LOCAL GOVERNMENT MANAGEMENT GUIDE

Financial Condition Analysis

Office of the New York
STATE COMPTROLLER
Thomas P. DiNapoli

Local Government and
School Accountability

BUDGETING AND PLANNING SERIES

Table of Contents

Introduction 1

Overview 1

Defining Financial Condition 2

Assessing Financial Condition 4

Using Analytical Tools to Evaluate Financial Condition 7

Improving Financial Condition Through Corrective Action 9

Conclusion 13

Appendix A–Financial Measures and Demographics Indicators 14

Appendix B–Glossary of Terms 30

Appendix C–Other Resources 33

Notes 34

Contacts 35

Introduction

Sound fiscal health is imperative to ensuring the effective operation of local governments and school districts in New York State. For this reason, you should periodically assess the financial condition of your local government or school district. Performing a regular, timely financial condition analysis can provide you with valuable information on the current and future state of your finances. Regular analysis can highlight potential fiscal problems and provide information necessary for timely corrective action. By taking action to address weaknesses and strengthen fiscal health, you can better ensure that resources are available to fund the level and quality of services expected by taxpayers.

Performing a regular, timely financial condition analysis can provide you with valuable information on the current and future state of your finances.

Overview

This guide includes the following sections that are designed to help you analyze the financial condition of your local government or school district:

- Defining Financial Condition
- Assessing Financial Condition
- Using Analytical Tools to Evaluate Financial Condition
- Improving Financial Condition Through Corrective Action

Appendix A of this guide provides a series of financial measures and demographic indicators which can help highlight issues and trends in your government's operations. The appendix also gives guidance on what these trends may mean in terms of your government's fiscal health, and provides suggestions for managing unfavorable trends.

Appendix B includes a glossary of frequently used financial terms.

Appendix C contains data resources that may be helpful in conducting financial condition analysis.

Defining Financial Condition

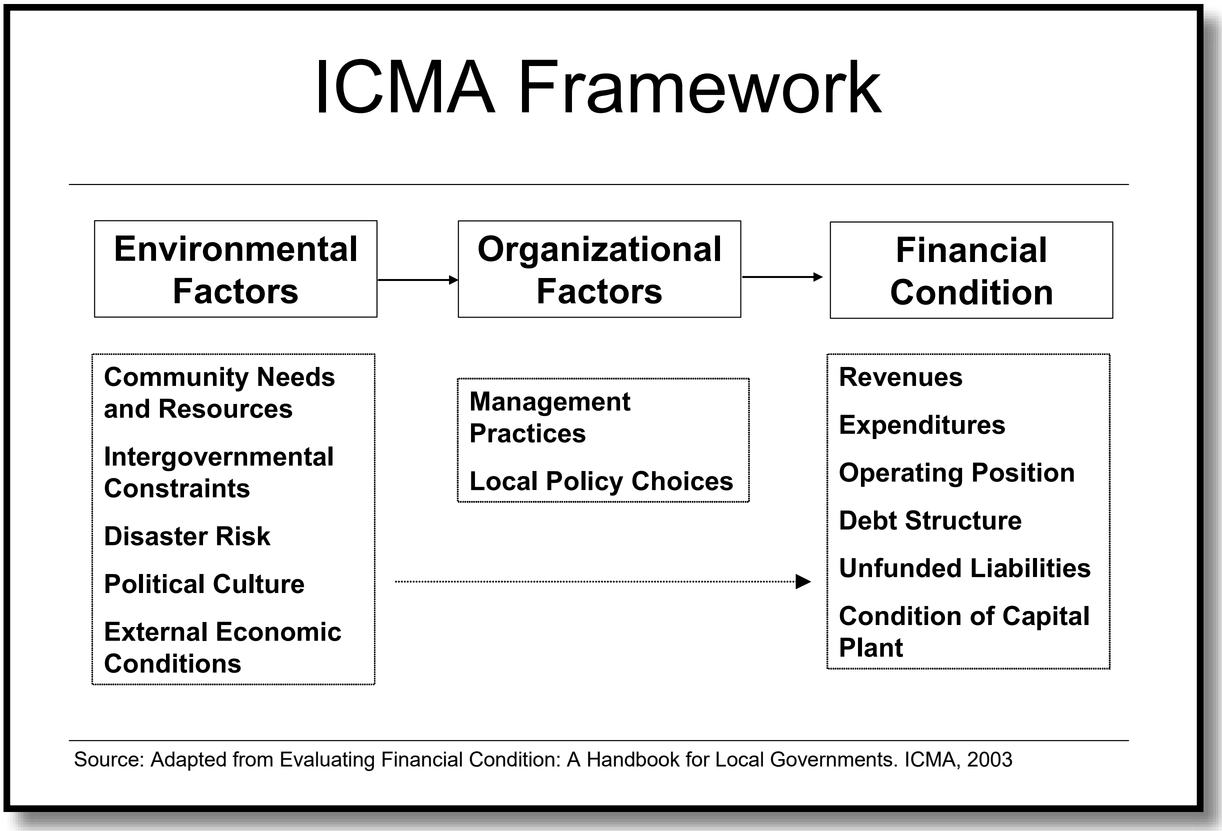
Financial condition may be defined as the ability of a local government or school district to balance recurring expenditure needs with recurring revenue sources, while providing services on a continuing basis. A community in good financial condition generally maintains adequate service levels during fiscal downturns, identifies and adjusts to long-term economic or demographic changes, and develops resources to meet future needs. Conversely, a community in fiscal stress usually struggles to balance its budget, suffers through disruptive service level declines, has a difficult time adjusting to socioeconomic forces, and has limited resources to finance future needs. Maintaining or restoring sound financial condition requires local officials to adjust to long-term socioeconomic and demographic changes, respond to the economic impact of the business cycle, and plan for the future.

Financial condition may be defined as the ability of a local government or school district to balance recurring expenditure needs with recurring revenue sources, while providing services on a continuing basis.

There is no single measure that fully captures the financial condition of a local government or school district. Rather, local governments need to take a comprehensive approach that focuses on both external and internal fiscal indicators that are easy to measure, evaluate and understand. Ideally, you want a financial indicator system that is comprehensive enough to match the complexity of your government (suburban counties might have a very different fiscal indicator system than rural towns), but that is operationally manageable and produces regular, reliable reports for decision making.

Financial condition is affected by a combination of environmental, fiscal and organizational factors, including decisions and actions of the governing board.[1] For example, a steady population decline can lead to an erosion of the property tax base (a negative environmental trend). However, the ways in which local officials respond to this decline (such as cutting services, increasing tax rates, or engaging in economic development) also affect the financial condition of the local government.

Environmental factors include measures of community needs and resources such as population, property value and poverty, and economic factors such as inflation, personal income and employment. These environmental indicators often provide the best “early warning” of future fiscal stress. Research by OSC has concluded that there is a strong correlation between environmental factors and financial condition, and that fiscal stress is often apparent in these measures before it is evident in the financial data.[2]



Source: Adapted from Evaluating Financial Condition: A Handbook for Local Governments. ICMA, 2003

Financial factors include intergovernmental constraints such as tax and debt limits, access to major revenue sources (such as sales tax), and mandated expenditure requirements. These fiscal constraints often limit the choices available to local officials in managing their budgets.

