

Internal Audit Report 18-04
Financial Condition Analysis
December 2018



City of Sioux Falls
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FINANCIAL CONDITION ANALYSIS INTERNAL AUDIT REPORT 18-04

INTRODUCTION

This review of the City of Sioux Falls' (the City) financial statements is intended to encourage discussion of the City's financial condition. Internal Audit selected various financial ratios and indicators for analysis based upon research of useful indicators and ratios. Comparison data from other regional cities is reported for additional perspective on the City's finances. We performed our last analysis in 2013 for the years 2003 through 2012.

BACKGROUND

The City's financial statements are required by state law to be audited by an external audit organization each year. These financial statements are included in a Comprehensive Annual Financial Report (CAFR) along with the auditor's report, management's discussion and analysis, background on the City, and statistical information. The Government Accounting Standards Board (GASB) requires that financial statements for governments be prepared and presented under uniform accounting rules and principles.

Analysis of the audited financial statements is not performed by the external auditors. The users of the financial statements need to review and interpret them.¹ There is no widely accepted standard definition for fiscal sustainability. However, generally a city should be able to balance service demands while demonstrating it can withstand economic downturns. A fiscal sustainability or financial condition analysis aids in determining how the City's policy decisions impact current citizens.

Although reviewing the financial condition of a municipality is a complex exercise, this analysis can assist key stakeholders, such as the Mayor's Office, City Council, and the Finance Department to address negative trends as they emerge and help inform discussions involving financial and policy objectives.

OBJECTIVES

The objectives of this audit were to:

1. Determine if there are any trends, favorable or unfavorable in the City's liquidity, debt load, net position, employees per 1,000 residents, dependency on a few property taxpayers, and dependency on revenue from other governments.
2. Compare the City's financial performance to ten benchmark cities in our region for 2017 for selected financial indicators.

SCOPE AND METHODOLOGY

¹ Users of a municipality's audited financial statements include management (the administration), elected officials, bond rating agencies, potential investors (municipal bonds), public interest groups, and the citizens.

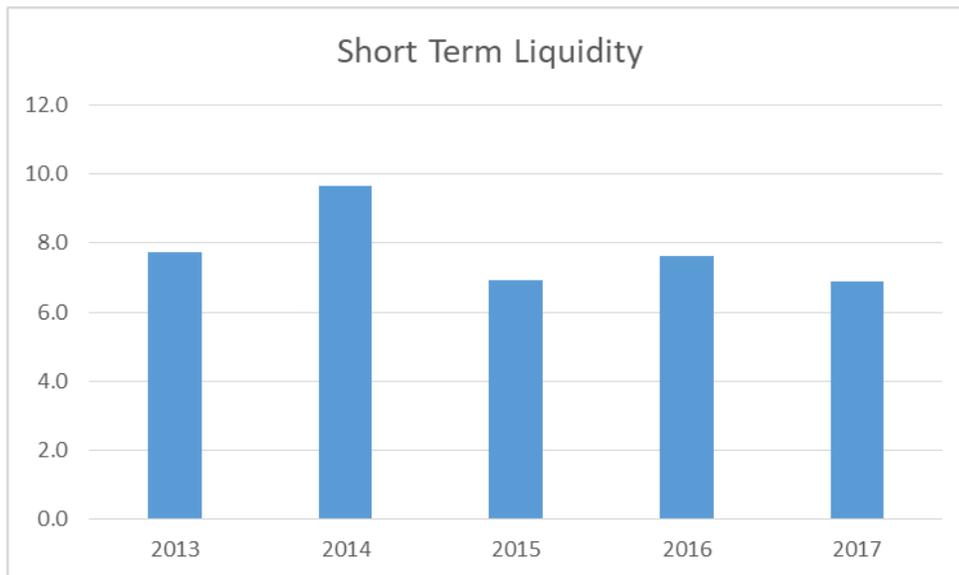
The scope of this audit included an analysis of data from the City’s CAFR for the years 2013 through 2017. We also used CAFR data from ten benchmark cities – Cedar Rapids, IA; Des Moines, IA; Duluth, MN; Fargo, ND; Lincoln, NE; Omaha, NE; Rapid City, SD; Rochester, MN; Saint Paul, MN; and Sioux City, IA- for 2017. We researched commonly used financial indicators and ratios for local governments and made comparisons between the City of Sioux Falls and the benchmark cities for some of the indicators and ratios.

