



City of Dublin

Office of the City Manager

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Memo

To: Members of Dublin City Council
From: Dana L. McDaniel, City Manager
Date: February 23, 2017
Initiated By: Angel L. Mumma, Director of Finance
Jerry O'Brien, Chief Accountant
Re: Auditor of State Financial Health Indicator Report

Background

The Office of the Auditor of State of Ohio (Auditor) has compiled a document called the Financial Indicators Report to help determine if a governmental entity is experiencing fiscal stress. The report consists of 17 financial health indicators which "are a series of financial information, percentages, and ratios gathered from annual financial statements, filed by local governments, which are useful in predicting financial stability." The report instructs the reader to consider all of the indicators and analyze those that might present an issue. The report should be read in conjunction with the Frequently Asked Questions (FAQ) document written by the Auditor's staff and available to the public on the Auditor's website. The answers to these questions are helpful in understanding various aspects of the report and what they mean.

For each of the FHI, the report uses three categories to characterize whether the trend in the data represents a positive outlook, cautionary outlook, or critical outlook. In the report, these three categories are identified by the colors green, yellow or red, respectively. The report states, "FHI will be used to recognize early signs of fiscal stress at specific local governments and take a proactive approach to monitoring or assisting these local governments" to identify and correct negative financial trends before the negative trends lead to more serious fiscal distress.

The City's Finance 2015 Financial Health Indicator Report

In the City's report, two of the seventeen financial indicators were identified as "yellow" or a "cautionary outlook". These indicators are identified in the report as Indicator #1 and Indicator #2. Fourteen of the other indicators were categorized as "green", which indicates a "positive outlook" and one was "black", which indicates not applicable. There were no indicators with a "red" or a "critical outlook".

Staff analyzed the yellow indicators using the Comprehensive Annual Financial Report (CAFR) data represented in the report and internal data used to compile the CAFRs to determine the reasons for the trends. Background for the information and the analysis is presented below.

The report was compiled using the financial data from the City's CAFR for the years 2012, 2013, 2014, and 2015. The report only looks at governmental activities. It does not look at business-type activities. Governmental activities consist of functions of the City that are principally

supported by taxes and intergovernmental revenues while business-type activities are intended to recover all or a significant portion of their costs through user fees or charges. The governmental activities of the City include general government, community environment, basic utility services, leisure time activity, security of persons and property, public health services, and transportation. The business-type activities of the City include the water system, the sanitary sewer system, and the merchandising operations.

While the City (along with the majority of other public entities in Ohio) operates on a cash basis throughout the year (recognizing revenue at the time of receipt and expenditures at the time the payment is made), much of the financial information in the CAFR is compiled using the accrual basis of accounting, as required by the Auditor and GASB. Accrual basis accounting includes information such as receivables and payables, long-term debt, and capital assets. These components represent amounts not yet received or paid, as well as non-cash assets. Accrual basis accounting is not looking at cash balances of funds. Reconciliations are required in the financial statements to show how the accrual basis information relates to cash basis activity.

The CAFR presents government-wide financial statements which are designed to provide readers with a broad overview of the City's finances, in a manner similar to private-sector business. They consist of all information for governmental activities combined into one column and all business-type activities combined into another column. The two government-wide statements are the statement of net position and the statement of activities.

The CAFR also presents fund financial statements which are composed of information for each fund. A fund is a grouping of related accounts that is used to maintain control over resources that are segregated for specific activities or objectives. The City uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All of the funds of the City can be divided into three categories: governmental funds, proprietary funds, and fiduciary funds.

Governmental funds are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on the near-term inflows and outflows of spendable resources, as well as on balances of spendable resources available at the end of the fiscal year. Such information may be useful in evaluating a government's near-term financing requirements.

INDICATOR 1 – Unrestricted Net Position of Governmental Activities

The statement of net position is the first of the two government-wide statements within the CAFR, which presents information on all of the City's assets, deferred outflows/inflows of resources, and liabilities with the difference reported as net position. Net position is composed of three categories: net invested in capital assets, restricted, and unrestricted. Net invested in capital assets is the amount of capital assets after subtracting depreciation that has been applied to date and debt used to purchase the assets. Restricted net position represents resources restricted by legal or contractual purposes to specific purposes. Unrestricted net position represents the remaining resources that can be used for any purpose of the government.

