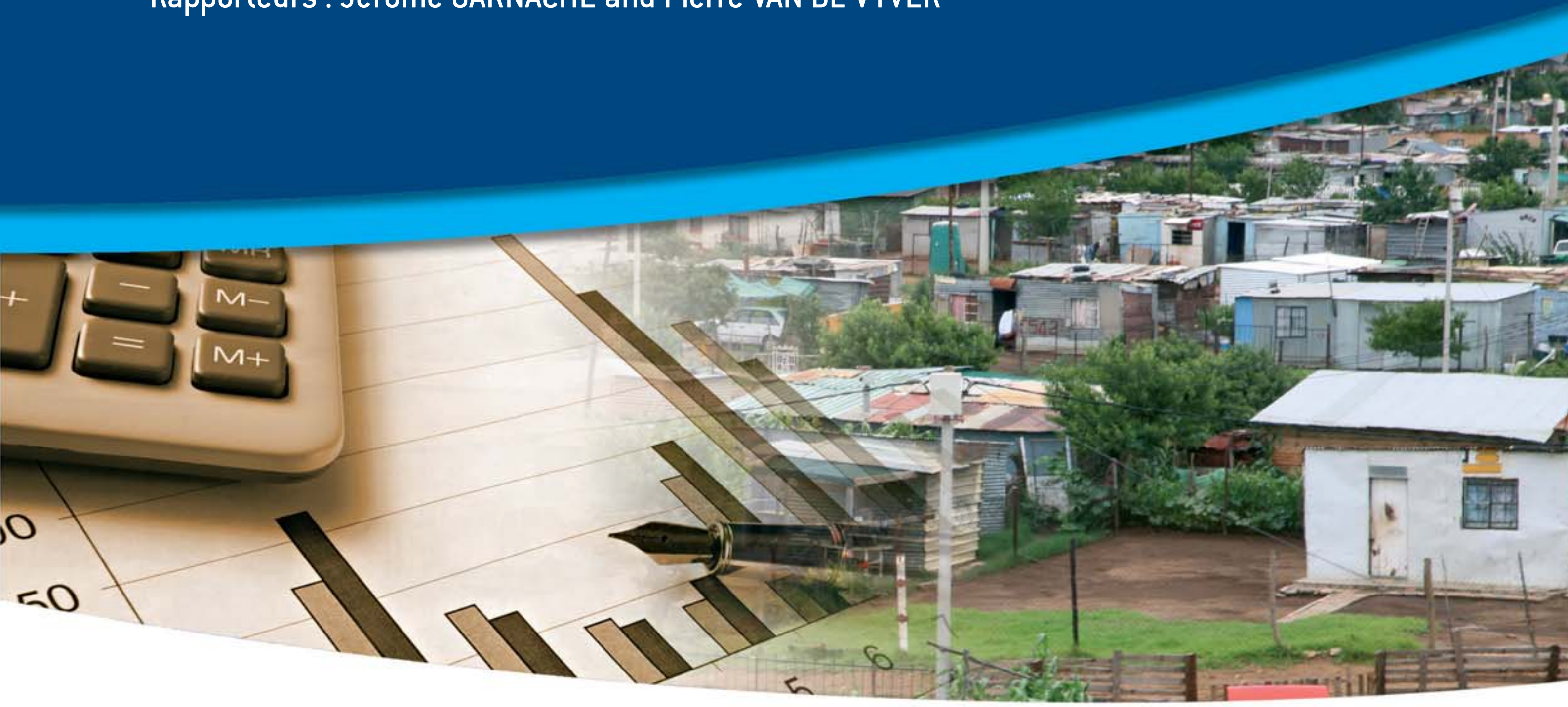
Financial self-evaluation guide for local authorities

Rapporteurs : Jérôme GARNACHE and Pierre VAN DE VYVER



Provisional report by the working group
« Financial self-evaluation for local authorities »
chaired by Michel Gonnet

In partnership with United Cities and Local Government

IGD
The French Institute for PPP

Committee for the Charter of essential services

INSTITUT DE LA GESTION DELEGUEE

Final report by the working group Financial self-evaluation for local authorities

Chairman : Michel GONNET

Managing the budget, administrating development, and creating opportunities for dialogue between financial partners.

Rapporteurs : Jérôme GARNACHE and Pierre VAN DE VYVER

Associated partners to the promotion and the dissemination of the Guide :

The Municipal Development Partnership

The bank for local development in Morocco

PREFACE

Since 2002, the French Institute for PPP has promoted, on an international level, a clearer framework of governance for essential services. The principles behind this were stated in the **Charter of Essential Services drafted in Johannesburg in 2002**. The IGD and the members of its Committee for the Charter have actively worked in close collaboration with the Ministry of Foreign Affairs and numerous international partners towards the official adoption of **a reference framework by the Member States of UN-Habitat** on April 2007[1]. The operational aspects of its implementation will henceforth be articulated with UN agencies and other actors in international cooperation.

Within this reference framework, **local authorities are accorded a key role in reaching the goal of providing access to essential services[2] for all**, an attainment that is synonymous with universal economic development and with an improvement in living conditions. Given that they are in direct contact with the daily needs of the population, local authorities possess the greatest legitimacy in choosing the most suitable methods for servicing all neighborhoods and all residents. In order to achieve this, **local authorities must be able to rely upon the support of all of the following partners**: representatives of the State; operators of essential services-public, private, and community-based; and the users themselves, who form organizations that represent their constituents and are best able to recognize the relevance and effectiveness of services rendered.

All actors involved in the process share the same focus on supporting local authorities as IGD, which has notably implemented "Quadrilogues for the access of all to essential services"[3]. This support necessarily includes **improving access conditions to financing sources** for essential services and for all activities undertaken by local authorities. There are numerous obstacles to attaining this goal, but they can be technically overcome, and numerous studies have shown that all regions across the world generally have available savings, often in large quantities. However, it is widely acknowledged that cash flow depends on confidence, or in Latin, *fiducia*. This is no doubt a priority in facilitating local authorities' access to financing by creating a suitable institutional and regulatory framework-how to consolidate confidence between the aforementioned authorities and those who can offer them the necessary capital?

Certainly, the financial backers are expected to make efforts towards **better understanding the contextual background and distinctive characteristics of local authorities**. United Cities and Local Governments (UCLG), a worldwide association active in current efforts, has made a priority of increasing access to financing for local authorities. Armed with proven and practical international experience[4], French actors in financing, banking, and cooperative bodies have been heavily involved in the working group set up and co-led by the IGD-a positive sign that reflects efforts towards improved understanding. Local authorities, especially those of small or medium size, have a considerable **need for budget and financial management training**, which will enable them to develop a shared language with their financial partners and to knowledgeably discuss future financial issues pertinent to their development. Over the course of meetings held at the Africities Summit 4 in Nairobi in September 2006, elected officials and technical personnel at the local level widely expressed their concern for this need. Therefore, we must find a **tool that facilitates dialogue between local authorities and outside financial partners** and consequently reduce the margin of lack of understanding between these two worlds that need to understand each other. The working group has dedicated itself to the cause in offering this **"Financial self-evaluation guide for local authorities"**.

Large cities in the south of France with skilled human resources at their disposal will not have much use for this guide, as there are numerous methodological works and training programs that are more complete and targeted in supporting those who already possess some expertise. The working group's aim was to **take into consideration the very large number of local authorities** that are not involved in the usual cooperation channels but that nevertheless represent a great majority of the population. The **self-evaluation method** was adopted with the goal of reaching the largest constituency-it is important to offer a flexible and educational framework that is easily and autonomously adoptable so that **local authorities can themselves**

[1] UN-Habitat Governing Council's Resolution 20/5 dated April 8, 2005; UN-Habitat Governing Council's Resolution 21/4 dated April 20, 2007.
[2] This paramount role is notably recognized in Resolution 21/2 of April 20, 2007 adopting the directing principles for decentralization.
[3] http://www.fondation-igd.org
[4] See the working group members list in appendix 1

take up the initiative to implement it. For this reason UCLG makes improving capabilities of financial self-evaluation a priority in its guidance on local finances[5].

Information resulting from this self-evaluation constitutes the first step towards creating a balanced relationship between local authorities and financial partners, but it is not in itself sufficient enough to provide access to financing. The relationship will grow with information input, but building up trust requires time, skill and mutual transparency. This approach may also be a useful aid in making development decisions and in programs for elected officials and technical personnel at the local level. It is also important for the democratic dissemination of information to the general population. By using this approach, **a constructive dialogue can be established not only with financial partners, but also between elected officials and the general population**. In this way, balanced and sustainable local development can take shape to offer access to essential services for all.

Claude **MARTINAND**
Chairman of
the French Institute for PPP

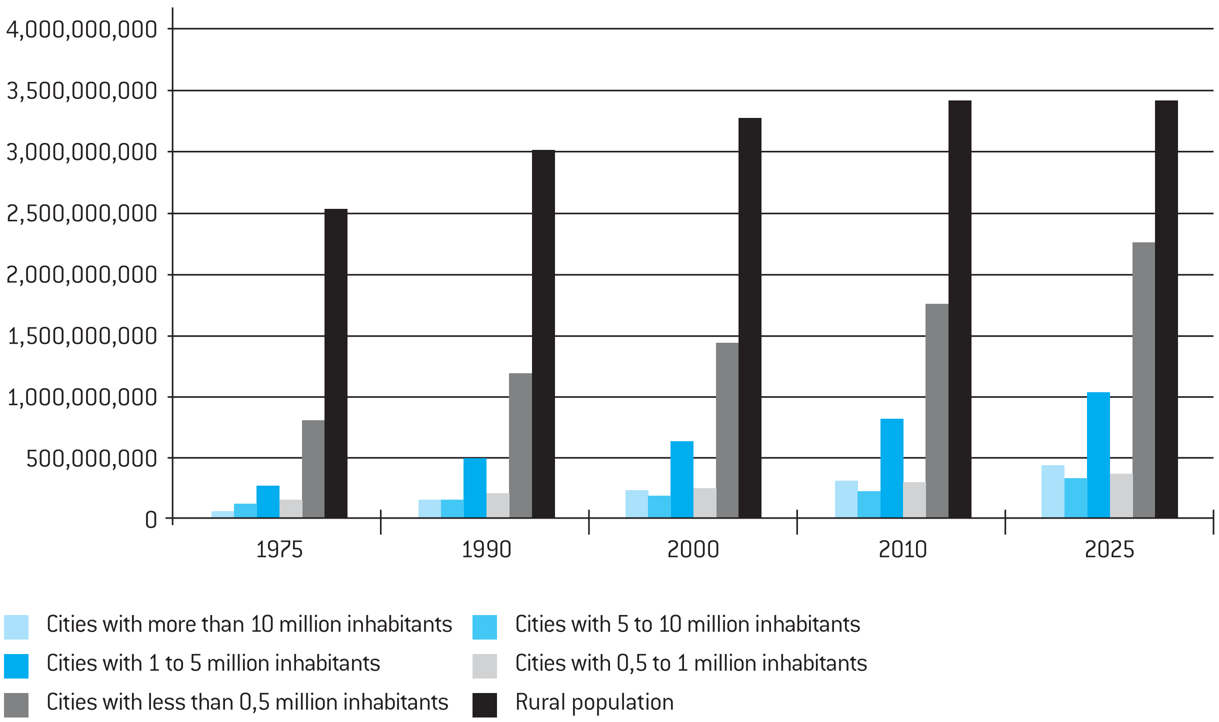
Michel **GONNET**
Chairman of the working group
« Financial self-evaluation
for local authorities »

[5] Available at : http://www.cities-localgovernments.org/uclg/upload/template/templatedocs/local_finance_policy_paper_en.pdf

SUMMARY

LOCAL AUTHORITIES ACROSS THE WORLD AND THEIR POPULATION

POPULATION DIVIDED BY INHABITANT ZONES



Source: World urbanization prospects : the 2007 revision, United Nations, Department of Economic and Social Affairs, Population Division

In 2025, 72% of the world's population will live in cities with less than 500,000 inhabitants or in rural areas.

INTRODUCTION

Dear Colleagues and Friends,

It is my great pleasure, as chair of the United Cities and Local Governments (UCLG) Committee on Local Finance and Development and Mayor of Maputo, to introduce you to the financial self-evaluation Guide for local authorities. The Guide is the result of a pilot initiative led by a working group constituted by IGD and its partners and to which the UCLG Committee actively collaborated. We hope that it will be useful for many small and medium size local governments across the world.

Founded in May 2004, United Cities and Local Governments is the united voice and world advocate of democratic self government. Accounting for over half the world's population, UCLG is the largest local government organization and is represented in 136 UN member states across seven world regions. Local Finance is instrumental in any decentralization process and a priority for the world organization, which set up the UCLG Committee on Local Finance and Development as an active network of mayors and representatives of local government associations, to promote financial autonomy of local governments, share experiences and broaden access to finance for local public infrastructure. The Committee drafted the UCLG Policy Paper on Local Finance, adopted by the world organization at the 2007 UCLG World Congress in Jeju, Republic of Korea. The Policy Paper contains 25 concrete recommendations for increasing local government access to infrastructure financing, particularly in developing country cities where infrastructure planning and construction have not kept pace with rapid urbanization.

In this regard, the financial self-evaluation Guide for local authorities is a powerful tool for all local governments wishing to improve their access to financial resources for their high priority investment projects. A large number of small and medium size local governments is indeed keen to explore external sources of finance for local infrastructure, but too often fail in their initial discussions and negotiations with potential financial partners. The major objective of this guide is ultimately to enable local governments to improve their communication and common understanding with banks, donors and investors, by helping local governments to shape and provide a clear and fair financial analysis to their partners in support to their funding requests. The handbook aims to provide local governments with a simple and suitable methodology to complete these needed financial analysis through self-evaluation.

We would like to thank the IGD and its partners for this inspiring document and call on local governments that will use the manual to comment and complement it as well as share their experiences in order to help us improving the Financial self-evaluation guide for local authorities.

We look forward to receiving your feedback and experiences.

Eneas da Conceiçao Comiche
Mayor of Maputo
Chair of the UCLG Committee on Local Finance and Development

PART 1: LOCAL AUTHORITIES' FINANCIAL PARTNERS

SUMMARY

Public facilities and services put into place by local authorities are always financed by **taxpayers** or by **users** paying a fee in exchange for using a public service.
However, local authorities can also turn to other actors, **outside financial partners**. The latter may, depending upon their vocation, provide resources of various means: State grants, commercial bank loans, contributions from international cooperation groups, loans on financial markets, etc. Certain resources, such as loans, must be paid back in time. Others, such as contributions and grants, are retained by the local authority.
These financial partners would also like to grasp **the local authority's ability to manage its projects well**, and, should the case be, to pay back the borrowed resources. This is because they are actually **tied to the local authority's success**: if the project fails or if it is no longer able to reflect the level of financial investment, they will also lose money. The more the financing obtained by the local authority is dependent on the financial markets, the higher the partners' expectations of local authorities will be in terms of **transparency, management, and expertise**.

