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Financial Health Indicators

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The Great Recession of 2007-2009

- The longest and deepest downturn since the 1930s.
- Experienced significant decreases in State and local tax revenue, while escalating demands for government services and social programs like Medicaid and unemployment benefits existed.

Source: *Money News*. (2011, 06 07). Retrieved 08 28, 2013, from Money News:
<http://www.moneynews.com/InvestingAnalysis/Economy-State-LocalCuts/2011/06/07/id/399060>



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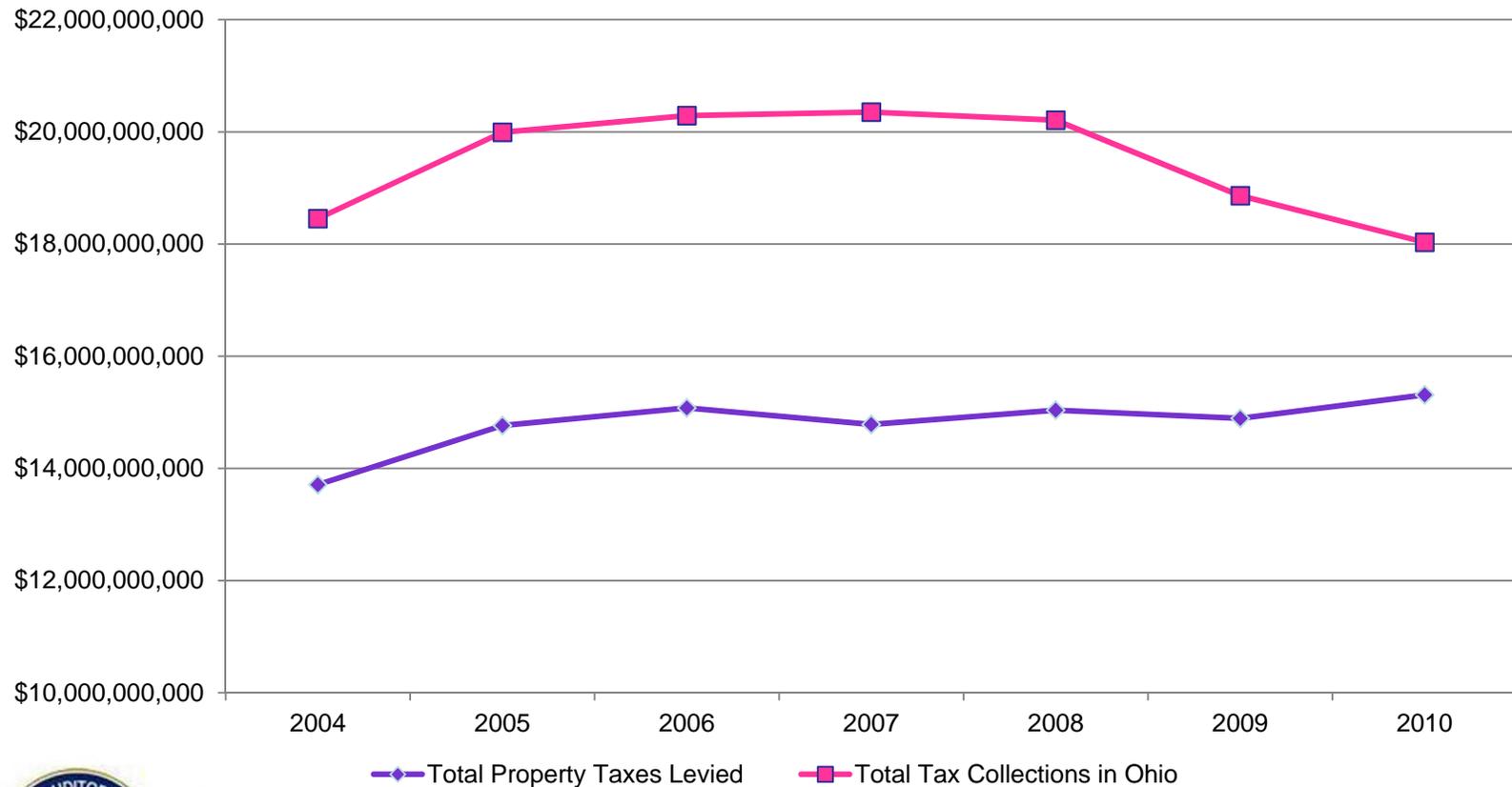
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A Deeper Look at the Effects on Ohio Governments

- With the increase in unemployment rates and the decrease in the gross income of Ohioans during the Great Recession, tax collections and distributions to local governments decreased, as depicted in charts from information gathered by the Ohio Department of Taxation.



