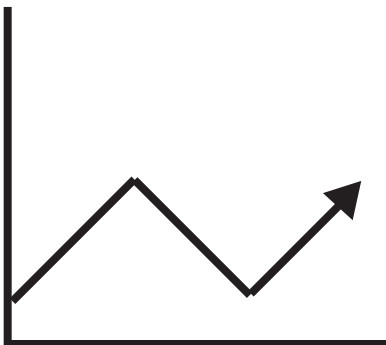


# Financial Condition in the City of Portland

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1995 - 2004



Office of the City Auditor  
Portland, Oregon  
March 2005





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CITY OF  
**PORTLAND, OREGON**

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OFFICE OF THE CITY AUDITOR  
Audit Services Division

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March 18, 2005

TO: Tom Potter, Mayor  
Sam Adams, Commissioner  
Randy Leonard, Commissioner  
Dan Saltzman, Commissioner  
Erik Sten, Commissioner

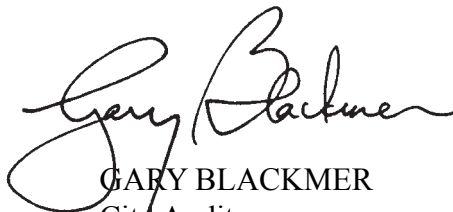
SUBJECT: *Financial Condition in the City of Portland, 1995-2004, Report #306*

Attached is Report #306, an audit of the financial condition of the City of Portland during the past ten fiscal years.

The Office of Management and Finance reviewed the report and is in general agreement.

As a follow-up to our recommendations, we ask that the Chief Administrative Officer of the Office of Management and Finance provide a status report within one year, detailing steps taken to address the report's recommendations. This status report should be submitted to the Audit Services Division and coordinated through the Commissioner-in-Charge's office. OMF has indicated it will continue to monitor the City's financial situation and will report on the status of the recommendations annually.

We appreciate the cooperation and assistance we received from staff in the Office of Management and Finance in conducting this audit and preparing the report.

  
GARY BLACKMER  
City Auditor

Audit Team: Kristine Adams-Wannberg  
Amoy Williamson



## SUMMARY

This report provides City officials and citizens with information to help them understand the financial condition of the City of Portland. A wealth of information is produced each year in the *Adopted Budget* and the *Comprehensive Annual Financial Report* (CAFR). This *Financial Condition* report, however, presents an alternative view of financial information. It focuses on general government operations and adjusts the financial information for inflation. The report excludes business activities of the City, such as water and sewer services.

This report presents 22 financial and demographic trends covering a 10-year period from fiscal year 1994-95 through fiscal year 2003-04. We have identified both favorable and unfavorable trends and offer some general recommendations for consideration by the Office of Management and Finance and the City Council. Information on the report scope and methodology follows this Summary section.

### What is good financial condition?

A city in good financial condition can finance services to the public on a continuing basis. Such a city can maintain existing service levels, withstand economic disruptions, and respond to growth, decline, and change. Put simply, a financially stable city collects sufficient revenue to pay short-term bills, finance major capital expenditures, such as street maintenance, and meet long-term obligations, such as employee retirement costs.

Financial conditions can be monitored by analyzing trends in several broad areas:

- revenues (income)
- expenditures (costs)
- operating position and debt
- liabilities
- economy and demographics

Tracking trends in these areas over time permits City managers and officials to monitor finances and identify problem areas that may need attention.

### Highlights: Significant financial trends

The City of Portland is coping with growing financial pressures. While City revenues per resident have remained relatively constant over the past 10 years, general purpose revenues have slipped as a result of property tax limitation measures and a weak economy. In response, the City has looked to short-term solutions to finance ongoing needs. For example, the City Council supported and voters approved a five-year parks levy to support some of its operating and maintenance needs which are usually supported with regular tax dollars and fees.

Money dedicated to supporting specific service areas has been the principal growth area. For example, over 10 years public safety pension and disability taxes are up 61 percent, and user fees and charges are up 80 percent. Gasoline taxes have risen 11 percent in the past two years.

Growing expenses are also creating challenges for the City. While the number of employees per resident has remained flat, employee costs have increased by 8 percent over the past 10 years. To reach a balanced budget, for example, City Council has cut back capital spending from its 2000 peak.

Liquidity ratios remain healthy; however, current liabilities at year-end have been higher in the past two years. Although City actions and state legislation reduced the cost of most City employees' retirement, the cost of fire and police retirements continues to grow.

Some trends are more likely to continue into the future. Tax limits will continue to constrict general purpose revenues and employee benefit costs and liabilities are likely to reduce the flexibility of City spending. In contrast, user fees may not be able to sustain the previous rates of revenue growth and the Council will face another challenge when the parks levy expires.

