

# **Guide to Best Practices in Local Financial Management**



Madrid City Government

**URB-AL Cooperation Programme  
between the European Union and  
Latin America**



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## PREFACE

This *Guide to Best Practices in Local Financial Management* arose from the concern of the Madrid City Government to strengthen the level of citizens' confidence in the functioning of their institutions, especially in the area of local finance.

On occasion, the image of public administration may deteriorate in the eyes of the society as a result of bad practices, and it is necessary to restore confidence in the system of government and the functioning of public administration. An institutional strengthening should in and of itself enhance relations between government at various levels and the citizenry, promoting values such as social awareness in the exercise of fiscal duties and the increase of citizen demands for the internal improvement of the management of public resources, as well as for institutional information of better quality.

This is why at the Madrid City Government it was deemed necessary to initiate a project such as this one to place a reference document at the disposal of holders of elective office, managers and public employees of various departments that would bring together values that are common not only to European but also to Latin American governments, thus facilitating the exchange of experience and best practices among public institutions.

For this reason, and in keeping with the spirit of collaboration with Latin America, the City Government decided that the proper context in which to carry out this project was through the European Commission's URB-AL Program of Cooperation in Urban Policy between the European Union and Latin America, and in particular, attending to the specific needs of Study Network no. 9 on *Local Finance and Participatory Budgeting*. This Network, coordinated by the Municipal Government of Porto Alegre (Brazil), has as its purpose to provide a permanent process of change and deepening of experiences among local governments in Latin America and Europe for socializing, systematizing and implementing the best experiences in the sphere of local finance and the practice of participatory democracy.

Thus, together with the Government of the Autonomous City of Buenos Aires (Argentina), the Municipal Superintendancy of Montevideo (Uruguay), the Commune of Rome (Italy) and the Municipality of Valparaiso (Chile), we presented this project to the European Commission, which decided to select it and co-finance its execution.

For two years, together with European and Latin American partners, and drawing on the technical assistance of consultants in public administration, the Madrid City Government has worked on drafting this Guide whose purpose, first and foremost, is to contribute to the development of the structural capacity of local governments and to their institutional strengthening by making available to elected office holders, managers and public employees of various local



governments in Europe and Latin America the best practices in local financial management.

This Manual seeks to forge a consensus on a new concept of management that is efficient, ethical, responsible and grounded in solidarity, setting forth the recommendations and standards necessary to make it a reality in the realm of local governments in Europe and Latin America.



## I. INTRODUCTION

This *Guide to Best Practices in Local Financial Management* is framed in a context of growing concern about improving the democratic quality of institutions and the need to promote effective participation by citizens in local public life. Increasingly, international agencies are making efforts to strengthen citizens' confidence in the management of the public sector. As the Council of Europe has pointed out<sup>1</sup>, it is becoming harder and harder for citizens to accept the "opaque" practices of public institutions. The degree of resistance to change depends, in turn, on the cultural traditions of the various countries, the history of their democratic institutions, the stage of regulatory development attained and the extent to which new technology has been applied in the processes of management and keeping the public informed. Recovery of public trust demands reestablishing *"irreproachable ethical conduct based on clear rules, transparent procedures and effective sanctions."*

Owing to its closeness to citizens, the domain of local government faces the challenge of assuming a prominent role in this necessary process of institutional strengthening. Indeed, local government proves the most appropriate space to innovate, tackle reforms and particularly to facilitate and foster citizen participation. Nevertheless, in the event of any irregular conduct, the proximity, visibility and accessibility of political leaders and municipal officials causes more direct and undeniable damage to the image citizens have of institutions overall.

Without disregarding the existence of other areas of interest in local public administration, it must be emphasized that the chief concern of citizens, in their capacity as taxpayers, focuses on the use and allocation of public funds. Any initiative geared towards fostering transparency in municipal financial management and the efficiency of performance in financial matters comprises the only viable way to improve the image of local government in the eyes of the citizens and to renew trust in public institutions.

This guide assumes that municipal governments have a role to play in strengthening the credibility of public institutions through exemplary conduct in the economic and financial realm. Government is indeed the agent that must function as a model for citizens and the economic and social institutions with which they interact. The purpose of this guide is to show the way through the identification of best practices in local financial management, and drawing on concrete international examples that illustrate how to undertake properly any initiative for change. In particular it seeks not only to reduce the danger of incorrect and inefficient practices in local government but also to function as a source of inspiration in undertaking projects and reforms that other local institutions have successfully executed in order to solve problems that are common to us all.

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<sup>1</sup> Manual of Good Practices in Public Ethics at the Local Level, by the Council of Europe.



There are three basic principles on which the best practices gathered in this guide are based:

1. Respect for and fostering of ethical values in obtaining and using public funds.
2. Constant improvement of the efficiency of municipal performance in financial matters.
3. Access to information, transparency and communication of local financial management and its results.

Though these values constitute the pillars that sustain this undertaking, transparency becomes the most essential of all in exemplary local financial management, since it functions as an oversight mechanism for public conduct with direct impact on public opinion. The evaluation of transparency in local financial management has been carried out from three distinct perspectives: The need to justify the making of public decisions in a thorough and objective fashion, the presentation of accounts to supervisory bodies, citizens and diverse economic and social agents, and the active dissemination of this information in a clear and accessible way.

Finally, one must not overlook the role played by Information and Communication Technologies (hereinafter ICT's) in achieving greater efficiency in municipal management, and in particular in improving access to, and the exchange of information on economic and financial subjects with third parties online. The advantages of using of ICT's in municipal management go beyond improvements in versatility and precision in the execution of internal processes, budgeting, accounting and procurement, among other things – bringing about substantial changes in those local institutions that successfully invest in the improvement of their information systems, such as increased effectiveness in the collection of funds, improved control and execution of programming and a more dynamic interchange among economic and social actors.



## II. BACKGROUND: GUIDES AND CODES OF LOCAL BEST PRACTICES

The drafting and dissemination of this guide comes in addition to various initiatives that international organizations have undertaken to overcome a decline in the level of citizens' trust in public institutions.

In the local domain, responses to this phenomenon have been significant and diverse, though the concern of international agencies has focused on the adoption of codes of conduct and manuals of behavior that guarantee first and foremost ethical conduct at the local level. Safeguarding moral and ethical principles entails the first step towards reestablishing the trust of the citizenry.

In this regard, the Council of Europe<sup>2</sup> has directed its efforts in recent years towards prevention more than the correction of irregular conduct and economic crimes in the realm of local government. Some of these efforts include Recommendation No. R (2000) 10 on the code of morality for public officials, Recommendation No. (98) 12 on monitoring the conduct of local government, and Recommendation No. (99) 8 on the financial responsibility of elected office holders for acts and omissions in the exercise of their duties.

The Congress of Local and Regional Authorities of Europe (CLRAE) has also drawn up other documents with similar aims: Recommendation 60 (1999), which contains a European code of conduct concerning the political integrity of local and regional elected officials, and Urban Charter and Recommendation 86 (2000), concerning transparency in the financing of political parties and their democratic functioning at the regional level.

However, as a result of the program undertaken by the Council of Europe in 2002, the *Manual of Best Practices of public ethics* is the document that constitutes the reference guide for these matters at the local level. This document covers subjects ranging from rules for elected officials and the financing of parties to other areas most closely linked to the financial management of local institutions, such as transparency, access to information, administrative procedures and relations with the private sector. The conclusions reached in the realm of information transparency merit particular attention: Validation by the citizenry of public institutions depends to a great extent on the information given to taxpayers on the use of public funds. Indeed, it points out that a lack of communication on economic and financial information on the part of government fosters irregular conduct as a result of the disappearance of oversight, and recommends the extension of administrative transparency to the rules governing the individual conduct of officials.

Just as we have noted in the introduction to this Guide, the Council of Europe's *Manual of Best Practices* points out in its introductory chapter that it should not be construed as a document of a regulatory nature due to the varied domains in

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<sup>2</sup> International organization whose main purpose is to promote local autonomy.



which it may be brought to bear. It should also be borne in mind that what could be a common practice at the local level in certain countries might amount to a major innovation in others.

Efforts by the Council of Europe towards the restoration of trust in government have not been limited to the sphere of public ethics, but have also moved forward specifically with regard to the improvement of local management, and in particular, financial management. Conscious of the financial needs arising from the provision of public services at the local level and the desire on the part of municipal governments to enjoy a high degree of autonomy in the management of their own resources, the Council of Europe, through its Department of Local Government and Transfrontier Cooperation has carried out a number of projects geared to facilitating recommendations in the realm of local financial management. Of particular interest was the publication in 2002 of the report *“Recovery of local and regional governments in financial difficulties,”* and in 2003 of the report *“Budgeting processes and budget management at the local government level.”*

The first of these reports was drawn up with the aim of guiding central governments on ways to help local and regional administrations that find themselves in financial straits. Among other things, the report touches upon: criteria for ascertaining whether these difficulties are genuine or the result of abuse on the part of local entities; the definition of strategies and measures to prevent municipalities from sinking into these circumstances; and strategic guidelines on how the central government should act in such cases.

The second report, in keeping with the significant role we assign in this Guide to budgeting in local financial management, underscores the need to understand the budgeting process from a double perspective, both technical and political, resulting from the joint application of technical and discretionary considerations in the making of certain decisions. The experts at the Council of Europe understand that the budget must comprise a key component in local economic and financial information systems, and contribute, in turn, to improving efficiency in the provision of municipal services.

For its part, the Organisation for Economic Cooperation and Development (OECD), through its Bureau of Public Management has been working on the preparation of guides of best practices and recommendations intended to improve public financial management and the consolidation of ethical management of public services<sup>3</sup>. However, its guidelines are not strictly geared towards the local sphere but rather towards central governments. The OECD’s PUMA Policy Briefs series has addressed various subjects relating to public financial management such as, taxation, budget transparency, procurement and the evaluation of public policy, among others. The principles and values put forward in these guides have served as a reference in the preparation of this guide<sup>4</sup>.

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<sup>3</sup> Principles for an ethical management of public services. OECD 1998.

<sup>4</sup> Especially: Guide to Best Practices for External Procurement, Guide to Best Practices for Establishing Public Services, Guide to Best Practices for Budgetary Transparency, Best Practices in Evaluation of Public Policies.



One must also remember the publications produced by the Department of Finance of the International Monetary Fund (IMF) concerning tax transparency and transparency in monetary and financial policy. However, their contents are at times difficult to translate to the local public level since they are oriented to the general needs of government (in practice, to central governments). The basic reference document is the *Manual of Fiscal Transparency* and the *Code of Good Practices on Fiscal Transparency*.

The IMF's *Code of Good Practices for Fiscal Transparency* was prepared in 1998 in the context of an international consensus on the importance of good governance as a key factor in macroeconomic stability and solid growth, and the concept of fiscal transparency as a fundamental element of good governance. If fiscal transparency facilitates accountability of public officials, fiscal policy will enjoy the credibility of well informed public opinion. This situation undoubtedly favors access to capital markets and would be appropriate for reducing the likelihood of potential crises. However, with time it was considered necessary to add a new section to this Code relating to the quality of financial data. Furthermore, the document was subject to various revisions for the sake of providing greater clarity. The four foundations of this Code are as follows: A clear definition of duties and responsibilities regarding fiscal transparency; obligations concerning public access to information; transparency in the preparation, execution and publication of the budget; and guarantees of the integrity of the financial information, whose data must satisfy certain quality standards and must be subject to an independent breakdown.

The IMF's *Manual of Fiscal Transparency*, for its part, whose earliest versions also appeared in 1998, goes one step farther than the Code, since it identifies the best practices of fiscal transparency that should be employed by advanced economies that have already adopted or are about to adopt the rules of the Code. The Manual has been used especially to support member countries when they evaluate the transparency of practices of public financial management in relation to what is set forth in the Code, and draw up priorities for improvements of fiscal transparency.

A common characteristic of all the documents mentioned thus far is the prudence of the authors concerning the application of these guides. Aware of the variety of countries to which its contents are directed, and thus of the substantial differences in regulatory frameworks, institutional culture and the basic organizational and financial situation of the public institutions in each of these countries, the authors caution their audience on the limitations of scope and detail of the measures proposed, since the recommendations offered must be viable for implementation in different countries, though the period of time necessary in each case may vary.

Finally, it is appropriate to emphasize that most of the documents, manuals and guides mentioned here have drawn up their recommendations in connection with fiscal and budgetary transparency, these being one more aspect of good management in public finance. It remains to incorporate two other fundamental points into our analysis thus far: The efficiency of fiscal policy, and the solidity of



public finances. In view of the difficulties posed by preparing a guide addressed to a mixed group of countries with very different regulations and starting points as well as the diversity of settings that are dealt with, we have chosen to include the criterion of efficiency as essential in the detection of best practices, in addition to criteria for transparency and ethical management.

### III. PURPOSE AND SCOPE

As noted in the Preface, the purpose of this guide is to make available to elected officials and public employees of local government in Latin America and Europe a manual that brings together and disseminates standards of conduct and useful recommendations for the various areas of economic and financial management in local government. The wish to endow the standards brought together in this manual with a universal character has made it necessary to compile especially those experiences that are *transferable*<sup>5</sup> irrespective of the legal and market framework existing in each different country.

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<sup>5</sup> “Transferable” is understood to refer to those practices that can be adapted to different settings in such a way that their essential features can be successfully reproduced.



The contents of this Guide are intended primarily to cover the following areas:

- To establish a code of common values that are valid for all governments based on a set of basic principles, standards and recommendations that enable members of such institutions to make the right decisions, and can serve as a reference for dealing with concrete and universal problems that affect local financial management.
- To identify areas and procedures that are especially sensitive to irregular practices, and strategies for overcoming the obstacles that get in the way of transparency, efficiency and ethical conduct in local financial management.
- To get to know the **factors for success** from a synthesis of case histories as well as the process for their implementation, and the actual effective results of their application.

This analysis focuses on local financial administration as seen from a broader perspective than one linked exclusively to public borrowing and budget management in local government (which are addressed specifically in Chapter V.2), particularly bearing in mind that in certain countries there are strict limitations on how much municipalities can borrow. With the aim of broadening as much as possible their application in all European and Latin American governments, the target area that has been the focus of thought in this Guide consists of the ***relation of the Government in its financial and economic dealings with third parties, such as citizens, suppliers, economic and social agents, and supervisory bodies***, among others. The variety of kinds of financial relations between local government and third parties and the need to institute conduct and procedures across-the-board such as in budget planning or public procurement, impose a need to approach the preparation of this Guide from the six different areas of which they are comprised, with regard to public revenues as well as expenditures.

#### 1. **Information and management of taxation and public revenues.**

The tax relation between local government and its citizens and social and economic agents is one of the most sensitive to public opinion. The aim of local government should be to facilitate procedures for taxpayers through greater transparency of procedures as well as more skillful and effective management. Once again, ICT's play a key role in the attainment of these aims.