Organizational factors include management practices and legislative policies that guide fiscal decision making, often in response to environmental or political factors. While sound budgeting and management practices can help protect the financial condition of local governments and school districts, these factors cannot always avert fiscal stress — especially when negative environmental trends are severe. However, poor budgeting and management practices can create fiscal problems despite a sound economic environment.

While sound budgeting and management practices can help protect the financial condition of local governments and school districts, these factors cannot always avert fiscal stress – especially when negative environmental trends are severe.

Assessing Financial Condition

Finding out where your finances are going often starts by analyzing where you've been. The first step in assessing the financial condition of your municipality is to begin gathering information that is correlated to these environmental and organizational factors. Some of this information should be available using your own accounting and budgeting systems, but other data will have to be assembled from third-party sources. This data should be examined over a reasonable time horizon, typically 5-10 years. Appendix C provides a listing of possible data sources for certain statistical information that may be helpful for this analysis.

The first step in assessing the financial condition of your municipality is to begin gathering information that is correlated to these environmental and organizational factors.

Examples of environmental factors you may want to examine include:

- Population trends
- Median household income levels
- Unemployment rates
- Property full value trends
- Educational attainment, such as population with at least high school education equivalency
- Age characteristics, such as population over 65
- Poverty indicators, such as numbers of single heads of households or school lunch recipients as a percentage of your community's population.

Financial trends that may be useful to examine include the following:

- Recurring major revenues (sales tax, property tax, State aid)
- Recurring major expenditures by object (salaries, fringes, contractual)
- Debt outstanding and debt service levels
- Percentage of tax and debt limit exhausted.[3]

Organizational factors that you may want to consider include:

- Budget to actual financial variances for major budget categories
- Timeliness and accuracy of financial transactions (vouchers, etc.)
- Quality and timeliness of financial reporting (audits, etc.).

Data Integrity

Keep in mind when performing any analytical procedure that the results are only as good as the data from which they were derived. Any unusual results should be rechecked for validation before proceeding to more complex and time-consuming explanations. Ideally, the supporting data should be reviewed for consistency and reasonableness before it is used for analytical purposes. This review should answer several questions:

> A trend analysis can help identify underlying causes of fiscal stress and help predict future financial outcomes.

- Is the data from a reliable source?
- Are the numbers current and complete?
- Are there any data or methodological assumptions to be aware of?
- Do the trends or results intuitively make sense?

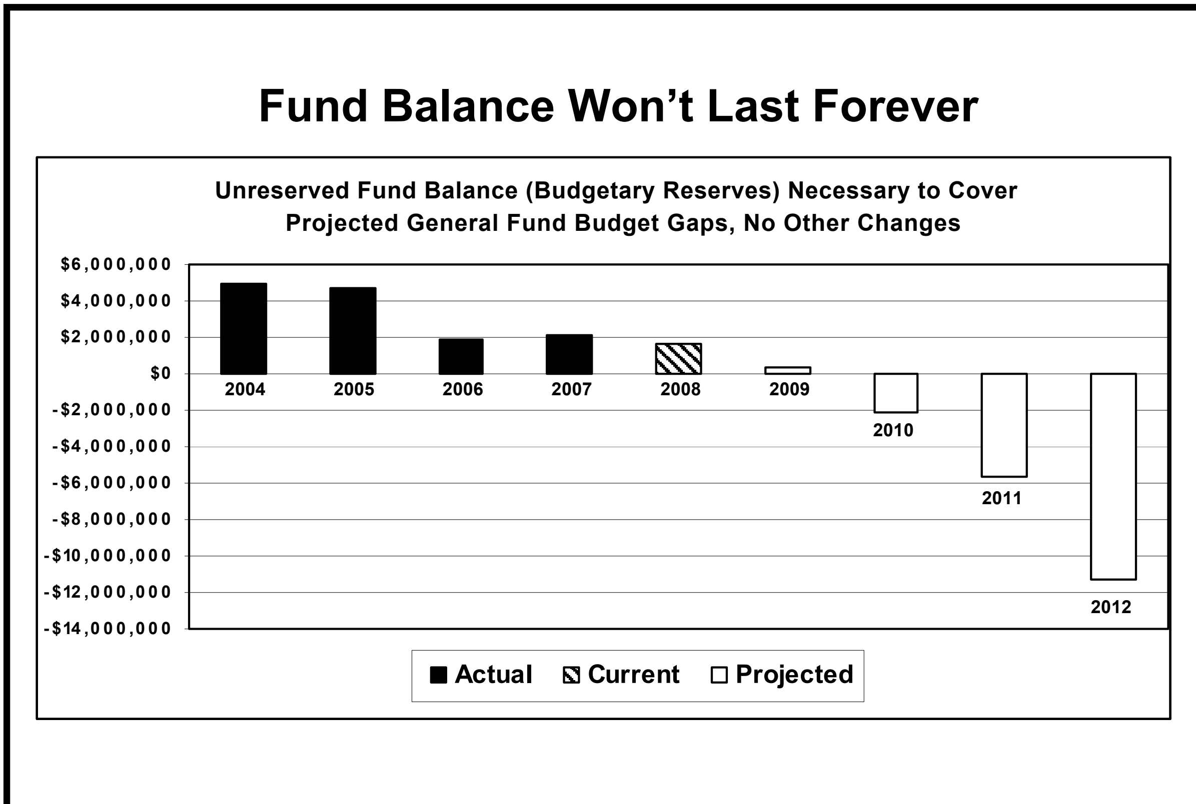
Reviewing the quality of the supporting data may also help identify reporting deficiencies or other operational concerns that require attention.

Trend Analysis

Analyzing historical trends can provide valuable information about current and future fiscal health. A trend analysis can help identify underlying causes of fiscal stress and help predict future financial outcomes. It can also help put the current year's budget into context by revealing whether the most recent year is the continuation of an upward trend, a downward trend, or one that fluctuates. Managers can then use this information to develop or modify plans that will help ensure continued delivery of services within resource constraints. By coupling historical trend analysis with multiyear budget projections, decision makers can quickly identify those financial assumptions that seem unusual or outside the trend, pinpointing areas that require further investigation.

Trend analysis can also help trigger corrective action to address the underlying causes of a problem before it worsens. Analyzing why large fluctuations have occurred can help determine if they were unforeseeable in one year or if the values are consistently under- or overestimated. Budget estimates (current and future) can then be modified to reflect historical reality. If corrective action is not possible immediately, the item can be flagged as a risk for monitoring and correction during the next budget cycle.

One way to help tell the fiscal story for your community is to present financial trends graphically, as in the chart below which depicts a hypothetical local government's projected budget gap. The old adage about a picture being worth a thousand words is certainly true when trying to explain complex financial data to decision makers. A series of simple charts or graphs can help succinctly summarize your financial condition and help focus the discussion on the larger trends and issues.