The most **favorable** trends are:

- + Sustained operating revenues
- + Fund balances appear to be adequate to meet emergencies and to pay for equipment replacement and insurance claims
- + Healthy liquidity ratios indicating the City's ability to its bills
- + Continued growth in property values and population over the past decade
- + Recent drop in unemployment

The most significant **unfavorable** trends that warrant attention:

- Revenues sensitive to changes in the health of the economy (elastic revenues) have not grown the past few years
- Increasing City expenses with employee costs a significant component
- Higher retirement costs may reduce the City's flexibility
- Reliance on a temporary parks levy to fund operations and maintenance efforts
- Declining number of jobs and increasing unemployment in the past few years

#### **General recommendations to the Office of Management and Finance**

1. Continue to take actions to moderate growth in operating expenditures for ongoing City programs in order to match available revenues.
2. Review ongoing pension and disability costs for opportunities to moderate increases.
3. Re-evaluate the City's financial policy to incorporate past and emerging patterns of revenue, expenditure, and service growth.

## REPORT SCOPE AND METHODOLOGY

The methodology used in this report is based on that developed by the International City/County Management Association (ICMA) in their publication, *Evaluating Financial Condition: A Handbook for Local Government*. In accordance with the ICMA methodology, Audit Services developed a definition of general government operating expenditures that includes the following City funds:

- General Fund
- General Reserve
- Transportation Operating
- Transportation Reserve
- Emergency Communications
- Public Safety
- Planning and Development Services
- Governmental Bond Redemption
- Pension Debt Redemption Fund
- Gas Tax Bond Redemption
- Portland Autoport (portion of Parking Facilities)
- Parks Memorial
- Fire and Police Disability and Retirement

Excluded from the definition of general government operations are enterprise and internal service funds, as well as those funds whose revenues are restricted to specific purposes (i.e. not available for general government operations.)

The data in the report covers ten years – from fiscal

year 1995 through fiscal year 2004. We obtained expenditure and revenue data from *Comprehensive Annual Financial Reports* and Portland's accounting system. We used the City's *Adopted Budget* document for background information and the Bureau of Human Resources' position management system and the *Portland Development Commission's Adopted Budget* for position information. The Center for Population Research at Portland State University, the State Employment Division, and the Bureau of Labor Statistics provided socio-economic data.

To eliminate the effects of inflation for year-to-year comparisons, we adjusted dollar amounts for each prior year to equal the purchasing power in fiscal year 2003-04, using the Portland-Salem/Vancouver Consumer Price Index for All Urban Consumers, as reported by the Bureau of Labor Statistics, U.S. Department of Labor.

Unless otherwise indicated, data are presented on a fiscal year basis (e.g., 2003 represents FY 2002-03, 2004 represents FY 2003-04).

We conducted the audit in accordance with generally accepted government auditing standards. Audit work was conducted primarily in the fall of 2004 and winter of 2005.

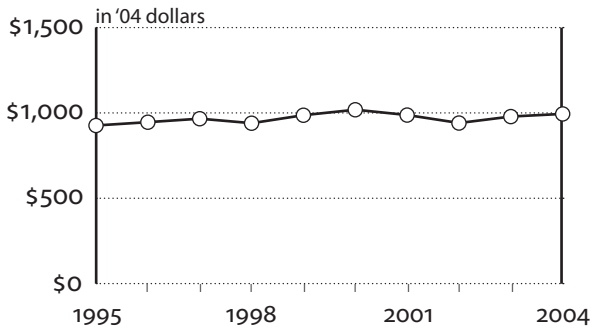




# FINANCIAL CONDITION INDICATORS

# REVENUES

## 1 OPERATING REVENUES PER CAPITA



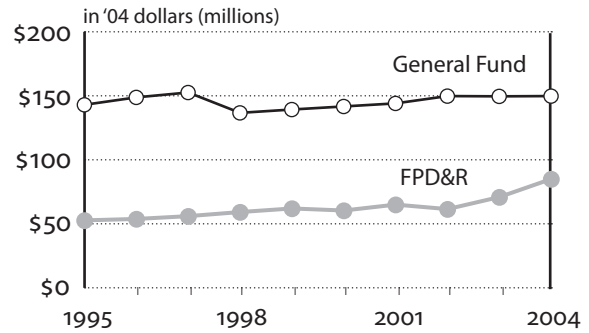
**Total operating revenues are stable, increasing slightly over the past 10 years.**

- Adjusted for inflation, net operating revenues per Portland resident increased 8 percent since 1995.
- The poor economy was largely responsible for revenue declines in 2002.
- Property taxes remain the largest source of general revenue for the City.

**Indicator Explanation.** Operating revenues include income such as property and gas taxes, business licenses and user fees, and revenues from other governments. These revenues are used for services such as police, fire, parks, streets, and central administration. Revenues from business activities such as water and sewer services are excluded.

Declining revenues per resident is a concern because it may signal the City's inability to provide existing services as the population grows.

