

## Identifying and Monitoring Locality Fiscal Distress



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## Background – Legislature Inquiry & Review

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- Starting in September 2016, APA worked with the General Assembly to review current locality requirements and determine how best to expand locality oversight to address fiscal stress indicators and implement a monitoring process
- Legislative money committees, Secretary of Finance, and APA reviewed available research and other state practices and methodologies for monitoring fiscal distress

## New Requirements – Chapter 836, §4-8.03

### Fiscal Distress Defined

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- “Fiscal Distress” defined in the context of Chapter 836, § 4-8.03:
  - *provision and sustainability of public services is threatened **by various administrative and financial shortcomings** including but not limited to cash flow issues; inability to pay expenses; revenue shortfalls; deficit spending; structurally imbalanced budgets; billing and revenue collection inadequacies and discrepancies; debt overload; failure to meet obligations to authorities, school divisions, or political subdivisions of the Commonwealth; and/or lack of trained and qualified staff to process administrative and financial transactions.*

## APA New Requirements – Chapter 836, § 4-8.03

### Identifying Potential Fiscal Distress

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- APA to establish workgroup to develop criteria for a **preliminary determination** to identify potential fiscal distress
- Workgroup members:
  - Secretary of Finance
  - Staff Directors for HAC and SFC
  - Governor's Deputy Chief of Staff
  - Commission on Local Government
  - Virginia Association of Counties
  - Virginia Municipal League

## APA New Requirements – Chapter 836, § 4-8.03

### Identifying Potential Fiscal Distress

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- APA to establish a prioritized early warning system
- APA to notify localities where we make a preliminary determination of fiscal distress
- **Based on request of local governing body or CEO,** APA may conduct a review and request additional information to determine extent of fiscal stress
  - Based on results of review, APA shall notify the Governor and chairs of the money committees if APA is of the opinion that state assistance, oversight or targeted intervention is needed

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*Such criteria shall be based upon information regularly collected by the Commonwealth or otherwise regularly made public by the local government. This information includes expenditure reports submitted to the Auditor, budget information posted on local government websites, and reports prepared by the Commission on Local Government on revenue fiscal stress. Information provided by the Virginia Retirement System, the Virginia Resources Authority, the Virginia Public Building Authority, and other state and regional authorities concerning late or missed debt service payments shall be shared with the Auditor. Fiscal distress as used in this context shall mean a situation whereby the provision and sustainability of public services is threatened by various administrative and financial shortcomings including but not limited to cash flow issues; inability to pay expenses; revenue shortfalls; deficit spending; structurally imbalanced budgets; billing and revenue collection inadequacies and discrepancies; debt overload; failure to meet obligations to authorities, school divisions, or political subdivisions of the Commonwealth; and/or lack of trained and qualified staff to process administrative and financial transactions. Fiscal distress may be caused by factors internal to the unit of government or external to the unit of government and in various degrees such conditions may or may not be controllable by management, or the local governing body, or its constitutional officers.*

*Under the prioritized early warning system, the Auditor of Public Accounts shall establish a regular process whereby it reviews data on at least an annual basis to make a preliminary determination that a local government is in fiscal distress.*

### **New Requirements – Chapter 836, §4-8.03**

#### **State Assistance, Oversight or Intervention**

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- After receipt of notification by APA indicating fiscal distress in a particular locality, Governor and Chairmen of HAC and SFC will create a plan for either assistance, oversight, or state intervention prior to any expenditure of funds from the cash reserve.
- Plan to specify the purpose of intervention
  - Further assess, help stabilize, or remediate the situation
  - Estimated duration, and anticipated resource needs (dollars and personnel)

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*The staffing necessary to carry out the intervention plan may be assembled from either public agencies or private entities or both and, notwithstanding any other provisions of law, the Governor may use an expedited method of procurement to secure such staffing when, in his judgment, the need for intervention is of an emergency nature such that action must be taken in a timely manner to avoid or address unacceptable financial risks to the Commonwealth.*