Local public investment must take a long-term approach: **funding a project today creates revenues for tomorrow that will give the local authority the means to continue its development**.

In order to obtain the initial capital to finance projects and activities under their jurisdiction, it is important to preliminarily keep in mind that local authorities interact with three types of parties who have the resources that they need: **taxpayers, users of public services, and investors**. These parties may be households, businesses, organizations, etc., and they may be located nearby or far away. It is important to add that for investors, the influx of capital is only temporary, because they must eventually be paid back, either by users of public services or by the taxpayers.

1. FREE CHOICE OF INVESTORS AND SHARED INTEREST WITH LOCAL AUTHORITIES.

Oftentimes however, local authorities do not directly interact with these parties, as they are represented by intermediaries. **Taxpayers** are represented through the State and other structures authorized to collected taxes and fees, or through international cooperation bodies whose resources come from taxes collected in other countries, or even through NGOs, which receive grants allocated by public authorities. **Investors** are represented by banks, which have the responsibility of managing and adding value to households' and businesses' assets. Also included are certain international organizations that take the sums borrowed from banks or capital, and then lend it to others. Ultimately, the investors contribute funds via financial markets using the money that others have placed in their trust. A particularity of these financial partners is that **they can choose whether or not to invest in projects that local authorities would like to implement**. Investments can then take different forms: contributions, loans, investments, etc. However, the common denominator is of course the free choice of whether or not to contribute to financing the local authority.

The self-evaluation guide can therefore be viewed as a first step, at which a local authority must promote itself to convince an outside partner of the quality of its credit and management, and consequently, that offering them financial support is a great opportunity. Therefore, this guide will address neither procuring resources that the local authority can obtain directly via taxpayers through local taxation nor transfers that the State or other public entities can give in exchange for the local authority's carrying out certain actions.

This being said, a willingness to be open to outside financing may lead to a potentially advantageous dynamic as regards direct resources: this openness necessarily implies establishing a clear set of information, improving the transparency of budget management, and articulating short- and long-term development perspectives. The local authority can then report to the people and to the State on its use of resources and on the effectiveness of its actions, which then strengthens the legitimacy of taxpayer contributions. **Local authorities' careful management of public funds and being accountable to the people constitute responsible practices that are democratic and respectful of the general interest**.

As it were, outside financial partners expect local authorities to provide "good accounts", because they need to access reliable information on the local authority's accounts and to be reassured that that any potential investment will be put to good use. **If they cannot make a decision on the validity or opportunity to carry out projects due to interference concerns, they must at least be able to verify that their funds are being put to good use**.

The common point between external financial partners and local authorities **is their vested interest in the future success of the local authority's projects**, for should the projects fail, both the local authority and the investors will suffer consequences. This commonality of interest between the local authority and its financial backers is integral to their **partnership**. The outside financial partners and local authorities share the same goal of seeing the financing contribute to the growth of the local authority and of its revenues (in the form of additional tax returns or collection of fees). **Funding a project today creates revenues for tomorrow**, thus strengthening the local authority's financial autonomy and **giving it the means to continue its development**. The returns can be directly linked to the project, and be collected in the short term. Thus, a market generates taxes on professional services and commercial taxes. They may also be indirect and difficult to quantify-investing in a school will, in the middle-term, increase human and economic development (by creating a more qualified labor force and by widening the offering of skills, consequently stimulating economic growth and through that, tax bases), which could then contribute to improving the local authority's financial well-being. But in each case, the utility of public expenses depends on the effect that they generate, which will have a considerable impact on the local authority's revenues.

2. PROFILE OF LOCAL AUTHORITIES' OUTSIDE FINANCING PARTNERS.

Not all outside financing partners have the same level of expectations for local authorities:

- *those who give **contributions or grants** are concerned above all with knowing that the project will be carried out according to set goals and that the local authority has enough resources to prevent the project from collapsing as a result of insufficient funds;*

- *those who provide **loans or investments** are more concerned about new resources generated by the project, whether it be an increase in tax revenues or fees imposed on users, whose amount will allow the authority to reimburse and pay back the invested sum. If the project does not generate additional resources, the financial partners will be interested in the capacity of the local authority to honor its debt using existing resources;*

Therefore, outside financial partners belong to several categories, each with its own characteristics:

- ***The State and other public authorities**. These are voluntary contributions from the State or other governing bodies (regional, provincial, etc.) with a specific target (e.g., an investment grant for a library). These contributions do not come automatically, unlike grants and budget transfers linked to the carrying out of certain activities by local authorities. In certain cases, they may be accorded contingent upon the fulfillment of certain conditions. Technical help for implementing the project may also be offered. The resources come directly from the State budget through taxation, local fees (mobile phone licenses, occupancy fees, etc.) or even loans.*

- ***Specialized financing institutions**. These are often monopolistic entities specialized in financing local governments. This model was developed by the State in order to alleviate the insufficiency of other financing sources, because commercial banks are generally, although not systematically, absent from this market. Using specialized financial institutions (SFIs) to fulfill the financing needs of local governments is currently the predominant model in many countries, especially in sub-Saharan Africa, northern Africa, the Middle East and South America. These SFIs generally provide loans and support missions to local governments through investment programs and more widely, organizational support. SFIs' financial interventions take the form of loans to local governments, usually with advantageous conditions (an interest rate lower than the market rate, a longer loan maturity date) and/or grants on behalf of the State. Most often, SFIs are financed by the public domain (public funds, city funds, etc.), and also by international lessors through public savings or direct* *financing on the markets. Examples of this include: Morocco's Communal Supply Fund (Fonds d'Equipement Communal, FEC); the Development Bank of South Africa (DBSA); Tunisia's Caisse de prêts et de soutien des collectivités locales (CPSCL); and Brazil's Caixa Econômica Federal (CEF).*

- ***International cooperation bodies**. These actors give financing based on goals that may extend beyond the economic aspect of the project. Their giving capacity does not increase with need, and the loan conditions they provide fall between those offered by specialized institutions and the banking sector. Their main resources derive from taxation, transferred to them by States or groups of States, and from sums borrowed from loan institutions or directly issuing from financial markets. International cooperation bodies may intervene with local authorities, but this is most often done via the State, which is responsible for transferring the grants received in the form of loans with more advantageous conditions than those in the banking industry or of contributions. Actors that are a part of decentralized cooperation (notably local European governments) can be included in this category. However, their participation is weighted less in terms of potential funding, and more towards the support for public works and the transfer of skills that they emphasize.*

- ***Commercial banks**. These operate by a shared set of standards that they must adhere to in order to guarantee the "credit quality", i.e. the solvability, of the clientele in order to attain a specific risk/reward ratio. Their contributions take the form of transforming savings and collected funds, as well as loans taken from other banks or the financial market. They undertake loans, whose interest rate and maturity conditions are closely correlated to those of the resources that they are mobilizing. Local governments' solvency and capacity to program and carry out investments remain the primary conditions for the development of bank credit on the local level in developing countries. For commercial banks, an assessment of the borrower's credit risk is one of the first criteria for whether or not to participate. In certain cases, they have their own evaluation tools for assessment, similar to those used by credit ratings actors (cf. below). Credit risk is defined as the uncertainty of the other party (or 'borrower'), either due to circumstance or decision, in being able to fulfill its obligations, notably paying back debt and interest. When a bank approves a loan[6], it must ensure that it has enough equity (or capital) corresponding to the level of risk represented by the borrower-the higher the risk, the higher the amount of equity allocated to covering losses in the case of loan default.*

- ***Financial markets without intermediation**. Using direct bond issues is another source of financing. It is linked to the idea of municipal autonomy and assumes the existence of a structured national financial market for investments in the domestic market, when the bond is not going onto the international capital market. Resorting to the bond market is still an uncommon phenomenon, limited by organizational demands (rating, numerous participating parties, trusteeship agreement, guarantees) and by their cost (financing profiles, intermediation cost). Recently, however, several cities in the South have nevertheless managed to issue municipal bonds on the markets[7]. This non-intermediation approach may be facilitated by security funds or by credit enhancement mechanisms[8].*

- ***Financial rating actors** : Financial rating refers to attributing ratings to borrowers or securities in order to evaluate their loan default risk. Ratings are given by financial ratings agencies specialized in studying solvency risk. The particularity of ratings agencies lies on one hand in their independence from financial intermediaries, and on the other hand, in the fact that their ratings are not exclusively based on statistical analyses.*

[6] So-called prudential rules prescribed by the Basel Committee.

[7] For example, the City of Ahmedabad (India) in 1999 and 2000, the City of Buenos Aires in 1997, the City of Johannesburg (South Africa) in 2004, the Urban Community of Douala (Cameroon) in 2005, and Mexico City in 2007. Cities of the North are also present on the municipal-bond market. These include capitals and large cities, of course, but also cities with populations of less than 100,000: Aubagne, in France, and Viareggio and Busto-Arsizio, in Italy.

[8] Credit enhancement is a financial operation by which a specialized financial establishment, called a credit enhancer, provides its guarantee to an entity (public or private) that takes out loans on financial markets, with the goal of reducing the level of risk and the cost of the loans.

Some have developed methodologies that go beyond the strictly quantitative by widening the scope of analysis beyond macroeconomic data and taking into account the specificities of regional and local public systems (effects of recent reforms, modes of control, intervention and support coming from various levels of government, etc.). Prospective items based on estimations and assumptions on evolution are approved by the local or regional executive. Ratings can be used in the first place by a government to finance itself on the capital market (also called "disintermediated" market), which will allow it to diversify its financing means. For governments that do not have the desire or sufficient funds to finance themselves on these markets, ratings are also a means of dialogue with their usual banking partners.

Actually, banks themselves are also rated and use the ratings in their risk evaluation. Therefore, the rating allows governments to appeal to a diverse group of banking establishments that are sometimes unfamiliar with the public sector, but eager to offer loans to entities whose credit quality can be measured in an objective manner and on a universal rating scale. Finally, some governments may wish to use ratings for financial communication. The non-mandatory aspect of this approach, conducted by an independent entity, makes it instrumental for achieving financial transparency.

Generally speaking, **the more that financing is dependent upon financial markets, the greater the number of conditions required, and the amount of information that is expected from the local authority will be of a higher level**. In addition, the local authority must have more qualified personnel and sophisticated technical systems and stable and foreseeable resources of its own.

Furthermore, the more generalized the financing, i.e. direct financing of the local authority rather than financing a specific project, the greater the demand for quality information that evaluates the local authority's conduct. The generalization of financing is a goal for all, because it respects the local authorities' autonomy of choice, but in return, they must prove through the long term that they are capable of managing their financial development. Also, as concerns different forms of potential financing, **local authorities and their financial partners must maintain a spirit that embraces the principles of progressiveness and learning**, which are at the heart of the confidence to build with the aim of an effective local development.

PRIVATE SECTOR PARTICIPATION AND ESSENTIAL SERVICES

Some of the local authorities' jurisdictions can be transferred to businesses within the framework of public-private partnerships: distribution of drinking water, public transportation, collection and processing of waste, etc. For these cases, there is not a method of financing different from those presented above. Actually, it is uncommon that the business directly contributes the ensemble of the financing (equity): like the local authority, it turns to external financing partners such as specialized financial institutions, international cooperation bodies, banks, financial markets, and even public authorities themselves. For most of the necessary financing, the business takes the place of the local authority in contacting partners. Consequently, the business and the project it implements will be evaluated by the financial partners. These partners may however also seek to evaluate the local authority, for it is the entity that delegated responsibility to the business. This is all the more pertinent if the local authority must provide a portion of the revenues that the business must collect during the operation phase (grants, payments in exchange for using the investment...).

PART 2: EVALUATION OF THE LOCAL AUTHORITY'S ENVIRONMENT

SUMMARY

Before entering into direct contact with financial partners, local authorities should familiarize themselves with the characteristics of their **economic, demographic, institutional, and financial environments**, even if, in part, these aspects do not fall under their specific jurisdiction. Financial partners may be sensitive to certain factors that they themselves deem favorable or unfavorable, regardless of the quality of management within the local authority.
The first type of evaluation occurs at the **national level**, i.e., what is the country's level of development, how is its population evolving, how can relations between the state and local authorities be characterized, what kinds of resources are available to local authorities, etc.?
Second, the local authority determines **its situation in comparison with the national average: what are its strengths and weaknesses relative to the situation of the country as a whole**?
This analysis is not intended to be a value judgment: **it aims, rather, to better identify the external factors that may explain the current position of the local authority and to focus on the factors that may influence its future development**.

The first step in a financial partner's analysis is examining the environment in which a local authority evolves. The financial partner is therefore responsible for measuring the impact of a number of factors (such as economic or demographic growth), for understanding the legal and budgetary regulations that it must respect, and for evaluating the risks and opportunities that may arise throughout the duration of its involvement with the local authority.

This analysis considers elements that are, for the most part, **outside the jurisdiction of the local authority. The local authority** is not responsible for determining the rules that dictate the sharing of jurisdiction between central and local authorities, nor can it have a direct influence on the growth of the Gross Domestic Product or on the macroeconomic policies set in place by the State.

This analysis is therefore meant to remind the local authority of certain outside factors that affect its environment. If the local authority cannot control these outside factors, it should still be familiar with them. It should also be ready to evaluate these factors in order to better understand the attitude adopted by a potential outside financial partner as it begins dialogue with the local authority. To cite two examples:

- *An international cooperation organization wishes to finance a local project with contributions. However, the organization learns that local authorities are not permitted to receive its help directly. Any transactions must first pass through the State. Consequently, the international cooperation organization will keep a close eye on the rapport between the State and the local authority in question, paying special attention to the level of efficiency of budgetary transfers carried out between the two entities;*

- *A bank wishes to grant a loan to a local authority. However, it is drawn to the bank's attention that certain rules applying to local authorities do not allow for sufficient reimbursement of loan debt. The bank is also informed that if the local authority neglects to pay off the loan, the bank's ability to contest this type of case in a court of law is limited. Consequently, the bank will request a more detailed guarantee from the local authority, even if the authority demonstrates efficient management practices and maintains a high level of jurisdiction. These guarantees will have a direct effect on the cost of the debt. The cost will be reduced if the risk level to which the loan establishment is exposed is reduced or initially included in the terms of the guarantee.*

The analysis of a local authority's environment is based on both **quantitative and qualitative elements**. Qualitative elements are often more significant, although they can be difficult to assess.

