Performance Audit: Financial Indicators

September 2011

City Auditor
City of Lawrence, Kansas

September 22, 2011

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 two recommendations in this report intended to provide additional forward-looking financial information.

I provided the City Manager with a draft of this report on August 19. His written response is included.

Michael Eglinski
City Auditor

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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:

- Governmental activities indicators are generally favorable compared to the medians and improved compared to last year. Much of the improvement relates to the $8.5 million the city received to clean up the former Farmland Industries property.

- Governmental capital assets – which include infrastructure, buildings, and machinery and equipment – have generally worsened over the period of 2003-2010, but the ratio remains more favorable than the median. An area of concern is the city's relatively old machinery and equipment.

- Reviewing governmental funds adjusted for inflation shows that per capita debt declined to its lowest level during the period of 2003-2010, per capita revenue reached its highest level during the period, and per capita expenditure was at its highest level since 2006. The city lacks some forward-looking financial information recommended by local government finance experts and common among cities similar to Lawrence.

- Business activities indicators are mixed. Perhaps most striking, the business activities indicators for 2007-2010 are generally less favorable than they were for 2003-2006. An area of concern are the transfers from the business activities to the governmental activities, which are high compared to similar cities. An audit recommendation from 2009 to develop policy guidance has not been implemented.

The report includes two recommendations intended to develop forward-looking information by projecting major revenues and expenditures and reinstating 5-year capital improvement planning city-wide.

Performance Audit: Financial Indicators

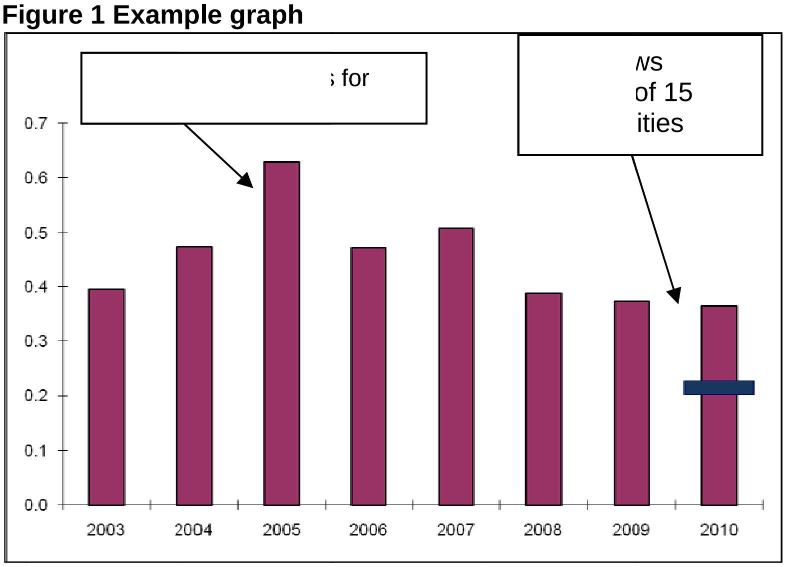
Financial indicators help understand Lawrence's financial condition

This performance audit, which analyzes financial ratios, provides the City Commission and city management with an assessment of 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 15 cities

Financial ratios are presented as graphs throughout the report. To evaluate the ratios, consider both the trend and the level compared to the median (see Figure 1). Trends can be characterized as more favorable, less favorable, or unclear. Likewise, levels can be characterized as more favorable, less favorable, or neutral. Characterizing each indicator using this method allows for overall conclusions about relative strengths and weaknesses of the city's finances.

Figure 1 Example graph



The City Auditor selected ratios to include in the performance audit. Most of the ratios come from *The New Governmental Financial Model: What it Means for Analyzing Government Financial Condition*.[1]

This report includes eight years of data for Lawrence (2003-2010), and compares data for Lawrence with medians based on an analysis of similar cities. 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.

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.

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

- urban area population
- portion of population under the age of 18
- per capita income
- median age of housing

See the Scope, Method and Objectives section for more detailed information on the similar cities.

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 strengths and limitations of the ratio analysis.

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[1] 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.

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

Evaluating Fiscal Sustainability

Fiscal sustainability refers to a local government's ability and willingness to generate resources to meet service commitments and financial obligations. Evaluating fiscal sustainability requires forward-looking information. The organization that sets government accounting standards is researching fiscal sustainability and has identified five measures needed to assess sustainability:

- projections of major cash in-flows
- projections of major cash out-flows
- projection of major financial obligations, like bonds, pensions and retiree health care
- projections of annual debt service payments
- information about intergovernmental dependencies

Government activities ratio analysis

Governmental activities include public safety, public works, and general government and are mostly supported by taxes. Figure 3 summarizes the analysis of ratios for governmental activities.

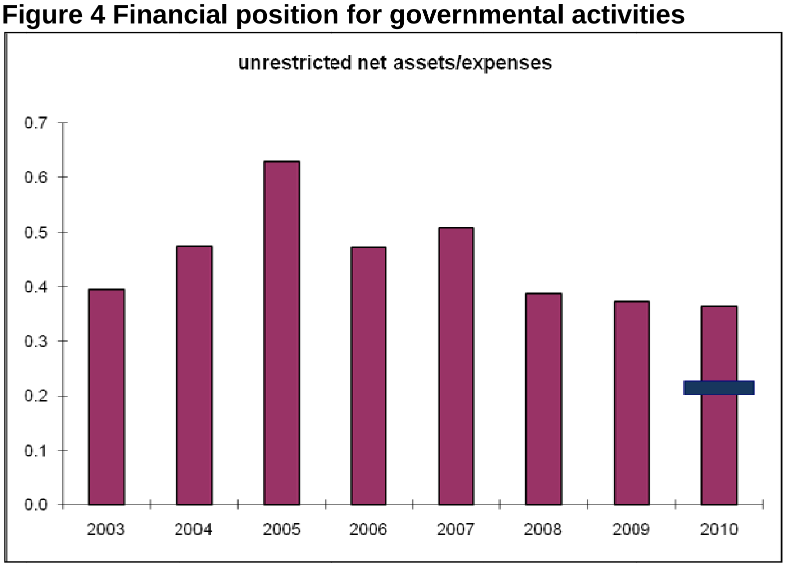
Figure 3 Governmental activities: summary of ratio analysis

Strength	Indicator	Compared to prior year
Stronger	Rate resources grow	Improved
	Resources to meet immediate needs	Remained the same
	Interest payment effect on financial flexibility	Improved
	Age of capital assets (mainly infrastructure) relative to comparison communities	Improved
	Ability to maintain services	Remained the same
	Debt burden	Improved
Weaker	Reliance on taxes to pay expenses	Weakened

Financial position: ability to maintain services

Lawrence's financial position shows an unfavorable trend and is above the median (see Figure 4). The measure indicates that the city's ability to maintain the provision of services.