Using Analytical Tools to Evaluate Financial Condition

Ratios

Once historical trend information is gathered and analyzed, financial managers can begin to drill down and investigate areas of concern. As a part of this step, it is often helpful to begin combining the environmental and financial data into key indicators or ratios. Using various ratios can provide a more refined picture of financial position and results of operations. They can also serve as the basis for benchmarking and intergovernmental comparisons that may help establish goals for fiscal health. However, just like trend data, the ratios you select should be appropriate for the scope and complexity of your government, easy to calculate and update, and simple to explain.

Financial ratios provide snapshots of financial activity and results of operations. Appendix A includes some ratios and measures that OSC believes are helpful in analyzing such issues as fund balance, cash position, reserve levels, or fixed costs. There are many others you can create on your own.

Once historical trend information is gathered and analyzed, financial managers can begin to drill down and investigate areas of concern.

Benchmarks

Once the ratios are calculated, they can be looked at over time and compared to internal or external benchmarks. Internal benchmarks for a local government or school district may be set by policy. For example, management may set an internal threshold for taxes receivable as a certain percentage of real property tax revenues, and if the percentage is exceeded, then management would be notified. External benchmarks are standards set by convention or practice, such as norms for cash as a percentage of current liabilities or debt per capita. These benchmarks may be found in management textbooks, rating agency guidelines, or government finance literature. Any ratios that produce results that vary significantly from established benchmarks should be investigated. Positive variances may indicate an improved practice or stronger operations. A negative variance may indicate the need for further analysis and corrective action.

Peer Comparisons

Another way to use financial ratios to provide important information to decision makers is through peer comparison. While any financial ratio could be used for peer comparison, per capita or per unit ratios are particularly useful for this type of analysis. This helps normalize your data and more easily compare financial numbers with similar local governments or school districts. Developing peer group averages or ranges can further increase the value of these comparisons by providing a relative relationship to the group norm.

Peer comparisons can highlight operational areas where a local government or school district is doing something well, or where financial operations are below average. This might suggest areas for further investigation and possible improvement. Contacting peer local governments or school districts that have better numbers may yield ideas for improving current practices.

Once the financial condition analysis is completed, the next step is to identify the underlying causes of any negative variances.

Improving Financial Condition Through Corrective Action

Once the financial condition analysis is completed, the next step is to identify the underlying causes of any negative variances. Fiscal problems are generally interconnected, but the degree of fiscal stress will also vary from situation to situation. Severe budgetary stress usually causes cash flow problems as well as service level concerns. But cash flow problems may be no more than a temporary annoyance caused by timing-related factors. Similarly, a fund deficit may represent a one-time shortfall or reflect years of operating losses.

By developing a clear understanding of the causes of fiscal stress, there is a better opportunity for corrective action. Sometimes more than one reason will be identified, including factors outside local control. These issues – often related to the external socioeconomic environment – require more complex solutions.

For purposes of this discussion, financial problems are divided into four types: budgetary issues, cash flow problems, inadequate planning, and management capacity.

Budgetary Issues

Problems that produce unfavorable budget variances often include the following:

- Initial budget estimates were based on faulty assumptions.
- Revenue or expenditure controls are weak or nonexistent.
- Information systems are ineffective in monitoring financial activity.
- External factors (such as new State or federal mandates, severe weather, or sudden loss of an industry) unexpectedly impact finances.
- Negative environmental trends (population loss, property values, etc.) have accelerated.
- Timing-related transactions have produced a temporary variance.

Improving budgetary practices is often a critical first step in addressing financial problems. Most of these efforts will fall into these general categories: improving budget accuracy, strengthening budget monitoring throughout the year, controlling costs, and improving internal controls.

Improving budgetary practices is often a critical first step in addressing financial problems.

Start the fiscal year with sound, conservative estimates of revenues and expenditures. Enact a structurally balanced budget that limits the use of one-shot, nonrecurring revenues except to fund nonrecurring or capital expenditures. Keep an adequate unrestricted fund balance available to manage risks and help avoid year-end deficits.

Develop a budget monitoring system that identifies significant revenue or expenditure fluctuations in a timely manner. Give periodic status reports to department managers so that corrective action can be discussed and implemented as soon as possible.

Control cost overruns by improving cost estimation techniques, using appropriate levels of cost segregation for tracking purposes, and preventing efforts to spend down allocations at year end. The use of purchase orders and an encumbrance system assures approved funds are available prior to purchase.

Internal controls can be strengthened by establishing procedures that properly protect fixed assets and inventories; segregate the duties of authorizing, reviewing and approving all expenditures; and regularly reconcile accounts.

Cash Flow Problems

Cash flow problems often result from budgetary issues, but they can also result from one or more of these conditions:

- Billings or claim filings are not frequent enough or occur at the wrong time of the year.
- Cash management procedures are not documented or understood.
- Unpaid (receivable) amounts are increasing.
- Reserve levels are inadequate.
- Budgetary transfers are not being monitored and controlled effectively.

Possible actions to remedy cash solvency problems include changing the timing and/or frequency of billing cycles for fees or other charges, such as for water and sewer services. Collection efforts can be improved through stricter enforcement and increased penalties (within legal parameters). In certain circumstances, contractual payment schedules may be renegotiated. It may also be possible to modify payroll schedules subject to collective bargaining agreements.

Adopting an explicit fund balance policy (and budgeting to maintain these reserves) not only buffers your finances against unforeseen risk, it also provides a cushion throughout the fiscal year that can help smooth out cash flow troughs.

Borrowing is another option. The use of tax or revenue anticipation notes can help smooth cash flow fluctuations and avoid potential shortfalls. When considering this option, keep in mind that temporarily advancing money to one fund from another may result in lower costs than issuing short-term notes.[4]

Adopting an explicit fund balance policy (and budgeting to maintain these reserves) not only buffers your finances against unforeseen risk, it also provides a cushion throughout the fiscal year that can help smooth out cash flow troughs.

Inadequate Planning

Fiscal problems can arise when local officials neglect to plan ahead for future events or needs. For example, reductions in maintenance and upkeep can suddenly accelerate asset replacement timetables. Other examples of inadequate planning that can produce fiscal problems include:

- Neglect of deteriorating infrastructure
- Inadequate funding of long-term liabilities such as compensated absences
- Failure to properly account for multiyear obligations such as collective bargaining contracts, long-term contractual services, or indebtedness
- Failure to adjust for nonrecurring revenues or time-limited grants.

Planning helps identify future financial obligations so that sufficient funding for those obligations can be identified. It also helps identify the long-term implications of financial decisions – actions taken in one year can have implications over multiple years.

Multiyear financial plans and capital plans are increasingly viewed as essential for long-term fiscal health. By projecting financial trends beyond the current year, local officials can better anticipate and prepare for necessary budget adjustments and reduce the likelihood of sudden tax increases, service cuts or costly “emergency” expenditures. For more guidance on preparing a multiyear financial or capital plan, please refer to the OSC’s *Multiyear Financial Planning* guide and *Multiyear Capital Plans* guide.

Planning helps identify future financial obligations so that sufficient funding for those obligations can be identified.

Management Capacity

Budgetary problems can result if there is inadequate staff or management capacity to run operations effectively. These problems can arise from:

- Understaffing of key fiscal positions
- Inadequate training or professional competency
- Poor communication or lack of understanding by decision makers
- Weak or antiquated financial accounting systems.