### **New Requirements – Chapter 836, §4-8.03**

#### **Identifying Funding and Central Contract**

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- Director of DPB to identify unexpended general fund appropriations which constitute state aid to localities
  - Provide listing to the Governor and the Chairmen of HAC and SFC
- Governor may reappropriate up to \$500,000 to be used for providing technical assistance and intervention actions
- Prior to expenditure, Governor and Chairmen of HAC and SFC must receive notification from APA of fiscal distress
- DGS to develop central contract of qualified private sector turnaround specialists

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DGS, Department of general services, encouraged to develop a contract for the Governor to use to procure intervention services in an expeditious manner when he determines that state intervention is warranted in situations of local fiscal distress.

### **New Requirements – Chapter 836, §4-8.03**

#### **Locality Subject to Intervention**

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- Governing body and elected constitutional officers shall assist all state appointed staff conducting the intervention
- Intervention staff will provide periodic reports to Governor and Chairmen of HAC and SFC outlining the scope of issues discovered and any recommendations or remediation efforts

*These periodic reports shall specifically address the degree of cooperation the intervention team is receiving from locally elected officials, including constitutional officers, city, county, or town managers and other local personnel in regards to their intervention work.*



## **New Requirement - Secretary of Finance \$500,000**

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### **Item 257**

*C. Out of this appropriation, \$500,000 the first year from the general fund is to be used at the discretion of the Secretary of Finance to conduct intervention and remediation efforts in situations of local fiscal distress that have been previously documented by the Office of the Secretary of Finance prior to January 1, 2017. The Secretary shall report periodically on his efforts to the Chairmen of the House Appropriations and Senate Finance Committees.*

## **APA New Procedures beginning FY2017**

### **Financial Ratio Model**

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- APA using a model to calculate 10 ratios using audited data from the localities' FY14-FY16 CAFRs
- The model ranks each locality's performance by ratio and converts into percentile rankings
- The model uses an average of the percentile rankings to determine an overall Financial Assessment Model (FAM) percentage or "score"
  - FAM score calculates based on comparison of all localities' ratio results to each other for each FY
- APA uses the FAM score to evaluate and make a preliminary determination for need to follow-up

### **Ratios Used – from Governmental Activities and Business Type Activities Funds in Gov't Wide Statements**

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- Compare unrestricted reserves net of current liabilities to normal revenues - ability to make up revenue shortfalls
- Compare unrestricted reserves to current liabilities - ability to pay current liabilities without need for additional revenue
- Compare unrestricted reserves to total liabilities -ability to pay total liabilities without need for additional revenue
- Compare revenues plus unrestricted reserves to expenses plus liabilities – ability to meet future obligations
- Compare unrestricted net position to total expenses – ability to fund expenses in event of revenue shortfall
- Compare total assets to total liabilities – measures the degree to which the assets are being financed with debt

## **Ratios used – from General Fund Balance Sheet and Income Statement**

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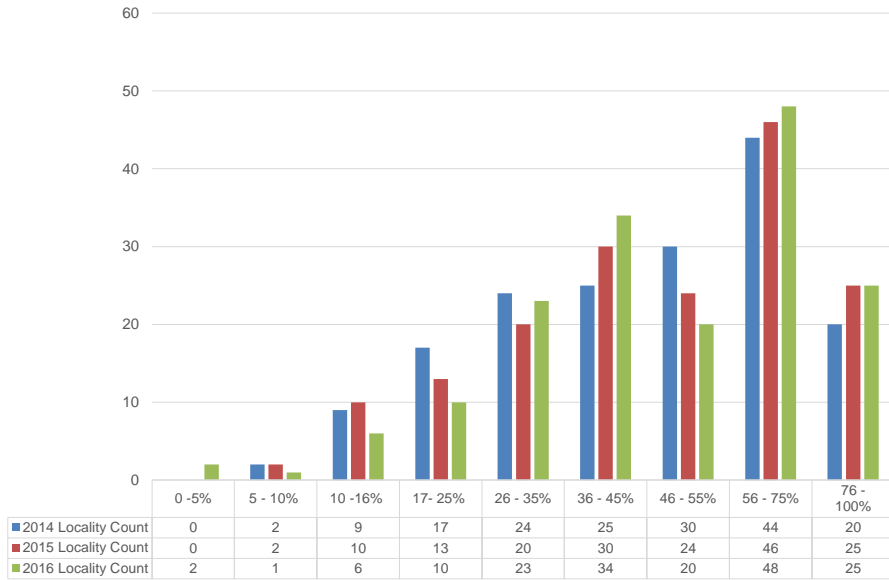
- Compare liquid assets to total liabilities – ability to pay liabilities without needing additional revenues
- Compare total expenditures to total liabilities – measure how well locality is paying its general fund bills
- Compare assigned & unassigned fund balances to total expenditures – measures ability to fund expenditures from reserves in event of a revenue shortfall
- Compare total fund balance to total revenues – measures sufficiency of reserves relative to revenue