#### 2. **Government procurement**

The spending that local governments undertake for such things as purchases of goods, provision of services, technical assistance, construction projects, contracting of management services, have an inescapable impact on the formulation of the contractual relationship between the municipality and its contractors. The legal framework for public procurement by the various countries seeks in general to fulfill



standards of openness, objectivity and competition. Nonetheless, government should foster conduct that reinforces these guarantees, as well as ensuring within the existing legal framework the inauguration of mechanisms to expedite procedures and enhance their transparency.

### **3. Financial management in the narrow sense (public borrowing and public spending )**

The strategies, recommendations and standards that should underpin the management of borrowing by local government, as well as the optimal management of its resources.

### **4. Management of public assistance and grants.**

A significant portion of public funds are allocated towards transferring resources to individuals and institutions for strictly redistributive purposes, that is, with the aim of promoting certain kinds of activities in the local vicinity to bring about the growth and development of the municipality. If the granting of assistance has no reason to adhere strictly to factors of efficiency, as is the case with assistance to low-income families, transparency and objectivity in the procedures for granting such assistance, as well as skillfulness in the management of associated procedures should constitute one of the basic priorities in the management of these public funds.

### **5. Budgeting and oversight.**

The budget constitutes the basic instrument that reflects the economic activities of the governing body. Best practices tied to the budget phases of planning and preparation, execution and follow-up are identified in this Guide. Furthermore, particular attention has been paid to real possibilities of citizen access to economic/financial information that is complete and in a comprehensible language that goes beyond the limitations besetting the sort of information that has been traditionally prepared for experts and inside users.

### **6. Evaluation of public policies**

Evaluation, as an activity that implies reflection on public actions, involves an obligatory step that is rarely undertaken with transparency and a rendering of accounts to third parties. Furthermore, it contributes to continuous improvement of public management inasmuch as it allows for a redesign and redefining of public programs.

Finally, the need to promote the implementation of ITC's in local financial management has made it necessary to dedicate an entire chapter to the subject in this Guide.



#### **IV. METHODOLOGY AND CRITERIA FOR IDENTIFYING EXAMPLES OF BEST PRACTICES IN LOCAL FINANCIAL ADMINISTRATION.**

This *Guide to Best Practices in Local Financial Management* is the result of an exchange of reflections on the principles that should govern the intake and uses of public funds by the working group made up of local experts from five cities (Buenos Aires, Montevideo, Valparaíso, Rome and Madrid) based on the identification and presentation of successful initiatives for the resolution of universal problems in local financial management.

The holding of a seminar in Madrid to launch the project, and two round tables that took place in Buenos Aires and Rome allowed the group of participants to debate the key areas addressed in the Guide: From the definition of the code of principles and values that should govern each of the areas in question, to the presentation of particular cases of success at the local government level for each of the participants whose description was to be adapted to a previously established model in the form of a descriptive label. Each of the experiments submitted had to include at least the following information:

- Name of the experiment
- Timetable of development
- Specific area of activity
- Analysis of the positive impact of the best practice
- Factors for success
- Resistance and necessary changes in the development of the initiative
- Description of the experiment:
  - Description of the problem area prior to its implementation
  - List of the main actions undertaken
- Continuity of the project (detailed description of the current status of the experiment and future prospects)
- Self evaluation of the transferability of the experiment, assessed in terms of local autonomy for the development of the initiative, affordability, simplicity and clarity in its startup as necessary pre-conditions for its implementation, as well as the universality of the underlying problem set.

The process of identifying concrete cases of best practices in local financial management resulted from various lines of work:

1. The work of surveying the respective participating organizations and speaking to those in charge of the various administrative areas.
2. Locating a “circle of exemplary local agencies” that serve as a reference, either because they had undertaken comprehensive processes of improvement and modernization, or else because of their receptiveness to the implementation of new initiatives.
3. Circulating a questionnaire for the identification of best practices.



Considering that the purpose of this manual is to serve as a guide to local managers providing standards and recommendations on procedures to follow in financial management, only those successful experiments that were presented in the course of the workshops were included that fully met the following criteria for best practices<sup>6</sup>:

**Table 1. Criteria for best practices.**

<b>CRITERION</b>	<b>DEFINITION OF CRITERION</b>
<b>POSITIVE IMPACT:</b> -Improves efficiency -Improves transparency -Strengthens ethics	<b>Achievement of objectives established with the project:</b> a positive observable change occurs in any of the defined areas (efficiency, transparency, strengthening of ethical values). It must be possible to measure and compare results between the situation before and after implementation.
<b>PARTICIPATION (in the broad sense, third parties)</b>	<b>Participation by public employees and citizens</b> in decision making. This involvement can be verified on three levels: presence (receptive or passive), active (the “third party” is the initiator of actions), and participation (takes part in decision making).
<b>TRANSFERABILITY</b>	<b>The practice can be adapted to various settings</b> , in such a way that its essential elements can be reproduced with the possibility of success. Transferability depends on the following factors: <b>simple mechanisms for implementation, efficient use of resources, “equivalent degree of local competence” to undertake it, universality of the underlying problem, and pre-conditions for implementation.</b>
<b>FEASIBILITY</b>	<b>Possibility of success of the practice:</b> Economic, technical and socio-political viability.
<b>INNOVATION</b>	<b>Ability to introduce new elements or methodologies</b> into the initial situation for which the organization was not prepared (new tasks, new organization, new organizational culture, new relationships with the environment)

<sup>6</sup> Among the available studies on the definition of criteria for best practices, those by the Pi i Sunyer Foundation are noteworthy for creating a Bank of Best Practices of the Provincial Government of Barcelona, as well as a study put out by the Institute of Government and Public Policy (IGOP) of the Autonomous University of Barcelona for the identification of Best Practices in Social Inclusion. Other organizations have also sponsored initiatives on these matters but without attaining the systematic methodology of these latter two. In the present guide, methodological criteria from both have been adapted to the specific goals of the project and the initial point of departure:

With respect to the process of identifying best practices: it has been decided to complete the work of research by the project's working group and of initiating direct contact with exemplary organizations, by issuing an open invitation to participate to municipalities that have developed model initiatives on a smaller scale.

As far as criteria for identifying of best practices are concerned, the following “basic criteria” have been defined: Innovation and transferability (according to Pi i Sunyer’s “specifics of good practice”), and feasibility and positive impact (“effectiveness” according to IGOP). Other criteria have been discarded whose application dealt more specifically with the particular goals of the projects of both organizations. Furthermore, the criteria of "participation" has been defined from a broader perspective, taking into account not only active involvement in the experience of citizens and social agents but also of the public employees themselves.



Although the criteria enumerated here are the ones defined as fundamental for inclusion in a complete case study in the *Guide*, other additional criteria have also been taken into consideration that enhance the quality of the experiment in question:

- **Sustainability** of the practice: Ability of the best practice to endure over time. The project should have sufficient flexibility to allow for it to be adapted to possible changes of environment without altering its essential elements.
- **System for evaluation and oversight** of the practice: Evaluation of the system for follow-up of a best practice and oversight of the results achieved over time. It is understood that greater monitoring of the practice allows for greater sustainability over time.
- **Project Planning**: Evaluation of the degree of preparation and time organization for the best practice. It is thought that the availability of a plan prior to implementation enhances its transferability to other local governments.
- **Leadership and definition of responsibilities**: The viability of best practices depends to a great extent on the existence of a final guarantee that fosters motivation and participation by public employees, and makes it possible to clearly identify a system of responsibilities and therefore, of accountability.

## V. BEST PRACTICES IN LOCAL FINANCIAL MANAGEMENT.

### V.1. MANAGEMENT OF TAXATION AND PUBLIC REVENUE.

#### V.1.1. Initial considerations.

Most citizens relate to local government in their capacity as taxpayers. The particular sensitivity of public opinion to issues of taxation, both from a macroeconomic perspective (increases of tax rates, new taxes), as well as microeconomic (errors in receipts, lack of necessary information to comply with tax obligations, etc.) is a phenomenon common to most municipalities in the European and Latin American context. These factors have contributed to a concentration of interest in identifying, in matters concerning public revenue, the best practices for the intake and management of tax revenues.

As in the other areas, it has been deemed suitable to focus attention on those aspects of tax management in which local governments have a measure of autonomy for developing their own initiatives, and designing and charging fees for the use of certain services or for the occupation of public space. Thus, in matters of taxation and public revenue, the work of identifying best practices has been focused on the following areas:



- The setting of local rates,
- Systems of tax management from an organizational and procedural perspective;
- Providing attention and information for taxpayers;
- Improvement in the management of payments.

To be sure, in this realm, central, regional and supra-municipal governments can play an important role in promoting processes for the improvement of fiscal transparency, most particularly by supporting smaller government institutions in the application of systems and processes for tax management that pay off with improvements in efficiency and effectiveness in revenue collection. The experiences of Italy, Uruguay, Argentina and Spain where there are public registries of local tax rates available to any local citizen or manager who is interested, serve as examples. On the other hand, the option Spanish municipalities have at their disposal, to delegate the management of taxation and public revenue to the provincial authorities, makes it possible for smaller local governments to take advantage of economies of scale resulting from this kind of management which would not be available if each municipality retained these duties.

It should also be pointed out that whereas the local tax system is commonly based on taxation of real estate, economic activities, vehicles or operating licenses, and various assessments for the provision of services or occupation of space, some big cities provide exceptions to this general framework, such as the City of Buenos Aires, a participant in this project, which has a special financial regulatory regime that is different from that of other the local governments in the rest of the country. Its principal taxes are also different to some extent from the standard arrangements of the other participating governments. Its key distinguishing trait is that it is determined by the weight of indirect taxation in its combined revenues. The importance of the tax on consumption in the finances of Buenos Aires underscores the risks to the long-term sustainability of the financial system due to the strong correlation between public revenue and the economic cycle; which in turn calls for a source of revenue with substantial potential, and this has given rise to the design and implementation of the Anti-cyclical Fund, a mechanism which has guaranteed funding to the City of Buenos Aires for social and sanitary services in periods of crisis.

Finally, the identification of current challenges in local finance has been one of the subjects that has also been subject to debate by international experts at the roundtables. The compartmentalization of revenue collection, to a great extent tied to taxation on real estate and disconnected from the fluctuations in the income capacity of citizens, the strains on tax funds generated by a growing demand for the number and quality of municipal public services, the need to improve the way rates are calibrated, the problems of updating property values in urban centers, improving equity in the distribution of charges and the need in big cities for greater autonomy in management, comprise the main challenges to local oversight.



## V.1.2. Principles and values.

The management of local taxation and public revenue should be based on the following principles and values:

1. **The application of ICT's to tax information systems** constitutes a basic element in improving the efficiency and transparency of processes.

The implementation of ICT's in this area makes possible a broader provision of services and a more flexible relationship with taxpayers. The government may offer services ranging from the release of publications and offering clear information on each tax to the option for individuals to make payments via computer.

2. **Local governments should guarantee compliance with the regulatory provisions** that regulate their finance systems.
3. **Definition of the strategies and goals of tax policy and their explicit formulation.**

Local public administrations should define and solidify their aims qualitatively and quantitatively in such areas as: Effectiveness of revenue collection, fiscal procedures, fiscal pressure, tax equity, exemptions and abatements, and the quantification of service costs against required rates.

4. **Local government must see to the proper administration of public funds.**

With independence from external oversight, responsibility for the handling of public funds imposes on municipalities the need to establish internal controls and foster an appropriate culture of public service.

5. **To maximize the effectiveness of revenue collection of existing taxes**

Local governments should promote conduct and measures that allow them to ensure maximum compliance by taxpayers in the period of voluntary tax payment without disregarding follow-up on outstanding debts in the executive period, and the design and execution of plans for tax auditing.

6. **To facilitate tax payment for citizens.**

Local governments should guarantee to citizens the possibility of making payment for their tax obligations through various means with the aim of improving the effectiveness of revenue collection (paying by card, automated bank withdrawals, virtual offices visits, etc.) with special emphasis on the use of electronic means.

7. **The professionalism of teams managing taxation and public revenue.**



Guarantee of the stability and training in tax management of the teams assigned to this service are a condition for success in tax effectiveness and preclude the use of irregular practices in the management of public funds.

## **8. Accessibility and clarity of tax information.**

The complexity of the tax system deriving from the great number and variety of taxes constitutes an additional problem in relations between tax authorities and taxpayers. Local governments should guarantee access to tax information, and see to its clarity and correctness. Effective fulfillment of this principle requires adapting the legal language of tax legislation to the informational needs of taxpayers who lack specialized legal training.

### **V.1.3. Areas that are especially sensitive to irregular conduct and losses of efficiency.**

In the first place, it makes sense to lay out clearly several factors that compete in the realm of municipal taxation and impede the achievement of the goals of efficiency and transparency.

#### **❖ The characterization of local tax debts.**

The small size of local tax debts against which the municipal administration sets discounts causes losses of efficiency arising from the difficulty of achieving economies of scale in its own tax management activities and the follow-up on the degree of compliance, both in the voluntary payment period and the period of enforcement.

#### **❖ The volume and elaboration of tax legislation.**

The abundance of rules in the tax realm and the constant modifications to which they are subject entails an additional obstacle for management, which not only demands a high degree of specialization and training of officials and managers but also a need to update the related management systems periodically.

From these overlapping circumstances it can be deduced that activities performed for the management of taxes and public revenue are undertaken in a setting of explicit difficulties. Among the most critical aspects of tax management are the following:

#### **1. The need for constant updating of the register of taxpayers.**

Local governments manage their taxes for the most part through taxpayer registers, and keeping them up to date requires constant work. Frequently, the related databases display clear dysfunctions: Delays in the inclusion of new sources of tax revenue, lack of coordination among the various



taxpayer registers within the same municipality, duplicate entries in new registries, etc.

## **2. Internal coordination with other non-tax-related municipal services.**

To act as though public agencies were watertight compartments poses an obstacle to effective revenue collection. The exchange of information with other departments of city government (land surveying, processing of various city licenses, etc.) with direct effects on local revenue collection constitutes an overdue task in the improvement of municipal management.

## **3. Interaction with other administrations and agencies.**

To share tax information with other levels of government or, as noted previously, to establish mechanisms of assistance by higher levels of government for smaller local administrations that cannot achieve economies of scale from the management of tax resources, are key aspects in the improvement of effective revenue collection.

## **4. Taxpayer support service.**

The relationship between the local government and the citizen is especially sensitive to issues of taxation. A large number of the initiatives and best practices gathered in this section concern the need to resume the work of organization and place the citizen at the heart of public service. Waiting on lines, attention to taxpayers that is mostly impersonal, and high rates of late tax payment underscore the point that communication with taxpayers is a critical aspect of tax management. Municipalities that have undertaken projects aimed at resolving citizen discontent about the processing of their taxes have brought about notable improvements in public opinion about the tax administration thanks to an image of modernity, efficiency and greater closeness to the citizen.

