

Financial Health Indicators

Ohio Revised Code Section 118.025 requires the Auditor of State to “develop guidelines for identifying fiscal practices and budgetary conditions, amongst municipal corporations, counties, and townships that, if uncorrected, could result in a future declaration of fiscal watch or emergency.”

Pursuant to Ohio Revised Code Section 118.025, the Auditor of State may declare an entity in fiscal caution for engaging in certain fiscal practices or budgetary conditions. In addition to these fiscal caution guidelines, the Auditor of State has developed Financial Health Indicators. Financial Health Indicators are a series of financial information, percentages, and ratios gathered from annual financial statements, filed by the local governments, which are useful in predicting financial stability.

The Auditor of State will use these Financial Health Indicators to recognize early signs of fiscal stress at specific local governments and take a proactive approach to monitoring or assisting these local governments, rather than only a reactive approach after declaration of fiscal caution, watch, or emergency.

The Auditor of State has determined that an entity, reporting on a GAAP basis of accounting, should be monitored for fiscal stress if they meet at least 6 Critical Financial Health Indicators. An entity should be considered for assessment of fiscal stress if they meet a combination of at least 8 Critical or Negative Financial Health Indicators.

The Auditor of State has determined that an entity, reporting on a Cash or Modified Cash basis of accounting, should be monitored for fiscal stress if they meet at least 4 Critical Financial Health Indicators. An entity should be considered for assessment of fiscal stress if they meet a combination of at least 6 Critical or Negative Financial Health Indicators.

This document outlines a list of Financial Health Indicators including the description, meaning, and importance of each indicator.

Financial Health Indicators

Sixteen (16) Financial Health Indicators have been identified as useful in determining signs of fiscal stress. The indicators are based on information derived from the annual financial statements submitted to the Auditor of State by local governments. These financial statements are currently required to be submitted within 150 days after the end of the local government's annual reporting period.

The Auditor of State has evaluated these 16 Indicators as useful in identifying fiscal stress in local governments who report financial statements prepared in conformity with Generally Accepted Accounting Principles (GAAP). For local governments who choose to present their financial statements on an Other Comprehensive Basis of Accounting, it has been determined that at least 14 of the Indicators are useful in identifying fiscal stress. Indicators 10 and 15 may not be able to be evaluated depending on the basis of accounting reported upon.

From the financial statements, we gather information as it relates to:

Governmental Type Activities (GTA):

The financial information for Governmental Type Activities is from the government-wide financial statements, Statement of Net Assets/Position and Statement of Activities.

General Fund and All Governmental Funds:

General Fund and All Governmental Fund information is from the governmental fund type financial statements – Balance Sheet and Statement of Revenues, Expenditures, and Changes in Fund Balances.

The 16 Financial Health Indicators are:

1. Unrestricted Net Assets/Position of Governmental Type Activities (GTA)

- There are three major components to net assets/position (equity) - Net investment in capital assets, restricted net assets/position, and unrestricted net assets/position.
- Unrestricted net assets/position represents the portion of net position that has no related liabilities or restriction as to use.
- Negative unrestricted net assets/position occurs primarily if liabilities exceed assets.

Description of indicator and what it means?

This indicator identifies when an entity has negative unrestricted net assets/position.

Why it is important?

This indicator identifies if net assets/position is available for unrestricted purposes. Although unrestricted net assets/position may not be in liquid form, it is important to have net assets/position available and unrestricted as to use. If an entity's unrestricted net assets/position is declining or is negative, it leaves little or no room for unexpected expenses; and therefore, is a sign of fiscal stress.

Critical Indicator – Negative amounts

Negative Indicator – Declining trend over a three year period

2. Unassigned Fund Balance of the General Fund

- A component of equity.
- There are five components of fund equity – Nonspendable, Restricted, Committed, Assigned, and Unassigned. Unassigned fund balance is the portion of fund balance that has no related liabilities or has not otherwise been obligated.

Description of indicator and what it means?

This indicator identifies when an entity has negative unassigned fund balance.

Why it is important?

This indicator identifies if fund balance is available for unrestricted purposes. Although unassigned fund balance may not be in liquid form, it is important to have fund balance available without restrictions as to use. If an entity's unassigned fund balance is declining or is negative, it leaves little or no room for unexpected expenses; and therefore, is a sign of fiscal stress.