A Deeper Look at the Effects on Ohio Governments (cont.)

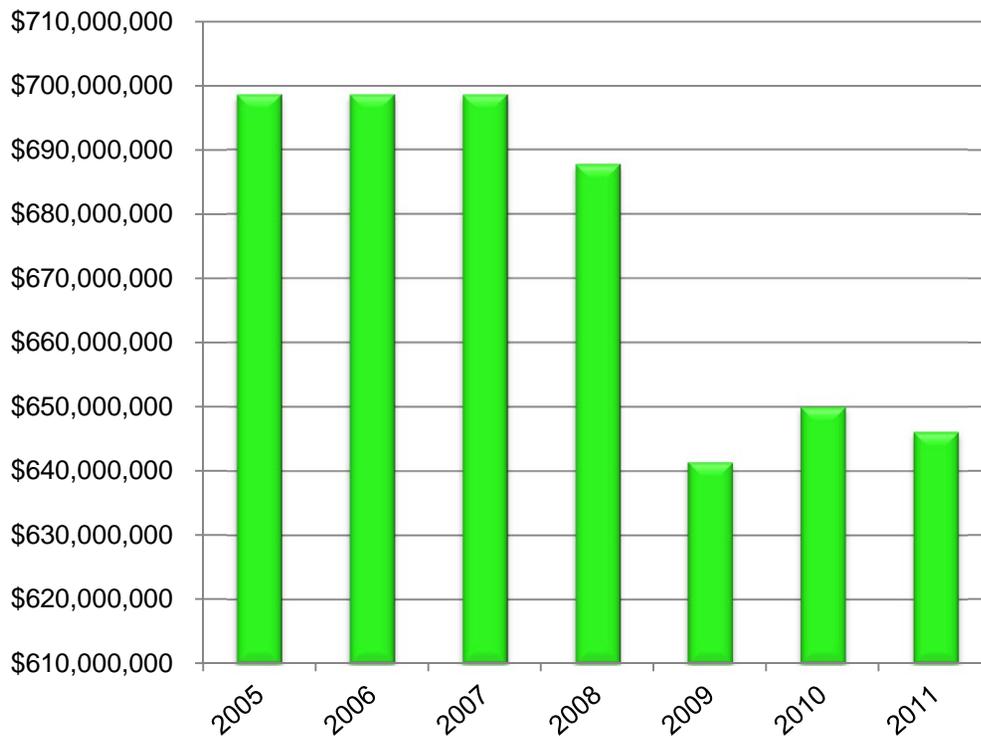


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A Deeper Look at the Effects on Ohio Governments *(cont.)*