### **V.1.4. Best practices: Management of taxation and public revenue.**

As noted at the beginning of this section, the process of identifying best practices has taken place on three levels around which exemplary initiatives in the management of taxation and public revenue gravitate.

#### **A. Design of tax policy.**

Improvements to systems for the management of taxation and public revenue.

#### **C. Relations between local tax authorities and taxpayers.**

#### **D. Improvement in the management of payments.**

Improvement in the transparency of management of taxation and public revenue: Availability and access to tax information and results.



## A. Design of tax policy.

### Best practices for setting municipal rates

In 1998 the OECD's Service of Public Management published a guide to best practices concerning the design of rates for the use of public services. Although the guidelines gathered in the reference document can be generally applied at all levels of government (central, regional and local), most of the recommendations are directly applicable at the local level:

- Services for which local governments can require payment should be clearly indicated in regulations (in this case, fiscal ordinances).
- When it is decided to introduce a new fee or significantly alter the amount charged for an existing one, it is recommended to take the views of users into consideration. However, according to the OECD, the aim is not to subject the introduction of the fee to debate, but to gather opinions about the best way to implement it. In this consultation processes, it is recommended to include the perspective of front-line public employees<sup>7</sup>, who know with the greatest precision the needs and concerns of the service's users.
- **The systems of fees should be combined with the implementation of systems of goals and oversight of service quality.** This information should be supplemented with the periodic provision of data on the degree of user satisfaction to ensure that the government is providing the service at the appropriate level of efficiency and quality.
- **The cost of the provision of services should be quantified,** independently of whether the fee to be set wholly or partially covers such cost. In the latter case, the exact quantification of the cost brings transparency to the tax system, since it permits users to know the level of subsidy implicit in it. The cost should be periodically reviewed and should not only include direct costs, but also an adequate imputation of general costs (see Chapter V.5.) PE Practice VI)
- **Simplicity and uniformity** in the rate structure, without disregarding the variations that may apply to users on the individual level.
- **Considerations of equity should be included.** Local governments should establish discounts to facilitate access to the service for those potential users for whom the fee may pose a financial impediment to its effective use.

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<sup>7</sup> Front office employees, those who are in direct contact with the public.



## *B. Improvements to systems for the management of taxation and public revenue.*

### ■ **GT Practice I: Organizational model for Integrated Management.**

The local tax authority typically often organizes itself internally according to the type of taxes instead of establishing an organizational logic based on the performance of common tasks. The first of these organizational designs creates dysfunctions in the conduct of internal activities and in the relationship with the taxpayer since it causes redundancy in the requirement for documentation and unnecessary delays.

Therefore it is key to the modernization of tax management to adapt and reorient organizational structures towards models that support a management style that is based on participation and delegation as fundamental principles and that place the client at the center of the organization's goals.

These processes have involved abandoning the traditional model in which revenue collection usually depends on the municipal treasury in collaboration with departments tied to the management and processing of resources, to a comprehensive management model in which three separate areas are identified: Management, revenue collection (in voluntary and enforcement periods), auditing, specific legal services – among which are included the processing of tax revenues and the regulatory analysis -- of the relation with other governmental units, of financing and internal coordination – in which the specialization of information systems becomes a key factor.

A model that goes beyond the traditional structure of separate departments for each tax collaborates in fulfilling principles of efficiency, sufficiency, flexibility and unity for the municipal taxation system, improved efficiency in taxation procedures through greater coordination of management and information, and makes it possible to take advantage of savings derived from unified management.

It is, furthermore, appropriate to recall the notice by the OECD in its document on Best Practices in taxation for public services<sup>8</sup>: *“The management of taxation requires the development of multiple skills on the part of local government, especially in the area of human resources management and the application of ICT's to information systems.”*

### ■ **GT Practice II: Implementation of a System of Management by Goals.**

Management by Goals is a management system focused on results that requires defining in the short term the organizational goals, providing tools for the organization's strategic planning. Implementing this system involves taking the following steps:

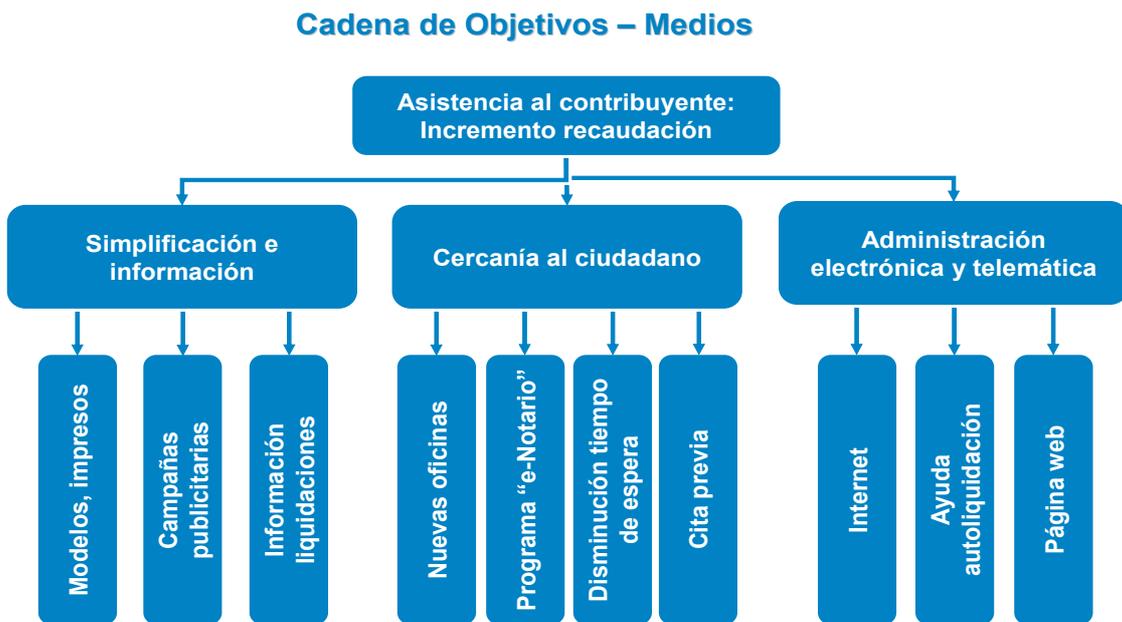
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<sup>8</sup> PUMA Policy Brief no. 3. Public Management Service. March 1998

1. Define the key areas of results, which will be subject to change over time and should be identified by variables of growth (expansion of activity) and profitability.
2. Formulate in a coordinated and negotiated fashion the goals or results to be achieved in periods greater than one fiscal year.
3. Determine concrete and measurable objectives in a fixed period of time.
4. Design indicators that serve as criteria for measuring the degree to which goals have been achieved.

Among several examples of modernization of tax organization through the application of these characteristics we find SUMA, Taxation Authority for the Government of Alicante, and more recently, the Madrid Bureau of Taxation, both in Spain.

**Figure 1. System of Management by Objectives in the Madrid Bureau of Taxation.**



Taxpayer Assistance: Increase of revenue collection		
Simplification & information	Closeness to citizens	Electronic and telecommunications administration
Models, publications Advertising campaigns Filing information	New Offices E-Notary Program Reduced waiting time Advance appointments	Internet Help with do-it-yourself tax payment Web page



### C. Relations between local tax authorities and taxpayers.

#### **Best practices for the improvement of taxpayer support services.**

##### **■ GT Practice III: Direct and personalized service for taxpayers.**

Under this heading we include all measures designed by local taxation authorities geared towards improving the attention and information they offer to their taxpayers. Launching initiatives to provide service oriented towards the concerns of citizens and that assists them in fulfilling their tax obligations in the voluntary payment period has entailed in most instances a thorough reorientation of the service as well as adaptation of material provisions and human resources.

Many practices oriented towards ensuring a more effective exchange between tax authorities and taxpayers arise for the purpose of avoiding the formation of long lines to pay taxes that tarnish the image of the municipality. The factors that give rise to these situations of overload of municipal tax services arise chiefly due to:

- Limitation of the method of payment to in-person encounters at municipal offices.
- Lack of information in advance about tax obligations.
- Lack of coordination with other municipal departments.
- Generic responses to taxpayer inquiries that provide neither prompt nor effective solutions.

To enhance the management of revenue collection and improve the public image of the service requires active communication with the taxpayer. To this end, concrete activities can be undertaken that may be implemented in isolation or could rather form part of a comprehensive project to “create offices to provide support services for taxpayers.” The key to success for these initiatives involves overcoming bureaucratic management and working on the processes so they can offer dynamic solutions to the public. Among other things, the following measures are recommended:

**■ To assign priority support services for citizens** through the following activities:

- Replace the traditional counter with individual tables that ensure confidentiality and more personalized service.



- Change the working mentality of the team that provides taxpayer support, fostering and internalizing the culture of service.
- Improve the endowment of the physical setting in such a way that the taxpayer relates to the government in a comfortable setting to reduce the dissatisfaction that arises from having to wait. These improvements can be brought about by:
  - o Improving the physical setting (waiting areas, lighting, image of modernity, functional and comfortable furniture, and so on).
  - o To provide technical resources that help taxpayers meet their fiscal obligations (photocopiers, appropriate hardware and software, scanners, printers, etc.)
- Extend the hours of service to the public, adapting them to the needs of citizens.
- Set up new channels of communication, beyond in-person encounters. Municipal phone help line, and virtual office hours (see GT Practice VIII in this same chapter)
- Improve the existing channels of communication (help for tourists, adaptation of support services for immigrants). With regard to help for tourists with a second residence in the municipality, the work carried out by the SUMA Taxation Authority in Alicante, Spain is especially noteworthy, which provides special service for resident alien taxpayers who have a second residence in the municipality.

**■ Foster and expedite direct communication between taxpayers and local taxation authorities.**

The achievement of a smooth interaction between the taxation authority and the taxpayer also depends on the responsive and efficient routing of complaints presented by citizens. The idea is to make available to taxpayers additional ways to process things so that their complaints and feedback reach officials swiftly and effectively. Some activities that can be pursued in the framework of this goal are as follows:

- Standardize procedures for the submission of complaints and suggestions.
- Commit to individualized response to taxpayers by tax officials.
- Offer a broad range of possibilities to facilitate the submission of complaints: By phone, a book of suggestions and complaints, message boxes in various municipals offices, e-mail and fax for routing complaints and feedback.



- Overcome the traditional notion of complaints and transform them into an opportunity for improvement.

## ■ Simplification and standardization of tax procedures.

■ **Adaptation of enhanced taxpayer information in language that is clear and accessible.** Under this heading, we should mention the activities of the Commune of Rome to ensure a proactive dialogue between government and taxpayer. One of the initiatives with the greatest impact in improving the accessibility of the system and simplification of the rules has involved converting tax jargon into a language that is easy for the public to understand.

Projects geared towards modernizing taxpayer support services are endowed with a high degree of transferability of application. The clarity of objectives and systematic planning of the program facilitate the sharing of experience and its application among very diverse municipalities. In Uruguay, as explained below, the Municipal Superintendancy of Montevideo has successfully launched a project to improve taxpayer support services, and the Municipality of Valparaíso has set in motion an experiment with a “single payment window” approach that has expedited the management of revenue collection, processing of licenses and permits, and other services of interest to taxpayers such as matriculation in courses of study and various other programs.

### **Success story: The Easy-Plus project by the SUMA Taxation Authority of the provincial Government of Alicante (2000-2002)**

#### **Initial situation**

The need to give a new impetus to the organization able to get past the phase of exclusively quantitative improvement with the aim of placing the citizen at the heart of public service arose from analysis of the kinds of problems that beset local taxation, of the results achieved by management up to the year 2000, and the internal assessment of opinions gathered in the taxpayer surveys that were conducted.

#### **Aims of the practice:**

##### **General aims**

- To simplify and expedite administrative procedures.
- To expedite procedures via new technologies.

##### **Specific aims**

- Qualitative improvements in services provided to citizens.
- Expansion of the catalogue of services in local taxation and other municipal services.
- Expansion of new collaborative agreements among the Tax Authority, the Property Registrars, the Business Registry, the notaries, the Provincial Directorate of Traffic and the General Bureau of Real Estate Registration.
- Greater dissemination of administrative formulas via seminars or publication in specialized journals.
- Diversification of our activities and outreach.

These same aims were summed up in four lines of activity in SUMA's strategic plan:

1. To reach 90% of collection for all tax registers during the voluntary payment period.
2. To reduce to a maximum of 4 years the backlog of receipts pending under the enforcement regime.
3. Increase substantially the use of ICT's.
4. Institute outreach of personnel at local, provincial and Autonomous Community levels



whereby they will pool and compare the experience and knowledge of SUMA.

#### Description of activities undertaken

The EASY-Plus project is a set of five programs comprising a three-year (2000-2002) strategic plan with the aim of facilitating the meeting of tax obligations at the provincial level by Alicante's citizens.

- The OPINA program, specifically tagged as a campaign for communication and group image projection, allows any citizen to have his complaints or suggestions heard.
- Direct Taxpayer Service, which involves a complete overhaul of these elements of the service.
- No Waiting on Line, a program whose name speaks for itself, and includes organizational arrangements that do away with obsolete Front-Office and Back-Office schemes.
- Campaigns for payment during the voluntary period, with numerous measures to improve procedures, communications and error correction.
- Virtual Office Hours by Internet, that bring electronic administration a little closer to citizens, with special attention to user-friendliness and security.

#### Results obtained

The main achievements of the EASY-Plus project can be summed up as follows:

1. There are now 41 offices available to citizens where the average waiting time is less than five minutes, with satisfaction ratings above 80%. Any additional delay for citizens in resolving their concerns is avoided.
2. The taxpayer can communicate directly with the management of the agency, with an explicit commitment to respond in less than 20 days.
3. The taxpayer can take advantage of extended office hours one day a week.
4. Through the greater implementation of electronic banking in the province, the taxpayer can pay his taxes from home during the voluntary payment period and locate, authenticate and select any outstanding debt during the enforcement period, giving payment instructions on-line. This information is transmitted in real time to the SUMA database.

#### Success story: Improved taxpayer service in the Municipal Superintendancy of Montevideo

The project for the improvement of taxpayer information in the Municipal Superintendancy of Montevideo was launched in 1998, and since then has pursued a process of continuous improvement and adaptation to changing needs in the environment.

#### Initial situation

The launching of the project was in response to the need to solve the common problem of an overload of municipal tax services that had provoked a high degree of citizen discontent in Montevideo due to lack of adequate personalized service in particular areas. The restriction of payment possibilities to the formula of in-person settlement at the payment window, and the lack of generic information on basic tax matters (tax categories, amounts and due dates of the main taxes) were characteristic features of the situation at the outset at the Municipal Superintendancy of Montevideo.

