

Beyond Budget: Embracing Financial Sustainability



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Purpose of workshop



- ⌘ To present a model for analyzing the financial condition of a county government and for using the results for making sound financial decisions.
- ⌘ To discuss the need for an effective capital improvement program.

Fiscal policy of county government



- ⌘ The board of commissioners has and shall exercise the responsibility of developing and directing the fiscal policy of the county government under the provisions and procedures of the Local Government Budget and Fiscal Control Act (G.S. 153A-101).

Local Government Budget and Fiscal Control Act



- ⌘ County commissioners are responsible for adopting an annual budget ordinance, where estimated net revenues plus appropriated fund balance is equal to appropriations (G.S. 159-8).
- ⌘ County commissioners also are responsible for the annual audit. G.S. 159-34(a) states that the auditor shall be selected by and shall report directly to the governing board.

Beyond budget



- ⌘ Financial sustainability is measured by the information contained in financial statements rather than budgets.
- ⌘ Budgets represent a financial plan; financial statements provide information on actual resource flow (operating statement) during a fiscal year and on actual resource stock (balance sheet) at the end of a fiscal year.

Case

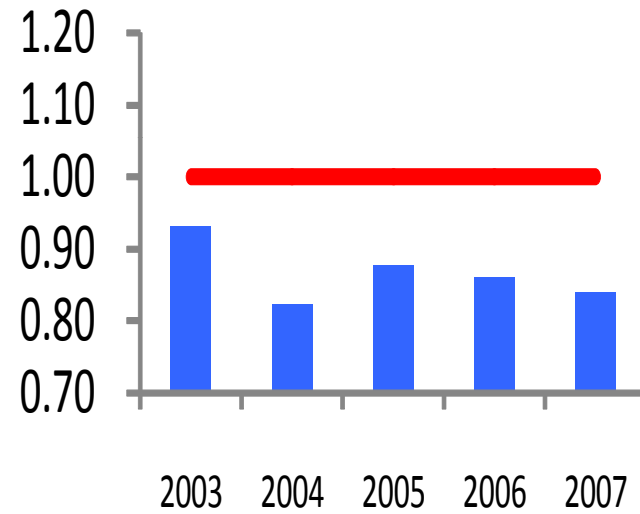


- ⌘ Review the attached budget ordinance for the general fund.
- ⌘ Review the attached operating statement and balance sheet for the general fund.
- ⌘ What questions would you ask as a county commissioner?

Case

Service obligation

Operations ratio

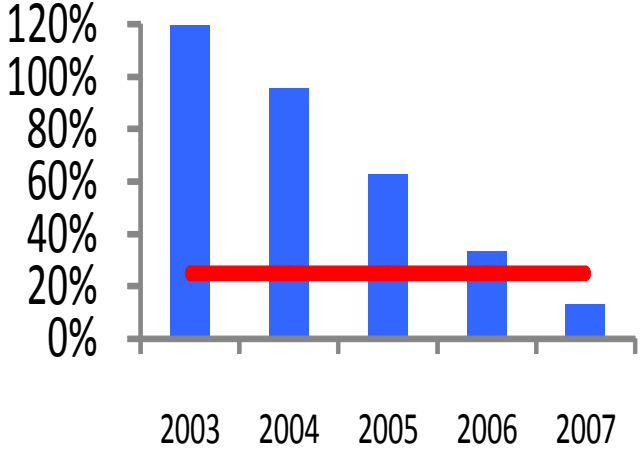


County = .83 Benchmark = 1.00

Case

Solvency

Fund Balance as percentage of expenditures



County = 13.2% Benchmark = 25%

Problems with analyzing financial condition in local government



- ⌘ Difference between financial position and financial condition
- ⌘ No agreed upon definition of financial condition
- ⌘ Definitions that do exist are either specific in nature or broad in scope

Problems of analyzing financial condition in local government



- ⌘ There are two levels of reporting in local government (government-wide and fund), with multiple operating statements and balance sheets.
- ⌘ There also are two different methods of applying the accrual concept.
 - ☒ The measurement focus of *economic resources* presented on the accrual basis of accounting.
 - ☒ The measurement focus of *financial resources* presented on the modified accrual basis of accounting.

Definition of financial condition



- ⌘ Financial condition is a local government's ability to meet its ongoing financial, service, and capital obligations based on the status of resource flow and stock as interpreted from annual financial statement.

Reporting model

Primary Government		
<i>Government-Wide Level</i>	Governmental Activities <i>(economic resources)</i>	Business-Type Activities <i>(economic resources)</i>
<i>Fund Level</i>	Governmental Funds <i>(financial resources)</i>	Enterprise Funds <i>(economic resources)</i>

Financial condition of general fund



⌘ Resource flow

- ☑ Operations ratio
- ☑ Intergovernmental ratio
- ☑ Debt service ratio

⌘ Resource stock

- ☑ Quick ratio
- ☑ Fund balance as % of expenditures
- ☑ Debt as % of assessed value

Financial condition of general fund



- ⌘ The financial dimension of service obligation is whether or not annual revenues were sufficient to pay for annual operations.
- ⌘ The operations ratio is used to analyze this dimension, where total revenues are divided by total expenditures.
- ⌘ The benchmark is one or above.

Operations ratio



72,086,457

69,148,218

= 1.04

Financial condition of general fund



- ⌘ The financial dimension of financing obligation provides feedback on service flexibility with the amount of expenditures committed to annual debt service.
- ⌘ The debt service ratio is used analyze this dimension, where debt service is divided by total expenditures.
- ⌘ The benchmark is policy.

