

Performance Audit: Financial Indicators

September 2012

City Auditor
City of Lawrence, Kansas

September 27, 2012

Members of the City Commission

This performance audit of financial indicators for Lawrence is intended to identify significant existing or emerging financial problems, put the city's finances in context, and encourage discussion of the city's finances.

I make no recommendations in this report but identified several areas for consideration for further performance audit work. Because I make no recommendations, I did not ask the City Manager to provide a written response though I shared a draft of the report on September 14, 2012.

Michael Eglinski
City Auditor

Performance Audit: Financial Indicators

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Performance Audit: Financial Indicators

Results in Brief

This analysis of financial indicators for Lawrence is intended to identify significant existing or emerging financial problems, put the city's finances in context, and encourage discussion of the city's finances.

Overall, the financial indicators show mixed results for the city. Among the highlights:

- Government activities indicators are generally strong when compared to medians and looking at changes over the last two years. Business activities indicators are mixed but generally weaker than indicators for government activities..
- Over the longer-term (2003-2011) trends in indicators for government activities are more favorable than those for business activities.
- Reviewing governmental funds adjusted for inflation show the level of debt per resident declining in recent years and over the longer-term (2001-2011). Revenues per resident shows no clear trend in recent years and an increase in the longer-term. Expenditures per resident show no clear recent trend and a decrease in the longer-term.

The report does not include specific recommendations but highlights areas for additional performance audit work or other analysis. Those areas are:

- Additional performance measures of city services
- Analysis of revenues
- Measures of conditions of infrastructure, vehicles, equipment, and buildings
- Performance of golf and parking operations
- Reliability of population estimates and forecasts

Performance Audit: Financial Indicators

Financial Indicators Help Understand Lawrence's Financial Condition

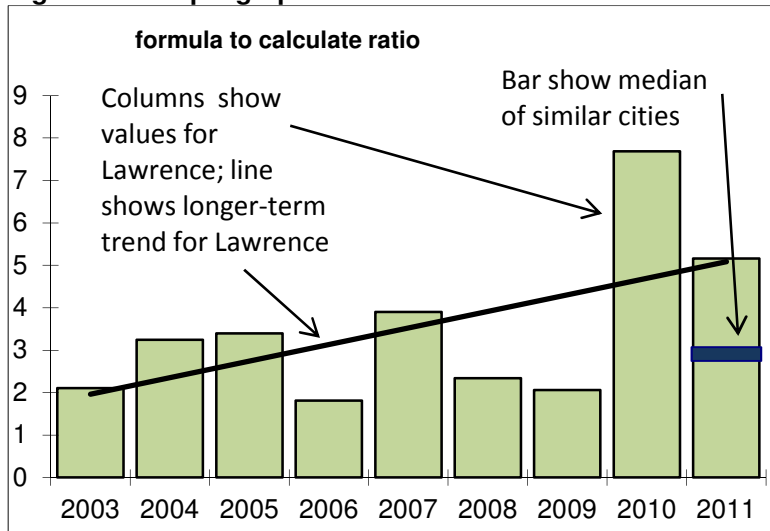
This performance audit, which analyzes financial ratios, provides the City Commission and city management with information about Lawrence's finances. The performance audit is intended to encourage discussion of the city's finances and to:

- identify significant existing or emerging financial problems
- put the city's finances in context by compiling data for eight years and comparing to the median of 14 cities

This report includes nine years of data for Lawrence (2003-2011) and compares data for Lawrence with medians based on an analysis of similar communities. Comprehensive annual financial reports provide most of the data. Information from the annual financial reports provides consistent, reliable data because it conforms to generally accepted accounting principles and is audited under generally accepted government auditing standards.

Financial ratios are presented as graphs throughout the report. To evaluate the ratios consider both the trend over the last 2-3 years, the level compared to a median, and the longer-term trend over the period of 2003-2011. Both trends and levels can be characterized as more or less favorable. Characterizing each indicator using this method allows for overall conclusions about potential financial strengths and weaknesses.

Figure 1 Example graph



The cities used to create medians for comparison to Lawrence have characteristics similar to Lawrence. Based on 2005-2009 data from the U.S. Census Bureau, the cities have similar:

- Urban area populations
- Portion of population under the age of 18
- Per capita income
- Median age of housing

All of the cities have significant university student populations.

Analyzing financial ratios provides an assessment of Lawrence’s financial condition, but it is important to recognize strengths and limitations to this sort of analysis. Figure 2 highlights some of the strengths and weaknesses of the method.

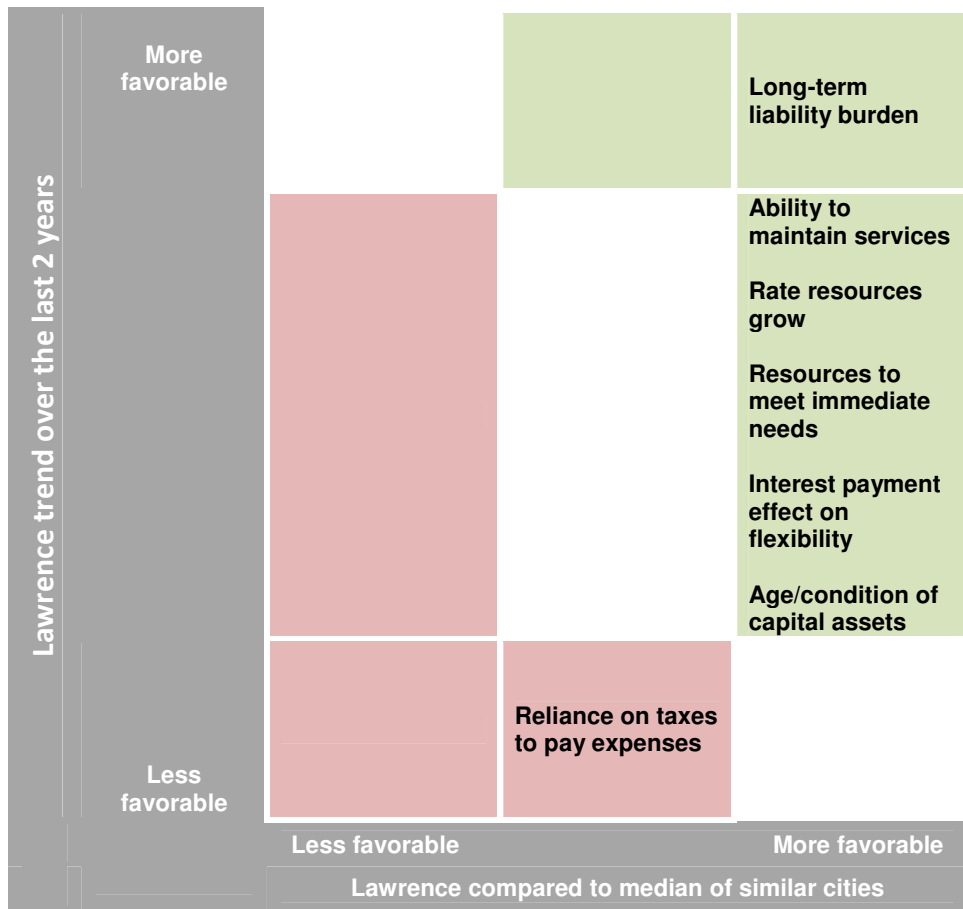
Figure 2 Strengths and limitations of the ratio analysis