It is important that competent financial staff be hired and trained to fill management positions. Local government finances in New York State are growing increasingly complex, and require that staff keep current on legal, accounting and financial standards.

Many elected officials serve part-time and often enter office without the knowledge necessary for sound financial decision making. Adequate training on their fiduciary responsibilities, coupled with regular, effective communication on financial issues is critical to the success of the budget process.

Improving financial tools such as modernizing your accounting system can help track and control revenues and expenditures and provide faster, more reliable financial information.

Conclusion

The routine analysis of financial condition is analogous to visiting your doctor: regular check-ups and early detection and treatment are key components of good fiscal health. However, a financial condition analysis goes beyond a periodic review of budget status reports. It should provide a broader, long-term picture of the financial position of your local government or school district, and produces key indicators or ratios that help you make informed fiscal decisions and plan better for the future.

The goal of financial condition analysis is to provide valuable information regarding the past, present, and future direction of your government's finances. But that information must be relevant and useful in managing your finances. Make sure your fiscal indicators are appropriate for the size and scope of your government, easy to calculate and update, and simple to explain. By monitoring the fiscal health of your government, you can more easily balance recurring expenditure needs with recurring revenue sources, while providing essential government services on a continuing basis.

The goal of financial condition analysis is to provide valuable information regarding the past, present, and future direction of your government's finances.

Appendix A:
Financial Measures and Demographics Indicators

A number of financial measures can be used to gauge the financial condition of a local government (LG) or school district (SD). They can help to facilitate comparisons with similar local governments or school districts, and to give a picture of what has been occurring in a particular local government or school district over a period of five to 10 years. These measures are intended as a guide, rather than an all-inclusive list, and include account codes to consider in performing financial condition analysis. The account codes included here are described in detail in the OSC *Accounting and Reporting Manual* (ARM) and the *School Districts Accounting and Reporting Manual* (SDARM). Not all measures will be useful to both local governments and school districts.

It is important to analyze the numbers that make up the measures to obtain a better understanding of what is occurring and whether there is a need for concern. No one measure alone should be accepted as an indication of a positive or negative trend. Although the measures are not weighted, a few tend to provide a stronger measure of fiscal condition than others: measures 1, 2, and 4 are considered key for financial condition analysis.

The following financial measures are explained in this section:

1. Declining Fund Balance (LG/SD)
2. Operating Deficits (LG/SD)
3. Fixed Costs as a Percentage of Total Expenditures (LG/SD)
4. Cash and Investments as a Percentage of Current Liabilities (LG/SD)
5. Tax Limit Exhausted (LG)
6. Short-Term Debt Issuance (LG/SD)
7. Timeliness of Financial Reporting (LG/SD)
8. Intergovernmental Revenues as a Percentage of Gross Revenues (LG).

A detailed explanation of each measure includes (where applicable):

- Purpose
- Measurement
- Formula
- Negative Trends
- Recommended Funds to Review
- Account Codes to Use
- Analysis
- Possible Practices.

Appendix A:
Financial Measures and Demographics Indicators

For local officials, monitoring nonfiscal measures also can provide useful insights into where local government finances are headed. These indicators are important for program planning and budgeting. Local officials must choose which demographic indicators are most appropriate based on their particular situation and needs. For example, in a community where the employment landscape is changing rapidly, it may be necessary to monitor workforce indicators and consider the ways in which these changes will impact service demand and local revenues. Other communities face troubles in the housing market, or have to plan for services in the midst of population decline or for an aging population. These factors will affect local government operations as well as finances.

The latter part of this appendix focuses on five of the most common and typically used demographic indicators. The choice of which indicators to include is dependent on local conditions, and many others could also be constructed. The following demographic indicators
are explained in this section:

1. Population Trends
2. Age of Population
3. Property Value Trends
4. Poverty Rate
5. Unemployment and Workforce.

Note: See Appendix B for definitions of terms used in this Appendix.

Appendix A:
Financial Measures and Demographics Indicators

Financial Measure 1. Declining Fund Balance (LG/SD)

Purpose: To identify trends in a local government's or school district's fund balance

Measurement: The relationships of unreserved fund balance and of appropriated fund balance to total operations (gross expenditures)

Formulas: a. $\frac{\text{Unreserved Fund Balance}}{\text{Gross Expenditures}}$

b. $\frac{\text{Appropriated Fund Balance}}{\text{Gross Expenditures}}$

Negative Trend: Percentages decreasing over time

Recommended Funds to Review: All major governmental operating funds

Account Codes to Use:

Unreserved Fund Balance – Account codes 910, 911

Appropriated Fund Balance – Account code 910

Gross Expenditures – This figure is the total from the AUD filed with OSC or the ST-3 filed with SED

Analysis: A positive unreserved fund balance provides a cushion to help deal with revenue shortfalls or expenditure overruns. Continuous reductions in fund balance may indicate poorly structured budgets that could lead to future budgetary problems, even if the current fund balance is positive. Even more significant is a fund balance that is negative, or what is known as a deficit fund balance. This situation could seriously affect the ability of a local government or school district to continue to provide services at current levels. Deficits in major funds in excess of 1.5 percent of fund expenditures or $50,000 (whichever is greater) are generally causes for concern. Conversely, note that school districts have a statutory cap on the percentage of fund balance they may retain from year to year.

Appropriated fund balance information can provide insight into declining fund balances. Annual appropriations of available fund balance would normally reduce unreserved fund balance each year. However, favorable budget variances (revenue and/or expenditure) could offset some, or all, of this otherwise negative trend.

Possible Practices: Careful budgeting and limited use of reserves and appropriated fund balance can help stabilize reserve levels. Adopting specific policies to maintain a reasonable level of fund balance will help protect your local government or school district from cash flow problems caused by unexpected budget variances.

Appendix A:
Financial Measures and Demographics Indicators

Financial Measure 2. Operating Deficits (LG/SD)

Purpose: To identify trends in revenues, recurring revenues, expenditures and the resulting surpluses or deficits in a local government or school district

Measurement: The relationship of operating results (gross revenues less gross expenditures), both with and without one-time revenues, to total operations (gross expenditures)

Formulas: a. $\dfrac{\text{Gross Revenues} - \text{Gross Expenditures}}{\text{Gross Expenditures}}$

b. $\dfrac{\text{Gross Revenues} - \text{Gross Expenditures} - \text{One-Time Revenues}}{\text{Gross Expenditures}}$

Negative Trend: Percentages decreasing over time

Recommended Funds to Review: All major governmental operating funds

Account Codes to Use:

Gross Revenues – This figure is the total from the AUD filed with OSC or the ST-3 filed with SED

Gross Expenditures – This figure is the total from the AUD filed with OSC or the ST-3 filed with SED

One-Time Revenues – Account codes 2660, 2690, 5700-5791

Analysis: The annual operating surplus or deficit is the difference between the revenues and expenditures for a fiscal year. If expenditures exceed revenues, the local government or school district has an operating deficit; if revenues exceed expenditures, the local government or school district has an operating surplus. The ratios depict how large or small the surplus or deficit is in relation to each fund's operations for the year. Over time, operating deficits in individual years may offset operating surpluses from other years. Since several successive years of operating deficits could cause financial hardship for a local government or school district, reviewers should consider the results over several years of operation.

