A Practitioner's Guide to Improve Local Authority Creditworthiness

ICMA-Latin America*

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Table of Contents

Executive Summary

With limited resources, local authorities have to prioritize their spending between day-to-day needs and building infrastructure that is essential for the future. Local economic growth, employment, and citizen well being all depend on adequate local infrastructure. In many cases, local authorities need extra funds to invest in essential infrastructure. In the absence of sufficient grant funding, local authorities have to finance at least part of their infrastructure investments through borrowing. So, it is important for local authorities planning large infrastructure projects to undertake analysis of the potential sources of capital, types of financing mechanisms and cost of borrowing.

The cost of long-term financing for a local authority depends on the level of trust that financial institutions have in the borrower. The creditworthiness of a local authority is actually a way of expressing that level of trust. A local authority's creditworthiness is determined by its demonstrated ability and willingness to repay its debts. Some local authorities demonstrate they are more creditworthy than others. The more creditworthy obtain financing for their projects at less cost than the less creditworthy. Ultimately, the institutionalization of good financial management practices is what enables a local authority to achieve the highest level of creditworthiness.

Demonstrating a local authority's creditworthiness to financial institutions is the primary function of a credit rating. The credit rating is based on an objective external analysis of the local authority in terms of the factors affecting its creditworthiness. As a result, the credit rating report also provides the local authority important information on the creditworthiness factors which can be improved through better financial management.

It is important to keep in mind that a lender wants to have the highest possible confidence that they will receive all the debt service payments at the agreed times. Therefore, identifying reliable revenue sources for the debt service payments is central to support the required trust. As a result, it is common practice for the structure of each specific bond or loan transaction to be rated independently of the local authority itself. What that means is that is possible to have a bond with a credit rating different from that of the issuing local authority based on the source of revenue backing the bond. However, financial institutions also care about the underlying credit rating of the issuing local authority since it provides information about possible problems facing the bond issuer that could impact the ability of the lender to collect payments.

Even before a credit rating is obtained, local authority leaders can conduct a Management Review to assess the current quality of financial management. The Management Review presented in this Guide is based on the lessons drawn from the ICMA Latinoamérica "Regional Creditworthiness Improvement Program", funded primarily by a grant from the Public Private Infrastructure Advisory Facility (PPIAF) of the World Bank. The Management Review should examine the management factors which most affect creditworthiness:

- Debt management;
- Management of other long-term and contingent liabilities;
- Liquidity management and maintenance of a healthy operating margin;
- The quality of financial information and monitoring;
- The planning of long-term capital expenditures;
- Professionalization of management;
- The quality of services, and the level of user satisfaction with those services.

The objective of the Management Review is to identify areas where the local authority can improve their financial management practices. Institutionalizing appropriate policies is an important first step, but local authorities also need to undertake process mapping to make sure that their procedures properly match and apply their policies. The essential policies that all local autjorities must have include the following: debt management, financial planning, budgeting and capital investment. This Guide contains examples of such policies.

As a practical matter, the types of policies and procedures described in this Guide should be adapted to the specific context of the local authority undergoing the Management Review. For example, it is less important that a local authority adopt formal 5-year projected operating budgets, than it is that the local authority anticipates future expenditures under varying scenarios that have been subjected to sensitivity analysis. On the other hand, even when a local authority is audited by a government agency, good financial practice calls for independent external audits that certify the accounts and verify internal control procedures. Adapting and institutionalizing the kinds of policies and procedures used by the most creditworthy local authorities will enable every local authority to consistently practice good financial management and demonstrate creditworthiness with the highest credit rating possible.

Introduction

This Practitioner's Guide is intended to enable officials from local authorities to identify the issues they need to address in order to improve the creditworthiness of their organization. For the purposes of this Guide, local authorities include all levels of government below the national level**:** regional, state/provincial, county/district, metropolitan and municipal. Local authorities also include sub-national entities which provide local public services such as water supply, sewerage, sanitation, markets, roads, public transportation, education, health care or others when these services are not provided directly by local governments.

The creditworthiness of a local authority is determined by its ability and willingness to repay its debts. Creditworthiness is a relative term. Some local authorities are more creditworthy than others because they demonstrate a lower risk of defaulting on their debt. A local authority's creditworthiness is judged by financial institutions based on a variety of factors. In more and more countries, financial institutions are using credit rating agencies to provide an objective and comparable assessment of the creditworthiness of local authorities. Credit rating agencies employ standard methodologies for assessing the factors that determine the risk of a borrower defaulting on their debt – so all local authorities are evaluated on the same criteria.

Credit rating agencies assign a rating to a local authority based on rigorous objective analysis of information about that local authority, and the application of a methodology which weighs the factors predicting the likelihood of a failure to repay debt. Although each credit rating agency employs its own system of designators, generally the ratings range from AAA (highest credit quality) through BBB (credit quality good enough to be considered "investment grade") to C (exceptionally high levels of credit risk) on a scale that progresses: AAA, AA. A, BBB, BB, B, CCC, CC, C with "+" and "-" to signal degrees of risk between the letter ratings. Local authorities which achieve a rating of BBB– or better are considered by most financial institutions to be creditworthy. Those with lower ratings are generally seen as not creditworthy.

In this Guide, the management issues that relate to improving a local authority's creditworthiness are derived from the actual experience of local authority practitioners. Since 2009, the Latin America affiliate of ICMA (the International City/County Management Association) has assisted local authorities in Argentina, Costa Rica, and Mexico to review the issues affecting their creditworthiness and implement improvement plans. The lessons drawn from the ICMA Latinoamérica "Regional Creditworthiness Improvement Program", funded primarily by a grant from the Public Private Infrastructure Advisory Facility (PPIAF) of the World

Bank, provide the basis for defining the content of the Management Review presented in this Guide.

I. Local Authorities, Debt, and Creditworthiness

Prioritizing the use of limited resources…

It is common for local authorities to face difficult choices when deciding how to best address their community's needs with very limited resources. Recently, these choices have become even more difficult as a result of the economic and financial crises that have affected countries worldwide. Local authority leaders must balance attention to their citizens' day-to-day needs with the need to build infrastructure for the future. If they concentrate their efforts only on today's needs, very soon the community will find itself without the means to satisfy the demand for essential services; a common complaint in many countries. Without timely strategic investments, the service delivery capacity of local infrastructure is soon overwhelmed and in many cases aging infrastructure is outdated and inefficient at best.

On the other hand, if local authority leaders focus their attention only on tomorrow's needs, their community is likely to face serious problems with basic service delivery because current services are not adequately funded to sustain well managed operations. So, local authorities must find a balance in the way they prioritize the use of their limited resources; making sure services are provided today, at the same time preparing to adequately deliver services in the future. Public debate over these priorities will have an important impact on the choices made by local officials.

The importance of investing in infrastructure…

Local economic growth, employment, and citizen well being all depend on local infrastructure capable of meeting the community's demand for services. In the 21st century, the development of businesses of all kinds requires investment in infrastructure for delivering telecommunications, electric power, and other forms of energy. Trading in food and other goods requires building market places. Adequate transportation for goods and people requires investment in ports, airports, highways, roads, streets, buses and other forms of public transit. An educated workforce requires building schools. A healthy community requires building hospitals and clinics as well as investment in infrastructure for safe water distribution, plus removal and treatment of sewage and solid waste. While not every local authority is responsible for all the infrastructure projects, every local authority is responsible for some of it, and this means that they sometimes have to undertake the construction of large infrastructure projects.

When limited resources don't match the funding needs of large infrastructure projects…

The limited resources available each year to local authorities after funding day-to-day operations are usually not adequate for the timely completion of large infrastructure projects that require a large amount of money in a single year. Therefore, local authorities usually need to obtain extra funds to invest in essential infrastructure. There are really only two options for local authorities to obtain the additional capital they need for large infrastructure projects: 1) grants from another level of government or a donor; and 2) borrowing.

While every local authority logically prefers grant funding to borrowing, the reality is that there is never enough grant money available to meet the investment needs of all local authorities in any country. Deferring investment in essential infrastructure in the hope of eventually receiving 100% grant funding for the project has proven to be a bad strategy for local authorities. Deferred investment means the infrastructure needed to sustain the local economy becomes increasingly inadequate. With inadequate infrastructure the local economy and the community suffers. So, in the absence of sufficient grant funding, local authorities have to finance their infrastructure investments (at least in part) through borrowing.

Justification for long-term debt financing…

Borrowing by local authorities to finance infrastructure is a subject that should be open for public debate. Local officials need to justify why the community should go into debt, and how the project costs should be paid. Those are key questions which become central issues in the discussion. To answer these questions, local officials need to:

1. Demonstrate the importance of the particular infrastructure project to the future development and well being of the community;
2. Show that paying for the timely construction of the project requires more money than can be prudently taken from current operating budgets; and
3. Justify sharing the cost of the project among current and future members of the community.

If the infrastructure is to be use for many years, long-term debt financing enables the cost to be paid over its useful life. In order words, the cost of the project is paid as the asset is used and future members of the community share in both the cost and the benefit from the infrastructure investment. On the other hand, a common question raised by the public is why future residents should pay for something that the current residents want. Of course, the reality is that local authorities have to think ahead because they are responsible for assuring the community is prepared for the future. Therefore, the use of long-term debt financing is a matter of generational fairness. That is, since the asset life will span several generations, it is only fair that each generation pay for its share of the usage.

Options for sourcing long-term debt financing…

Once a local authority decides to make use of long-term debt financing, the next issues to be addressed are: 1) what type of mechanism to use; and 2) from what source or sources to raise capital. Debt financing can come from private or public sources. It can be accessed through bank loans or by issuing bonds directly to interested investors, including selling bonds in the open market.

