

Performance Audit: Financial Indicators

November 2014

City Auditor
City of Lawrence, Kansas

November 20, 2014

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 to provide information to the City Commission on the annual financial audit and changes in accounting standards that will require the City to report pension liabilities.

I provided the city Manager with a draft of this report on September 19, 2014. The City Manager's response is included in the report.

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. Among the highlights:

- Financial performance indicators for both government activities and the enterprise operations low. For government activities this reflects a decline in capital and operating grants combined with increased expenses. For the enterprise operations this reflects a decline in revenue related to lowered demand for water.
- While long-term liabilities indicators were low in 2013, those indicators exclude significant temporary notes payable. Temporary notes fund construction and get repaid when the City issues long-term debt. The City had \$56.1 million in temporary notes for government activities and \$36.4 million in temporary notes for business activities. Long-term liabilities will increase significantly as the city issues long-term debt to pay those temporary notes.
- Capital asset indicators show aging infrastructure, buildings and machinery and equipment. The indicator for machinery and equipment suggests that the City may face significant replacement costs or service disruptions in the near future.
- Governmental fund expenditures per resident have grown over the last 10-years after adjusting for inflation.
- Two indicators of community resources – employment and assessed value – have been relatively flat.

The report includes two recommendations about providing the City Commission with additional financial information and information on changing accounting rules that will require the City to show pension liabilities in the City's financial statements.

Performance Audit: Financial Indicators

Financial indicators help understand Lawrence's financial condition

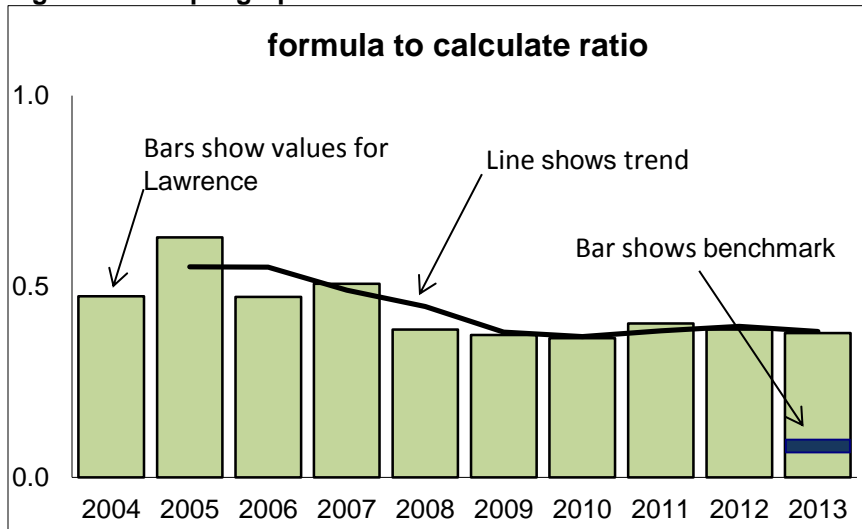
This performance audit, which analyzes financial ratios, provides the City Commission and city management with information about Lawrence's finances. The performance audit is intended to encourage discussion of the city's finances and to:

- identify significant existing or emerging financial problems
- put the city's finances in context by compiling data for 10 years and comparing to the median of 14 cities

This report includes 10 years of data for Lawrence (2004-2013) 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 the trend and the level compared to the benchmark. Throughout the report, indicators are characterized as more or less favorable in terms of both the trend over the last three years and the level in relation to the benchmark. Graphs for each indicator also show a trend line for the entire 10-year period to help identify long-term trends.

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 ratio analysis method.

Figure 2 Strengths and limitations of 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
Accrual accounting provides info to understand long-term financial condition	Provides historical analysis rather than projections of future condition

City Commission should review the annual financial audit

The City Commission should review the annual financial audit. In recent years members of the City Commission have received copies of the annual financial audit, but the governing body has not reviewed it. The annual financial audit provides a wide range of information and is suitable for understanding the City’s long-term financial condition. When the City issues debt, the City agrees to have the City Commission review the annual financial audit soon after it is completed. The City Manager should ensure that the annual audit is reviewed by the City Commission each year.¹

¹ An example of the specific language from an official statement is, “as soon as possible after the completion of the annual audit, the governing body of the Issuer shall review the report of such audit...” (*Final Official Statement, City of Lawrence, Kansas, Taxable Water and Sewage System Improvement Revenue Bonds, Series 2009-A Build America Bonds*, July 17, 2009). Identical language is included in bond sale resolutions such as resolutions 7090, 7091 and 7092 adopted on September 9, 2014.

Government activities ratio analysis

Government activities include public safety, public works and general government. Taxes provide the funding for most of government activities. The following table summarizes the results of the analysis of financial ratios for government activities.

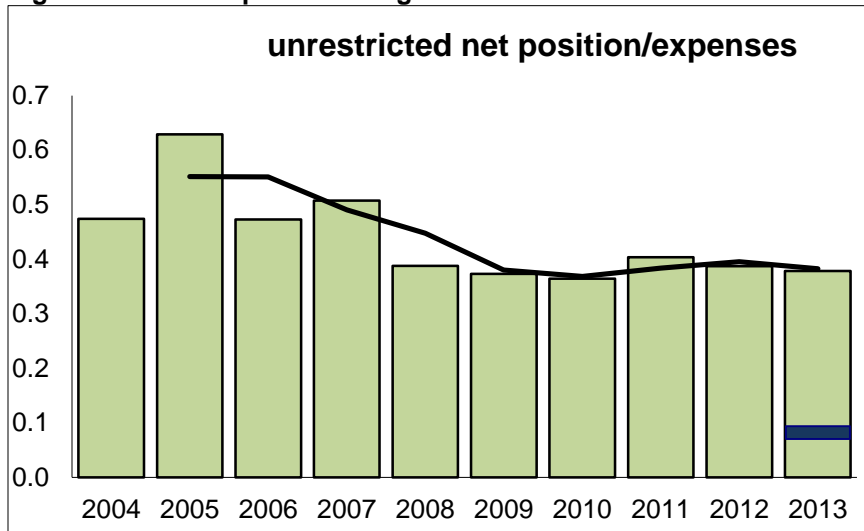
Figure 3 Governmental activities indicator summary

Measure	Trend	Compared to benchmark	Compared to last year's analysis
Position: ability to maintain services	less favorable	more favorable	worsened
Performance: financial resource growth	less favorable	less favorable	worsened
General support: reliance on taxes and transfers to pay expenses	more favorable	not evaluated	improved
Liquidity: resources to meet immediate needs	less favorable	less favorable	unchanged
Long-term liabilities: burden of debt and other long-term liabilities	more favorable	more favorable	unchanged
Interest coverage: interest payment effect on flexibility	no clear trend	more favorable	unchanged
Capital assets: aging of capital assets	less favorable	more favorable	unchanged

Financial position: ability to maintain services

Lawrence's financial position shows a less favorable trend in recent years and is more favorable than the benchmark. While the trend over the last few years is less favorable, the level of the indicator is well above the benchmark. The measure indicates the city's ability to maintain the provision of services.