The fund balance is the total accumulation of all operating surpluses and deficits since the beginning of a local government's or school district's existence. Each year's operating surplus or deficit is added to or subtracted from the prior fund balance. A local government or school district that relies on surplus fund balance to finance current operations may eventually experience fiscal problems.

Ratio 2b addresses one-time, nonrecurring revenues, which are not derived from the normal operating cycle and, therefore, cannot be relied upon from year to year. These revenues are subtracted from the fund surplus or deficit to present a more conservative picture of the results of operations. This ratio measures only recurring revenues as they compare to expenditures. Using one-time revenues to finance recurring expenditures could create fiscal problems, because future budgets would require new revenues to compensate for past one-time revenues. However, if the one-time revenue was used to finance a one-time expenditure (such as using the proceeds from the sale of real property to purchase a piece of equipment) it would not create a need for replacement revenues.

Possible Practices: Local governments and school districts should try to avoid large fluctuations in operating results. One-shot revenues (including appropriations from available fund balance) should not be relied upon to balance annual budgets.

Appendix A:
Financial Measures and Demographics Indicators

Financial Measure 3. Fixed Costs as a Percentage of Total Expenditures (LG/SD)

Purpose: To identify how much of a local government's or school district's total costs are nondiscretionary, and therefore more difficult to control during times of fiscal stress. A high level of fixed costs also lessens the amount of money available for discretionary or unexpected expenses.

Measurement: The relationship of costs for salaries, fringe benefits, and debt service to total operating expenditures. Within salaries and fringe benefits, it is often helpful (if applicable) to look at public safety costs as a share of total expenditures, since these tend to be the more expensive services to deliver.

Formulas: a. $\dfrac{\text{Salaries and Fringe Benefits}}{\text{Gross Expenditures}}$

b. $\dfrac{\text{Salaries and Fringe Benefits + Debt Service}}{\text{Gross Expenditures}}$

Negative Trends: Percentages are high or increasing over time

Recommended Funds to Review: All major governmental operating funds

Account Codes to Use:

Salaries and Employee Benefits – All account codes ending in .1 and .8, respectively

Debt Service – All account codes ending in .6 and .7

Gross Expenditures – This figure is the total from the AUD filed with OSC or the ST-3 filed with SED

Analysis: As the relative level of fixed costs increases, officials have less flexibility to respond to economic changes. The generally fixed nature of personal service costs and debt service makes it more difficult to adjust service levels if resources decline. Because there is no established benchmark for this ratio, local governments and school districts should review the trend in this ratio over time. If the ratio is increasing, it indicates that the local government or school district is losing flexibility to adapt to changing circumstances.

It may be helpful to compare this ratio with other governments that offer similar services. For example, a town that provides police protection typically will have a higher percentage of personal services costs to total expenditures than a similar town that does not. For such a town, the best test for reasonableness is to compare this ratio with those of other towns that also provide police protection.

Possible Practices: Officials should review salary rates and overtime costs to see if they are consistent with similar local governments or school districts in the same region. Fringe benefit packages should be reviewed and modified as necessary. Capital project levels and debt service policies should be reviewed to make sure levels are affordable.

Appendix A:
Financial Measures and Demographics Indicators

Financial Measure 4. Cash and Investments as a Percentage of Current Liabilities (LG/SD)

Purpose: To identify trends in the year-end cash balances of a local government or school district

Measurement: The ability to liquidate current liabilities or to fund ensuing operations from available cash. This ratio measures the amount of cash on hand at the end of the year in relation to the amount of current liabilities.

Formulas: $$\frac{\text{Cash and Investments}}{\text{Current Liabilities}}$$

Negative Trend: Percentages decreasing over time

Recommended Funds to Review: This ratio typically is an aggregate of all the funds included in the analysis. Individual funds and other combinations can also be analyzed.

Account Codes to Use:

Cash and Investments – Account codes 200-201, 450-451

Current Liabilities – Account codes 600-626, 630-688

Gross Expenditures – This figure is the total from the AUD filed with OSC or the ST-3 filed with SED

Analysis: This ratio measures the availability of cash in relation to current liabilities at the end of the year. A downward trend (percentages are decreasing) indicates that the local government or school district may be having difficulty raising the cash needed to meet its current expenditures. Real property taxes, a significant revenue source in most local governments and school districts, are generally collected at the beginning of the fiscal year and spent down as the year progresses. To create a conservative ratio, use year-end figures, when cash balances are usually at their lowest.

Possible Practices: Cash flow analysis helps identify money available for investment in longer-term instruments (as authorized by law), thereby maximizing investment yields. The timely collection of receivables makes cash available for investment sooner. Cash collections may be enhanced through timely filing of claims, improved billing cycles and stricter enforcement efforts. Extending or delaying cash disbursements can also have a positive effect on cash flow, as long as it does not result in interest or payment penalties.

Appendix A:
Financial Measures and Demographics Indicators

Financial Measure 5. Tax Limit Exhausted (LG)

Purpose: To identify tax limit trends for counties, cities, and villages

Measurement: The relationship of the tax levy to the tax limit

Formulas: $\dfrac{\text{Tax Levy}}{\text{Tax Limit}}$

Negative Trend: Percentage increasing over time

Analysis: This ratio measures the extent to which a county, city, or village has exhausted its tax limit. The tax limit is the maximum amount of taxes that can be levied based on the State Constitution and other applicable statutory authority. These laws limit the amount of taxes that can be levied by imposing mandated ceilings linked to a five-year average of taxable full valuation of property. (Towns and school districts do not have such a limit.) The tax limit applies to taxes raised for specific or general purposes. However, taxes levied for certain purposes are not subject to the tax limit. The Constitution and related statutes allow for taxes in the amount of certain appropriations to be excluded when determining the amount of levy that must be below the tax limit. For instructions on tax limits, refer to the OSC website at **www.osc.state.ny.us/localgov/finreporting/ctl.htm**.

Percentages increasing over time could be an indication that tax levies are growing faster than the real property tax base. Such trends could be the result of increased spending, the loss of other revenues, or a declining tax base. A county, city, or village that is at or near its tax limit has fewer financing options. This lack of options is critical, because these local governments generally rely on real property taxes as a major source of financing for operations.

Possible Practices: The tax limit percentage represents a long-term indicator of fiscal health. OSC regularly notifies local governments who are approaching their Constitutional tax limits, and officials should consider this notification an early warning sign of fiscal stress. As a municipality advances towards its tax limit, it loses flexibility in its revenue structure and may not be able to sustain the current level of services provided to its citizens. Even routine cost increases can pose serious budget difficulties if there is no corresponding growth in nonproperty tax revenues. Also, both declines in property values and changes in amounts excluded from the tax limit will impact the calculation of the taxing capacity of the county. Thus, a municipality can approach or exceed its tax limit even with no change in real property tax levies from year-to-year.