In 2015, the unrestricted net position of governmental activities decreased \$22.6 million from 2014. This was due to an increase in noncapital debt. In 2015, revenue bonds in the amount of \$32,000,000 were issued for the purposes of constructing two parking facilities within the Bridge

Street District. The liability was reported in the unrestricted net position category due to the fact that the two parking facilities will not be assets of the City, rather reported as assets of the Franklin County Finance Authority.

Normally, the amount of outstanding debt reduces the restricted category of net invested in capital assets. It offsets the capital assets purchased or constructed. However, according to GASB standards, when debt is issued for construction of assets that will be reported by another entity, the liability is reported in unrestricted net position. Had the City had not issued the revenue bonds in 2015, unrestricted net position would have shown an increase of approximately \$9,400,000 from 2014.

INDICATOR 2 – Unassigned Fund Balance of the General Fund

Unassigned fund balance is found in the balance sheet of the General Fund. Fund balance in governmental funds is divided into five classifications based primarily on the extent to which the City is bound to observe constraints imposed upon the use of the resources in the governmental funds. The classifications are nonspendable, restricted, committed, assigned and unassigned. The two that have a bearing on the discussion of this indicator are the nonspendable and unassigned classifications.

The **nonspendable** fund balance category includes amounts that cannot be spent because they are not in a spendable form, or legally or contractually required to be maintained intact. The “not in spendable form” criteria includes items that are not expected to be converted to cash such as supplies and materials inventory. The **unassigned** fund balance category is the residual classification for the General Fund and includes all spendable amounts not contained in the other classifications.

The decrease in unassigned fund balance of the General Fund presented in Indicator 2 is due to advances being made from the General Fund to various capital projects funds (i.e. TIF funds). Advances to other funds are reported on the governmental funds balance sheet as an asset because they are long-term receivables from other funds. Because they will not generally be paid back in the next year and are therefore not available to spend, they are reported in nonspendable fund balance rather than unassigned fund balance.

In 2014, advances to other funds in the General Fund were \$22,683,348. In 2015, advances to other funds were \$35,565,348. This represents an increase of advances in 2015 of \$12,882,000. Since advances to other funds are reported in the nonspendable fund balance classification rather than in unassigned fund balance, nonspendable fund balance was increased while unassigned fund balance was decreased.

The unassigned balance is the amount left over after every other category of fund balance. Advances to other funds is the only item included in these other categories that is significantly affecting the unassigned fund balance. This does not indicate the General Fund is experiencing financial stress. Overall, fund balances in the General Fund for 2014 and 2015 were \$80,555,318, and \$93,540,844, respectively, which represents an increase in total fund balance for each year. In the City’s case, the decrease in unassigned fund balance is indicative of an increase in capital projects.

CONCLUSION

The Auditor's report cautions that "No individual FHI indicator is of use in identifying overall fiscal stress". It goes on to say "These indicators must be considered together to obtain insight as to whether or not an entity is experiencing the signs of fiscal stress." This is because one or more ratios may not give a true picture of the financial condition of an entity or be indicative of a problem. In a government with complex finances, many of the financial statement components being analyzed in this report, especially in the government-wide statements, contain several aspects of financial operations.

Moreover, in the FAQ document published by the Auditor's Office, one of the questions posed was, "Does a "red" or "yellow" indicator reflect poor management of the city or county? The answer provided was, "No". It goes on to say in part:

The FHI report is not intended to criticize the operating decisions made by individual entities. Many times local leaders have made conscious decisions that may, because the FHI report is an automated process, trigger an indicator as having a "critical" (red) or "cautionary" (yellow) outlook. Those decisions are purposeful and usually are not indicative of a problem.

Therefore, each ratio not categorized as positive must be analyzed to determine the underlying reason or reasons for the trend. It then must be considered in conjunction with all of the other ratios to gain a true picture of the financial condition of the entity. According to the Auditor's analysis, for entities reporting on the GAAP basis of accounting, six red indicators or a combination of eight red and yellow indicators implies fiscal stress. After analysis of the reasons behind the trends in the report for the City, these two yellow indicators do not reflect any fiscal distress.

Recommendation

Information only. Attached for Council's review are four documents:

- The City of Dublin Final 2015 Report
- The Financial Health Indicator – Special Report Dated January 25, 2017
- The Financial Health Indicator – Frequently Asked Questions and Answers
- City Heat Map for 2015 – This report shows all City's in Ohio and their color-coded ratings for each of the 17 indicators

In the spirit of full transparency to our residents, Staff will post the City's Final 2015 Report along with the Special Report, FAQ and this memo on the Finance page of the City's website.

Attachments