

COMMONWEALTH OF PENNSYLVANIA  
OFFICE OF THE BUDGET, COMPTROLLER OPERATIONS  
**AN APPROACH TO USING ESTIMATES IN THE  
PREPARATION OF THE JUNE 30, 2005 CAFR**

The preparation of financial statements generally entails the use of estimates – whether it be in the determination of uncollectible receivables, the valuation of inventories, or the determination of asset depreciable lives. Estimates are a logical approach to determining amounts that cannot yet be supported by actual data and are necessary to enable the reporting of amounts that reasonably represent the asset, liability, revenue or expense being reported.

At the Commonwealth, estimates have been used in a number of areas in previous audits. Examples are – Tax revenues, tax credits and fixed asset depreciable lives. This year, given the desire to issue the CAFR quicker, the Commonwealth has implemented a plan to rely on estimates for certain liabilities. These estimates are primarily focused on payables resulting from operations but may also be expanded to amounts due to political subdivisions and amounts due to other governments.

The attached document provides guidance to Comptroller Offices on the development of estimates. It focuses on the types of information that should be gathered and analyzed and the processes that should occur to ensure the validity of each estimate. Following this guidance, each Comptroller Office has developed estimates for liability amounts where system-supported liabilities (whether it be SAP or other legacy systems) were not available at the time of template preparation. BFM then met with each office to review its estimate documentation and methodologies. Upon BFM's review and acceptance, the estimate packages were then shared with the auditors at meeting where the liability being estimated and the methodology being used to make the estimate were explained and discussed.

Overall, the process has worked well and has demonstrated that a process can be developed and applied that we believe will result in reliable estimates for financial reporting purposes. The reliability of this process is supported by a number of factors:

- The availability of 3 to 5 years of historical liability data
- The availability of 3 to 5 years of expenditure data against which to cast historical liability balances.
- The use of July 2005 actuals as a gauge of the accuracy of the liability estimate.
- The use of input from agency program personnel to determine trends and anomalies related to the liability estimate.
- Program knowledge within Comptroller Offices that enhances the ability to compute a more accurate estimate by taking into account experienced program changes, legislative and budgetary impact, trends and anomalies.
- The use of a September look back to determine the reasonableness of the estimate and, if necessary, the posting of Period 15 adjustments to correct for

significant estimate variances. Also, such lookbacks will be used as a basis to improve or modify the estimation process for the next fiscal year.

This process should work to ensure that those liabilities which are subject to estimation are fairly reported, in all material respects relative to the Opinion Unit.