Local officials should track the direction of property valuation in their municipality in order to anticipate changes in the general direction of their tax limit. Actions that increase the average full valuation of taxable real property, without an increase in the tax levy, will also serve to improve the tax margin. Similarly, efforts to limit the growth in the property tax levy may help improve the tax margin over time. Some counties may be able to increase their tax limits through board action.5

Appendix A:
Financial Measures and Demographics Indicators

Financial Measure 6. Short-Term Debt Issuance (LG/SD)

Purpose: To identify trends in short-term debt issuance

Measurement: The trends in the dollar amounts of issued revenue anticipation notes, tax anticipation notes and budget anticipation notes

Negative Trend: Increasing amounts of short-term debt being issued each year to meet current obligations

Recommended Funds to Review: All major governmental operating funds

Analysis: As local governments and school districts experience financial stress, they may start to issue more short-term debt to meet current obligations. Increasingly relying on short-term debt can obscure the need for a local government or school district to budget appropriately and adjust its cash flow practices to manage more effectively. Factors to take into consideration when analyzing the short-term debt burden are the interest costs associated with note issuance, the relative dependence on seasonal borrowing as a share of total cash needs, the total amount of overlapping short-term and long-term debt, and how well the local government collects taxes, State aid or other receipts pledged for repayment of its notes.

Possible Practices: Local governments and school districts should review the need for issuing short-term debt by conducting a thorough cash flow analysis. Modifying cash flow practices should occur prior to sizing the issuance of short-term debt. Officials should make sure interest and principal repayment costs are accurately reflected in the budget.

Appendix A:
Financial Measures and Demographics Indicators

Financial Measure 7. Timeliness of Financial Reporting (LG/SD)

Purpose: To analyze the timeliness of annual financial reporting

Measurement: The trend in how long after the end of the fiscal year that a local government or school district files its annual reports with State agencies, and prepares and presents an independently audited financial report (if such a report is prepared) or other required annual reports

Negative Trend: Increasing lengths of time between the end of the fiscal year and the date of filing

Analysis: Local governments and school districts that lack adequate management capacity may not file required annual financial documents in a timely manner, or at all. This may indicate inadequate staffing, a lack of adequate training, or poor financial recordkeeping.

Possible Practices: It is important that competent financial staff be hired and trained to fill management positions. Local government finances in New York State are growing increasingly complex, and require that staff keep current on legal, accounting and financial standards. Improving financial tools, such as maintaining a modern accounting system, may also provide faster, more reliable financial information.

Appendix A:
Financial Measures and Demographics Indicators

Financial Measure 8. Intergovernmental Revenues as a Percentage of Gross Revenues (LG)

Purpose: To identify trends in State and federal revenues as financing sources for a local government

Measurement: The relationship of intergovernmental revenues to gross revenues

Formulas: $\dfrac{\text{Intergovernmental Revenues}}{\text{Gross Revenues}}$

Negative Trend: Percentage increasing over time

Recommended Funds to Review: All major governmental operating funds

Account Codes to Use:

Intergovernmental Revenues – Account codes 3001-3999, 4001-4999

Gross Revenues – This figure is the total from the AUD filed with OSC or the ST-3 filed with SED

Analysis: This ratio measures the extent to which a local government's operations are supported by intergovernmental revenues from State and federal sources. It compares State and federal revenues to total fund revenues. Because a local government does not directly control most intergovernmental revenues, there is risk that the revenues may not be available to fund operations. This is particularly true of intergovernmental revenues such as grants or entitlements that require no action by the local government. Changes in State or federal policy or solvency also could have a significant impact on a local government's revenue streams, since budgetary stress at these levels could result in aid reductions. In general, the higher the percentage of operations funded by intergovernmental revenues, the greater the revenue risk that a local government or school district bears.

Possible Practices: A local government may reduce the risks associated with intergovernmental revenues through sound budgeting practices. Intergovernmental revenues should be budgeted conservatively, and those that are grant-based and/or nonrecurring should be tracked by grant expiration. Developing local sources of revenue will lessen the relative effect of any reductions in State and federal revenues.

Appendix A:
Financial Measures and Demographics Indicators

Demographic Indicator 1. Population Trends

Purpose: To identify trends in a local government's resident population

Measurement: Total number of residents and percentage change over time, with short-term trends based on annual census population estimates, and long-term trends based on decennial census figures

Negative Trend: A significant or chronic decline in population

Suggested Source: http://factfinder.census.gov/home/saff/main.html

Analysis: A declining population may be indicative of an unhealthy local economy. A declining population may also affect property values and the associated tax base, and often indicates less favorable labor market conditions. And, despite the fact that a population might be declining, local officials are often unable to cut costs associated with service provision, since many expenditures, including debt payment, contractual or mandated expenses, and pensions, are fixed in the short run. All of these factors can pose challenges to local budgets.

Along with population changes, it is important that local officials understand how the demographic profile of the community is also changing: are the citizens becoming older, more ethnically diverse, less wealthy, etc.? This information can help local officials anticipate changes in the types and amounts of services that residents need or desire. Additionally, it is important to monitor the changes that may be occurring in the portion of the population that resides in group quarters. A community may appear to be growing, but the implications associated with growth in a prison population or college-student population are vastly different from growth in the general population of a community.

Appendix A:
Financial Measures and Demographics Indicators

Demographic Indicator 2. Age of Population

Purpose: To understand the age distribution of the resident population

Measurement: The number of residents, and percentage of total population, in three age groups: less than 18 years of age, from 18-64, and 65 years and over

Negative Trends: Increases in the proportion of residents who are under 18 or at least 65 years of age

Suggested Source: http://factfinder.census.gov/home/saff/main.html

Analysis: The age of the resident population provides important insights into the service needs within a community. For example, older residents may need more assistance with administrative transactions, may require additional public transportation, and may have greater healthcare needs. For communities with more young families and children, there may be a greater need for educational services and community activities such as recreation programs, libraries and after-school programs.

It is important to monitor the age distribution of the population and analyze how it changes over time. Identifying these changes can assist local officials in making sure that services provided are aligned with community needs. It may also be helpful to compare the age mix of a local government with that of other localities in a particular region, to determine whether entities with similar age-related demographics are spending at a similar level for particular services.

Demographic Indicator 3. Property Value Trends

Purpose: To understand trends in key tax base measures which may affect local revenue streams

Measurement: Total full valuation of property within a local government in each year, and percentage change in full value over time

Negative Trend: Declining or stagnant full value over time

Suggested Source: http://www.osc.state.ny.us/localgov/datanstat/findata/index_choice.htm

Analysis: Change in property value is an important indicator for those localities relying on the property tax for a significant portion of revenues. Property values are also linked to other demographic patterns, such as crime, urban decay and income levels.

When examining property value trends, it is important to note the extent to which full value changes for a locality, both overall and in comparison to other local governments within a region. Additionally, it is important for local officials to determine whether property value growth is keeping pace with inflation.

When property values are increasing, local officials need to understand the factors driving the growth so that it can be managed. For example, where growth is due to new construction in a community, local officials may need to manage growth through planning and revisiting existing zoning laws. Growth from new construction may be an indication of increasing service demands, since a larger population likely will require additional police and fire protection, as well as increased educational services.

Additionally, increasing property values can adversely affect a percentage of established property owners. If property values increase more rapidly than their incomes, some residents may have difficulty paying their taxes.

