

The City of Providence, RI: A Case Examining the Financial Condition of a U.S. Municipality

ABSTRACT: This case is intended for use in a wide variety of learning contexts, including undergraduate and graduate government and not-for-profit accounting courses, advanced accounting courses, public policy courses, along with courses that address municipal pensions at the college or university level, or other training programs. The case achieves four primary objectives: developing proficiency in ratio analyses for a municipality, conducting research related to the financial status of a municipality, improving critical thinking and problem-solving skills, and developing an awareness of potential public interest issues facing municipal leaders. We find that students benefit from analyzing the financial condition of the City of Providence and develop critical thinking skills through their analyses.

Keywords: government accounting; municipality; financial distress; ratio analysis, pensions.

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INTRODUCTION

The economic recession and financial crisis of 2008 had a dramatic impact on the financial position of government entities, particularly at the state and local levels. There are numerous articles in the popular press and media stories of clashes between state governments and their citizens, and cities and towns on the verge of bankruptcy and in some extreme cases going bankrupt. We have developed this case to enable you to learn firsthand about the challenges government entities face by having you perform an in-depth study and analysis of the financial condition of a medium-sized city, Providence, RI, that is currently facing significant financial challenges. Through this analysis you will deepen your understanding of governmental accounting issues and better understand the public interest complexities that occur in decision making for governmental entities.

BACKGROUND

City of Providence Overview

The City of Providence, Rhode Island was founded in 1638 by Roger Williams, who fled religious persecution in Massachusetts and started a settlement based on religious and political freedom (goprovidence.com 2012). Providence is a medium-sized city, ranking 121st of U.S. cities in terms of size (citymayors.com), with a population of 178,042 based on the 2010 U.S. Census (U.S. Department of Commerce 2010). The current mayor is Angel Taveras, the 37th mayor and first Latino mayor of Providence, who began serving in January 2011 (Angel Taveras for Providence 2010).

Due to its easy accessibility by water, Providence has a rich history as a major world seaport, but has also been vulnerable to hurricanes, experiencing devastating effects of the great New England Hurricane of 1938 and Hurricane Carol in 1954. In the late 1970s the city's infrastructure was greatly enhanced and in the 1990s two major rivers running through the city were uncovered and moved, adding a pleasing aesthetic aspect to the city. As a result of the major improvements to the infrastructure as well as significant building projects in the 1990s and the first decade of the 21st century, the city has experienced a cultural revival and has been successful in attracting visitors to its world-renowned restaurants and cultural events, particularly Waterfire, an event that occurs over numerous weekends in the summer and early fall. Cultural institutions include the Tony award-winning Trinity Repertory Company and Providence Performing Arts Center. Providence is also home to a number of colleges that lend an academic and innovative air to the city, including Brown University, Providence College, Rhode Island College, the Rhode Island School of Design (RISD), and Johnson and Wales University (JWU). The prominence of RISD has led to growth in the Providence arts scene, and JWU's culinary school has fueled the growth and national reputation of the Providence restaurant scene (goprovidence.com 2012).

The Providence Economy

Manufacturing was the predominant industry in Providence from the 1830s until the 1980s, with the production of textiles, light metals, and jewelry being most prevalent. The textile industry saw a sharp decline in the late 1920s, as companies in the northern states faced increasing competition from those in the south, and therefore jewelry and light metal manufacturing grew to be the dominant manufacturing sectors during the middle part of the 20th century. However, after World War II, Providence saw a big decline in population and many of

the large manufacturing companies left the city for the suburbs. By 1970, four of the five largest companies with a strong manufacturing presence during the industrial revolution of the 1800s had left the city, and only Gorham Silver remained. Other companies, such as Speidel, Federal Products and Imperial Knife, were also present, but were not as dominant as their earlier counterparts. During this time service industries, such as financial, educational, and health services were beginning to overtake manufacturing as growth industries (Conley and Campbell 2012).

