METRO

PEOPLE PLACES
OPEN SPACES

Financial Condition of Metro
FY98-FY07

April 2008

A Report by the Office of the Auditor

Suzanne Flynn
Metro Auditor

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M E M O R A N D U M

April 25, 2008

To: David Bragdon, Council President
Rod Park, Councilor, District 1
Carlotta Collette, Councilor, District 2
Carl Hosticka, Councilor, District 3
Kathryn Harrington, Councilor, District 4
Rex Burkholder, Councilor, District 5
Robert Liberty, Councilor, District 6

From: Suzanne Flynn, Metro Auditor

Re: Financial Condition of Metro, FY98-FY07

The following report represents our audit of the financial condition of Metro over the past ten years. The last audit of financial trends was completed in September 1998. This report provides a check-up of how well Metro is doing financially based upon financial indicators that are recommended by the International City/County Management Association.

This audit was not included in the annual audit schedule but was added because I felt it would be a worthwhile report for the Metro Council and COO to receive on a regular basis. In the future, my office will conduct this audit every two years. We have discussed our findings and recommendations with Finance and Administrative Services and the COO and would like to acknowledge their assistance and cooperation in reviewing the report.

Suzanne Flynn

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INTRODUCTION

A government in good financial condition can afford to provide services on an on-going basis without disruption and can respond to changes. Financial condition can be monitored by reviewing long term trends in the areas of revenues received, expenditures, debt, assets, and the community's demographics and economy.

This report provides citizens and public officials with an overview of Metro's financial condition. It includes 25 financial and demographic measures covering a 10-year period, from fiscal year (FY) 1997-98 through 2006-07.

Highlights

- Revenues have grown faster than inflation and have increased at a higher rate than expenditures. However, revenues per capita have declined.
- As Metro has repaid long term debt from voter-approved bonds for the purchase of open spaces, the property taxes collected from residents have decreased.
- Revenue from excise taxes has increased 77%.
- Metro has over-estimated revenues in nine out of the ten past years.
- Expenditure per capita has declined 7%, perhaps indicating expenditure for Metro services has not kept up with population increases.
- Fixed costs have declined both in amount and as a percent of total expenditure.
- The number of Metro employees has remained stable in the last ten years. Employees per capita have declined.
- Expenditure on employee wages has increased 21% and fringe benefits have increased 27%.
- Unreserved fund balances are available to withstand financial down turns.
- Metro has a strong cash flow position to meet short-term requirements.

SCOPE & METHODOLOGY

The methodology in this report is based on recommendations from the International City/ County Management Association in the publication *Evaluating Financial Condition: A Handbook for Local Government*. Funds included as operating funds are the general fund, special revenue funds, debt service funds, and the permanent fund. Not included as operating funds are capital projects funds, enterprise funds (Solid Waste and MERC), internal service funds, and trust funds.

We obtained data from the *Comprehensive Annual Financial Report* (CAFR) with the exception of some budgetary information from the adopted budgets and personnel cost information from the financial accounting system, PeopleSoft. Economic and demographic data is from outside published sources. All dollars are adjusted for inflation in current FY07, or 2007 dollars, whichever is appropriate.

Identifying and reporting on operations for Metro using the CAFR was somewhat complex because in the ten-year period we examined:

1 Metro's financial reporting of funds by fund type varied considerably. The majority of the changes were due to:

   a. implementation of GASB Statement 34 in 2002, and

   b. consolidation of a number of funds into the General Fund in FY06.

   A schedule of the reclassification of fund types is included in the appendix. Funds over the ten year period were restated to reflect accounting treatment in the CAFR at June 30, 2007.

2. Reported transfers do not clearly identify amounts as transferred in and out for services provided by one fund to another, transfers of revenues collected by one fund for another, inter fund loans and transfers of fund balances. As a result, transfers among funds are not included. Although transfers among funds net to zero, when some funds are excluded from operating revenues or expenses, there will be a net balance between transfers in and transfers out.

As a result of the above, some indicators based upon CAFR information on assets and liabilities are reported for Metro as a whole and include Solid Waste and MERC business-type activities.

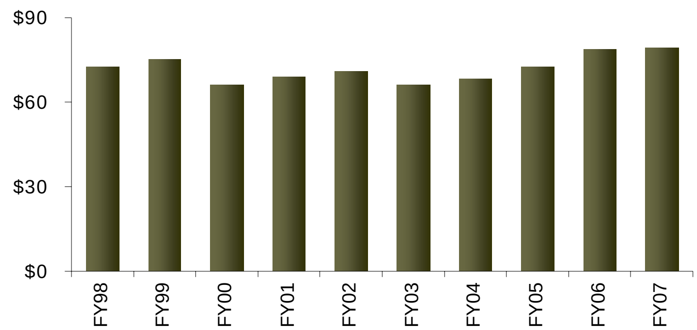
We reviewed information for reasonableness and consistency. We did not audit the accuracy of source documents or reliability of data in computer-based information. Most of the financial information in the report is from the CAFR and we therefore relied on the work of the Metro's external financial auditors. We conducted our work in accordance with generally accepted government auditing standards.

Revenues

Metro receives resources that pay for its operations from taxes levied, fees and charges earned as a result of the services it provides, or through grants received from other agencies or governments.

