

Lease Accounting: The payments required under the terms of the lease with Lummi Nation have been accounted for improperly by Whatcom County and need to be corrected.

Leases: There are two leases between Whatcom County and the Lummi Nation necessary for ferry operations. One for the tidelands and one for the uplands. (Hereinafter Tidelands Lease, Uplands Lease) as well as a Framework Agreement that applies to both.

Tidelands Lease: This lease was signed on October 27, 2011 by Clifford Cultee the Lummi Nation Chairman, and on November 15, 2011 by the Whatcom County Executive following approval by the Whatcom County Council on September 13, 2011. This lease was approved by the Bureau of Indian Affairs in April 2012. The term is for 25 years followed by a 10-year extension and approval was granted for the full 35 year term. Tidelands Lease at 3, paragraph 2, The lease requires payments of \$200,000/year with annual adjustments base on the CPI. Tidelands Lease at 4, paragraph 3,4.

Uplands Lease: This lease was entered into on the same dates as the Tidelands Lease but required no approval from the BIA. The Uplands Lease is also for the same 25 year term plus 10 year renewal. Uplands Lease Page 3, Paragraph 2. The consideration for the Upland Lease was for the County to spend \$6 million in three installments of \$2 million each, during year 1, year 6, and at year 15. Uplands Lease page 3-4, paragraph 3,b. The third amount will be adjusted for inflation. *Id.* At their November 23, 2011 meeting the County Council passed an ordinance to establish the Lummi Nation Ferry Lease Fund. Ord. 2011-049. This ordinance solely addressed the \$6 million in improvements required by the Uplands lease. The Council also passed an appropriation of \$2 million from Public Works to that fund. Ord. 2011-386. These funds are for capital improvements and are not included in annual operations cost for the ferry.

Framework Agreement: Contemporaneously with the the two lease documents the parties entered into an Intergovernmental Framework Agreement. (Agreement). Within this agreement is an acknowledgement of payment from the county of \$16,667/month beginning in February 2010 and continuing to the date of the Agreement. These payments were made even though there was no lease in place at that time and while the terms of the leases ultimately were negotiated. Agreement page 4.

The Problem:

Issue 1: Whatcom County Charter section 6.90 requires that real property shall not be leased to the county for more than 1 year unless included in a capital budget ordinance. A review of Council minutes for 2009, 2010, 2011, and 2012 finds no such ordinance for the Tidelands Lease. The provision in the County Charter is a clear expression of intent that a lease with this term is intended to be recorded as Capital. I want to make it clear that in my opinion not complying with this provision does not invalidate the lease itself. It does, however, call into question the accounting of the Tideland Lease payments since their inception. The Upland Lease payments were properly addressed.

A review of the 14 year Capital Program for the years 2011-2022, as well as the 6-year Transportation Plan for those years shows an escalating cost for the Gooseberry docks in

operations beginning in 2014 at \$265,000 increasing to \$400,000 in 2021. A review of the annual Ferry Operations Report for the same time frame includes space rental of \$200,000+ every year for the Gooseberry docks. Clearly, the annual lease payments have been included as an operational expense.

Issue 2: In 2016, the Financial Accounting Standards Board (FASB) made an amendment to its accounting rules requiring all leases with contract terms for more than one year to be capitalized. This has been interpreted by the Office of the Washington State Auditor that states this is effective for fiscal years ending June 30, 2022 and after. And, that the new standard applies not only to new lease agreements going forward, but also retroactively to existing agreements. See, <https://sao.wa.gov/bars-annual-filing/leases/>

Both the Tideland and Upland leases are Right of Use (ROU) assets. Those leases not considered to be an ROU asset are those defined as having a term of 12 months or less at commencement and no option to purchase the leased asset. However the lease is a capital asset if it is for a building, land, or equipment; the lease is not between state agencies; and, the lease term is greater than 1 year. All ROU assets with total payments over the lease term of \$500,000 or greater must be capitalized. The consideration in the Uplands Lease is being properly treated at Capital. The consideration in the Tidelands Lease is not and this must be corrected.

Resolution: All lease payments from 2010 to date should be removed from the calculation for Total Operating Expense (TOE) from which the Adjusted Total Operating Expense (ATOE) is derived and the fare box rate determined.