## 2 PROPERTY TAX REVENUES



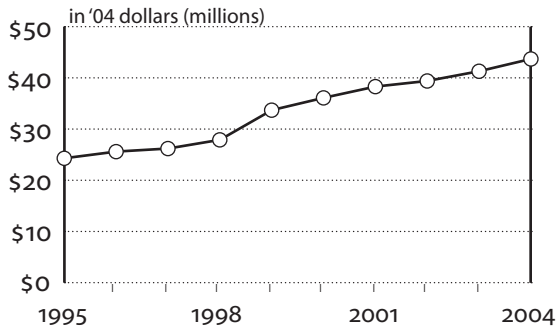
**Fire and police pension and disability costs are driving increased property tax revenues.**

- Adjusted for inflation, total property tax revenues grew by 20 percent over the past 10 years.
- Property taxes dedicated to the Fire and Police Disability and Retirement Fund grew by 61 percent, whereas property taxes for the General Fund grew 5 percent.
- Special levies for public safety and street lighting ended in the mid-1990's, resulting in a temporary downturn.
- The Parks Local Option Levy and the Children's Investment Fund Levy, passed in 2002, generated in excess of \$17 million. These special purpose revenues are not included in the graph above.

**Indicator Explanation.** Property taxes are paid on the assessed value of real, personal, and utility property. City property taxes are also generated by separate levies that support police and fire employee retirement and disability benefits, and various capital improvements. Because of their significance in supporting general government operations, declining tax revenue is a problem.

### 3

## USER CHARGES AND FEES



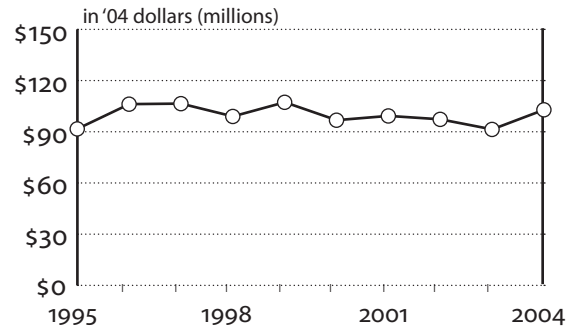
**User fees increased significantly, and now comprise over 8 percent of operating revenues.**

- Total charges and fees for service grew 80 percent since 1995.
- On average, Portland residents pay \$80 per year in City fees and charges, up from \$49 in 1995.
- Parking fees and fines represent the largest component of user charges, followed by park fees and building permit charges.

**Indicator Explanation.** This revenue source changes with the level of usage. User charges and fees should cover all or an agreed upon percentage of the costs of providing services such as recreation programs and building permits. Prices should keep pace with inflation and other cost increases. A decline in collections or a reduction in fees relative to total revenues are both problems. Water and sewer and other business activities are excluded from this indicator.

### 4

## INTERGOVERNMENTAL REVENUE



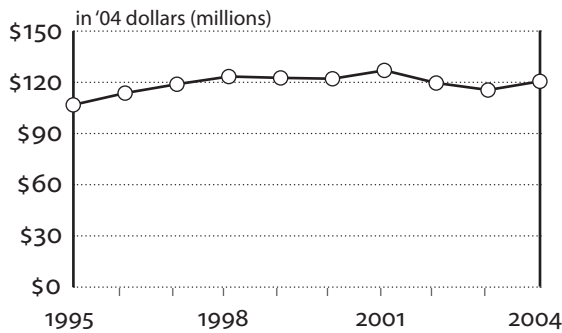
**Growth in intergovernmental revenues is stable.**

- Over the past 10 years, total income from other governments has increased slightly.
- State gas taxes account for the largest share of intergovernmental revenues, followed by federal housing and community development grants and state and local shared revenues.
- Over the past ten years, revenues from other governments has been stable per Portland resident.

**Indicator Explanation.** The City receives money from federal, state, and other local governments from sources such as federal housing grants, state gas tax revenues, and cigarette and liquor taxes.

Because this revenue is subject to change by those governments, over reliance on these funds to support general government services is considered unwise.

## 5 ELASTIC REVENUES

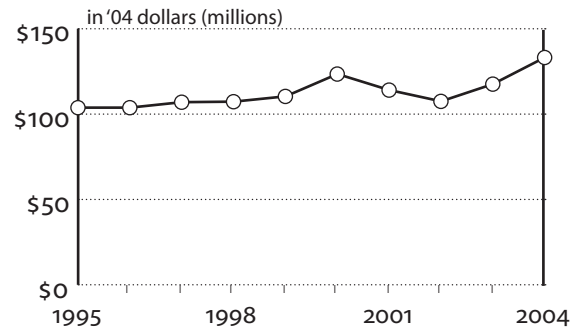


**Elastic revenues declined significantly in 2002 and 2003.**

- After fairly steady growth from 1995 through 2001, elastic revenues slowed and declined significantly in two of the past three years.
- Business license revenues, comprising over one-third of elastic revenues, were most affected by the slow economy. The Office of Management and Finance indicated that the License Bureau's revised policy on business license refunds may also have been a factor.
- Elastic revenues are 22 percent of total net operating revenues, down from a high of 26 percent in 1995, but about the same as 10 years ago.