#### Aims of the practice:

- Improvement of public image
- Facilitating procedures for citizens
- Reducing service time
- Improving intake of revenue during voluntary payment period
- Updating information systems
- Information broken down and relevant

#### Description of activities undertaken

The practice was implemented in several stages:

1. Implementation of a decentralized collection system for the main taxes through:
  - a. Expansion of the network of payment sites
  - b. Expansion of hours of service extended to every day of the week.

- C. Clear and complete information on the notices accompanying tax bills. Due date, detailed breakdown of charges, notice of future due dates.
2. Creation of a centralized unit of taxpayer service for the main taxes. This unit provides the following services: Consultations and diverse transactions (automated bank withdrawals, change of address, setting up payment arrangements, change of taxpayer information via two approaches: In-person service desks and telephone service.
  3. Implementation of supplementary measures: >> Making available automated consultation, audible response unit, web page, e-mail and generally decentralized payment of other taxes such as sanitation fees, food taxes, elevator tax and installment payments.

#### Results obtained

- Disappearance of lines once payment was made possible at a broad array of payment centers with extended office hours.
- Greater convenience for citizens with the addition of telephone, Internet and automated consultation service. User surveys showed a reduction of taxpayer dissatisfaction in the key areas (delays in processing, recurring lack of response, numerous delays at central municipal facilities, and the unsatisfactory condition of local facilities).
- Clearer and more transparent information through periodic updates sent to taxpayers' addresses with information on tax categories and rates before the due date.
- A 20% reduction of delays in payment.

### ■ GT Practice IV: Safeguarding taxpayer rights

The existence of certain rights and guarantees for taxpayers constitutes a strengthening of the principle of legal security characteristic of the most advanced democratic societies, for the purpose of improving their compliance with taxation procedures. To this end it is necessary to incorporate into the general tax regulations a set of basic rights for the citizen.

The establishment of general rights for taxpayers should be protected in the general tax regulations of the countries involved; without overlooking the fact that local government can and should assume an active role as guarantor of such rights in its tax relations with its citizens. In a general way, the following rights for taxpayers should be ensured:

- To be treated with due respect and consideration by personnel on duty at the government tax offices.
- To be informed and assisted in the exercise of one's rights in fulfilling one's tax obligations.
- To request assistance and technical information concerning rights and obligations of the local tax authority.
- To carry out procedures free of charge within the period established by law.



- The taxpayer shall be able to denounce ill treatment, extortion or any other inappropriate conduct by an official of the tax administration.
- To draft written inquiries about tax subjects addressed to the appropriate authority.
- To enjoy exemptions established by law, duly formalizing such rights before the tax authority according to procedure.
- To implement procedures before the tax authorities either in person or through legal representatives or proxies.
- To request a statement of the extinction of tax obligations in cases established by law.
- To have tax refunds processed.
- To have the refund of undue or excess payments processed.
- Protection and withholding of one's tax data and personal or background information.
- To be notified of the nature and timetable of government practices.
- To request certificates and document extracts that prove the fulfillment of tax obligations.
- To have access to and be informed of the status of administrative procedures in which one is involved.
- To take advantage of tax incentives pursuant to the terms provided for by tax law.
- To challenge actions of the tax authority imposing tax charges or applying sanctions within the periods provided for by law.
- To request special payment terms as long as the tax due has not reached the stage of compulsory collection.
- The right to not submit documents that have already been submitted to the local government.

Local government agencies should adhere to the following guidelines to promote their active role as guarantors of these rights for their taxpayers:

- **To institutionalize the defense of the taxpayer in municipal law including through the creation of specific institutions.**



■ **To expedite taxpayer access to tax information through the implementation of ICT's.**

■ **To guarantee mechanisms to permit the taxpayer to present complaints or suggestions on the functioning of tax management.**

**Success story: The Madrid City Government's *Taxpayer Protection* program.**

In 2004 the City Government of Madrid created the Office of Taxpayer Protection to process any complaints, claims or suggestions that might be submitted concerning the functioning of the municipal tax services or related administrative procedures.

**Aims and functions of the Office**

The Office of Taxpayer Protection was created for the best defense of the rights and safeguards of taxpayers in their relations with the municipal tax authorities, exercising the following functions:

- a) To receive and process complaints, claims or suggestions presented by citizens directly or indirectly related to administrative procedures having to do with taxes, prompted by delays, unresponsiveness or other failings observed in the working of the various offices and units of the municipal tax services, gathering from the latter as much information as necessary for the clarification of the facts giving rise to such difficulties.
- b) To draft the reports and replies that are in order, duly notifying the interested party.
- c) To submit quarterly copies of reports, claims and suggestions received to the Special Commission on Suggestions and Claims<sup>9</sup> through the Governmental Area of the Treasury and Public Administration, as well as the responses given to such submissions.
- d) Formulate for the services in question the recommendations it deems necessary for the best defense of the taxpayer rights and guarantees regarding the complaints, claims and suggestions presented. At the same time, such recommendations are to be sent to the Special Commission on Suggestions and Claims, to be recorded and taken into consideration.
- e) To assist citizens in the exercise of their right recognized in Article 29 of the Spanish Constitution to file claims concerning tax matters, which shall be governed in all cases by the specific respective legislation.
- f) To draft an Annual report in which is reflected a summary of its activities during the fiscal year, and procedural or regulatory measures deemed suitable as the best ways to protect taxpayers are suggested. The report in question is submitted to the Madrid City Council via the Governance Department of the Treasury and Public Administration, and also to the Special Commission for Suggestions and Claims. Once this process is completed, the Report is released to the public.

The maximum period for the presentation of claims and complaints will be one year, counting from the moment in which the facts prompting such objections become known.

**Procedural aspects for the processing of claims and suggestions.**

The office aspires to prepare within a period no greater than fifteen days a reasoned response to the claim or complaint after gathering from the departments involved as much information as necessary, and, as appropriate, to determine what corrective measures are to be adopted.

**Procedural aspects for the processing of claims and suggestions.**

The Office forwards suggestions received and entered into the Registry of Claims, Complaints and Suggestions to the department to which they are addressed. If several departments are involved or if due to its importance it deserves special treatment, the Office will make its recommendation proposing the improvements or reforms it deems necessary for the best defense of the rights and guarantees in favor of taxpayers.

<sup>9</sup> Spanish law (Law 57/2003, December 16, on measures for the modernization of local government) provides for the creation of a special Commission of Suggestions and Complaints, made up of representatives of all groups comprising the City Council, for the defense of the rights of citizens before

## ■ GT Practice V: Incentives for the good taxpayer

With the aim of rewarding and fostering taxpayer cooperation in the payment of local taxes, and of assuring high levels of effectiveness in revenue collection during the voluntary payment period, most local government institutions can avail themselves of a variety of mechanisms, as long as they are duly supported by law.

- The possibility of establishing discounted rates on installments for those taxpayers owing money who arrange for automatic payment of their debts at regular intervals through their bank, make advance payments or otherwise engage in activities that involve cooperating in the process of revenue collection. In the case of local Spanish corporations, the latter may apply a discount of up to 5%.

- Penalties assessed for taxpayers at the end of the voluntary tax payment period in the form of lateness fees and interest can serve as an incentive for paying taxes owed within the period designated on the tax calendar.

- Lotteries and other incentives. For example, the municipality of Montevideo conducts a lottery to award a one hundred percent discount on taxes for the year among all those taxpayers who have not resorted to installment payment plans (one prize for every ten thousand taxpayers).

### *D. Improvement in the management of payments.*

## ■ GT Practice VI: Tax payment plans and alternative payment methods.

The most common way to eliminate tax debts is to pay them outright, which is usually done in cash through such arrangements as the government may provide. In order to “make things easy” for the taxpayer in settling his tax debts, and thereby improve the rates of effective revenue collection in the voluntary payment period, local tax authorities should concentrate their efforts on offering alternative payment methods to their citizens. General tax legislation should regulate the terms and conditions so that payment can be made via diverse methods, especially online.

Some measures that local tax authorities may adopt to this end are as follows:

- **The option for taxpayers to defer and spread out tax payments in installments.**

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the municipal government. This Commission was created for the purpose of fostering citizen participation in big cities where there is a greater risk of distancing between citizens and government officials.



When financial and economic circumstances temporarily prevent a taxpayer from paying his taxes all at once, whether in the voluntary period or the period of enforcement, he should have the option, upon request, to defer or spread payments out in installments.

In general, it is advisable for local governments to allow taxpayers to arrange the payment of their taxes in accordance with their solvency over the course of the year. To this end, the creation of a Taxpayer Account, such as the City of Madrid's Bureau of Taxation is implementing, may become a clear incentive to improve the rate of effective revenue collection during the voluntary period.

- **To make provisions for settling tax liabilities among different levels of government**

Although this involves an initiative that goes beyond exclusively local jurisdiction, it does have a positive effect on the taxpayer's liquidity. In Italy, the Institute of Compensation, founded in 1997, operating at the national and municipal government levels, provides tax refunds through VAT credits. This approach allows the Treasury to avoid having to make direct refunds. The questionnaire given to the taxpayer only demands that he fill in the amount of tax owed, and indicate the form of credit with which he wishes to settle the liability, the amount, and the relevant tax code.

**To make online tax payment possible.**

Some of the operations related to tax payment that local tax authorities are increasingly allowing to be transacted via the Internet are the following:

- ***Payment of various local taxes via electronic signature over the Internet.***

In Spain, the Madrid City Government offers this option for the payment of tax settlements and installment payments during the voluntary period, and of all debts during the enforcement period; it is also possible to pay the Property Tax through the Special Payment System (discounted automatic withdrawal payments).

- ***Automatic withdrawal payment of taxes arranged over the phone and through municipal Internet portals.***

Payment arrangements for taxes, fees and public rates regularly charged against taxpayers' checking accounts or savings accounts simplify the payment of taxes for citizens and allows for a greater degree of effectiveness in revenue collection. Traditionally, the request for this service is made by an appearance in person at the office of the tax authority; however, with increasing frequency it has been noted that municipalities are allowing for this arrangement to be made through specially equipped telephones and over the Internet.



It is also possible to offer other related services such as change of address and terminating the automated payment arrangement.

Services offered by the city governments of Barcelona and Madrid provide clear examples of these arrangements: Their citizens can arrange online for automated payment of their Property Tax (IBI), Tax on Economic Activities (IAE), trash collection rates, pavement rate (sewers), and fees for use of public thoroughfares (sidewalk spaces)

- ***Provide clear and detailed information on procedures and payment methods available to taxpayers.***

Taxpayers, especially those who are encountering tax authorities for the first time, have no reason to know what payment methods are available to them. Local governments should provide information on the location of offices where payments can be made in cash or by bank card, the phone number, if phone service is available, and the scope of services offered over the Internet.

#### **Experience of success: Online tax payment in the Commune of Rome**

##### **Context in which this initiative has emerged**

This practice has emerged in the new context of Law 212 of 2000 (Statute of Taxpayers), which establishes the following general principles of information for taxpayers.

1. Taxpayers should receive in writing the appropriate information at their residence.
2. If any deduction is denied to a taxpayer, he should be notified of the circumstances and all necessary information should be made available to him.
3. Any change in the elements of the tax system in the Official Bulletin and in all available documents on this subject.

##### **Description of the practice**

Taxpayers in the Commune of Rome can pay their ICI property tax online, which amounts to 4% of the registered value of the primary residence, though the percentage varies for additional residences. To make this payment the taxpayer must take the following steps:

1. Enter his tax ID and a password to register.
2. The taxpayer must choose between sending a message, changing his information or opting for a reduced rate of payment.
3. The user enters his personal data and the respective number of the tax. In this module, the location of the municipality appears on the screen by default. Finally, the taxpayer must determine whether the payment corresponds to the first or second installment.
4. At this point information concerning the payments that are due appears on the screen. The taxpayer should indicate whether the payment corresponds to farm land, building lots, other property or primary residence. Once this question is settled, payment can be made, or else information can be sought to retrieve additional data.
5. The system gives notice of the correct execution of the transaction, then sends an electronic confirmation.
6. The system allows for direct consultation of the taxpayer's status.

##### **Continuity and prospects**

The main weakness of online payment is that taxpayers who are eligible for various exemptions frequently do not have easy access to the Internet. Because of this, online functions are supplemented by programs geared to training and supporting the weaker sectors of society in the use of the Internet.



- ***To provide information on the size of a citizen's tax obligations through the use of simulators.***

### ■ **GT Practice VII: Clarity and simplicity in tax bills.**

With respect to payment of public fees and rates that cannot be charged at the same time that service is delivered, the OECD's document of Best Practices enumerates a series of requirements that tax bills issued by the government must meet:

- Bills must be issued on time and with clear payment instructions.
- Bills should provide adequate information but avoid excessive detail that could cause confusion or discourage their being read.

### ■ **GT Practice VIII: Virtual Office Hours.**

A Virtual Office offers all procedures and transactions connected with a particular government department that can be offered online, with the aim of improving the flexibility, effectiveness and quality of services provided by that department. These online offices have high potential in the area of taxation and public revenue collection since they entail a major step forward in improving relations with the public and support the priority aim of simplifying and facilitating the fulfillment of tax obligations.

Services that can be offered via virtual offices are as follows:

- Delivery and recording of written statements, applications and messages.
- Automatic withdrawal payment of taxes
- Maintenance of personal data.
- Follow-up on the status of processing: Consultation on bills paid and outstanding.
- Selection of payment operations.

#### *Benefits of implementation*

- Facilitates the fulfillment of tax obligations and permits a more active and direct exchange with taxpayers.
- Permits increase of hours of service up to 24 hours a day.
- Citizens can select the amounts and/or particular returns they wish to pay in a single operation, linking it to a valid payment confirmation immediately.
- Allows for economies of scale for a heavily centralized service with the ability to attend to a wide number of clients.

#### *Constraints on program implementation and risks*



Setting up a virtual office should be done bearing in mind the following considerations that should be incorporated into plans for implementation:

- ***Unequal access to the Internet for different citizens.***

Offering services on the Internet is inefficient if access is seriously limited in the municipality in question. Given that not all citizens enjoy the same possibilities of access due to their economic and financial situation, local government should promote the preparation of public access points.

- ***The lack of familiarity on the part of certain groups with the use of these tools and the security regime required to operate them.***

At times, citizen resistance to the use of online means for paying their taxes results to a great extent from their not knowing how to make use of them and the lack of confidence that systems provide security and confidentiality of information. The availability of training classes for particular groups and a clear explanation to the public of the security systems designed to guarantee the protection of information that circulates in the network are key issues in increasing public use of virtual tax offices.

- ***The development of electronic banking in the country of origin.***

The possibility of making online tax payments through a municipal portal requires collaborating financial institutions to have developed electronic banking services that allow taxpayers actually to make such payments drawn from their accounts.