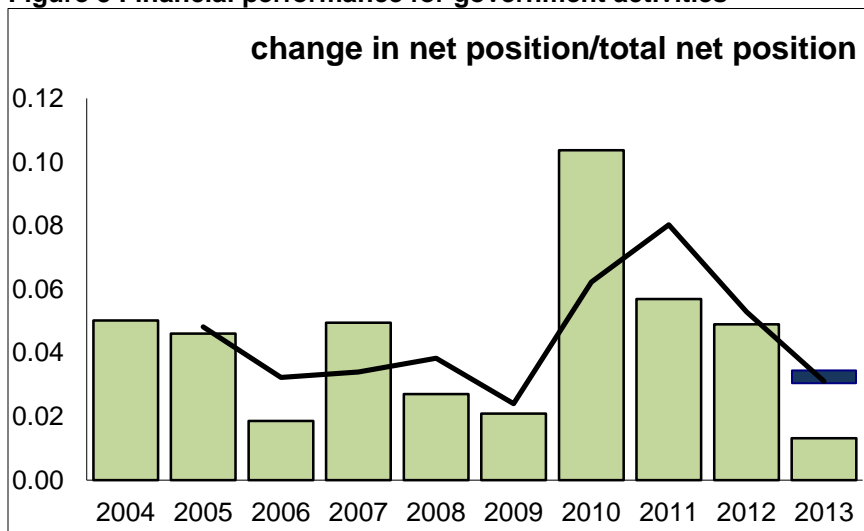
Figure 4 Financial position for government activities



Financial performance: rate resources grow

Lawrence’s financial performance shows a less favorable trend in recent years and is less favorable than the benchmark. The ratio in 2013 was at the lowest level for the entire 10 year period. The measure indicates the rate at which resources grow.

Figure 5 Financial performance for government activities



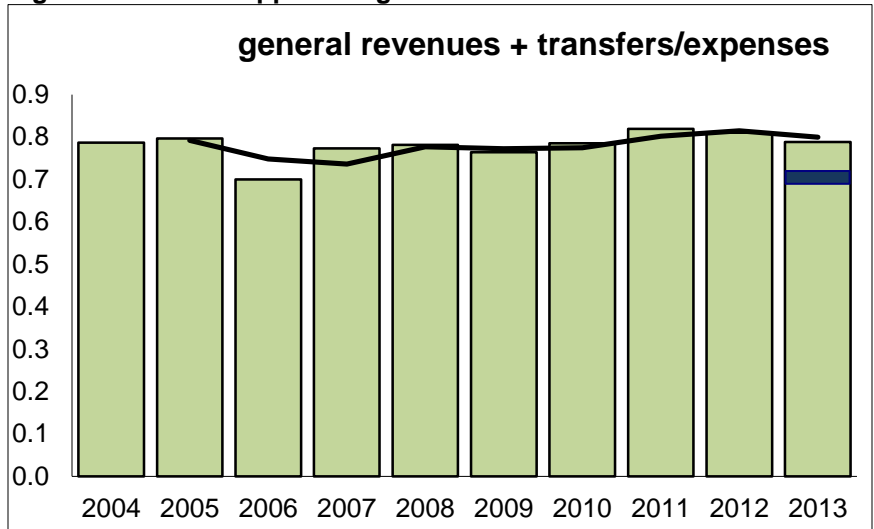
The sharp decline in the financial performance indicator for 2013 reflects growing expenses combined with a decrease in revenue from capital and operating grants.

The financial performance indicator was very high in 2010. This largely reflects the \$8.5 million the City received when it acquired the former Farmland property and \$2 million in federal American Recovery and Reinvestment Act Funds.

General Support: reliance on taxes and transfers to pay expenses

Lawrence’s general support indicator shows a favorable trend and is above the benchmark. This indicator is evaluated only on the trend and a trend toward the benchmark is considered favorable. 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, such as Lawrence’s, indicate greater reliance on taxes and transfers.

Figure 6 General support for government activities



Changing revenue structure for providing governmental services

Over the last 10 years the way the City pays for government activities has changed. Sales and property taxes remain the main sources of revenue. However, the mix of revenues has changed. Comparing 2013 to 2004 shows that some revenues are more important and some are less.

More important	Less important
Sales taxes	Program revenue
Transfers	Property taxes
Franchise taxes	

The most significant changes in how governmental activities are paid for have been the increasing importance of sales tax and the decreasing importance of program revenues.

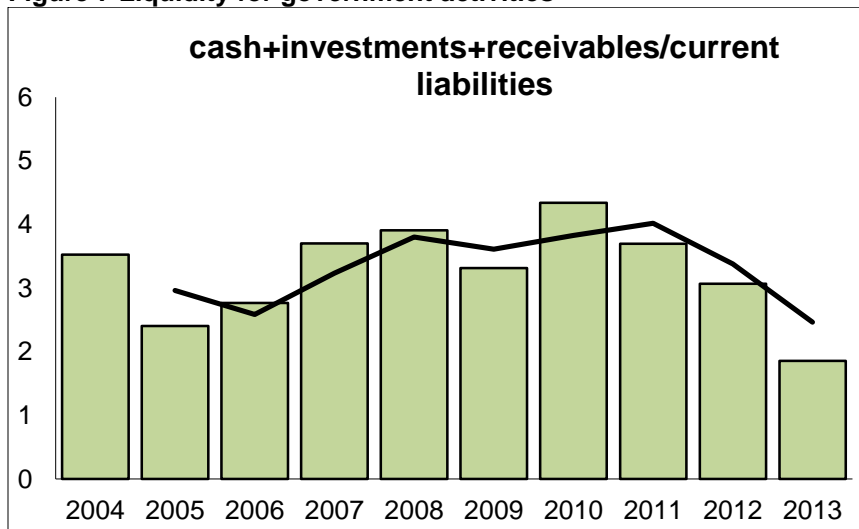
Sales taxes generated slightly less revenue than property taxes in 2004, but by 2013 sales taxes generated significantly more revenue than property taxes.