**Indicator Explanation.** Elastic revenues are highly responsive to economic conditions, growing and declining as local economic conditions change. These revenues include business licenses, utility franchise fees, hotel and motel taxes, and building permits. Over reliance on elastic revenues can limit support for programs and services during periods of economic downturn.

## 6 RESTRICTED OPERATING REVENUES

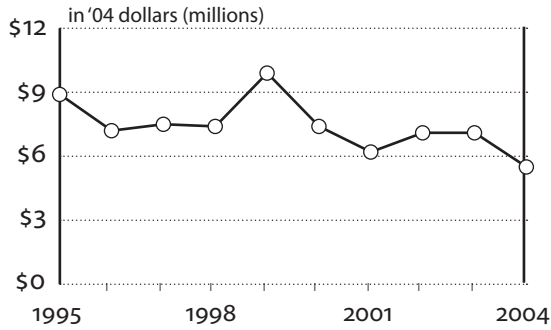


**Restricted revenues have increased over the past three years.**

- Restricted revenues have grown approximately 28 percent over the past 10 years. The large increase is due primarily to the property taxes restricted to pay for Fire and Police Disability and Retirement benefits.
- The Fire and Police Pension Levy comprises 64 percent of restricted revenues.
- In 2004, restricted revenues represent approximately 25 percent of net operating revenues, the highest percentage in the past 10 years.
- Restricted revenues relating to the Fire and Police Disability and Retirement Fund are also reflected in the Property Tax indicator.

**Indicator Explanation.** These revenues are legally restricted for specific purposes. For example, gas taxes can be used only for roads and transportation related activities. Similarly, tax levies for fire and police pensions can only be used for that purpose. An increasing portion of restricted revenues is a concern, because it may mean that less revenue is available for general uses and services.

## 7 SHORT-TERM REVENUES

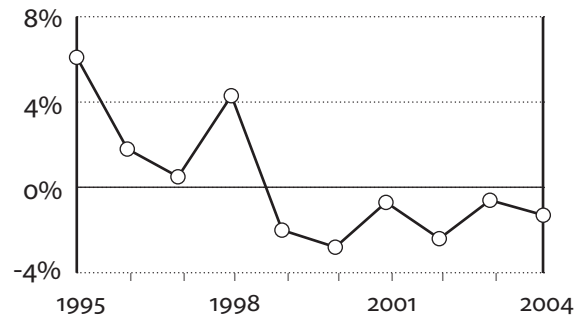


**Short-term revenues, normally used to pay for one-time needs, have generally declined in recent years.**

- The increase of short-term revenues in 1999 reflected a \$2.4 million federal disaster relief reimbursement for costs incurred by the City during 1996.
- Short-term revenues remain a small percent of net operating revenues, approximately 1 percent in 2004.
- Generally, short-term revenues are transfers and miscellaneous revenues in the General Fund, Transportation Operating Fund and Planning and Development Fund. The five-year Parks Local Option Levy of \$8.5 million, passed in 2002, is not included in the graph above.

**Indicator Explanation.** Short-term revenues are resources that are not expected to continue beyond five years. They generally include inter-fund transfers, use of various reserves or contingencies, and funds gained from sales of assets. Reliance on short-term revenues to fund ongoing programs is considered a problem.

## 8 REVENUES OVER/UNDER ESTIMATES



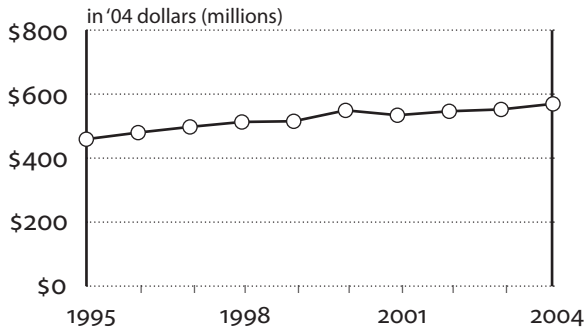
**Revenue estimates closely match amounts actually received, but the slow economy resulted in several shortfalls the past 6 years.**

- The under-estimation of revenues for most years was caused in part by the reversal of business license refunds. These were previously recorded as revenues in the General Fund.

**Indicator Explanation.** This indicator shows the difference between estimated/budgeted revenues and actual revenues received. Overestimating revenues may require use of reserves or mid-year cuts in service levels to ensure the budget balances. Under-estimating revenues can result in fund surpluses.

# EXPENDITURES

## 9 OPERATING EXPENDITURES



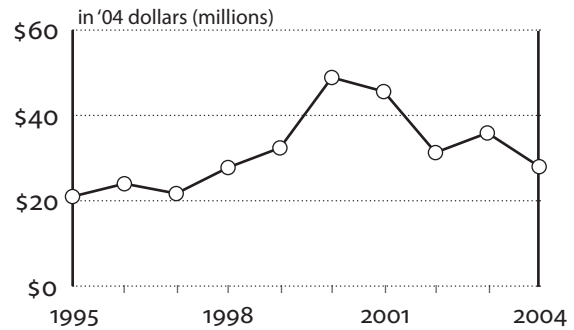
**The trend is unfavorable, with both total and per capita operating expenditures increasing.**

- Total operating spending increased 24 percent over the past 10 years, while spending per resident grew 13 percent.
- Community development spending increased the most due to more support for affordable housing, planning and building development.
- Legislative and administrative costs also increased by 42 percent over this period due primarily to support for schools, program changes within the General Fund bureaus, and payments on Public Employee Retirement System (PERS) debt. According to the OMF, the PERS debt causes short-term increases to pension liability but produces savings over the life of the debt.

