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Fiscal Indicators:
A Proactive Approach to Local Government Financial Assistance

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Introduction

The economic recession that began in December 2007 is profoundly affecting local governments' ability to deliver traditional services to citizens. In 2009, the National League of Cities' *City Fiscal Conditions in 2009* survey reported that 90 percent of responding fiscal officers thought their cities were "less able to meet fiscal needs in 2009 than in the previous year" (Hoene and Pagano, 2009). Fiscal officers indicated that year-over-year expenditure growth was expected to outpace revenue growth as income and sales tax revenue declined. Further exacerbating revenue woes, property taxes are expected to grow at a much slower pace than in previous years and would not fill the lost income and sales tax revenue gap. Finally, economic recovery in state and local governments generally lags broader economic recovery and government revenues trail increases in personal wealth and property value.

In many circles, elected leaders and local government officials are asking, "How can my local government continue to meet the needs of its citizens, often increased during times of economic turbulence, while encountering steep declines in revenue?" Governments across the U.S. have instituted hiring freezes, layoffs, and unpaid furlough days to reduce personnel expenditures while delaying non-necessary projects. However, at the close of 2009, it is uncertain if these actions will be sufficient to stave off fiscal crises.

In Ohio, like many other states, there is no formal mechanism to monitor local governments' fiscal stability. Governments are often required to manage their respective financial problems until the situation becomes dire and expenditures are projected to exceed revenues by a substantial percentage, or one or more funds close the fiscal year in deficit. Once a government has reached a level of fiscal crisis, the triage used to correct budgetary imbalances and deficits can have a detrimental and lingering effect on services, community stability, and citizens' confidence. Though states may provide assistance at various points during the development and culmination of a fiscal crisis, local governments can also use financial indicators to monitor financial position and make incremental adjustments.

Fiscal Distress and Fiscal Crisis in Local Governments

Fiscal distress is an imbalance between the level of financial resources a unit of government has committed and its potential available resources (Citizens Research Council of Michigan (CRCM), 2000). It may also include long-term considerations such as the local government's fiscal situation over several years. Fiscal distress often encompasses trends in a local government's tax base relative to its expenditures and commitments. In some instances, it also includes instances where a government is able to meet its financial obligations but not able to sufficiently meet the needs of its community (Kohla et al, 2005).

Fiscal distress can lead to **fiscal crisis**, which occurs when the local government cannot pay its bills or provide existing levels of service (Advisory Commission on Intergovernmental Relations (ACIR), 1973; Honadle, 2003). If the government is unable to identify a combination of expenditure cuts, revenue increases, and borrowing to resolve its financial situation, its continued operation is threatened (Honadle, 2003).

Historically, local government fiscal distress occurred largely in isolation from state government intervention. However, when the cities of New York and Cleveland approached fiscal meltdown and near bankruptcy in the 1970s, local government fiscal distress drew national attention. State leaders in New York and Ohio grew concerned about the effects of these cities' financial conditions on the states' fiscal conditions, particularly the credit ratings of the states and all their subdivisions¹ (CRCM, 2000). In reaction to these local government fiscal crises, some states adopted legislation that defined fiscal distress and the state's role in monitoring the fiscal health of local governments. Since the 1980s, ten states have developed formal determinations of fiscal crises² and fourteen have informal determinations or indicators used to identify when fiscal crises are probable (Honadle, 2003).

In states that have enacted laws defining a fiscal crisis and response, several criteria must be met before state intervention can be initiated. Triggers include the following:

- Debts are not being repaid -- bonded debt, rentals, money owed other governmental units.
- Past and present employees are not being paid -- employee payroll, taxes on employee income, pension obligations.
- There is a deficit -- in the general fund, in all accounts.
- There are recurring financial problems -- deficits in consecutive years, short-term borrowing in consecutive years, borrowing against future revenues (CRCM, 2000).