- ***The development of secure processes and conditions that guarantee the confidentiality of the information.***

As can be learned from the SIBIS Pocket Book Report for 2002 and 2003, significant resistance on the part of citizens to take advantage of online arrangements for payment of their taxes has been observed – more than 67% of those surveyed indicate that they favor more traditional payment methods. The main argument to justify this reluctance is the lack of trust in the security of online services. In this regard, systems developed for virtual offices must guarantee the security of the connection through processes of encrypted communications. Thus, it must require identification in advance by the citizen, who must have an identification number and private access codes to retrieve personal information on his tax status.

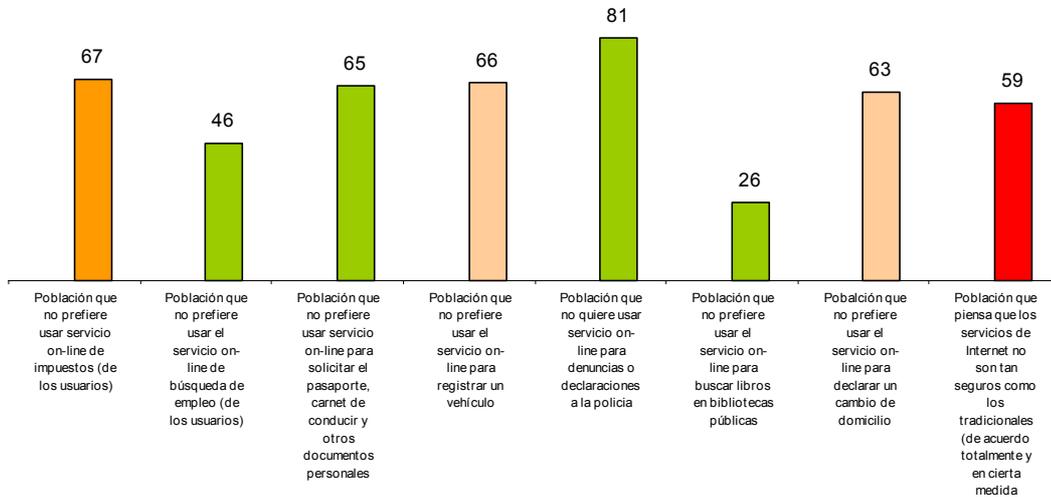
- ***The cost of its development for smaller municipalities.***

The advantages to be gained from these virtual offices in comparison to the cost of their development are especially relevant when dealing with large municipalities. Local governments can avail themselves of economies of scale resulting from these online services as long as the actual service is provided by a supra-municipal agency, or jointly by a group of municipalities, or municipal union.



## Obstacles to E-government.

### Barreras para el Despliegue de Servicios de e-Administración (UE-25) (% de ciudadanos)



### Obstacles to the implementation of e-administration services (UE-25) (% of citizens)

67: Population that prefers not to use online tax service (for users)

46: Population that prefers not to use online job searching (for users)

65: Population that prefers not to use online service for requesting passport, driver's license and other personal documents

66: Population that prefers not to use online service for car registration

81: Population that does not want to use online service for reporting crimes and making statements to the police

26: Population that prefers not to use online service to look for books at the public library

63: Population that prefers not to use online service to provide notification of a change of address

59: Population that thinks online services are not as secure as traditional services (agree completely and agree somewhat)

Source: SIBIS Pocket Book 2002-2003 December, 2003

In Spain, a number of local governments display a high degree of sophistication in the implementation of virtual taxation offices. The system developed by the Córdoba (Spain) City Government merits special mention, which makes available to citizens through its web page the possibility of inquiring about pending tax bills, and settling those tax debts that can be paid online. There is also the Provincial Government of Alicante's SUMA Taxation Authority, a universal online tax service independent of the municipality taxpayers belong to, since the services available are not differentiated on the basis of the size or



wealth of the municipality. Therefore the project plays an important role in upholding principles of inter-territorial equity.

### **Success story: “Virtual Office:” Taxpayer’s Guide by the Barcelona City Government**

The Taxpayer’s Guide by the Barcelona City Government, available on its web page, presents a simple and versatile structure that turns it into a reference tool for communication between municipal tax authorities and taxpayers for the purpose of facilitating payment of tax obligations on time.

#### **Description of the practice:**

The guide contains clear and detailed practical information on all questions concerning payment of local taxes and allows the taxpayer to perform specific tax-related operations such as applying for automatic withdrawal payment, changes of deed for property ownership, etc. It offers the following sections:

- A Taxpayer’s Calendar that includes the date of payment for automatic withdrawals, date of payment for automatic withdrawals during the collection period, date of payment for automatic withdrawals transacted over the Internet during the collection period, and collection period for bills not subject to automatic withdrawal payments.
- **Information on taxes and fees.** Includes description of tax, process of signing up and quitting, cases eligible for exemption and any other issue relating to taxes.
- **How can I get in touch with the Municipal Institute of the Treasury?** This section provides the citizen with all available ways for getting in touch with this institution (by phone, Internet, in writing and in person in the various districts). It also gives all kinds of information about the institution.
- **Information having to do with:** Methods of payment, installment payments, inquiries about fines and taxes due, list of offices and telephones, taxpayer rights, practical advice, tax regulations, tax categories of streets and related legislation.
- **Performing transactions requiring security and confidentiality:** Change of ownership of property, Change of tax address and/or notification address, Correction of errors in a citizen’s personal data, Request for advance appointment arranged with the Municipal Institute of the Treasury, Application for payment document to make payments of taxes, rates or public fees, Notification of outstanding payments, Formalization of installment payments (spreading out payments), Proof of Payment, Payment of taxes, rates or public fees and fines by credit card or automatic account deduction. Automatic Withdrawal Payment Arrangements for taxes, public fees and rates, Reconciliation and payment of electronic entries for businesses, Identification of vehicle drivers for whom warrants have been issued (for businesses with fleets of vehicles that have signed the relevant agreement).
- **Rate simulators:** Estimates rate and/or auto-liquidation of tax on Land Appreciation (profits tax)
- **Special relations with professional management executives:** The purpose is to allow professional management executives such as managers, financial advisors or property administrators to conduct their tax business through the web page of the Barcelona City Government. To this end, an agreement has been signed with fourteen Professional Schools in the financial management field, in order to facilitate use of the Internet as the preferred channel for communication with the Municipal Treasury.
- **Highlights of the year in local taxation.**
- **How can you pay?** This section provides information on various forms of payment of local taxes.
- **Taxation Council:** Provides information on the Taxation Council as an external advisory and oversight body for tax matters.
- **Collaboration with business associations:** This section of the web page provides information and direct links to business and trade associations that are members of the Council of Associations of Trade, Services and Tourism of the city of Barcelona with standing as collaborating institutions of the Municipal Treasury of the Barcelona City Government, enabling citizens to address any tax issues through these institutions.

**Success story: “Virtual Office:” Online services of the Madrid City Government.**

From the web page of the Madrid City Government (munimadrid.es) one can access the Madrid Bureau of Taxation (+m), which provides convenient information about tax matters, as well as the option of transacting multiple operations and processes, thus simplifying administrative procedures and the fulfillment of tax obligations on time. One can also make inquiries about traffic tickets through munimadrid and pay them off during the voluntary period.

**Description of the Madrid Bureau of Taxation’s virtual office:**

Contains clear and detailed practical information on all questions concerning payment of local taxes and allows the taxpayer to perform specific tax-related operations such as applying for an automatic withdrawal payment arrangement, changes of deed for property ownership, etc. Enables access to applications for information, suggestions and claims, and the following sections:

**Functions** Supplies information from +m, facilitating access to the statutes of this agency.

**Tax information**

Calendar of periodic taxes, including their period of payment.

**Collection of taxes and fees. Periods and methods of payment.** Access to information and procedures concerning the Tax on Economic Activities (IAE), Property Tax (IBI), Tax on Mechanical Traction Vehicles (IVTM), the rate for use of airspace, land and underground. Dates of payment during the voluntary period, payment method, process of signing up and leaving system, discounts, exemptions, appeals, refunds, automated bank withdrawal payments, special payment arrangements and any other information having to do with such taxes.

**Service offices**

**Taxpayer service offices.** This section offers citizens all options for getting in touch with taxpayer service offices, by phone, Internet, in writing and in person, indicating the various public transportation routes to get there.

**Submitting information requests, suggestions and complaints. Taxpayer Protection Service.**

This allows for submission of information requests, suggestions and tax-related claims via the Internet (by e-mail), and it is also possible to ascertain the status of information requests, suggestion or claims submitted.

**Publications** Access to Tax Ranking, Tax Ordinances and Public Fees

**Procedures and transactions**

**Do-it-yourself payments Programs of assistance** Programs of assistance for carrying out do-it-yourself payments of the IVTM, Land Appreciation Tax for Urban Real Estate (IIVTNU), Vehicle Circulation Fee, Large Generators of Waste Fee.

**Available publications:** Tax refund claims; Municipal Sporting Facilities; Do-it-yourself 2006; Property Tax (IBI) (Special Payment System for IBI property tax, order for automatic withdrawal payments with change of ownership on next bill, application large family tax credit); Automated bank account withdrawal payments (sign-up and termination); Application for certification that tax payments are up-to-date; Application for spreading out or breaking up payments during the voluntary period; Application for IVTM exemption for the handicapped; Suggestions and complaints

**Obtaining a Digital Certificate:** Obtaining the electronic signature in order to execute processes and transactions for which a digital certificate is necessary. A table illustrates the various processes and transactions that do or do not require a digital certificate.

**Payments via the Internet:** Payment of taxes, periodic tax payment during the voluntary period, traffic tickets and debts during the enforcement period.

**Processes with digital certificate:** Automatic withdrawals to pay the IBI, IVTM, Rate for use of airspace, land or underground, Vehicle Circulation fee. Payment of taxes, periodic tax payment during the voluntary period, traffic tickets and debts during the enforcement period. Application to Special System for Payment of the IBI property tax. Electronic payment of the IVTM during the voluntary payment period.

Processes without digital certificate: Breakdown of tax categories IVTM (application for duplicate bills, electronic payment, application for bank withdrawal, application for tax exemption). IBI (Application for bank withdrawal payments, application for Special Payment System). IAE and Fee for use of airspace, land and underground (application for automated bank withdrawals), IIVTNU (Calculation of Real Estate Sales and Inheritance taxes).

**Agreements.**

Access is available to agreements signed with other governments or agencies by the Madrid Bureau of Taxation to facilitate the payment and fulfillment of tax obligations by taxpayers (such as, for example, one signed with Madrid College of Notaries).



- **GT Practice IX: Effectiveness of systems for collecting outstanding payments.**

The priority goal of local tax authorities should be to maximize the effectiveness of revenue collection during the voluntary payment period; nevertheless, this should not be an impediment to adopting efficient systems for managing outstanding payments. To this end, the OECD provides various guidelines to achieve maximum efficiency in following-up on outstanding tax liabilities in the period of payment enforcement.

- Immediate application of the system for follow-up on outstanding taxes when the deadlines for voluntary payment have lapsed.
- Procedures for tax collection during the enforcement period should be fully and clearly defined prior to demanding payment of tax.
- The taxpayer should be notified in a clear and transparent fashion of the possibility of applying funds to these mechanisms.
- The amount of outstanding tax payments owed to the local administration should be transparent and known to taxpayers.
- Follow-up on payment of small outstanding tax liabilities should be worth the cost.

In order to improve the efficiency of the revenue collection systems, the OECD illustrates its conclusions with an analysis of the case of the Barcelona Fire Department with respect to the payment by taxpayers for services that end up not being classified as emergencies. Prior to the application of measures to strengthen the system for following up on tax arrears, the effectiveness of revenue collection was rated at 20% to 30% of tax bills issued. Efforts were concentrated on resolving the following dysfunctions: A lack of definition of responsibility for revenue collection, a long process of issuing tax bills, the complexity of these bills and the application of new follow-up mechanisms on outstanding tax liabilities.

It is worth adding to these OECD recommendations other action proposals made by participants in the Working Group:

- To convert the specific documents sent in cases of lateness into legally binding documents for collection and notification, as was done by the Superintendancy of Montevideo.



- To require that tax payments be brought up to date in order to do business with the government (receive assistance, enter into contracts or collect on invoices for public agencies)
- To stimulate greater public awareness of the tax culture.

*Improvement in the transparency of management of taxation and public revenue: Availability and access to tax information and results.*

Activities geared towards improving tax transparency promote accountability for management of public funds and improvements in processes for executing tax policy. The aim is to make citizens aware of how much they contribute to the local treasury, thus inducing them to demand ethical and efficient management of public funds.

The main guidelines with respect to tax transparency should be as follows:

- Tax revenues must be covered by explicit legal provisions. Citizen access to tax legislation must be provided.
- The public must receive complete and comparative information with respect to similar municipalities regarding the most important indicators of the management of taxation and public revenue, in clearly understandable terms.

It is recommended that as a minimum, the following list of tax indicators be provided to citizens by local government in a general and accessible terms:

- **Financial pressure on GDP:** Contribution by taxpayers to local revenues versus the municipality's overall income. It is calculated as the quotient between tax revenue and municipal income. This indicator is viable to the extent that data on municipal income are available<sup>10</sup>.
- **Fiscal pressure per resident:** Average payment per resident in taxes and fees to local treasury. It is calculated as the quotient between tax revenue and the number of residents. It needs to be broken down by type of tax and by fee.
- **Effectiveness of revenue collection in the voluntary period<sup>11</sup>:** Effectiveness of local tax authority in voluntary tax filings. To maximize this indicator should be one of the priority goals of local tax authorities. It

<sup>10</sup> The availability of such data is dependent on the state of development of statistics in each country.

<sup>11</sup> Other renderings are possible, such as Collections against amount levied or Percentage of payment in voluntary period against total tax billing.



measures indirectly the availability of tax revenues and citizen responsibility for assuming the cost of public services. This is calculated as a quotient between fees paid or charged for the fiscal year and Net recognized fees from tax revenue. This can be broken down by type of tax.

- **Own revenue versus total revenue:** This indicates the degree of tax autonomy of the municipality. This is calculated as a quotient between Taxes and fees assessed by the municipality versus total local revenue.
- **Share of National revenue versus total revenue:** Measures the financial dependence of the municipality on funds coming from the national government and, definitively, the size of the local entity's share in national revenue. This is calculated in terms of all municipal revenue.
- **Index of coverage of public services<sup>12</sup>** Capacity of a public service to generate income associated with fees or public rates. It is calculated as a quotient between revenue assessed for rates or public fees payable when the service is rendered and the cost of the service. As previously noted in this section, the main difficulty in calculating this indicator consists in quantifying the cost of the service and accounting for overhead.
- **Financial benefit versus total tax revenue:** Reduction of tax revenue through the application of discounts and exemptions to particular groups. The financial benefits to taxpayers function as tax expenditures for the municipality.