Today the largest companies in the city include Textron, a large manufacturing and financing conglomerate which bought Gorham and Speidel in the late 1960s/early 1970s (www.textron.com 2012), and GTECH, a manufacturer of lottery machines and provider of lottery and gaming solutions (GTECH Corporation 2012). Although both companies have their corporate headquarters in Providence, their manufacturing facilities are located elsewhere. Providence has been positioning itself at the forefront of the “Knowledge Economy,” and has attempted to attract companies to the city in industries such as technology and healthcare that focus on innovation. In keeping with this strategy, a district of the city once known as the Jewelry District, which housed the major jewelry manufacturers, has been transformed into the “Knowledge District,” with the new location of the Brown University Medical School (Brown University 2011), and an IBM grant in 2011 of \$400,000 to encourage innovation (WPRI 2011). In 2011, Providence ranked 110 of the top 200 largest U.S. cities for job growth according to the Milken Institute (Milken Institute 2011).

Current Economic Challenges

Despite the investment in infrastructure and growth of cultural opportunities during the first decade of the 21st century, Providence has faced significant challenges, many associated

with the downturn in the real estate market nationwide and the financial crisis of 2008. Unemployment during the economic downturn has been higher in Providence than in other parts of the country. For example, while the national unemployment rate in 2011 was 9%, the unemployment rate in Providence was 11.2% (U. S. Department of Labor 2012). In addition, because many of the businesses in the city such as colleges and hospitals are not-for-profit entities and therefore not subject to property taxes, the city has had to forego property tax revenues from these entities. The not-for-profit entities have all agreed to make payments in lieu of property taxes (known as PILOT) that when combined with State of RI PILOT Payments total over \$29 million per year (Commission to Study Tax Exempt Institutions 2010). Although this amount seems generous, a report generated by a commission of the Providence City Council estimates that if these entities paid the same tax rates as for-profit organizations, the total tax revenue would be over \$82 million per year (i.e., over \$53 million per year more than the PILOT payments, Commission to Study Tax Exempt Institutions 2010). In addition, the city was dealt a blow in a failure of a new knowledge economy company when the 38 Studios video game company started by Curt Schilling (former pitcher for the Boston Red Sox) defaulted on state loans and went bankrupt, resulting in hundreds of lost jobs in 2012 (Stanton 2012; Kain 2012). Also in 2012 both Fitch and Moody's downgraded the credit rating of the City of Providence, limiting the city's ability to raise additional funds through borrowing (McGowan 2012; Thomson/Reuters 2012).

CASE DESCRIPTION

Assume you are a recent graduate of a business program and have been hired for a budgeting/accounting position in the Director of Administration office for the City of Providence, RI. You are excited about this position for a variety of reasons. First, significant

responsibility is associated with this position, and you will be a key individual in both the Administration office and the Mayor's staff. Your specific responsibilities include working on the development of the City's budget and financial statements, along with providing financial information to other members of the Mayor's office. Like many cities in the United States, Providence has some financial challenges involving both sources of revenues (nobody likes paying higher taxes!) and expenditures associated with city operations, including costs related to public safety (police and firefighters) and the education system.

It is your first week on the job and to orient you to your new position, your supervisor has given you the following assignment. In approaching this assignment, you want to do an excellent case analysis to make a favorable first impression.

REQUIREMENTS

Use the official website of the City of Providence, Rhode Island (see the following link) to download the Comprehensive Annual Financial Reports (CAFRs) of the City of Providence from 2011 to 2013: <http://www.providenceri.com/finance/financial-reports>. More specifically, the financial statements in the CAFRs for 2011 to 2013 are on pages 12 to 22 in each year's CAFR. For example, on pp. 12-13 in all three years of reports, you will find the Statement of Net Assets and the Statement of Activities for both Government Activities and Business-type Activities. Pages 14-22 provide more specific information on Government Funds, Proprietary Funds, and Fiduciary Funds. Search for articles about the City of Providence from 2011 to present in the library databases such as *Lexis-Nexis* and popular media outlets like *The Wall Street Journal*. Answer the following case questions using the CAFRs and the articles that you have found.

Part I

A: Background Questions/General Knowledge of Accounting for Municipalities

- (1) Typically which branch of the city level of government structure is responsible for managing the city's expenditures within the budget and maintaining the accounting, budget, and financial reporting systems? What financial reports does a municipality need to prepare? What standards guide the preparation of municipal financial reports? Municipalities use modified accrual basis of accounting. How does this differ from accrual accounting?
- (2) In the City of Providence, who is responsible for developing the budget? How is the budget voted on and implemented?
- (3) Using articles from Lexis-Nexis or other business media, along with the Letters of Transmittal for 2011-2013 (pp. i-x for 2011 and 2012, pp. i-vii for 2013), write a brief summary of recent events that are related to the City of Providence and its financial condition.