These indicators are commonly considered harbingers of severe fiscal crisis necessitating rapid intervention to prevent a financial collapse.

The Causes of Fiscal Crisis

Although unforeseen events can sometimes create a fiscal crisis, the signs of fiscal distress are often revealed in several recurring indicators. These include structural, economic, demographic and institutional factors.³ The indicators might manifest in an erosion of the economic base, a decrease in population size, or an interruption in the tax base. A loss of financial independence (through a greater reliance on intergovernmental revenues), a decline in productivity, or a large amount of immediate local government costs can also be indicative of the development of financial imbalances (Roseburg, 1978).

The First National Bank of Boston noted that, while socio-economic indicators can reveal unstable fiscal conditions, they are not the main causes of fiscal distress. With proper management controls, many local governments could continue to avoid fiscal distress. For

¹ States must be able to assure the performance of contractual obligations by local units and the continuation of necessary public services, such as providing for the health and safety of residents, property assessment and taxation, and conducting and certifying elections.

² Alaska, Pennsylvania, Rhode Island, Florida, Michigan, New Mexico, New Jersey, Ohio, Tennessee, and West Virginia.

³ There are also non-structural factors that consistently come into play such as mismanagement by leaders as well as management restrictions such as labor contracts (CRCM, 2000).

instance, a 2004 study conducted by the Center for European Integration Studies identified consistently high debt levels in cities in fiscal crisis. A city with high debt uses a disproportionate amount of available resources to pay interest on the existing debt. This limits alternatives and solutions to financial challenges. Cities characterized as in financial crisis had an average debt burden 10 times higher than the average debt burden in the rest of the cities in the sample (Wolff, 2004).

Although the high debt burdens in cities in the study could be partially explained by structural factors, large non-structural components, such as management and political factors, also were elemental in the crises. Specific factors – including unionization and the negotiation power of public employees (in the case of New York and Philadelphia) and excessively high cost social programs– can lead to excessive spending, debt, and ultimately crisis. Ultimately, extreme fiscal outcomes result from nonstructural factors such as mismanagement, union power in public administrations, and the willingness to make difficult choices in local government operations and service delivery, along with efforts to avoid the potential political outcomes of such decisions (Wolff, 2004).

Local Government Fiscal Health is Important to States

States have a vested interest in the management of local funding, as many local services are financed by states (CRCM, 2000). A state may monitor local governments' financial conditions to assure minimal levels of services, protect contractual obligations, prevent collateral damage to the credit ratings of the state and its other subdivisions, protect the finances of overlapping local units, assure efficient use of state revenue, and assure success of local home rule (CRCM, 2000). Furthermore, monitoring a local government's financial condition, combined with early intervention, may avoid more costly involvement if an emergency is averted (Honadle, 2003). Finally, the public perception regarding the financial status of a local government cannot be overstated. As a Michigan Department of Treasury staffer recently explained, if a local government declares bankruptcy, "From the perception of the news media, the implication would probably be that something might be amiss with the state as a whole" (Carvlin 2002; Kohla et al, 2005).

Studies have recognized four potential roles state governments may take on either before or during a fiscal crisis. A state may seek to do one of the following:

1. **Predict**, so that it can be prepared to deal with the crisis or warn the affected local government;
2. **Avert** and take action to help the local government avoid the catastrophe;
3. **Mitigate** by stepping in and assisting the local government in regaining sound financial footing, or at least containing the problem; or
4. **Prevent a recurrence** after the local government has passed the crisis stage. (Hondale, 2003)

Since the mid-1880s, local government creditors have been among the most consistent voices for state involvement in local affairs during times of financial crisis. Creditors have sought state intervention because courts have consistently refused to grant creditors the same remedies against cities (and counties) experiencing financial difficulties and/or bankruptcy as

against bankrupt private entities, thus leaving creditors' interests inadequately protected (Harvard Law Review, 1996).