Appendix A:
Financial Measures and Demographics Indicators

Demographic Indicator 4. Poverty Rate

Purpose: To understand the level of poverty within a local government, and how the poverty rate has been changing over time

Measurement: The percentage of a local government's residents living in poverty

Formulas:

$$\frac{\text{Population Living Below Poverty}}{\text{Total Population (for whom poverty level has been determined)}}$$

Negative Trends: Increasing percentage of residents in poverty, or a high poverty rate compared to similar communities within a region

Suggested Source: http://factfinder.census.gov/home/saff/main.html

Analysis: The level of poverty within a locality is an important indicator of community needs and should therefore be monitored routinely as a part of local planning. Having a relatively large number of low-income residents may also signal potential revenue stress, as any revenue raised locally will represent a greater fiscal burden for these taxpayers.

In order to properly interpret the poverty rate, the percentage of residents in poverty should be compared to the statewide average, as well as regional averages and government class averages. Local officials should also track changes in the poverty rate. If poverty is increasing, this could mean that unemployment is increasing or the local workforce conditions are deteriorating. Additionally, local officials may want to evaluate the poverty rate at finer levels of geography, such as the census tract and block group levels, to determine whether poverty is concentrated in particular neighborhoods.

Appendix A:
Financial Measures and Demographics Indicators

Demographic Indicator 5. Unemployment and Workforce

Purpose: To understand the recent unemployment and workforce patterns of a locality

Measurement: The unemployment rate, as well as trends in the total numbers of public and private sector jobs in the locality

Formulas:

$$\text{Unemployment Rate} = \frac{\text{Residents in a locality who are unemployed}}{\text{Total civilian labor force}}$$

Negative Trends: Comparatively high unemployment or increasing unemployment rate, declining labor force (number of jobs) within a locality, or labor force mix shifting to low paying jobs

Suggested Sources:

http://www.labor.state.ny.us/workforceindustrydata/index.shtm

http://www.bls.gov/bls/unemployment.htm

http://www.bls.gov/bls/employment.htm

Analysis: The unemployment rate is the percentage of residents in a locality who are not employed, regardless of the location of the job. A high rate of unemployment means that residents are having difficulty finding employment, and increases in unemployment lead to reductions in personal income. Additionally, the number of jobs in an area is an indicator of the strength of local economic activity.

Local officials should monitor the unemployment rate for their specific local government, as well as for the broader labor market region. The rate should be compared to the statewide unemployment rate as well as to other regions of the State, and monitored closely over time.

The number of jobs within the locality should also be monitored periodically. The analysis should include the percentage of jobs in each major sector: public, private, manufacturing, information, retail, services, etc. Local officials should also be aware of the largest employers in a community and monitor trends in the business sector for these “major players.” Decline in critical components of the business sector may indicate a need for economic development activities and planning.

Appendix B – Glossary of Terms

The definitions included here provide further explanation of terms used in this document, and should be used in that context only.

Budgetary Solvency – The ability to generate sufficient recurring revenues during the fiscal year to meet recurring expenditures without incurring a fund deficit.

Capital Outlay – Expenditures to either construct or extend the life of infrastructure, buildings, machinery, or equipment having a large initial cost and a useful life of more than one year. Some minor equipment purchases may also included in this category.

Cash and Investments – All cash and investment accounts that have not been legally reserved and are available to pay current liabilities as they become due.

Cash Solvency – The ability to generate enough cash to pay bills over a period, typically from 30 to 60 days.

Cost Accounting – The process of tracking, recording, and analyzing costs associated with the products or activities of an organization.

Current Liabilities – Obligations that will be liquidated with expendable available financial resources. Examples include short-term debt issues, accounts payable, accrued liabilities, and liabilities that are due to other governments.

Debt Limit – The maximum amount of indebtedness that may be contracted by a local government or school district under law.

Debt Service Expenditure – The amount that a local government or school district must pay each year for principal and interest on debt. Expenditures are made from the major governmental operating funds and the debt service fund, and are recorded in accordance with prescribed accounting principles.

Expenditures – For purposes of financial condition analysis, any use of funds to provide services or support those services.

Financial Condition/Solvency – A local government's or school district's ability to finance expected services on a continuing basis. A local government or school district with a positive financial condition maintains adequate service levels while surviving economic disruptions, has the ability to identify and adjust to long-term changes, and anticipates future problems.

Fiscal Stress – The inability of a local government or school district to maintain solvency in one or more of the following: cash solvency, budgetary solvency, long-term solvency or service-level solvency.

Full Value Assessment – The assessed value of real property divided by the equalization rate. In effect, this formula provides an estimate of the actual value of real property subject to taxes.

Appendix B – Glossary of Terms

Fund Balance – For purposes of financial condition analysis, the total accumulation of all operating surpluses and deficits since the beginning of a local government's or school district's existence (Assets - Liabilities = Fund Balance).

Fund Balance Appropriated – The part of the unreserved fund balance that has been appropriated for use in the next fiscal year's budget.

Fund Balance Reserved – The part of fund balance that is not available for discretionary appropriation due to accounting treatment or the creation of legally authorized reserves.

Fund Balance Unreserved – The total fund balance at the end of the fiscal year less any reservations of fund balance.

Gross Expenditures – The total of all expenditures for a specific fund for the year.

Gross Revenues – The total of all revenues for a specific fund for the year.

Intergovernmental Revenues – Those revenues received from the State and/or the federal government.

Long-Term Debt – Debt with a maturity date more than one year after the date of issuance.

Long-Term Solvency – A local government's or school district's ability to pay all the costs of doing business in the long run. This includes maintaining the infrastructure, meeting employee benefit obligations, and paying debt as it comes due.

Major Governmental Operating Fund – Any fund with total expenditures greater than 10 percent of the aggregate expenditures for all governmental operating funds.

One-Time Revenues – Revenues that are not derived from the normal operating cycle and, therefore, may not be available from year to year (also known as "one-shot" revenues). One-time revenues include such items as proceeds from the sale of real or personal property, special nonrecurring grants, and proceeds from the issuance of long-term obligations.

Operating Deficit – The result when total expenditures for the year exceed total revenues for an operating fund.

Operating Surplus – The result when total revenues for the year exceed total expenditures for an operating fund.

Per Capita Debt – The amount of a local government's or school district's debt divided by its population or enrollment. Per capita debt is used to indicate the credit position by showing the proportionate debt borne per resident or student.

Appendix B – Glossary of Terms

Real Property Tax Receivables – Real property taxes that remain unpaid at year-end.

Real Property Tax Revenues – Real property taxes levied for the budget of the current year.

Recurring Expenditures – Expenditures made during the normal year-to-year operations of a local government or school district.

Recurring Revenues – Revenues derived through the normal year-to-year operations of a local government or school district. These do not include one-time revenues.

Revenues – For purposes of financial condition analysis, any funding source generated through operations to finance local government or school district services.

Service-Level Solvency – The ability to provide needed and desired services at the level and quality required for the basic health, safety, and welfare of the community.

Structurally Balanced Budget – A budget that is structured to finance recurring expenditures with recurring revenues.

Tax Limit – The maximum amount that may be raised by real property tax in any fiscal year under law.

Total Fixed Costs – Salaries and fringe benefits plus debt service.