In many countries there are public sector development banks that provide long-term loans for local authorities' infrastructure projects. When they are well managed, public sector development banks offer infrastructure financing on terms that are very similar to private sector banks. In the private sector, it may be possible to obtain long-term loans from commercial banks, but unless they have access to long-term funds, commercial banks generally prefer to lend for shorter duration in order to preserve their liquidity. Other private institutions that may offer long-term financing for infrastructure include life insurance companies, pension funds (where available), and investment banks.

The two types of financing mechanisms, loans and bonds, have different characteristics. There are advantages and disadvantages to each. In the case of loans, the terms and conditions of the financing are presented to the local authority by the bank. The bank acts as an intermediary between capital seeking a return on investment and local authorities seeking capital for their projects. Loan financing is relatively simple for a local authority to complete because most of the legal and administrative work is done by the lender. However, the local authority pays for the bank's intermediation services through an undisclosed margin between the bank's cost of capital and the interest rate charged on the loan, as well as a variety of bank fees associated with making the loan.

In the case of bonds, the terms and conditions of the financing are presented to investors by the local authority. With bonds there is no intermediary between the local authority and the capital market, and hence no undisclosed interest rate margin to pay to a bank. However, the process for a local authority to issue bonds is more complicated than it is for a bank loan. As a result, for a bond issue it is recommended that a local authority hire specialized financial advisors, lawyers and bond underwriters all of which charge fees for their services. In order to attract the most investors, the bond should be rated by a credit rating agency (sometimes by more than one) for a fee. By issuing bonds a local authority gains greater control of its financing process but loses the relative simplicity of taking a loan.

It is important for any local authority planning to finance large infrastructure projects to undertake a serious and deep analysis of their potential sources of capital and types of financing mechanisms. Local authority leaders need to compare the financing terms available under each of the options: the maximum duration of the debt, the likely interest rate, any special conditions on the financing, and any penalties for early payment, among others.

The importance of demonstrating creditworthiness…

The terms available to a local authority for long-term financing have their foundation in the level of trust that creditors have in the borrower. The concept of a local authority being creditworthy is actually a way of expressing the level of trust felt by financial institutions. In fact, the word credit comes from the Latin *creditum* meaning trust. Creditors have to trust the local authority to repay its debt in full as it comes due incrementally over many years. Naturally, potential creditors look for evidence that the local authority seeking their funds is trustworthy, i.e. creditworthy. For them it is not just a matter of trusting the individuals currently managing the local authority; rather they want to be able to trust the institutional strengths of the local authority.

Financial institutions know perfectly well that the people managing a local authority are likely to change over the repayment period of a long-term debt. Therefore there must be a solid institutional structure of written policies and procedures which assures that the local authority's commitments will be honored. Creditors also know that a local authority's financial conditions can change over time, so when large long-term debts are involved, they require regular reports to maintain their level of trust.

This is where credit ratings play an important role. They provide an objective external assessment of a local authority's degree of institutional creditworthiness. A credit rating is normally established before a local authority obtains long-term debt financing so that potential creditors can determine how much trust they can place in the institution. Once a credit rating is established, it is also updated on a regular basis by the credit rating agency to reflect any changes in the local authority's creditworthiness. This enables creditors to reassess their level of trust in the local authority and adjust their portfolio of assets accordingly.

A local authority's creditworthiness has a direct impact on its cost of borrowing capital. The higher the credit rating the lower will be the cost of borrowing from market-based financial institutions. Local authorities that are deemed not creditworthy (rated BB+ or lower) may still be able to borrow, but market-based financial institutions will require a high rate of interest on the debt as compensation for the higher default risk and this can make the borrowing unaffordable. On the other hand, even creditworthy local authorities (rated BBB– or higher) can reduce their cost of borrowing by demonstrating improved creditworthiness through higher credit ratings until the AAA rating is achieved.

Regular updating of a local authority's credit rating has two major benefits. First, the financial community obtains timely information about the financial condition of the local authority. When the rating improves it helps increase investor confidence. In turn, this can help to lower interest rates or improve other terms for additional borrowing or refinancing of existing debt. Second, an updated credit rating provides timely and objective feedback to local authority leaders and other stakeholders on the quality of the local authority's financial management. The detailed report that accompanies the rating can be used as a guide for the development of financial management improvement plans.

The importance of institutionalizing good financial management…

The institutionalization of good financial management practices is what ultimately enables a local authority to achieve the highest level of creditworthiness possible under its prevailing economic and demographic conditions. Adapting and institutionalizing well respected financial policies and procedures used by the most creditworthy local authorities is an effective way for local leaders to achieve the highest possible rating. The more financial policies are formally established by decision of the local authority's legislature, governing council, or board, the more transparent they are to investors, and the less likely they are to depend on ad hoc decisions of individuals. Written procedures that are linked to a local authority's financial policies help to insure that managers and staff routinely follow good financial management practices. When a local authority's financial management practices are fully transparent and consistently followed, then local policy makers and managers are doing their best to institutionalize creditworthiness.

II. Preparing a Management Review: Understanding the Factors that Influence Creditworthiness

By now it should be clear that the creditworthiness of a local authority is in the hands of its leaders; elected or appointed, whether policy makers or managers. It should also be clear that demonstrating improved creditworthiness is financially beneficial to any local authority that uses debt financing. It can also be a matter of pride for local authority leaders because it reflects sound fiscal policies and good financial management as well as appropriate stewardship of the community's funds.

Creditworthiness factors assessed by credit rating agencies…

To demonstrate improved creditworthiness, a local authority needs to achieve (or improve) an "investment grade" credit rating. But before embarking on the formal credit rating process, it is useful for local authority leaders to conduct their own Management Review to identify the steps they can take toward securing the best possible rating. The following creditworthiness factors examined by the credit rating agencies provide the basis for a Management Review:

1. The institutional framework surrounding the local authority such as: the degree of centralized/decentralized governance of the country; the local authority's degree of fiscal autonomy; the formal responsibilities of the local authority especially with regard to capital investment projects; the extent of legally mandated annual expenditures; and the characteristics of any funding provided to the local authority from the national government.

2. The local authority's debts and other liabilities including: the size and structure of current debt (long or short term, fixed or variable interest rate, to be paid in local currency or foreign currency); the trend over the past several years in the debt service burden; the anticipated needs for future debt financing; the amount of the local authority's other liabilities and how they are funded; and the extent of the local authority's contingent liabilities and how they are funded.

3. The local authority's finances including: the trend over the past several years in total revenues (their volatility, their diversity, their predictability); the trend over the same period in total expenditure and the degree to which the local authority can adjust expenditures when necessary; the trend in the balance (surplus or deficit) between recurrent operating revenues and recurrent operating expenditures; the size of fund balances held as reserves; and the local authority's record of managing its liquidity over the past several years.

4. The management and administration of the local authority including: the extent of institutionalized financial policies and procedures; the process for developing and managing the budget; the quality of accounting and financial reporting; the existence or absence of independent external audits; the extent to which financial management is affected by politics, labor issues, or citizen initiatives; and the degree to which officials make use of available revenue and expenditure flexibility to manage their local authority's finances.

5. The economic outlook for the local authority's jurisdiction including: the degree of diversity and growth in the economic base; the trend in the size of the local revenue base and composition of the largest tax/fee payers; the current and projected employment conditions; the trend in local income and wealth in the jurisdiction; the trend in population size and age structure; and the per capita local tax/fee burden compared to other similar jurisdictions and the national average.

Of course, not all of the factors analyzed by the credit rating agencies can be directly affected by the management choices of a local authority. To some extent, the creditworthiness of a local authority is constrained by a number of factors beyond the immediate control of their leadership. Yet there are enough other factors that can be managed so that improved creditworthiness is an achievable objective.

Creditworthiness factors that can be affected by good management…

The leaders of a local authority are not likely to be in a position to modify the larger institutional framework that affects them. However, they can affect the management of the local authority's debts and other liabilities. Unless unduly constrained by institutional factors, local authority leaders may also be able to adjust their revenue collection efforts to meet essential expenditure needs, or reduce lower priority expenditures to accommodate realistic revenue levels. With strong leadership commitment, many local authorities on every continent have been able to systematically put aside funds in reserves to cope with the uncertainties of the future.

In the short run, local authority leaders can do little to improve their economic and demographic situation. However in the longer run, creative local leadership can stimulate economic diversity and growth which help improve employment opportunities, incomes and wealth in the community while the tax burden remains acceptable to all. Most importantly, local leaders can implement management improvements that will increase creditworthiness. The next seven sections of this Guide discuss the issues to be examined in a Management Review that local authority leaders can use to plan their creditworthiness improvement efforts in advance of a formal credit rating. These management issues can all be addressed in the short run, and doing so will have a positive impact on a local authority's creditworthiness.

III. Management Review Issues: Debt

The crucial importance of timely debt repayment…

The way in which a local authority manages its debt is undoubtedly the most important factor in determining its creditworthiness. Remember, creditworthiness is demonstrated by a credit rating which indicates the degree of risk that the rated entity will not repay its debts. If a local authority were ever to fail to make a required payment on its debt, credit rating agencies would immediately downgrade its rating to "D" (defaulted) and it would take a long time and enormously painful efforts for the local authority to become creditworthy again. In those circumstances, the local authority would be effectively cut off from any future debt financing, and this usually results in bad consequences for the development of the community. Therefore the actions taken by a local authority to properly manage its debts are crucial to achieving its highest possible level of creditworthiness and lowest cost of access to needed capital.

Because of the crucial importance of debt management, this is where a local authority Management Review should begin. Experienced local authority practitioners start by reviewing their existing policies and procedures concerning debt service (debt repayment). Where policies and procedures are lacking or inadequate, experienced practitioners prioritize the correction of these problems.

Essential debt management policies…

The most creditworthy local authorities have institutionalized a set of key debt service policies, and they follow them scrupulously.