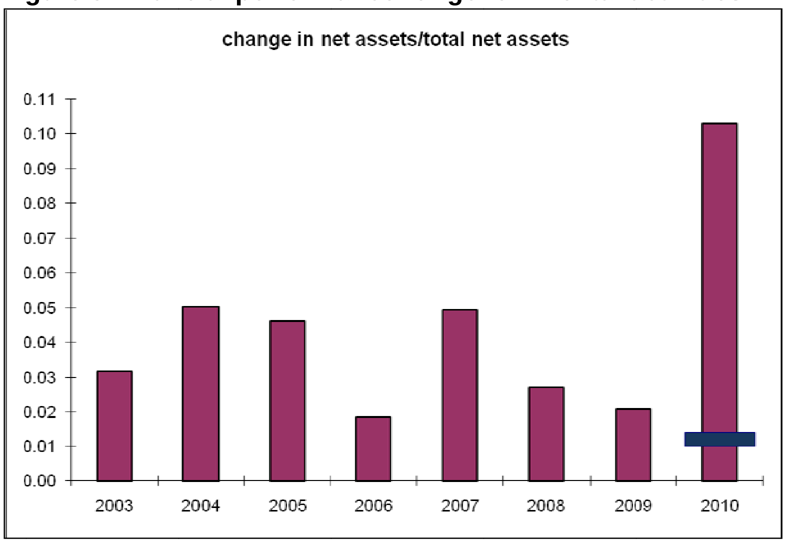
Figure 4 Financial position for governmental activities



Financial performance: rate resources grow

Lawrence's financial performance ratio shows no clear trend and is well above the median (see Figure 5). Compared to the median of similar cities, Lawrence's net resources grew much more in 2010. The sharp growth is largely related to the city receiving $8.5 million to remediate pollution at the former Farmland Industries property.

Figure 5 Financial performance for governmental activities



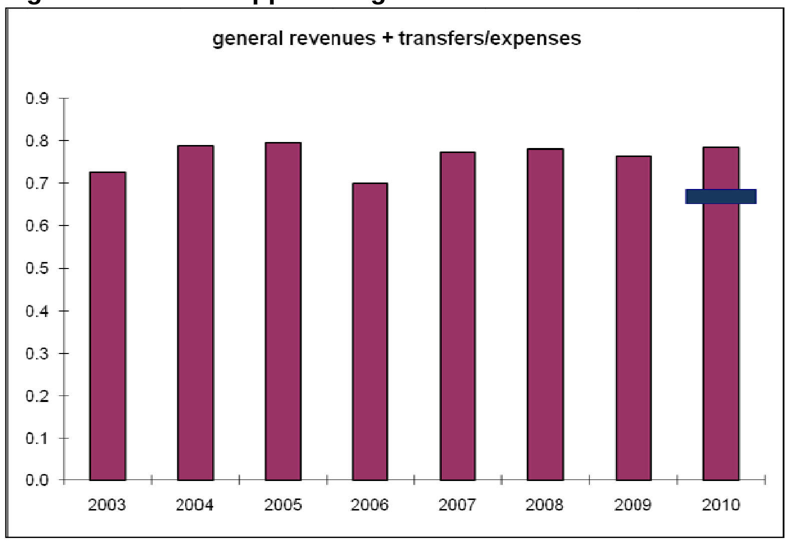
Former Farmland Industries Property

The sharp growth in the financial performance ratio in 2010 largely reflects the city's acquisition of the former Farmland Industries property and receiving $8.5 million to pay for the cleanup. The city owns the property and plans to remediate the environmental problems and develop it as a business park. Developing the property will require building infrastructure. Management estimates that the property will be valued at $17.2 million once the city builds the infrastructure and remediates the environmental problems.

General support: reliance on taxes to pay expenses

Lawrence's general support for governmental activities shows no clear trend and is above the median (see Figure 6). General support level reflects the extent to which the city relies on general taxes and transfers from enterprise operations rather than service charges and grants. In evaluating the general support level, focus on unexpected substantial changes more than the level.

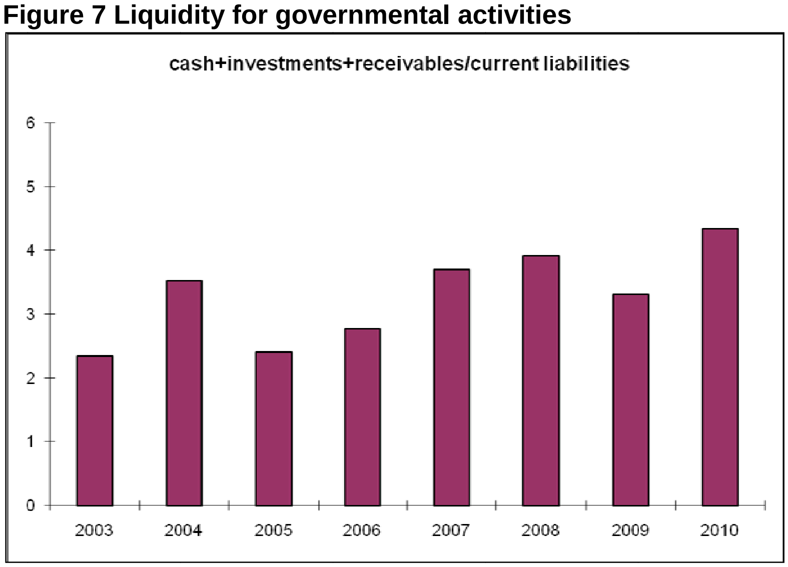
Figure 6 General support for governmental activities



Liquidity: resources to meet immediate needs

Lawrence’s liquidity ratio shows no clear trend and is above the average value for Lawrence for the period of 2003-2010 (see Figure 7). The indicator is interpreted in relation to Lawrence’s average rather than the 15 city median and the level is considered favorable because it is above that average.[2] The measure indicates the city’s access to resources to meet immediate needs.

