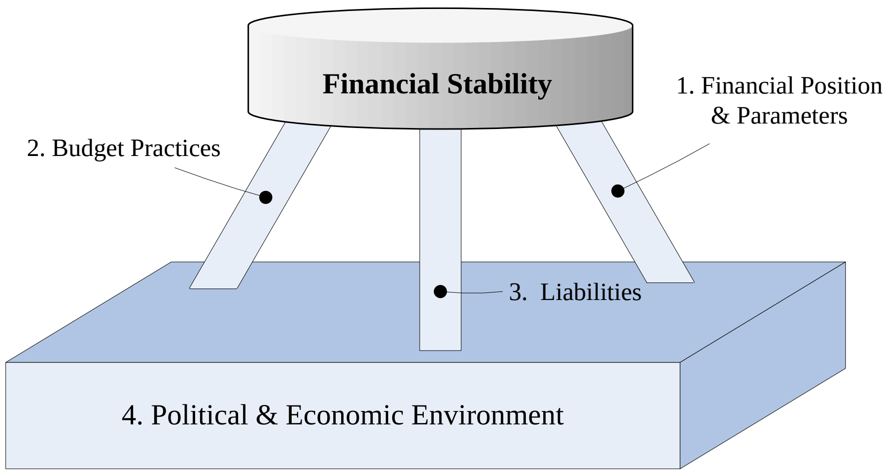
# GFOA Financial Health Diagnostic

**About the Diagnosis.** A financial health diagnosis identifies the most immediate causes of financial distress. Knowing the causes will help you select the most appropriate financial health strategies. The initial diagnosis should examine four components, which together are like the foundation and legs of financial stability, as the diagram below shows.

1. Financial position and parameters
2. Budget practices
3. Liabilities
4. Political and economic environment




**Instructions.** In your groups, choose one group member as the "patient" and one as the lead diagnostician. The other members will be assistant diagnosticians. The lead diagnostician poses the questions to the patient and the patient answers based on his or her real-life organization. All the diagnosticians should ask follow-up questions and go beyond the questions included in GFOA's diagnostic tool as they feel might be necessary to make the best diagnosis. One diagnostician should record the results.

## Financial Position and Parameters

This part of the diagnosis covers cash position, revenues, expenditures, and long-term forecasting.

### *Cash*

Cash is king during financial distress. A monthly (or more frequent) cash flow budget that shows anticipated income and expenses for each month will help anticipate and guard against shortfalls. Improved cash flow monitoring will also help reveal when and why cash reserves are being used and if there is a pattern. By identifying this potential shortfall early, actions can be taken to bolster cash reserves and/or reduce expenditures in a much more proactive fashion

**Q.1** Is there a monthly cash flow budget in place? If not, is there some other tool for remaining on top of cash position and identifying major inflows and outflows?

## *Reserves*

Financial reserves represent the basis of financial flexibility. They can be used to buffer shocks and provide working capital during revenue dry spells.

**Q.2** Is it clear what reserve requirements are (minimums and maximums) and which reserves are available to help manage through financial distress? Is this formalized in a written policy? How do is compliance with the policy monitored?

**Q.3** Is there a fund balance inventory to identify what the balances are in each fund, how those balances are authorized, and if the amount of fund balance is appropriate?

## *Revenues*

When considering revenues, a good place to start is with aging receivables and calculating collection rates to see if collections can be enhanced. Compared to other revenue-increasing opportunities, improving collections can be done relatively quickly for relatively little cost. It is also useful to consider revenue trends to see if certain source are increasing or decreasing in importance. Finally, it may also be helpful to compare user fees or other revenues generated directly by program activities to the associated expenditures. If a fee-generating service is consistently covering a decreasing portion of its expenses through fees, it may indicate an outdated fee structure or, more importantly, inadequate incentive and control systems to encourage departments look for opportunities to improve their fee coverage. If a grant-funded service is consistently recovering fewer costs it could indicate insufficiently vigorous pursuit of grants, inadequate grants management (such as poor documentation of grants activities or expenditures) or changing priorities of grantors.