- First, there is a <u>policy of giving debt repayment priority</u> over all other payments by the local authority unless specifically indicated otherwise in the indebtedness document. This gives the local authority's creditors reassurance that they stand at the front of the line for payment unless they have specifically agreed otherwise.
- Second, there is a <u>policy concerning the local authority's allowable uses of debt financing</u> which restricts long term debt to financing only long lived capital improvements (sometimes quite specifically defined) and restricts short term financing (to be repaid within the budget year) to covering routine expenses during temporary delays in receipt of revenues. Debt financing that is neither long-term nor short-term is sometimes used to fund infrastructure improvements that need to be done very quickly (more quickly than it takes to arrange long-term financing). In such cases, policies should establish the allowable circumstances for using medium-term debt and require full repayment within the remaining term of the elected officials that approve it. This demonstrates that the local authority is careful to use debt financing appropriately.
- Third, there is a <u>policy that officially limits the local authority's indebtedness</u> either in terms of total amount or in terms of the percentage of recurrent revenue that can be pledged to debt service. This assures that the local authority cannot take on more debt than it can afford to repay.
- Fourth, there is a <u>policy of entering into debt only in local currency</u> so that the currency in which revenues are received is the same as the currency required for debt repayment. This avoids the risk of sudden uncontrollable debt service increases in the event that the country's currency devalues against foreign currencies. In case of deciding to allow debt to be contracted in another currency, there must be a policy that requires the collection of sufficient revenues in that same currency to reduce the financial risks of possible devaluations.
- Fifth, there is a <u>policy of repaying debts as rapidly as possible</u> so that the debt service burden is reduced even more quickly than planned when there is an opportunity to do so. This reduces the local authority's overall financing costs, freeing future revenues for other purposes.
- Finally, there is a <u>policy of monitoring and evaluating financing and refinancing options</u> so that the local authority can take advantage of financial market changes to minimize its overall financing costs. This demonstrates a proactive approach to debt management that reduces repayment risk.

Going from policy to practice…

In addition to formally establishing essential policies, the most creditworthy local authorities have institutionalized the use of a variety of procedures designed to implement and supplement those policies. Process mapping by a local authority will reveal whether current procedures properly match established policies. Essential written debt management procedures for a local authority include:

- Setting aside the funds for periodic debt payments in advance of the payment due date. By requiring the local authority's executive to deposit debt service funds in a special account at least 60 or 90 days in advance of the payment, any potential shortage of cash is identified early enough to rectify the problem by curtailing other payments before a debt payment is missed.
- Reviewing and approving the use of debt financing. By requiring the formal approval of the local authority's legislature, governing council, or board before seeking debt financing, there is a check on the appropriateness of the financing in terms of the policies on allowable uses of debt and the debt limit. In some jurisdictions, the specific purpose for major new long-term debt financing even has to be approved in advance by a local referendum. In other jurisdictions the local authority's executive may have limited authority to contract small short term loans to cover routine expenses during temporary revenue delays.
- Conducting debt affordability reviews. By requiring all debt financing proposals to be subjected to an affordability analysis prior to submission for approval, officials can enforce the local authority's debt limitation policy. Conducting debt affordability reviews is considered a best practice for local authorities and more detailed information about this procedure can be found through the Government Finance Officers Association of the United States and Canada (www.gfoa.org). Debt affordability reviews may also indicate opportunities to accelerate repayment of existing debt that will free up resources for future borrowings.
- Reviewing and approving specific financing and refinancing transactions. By following a formal review and approval procedure established for all financing transactions before executing any debt contract, there is a final check on the terms of the financing. Formal review and approval by the local authority's legislature, governing council, or board is essential and gives investors/lenders assurance that the local authority understands the terms of the debt and cannot later repudiate the debt as being "unauthorized".

Avoiding missed debt service payments…

In addition to examining policies and procedures, a Management Review should check to see if appropriate mechanisms are being used to safeguard the local authority against missed payments. Since the single most important factor in obtaining credit is the ability to identify a reliable funding source to service the debt, the greater the degree to which debt service payments are automatic, and beyond the responsibility of any official, the less is the risk of a default and the more creditworthy is the local authority. It is also possible to structure the legal provisions of specific bond issues or loans to guaranty automatic access to a reliable revenue source for debt service payments. The most automatic payment mechanism involves a "revenue intercept" which diverts a portion of a specific revenue source (often transfer revenue from national government) into a special account before the money ever reaches the local authority's general account. Such special accounts are typically established as "irrevocable trusts" or "escrow accounts" in a financial institution with written authority to only disburse the funds for debt service payments. Of course, the revenue source that is intercepted through this mechanism must be one that will produce a reliably adequate level of revenue over the full term of the debt.

Less automatic debt service mechanisms can also be used. A local authority can pledge a portion of a reliable revenue source by passing a local law/resolution that requires the authority's executive to set aside funds in a debt service reserve fund, escrow account or trust as soon as those funds become available in the general account (so long as they are always well in advance of the payment due date). Maintaining a positive balance greater than the annual debt payments due in a debt service reserve fund is an essential mechanism. So long as the debt service reserve fund cannot be diverted to other uses, it reduces the risk of default and improves a local authority's creditworthiness.

In many cases, the structure of repayment mechanisms in a specific bond issue or loan will be rated by credit rating agencies. When well structured, such debt can achieve a higher credit rating than the underlying institutional rating of the local authority issuing the debt. However, the underlying institutional rating remains a key factor in achieving the necessary confidence of lenders in the financial management of the local authority itself, and its ability to manage its overall debt.

IV. Management Review Issues: Other Long-Term and Contingent Liabilities

Identifying long-term liabilities…

While debt is one type of long-term liability, there are other types of direct and contingent liabilities that a local authority may incur. The most common types of additional liabilities include staff pensions or post-employment benefits, and contingent liabilities created by entities owned or controlled by the local authority. Because these other liabilities may affect a local authority's ability to repay its debts, the most creditworthy authorities manage these liabilities carefully. A Management Review needs to assure: 1) that the local authority has identified all of its long-term and contingent liabilities; 2) that financial provisions have been made to deal with these liabilities; and 3) that these liabilities are clearly disclosed in the local authority's financial reporting.

If a local authority is responsible for the payment of pensions or other kinds of post-employment benefits to its staff (e.g. medical insurance, school fees, housing subsidies, etc.), then the amount of this liability needs to be quantified on the basis of current staffing and their accrued benefits according to applicable benefit policies. An analysis of the trend in accrued and actual benefit claims can be used to project expected claims into the future. Once the expected claims have been estimated, the local authority needs to set aside funds in a reserve account adequate to meet the claims projected for each year in the future. The same is true for the management of other types of long-term liabilities such as leases for long-lived equipment and buildings, or other legal obligations that require future payments to others. All long-term liabilities and associated reserves must be properly included in a local authority's accounting statements. Local authorities which have not estimated their long-term liabilities, or which have not made adequate funds available to meet their needs will be viewed negatively by credit rating agencies.

Contingent liabilities are important too…

Contingent liabilities are another area that a Management Review needs to examine carefully. Contingent liabilities can be defined as follows:

A contingent liability is a hypothetical liability that depends on a possible (even if unlikely) event or situation to occur before becoming an actual liability. Examples include financial guarantees, unfinished contracts, pending court cases, unfilled purchase orders, and unsettled disputes that may require payments to others.

The financial obligations of entities entirely owned by a local authority (e.g. the debts of a bus company owned entirely by a local government) must be considered contingent liabilities of the local authority itself. For a local authority's accounts to be considered accurate, contingent liabilities must be disclosed on the balance sheet via an explanatory note. In addition, an appropriate provision for the contingency needs to be made in the form of funds held in a reserve account. Failure by a local authority to accurately report and provision for contingent liabilities can lead to an unnecessary downgrade in its creditworthiness. In addition, it is also recommended that local authorities plan and make financial provisions as appropriate for other types of contingencies such as natural disasters or the unexpected breakdown of essential equipment.

V. Management Review Issues: Liquidity & Operating Margin

A healthy operating margin makes creditworthiness possible…

The ability of a local authority to manage its operating margin (the percentage of operating revenues not consumed by operating expenditures) and to maintain adequate liquidity are important factors used by credit rating agencies to measure creditworthiness. A Management Review needs to examine the local authority's recent history of liquidity and determine if operating margins have been adequate, or are in need of improvement. The Management Review should start by examining operating revenues. Operating revenues are all revenues except those specifically designated for funding long-lived capital improvements (e.g. proceeds of a debt financing transaction, or an external grant from national government or other donor). Operating revenues fund the local authority's operating budget that typically pays for current expenses such as debt service, wages, salaries, supplies and services including routine maintenance of assets and purchase of short-lived assets such as office equipment or automobiles.

Operating revenues can be larger than the operating budget if operating expenditures are carefully planned and controlled. In those cases, the revenue surplus creates a positive operating margin that can be used to fund essential reserves, accelerate debt repayment, finance capital improvements or take care of other priorities. A history of healthy operating margins is a positive factor in a creditworthiness assessment. Implementing a plan to increase own source revenues is an excellent way to improve a local authority's operating margin and is viewed favorably by credit rating agencies. Implementing a formal policy of using non-recurrent revenues (sale of assets, extraordinary windfall revenues, etc.) only for non-recurrent expenditures such as building up reserves or pre-paying debts also makes a local authority more creditworthy.

Liquidity enables timely payment of obligations…

Even when a local authority achieves a healthy operating margin at the end of the budget year, it also needs to maintain sufficient liquidity through out the year to cover current expenses as they arise. Unfortunately for many local authorities, operating revenues may not always arrive exactly when needed over the course of the budget year. When delays in the receipt of revenues are common, it is important for the local authority to institutionalize a policy of maintaining an operating reserve in order to avoid the expense of external short-term borrowing. Operating reserves should also be governed by a prudent written investment policy that uses the money in the reserve to generate income while allowing quick access to cash. Establishing and implementing these operating reserve policies help improve a local authority's creditworthiness. Local authorities should avoid using inordinate delays in payments to suppliers and contractors (and especially to employees) to cope with liquidity problems since this reflects negatively on creditworthiness; as does taking on commitments that threaten to create illiquidity in the future.