Program revenues include various charges for services and grants. Over the 10 year period, program revenues grew little. In 2004 the City had \$21.9 million in program revenue and in 2013 that number was \$22.3 million.

Liquidity: ability to meet immediate needs

Lawrence’s liquidity shows a less favorable trend in recent years and is below the median value for Lawrence over the ten year period. The ratio is at the lowest level it has been for the entire 10 year period. The liquidity measure is evaluated in relation to the median value for Lawrence over the ten year period. The median was 3.4 compared to the 2013 level of 1.9. The measure indicates the city’s ability to meet immediate needs.

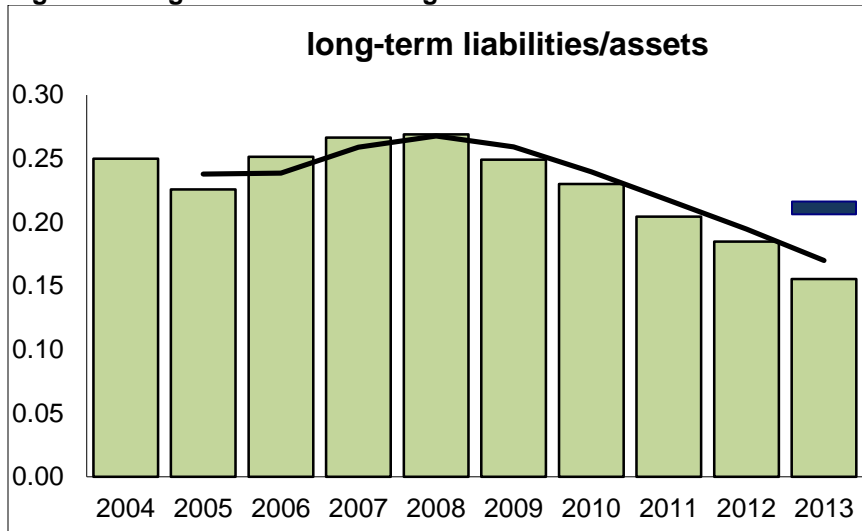
Figure 7 Liquidity for government activities



Long-term liabilities: debt burden

Lawrence's long-term liabilities ratio shows a favorable trend and is more favorable than the benchmark. While the ratio was at the lowest level for the entire 10 year period, it doesn't include temporary notes issued to finance construction.² The ratio measures the burden of debt and other long-term liabilities.

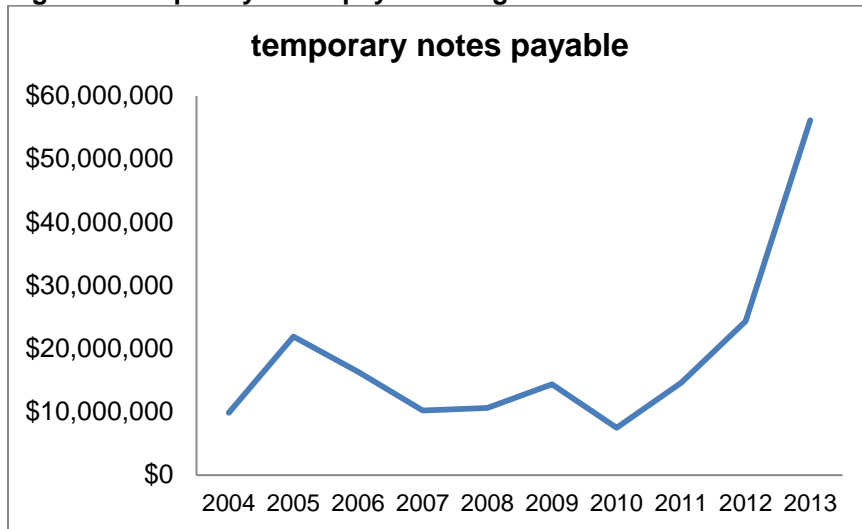
Figure 8 Long-term liabilities for government activities



While the long-term liabilities ratio is low, the city has a lot of temporary notes payable related to future long-term debt. Temporary notes were higher in 2013 than any of the previous 10 years. The City issues temporary notes to fund construction of projects. The City then issues long-term bonds to repay the temporary notes. In the City's financial statements, temporary notes are not considered long-term liabilities.

² Government activities had \$56.1 million in temporary notes in 2013. In the same year, long-term liabilities due in more than one year totaled \$56.8 million.

Figure 9 Temporary notes payable for government activities



Long-term liabilities include costs related to vacation and sick leave for employees and health care benefits for retired employees. Those costs totaled \$9.8 million in 2013. Those costs have increased in recent years. Since 2009 those cost have grown at an annual rate of 16 percent with retiree health care costs growing most significantly.

Beginning 2015 the City will report KPERS and KP&F pension costs

The City's annual financial audit for 2015 will include information on the City's pension obligations. Currently, the City doesn't show the pension liabilities in the financial statements. Under new government accounting standards that will change. The City will have to report its share of the costs and obligations for the Kansas Public Employees Retirement System (KPERS) and the Kansas Police and Firemen's Retirement System (KP&F).

The change in how the City will report pensions is designed to:

- Improve information about pension costs for decision-making
- Increase the transparency of information about pension costs
- Provide more consistent and comparable information across different local governments

The change may have significant implications for revenue bonds, such as those backed by water and sewer revenues. Experts recommend that local government management:

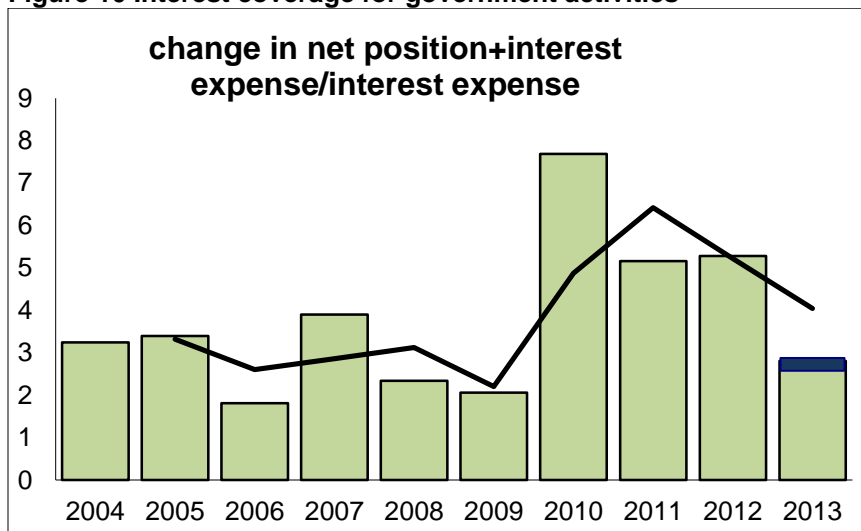
- Communicate implications of the accounting change to the governing body
- Explore implications for revenue bonds

The City Manager should provide the City Commission with information on the implications of the change in accounting standards.