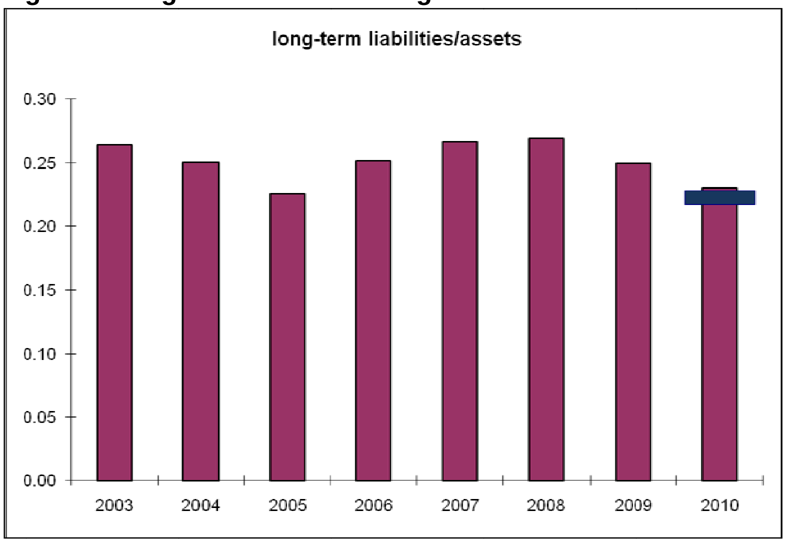
Figure 7 Liquidity for governmental activities



[2] The ratio for Lawrence includes $7.5 million in temporary notes payable, which is unusual among the similar cities. Lawrence initially finances projects with temporary notes during construction and then refinances with bonds once the project is complete. Because the comparison cities don’t use temporary notes to the same extent, the ratio is interpreted in relation to the trend and the average level over the period of 2003-2010. That average is 3.3 and the level for Lawrence in 2010 is 4.3. The 15 city median is 4.5 but is not included in the graph and is not the basis of the ratio’s evaluation.

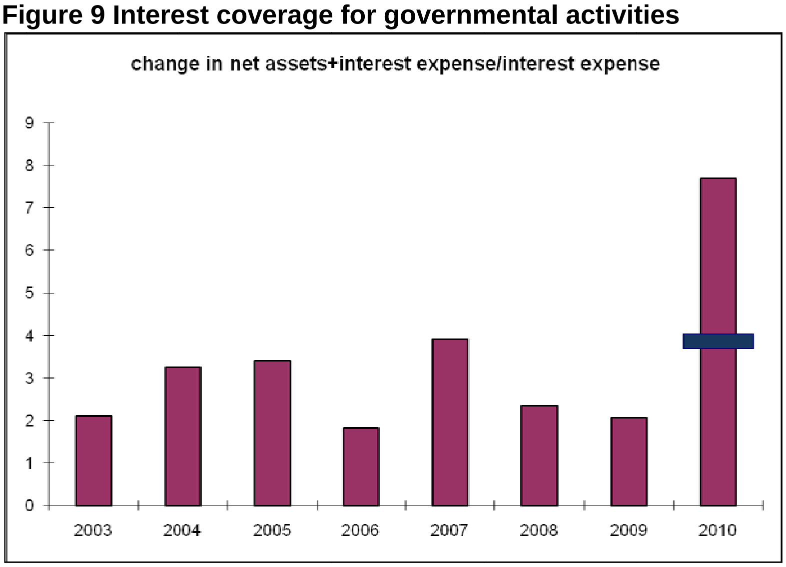
Long-term liabilities: debt burden
Lawrence's long-term liabilities measure shows a favorable trend and is above the median (see Figure 8). The ratio measures debt burden and suggests' that Lawrence's debt burden is higher than the median of similar cities.

Figure 8 Long-term liabilities for governmental activities



Interest coverage: interest payment effect on flexibility
Lawrence's interest coverage ratio shows no clear trend and is above the median (see Figure 9). Higher levels generally indicate that the city has more near term flexibility. However, the high level for this ratio largely reflects the city's acquisition of Farmland.

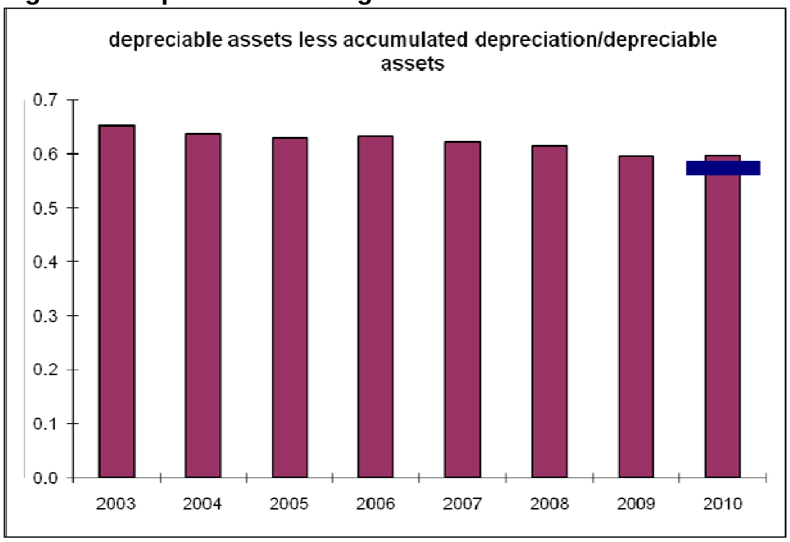
Figure 9 Interest coverage for governmental activities