Operating Revenues

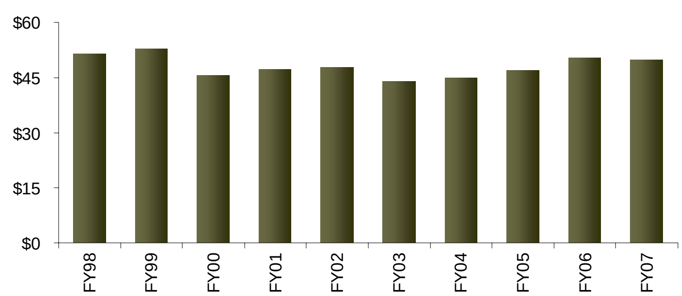
Operating revenues adjusted for inflation have increased 9% in the last 10 years.



In millions, adjusted for inflation

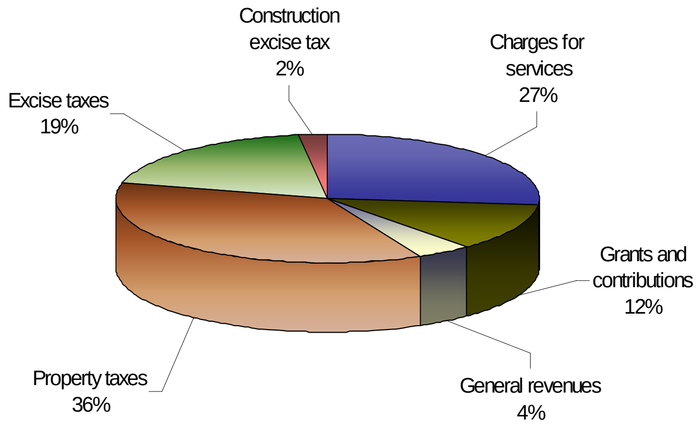
Operating Revenue Per Metro Resident

Operating revenues per Metro region resident have declined by 3%. In FY07, Metro received $50 per resident in revenues.



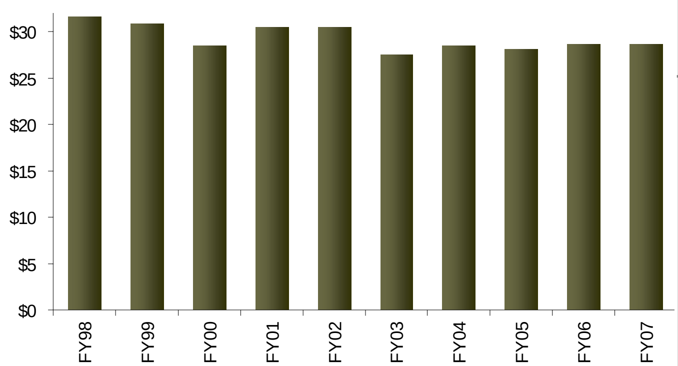
In millions, adjusted for inflation

Oregon Convention Center



Operating Revenues FY07

In FY07, revenues from taxes were the largest source of revenue (57%).



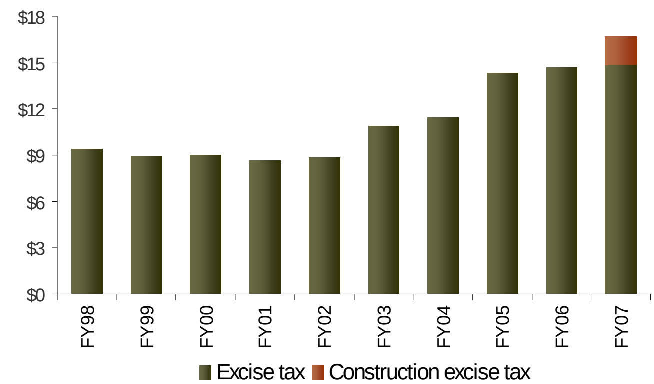
In millions, adjusted for inflation

Property Taxes

Revenues from property taxes have declined 9% over the last ten years as Metro repaid long term debt. In FY08, property tax revenues will increase because of the 2006 Natural Areas bond measure.

Total Excise Taxes

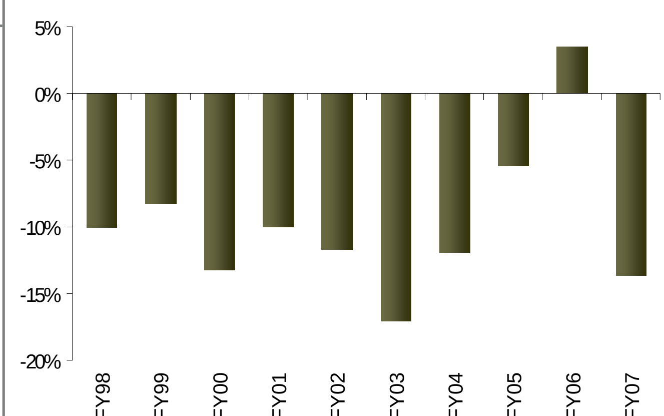
The excise tax is received from users of Metro facilities and services and is governed by the Metro Charter and Code. Revenues from excise taxes increased 77%. In FY06, Metro adopted a temporary construction excise tax levied on new construction to be used to support planning in areas of expansion. In FY07, this tax accounted for $1.8 million, or 11% of the total excise tax received.



