The Importance and the Know-How of the Generic Accounting Framework, Historical analysis, Ratio analysis for development of the Action Plan of MFSA

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MUNICIPAL FINANCE - KEY FACTS

- Localization with urbanization is increasing process
- LGs are starved of development resources – in developing coutries local taxes account for 2.3% of GDP compared to 6.4% in developed countries
- **LGs are under pressure to do more with less**
- LGs have opportunities to leverage their own resources with the support of national government and the international community, as well as by access to financial market (loans, bonds, PPP)
- LGs have to learn to deliver services more effectively and efficiently with better public financial management

Key drivers for improving PFM

The key drivers for improving PFM vary from country to country, because of political, legal, social and economic differences, such as for example:

- Public sector financial management reforms lagged behind those in the private sector
- **The legislative framework is weak**
- **Skills deficit and retention issues**
- Losses and waste in the public sector
- The **need to improve accountability and transparency over public spending** for the general public and tax payer
- **Weak resource allocation**
- **Deficiencies in financial data and budget reporting**
- **Outdated accounting and auditing system**
- There is need to comply with international accounting practice
- The **need to improve efficiencies and effectiveness in service delivery**
- ....etc

MFSA - main aspects for your considerations

1. Generic Accounting Framework
2. Historical Analysis
3. Ratio Analysis

Legend

1. City Profile	• Summarize through key data the institutional position of the city • Complete with preliminary data from Urban Audit methodology • List the main urban management & development challenges
2. Basic database for MFSA	• Put together basic data to perform self-evaluation • Involve the different municipal departments
3. Generic Financial Framework	• Assess the ability to generate gross saving and operating surplus • Calculate capital investment effort
4. Historical Analysis	• Conduct a detailed analysis of revenues and expenditures composition and trends • Assess the level of financial autonomy • Assess the level of service provided
5. Ratio Analysis	• Review the economic & financial performance through main indicators • Compare with benchmarks
6. Financial Projections	• Identify budgetary applications of the policy decisions (ex: investment plan, recurrent costs, tax pressure, etc.) • Fix the financing needs for investment • Identify the expected changes in existing regulation with impact on the city budget
7. Financial Management Assessment	• Review briefly budget credibility (Based on PEFA methodology) • And quality of the reporting: Comprehensiveness, transparency, predictability
8. Finance Improvement Plan	• List the key measures to qdopt to improve financial management and financial performance

1. PUBLIC SECTOR ACCOUNTING FRAMEWORK

PUBLIC SECTOR ACCOUNTING FRAMEWORK

- Accounting systems should provide **complete**, **timely**, and **accurate information** concerning budget revenues, proceeds, expenditures, assets, and liabilities
- **International Public Sector Accounting Standards** (**IPSAS**) are used by public sector entities around the world in the preparation of financial statements
- Public Sector Accounting System **in developing countries are** usually **set by national level** and might not be in full compliance IPSAS
- Thus, budget accounting systems and statements **can differs from one country to another**

MFSA GENERIC ACCOUNTING FRAMEWORK

- It is **in compliance with the IPSAS**
- It enables LGs to evaluate its **financial position based on the same budget data classification**
- The objective is to evaluate **at a glance the financial position** and to assess:
  - ability to generate operating surplus to finance capital investments
  - level of the debt service and adequacy with financial position
  - level of capital investment effort compared with operating budget; etc.

MFSA GENERIC ACCOUNTING FRAMEWORK

	REVENUES	EXPENDITURES
Current Budget	**Current Revenues** Own Revenues: taxes, fees Transfers from Government Other revenues (rents) Surplus carried forward	**Current Expenditures** Payroll Goods and services Operation & Maintenance Interest payments Deficit carried forward (if any)
		Operating Surplus
	Self-financing	
Capital Budget	**Capital Revenues** Sale of property, land Grants Loans	**Capital Expenses** Civil works Purchase of property, land Repayment of Loan principal

MFSA GENERIC ACCOUNTING FRAMEWORK

Definitions

Current /operating budget = expenses and receipts used to provide for daily operation. They are mandatory and repeat relatively predictably.

- **Current revenues** = tax receipts, current transfers and grants, fees, charges, and tariffs generated by the local assets (land lease, public utilities and facilities, etc.).
- **Current expenditures** salaries, running costs, goods and services, O&M, current subsidies/grants to budget beneficiaries and debt expenses

Capital budget = revenues/proceeds and expenditures that increase or reduce the municipal assets (acquisitions or sales, civil works). Capital expenditures are implemented on more than one year and have to be split on several fiscal years. They are variable from one year to another.

Debt service is split between current budget for loan interests and capital budget, for loan repayment. In a more prudential approach, all the debt service (including loan principal repayment) should be covered by the operating surplus, as a proof of debt service ability

Total budget or annual account can be balanced, in surplus or in deficit.