Ohio's Fiscal Watch and Emergency

Ohio has instituted a system that reacts to local governments facing or currently in precarious fiscal positions by using **Fiscal Watch** and **Fiscal Emergency** designations. If a local government is placed in fiscal watch, the State Auditor's Office provides technical assistance, and the government develops and implements a recovery strategy. If the designation is elevated to fiscal emergency, meaning the deficit is severe or the government has been unable to reach an acceptable recovery plan, a Financial Planning and Supervision Commission is convened to assist the local government in making financial decisions, which will lead to fiscal recovery. The cost for technical and support services is borne by the State.

A local government may request the Auditor of State to examine its financial position. Likewise, the Auditor of State may examine a government's financial statements if she believes it is at risk of entering Fiscal Watch or Emergency. Although several factors can trigger a fiscal oversight designation, key indicators for fiscal watch are an inability to pay current operating expenses within 30 days, or combined deficits (less any funds available to help offset those deficits) that exceed one-twelfth of the year's budget. A Fiscal Emergency designation may be appropriate when a local government has defaulted on a debt obligation, does not have enough funds to make payroll, or if debts or deficits equal more than one-sixth of that year's revenue. However, a designation is usually imminent by the time the Auditor of State's office has had an opportunity to review an entity's financial statements.

If an entity is designated in fiscal emergency, a Financial Planning and Supervision Commission is formed⁴ and the Auditor of State serves as a financial supervisor. Within 120 days of its first meeting, the local government must prepare a detailed plan on how it will achieve a balanced budget (financial recovery plan). The plan is then approved by the Commission. The Commission has full authority to approve decisions regarding all financial matters of the local government body and monitors its progress in achieving its financial recovery and meeting procedural and reporting requirements of the Auditor of State's Office. The Commission is also obligated to report the status of any local government entity in Fiscal Emergency to the State Legislature each year. The Financial Planning and Supervision Commission is dissolved when:

- An effective financial accounting and reporting system is being implemented, with expected completion within two years;
- All fiscal emergency conditions have been or are in the process of being eliminated, and no new emergency conditions have occurred;
- The financial recovery plan objectives are being met, and the entity has a five-year financial forecast that the Auditor of State determines is "non-adverse" (CRCM, 2000).

⁴ The size and composition of the Commission varies by the type of governmental entity.

Ultimately, Ohio's fiscal watch and emergency designations are enacted to **mitigate** a fiscal crisis and **prevent a reoccurrence**. They use what could be described as a **reactive or "take over"** approach.

Other States' Approaches to Addressing Fiscal Crisis

Most of the fiscal distress legislation adopted since the 1970s is based upon three key assumptions.

First, fiscal emergency is temporary. Most legislation assumes that, after a period of time, the problems which caused the distress will be corrected and the state may withdraw its assistance.

Second, fiscal emergency has occurred because of inappropriate managerial actions and/or political decisions. States seek to address this through enacting new laws directed at correcting inefficient or ineffective managerial practices, and they may also implement training for local government officials, installation of computer-based financial management programs, and improvements in tax collection systems. Less visible remedies, such as economic development efforts and infrastructure improvements, seek to ameliorate drastic changes in tax bases caused by long-term economic forces.

Third, the effects of the fiscal emergency can be alleviated by providing short-term loans or grants (as increased revenue flows) to improve cash flows. Such actions, however, are a tacit admission that current revenue flows are insufficient to maintain services at acceptable levels (Cahill and James, 1992).

The States' Role in U.S. Local Government Fiscal Crises: A Theoretical Model and Results of a National Survey (Honadle, 2003) identified a number of approaches that states may use to address local fiscal crises, whether formal legislation has been enacted or not.

Several states have no specific legislation or defined approach to addressing local government fiscal crises.

- New York uses an **"Ad Hoc Approach"** since it does not have statutes addressing the situation.
- Illinois and New Hampshire have used **"Special Legislation"** to deal with particular local governments in crisis on a case-by-case or as-needed basis.