In millions, adjusted for inflation

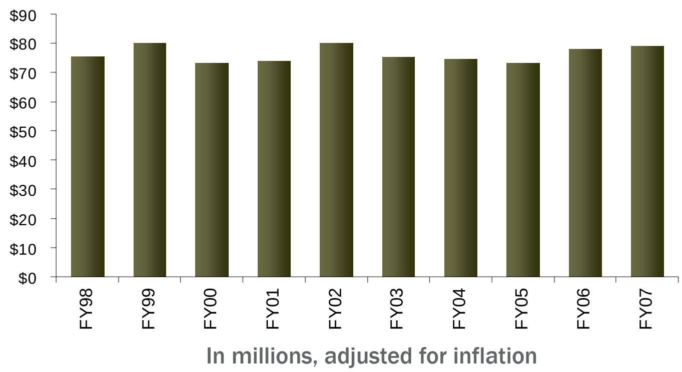
Revenue Shortfalls

Revenue shortfalls measure how well expected revenues were estimated each year. This is an important measure to track because significant shortfalls could require mid-year cuts of services or spending of reserve funds since Oregon does not allow deficit spending. The most significant shortfall (-17%) occurred in FY03. Most of the shortfalls that Metro has experienced are the result of the Planning Department overestimating revenues from grants.



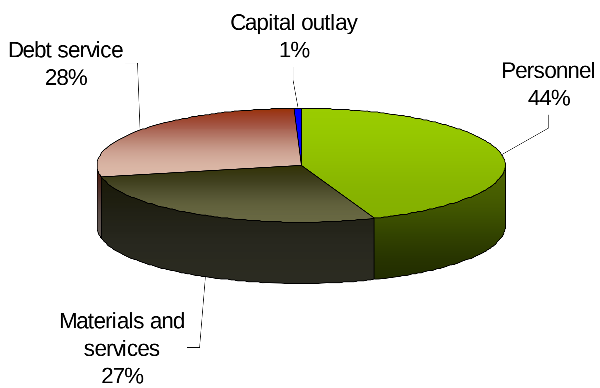
MetroPaint Recycled Paint

Expenditures



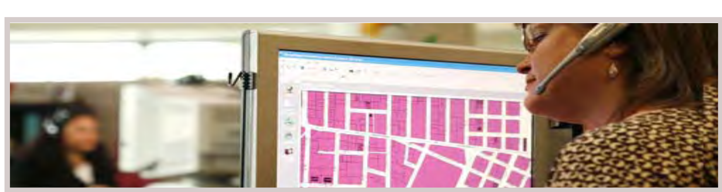
Operating Expenditure

Once adjusted for inflation, Metro spending has increased slightly (5%) in the last ten years. However, spending per Metro resident has declined by 7%.



Operating Expenditure FY07

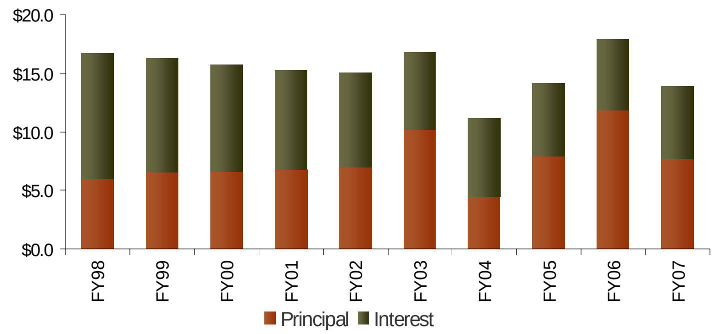
During last fiscal year the largest single expense was for employee costs. Wages represented 74% of total cost for employees.


Solid Waste & Recycling Department Operators

Expenditures

Fixed Costs

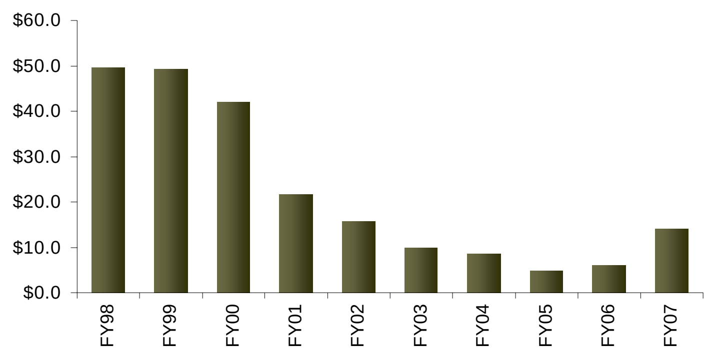
Decreasing fixed costs as a percentage of total operating costs are a favorable trend. Total fixed costs have declined 17%. As a percentage of total expenditures, fixed costs have decreased five percentage points.



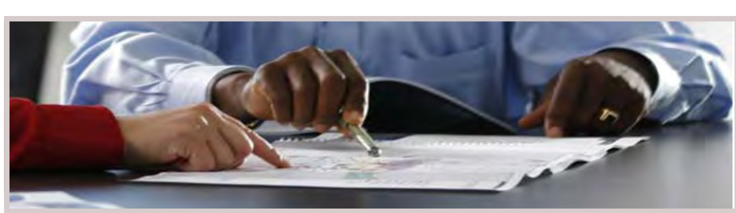
In millions, adjusted for inflation

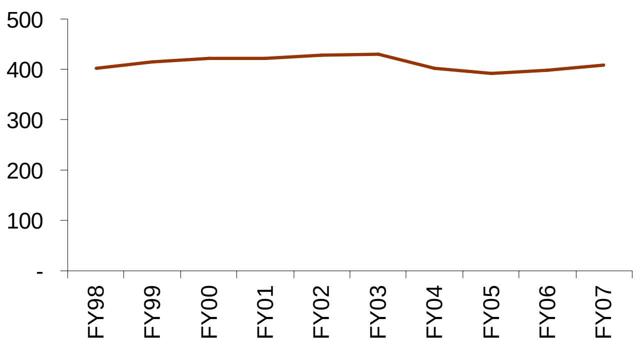
Capital Spending

Capital spending reflects investment in significant assets or improvements on assets such as buying land, buildings, exhibits and making improvements on parks. Capital spending declined as land purchases authorized by the 1996 Open Spaces bond measure decreased. Spending will again climb beginning FY08 as the 2006 Natural Areas bond measure becomes operational.