**Indicator Explanation.** Operating expenditures include personnel, materials and services, and capital costs for general government services. These can include public safety, parks and community development activities. The indicator excludes enterprise expenditures such as water and sewer, and major capital improvements, such as public safety and park improvements funded by special levies or bonds.

Increasing expenditures per capita is a warning trend. It may signal declining productivity or greater burden on taxpayers. Declining expenditures may indicate increased productivity or a reduction of services.

## 10 CAPITAL OUTLAY EXPENDITURES



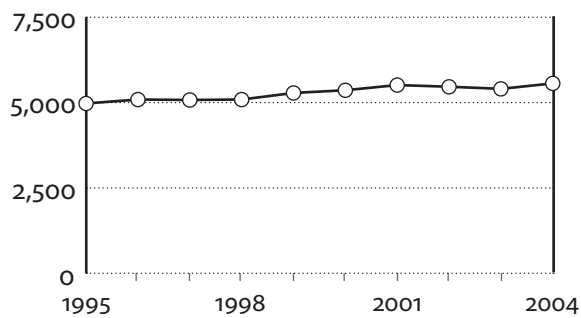
**Recent declines in capital expenditures is a warning trend.**

- Capital outlay expenditures grew by 33 percent over the past 10 years. This growth is due to increased capital spending in Transportation and Parking, such as for the streetcar. Declining capital expenditures in other areas such as parks and recreation and public safety could be a warning trend.
- Capital outlay for other general government activities has been minimal.
- Capital outlay represents about 5 percent of total operating expenditures.
- City expenditures for enterprise projects, such as the Big Pipe, and internal services, are not included in the graph.

**Indicator Explanation.** Capital outlay expenditures are costs to repair, maintain, and improve long-lived items such as equipment, buildings, vehicles. It also includes construction, such as street repairs and park improvements. This indicator does not include expenditures resulting from serial levies, bond sales or enterprise activities.

Deteriorating infrastructure and physical assets may discourage business activity, reduce property values, and increase operating expenses. Moreover, deferring capital maintenance and repairs transfers these costs from one generation of taxpayers to the next.

## 11 TOTAL EMPLOYEES

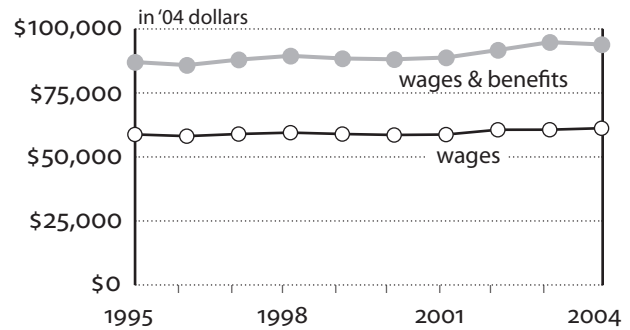


**Total City employment has grown, but the number of employees per 1,000 citizens has remained relatively constant, a positive trend.**

- The number of City employees grew from 4,975 in 1995 to 5,563 in 2004, a 12 percent increase.
- The number of employees per Portland resident has remained at 10 per 1,000 over the past 10 years.
- The Bureau of Development Services (BDS), Parks and Recreation, and Technology Services experienced the largest staff growth.
- Reorganization of services in the City contributed to the staff increases within BDS and Technology Services.

**Indicator Explanation.** An increasing number of employees could be a warning trend because it may indicate more labor intensive services or declining productivity. This indicator includes employees in enterprise bureaus, such as water and sewer funds.

## 12 EMPLOYEE COMPENSATION

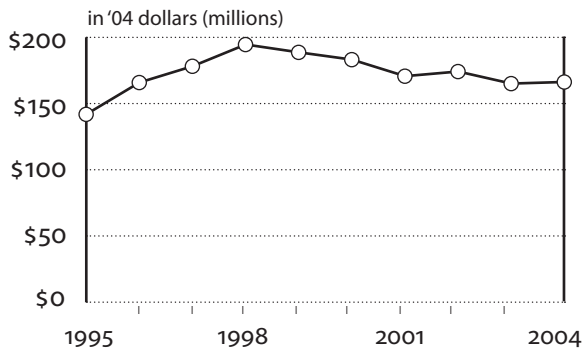


**The average employee's wage compensation has grown slightly while health and pension benefits have shown a greater increase.**

- Total average compensation for general government employees increased by 8 percent over 10 years. Public safety employee compensation made up a significant part of this growth.
- Health and pension compensation comprise about 35 percent of total wages and benefits. These expenses are significant factors in rising compensation rates.
- Total employee compensation has remained about 66 percent of total operating expenditures over the past 10 years.