Capital assets: aging of capital assets

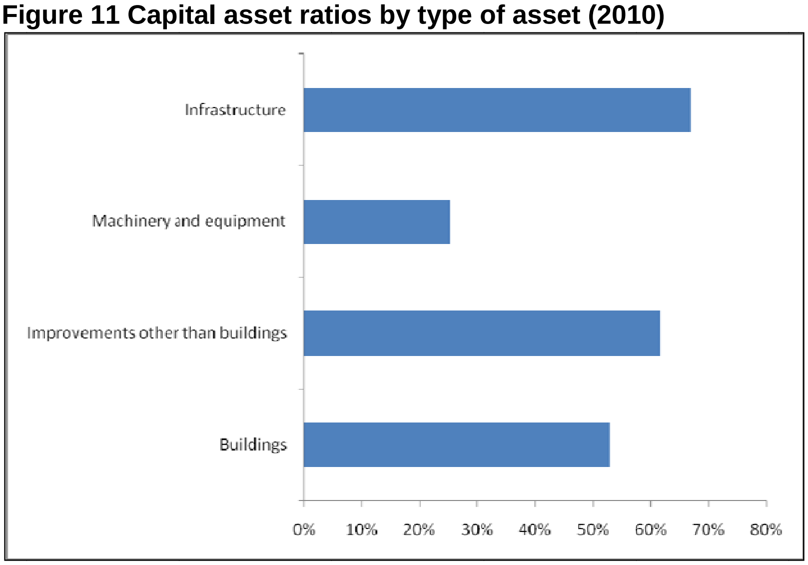
The capital asset measure shows no clear trend and a more favorable level than the median (see Figure 10). The ratio measures the aging of capital assets – primarily infrastructure and buildings. An increasing level would indicate improvement. The ratio for 2010 shows no clear trend, because the measure in 2010 is 0.001 better than 2009. The long term trend over the period of 2003-2010 is unfavorable, indicating that the city may not be keeping up with maintenance of infrastructure.

Figure 10 Capital assets for governmental activities



Machinery and equipment had the least favorable level among the different types of capital assets, while infrastructure had the most favorable level. See Figure 11.

Figure 11 Capital asset ratios by type of asset (2010)



Lawrence's ratio for machinery and equipment is less favorable than the ratio for similar cities. The median ratio for the similar cities is 37.5 percent, while Lawrence's ratio is 25.2 percent. The ratio for Lawrence is the lowest for any of the 15 cities considered; indicating that the relative age of Lawrence's machinery and equipment is unfavorable.

Declining capital ratio consistent with citizen survey responses

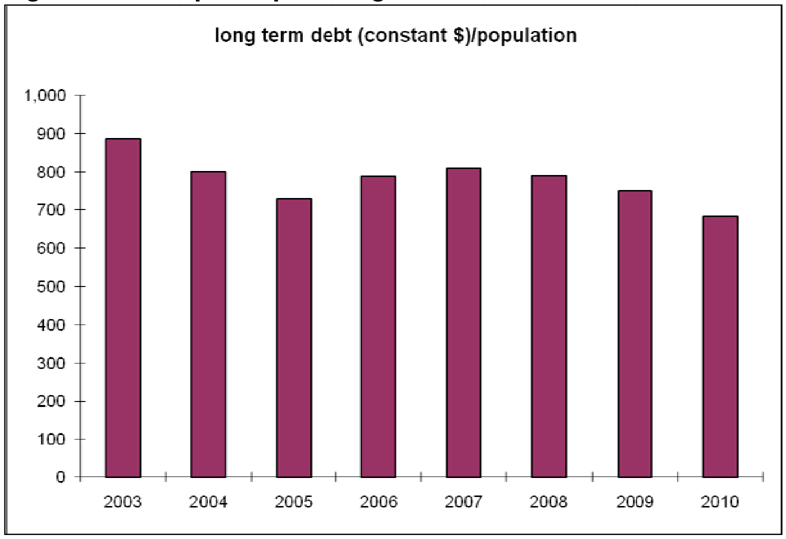
The general decline in the ratio is consistent with data from the citizen surveys. The surveys ask respondents which city services should receive the most emphasis over the next two years and the dominant answer in 2011 was maintenance of streets/sidewalks/infrastructure, with 69 percent of the respondents identifying it as a top priority. The 2011 survey results showed an increase in maintenance as a top priority. In 2007, 62 percent of respondents identified maintenance as the top priority.

Debt, revenue and expenditure trends

Debt, revenue and expenditures trends for governmental funds provide information on financial flexibility and sustainability. The graphs show data for all governmental funds on a per capita basis and adjusted for inflation. In this analysis, the governmental fund indicators aren't compared to medians.

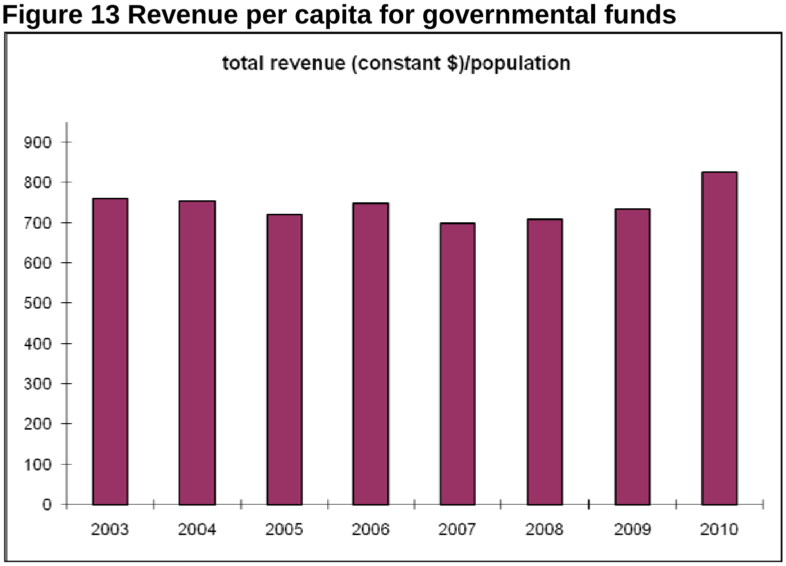
Long-term debt per capita decreased and reached the lowest level during the period of 2003-2010 (see Figure 12).

