Financial Condition Analysis

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Presentation outcomes

1. Understand the purpose and design of model
2. Calculate and interpret financial indicators for the general fund
3. Calculate and interpret financial indicators for an enterprise fund
4. Communicate financial condition of a local government

Purpose of model

1. To provide local officials with a systematic , comprehensive, and manageable approach to analyze financial condition within the context of trend and benchmark data
2. To provide local officials with a systematic, comprehensive, and manageable approach to communicate financial condition to elected officials

Design of model

1. Provides trend and benchmark data for the general fund
   - Measures financial resources on the modified accrual basis of accounting
   - Analyzes three dimensions of resource flow and three dimensions of resource stock

Design of model

1. Provides trend and benchmark data for governmental activities
   - Measures economic resources on the accrual basis of accounting
   - Analyzes four dimensions of resource flow and four dimensions of resource stock
2. Does not include business-type activities because enterprise funds already use accrual basis of accounting

Design of model

1. Provides trend and benchmark data for water & sewer fund and electric fund
   - Measures economic resources on the accrual basis of accounting
   - Analyzes four dimensions of resource flow and four dimensions of resource stock
2. All local governments have a general fund and governmental activities— only selected local governments have a water & sewer fund and/or an electric fund

Design of model

1. Selecting benchmark peers
   - Similar services
   - Population
   - Geography
   - Tax base
   - Bond rating
   - Other criteria

Financial condition of general fund

Resource Flow (operating statement)	
Financial Dimension	Financial Indicator
Service obligation	Operations ratio
Dependency	Intergovernmental ratio
Financing obligation	Debt service ratio

Operations ratio

- Used to analyze the financial dimension of service obligation, which determine whether or not annual revenues were sufficient to pay for annual operations
- Total revenues are divided by total expenditures (plus transfers to debt service fund and less proceeds from capital leases and installment purchases)

Operations ratio

$$\frac{44,614,463}{41,200,019} = 1.08$$

Benchmark

- 1.0 or higher

Intergovernmental ratio

- Used to analyze the financial dimension of dependency, which determines the extent to which a government is reliant on other governments for resources
- Intergovernmental revenue (unrestricted and restricted) is divided by total revenue

Intergovernmental ratio

$$\frac{(2,165,377 + 787,532)}{44,614,463} = 7 \text{ percent}$$

Benchmarks

- Trend analysis
- Selected peers

Debt service ratio

- Used to analyze the financial dimension of financing obligation, providing feedback on service flexibility with the amount of expenditures committed to annual debt service
- Debt service (principle & interest and transfers to debt service fund) is divided by total expenditures (plus transfers to debt service fund and less proceeds from capital leases and installment purchases)

Debt service ratio

$$\frac{(992{,}686 + 100{,}500)}{41{,}200{,}019} = 3 \text{ percent}$$

Benchmarks

- Selected peers
- Internal policy

Financial condition of general fund

Resource Stock (balance sheet)	
Financial Dimension	Financial Indicator
Liquidity	Quick ratio
Solvency	Fund balance as percentage of expenditures
Leverage	Debt as a percentage of assessed value

Quick ratio

- Used to analyze the financial dimension of liquidity, which is a government's ability to address its short-term obligations
- Divide cash & investments by current liabilities (not including deferred inflows of resources)

Quick ratio

$$\frac{33,184,361}{(2,707,424 - 390,666)} = 14.32$$

Benchmarks

- Trend analysis
- Selected peers

Fund balance as percentage of expenditures

- Used to analyze the financial dimension of solvency, which represents a government's ability to address long-term obligations
- Available fund balance is divided by total expenditures (less proceeds from capital leases and installment purchases) plus transfers out

Fund balance as percentage of expenditures

$$\frac{34{,}366{,}115 - (409{,}899 + 3{,}771{,}100)}{41{,}200{,}019 + 3{,}095{,}796} = 68.14 \text{ percent}$$

Benchmarks

- Internal policy
- Population average

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Debt as percentage of assessed value

- Used to analyze the financial dimension of leverage, which represents the extent to which a government relies on tax-supported debt
- Tax-supported, long-term debt is divided by assessed value