Interest coverage: interest payment effect on flexibility

Lawrence’s interest coverage shows no clear trend over recent years and is at the benchmark. Higher levels generally indicate more financial flexibility. Keep in mind that this ratio is likely to be less favorable as the City issues long-term debt to repay temporary notes.

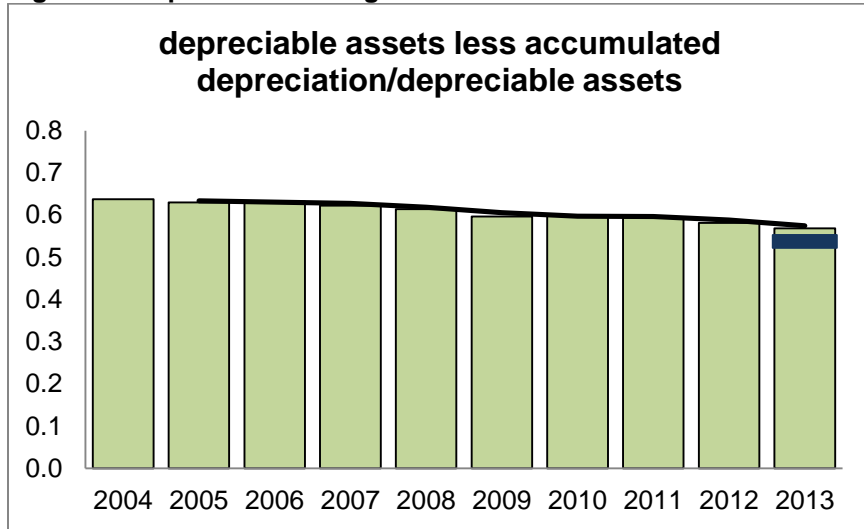
Figure 10 Interest coverage for government activities



Capital assets: aging of capital assets

The capital asset indicator shows less favorable trend over recent years and is more favorable than the benchmark. The measure indicates the aging of capital assets such as streets, buildings and vehicles. The trend indicates that the city may not be keeping up with maintenance of capital assets.

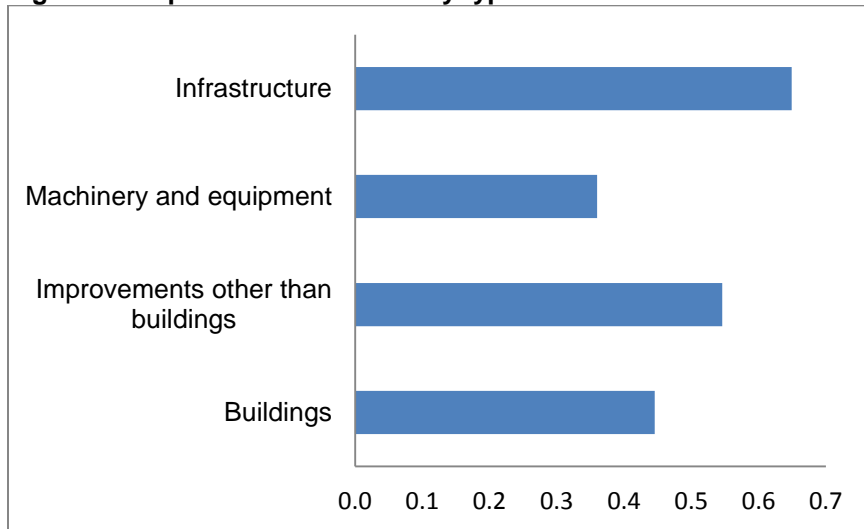
Figure 11 Capital assets for government activities



Capital assets include things such as roads, buildings, vehicles and other equipment. Capital assets are designed to last for years and to provide service over several years.

Machinery and equipment have the least favorable level for the indicator. This indicates a higher chance that the City will face significant replacement costs or service disruptions in the near future. Buildings also have a relatively low level for this indicator.

Figure 12 Capital asset indicator by type of asset



Business activities ratio analysis

The City of Lawrence business activities include water and sewer, solid waste, parking, stormwater and golf. User fees and charges provide most of the support for these business activities. The following table summarizes the results of the analysis of financial ratios for government activities.

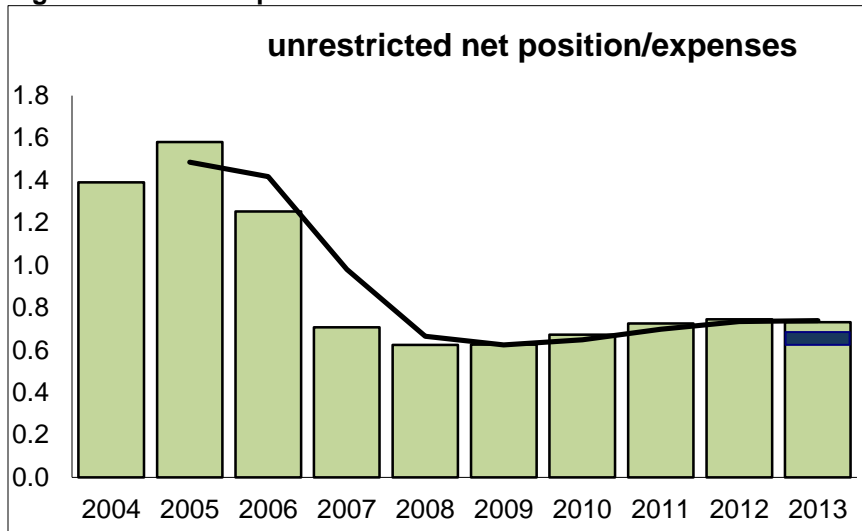
Figure 13 Business activities indicator summary

Measure	Trend	Compared to benchmark	Compared to last year's analysis
Position: ability to maintain services	no clear trend	more favorable	worsened
Performance: financial resource growth	no clear trend	less favorable	worsened
General support: reliance on taxes and transfers to pay expenses	more favorable	not evaluated	unchanged
Liquidity: resources to meet immediate needs	less favorable	less favorable	worsened
Long-term liabilities: burden of debt and other long-term liabilities	more favorable	more favorable	improved
Capital assets: aging of capital assets	less favorable	more favorable	worsened

Financial position: ability to maintain services

Lawrence's financial position shows no clear trend over recent years and is more favorable than the benchmark. The measure indicates the city's ability to maintain the provision of services.