Debt service ratio



(1,867,123 + 2,206,846)

69,148,218

= 0.059

Financial condition of general fund



- ⌘ The financial dimension of solvency represents a government's ability to address long-term obligations.
- ⌘ Fund balance as % of expenditures is used to analyze this dimension.
- ⌘ The benchmark is policy.

Fund balance as % of expenditures



- ⌘ Chatham County = 23 percent
- ⌘ Population group = 24 percent
- ⌘ Statewide average = 20 percent

Reporting model

Primary Government		
<i>Government-Wide Level</i>	Governmental Activities <i>(economic resources)</i>	Business-Type Activities <i>(economic resources)</i>
<i>Fund Level</i>	Governmental Funds <i>(financial resources)</i>	Enterprise Funds <i>(economic resources)</i>

Financial condition of governmental activities



⌘ Resource flow

- ☑ Total margin ratio
- ☑ Percent change in net assets
- ☑ Charge to expense ratio
- ☑ Debt service ratio

⌘ Resource stock

- ☑ Quick ratio
- ☑ Net assets ratio
- ☑ Debt to assets ratio
- ☑ Capital assets condition ratio

Financial condition of governmental activities



- ⌘ The financial dimension of self-sufficiency addresses the extent to which service charges covered total expenses.
- ⌘ The charge to expense ratio is used to analyze this dimension, where service charges are divided by total expenses.
- ⌘ The benchmark is a policy decision.

Charge to expense ratio



$$\frac{\underline{6,348,815}}{69,367,073}$$
$$= 0.09$$

Financial condition of governmental activities



- ⌘ The financial dimension of capital represents the remaining useful life of capital assets assigned to governmental activities.
- ⌘ The capital assets condition ratio is used to analyze this dimension.
- ⌘ The benchmark is often cited as 50 percent or above.

Capital assets condition ratio



$$1 - \frac{15,861,819}{24,373,993}$$

$$= 0.35$$

Reporting model

Primary Government		
<i>Government-Wide Level</i>	Governmental Activities <i>(economic resources)</i>	Business-Type Activities <i>(economic resources)</i>
<i>Fund Level</i>	Governmental Funds <i>(financial resources)</i>	Enterprise Funds <i>(economic resources)</i>

Financial condition of the utility fund



⌘ Resource flow

- ☑ Total margin ratio
- ☑ Percent change in net assets
- ☑ Charge to expense ratio
- ☑ Debt service ratio

⌘ Resource stock

- ☑ Quick ratio
- ☑ Net assets ratio
- ☑ Debt to assets ratio
- ☑ Capital assets condition ratio

Financial condition of the utility fund



- ⌘ The financial dimension of self-sufficiency addresses the extent to which service charges covered total expenses.
- ⌘ The charge to expense ratio is used to analyze this dimension, where service charges are divided by total expenses.
- ⌘ The benchmark is one or higher.

Charge to expense ratio



$$\frac{\underline{6,387,968}}{4,256,229 + 85,077 + 50,661} = 1.45$$

Financial condition of the utility fund



- ⌘ The financial dimension of capital represents the remaining useful life of capital assets assigned to the utility fund.
- ⌘ The capital assets condition ratio is used to analyze this dimension.
- ⌘ The benchmark is often cited as 50 percent or above.

Capital assets condition ratio



$$1 - \frac{8,542,962}{31,947,812}$$

$$= 0.73$$

Rationale for separate capital budgeting process



- ⌘ Ensures annual investment in capital assets
- ⌘ Policy decisions extend for years
- ⌘ Spending varies from year-to-year
- ⌘ Debt financing is often used

Characteristics of an effective capital improvement program




- ⌘ Covers a multiyear period
- ⌘ Includes capital assets to be acquired in each of the planning years
- ⌘ Forecasts the costs of acquiring the assets
- ⌘ Identifies the funding sources to finance the capital assets.
- ⌘ Determines the impact on future operating budgets

Using pay-as-you-go financing



- ⌘ Annual revenue – transferring revenue from the operating budget to the capital budget on an annual basis.
- ⌘ Cash reserves – using cash reserves that exceed the fund balance policy’s threshold are often transferred to the capital budget.
- ⌘ Capital reserve fund – transferring annual revenue to a special revenue fund, established by law, to accumulate resources for capital assets.

Types of debt used to finance capital assets



- ⌘ General obligation bonds – debt secured by the taxing authority of a county.
- ⌘ Installment-purchase financing – debt secured by the capital asset.
 - ☑ Commercial bank
 - ☑ Certificates of participation
- ⌘ Revenue bonds – debt secured by the net revenues of an enterprise activity.

III. Types of debt used to finance capital assets



- ⌘ Special obligation bonds – debt secured with revenue that will not create general obligation.
- ⌘ Tax increment bonds – debt secured with property taxes from the incremental increase of assessed value in a tax increment district.

Role of bond rating agencies



- ⌘ Bond rating agencies issue a bond rating for a particular debt by using four categories to analyze the creditworthiness of a municipality:
 - ☑ Economic condition of the community (major tax payers, unemployment rate, tax base growth)
 - ☑ Management capacity (review of financial policies)
 - ☑ Financial condition of the county (cash reserves)
 - ☑ Current debt obligations (debt service)

Sustainable practices for financing capital assets



- ⌘ Adopt financial policies (capital maintenance and replacement, debt management)
- ⌘ Adequate public facilities ordinance – capital assets to serve the new development be in place or planned for before approving the new development.

Sustainable practices for financing capital assets



- ⌘ Impact fees – paid by developer for each new residential unit to finance capital assets. Requires local legislation.
- ⌘ Inter-local arrangements – partnering with other counties to finance capital assets.
- ⌘ Public-private partnerships