 14,720	$ 49,902	$ 66,668	$ 82,911
300 Vehicles				
Capital Investment	$ 2,070,000	$ 2,070,000	$ 2,070,000	$ 2,070,000
100 Chevettes 100 Cavaliers 100 Celebrities				
Present value lease payments ($42,650 x 60 months)	2,024,066	1,936,506	1,894,779	1,854,354
Savings to lease	$ 45,934	$ 133,494	$ 175,221	$ 215,646
600 Vehicles				
Capital Investment	$ 4,140,000	$ 4,140,000	$ 4,140,000	$ 4,140,000
200 Chevettes 200 Cavaliers 200 Celebrities				
Lease Terms				
$43,377 x 36 months	1,355,509	1,319,033	1,301,329	1,283,970
$33,899 x 48 months	1,347,713	1,300,152	1,277,280	1,254,991
$28,241 x 60 months	1,340,250	1,282,271	1,254,641	1,227,874
Present value of lease payments	4,043,472	3,901,456	3,833,250	3,766,835
Savings to lease	$ 96,528	$ 238,544	$ 306,750	$ 373,165

MOTOR VEHICLES REPLACEMENT PROGRAMS -- PRESENT VALUE ANALYSIS

Replacement Program With Manufactures Concessions	Present Value of Lease Payment at Interest Rates of 10%	12%	13%	14%
120 Vehicles				
Capital Investment	$ 768,000	$ 768,000	$ 768,000	$ 768,000
40 Chevettes				
40 Cavaliers				
40 Celebrities				
Present value lease payments ($15,895 x 60 months)	754,338	721,706	706,155	691,089
Savings to lease	$ 13,662	$ 46,294	$ 61,845	$ 76,911
300 Vehicles				
Capital Investment	$ 1,770,000	$ 1,770,000	$ 1,770,000	$ 1,770,000
100 Chevettes				
100 Cavaliers				
100 Celebrities				
Present value lease payments ($36,469 x 60 months)	1,730,730	1,655,860	1,620,180	1,585,614
Savings to lease	$ 39,270	$ 114,140	$ 149,820	$ 184,386
600 Vehicles				
Capital Investment	$ 3,428,000	$ 3,428,000	$ 3,428,000	$ 3,428,000
200 Chevettes				
200 Cavaliers				
200 Celebrities				
Lease Terms				
$35,833 x 36 months	1,119,763	1,089,630	1,075,006	1,060,666
$28,004 x 48 months	1,113,347	1,074,057	1,055,163	1,036,750
$73,330 x 60 months	1,107,186	1,059,290	1,036,464	1,014,351
Present value lease payments	3,340,296	3,222,977	3,166,633	3,111,767
Savings to lease	$ 87,704	$ 205,023	$ 261,367	$ 316,233

FOOTNOTES

[1]"1983 National Association of Fleet Administration Survey Results", NAFA Bulletin (April 1984), 8.

[2]1981 Operating Budget, N.H. Laws of 1981, Chapter 568, 143.

[3]Special Report, "Fleet Administrators Standing Firm", Dun's Business Month (October 1982) 111-112.

[4]Ibid.

[5]Robert G. Edwards, Public Automotive Fleet Administration. (San Jose, CA: CFN Publishing 1983), Preface.

[6]B.W., "Case in Point: Xerox Fleet", Dun's Business Month (October 1982), 126-127.

[7]Edward, op.cit., p. 65.

[8]Ibid., p. 82.

[9]Special Report, op.cit., p. 112.

[10]Joe Alacchi, NAFA Bulletin (April 1984), 44.

[11]John Vogt, et.al., A Guide to Municipal Leasing, (Chicago: Municipal Finance Officers Association of the United States and Canada, April 1983) p. 52.