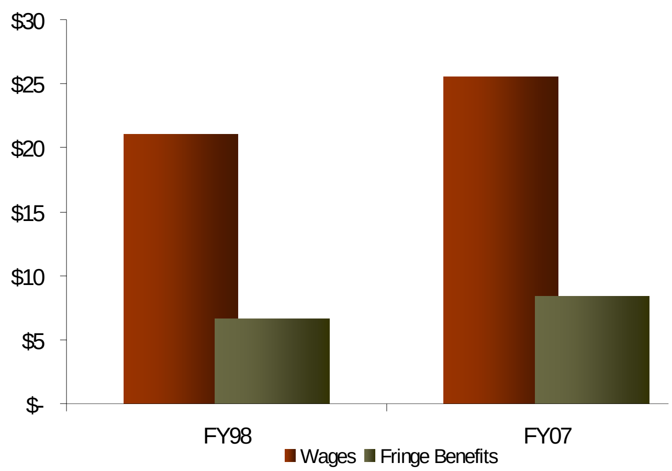
In millions, adjusted for inflation





Metro Employees *

Employee wages and benefits represent the largest single operating expense. The total number of employees in the last ten years increased only 1%. Employees per 10,000 residents in the region have declined from 2.8 to 2.56.



In millions, adjusted for inflation

Metro Employee Wages and Benefits *

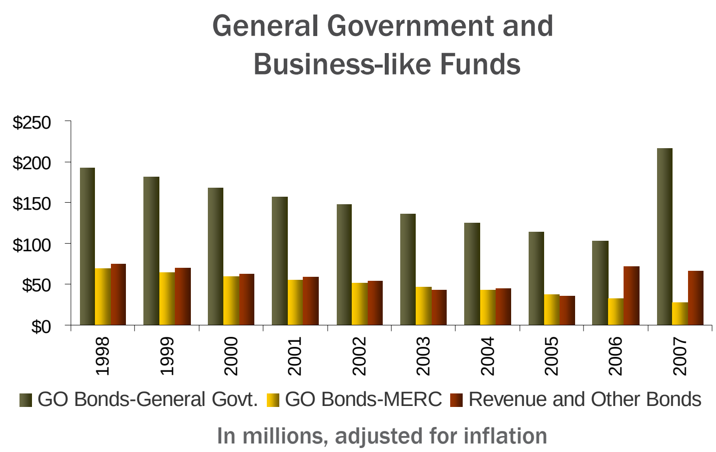
Wages in the last ten years have increased 21% and fringe benefits have increased 27%. Average total compensation per employee has increased from $69,000 to $83,400. Most of this increase is likely the result of annual 3% adjustments based on bargained union contracts requiring Metro to increase wages correlative to increases in the Consumer Price Index (CPI).

* Excludes employees from MERC and Solid Waste Management


Oregon Convention Center

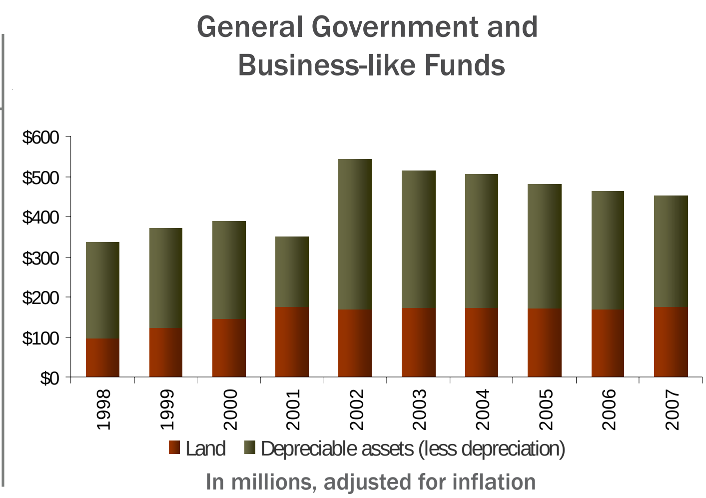
Long Term Debt at June 30, 2007

Most long term debt is from the sale of general obligation bonds that are approved by voters. As debt is repaid, the total long term debt declines. In 2007, Metro issued $124 million in bonds intended for the purchase and preservation of natural areas. Approximately $100 million in bonds authorized by voters remains unissued.



Capital Assets at June 30, 2007

Capital assets are defined by Metro as having an initial cost of $5,000 or more and an estimated useful life over one year. This chart represents assets in Metro's general government and business-type operations. Decreases beginning in FY04 are from increasing depreciation. The ratio of depreciation to depreciable assets increased from 24% in FY03 to 36% in FY07.

