# INTERNATIONAL ASSOCIATION OF FIRE FIGHTERS



November 12, 2024

Mr. John Smith, President
IAFF Local A
Address

Dear President Smith,

In response to your request for a municipal financial analysis, we have reviewed the FY21 - FY23 financial documents for the City of A.

Businesses and governments have different objectives and operate in distinct environments. A business enterprise aims to maximize profit, and the profit reported on its income statement usually provides a reasonable measure of its success. A local government aims to provide services to its constituents within budgetary constraints, and while it tries to provide those services in a cost-effective way, it is not profit motivated.

Because of these differences, governments use an accounting technique that is unique to governments known as “fund accounting.” A fund represents an entity with a separate set of accounting records segregated to carry out a specific activity. Each fund has assets, liabilities, and a **fund balance** or **fund equity** that equals assets minus liabilities. Each fund begins the fiscal year with a beginning fund balance from the previous year, takes in revenue during the current year, pays expenses for the current year, and ends the year with a new fund balance that carries over into the next fiscal year.

The fund balance is significant because it represents the fund’s reserves and is an important measure of a government’s fiscal strength. While the condition of every fund is relevant when analyzing a government’s financial health, this analysis focuses primarily on the **general fund** because it finances general government operations, including the day-to-day operations of the fire department, such as salaries. Most cities account for the fire department within the general fund.

Most of the information needed to evaluate a local government’s financial condition can be found in its **comprehensive annual financial report** or **audited financial statement**. This document contains two important financial statements, each of which calculates the fund balance in a different way, but both of which give the same dollar figure. They are:

1) The **balance sheet** shows the assets and liabilities of each fund on the last day of the fiscal year. The balance sheet calculates the fund balance as assets minus liabilities, inclusive of deferred inflows of resources, where applicable.

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2) The **statement of revenues, expenditures, and changes in fund balance** (often called the **revenue and expense statement**) shows how much money came in and how much money the government spent during the fiscal year. The revenue and expense statement calculates the fund balance as the old fund balance plus yearly revenue minus yearly expenses.

The balance sheet is a snapshot of what the city owns and owes at a point in time, specifically the last day of the fiscal year. The revenue and expense statement provides a picture of the entire fiscal year and is similar to a profit and loss statement in a corporate report. The fund balance is analogous to owners' or stockholders' equity. The balance sheet and the revenue and expense statement both give the fund balance for each fund, and they usually list each fund individually and often total all funds or certain groups of funds. Although these two financial statements are the usual starting point in a municipal financial analysis, the entire annual financial report is important.

What we hope to find in reviewing the financial statements includes an unreserved fund balance in the general fund of over 16.67 percent of the general fund's annual expenditures. There should be sufficient cash and equivalent assets to cover most of the general fund balance. We would also like to see revenue increasing over time and sufficient to meet expenditures, a manageable level of debt, and the other funds in good enough condition so that the general fund (the fund of last resort) is not required to cover the expenses of such other funds. One obvious situation we might not find these conditions is when a local government has little or no discretionary money. There are also instances where a jurisdiction moves or otherwise diverts money to other funds because of changing priorities. While we can usually determine where money is being concentrated, we generally cannot comment on priorities nor on the appropriate level of funding for particular departments or projects because these are political decisions and are unique to the jurisdiction.

The purpose of this analysis is to help you interpret what the financial statements report with the understanding that these statements do not always tell us everything. The reader has no way of knowing, for example, if a jurisdiction has failed to record significant revenue or expenditures that should have been accounted for in the reported fiscal year. The financial reports usually tell us little about local or regional economic conditions, except what is self-reported by the city, and it is unlikely that they provide any clues about the local political situation or possible personal agendas of elected or appointed officials.

**General Fund Assets and Liabilities:**

The table on the next page traces the general fund's asset, liability, and balance history over the past three completed and reported fiscal years. We are interested in both the current ratio of assets to liabilities and the trend over the past few years. This ratio can vary widely due to the timing of the receipt of tax revenues, payment of bills, etc., but the report should explain any precipitous drop. We would like to see this ratio increase over time, or if it is already healthy, remain relatively steady. There is no widely accepted threshold number separating a good from a very good or excellent ratio. However, a ratio barely greater than one, for example 1.03, leaves very little fund balance, and an asset to liability ratio below one means that liabilities are greater than assets, which is clearly a serious problem. The higher the asset to liability ratio the better. We are also interested in the dollar value of the assets, which should tend to increase over time.

