

Deciphering Governmental Financial Reports (A)
The Case of a Jefferson County, Alabama Resident

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Margaret hung up the phone and shook her head. Her brother, Larry, had just announced that he and his wife were leaving Alabama forever! He was fed up with the political shenanigans and the ever-increasing costs imposed on the citizens as a result.

Larry had called his sister after opening the day's mail and examining his water bill to compare his bill to her water and sewerage charges. He had noted the line item on his water bill -- *Monthly Base Charge \$39.30*. This amount reflected what each resident owed before calculating actual monthly water consumption. Over the past five years, this base charge had increased over one hundred and fifty percent.

Margaret wondered why her brother had not seen this coming! As a CPA, she was sure the need for more and more increases in charges for government-provided services should have been evident on the county reports.

Background

Larry was a long term resident of Jefferson County, Alabama (the County) which was home to Alabama's largest city, Birmingham. The County had approximately 660,000 residents. It was estimated that one-third of the residents of Birmingham had income levels below the poverty line.

The County had entered into a consent decree with the Environmental Protection Agency (EPA) in the mid-1990's under which the County agreed to buy and repair the sewer lines of the municipalities within the county. The EPA had sanctioned the County for dumping raw sewage into the Cahaba and Black Warrior Rivers. The elected officials decided to act, borrowing \$3.2 billion and launching construction projects to not only upgrade the sewer system but also to create jobs and foster development, thus reversing the decline of the city of Birmingham and the surrounding county.

Huge construction contracts were granted, but instead of replacing the 2,000 plus miles of sewer lines that were falling apart, administrative buildings, water treatment plants and pumping stations were built. Contracts were padded and other instances of graft were rampant. The debt

was supposed to be paid off with increased revenue from the sewer system, including new users hooked up to the system. In one attempt to add new users and increase revenue accordingly, the County decided to tunnel underneath the Cahaba River to expand the reach of the system. However, after spending \$19 million the tunnel was too unstable to complete (Walsh, 2012).

Sewer rates were raised to the point that by 2002 the average monthly sewer bill was \$18, a significant increase over prior years. Residents were up in arms. The County was desperate for more funds, because after all of this borrowing and spending the sewer system was still broken. JPMorgan Chase “came to the rescue” and entered into a bond deal with the County with complex interest-rate swaps as part of the terms (Walsh, 2012).

The elected officials breathed a sigh of relief as another crisis was averted. Once again, life was good. Once again, the future was bright. One elected official (who is now serving a 15 year prison sentence) was so enamored of the power of interest rate swaps that he conducted seminars to “teach” officials from other cities and counties how to structure these deals to benefit their communities. According to 16th Amendment Advisors LLC (2011), however, the County was overcharged for these interest rate swaps totaling about \$5.4 billion. Some of these were structured to have very low payments early in the agreement with later payments ballooning. Larry surmised the payments were designed to balloon after certain officials would no longer be in office.

According to the financial statements of the County, as of September 30, 2010, over \$4.3 BILLION of warrants payable were due within one year from the date of the financial statements, “including acceleration of certain warrant payments and all warrants in default that may be payable on demand.” Almost \$3.2 billion of these were for the County sewer system; the remainder was general obligation or limited obligation school warrants (Jefferson, 2010). On November 9, 2011, the County declared bankruptcy.

The sewer repairs that had been completed had cost twice as much per mile as comparable repairs in Atlanta and Nashville. The system was still broken. Almost twenty years later, AL.com reported that more than 27 million gallons of raw sewage spilled from the County's sewer lines in April of 2014 (Wright, 2014).

Larry’s Frustration

As Larry discussed the County’s financial woes leading up to the bankruptcy declaration with his sister, he posed the following questions:

- Why had the monthly base charge on his water bill increased so significantly over the past years?
- Why had the County declared bankruptcy if it was receiving the additional revenues from the increased monthly base charges? How were these increases determined and justified?
- Why did the replacement sewer line construction projects that were seen as the means of reversing Jefferson County's decline instead result in a rapid spiral into economic despair for the area?
- What information was being reported in the County’s annual audited financial statements? Was there no forewarning of the bankruptcy declaration and, if not, why not?

Larry's sister, Margaret, had taught governmental accounting in the past so she offered to take a look at the County's financial reports.

Margaret's Next Steps

Margaret knew that the audited financial statements of the County were a matter of public record and could be found on the County's website. Sure enough, with a little digging she discovered the County's website: <http://www.jccal.org>. At the bottom right hand side of this webpage, she clicked on "Financial Info," and on the resulting page, "Audits and Financials." Before her eyes a list of pdf files of the County's audited financial statements from 1997 through 2014 appeared.

Margaret was interested in looking at the Management Discussion and Analysis (MD&A) for the years leading up to the county's bankruptcy. The Governmental Accounting Standards Board (GASB) had added this requirement in GASB Statement No. 34 in order to increase transparency of the government's operations and provide information to the public that could be understood by ordinary citizens. She wondered how, or even IF, the impending financial disaster had been clearly communicated to the public in these MD&As leading up to the County's bankruptcy.

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