Local Government Distributions

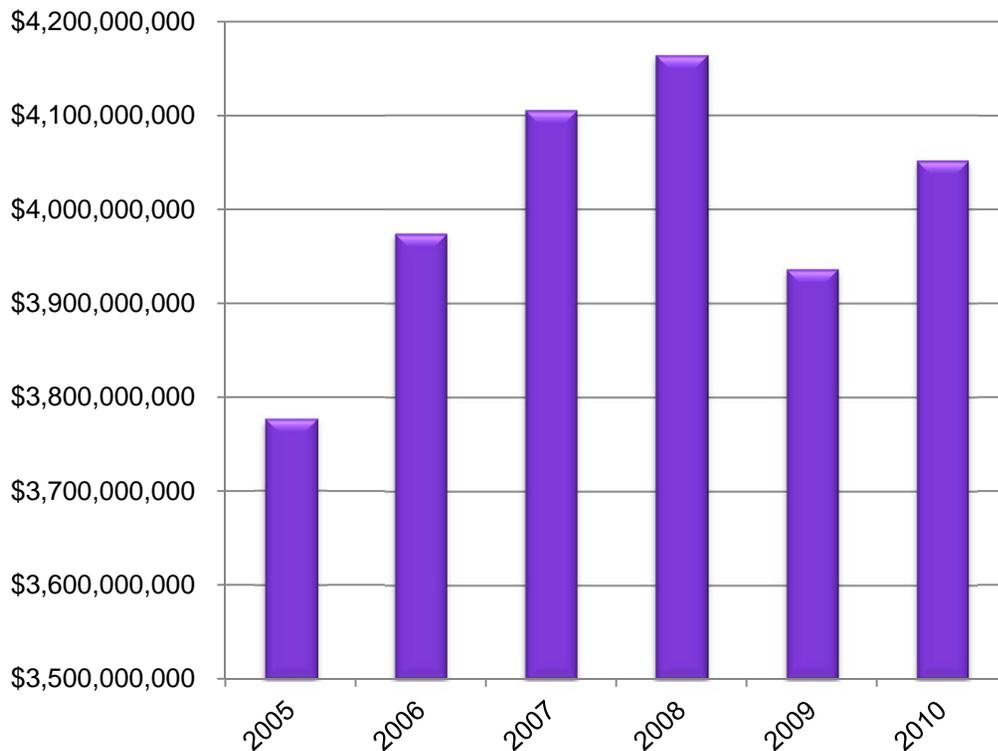


Ohio's local government distributions have decreased since the beginning of the recession. This has had a tremendous impact on the local governments as they continue to deal with decreases in federal and State funding, as well as an increase on the demand for services.



A Deeper Look at the Effects on Ohio Governments *(cont.)*

Municipal Income Tax

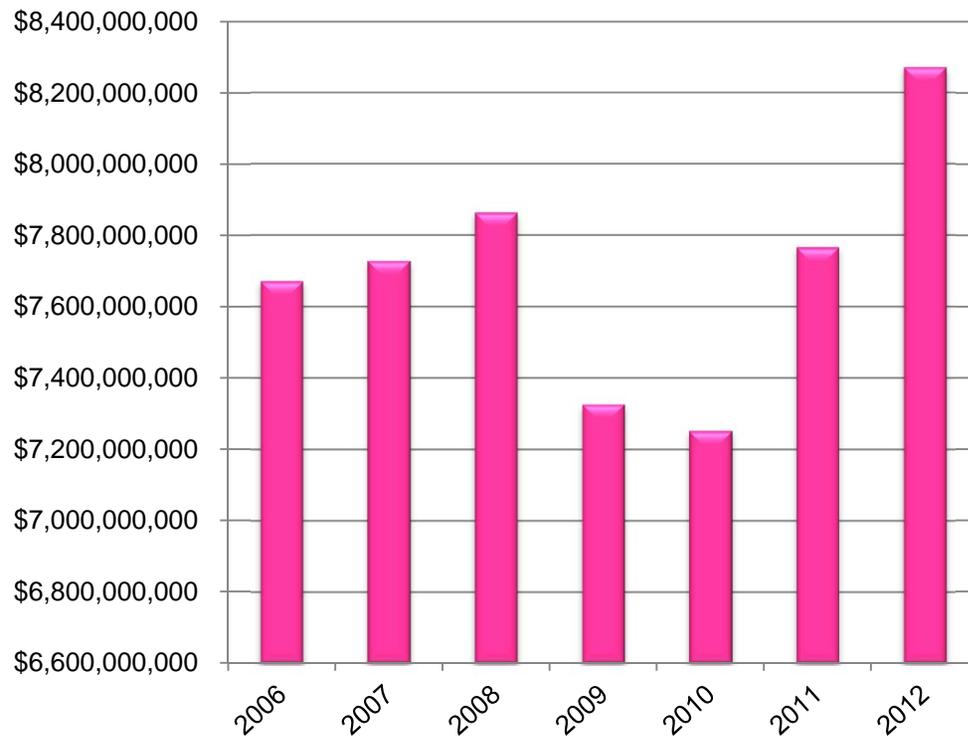


Prior to the recession, Ohio's municipalities were experiencing a steady increase in annual income tax collections. As Ohio continues to experience higher than usual unemployment rates, the amount of income tax collections for municipalities in Ohio has decreased. Even though the recession has ended, municipal income tax collections have yet to recover to peak levels.



A Deeper Look at the Effects on Ohio Governments *(cont.)*

State Sales Tax



Prior to the recession, Ohio was experiencing increasing collections for sales taxes. As Ohioans adjusted to the effects of the recession, state sales tax collections decreased and are just now beginning to recover and exceed peaks experienced during the past decade.