**Indicator Explanation.** Total employee compensation includes both wages and benefits, such as employer-paid taxes, retirement pensions and health insurance. Increasing compensation is a warning trend, because it can reduce resources available for other services and can affect service levels. Conversely, compensation that lags behind inflation places the City at a competitive disadvantage, making it difficult to attract and retain quality personnel.

## 13 FUND BALANCES



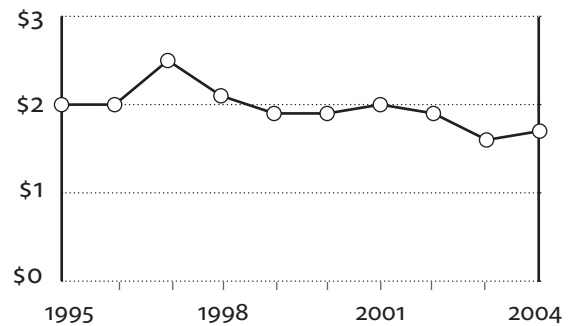
**Fund balances have declined from previous highs, generally a positive trend at this point.**

- Adjusted for inflation, total fund balances increased by 46 percent over the past 10 years.
- About one-half of the fund balance total is reserved to pay for insurance claims, replace vehicles and equipment and other internal service fund expenses.
- General Fund balances of \$57 million represent about 10 percent of total net operating revenues. This meets the City's General Fund Reserves Use Policy. Almost \$37 million is available to meet financial emergencies and contingencies.
- OMF indicates that General Fund balances are a key consideration in the City's Aaa bond rating.

**Indicator Explanation.** Unreserved fund balances represent money available for capital purchases and future obligations. Maintaining reserves also helps the government avoid short-term borrowing and respond to emergencies.

Declining or low balances are a warning trend. This may indicate that a government may not be able to meet service needs in an economic downturn or financial emergency. It may also limit its ability to fund capital purchases without borrowing. Very high fund balances may indicate that the City is collecting more revenues than it needs or is deferring expenditures.

## 14 LIQUIDITY RATIO



**The liquidity ratio has remained positive over the past 10 years.**

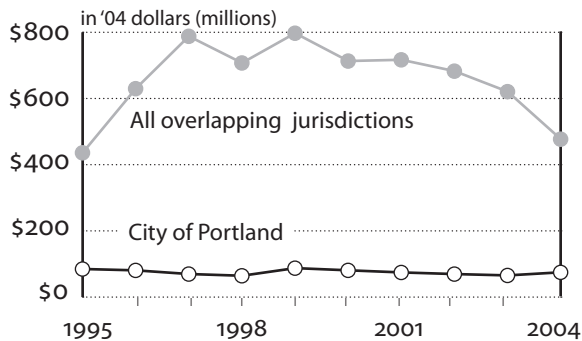
- Since 1999 the liquidity ratio has held steady at just under \$2 in assets to \$1 in liabilities.
- Net cash declined slightly since 1995, while accrued compensated absences remained steady.

**Indicator Explanation.** Liquidity is the ratio of cash and short-term investments to current liabilities including total accrued compensated absences. It is an indicator of the City's ability to pay its short-term obligations. A low ratio, below \$1:\$1, is a warning trend and may indicate a cash flow problem and increase the need for short-term borrowing.



## 15

## COMBINED LONG-TERM GENERAL OBLIGATION DEBT

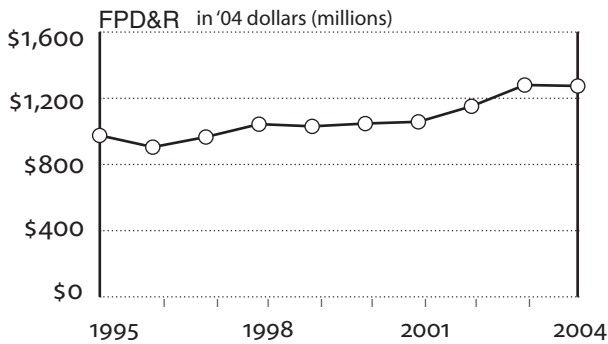


**Combined long-term debt has declined significantly and continued to be much lower than legal debt limits.**

- After peaking in 1999, combined general obligation debt for all overlapping jurisdictions has declined steadily for four years.
- Debt per citizen dropped from \$1,564 in 1999 to \$876 in 2004, a 44 percent decline.
- Schools and colleges are responsible for 46 percent of the debt in the county, followed by the City, Multnomah County and Metro.

**Indicator Explanation.** Combined long-term debt includes the total general bonded debt incurred by all governments in the region, such as the City, TriMet, Multnomah County and schools. It excludes revenue bonds. High and increasing levels of debt can strain citizen resources to repay, hindering governments' ability to borrow funds for capital repairs and improvements.