[12]The Equivalent Annual Worth Method uses a Uniform Series Capital Recovery Formula to convert a one-time capital outlay in todays money into an equivalent series of uniform annual cost over the assets' useful life . We have applied the same concept to arrive at the equivalent monthly worth (Exhibit 8). The formula is:

$$A = P\left[\frac{i(1 + i)^n}{(1 + i)^n - 1}\right]$$

where: A = Periodic cost
P = Purchase price today
N = Useful life
i = Interest rate for each future period over N periods

[13]The Present Value Method converts a series of future lease payments into their present value using the Uniform Series Present Worth Formula:

$$P = A \left[\frac{(1 + i)^n - 1}{i(1 = i)^n} \right]$$

where: P = Purchase price today
A = Periodic lease payment
N = Lease term
i = Interest rate for each future period over N periods

[14]The Equivalent Monthly Worth Analysis is not presented for the replacement program of 600 vehicles since the lease term is not uniform for all 600 vehicles. The lease has been structured to make payments over terms of 3, 4 and 5 years to allow for the introduction of a staggered retirement schedule.

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PART Adm 305 STATE-OWNED MOTOR VEHICLES

Adm 305.01 Operation. Only properly authorized, licensed operators shall be allowed to operate state-owned motor vehicles. Employees licensed in another state shall be considered properly licensed as long as said license is considered valid by the department of safety.

Source. #2235, eff 12-30-82

Adm 305.02 Use.

(a) Governing policy. Any classified employee of the state of New Hampshire who uses or authorized the use of any state-owned vehicle, or of any motorized leased vehicle for other than official purposes, shall be subject to penalties of applicable sections of personnel rules.

29 Adm 3-84

(b) Authorization for use. Each state department head shall act as transportation control officer or designate one or more officials of his department to act in this capacity for the purpose of (1) authorizing, and (2) enforcing the rules and regulations pertaining to, the use of state-owned vehicles. The department of administrative services shall maintain a listing of all officers so designated.

(c) Use classification

(1) General use assignment. The transportation control officer shall ascertain that all state employees routinely using state-owned vehicles are fully qualified, licensed, and authorized to operate said vehicles. Occasional overnight or weekend use of a vehicle is permitted <u>if</u> determined to be in the best interest of the state.

(2) Home or location assignment. The transportation control officer shall approve or disapprove requests for assignment of state-owned vehicles to employees whose headquarters are designated permanently as their home or location assignment. Such requests shall be in writing showing approval of the division head and shall describe fully the need for an official headquarters other than the department office including the frequency in which travel is required to the department office. Requests, showing action by the transportation control officer, shall be kept on file.

(3) Home or location assignment - temporary. Temporary home or location assignments shall meet the same requirements as indicated in subparagraph (2) above, except duration of need shall be indicated in request.

(4) Permanent assignment.

a. The department head shall forward to governor and council for approval, with the transportation control officer's recommendations, all requests for assignment of state-owned vehicles on a twenty-four hour, seven day a week basis. Requests for this type use authorization shall show approval by the department head and include:

1. Estimated frequency of use outside regular working hours.

2. Examples of required use outside regular working hours.

3. Employee's home location.

4. Round-trip distance between employee's home and official head quarters.

5. Estimated annual cost of operation of state-owned vehicle for routine travel between employee's residence and official headquarters.

6. Reasons why employee should not be reimbursed for use of own vehicle when duties require travel outside of regular working hours in lieu of permanent assignment of a state-owned vehicle.

b. Law enforcement employees with the exception of staff officials, shall be exempt from this requirement and may be assigned a state vehicle for 24 hour, 7 day a week use.

(d) Use control. To insure proper use of state-owned motor vehicles, the duties of the transportation control officer shall:

(1) Maintain a record of all state employees in the department assigned use of a state vehicle including plate number of vehicle and category of use.

(2) Make such other rules and regulations for employees of his department as may be deemed necessary for adequate control.

(3) Initiate disciplinary action when aware of improper use of a state-owned vehicle by any state employee or, if by a state official, advises the appointing authority for appropriate action.

Source. #2235, eff 12-30-82

Adm 305.03 Report of Operations. (Form MV-2) (See Appendix A)

(a) This form, provided in booklet form with tear-out pages shall remain in the vehicle concerned at all times. It shall be the responsibility of the operator to completely fill in any costs incurred while operating the vehicle. On the first working day of each month the page covering expenditure for the previous month shall be torn out and forwarded to the business office of the department concerned, for summation and posting to annual records form number MV-3.

(b) The steps for filling out this form are as follows:

(1) Number - Record here the number of the vehicle registration plate.

(2) Make - Record here the make of the vehicle concerned.