These indicators should be communicated to the public in a single package, without offering isolated data that prevent a comprehensive analysis of the municipal tax situation, and providing sufficient understanding concerning the sums derived. For example, above-average fiscal pressures can be explained by the need to ensure municipal financial autonomy to offset a small share of national government revenue.

#### **Success story: The Tax Ranking of the Madrid City Government.**

The Tax Ranking of the Madrid City Government is presented as a practical instance of public access to tax information.

The Madrid City Government has been publishing for years a tax ranking obtained from data concerning the main municipal taxes and rates of the 52 municipalities that are provincial capitals, including the Autonomous Cities of Ceuta and Melilla; as well as of the largest municipalities of the Madrid Community with a population above 50,000 residents.

The taxes that are the subject for comparison among the towns mentioned above are:

- Urban Property Tax
- Tax on Economic Activities
- Tax on Vehicles with Mechanical Traction
- Tax on Construction, Installations and Works

<sup>12</sup> Another proposed version: Extent of self-financing for public services

- Urban Land Appreciation Tax
- Solid Waste Removal Tax

The indicators provided are:

- *For each tax:* Absolute fiscal pressure, Relative fiscal pressure<sup>13</sup>, yearly variation
- Average relative fiscal pressure for all taxes in provincial capital municipalities and in the municipalities of the Community of Madrid.
- Financing of Solid Waste Removal Services
- Position held by the Madrid City Government with respect to each indicator.

## **IV.2. FINANCIAL MANAGEMENT (PUBLIC DEBT AND PUBLIC SPENDING)**

### **V.2.1. Initial considerations.**

As the goal of this chapter we will try to identify, define and analyze the principles and values that should govern financial management of local government as far as policies of indebtedness and financing are concerned.

In a market such as the current one that is highly developed and competitive, and owing to the constant process of innovation in the provision of financial instruments, payment periods and interest rates, the management of government borrowing has become increasingly complex. In this regard, the sophistication achieved by capital markets has obliged government managers to avail themselves of financing methods and mechanisms that are alternatives to the traditional ones, as well as to define new processes – altering the existing ones – to manage financial resources as the only way to achieve an efficient management of its debt portfolio so as to optimize binomial costs in light of the risks taken.

Therefore, to the extent that as more methods and resources are acquired to achieve such efficiency and portfolio optimization, it becomes fundamental to define a set of criteria and goals to govern debt management and facilitate decision making concerning all the elements comprising a debt portfolio.

### **V.2.2. Principles and values.**

The development and subsequent analysis of different policies of financial management to identify best practices and mistaken processes within them make it possible to extract a series of principles and values that should govern financial management of the debt portfolios of municipal governments.

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<sup>13</sup> The key indicator is Relative fiscal pressure, which is derived as a percentage between the established range – difference between the established tax rate and the minimum rate permitted by law -- against the maximum range -- difference between the maximum tax rate and the minimum the municipality can charge. In the case of the IBI, in order to neutralize the reduction of the minimum rate applied for city governments that have revised their real estate assessments, the category of established range is replaced by equivalent range, obtained by the difference between the equivalent rate and the minimum.



Knowledge of the fundamentals and techniques of debt management is essential for good strategic planning of government debt portfolios.

## **1. Financial Management: Comprehensive and dynamic**

Management of government financial resources must be understood from a comprehensive perspective. An individual and isolated approach to each of the transactions in the portfolio as separate elements should not be considered. It is necessary to analyze the way each operation fits together under the policy and strategy previously defined by the government for its debt portfolio.

The managers' approach should go beyond mere decision-making concerning the disposition of financial needs at a given moment. Their analysis must not be limited to satisfying material requirements of financing at a given moment, but rather must of necessity include an evaluation of the impact of such operations for the portfolio as a whole in the short, medium and long-term.

Furthermore, financial management must be dynamic and flexible, allowing for modification of the structure of the portfolio whenever market conditions demand and/or the local government itself (for budgets, sanitation programs, etc.).

An efficient management makes it possible to minimize the risks to the portfolio and the cost of financing resources, and will therefore take into account the selection of the best means of financing according to the characteristics of each operation and of the debt portfolio in hand, as well as ongoing follow-up in order to identify in each scenario which operations could be improved.

## **2. Limits to debt**

Limits to debt are determined in the great majority of cases by supra-municipal legislation, without the municipal financial manager being able to modify or in any way affect such constraints. Nonetheless, to the extent that the existence of such legislation translates chiefly into the establishment of constraints or procedural delays for the formalization of indebtedness, an exhaustive knowledge of the applicable law on the part of the manager becomes necessary for him to operate in the existing budgetary framework. Knowledge of the law by the manager may in some instances make it possible to channel resources to alternative financing sources, thus avoiding a possible resurgence of financial circumstances arising from non-compliance with applicable regulations.

## **3. Fixed/variable distribution of the portfolio – Market expectations**

The setting or choice of an indebtedness parameter such as choosing formalization of debt at a fixed or variable rate of interest (or, what is the same thing, over or under-estimating one or another modality of debt), will uniquely and exclusively depend on the expectations of the debt manager concerning the financing conditions – the interest rates – and the market discount.



If the manager has a well-founded opinion that interest rates will go above the market discount – implicit rates or future rates discounted by the market – then he should increase the portfolio's weight of debt at fixed interest rates. If he thinks that interest rates will go down below what the market expects, the decision must be the opposite, that is, to raise indebtedness at variable interest rates. In the event that the manager's expectations agree with those of the market, the percentage of fixed or variable rate will be unimportant considering that it will not be possible to realize any gain (subsequently reducing the cost of indebtedness) based on the difference of expectations.

In any case, it is important to remember that prudence should guide all decisions in matters of public administration, so that it is equally risky to keep 100% of the portfolio with one choice of interest rate, whether fixed or variable.

#### **4. Term of indebtedness – Half life and degree of concentration -**

The maturity of debt is another key characteristic to determine, comprising one of the essential elements in good financial management of indebtedness.

The determination of this variable must be based on two foundations: One, more strategic, which is the choice of the half life of the debt and its relation with the life of the investments it is financing; the other, the degree of concentration of the calendar of dates when debt falls due and the impact on it of new debt. In the first case, it is advisable for the half life of the debt portfolio to approach the period of maturity of the investments which the debt finances (based on the theory of intergenerational solidarity). In the second case, it is a matter of not concentrating an excessive volume of payments falling due in the same period, to avoid problems of liquidity for the local government.

However, Financial Management must not only take into consideration the inherent characteristics of the debt portfolio, observing and analyzing each one in isolation, but must supplement this with analysis of the portfolio in terms of the economic context and conditions for financing that exist in the market. Because of this, furthermore, the levels of conditions of financing and profitability of interest rates at each different maturity must also be taken into account, as well as the slope of the interest rate curve (difference of cost, for example, between operations of 3 and 15 year maturities). Based on observation of the differentials between maturities and their evolution, as well as the current conditions of the debt portfolio, degree of concentration and level of half life, it should be inferred which maturity is most suitable for formalizing indebtedness. Furthermore, it is necessary to analyze the differentials applicable to the borrower in terms of the maturity of the debt according to the historical breakdown and the prospects being managed.

#### **5. Optimum instruments for financing – Financial conditions-**

In spite of the fact that there are a number of sources or instruments for financing currently used in markets, the material basis for financing local government has concentrated mainly in credit transactions and lending



(traditional bank financing), with certain large governments availing themselves of bond issues as an alternative financing method.

The choice among different financing options will depend on the volume of debt to be formalized, the technical and human resources at the disposal of the administration, and direct or indirect benefits in terms of the cost that each type of financing generates for the government, as well as the tax treatment for each of the different methods.

In many cases, bond issues make it possible to bring down financial costs, while diversifying the sources of financing (the investor base) of the local government. Nevertheless, it is necessary to bear in mind that a bond issue normally requires a larger volume of shortfalls in order for it to be implemented, and lacks the flexibility that is available from lending operations (generally standard amortization periods for securities compared to waiting periods and level-payment or non-level-payment amortizations for bank loans ). Furthermore, a bond issue in most cases, if the debt is registered or negotiated in foreign markets, requires obtaining a credit rating by an external rating agency, which increases the final cost of the transaction. Thus, in the case of governments with a high volume of debt and a regular need for recourse to markets, a bond issue, as opposed to borrowing, is more often justified than it would be for a “small” government.

Therefore managers must analyze both the quantitative and qualitative conditions of financing methods and compare them, in such a way that they can make the most appropriate decision in terms of financial cost and best fit for their debt portfolio.

## **6. Matching the debt to the investments it will finance**

The contracted debt should be in tune with the investments that it is intended to finance. Thus the contracting of debt for periods longer than twelve months should be directed towards defraying the cost of long-term investments while short-term resources should be directed towards covering existing transitory needs for liquidity.

## **7. The need to establish indicators for follow-up and monitoring of the debt portfolio**

Efficient management of debt calls for definition of a series of indicators that allow for a swift and reliable appraisal of the status of the debt portfolio at any time (present and future). In this way it is possible to perform an evaluation of financing terms and debt portfolio management efficiently, effectively and dynamically, using the least amount of resources and minimizing execution time.

## **8. Determine the procedure for contracting debts**

One of the essential stages in debt management is the process of contracting the debt that will cover the needs for resources identified by the local government. The absence of a procedure at the time of contracting debt may have a negative impact on the efficiency of the management performed.

Determining the real needs for debt of the institution, mapping out the characteristics of the financing that needs to be formalized, developing and sending to financial institutions a particular application without deficiencies, evaluating the transactions offered by the financial institutions, choosing the best transaction – if not the least expensive – and subsequently implementing it, are the main stages through which a financial manager must proceed. The absence of a procedural framework that defines and distinguishes each phase, may lead not only to the execution of the least suitable transaction, both in terms of cost as well as its relation to the debt portfolio, but may also imply an excessive increase in the term of maturity, overexposing the debt to market risk (the risk to which it is exposed by movements in the interest rate curve), thus diminishing the efficiency of the local government’s financial management.

**Figure 3. Breakdown of Stages in the Contracting of Debt**

<i>Optimal</i>	<i>Generic</i>
Phase 1: Definition of strategy: <ul style="list-style-type: none"> <li>➤ Fixed vs. Variable Rate</li> <li>➤ Total or Partial Coverage</li> <li>➤ Risks vs. Costs</li> <li>➤ Forecasts and expectations: Arrears vs. standard maturity</li> </ul>	
Phase 2: Design mechanism for financing / hedges .	Phase 1: Reception of bids.
Phase 3: Price Request.	Phase 2: Qualitative analysis of bids. <ul style="list-style-type: none"> <li>➤ Risks and implications</li> <li>➤ Pros and Cons</li> <li>➤ Appropriateness of defined strategy.</li> </ul>
Phase 4: Negotiation and formalization.	Phase 3: Assessment of bids. <ul style="list-style-type: none"> <li>➤ Identification of implicit elements.</li> <li>➤ Assessment .</li> <li>➤ Equalization and comparison</li> </ul>

In the second case the administration would formalize the best operation of those proposed by the financial institution, while in the first, the operation selected would be the best.



### **V.2.3. Areas that are especially sensitive to irregular conduct and losses of efficiency.**

The empirical review of situations experienced by local governments have made it possible to pinpoint those areas or aspects that are most sensitive to losses of efficiency:

- The assessment of bids for financing submitted by lending institutions.
- The absence of indicators for management or the non-application of them in day-to-day management of the government's debt.
- Lack of knowledge of the economic/financial context, of the existing economic reality and its implications and effects regarding conditions for financing and the contracted debt. Lack of analysis of the match between the debt and the economic environment.
- Dysfunctions in mapping out prospects for evolution of financing terms. Some financial managers map out expectations of the evolution of financing conditions that determine the financing conditions to be formalized.
- Lack of an analysis of the debt portfolio prior to formalization of the financing directed towards covering the needs for indebtedness.
- Lack of determination of the characteristics of the debt to be requested. Not determining in advance the characteristics of the new debt to be formalized.
- Lack of concreteness in the application for financing. Sending applications for financing to lending institutions without specifying all the terms, thus receiving a broad and heterogeneous variety of financing bids that cause extension of the period of formalization of the debt and the time need to evaluate the transactions.
- Lack of training of financial managers in some local governments, especially smaller ones.
- Lack of knowledge of existing instruments available for financial management of local government debt.
- Lack of monitoring of indebtedness.

### **V.2.4. Best practices in financial management.**

- **GF Practice I: Guidance in financial techniques. Supra-municipal initiatives.**

The limited training of municipal managers in small local governments who face the growing complexity of financial markets makes necessary the presence of a higher institution or agency that helps and advises in the work of financial management of the resources of local governments, attempting to avoid signing



up for operations that are more expensive or subject the debt portfolio of the municipal administration to over-exposure with its attendant risks.

#### **Success story: Municipal Advisory Service. Alicante Provincial Government**

In view of the evidence that emerged from reviewing the debt portfolios of the municipalities of Alicante, in 1998 the Provincial Government undertook to create the Municipal Debt Assistance Service for the municipalities of the Province of Alicante. The Municipal Debt Assistance Service came into being with the purpose of generally **improving and monitoring fulfillment of the existing legislation** and improving communication and transparency with respect to financial and economic results of municipalities as well as the planning of their economic and financial processes.

##### **Initial situation**

Prior to the intervention of the service, the provincial municipalities found a great many obstacles to attaining favorable financial terms. Debt was contracted at high interest rates and non-standard bids for coverage from lending institutions were numerous, implying a loss for their debt portfolios and raising their financial costs. Difficulty of access to credit by public entities and the financial difficulties created by operations that were already formalized and that resulted invariably in the need to refinance the debt portfolio for the sake of extending their period of maturity simply made plain the municipal managers' lack of training.

In the face of the losses that this reality entailed for the debt portfolios of the different municipalities, the Provincial Government of Alicante created the Municipal Debt Assistance Service, managed through the SUMA Taxation Authority, an independent tax management agency of the Provincial Government.

##### **Development of the project**

A series of actions were then undertaken which made it possible to clean up the debt portfolios of the municipalities. An inventory was taken of the financial operations that made up the debt portfolio and the financial debt of the local governments was analyzed and beyond this, plans for economic and financial cleaning up were undertaken where it was necessary. Similarly, the Municipal Debt Assistance Service proceeded to evaluate the bids for refinancing received by the municipalities for the restructuring of their debt portfolios.

There were a number of initial obstacles that surfaced in the process of implementing and developing the service. The shortage of material and technical resources, the lack of personnel, the lack of initiative on the part of the municipalities to make use of the Service, their mistrust of the agency and the reluctance of local governments to supply information concerning their respective debt portfolios or any other component of their internal functioning were some of the difficulties the Service had to deal with.