VI. Management Review Issues: Quality of Financial Information and Monitoring

Timely, accurate and complete information is essential for local authority leaders to manage their organization's financial affairs. Unless officials make use of high quality financial information to manage the local authority, credit rating agencies will downgrade the organization's creditworthiness. In fact, the ability of local authority leaders to provide credit raters with the kinds of detailed financial information they require is often the first indicator of whether the local authority is creditworthy or not. So, assessment of the quality of a local authority's financial information is an essential part of a Management Review.

Obtaining good financial information…

The most creditworthy local authorities have budgeting and accounting systems that provide management with the timely, accurate and complete information they need. While this is fundamental, good practices go beyond this minimum. The most creditworthy local authorities have a formal policy of preparing multi-year financial forecasts. Their forecasting procedures project revenues (both transfers and own source revenues) several years ahead based on current data and sensitivity analysis on the factors known to affect their revenues. They also anticipate expenditures in advance; especially for growth in personnel costs, and periodic costs for major maintenance or replacement of important assets. Creditworthy local authorities use accrual accounting for expenditures so that costs are recognized when they are incurred rather than simply when they are paid. On the other hand, anticipated revenues are tracked, but not booked to the accounts until they are actually received. Good financial information needs to provide a complete picture of a local authority's finances. For this reason, the most creditworthy local authorities prepare consolidated financial reports that include (as appropriate) financial information from any subsidiary entities they own or control.

Using financial information well…

Good financial information only serves its purpose if it is used. Established procedures for monthly and quarterly financial monitoring should cause managers at different levels of the organization to understand their financial and budgetary positions accurately. At the highest levels of the local authority, officials have to be confident in the financial information they receive. So, the most creditworthy local authorities use an independent external auditor to check their accounting systems and certify their accounts. This enables them to make use of independently verified information rather than relying only on a government auditing authority. They also make their audited accounts easily available to creditors, financial institutions and the public to help build trust.

VII. Management Review Issues: Long-Term Capital Expenditure Planning

As previously discussed, capital expenditures are essential when local authorities are responsible for the provision of infrastructure. Infrastructure provides the foundation for local economic development, but many infrastructure projects are too costly to fund from annual operating revenue surpluses. Since capital expenditures frequently require debt financing, a Management Review needs to include examination of a local authority's capital expenditure planning policies and procedures.

The value of multi-year planning…

The most creditworthy local authorities are very prudent about undertaking capital expenditures. They recognize the importance of investing in infrastructure that promotes development, but they plan their investments carefully. The most creditworthy local authorities have institutionalized a policy of formally approving multi-year capital expenditure plans and updating them for approval on a regular basis. Requiring the local authority's legislature, governing council, or board to approve multi-year capital expenditure plans assures continuing consensus on investment priorities over time. When coupled with a formal policy on the appropriate uses of debt financing, this assures institutional commitment to repay any debt needed to implement the plan, and that is a positive factor for creditworthiness.

Local authorities should follow written procedures for the development of realistic capital improvement plans and investment budgets that take into account both the financial resources and the management capacity required to successfully implement the projects. Capital improvement planning should assess the advantages and disadvantages of pay-as-you-go funding compared to debt financing of the various projects. If debt financing is contemplated, then a realistic phasing of the construction projects should guide the phasing of the amounts to be borrowed. This helps to avoid unnecessary financing costs and unplanned diversion of temporarily excess capital.

Estimating the impact of projects on future year operating budgets…

The formal capital expenditure planning procedures of the most creditworthy local authorities include projection of changes to the annual operating budget as a result of completing the capital improvement projects. This may be a cost savings (e.g. replacing inefficient water supply pumps to reduce energy expenses), a revenue enhancement (e.g. increasing property tax collections in neighborhoods where property values are improved through extending roads and other services), or a cost increase (e.g. increasing the personnel budget to staff a new function or facility). Local authorities that can anticipate the operating budget implications of their capital investment plans are always considered more creditworthy than those that cannot.

VIII. Management Review Issues: Professionalization

Managing the various functions of a local authority is important work. The efficient and effective delivery of services is a product of good management. Local authorities that employ managers that are well trained and experienced in their functions perform better than ones where poorly qualified appointees direct operations. A Management Review should examine the qualifications and experience of the local authority personnel in management positions, and the rules and procedures for hiring and firing them.

Hiring and retaining professional managers…

The most creditworthy local authorities have an established policy of hiring managers through a competitive process based on written job descriptions that specify the knowledge, skills and abilities required to perform the work. As a result, their managers are well qualified for their functions. Creditworthy local authorities also invest in training and professional development to keep their managers abreast of developments in their field. They also value continuity of management personnel as a means of institutionalizing the policies and procedures adopted by local authority leaders. Credit rating agencies see well qualified managers as an enhancement to creditworthiness. Raters will also examine a local authority's record of retaining key managers under more than one elected administration, and under the administrations of different political parties. Local authorities that professionalize their management functions are seen as more creditworthy than those that do not.

IX. Management Review Issues: Quality of Services & Citizen/User Satisfaction

Service quality affects financial performance…

At the core of a local authority's responsibilities is delivering good services, as well as making sure that citizens are satisfied with those services. The quality of local services is always a crucial factor determining peoples' willingness to pay for those services, especially if the service requires payment of a user fee. When people perceive services to be poor, local authorities find themselves unable to increase user fees enough to cover inevitable increases in operating costs. This typically leads to inadequate funding for current operations, with the result that the quality of services declines even more.

This vicious cycle of declining services can even lead to declining revenues if people refuse to pay or seek other sources for the services they require (e.g. people use their own wells for water rather than the municipal supply; businesses generate their own electricity rather than buy it from the local electric utility). In either case, poor service delivery is bad for the financial health of a local authority, and credit rating agencies will downgrade the institution's rating as a result.

Assessing service quality and institutional responsiveness to users…

A Management Review should examine what steps the local authority is taking to assure that people are satisfied with the services provided. The most creditworthy local authorities make efforts to monitor the quality of their services and correct problems before they begin to cause financial difficulties. This can be done in a variety of ways depending on the type of service involved, but two management tools can be used for a variety of services.

The first tool is performance benchmarking. This involves the systematic comparison of the performance of a local authority's service operations to the performance of the same service operations in similar local authorities elsewhere in the country (or elsewhere in the state/province or region). Benchmarking is done in technical terms (e.g. percentage of population served by regular garbage collection; hours of uninterrupted electric supply per month; etc.) as well as financial terms (e.g. revenue lost due to unbilled water distribution; salary and wage expenses per ton of garbage collected; etc.). Organizing standardized inter-authority benchmarking exercises can be an important function of Associations of Local Authorities, but even one-to-one cooperation between similar authorities can yield results. If comparisons to the operations of similar local authorities indicate relatively poorer technical or financial performance, local authority leaders need to identify the underlying causes and address them.

The second tool is user satisfaction monitoring. This involves establishing "customer service" units or "ombudsman" offices that accept and record people's service delivery complaints. These same units then notify the appropriate technical department about the problem and follow up with the people who complained to find out when their problems have been resolved. Information collected by customer service units enables local authority leaders to get a sense of peoples' satisfaction with their services and institutional response.

Local authorities that are proactive in maintaining good service delivery performance are unlikely to fall into the vicious cycle of declining services. Local authority leaders need to understand the technical and financial performance of their service operations. They also need to understand the degree to which their service operations are responsive to the people who are paying for the service; whether through user fees or local taxes. Failure to understand these things can lead to financial problems for the local authority and will have a negative impact on its creditworthiness.

X. Conclusion:

Achievement of the highest possible degree of creditworthiness benefits every local authority. By demonstrating a high level of creditworthiness to financial institutions through an investment grade credit rating, local authorities can minimize the cost of any long-term debt financing they need to construct large essential infrastructure projects. Local authority leaders can achieve or improve an investment grade credit rating by addressing the financial management issues that most directly affect their rating.

Conducting a Management Review of the kind described in this Guide enables local authority leaders to identify their financial management strengths and weaknesses. This helps them to concentrate their efforts on management improvements that enhance creditworthiness and lead to the best possible credit rating. The recommended Management Review examines the financial management factors which credit rating agencies use to determine creditworthiness:

- Debt management;
- Management of other long-term and contingent liabilities;
- Liquidity management and maintenance of a healthy operating margin;
- The quality of financial information and monitoring;
- The planning of long-term capital expenditures;
- Professionalization of management;
- The quality of services, and the level of user satisfaction with those services.

Institutionalizing the kinds of policies and procedures used by the most creditworthy local authorities will enable every local authority to consistently practice good financial management and demonstrate creditworthiness with the highest credit rating possible.

