Financial Management Checklists for Elected Officials

As you consider your fiduciary responsibilities as an elected official, here are some checklists to consider and questions to ask about the financial operations in your city:

Financial Policies: The Best Way to Assure Your Fiscal Health

Fiscal heath is a lot like your personal health—it's not what you live for . . . but it's hard to enjoy your life without it. Like personal health, fiscal health is rarely luck—clear, articulated fiscal policies are an important foundation for fiscal health.

In looking at cities across the nation that have reputations for being well-managed financially—and have maintained their fiscal health through good times and bad—the one thing they have in common are clearly articulated fiscal policies, and they use them in financial decision-making. While the underlying economic health of a community is important, it is ***not*** the most critical factor in determining fiscal health. All we have to do is look at the Orange County bankruptcy to know that financial management counts. Their bankruptcy was not due to faltering performance of the local economy—Orange County is one of the wealthiest areas in the world—but due to a lack of clear, appropriate investment policies, and then following them.

Questions to Ask

- Do you have written fiscal policies?
- How often does the Council review them?
- What do they cover? Some suggestions:
  - Balanced budget (and what does this mean).
  - Revenue management.
  - User fees—what level of cost recovery should they achieve for what services?
  - Enterprise funds—does the General Fund subsidize them? Do they subsidize the General Fund?
  - Revenue earmarking— a bad idea in general, but if you do it, are you clear when and why?
  - Fund balance—how much should it be?
  - Capital financing and debt management—when should you use debt for either short or long-term needs? What type of debt is appropriate for your community? How do you manage "conduit" financings or developer-driven, land-based financings?
- How do your policy goals compare with actual circumstances?

Long-Term Financial Planning

Policies are critical for fiscal health. However, a longer-term financial plan that looks beyond the current fiscal year is your next best friend in assuring your fiscal health. In short, if you don't know where you're going, any road will get you there.

Why You Want to Do Fiscal Forecasts

- Forecasts require clearly-stated assumptions.
- This forces you to think about the factors that affect your fiscal health.
- And what you can and can't do about them

Why You Don't Want to Do This

It's risky! Facts and assumptions will be out-of-date before the laser jet ink is dry. So what should you do?

- Recognize perils.
- Act anyway.

The solution: Have clearly stated assumptions.

☛ *Questions to Ask*

- Do you periodically prepare a long-term fiscal forecast?
- Does it show key past trends for revenues and expenditures, and demographic factors that affect you like population, inflation, new construction, business growth, assessed value and taxable retail sales?
- Does it reach a clear conclusion about what happens if current trends continue?

Budgets

The Government Finance Officers Association of the United States and Canada (GFOA) says that budgets should do four things:

- **Policy Document.** The budget should address policy issues such as tax policy, funding priorities and "macro problems" facing your community.

- **Financial Plan.** It should show where your resources come from and how they are used. Your budget should demonstrate your ability to pay for the services that it funds—not just this year, but into the foreseeable future.

- **Operations Guide.** It should show how you are organized to deliver services. It should describe programs and activities, and provide measures on how effectively and efficiently you are doing this. In short, it should show what you do and why, not just how much does it cost.

- **Communications Tool.** It should be prepared in a way that facilitates public study, and effectively communicates key economic and fiscal issues to policy makers and the public.

In short, the budget should be your key tool for linking what you want to accomplish for the community in the near term with the resources necessary to do so. For example, most cities have long-term plan, goal and policy documents like their General Plan (and related elements such as circulation, parks and open space); urban water management plans; short-range transit plans; pavement management plans; and other "master plans."

Either explicitly or implicitly, your budget answers the question: of all these important goals in these master plans, *what are you going to do* ***this*** *year?*

Questions to Ask

- Does your budget show your top ten General Fund revenue sources? Does it discuss how these projections were made? Stay focused on these, because they probably account for close to 90% of your total General Fund revenues.
- Does your budget summarize your major expenditures:
  - By function? (Police, fire)
  - By type? (Operating –staffing, contract services, supplies; capital; and debt service)
  - By funding source? (General fund, other governmental funds, enterprise funds)
- Does your budget show how your financial condition changes? How do you measure financial condition in your budget?
- Does your budget tie to your audited financial statements?
- Does your budget link goals and resources?
- Is there a meaningful opportunity for Council members to shape major goals and objectives before the preliminary budget is issued?
- Is there a clear, concise budget message that outlines major issues?
- Does your budget balance due to one-time fixes, or does it reasonably set forth a funding program that can be sustained for the foreseeable future?
- Do you have a clear understanding of your role in the process? Are you looking at the forest or the trees? Which do you want to look at?

