

FINANCIAL HEALTH INDICATORS

Preface

For the past several years, staff in the Ohio Auditor of State's office has been developing a tool that will help city and county officials better predict the financial stability of their communities and make well-informed decisions. It will also provide citizens and state officials with meaningful, easy-to-understand insight when they consider actions that financially impact cities and counties throughout Ohio.

Through newly created Financial Health Indicators (FHI), which are generated using data from financial statements submitted annually to the Ohio Auditor of State's office and their audit reports, cities and counties predisposed to fiscal stress will be identified and allow the Auditor's staff, upon request, to provide support to those potentially at risk.



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The process began with research to identify other states that were using financial indicators for similar purposes. The states of Washington, New York and Michigan were studied, as was the Colorado school system. The goal was to learn from those experiences by understanding their processes and evaluating which indicators they chose to use.

Additionally, research from the Government Finance Review and the International City/County Management Association (ICMA), as well as other accounting literature, was examined to help identify ratios and other financial indicators that are proven predictors of financial stability. This research aided members of the Auditor's office in constructing Ohio's new FHI tool. While many useful financial ratios and indicators exist, the Auditor wanted to utilize the best indicators of an entity's financial stability that were also readily available from the financial statements and audit results of cities and counties.

A collection of financial information, percentages and ratios gathered from these financial statements was used to build a five-year history of data to generate up to 17 financial health indicators. It was determined the most beneficial and determinative method to test the proposed indicators would be on those cities and counties that were already placed in fiscal caution, watch or emergency. In each of those cases, the new financial indicators were applied using data for the years prior to their fiscal distress. From this, a clearly identifiable trend of increasing fiscal stress emerged. Had the FHI tool been in place at that time, those entities could have requested assistance from the Ohio Auditor of State two to three years prior

Continued on next page

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Preface (continued)

to their financial stress worsening and being placed in fiscal caution, watch or emergency.

These FHI trends helped establish benchmarked criteria needed to determine a city's or county's financial outlook. Using averages based on five years of historical information from all Ohio counties and cities, benchmarks were set for "critical outlook" and "cautionary outlook," which are reflected in each entity's report with the colors red and yellow, respectively.

In analyzing how the FHI would be reflected in those entities already in fiscal distress (fiscal caution, watch or emergency), staff determined that all of these entities scored poorly in at least nine of the 17 indicators, and all had at least six indicators with "critical outlook" or red scores. And when the FHI were analyzed using financial data for those distressed communities two to three years before their conditions worsened, all of the entities scored poorly in at least eight of the indicators, with all having a combination of eight "critical" and "cautionary" indicators.

The benefit of identifying the stress indicators early is for communities to take a proactive approach in dealing with their areas of financial stress.

No individual financial indicator is of use in identifying overall fiscal stress or predicting that an entity will fail. While individual indicators do point to specific areas of concern, the indicators should be considered together to obtain an insight as to whether or not an entity is experiencing the early signs of fiscal stress.

The FHI will be updated twice a year. The first update occurs when a city or county submits its financial reports to the Auditor's office via the Hinkle System. At that time, a preliminary FHI report will be generated. Once the financial data is audited and necessary adjustments are made, a final report will be generated.



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