B: Preliminary Analysis of the City of Providence CAFR

- (4) Find the Total Assets, Total Liabilities, Net Assets, Unrestricted Net Assets, Total Revenues, Total Expenses, and Change in Net Assets of the City of Providence for 2011, 2012, and 2013. Explain the trends.
- (5) Calculate the current ratio and the debt ratio for 2011, 2012, and 2013. How is the City of Providence 2013 performance on these measures relative to 2011 and 2012?

Part II: Additional Analysis of the CAFR

- (6) Discuss the financial performance of the city over the last three years. Pay attention to specific items from the Financial Statements that reflect the city's performance.

(7) An article by Trussel and Patrick (2009) titled “*A Predictive Model of Fiscal Distress in Local Governments*” summarizes the ways to measure fiscal distress and related financial risk factors of municipalities.

- a. Trussel and Patrick (2009) (p. 590) define the condition of fiscal distress “as a local government that experiences a significant and persistent imbalance between revenues and expenditures.” Trussel and Patrick “operationalize the definition of fiscal distress as a local government that experiences three consecutive years of operating deficits (scaled by total revenues) with a cumulative three-year operating deficit of more than five percent.” By reading the three-year financial statements of the City of Providence, do you think the city is experiencing fiscal distress? Explain how you derive your conclusion regarding the city’s financial condition.
- b. Trussel and Patrick (2009) identify risk factors or indicators of fiscal distress and use the risk factors to develop a model to predict the likelihood of fiscal distress. They use the following risk factors or indicators of fiscal distress: revenue concentration, administrative expenditures, debt usage, and entity resources. The definitions and measurements of these factors are listed in the following table (Trussel and Patrick 2009):

Risk Factor	Measure	Expected Relation with Fiscal Distress
Taxes to Revenues	$\frac{\text{Tax Revenues}}{\text{Total Revenues}}$	+
Inter-governmental Revenues	$\frac{\text{Revenues from Federal and State}}{\text{Total Revenues}}$	+

Administrative Cost Ratio	$\frac{\text{Administrative Expenses}}{\text{Total Expenses}}$	-
Debt Level	$\ln(\text{Total Liabilities})$	+
Debt to Revenue	$\frac{\text{Total Liabilities}}{\text{Total Revenues}}$	+
Size	$\ln(\text{Total Assets})$	-
Revenue Growth	$\frac{\text{Total Revenues}_t - \text{Total Revenues}_{t-1}}{\text{Total Revenues}_{t-1}}$	-

Calculate three risk ratios suggested by Trussel and Patrick (2009) for the City of Providence for 2011, 2012, and 2013, and report your findings. Use charts or graphs to support your points.

- (8) City of Providence officials considered a number of ideas to mitigate the financial pressures facing the city, including reducing the education budget and instituting an income tax for the City of Providence. Comment on these ideas.
- (9) The 2011-2013 Letters of Transmittal (pp. i-x for 2011 and 2012, p. i-vii for 2013) described a number of actions taken to avoid the fiscal crisis facing the City. Given your understanding of these Letters and the Financial Statements, how would you assess the effectiveness of the actions taken in 2011 (e.g., did they improve Providence's financial position and permit a more sustainable fiscal approach for the City?). What are the short and long-term implications of the cost saving initiatives? Will the initiatives provide long-term solutions to the City's problems?
- (10) Given your answer in Question 9, what fiscal and operational challenges does Providence face in the next few years? What else should the City of Providence do to achieve financial and operational success?

Part III: Analysis of Pension and Other Post-Employment Benefit Costs

- (11) Find the annual pension cost, pension contributions made, net pension obligation, and actuarial accrued liabilities of the City of Providence as reported in the 2011, 2012, and 2013 CAFRs. How well does the City of Providence fund its Employees' Retirement System (ERS) for 2011, 2012, and 2013? (Hint – the annual pension cost, pension contributions made, net pension obligation for all three years are listed in the 2013 financial statement footnotes).

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