Strengths	Limitations
Lawrence data compiled under consistent accounting principles and audited under Government Auditing Standards	Analysis provides a broad overview rather than detailed analysis
Ratios developed independent of city management and provides an independent view of Lawrence finances	Excludes information on level and quality of services and infrastructure
Comparative data compiled under consistent accounting principles and audited under Government Auditing Standards	Excludes external factors, such as demographic and economic trends, that may affect city finances
	Provides historical analysis rather than projections of future condition

Government Activities Ratio Analysis

Government activities include public safety, public works and general government. Taxes provide the funding for most of government activities. Figure 3 summarizes the analysis of ratios for government activities and identifies potential strengths (green shading) and weaknesses (red shading).

Figure 3 Government activities: summary of ratio analysis



Legend
 Potential strength
 Potential weakness

Long-term trends (2003-2011) have generally been more favorable although two indicators have been less favorable. Figure 4 summarizes the long-term trends based on data for 2003-2011.

Figure 4 Summary of government activities ratio analysis 2003-20011

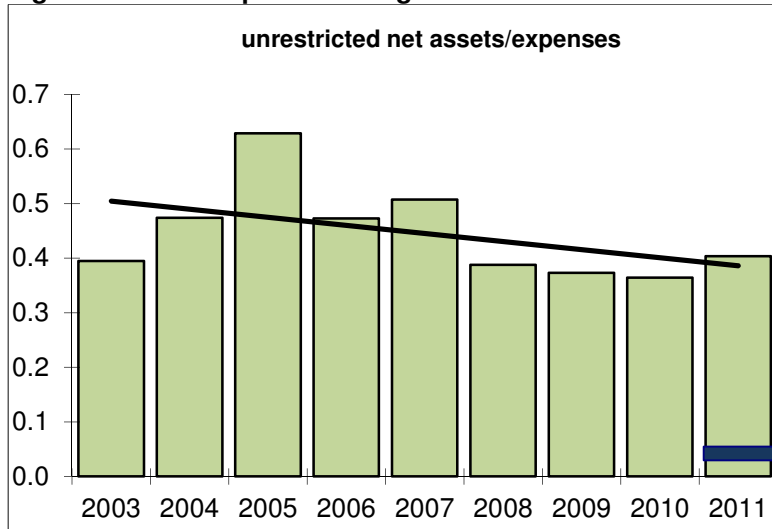
Indicator	Evaluation of long-term trend (2003-2011)
Financial position: ability to maintain services	Less favorable
Financial performance: rate resources grow	More favorable
General support: reliance on taxes to pay expenses	Increased reliance on taxes and transfers
Liquidity: resources to meet immediate needs	More favorable
Long-term liabilities: long-term liability burden	More favorable
Interest coverage: interest payment effect on flexibility	More favorable
Capital assets: age and condition of capital assets	Less favorable

Financial position: ability to maintain services

Lawrence’s financial position shows no clear trend for the most recent years and has a level more favorable than the median. The measure indicates the city’s ability to maintain the provision of services.

The long-term trend (2003-2011) is less favorable.

Figure 5 Financial position for government activities

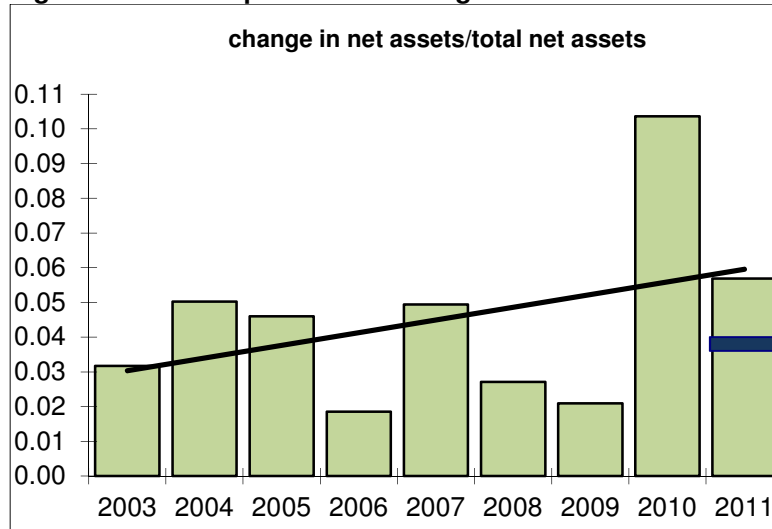


Financial performance: rate resources grow

Lawrence's financial performance shows no clear trend for the most recent years and the level is more favorable than the median.

The long-term trend (2003-2011) is favorable.

Figure 6 Financial performance for government activities



The financial performance indicator has been especially high in 2010 and 2011. Among the reasons:

- Government activity expenses have remained relatively constant
- The city received \$8.5 million associated with the acquisition of the former Farmland property
- The city received \$2 million in federal American Recovery and Reinvestment Act funds
- Sales tax rates were increased in 2009 with 2010 reflecting the first full year of collections under the higher rates.

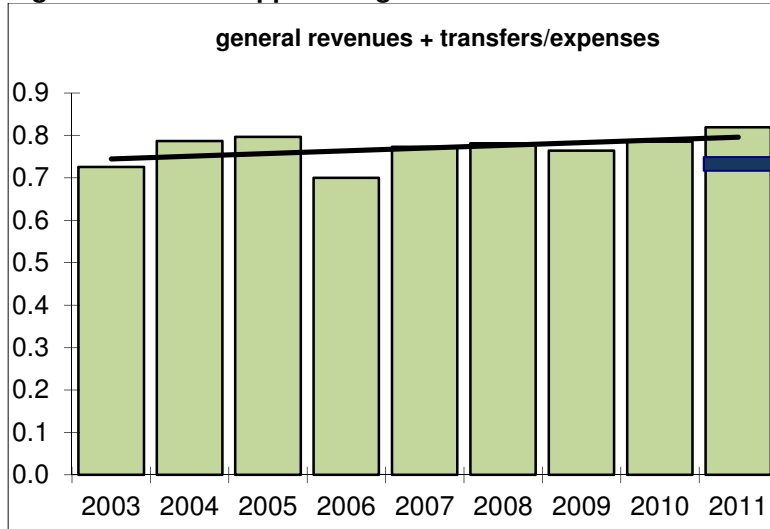
The trend for the financial performance indicator for 2003 to 2009 was less favorable.