XI. Annexes

A) Management Policies Models:

I. Model Debt Policy

1. OBJECTIVES	POLICY	REFERENCE
1.1 DEBT USE	1.1.1 Applicable only to investments of capital and long term assets	
	1.1.2 Debt should not be used to subsidize the operation.	
1.2 CONDITIONS	1.2.1 To allow reaching prudent (safe) risk levels of financing/funding that will provide flexibility for future capital requirements.	
	1.2.2 To allow reaching and maintaining a high credit rating	
1.3 UPDATING	1.3.1 Debt policies should be audited and adjusted at least every other year as an updating mechanism to the financial environment of the entity	
2. DEBT STRUCTURE	**POLICY**	**REFERENCE**
2.1 PERIOD/TERM	2.1.1 Period of attention or debt issuing should be the same or shorter of the useful life of the financed asset	
	2.1.2 Do not exceed the maximum due date (period) allowed by law	
	2.1.3 The average life of credits, bonds, commercial papers or any other financing mechanism should not be longer than 20 years.	
2.2 COST	2.2.1 Existence of payments (relatively quick/fast) to the principal as a decreasing measure of the whole financial cost.	
	2.2.2 If applicable, the requirements to provide bond issuing for calls previous to the date of expiration should be used the least possible and with the smallest interest rate to minimize the cost for the entity. (This refers to the call the buyer is allowed to make to redeem his bond before the expiration date, according to the fluctuation of the market, which may generate a cost or income to the issuing subject/company. However, the issuing subject must try to agree on the lowest rate, trying to minimize the cost for the entity.	
	2.2.3 Provide for future tax (lien) if applicable	

	2.2.4 The service contract of the debt must allow payments to the principal without causing additional cost. Anticipated payments should be applied to the capital without any kind of cost to the entity.	
2.3 PAYMENTS	2.3.1 A payment to the principal will be made no later than the second fiscal year after the sale of the bonds.	
	2.3.2 The initial due date to pay interest must be defined, after the sale of the bonds.	
	2.3.3 The longest term for the call of the bonds will be a period of 10 years.	
2.4 INTEREST RATE	2.4.1 As a priority a debt must be set with fixed interest rate.	
	2.4.2 The entity may issue variable interest rate debt only when the market/analysis justifies it.	
	2.4.3 The commercial paper must be considered as an obligation of variable interest.	
3. OTHER OPTIONS (ALTERNATIVES) FOR FINANCING / FUNDING	**POLICY**	**REFERENCE**
3.1 BONDS OF GENERAL OBLIGATION	3.1.1 Minimum issuing/flotation/emission must be published and adjusted according to the budget policies	
	3.1.2 To be used exclusively for new facilities or its improvement. (Remodeling, etc.)	
	3.1.3 The minimum period of the operational life of the acquired assets must be determined as well as the option for its extension.	
	3.1.4 The final amount will not exceed the estimated capacity of earnings of the entity for the next 6 years.	
	3.1.5 The circulating bonds should not exceed the 120% of the investment portfolio (the complete investment held by a Financial Organization) of the entity.	
	3.1.6 The total amount of bonds (the bonds minus the investment of the portfolio) should not be more than 25% of the final debt under a fixed rate.	
	3.1.7 Commercial paper could be considered as bonds only when the economical conditions of the business allow so and when it is approved by its committee.	
3.2.1 CERTIFICATES OF OBLIGATION	3.2.1.1 The minimum amount of issuing/emission must be set according to the budget level and must be approved by the highest empowered committee in the specific area.	

	3.2.1.2 Emission specially for the following projects: Capital assets, Extension of the useful life of facilities, renewal of streets, Public Electricity, Infrastructure Projects, Emergencies in the entity.	
	3.2.1.3 The capital assets must have value of at least X amount in relation with the budgeted capacity with duration of at least 4 years.	
3.2.2 OTHER CONSIDERATIONS	3.2.2.1 Need for an urgent project	
	3.2.2.2 The project is necessary to avoid an economic loss and must have the validation of a socioeconomic and environmental analysis before its endorsement.	
	3.2.2.3 Specific earning sources hoping to be able to pay additional debt.	
	3.2.2.4 Anticipated debt is the most economical/inexpensive and efficient funding option.	
3.3 EARNING/INCOME BONDS	3.3.1 Earning/income bonds will be issued when an income flow of known fees generated by the company could be assigned to support the service of the debt. 3.3.2 Its emission/issuing may happen without being voted only when the Law and the state ask this to be done this way.	
	3.3.3 The expiration date will be determined by the calculated duration of the funded project and by the available earnings to pay the debt during the "life" of the bond.	
4. SALES METHODS	**POLICY**	**REFERENCE**
4.1 CONSIDERATIONS	4.1.2 The selected sales method is determined after considering: Funding conditions of the market and specific transactions, to diminish the risk.	
4.2 SELECTION	4.2.1 A sales method with the lowest interest rate should be used and the service of the debt will be deducted from it.	
5. DEBT REFINANCING	**POLICY**	**REFERENCE**
5.1 IMPLEMENTATION	5.1.1 Saving financing transactions must be considered when the net actual/present value of the savings, as nominal value percentage of the refinanced bonds be at least 2%.	
	5.1.2 The anticipated refinancing for savings must be taken in consideration whenever the actual/present net value is at least 3%.	
6. DEBT LIMITS / RESTRICTIONS	**POLICY**	**REFERENCE**
6.1 RESTRICTIONS	6.1.1 The total amount of bonds along with the amount of capital of all the circulating debts will not exceed a 10% of the total estimated value of taxpayers of the company/entity	

	6.1.2 The payment to the service of the debt should not be more than 15% as a percentage of the net spending of the organization/entity.	
	6.1.3 The emission of debt will consider the estimated cash flow in at least 5 years, by calculating a separate factor for each type of emission that considers impact on population taxes and the rating of the same instruments.	
7. MATURITY (time limits)	**POLICY**	**REFERENCE**
7.1 EXPIRATION	7.1.1 The expiration date of the Debt should not exceed the expected duration of the capital assets to be funded and never could it be more than 30 years.	
	7.1.2 The weighted expiration date of the general obligation bonds will be equal or less than 15 years.	
8. MANAGEMENT OF DEBT SERVICE FUND	**POLICY**	**REFERENCE**
8.1 USE	8.1.1 The earnings by general obligation bond interests and obligation certificates will serve exclusively to fund capital's spending or directly for spending on service of future and actual debt.	
8.2 SIZE	8.2.1 The reserve for taxes on debt service should not be more than 3 months of reserve for spending actual budget for the debt service. (Total budget of the service of the debt / 12 months X 3 months) the amount of the passive reserve for taxes should not be more than 3 months of what was budgeted.	
	8.2.2 If the reserve for taxes exceeds policy 8.2.1, a plan for the reduction of such reserves must be adopted as soon as possible avoiding large variations to the estate tax or whatever income source that supports it.	
9. TAX RATE	**POLICY**	**REFERENCE**
9.1 MAXIMUM RATE	9.1.1 The contract for the debt service must consider the evaluation of the interest rate that allows to take care of the service to the principal debt, interests and fee payments for each fiscal year subject to availability of budget and to the estimated reserves.	D fee
10. RATING AGENCIES	**POLICY**	**REFERENCE**
10.1 PROMOTION/SHARING INFORMATION	10.1.1 The entity/organization will show efforts to maintain good relations with the rating agencies, as well as to reveal financial reports and information of these agencies to the public.	
	10.1.2 2 The organization will pursuit at least a national recognition of its bonds by these rating agencies or about anything related to its credit profile	

11. SELECTION OF FINANCIAL ADVISORS	POLICY	REFERENCE
11.1 ADVISORY	11.1.1 To obtain a better price, raise the quality standards, promote equity and objectivity, the entity should select a financial advisor, at least once every 5 years.	
	11.1.2 Company/entity staff must periodically revisit the current contracts to make sure the financial advisor is doing his job in a satisfactory way	
11.2 PROFILE OF THE ADVISOR	11.2.1 The selected financial advisor must offer (among his advisory services) a critical point of view regarding authorization and emission of debt instruments/tools or any other values, as well as planning of the debt management.	
	11.2.2 The advisor must state in any of his work proposals, the spectrum of this advisory issues and how it will impact his job in the improvement of the credit rating (assessment).	
12. COVERAGE	**POLICY**	**REFERENCE**
12.1 EXCHANGE RISK	12.1.1 The entity/organization will consider risks in fluctuations of ratings and exchange rates in the event of an existing debt in foreign currency and the proper use of instruments/tools created as protection, according to the policies of use in the entity of each one of these instruments.	
	12.1.2 The financing in National Currency must be backed up with earnings/income in the same functional currency of the country.	
	12.1.3 Debt contracts in foreign currency must be supported by a financial analysis that validates it as the best option before the national currency options. And also by income/earnings in the contracted foreign currency	
	12.1.4 Debt in foreign currency should have coverage mechanisms that minimize the exchange risk for the company/entity. This should not be a suggestion when the entity doesn't have earnings/income in the debt's currency	
	12.1.5 Hiring an insurance service for diverse emissions should be considered when an economic profit for each emission is validated.	

II. Model Budget Policy

1. OBJECTIVE	POLICY	REFERENCE
1.1 NEEDS	1.1.1 Establishing a strategy to meet the financial needs of the resource demands of the entity, which ensures a long-term fiscal stability.	
1.2 SCOPE	1.2.1 The final budget must tie the objectives of the administrative body for both budgets; Current Expenditure Budget, and Capital and Operating Investment Budget according to the priorities of the entity.	
2. BUDGETARY PROCESS	**POLICY**	**REFERENCE**
2.1 STRUCTURE	2.1.1 The Mayor and City Council set the parameters and priorities at the beginning of each budget cycle.	
	2.1.2 The Management and Budget Office shall publish annually a budget preparation manual that will guide the departments in developing their budgets. The manual will include a timetable for the preparation of the operating and capital budgets (current expenditure and investment).	
	2.1.3 The budgetary process should include a financial forecast of at least three years to assess long-term financial consequences of current policies, proposals, programs and budgets, ensuring that they conform to the objectives of the entity defined by the Mayor and City Council.	
	2.1.4 The Mayor shall submit a proposed budget to City Council for approval.	
2.2 HOW TO INFORM	2.2.1 The Mayor shall submit a summary of the main changes in priorities or service levels in the current year and the factors that lead to these changes.	
	2.2.2 The Mayor shall submit a summary of results for the year in turn on the main items, programs or services.	
	2.2.3 The Mayor will include the priorities and key issues for the new budget period.	
	2.2.4 The Mayor shall identify and summarize the key financial factors and the trends that affect the budget, such as economic factors, long-range perspectives, significant changes in the collection of revenue, the tax rates or other changes, the current and future debt obligations, and a significant use or the increase in the unreserved fund balance.	