(3) Type - Enter here the type of vehicle: i.e. sedan, pickup, 2T truck.

(4) Year - Enter here the year of manufacture.

(5) Date - The numbers in this column are printed. Enter information necessary opposite appropriate date. Enter month in space above printed word "date".

(6) Speedometer Reading - Enter here the speedometer reading at time of entry.

(7) Gasoline - Gallons Enter here the number of gallons of gasoline purchased to the nearest tenth of a gallon.

(8) Gasoline Cost - Enter here the cost of gasoline purchased.

(9) Oil - Quarts - Enter here the number of quarts of oil purchased.

(10) Enter here the cost of oil purchased.

(11) Enter here all lubrication costs including grease jobs, gear oil, etc.

(12) Enter here the cost of all vehicle repairs including labor.

(13) Enter here any other costs not covered elsewhere such as tire repairs, or purchases, battery purchases, wash jobs, etc.

(14) Enter here brief descriptive remarks necessary to identify the recorded expenditure such as identification of a wash job under (13) or carburetor repairs under column (12).

(15) Show here the mileage at the beginning of the month. This should be same figure as the ending mileage shown for preceding month.

(16) Show here the mileage at the end of the month.

(17) Enter here the totals of all columns. In case of speedometer reading enter here the difference between ending mileage and beginning mileage.

<u>Source.</u> #2235, eff 12-30-82

Adm 305.04 Life History of Vehicle. Form MV-3 (See Appendix A)

(a) This form shall be used by the department's business office to keep a life history on all department vehicles. It is posted to monthly from operator's record number MV-2.

(b) The steps in filling out this form are as follows:

(1) Enter here the vehicle number.

(2) Enter here the inventory equipment number assigned to this vehicle.

(2) Enter here the fiscal year covered by the form in use.

(3) Enter here type of vehicle such as passenger car, truck, tractor, etc.

(4) Enter here the make of the vehicle.

(5) Enter here the year of vehicles manufacture.

(6) Enter here the color of the vehicle.

(7) Enter here the model such as 2-door sedan, 1/2 ton pickup, etc.

(8) Enter here the department operating the vehicle.

(9) Enter here the agency or division to which assigned.

(10) Enter here either the engine or makers serial number or both if vehicle has both.

(11) Enter here the number of the state registration plate assigned the vehicle.

(12) Enter here the date of registration of vehicle.

(13) Printed list of months.

(14) Enter here the miles operated for each month.

(15) to (21) Enter here the information found in totals under form number MV-2 by direct posting.

(22) Enter here any pertinent remarks concerning the vehicle concerned.

(23) At end of current fiscal year total all columns to obtain annual.

(24) Post totals from previous years to these items at beginning of current fiscal year.

(25) Show here and post to new record the cumulative life history totals.

Source. #2235, eff 12-30-82

Adm 305.05 Identification of State-owned Motor Vehicles.

(a) All state-owned motor vehicles shall be identified in standard, prescribed manner plainly visible at all times.

(b) All vehicles shall be identified as to the department responsible for their operation as well as the state of New Hampshire by use of the official state identification stick-ons including the name of the department on the right and left doors of each vehicle. (Such stick-ons are available in the bureau of purchase and property)

(c) Prescribed official state plates of a perpetual type shall be used on all state-owned motor vehicles. Such plates shall be approved and assigned by the director of motor vehicles.

Source. #2235, eff 12-30-82

Adm 305.06 Purchase Procedures for State Passenger Carrying Vehicles and Trucks of 1-ton Capacity or Less.

(a) Requisitions for vehicles shall be submitted to the director of the bureau of purchase and property on an annual basis. All requisitions shall be due in the director's office not later than August 15th for all vehicles requisitioned. Delivery can usually be expected from 30 to 60 days after issuance of the purchase order by the bureau of purchase and property.

(b) Vehicles may be replaced only if budgeted or otherwise officially authorized, but 4 years of age or 60,000 miles, whichever occurs first, is generally the minimum requirement.

(c) It shall be the general policy of the state of New Hampshire to require any employee who exceeds 15,000 miles per year to operate a state-owned vehicle. Budgetary requests for new vehicles must be based on such a policy.