**Historical General Fund Assets and Liabilities Trend**

| Date | Total Assets | Unrestricted Cash and Investments | Total Liabilities | Asset to Liability Ratio | General Fund Balance | Unreserved Fund Balance |
|---|---|---|---|---|---|---|
| 6/30/21 | $134,241,000 | $95,112,000 | $21,493,000 | 6.25 | $112,748,000 | $90,354,000 |
| 6/30/22 | $163,453,000 | $129,246,000 | $33,411,000 | 4.89 | $130,042,000 | $117,482,000 |
| 6/30/23 | $176,002,000 | $136,403,000 | $35,336,000 | 4.98 | $140,666,000 | $122,015,000 |

The general fund's asset to liability ratio of 4.98 at the end of fiscal 2023 means City A had general fund assets of $4.98 for every $1.00 in general fund liabilities, which is a positive ratio although it decreased over 20% from FY21 to FY23 while increasing nearly 2% from FY22 to FY23. The general fund balance increased nearly 25% from FY21 to FY23. Unrestricted cash and investments at the end of fiscal 2023 were sufficient to cover nearly 97% of the general fund balance. The percentage of unrestricted cash is important because to be available for appropriation the fund balance must be liquid, i.e., available in cash or investments that are easily converted to cash. As discussed in more detail below, the unreserved balance in FY23 includes assigned and unassigned funds.

**General Fund Balance:**

One very important indicator of financial health is the level of fund balance. As mentioned earlier, the fund balance can be defined as assets minus liabilities. If the general fund is short of cash and/or equity, we cannot assume that transfers can be made from other funds to correct the problem because there are usually restrictions on the use of assets of other funds. Even where the equity is sufficient, not all the fund balance is available for appropriation.

First, there are two subdivisions within the fund balance for any fund—reserved balance and unreserved balance. In theory, the reserved fund balance includes money that must be set aside for a specific purpose due to a legal obligation. It is similar but not the same as a liability. The reserved balance includes the non-spendable and restricted general fund balances.

The unreserved fund balance is what remains after the reserved funds have been set aside. The unreserved fund balance also has three subdivisions—committed, assigned, and unassigned. Although the committed and assigned funds are both intended for a particular use, there is no legal obligation to use them for that purpose. The council or other authorized official can change or rescind their designated purpose. The unassigned fund balance is again whatever remains.

**Reserved Funds**

- Non-spendable fund balance—amounts that are not in a spendable form (such as inventory) or are required to be maintained intact (such as the corpus of an endowment fund)
- Restricted fund balance—amounts constrained to specific purposes by their providers (such as grantors, bondholders, and higher levels of government) through constitutional provisions or by enabling legislation

**Unreserved Funds**

- Committed fund balance—amounts constrained to specific purposes by a government itself, using its highest level of decision-making authority; to be reported as committed, amounts cannot be used for any other purpose unless the government takes the same highest-level action to remove or change the constraint. In other words, although technically unreserved, these funds have been committed by a vote of the governing body or other decision-making authority. For these funds to be made available, it would require reallocation by this authority.
- Assigned fund balance—amounts a government intends to use for a specific purpose; intent can be expressed by the governing body or by an official or body to which the governing body delegates the authority
- Unassigned fund balance—amounts that are available for any purpose

**Fund Balance as a Percentage of Expenditures:**

Local governments must maintain a certain level of fund balance to obtain a favorable bond rating. A high bond rating is desirable because it enables a government entity to borrow money at a lower interest rate. It is also simply good management to maintain a reserve to cover emergencies and unforeseen circumstances.

The appropriate fund balance level is related to the level of expenditures. The table below compares both the total general fund balance and the unreserved portion of the fund balance to expenditures.