This analysis was not intended and should not be used as a predictive (prospective) analysis, but rather as a broad analytical and diagnostic tool. This analysis was done independently of City management and is best used in conjunction with the analysis provided in the CAFR by the City’s Finance Director and Finance team.²

RESULTS

Short-term liquidity ratio

Why this is important: short-term liquidity is the ability of the City to meet its short-term debt obligations as they come due. The ratio is calculated by dividing the current assets (cash and cash equivalents, net receivables) by the current liabilities (accounts payable and other current liabilities, interest payable, and long-term liabilities due within one year). A ratio below 1.0 would be a problem because it would indicate that current liabilities exceed current assets making it difficult for the City to pay its current debt as it comes due. The chart below is for governmental activities of the City.

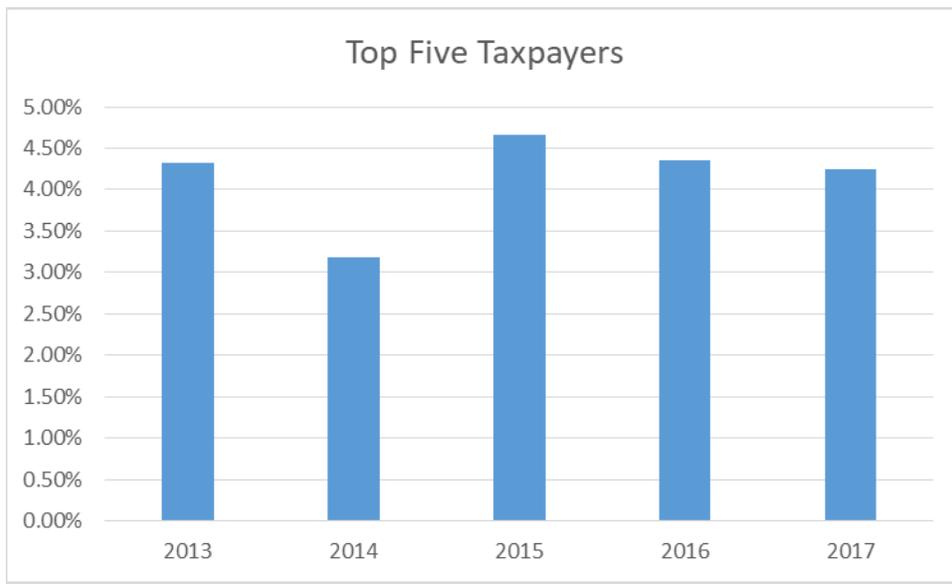


² A Management Discussion and Analysis (MD&A) is required by government financial reporting standards (GASB statement no. 34) to be included in CAFRs. This analysis is intended as an introduction to audited financial statements.

Conclusion: No warning trends. Current assets far exceed current liabilities for the past five years. The City is in a position to meet its short-term obligations as they come due.