**Q.4** Are collection rates regularly calculated and receivables aged to gauge effectiveness of collections?

**Q.5** Are any major revenue sources declining in absolute or relative importance? If so, are the reasons known? Is this a long-term or temporary condition?

**Q.6** Are resource allocation decisions influenced by the revenues generated by your organization’s functional units (departments, divisions, etc)? If yes, how does your organization differentiate them from “general government” revenues such as taxes, earnings on investments, franchise fees, etc.?

## *Expenditures*

Two essential questions should be considered when thinking about expenditures. First, is how are expenditures authorized and what is the strength of control systems?  Second, what is money spent on? The answer to the first question might reveal better means controlling expenditures and the second should reveal which areas of expenditure are the biggest and which are growing the fastest, thereby suggesting where to focus cost-control strategies.

**Q.7** Are effective controls in place for personnel (position budgeting, compensation plan)?

**Q.8** Do you undertake full-cost (wages plus benefits) compensation studies to determine the reasonableness and competitiveness of your compensation structure?

**Q.9** Have you designed and formally adopted a long-term, strategic health care plan that includes guiding principles and key objectives for managing health-care costs and improving participant wellness?

**Q.10** Are effective controls in place for budget (hard and soft controls at the appropriate level of the budget)?

**Q.11** Are effective controls in place for capital project management (projects stay on schedule and within budget)?

**Q.12** Are effective controls in place for ensuring accountability for results (business plan)?

**Q.13** Which areas of expenditure are the largest and which are growing the fastest? (Both in terms of programs/functions and objects of expenditure such as health care, salaries, etc.)

**Q.14** Does a comprehensive program inventory exist, including direct and indirect costs?

### *Long-Term Forecast*

A long-term forecast reveals the long-term impact of current decisions and provides a more accurate perspective on financial position.

**Q.15** Do you prepare a multi-year forecast of revenues and expenditures?

## Budget Practices

The budget ultimately creates or destroys fiscal balance because it is here that the organization's financial strategy is given its most authoritative expression.

### *Structural Balance*

Fiscal distress may be at least partially due to a mismatch between recurring revenues and ongoing expenditures.

**Q.16** Does your organization differentiate between one-time and ongoing revenues and expenditures?

### *Variance Analysis*

Analyze variances between planned and actual spending to understand the reasons behind the variances. First, is there a systematic reason for variances that could lead to more accurate budgeting? Second, what areas have traditionally been most difficult to control? Which might be in the future? Examine multiple years of history to see where the overruns have been so that control efforts can be focused on areas of greatest need. Variance analysis can also address revenues. The development of a single graph/chart that tracks major revenue categories over the years will assist in the identification of the most volatile revenue sources. This may help avoid future financial distress by preventing overreliance on volatile sources.

**Q.17** At year-end, are variances between budgeted and actual revenues and expenditures analyzed and explained? What about variances between prior year and current year budgeted amounts?

**Q.18** If yes, how do those variances impact future budget cycles?

## Liabilities

Liabilities can represent potentially very large obligations or unsustainable practices that could seriously harm financial condition if countervailing actions are not taken.

**Q.19** Are comprehensive repayment schedules available and are future debt service payments affordable?

**Q.20** Is a formal policy in place to describe how much debt the government will incur? How do current levels of debt compare to this policy?

**Q.21** Are post-employment benefits sustainable? Are actuarial liabilities suitably funded?

## Political and Economic Environment

The political and economic environment is the base on which financial stability ultimately stands.

**Q.22** Do decision-makers have a clear sense of how prevailing and expected economic conditions will impact financial condition and the nature of the financial strategies selected?

**Q.23** Are you informed of state financial conditions and changes in state policy that could impact you?

**Q.24** Are there any major changes in service demands that could cause pressure for increased expenditures? Conversely, are there areas of service that are experiencing reduced demand that could be early candidates for spending cutbacks?

**Q.25** Are management practices such as unclear lines of accountability, lack of accountability, lack of team-based management, or excessive red tape contributing to financial distress?