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Debt as percentage of assessed value

$$\frac{1{,}626{,}063}{4{,}727{,}215{,}708} = .03 \text{ percent}$$

Benchmarks

- Internal policy
- State law is 8 percent

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Financial condition of water & sewer fund (enterprise fund)

Resource Flow (operating statement)	
Financial Dimension	Financial Indicator
Interperiod equity	Total margin ratio
Financial performance	Percent change in net position
Self-sufficiency	Charge to expense ratio
Financing obligation	Debt service ratio

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Total margin ratio

- Used to analyze the financial dimension of interperiod equity, which addresses whether or not a local government lived within its financial means
- Total resource inflow is divided by total resource outflow
  - Operating revenues/expenses, nonoperating revenues/expenses, and transfers in/out

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Total margin ratio

$$\frac{22{,}956{,}285 + 135{,}513 + 103{,}605 + 885{,}000}{18{,}504{,}813 + 378{,}238 + 1{,}177{,}699 + 2{,}026{,}735} = 1.09$$

Benchmark

- 1.0 or higher

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Percent change in net position

- Used to analyze the financial dimension of financial performance, which provides the magnitude of a government's financial position improved or deteriorated as a result of resource flow
- Change in net position is divided by net position, beginning

Percent change in net position

$$\frac{2{,}095{,}579}{97{,}687{,}900} = 2.15 \text{ percent}$$

Benchmark

- 0 percent or higher

Charge to expense ratio

- Used to track the financial dimension of self-sufficiency, which addresses the extent to which service charges covered total expenses
- Service charges are divided by total expenses

Charge to expense ratio

$$\frac{22,483,696}{18,504,813 + 378,238 + 1,177,699} = 1.12$$

Benchmarks

- 1.0 or higher
- Trend analysis
- Policy decision

Debt service ratio

- Used to track the financial dimension of financing obligation, providing feedback on service flexibility with the amount of expenses committed to annual debt service
- Debt service (principal and interest payments) divided by total expenses plus principal

Debt service ratio

$$\frac{3,237,838 + 1,177,699}{18,504,813 + 378,238 + 1,177,699 + 3,237,838} = .19$$

Benchmarks

- Trend analysis
- Selected peers
- Policy decision

Financial condition of water & sewer fund (enterprise fund)

Resource Stock (balance sheet)	
Financial Dimension	Financial Indicator
Liquidity	Quick ratio
Solvency	Net positon ratio
Leverage	Debt to assets ratio
Capital	Capital assets condition ratio

Quick ratio

- Used to track the financial dimension of liquidity, which provides feedback on a government's ability to address short-term obligations
- Cash & investments are divided by current liabilities (not including deferred revenues)

Quick ratio

$$\frac{18{,}980{,}767}{5{,}482{,}360 - (556{,}075 + 44{,}028 + 156{,}822)} = 4.02$$

Benchmarks

- 2.0 or higher
- Trend analysis

Net positon ratio

- Used to track the financial dimension of solvency, which provides feedback on a government's ability to address long-term obligations
- Unrestricted net position is divided by total liabilities

Net position ratio

$$\frac{19,464,584}{40,503,183} = .48$$

Benchmarks

- Trend analysis
- Selected peers

Debt to assets ratio

- Used to analyze the financial dimension of leverage, which is the extent to which total assets are financed with long-term debt
- Long-term debt is divided by total assets

Debt to assets ratio

$$\frac{36,764,581}{140,286,662} = .26$$

Benchmarks

- Trend analysis
- Selected peers

Capital assets condition ratio

- Used to analyze the financial dimension of capital, representing the remaining useful life of capital assets assigned to governmental activities
- Accumulated depreciation is divided by assets being depreciation and then subtracted from 1

Capital assets condition ratio

$$1 - \frac{65,945,575}{169,520,756} = .61$$

Benchmarks

- Trend analysis
- Selected peers

Communicate

Financial Condition

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To help elected officials grasp financial condition you have to first teach Financial Condition 101

- Key differences in governmental accounting
- Financial position vs. financial condition
- Key parts of financial condition model
- How peers were selected

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To make it stick, you have to tell a story.

- **Structure and order your story.**
- **The critical few issues rather than many.**
- **Policy implications and choices.**

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With good interpretation and communication, we move up the pyramid to support better policy decision making.