Top five taxpayers

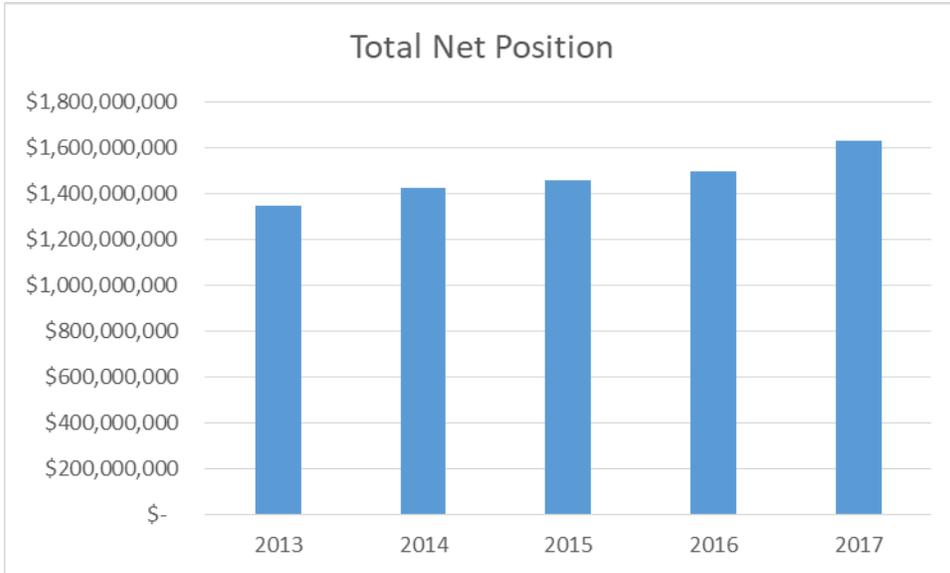
Why this is important: The chart below identifies the percentage of the City’s property tax revenue that is paid by the top five taxpayers combined. Top property taxpayers are almost always business organizations. Heavy reliance on a few property taxpayers can be an issue if a top taxpayer relocates or goes out of business and thus is no longer paying the City property taxes.



Conclusion: No warning trend. The top five property taxpayers for the past five years have accounted for less than five percent as a percentage of the total city assessed value.

Change in total net position

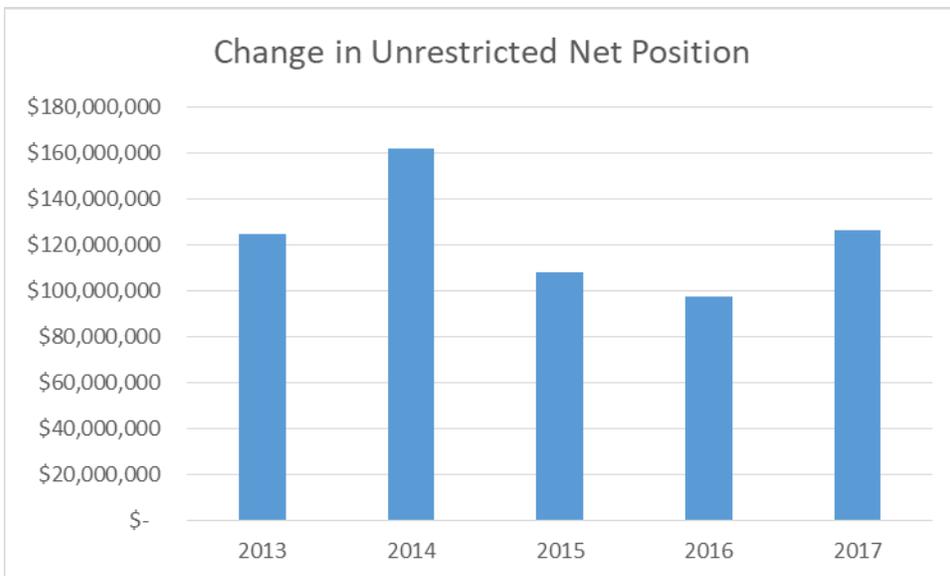
Why this is important: Net position is the difference between a government’s assets (resources it can use to provide services and operate the government) against its liabilities (its obligations to turn over resources to other organizations or individuals). A declining net position from year to year would be an indication of fiscal stress.



Conclusion: The total net position of the City has consistently increased each year from 2013 to 2017. Based upon this indicator of financial health, the City is not undergoing fiscal stress.