Critical Indicator – Negative amounts

Negative Indicator – Declining trend over a three year period

3. Change in Unrestricted Net Assets/Position for Governmental Type Activities

Description of indicator and what it means?

This indicator identifies changes (increases or decreases) in unrestricted net assets/position from the prior year to the current year and will be useful in identifying local governments whose unrestricted net assets/position is deteriorating.

Why it is important?

As stated in Indicator #1, declining unrestricted net assets/position can be a sign of fiscal stress. This indicator is important in identifying a trend of deteriorating unrestricted net assets/position as well as how rapidly it is deteriorating.

Critical Indicator – Negative percentage change or rapidly declining trend

Negative Indicator – Declining trend over a three year period

4. Change in Unassigned Fund Balance of the General Fund

Description of indicator and what it means?

This indicator identifies changes (increases or decreases) in unassigned fund balance from the prior year to the current year and will be useful in identifying local governments whose unassigned fund balance is deteriorating.

Why it is important?

As stated in Indicator #2, declining unassigned fund balance can be a sign of fiscal stress. This indicator is important in identifying a trend of deteriorating unassigned fund balance as well as how rapidly it is deteriorating.

Critical Indicator – Negative percentage change or rapidly declining trend

Negative Indicator – Declining trend over a three year period

5. General Fund Balance / General Fund Revenues

Description of indicator and what it means?

This indicator identifies reserves available in the General Fund. The larger the reserve the better the entity is able to absorb, in the short term, the impact of sudden revenue loss or significant increases in operating costs, and begin planning financial adjustments.

This indicator is calculated by taking the total General Fund balance divided by total General Fund revenues. This will determine the percentage of total General Fund revenues (or the current year budget) that has been reserved or available for carry over to the following year.

Why it is important?

This indicator identifies a low reserve of fund balance even if Indicators 1 through 4 do not indicate negative unrestricted net assets/position or unassigned fund balance.

Critical Indicator – Negative percentage, very low percentage, or rapidly declining trend

Negative Indicator – Low percentage (< 1/12th or 8%) or declining trend over a three year period

6. Decline in General Fund Tax Revenue

Description of indicator and what it means?

This indicator reflects the percentage change from year to year for:
Property tax revenue for all entity types, and
Sales tax revenue for counties and income tax revenue for cities.

Why it is important?

This indicator reflects declines in these revenue types and is an indication that an entity may be facing financial hardship due to declines in significant revenue sources. It will also reflect the need for additional sources of revenue to maintain stability.

Critical Indicator – Trend of declining tax revenue over a three year period

Negative Indicator – Decrease in tax revenue

7. Percentage of General Fund Revenues that Exceed General Fund Expenditures

Description of indicator and what it means?

This indicator is calculated as total General Fund revenues less total General Fund expenditures, divided by total General Fund revenues. It will provide an indication of operating deficits and the size of the operating deficit compared to the current year budget. An operating deficit is the difference between revenues and expenditures. If expenditures exceed revenues, an operating deficit exists.

Why it is important?

This indicator is important because it reflects if an operating deficit exists but also emphasizes the size of the deficit as compared to the current year's budget. This is an indication of the shortage in the current budget. A trend of operating deficits indicates potential financial hardship.

Critical Indicator – Negative percentage or rapidly declining percentage

Negative Indicator – Less than 5% or a trend of declining percentage over a three year period

8. General Revenues of GTA / Net Expenses of GTA

Description of indicator and what it means?

The ratio of this indicator reflects coverage of net expenses by general revenues. Similar to indicator #7, this indicator determines if, on a government-wide basis, expenses are exceeding revenues. For example, local taxes, unrestricted revenues (e.g. investment earnings) and unrestricted grants should be sufficient to meet expenses not covered by program revenues. Program revenues include charges for services (e.g. fees and fines), operating grants and capital grants.

Why it is important?

As with Indicator #7, this indicator is important to be aware if a shortage in revenues to cover expenses exists. A declining trend would indicate fiscal stress.