Financial Reporting

Monitoring financial results is an essential component of effective financial management. There are two kinds of financial reports:

- **Interim Reports.** This could be on-line access to your finance system, monthly reports, quarterly reports or mid-year year budget reviews.

- **Annual Reports.** This is your annual audit, which may be presented as part of a "comprehensive annual financial report" (CAFR)—the approach recommended by the GFOA and the California Society of Municipal Finance Officers (CSMFO).

While audited financial statements are important, in many ways interim reports are more important.

Why? Because annual reports are often not issued until six months after the year is over. If there have been adverse fiscal results, it is simply too late to do anything about it by the time the annual audit is issued. Good interim reporting will identify negative—or positive—trends, and allow you to take timely corrective action.

☛ ***Questions to Ask***

Interim Reporting

- Do you receive interim financial reports? How often? What kind?
- Do they provide meaningful information? Are they concise, focused?
- Do they compare what you expected to happen with actual results? Do they discuss key variances?
- Do they "add value"—do they make you "wise" about your city's fiscal condition?
- What kind of reports do managers receive? What do they do with them?
- Are you often surprised by your fiscal results?

Annual Reporting

- How is your auditor selected?
- Are your annual financial reports prepared and issued to you on a timely basis? They should be issued ***no later*** than 180 days after year-end (earlier is obviously better).
- Are they prepared in accordance with generally accepted accounting principles?
- Do you receive a "clean" (unqualified) auditors' opinion?
- Are the statements accompanied by a transmittal letter that clearly and concisely describes your fiscal results for the year?
- Do you prepare a CAFR in accordance with GFOA and CSMFO "Award for Excellence in Financial Reporting" guidelines? If not, why not?

Purchasing

Purchasing goods and services on behalf of your city in a fair, efficient and effective way is an important goal. However, we should put this into perspective. The typical California city will spend about 85% of its budget on operations, about 10% on construction-type projects, and about 5% on debt service. For most California cities, contracting for construction projects is performed pursuant to clear State competitive bidding requirements, and debt service payments are made pursuant to the bond convenants.

This means that the focus for most city purchasing operations is in the operating budget. In this case, 80% of most city operating costs are for staffing. And of the remaining 20%, much of this is for utilities, communications and insurance, where there are limited competitive purchasing opportunities.

Long Story Short: Your purchasing activities probably affect less than 10% of your total expenditures.

The Moral to the Story: Be sure the effort you put into the purchasing function is commensurate with its costs and benefits.

For this reason, many cities have moved to:

- More decentralized purchasing systems.
- Greater reliance on their vendors to provide "just-in-time" deliveries so they don't have to maintain large inventories and warehouse systems.
- Use of cooperative purchasing with other agencies.
- Use of credit cards for "over-the-counter" and Internet purchases.

Questions to Ask

- Is it clear who does what?
- Can the system be summarized on one page?
- If you have a decentralized purchasing system, are there clear organization-wide standards and guidelines? *(There's a big difference between cutting the red tape and chaos.)*
- Does it take too long to do get stuff done?
- Do local vendors complain to you that it takes too long to get paid by the city?
- Does your role make sense? When you are involved in the purchasing process, are you making a decision only an elected official should make? Or is this really just a ministerial decision that could be delegated to staff, freeing your time for more important matters? (A good question to ask about any item on your Council meeting agenda.)

Cash Management and Investments

There have probably been no greater instances where local government has lost credibility in managing its fiscal affairs than in managing its investments—the sad experiences in Orange County and the Cities of Camarillo and San Jose quickly come to mind.

Why has this happened? Because in an often honest and sincere desire to boost the City's bottom line, investment managers took risks inappropriate to the investment of public funds. Either:

- Policies were not clear.
- Policies were inappropriate.
- Policies were not followed.
- Oversight was inadequate.