In other instances, early intervention or preventive legislation may be used.

- New Mexico takes a **"Proactive Approach."** It examines the long-term financial picture of its local governments, provides technical assistance when appropriate, and may make emergency loans.

- Arizona and California have used the “**Reform Approach**” and made reforms after a crisis has occurred. These are not directed at a particular unit of government and seek to address and prevent future problems of the same kind.
- Michigan begins its fiscal oversight in an “**Advisory Role**” because local home rule laws prohibit the takeover of a local government entity. The law therefore allows the state to work collaboratively to address the political body’s fiscal troubles.

Finally, several states have implemented strong approaches to addressing financial crises in local governments.

- Pennsylvania uses a “**Responsive Approach**” in which the state is brought in to help with a crisis at the request of the governing body itself. The state provides technical and financial assistance and develops a recovery plan for the community. Similarly, in Florida, state intervention is negotiated through an intergovernmental agreement.
- The “**Takeover Approach**” is used in Illinois, Connecticut, Mississippi, New Jersey, and Rhode Island. In these states, financial control boards oversee the financial operations of a locality.
- In several states that initially use less invasive approaches, fiscal oversight may culminate in a takeover if corrective actions are not implemented or are not effective. For example, if New Jersey’s advisory role fails, the state assumes **Full Financial Control**. Local finance boards are appointed by the governor, with advice and consent from the legislature. All spending and revenue raising responsibilities fall under control of the local finance boards.

North Carolina has the most extensive powers to monitor and intervene in the financial affairs of a local unit of government. Its Local Government Commission is empowered to perform adequate and frequent financial reviews, has a broad set of control powers that allow it to intercede in the financial affairs of local government, and has been allowed to do what is needed to maintain the financial health of its local units of government.

- Connecticut, Maine, Massachusetts, and Nevada have adopted fiscal distress legislation that places a local government under **State Receivership**. The powers of the receivers in Connecticut and Massachusetts are granted under special legislation. Similarly, in Nevada, the law does not provide for a board of control or any other similar distress agent. If the State Tax Commission determines that a municipality is in severe fiscal distress, it can order the State Tax Department to “take over the management of the local government.”

Model Programs in Use in Other States

In recent years, a number of states have begun to take a more active role in monitoring the fiscal status of local governments. These efforts followed well-publicized fiscal difficulties in Miami, Pittsburgh, and Philadelphia during the 1990s. Instead of waiting to react until a local

government has experienced full-blown financial problems, these states use **proactive** systems to intervene when local governments exhibit an upsurge in indicators indicative of future financial problems (Kohla et al, 2005).

Proactive systems involve the development and monitoring of early warning programs designed to predict financial distress and to trigger action by states, generally in the form of technical assistance to jurisdictions facing potential fiscal trouble. Early warning systems are built on a series of fiscal indicators, which are assumed to predict pending distress sufficiently early to permit ameliorative action. The most widely used indicators are based upon measuring impacts of resource flows and various forms of solvency.

North Carolina: Local Government Commission

North Carolina laws for fiscal oversight and responding to fiscal distress generally empower its Local Government Commission, rather than dictating when actions must occur. North Carolina law requires local governments to submit semiannual self-reported financial statements and audited annual financial statements. While the financial control powers of the Local Government Commission are substantial, the Commission's ongoing financial surveillance prevents fiscal stress from becoming a crisis for local governments. The ongoing monitoring includes a state-level review of all planned debt issues to ensure that local governments can appropriately manage their debt. On-site assistance is also offered to help local governments implement accounting systems and proper internal controls, manage cash and investments, develop budget preparation processes, implement risk management and capital planning, and make changes in law and regulations (CRCM, 2000). As a result of the proactive monitoring performed by the LGC – strong fiscal and debt management and superior disclosure – local units of government receive above-average debt ratings for local general obligation and revenue bond issues. North Carolina taxpayers ultimately benefit from this oversight with savings that result from lower interest rates.