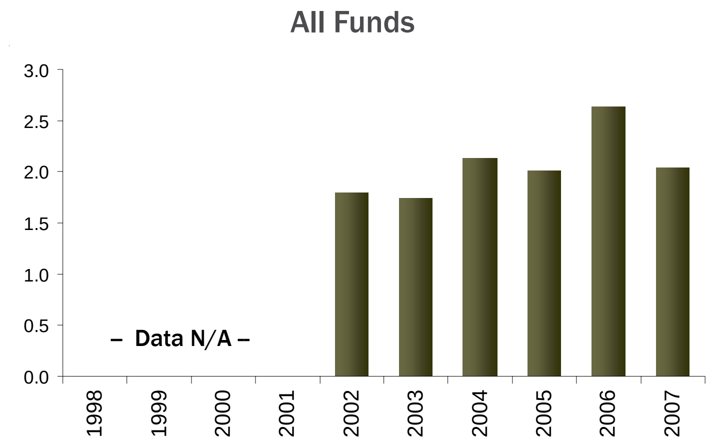


Columbia Ridge Landfill

Financial Health

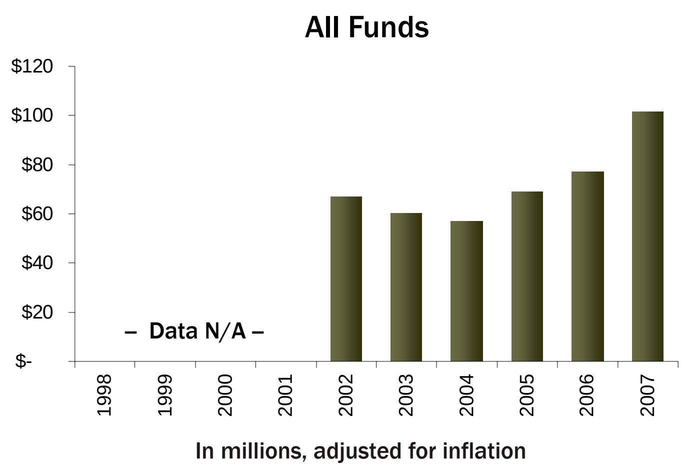
Liquidity
Ratio of cash to current liabilities as of June 30

Liquidity measures Metro's ability to meet its short-term obligations. A ratio less than one-to-one is considered to be a warning sign. The liquidity ratio at Metro has consistently been above 1.0 and has been increasing. Because of accounting changes to meet new accounting standards, comparable data is not available prior to 2002.



Unreserved Fund Balances
as of June 30

The size of Metro's fund balances can affect the ability to withstand financial emergencies. Since 2005, unreserved fund balances have increased. Because funds were reported differently over the last ten years, unreserved fund balances can only be reported for all funds and is only comparable since 2002.



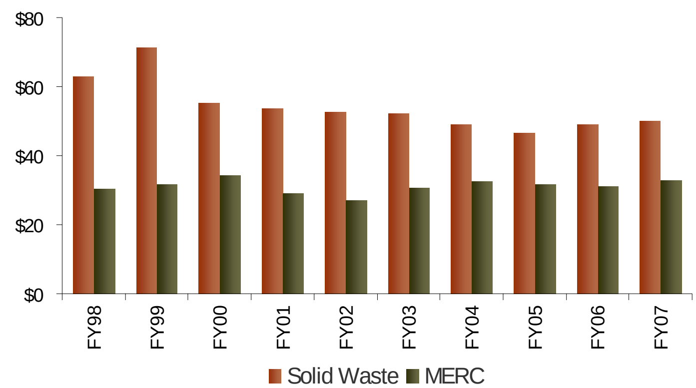
Metro Regional Center

Proprietary Funds

Proprietary funds are funds that are used to track government activities that are operated similar to a business or to account for internal business services. Metro has three proprietary funds - two to track the business-type operations of the Metropolitan Recreation Exposition Commission (Oregon Convention Center, Portland Center for the Performing Arts, and Portland Metropolitan Exposition Center) and the Solid Waste Management System. The Risk Management Fund is Metro's internal insurance service and accounts for charges and expenditures relating to insurance, workers' compensation and liability for pollution related losses.

Expenditures for Business-type Operations

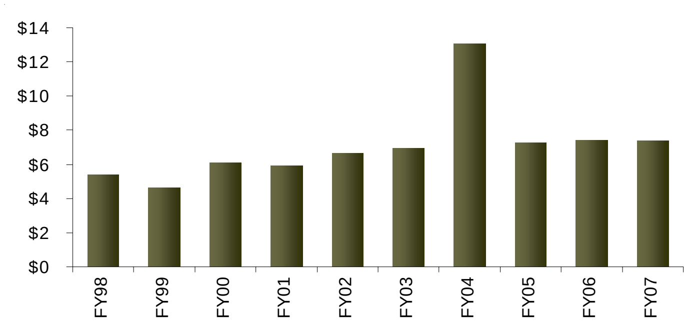
In the last ten years, expenditures for the **Solid Waste Management System** declined 21% while expenditures for **MERC** operations increased 8%.



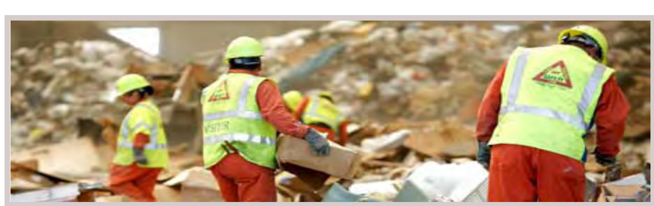
In millions, adjusted for inflation

Expenditures for Risk Management

Expenditures on **risk management** activities have increased 37% in the past ten years. Because of probable future costs related to environmental conditions in the **Solid Waste Management System**, expenditures in FY04 increased by $5.2 million as an acknowledgement of that liability.