MFSA GENERIC ACCOUNTING FRAMEWORK

INSTRUCTIONS

Discussion about the MFSA use to evaluate the financial position of the municipality :

- Ability to generate operating surplus to finance capital investment budget
- Creditworthiness/ level of the debt service
- Level of capital investment effort compared with operating budget
- Degree of dependency from State transfers
- General surplus at the end of the year

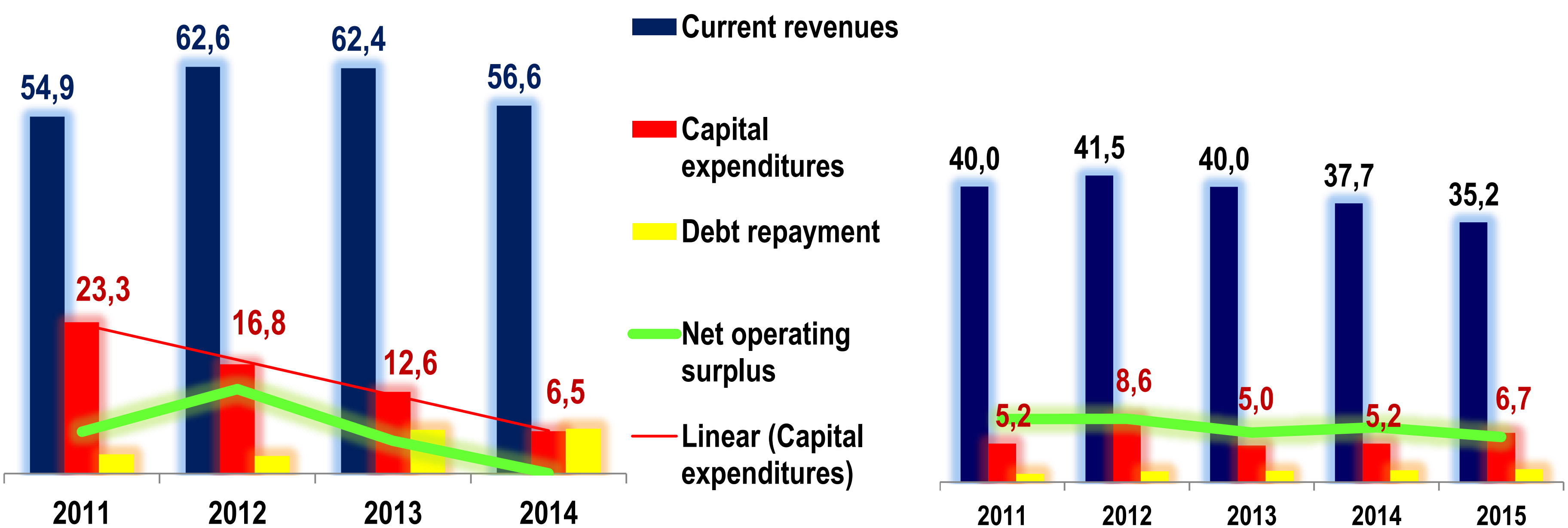
QUESTIONS:

- **How well do the official financial statements compared to MFSA reflect municipal financial position?**
- **Is municipal performance stronger or weaker than reported?**
- **Are there sizable off-balance-sheet liabilities (e.g., operating leases, PPP fees,…) that would affect the municipal ability to pay legal obligation or to repay the debt?**

2. HISTORICAL ANALYSIS

MFSA HISTORICAL ANALYSIS

- **Mainly based on operating budget surplus/gross self-financing**
- Operating budget surplus is a crucial **indicator of quality management** of the local government, and is a **strong component in dialogues** with financial partners, private investors and creditors



HISTORICAL ANALYSIS

INSTRUCTIONS

Discuss and give a summary on the main lessons learnt from the historical analysis of:

- Financial position
- Main revenue sources, including transfers from central governments
- Tax potential and tax performance
- Main operating expenses by category
- Capital investment budget financing
- Indebtedness situation
- Cash balance
- Arrears

QUESTIONS:

- **How MFSA can help during the historical analysis of budget structure, execution, trends and performances in level of services provided by the municipality**
- **How it can help in preparing a budget or in making a mid-term budget forecasts**

3. Ratio Analysis

MFSA Ratio Analysis

MFSA Ratio Analysis contains number of ratios that are used to evaluate various aspects of municipal operating and financial performance:

- Credit worthiness
- Indebtedness
- Fiscal autonomy
- Capital investment effort
- Level of service efficiency
- Liquidity and solvency

The trend of the ratios over time is studied to check whether they are improving or deteriorating

Ratio Analysis

INSTRUCTIONS

- Identify and analyze the strongest financial performance indicators for the municipality
- Identify and analyze the weakest financial performance indicators for the municipality, and propose the possible way of its improvement
- Make comparison of the ratios between the municipalities within your group

QUESTIONS

- **What does Ratio Analysis tell you about municipal financial management?**
- **How MFSA can help in setting priorities for the Financial Improvement Action Plan?**

Ratio analysis (municipal finance dashboard)

Objective and Indicator	Benchmark
Credit worthiness	
Capacity to borrow and to invest (Operating savings before interests / Current actual revenues)	> 0.3
Capacity to borrow more (Net Operating Surplus / Current actual revenues)	> 0.2
Ability to meet its short-term obligations (Cash end of the year /current liabilities divided by 365 days)	90 days
Indebtedness	
Capacity to clear its debt with operating surplus (Debt outstanding / operating surplus)	< 10 years
Annual debt burden is correct regarding current revenue (Debt service / Total current revenues)	< 10 %
Fiscal autonomy	
Ability to increase the revenues (Own tax receipts + unconditional grants / Current actual revenues)	> 80 %
Capital investment effort	
LG favours development expenditures (Capital investment expenditures / Current actual revenues)	> 40 %
Level of service	
LG has important non-current assets to maintain and make it a priority (Maintenance works expenditures / Operating expenditures)	> 30 %
Others	
Limited room for financing maintenance & capital investment (Salaries & wages / Operating actual expenses)	> 40 %
LG accumulate short term debt and reduces its credibility	> 1