Figure 12 Debt per capita for governmental funds



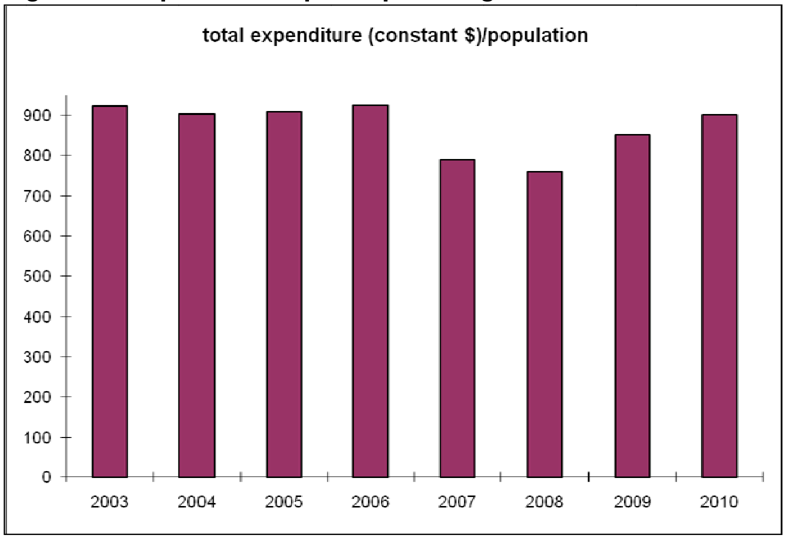
Revenue per capita increased in 2010 and reached the highest level in the period of 2003-2010 (see Figure 13). The increase reflects a full year of collections of the voter approved sales tax increase that went into effect in April 2009 and the $8.5 million to clean up the Farmland site.

Figure 13 Revenue per capita for governmental funds



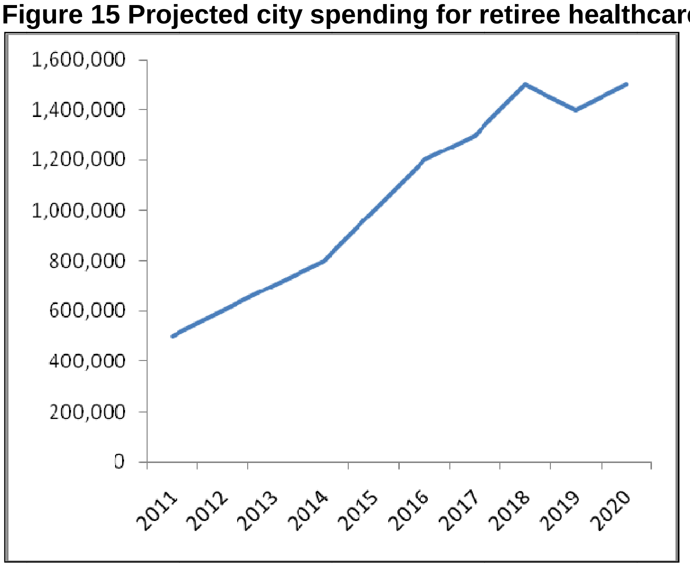
Expenditure per capita increased in 2010 but remained below the levels of 2003-2006 (see Figure 14).

Figure 14 Expenditures per capita for governmental funds



The increasing cost of providing health care benefits to retired employees represents a small but growing part of the increase in 2010. The financial statements highlight the growth, and recent analysis suggests that the expenditures will grow quickly. Under the current funding approach and given the level of city employees at the end of 2010, the annual payments will double by about 2015. See Figure 15.

Figure 15 Projected city spending for retiree healthcare



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.[3]

Forward-looking financial information could help understand fiscal sustainability. The growing expenditures on retiree health care benefits raise the general issue of forward-looking financial information. Forward-looking information helps evaluate fiscal sustainability. Many other local governments have tools to project future revenue and expenditure trends and identify and prioritize capital improvement needs.

Lawrence does not prepare multi-year financial projections and multi-year capital improvement plans. Local government finance experts recommend both as tools to identify financial problems and ensure financial health. The Government Finance Officers Association recommends both financial projections and multi-year comprehensive capital improvement plans.[4] Lawrence prepared 5-year Capital Improvement Plans in the past, but has not prepared a plan since 2008.

Most of the similar communities used in the analysis in this report prepare both financial forecasts and multi-year capital improvement plans. Of the 14 similar communities used in the report, 12 prepare financial projections and 13 prepare multi-year capital improvement plans.

The City Manager should prepare multi-year financial forecasts and 5-year capital improvement plans.

Business activities ratio analysis

Business activities include water and sewer, solid waste, parking, stormwater, and golf, and are mostly supported by user fees and charges. Figure 16 summarizes the analysis of ratios for business activities.

[3] 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, 2001, and *City of Lawrence, Kansas Retiree Health Care Plan Actuarial Valuation as of January 1, 2011*, EFT Actuaries, April 20, 2011.
[4] Government Finance Officers Association, *Financial Forecasting in the Budget Preparation Process* (1999) and *Preparing and Adopting Multi-Year Capital Planning* (2006).

Figure 16 Business activities: summary of ratio analysis

Strength	Indicator	Compared to prior year
Stronger	Ability to maintain services	Improved
	Resources to meet immediate needs	Remained the same
	Rate resources grow	Improved
	Debt burden	Remained the same
	Reliance on taxes to pay expenses	Remained the same
Weaker	Age of capital assets relative to comparison communities	Weakened

Evaluating the indicators for the period of 2003-2010 indicates that the business activities' financial condition was stronger in the first half of that time period. The business activities' financial position, financial performance, liquidity and long-term liability ratios were all less favorable for the period of 2006-2010 compared to the previous four years. The trend for the capital asset ratio generally worsened over the period of 2005-2010.

The city provides five business activities. Water and sewer and solid waste make up most of the business activities. Figure 17 summarizes the different activities.

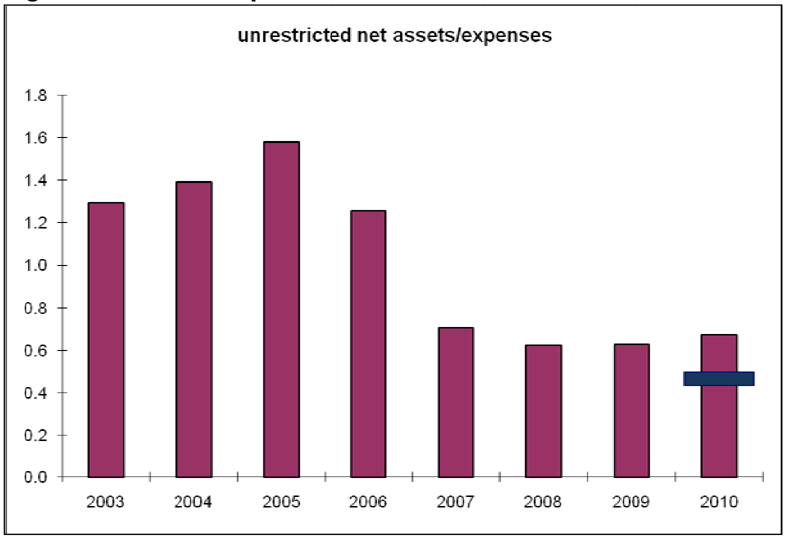
Figure 17 Business activities summary

Activity	Services provided	Expenses 2010
Water and sewer	Water and sewer services for commercial, residential, and wholesale customers	26,269,408
Solid waste	Solid waste collection and recycling services for commercial and residential customers	9,202,456
Parking	Downtown parking and parking enforcement services	1,329,347
Stormwater	Maintain and improve stormwater infrastructure	1,695,136
Golf course	Operates the Eagle Bend Golf Course	998,557