General support: reliance on taxes and transfers to pay expenses

Lawrence's general support for governmental activities increased in recent years and is above the median. General support reflects the extent to which the city relies on general taxes and transfers from enterprise operations rather than service charges and grants. Higher levels indicate greater reliance on taxes and transfers.

The long-term trend (2003-2011) has been for increasing reliance on taxes and transfers.

Figure 7 General support for government activities

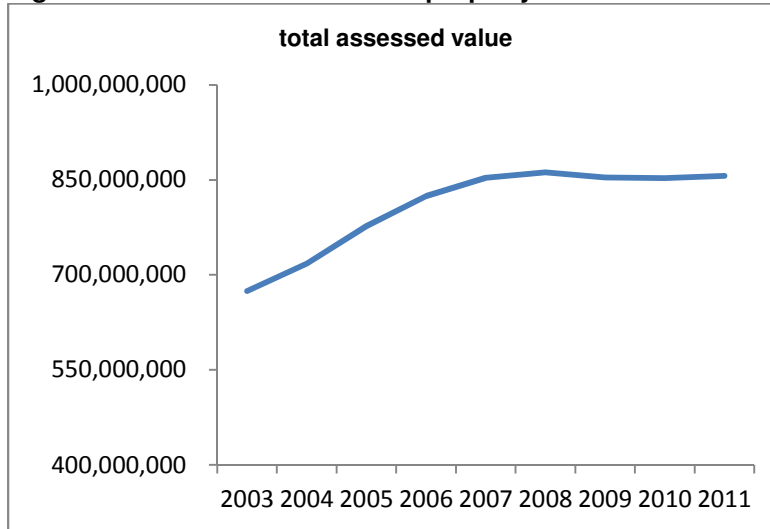


The city's reliance on charges for services decreased over the period of 2003-2011. Charges for services grew more slowly than expenses. Charges for services also grew more slowly than sales taxes but more quickly than property taxes. Had charges grown at the rate of other revenues, including property and sales taxes, total charges for services would have been more than \$1 million more in 2011.

The city's reliance on sales taxes increased over the period of 2003-2011. Sales taxes grew more quickly than other sources. Sales taxes are more sensitive to economic conditions and respond more quickly to changing conditions than property taxes do.

The city's reliance on property taxes decreased over the period of 2003-2011. Part of the decreased reliance on property taxes reflects the flattening of growth in total assessed value in Lawrence.

Figure 8 Total assessed value of property

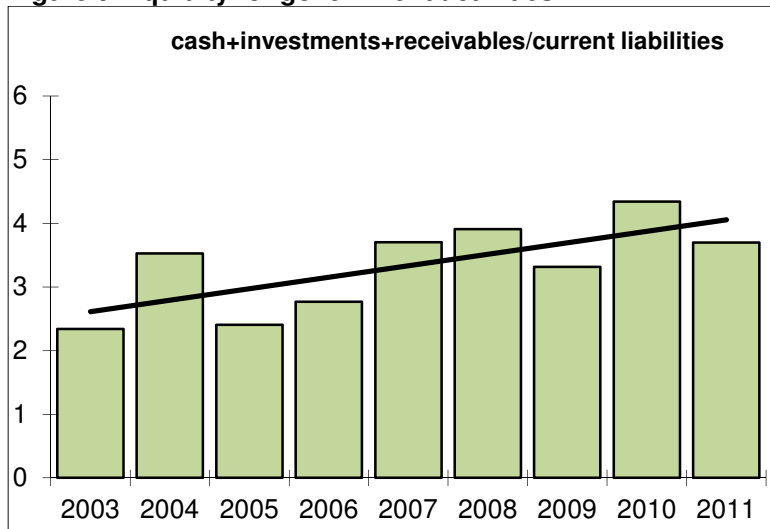


Liquidity: ability to meet immediate needs

Lawrence’s liquidity ratio shows no clear trend in recent years and the current level is above the city’s median for the entire period. The indicator is interpreted in relation to Lawrence’s median and is considered favorable because it is currently above that level.

The long-term trend (2003-2011) is favorable.

Figure 9 Liquidity for government activities

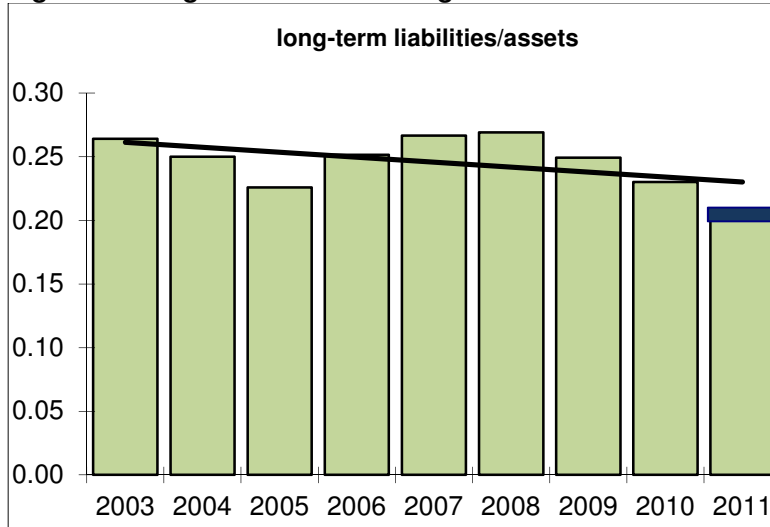


Long-term liabilities: debt burden

Lawrence's long-term liabilities ratio shows a favorable (decreasing) trend and is at the median. The ratio measures the burden of debt and other long-term liabilities.

The long-term trend (2003-2011) is favorable.