A Deeper Look at the Effects on Ohio Governments *(cont.)*

- The blow of the Great Recession will be felt for many years as a result of the nation's struggling housing market, the likelihood of additional cuts in federal and State funding, and greater demands for government services.
- Therefore, the need to monitor the impact of decreasing sources of revenue and the rising demand for services was ever increasing and prompted the development of the Financial Health Indicators by the AoS.



Brief History & Development of AoS Financial Health Indicators

- Goal was to be able to identify local governments that may be experiencing fiscal stress and provide support to these entities in a proactive manner rather than a reactive manner.
- Research of other states was conducted to determine if they used similar analyses, which indicators were used, and pros and cons.
- Examined various accounting literature from the *Government Finance Review* and the *International City/County Management Association* to identify ratios and other financial indicators proven to be predictors of financial stability.
- From this research, the AoS developed a set of Financial Health Indicators encompassing a series of financial information, percentages, and ratios gathered from the annual financial reports of local governments.



Financial Health Indicators

- There are sixteen (16) indicators identified as useful in determining signs of fiscal stress.
 - All 16 are applicable to those entities who prepare GAAP financial statements.
 - At least 14 of these indicators have been determined useful to those entities who prepare their financial statements on an Other Comprehensive Basis of Accounting (OCBOA).
- **Important: Since certain important financial information is excluded from the financial statements of an OCBOA, preparing GAAP financial statements allows for a stronger analysis of fiscal health to occur.**



Financial Health Indicators (*cont.*)

- There are two classifications an indicator may meet to assist in identifying the level of potential fiscal stress within an entity.
 - ❑ **Critical** = Indicators which identify a calculation that resulted in negative amounts/percentages, rapidly declining or declining trends existing, percentages or values above/below an established benchmark, or repeated non-compliance citations. An entity having a number of indicators meeting this classification holds a stronger potential that fiscal stress exists.
 - ❑ **Negative** = Indicators which identify a calculation that resulted in a declining trend over a period of time, percentages or values above/below an established benchmark, or a non-compliance citation. An entity having a number of indicators meeting this classification holds potential that fiscal stress exists or could exist in the near future.



Financial Health Indicators (*cont.*)

Important

- **No financial indicator by itself is of use in identifying fiscal stress. It takes multiple indicators working together to recognize the early signs of fiscal stress.**



Indicator #1: Unrestricted Net Assets/Position of Governmental Type Activities

- Identifies when an entity has negative unrestricted net assets/position.
- Important to have net assets/position available that has no liabilities or restriction as to use.
- If unrestricted net assets/position is declining or is negative, it leaves little or no room for unexpected expenses and results in a sign of fiscal stress.
 - Critical Indicator = negative amount
 - Negative Indicator = declining trend over a three year period



Indicator #2: Unassigned Fund Balance of the General Fund

- Identifies when an entity has negative unassigned fund balance.
- Important to have fund balance available without restrictions as to use.
- If unassigned fund balance is declining or is negative, it leaves little or no room for unexpected expenses and results in a sign of fiscal stress.
 - Critical Indicator = negative amount
 - Negative Indicator = declining trend over a three year period



Indicator #3: Change in Unrestricted Net Assets/Position of Governmental Type Activities

- Identifies changes in unrestricted net assets/position from the prior year to the current year to determine if unrestricted net assets/position is deteriorating.
- Important in identifying if unrestricted net assets/position is declining and how rapidly.
- Declining unrestricted net assets/position, especially at a rapid pace, can be a sign of fiscal stress.
 - Critical Indicator = negative percentage change or rapidly declining trend
 - Negative Indicator = declining trend over a three year period



Indicator #4: Change in Unassigned Fund Balance of the General Fund

- Identifies changes in unassigned fund balance from the prior year to the current year to determine if unassigned fund balance is deteriorating.
- Important in identifying if unassigned fund balance is declining and how rapidly.
- Declining unassigned fund balance, especially at a rapid pace, can be a sign of fiscal stress.
 - Critical Indicator = negative percentage change or rapidly declining trend
 - Negative Indicator = declining trend over a three year period



Indicator #5: General Fund Balance / General Fund Revenues

- Identifies reserves available in 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.
- Important because this indicator can identify a low reserve of fund balance even if Indicators 1-4 do not indicate stress.
- 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.
 - Critical Indicator = negative percentage, very low percentage (4%), or rapidly declining trend
 - Negative Indicator = low percentage (8%) or declining trend over a three year period