Michigan: Indicators of Fiscal Distress

Michigan implemented a suite of fiscal indicators to predict and address fiscal crises during the 1980s. Using readily available annual reports, its Department of Treasury used the information to try to proactively address local financial crises. However, the complexity of the system and concerns about its internal validity led the Michigan Department of Treasury to enlist Michigan State University's Institute for Public Policy and Social Research to evaluate local government fiscal indicators during the early 1990s. As a result of its work, the Institute proposed a more limited but effective set of fiscal indicators which are in use in Michigan's current Fiscal Indicators program, though the updated indicators also undergo continual reevaluation. The indicators include nine specific gauges to determine a local government's fiscal condition:

1. Population growth
2. Real taxable valuation growth (includes only real property)
3. Large real taxable value decrease
4. General fund expenditures as a percent of taxable valuation

5. General fund operating deficits
6. Prior general fund operating deficits
7. Size of general fund balance
8. Fund deficits in current or previous years
9. General long-term debt as a percentage of taxable value

Michigan's indicator system uses a small number of variables and a simple additive diagnostic index that categorizes cases according to their degree of fiscal health or distress.⁵ While the design of the Michigan index has been subject to some retrospective validation (Kloha et al., 2005), its predictive validity and its ability to accurately discern among levels of fiscal health and temporal urgency appear to have been confirmed (Scorsone, 2008).

However, even though there are early warning systems in place in North Carolina and Michigan, such systems are not necessarily panaceas. First, they may not always function as planned due to poor reporting or political concerns. In addition, there is some concern about the appropriateness and predictive value of the indicators. Finally, states do not publish information on local government indicators and financial positions on a systematic or comprehensive basis (Cahill and James, 1992).

What Makes a Good Indicator of Fiscal Distress?

Several conditions should be considered when examining potential indicators of fiscal distress. Indicators should have theoretical validity, meaning does the data they measure correspond to the theories behind the indicators selected. Furthermore, the indicators should predict fiscal distress before it occurs rather than merely reporting that fiscal distress has already occurred, making it too late to recommend preventive action. When a state is the entity using indicators, they should also capture concepts relevant to the state's interest. As important, the indicators should provide a sense of proportion and be able to discern progression in levels of financial difficulty.

In addition, it is helpful if the data used to construct the indicators are already publicly available, saving the time and monetary costs associated with identifying and collecting a new data set. The data for constructing the indicators should also be uniformly collected, to ensure an "apples to apples" comparison, and somewhat frequent in its collection so that changes in indicators can detect the onset of distress signals. Also, the indicators should be simple and straightforward, to be easily implemented and readily understood by local government officials and constituents. The indicators must also be resistant to manipulation, so that officials refrain from changing their behavior to score well on the indicators while creating problems in other areas not subject to the measure.

Effective fiscal indicators also should embody a measure of hope for those in distress, and forgiveness for those units of government that are doing well generally. Ultimately, the indicators should distinguish among units so that the system of indicators exactly identifies the set of units which ought to be monitored and does not identify units which should not be.

⁵ For detailed literature reviews, a survey of other states' oversight indicators, and a full exposition of the rationale for the design of Michigan's system, see Hendrick, 2004; Kleine et al, 2003; and Kloha et al., 2005.

Each of the systems of fiscal indicators in use in states today, though generally achieving the abovementioned criteria, have liabilities, which vary in degree of seriousness and impact on the utility of the indicators. Some do not provide simple rules that are empirically driven or that link specific scores to the probability and timing of fiscal emergencies or to specific responses by state fiscal monitors. Others omit critical economic or accounting indices, calling into question the ability of these systems to predict economic crises adequately.