Critical Indicator – Ratio less than 100%

Negative Indicator – Declining trend of at least three years

9. General Fund Intergovernmental Revenues as a percentage of Total General Fund Revenues

Description of indicator and what it means?

This indicator will reflect an over-reliance on intergovernmental revenues which are subject to state budget cuts. A high percentage suggests the entity is heavily reliant on external governmental organizations for grants, entitlements, or shared revenues; and therefore, vulnerable to decreases in these revenue sources.

Why it is important?

It is important to be aware of the percentage of total revenues that are not considered "own-source", or local sources, of revenue. Understanding the percentage of total revenues derived from intergovernmental sources is important when trying to maintain fiscal stability, while dealing with an economic downturn.

Critical Indicator – Percentage above benchmark

Negative Indicator – Percentage near benchmark

10. Condition of Capital Assets*

Description of indicator and what it means?

This indicator is accumulated depreciation as a percentage of depreciable capital assets. This indicator will identify apparent situations in which repair or replacement of the local government's assets will be necessary. A high percentage indicates assets replacement is imminent and the entity may be delaying replacement of assets or significant repairs for cash flow purposes.

Why it is important?

When entities delay improving or replacing assets in order to maintain cash flows for other purposes, improvements and replacements become absolutely necessary and may contribute to financial hardship on an already strained budget.

Critical Indicator – Percentage above benchmark

Negative Indicator – Percentage near benchmark

11. Debt Service Expenditures / Total Revenues

Description of indicator and what it means?

This indicator is total debt service expenditures divided by total revenues (for all governmental funds). This indicator identifies the percentage of the budget used/needed for repayment of debt.

Why it is important?

Higher debt service expenditures to total revenues is unfavorable since the entity spends more of its current budget on debt repayment. An increasing trend of debt service expenditures to total revenues may mean the percentage of budget dedicated to debt payments is increasing; and therefore, less revenue will be available for asset repair/replacement or meeting current service demands.

Critical Indicator – Percentage above benchmark

Negative Indicator – Percentage near benchmark

Average Daily Expenses or Expenditures Ratio (Indicators 12, 13 & 14):

Description of indicator and what it means?

Indicators 12, 13 and 14 identify the number of days the local government's unrestricted net assets/position, unassigned fund balance, and cash and investments will sustain the entity. The indicators are based on the daily average expenses/expenditures.

Why it is important?

These indicators are important because they identify the number days the entity may operate using their unrestricted net assets/position, unassigned fund balance, and cash and investments. The fewer days the entity can operate, the more financial stress they are under. It provides an early indication of an entity's need to adjust their financial/expenditure planning.

12. Unrestricted Net Assets/Position of GTA / Average Daily Expenses of GTA

13. Unassigned Fund Balance of the General Fund / Average Daily Expenditures of the General Fund

14. Cash & Investments of the General Fund / Average Daily Expenditures of the General Fund

Critical Indicator – Zero days (or negative number of days when reporting on a basis other than GAAP)

Negative Indicator – Less than 30 days

15. Total Liabilities-to-Net Assets/Position*

Description of indicator and what it means?

This indicator is the ratio of total liabilities of GTA divided by total net assets/position of GTA and indicates the percentage of every dollar of resources, available for providing public services, that is owed by the entity.

Why it is important?

This indicator identifies entities that are over-extended in terms of the percentage of every dollar which is owed to others.

Critical Indicator – Ratio above benchmark

Negative Indicator – Ratio near benchmark

16. Direct and Material Non-Compliance (Budgetary Violation)

Description of indicator and what it means?

This indicator identifies entities with a simple “yes” or “no” if their audit report included non-compliance budgetary violations, or the entity had unreconciled and/or unauditible records during the audit period.

Why it is important?

This indicator will reflect if an entity is not following Ohio budgetary law or proper accounting methods. Maintaining accurate, reconciled accounting records and adherence to Ohio budgetary law, is a significant factor in maintaining fiscal stability.

Critical Indicator –Repeated Direct and Material Non-Compliance (Budgetary Violation)
for at least three years

Negative Indicator –Direct and Material Non-Compliance (Budgetary Violation)

- * These Indicators will only be used to evaluate local governments reporting on a GAAP basis of accounting or reporting this information on a Modified Cash basis of accounting.