Indicator #6: Decline in General Fund Tax Revenue

- Identifies the percentage change in property tax revenue and sales tax (if county) or income tax (if city) revenue from the prior year to the current year within the General Fund.
- Declines in these revenue types is an indication an entity may be facing financial hardship due to declines in significant revenue sources.
- Important in reflecting the need for additional sources of revenue to maintain stability.
 - Critical Indicator = declining trend over a three year period
 - Negative Indicator = decrease in tax revenue



Indicator #7: Percentage of General Fund Revenues that Exceed General Fund Expenditures

- Calculation = $[\text{General Fund Total Revenues} - \text{Total General Fund Expenditures}] / \text{Total General Fund Revenues}$
- Identifies operating deficits and size of the operating deficits compared to the current year budget.
- A trend of operating deficits indicates potential financial hardship.
 - Critical Indicator = negative or rapidly declining percentage
 - Negative Indicator = less than 5% or a trend of declining percentage over a three year period



Indicator #8: General Revenues / Net Expenses of Governmental Type Activities

- Reflects coverage of net expenses by general revenues to determine if, on a government-wide basis, expenses are exceeding revenues.
- A declining trend would indicate fiscal stress as unrestricted revenues should be sufficient to meet needs not covered by program revenues.
 - Critical Indicator = ratio less than 100%
 - Negative Indicator = declining trend over a three year period



Indicator #9: General Fund Intergovernmental Revenue as a Percentage of Total Revenues

- Important to be aware of the percentage of total revenues that are not considered “own source”, or local sources, of revenue.
- A high percentage suggests the entity is heavily reliant on intergovernmental revenues and vulnerable to their decreases (i.e., State budget cuts).
- Understanding this percentage is important in maintaining fiscal stability while dealing with an economic downturn.
 - Critical Indicator = percentage above benchmark of 20%
 - Negative Indicator = percentage above benchmark of 15%



Indicator #10: Condition of Capital Assets

- Calculation = Accumulated Depreciation of Governmental Type Activities / Depreciable Capital Assets of Governmental Type Activities
- A high percentage indicates asset replacement is imminent and the entity may be delaying replacement of assets or significant repairs for cash flow purposes.
- Delaying the improvement or replacement of assets in order to maintain cash flows could subject the entity to financial hardship when the repairs become absolutely necessary.
 - Critical Indicator = percentage above benchmark of 70%
 - Negative Indicator = percentage above benchmark of 50%
- **May not be applicable to financial statements prepared on an OCBOA**



Indicator #11: Debt Service Expenditures / Total Governmental Fund Revenues

- Calculation = Total Debt Service Expenditures / Total Governmental Fund Revenues
- Indicates the percentage of the budget used/needed for the repayment of debt.
- A high percentage is unfavorable since this means the entity is spending 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. Thus, less revenue will be available for asset repair/replacement or meeting current service demands.
 - Critical Indicator = percentage above benchmark of 15%
 - Negative Indicator = percentage above benchmark of 12%



Indicator #12: Unrestricted Net Assets/Position of Governmental Type Activities / Average Daily Expenses

- Calculation = Unrestricted Net Assets/Position of Governmental Type Activities / [Total Expenses of Governmental Type Activities / 365]
- Indicates the number of days the entity may operate using its unrestricted net assets/position. The fewer days the entity can operate, the more financial stress exists.
- This indicator provides an early indication of an entity's need to adjust its financial/ expenditure planning.
 - Critical Indicator = zero or negative number of days
 - Negative Indicator = less than 30 days



Indicator #13: Unassigned Fund Balance of the General Fund / Average Daily Expenditures of the General Fund

- Calculation = Unassigned Fund Balance of the General Fund / [Total Expenditures of the General Fund / 365]
- Indicates the number of days the entity may operate using its unassigned fund balance. The fewer days the entity can operate, the more financial stress exists.
- This indicator provides an early indication of an entity's need to adjust its financial/ expenditure planning.
 - Critical Indicator = zero or negative number of days
 - Negative Indicator = less than 30 days



Indicator #14: Cash & Investments of the General Fund / Average Daily Expenditures of the General Fund

- Calculation = Cash & Investments of the General Fund / [Total Expenditures for General Fund / 365]
- Indicates the number of days the entity may operate using its cash and investments. The fewer days the entity can operate, the more financial stress exists.
- This indicator provides an early indication of an entity's need to adjust its financial/ expenditure planning.
 - Critical Indicator = zero or negative number of days
 - Negative Indicator = less than 30 days