**General Fund Balance as a Percent of Expenditures, Plus Transfers**

| FY | Total General Fund Balance | Unreserved Fund Balance | GAAP Basis General Fund Expenditures | Total Fund Balance as % of Expenditures | Unreserved Fund Balance as % of Expenditures |
|---|---|---|---|---|---|
| 21 | $112,748,000 | $90,354,000 | $187,821,000 | 60.0% | 48.1% |
| 22 | $130,042,000 | $117,482,000 | $185,226,000 | 70.2% | 63.4% |
| 23 | $140,666,000 | $122,015,000 | $205,644,000 | 68.4% | 59.3% |

As to whether this fund balance is adequate, the Government Finance Officers Association (GFOA) states:

> *"The adequacy of unrestricted fund balance in the general fund should be assessed based upon a government's own specific circumstances. Nevertheless, GFOA recommends, at a minimum, that general-purpose governments, regardless of size, maintain unrestricted fund balance in their general fund of no less than two months, or 16.67%, of regular general fund operating revenues or regular general fund operating expenditures."*

It is reasonable to assume that the 16.67 percent guideline is appropriate during relatively normal non-recessionary economic conditions, and it is understandable that a municipality would want to maintain a higher reserve level in uncertain financial circumstances when the likelihood of drawing on the balance is greater. However, if a local government determines a high reserve is essential, it should be able to justify the level it wants to maintain. City A's general fund balance, both total and unreserved as a percentage of expenditures, is above the 16.67 percent guideline in the last three years reviewed.

**General Fund Revenue and Expenses:**

Local government financial officers generally make cautious predictions. They tend to underestimate revenue and slightly overestimate expenditures. Exact predictions are impossible, and it is better to build in a margin of error than to underestimate revenue and have unexpected expenses. If we compare budgeted versus actual revenue and expenses over several years, we can get an idea of the city's ability to forecast revenue and control expenditures and in some cases establish a pattern of over and/or underestimates.

The numbers in the table below may differ from those used elsewhere in the financial statements and in this analysis because they are based on what is called the "budgetary basis" of accounting as opposed to the "GAAP (generally accepted accounting principles) basis," which is used in most financial statements. The two methods differ as to when revenue and expenditures are recognized. The only reason we use the budgetary basis is that we are comparing to a prediction made using that method. We have included not only revenue and expenditures but also transfers into and out of the general fund (if any).

**General Fund Actual Versus Budgeted Revenue and Expenditures Plus Transfers, Budgetary Basis**

| | General Fund Revenue and Transfers In | | | General Fund Expenditures and Transfers Out | | |
|---|---|---|---|---|---|---|
| FY | Total Budget | Actual | Actual as % of Budget | Total Budget | Actual | Actual as % of Budget |
| 21 | $166,029,000 | $187,666,000 | 113.0% | $207,324,000 | $187,821,000 | 90.6% |
| 22 | $200,296,000 | $202,520,000 | 101.1% | $207,792,000 | $185,226,000 | 89.1% |
| 23 | $218,554,000 | $216,268,000 | 99.0% | $244,525,000 | $205,644,000 | 84.1% |

Revenues and transfers into the general fund were above budget predictions in FY21 – FY22. Expenditures and transfers out were lower than budgeted in all three years. More important than this comparison, however, is whether general fund revenue was sufficient to fund general fund expenditures. In FY22 – FY23, actual revenues and transfers in exceeded actual expenditures and transfers out, at least on a budgetary basis. In FY21, expenditures and transfers out exceeded revenues and transfers in.

When expenditures exceed revenue is often referred to as an operating deficit. An operating deficit is not a good indicator, but whether it is cause for serious concern depends on the amount of the deficit, the level of fund balance, and whether it is an isolated case that is unlikely to repeat or part of a trend of insufficient revenue. An operating deficit does not signify that the city or the fund has a negative fund balance but rather that more money went out of the fund than came in during that fiscal year. If the general fund or all the funds combined have a negative fund balance (i.e., liabilities are greater than assets) the city is almost certainly in serious financial difficulty. This has not been an issue in the general fund for at least the last three reported fiscal years.

**More About Other Funds:**

As of 6/30/2023, the total fund balance (assets minus liabilities) of all governmental fund types was $269,814,000, of which $226,103,000, nearly 84%, could be covered by unrestriced cash and investments. Total fund equity represents the amount by which assets exceed liabilities. For the same funds, the city has total assets of $314,548,000 and total liabilities of $44,734,000.

The ratio of assets to liabilities is 7.03; in other words, the city has $7.03 in assets for every $1.00 in liabilities, at least for the governmental fund types.