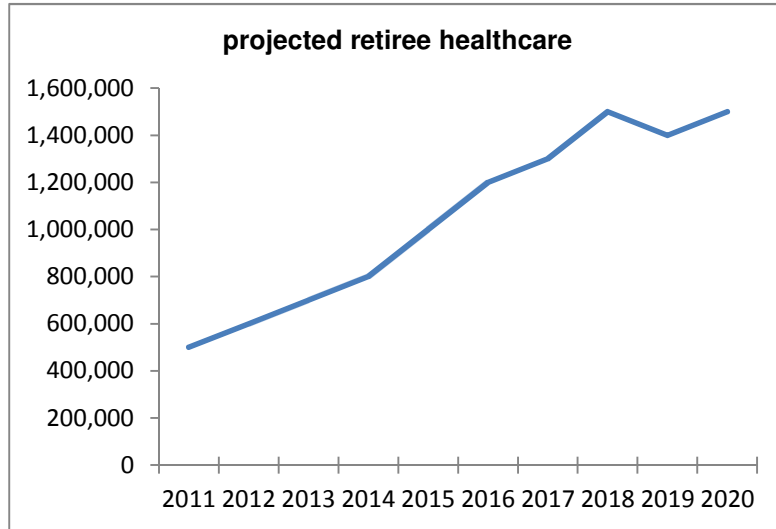
Figure 10 Long-term liabilities for government activities



Bonds make up most long-term liabilities, however a significant and growing portion are related to obligations for employee compensation. Specifically, both compensated absences and retired employee health care obligations made up 10 percent of long-term liabilities in 2011. Since 2008, those employee-related long-term obligations increased at a rate of 14 percent per year. Over the same period of time, long-term liabilities for bonds declined.

Increasing costs of retired employee health care benefits

The increasing cost of providing health care benefits to retired employees represents a small but growing part of the long-term liabilities. Under the current funding approach and given the level of city employees at the end of 2010, the annual payments are expected to double by about 2015.



The city's approach has been to pay for each year's claims for current retirees, but not contribute money to address the future benefits being earned by current employees. Under this approach, the city's obligation grows sharply. The most recent analysis shows the obligation more than tripling from \$1 million in 2010 to \$3.5 million in 2012. City staff have prepared and provided information to the City Commission on the costs, future costs, and options for addressing those costs.¹

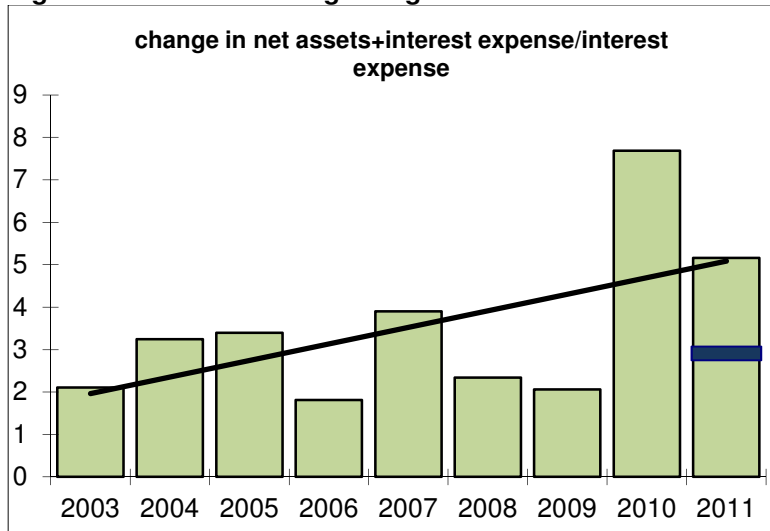
¹ Among the information presented by city staff are memos from Ed Mullins, Finance Director, to Dave Corliss, City Manager on *OPEB Liability* on May 19, 2011 and June 24, 2011, and *City of Lawrence, Kansas Retiree Health Care Plan Actuarial Valuation as of January 1, 2011*, EFT Actuaries, April 20, 2011.

Interest coverage: interest payment effect on flexibility

Lawrence's interest coverage ratio shows no clear trend in recent years and is more favorable than the median. Higher levels generally indicate more near-term flexibility.

The long-term trend (2003-2011) is favorable.

Figure 11 Interest coverage for government activities

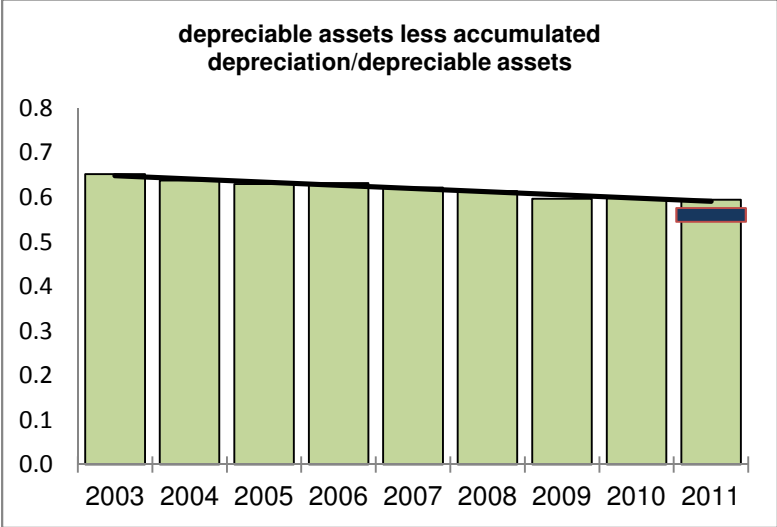


Capital assets: ageing of capital assets

The capital assets ratio shows no clear trend in recent years and is more favorable than the median.

The long-term trend (2003-2011) is less favorable. The less favorable trend indicates that the city may not be keeping up with maintenance of capital assets such as streets, buildings and vehicles.