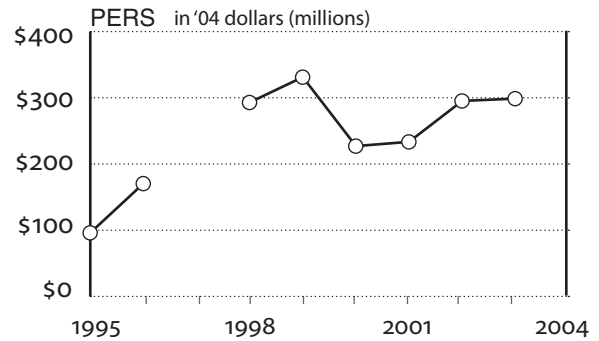
## 16 PENSION LIABILITIES



**FPD&R: The rise in pension liability over 10 years is an unfavorable trend.**

- The Fire and Police Disability and Retirement unfunded liability has increased by \$298.8 million from 1995 to 2004, a 31 percent increase.
- As of the end of June 2004, the unfunded liability was \$1.27 billion.
- The Fire and Police Disability and Pension plan is a pay-as-you-go system supported by a dedicated property tax levy capped at \$2.80 per \$1,000 real market value. The rate was \$1.59 at the end of 2004.

**Indicator Explanation.** Unfunded pension liability is an estimate of the cost of future retirement payments for present employees for which funds have not been set aside. Inadequate funding of these obligations can cause large drains on operating resources in the future when the obligations must be paid. Increasing unfunded liabilities or diminishing assets are both warning indicators.

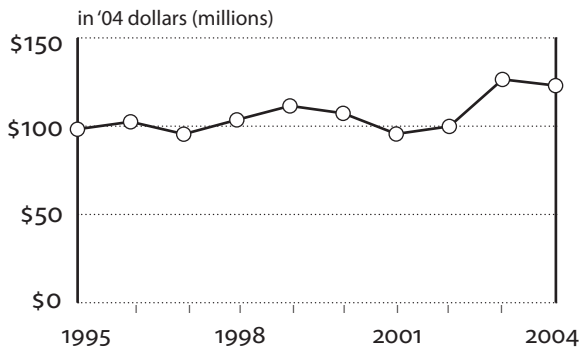


**PERS: The decrease in PERS liability in 2000 and 2001 was a positive trend. However, the liability has increased in the last two years.**

- The City's unfunded pension liability grew to \$257 million by 1997, based on actuarial estimates.
- In FY 2000, the City issued over \$300 million in pension bonds to completely pay off the City's pension obligation to PERS. Principal payments are not due until 2007.
- At the end of 2004, the outstanding balance on the pension bonds was \$300 million. According to OMF, the debt produces savings over the life of the obligation.

The City has two pension programs. The Fire and Police Disability and Retirement Plan provides benefits for most police officers and firefighters. All other employees are covered by the state-mandated and pre-funded Oregon Public Employees Retirement System (PERS). Contribution rates are set by PERS and pension benefits are paid from employer contributions, accumulated reserves, and investment earnings.

## 17 CURRENT LIABILITIES



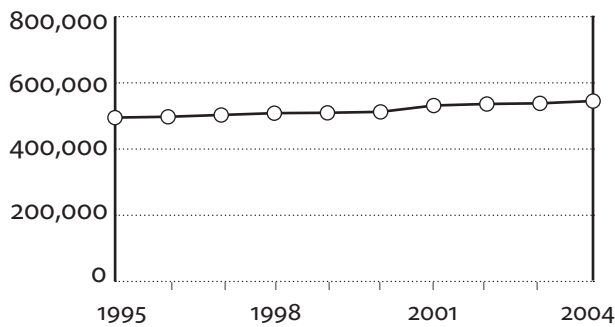
**The trend has been unfavorable over the past two years.**

- Current liabilities as a percent of net operating revenues averaged 21 percent over the past 10 years.
- Accounts payable as a percent of operating expenditures has remained steady at 6 percent.
- Accrued compensated absences represent about one-third of current liabilities.
- Accounts payable as a percent of operating expenditures has remained relatively stable over the years.

**Indicator Explanation.** Current liabilities include accounts payable. These are amounts owed at year end that are expected to be paid within the following fiscal year, and accrued compensated absences, which may be paid in later fiscal years.

Increasing amounts owed creditors at year-end is a warning trend because it can indicate that a government is short of cash to pay bills.

## 18 CITY POPULATION

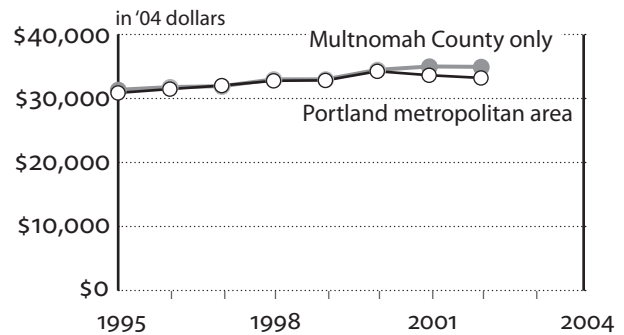


**The population has increased gradually since 1995.**

- Population has increased about 10 percent over the past 10 years – from 495,090 to 545,140.
- Between April 2000 and July 2003, Portland added 16,019 to its population, the largest in-migration of any city in Oregon during this period.
- In 2004, 36 percent of the regional population resided in the City of Portland.