Financial position: ability to maintain services

The financial position for business activities shows a favorable trend and is above the median (see Figure 18). Financial position measures the ability to maintain the provision of services.

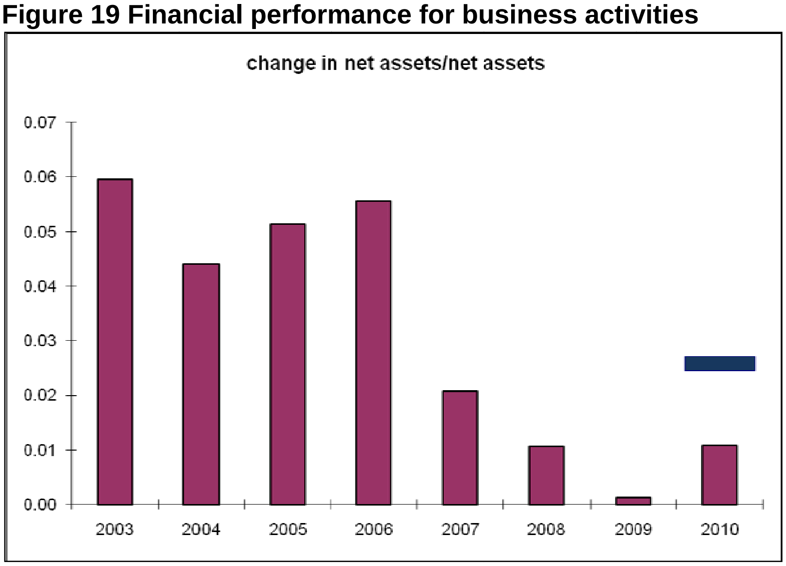
Figure 18 Financial position for business activities



Financial performance: rate resources grow

The financial performance for business-type activities shows no clear trend and is below the median (see Figure 19). Financial performance measures the rate at which resources grow.

Figure 19 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 20 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.[5]

[5] 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

Figure 20 Business activities net revenue

Service	2006	2007	2008	2009	2010
Water sewer	6,694,331	4,124,858	3,419,804	3,237,253	4,093,001
Solid waste	-322,906	-595,396	-746,555	-30,954	799,881
Parking	20,457	-233,451	-236,315	-286,022	-167,204
Stormwater	1,085,129	1,058,478	1,115,533	1,051,813	1,253,491
Golf	82,828	-2,301	-83,312	-96,595	-217,717

Over the last five years, solid waste, parking, and golf have generated less revenue than expense (see Figure 21).

Figure 21 Cumulative net revenue (2006-2010)

Service	Revenue less expense (2006-2010)
Solid waste	-895,930
Parking	-902,535
Golf	-316,934

Solid waste generated more revenue than expense in 2010 after 5 years during which expenses exceeded revenues. In 2010, the city collected more revenue and reduced operating costs for solid waste operations.

Most of the similar communities that have parking operations generate more revenue than expenses. Seven of the similar cities operate parking as a business activity. Five of those seven generate more revenues than expenses. If the city's parking activity performed at a level consistent with the median of the similar communities, the program would have had expenses about $100,000 a year lower than revenues in 2010.

General support: mix of funding

The level of general support for business-type activities shows a declining trend in recent years and is below the median (see Figure 22). General support measures the extent to which taxes, rather than service charges, support business-type activities. In evaluating the general support level, focus on unexpected substantial changes more than the level. Lawrence has a negative level, which means that the business-type activities, taken as a whole, support governmental activities.

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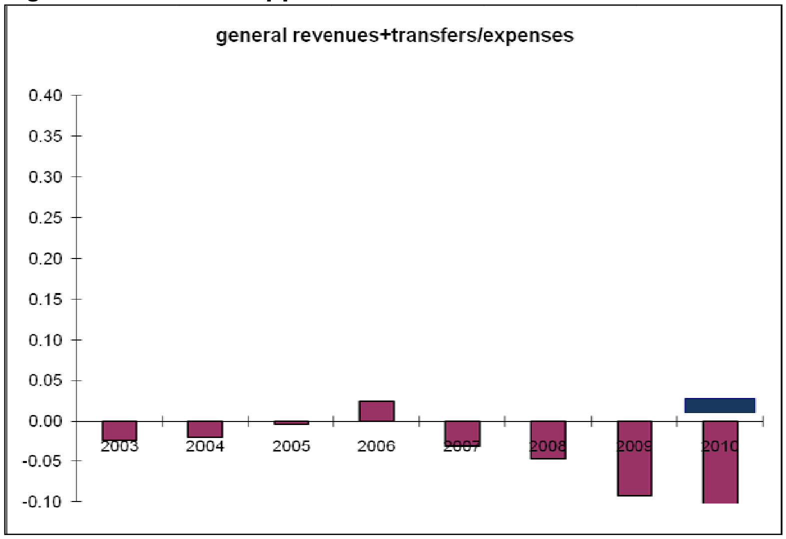
of capital assets using straight-line depreciation. That means, for example, that if a vehicle was bought in 2006 for $50,000 and is expected to last 5 years, it would be included as a $10,000 expense in each year from 2006 to 2010.

Figure 22 General support for business activities



The ratio shows that the city has increasingly come to rely on transfers from the business activities to support general government activities. Transfers from the business activities doubled in 2007 and have remained high since then (see Figure 23).