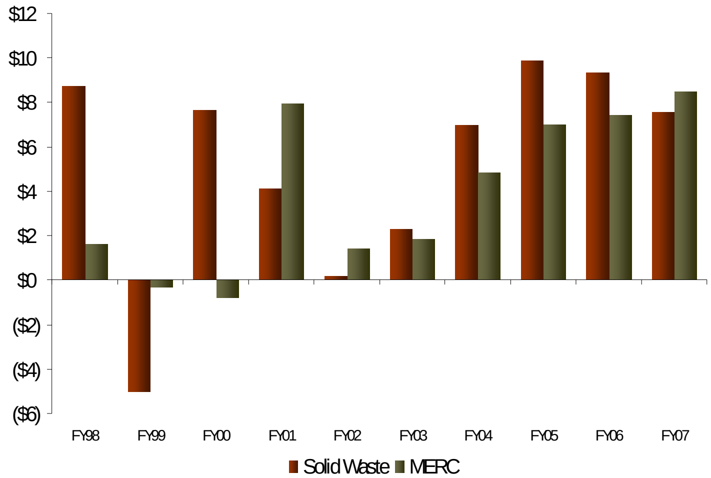


In millions, adjusted for inflation



Solid Waste & Recycling Department Operators

Proprietary Funds



In millions, adjusted for inflation

Expenditures Under (over) Revenues

Since FY02, S**olid Waste and MERC** revenues have been above expenditures. In FY99, Metro prepaid future fixed costs in the Solid Waste transport contract, resulting in a $4 million expenditure over revenues.

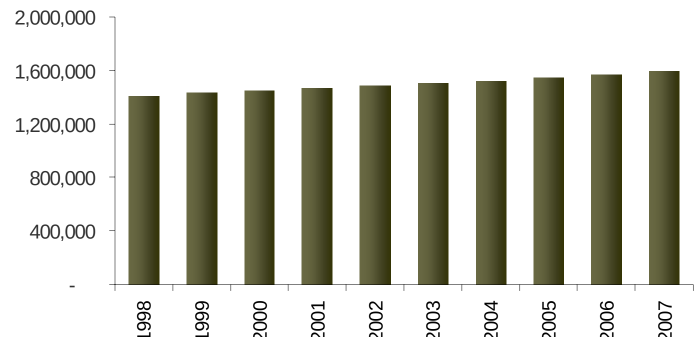
Economic and Demographic Trends

Bond rating agencies consider the socio-economic base of a community to be the most important area for valuation of the financial ability of a government to repay its debt obligation. A significant increase in population, decline in number of jobs, businesses, per capita income, or increase in the unemployment rate could be warning signs for a government's financial condition.

Population on July 1

Washington, Clackamas and Multnomah Counties

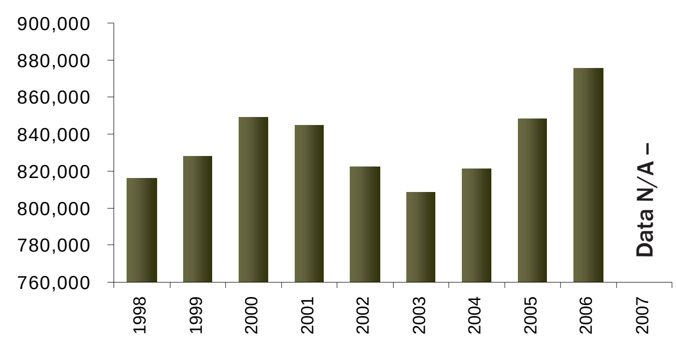
The population of the tri-county area has increased 11% in the last ten years. Collectively, these three counties represent 43% of Oregon's total population.



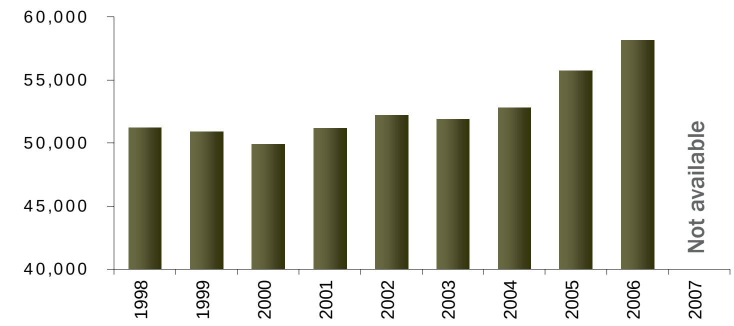
Number of Jobs

Portland Metropolitan Area

During the ten year time period, the number of jobs in the Portland Metropolitan Area increased 7%.



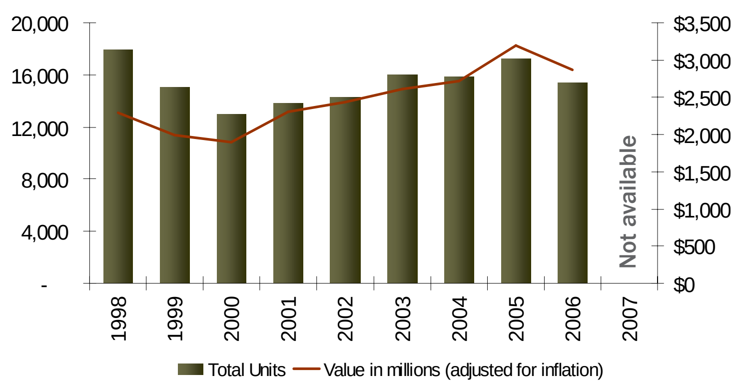
Max Light Rail System



Number of Businesses

Portland Metropolitan Area

The number of businesses in the greater Portland metropolitan area has increased 13% from FY98.