Change in unrestricted net position

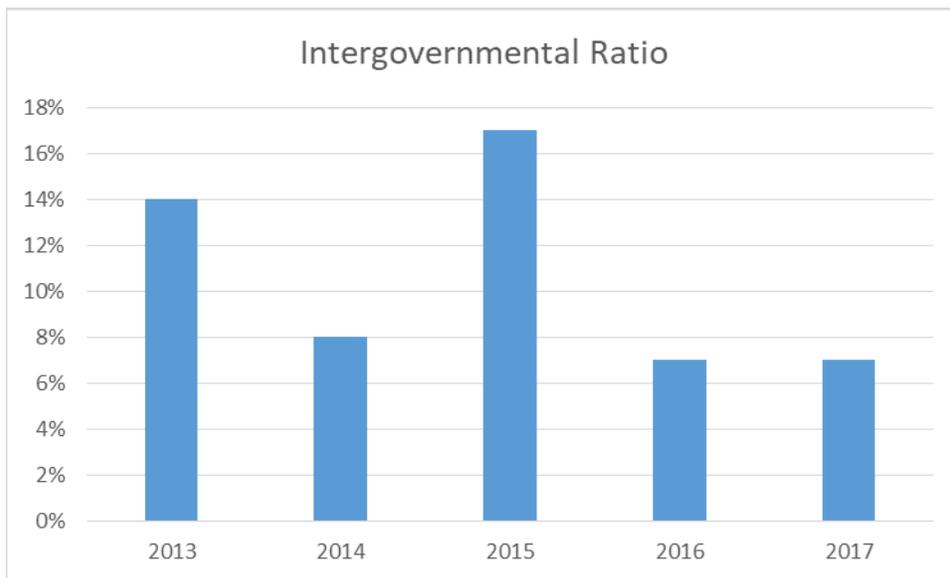
Why this is important: unrestricted net assets/position represents the portion of net position that has no related liabilities or restriction as to use. If the City’s unrestricted net assets are declining, it leaves little room for unexpected expenses. It would therefore be another sign of fiscal stress.



Conclusion: No warning trend. The unrestricted net position of the City for both governmental activities and business-type activities stayed essentially the same when comparing 2013 to 2017. The significant negative changes from 2014 to 2016 are due primarily to changes in accounting standards for reporting assets and liabilities.³

Intergovernmental ratio

Why this is important: This ratio is a measure of the extent to which the City relies on other government resources. It is calculated by dividing the total intergovernmental revenues by the total revenue for each year. Other government resources are federal and state funds. Because the City does not directly control most intergovernmental revenue, there is a risk that the revenues may not always be available to fund operations. In general, the higher the percentage of operations funded by intergovernmental revenues, the greater the risk that a local government bears.



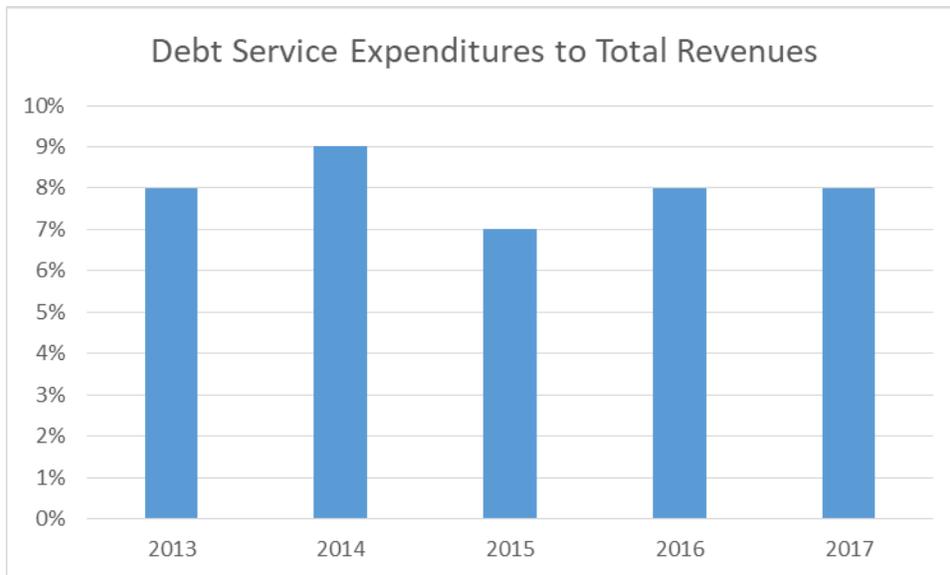
Conclusion: The percentage of revenues from state and federal sources as a percentage of gross revenues in the governmental funds for 2014, 2016, and 2017 has been below 10 percent indicating that the City is not excessively reliant upon other governments for financial resources. The increase in 2013 and 2015 were due to one-time revenues from the federal government.⁴

³ The decrease from 2014 to 2015 is due to the implementation of GASB statement 68 (recognition of pension assets and liabilities). The decrease from 2015 to 2016 is due to inclusion of assets held for management agreements and restatements of revenue and for notes receivable and rehabilitation loans.