#### **Success story: Municipal Advisory Service. Alicante Provincial Government**

##### **Results**

In spite of these initial difficulties, the Service has achieved a number of goals set out in its original plan.

- The Municipal Assistance Service has made it possible to improve for the medium term the financial situation of these local governments, cleaning up part of their debt portfolios through a review of the local pressure on municipalities, of cost containment they must undertake, advance amortization and refinancing on terms in accordance with market conditions or, at least, more advantageous than those accepted previously, and the creation of financial savings that make it possible to finance the structural deficits existing in the municipal budgets of the local governments.



- The bargaining power of the municipalities has also been increased, and therefore, the available terms have improved not only in the formalizing of debt but also in the bids submitted by lending institutions, thanks to the external guidance.

Since its creation, the development of a support service of this kind has implied or created a series of improvements and engagements in the management of municipal debt portfolios for the province of Alicante.

- SUMA's guidance has meant greater access and an improvement in the terms of municipal finance.
- It has permitted a cleaning up of the financial situation of the local governments that exhibited imbalances in their portfolios and/or budgets.
- It has raised the level of information and training of municipal managers.
- It has endowed information channels between municipalities and the independent advisory agency with greater fluidity.
- Creation of the participatory mechanisms designed by the Service such as days for training and getting acquainted, where municipalities not only have access to courses on subjects affecting their common activities, but also have a chance to share their experiences.



- **GF Practice II: Institutional behavior and processes for formalization of operations.**

**Success story: Prior definition and enhancement of processes. Madrid City Government**

The goals of this initiative of the Madrid City Government are geared towards improving the efficiency of decision making about contracting of operations and the need to adapt to an environment that is subject to constant change. To these goals the importance of guaranteeing transparency and competitiveness in government contracting is added.

**Development of the project**

Prior to the design and implementation of this new practice, the City Council or the Mayor's office was the body that approved individual debt operations to be formalized by the Madrid City Government based on debt terms already solidified and defined. This entailed a number of losses to the City Government, specifically in the efficient management of indebtedness: The monthly schedule of sessions of the City Council increased the rigidity of the process of contracting debt, causing excessive delays in the execution of operations, with attendant disadvantages in terms of the costs it could entail, given the extraordinary volatility of financial markets.

Furthermore, before the implementation of the "best practice," the requests for financing bids were sent out without indicating the specific and detailed characteristics of the operation to be executed, except for the amount, which prompted lenders to submit entirely different sorts of bids that were difficult to compare: Different maturity dates, currencies, reference rates, with and without derivatives, etc. Because of this, the process of formalizing operations became drawn out due to the need to request numerous clarifications, to the point of requiring second rounds of bidding.

**Content of the project and work performed**

To put an end to the set of problems identified in the process of formalizing debt, the Madrid City Government undertook to establish a series of standards and activities that made it possible not only to enhance the specificity and definition of debt operations, but also to increase the efficiency of the process in terms of cost and duration of the process.

To do this, when it formalized a debt operation, the City Government of Madrid specified the terms of requests for operations down to the smallest detail, spelling out all characteristics in terms of amount and maturity date as well as rates, currency, payment and amortization schedules, etc., avoiding in this way the wide variety of bids coming from lending institutions as well as the need to call for a second round of bidding.

On the other hand, as a result of changes in the law that took effect in 2004 with the Law for the Modernization of Local Government (subsequently ratified in the Law on the Status of Madrid as Capital and Special Regime, July 2006), which granted authority to approve debt operations to the Board of Local Government (as opposed to the City Council or Mayor's Office as previously), it was decided to approve an initial borrowing for the whole year, establishing the general framework of terms for such operations.

At the same time, subsequent approval was delegated to the Council of the Treasury and Public Administration of each individual operation with its specific characteristics within the established framework, which endowed administrative activities with greater flexibility. The delegation of the necessary competencies for the formalization of operations has made it possible to reduce the time required for approval of operations. Furthermore, bids are requested at a sufficiently large number of lending institutions and varying according to the kind of operation, allowing for competition among a larger number of institutions, which is conducive to a positive conclusion of the operation, in turn making it possible to gain the best financing terms through the opening up of the array of financing sources.

**Success story: Prior definition and enhancement of processes. Madrid City Government**

## Results

In this way, the Madrid City Government achieved the following:

- An increase in the number of institutions favors **competition**, one of the basic principles that should govern the conduct of the administration, and which augments the transparency of the process of the City Government's debt operations.
- To simplify and expedite administrative procedures.
- The equalization of bids thus brought about facilitates their analysis and comparison by streamlining their characteristics, which allows for **improved calculation of the costs of the operation** and also a reduction in the time given over to reviewing them, and therefore, in the total time for the approval process since additional clarifications are not needed. The lack of differences in the characteristics of the operations submitted for bidding precludes the need to have second rounds and thus the unnecessary prolonging of the process that could lead to the bids ceasing to be in tune with market conditions.
- Lending institutions are **obliged to bid at their best price**, knowing that they will not be able to improve it in a new bid, since they are now aware that there are no "second rounds" or "rematches."
- To increase **competitiveness** among lending institutions by increasing the number of them who are asked to bid in the process, with the attendant benefits in costs that this entails.
- The need to work out the specifications prior to the call for financing bids has obliged the Madrid City Government to conduct an initial study of the qualitative and quantitative characteristics of the debt portfolio in line with the practice of defining the debt strategy ahead of time. Thus, **uncertainty is eliminated** in the financing process which also shortens the time required for formalization, since it is no longer necessary to spend time determining what kind of operation to execute.
- The delegation of competencies has **reduced the time necessary for upholding the bids** by the lending institutions, which allows them to adjust their costs more readily.
- On increasing the degree of transparency of the process of financing and requesting financing from a sufficiently large enough number of institutions, it becomes possible to know in advance the various instruments or kinds of operations the market has, favoring competition, **avoiding the disadvantages that may result from contacting a smaller number** of lending institutions.



### V.2.5. New trends in debt management.

The investments to be made by governments, the varying configurations of their needs for debt and the constant evolution of financial markets has given rise to a series of new debt instruments and financing trends in the public sphere.

The investments governments have to make and the financing needs they create have not found in debt instruments for what is traditionally referred to as the Public Sector the effective and optimal response or method for financing the projects that have to be undertaken. The constant innovation in financial markets, in continuous transformation, have made it possible to find the response to the new needs identified by administrations, creating new financing instruments and initiating new trends of debt management in the Public Sector.

Nowadays the use of *Monolines* or *securitization of assets* is increasingly common, as well as joint issues, though less frequent, by a number of governments to cover Public Sector shortfalls.

Below we shall provide an overview of the latest trends in debt management.

#### Financing with Monolines

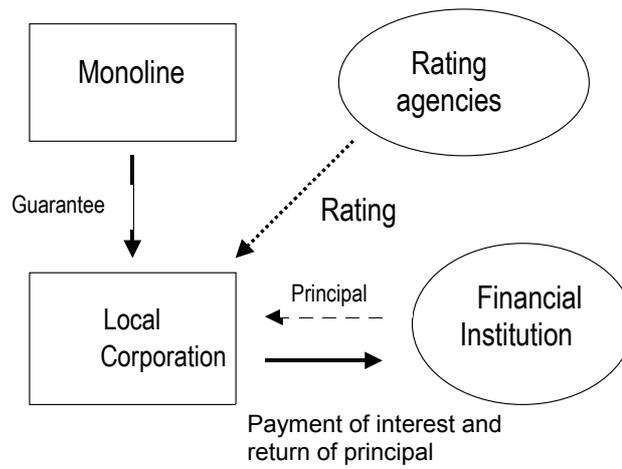
Originating in the United States and Great Britain, these are financing instruments that enable the institution to reduce the cost of financing through a credit guarantee granted by an investor. With this instrument the idea is to guarantee the credit-worthiness of financing operations granting them credit ratings generally of the highest level (AAA). Instead of paying a premium, the institution covered improves its risk, reducing its financing cost and may even win access to maturity dates that were not attainable with the original credit rating without the Monoline guarantee.

The functioning of the Monoline financing system is actually quite simple. In the first place, the company requesting Monoline service must submit to an exam by the credit rating agency in which the credit risk it poses is determined, based on its particular characteristics. In order to have access to Monoline services, the result of the credit rating of the institution seeking coverage must not be lower than Investment Grade (BBB or better).

Once a credit rating is obtained, the institution providing the guarantee, Monoline, will offer a quote on the cost of granting a credit rating to the company seeking an improvement of its rating. This will permit the local government to have access to more advantageous financing with the subsidiary guarantee of the insurer Monoline.

The advantages of providing the lender with financing through an instrument of this type center on the cost of debt operations. In this way, the firm of Monoline can permit the seeker of funding to reduce its financing costs, since with Monoline it presents a smaller credit risk to the lender, and therefore, less related profitability. What's more, the greater security represented by the new guarantee or status in the financial environment can permit a greater, broader and better access to markets for financing, not only determined by potential reduction of financing costs but also an increase in the variety of maturity dates, instruments through which debt can be configured and a number of other financing characteristics.

**Figure 4. Structure of Monoline**



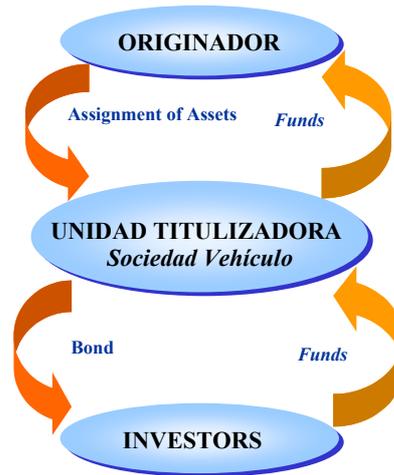
### Securitization of assets or rights

A financing mechanism that seeks markets on more favorable terms, through securities not issued directly by the financed party, but rather on the basis of and with the support of the assets or other sources of funding owned by the latter through an intermediary vehicle called the Securitization Fund.

The functioning of a securitization begins with the transfer by an Originator or assignor of rights of ownership of an asset or right to receive future income, to a securitizing entity, specifically created, called Vehicle for Partnerships (SV) To finance the purchase of assets or rights to collect future revenues the SV ask for loans of funds in its own name, generally through the issuance of bonds, and uses the income deriving from the assets or their sale to meet payments of the debt.

The securities created and issued by the Securitization Fund or SV are negotiable securities on Securities Exchanges as bonds or IOUs and will have a high quality credit rating, it being common to issue securities of different ratings.

**Figure 5. Securitization of Assets**



The motives that may lead a local government to select this method of financing over the traditional alternatives may be varied:

- To diversify sources of financing through new debt instruments.
- Access to very competitive financing.
- In the case of private institutions,
  - To increase their levels of solvency
  - To find a source of financing
  - To improve their financial ratios
  - To improve the management of their risk portfolio.
- In the case of public institutions,
  - To find alternatives, faced with the constraints of fiscal policy
  - To improve public administration
  - To rationalize net worth.

An analysis of the structure as well as the process of debt management makes it possible to distinguish a number of advantages for local governments that this method of financing provides compared to other alternatives.

- It involves financing out of balance.
- It involves the transformation of liquid assets into negotiable securities.
- The assignor retains the management of the assets assigned.



- Full and unconditional assignment: Separation of risks
  - o Separation in case of bankruptcy
  - o Without recourse to the assignor
- Reassignment of risks
  - o Originating from assigned assets
  - o Originating from the actual structure of the Fund
- Mitigation of risks: External improvements
- Given the high fixed ancillary costs (bank commissions, rating fees, SPV guarantees, etc.) it is necessary to ascertain whether the value of the asset assigned is sufficiently high. Otherwise, the operation would become too onerous.

### Joint issues

Although there are a great many sources, approaches and possibilities of financing to secure funding for local governments, the reality is that the ability to choose and the array of possible instruments shrinks in the face of one serious constraint: The reduced volume of shortfalls.

The issuance of bonds and/or obligations by public borrowers has proved to be one of the sources with lowest related costs that they choose, but this financing instrument has been used exclusively by big municipalities, cities with high housing density.

The lesser financing needs of most municipalities has made their presence rare in the primary debt markets, which precludes their diversifying their sources of borrowing as well as access to an instrument with lower related financing costs. What's more, the issuance of securities by these issuers with such a tenuous volume compared to the existing issues in the market could only have a negative impact on financing costs for their debt portfolios.

In view of this possibility, some municipalities and regions have come up with a solution that provides them with access to more advantageous sources of financing on the same terms as the participants in the market in question. To this end, they have undertaken joint issues of bonds and obligations, putting together different needs until they reach a sufficiently large volume to lower the cost of financing.

#### ***Gemeinsame Deutsche Bundesländer***

This is an institution created by the cooperation of seven German District's known as "Länder," which have carried out a process of financial unification with the aim of undertaking borrowing on a scale that gives them access to more advantageous financial markets.

Started in 1996, at present the number of active references in the market stands at 21, and the group is an active and recognized borrower issuer in the community of European issuers of



public debt, with a frequent presence in financial markets, carrying out two or three annual issues for an average value of 1.25 billion euros.

The coming together of the different governments has made possible the adding up of a high volume of borrowing and access to public debt markets, and the opening of new financing instruments has made possible a reduction of financing costs. At present, the total volume of debt issued by this association of governments is up to 26.183 million euros, issues in references with maturities of 3 and 15 years.

### ***Communautés Urbaines de France***

A group of eleven French municipalities with similar credit ratings (either estimated or not effective as issued) located in the same geographic area. With less presence than the first group, they have only issued two references with a total volume of borrowing of 2.5 billion euros.

Through a fiscal intermediary, the group of issuers can have access to financing at lower costs, with the spread or differential to pay against the reference rate of interest the same for all the municipalities.

Although a group of issuers is involved with similar characteristics and credit ratings, and therefore, similar credit risks, there is not subsidiary liability, the credit rating for the issue being the average of the estimated or real rating of the different governments that comprise the group.

Because of this, in the case of default or delinquency, only the proportional share of the delinquent issuer is amortized in advance, which thus makes it necessary to recalculate the rating of the issue, taking into account the new rating of the unpaid portion. In the same way, there is a possibility of advance amortization of all or part of the share of the nominal debt of one or several issuers.

### ***Italy***

Similarly, in the case of Italy, the 2004 Financial Law provides for the issue of bonds and obligations among several joint issuers, which makes it possible to achieve a critical mass sufficiently great to be attractive to the market, and avoid the losses in terms of issue costs for a marginal volume.

## **Bonds pegged to inflation**

In a Nominal Bond, which is standard, the nominal value of all flows is fixed and known in advance, but its real value, or purchasing power, depends on inflation during the whole life of the bond. Therefore, the real value is not known.

Bonds pegged to inflation are fixed yield instruments whose final yield is a result of the evolution of inflation over the course of its life. The reference is commonly an index that keeps track of the evolution of prices of a basket of items and/or services that representative of an economy or economically homogeneous region.