(d) The following shall apply to vehicles requisitioned:

(1) Types - Group 1 -4-door sedans
Group 2 - 4-door station wagons
Group 3 - Pickup or other truck-type vehicles of 1-ton capacity or less.

(2) Model - Models purchased shall be only those officially authorized by law or rule.

(3) Color - Dark green unless otherwise specified and available.

(4) Engines - Engine capacity is to be determined by need as approved by the Director of Purchase and Property.

(5) Equipment - Group 1 and 2 - Equipment furnished shall be all manufacturer's standard equipment for all groups including but not necessarily limited to deluxe fresh air heater and defroster, directional signals with four-way hazard flashers, back up lights, two speed electric wipers with washers, front seat belts, interior day-night mirror and left hand exterior mirror, oil filter, heavy duty battery, radial tires and rust proofing.

(6) Equipment - Group 3 - Equipment furnished shall be all manufacturer's standard equipment including but not necessarily limited to deluxe fresh air heater and defroster, class "A" directional signals with four-way hazard flashers, two-speed electric wipers with washers, interior day-night mirror and left hand exterior mirror, arm rests, cigar lighter, heavy duty clutch, foam cushion seat with heavy duty vinyl cover, front and rear shock absorbers, heavy duty springs, dual sun visors, oil filter, heavy duty battery, rear bumper, and spare wheel and tire with carrier. (Radial tires and/or rustproofing when applicable.)

(e) Not allowed shall be equipment such as AM standard broadcast receivers, two-tone paint, spot lights and white wall tires. Deviations shall be allowed only upon written request signed by department head and including sufficient reasons therefore.

(f) Any deviations from the above specifications not approved by the director of purchase and property must be requested in accordance with existing budgetary restrictions and rules adopted thereunder.

Source. #2235, eff 12-30-82

Appendix B
NATIONAL COUNCIL ON GOVERNMENTAL ACCOUNTING STATEMENT 5, "ACCOUNTING AND FINANCIAL REPORTING PRINCIPLES FOR LEASE AGREEMENTS OF STATE AND LOCAL GOVERNMENTS"

Preface

This statement by the National Council on Governmental Accounting (NCGA) provides authoritative guidance on accounting and financial reporting principles for lease agreements of state and local governments. The NCGA due process procedures were followed in developing this statement. The NCGA issued a discussion memorandum on this subject in February 1982 and an exposure draft in August 1982.

Introduction

1) Accounting and financial reporting for state and local governments is guided by the principles set forth by the National Council on Governmental Accounting (NCGA) in Statement 1, *Governmental Accounting and Financial Reporting Principles*, issued in 1979.[1] Through widespread acceptance, Statement 1 and subsequent NCGA pronouncements are acknowledged as the primary authoritative statements of generally accepted accounting principles applicable to state and local governments.

2) Footnote 6 of NCGA Statement 1 provides that the Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards (SFAS) No. 13, *Accounting for Leases*,[2] as amended and interpreted, applies to state and local governments. Statement 1 does not, however, provide specific accounting and financial reporting guidance for lease agreements of those governments. Consequently, uniformity does not exist in the way governments account for and disclose information on lease agreements.

3) The NCGA believes that this lack of uniformity is the result of uncertainty as to the proper application of the accounting and financial reporting

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requirements for leases contained in FASB pronouncements. The NCGA issues this statement to clearly define the accounting and financial reporting requirements for lease agreements of state and local governments. This statement is not intended to determine or in any way affect the legal aspects of lease agreements.

Background

4) Footnote 6 of NCGA Statement 1 states:

> In the Council's view, the lease capitalization and disclosure requirements of Financial Accounting Standards Board, Statement of Financial Accounting Standards No. 13, "Accounting for Leases" . . . are applicable to governmental units.[3]

Statement 1 does not otherwise specify the accounting and financial reporting requirements for lease agreements.

5) In determining the accounting and financial reporting treatment for lease agreements of state and local governments, consideration must be given to the distinctions between the governmental fund and proprietary fund models with respect to fund long-term liabilities and general long-term liabilities. Accounting and financial reporting will differ depending on whether the liability is accounted for in a governmental fund or a proprietary fund.