In no way does **this analysis establish a standard approach to defining the "ideal" environment surrounding a local authority**, although financial partners may consider some elements as minimal conditions to fulfill. The quality of an environment depends not so much on a list of required criteria or limitations, but rather more on the **general organization and coherency of factors within it**.

An environmental analysis may be conducted in two parts. It is first necessary to evaluate the credit status of the country in which the local authority evolves, often termed "country risk" analysis. Next, local characteristics of the community in question may be evaluated.

1. COUNTRY RISK ANALYSIS.

A complete assessment of country risk, which integrates a multitude of institutional, economic, social, and financial data, is not necessary in the context of this type of self-evaluation. However, local authorities should not overlook the importance of **national political and economic factors** in the analysis, which outside financial partners may take into account. It is therefore necessary to identify the country risk dimensions that may affect the credit status of local authorities.

An environmental analysis assumes **the existence of a prior statistical tool**. If this type of reliable source is unavailable, an approximate estimation based on information from non-official sources may be used in this context of self-evaluation.

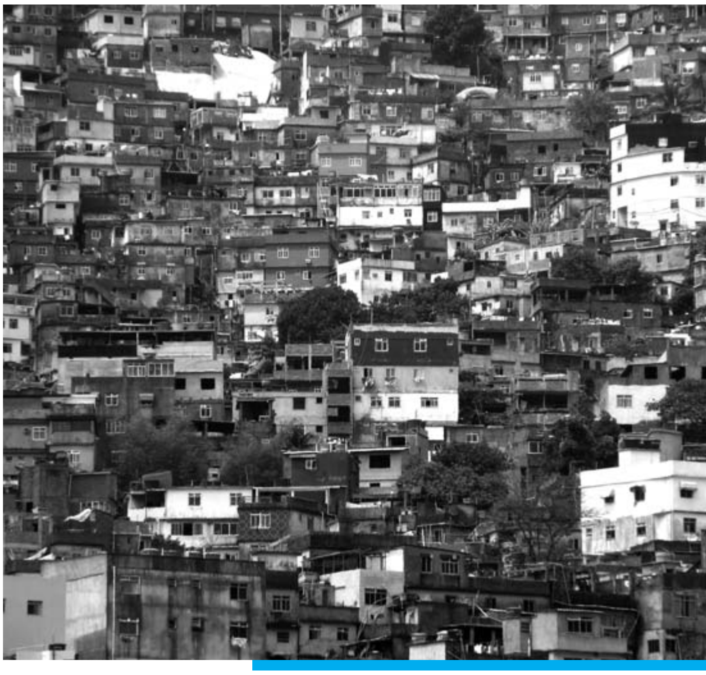
The desired information includes:

- ***The demographic framework***. *This analysis allows for the study of the country's wealth potential, which often plays a role in determining public budgets. Demographic studies also provide an indication of the future needs of the population, particularly in terms of infrastructure and public services;*

- ***The economic framework***. *The intervention of outside financial partners is often linked to the existence of a financial market, a national savings network, and a stable social and economic environment;*

- ***The institutional and political frameworks***. *Several items are evaluated in this category: the legal agreements and regulations that define the status and jurisdiction of local authorities, the relations they maintain with other levels of government (particularly with the State), the predicted nature (stable and non-arbitrary) of the financial relations between the State and the local authorities, and the characteristics of interior or exterior politics that may have an influence on the future development and stability of the country. Some legislation does not allow for partnerships with local authorities, and potential outside financial partners may perceive certain laws as too vague or unstable as they weigh their decision to interact with a local authority;*

- ***The financial and accounting frameworks***. *This category specifically addresses the way in which public accounts are managed, the rules applying to these accounts, and the nature of the financial relations between the local authority and other levels of government.*



The chart presented below is a simplified overview of country risk analysis[9]. It should be adapted for use according to the country or context in question. **It is not meant to be prescriptive in nature**. Nevertheless, it can serve as a guide for a local authority as it answers common questions posed by an outside financial partner, before the two partners engage in a more in-depth discussions.

[9] Country risk analyses and assigned ratings may also be found on the internet: links are indicated in appendix 5.

CHART FOR SELF-EVALUATION OF COUNTRY RISK

FACTOR	INDICATOR	INTERPRETATION
1. ECONOMIC AND DEMOGRAPHIC FRAMEWORKS		
a. Wealth	- GDP per inhabitant - Yearly change in GDP per inhabitant	This indicator aids in defining the relative wealth of the nation as a whole.
b. Currency	- Inflation rate and variations - Evolution of the exchange rate	A weak or unstable currency may lead to an increase in the risk premium requested by the financial partners, a reduction in the duration of loans, or the execution of transactions in a foreign currency
c. Economic activity	- Division of the service sector with respect to primary sectors (agriculture) and secondary sectors (industry) - Percentage of exportation in the GDP - Percentage of raw materials in exportations	The more the country's economic activity is based on services (commerce, technology, etc.), the greater the added value created by the country. The more dependent the economy is on exportations, particularly of raw materials, the greater the risk of instability due to an international crisis.
d. Employment	- Unemployment rate - Yearly change in the unemployment rate	This indicator allows for the evaluation of the population's rate of productivity.
e. Population	- Population growth rate - Percentage of the population under 15 years of age - Percentage of the population above 60 years of age	Population growth is a sign of economic dynamism, but it leads to more spending on supplementary facilities. The youth and the elderly make up the greatest portion of consumers of services, yet they produce the lowest amount of immediate income.
2. INSTITUTIONAL AND POLITICAL FRAMEWORKS		
a. Status of local authorities	- Length of time since decentralization	The granting of a legal status to local authorities is considered an asset. It is also advantageous if the management of public affairs conducted at the local level has been in existence for some time.
b. Local jurisdiction	- Stability of the scope of jurisdiction transferred - Quality of negotiation for the transfer of jurisdiction - Existence of a mechanism for financial compensation for the transfer of jurisdiction	If decentralization exists in a context of stable jurisdiction (characterized by a spirit of negotiation between the state and local authorities), and if the costs resulting from transfers of jurisdiction are evaluated and approved by both parties, the financial partner will have a positive view of the local authorities and their ability to assume their jurisdiction.
c. Rule of law	- Existence of efficient means of legal recourse against public authorities - Existence of multilateral or bilateral agreements concerning investments	The outside financial partner is aware of all legal means allowing it to enforce its rights if any should be overlooked in the context of its relations with the local authority.
d. Corruption	- Assessment corruption level by independent organizations (World Bank, Transparency International)	UA secure business environment (public or private) is an asset and evidence of transparency.
e. Elections	- Regular elections - Imminence of elections	Running proper elections, both at the national and local levels, is an indicator of political stability favorable to the development of professional relations. The imminence of elections (particularly if they are viewed as bringing major changes in political perspectives), likely to threaten institutional or political stability of the local authority, is a factor to which potential financial partners of the community will be particularly attentive. Furthermore, a financial partner concerned about its image may not wish to associate itself with a policy deemed to be disrespectful of certain principles recognized by the international community (especially democracy and human rights).

CHART FOR SELF-EVALUATION OF COUNTRY RISK (END)

3. FINANCIAL AND ACCOUNTING FRAMEWORKS		
a. Local resources	- Local authorities have the possibility of dealing with fiscal concerns and fiscal control (base and/or rates) - Endowments from the State are provided by law: predictable, reoccurring, and evenly distributed - Resources of local authorities are (or are not) pre-allocated for expenditures	On one hand, these factors are indicators of the local authority's ability to generate autonomous resources, and on the other hand, to efficiently use resources guaranteed to them by the state.
b. Accounting	- Existence of national accounting - Existence of a standard accounting framework for local authorities	These factors are an indicator of the level of transparency of available statistical information and its quality, as well as the existence of certain regulations that may be monitored.
c. Guarantees	- The reimbursement of debt is a mandatory expense for local authorities - The state may act as a guarantor for local debts - The state itself is not excessively in debt	An outside financial partner may use these factors to evaluate the degree of probability of non-payment of funds it has given out and for which it must be reimbursed.
d. Audits	- Existence of prudential ratios relative to local indebtedness - Existence of an agency responsible for local authority budget inspection	An external inspection of local budgets will reassure the financial partner with regard to the appearance of budgetary errors.

The impact of these factors (and possibly that of other factors not appearing on this chart) determines the conditions under which the state finances its own debt (duration of loans and especially interest rates). However, it has generally been established (excluding particular cases) that **the financing rate of the state constitutes the interest rate floor for local authority borrowing rates**, with the exception of certain local communities that have fiscal autonomy (e.g. the Italian provinces). A local authority's efforts to practice good management will only allow it to benefit from conditions identical to those of the state, at best. Moreover, although these factors may not fall within their jurisdiction, **local authorities may appeal to the State via their representatives or possibly via certain organizations that defend their interests**, especially with regard to regulatory, financial, and accounting aspects of their environment.

2. CHARACTERISTICS OF THE LOCAL ENVIRONMENT.

In addition to their interest in the national environment, and prior to the budgetary analysis of the local authority, financial partners will be attentive to certain local economic and demographic factors, aiming to situate these factors **with respect to the national average**. As at the local level, the prior existence of reliable statistics constitutes an important prerequisite, but is nevertheless unnecessary for this step. Substitutional measures may also be chosen.

- ***Wealth***. *The local GDP indicator per inhabitant may be used. In the absence of a GDP indicator, the amount of revenue per inhabitant (fiscal declaration) or the fiscal potential per inhabitant (existence of a fiscal base) may also be used. The assessment may be carried out in terms of absolute value and by trends over the last five years, for example. A position superior to the national average is a positive factor in the eyes of outside financial partners..*

- ***Infrastructures and public facilities***. *There may exist substitutional indicators for evaluating a territory's level of development. For example, the rates of access to essential services (water, decontamination, electricity, waste collection, etc.) or statistics indicating the educational levels attained by those in the population under the age of 15 may be used.*

- ***Economic activity***. *Descriptions by sectors of activity (primary, secondary, and tertiary) may also be used. Other indicators may be analyzed: the number of companies located within the territory and the evolution of this number, the net establishment of companies per year. These may attest to local economic dynamism.*

- ***Employment***. *The local unemployment rate, the number of jobs per thousand inhabitants, and the employment rate for the working population are all indicators of the distribution of revenue within the territory, and may be compared to the national average.*

- ***Population***. *A variety of demographic characteristics may be studied:*
  <u>The size of the population</u> and the city's position in the urban hierarchy (major cities are more likely to enter into dialogues with central authorities). Larger cities are also considered to have a better "financial surface";
  <u>The local population's rate of growth</u> with respect to the national average and to trends during the past five years;
  <u>The net migration rate</u> (is the community attracting new inhabitants or are more people leaving the area?);
  <u>Size of population under 15 years of age</u>, in and of itself and also as compared to the national average;
  <u>Size of the population over 60 years of age</u>, in and of itself and also as compared to the national average.

- ***Politics***. *If the local executive director is an elected official, financial partners may be interested in the following information: the length of his/her term, his/her popularity with the community's inhabitants (to evaluate the level of support from which he or she would benefit in cases of reform), and the quality of the relations he or she maintains with the central authority.*

In terms of this evaluation, the more the environment is considered unstable or unfavorable, the more the financial partners will tend to request from the local authority. This may lead to an increase in cost for providing certain data, an increase in follow-up costs, an increase in interest rates (if applicable), a reduction in the total amount of money the financial partners are willing to invest, or a reduction in the length of time during which the financial partners plan to be involved with the local authority.

IMPACT OF AN INTEREST DIFFERENTIAL ON REIMBURSEMENT COSTS.

Two local authorities (A and B) both wish to borrow €10,000 and repay the loan over a 20-year period. Both authorities are managed in an identical manner. However, authority A boasts a promising demographic and economic environment (for example, it has specialized in a promising commercial sector) whereas B finds itself in a more difficult situation (its main companies experience less growth opportunities). At best, A will benefit from a 5% rate, whereas B will be offered a 6% rate.

In the context of a fixed, regular schedule for loan repayment (growing depreciation of borrowed capital and decreased payment of interest), the impact of this differential on B's finances is sizeable:

	Amount borrowed	Rate	Duration of loan	Amount of accrued interest
Authority A	10 000	5% per year	20 years	5,250
Authority B	10 000	6% per year	20 years	6,300

Therefore, with respect to the amount of capital borrowed, local authority B will be charged extra interest (€1,050) over a period of 20 years, that is to say 10% more than local authority A.

PART 3: BUDGETARY APPROACH AND STRUCTURING OF A GENERIC ACCOUNTING FRAMEWORK

SUMMARY

The **accounts of local authorities** are the main argument in the relationship with financial partners. It is important therefore that these accounts are readable, faithful, and give an accurate image of the financial position of local authorities.
Each country creates its own accounting framework that best corresponds to the method of operation of its institutions. A financial partner will have a tendency to **restate accounting data into a standardized framework**, such as the one recommended here, in order to conduct its own financial analysis.
The account of a local authority may therefore be viewed as a **classification of receipts and expenses** based on whether they are allocated to **continuing operations** (which are regular and relatively stable) or to **investment operations** (which occasionally increase or decrease the wealth of the local authority).

Strictly speaking, the following section is not a financial analysis of the local authority. Rather it is a recommended flexible framework of accounting entry, which serves as the basis of the analysis that may then take place (parts 4 & 5). In fact, this section is an entry on the local authority and its budget for the purpose of **constructing primary data that can be understood by all outside financial partners**. Each country has actually developed accounting cultures and classification practices that make comparisons and discussion among partners difficult if they do not share the same references.

Reducing complexity and difficulties is always a possibility if a simplified typology based on the restating of accounting information is used. The objective here is not to recommend a universal accounting standard, but to put forth **the elements of a common language**.
We will also try to construct major equilibriums without aiming for the perfect superimposition of this model onto the infinite diversity of existing accounting nomenclatures.

The precondition to all accounting is naturally the existence of data on transactions by a local authority, preferably in respect of **real operations** (either cash flow: payment for a service, collection of a fee, etc.) that gives rise to a receipt or an expense by the local authority.

Under this guide, suspense transactions do not appear (increases to amortizations, miscellaneous provisions, etc.).

Data origin must also appear in summary documents such as profit and loss statements, administrative accounts, budget forecasts, whatever they are called. Unlike the budget, which is a forecast document, **the account retraces actual transactions**. It recognizes receipts and expenses for the year.