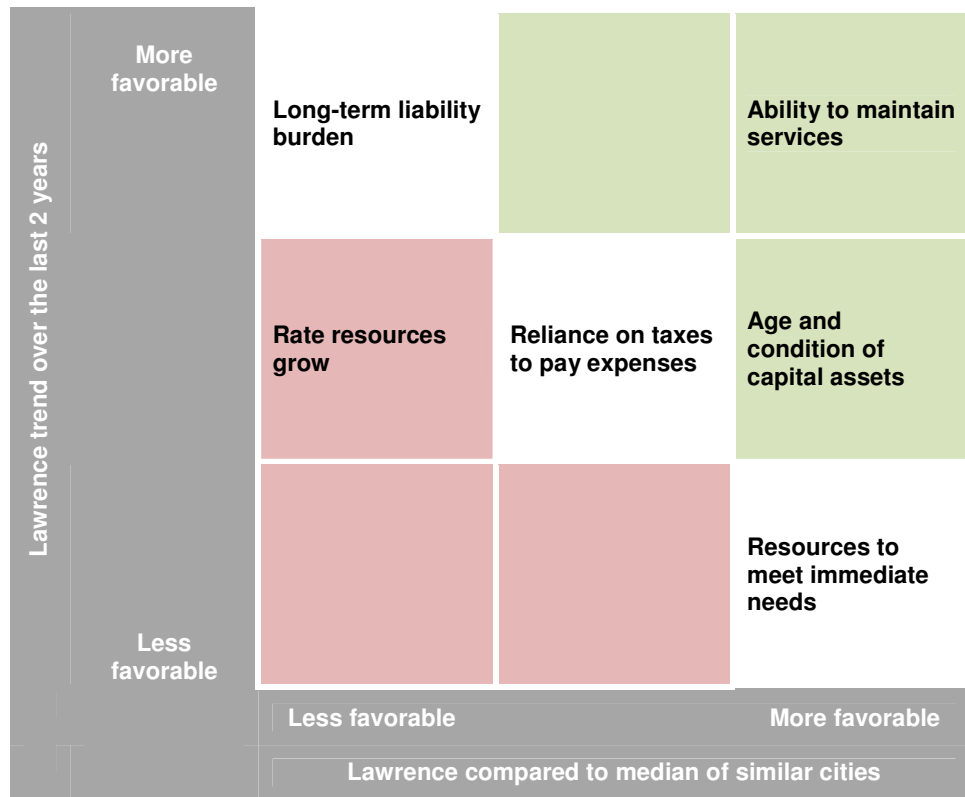
Figure 12 Capital assets for government activities



Business Activities Ratio Analysis

The City of Lawrence business activities include water and sewer, solid waste, parking, stormwater and golf. The business activities are mostly supported by user fees and charges. Figure 13 summarizes the analysis of ratios for government activities and identifies potential strengths (green shading) and weaknesses (red shading).

Figure 13 Business activities: summary of ratio analysis



Legend

- Potential strength
- Potential weakness

Long-term trends (2003-2011) have generally been less favorable although one indicator has been more favorable. Figure 14 summarizes the long-term trends based on data for 2003-2011.

Figure 14 Summary of business activities ratio analysis 2003-20011

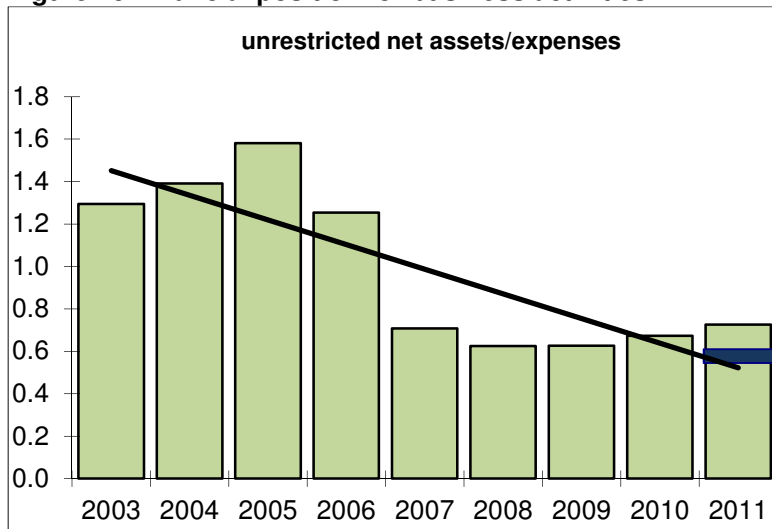
Indicator	Evaluation of long-term trend (2003-2011)
Financial position: ability to maintain services	Less favorable
Financial performance: rate resources grow	Less favorable
General support: reliance on taxes to pay expenses	Increasing shifts of resources to governmental activities
Liquidity: resources to meet immediate needs	Less favorable
Long-term liabilities: long-term liability burden	Less favorable
Capital assets: age and condition of capital assets	More favorable

Financial position: ability to maintain services

Lawrence’s financial position shows a favorable trend for the most recent years and has a level more favorable than the median. The measure indicates the city’s ability to maintain the provision of services.

The long-term trend (2003-2011) is less favorable.

Figure 15 Financial position for business activities

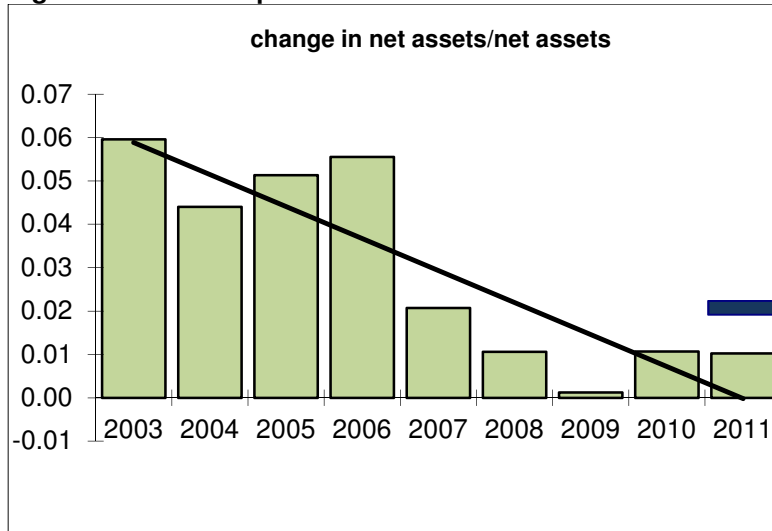


Financial performance: rate resources grow

Lawrence’s financial performance shows no clear trend for the most recent years and the level is less favorable than the median.

The long-term trend (2003-2011) is less favorable.

Figure 16 Financial performance for business activities



Comparing revenue and expenses helps understand the extent to which the user fees and charges cover the costs of providing the services. Figure 17 shows the difference between revenue and expenses for each activity, referred to as net revenue. If net revenue is negative, then the revenues for the activity haven’t covered the expenses.²

Figure 17 Net revenue for business activities

Activity	2007	2008	2009	2010	2011
water sewer	4,124,858	3,419,804	3,237,253	4,093,001	4,118,134
sanitation	-595,396	-746,555	-30,954	799,881	601,136
parking	-233,451	-236,315	-286,022	-167,204	-65,646
stormwater	1,058,478	1,115,533	1,051,813	1,253,491	1,130,787
golf	-2,301	-83,149	-96,595	-217,717	-199,441
total	4,352,188	3,469,318	3,875,495	5,761,452	5,584,970

Investment earnings peaked in 2006 and generally declined since then, while transfers generally increased. Both of these reduce the indicator for financial performance. The indicator for 2009 was especially low, in part

² These expenses include the costs of using up capital assets to provide services. Capital assets include buildings, vehicles, and infrastructure. The city estimates the depreciation of capital assets using straight-line depreciation. That means, for example, that if a vehicle was bought in 2006 for \$50,000 and is expected to last 5 years, it would be included as a \$10,000 expense in each year from 2006 to 2010.