Public officials in these cases forgot the fundamentals:

- **Always remember whose money it is (it's the community's, not yours)—and act accordingly in a responsible stewardship capacity.**

- **Keep focused on the generally accepted objectives in managing public funds, which are in priority order:**

  - Safety
  - Liquidity
  - Yield

  These objectives mean it should *never* be an investment manager's goal to earn *maximum* returns on the city's portfolio: this would expose the city to an acceptable level of risk. Instead, a more prudent goal would be to earn a reasonable rate of return on the city's investments, while preserving capital in the overall portfolio.

- **If it's too good to be true, it probably is.**

  In the real world, there is only one way to sustain above average yields, and that is to take above average risks.

☛ ***Questions to Ask***

- Do you review the investment policy? Is there a "plan?"
- Do you understand the city's investment program?
- Do you receive and review periodic investment reports?
- Are they clear, concise? Are they readable? Do you fully understand them? (If you can't, this is more likely to be because they've been presented poorly, and may in fact reflect problems, than any "technical" problems with your ability to understand them because it's too "complex." First, it's the job of your staff to make them readable and understandable; and secondly, if the city's portfolio is genuinely that complex, perhaps it shouldn't be.)
- Are there lots of investments and transactions? Why? Most cities do not have portfolios that justify "active" management with lots of sales, purchases and trades.
- Are your investments diversified? Or have you placed "all of your eggs in one basket?"
- What ongoing oversight is there? By who?

Capital Financing and Debt Management

Deciding the appropriate role of using debt in financing your city's operations is fundamentally no different than the way you approach this in your personal life. Stated simply, there are times when it makes perfect sense—like buying a home; and there are times when it doesn't—like buying groceries.

In this sense, debt financing is neither good nor bad—it is simply a tool for achieving your goals.

But it is important to have a clear sense of when it's the right tool. As with your personal circumstances, there are two ways of funding your city's operations:

- Pay-as-you-go.
- Debt financing.

Debt financing is most appropriate for:

- **Temporary Short-Term Cash Flow Problems.** This may be due to structural timing problems such as receiving key revenues (like property taxes in December and franchise fees in April) and your need to fund operations in the meantime. If you do not have adequate fund balances, you may need to issue "tax" or "revenue" anticipation notes. In this case, any amount borrowed must be paid back by the end of the fiscal year.

- **Improvements with long Lives.** You should never borrow long-term for operational or short-term capital needs. And the length of the debt should never be greater than the useful life of the debt-financed asset.

- **Lumpy Costs.** Even though they may have long lives, it makes no sense to debt finance improvement costs—like pavement resurfacing or water line replacements—that occur every year. But for improvements that are truly one-time, spreading this cost over 20 or 30 years may be the very best solution in meeting an important community goal today, and in having those who will benefit from it in the future also help pay for it.

- **High-Priority Project.** Remember that your debt capacity is not unlimited: amounts you borrow for a project today are funds you can not borrow tomorrow, so make sure this is truly a high-priority project. Also, you are committing funds for debt repayment in the future: money you pay for debt service tomorrow will not be available for other operating programs and services.

Questions to Ask

- Do you have a multi-year capital improvement plan? You cannot meaningfully consider key factors like project priorities and debt capacity without one.
- Do you have clear, concise capital financing and debt management policies?
- Do they address when debt financing is appropriate?

- Do they address your debt capacity? Borrowing is easy—paying back is hard!
- Do they address who is on your financing team, and how you select external consultants like bond counsels, financial advisors, trustees, assessment engineers and underwriters?
- Do they address disclosure and relations with rating agencies?
- Do they address conduit financings and developer-driven, land-based financings?

For More Information

Budgets. The *National Advisory Council on State and Local Budgeting* recently issued *Recommended Budget Practices*. This is a very concise and readable set of guidelines, and is available on-line at: www.gfoa.org/services/nacslb.

Financial Management. The GFOA has produced a series of elected officials' guides to public finance. These easy-to-read pamphlets cover:

- Government finance
- Investing
- Financial reporting
- Procurement
- Internal controls and fraud prevention
- Debt issuance
- Auditing
- Fund balance

These pamphlets are available for purchase from the GFOA at:

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