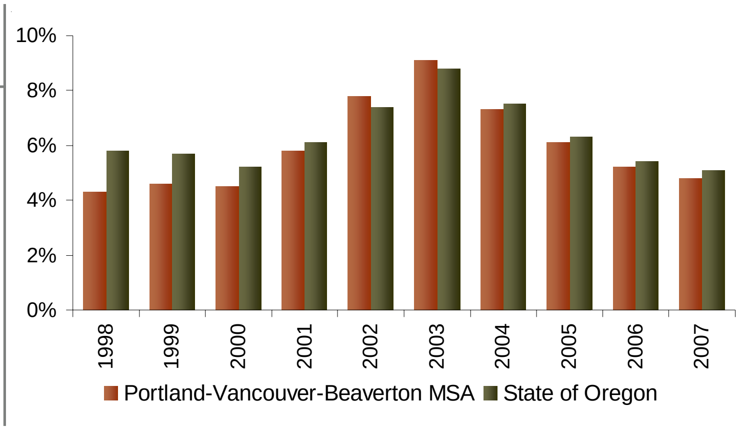
New Construction

The number of total units added through new construction decreased 13% since 1998. The value of new construction adjusted for inflation increased 26% in the same time period

Economic and Demographic Trends

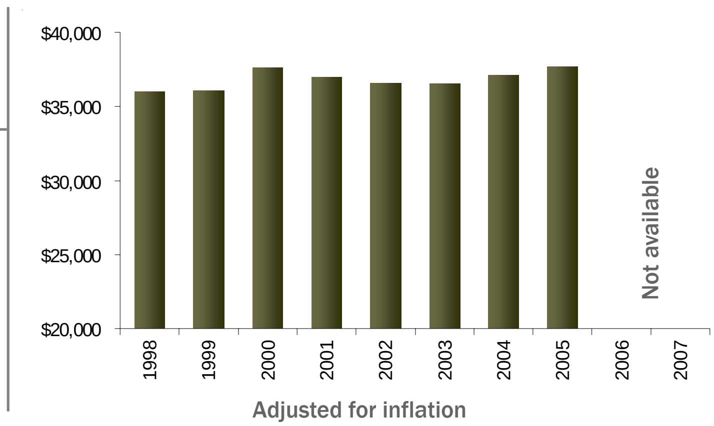
Unemployment Rate

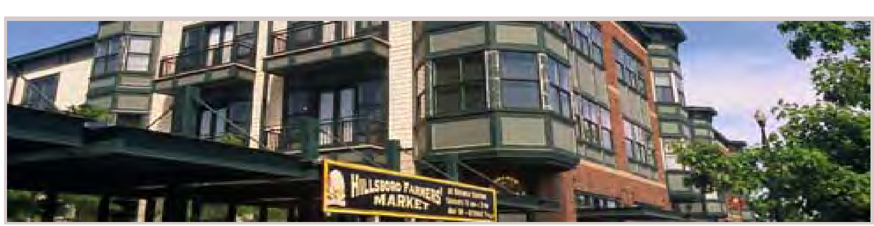
Since FY03, the Portland metropolitan area's unemployment rate has been declining. Except in 2002 and 2003, the area's unemployment rate has been lower than the state.



Income Per Capita

Income per capita in the greater Portland metropolitan area has increased 5% from 1998 to 2005.





Recommendations

Recommendations

1. Revenues have consistently been over-estimated in the past ten years. This unfavorable trend was also noted in the first Financial Condition report issued in 1998. Metro should adopt a financial policy to suggest more conservative procedures for forecasting revenues.

2. Employee wages and benefits represent a significant share of operating costs. Metro should begin reporting these costs on an annual basis and review any major changes as a trend becomes available.

Management Response

REGIONAL SERVICES

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METRO

April 11, 2008

Ms. Suzanne Flynn
Metro Auditor

Re: Financial Condition Report

We are very interested in the Financial Condition report produced by your office and have appreciated the opportunity to work with you during its development. Using the International City/County Management Association guidelines and a 10-year review period gives dimension and depth to the report. As you noticed, the steps Metro has taken to consolidate its funds make the report period challenging, and we appreciate the clarifying history chart in the appendix.

The report contains two recommendations to which we respond below.

1. Revenues have consistently been over-estimated in the past ten years. This unfavorable trend was also noted in the first Financial Condition report issued in 1998. Metro should adopt a financial policy to suggest more conservative procedures for forecasting revenues.

   Response: We agree that accurate forecasting of revenues is important for both policy making and management decision making. Metro's financial policies are reviewed annually and published in the adopted budget. The first policy in the Revenue section requires that "Metro shall estimate revenues though an objective, analytical process." Instructions about forecasting revenues are provided annually during the budget preparation process, and all departments are aware of the expedited process available under Oregon budget law to recognize unexpected grants or other dedicated funds during a given fiscal year.