Figure 23 Business activity transfers

Year	transfers
2003	1,288,000
2004	1,441,718
2005	1,892,038
2006	2,102,194
2007	4,269,392
2008	3,890,984
2009	4,297,080
2010	4,621,388

Lawrence relies on transfers to support general government activities more than all but one of the similar communities. Lawrence's transfers represent 10 percent of charges for service in business activities. One other community – Charlottesville – also has transfers at a 10 percent level; and State College has transfers or 7.5 percent. The other 12 communities have transfers below 4.6 percent. Charlottesville bases the transfers on a predetermined formula intended to cover the property taxes and business licenses that the city's water, sewer and gas utilities would pay if they were private businesses.

In last year's *Performance Audit: Financial Indicators* (July 2010), the City Auditor recommended that the City Manager present for the City Commission a recommended policy on transfers from enterprise operations. In 2008, the City Auditor had recommended documenting the method for allocating overhead and the basis of interfund transfers. To date, a policy and method have not been developed. A policy on interfund transfers would help ensure a sound basis for those transfers.

Study finds Lawrence's transfers unfavorable

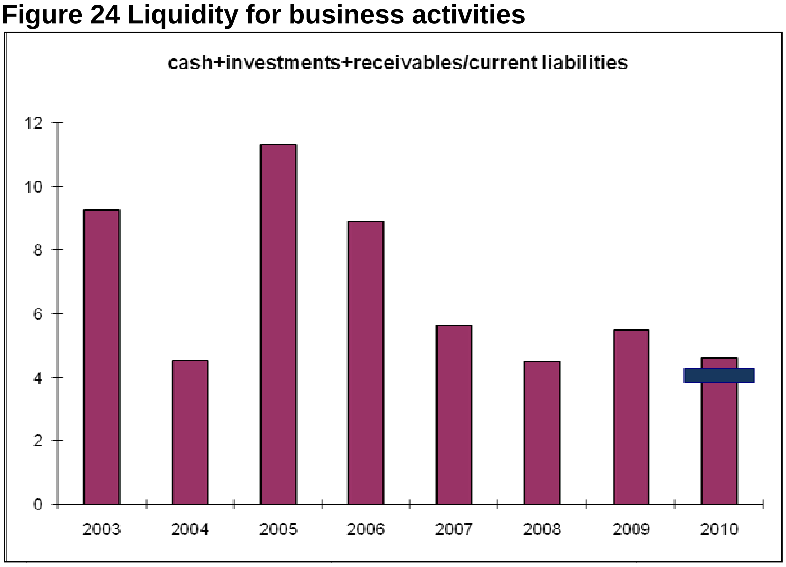
Lawrence's reliance on transfers was evaluated by Rubin Brown – an accounting firm – in their annual publication on public sector finances and found to be "less favorable." Rubin Brown calculates a ratio of transfers to the general fund as a percent of total revenues and transfers. In 2010, they reported that the ratio for Lawrence was 5.5 percent and that this was in the less favorable quartile for the Kansas City metropolitan area. Rubin Brown considered Lawrence's high ratio unfavorable because it indicates that the general fund is dependent on transfers.

Source: *Public Sector Stats 2010*, Rubin Brown, LLP.

Liquidity: resources to meet immediate needs

The business-type liquidity measure shows no clear trend and is above the median (see Figure 24). Liquidity measures access to resources to meet immediate needs.

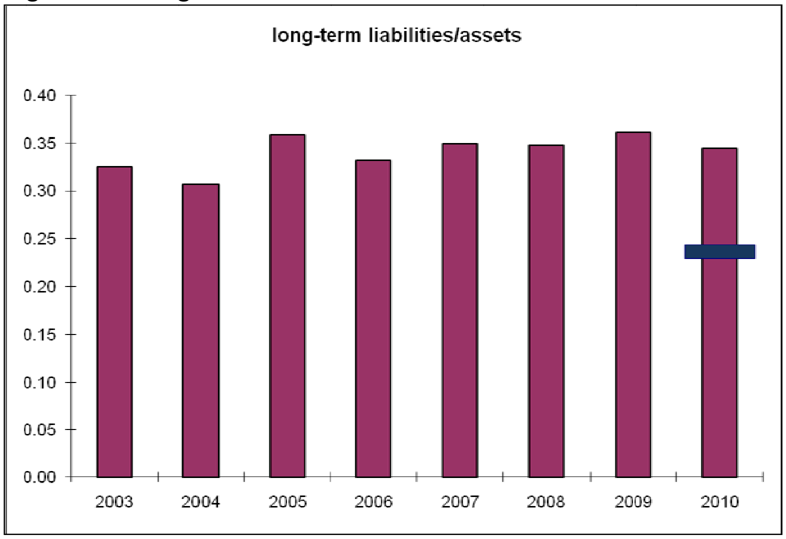
Figure 24 Liquidity for business activities



Long-term liabilities: debt burden

The business-type measure of long-term liabilities shows no clear trend and is above the median (see Figure 25). The ratio addresses debt burden.

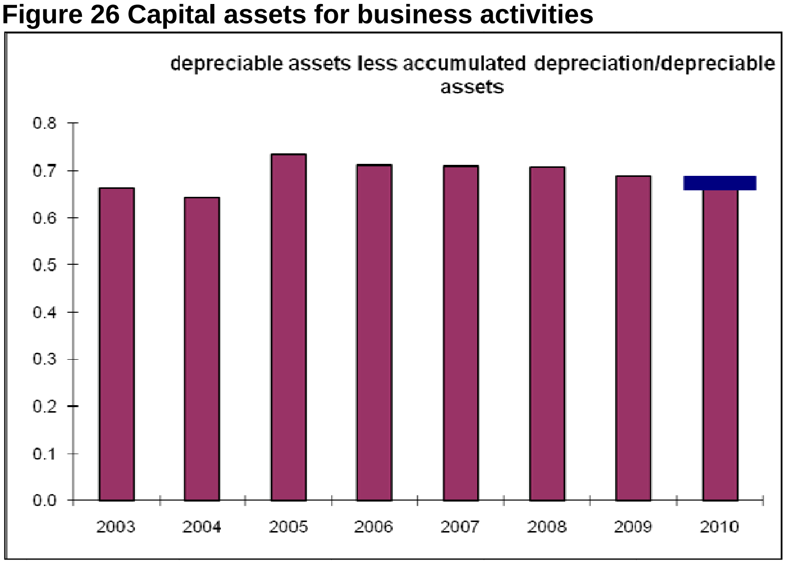
Figure 25 Long-term liabilities for business activities



Capital assets: aging of capital assets

The capital asset ratio measure shows a less favorable trend and is at the median (see Figure 26). An increasing level would indicate improvement. The ratio measures the aging of capital assets – primarily infrastructure and buildings.