	2.2.5 The Mayor shall provide summarized financial information on the income, other resources, and the expenditure for at least over a period of three years, including the previous year's actual budget; the current year's estimated budget and the actual executed exercise, as well as income and expenditure estimates for the following year's budget.	
3. BALANCED BUDGET	**POLICY**	**REFERENCE**
3.1 BALANCE	3.1.1 The Expenditure shall be equal to the Income in the final budget. The Mayor shall submit it to the Council for review and approval.	
	3.1.2 The long-term goal is that current expenditure never exceeds operating income on an annualized basis so that the structural balance remains balanced within each fund.	
3.2 USAGE	3.2.1 To establish the parameters for the use of funds not associated with reserves.	
	3.2.2 The Mayor shall provide a report to the Council on the financial impact of the city, using the fund that is not associated with reserves.	
	3.2.3 The budget for each of the funds should be balanced so that the credits for each fund in the fiscal year do not exceed the available resources, including estimated income and unreserved balances in the fund at the beginning of each year, ensuring that the entity does not spend beyond its means in relation to its financial health.	
4. LONG TERM PLANNING	**POLICY**	**REFERENCE**
4.1 MULTIANNUAL BUDGET	4.1.1 The multi-yearly projected income and expenditure must be reviewed at least twice a year, once before the budget process and once again following approval.	
	4.2.2 The multi-year budget projection can also be updated with the approval of the Council for any capital improvement plan. It may also be adjusted as a consequence of a political, legislative or economic change including factors of the market conditions.	
	4.2.4 The projection will cover at least 3 years as a minimum term.	
	4.2.5 The Office of Management and Budget Is responsible for presenting the multi-year projections for the Mayor and the Council as part of the operating cycle of the budget.	

5. INCOME	POLICY	REFERENCE
5.1 DIVERSIFICATION	5.1.1 Maintaining a broad revenue base to evenly distribute their load, and reduce to a minimum the exposure to the risk of deficits that could require support from income that would be additional to the budget of the entity.	
5.2 REVIEW AND IDENTIFICATION	5.2.1 During each year of the budgetary process, existing tax exemptions approved by the Council should be reviewed, and in turn recommendations should be made to the Municipal Administration for the identification of possible increases or decreases of approved exemptions, and of the new exemptions proposed.	
	5.2.3 The council or the authority should review the tax exemptions only during the budgeting process.	
	5.2.4 The sources of income should be reviewed at least once a month to report any significant change that could affect the budget, and determine the corrective measures, should they be necessary.	
	5.2.5 Potential new sources of income, identified during the year, must be evaluated and presented during the budgeting process of the next fiscal cycle.	
5.3 USAGE	5.3.1 The income directly related to a restricted fund will be used only for legally permissible purposes and with applicable fiscal backing.	
6. UNPREDICTABLE REVENUES	**POLICY**	**REFERENCE**
6.1 IDENTIFICATION	6.1.1 The entity must identify the main sources of unpredictable income and define how such income should be used.	
	6.1.2 Consider the variations in revenue collection and its impact in relation to the financial perspectives of the city and its ability to operate the programs in the current and future exercises.	
6.2 PREVISION	6.2.1 Establish in advance provisional measures to be taken if one or more sources of income generation become substantially higher or lower than projected.	
7. INCOME ESTIMATION	**POLICY**	**REFERENCE**

7.1 PROCESS	7.1.1 All administrative departments of the entity are obliged to submit annual estimates of income, with the support of documentation of the methodology used to determine said estimates.	
	7.1.2 There is a conservative approach to avoid budget deficits during the fiscal year.	
8. DEFINITION OF CHARGES AND FEES	**POLICY**	**REFERENCE**
8.1 UPDATING	8.1.1 The administrative departments shall review at least every two years for all costs associated with their department, and the changes to be made based on factors such as the impact of inflation, the adjustments to indirect costs and any other related expenses that impact on the cost of provision of public services.	
8.2 DETERMINATION	8.2.1 As part of the budgetary process the administration and the council must approve the new rates that may be submitted to the Mayor for inclusion in the budget.	
	8.2.2 The charges or fees shall be set at a level that ensures full cost recovery of the services provided. In the event that law limits a fee, that commission or license shall be set accordingly to what is established in the provisions.	
8.3 ENTERPRISE FUNDS	8.3.1 Enterprise funding must be self-sustaining in a way that the cost-income ratio is clearly identifiable.	
9. COLLECTING	**POLICY**	**REFERENCE**
9.1 SUPERVISION AND CORRECTION	9.1.1 The entity monitors the collection of revenue during the fiscal year.	
	9.1.2 When income is lower than the estimate, the departments notify the administration and the expected impacts to the budget for the current fiscal year are estimated and corrective actions and recommendations are implemented.	
10. APPROPRIATE ALLOCATION	**POLICY**	**REFERENCE**
10.1 SUFFICIENCY	10.1.1 Expenditure must be sufficient to provide quality services at a reasonable cost and within the available financial resources.	
10.2 FEASIBILITY	10.2.2 New applications for the financing of the programs must be accompanied by concise statements of the mission, objectives, and	

	expected and measurable results for each program.	
11. PERSONNEL/STAFF SERVICES	**POLICY**	**REFERENCE**
11.1 CONTENT	11.1.1 Benefits such as health insurance, life insurance, compensations for workers and their pensions, will be part of the budget of every department.	
	11.1.2 During the budgetary process, all the requests for personnel must be fully justified to show either that they will meet the purpose of the new program, or that the provision of services will be maintained and improved. All the additions must be approved by the Council	
12. BUDGETARY REDUCTIONS	**POLICY**	**REFERENCE**
12.1 PRIORITIZATION	12.1.1 All departments must ensure that administrative and service areas, insofar as possible, are reduced the least possible or that they are even preserved without any reduction.	
	12.1.2 Reductions should be focused on the latest positions added to the staff, and / or the more recent programs, or alternatively those that can be identified as not representative of the line of services inherent to the entity.	
	12.1.3 To focus on the reduction of non-discretionary programs, or, when the level of service is of a discretionary nature, focus on those that do not directly impact the entity's strategic plan.	
13. REPLACEMENT OF VEHICULAR STOCK	**POLICY**	**REFERENCE**
13.1 PLANNING AND PREVISION	13.1.1 A vehicle replacement plan should be followed throughout the entity to ensure the systematic replacement of vehicles based on the particular life cycle.	
	13.1.2 To define the guidelines of the systematic replacement policy through the establishment of a reserve to ensure that the specific departments carry out this replacement.	
14. CAPITAL IMPROVEMENT PROGRAM (CIP)	**POLICY**	**REFERENCE**
	14.1.1 There is a Capital Improvement Program	

14.1 TERM 14.2 CONSIDERATIONS	for two years, with the execution schedules for three years, to be presented to the Council for its approval. 14.2.1 The improvement plan includes a list of proposed capital improvements with the cost estimates, methods of financing, recommendations for each improvement and forecasts of income, and the maintenance costs of the facilities to be built.	
14.3 AMOUNT	14.3.1 The entity must establish the minimum amount for Capital Improvement Program projects, including operating and maintenance costs.	
14.4 PROJECT SUSTAINMENT	14.1.4 The investment projects presented in the CIP (capital improvement program) show operating and maintenance costs and will be taken into account during the evaluation of the operating budget.	
	14.1.5 Departments should have a plan developed with adequate funding for future repair and replacement for CIP projects.	
	14.1.6 CIP projects include a comparative balance of payments between capital improvements and funding, considering: debt -supported taxes; debt-supported income, and internally generated income.	
16. OPERATIONAL CONTINGENCIES	**POLICY**	**REFERENCE**
16.1 AMOUNT	16.1.1 To establish the minimum amount in the account of the operational contingency fund to cope with any unexpected expenditures during the full fiscal year.	
16.2 REPLACEMENT OF THE FUND	16.2.1 Any withdrawals from the contingency account must be approved by the Mayor.	
17. RESERVES	**POLICY**	**REFERENCE**
17.1 BALANCE	17.1.1 The entity will define the minimum cash balance to cover unexpected expenses.	
17.2 TERMS AND PAYMENTS	17.2.1 The entity will define the maximum payment terms for loans from the reserve fund, according to its own legislature.	
17.3 LEVEL	17.3.1 A general reserve fund will be maintained to respond to emergencies, (between 30 and 45 days of general fund expenditures). The entity must have a plan to achieve this level of reserves.	
17.4 USAGE	17.4.1 The fund will have flexibility for the use of reserves according to the following	

	prioritization: Unexpected events or emergencies, Capital Expenditures, Budgets for future years.	
17.5 FUNDING	17.5.1 Funding for this reserve is to come from: unique extraordinary income, excesses in the general fund and the excess of income higher than expenditure (surplus).	
18. BUDGET APPROVAL	**POLICY**	**REFERENCE**
18.1 DEFINITION	18.1.1 The entity defines the deadline for budget approval. If it were not approved by the date prescribed, the current budget shall be extended for personnel and basic operations for the maintenance of the entity, as were established the immediate previous year.	
19. ADJUSTMENTS TO THE BUDGET	**POLICY**	**REFERENCE**
19.1 AUTHORITY	19.1.1 The entity must define the appropriate staff members (usually, Heads of Department) to make the budgetary transfers that do not exceed the approved limits. Those that exceed this limit will require the approval of the Mayor.	
	19.1.2 A budget transfer for personnel services expenses, or one that affects revenue accounts, requires the approval of the Mayor.	
	19.1.3 The Council will have the authority to establish the budget for capital projects that have been approved by the Council.	
19.2 SUPPORT (JUSTIFICATION) AND DOCUMENTATION	19.1.4 The budget transfers submitted to the Council shall be accompanied by an explanation from the department. The department's explanation must be sufficiently clear and thoroughly detailed for the Council to determine the absolute need for the transfer to be made.	
20. PERFORMANCE MEASUREMENT	**POLICY**	**REFERENCE**
20.1 EXISTENCE	20.1.1 The departmental budgets must include performance indicators for each of the major functions within them.	
20.2 CONTENT	20.2.1 Performance measurements are based on the expected results of the programs and / or public services and should be focused on the most significant results, or on those prioritized by the government.	
20.3 MEASUREMENT	20.3.1 The results will be measured by their ultimate impact on the department's contribution to the mission and mandate of the entity.	
	20.3.2 Establish the minimum time for its updating and comparability with other entities.	
20. COST OF THE GOVERNMENT	**POLICY**	**REFERENCE**

SERVICES		
21.1 ESTIMATION	21.1.1 The office in charge of the budget will maintain a program to estimate the total cost of the various services offered by the city.	
	21.1.2 The total cost of a service includes both the direct and indirect costs associated to that service.	
20. REPORTS	**POLICY**	**REFERENCE**
22.1 TERM/PERIOD	22.1.1 The entity must establish the minimum time for submitting an expenditure analysis to the Office of Management and Budget.	
22.2 MONITORING/TRACKING	22.2.1 The Office of Management and Budget will keep a monthly expenditure monitoring and will report to the council on the budgeted versus the executed, on a quarterly basis.	