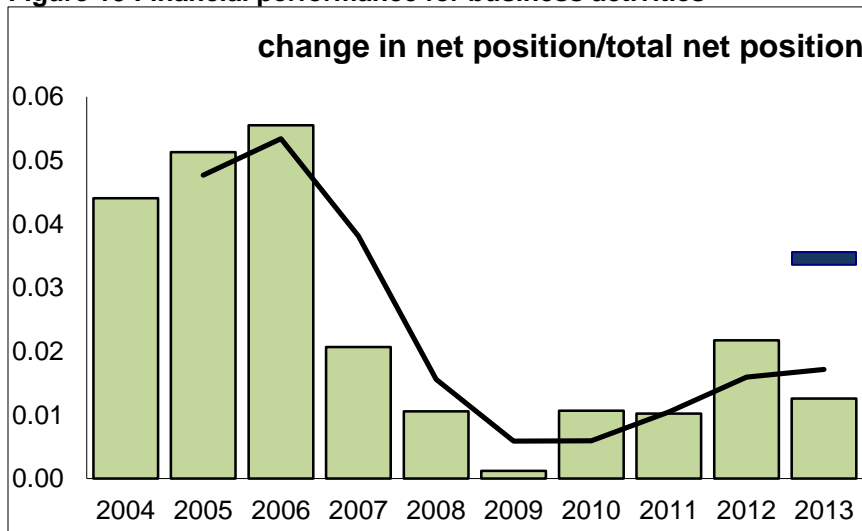
Figure 14 Financial position for business activities



Financial performance: rate resources grow

Lawrence’s financial performance shows no clear trend over recent years and is less favorable than the benchmark. The measure indicates the rate at which resources grow.

Figure 15 Financial performance for business activities



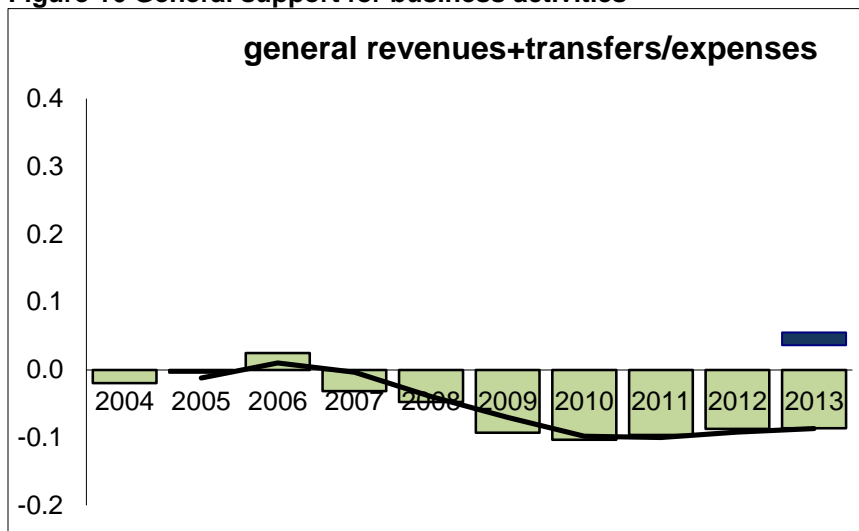
The large decrease in financial performance in 2013 is largely related to a decline in water sales that wasn’t offset by a decline in expenses. A hot and dry summer in 2012 resulted in a high demand for water. But a wetter summer in 2013 resulted in lowered demand for water. Utilities Department charges for service dropped by about \$2 million. The department’s expenses declined by \$0.3 million while transfers to government activities remained steady.

Two of the enterprise operations – parking and golf – generated less in revenues than expenses. Charges for services covered 81 percent of the expenses for golf and 86 percent of the expenses for parking. Several of the similar communities used in this report have golf and parking enterprise operations. Lawrence’s golf and parking operations recover less of their expenses than those services recover in other cities. This analysis should be viewed with caution because only eight of the 15 cities have parking operations and only three have golf operations. Comparatively large gaps between charges and expenses for golf and parking could indicate problems with cost controls and revenue and could result in reduced quality of services.

General support: reliance on taxes and transfers to pay expenses

Lawrence’s general support for business activities shows a trend toward the benchmark which is considered more favorable. The indicator reflects the extent to which the business activities rely on taxes rather than service charges. Levels below zero indicate that the business activities contribute to governmental activities.

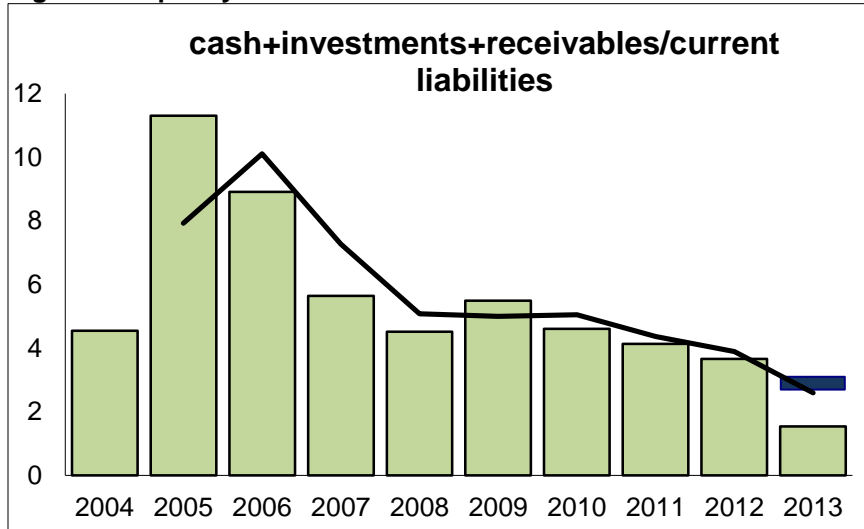
Figure 16 General support for business activities



Liquidity: ability to meet immediate needs

Lawrence’s liquidity indicator shows a less favorable trend over recent years and is less favorable than the benchmark. The indicator was at the lowest level for the entire 10 year period. The measure indicates the city’s ability to meet immediate needs.