⁴ Increase in 2013 was due to one-time revenue in the sales/use tax fund of \$10 million for reimbursement from the federal government for flood levees project. Increase in 2015 was due to one-time funds of \$27 million from the federal government for the railroad relocation project in downtown Sioux Falls.

Debt service expenditures compared to total revenue

Why this is important: Debt service expenditures divided by total revenues in the governmental funds identifies the percentage of the budget used or needed for repayment of debt. A trend of higher debt service expenditures compared to total revenues is unfavorable since the City would be spending more of its current budget on debt repayments. In such a scenario, less revenue may be available for asset repair and replacement or meeting current service demands.

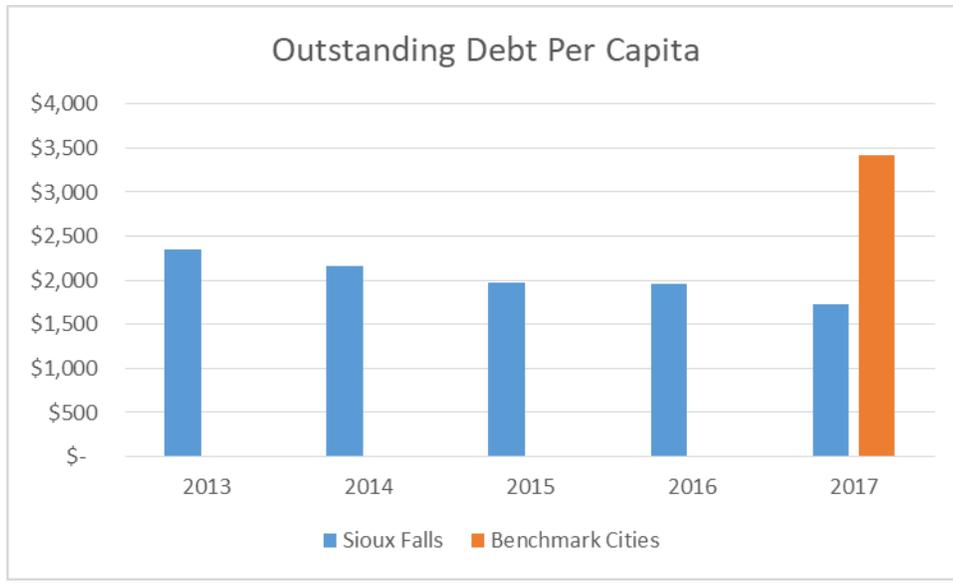


Conclusion: The ratio of debt service expenditures to total revenues in the governmental activities funds has consistently stayed in the seven percent to nine percent range the past five years. The City appears to have sufficient revenue to fund repairs and replacements of assets and meet current service demands based upon this financial indicator.⁵

Outstanding debt per capita

Why this is important: Outstanding debt per capita is calculated by dividing the entire outstanding debt of the City by the population of the City. A trend of increasing debt per capita would suggest that there is less revenue available to pay for current municipal services. Conversely, little or no outstanding debt per capita would suggest that the City is not investing in infrastructure such as the water or water reclamation utilities.

⁵ The Ohio State Auditor’s office suggest that cities should maintain a ratio less than 12% and that a ratio greater than 15% is a warning sign.