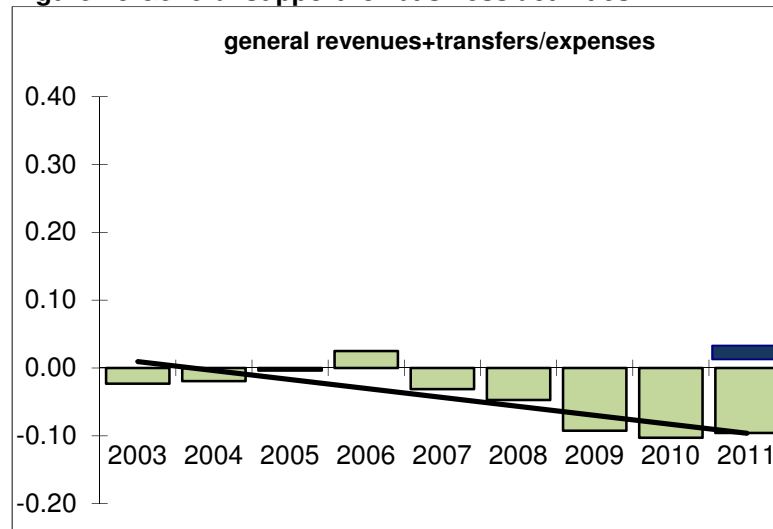
because investment earnings dropped by over \$1 million from the prior year.

General support: reliance on taxes and transfers to pay expenses

Lawrence’s general support for business-type activities shows no clear trend in recent years and is below the median. General support reflects the extent to which the enterprise operations rely on general taxes rather than service charges and grants. Levels below zero indicate that the enterprise operations contribute to general government activities.

The long-term trend (2003-2011) indicates an increase in the extent to which enterprise operations have provided resources to the government activities.

Figure 18 General support for business activities

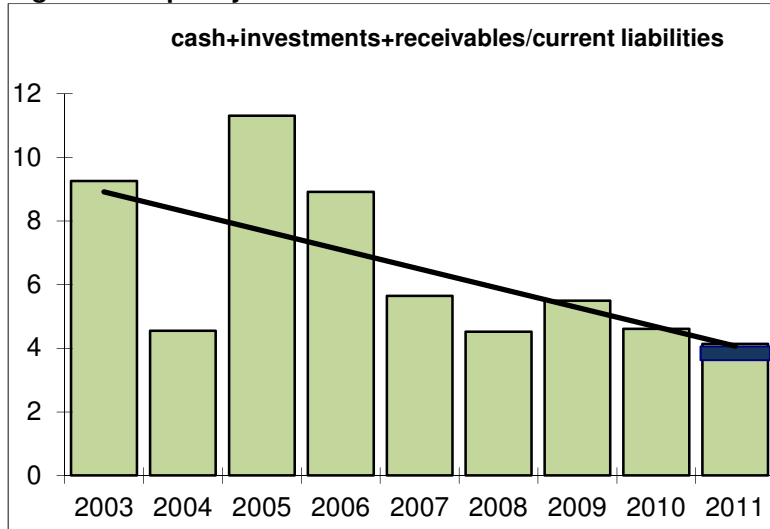


Liquidity: ability to meet immediate needs

Lawrence’s liquidity ratio shows a less favorable trend in recent years and the current level is above the median.

The long-term trend (2003-2011) is less favorable.

Figure 19 Liquidity for business activities

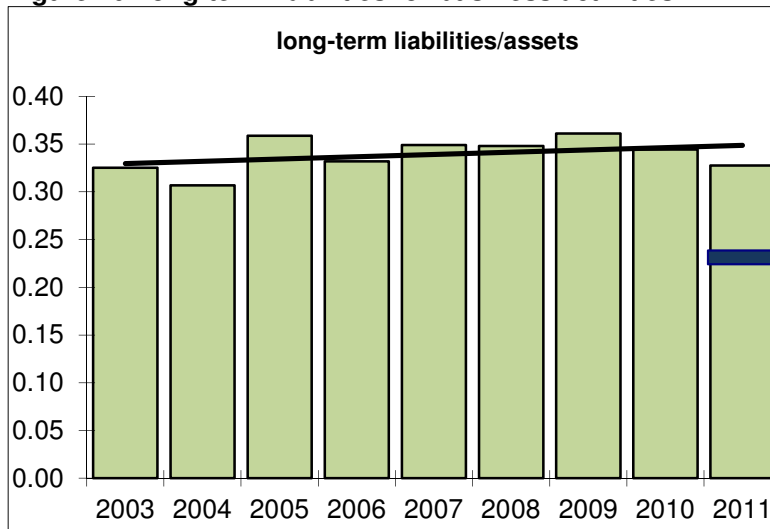


Long-term liabilities: debt burden

Lawrence’s long-term liabilities ratio shows a favorable (decreasing) trend in recent years but is above the median. The ratio measures the burden of debt and other long-term liabilities.

The long-term trend (2003-2011) is less favorable.

Figure 20 Long-term liabilities for business activities

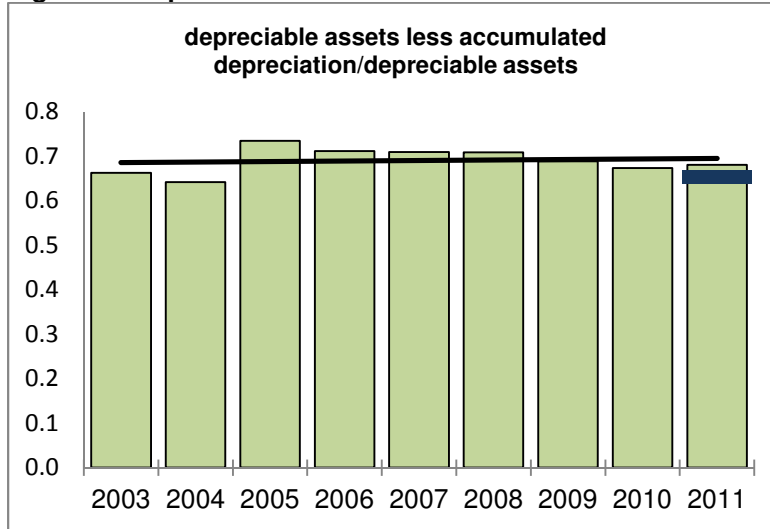


Capital assets: ageing of capital assets

The capital assets ratio shows no clear trend in recent years and is more favorable than the median.