Appendix C – Other Resources

LOCAL GOVERNMENT DATA

Office of the State Comptroller
Has historical data on all local government revenues, expenditures, debt, etc., on its local government services website.
www.osc.state.ny.us/localgov

NEW YORK STATE AGENCIES

Labor Department
Has data and analysis on unemployment and private sector jobs.
www.labor.state.ny.us

Department of Taxation and Finance
Has data and analysis of sales and use tax revenues, rates and bases by county.
www.tax.state.ny.us

Division of the Budget
Has budget documents, including the New York State Financial Plan, economic reports, and Aid and Incentive for Municipalities (AIM) legislation information.
www.budget.state.ny.us

ECONOMIC DATA

U.S. Bureau of Labor Statistics (BLS)
Has data on consumer price index (CPI-U), employment, unemployment, wages, productivity and many other things related to workforce issues.
www.bls.gov

U.S. Census Bureau
Has data on demographics and economic census (payroll, establishments by sector).
www.census.gov

http://factfinder.census.gov/home/saff/main.html

MEMBERSHIP ORGANIZATIONS

All Financial Planners
Government Finance Officers Association (GFOA)

- National GFOA: **www.gfoa.org**
- New York State GFOA: **www.nysgfoa.org**

Municipalities and Counties
New York State Association of Counties **(NYSAC): www.nysac.org**

New York State Association of Towns: **www.nytowns.org**

New York State Conference of Mayors and Municipal Officials (NYCOM): **www.nycom.org**

International City/County Management Association (ICMA): **www.icma.org**

School Districts
New York State Association of School Business Officials (NYSASBO): **www.nysasbo.org**

New York State Council of School Superintendents (NYSCOSS): **www.nyscoss.org**

New York State School Boards Association (NYSSBA): **www.nyssba.org**

Notes

[1] The model on which this analysis is based is taken from "Evaluating Financial Condition: A Handbook for Local Government," The International City/County Management Association (ICMA), 2003.

[2] For more information, see OSC's publication entitled *Analysis of Fiscal Stress in New York State's Cities* at **http://www.osc.state.ny.us/localgov/pubs/research/citiesfiscalstress.pdf**.

[3] Real property tax and debt limits are expressed as a percentage of a local government's five year average full valuation of taxable real estate (as per Article VIII, Section 4 of the New York State Constitution), or of statutory limits based on the most recent full valuation of taxable real estate in the district (as per State Local Finance Law, Section 104.00).

[4] General Municipal Law Section 9-a addresses the issue of interfund advances. Towns, villages, and counties are permitted by law to retain a "reasonable amount" of any remaining estimated unrestricted, unappropriated fund balance for each fund, consistent with prudent budgeting practices, necessary to ensure the orderly operation of their government. School districts, however, are limited to retaining 4 percent of the current school budget in unrestricted fund balance.

[5] County Law Section 233

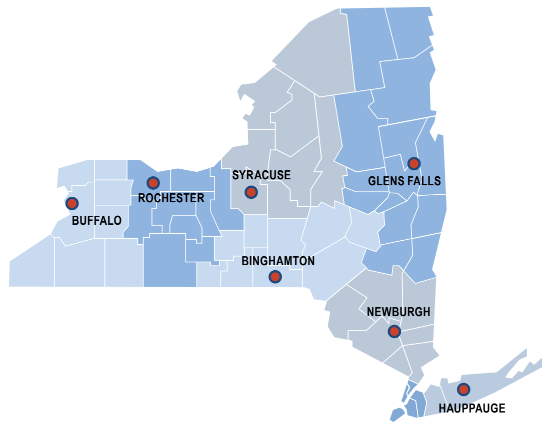
Contacts

New York State Comptroller
THOMAS P. DiNAPOLI

Division of Local Government and School Accountability

110 State Street, 12th Floor, Albany, NY 12236
Tel: 518.474.4037 • Fax: 518.486.6479
Email: localgov@osc.ny.gov

www.osc.ny.gov/local-government



Andrea C. Miller
Executive Deputy Comptroller

Executive • 518.474.4037
Robin L. Lois, CPA, Deputy Comptroller
Simonia Brown, Assistant Comptroller
Randy Partridge, Assistant Comptroller

Audits, Local Government Services and Professional Standards • 518.474.5404
(Audits, Technical Assistance, Accounting and Audit Standards)

Local Government and School Accountability Help Line • 866.321.8503 or 518.408.4934
(Electronic Filing, Financial Reporting, Justice Courts, Training)

Division of Legal Services
Municipal Law Section • 518.474.5586

New York State & Local Retirement System
Retirement Information Services
Inquiries on Employee Benefits and Programs
518.474.7736

Technical Assistance is available at any of our Regional Offices

BINGHAMTON REGIONAL OFFICE
Tel 607.721.8306 • **Fax** 607.721.8313 • **Email** Muni-Binghamton@osc.ny.gov
Counties: Broome, Chemung, Chenango, Cortland, Delaware, Otsego, Schoharie, Tioga, Tompkins

BUFFALO REGIONAL OFFICE
Tel 716.847.3647 • **Fax** 716.847.3643 • **Email** Muni-Buffalo@osc.ny.gov
Counties: Allegany, Cattaraugus, Chautauqua, Erie, Genesee, Niagara, Orleans, Wyoming

GLENS FALLS REGIONAL OFFICE
Tel 518.793.0057 • **Fax** 518.793.5797 • **Email** Muni-GlensFalls@osc.ny.gov
Counties: Albany, Clinton, Columbia, Essex, Franklin, Fulton, Greene, Hamilton, Montgomery, Rensselaer, Saratoga, Schenectady, Warren, Washington

HAUPPAUGE REGIONAL OFFICE
Tel 631.952.6534 • **Fax** 631.952.6530 • **Email** Muni-Hauppauge@osc.ny.gov
Counties: Nassau, Suffolk

NEWBURGH REGIONAL OFFICE
Tel 845.567.0858 • **Fax** 845.567.0080 • **Email** Muni-Newburgh@osc.ny.gov
Counties: Dutchess, Orange, Putnam, Rockland, Sullivan, Ulster, Westchester

ROCHESTER REGIONAL OFFICE
Tel 585.454.2460 • **Fax** 585.454.3545 • **Email** Muni-Rochester@osc.ny.gov
Counties: Cayuga, Livingston, Monroe, Ontario, Schuyler, Seneca, Steuben, Wayne, Yates

SYRACUSE REGIONAL OFFICE
Tel 315.428.4192 • **Fax** 315.426.2119 • **Email** Muni-Syracuse@osc.ny.gov
Counties: Herkimer, Jefferson, Lewis, Madison, Oneida, Onondaga, Oswego, St. Lawrence

STATEWIDE AUDIT
Tel 607.721.8306 • **Fax** 607.721.8313 • **Email** Muni-Statewide@osc.ny.gov

osc.ny.gov

Contact

Office of the New York State Comptroller
Division of Local Government and School Accountability

110 State Street, 12th floor
Albany, NY 12236
Tel: (518) 474-4037
Fax: (518) 486-6479
or email us: localgov@osc.ny.gov

www.osc.ny.gov/local-government

Updated June 2016