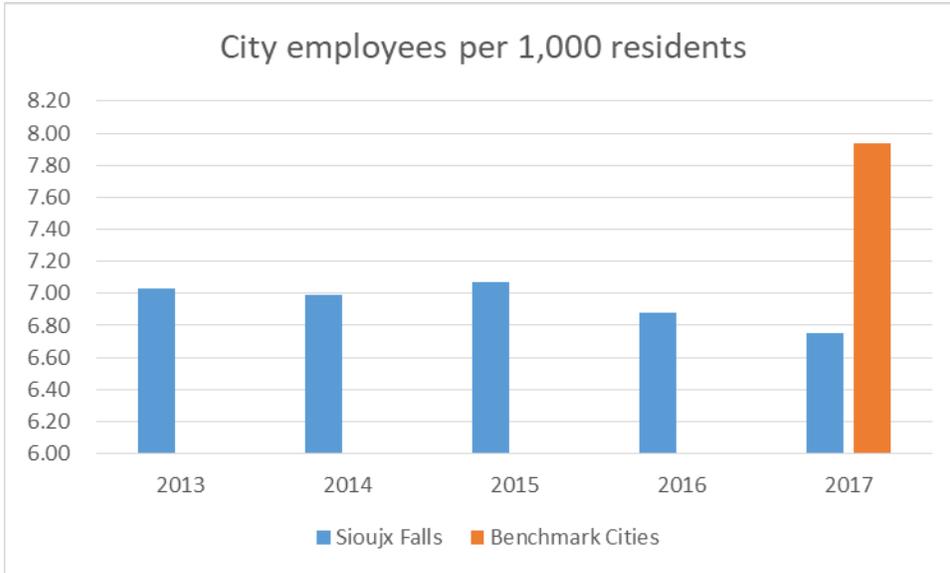


Conclusion: The City’s outstanding debt per capita has been declining each of the past five years which is a favorable trend. The City’s debt is in the moderate category according to Standard & Poor’s ratings. The average outstanding debt of the benchmark cities is significantly greater than that of Sioux Falls.⁶

Employees per 1,000 residents

Why this is important: Personnel costs are the major part of the City’s operating budget. An increase in employees per capita suggests that expenditures for payroll are rising faster than revenue, the City is becoming more labor intensive, or that personnel productivity is declining. When comparing the City of Sioux Falls to the benchmark cities, we adjusted figures for those cities that have municipal employees in an airport, a transit system, or municipal golf courses. The City does not have employees in the transit system, golf courses, or airport.

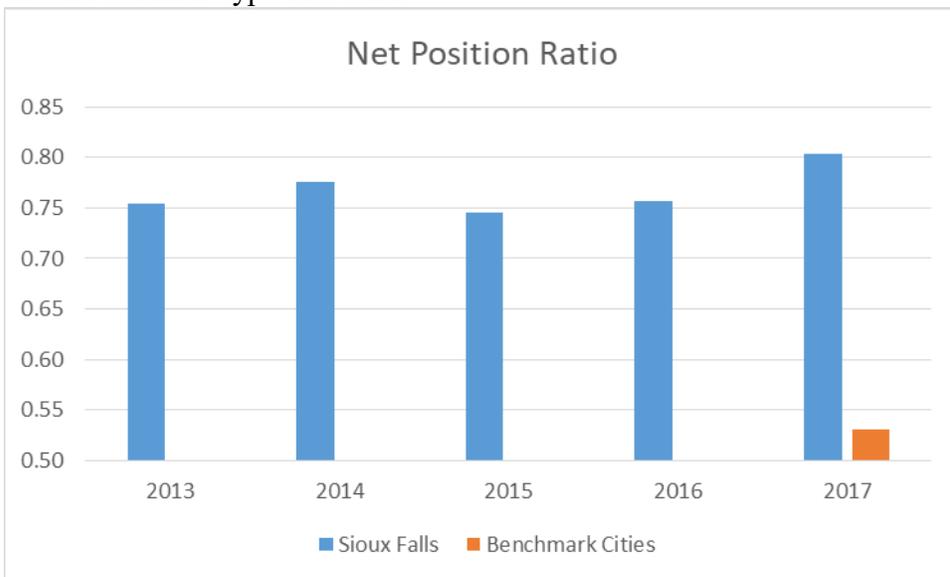
⁶ Standard & Poor’s is a United States based financial services company that issues credit ratings among other services. They would rate outstanding debt per capita as follows: low <\$1,000; moderate \$1,000 - \$2,500; high >\$2,500.



Conclusion: There is no warning trend based on this measure. The ratio of City employees per 1,000 residents has remained steady in the range of 7.0 to 6.7 for the past five years. The ratio for the benchmark cities is an average of 7.9 employees.⁷

Net position ratio

Why this is important: Net position ratio is a measure of long-term financial strength. It assesses the ability of the City to withstand financial emergencies during economic slowdowns, natural disasters, loss of major taxpayers, and similar negative situations. We calculated this ratio by dividing the total net position of the City by the total assets for both the governmental activities and the business-type activities.