The scales used may also be subject to some problems. Some states use a curve or fixed standard, which can allow states to overlook a municipality that is in trouble, but is doing relatively better than others. States using curves or standards must establish the benchmark and may need to change it over time to reflect changing conditions. Michigan assesses municipalities' financial health relative to one another, which has the advantage of providing a continual recalibration of its benchmark. However, the Michigan system may mask the underlying fiscal stress of certain municipalities if all municipalities are moving in a certain direction en masse. In any case, more dynamic thresholds are seen as being useful in ranking municipalities.

Finally, theoreticians have raised the question of whether or not different standards are needed for different types of governments. Population, jurisdiction, or budget size might require a different mix and level of indicators, or at a minimum, different thresholds. Using a fixed set of indicators ignores the political and financial realities of variations in the size and wealth of local governments. Moreover, a mix of indicators based on policy and tax base, such as those used in Michigan, ignores that some factors measured are outside the control of local policymakers, which affects the state's ability to determine the appropriate response (Scorsone, 2008).

Tools for Local Governments to Maintain Fiscal Health

Fiscal health is defined as the ability of government to meet its financial and service obligations both now and in the future (Hendrick, 2004). The International City/County Management Association (ICMA) decomposes this into four components:

- **Cash Solvency:** A government's ability to pay immediate obligations,
- **Budget Solvency:** Its ability to pay financial obligations within the current fiscal period,
- **Long-run Solvency:** Its ability to continue paying obligations in future fiscal periods, and
- **Service-level Solvency:** The government's ability to continue providing the level of services expected by its constituents. (Groves et al., 1981; Nollenberger et al., 2003)

The Governmental Accounting Standards Board (GASB) uses a similar conceptual definition, decomposing what it terms "economic condition" into current-period, longer-term, and service-delivery components (GASB, n.d.).

Maintaining fiscal health is an ongoing process including regular assessment and efforts to address early warnings of financial trouble. Indicators serve as diagnostic tools local governments can use to monitor their financial conditions and detect the warning signs of

impending fiscal crises. Oftentimes, though, local governments do not see or heed warning signs before it is too late to avoid financial emergencies.

The inability to deal proactively with financial problems results from several issues, including inadequate capacity to administer and manage finances and the lack of automated data processing capability, which hinders record-keeping, comparative fiscal analysis, and financial monitoring. In addition to these capacity issues, political reasons may impede local governments from anticipating and dealing with impending fiscal crises (Hondale, 2003). Other factors – few standards to measure financial position; unavailability of information in a readily useable format; comparison difficulties because of differences in population and services; external issues (political, economic, and social forces) – also limit local governments’ ability to use indicators of financial distress. Finally, the problems leading to fiscal difficulties seldom emerge overnight; rather, they develop slowly, thus making potential difficulties less obvious (Roseburg, 1978).

In the absence of statewide indicators that are predictive of financial health (or distress), and to avert conditions that could lead to fiscal oversight, local governments are encouraged to implement internal indicators of financial health. In the last 40 years, local governments have had access to several systems of indicators of varying degrees of complexity. The first comprehensive set of indicators was suggested by the Municipal Finance Officers Association in the late 1970s. These have been improved upon and expanded through the ICMA’s Financial Trends Monitoring System.⁶

The ICMA’s system constitutes the gold standard in terms of information quality and utility for predicting solvency and sustainability. Its 42 indicators measure many aspects of a local government's environment, fiscal structure, and adaptation. Financial indicator categories include (1) revenues; (2) expenditures; (3) operating position; (4) debt structure; (5) unfunded liabilities; and (6) the condition of a jurisdiction's capital assets. Environmental indicator categories include (7) community needs and resources; (8) intergovernmental constraints; and (9) disaster risk. The system also directs managers' attention to two categories of environmental factors for which it does not recommend specific indicators: (10) political culture and (11) external economic conditions. Finally, it emphasizes the central importance of legislative policies and management practices (i.e., organizational judgment, choice, and behavior) in determining precisely how a given set of environmental factors affects financial performance over time (Groves et al, 2003).