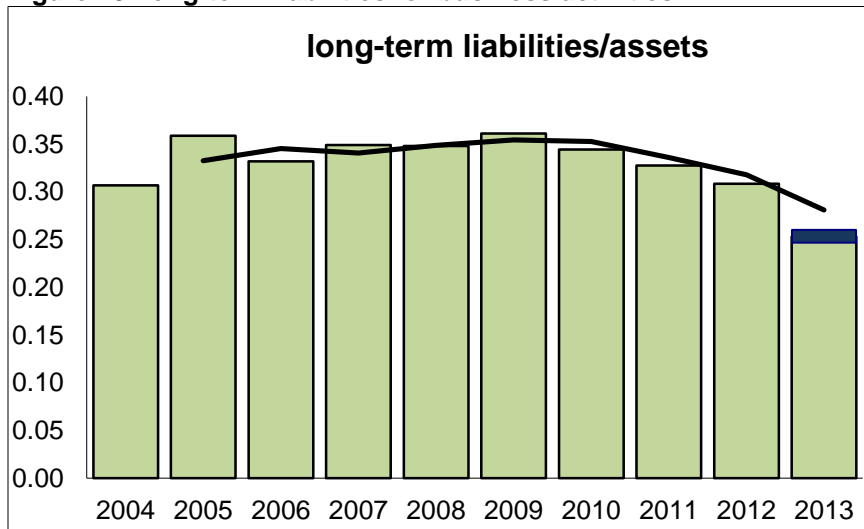
Figure 17 liquidity for business activities



Long-term liabilities: debt burden

Lawrence’s long-term liabilities indicator shows a favorable trend over recent years and is at the benchmark. While the ratio was at the lowest level for the entire 10 year period, it doesn’t include temporary notes issued to finance construction.³ The ratio measures the burden of debt and other long-term liabilities.

Figure 18 Long-term liabilities for business activities

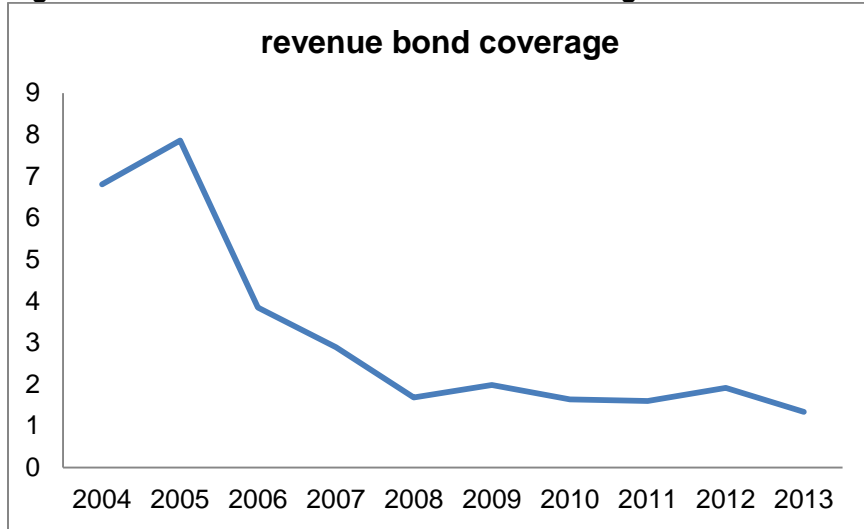


The indicator of revenue available for debt service in 2013 for the water and sewer fund was at its lowest level in the 10-year period. Revenue bond coverage is the ratio of revenue available for debt service divided by the

³ Business operations had temporary notes totaling \$36.4 million in 2013. In the same year, long term liabilities due in more than one year totaled \$72.5 million.

annual debt service requirement. The decline reflects the larger decline in operating revenues than in operating expenses and an increase in debt service required. Decreasing coverage is a less favorable trend.

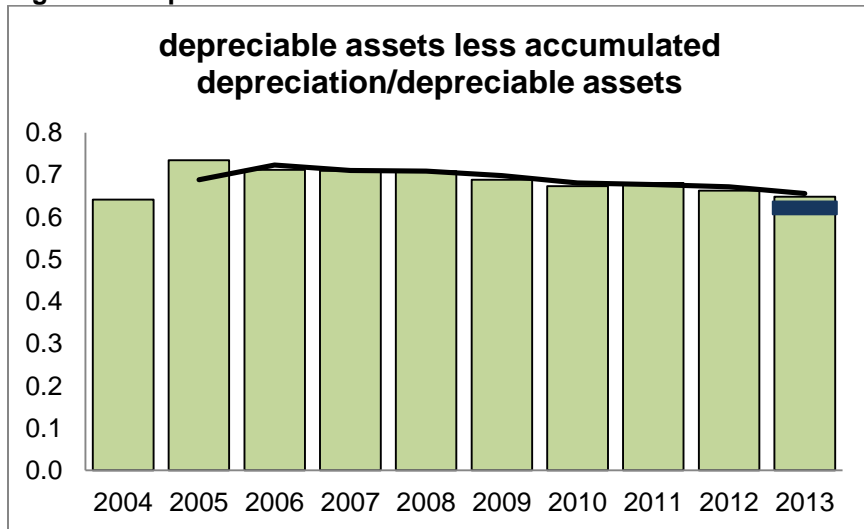
Figure 19 Water and sewer revenue bond coverage ratio



Capital assets: aging of capital assets

The capital asset ratio shows a less favorable trend and is more favorable than the benchmark. The measure indicates the aging of capital assets such as water and sewer mains, buildings and vehicles.

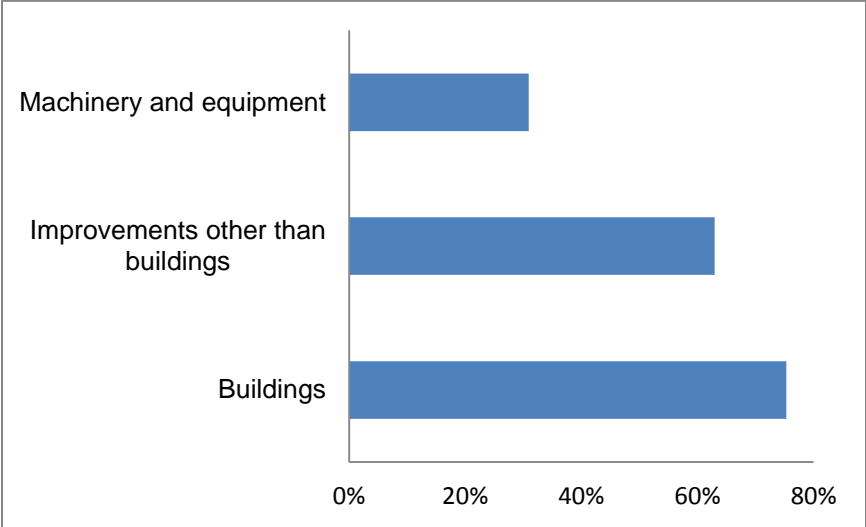
Figure 20 Capital assets for business activities



Machinery and equipment have the least favorable level for the indicator. This indicates a higher chance that the City will face significant

replacement costs or service disruptions in the near future. Note that the indicator for enterprise activities (31 percent) is lower than the same indicator for governmental operations (36 percent).