The recommended nomenclature can work using **cash accounting** (the transaction is recorded after recognizing a cash flow) or **commitment accounting** (the transaction is recorded when the principle of an expense or receipt is validated, which is after materialized by a security, an invoice, etc.). Each of these methods has advantages and disadvantages, and the practices of the local authorities must prevail.

1. STRUCTURE OF A GENERIC ACCOUNTING FRAMEWORK.

The basic principles of the general framework recommended here are the following:

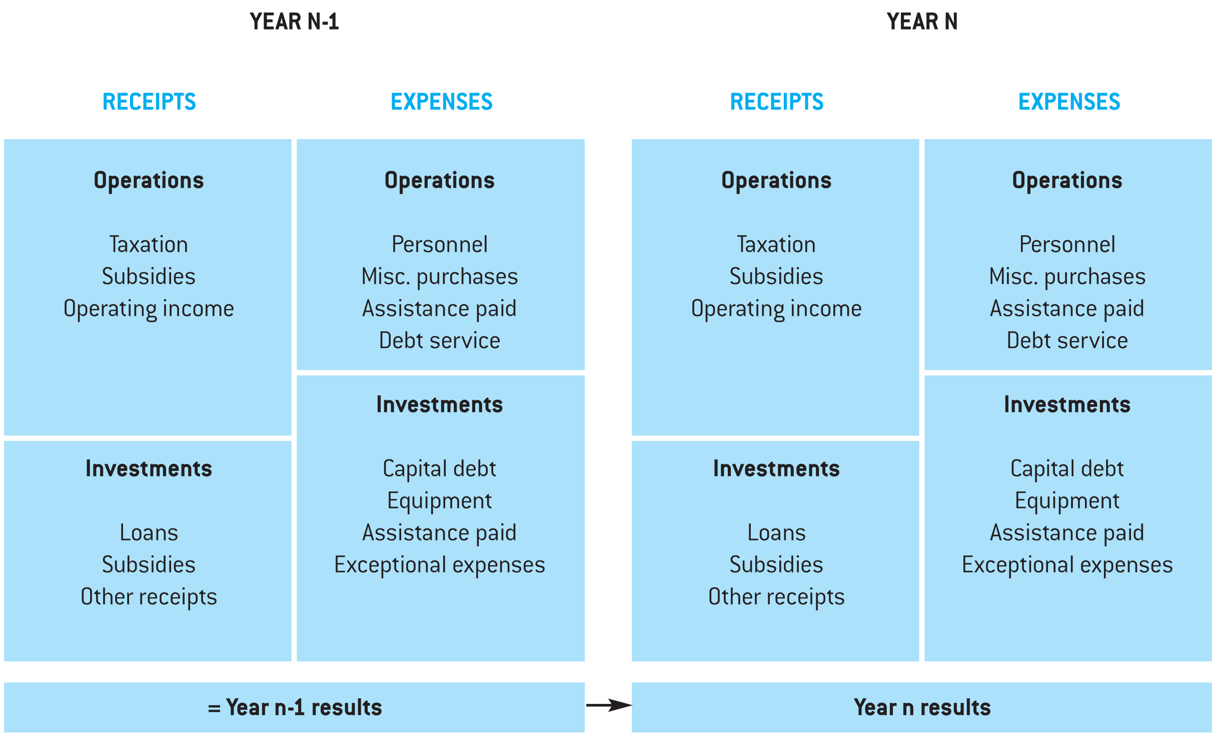
- *an account developed for a complete annual period, a calendar year for example;*
- *the integral recording of all receipts and expenses, which do not offset each other;*
- *the distinction between the section called "continuing operations" and a section called "investment operations".*

Continuing operations include the expenses and receipts used to **provide for the daily operation of the local authority**. They are recurring in nature. Each year these operations repeat themselves relatively predictably and are often considered mandatory. Receipts include tax receipts, operating contributions paid by the State or other levels of government, and resources received by the local authority (in the form of prices, rates, fees, remuneration, etc.) owing to the operation of its assets. Expenses are usually relatively limited. They mainly include personnel, procurement, subsidies paid by the local authority to assist other structures in their operation (associations, related budgets, etc.), and debt service incumbent on the local authority.

Investment operations are operations that **increase or diminish the wealth of the local authority** (buildings, land, etc.), the life duration of which is often greater than one year. These operations are usually unique and exceptional. They do not recur identically from one year to the next. Subsidies to complete investments are included here as receipts, as are receipts generated by the disposal of assets (sale of land or buildings, etc.) and new borrowing by the local authority. Expenses include the reimbursement of capital from earlier debt of the local authority, equipment transactions (work, renovations, acquisitions, etc.), and investment subsidies paid to other structures.

Total operating and investment receipts and operating and investment expenses constitute **annual results**, which can be zero (balanced account), in surplus (positive results) or in deficit (negative results).

FIGURE 1 : STRUCTURE OF THE GENERIC ACCOUNTING FRAMEWORK



Detail on nomenclature is provided below:

2. OPERATING RECEIPTS.

A. Tax receipts: *they include resources deriving from local and other direct or indirect taxes. The local authority may exercise control over these receipts (over the rate and/or base) or not (if for example the rates are set by the State). Ex: taxes on housing, companies, transportation, related to a service (cleaning, household garbage pick-up, etc.) or related to an event (property transactions, civil registry, etc.);*

B. Subsidies received: *these are resources transferred by the State or other public authorities in payment for activities provided by the local authority. Ex : operating contributions, solidarity, decentralization, etc. ;*

C. Income from services and assets: *this includes all the resources drawn from the operation of services by the local government or the use of its assets. Ex: amount paid by a user in exchange for a service received or provided by the local government (drinking water, childcare, highway depots, etc.), amount paid in exchange for the rental of land belonging to a local government (market place, cemetery, etc.) of the purchase of goods coming from land (wood, etc.); repayment of treasury funds of the local authority, etc.*

3. OPERATING EXPENSES.

D. Personnel expenses: *these include all expenses related to the employment of personnel by the local authority. Ex: civil service wages, salaries, training expenses, insurance, social benefit costs, etc. ;*

E. Purchase of goods and services: *these include purchase of furnishings, continuing maintenance of assets, payments to service providers. Ex: furnishings, expenses for utilities (water, gas, electricity, gasoline, etc.), contracts with consultants, services, etc. (unless they are related to an investment);*

F. Paid assistance: *these include all payments to public partners, private or associations, even if there is no direct service to the local authority. They are often similar to a subsidy. Ex : contributions paid to intercommunal structures, subsidies to associations, premiums for attracting businesses, social contributions to households, subsidies to service providers with a relationship with the local authority, etc.;*

G. Debt service: *these are direct financial expenses (interest on borrowed capital) or related expenses (related to operations and paid at one time) and borrowing by the local government over the short, medium or long term. These expenses are recurring and inflexible (because they are mandatory, but sometimes variable). Ex: cost for a credit line, interest on loans, fees for financing, etc.).*

4. INVESTMENT RECEIPTS.

H. Loans: *this is the volume of loans taken over the year to finance all or a part of the investments made by the local authority;*

I. Investment subsidies received: *these include the contributions of the State or other public authorities to provide for a portion of the financing of investment by the local authority;*

J. Other investment receipts: *these mainly include resources received by the local authority followed by a one-time change in its assets, or all other tax receipts legally earmarked for capital expenditures (tax for local infrastructure levied on local builders, etc.). Ex: sale of a building or land, contribution by an individual, insurance premiums, etc.*

5. INVESTMENT EXPENSES.

K. Debt amortization: *this consists of the annual reimbursement of a portion of the debt contracted by the local authority. The payment schedule can be monthly, quarterly, bi-annually or annual. These reimbursements may have come due (normally to the lender based on a payment schedule) or be made early..*

L. Equipment expenses: *these include all expenses that contribute to the growth of the wealth of the local authority. Ex : construction (new, renovation of buildings or networks) and acquisitions(land, building, heavy equipment, etc.) ;*

M. Equipment assistance paid: *this includes financial assistance paid by the local authority to other public authorities or public or private partners for the purpose of acquiring equipment. It is often similar to a subsidy ;*

N. Exceptional expenses: *these expenses are occasional and difficult to forecast, but they fall to the local authority. They are classified under investment operations because they affect the assets of the local authority. Ex : fire, natural disasters, etc.*

6. RESULTS.

O. Results for the year: *the balance between all tax receipts and all expenses.*

P. Net position: *the total result for the fiscal year are then added to net position for year n-1, to obtain the local authority's net position.*

PART 4: RETROSPECTIVE ANALYSIS AND SUMMARY TABLE

SUMMARY

The financial analysis of the books of a local authority begins with a review of past budget years. The objective is to **understand how the budget is structured** by the local authority and **identify the major trends** and their causes.

The crux of the analysis is based on **gross self-financing (or savings) by the local authority**: it is the positive difference between operating receipts and expenses. This self-financing makes it possible to pay for a portion of investments; it is above all **an indication of good management on the part of the local authority**, and is a strong element in dialogues with financial partners. Actually, no financial partner wants to see its resources used to **finance an operating deficit**.

After self-financing, the analysis turns to **the characteristics of debt already incurred** by the local authority: Is the level of debt acceptable? Who are the lenders? What is the cost of the debt, and how much time will be needed to pay it back, etc.? The capacity of the local authority to **develop a summary** table, such as the one recommended here, based on a transparent and controllable methodology, is proof of credibility and controlled management by the local authority vis-à-vis financial partners.

Retrospective analysis is the first step in financial analysis conducted by financial partners. It can also be of great interest for the local authority, which can derive significant information on its budget management. The objective of retrospective analysis is to understand the financial position of the local authority in order to determine the main forces in its budget structure and understand and explain past changes in the principal receipt and expense items. This analysis should lead the local authority to manage budgetary development, which will then serve in the second part of the analysis, namely the prospective analysis (part 5).

Budget analysis falls within **the overall environment of the local authority**. Data on changes in local demography and localized economic activity are therefore desirable (see part 2). These two factors can help explain changes in receipts (local taxation, contributions calculated based on population, etc.) and expenses (needs for services, etc.). Preferably, **recent data from over the past five years will be pulled together** in such a way that they show the major economic trends.

The basic materials in the retrospective analysis, however, are still **budget accounts of the local authority**, as constructed in part 3 of the guide. It is recommended that these data be drawn from the **five last years for which administrative accounts are available, a minimum of three budget years being desirable** to reveal major trends.

This analysis can be conducted in two stages:

- *first, through an examination of the major budget equilibriums of the local authority, in both absolute value and as trends;*
- *then, by examining more specifically the procedures of financing investments and debt in particular.*

1. THE ANALYSIS OF BUDGETARY EQUILIBRIUMS IN ABSOLUTE VALUE AND AS TRENDS.

Equilibriums can be calculated using the generic accounting framework. They are made up of ratios destined to reconstruct progressively the account results of the local authority by uncovering specific information. These ratios are the following:

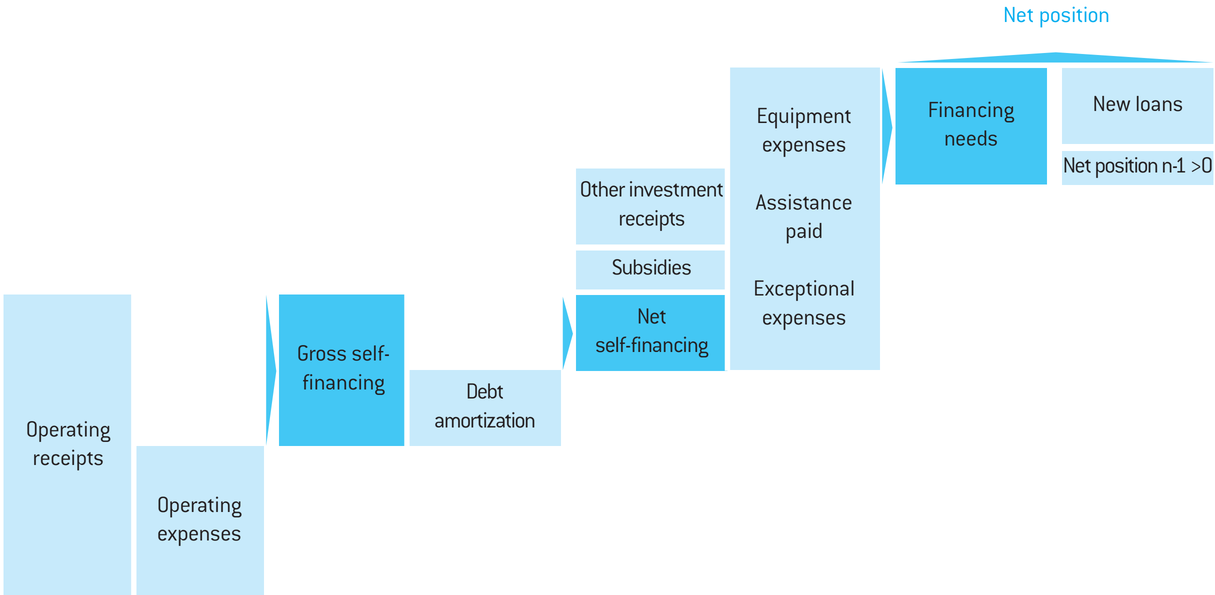
- ***1. Gross self-financing:*** *this ratio describes the relationship between all operating receipts and all operating expenses. The balance must always be positive. Otherwise the local authority is incapable of covering its on-going basic needs, including debt expenses, on a lasting basis. A solvency indicator, gross self-financing is at the crux of retrospective financial analysis.*
Calculation method: (A + B + C) - (D + E + F + G)

- ***2. Net self-financing:*** *this ratio is the margin of maneuver available for autonomous development once amortization on loans contracted in prior budget years has been paid. If the balance is positive, the local authority has not only been able to finance all of its operating expenses and cover the reimbursement of loan capital, it has also built up reserves for future development.*
Calculation method: 1 - K

- ***3. Financing needs or surplus:*** *this ratio sometimes describes the need to seek new loans to finance development and balance the investment operations (negative balance), and sometimes the savings that the local authority can put to use for projects in the future (positive balance).*
Calculation method: 2 + (I + J) - (L + M + N)

- ***4. Net position:*** *this is the point of budget equilibrium once all receipts and expenses from the year have been taken into consideration (results of the year). At this point, the net position from the prior year are included. Preferably it should tend toward zero.*
Calculation method: 3 + H + P^{n-1}

FIGURE 2: BUDGETARY EQUILIBRIUMS UNDER THE GENERIC ACCOUNTING FRAMEWORK



The outside financial partner will first look at **gross self-financing**, then net self-financing. Using these two ratios, he will know whether the local authority is living above its means, i.e., whether it is capable of financing ordinary expenses with ordinary receipts, and that the resources it might invest will not be used to finance an operating deficit. If net self-financing and moreover gross self-financing are negative, the local authority has little chance of entering into dialogue with outside financial partners, unless the rescheduling of debt and taxation in order to arrive at a possible "rescue plan" are first discussed.