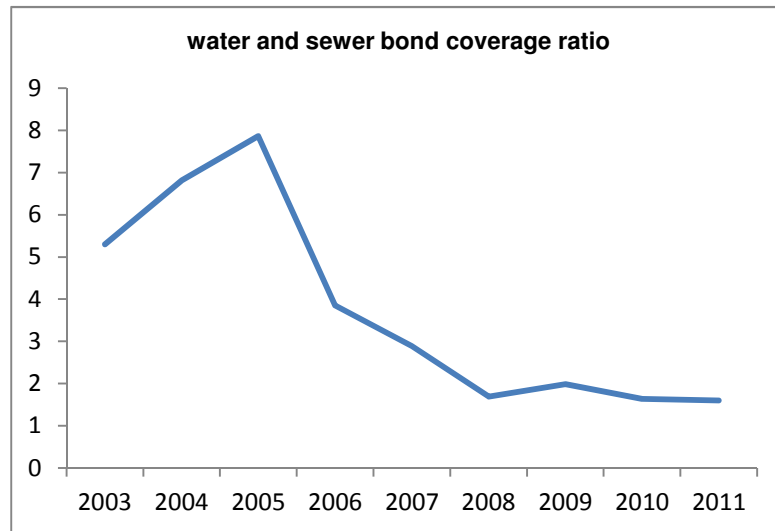
The long-term trend (2003-2011) is more favorable. While the trend is favorable, the increase over the period is very small and the trend for the most recent six years (2005-2011) is not favorable.

Figure 21 Capital assets for business activities



Financial indicators trends reflected in revenue bond coverage

Over the longer-term both financial position and performance have declined while long-term liabilities have increased. One result has been a decline in revenue available to pay debt service. The ratio of available revenue to principal and interest for water and sewer revenue bonds remains above 1.5 but has declined over the period of 2003-2011.

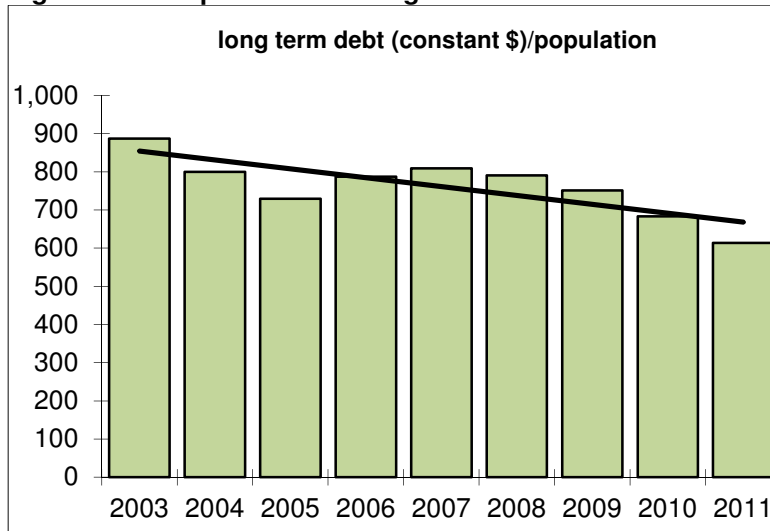


Debt, Revenue and Expenditure Trends

Debt, revenue and expenditure trends provide information on financial flexibility and sustainability. The graphs show data for all governmental funds. The graphs adjust for inflation and show each measure per Lawrence resident. In this analysis, the governmental funds aren't compared to medians.

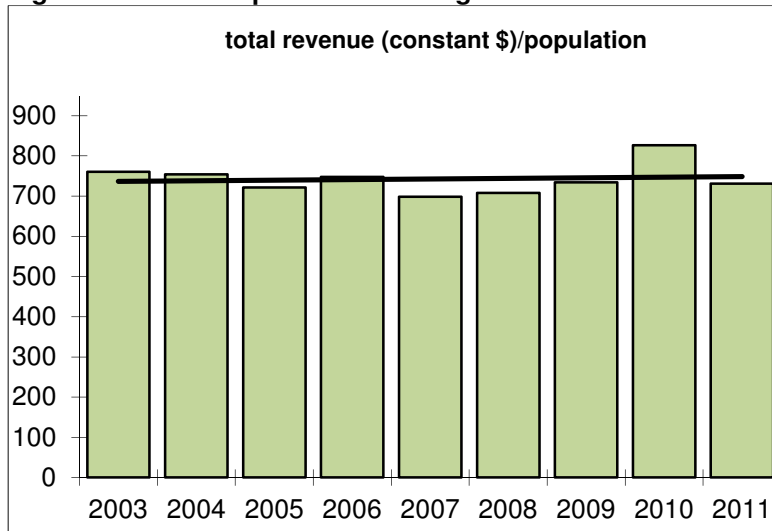
Inflation adjusted long-term liabilities per resident have declined in recent years and over the period of 2003-2011.

Figure 22 Debt per resident for governmental funds



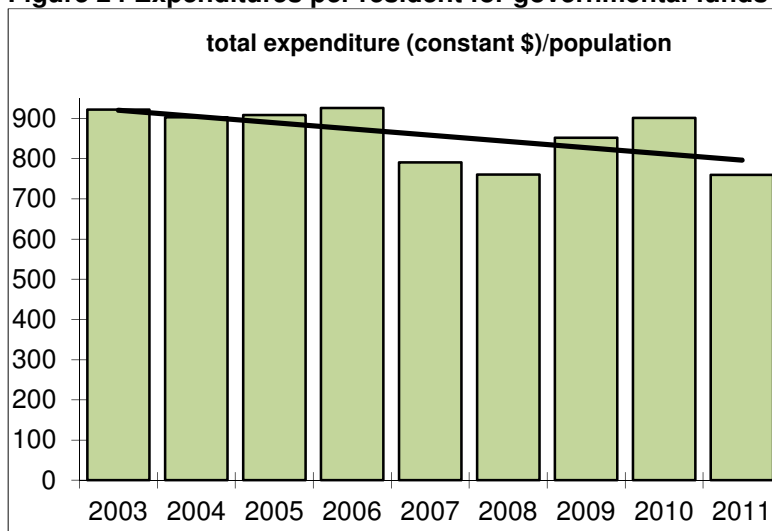
Inflation adjusted revenue per person has no clear trend in recent years and has increased over the period of 2003-2011.