Figure 21 Capital asset indicator by type of asset

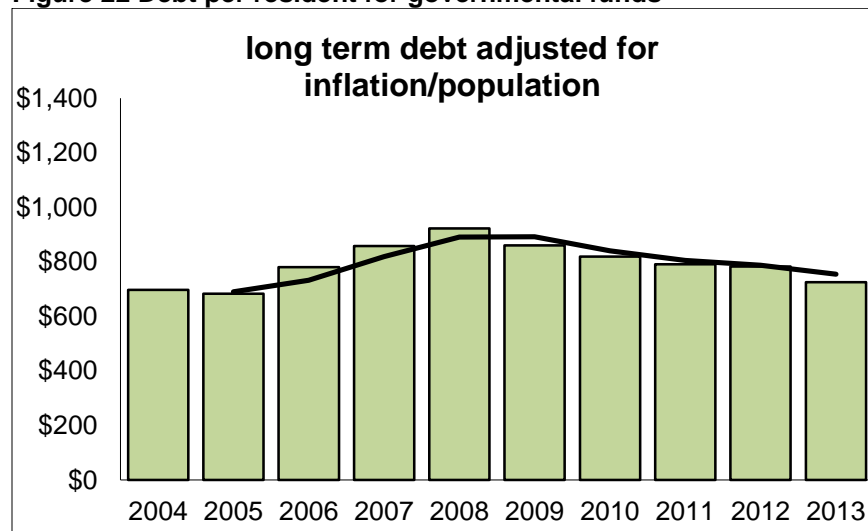


Debt, revenue and expenditure trends

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.⁴

Inflation adjusted long-term debt per resident has declined each year since 2008. As the City issues bonds to repay temporary notes, the long-term debt will likely increase in the future.

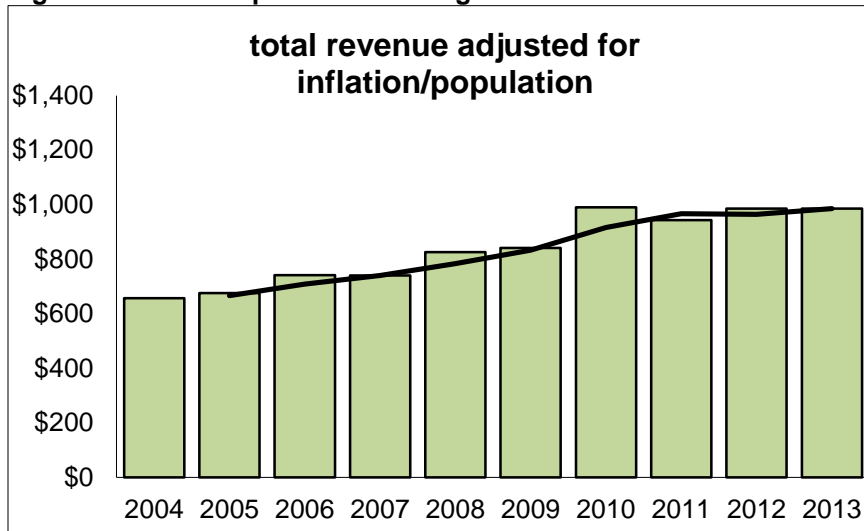
Figure 22 Debt per resident for governmental funds



Inflation adjusted revenue per person has generally increased throughout the 10 year period.

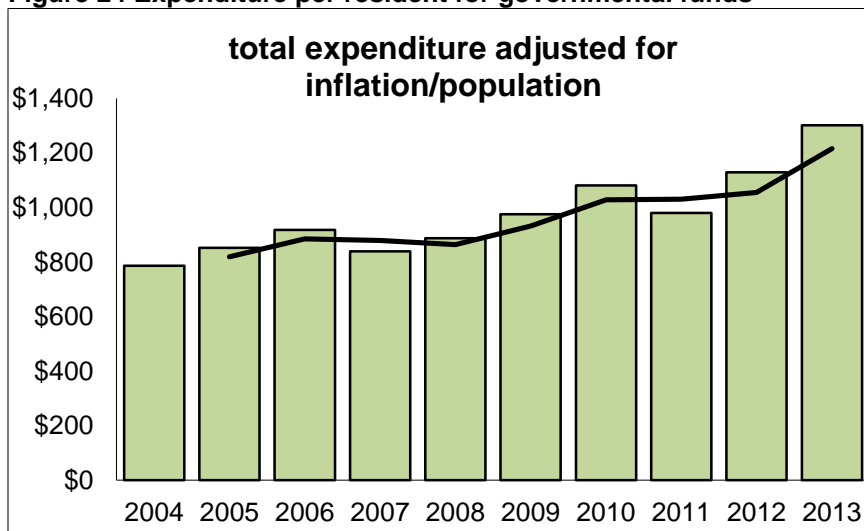
⁴ The analysis uses population estimates prepared by the City and reported in the Comprehensive Annual Financial Report. Compared to the U.S. Census estimates, the City estimates more people live in Lawrence but the population is growing at a slower rate since 2010.

Figure 23 Revenue per resident for governmental funds



Inflation adjusted expenditure per person has generally increased throughout the 10-year period.

Figure 24 Expenditure per resident for governmental funds



10-year expense and revenue growth

Over the 10-year period of 2004 through 2013, governmental expenses grew faster than revenues.