**Indicator Explanation.** Rapid increases in population can be a warning trend if service demands increase faster than revenue growth. Similarly, declines in population can reduce demand and revenue requiring cuts in government programs.

## 19 INCOME PER CAPITA

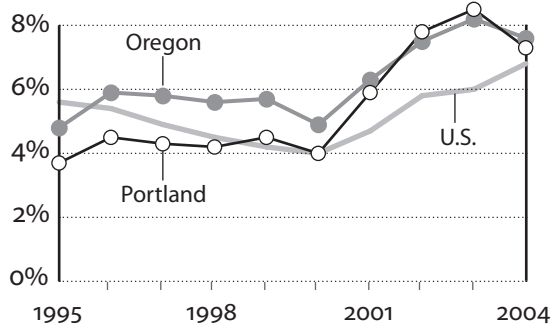


**Income per resident in the Portland metro area has declined slightly in recent years.**

- From 1995 to 2002, the Portland area's per resident income increased 8 percent, whereas Multnomah County increased 11 percent.
- Data for 2003 and 2004 are not yet available from the Oregon Department of Employment.

**Indicator Explanation.** Declining income per resident is a warning trend indicating general economic problems and decreased ability to provide tax resources for government services.

## 20 UNEMPLOYMENT RATE

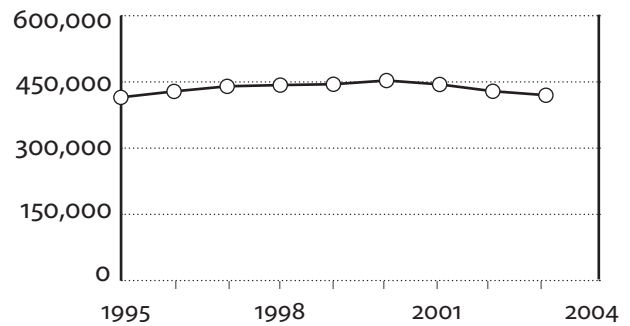


**The unemployment rate in the Portland area almost doubled between 2000 and 2004.**

- Portland area's unemployment rate was relatively constant from 1996 to 2000. It increased significantly in 2000, from 4 percent to over 7 percent in 2004.
- The Portland area and the State's average unemployment rates have generally mirrored each other during the last few years. Prior to 2001, Portland experienced less unemployment than the State.
- Both the State and the Portland area unemployment rates have been significantly higher than the U.S. average since 2001.

**Indicator Explanation.** A rising unemployment rate is a warning indicator of a declining employment base. This can lead to fewer revenues to support services, yet more demand for those services.

## 21 NUMBER OF JOBS

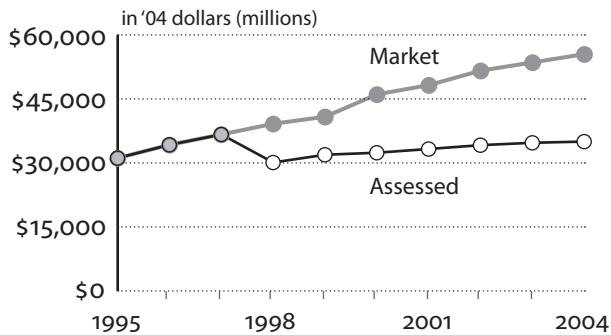


**After a peak in 2000, the number of jobs in Multnomah County has steadily declined.**

- The number of jobs in Multnomah County increased by 38,140 from 1995 to 2000. But, 24,480 jobs were lost between 2001 and 2003.
- The three sectors that lost the most jobs were manufacturing, construction, and professional and business services, accounting for 68 percent of the jobs lost.

**Indicator Explanation.** A decrease in the number of jobs indicates potential problems with economic health – contributing to higher unemployment rates and resulting impacts on government revenues and services.

**22 PROPERTY VALUES**



**Portland’s market values for property have continued to increase over the last 10 years.**

- After adjusting for inflation, market property values in Portland increased 78 percent from 1995 to 2004.
- However, assessed values grew more slowly due to tax limitation in 1998 that rolled back assessed values to 90 percent of 1996 values. Future assessed value growth was also limited to 3 percent per year plus the value of new construction.

**Indicator Explanation.** Assessed property value is a measure of the taxable value of real, personal, and utility property in the City. Declines in assessed value will typically decrease property tax revenues which can adversely impact ongoing government services and bonded debt repayment.

Market values are an indicator of sales value and can be an indicator of economic health.



THIS REPORT IS INTENDED TO PROMOTE THE  
BEST POSSIBLE MANAGEMENT OF PUBLIC RESOURCES

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