Notwithstanding its significant benefits, the Financial Trends Monitoring System does have its limitations. It is clearly designed for use within a local government, and would not be a suitable choice for state-level monitors to evaluate the financial health of hundreds of local governments because of its complexity. It requires access to and analysis of an enormous amount of information, much of which is not contained in annual financial reports or other publicly available sources. In addition, it requires significant time and attention on the part of analysts and decision-makers. Further, it does not yield a simple decision rule or a single summary indicator,

⁶ For an example of this system in use, see www.salina-ks.gov/content/8474/default.aspx, http://www.co.collin.tx.us/county_auditor/cafr/FY03_FY07_Trend_Report.pdf, or <http://www.sarasotagov.com/InsideCityGovernment/Content/Budget/FinancePDFFiles/2003FinancialIndicators.pdf>

instead requiring significant interpretation and judgment to assess the implications of dozens of environmental and financial trends.

Instead, the FTMS represents an analytical approach, which stops short of providing concrete answers as to whether a particular trend indicates a problem. It emphasizes the analyst's professional experience, knowledge about the local government, and judgment. With the exception of credit industry benchmarks for six of the indicators, it offers no standards by which a city could measure the existence or magnitude of a problem (Groves et al., 2003). Still, such a system can be an invaluable resource for local governments.

Another resource is GASB's economic condition assessment, which recommends using publicly-available information from government-wide and fund-level financial statements prepared under the Statement 34 reporting model. These financial statements can be used to generate indicators of a government's "financial position" (assets and liabilities), ongoing "fiscal capacity" to meet financial obligations over time, and "service capacity" to continue operations (GASB, n.d.). This significantly reduces the data-collection effort and cost compared with the ICMA system, but still requires considerable attention and judgment for computation and interpretation (Scorsone, 2008).

The Michigan model of fiscal indicators draws data from a number of required or readily available state and federal reports. The data set includes comprehensive annual financial reports, annual audits, municipal league reports, treasury department records, U.S. Census Bureau data, and U.S. Department of Labor data.

A review of ICMA, GASB, and state-level indicators shows consistent indicators are used in several models. These appear to fulfill several of the criteria of validity and consistency, though they may be more numerous than recommended. The table below summarizes several of the major indicators and the information they reveal.

Category	Indicator	Meaning
General Economic Trends	- Population Growth - Per Capita Income	Decline can indicate future business decline, and reduction in the amount paid into taxes.
Revenues	- Revenues per capita - Locally generated, intergovernmental, and restricted revenues as a percent of total - Value of tax base, tax rate, rate of uncollected taxes, earnings on investments	If per capita revenues are decreasing, government may be unable to sustain existing service levels. An increase in intergovernmental or restricted revenues as a percent of total budget indicates a loss of control and elasticity in the budget.
Expenditures	- Expenditures per capita - Expenditures by function - Operating expenses as a total of all expenses	Increasing per capita expenses can indicate cost of government is outstripping residents' ability to pay, or can indicate declining productivity. This indicator can illustrate and help analyze increases in government spending over time. Also, the higher the level of fixed costs, the less freedom officials have to adjust spending in response to changing economic conditions.
Fund Balances and Deficits	- Revenues to expenditures (general and all funds) - General Fund operating deficit or deficit as a percent of revenues. - Declining fund balance - Steady pattern of budget overruns - Increasing incidents of revenue shortfalls	This illustrates fund balance. These indicators represent red flags.
Debt	- Debt per capita - Debt service to revenues - Borrowing to cover cash flow needs	These illustrate a growing debt burden. These indicators represent red flags.
Pensions	- Struggling to make pension payments or deferring pension obligations	This is a red flag and is indicative of ignoring future liabilities.
Management	- Number of employees per capita - Rates charged for services	Increases indicate diminishing efficiency.
Other	- No long range plan - Consistent failure to obtain unqualified opinion on financial statements from independent auditor - Consistent failure to address audit findings - Deferred capital outlay and maintenance	

Though these measures represent important indicators for internal consideration, local governments should also consider externally reporting financial performance. Annual reports, made publicly available through a government's web site, improve communication with constituents and ensure that residents are aware of issues facing the local government. In addition, publicly reporting indicators and efforts to improve performance can illustrate a government's initiatives to address declining financial positions. Finally, annual review and

discussion of indicators and trends, either at an administration level or through a public forum, can spur action to address increasing debt, declining performance, or financial imbalances.

