

Salt Lake County Auditor's Office
Craig B. Sorensen, *AUDITOR*



June 20, 2002

David L. Beck
Chief Deputy

Kevyn Smeltzer,
Operations Division Director
Public Works Operations
7125 S. 600 W.
Midvale, UT 84047

Salt Lake County
Government Center
2001 S. State Street
Suite N2200
Salt Lake City
Utah 84190-1100
Tel (801) 468-3381
Fax (801)-468-3296

Dear Kevyn,

Re: Public Works Equipment Rental Rate Adjustments

As per your request, we have reviewed the formulas used to calculate the "Ownership Costs" listed in the *Rental Rate Blue Book*. When setting rental rates for your equipment, you should ensure that you are recovering the cost of providing the equipment. Because of lack of data, an actual cost analysis could not be performed. We recommend that you implement a system of tracking the hours that equipment is rented out over a year. This would enable you to calculate the cost per hour on the equipment by dividing the annual maintenance costs by the usage.

We agree that the *Blue Book* rates seem to be a good guideline to follow when setting rates. The formulas used are detailed and include many areas of cost recovery. However, due to the fact that we are a government entity, some adjustments should be made to the costing formulas in the *Blue Book*. These adjustments are:

- 1) As discussed earlier, there is a "major overhaul" portion of the ownership costs formula. We feel that this portion of the cost could be eliminated for some equipment that is on the revolving replacement program. There would be no costs for major overhauls on equipment that is under the manufacturer's warranty. Therefore, the overhaul portion of the ownership cost formula can be eliminated for equipment that will be replaced while still under warranty.
- 2) Indirect equipment cost is also a portion of the ownership cost formula. Included in indirect equipment cost is risk insurance, property taxes, mechanics' supervision, storage, licenses, and record keeping costs. The property tax portion of the formula should be removed based on the fact that the County is exempt from paying property taxes. We contacted Equipment Watch and were informed that property taxes make up 22% of the indirect cost.

We also reviewed the risk insurance portion of the indirect cost formula. Although the County is self-insured, each department is charged for governmental immunity costs via the indirect cost allocation. For 2002, \$96,238, of Public Works Operations' indirect costs are for governmental immunity costs. These costs include asset insurance for equipment and buildings as well as liability insurance for both auto and

general liability claims. Therefore, risk insurance should not be eliminated from the indirect equipment formula.

- 3) When discussing the County's situation with the Equipment Watch contact, they recommend that we consider subscribing to the "Custom Cost Evaluator" (CCE). This is an online system that breaks down all the costs that appear in the Ownership Cost formula, the Operating Cost formula, and Power Consumption factors. This program would enable you to customize equipment rates to best reflect your actual costs. For example, on this system you can enter the actual discount we receive off of list price for new equipment. This would result in a more accurate depreciation cost factor. CCE also allows you to adjust power consumption factors such as price per gallon on fuel. Attached to this letter you will find a sample of the CCE cost break down that Equipment Watch provided to us. A free trial subscription is available for the Custom Cost Evaluator. The yearly subscription cost for the CCE is \$1,249, but there is a 5% discount for customers who subscribe to 2 or more annual publications.

In our meeting on May 1, 2002, you asked if the depreciation factor could be eliminated from the ownership cost formula on equipment that is on a replacement program. We do not feel that this portion of the formula should be eliminated. Public Works is charged a monthly replacement fee for equipment enrolled in this program. These costs are similar to depreciation in that they charge for the reduction in value of the equipment. Therefore, these costs should be included in the ownership cost formula.

We feel the best solution is to initiate a record keeping process that would allow you to track the number of hours that equipment is used (by machine). This information is required to ensure that the cost of renting equipment is being recovered through rental rates. Until this information is available we feel comfortable with your decision to follow *Blue Book* rates. We recommend investing in the CCE program so that adjustments to costs could be made that would tailor the *Blue Book* rates to what a government entity actually pays.

If after adjustments are made to the *Blue Book* rates, you find that the rates are substantially higher than current rates, you may want to consider gradually increasing those rates as to avoid losing customers. For example, this could be done over a two to four year period. However, constant rate adjustments may also tend to lessen customer support and loyalty.

If you have any questions please feel free to contact Kaylene Eldridge, Internal Auditor, at 468-3787. Contact information for the Equipment Watch representative we spoke with is also included in the attachments. The representative was very helpful and informative.

Sincerely,

James Wightman, CPA
Director, Internal Audit

Enclosures

cc: F. David Stanley