III. Model Investment Policy

1. FUNDAMENTALS	POLICY	REFERENCE
1.1 PARAMETERS	1.1.1 Appropriate boundaries are established for each type of investment and are supported by analysis and parameters that are consistent with those required by law.	
	1.1.2 The policy of the entity considers prudent investment levels to provide adequate flash flow while maximizing returns safely within defined investment parameters.	
2. TERMS	**POLICY**	**REFERENCE**
2.1 TIME LINE	2.1.1 It is always the intention of the entity to maintain all investments from time of purchase to their expiration dates in order to ensure a return on the capital of the investment	
	2.1.2 Review mechanisms are defined to anticipate potential unrealized losses, according to fluctuations in interest rates, economic conditions, among others, during the life of different investments	
3. OBJECTIVES/GOALS	**POLICY**	**REFERENCE**
3.1 SAFETY	3.1.1 Guidelines are provided to ensure the stability of the invested funds while maximizing the interest income from the various investments	
	3.1.2 Investments are made with the primary objective to avoid capital losses and capital preservation	
	3.1.3 The municipality establishes the methods to diversify their investments and different types of securities, issuers and maturities (expiration dates), according to its regulation framework	
3.2 LIQUIDITY	3.2.1 The appropriate percentage is defined to maintain the necessary liquidity to meet the requirements of expected cash disbursements (expenditures)	
3.3 RETURNS	3.3.1 After meeting the basic requirements of safety and liquidity, the objective (goal) of funds is to reach/achieve a competitive rate of return consistent with the safety and liquidity constraints	

4. DELEGATION OF AUTHORITY	POLICY	REFERENCE
4.1 STRUCTURE	4.1.1 A framework for delegation of authority is established to deposit and invest public money; the organizations and employees authorized to do so.	
5. INVESTMENT ADVISORS	**POLICY**	**REFERENCE**
5.1 COMMITTEE	5.1.1 There is an Investment advisory committee established by the authority, and meeting dates are set, at least quarterly, to review investment operations, risk analysis and performance of various investments in the city to constantly provide recommendations or improvements	
6. LEVEL OF ATTENTION	**POLICY**	**REFERENCE**
6.1 PERSONNEL	6.1.1 Authorized personnel profile is established for them to perform their duties with care, skill, prudence and diligence to operate the money of the state.	
	6.1.2 Personnel with the authorization to handle funds, shall abstain from any activity that affects or endangers their ability to make impartial investment decisions for the entity	
	6.1.3 Authorized personnel diligently to follow the provisions of policies for assessing risks and fluctuations shall be relieved of responsibility for the change in market prices, as long as they provide deviations from expectations filed in a timely manner and take appropriate measures to control this contingency.	

A Practitioner's Guide to Improve Local Authority Creditworthiness

6.2 RELATIONSHIPS	6.2.1 Authorized personnel which operate investments must report (in writing) to the Director of Finances, material and financial interests, as well as existing relationships with its employees and/or officers of financial institutions with whom there may be some business with the entity	
7. INTERNAL CONTROL	**POLICY**	**REFERENCE**
7.1 STRUCTURE	7.1.1 The Finance Department provides internal control systems to prevent losses from fraud, negligence, misrepresentation by third parties and other foreseeable circumstances that may arise in the operation of investments.	
	7.1.2 The internal control structure provides reasonable assurance that objectives are met, measurable and comparable	
7.2 SECURITY SYSTEMS	7.2.1 Internal control provides security systems against possible collusion, where two or more employees can work together in search of fraud	
	7.2.3 Internal control is intended to separate the functions, and ensures that the agents and their transactions are independent as a preventive measure of risk	
	7.2.4 Securities purchased from banks, such as guarantees and others are placed in the entity's depository bank for safekeeping	
	7.2.5 There is a manual of operation for subordinate members to define their authority and responsibility in order to avoid improper actions	
	7.2.6 All phone operations are previously put in writing by authorized staff	
	7.2.7 There is a daily detailed manual of procedures, for the critical functions of investment operations, so that in case of absence of the person in charge, other authorized agent may perform the procedures, in a regular and continuing manner	
	7.2.8 Financial statements of the entity and its administrative procedures are audited on a yearly basis by external staff	
	7.2.9 The investments of the entity	

	and accounting practices and management are also audited annually by external staff	
	7.2.10 Auditor's department of the Entity shall review and evaluate internal controls and processes related to the investment of resources allocated annually to the city	
8. AUTHORIZED FINANCIAL INSTITUTIONS	**POLICY**	**REFERENCE**
8.1 SELECTION	8.1.1 There must be a format for classification and recruitment of Financial Institutions, which includes, personal data of the operator, in which countries it operates, sector customers and operating record, among others	
	8.1.2 The people representing the financial institutions that will have financial services links with the entity must certify in writing that they have read, understood and agree to comply with the requirements in the investment policy of the entity	
8.2 REPORTS	8.2.1 Financial institutions should provide at least an annual audited financial statement evidencing Capital requirement	
	8.1.2 Financial institutions must prove they are certified and regulated by agencies or financial commissions of the country / state / municipality	
9. BIDDING	**POLICY**	**REFERENCE**
9.1 ADMINISTRATION/NEGOTIATION	9.1.1 The bidding process shall be fully documented for all transactions and records	
	9.1.2 Bidding records/registrations should be retained to be audited and reported	
	9.1.3 In all cases the placement of bids must be supported by appropriate analysis of liquidity, performance/returns and security	
10. AUTHORIZED INVESTMENTS	**POLICY**	**REFERENCE**
	10.1.1 The negotiation of different types of investments with authorized financial	

A Practitioner's Guide to Improve Local Authority Creditworthiness

10.1 OBJECTIVE/GOAL	institutions aim to maintain diversification, limit the risk of market rates, lengths of maturity, and so on	
10.2 BALANCE	10.2.2 As much as possible, the Council will seek to match the expiration dates of investments with the anticipated expenditures	
	10.2.3 In some cases if the cash flows allows it, certain funds may be invested for longer periods when the interest rate environment is considered favorable for the extension of the period	
	10.2.4 In order to limit market risk, maturity of the funds (10.2.3) will be limited to deadlines defined by the entity	
10.3 INVESTMENT PARAMETERS	10.3.1 The entity must establish the limits of percentage of values and maturities for each type of investment, including corporate bonds (debt), bankers acceptances, municipal obligations, and so on	
10.4 AUTHORIZED ISSUERS	10.4.1 The entity will carry out due diligence for all commercial papers, banks and issuers of corporate debt agreement. A list of these should be developed and delivered to the Investment Advisers Committee on an annual basis for review	
11. CREDIT PROVISIONS	**POLICY**	**REFERENCE**
11.1 ADMINISTRATION	11.1.1 Where an investment is below the expected capitalization rate, the Finance Director of the entity shall take the necessary measures to ensure and minimize losses for the entity	
	11.1.2 The Director of Finance will take into account the time of maturity, earnings or losses and will make a decision that will be reported in writing to the Investment Advisers Committee for its proper implementation	
12. PERFORMANCE REGULATIONS / STANDARDS	**POLICY**	**REFERENCE**
12.1 PRIORITIZATION	12.1.1 All percentage restrictions on investments are based on the book (accounting) value of the portfolio from the investment's date of the operation	
	12.1.2 According to International Financial Standards the entity must consider their investments to market	

	prices on a monthly basis using an independent pricing source for its evaluation in time	
	12.1.3 Market values are considered indicators of price volatility when making investment decisions	
13. INVESTMENT REPORTS	**POLICY**	**REFERENCE**
13.1 DAILY REPORTS	13.1.1 Opening and closing balances in investment accounts	
	13.1.2 Major changes in indicators of volatility associated with investments	
	13.1.3 Cash flow projections for the next business day	
13.2 MONTHLY REPORTS	13.2.1 Portfolio Summary including; settlement date of purchase, date of maturity (expiration), Coupon rate, Returns, Cost of Amortization, Book (accounting) Value, Earnings and Losses in the corresponding currencies	
	13.2.1 Analysis of VAR (Value at Risk), Stress Analysis, Analysis of Duration, Portfolio Concentration	

IV. Model Audit Policy

1. IDENTIFICATION	POLICY	REFERENCE
1.1 BASES	1.1.1 Define the audit plan based on the allocation of risks for each area	
	1.1.2 Identify the audit universe by reviewing previous audit plans, annual financial statements and assessments prior to risk	
2. AUDITABLE AREAS	**POLICY**	**REFERENCE**
2.1 OFFICES	2.1.1 The auditable areas should be concentrated in the offices of: Mayor and Council of the entity, the Administrator of the entity, Fiscal/Tributary Office of the entity, Directorate of Finance, Comptroller, Directors of Community Services, the Departments of Inspection (Health, Safety, etc.)	
3. SCOPE	**POLICY**	**REFERENCE**
3.1 PROCEDURES	3.1.1 According to the International Standards on Auditing, a review of the reliability and integrity of the financial and operational information should be considered.	
	3.1.2 Identify and review the methods for measuring and reporting financial information.	
	3.1.3 Review the established systems to ensure compliance with policies, plans, procedures, laws and regulations that may have a significant impact on operations and reports.	
	3.2.1 Review of the means for safeguarding the assets and, in its case, verify the physical existence of said assets.	
	3.2.3 Evaluation of the efficacy of operations within the organization.	
	3.2.4 Revision of programs to determine if the results are consistent with the set goals and objectives, and whether the operations or programs are being executed as planned.	
4. HISTORY	**POLICY**	**REFERENCE**
4.1 CONCLUSIONS	4.1.1 The audit plan includes a comparison of results with a range of at least 5 previous years as a basis for conclusions and reports to the entity.	

