

Financial Health Indicators
Feedback and Comments Received

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➤ <i>Opinion</i>	This is a good project for the Auditor of State (AOS). It has been a few years (9, maybe) since an AOS has undertaken to compile operating financial statistics; it takes resources but it is worthwhile. Thank you.	None required.
➤ <i>No Indicator Can Stand Alone</i>	If you are looking for some feedback on the indicators themselves, I offer this. No ratio is perfect and can stand alone. It seems like with 16 (and the scoring criteria) there is a breadth of data that will provide a wide scope. Some of the indicators seem rather unique, but I will make the calculations, look at results and put each in the proper perspective. If you get good feedback on this project (and I expect you will) you will have some indication on the extent to which local governments trust the judgment of the technical staff of the AOS.	None required.
➤ <i>No Indicator Can Stand Alone</i>	One county commented that the indicators were useful in monitoring a local government's financial stability and monitoring trends affecting the overall fiscal health of a local government. This same county agreed that the indicators needed to be used in combination (for example, multiple critical or negative indicators) in order to be useful and reflective of fiscal stress.	No one indicator will be a clear sign of fiscal stress. It takes multiple indicators working together to assess financial stability; therefore, we have established the minimum number of indicators required to be met for consideration for monitoring or assessment status.
➤ <i>Trends</i>	The calculations as presented use data over a three year period. We suggest three years is not a sufficient period of time to monitor trends and would suggest a five or ten year period.	Per the Government Finance Officers Association (GFOA), a minimum of five years of data is typically necessary for effective trend analysis. Also, the GFOA

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<p>➤ <i>Format of Calculations</i></p>	<p>For those governments reporting on a generally accepted accounting principles (GAAP) basis of accounting, the order in which the calculations are presented switched back and forth from full accrual to modified accrual. We suggest formatting the order of the calculations into separate sections for the two bases of accounting, to allow readers to easily follow the information.</p>	<p>recommends that no more than ten years of data should be considered due to loss of relevance over time. The Financial Health Indicators consider five years of data in assessing the three-year trends of the local governments. This was a common approach utilized by the states of Colorado and New York during their early detection process. A three year trend period appears appropriate, allows nonrecurring events to be managed by the entity and provides a consistent basis to analyze the entity’s fiscal stability; however, we will continue to evaluate the financial data for subsequent periods to determine if a longer trend analysis would provide better insight.</p> <p>The Financial Health Indicators document serves as a reference source in understanding the 16 Financial Health Indicators established by the AOS. The order of the indicators does not signify importance and places no bearing on the calculations. Each indicator should be understood and calculated independently of the others. Once all calculations are complete, the entity can determine if the indicators meet critical or negative status and if the number of indicators meeting</p>

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<p>➤ <i>Number of Calculations</i></p>	<p>Sixteen calculations appear to be sufficient to capture the concerns expressed by the AOS. However, we believe that limiting the number of indicators will provide greater focus on the most important indicators of fiscal health. Further, some of the calculations seem to be repetitive and we suggest combining 1 and 3, 2 and 4.</p>	<p>these benchmarks meets the criteria for fiscal stress monitoring or assessment at a local government.</p> <p>Indicators 1 through 4 assess two different concepts and are effective measures of fiscal stress. Indicators 1 and 2 examine whether the values reported are negative or are deteriorating each year. They are useful in providing dollar amounts that have no related liabilities or obligations associated with them. Indicators 3 and 4 examine the percentage change in the values from year to year and determine how rapidly the values may be declining. By examining Indicators 1 and 2, it is known whether an increase or decrease exists within the Unrestricted Net Assets/Position and Unassigned Fund Balance of the General Fund, and Indicators 3 and 4 focus on the materiality of the change in relationship to the local government's size.</p>
<p>➤ <i>Number of Calculations</i></p>	<p>Another county suggested combining Indicator 2 (Unassigned Fund Balance of the General Fund) with Indicator 4 (Change in Unassigned Fund Balance of the General Fund). This county also suggested combining Indicator 1 and 3 together (Unrestricted Net Assets/Position of Governmental Type Activities,</p>	<p>Indicators 1 and 2 examine whether the values reported are negative or are deteriorating each year. They are useful in providing dollar amounts that have no related liabilities or obligations associated with them. Indicators 3 and 4 examine the</p>