Governmental activities	Compound annual growth rate (2004-2013)
Expenses	4.36 percent
Revenues	3.46 percent

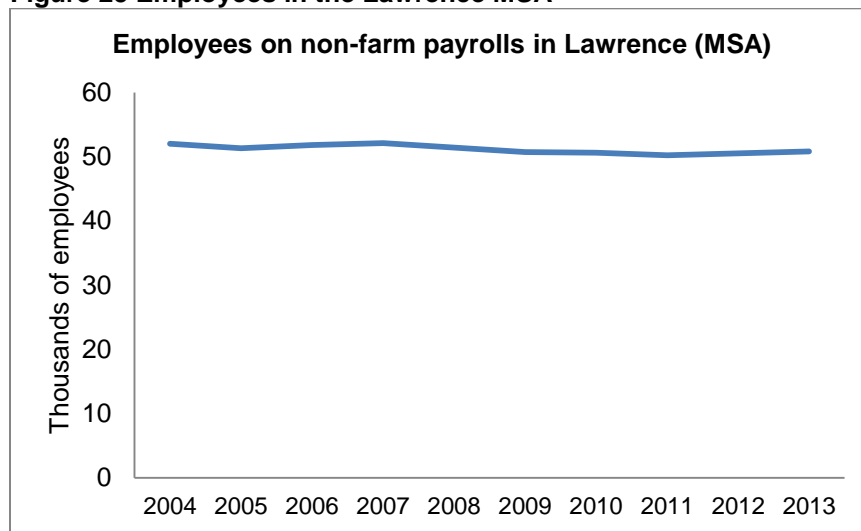
In the most recent 5-year period (2009-2013) expenses grew faster than revenues, but the gap between them was smaller.

Indicators of the economic environment

Measures of employment and assessed value provide additional context for understanding the economic environment and the City's finances. Both of these indicators help understand the community's resources.

The number of employees on non-farm payrolls in the Lawrence metropolitan statistical area was generally flat throughout the 10-year period. Non-farm payroll counts employees by the area of the job regardless of where the employee lives. The Lawrence metropolitan statistical area includes all of Douglas County.

Figure 25 Employees in the Lawrence MSA

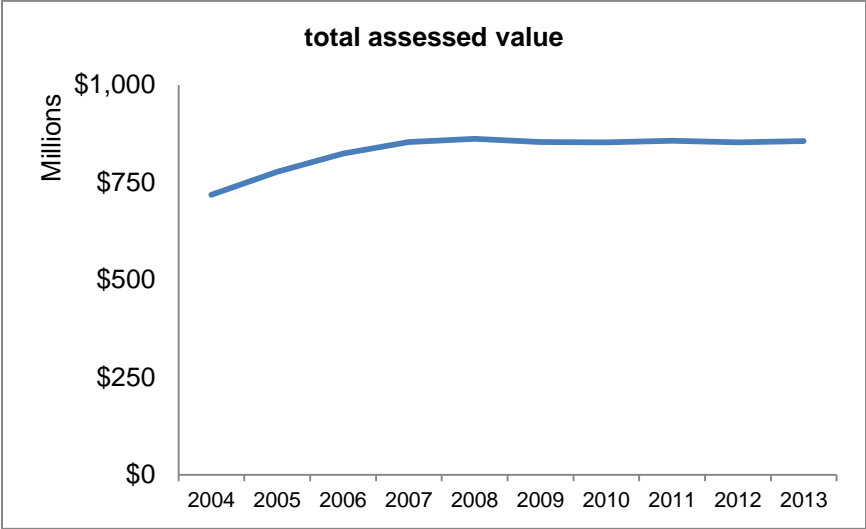


Of the similar cities, the median annual employment growth rate for the 10-year period was 0.76 percent.⁵ At that growth rate, Lawrence would have about 4,000 additional employees.

⁵ The analysis of medians excludes three cities that are included in data for much larger metropolitan areas. DeKalb is included in the Chicago MSA, Davis is included in the Sacramento MSA, and Norman is included in the Oklahoma City MSA.

Assessed value in Lawrence has been relatively flat since 2007 after growing in the first part of the 10-year period.

Figure 26 Total assessed value in Lawrence



Recommendations

The City Auditor recommends that the City Manager:

1. Ensure that the governing body reviews the annual financial report soon after the report is complete.
2. Report to the City Commission on the pension liability changes in government accounting standards to help understand the changes and implications for the City.

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 10 year period of 2004-2013 and through comparisons to medians of communities similar to Lawrence.

The City Auditor updated the analysis done in *Performance Audit: Financial Indicators* (October 2013). The auditor compiled information from Comprehensive Annual Financial Reports or financial statements 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

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

Comprehensive annual financial reports and financial statements 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.

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 a final draft of the report to the City Manager on September 19, 2014. The City Auditor followed-up on a written response on September 30, October 17 and 31, and November 7 and 18. The City Manager’s written response is included.

Comparable communities

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.

The City Auditor calculated ratios using the most recent available comprehensive annual financial report. All but two of the annual reports from other cities cover a 2013 fiscal year. Two annual reports cover a 2012 fiscal year.

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 adjust for deferred in and outflows of resources and the result is **net position**. The portion of net position that is not restricted for other uses and that may be used to meet ongoing obligations is referred to as **unrestricted net position**.

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.

Performance Audit: Financial Indicators

Management's Response

City Code requires a written response addressing agreement or disagreement with findings and recommendations, reasons for disagreement, plans for implementing solutions, and a timetable for completing such activities.



City of Lawrence KANSAS

CITY COMMISSION

MAYOR
MIKE AMYX

COMMISSIONERS
JEREMY FARMER
DR. TERRY RIORDAN
ROBERT J. SCHUMM
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www.lawrenceks.org

November 18, 2014

Mr. Michael Eglinski
City Auditor

Re: Financial Indicators Report

Dear Michael,

Thank you for your recent Financial Indicators Report. I believe it contains helpful data and information concerning the City's financial status. I also agree with your recommendations. We have previously provided the annual audit directly to the Commissioners and posted it on the City website. I believe making it a regular agenda item in the future will be an additional opportunity to review the material. This can also serve as a venue to discuss the second recommendation concerning City/State pension responsibilities.

As a follow up to our 2015 budget discussions, city staff has begun some additional initiatives which speak to issues raised in your report. For example, staff is currently reviewing a draft internal report comprehensively analyzing our fleet (vehicles and equipment) needs. As your report notes, these needs should be an area of focus for the city organization as well. I anticipate that vehicle and equipment needs will be an important budget topic in building the 2016 budget. While City revenues in the general fund have performed appropriately to-date in 2015, your report's conclusion that finances represent a mix of positive and negative indicators also appears to be appropriate. Growth for sales tax revenue and assessed valuation should continue to be a top priority for the community to ensure adequate revenue for community needs in the future.

Sincerely,

David L. Corliss
City Manager