Thereafter, the analysis is conducted over the last five years in order to reveal overall trends in respect of the budgetary equilibriums of the local authority. This step is without a doubt the most sensitive because it calls for the interpretation of observed trends **using information that does not appear in accounting statements** (socio-economic factors, policies implemented, etc.). Therefore, refined and transversal knowledge of the local authority and its environment are necessary, because when the same trend is seen in the accounts of two different local authorities, the causes can vary and lead to different impressions.

Once major changes and lasting trends over a period have been identified, there has to be an interpretation through an examination of the nature of the causes. The task of making an exhaustive list in this guide would be obviously difficult, and knowledge of the local context is of utmost importance. Several indicators can however be suggested. They are:

- *Can any differences be attributed to better or less efficient recovery of receipts? To better or less effective payment of expenses?*
- *In the event of deterioration of gross self-financing or "the scissor effect" (growth of operating expenses that is greater than that of receipts), is the change in expenses responsible? If so, is it due to rising personnel expenses or financial costs related to debt? Is this growth due to new transfers of responsibility, and if so, have the subsidies received offset these new expenses?*
- *What might be the impact of demographic and economic factors on the evolution of operating and investment receipts and expenses?*
- *For tax receipts, do changes owe to a change in rates (rising or falling taxes) or to a change in the tax base (number of taxable companies or individuals)?*
- *For operating income, is it the impact of a change in prices or rates, or a change in volumes sold?*
- *Are we in an election year, which might have an effect on a change in investment expenses, for example?*
- *In respect of investments, are changes in financing needs due to a drop or rise in subsidies received? To a drop or a rise in anticipated equipment?*
- *What is the degree of change in the forecast budget established in the early part of the year and the final one? Did any changes have a significant impact on one of the equilibriums? How often was the budget changed during the course of the year?*
- *Can changes observed between the forecast budget and the final budget be explained other than by difficulties in receipt recovery, owing for example to imprecise tax bases? By problems in expense payment that might be due to a lack of control by the local authority over completing projects in the allotted amount of time?*
- *...*

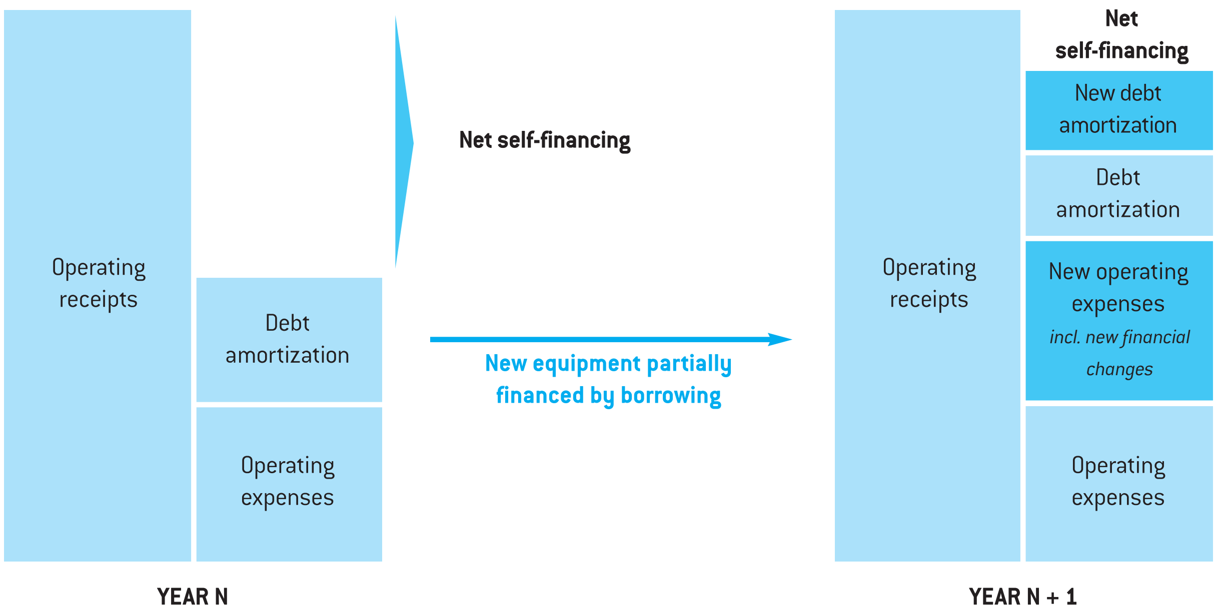
Many interpretations of results are possible, and out of context, most cannot be called favorable or unfavorable. The issue revolves mainly around **determining the extent of the local authority's control over observed changes** and its capacity to correct those that might harm its margin of maneuver in the future on a lasting basis.

2. PROCEDURES FOR FINANCING INVESTMENTS.

Usually local authorities are looking for relationships with outside financial partners because they are seeking new resources to finance investments. Based on the type of partner and the resources available, (contribution, loan, etc.), the importance given to different items will change, but their approach is comparable. Their attention will be directed successively to the following three points:

- *first, **the share of net self-financing in total investment resources**. The probability is high that a new investment will not only lead to new debt, but to new operating expenses. Therefore, outside partners will **evaluate the capacity of the local authority to meet these new expenses over time**, by lowering future self-financing margins (which should remain positive) if need be. Therefore, self-financing observed in recent years must remain stable and sufficient to absorb new expenses;*

FIGURE 3: IMPACT OF NEW EQUIPMENT ON NET SELF-FINANCING



- *then, the characteristics of existing debt of the local authority. It should be noted that the simplified profit and loss statements as present in part 3* ***make no mention of total debt stock****. They relate only to that portion of debt reimbursement during the fiscal year, interest paid relative to the stock of debt held by the local authority, and newly created debt. This information, which appears in the balance sheet of the local authority (see box 3), must therefore be obtained elsewhere:*

from a qualitative perspective, the partners will evaluate ***the debt profile*** *(who are the lenders? do any have particular prerogatives over the others? is any debt in a foreign currency?), the* ***amortization profile of the total stock of debt*** *(is it stable or have there been occasional rises and falls? is the trend going up or down?), and the* ***profile of debt cost*** *(are interest rates fixed or variable? if variable, how are they indexed?);*

quantified indicators will give a quantitative vision of debt. The two main ones used are: ***the total stock of debt compared to operating receipts****, which lends itself to a valuation of the weight of debt measured over time; and* ***total debt compared to gross self-financing****, which makes it possible to evaluate the number of years needed to absolve the debt of the local authority, if the structure of its budget does not change;*

- *and lastly, the rate of subsidizing investment expenses, calculated by the sum of equipment subsidies received compared to total investment expenses. This indicator can be a good index of the local authority's capacity to mobilize "free" financing and can show the close acquaintance and control of financing by local executives.*

USING THE BALANCE SHEET AS A COMPLEMENTARY TOOL IN FINANCIAL ANALYSIS

Unlike private enterprise, balance sheet analysis is not used often in the management of local governments. It is true that the main indicators used in balance sheet analysis do not shed the same light that they do in the case of private enterprise, owing to the fact that a local government has no share capital, no shareholders, no production cycle, and the end result is not to show a profit. However, the exercise can provide added information.

Unlike an operating account, **the balance sheet summarizes all the historic items comprising the assets and liabilities of a local government**. It makes it possible to follow the evolution of the financial and wealth position.

Schematic structure of a balance sheet

Statement of wealth — Source of financing (debt)

ASSETS	LIABILITIES
A. Fixed assets (long-term) *All fixed assets*	B. Long-term capital *Results of fiscal years* *Subsidies and assistance*
C. Current assets *Inventories* *Customer receivables*	D. Current liabilities *Supplier/employee debt* *Short-term debt (taxes and social benefits)*
E. Cash and equivalents on hand	E. Cash liabilities (bank credit lines)

Balance sheet analysis offers three major indicators of financial equilibrium and solvency, namely working capital, working capital needs and net cash.

Working capital (WC) = B - A

This ratio enables verification that the local government has financed its long-term assets with long-term resources. It amounts to the surplus of in-house resources that will provide for a portion or all of short-term needs. It is a sign of healthy management and a stable financial balance.

Working capital needs (WCN) = C - D

This shows the disparity between expense commitments and receipts generated by operations and the financing need that emerges. For a local government, owing to the absence of a production cycle, this need for short-term financing is essentially determined by supplier payment schedules, and those of "customers/debtors". In the event of positive WCN, it may be covered entirely or in part by positive working capital. Any remainder of working capital needs has to be financed by cash lending from banks. For a local government, highly negative working capital needs may indicate a significant capacity of recovery or sometimes a very long payment schedule for suppliers and employees. This situation can be the case of a local government that has had problems with bank loans (short or long) and that transfers its cash problems to its suppliers.

Net cash: WC - WCN

In terms of financial analysis, net cash appears as the balance of the overall financial position of the local government. It is the difference between the surplus of long-term resources (working capital) and short-term financing needs (working capital needs). When there is a negative cash position, it means that the local government does not have sufficient financial resources to meet its need. Therefore, it has to turn to additional financing. This can pose a financial risk if the local government does not manage to rapidly increase its long-term financial resources or limit its short-term operating needs (optimize schedules for recovery of receivables or lengthen supplier payment schedules).

3. SUMMARY TABLE OF RETROSPECTIVE FINANCIAL ANALYSIS INDICATORS.

The table below summarizes the main indicators that have been presented, and may be viewed as a summary table of the economic and financial performance of the local authority.

INDICATOR	DEFINITION	CONSTRUCTION[10]	INTERPRETATION
I. Proportion of personnel expenses compared to operating receipts	Evolution over the past five years in the proportion of personnel expenses (in %)	D / (A + B + C)	If the proportion rises, there is a risk that the local authority will lack margins of maneuver in the future.
II. Rate of gross self-financing	Balance of continuing operations compared to operating receipts (in %)	[(A + B + C) - (D + E + F + G)] / (A + B + C)	If positive and high, the local authority has resources for the self-financing of its investment expenses (incl. earlier loans).
III. Rate of net self-financing	Balance once reimbursed of debt due for the year compared to operating expenses (in %)	(Gross self-financing - K) / (A + B + C)	If positive and high, the local authority has the available resources to self-finance its investment programs.
IV. Variation in the rate of net self-financing	Evolution over the past five years of the rate of net self-financing (in %)	Calculation of the rate of net self-financing, and measure of deviation in each of those years	The variations may indicate either a deterioration in gross self-financing, or an evolution in the debt of the local authority.
V. Rate of financing need or surplus	Need for loans (through banks or on the market) to finance investments or the surplus that can be saved compared to all expenses (in %)	[Net self-financing + (I + J) - (L + M + N)] / (D + E + F + G + K + L + M + N)	It is positive in the case of a surplus, negative in the case of a need; the lower it is, the more the local authority can mobilize inexpensive resources for its development.
VI. Variation in the rate of financing needs	Evolution over the past five years in financing needs (in %)	Calculation of the rate of financing needs, and measure of deviation in each one of those years	A rising financing need can mean the local authority has difficulty finding its own resources or indirect ones to finance its development.
VII. Variation between forecast budget receipts and final ones	Comparison between all receipts forecast and all actual receipts (in %)	Total forecast receipts/ total actual receipts	A result near one means good control over receipt forecasts.
VIII. Variation between forecast expenses and final expenses	Comparison between all forecast expenses and all effective expenses (in %)	Dépenses totales prévisionnelles / dépenses totales effectives	A result near 1 means good control of receipt forecasts
IX. Debt profile	Evaluation of debt characteristics (qualitative evaluation)	Table of lenders, their nationality and their prerogatives	Based on the number and quality of lenders, the proportion of lending in foreign currencies

[10] Letters refer to definitions presented in part 3.

INDICATOR	DEFINITION	CONSTRUCTION[10]	INTERPRETATION
X. Profile of debt stock	Evaluation of future commitments of the local authority (qualitative evaluation)	Forecast table of amortization of debt stock	The more stable the profile, the greater the likelihood that adjustments may occur in continuity.
XII. Profile of the cost of debt	Evaluation of risks and the quality of debt management (qualitative evaluation)	Average interest rate and type of interest rates	Variable rates are riskier but may show a better capacity to manage debt.
XIII. Total debt/operating receipts	Evaluates the weight of debt compared to continuing receipts (in years)	Stock of debt / (A + B + C)	The smaller this ratio, the less indebted the local government appears.
XIV. Total debt/gross self-financing	Evaluates the capacity to absolve debt (in years)	Stock de debt / gross self-financing	The less high the ratio, the more the local government appears able to reimburse its existing debt rapidly.
XV. Rate of subsidization of equipment expenses	Evaluates the capacity to mobilize "free" financing for its projects (in %)	I / L	The higher the ratio, the more the local authority shows its capacity to profit from systemic opportunities for public financing .

INDICATORS OF COMMUNICATION

There are a certain number of usual indicators relative to local finances, whose usefulness is less for financial analysis. However, the local authority may have to construct them, because they make it possible to easily compare situations (taking all the appropriate precautions) and give the population and elected officials simple markers they can understand. The following indicators could comprise such a list:

- budget by inhabitant, which is often understood as the wealth of the authority;
- budget receipt by inhabitant, which can measure the tax potential on the local territory;
- operating expenses by inhabitant, which can be a measure of services rendered by the local authority
- equipment expenses by inhabitant, an indicator that serves sometimes to indicate the effort of the local authority to improve services and infrastructures;
- debt by inhabitant, which serves in the evaluation of debt expense remaining to be reimbursed by inhabitant.

PART 5: PROGRAMMING AND PROSPECTIVE ANALYSIS

SUMMARY

The prospective analysis of the accounts of a local authority translates the major **public policies** the latter plans to put into place in the years to come. It sheds light on the extent to which various actions to be undertaken are **sustainable** in the medium and long term by the budget and if there is a need to **define priorities** of intervention.   In this respect, the financial prospective is therefore a tool **of assistance in decision-making** of utmost importance for local officials.

Prospective analysis is based on the same indicators as retrospective analysis and tends therefore to extend **tendencies**. But they do not take on their full meaning until the **context** that might impact receipts and expenses as well as the financial translation of **actions voluntarily** implemented by the local government for the years to come have been integrated.