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	and Change in Unrestricted Net Assets/Position for Governmental Type Activities).	percentage of change in the values from year to year and determine how rapidly the values may be declining. By examining Indicators 1 and 2, it is known whether an increase or decrease exists within the Unrestricted Net Assets/Position and Unassigned Fund Balance of the General Fund, but Indicators 3 and 4 account for the materiality of the change in relationship to the local government's size. Therefore, each indicator is assessing different concepts and all indicators are valuable measures of fiscal stress.
➤ <i>Indicator Importance/Weight</i>	Another county expressed the view that the Governmental Type Activities (GTA) indicators were not nearly as important signs of financial stress as the general fund indicators. This view was based on the opinion that a local government was not likely to go into fiscal watch or emergency based on problems with one or more special funds rather than if the problem originated in the general fund. It was suggested by the same county that perhaps the GTA indicators and general fund indicators could be broken into two categories: 1) GTA indicators and 2) general fund indicators with greater importance attached to the general fund indicators.	The majority of the indicators utilizing the government-wide financial statement assess the unrestricted monies or the general monies that are not accounted for in special funds or activities of the local government. At this time, the AOS does not intend to weight one indicator of a greater importance than another.
➤ <i>Indicator Importance/Weight</i>	One county said that Indicators 1, 3, 8, 12, 15 and to some degree 10 related to governmental type	The government-wide indicators are important in assessing the unrestricted

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	<p>activities should be weighted relatively less importantly than the indicators pertaining to the general fund.</p>	<p>monies of the local government as well as how the government's long-term obligations are impacting its financial stability. During the development of the Financial Health Indicators, a weighted approach was discussed, but it was decided that establishing a minimum number of indicators to meet would be a sound approach in applying the guidelines.</p>
<p>➤ <i>Indicator 6 Decline in Tax Revenue</i></p>	<p>The calculation uses "property tax revenue" to compare the tax revenue trends for an organization. We suggest that more detail be required for this calculation. The property tax revenue line in the financial statements is net of any adjustments made for revenues not collected or written off from prior years (or even written off in prior years and collected in current). By providing more detail as to the make-up of the property tax revenue line, users of this analysis can better understand some of the changes that occur over the year, which often times can be significant.</p>	<p>The Financial Health Indicators have been established to utilize information directly available from the financial statements of local governments without additional detail. The primary users of the Financial Health Indicators are intended to be the local governments and the AOS; however, local governments may consider additional detail in their analysis.</p>
<p>➤ <i>Indicator 6 Decline in Tax Revenue</i></p>	<p>Questions were raised about the application of this indicator to both general fund and governmental type activities. It was suggested that an increase in tax revenue for a special fund purpose might make a county experiencing severe general fund tax revenue losses look healthier than might otherwise be the case. The AOS might wish to apply this indicator</p>	<p>Indicator 6 specifically examines the decline in tax revenue for the general fund only. No consideration of any special funds is provided. The title of the indicator has been modified to "Decline in General Fund Tax Revenue" in order to more accurately reflect the information included.</p>

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	<p>exclusively to the general fund. Another possibility would be to separate Indicator 6 into two categories: Decline in tax revenue for the general fund and decline in tax revenue for governmental type activities.</p>	
<p>➤ <i>Indicator 7 Percentage of General Fund Revenues that Exceed General Fund Expenditures</i></p>	<p>One county observed that in the current economic environment it may be unrealistic to expect local governments to consistently generate revenue growth of 5% over expenses each year. This county expressed the view that it might be more realistic to strive for revenue growth of 1 to 3% instead of 5%.</p>	<p>Indicator 7 measures the existence of an operating deficit and its size in comparison to the current year’s budget. This indicator is not expecting revenue growth for an entity. The goal is for an entity to carry over 5% or more of its general fund revenues annually to maintain fiscal stability. The intent is for an entity to keep expenditures in line with current revenue streams to avoid a declining general fund balance.</p>
<p>➤ <i>Indicator 9 Intergovernmental Revenue as a Percentage of Total Revenues</i></p>	<p>Though I believe you intend this to be measured on a modified-accrual basis, the language in the instructions may cause confusion as to if it should be measured on a modified or full accrual basis.</p>	<p>Additional wording has been included in the title of this indicator to clarify that only the general fund’s information will be utilized in the assessment of this indicator.</p>
<p>➤ <i>Indicator 9 Intergovernmental Revenue as a Percentage of Total Revenues</i></p>	<p>Two counties commented that various county agencies are set up to be dependent on intergovernmental revenues by design, and thus it is counterproductive to suggest that such offices or functions somehow have to reduce their reliance on state and federal intergovernmental funds. Examples of this type of dependence on intergovernmental</p>	<p>Indicator 9 is calculated using solely the general fund values. No special funds are considered in this indicator. The intent is to determine the reliance of a local government on the State or federal revenue sources that are more vulnerable to budget cuts. The title of the indicator</p>