The table below shows the city's total fund equity for governmental fund types as of 6/30/2023:

| Fund | Total Fund Equity | % Unrestricted Cash & Investments | Asset to Liability Ratio |
|---|---|---|---|
| General | $140,666,000 | 97.0% | 4.98 |
| Low/Mod Income Housing | $47,900,000 | 21.9% | 510.57 |
| Nonmajor Governmental | $81,248,000 | 97.5% | 9.73 |

We should note that assets are not necessarily transferable between funds. There are often restrictions on the use of cash and other assets. For example, revenue that comes into the capital projects and special revenue funds is often legally restricted to be used for those specified purposes for which the revenue was appropriated. On the other hand, it is not uncommon for a charter or statute to provide for certain amounts of revenue from another fund, the amount often determined by formula, to be transferred into the general fund on a regular basis. Such a transfer is not usually considered revenue by the strict definition, but it serves the same purpose and the city budgets for it as it would a revenue source.

However, even if the charter or governing law prohibits or makes difficult the transfer of money from other funds to the general fund, there is still a purpose in examining the financial health of these operations. We want to determine their potential impact on the general fund because it not only accounts for the day-to-day operations of the city but also serves as payer of last resort should any other fund be unable to meet its obligations.

If we look at all governmental fund types together, we get another perspective on the fund balance.

| Fund | Total Fund Balance | Fiscal Expenditures |
|---|---|---|
| General | $140,666,000 | $205,644,000 |
| Low/Mod Income Housing | $47,900,000 | $530,000 |
| Nonmajor Governmental | $81,248,000 | $60,279,000 |
| | | |
| **Total** | **$269,814,000** | **$266,453,000** |
| **Total Fund Balance as a Percentage of Expenditures** | **>100%** | |

**General:**

The general fund balance increased nearly 25% from FY21 to FY23. The general fund's asset to liability ratio decreased over 20% from FY21 to FY23 while increasing nearly 2% from FY22 to FY23. The general fund balance, both total and unreserved as a percentage of expenditures, is above the GFOA guideline for all three years reviewed. All governmental funds have positive fund balances and asset to liability ratios.

Please contact us if you have any questions or if further clarification is needed.

Fraternally,

Research Analyst
Collective Bargaining

***Talking Points - Financial Analysis***

City A

1) In the first chart, on page three, there are three important items to review:

    - **General Fund Balance -** The general fund balance is typically the primary focus of any IAFF financial analysis. This measures the fund's reserves and is an important measure of the government's fiscal strength. The general fund balance pays for the city's day-to-day operations, typically including fire department funding. The general fund is the fund of last resort – if other funds are deemed to be in poor financial condition, monies from the general fund may be transferred into these funds. Ideally, we would like to see the general fund balance remain relatively constant or increase over time. City A's general fund balance increased nearly 25% from FY21 to FY23.

    - **Asset to Liability Ratio -** The general fund's asset to liability ratio is a comparison of what the jurisdiction owns vs. what a jurisdiction owes. This ratio investigates how well the city is managing debt levels. There are no widely accepted standards for the ratio. However, we consider everything above 1 as a positive indicator. In City A, the general fund's asset to liability ratio was 4.98 in FY23. This is a positive ratio although it decreased over 20% from FY21 to FY23 while increasing nearly 2% from FY22 to FY23.

    - **Unreserved Fund Balance** - Unreserved funds are available for any purpose. In FY23, nearly 87% of the general fund balance was unreserved.

2) In the second chart, on page 4, we analyze the **General Fund Balance as a Percentage of Expenditures**. To be prepared for unforeseen emergencies, it is generally recommended that a government keep a general fund balance that is no less than two months of operating expenditures. Two months (conservative benchmark) is about 16.67%, so we are comparing the percentages in that chart to 16.67%. Additionally, local governments must maintain a certain level of fund balance to obtain a favorable bond rating, and the appropriate fund balance level is related to the level of expenditures. City A's general fund balance, both total and unreserved as a percentage of expenditures, is above the 16.67 percent guideline in the last three years reviewed.

3) The charts on page 6 refer to the **Other Governmental Funds**. We want to make sure there are no deficits in the other governmental funds and the asset to liability ratios are positive.

    - All governmental funds have positive fund balances and asset to liability ratios.