6) Statement 1 distinguishes between fund long-term liabilities and general long-term debt:

> Bonds, notes and other long-term liabilities (e.g., for capital leases, pensions, judgments, and similar commitments) directly related to and expected to be paid from proprietary funds, Special Assessment Funds, and Trust Funds should be included in the accounts of such funds. These are *specific* fund liabilities. . . . All other unmatured long-term indebtedness of the government is *general long-term debt* and should be accounted for in the General Long-Term Debt Account Group.[4]

7) Statement 1 also provides that general long-term debt can include noncurrent liabilities from capital lease agreements:

> General long-term debt is not limited to liabilities arising from debt issuances per se, but may also include noncurrent liabilities on lease-purchase agreements and other commitments that are not current liabilities properly recorded in governmental funds.[5]

8) Statement 1 provides that unmatured general long-term debt should be accounted for in the General Long-Term Debt Account Group rather than the governmental fund:

> . . . just as general fixed assets do not represent financial resources available for appropriation and expenditure, the unmatured principal of general long-term debt does not require current appropriation and ex-

penditure of government fund financial resources. To include it as a governmental fund liability would be misleading and dysfunctional to the current period management control (e.g., budgeting) and accountability functions.[6]

9) Statement 1 requires that fixed assets, except those related to specific proprietary funds and Nonexpendable Trust and Pension Trust Funds, be accounted for in the General Fixed Assets Account Group. Statement 1 notes that general fixed assets and long-term liabilities include fixed assets acquired and obligations arising from noncancelable leases.

10) The *noncurrent receivable* created when a government is the lessor in a capital lease agreement is not considered a *fixed* asset and, therefore, is not accounted for in the General Fixed Assets Account Group under NCGA Statement 1.

Statement of Accounting and Financial Reporting

Accounting and Financial Reporting for Lease Agreements

11) The council concludes, subject to the accounting and financial reporting distinctions of governmental funds and Expendable Trust Funds, that the criteria of FASB Statement 13 (as amended and interpreted) should be the guidelines for accounting and financial reporting for lease agreements. SFAS 13 (as amended and interpreted) should be consulted for specific guidance concerning detailed criteria referenced in this statement.

12) If a lease agreement is a capital lease following the criteria of this statement and SFAS 13, the lease agreement should be capitalized.

13) In governmental funds, the primary emphasis is on the flow of financial resources, and expenditures are recognized on the modified accrual basis. Accordingly, if a lease agreement is to be financed from general government resources, it must be accounted for and reported on a basis consistent with governmental fund accounting principles.

14) General fixed assets acquired via lease agreements should be capitalized in the General Fixed Assets Account Group at the inception of the agreement in an amount determined by the criteria of SFAS 13. A liability in the same amount should be recorded simultaneously in the General Long-Term Debt Account Group. When a capital lease represents the acquisition or construction of a general fixed asset, the acquisition or construction of the general fixed asset should be reflected as an expenditure and other financing source, consistent with the accounting and financial reporting for general obligation bonded debt. Subsequent governmental fund lease payments should be accounted for consistently with Statement 1 principles for general obligation debts.[7] A Debt Service or Capital Projects Fund is not necessary unless required by NCGA Statement 1, principle 4.

15) In governmental funds, lease receivables and deferred revenues should be used to account for leases receivable when a state or local government is

the lessor in a lease situation. Only the portion of lease receivables which represent revenue/other financing sources that are measurable and available should be recognized as revenue/other financing sources in governmental funds. The remainder of the receivable should be deferred.

16) Proprietary funds should follow SFAS 13 without modification. All assets and liabilities of proprietary funds are accounted for and reported in the respective funds. Therefore, transactions for proprietary fund capital leases are accounted for and reported entirely within the individual proprietary fund.

17) Depending on their purpose, trust funds are accounted for on either the financial flow or capital maintenance measurement focus. Expendable Trust Funds should follow the principles that apply to governmental funds (paragraphs 11–16). Nonexpendable Trust and Pension Trust Funds should follow the principles that apply to proprietary funds (paragraphs 11–12 and 16).