The **reliability of budgetary forecasts** developed by the local authority depends in part on the **quality of its management and its capacity to program** investments that contribute to territorial projects in a consistent manner. By developing a prospective, the local authority shows its financial partners that the projects developed are **compatible with the good financial health** of the local government. If the forecasts are ridden with uncertainty, the prospective is still an **indispensable tool of leadership** for the development of local authorities.

The last and most delicate step of the financial analysis, the financial prospective, relies in large part on the analysis of the past and on **the same major indicators** (see part 4) to evaluate the more or less good financial health of the local government in the years to come. This prospective must naturally take into consideration developmental ambitions in the years to come by the local authorities, **the programming of which makes it possible to give an image**. At this stage of the analysis, and as before, the capacity for self-financing and the capacity of reducing debt are central references in evaluating **the sustainability of public policies**.

1. THE FUTURE VISION OF DEVELOPMENT THROUGH PROGRAMMING.

Although this guide is not the place to develop the tools of programming, they still represent an indispensable step in then arriving at the prospective analysis of future budget equilibriums, including operating needs.

Local authorities are increasingly asked to promote the economic and social development of their territories. This task is extremely difficult in an environment characterized by **the inherent challenges to accessing essential services and a climate of competitiveness among the territories**, in the sense that everyone is attempting investments that bring sustainable development.

Planning can be an exercise that can help local authorities act in territorial development in this environment with **better mastery of the uncertainties to come** and become itself a fundamental challenge in social and economic development.

The **process is dynamic and rigorous and calls for the responsible commitment of the local authority**. Its objective is to facilitate decision making within the authority by enabling it to identify and examine the principal internal and external factors that can influence the optimal advancement and effectiveness of its intervention and develop its propensity to undertake lasting developmental actions.

Regardless of its institutional rank and size, the local authority will find an instrument in planning that offers numerous advantages and can be summarized as follows:

- *it is an approach that stimulates thought turned toward the future and incites the creation of a **shared vision of the future of the territory** and developmental strategies that respond to need and priority aspirations of populations ;*

- *it is an approach that provides a vigorous framework for monitoring programs and projects using **observable and measurable indicators**;*

- *it is a process that promotes and orients dialogue between all internal and external players in the territory of the local authority and offers a **framework of cooperation on the perspectives of development by participative action**;*

- *and lastly, planning contributes to keeping partners and residents informed on strategic objectives, programs in progress, their monitoring and evaluation on a regular basis and obtaining agreement on the actions of outside players;*

Therefore, the adoption of a participative approach, the creation of a clear vision of development using pertinent strategic diagnosis, the choice of strategic objectives translated into actions plans, the adoption of **pluri-annual programming and budgeting of investments**, recourse to techniques of projection and estimation of needs and resources as well as the evaluation of the results of various activities in actions plans are all crucial and characterize the process of planning and development.

The adoption of this process by the local authority favors stronger **capacities of negotiation and mobilization of financial resources** vis-à-vis partners, owing to the fact that it provides better technical and economic visibility of investments and more professionalism in their programming and effectiveness of their implementation. This is particularly useful when a local authority has to negotiate for access to transfers from the central State or look for financing through loans from national or foreign lenders, or exterior financing for the projects of developmental assistance organizations.

Moreover, some methods of development coming out of upper levels of territorial or sectorial development (tourism, highways, management of natural resources, agricultural and pastoral activity, etc.) are rolled out on a scale that surpasses the limits of the territory of a local authority. Any future projection for a territory assumes that there is a **negotiation between the expectations and needs of populations and economic players and the requirements of territorial management arising from concerns and decisions at a higher level** (national public policies, major infrastructures, regional authorities, etc.).

As a consequence, planning must allow for projects (touristic, agricultural, etc.) to work their way down to the territories when they are set forth in development plans at a higher level (provincial, regional, and national) or through the projects of ministerial, sectorial departments. It requires negotiation/permanent development with the decentralized services of the State.

2. THE DEVELOPMENT OF A FINANCIAL PROSPECTIVE.

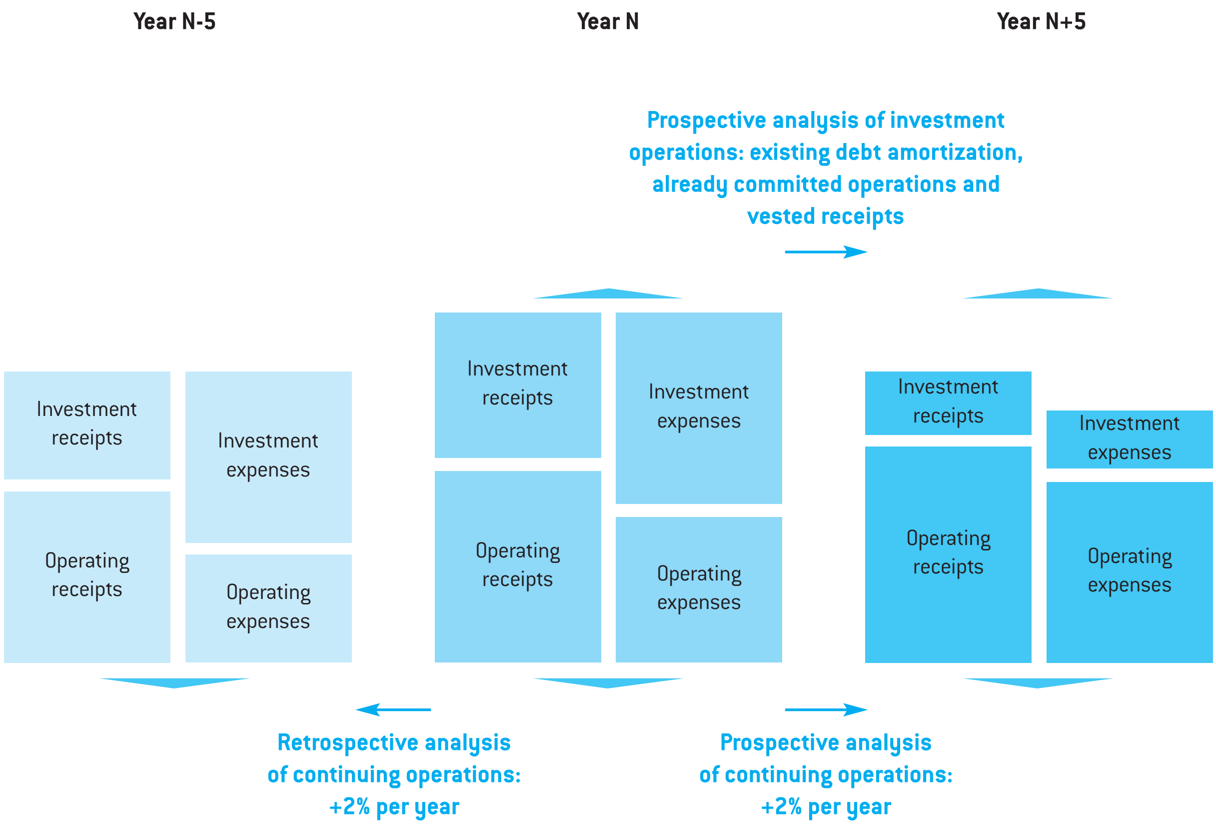
A true **tool of financial strategy**, prospective analysis makes it possible for the executive branch of the local government to determine the levels of reference of the main financial indicators that will enable him or her to **lead the programming of equipment** abiding by major financial equilibriums. Used as a monitoring tool, it also provides for **great reactivity and a heightened capacity to anticipate** corrective measures when results deviate from forecasts, whether though supplementary investments in the event of favorable changes in indicators or restrictive measures when changes are unfavorable.

Beyond the technicality and discipline with which **projections of accounts** of the local government over future years (at least the **five following** years) must be applied, this exercise makes it possible to translate the **major political orientations** of the local government into financial terms.

In order for forecasts to come as close as possible to future activities, a financial prospective must integrate various types of data, be they in respect of past changes, forecasts of the economic or political environment, or the financial translation of the political directions taken by the local government:

- *the implementation of a "**going with the flow**" scenario is the basic reference of the prospective. It uses first the same major line items for continuing operations as those used in the retrospective analysis and applies past trends (annual average changes) to years to come in a somewhat "mechanical" fashion by attempting to take exceptional aspects out of the calculation to the extent possible. It takes also into account the already committed investment operations: existing debt amortization, investments under achievement, and those that are already planned and certain (like those that have been contracted out with other partners).*

In terms of a simple identical projection, i.e., "all other things being equal", this exercise cannot be considered completed at this stage and is highly theoretical;



- the next step consists of integrating into this base scenario the projected consequences of ***change factors*** *on the budget. In terms of receipts, the issue is one of evaluating the impact of the social and economic environment on tax bases and therefore tax income, as well as estimating the probable changes from the past in operating subsidies and subsidization rates of investments. Procurement should also include inflation forecasts, and indexed loans, an estimate based on the outlook for changes in their index. It is also necessary to correct past tendencies for one-time events related specifically to the local authority, and to integrate the foreseeable one-time receipts or expenses. This step of development of the financial prospective is no doubt the one that is the most technical. Using fragile economic and political "crystal balling", 100% reliability is impossible but tries to the extent possible to come close. The exercise can be greatly facilitated by macro-economic forecasts of the transparency of State interventions when they are subject to pluri-annual contracting with local governments;*

ESTIMATE OF THE IMPACT OF ENVIRONMENTAL FACTORS ON PROJECTIONS

	IMPACT ON LOCAL ACCOUNTS	OUTLOOK			ASSUMPTION APPLIED
		FAVORABLE	NEUTRAL	UNFAVORABLE	
General economic outlook	Tax bases	+++		-	+3% per yr.
Leaving of an important industry	Tax bases			--	-2% from year N+1
Inflation	Procurement costs		=		Stable
Social claims	Personnel expenses			-	+2% per yr.
State policy	Subsidies		=	--	-2% per yr.
Interest rates	Debt servicing	+			-2% per yr.
Local elections	Equipment expenses			-	+ 5% for 3 yrs.
...					

- *the finalization of the financial prospective includes a third and last stage that integrates **the financial impact of new political decisions taken by the local government** (programming) into earlier forecasts. It translates the impact of various measures to be implemented in future years in financial terms. They can derive from tax policy (rates, heightened controls and identification of new tax bases) land and territorial development policy, rates applied to local public services, investment policy (territorial project, pluri-annual programming of investments, new equipment, etc.) It can also be a question of human resource management, indemnity schemes, training, etc.), management of public procurement (markets, economies of scale, etc.), choices between internal management of services and outsourcing, and the financial cost of new lending, or operating expenses deriving from newly created services or investments.*

IMPACT OF SCHEDULED POLITICAL CHOICES ON FUTURE ACCOUNTS

	INVESTMENT OPERATIONS					CONTINUING OPERATIONS			
	PROGRAMMED EQUIPMENT	YEAR OF OCCURRENCE	COST OF INVESTMENT	SUBSIDY OF EQUIPMENT EXPECTED	NEW DEBT	ANNUAL OPERATING COST	ANNUAL EXPENSE FOR NEW DEBT AND INTEREST	OPERATING SUBSIDY RECEIVED	OWN PROJECT RESOURCES
Scholastic policy	2 elementary schools	N+2	200	100	50	40	6	15	0
Transportation policy	Highway depot renovation	N+4	200	100	100	0	0	0	0
		N+5	100	50	50	30	6	0	35
Health policy	Dispensary renovation	N+3	100	70	0	10	0	5	0
	Supply improvements	N+1	0	0	0	30	0	10	10
Network policy	Extension of public lighting	N+1	500	50	300	25	33	0	0
Employment policy	Recruitment of 3 employees	N+3	0	0	0	15	0	0	0
Fiscal policy	Cut taxes	N+2	0	0	0	25 (reduction in fiscal revenue)	0	0	0

3. FROM FINANCIAL PROSPECTIVE TO STRATEGY.

The last part of this exercise:

- *Fully utilized as **a decision-making tool**, the financial prospective makes it possible for the local executive to **better understand the consequences of his or her choices in budgetary terms**. It may require the use of alternative scenarios organized around the changes in one or several assumptions (investment program, tax policy, debt reduction, etc.). Financial strategy can consist of establishing objectives.*

- *To the extent that the financial prospective consolidates different choices by the executive, it shows the extent to which **different public policies put into place can be sustained or not for local finances**. In this respect, the prospective clarifies for the decision maker residual margins of maneuver as well as any arbitration needed to not put the financial health of the local government at risk. It can be evaluated using the same major indicators as those used in the retrospective analysis (see above), and the exercise can then lead to true **strategic financial leadership** of the institution, based on the objectives of self-financing or the level of debt. The rate of net self-financing (indicator III) makes possible the evaluation of the proportion of actual operating receipts as a trend, which will be used to finance investment.*

  And the capacity to redeem debt (indicator XIV) is a strong indicator of the sustainability of recourse to loans. The financing of various public policies can then be rationalized, and arbitration between long resources (borrowing) and short resources (self-financing implying the choice of increasing receipts or controlling expenses) become objectives, i.e. what level of tax pressure, what level of indebtedness, what proportion of self-financing will the local government attain?

- *To the extent that expenses look like data that can be readily forecast, what political strategy has to be followed, principally in order to provide for **a favorable rate of subsidization of investment expenses**, and what level of commitment is there fore expected of the local executive? Is this effort realistic compared to past data and the opportunities offered by the public financing system?*

The financial prospective can also be used in the **contingency management** of the local government. If used regularly as a monitoring table, it makes deviations of actual receipts or expenses from forecasts possible to measure. The local government is then in a position **to act in advance to put accounts back into equilibrium** and reach objectives. Moreover, regular monitoring of the prospective solidifies the delicate job of "crystal balling" in the overall process, because readjustments can be made rapidly if projections prove to be inexact (economic turnaround, tax refunds or State contributions under forecast, level of inflation and interest rates, etc.).

The analytical grid presented below provides an example of financial prospective using several indicators recommended in part 4. When one or several indicators are unsatisfactory in light of objectives, the source of changes has to be identified in depth.