Figure 26 Capital assets for business activities



Recommendations

The City Auditor recommends that the City Manager prepare and present to the City Commission:

1. 5-year Capital Improvement Plans for the city as a whole.

2. Multi-year financial projections of major revenues and expenditures.

In addition, the City Auditor repeats last year's recommendation that the City Manager present for the City Commission a recommended policy on interfund transfers for enterprise operations.

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* (July 2010). 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.[6]

The City Auditor reviewed documents including comprehensive annual financial reports from Lawrence and a 14 other cities, best practices from the Government Finance Officers Association, and actuarial valuations for the city's retiree health care benefits.

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.

[6] 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 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 August 19, 2011.

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 27 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 **unresetricted 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. Most of the annual reports from other cities cover a 2010 fiscal year. However, in two of the other cities, the most recent annual report covered fiscal years that ended in 2009.

Management's Response

City of Lawrence
KANSAS

CITY COMMISSION

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September 14, 2011

Michael Eglinski
City Auditor
City Hall
Lawrence, Kansas

Re: Financial Indicators Audit

Dear Michael,

Thank you for your work on the financial indicators performance audit. Staff has had an opportunity to review the preliminary draft that you provided on August 19. I believe that it accurately reflects the City's financial challenges in balancing a number of important values: limiting increases in our property taxes, adequately funding responses to our aging infrastructure and equipment, limited growth in key general fund revenues, and a strong desire to maintain quality city services. Of course, a financial indicators performance audit does not seek to balance all of these values. For example, it does not take into account the quality of services as demonstrated by citizen survey results of comparison cities, their relative tax burdens, or possible state, inter-local, or federal funding assistance. Also, none of the comparison communities are other cities in Kansas so we don't have the same legal structures or revenue opportunities/constraints as other communities in the report. This probably works both ways – for example, a city in Oregon won't have sales tax revenue, which is obviously a significant revenue source for Lawrence. These differences in our revenue streams and/or expenditures may contribute to financial decisions made by the communities in this comparison and might explain the differences highlighted in your report.

The conclusion that our financial indicators for 2010 show mixed results is a conclusion that is supported by both this audit data and our other financial analysis and information. For example, it is clearly important to highlight the increasing gap in attending to our equipment needs – See Figures 10 and 11 in the draft document. The 2008 Sales Tax – with 2010 being the first year of full receipts - will assist with our infrastructure and larger equipment needs for the Fire/Medical Department. The first larger project under this funding source, the reconstruction of Kasold south of Clinton Parkway, began in 2010 and is on-going. Providing approximately $2 million in new radios because of the federal spectrum reallocation may artificially move the equipment number in the future. Funding of our equipment needs will continue to be an important priority. The decision to further reduce our commodities expenditures in 2012 from recommended levels will put additional strain on service delivery as well.

I note that our long-term debt per capita has decreased and reached the lowest level during the period of 2003-2010. While this can be viewed as a positive financial indicator, I believe we should be more aggressive in this area. Our community value of limited property tax increases has made it easier to reduce the bond and interest mill levy while increasing general fund support. Before the voter-approved mill levy increase for the library project, our bond and interest mill levy has steadily been reduced from close to 9 mills several years ago to approximately 7 mills. This was done as general fund operations required additional property tax support. But it also means that we are investing less in our community infrastructure through debt issuances than we did in the 1990s and 2000s. I do not believe this is good trend, even if it helps with our financial indicators and lets us spend more money in the general fund supported services without raising property taxes.

I believe it is appropriate to continue to highlight the financial impact of retiree health care costs on the City, as seen in Figure 15. We have highlighted this information in our discussions about our health care expenses and will continue to work with the City Commission on this issue.

We have prepared a policy concerning fund transfers for City Commission consideration. It should be noted that communities treat transfers under different methods. For example, we make transfers to pay for liability and worker's compensation expenditures under Kansas laws that create these special purpose reserve funds. Other municipalities may make those expenditures directly from their enterprise funds.

Multi-year forecasting is also valuable. We do have a multi-year capital improvement plan for the use of the proceeds of the 2008 infrastructure sales tax. This plan includes both sales tax proceeds and debt proceeds. We also are developing a new multi-year capital improvement plan for our wastewater and water utilities. Because our focus has correctly been on maintenance rather than new construction the development of a multi-year capital improvement plan has not been necessary. It would be appropriate to update our multi-year capital improvement plan in the coming year.

It is very important to note that any multi-year capital improvement plan, multi-year capital debt plan, or multi-year forecasting must provide the essential feature of flexibility to allow for changing conditions. We have numerous examples of why flexibility in plans is imperative. The rapidly deteriorating condition of Iowa Street south of Harvard required the City to alter its multi-year plan for the use of the 2008 infrastructure sales tax – moving projects to later years - in order to respond to this need. The difficulty with making and publishing a multi-year plan which is viewed as an ironclad guarantee of future projects is that citizens may make plans and assumptions based on these plans – when the plans will likely quickly be altered by changing circumstances. We should strongly avoid false reliance on multi-year capital plans which promise certain improvements which can not be guaranteed for delivery.

Similarly, we can also publish multi-year financial forecasts. Obviously, these can highlight a number of issues demanding attention. How will the economy be performing in 2013 and 2014? Will housing values continuing to stay/decline/grow? How will consumption drive sales tax numbers in 2013 or 2014? How will federal and state law changes impacting health care alter those costs in 2014 and 2015? The multi-year forecasts will only be as valuable as their underlying assumptions. Our multi-year plans have been appropriately prudent: conservative estimates on both revenue growth and expenditure trends, with no assumptions about significant changes in programs. The multi-year plan has been to match expenditures with available revenues. Given the Commission's 2012 decisions about employee compensation and police department staffing, and our continuing challenges regarding revenue growth, a forecast looking at 2013 and 2014 can be developed. However, the many underlying assumptions about such a forecast make it useful but with no guarantee of accuracy or reliance.

Sincerely,

David L. Corliss
City Manager