Fiscal Funding or Cancellation Clauses

18) In application of SFAS 13 to lease agreements of state and local governments, legal restrictions must be considered. One type of legal restriction relates to debt limitation and debt incurrence which prohibits governments from entering into obligations extending beyond the current budget year. Because of this type of restriction, governmental lease agreements typically contain a fiscal funding or cancellation clause, which permits governmental lessees to terminate the agreement on an annual basis if funds are not appropriate to make required payments.

19) This type of legal restriction is discussed in FASB Technical Bulletin No. 79-10, *Fiscal Funding Clause in Lease Agreements*[8]:

> . . . Statement 13 requires that a cancelable lease, such as a lease containing a fiscal funding clause, [a clause which generally provides that the lease is cancelable if the legislature or other funding authority does not appropriate the funds necessary for the government unit to fulfill its obligations under the lease agreement] be evaluated to determine whether the uncertainty of possible lease cancellation is a remote contingency. That paragraph states that 'a lease which is cancelable (i) only upon occurrence of the remote contingency . . ., shall be considered "noncancelable" for purposes of this definition' of lease term.[9]

20) The economic substance of most lease agreements with fiscal funding or cancellation clauses is that they are essentially long-term contracts. The potential for cancellation of most government lease agreements is remote, i.e., routine cancellations of such agreements would discourage potential lessors from entering into such lease agreements with the government in question and may have an adverse impact on the receptivity of investors to other obligations of that government. In substance, notwithstanding the fiscal

funding clause, the economic substance of lease agreements should be considered instead of the legal form.

21) The council concludes that fiscal funding or cancellation clauses should not prohibit lease agreements from being capitalized. Therefore, if a lease agreement meets all other capitalization criteria except for the noncancelable criterion, the likelihood of the lease being canceled must be evaluated. If the possibility of cancellation is remote, the lease should be capitalized.

Leases between State and Local Governments and Public Authorities

22) In application of SFAS 13 to lease agreements of state and local governments, lease agreements between a state or local government and a public authority must be considered. Public authorities are created to issue bonds to provide financing for the construction or purchase of fixed assets. Often the public authority takes title to the assets, leases them to the government and transfers title to the state or local government at the end of the lease.

23) In accounting and financial reporting for lease agreements between state or local governments and public authorities it must first be determined whether the public authority is part of the governmental entity for financial reporting purposes. The criteria of NCGA Statement 3, *Defining the Governmental Reporting Entity*[10] must be applied to determine inclusion for financial reporting purposes.

24) If under the criteria of NCGA Statement 3 the public authority is part of the governmental unit's entity for financial reporting purposes, the criteria of SFAS 13 do not apply. Instead, the public authority's debt and assets should be reported as a form of the state or local government's debt and assets for financial reporting purposes.

25) If under the criteria of NCGA Statement 3 the public authority is not part of the governmental unit's entity for financial reporting purposes, accounting and financial reporting for lease agreements between them should be treated in the same manner as any other lease agreement of a state or local government. These agreements, therefore, should be considered long-term contracts for accounting and financial reporting purposes and afforded capital lease treatment if they meet the criteria of this statement and SFAS 13.

26) When lease arrangements exist between state and local governments and public authorities, the related-party considerations of SFAS 13, paragraph 29, should be considered to determine if there are special reporting and disclosure requirements.

Disclosure Requirements

27) The council concludes that the disclosure requirements of SFAS 13 be followed for financial reporting purposes. The disclosures are required for capital and operating leases and must be followed by state and local

governments in accordance with NCGA Statement 1 and NCGA Interpretation 6, *Notes to the Financial Statements Disclosure*.[11]

Amendment of NCGA Statement 1

28) Provisions of NCGA pronouncements concerning lease agreements which conflict with this statement are hereby superseded.

Effective Date and Transition

29) This statement shall be effective for fiscal years beginning after June 30, 1983, although earlier application is encouraged.

30) Adjustments resulting from a change to comply with these principles should be treated as adjustments of prior periods and financial statements presented for the periods affected should be restated. In the year in which this statement is first applied, the financial statements should disclose the nature of any restatement and its effects. If restatement of financial statements for prior periods presented is not practicable, the cumulative effect of applying these principles should be reported as a restatement of the beginning fund balance or as retained earnings (as appropriate) for the earliest period restated. Also, the reason for not restating all prior periods presented should be explained.