SITUATION FROM YEAR N COMPARED WITH BUDGETARY OBJECTIVES FOR THE YEAR

INDICATOR		YEAR N	YEAR N+1	YEAR N+2	YEAR N+3	YEAR N+4	YEAR N+5
I. Proportion of personnel expenses compared to operating receipts	Value	2,5%					
	Objective	2%	2%	2%	2%	2%	2%
	Situation	☹					
III. Net self-financing rate	Value	13%					
	Objective	15%	15%	15%	16%	17%	18%
	Situation	😐					
IV. Change in rate of net self-financing	Value	-13%					
	Objective	0%	0%	0%	3%	3%	3%
	Situation	☹					
V. Rate of financing need or surplus	Value	15%					
	Objective	15%	15%	15%	10%	10%	8%
	Situation	☺					
XIII. Total debt /operating receipts	Value	3,7 yrs					
	Objective	3,5 yrs	3,5 yrs	3,5 yrs	3 yrs	3 yrs	3 yrs
	Situation	😐					
XIV. Total debt / gross self-financing	Value	12,2 yrs					
	Objective	12 yrs	12 yrs	12 yrs	11 yrs	11 yrs	10 yrs
	Situation	😐					
XV. Rate of subsidization of equipment expenses	Value	63%					
	Objective	50%	50%	50%	50%	60%	60%
	Situation	☺					

CONCLUSION

At the conclusion of the self-evaluation, the local authority has a simple yet determining data on its past and future financial trajectory, and the margins of maneuver it can provide to an external financial partner. But above all, it has an understanding and the leverage to better manage policy directions it plans to apply to development, as well as basic tools enabling a discussion of these directions with its populace.

This self-evaluation guide has been conceived by financing professional with proven international experience in their respective areas of expertise. In other words, despite its surface simplicity, this guide is based on a meeting of minds of the first order. It was designed for use by the largest possible number of people, but above all, by the non-specialist in budget management. It is a foundation of elementary knowledge of good management of local finances, which is indispensable in the implementation of balanced development in local territories.

This guide should be taken for exactly what it is: a first step in self-organization for local authorities and not the magic wand that will create abundant and easily accessible financing for local authorities. That is the task of others with different missions. The main objective of this guide is to provide the keys of useful understanding to local authorities on the expectations of external financial partners of all types. Its intent is to contribute to the progressive acquisition of budget skills by elected officials and local technicians.

To paraphrase a famous saying, "*money is the nerve of development*". Although nothing is possible without financing, it is also useful to bear in mind that financing does not automatically create development. The development of public policies, their transfer into the local context, the necessary shared vision among all development players and the populace are all preliminary to the concrete effectiveness of financing.

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- City of Atakpamé (Togo) : Mr Kasségné ADJONOU and Mr Komlavi AFANTCHAO
- City of Houdan (France) : Mrs Christiane CAYROL and Mrs Nelly CAILLE-ROBERT

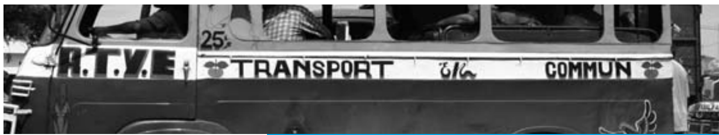
ANNEX 2: A RATING AGENCY'S EVALUATION METHODOLOGY: THE CASE OF FITCH RATINGS

The heterogeneity of institutional environments is fundamental and considered as given. The Agency takes this into account when evaluating the risks of local authorities in given countries. In France, for example, the status of local authorities is virtually identical in every case, but singular or linear models must nevertheless not be used. Such models produce invalid results at the first encounter with one of the rare communities with a special status. Moreover, considerable differences exist in other countries. In Switzerland, for example, the jurisdiction of the canton of Geneva differs from that of the Canton of Vaud; in Italy, the local laws of Sicily differ from those of Piedmont; and so on. Hence the need for ad hoc examination of budgetary, institutional, and financial documents concerning the communities in question.

The agency makes its evaluation after gathering and studying the following documents:

Political environment: If the local executive is elected:
Electoral results for the previous few years: shifts in the deliberating assembly's majorities, assembly composition by political group;
List of office and permanent-commission members;
Program of seated elected officials;
Publicly published documents;

Organization and means:
Organizational chart of departments, distribution of jurisdictions;
Processes for establishing the budget and planning, procedures for the execution of the budget (accounting of commitments, follow-up of payment deadlines, etc.), descriptions of budgetary processes, the budgetary calendar, and budgetary procedures, financial payments;
Description of the range of activities for the community and associated organizations: associated budgets, public institutions, associations, semi-public companies - purpose, agreements signed, control measures in place;
Activity reports and corporate financial statements (most recent two years) for the chief satellites and associations;
Audit reports (if applicable), oversight reports (if applicable);



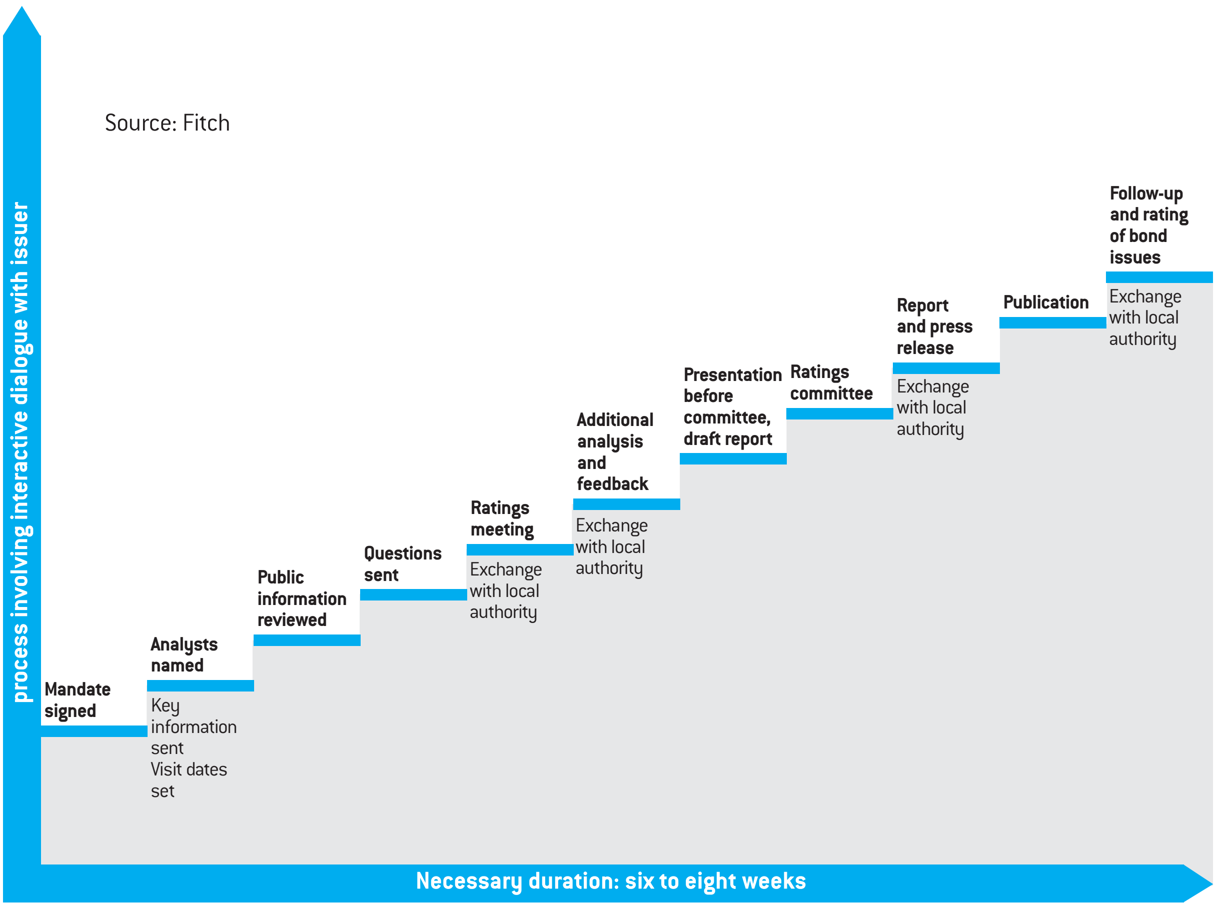
Socioeconomic matters:
Geographic and economic map of the territory;
Local businesses: characteristics of employer organizations (public and private) in the territory (number ; distribution by size, concentration, shifts in the annual number of business creations and closings, list of principal companies);
Demographics: statistical shifts, structure by age group;
Active population: statistical shifts, distribution by socio-professional group;
Salaried employees (official statistics) - Structure by economic sector and statistical shifts;
Unemployment rate (table showing December 31 and the two previous years);
Local or regional executive's policy on economic development, area planning, professional training, employment aid, etc., in accordance with the community's areas of competence;
Tourism statistics (overnight stays, sales figures, etc.), if need be;

Finances:
Administrative accounts by type with annexes (over five years): principal budget and ancillary budgets, complete annexes of the most recent administrative accounts, data on debt;
Reports on budget execution (most recent three years);
Management accounts (over five years): principal budget and annexes;
Initial budgets with, if need be, supplementary budgets and modification decisions;
Reports on budget orientation: principal budget and ancillary budgets;
Financial reports (if applicable);
Situation of tax-base and tax-rate notification;
Details on the principal payers of local taxes;
Long-term debt: structure by rate, existence of differed amortization or interest, debt-management policy, hedges, summary table of expected reimbursements (indicating refinanced amounts) - principal budget and ancillary budgets;
Treasury curves and cash-flow forecast (if available), management charts, treasury policy;
Overdraft facilities ;

Prospective:
Financial prospects / mid-term financial plan (if available);
Hypothetical evolution of the principal variables, budget simulations (if available);
Pluri-annual programming of investments, list of the principal facilities projects.

Analysts follow the calendar below in implementing this methodology:

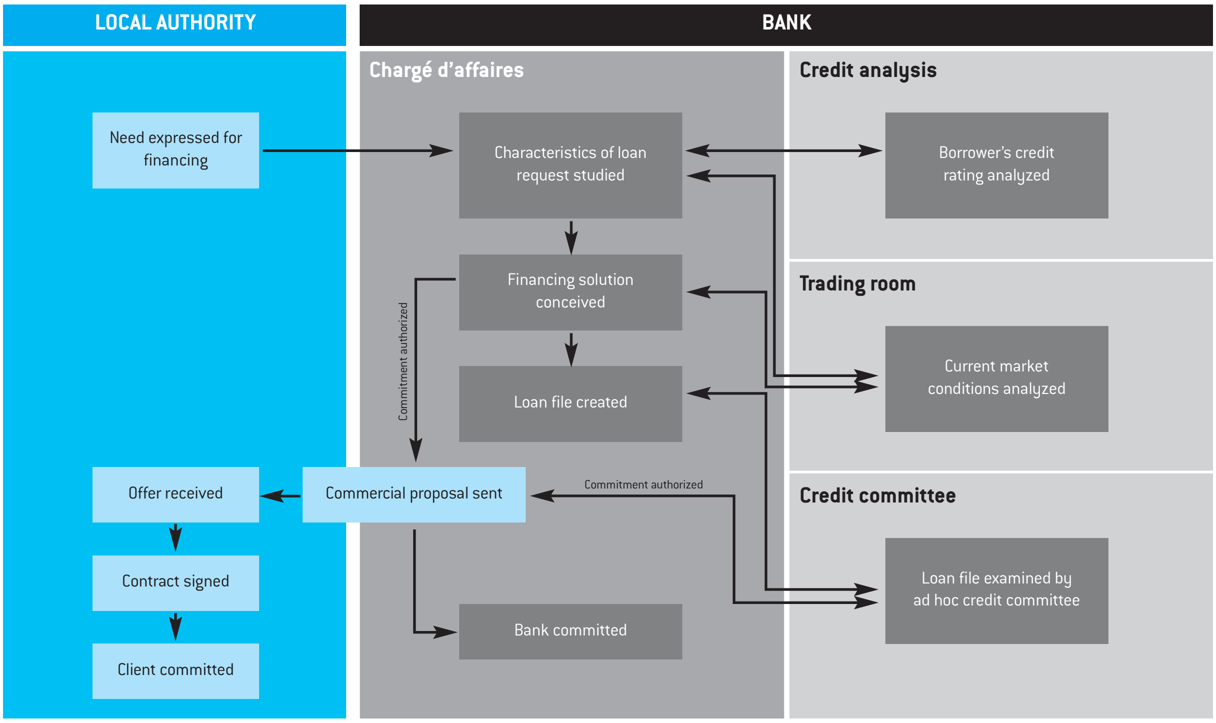
TEN STEPS FROM MANDATE TO PUBLICATION: THE PROCESS IN DETAIL



ANNEX 3: SCHEMATIC PROCEDURE FOR LOAN-REQUEST STUDY BY A BANKING PARTNER

FLOWCHART FOR THE STUDY OF A REQUEST FOR A LOAN FROM A BANK

The following procedure outlines the steps necessary for a commercial bank to validate a financing operation for a local authority:



A bank will base its study of a loan request from a local authority on the following:

- The local authority's **accounts** (complete fiscal years), the **budget** (forecast), and any **development plan** (programming), which allow for a financial analysis;
- The **purpose of the requested financing** (to finance a project or to boost the local authority's own resources, allowing it to balance its budget), and the eventual **means of reimbursement** (through revenues generated by the project or through regular inflows into the local authority's budget)
- Selected data on the community's **environment**: demographics, economic context, and, if available, extant ratings from rating agencies;
- The **history of the relationship** between the bank and the local authority.

For the bank, the analysis will focus more on the local authority's **ability to reimburse the loan** than on the strategic opportunities or operational qualities of its projects.

ANNEX 4: STEP-BY-STEP APPROACH TO SELF-EVALUATION

A blank spreadsheet covering the self-evaluation process step by step is available for download on the French Institute for PPP (IGD) website: www.fondation-igd.org. Sample self-evaluations are also available.

I. COLLECTING DATA

Before the financial analysis can begin, the following must be at hand:

- Macroeconomic and demographic data on the local authority and its country;
- The local authority's administrative accounts for the previous five years, in order to review them under simplified-accounting rules;
- A statement of assets or, instead, of the local authority's external debt
- Development and investment plans.

All of the following tables can be filled in with a spreadsheet program.

II. COUNTRY RISK ANALYSIS

Country's situation: absolute situation with respect to the given indicator, compared with that of other countries and international norms
Impact on the local authority: does the country's overall situation affect the local authority's position?
Local authority's position: is the local authority's position better or worse than the country's?