Indicator #15: Ratio of Total Liabilities to Net Assets/Position

- Calculation = Total Liabilities of Governmental Type Activities / Total Net Assets/Position of Governmental Type Activities
- Indicates the ratio of every dollar of resources, available for providing public services, that is owed by the entity.
- Identifies whether an entity is over-extended in terms of the ratio of every dollar that is owed to others.
 - Critical Indicator = ratio above benchmark of 0.60
 - Negative Indicator = ratio above benchmark of 0.40
- **NOTE: May not be applicable to financial statements prepared on an OCBOA**



Indicator #16: Direct and Material Non-Compliance (Budgetary Violation)

- Identifies entities who have non-compliance budgetary violations or if an entity had unreconciled and/or unauditible records during the year.
- Maintaining accurate, reconciled accounting records and adherence to Ohio budgetary law is a significant factor in maintaining fiscal stability.
- Identifies if an entity is not following Ohio budgetary law or proper accounting methods.
 - Critical Indicator = repeated violations over a three year period
 - Negative Indicator = reported violation during a year



Financial Health Indicators

- **GAAP Basis Entities**
 - Should be monitored if they meet **at least 6** Critical Financial Health Indicators.
 - Should be considered for assessment of fiscal stress if they meet a combined total of **at least 8** Critical or Negative Financial Health Indicators.
- **OCBOA Basis Entities**
 - Should be monitored if they meet **at least 4** Critical Financial Health Indicators.
 - Should be considered for assessment of fiscal stress if they meet a combined total of **at least 6** Critical or Negative Financial Health Indicators.



Summary of County A

- The following are examples that illustrate the usefulness of the Financial Health Indicators.
- Prepares its financial statements using Cash Basis reporting.
- Indicators 3, 4, 7 and 16 were identified as Critical Financial Health Indicators for 2011.
- Indicators 12 and 13 were identified as Negative Financial Health Indicators for 2011.
- A total of 6 (4 critical, 2 negative) were met and would qualify this entity for monitoring.
- [Financial Health Analysis of County A](#)



Summary of City B

- Prepares its financial statements using GAAP.
- Indicators 3, 4, 5, 8, and 15 were identified as Critical Financial Health Indicators for 2011.
- Indicators 1, 2, 6a, 6b, 7, 9, 13 and 14 were identified as Negative Financial Health Indicators for 2011.
- A total of 13 (5 critical, 8 negative) were met and would qualify this entity for fiscal assessment.
- [Financial Health Analysis of City B](#)



Assessment of Local Governments Currently in Fiscal Caution, Watch, or Emergency

- The financial indicators identified a trend of increasing fiscal stress in entities placed in Fiscal Caution, Watch, or Emergency. By assessing the current financial indicators, each entity would have been considered for proactive assistance from the AoS two to three years prior to being placed in Fiscal Caution, Watch, or Emergency.
- At the time of being placed in Fiscal Caution, Watch, or Emergency, these entities met between 9 and 13 total indicators, with 6 to 12 being critical indicators.
- If we looked back two to three years prior, when the signs of fiscal stress were beginning to show, these same entities met between 8 and 12 total indicators, with 6 to 9 being critical indicators.



Summary of City C

- Prepares its financial statements using GAAP.
- **Declared in Fiscal Watch in April 2013, after being place in Fiscal Caution in November 2011.**
- Indicators 1, 2, 3, 4, 5, 7, 8, 9, 12, 13 and 16 were identified as Critical Financial Health Indicators for 2011.
- Indicators 6, 10 and 14 were identified as Negative Financial Health Indicators for 2011.
- A total of 14 (11 critical, 3 negative) were met and would qualify this entity for monitoring.
- Our five-year history shows that this City would have met the conditions to receive assistance/monitoring from the AoS at least three years prior to being declared in Fiscal Caution had the Financial Health Indicators existed.
- [Financial Health Analysis of City C](#)



Financial Health Indicators Conclusion

- Again, goal is to be able to identify local governments that may be experiencing fiscal stress and provide support to these entities in a **proactive manner** rather than a reactive manner.
- **Since no one financial indicator by itself is of use in identifying fiscal stress, you must consider these indicators together to obtain an insight as to whether or not an entity is experiencing the early signs of fiscal stress.**



Questions???





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