## Financial Ratio Model Evaluation Scale

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- APA used the FY16 FAM score result to determine need for additional follow-up with a locality
- APA set a threshold/cutoff point to perform follow up procedures - for 2016, set at less than or equal to 16%
- APA also selected localities based on trends or other qualitative factors
- Identified 6 localities based on current FAM score and 2 localities due to delinquent CAFR filings for further follow-up

## FAM Trends Across Virginia Localities



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## Notification to Locality

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- For localities that have a FAM score that causes concern, notification letter sent to
  - Governing body and Management
- Explained the FAM calculation process and the cause for concern
- Explained APA's follow up process using the questionnaire
- Explain potential assistance available
- Sent notification letters to all other localities to update on the new process and notify they did not fall below our threshold

## APA Follow-up Questionnaire to Locality

- Follow-up to identify other qualitative, policy and management type factors potentially impacting the Locality's ratio results in the model
  - Budget process
  - Debt and Borrowing
  - Expenses and Payables
  - Revenue and Receivables
  - Other Areas
    - Vacancies in key positions?
    - New systems or technology issues?
    - Results of annual audit

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Structurally balanced budget? Use of transfers between funds to balance budget? Frequent amendments to budget? Budget monitoring process; Periodic discussions by the governing body; Any external factors that have impacted your budget for the current fiscal year?

Delinquent with any debt service payments to Authorities? Compliance with debt covenants? Recent change in bond ratings? Significant interfund borrowings between General fund and other funds? If so, plans for repayment Any Tax or Revenue Anticipation Notes? If so, sufficiency of revenues to repay Other short-term financing during the year? If so, used for operating expenses? Any unusual factors during the year, including external factors, that impacted debt/borrowings?

Any payments in arrears to vendors or Authorities? Age of payables – prompt pay being met? Discussion of age of payables with governing body? Delinquent in paying wages or payroll taxes? Delinquent in paying VRS, worker's compensation or health care premiums?

Major one-time revenue items Any difficulties in collecting receivables? Age of accounts receivable, monitoring process Discussion of delinquencies with governing body? Significant increase in delinquencies? Any significant revenue shortfalls? Plans by governing body to address



## APA Current Follow-up Process

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- Review completed questionnaire responses for “follow-up” localities that choose to respond
- Schedule meeting with locality officials to discuss responses
- Make a determination of whether there is a need to report to the Governor and Chairs of the money committees that the locality needs assistance
- Report to General Assembly summarizing follow-up at all localities and APA’s considerations and plans to refine the model for next year

## **APA Future Actions**

### **Refine Criteria and Early Warning System**

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- Refine criteria for next year as APA considers feedback from localities and workgroup members
- Consider adjustments for other unique factors impacting ratio calculations
- Incorporate Commission on Local Government fiscal stress rankings on locality revenue capacity/effort
- Incorporate more qualitative and environmental criteria along side the financial ratio calculations
- Evaluate scoring process and how model demarcates localities for initial determination of potential distress for further follow-up

## APA Local Government Contact Information

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## Questions and Comments

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