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<p>➤ <i>Indicator 11 Debt Service Expenditures/Total Revenues</i></p>	<p>One county suggested that instead of Total Governmental Fund Revenues the AOS use “Total Available Resources in the General Fund.” Another county said that this indicator might confuse counties that exceed a critical indicator or negative indicator when in fact the total debt does not violate the debt service limits established under the bond law and based on property tax valuations.</p>	<p>Most local governments have a specific tax levy for which the proceeds are used to pay debt obligations, and this activity is typically accounted for in a debt service fund. Therefore, it is not realistic to base the calculation on the resources available in the general fund when these are not the resources that are likely going to be utilized to satisfy the debt service related expenditures. Also, while many local governments do not experience a violation of their debt service limits, this indicator can identify other debt arrangements that are not included in the legal debt margin calculation. It is becoming more and more apparent that local governments are entering into lease arrangements rather than issuing bonds for the financing of various capital projects. These arrangements are not considered in an entity’s legal debt margin calculation. Therefore, this indicator is a valuable resource into examining the true debt service expenditure activity of a local government.</p>
<p>➤ <i>Indicator 12 Unrestricted Net Assets/Position of GTA, Indicator 13 Unassigned Fund Balance of</i></p>	<p>One county did not believe that any of these indicators were meaningful measurements of fiscal stress. Two counties commented that they did not</p>	<p>These indicators examine how long a local government may operate on its current unrestricted net position, unassigned fund</p>

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<p><i>the General Fund/Average Daily Expenditures of the General Fund, and Indicator 14 Cash and Investments of the General Fund/Average Daily Expenditures of the General Fund</i></p>	<p>think that Indicators 13 and 14 are both needed.</p>	<p>balance, and cash and investments. The shorter the number of days calculated, the more concern exists that a local government may be experiencing fiscal stress. Indicators 13 and 14 are examining two separate and unrelated criteria. If an entity reports on a GAAP basis of accounting, these two amounts are likely never the same. Both have been determined to be useful in assessing fiscal stress.</p>
<p>➤ <i>Indicator 15 Debt-to-Net-Assets/Position</i></p>	<p>The calculation is the ratio of total liabilities of GTA to Net Position. It is my belief that the label should be changed to accurately reflect what the indicator is measuring.</p>	<p>The title of the indicator has been modified to “Total Liabilities-to-Net Assets/Position” in order to more accurately reflect the information examined.</p>
<p>➤ <i>Indicator 15 Debt-to-Net-Assets/Position</i></p>	<p>One county said that excluding capital assets from the calculation might prove to be a better indicator because capital assets cannot be sold to satisfy debts. Another county questioned whether this would be a true indicator of fiscal distress. The County Commissioners Association of Ohio (CCAO) also asks whether the new requirements of the Governmental Accounting Standards Board (GASB) for allocation of the proportionate share of the Ohio Public Employees Retirement System (OPERS) net pension liability and OPERS pension expense to individual local governments under GAAP accounting is going to be included within the definition of county debt or</p>	<p>Indicator 15 identifies entities that may be over-extended in terms of the percentage of every dollar which is owed to others. Because many of the liabilities (or at least the larger ones) are likely to be related to the acquisition of capital assets, it is a better representation to include net position resulting from capital assets within the denominator. If very little monies are available to provide public services, or the majority of resources have already been committed by the local government, a concern does exist as to the</p>