B) Outline for a Financial Management Diagnostic

Program for the Improvement of Creditworthiness: A Self-diagnosis Tool for Sub-National Entities

I. Description of the organizational and operational structure.

1) What are the responsibilities of the entity, and how is it organized to fulfill those responsibilities?
2) How does the financial structure of the entity support the operations? In particular, what are the types of revenues available and what is the proportion of each type to total revenues?
3) How are costs allocated to responsibility areas?

II. Background Information on Debt Level and Liquidity

Background on Debt:

1) What are the characteristics of existing debts and debt service requirements (for all operating units including contingent liabilities)? In particular:
   a. The total amount of debt (loans and bonds) broken down by debts that are guaranteed (legally or morally) by some other level of government, and debts that are not guaranteed.
   b. The maturity profile and other terms and conditions of all debt contracts (term, repayment schedule and years of grace on principal payments, interest rates).
   c. The ratio of debts with interest payments at fixed rates versus those at variable rates.
   d. The forecast of annual debt service (principal payments and interest).
   e. Payment history and any payment modifications over the last five years with respect to the timely and full payment of interest and principal on debt under the original terms of the loan/bond. (Review any payment records of the entity that have been submitted to regulators or auditors, and any payment records related to debt guaranteed by the entity.)
   f. Evidence of any cancellation or less than full and timely payment of obligations to suppliers, according to the agreed terms, in the last five fiscal years.
2) What is the size of the entity's annual debt service compared to its operating surplus (operating savings)?

3) What are the entity's plans for undertaking additional medium and long-term indebtedness (for all operating units, on-budget and off-budget) and the likely impact on the amount of annual debt service?

Background on Liquidity

Operational Savings: What is the relationship between revenues and "mandatory" current expenditure? Is there sufficient revenue available after mandatory expenditures to secure the payment of current debt service?

Are the entity's Cash Flows compatible with the cyclical and periodic expenditure needs? Are revenue resources available when they are needed? Is the entity's liquidity position formally reviewed at least twice per fiscal year? Is the entity's finance unit constantly monitoring cash flows?

III. Review of Revenue Generation

1) What are the sources and uses of the entity's revenues?
2) For each type of revenue, what has been the trend in collection?
3) What factors inhibit higher collection of the most important revenue sources?
4) What has been the trend in total own source revenue collection over the last 3 to 5 years (for all operating units)?
5) Is there a strategy or plan to increase own source revenue collection and, if so, what could hinder its successful implementation? Examine:
    a. Revenue potential.
    b. Billing and collection.
    c. Collection projection and monitoring (current year and multi-year projection).
    d. Documented revenue collection policies.
6) In order to maintain a balanced budget:
    a. Does the entity make a distinction between recurrent revenue and expenses and non-recurrent ones?
        i. If so, how do they monitor them?
        ii. Do the revenue and expenditure forecasts show this differentiation?
    b. Can functional units of the entity (departments, agencies, companies) retain any revenues that they produce (from fees, or tariffs), or must all such revenue be deposited in the entity's General Fund for reallocation through the annual budget process. If retained at unit level, how does the entity differentiate them from general revenues such as taxes, transfers, etc.?
    c. Does the entity have a formal manual on revenue administration? If so, what kind of information is included (e.g. description of all revenue sources, policies, procedures and documentation on establishing rates/fees, billing, and collection)?

d. Does the entity have established policies for how budget surpluses will be used, and how any budget deficits will be covered?

IV. Review of Cost Control

1) Has the growth of total expenditure (including all operating units) remained below the total revenue growth? If not, what are the causes of the higher rate of expenditure growth?
2) Are there certain categories of expenditure where the rate of growth exceeds the growth rate of total revenues? If so, what are the underlying causes of the higher rate of expenditure growth?
3) How precisely are expenditures kept within the authorized budget? What is the degree of deviation from the operating budget?
4) Are there specific policies governing expenditure?
5) How does the entity make its projections of wages and benefits for the budget? Are the amounts of salary and benefits calculated separately? Do wages increase based on the behavior of the previous year's budget, or by raises monitored through review dates?
6) Does the entity make use of Internal Services units for things such as fleet services, information technology, purchasing/acquisitions/procurement, personnel, or others? If so, what services does each unit provide, and how are internal charges (costs) established and distributed across the entity?
7) Does the entity prepare a plan for the allocation of total cost? If so, how is this plan incorporated into the budgetary process?

V. Review of Debt Management

1) What has been the entity’s experience with debt repayment?
2) Is there a set of debt management policies in place for:
    a. prioritization of debt payments over other payments,
    b. permitted uses of debt financing,
    c. Debt limits or debt service costs limits, and
    d. Tracking and evaluation of financing and/or refinancing options.
3) Is there a set of procedures for debt management in place for:
    a. Reserving funds for payment of the debt before the due date,
    b. Revising and approving the use of debt financing,
    c. Enforcing debt limits, and
    d. Reviewing and approving specific financing/refinancing operations.
4) Does the entity employ specific mechanisms to ensure payment of the debt on time (for example, revenue intercepts, sinking funds, debt service reserve funds, escrow accounts, irrevocable trusts, or others)?

VI. Review of the Management of Liquidity and Operating Margin

1) What has been the entity’s experience over the last 3 years (including all operating units) with respect to maintaining sufficient liquidity to meet current expenses as they occur?

2) Are there circumstances that suggest that maintaining adequate liquidity will not be possible in the future?
3) Has the entity resorted to short-term loans to maintain liquidity?
4) Is there any evidence of excessive delay in payments to suppliers or contractors?
5) What has been the annual operating margin (revenue surplus as % of total expenditures) for the last 3 years, and what factors have caused significant changes in the operating margin from year to year?
6) Has the entity identified the possible seasonality of inflows and outflows of cash and the potential magnitude of differences, in order to identify times of need for liquidity during the year?
7) Does the entity perform stress tests and build financial scenarios to help manage its liquidity and operating margin?

VII. Review of Planning for Long-Term Investment Expenditure

1) Does the entity prepare an investment plan? If so, what information is included and how is it used in the budgetary process and financial forecasts? Is the plan formally approved and does it cover a multi-year period? Does the plan allow for unexpected contingencies that could have a significant impact on available resources?
2) If there is no formal plan, can the entity articulate a well-designed informal plan for capital investment over the next 3 years? Do these plans require financing with debt?
3) If there is a multi-year budget forecast, does it take into account the revenue and expenditure impact of the long-term investment plans of the entity? If so, is there an outline of the plans that are included and how they are incorporated into the forecasts?
5) Does the entity have a clear understanding of the organizational implications of undertaking capital investment projects? For example:
    a. The costs are of great magnitude in relation to the operating budget;
    b. Decisions have a long-term impact on operating budgets;
    c. The costs are applied in multi-year periods;
    d. The implementation takes time;
    e. The use of debt is common;
    f. The projects differ from year to year,
4) What kinds of investments does the entity consider when planning their capital investment projects?
    a. Land purchases, and land improvements
    b. Buildings and major improvements to buildings
    c. Vehicles
    d. Equipment and machinery
    e. Protection of historical treasures (including artwork)
    f. Community infrastructure
    g. Other tangible and intangible assets

VIII. Review of the Quality of Financial Information and Monitoring

1) Do the budgets and accounting systems (for all operating units) provide accurate, complete and timely financial information to management? If not, what are the problem areas?
2) Does the entity use accrual accounting for revenues and/or expenditures?
3) Are the accounts of all operating units consolidated into a single financial reporting package?
4) Is the management review and analysis of financial information done properly, and can the entity's management describe its financial position accurately?
5) At year end, are the variations between budgeted revenues and expenditures and actual revenues and expenditures analyzed and explained? What about the variations between budgeted amounts for the previous and current year? If so, how do these variations impact the future budget cycles? How significant are these reported variations with respect to capital projects?
6) Is the management team able to anticipate the entity's expenditures? If so, how many months in advance? If not, what are the problem areas?
7) Is the management team capable of accurately projecting revenues (both transfer revenues and own source revenues), and if so how many months in advance? If not, what are the problem areas?
8) Does the entity's management understand the concept of contingent liabilities? Can they explain why they do or do not have contingent liabilities? If they have any contingent liabilities, are these adequately provisioned and are they disclosed in the entity's financial reports?
9) Does the entity have policies governing the establishment of special reserve funds? Are there any minimum and maximum value levels for each fund, and how they are monitored?
10) What tools are used to communicate financial information to those elected to make decisions? What communication tools does the entity use to inform the public and capital market institutions about their financial condition and future plans?

IX. Review of Professionalization

1) Are the key managers well qualified (through training and/or experience) to meet their responsibilities? Is there any apparent area with specific problems?
2) How many of the key managers have worked in more than one administration? How many of them have worked in administrations of different parties?
3) Does the entity make use of a formal compensation plan to establish wage levels for all employees? If so, how is such a plan developed (e.g., market comparisons, union negotiations, to conform to labor laws, etc.)? How often is this plan updated?

X. Review of Independent external audits

1) Does the entity have annual independent external audit reports (covering all business units), and are they available? If not, why not?
2) Have external audits produced any observations or offered only a "qualified" opinion? And, if so, how and how quickly have auditors' concerns been addressed?

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Leaders at the Core of Better Communities

ICMA-Latin America*

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Content