Figure 23 Revenue per resident for governmental funds



Inflation adjusted expenditures per resident have no clear trend in recent years and have decreased over the period of 2003-2011.

Figure 24 Expenditures per resident for governmental funds



Differing population estimates

City staff estimates the population of Lawrence is about 6 percent greater than the U.S. Census Bureau reports. Over the period of 2000-2010, city staff estimates that the city grew at an average annual growth rate of 1.3 percent while Census figures put the annual average growth rate at 0.9 percent.

The city is preparing a challenge of the Census count for Lawrence which may help resolve the discrepancy.

Other Issues

The financial indicator analysis suggests areas to consider for future performance audit work. The City Auditor will discuss these ideas with the City Manager as part of developing a proposed annual performance audit work program for 2013:

- Additional performance measures of city services
- Analysis of revenues
- Measures of conditions of infrastructure, vehicles, equipment, and buildings
- Performance of golf and parking operations
- Reliability of population estimates and forecasts

Performance Audit: Financial Indicators

Scope, methods and objectives

Analyzing financial ratios provides the City Commission and city management with an assessment of Lawrence's financial condition. The analysis is intended to encourage discussion of the city's financial condition and to:

- Identify significant existing or emerging financial problems; and
- Put the city's financial condition in context of the eight year period of 2003-2010 and through comparisons to medians of communities similar to Lawrence.

The City Auditor updated the analysis done in *Performance Audit: Financial Indicators* (September 2011). The auditor compiled information from Comprehensive Annual Financial Reports for Lawrence and 14 similar cities; evaluated ratios for Lawrence by looking at trends and comparing Lawrence to medians; and discussed the analysis with city staff. Chaney, Mead and Scherman developed most of the indicators in this performance audit.³

What is the source of the financial information in this report?

Comprehensive annual financial reports from Lawrence and the similar cities provide the financial data used in this performance audit. Nearly all of the information comes from the government-wide financial statements. Those statements rely on "full accrual" accounting. That means that the financial statements include capital assets and long-term liabilities as well as current assets and liabilities. The government-wide financial statements report all revenues and costs of providing government services, not just those received or paid in the current year or soon after.

The government-wide financial statements provide information about the cost of government services, including the cost of consumption of capital as well as financial resources. Capital resources include buildings, machinery, roads, and other assets.

³ Barbara A. Chaney, Dean Michael Mead, and Kenneth R. Scherman, "The New Governmental Financial Reporting Model: What it Means for Analyzing Government Financial Condition," *Journal of Government Financial Management*, Spring 2002.

The City Auditor did not follow-up on recommendations from last year's *Performance Audit: Financial Indicators* (September 2011) because those recommendations will be included in follow-up work that will be released soon after this report is released. Those recommendations were to prepare 5-year capital improvement plans for the city as a whole and make multi-year financial projections of major revenues and expenditures.

The Planning and Development Services Department provided estimates for Lawrence population that are included in the Comprehensive Annual Financial Report. Those estimates were used to calculate per capita debt, revenue, and expenditure trends. The trends were adjusted for inflation using *American City County Magazine's* municipal cost index and a base year of 2003.

The City Auditor conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require planning and performing the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for the findings and conclusions based on the audit objectives. The City Auditor believes that the evidence obtained provides a reasonable basis for the findings and conclusions based on the audit objectives.

The City Auditor provided the City Manager with a draft of the report on September 14, 2012.

Comparable cities

To identify comparable cities, the City Auditor reviewed data from the U.S. Census Bureau American Community Survey 2005-2009 five-year estimates. Data on 3,602 urban areas and urban clusters were used to identify those most similar to Lawrence on four measures:

- Population of the urban area or cluster
- Portion of residents under the age of 18
- Per capita income
- Median year of construction of housing

Figure 25 Similar communities

Urbanized area	Population	Per capita income 2009	Median year housing built	Portion of population under 18
Lawrence, KS	83,482	22,289	1978	15.9%
Iowa City, IA	94,499	24,770	1978	17.0%
Bellingham, WA	96,400	24,151	1979	17.0%
Norman, OK	92,321	24,257	1978	18.0%
Missoula, MT	77,502	21,829	1974	18.0%
Bloomington, IN	93,884	19,071	1978	14.3%
Charlottesville, VA	87,086	26,624	1977	17.9%
Chico, CA	96,424	22,839	1978	19.3%
DeKalb, IL	62,167	20,829	1975	18.2%
St. Cloud, MN	97,914	23,587	1980	19.9%
Auburn, AL	66,206	21,337	1985	17.7%
Corvallis, OR	59,610	22,738	1975	18.3%
Davis, CA	67,947	28,590	1978	16.0%
Morgantown, WV	60,920	21,042	1972	15.0%
State College, PA	76,348	20,038	1976	11.0%
Grand Forks, ND-MN	57,403	22,416	1974	18.3%

The City Auditor excluded Bloomington from the analysis because Bloomington did not follow accounting principles generally accepted in the U.S. in its most recent annual financial report. Consequently, the financial statements from Bloomington would not be comparable to the financial statements from Lawrence or the other similar communities.

Key Terms

City finances cover both governmental activities and business-type activities. **Governmental activities** include services like police and fire, public works, and administration. **Business-type activities** include services paid for largely by charges for service, such as trash collection and water and sewer utilities.

City **assets** are resources the city can use to provide services and operate the government. Among other things, assets include cash, investments, land, buildings, streets and water mains.

City **liabilities** are obligations the city has to turn over resources to other organizations or individuals. Liabilities include things like money the city has to pay to companies that provide services to the city and repayments for money the city borrowed.

Subtract liabilities from assets and the result is **net assets**. A portion of the city's assets may be used to meet ongoing obligations and this is referred to as **unrestricted net assets**.

The city collects taxes, such as sales taxes and property taxes, as **general revenues**. In addition to general revenues, **transfers** from other governmental activities can provide resources.

Expenses include costs incurred regardless of whether or not cash has actually changed hands. Expenses include depreciation of capital assets. These "accrual-basis" expenses provide a comprehensive measure of the cost of providing services.

Source of Financial Data

Comprehensive annual financial reports from Lawrence and the similar cities provide the financial data used in this performance audit. Nearly all of the information comes from the government-wide financial statements. Those statements rely on "full accrual" accounting. That means that the financial statements include capital assets and long-term liabilities as well as current assets and liabilities. The government-wide financial statements report all revenues and costs of providing government services, not just those received or paid in the current year or soon after.

The City Auditor calculated ratios using the most recent available comprehensive annual financial report. All but one of the annual reports from other cities covers a 2011 fiscal year. One annual report covers a 2010 fiscal year.