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<p>➤ <i>Indicator 16 Direct and Material Non – Compliance (Budgetary Violation)</i></p> <p>➤ <i>Suggestions for Additional Assessment Consideration</i></p>	<p>liability for purposes of complying with Indicator 15 (Debt-to-Net Assets/Position)?</p>	<p>fiscal stability of the entity. The AOS is currently working on the implementation requirements of GASB 68 and will assess its effect on the Financial Health Indicators at the time of implementation.</p>
	<p>One county commented that budgetary compliance failures are overstated in terms of indicators of financial distress as compared to unreconciled and/or un-auditable records. The thought was that unreconciled/un-auditable records was a better indicator of fiscal distress. This same county went on to note that “there are budgetary laws that, if proven to be non-compliant, are hardly indicators of poor financial health.”</p>	<p>Indicator 16 does consider non-compliance budgetary violations as well as unreconciled and/or un-auditable records during the audit period. If any of these items are noted in the audit report, this indicator will be identified as negative. However, if a local government reports non-compliance budgetary violations for three consecutive years, a critical indicator will be identified.</p>
	<p>Currently, the only mention of budgetary analysis is regarding budgetary violations. Since 99% of clients budget on a non GAAP basis, this may be easier for them to understand. The GAAP analysis is important (LGS has said the GAAP basis predicts financial trouble 1 or 2 cycles in advance of budgetary numbers), but budgetary number analysis should be included.</p>	<p>Good standard budgetary information to use for the indicators may not be obtainable. The current indicators represent a clear picture of the amounts owed to and by the entities and their true status, whereas budgetary information will only include anticipated cash transactions. However, if entities are consistently cited for budgetary violations, which would indicate issues at a budgetary level, our current indicators will reflect the trend.</p>

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<p>➤ <i>Suggestions for Additional Assessment Consideration</i></p>	<p>We noted that all of the calculations involve governmental funds activity and no calculations for enterprise funds. In some instances at the local level enterprise fund activity can make up a substantial part of the local government’s financial statements and should be monitored as well.</p>	<p>Enterprise funds are established primarily as a result of the local government collecting fees and charges for providing services that are designed to recover costs, including capital related costs. Therefore, in theory, they are considered to be “self-supporting” and should not impact the financial stability of a local government and the other services it provides.</p>
<p>➤ <i>Suggestions for Additional Assessment Consideration</i></p>	<p>I took a look at the financial indicators report. It is very good. I would recommend that in looking forward and in consideration of financial indicators of future activity that collective bargaining unit contracts, lease escalations of facilities and equipment contracts, service contracts and other strategic initiatives to be enacted. It is important to use past activities, however, future commitments should be evaluated.</p>	<p>The annual financial reports of the local governments are utilized to collect the information used in the analysis of the financial health indicators. The items suggested are items that are not included in the annual financial report but should be monitored and considered by the local government as agreements/contracts are approved and in preparation of annual budgets and forecasts.</p>
<p>➤ <i>Opportunity for Entity to React and/or Provide Comments/Explanations</i></p>	<p>While we are not certain if these indicators will be calculated at the local level and sent to the AOS, or if the AOS plans to perform the calculations on a routine basis we would like to emphasize that this process should allow local governments the opportunity to provide comments and explanations, beyond the pure calculation of numbers. We feel the circumstances behind the numbers are an important part of this analysis and can only be gained at the</p>	<p>The AOS intends to use the indicators to recognize early signs of fiscal stress and take a proactive approach to monitoring or assisting these local governments, rather than continuing in a reactive manner after the declaration of fiscal caution, watch, or emergency. The AOS is aware that certain reporting requirements do affect the comparability of data from year to year.</p>