Considerations in Implementing a Proactive Approach

Overall, states seem to be much more involved in mitigating crises than in trying to avert them. In a national survey, states responded that they look for signs of impending crises in audit reports, in addition to using various formal or informal monitoring systems (Hondale, 2003). One explanation for limited state intervention earlier in the process is that home rule impacts the degree to which many states can exercise authority over local governments. However, states have developed more policies governing what to do once a crisis becomes reality, particularly as fiscal crises can affect the state's financial position.

Using a proactive approach to monitoring and early intervention in Ohio, as has been implemented in a few other states, could harness the state's financial expertise to track local government financial position and use technical assistance to avert more serious financial problems before they arise. Such a role would not imply state takeover or financial control, where financial responsibility rests primarily with the state and the local government is merely an agent. The aim would be to provide the guidance to keep local governments financially healthy and to identify potential problems before they become serious. By identifying indicators of potential future fiscal distress, the state could assist local government officials in making positive changes to avoid imposing more aggressive financial intervention at a later date (CRCM, 2000).

A "triage" strategy would reduce the number of units requiring active state oversight as a beginning point. Generally, local governments are clustered in three groups:

1. Minimal Attention—units are assumed to be financially healthy based on past experience, barring any misdeeds or catastrophic acts.
2. Consistent and Close Attention—units consistently experience fiscal distress.
3. Moderate Attention—units receive a fair amount of attention, but are assumed to be healthy and will remain healthy.

Ohio already possesses some means to identify local units experiencing fiscal distress, such as annual audit reports and local government technical services offered by State-level offices and departments. The problem for the state is how to make these tools work to achieve a more proactive level of oversight, in order to identify governments needing attention before it is necessary to take emergency action, which can negatively affect services and constituent confidence. Fiscal benchmarking could strengthen the state oversight role, but officials should understand the benefits and limitations of benchmarking when implementing such a system, as outlined above. Ultimately, though, benchmarking, comparative analysis and public reporting benefits local governments, the state, and constituents as it leads to stronger financial management and opportunities to improve performance, thereby reducing service costs (CRCM, 2000).

Direct steps Ohio could consider in implementing a more proactive approach to mentoring the fiscal health of its local governments include the following:

1. Adopt a set of proven financial indicators that can be derived from existing data.
2. Require annual or semi-annual reporting of financial indicators.
3. Assign monitoring responsibility as a component of audit oversight.
4. Develop an educational program for local government officials and employees through Ohio's higher education system.
5. Provide observation of local government finances through monitoring of economic and management policies, fiscal management practices, and debt management practices.
6. Adopt a "triage" strategy for addressing the most critical economic circumstances first.
7. Use existing fiscal oversight resources to avert fiscal crises and maintain Ohio local government financial health.

Through the adoption of proactive fiscal monitoring practices, Ohio could reduce the incident rate of local government fiscal crises, particularly during periods of economic constraint and revenue downturns. As additional local governments in Ohio suffer from reduced revenue and enter into periods of financial distress and service-level reductions, benchmarking and fiscal indicators would provide a bulwark against financial meltdowns and the resulting impacts on surrounding municipalities and the State. Finally, adoption of a fiscal monitoring strategy could, over time, help improve overall governmental efficiency, freeing up revenues for enhanced service delivery or tax reduction.

Betsy Bashore and Penny Seipel contributed to this report.

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