	COUNTRY'S SITUATION	IMPACT ON THE LOCAL AUTHORITY	LOCAL AUTHORITY'S POSITION
Rating method	1 = good; 2 = satisfactory; 3 = bad	1 = favorable ; 2 = negligible ; 3 = unfavorable	1 = better; 2 = the same; 3 = worse
Economic and demographic indicators			
a. Wealth			
b. Currency			
c. Economic activity			
d. Employment			
e. Population			
Institutional and political indicators			
a. Status of local authorities			
b. Local competencies			
c. Rule of Law			
d. Corruption			
e. Elections			
Financial and accounting indicators			
a. Local resources			
b. Accounting			
c. Guarantees			
d. Controls			

By conducting this analysis, the local authority will be able to determine quite easily whether the conditions for external financing are favorable or not.

III. RETROSPECTIVE ANALYSIS

1. Generic accounting framework

	N-5	N-4	N-3	N-2	N-1	N (FORECAST)	CHANGE N/N-5
Operating receipts							
A. Tax receipts							
B. Subsidies received							
C. Income from services and assets							
Operating expenses							
D. Personnel expenses							
E. Purchase of goods and services							
F. Paid assistance							
G. Debt service							
Investment receipts							
H. Loans							
I. Investment subsidies received							
J. Other investment receipts							
Investment expenses							
K. Debt amortization							
L. Equipment expenses							
M. Equipment assistance paid							
N. Exceptional expenses							
O. Results of the year							
1. Gross self-financing							
2. Net self-financing							
3. Financing needs or surplus							
4 or P. Net position							

2. Retrospective analysis indicators

INDICATORS	N-5	N-4	N-3	N-2	N-1	N (FORECAST)	CHANGE N/N-5
I. Proportion of personnel expenses compared to operating receipts							
II. Rate of gross self-financing							
III. Rate of net self-financing							
IV. Variation in the rate of net self-financing							
V. Rate of financing need or surplus							
VI. Variation in the rate of financing needs							
VII. Variation between forecast budget receipts and final ones							
VIII. Variation between forecast expenses and final expenses							
IX. Debt profile							
X. Profile of debt stock							
XII. Profile of the cost of debt							
XIII. Total debt/operating receipts							
XIV. Total debt/gross self-financing							
XV. Rate of subsidization of equipment expenses							

IV. « GOING WITH THE FLOW » SCENARIO AND IMPACT OF ENVIRONMENTAL FACTORS

1. Projected changes

These projections do not take into account any expenses or revenues related to investments.

	CHANGE N TO N+5 (SAME AS N-5 TO N)	CORRECTIONS AFTER ANALYSIS OF IMPACT OF CHANGE FACTORS
Operating receipts		
A. Tax receipts		
B. Subsidies received		
C. Income from services and assets		

	CHANGE N TO N+5 (SAME AS N-5 TO N)	CORRECTIONS AFTER ANALYSIS OF IMPACT OF CHANGE FACTORS
Operating expenses		
D. Personnel expenses		
E. Purchase of goods and services		
F. Paid assistance		
G. Debt service		

2. "Going with the flow" scenario

Only investment revenues and investment expenses that are already committed (with certainty or near-certainty) appear here.

	N	N+1	N+2	N+3	N+4	N+5
Operating receipts						
A. Tax receipts						
B. Subsidies received						
C. Income from services and assets						
Operating expenses						
D. Personnel expenses						
E. Purchase of goods and services						
F. Paid assistance						
G. Debt service						
Investment receipts						
H. Loans						
I. Investment subsidies received						
J. Other investment receipts						
Investment expenses						
K. Debt amortization						
L. Equipment expenses						
M. Equipment assistance paid						
N. Exceptional expenses						
O. Results of the year						
1. Gross self-financing						
2. Net self-financing						
3. Financing needs or surplus						
4 or P. Net position						

V. PLURI-ANNUAL PROGRAMMING

The following tables account only for expenses related to projects implemented by the local authority, with receipts generated thereby, and for expenses related to new projects. For year N, programming is including projects not known at the time of the first forecast budget, or takes into account the candellation or delay in achieving planned projects.

Chart of expenses:

	N	N+1	N+2	N+3	N+4	N+5
Project 1						
Investment expenses						
Equipement expenses						
Equipement assistance paid						
Annual operating expenses						
Personnel expenses						
Purchase of goods and services						
Paid assistance						
Project 2						
Investment expenses						
Equipement expenses						
Equipement assistance paid						
Annual operating expenses						
Personnel expenses						
Purchase of goods and services						
Paid assistance						
Project N						
Investment expenses						
Equipement expenses						
Equipement assistance paid						
Annual operating expenses						
Personnel expenses						
Purchase of goods and services						
Paid assistance						
Total of new investment expenses						
Total of new operating expenses						

Chart of receipts:

	N	N+1	N+2	N+3	N+4	N+5
Project 1						
Tax receipts from the project						
Income from services and assets due to the project						
Operating subsidies received for the project						
Investment subsidies received for the project						
Other investment receipts for the project						
Project 2						
Tax receipts from the project						
Income from services and assets due to the project						
Operating subsidies received for the project						
Investment subsidies received for the project						
Other investment receipts for the project						
Project N						
Tax receipts from the project						
Income from services and assets due to the project						
Operating subsidies received for the project						
Investment subsidies received for the project						
Other investment receipts for the project						
Total of new investment receipts						
Total of new operating receipts						

1. Consolidation of the "going with the flow" scenario and programming.

	N	N+1	N+2	N+3	N+4	N+5
Operating receipts						
A. Tax receipts						
« Going with the flow » scenario						
Programming						
B. Subsidies received						
« Going with the flow » scenario						
Programming						
C. Income from services and assets						
« Going with the flow » scenario						
Programming						
Operating expenses						
D. Personnel expenses						
« Going with the flow » scenario						
Programming						
E. Purchase of goods and services						
« Going with the flow » scenario						
Programming						
F. Paid assistance						
« Going with the flow » scenario						
Programming						
G. Debt service						
« Going with the flow » scenario						
Recettes d'investissement						
H. Loans						
« Going with the flow » scenario						
I. Investment subsidies received						
« Going with the flow » scenario						
Programming						
J. Other investment receipts						
« Going with the flow » scenario						
Programming						
Investment expenses						
K. Debt amortization						
« Going with the flow » scenario						
L. Equipment expenses						
« Going with the flow » scenario						
Programming						
M. Equipment assistance paid						
« Going with the flow » scenario						
Programming						
N. Exceptional expenses						
« Going with the flow » scenario						

	N	N+1	N+2	N+3	N+4	N+5
0. Results of the year						
1. Gross self-financing						
2. Net self-financing						
3. Financing needs or surplus						
4 or P. Net position						

2. Financial trade-offs.

The financial trade-offs below should help balance budgets for the consolidation stage above.

	N	N+1	N+2	N+3	N+4	N+5
Operating receipts						
A. New tax receipts to collect						
B. New subsidies to solicit						
C. New income from services and assets to collect						
Operating expenses						
G. New debt service (following the new loans, see H)						
Investment receipts						
H. New loans to contract						
I. New investment subsidies to solicit						
J. Other investment receipts to collect						
Investment expenses						
K. New debt amortization following the new loans						

VII. PROSPECTIVE ANALYSIS

1. Projections with simplified accounting methods.

Integration of the basic scenario and of the results of programming and financial strategy.

	N	N+1	N+2	N+3	N+4	N+5
Operating receipts						
A. Tax receipts						
B. Subsidies received						
C. Income from services and assets						
Operating expenses						
D. Personnel expenses						
E. Purchase of goods and services						
F. Paid assistance						
G. Debt service						
Investment receipts						
H. Loans						
I. Investment subsidies received						
J. Other investment receipts						
Investment expenses						
K. Debt amortization						
L. Equipment expenses						
M. Equipment assistance paid						
N. Exceptional expenses						
O. Results of the year						
1. Gross self-financing						
2. Net self-financing						
3. Financing needs or surplus						
4 or P. Net position						

2. Prospective analysis indicators.

INDICATOR	N	N+1	N+2	N+3	N+4	N+5	CHANGE N+5/N
I. Proportion of personnel expenses compared to operating receipts							
III. Net self-financing rate							
IV. Change in rate of net self-financing							
V. Rate of financing need or surplus							
XIII. Total debt / operating receipts							
XIV. Total debt / gross self-financing							
XV. Rate of subsidization of equipment expenses							

ANNEX 5: BASIC GLOSSARY

This glossary covers terms specific to financing, a field where the influence of English is considerable. The definitions come from the following two reports:

- **The "Financing the Investments of Local Authorities" Working Group (Groupe de travail « financement des investissements des collectivités locales »)**, *Financing Investments for Developing Cities (Financer les investissements des villes en développement),* Agence française de Développement - Research Department, 2005
- **Working Group for Member Banks and Financial Organizations of the French Institute for PPP (Groupe de travail des banques et organismes financiers membres de l'IGD)**, *PPP Financing in France (Le financement des PPP en France)*, French Institute for PPP, 2006

BASIC POINT:
Sometimes abbreviated to "bp." It is equal to one-hundredth of a percentage point. A margin of 1% is thus equal to 100 base points, a margin of 0.50% to 50 base points, and so on.

BOND:
Security issued by a company, government, or government organization in order to raise capital and committing the issuer to pay interest at precise dates throughout the term and, at the end of the term, to reimburse the capital raised.

CASH-FLOW:
Gross self-financing representing the liquidity that an entity has by virtue of its operation. The expression is applied essentially to companies. It is a resource often used to finance new investments, reimburse loans, or pay dividends to shareholders.

CLOSING:
The finalizing and signing of financial and industrial contracts, allowing operations to commence.

CREDIT ENHANCEMENT:
A technique allowing a debt issuer to lower an operation's cost by improving its credit rating, through backing from a first-tier (single-line) insurer. The rating obtained through credit enhancement reduces the lender's risk. The lender allocates less of its own funds, thereby reducing the operation's cost, and can then reduce the margin offered to the borrower.

DUE-DILIGENCE:
The preparations and checks deemed necessary to begin a project.

JUNIOR:
As opposed to "senior." Designates a loan whose reimbursement is not a priority - also called subordinated debt. "Junior" debt is the first to be affected by the borrower's financial troubles.

RATING:
A measurement, established by rating agencies, of the risk run by creditors when lending to an institution or on a given transaction (for example, a loan or a bond issue).

RISK:
Liquidity risk occurs when a long-term loan is financed by short-term resources. The risk is to be forced to refinance at a higher cost for the remaining years.

Foreign-exchange risk occurs when a loan is financed in a foreign currency. The risk is that exchange-rate fluctuations will increase the value of the resources with respect to their use.

Interest-rate risk occurs when the interest rate for the resource (e.g., a bank's demand deposits) differs from the rate for the loan (e.g., a ten-year loan), over the period of amortization, the index, or the parameters for establishing the index.

Tax Risk is due to a reduction in local authorities' share of the central government's resources.

Systemic risk is due to a change in government policy with respect to the entire sector.

RISK MATRIX:

Simplified table (generally non-contractual) summarizing the distribution of risk between the various participants in a project.

SENIOR:

As opposed to "junior." Senior financing guarantees creditors the status of priority creditor, at the same level as other senior creditors (such creditors are said to be pari passu: i.e., should the borrower have financial trouble, they share available sums equally for the payment of financial debts).

SPREAD:

Margin on a loan or bond measured against an index.

SWAP:

Financial technique in which elements of a transaction are exchanged. A rate swap exchanges rate indexes on a reference loan. Another swap could make a variable-rate loan into a fixed-rate loan.

ANNEX 6: ADDITIONAL REFERENCES

1. Guides, manuals, and studies:

- **SNV Mali** (Dutch development organization), *Self-Evaluation Tool for the Performance of Local Authorities (Outil d'autoévaluation des performances des collectivités territoriales)*, MATCL SNV Helvetas, 2004. Publication available online: http://www.snvmali.org/publications/outilautoeval.pdf
- **Anwar Shah**, *Local Budgeting*, Public Sector Governance and Accountability Series, The World Bank, 2007 - Available in English only; can be ordered for $35 at the following web address: http://www.worldbankinfoshop.org/ecommerce/catalog/product?item_id=6355058
- **Anwar Shah**, *Local Public Financial Management*, Public sector governance and accountability Series, The World Bank, 2007 - Available in English only; can be ordered for $35 at the following web address: http://www.worldbankinfoshop.org/ecommerce/catalog/product-detail?product_id=6354743&
- **Fund for Moroccan Township Facilities and Infrastructure (Fonds d'équipement communal du Maroc)**, *Practical Guide to Participative Planning in Local Development (Guide pratique de la planification participative du développement local)*, General Directorate of Local Authorities, Ministry of the Interior, 2008
- **Thierry Paulais**, "Financing Urban Development in Developing Countries: Needs and Paradoxes" ("Le financement du développement urbain dans les pays émergents : des besoins et des paradoxes") in *Revue d'Économie Financière* n°86, November 2006 (p.309)
- **"Financing the Investments of Local Authorities" Working Group (Groupe de travail « financement des investissements des collectivités locales »)**, *Financing Investments in Developing Cities (Financer les investissements des villes en développement)*, Agence Française de Développement - Research Department, 2005. Publication available online: http://www.afd.fr/jahia/webdav/site/myjahiasite/users/administrateur/public/publications/notesetdocuments/ND-24.pdf
- **Municipal Development Partnership (Partenariat pour le Développement Municipal)**, *Loans to Local Authorities in Sub-Saharan Africa (L'emprunt des collectivités locales d'Afrique subsaharienne)*, La Revue Africaine des Finances Locales, June 2008. Publication available online: http://www.pdm-net.org/PDM_final_130608_web.pdf

2. Information on financial ratings:

Several websites provide access to country-risk analyses carried out by international institutions or rating agencies. These analyses can serve as departure points for the environmental analysis proposed in this guide to self-evaluation:

- **World Bank**: "Country at a Glance" collection, a selection of economic and financial indicators by country (in English). Web address: http://web.worldbank.org/WBSITE/EXTERNAL/DATASTATISTICS/0,,contentMDK:20485916ffmenuPK:1297819ffpagePK:64133150ffpiPK:64133175fftheSitePK:239419,00.html

- **Fitch Ratings**: only paying subscribers have access to full ratings reports, but access to all of Fitch's ratings, as well as to its methodology, is free. Web address: http://www.fitchratings.com/corporate/sectors/issuers_list_corp.cfm?sector_flag=5&marketsector=1&detail=&body_content=issr_list
  Rating files for French local authorities are available free of charge. Web address: http://www.fitchratings.fr/default.aspx?Page=FinancesPubliques

- **Coface**: a selection of economic and financial indicators as well as perspective analysis on the macroeconomic evolution of more than one hundred countries. Web address: http://www.trading-safely.com/sitecwp/cefr.nsf

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