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<p>➤ <i>Opportunity for Entity to React and/or Provide Comments/Explanations</i></p>	<p>local level. As an example, some of the indicators are directly affected by the changes required from the institution of GASB 54. This change directly affects the comparability from year to year for some of the indicators and without commentary could be misleading.</p> <p>CCAO strongly recommends that the AOS provide counties with an opportunity to comment on draft reports of critical and negative indicators while the AOS assessment process is underway and before such reports are finalized for publication. In this manner counties could provide information and clarify issues that might be under review by the AOS as part of the assessment process.</p>	<p>Once a local government shows signs of fiscal stress, as detailed in the document, conversations will occur with the local government regarding the concerns and if the entity has already addressed the concerns.</p> <p>The intent of the AOS is to utilize the Financial Health Indicators to identify entities that are potentially experiencing fiscal stress and take a more proactive approach to assisting with their fiscal concerns. The calculations and analysis may be made available online, but the AOS does not intend to publish a report that includes this information. The AOS advises each local government to become familiar with these indicators for use in assessing their fiscal stability. If a concern about the fiscal stability of an entity arises, the AOS will contact the entity to discuss any concerns and determine how to provide assistance.</p>
<p>➤ <i>Corrective Action Concerns</i></p>	<p>One county commented that the meaning of certain key terms needs to be better defined and a course of corrective action should be suggested for failure to meet any collection of critical or negative indicators.</p> <p>a. It was suggested that “monitoring” and “assessment” be defined.</p>	<p>a. Currently, the AOS is considering the method(s) of monitoring and assessing the entities identified as experiencing fiscal stress. A better understanding and definition will be provided in the future, however, since each entity’s</p>

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<p>➤ <i>Relationship to Audit Process</i></p>	<p>b. There was an expression of concern regarding what AOS intends to do with the assessment information and how will the information be shared.</p> <p>c. While AOS responses are going to be case specific, there was a general recommendation that some type of corrective course of action be proposed by the AOS to the local government to alleviate the negative or critical indicators. (Presumably this would be handled by AOS on a case by case basis with individual local entities as the “assessment” and “monitoring” process continues.)</p> <p>The AOS summary on Financial Health Indicators (FHI) defines FHI as “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.” At</p>	<p>needs vary, the proactive approach with each entity will also vary.</p> <p>b. The Financial Health Indicators should be used as a tool by the local governments to identify potential fiscal hardship. The AOS encourages each entity to be aware of its fiscal stability and hopes the Financial Health Indicators can provide a basis for local governments to gauge their fiscal stability. The AOS will calculate and analyze the indicators to determine if any local governments may be in need of assistance. This information may be made available online.</p> <p>c. The AOS would like to provide proactive assistance to the entities who meet the negative and/or critical indicators. This assistance and actions necessary will vary on a case by case basis but the ultimate goal is to ensure the stability of the local government. The ultimate responsibility still lies on the local government.</p> <p>a. The AOS intends to use the indicators to recognize early signs of fiscal stress and take a proactive approach to monitoring or assisting these local governments, rather than continuing in a reactive</p>

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	<p>least two counties raised questions as to the application of the FHI to county audits. Questions raised included the following:</p> <ul style="list-style-type: none"> a. Are the FHI going to be applied as a standard part of each audit? b. Will the AOS be giving each entity a breakdown of where that entity falls with respect to each indicator as part of presenting the audit results? c. Will the use of the FHI extend the length of the audit and/or increase the cost of the audit? d. If the government entity uses an independent public accountant will the stress testing using the 16 indicators occur with respect to that type of audit? e. Will the AOS apply the FHI to all local government entities or only certain local government entities at the discretion of the AOS or where the AOS believes there is a problem? f. How will the AOS monitor local governments, and what will be required of local government entities to exit the process? 	<p>manner after the declaration of fiscal caution, watch, or emergency. The calculations and analysis are not to be incorporated as part of the audit process. However, should any concerns arise during the analysis of the Financial Health Indicators, those concerns will be communicated to the audit staff.</p> <ul style="list-style-type: none"> b. The AOS encourages the local governments to be aware of these measures in their own daily processes. The indicators will not be addressed during the audit process. However, if the AOS identifies an entity that may be experiencing fiscal stress, the AOS will likely contact the entity for further discussion and make the audit staff aware of such concerns. c-d. Again, the indicators are not intended to be calculated and analyzed during the audit process. e. The AOS encourages each entity to be aware of its fiscal stability and has provided the Financial Health Indicators as a basis for local governments to gauge their fiscal stress/stability. While the AOS may perform the calculations to determine if any local governments may be in need of assistance, the Financial Health

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		<p>Indicators should be a tool for the local governments to identify potential fiscal hardship.</p> <p>f. The AOS believes the monitoring or assessment process will vary depending on each entity's particular situation. The goal is to provide appropriate assistance to the entities identified by the Financial Health Indicators in a proactive manner and ensure their road to fiscal stability.</p>