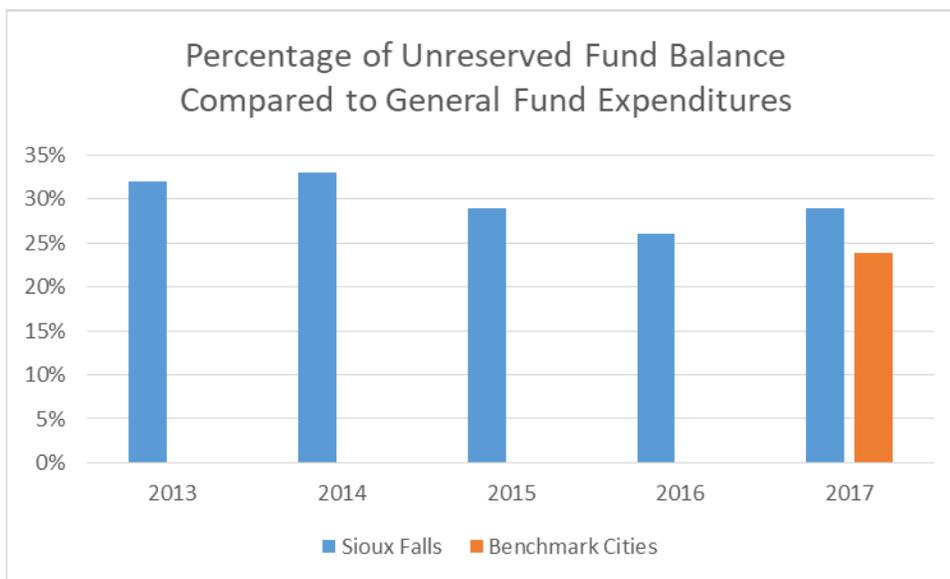


⁷ Rapid City was not included in this benchmark city comparison for employees per 1,000 residents because their CAFR lacked a statistical section with information about the number of city employees and estimated population.

Conclusion: The City’s net position ratio has been steady for the five years from 2013 to 2017 in a range of 0.75 to 0.80. Generally speaking, the higher the net position ratio (approaching 1.00), the better the long-term financial position of a municipality. The City’s ratio is higher than the average of the benchmark cities which is 0.53. Based upon this measure, the City has long-term financial strength.

Percentage of unreserved fund balance

Why this is important: The City has a reserve policy target of 25 percent (unassigned and assigned) fund balance in the general fund compared to expenditures at the close of the fiscal year. This reserve is sometimes referred to as the City’s “rainy day” fund.



Conclusion: The City has consistently exceeded the goal of finishing the fiscal year at 25 percent of unreserved fund balance remaining compared to expenditures in the general fund. The City has funds available for unanticipated financial emergencies. The City’s percentage exceeds the average of the ten benchmark cities.

CONCLUSION

The financial condition of the City of Sioux Falls is strong based upon the following:

- 1) We identified no warning trends for the period 2013 through 2017.
- 2) The City is in a financial position to weather economic downturns and emergency situations based upon the net position ratio, the percentage of unreserved fund balance maintained in the general fund, and the City’s short-term liquidity.
- 3) The City outperforms the average of the benchmark cities for all the financial indicators used in this analysis.

AUTHORIZATION

The Sioux Falls City Council approved this analysis by resolution in February 2018 as part of the 2018 Annual Audit Program. The Internal Audit Division operates under the authority of an Internal Audit Charter adopted by City Council resolution 11-13.

STATEMENT OF INDEPENDENCE

Internal Audit is administratively and operationally independent of the programs and departments it audits, both in appearance and in fact. The Internal Audit Manager is accountable to an Audit Committee appointed by the City Council per section 32.022 of the Code of Ordinances of Sioux Falls, SD.

DISTRIBUTION OF REPORT

This report is intended for the information and use of the Mayor and City Council, management, and others within the City of Sioux Falls. However, the report is a matter of public record and its distribution is not limited.

PERFORMED BY

Rich Oksol
Internal Audit