

Commonwealth of Pennsylvania  
Using Estimates in the June 30, 2005 CAFR

**Process for Performing the September Accounts Payable Lookback**

In an effort to expedite the June 30, 2005 CAFR production process, the Commonwealth has utilized estimation procedures to determine several accounts payable amounts. Two separate documents, "An Approach to Using Estimates in the Preparation of the June 30, 2005 CAFR" and "Using Estimates in the June 30, 2005 CAFR", provide guidance on the processes to be used for estimating accounts payable amounts. A summary of the extent of accounts payable estimates, by opinion unit, is presented below and is based on June 30, 2004 audited amounts:

Fund/OPINION UNIT	Total Liabilities (in millions)	Amount of Estimated Liabilities (in millions) [as % of Total Liabilities]	Comfort Level - Amount and as percent of total estimated liabilities					
			10	9	8	7	6	5
<b>General Fund</b>	<b>7,457</b>	<b>1,514</b>	<b>383</b>	<b>424</b>	<b>603</b>			<b>104</b>
		[20%]	25%	28%	40%			7%
<b>Motor License Fund</b>	<b>748</b>	<b>271</b>	<b>271</b>					
		[36%]	100%					
<b>Unemployment Comp</b>	<b>109</b>	<b>13</b>		<b>13</b>				
		[12%]	2005	100%				
<b>Lottery</b>	<b>337</b>	<b>16</b>		<b>16</b>				
		[5%]		100%				
<b>Tobacco Settlement</b>	<b>383</b>	<b>92</b>	<b>76</b>	<b>16</b>				
		[24%]	83%	17%				
<b>SWIF</b>	<b>2,018</b>	<b>0</b>						
<b>TAP</b>	<b>1,071</b>	<b>0</b>						
<b>Aggregate Remaining Funds</b>	<b>13,471</b>	<b>188</b>	<b>20</b>	<b>167</b>				
		[1%]	11%	89%				

The Comfort Level is expressed on a scale of 1 to 10 with 10 being very comfortable and 1 being not comfortable. A comfort level of 10 indicates that the estimate is well-founded, i.e., may be based on a sound historical record of consistent and reliable estimates, may be based on a calculated liability such as number of eligible clients times a specific rate, or may be based on an historically consistent liability as a percentage of expenditures. Comfort levels of less than 10 reflect situations where a consistent and reliable pattern or trend may not be established as a basis for an estimate, resulting in a less reliable estimate that is generally subject to greater variation and thus making the projected accounts payable amount less predictable.

A review of these spreadsheets reveals that estimated numbers generally do not comprise a large portion of an Opinion Unit's overall liabilities and, where estimates were used, the reliability and accuracy of the estimate (Comfort Level) was generally viewed as very good. Also, since estimated liabilities as of June 30, 2005 were used in preparing templates that were due on August 15 or later, Comptrollers had the benefit of reviewing actual data for the month of July, where appropriate, and using that data to further refine the June 30, 2005 estimated accounts payable amount.

To further strengthen our estimation strategy, Comptroller Offices will perform a Lookback of each estimated liability by comparing the amount of the estimate to the total actual June 30, 2005 accounts payable amount as realized through August 31, 2005. This process will serve to verify the accuracy of the accrual estimates since a majority of the June 30 accrual is usually paid by August 31. Where the Lookback process discloses significant variation between the estimated amount and the liability as computed as of August 31, an appropriate Period 15 adjustment will be proposed to the auditors. Regardless, the results of the Lookback process will be documented and presented to the auditors as evidence of the accuracy of the estimate or, where the variance is significant, the need for, and nature of, any adjustment.

The significance of a variance should be viewed in light of the total amount of liabilities being reported for the respective Opinion Unit. In the case of the General Fund, and using June 30, 2004 audited figures for reference, total liabilities of \$7,457M were reported. Two percent of this amount would be \$149M and should be considered as a reasonable threshold for determining whether a variance is significant. Another measure of the validity of the estimate is the degree to which the original estimate varies from the recalculated estimate. A variance that is within +/-5% Of the original estimate can be considered as reasonable and acceptable provided it is also less than 2% of the total liability amount. Applying this logic to all the opinion units would yield the following thresholds for significant variances:

Fund/OPINION UNIT	Total 6/30/04 Liabilities (in millions)	Amount of Estimated 6/30/04 Liabilities (in millions)	Threshold for Significant Variances The lesser of:	
			2 % of Total 6/30/04 Liabilities	5% of Each 6/30/05 Estimated Liability
General Fund	7,457	1,514	\$149,000,000	5%
Motor License Fund	748	271	\$15,000,000	5%
Unemployment Comp	109	13	\$2,000,000	5%
Lottery	337	16	\$7,000,000	5%
Tobacco Settlement	383	92	\$8,000,000	5%
SWIF	2,018	0	N/A	N/A
TAP	1,071	0	N/A	N/A
Aggregate Remaining Funds	13,471	188	\$269,000,000	5%

These thresholds would be applied individually to determine the need for a Lookback adjustment. Any such adjustment would entail a corresponding adjustment of the reserve for encumbrances to the extent that amount was impacted by the original estimated accrual.

The Lookback process is then defined as follows:

1. A Lookback must be performed for each June 30, 2005 estimated liability amount.
2. The Lookback will entail a comparison of two numbers:
  - a. The actual liability amount based on activity for the months of July and August, 2005 plus an estimate of the June 30, 2005 liabilities expected to be liquidated during the remaining 10 months of the 05-06 fiscal year if that amount is considered material. (This calculation assumes that a majority of the accrued liability will have been paid during the 2 months ended August 31 and that the remaining liability may be insignificant in amount or, if significant, can be reasonably and rationally estimated. Appropriate supporting worksheets should be prepared for this calculation.)
  - b. The estimated liability amount as presented in your template submission.

Care must be taken to ensure comparability of these two numbers, e. g., where certain programs or vendors were not included in the original liability estimate, those programs or vendors should not be included in the liability calculated as of August 31, 2005. \*

3. A spreadsheet should document the above comparison. This spreadsheet should show:
  - a. the amounts from a. and b. above,
  - b. the support for the calculation in a. above, and the difference between these two amounts;
  - c. a comparison of the difference to the respective thresholds noted above, and
  - d. a statement as to whether or not an adjustment is needed.
  - e. Where an adjustment is needed, the proposed adjustment to the estimated liability and to the reserve for encumbrances should be presented on the spreadsheet.
4. This spreadsheet should be emailed to the Eric Bartholomew, with a cc to Herb Maguire, by no later than Tuesday, September 13<sup>th</sup>.

\* For estimates related to the Capital Facilities Fund, the Lookback shall be based on activity through September 30, 2005 and the spreadsheets shall be submitted to BFM by no later than Wednesday, October 13, 2005.

Questions regarding the Lookback process should be directed to Herb Maguire.