   Most Metro revenues have been forecast well, perhaps even conservatively, for the last several years. As your report points out, the primary area of over-estimation throughout the reporting period occurs in the Planning Department's grant estimates, a substantial portion of which are pass-through federal transportation grant awards to other agencies. While the grant awards did not mature as forecasted, neither did the corresponding expenditures. In some cases grants budgeted in one year were not received until the succeeding year. Because transportation awards involve regional decision making, the past practice has been to relate the budgetary estimates to the regional Unified Planning Work Program (UPWP). Detaching the Metro budget plan from the UPWP is manageable at the operating level, but may have some unforeseen or unintended consequences at the political level. We have encouraged the Planning Department to make more realistic budget estimates, and we are pleased to see this reflected in the department's requested FY 2008-09 budget. We will continue to monitor the department's progress.

2. Employee wages and benefits represent a significant share of operating costs. Metro should begin reporting these costs on an annual basis and review any major changes as a trend becomes available.

   Response: We agree with the recommendation and can see incorporating it into the budget summary section of the annual proposed budget volume and, later, the adopted budget volume. In the Budget Summary section we currently present a 10-year FTE chart and a "Current expenditures by category" chart, which shows personal services (wages plus benefits) as a proportion of total expenditures. Charting total wages and total benefits over time would display the relative proportions of wages and benefits side-by-side. In addition it would include the temporary and seasonal labor costs at MERC and the Zoo, information that is not captured in the standard FTE presentation because these types of employees are not included in FTE counts. In gross values we would expect to see a significant upward curve in both wages and benefits. Adjusted for inflation, we could provide a deeper context. Including a wages and benefits trend report in the CAFR is a bit more problematic because of the budgetary basis schedule construction, but we will consider if there is an appropriate way to include it in the statistical section where we report FTE using the Metro Adopted Budget as the source document.

We appreciate your work on this report. It focuses in on certain information specific to Metro's operation, but it also provides a regional economic perspective. While it may be ambitious to produce this report too frequently, we hope that you will consider periodic updates.

Sincerely,

Michael Jordan
Chief Operating Officer

William L. Stringer
Chief Financial Officer

Appendix

History of Metro Funds by Fund Type

Source: Metro CAFRs

FUND TYPE / *FUND NAME*	History FY98	FY99	FY00	FY01	FY02	FY03	FY04	FY05	FY06	FY07	Operating Fund?
Current Structure:											
Governmental Funds											
General Fund	GF	GF	GF	GF	GF	GF	GF	GF	GF	GF	Yes
Including consolidation of subfunds:											
Zoo Operating Fund	SR	SR	SR	SR	EF	EF	EF	EF	GF	GF	Yes
General Revenue Bond Fund - Zoo	SR	SR	SR	SR	EF	EF	EF	EF	GF	GF	Yes
Planning Fund	SR	SR	SR	SR	SR	SR	SR	SR	GF	GF	Yes
Regional Parks Fund	SR	SR	SR	SR	SR	SR	SR	SR	GF	GF	Yes
Building Management Fund	IS	IS	IS	IS	IS	IS	IS	IS	GF	GF	Yes
General Revenue Bond Fund-Bldg Mgmt	IS	IS	IS	IS	IS	IS	IS	IS	GF	GF	Yes
Support Services Fund	IS	IS	IS	IS	IS	IS	IS	IS	GF	GF	Yes
Special Revenue											
Smith & Bybee Lakes Fund	ET	ET	ET	ET	SR	SR	SR	SR	SR	SR	Yes
Rehabilitation & Enhancement Fund	ET	ET	ET	ET	ET	ET	ET	SR	SR	SR	Yes
Washington Park Parking Lot Fund		SR									Yes
Debt Service											
General Obligation Bond Debt Service Fund	DS	DS	DS	DS	DS	DS	DS	DS	DS	DS	Yes
Capital Projects											
Open Spaces Fund	CP	CP	CP	CP	CP	CP	CP	CP	CP	CP	No
Natural Areas Fund										CP	No
Metro Capital Fund									CP	CP	No
Including consolidation of subfunds:											
Zoo Capital Fund	CP	CP	CP	CP	EF	EF	EF	EF	CP	CP	No
Regional Parks Capital Fund								CP	CP	CP	No
Regional Parks Special Accounts Fund	ET	ET	ET	ET	SR	SR	SR	SR	CP	CP	No
Permanent Fund											
Cemetery Perpetual Care Fund							PF	PF	PF	PF	Yes
Fiduciary Funds											
Pension Trust											
Deferred Compensation Fund	PT	ET	ET	ET	PT						No
Proprietary Funds											
Enterprise Funds											
Solid Waste Fund	EF	EF	EF	EF	EF	EF	EF	EF	EF	EF	No
MERC Fund	CU	CU	CU	CU	CU	CU	CU	CU	CU	EF	No
Internal Services											
Risk Management Fund	IS	IS	IS	IS	IS	IS	IS	IS	IS	IS	No

Notes

Changes in FY02 due to implementation of GASB 34.

Changes in FY06 due to consolidation of funds directed by Metro Council.

Fund Type Legend		Op Fund
General **F**und	GF	Yes
Special **R**evenue Funds	SR	Yes
Debt **S**ervice Funds	DS	Yes
Permanent **F**unds	PF	Yes
Pension Trust Funds	PT	No
Expendable **T**rust Funds	ET	No
Capital **P**rojects Funds	CP	No
Internal **S**ervice Funds	IS	No
Enterprise **F**unds	EF	No
Component **U**nit	CU	No

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