The provisions of this statement need not be applied to immaterial items

This statement was adopted on December 7, 1982, by the affirmative vote of members Granof, Greathouse, Grossman, Hadley, Hensold, Ives, Miller, Murphy, O'Connor, Orne, Points, Raftery, Rogan, Schirman, Schlanger and Vaughn.

Footnotes

[1]Statement 1, *Governmental Accounting and Financial Reporting Principles* (Chicago: National Council on Governmental Accounting, 1979).

[2]Statement of Financial Accounting Standards 13, *Accounting for Leases* (Stamford: Financial Accounting Standards Board, 1976). (The references in this statement to SFAS 13 mean SFAS as amended and interpreted.)

[3]Statement 1, p. 27.

[4]Statement 1, p. 9.

[5]Ibid.

[6]Ibid.

[7]Statement 1, principle 8, p. 12.

[8]Technical Bulletin No. 79-10., *Fiscal Funding Clause in Lease Agreements* (Stamford: Financial Accounting Standards Board, 1979).

[9]Ibid, p. 1.

[10]Statement 3, *Defining the Governmental Reporting Entity* (Chicago: National Council on Governmental Accounting, 1982).
[11]Interpretation 6, *Notes to the Financial Statements Disclosure* (Chicago: National Council on Governmental Accounting, 1982).

The National Council on Governmental Accounting

The National Council on Governmental Accounting (NCGA) develops, promulgates and interprets principles of accounting, financial reporting and related financial management activities for governments in the United States and Canada. While accounting and reporting for governmental operations that are similar to business enterprises closely parallel commercial accounting and reporting, there are environmental considerations which may require modification of commercial accounting practices and professional pronouncements as they apply to proprietary funds of governments. NCGA's responsibilities are directed to state and provincial governments and to all classes and units of local governments and quasigovernmental units.

The genesis of the National Council on Governmental Accounting dates to the 1934 formation of the National Committee on Municipal Accounting, which began the work of formalizing accounting, auditing and financial reporting standards for governmental units under the sponsorship of the Municipal Finance Officers Association (MFOA). The name change in 1949 to the National Committee on Governmental Accounting emphasized that the authoritative pronouncements apply to states and all types of local governments. The National Council is the successor to the National Committee.

The NCGA was established in 1974 through the sponsorship of the MFOA as a continuing body. To assure that principles and procedures for government are in conformity with generally accepted accounting principles, the NCGA maintains close liaison with the Financial Accounting Standards Board and the American Institute of Certified Public Accountants.

The NCGA consists of 21 members who are local, state and federal governmental accountants, auditors and managers; practicing certified public accountants; governmental accounting/financial management educators; and members at large. Within the appropriate membership classifications, council members are elected by vote of the council to serve four-year terms. The council and its Executive Committee are assisted by the NCGA Committee of Advisors, comprised of representatives of accounting, public interest and governmental organizations. The work of the council is facilitated by project area task forces (which include council members, advisors and others who possess an expertise or viewpoint relative to the project) that research issues and draft recommendations for council consideration.

The NCGA Rules of Procedure provide for several types of council issuances:

1. Statements reflect the conclusion of at least a majority plus one of the council as to governing principles and explain and illustrate their

application, including alternative applications where such alternatives are deemed appropriate.

2. Interpretations are issued by a majority plus one of the council to clarify, elaborate upon or explain a council statement, a principle or illustration or related matters.
3. Exposure drafts, proposed statements, background papers, working drafts and discussion memoranda may be issued by the council as necessary to solicit comments and assist in resolving issues.

NCGA Members

State Finance Officers

*Frank L. Greathouse, chairperson, director of state and municipal audit, Department of Audit, Division of State Audit, State of Tennessee, Nashville

John F. Rogan, state finance director, Department of Administration, State of Wisconsin, Madison

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*W. Gary Harmer, administrator, Salt Lake City School District, Salt Lake City, Utah

*Martin H. Ives, first deputy comptroller, City of New York, New York

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City Chief Executive

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At-Large

*Hyman C. Grossman, vice-president/municipal ratings, Municipal Bonds Department, Standard & Poor's Corporation, New York, New York
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*Executive Committee member

James D. Remis, director