From the investor's point of view, this makes it possible to have an investment whose yield is adjusted in terms of its purchasing power. Offering "effective" protection from inflation, it eliminates the risk of inflation increasing, in exchange for a lower nominal rate of interest on the investment.

From the point of view of the issuer, tying payments to the evolution of inflation involves “effectively” paying a lower nominal rate during the life of the operation, although the real flows will depend on inflation. The issuer therefore runs the risk of inflation going up, instead of securing financing for a lower nominal rate.

To protect the real value of a Nominal Bond investors ask for compensation against the average expected rate of inflation during the life of the bond. This compensation is reflected in the price paid for the Bond and, consequently, in its nominal yield (IRR<sup>14</sup>). Thus, if the expectation of inflation increases, the nominal IRR for a conventional bond will go up.

### **Pros**

- Borrowers can benefit from bond issues pegged to inflation, considering that investors do not need to be compensated for inflation associated with inflation, and therefore require a lower interest rate.
- The benefits are greater if the borrower’s expectation of inflation is well below that of the investors, and the former turn out to be correct. In particular, only if subsequent inflation goes below the existing level on the date of issue will there be an associated benefit for the borrower from the issue of nominal or conventional debt.
- Debt indexed to inflation will be especially attractive for the borrower in the event of a positive shock of demand, with a positive correlation between GDP growth and inflation (Missale, 1999). In this case, the greater income will give rise to greater tax revenues while inflation will increase nominal interest payments of the indexed debt.
- The curve of real interest rates is generally flatter (there is less slope or difference of rates between the short and long term). This is because for debt pegged to inflation there is no inflation risk premium, which does however exist for the nominal debt and furthermore increases upon maturity.
- From the point of view of ALM<sup>15</sup> (Asset Liability Management), the issue of references indexed to inflation makes it possible (1) to stabilize the level of net indebtedness, which softens the deficit; and therefore (2) to stabilize taxation levels.

### **Cons**

- Less predictability for nominal payments of interest and principal for the nominal debt, which could give rise – if current revenues are not sufficiently correlated with inflation—to greater sensitivity of the budget to inflation and greater volatility of the deficit.

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<sup>14</sup> Internal Rate of Return (IRR)

<sup>15</sup> Assets and Liabilities Management (ALM). En castellano, Gestión de Activos y Pasivos.



- Risk of segmentation of the debt market since investors demand a premium for low liquidity relative to the debt indexed to the nominal rate. This risk becomes increasingly smaller, due to the growth of this market and strong demand from insurers and pension funds.
- It is necessary to verify in advance the total exposure of the borrower to inflation in order to verify the need to formalize hedges.

In the case of those countries in which local government revenues are tied to inflation by the nature of taxes and fees while expenses grow in pace with the cost of living, an issue pegged to inflation could cause a greater imbalance.

### **V.3. MANAGEMENT OF PUBLIC ASSISTANCE AND GRANTS.**

#### **V.3.1. Initial considerations.**

Included here are cash transfers that are not repaid made by local governments, whether directly or through their departments. These cash transfers can be directed towards various purposes. For the sake of universal validity that orients the preparation of this guide, these transfers have been categorized according to two possible purposes:

a) **Public Assistance:** This is granted for purposes of social welfare, to support persons and families with income below a minimum threshold that guarantees coverage of basic household necessities.

b) **Grants**<sup>16</sup>: These are granted to foster certain social welfare activities or to promote a public purpose. In general, these transfers are allocated for the sake of local economic development.

Because of the volume they represent in the local budget, the difficulties arising from procedures associated with their management and effects on the dynamics of the municipal economy, the contents of this chapter have been geared especially towards establishing recommendations for best management of grants, as defined above. Nonetheless, a specific allocation for the management of assistance is made, a notable example of which is seen in the programs of the City of Buenos Aires.

With respect to grants, most local governments share a double aim: To achieve maximum effectiveness of goals set forth in programs, and to maximize budget execution toward such ends. In this latter respect, skillfully managed procedures facilitating relations between applicants and beneficiaries and the

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<sup>16</sup> Nonetheless, to simplify the reading of this manual, at times we have made use of the term “assistance” without distinction when referring to transfers made to foster social and public interests. Financial assistance allocated to families for the purpose of improving their economic situation is the subject of a special section in this guide.



government providing assistance claims special importance. Because of this, procedural improvement holds a priority place in the sphere of best practices.

It is also necessary in this area to consider that third parties (citizens, institutions or companies) involved with the government may assume two different roles: That of interested party or applicant for assistance, and that of beneficiary. Both perspectives need to be integrated when it is time to initiate activities and measures for management improvement, since needs for information and demands are different as a result of this profile.

It is worth emphasizing, as noted below, that in this area it has not been easy to identify innovative initiatives emerging from the local sphere. It has been large central governments that have by far undertaken best practices with impact on the comprehensive management of their assistance. A project of the Spanish government's Ministry of Industry, Commerce and Tourism (AYUD@EC) currently underway, provides an example, which was launched for the purpose of expediting, simplifying and endowing with greater transparency the process for applying for, processing and justifying public assistance and grants through the use of ICT's. Nonetheless, one must remember that economic and social players often find themselves entangled in a thicket of assistance programs originating from all levels of government comprising a complex universe that requires action geared toward controlling the competition of different grants for a single initiative. Because of this, improved administrative coordination with respect to grants could be considered a priority best practice. The creation of a single registry of applicants for assistance or a comprehensive portal for public assistance and grants by all governments and available to participants among other measures, would be the key to improving transparency and control of competition among different kinds of assistance and their final efficiency.

Finally, it is necessary to clarify certain concepts strictly linked to the management of grants and in particular, the regime that applies to management procedures.

The competitive bidding regime implies that grants, characterized as a single budget item, involve numerous applications and their granting requires a comparison of applications through a single procedure in accordance with such criteria as may have been established in their regulatory legislation or in the call for applications. It is thought that the grants, in turn, adhere to the regime of *direct grants*, when specifically allocated in the General Budget of the government and its purpose, a budget allocation and beneficiary appear expressly stated in the Statement of Expenditures. Finally, an *open call for applications* is understood to indicate when the government agrees simultaneously to carry out various sequential selection procedures in the course of a budget year for the same line of grants. In these cases, the submission of applications is open throughout the fiscal year and subject to the exhaustion of budget credits. In principle, recommendations incorporated into this chapter are geared to cases of grants granted in the competitive regime, and in some cases, under the regime of an open call for applications.



### V.3.2. Principles and values.

The experts taking part in the Working Group on public assistance and grants reached a consensus on the following principles and values on which management should be based:

#### 1. **Transparency of procedures.**

Objectivity and transparency should be guaranteed throughout the entire process of awarding of public assistance and grants, especially with respect to the criteria and requirements for arranging access to them. The parameters for evaluation of their granting should be cleared and known by all interested parties.

#### 2. **Objectivity and equality of access.**

Local governments should promote the necessary actions to ensure that individuals who fulfill the necessary requisites to qualify for the grant, whether due to their characteristics, or because of the purpose of the activities they wish to undertake, all have the same possibility of access. To this end, a complete and appropriate dissemination of calls for applications constitutes a key element.

#### 3. **Processing should be flexible and efficient.**

The swiftness of resolution in awarding a grant starting with the publication of the call for applications to its subsequent disbursement is a fundamental element in the management of such transfers. A prolonged processing period may affect not only the final success of the project but also its actual initiation. Achieving efficiency in the processing of assistance and grants can be done through an optimal management of processes, the use of ICT's – facilitating applications and electronic processing – and training, enhancing credentials, and active involvement by managers in the process.

Without overlooking the fact that in certain countries local governments are subjected to general regulation concerning management of grants, there is an ample margin of discretion to optimize the time spent on processing. Some measures within reach of all municipalities are found in the simplification of credentials requirements for beneficiaries – to the extent that they are non-essential – and the elimination of unnecessary procedures.

#### 4. **Publicity and adequate dissemination of calls for applications**

An active policy of disseminating and publicizing calls for applications for assistance and grants has a positive effect on the improvement of program performance indexes and upholds the general principle of equal access. The government initiating the transfers should not confine itself to publishing the calls for applications only through the means of



communication specified by legislation – official bulletins, for the most part – but can avail itself of ICT's to expand the range of parties addressed and launch targeted promotional campaigns of assistance geared to the profiles of the parties in question.

## **5. Control of the efficiency of public funds through accountability and evaluation of objectives.**

Government authorities should guarantee and ascertain the effective use of the funds they have transferred. The beneficiaries of grants must be obliged to provide an accounting indicating fulfillment of the goals for which they received the transfers. Nonetheless, the local government should provide the ways and means through which third parties can provide their accounting for the payments received without being subject to high opportunity costs.

The local government should undertake timely verification of the required documentation that accounts not only for the costs associated with the grant, but also for the effective performance of the subsidized activity and the fulfillment of the goals for which the grant was awarded.

## **5. To promote values and principles of public ethics, and provide such orientation to third parties that deal with the government**

The fact that third parties do not pay back these transfers could provide incentives towards behavior at variance with the ethical conduct that should govern relations between citizens and government. Because of this, local governments must include provisions in their calls for applications and ground rules for assistance for possible sanctions that may apply in cases where irregularities by applicants and beneficiaries are detected, as well as instituting preventive measures that preclude possible criminal conduct. Because of this, local government must let its conduct be guided by the public interest and serve as an exemplary model for third parties of the ethical values that it should promote through rigorous adherence to the principles of impartiality and equality of access.

### **5.1 Ensuring the ethical conduct of applicants.**

Falsification of documents to receive assistance would be one of the possible irregularities that could be detected in the application phase. Local governments should institute practices that restrict such conduct by third parties as much as possible: The conduct of local governments should be exemplary, transparent and impartial throughout the entire process, and measures must be taken to prevent criminal conduct and to check and validate documentation submitted, and effective penalties must be brought to bear to ensure that no improper conduct goes unpunished.



## **5.2. Ensuring the ethical conduct of beneficiaries.**

Local governments must exert themselves to be sure that the actual use of assistance and grants is in accordance with the goals and purposes for which they were granted and ensure that the recipients of such support fulfill the obligations that they undertake in connection with it.

## **6. Internal/External analysis and evaluation of the impact of assistance and grants.**

Evaluation should not be confined to individual verification of each portion of assistance granted, but should rather be understood from a comprehensive and strategic standpoint. This analysis should not be confined to studying the impact of each of the different lines of assistance granted and the corresponding programs with which they are associated, but should rather be supplemented with a strategic evaluation of how grants contribute to achieving the objectives set forth in the different local public policies.

## **7. Clarity and reliability of information presented in calls for applications.**

The call for applications is a basic element that determines the relationship between the government offering assistance and grants and the interested parties. The clarity of the terms regulated by the call for applications -- requisites for receiving assistance, documents to be submitted, scope of the grant, determination of expenses that can be subsidized, obligations of the beneficiary, etc., determine the flexibility of the relationship between the sponsoring government and the interested parties, and has a direct bearing on the smoothness of the procedures. It is also advisable to include full and pertinent information regarding the obligations assumed by beneficiaries. The clarity of the terms with which the justification of expenditures and verification of the milestones associated with the project need to be conducted may be a decisive factor in persuading an interested party to apply, and has a positive effect on the satisfactory execution of the justification phase.

### **V.3.3. Areas that are especially sensitive to irregular conduct and losses of efficiency.**

The procedure for managing grants can be broken down into three phases. This division facilitates the identification of especially critical aspects throughout the entire management process.

- a) Opening phase, which encompasses the publication of the call for applications through to their submission.
- b) Evaluation phase, pursuant to procedures.



- c) Justification phase for grants.
- d) Analysis and evaluation of the impact of grants and programs of assistance.

*a) Opening phase (from publication of the call for applications through to submission of applications)*

There is a wide margin of local discretion for undertaking steps to improvement during this phase of the process. The aspects comprising the main concern of local governments in this phase are as follows:

- Documents submitted by applications often have major problems or are incomplete.
- The intake of documents and cleanup of errors are usually the most critical element in this process<sup>17</sup>. There is a clear tendency for processors to treat the documents to be submitted by the applicant in a uniform manner, without drawing distinctions between what documentation is indispensable to make the application eligible for processing, what is necessary to evaluate the candidate and what documentation might be required for submission once the grant is awarded. Such differentiation can avoid delays in processing resulting from the submission of incomplete or flawed applications.
- The risks of bidding for several kinds of assistance in a single project give rise to the need to have mechanisms available that make it possible to recognize such a situation. In general, it is common to accept a sworn statement from the applicant as a legitimate form of identification.
- A delay in the implementation of the budget for allocation of grants and relatively low amounts in comparison with other budget allocations.
- Identification of behavior tending towards falsification or concealment of information by applicants<sup>18</sup>.
- Manual entry of files, an especially critical factor in large-scale procedures.
- Internal management culture based on the expiration of intermediate periods for processing.
- Lack of precision in the drafting of calls for applications to assistance programs.
- The need for greater qualifications and competence on the part of staff involved in the management and processing of grants.

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<sup>17</sup> Especially serious in procedures subject to the rules of competitive bidding.

<sup>18</sup> Falsification of documents to receive grants is characterized as a crime in the penal code of most countries.



## *b) Evaluation of applications.*

Local discretion in adopting measures and designing best practices that improve the transparency, efficiency and impartiality of the process of application evaluation is very considerable. In this phase it must be a priority for evaluators, processors and applicants to have clear criteria and transparent and public assessment objectives.

In general, the most important elements identified in the application evaluation phase are as follows:

- Insufficient coordination between evaluators, especially in cases where the government seeks an external evaluation in addition to the internal one.
- Assignment of appropriate workloads, especially critical in procedures under the competitive bidding regime.

## *Justification of grants.*

Accounting for the actual use of public funds received by beneficiaries must be especially efficient and transparent. In general, the critical points to be observed in local government are:

- Lack of interest on the part of beneficiaries in the process of justification.
- Lack of specific training of beneficiaries receiving grants concerning their obligation to account for assistance received.
- Failure by beneficiaries to observe deadlines in the submission of documentation accounting for expenditures made and/or concerning the conduct of activities.
- Lack of clear instructions for beneficiaries on the terms of justification.
- The diversity of standards and their lack of streamlining among the officials who take part in the oversight of assistance.
- Greater publicity for accountability of beneficiaries.
- Delays in payments and/or release of deposits by the government.
- Lack of awareness among municipalities, as parties responsible for economic life of cities which explain a certain level of sluggishness in delayed payments and refund of deposits.

## *d) Analysis and evaluation of the impact of grants and programs of assistance.*



As explained in Chapter V.6, the practice of evaluation of public policies is long overdue in the usual management practice of most local governments. Nonetheless, it is precisely in the realm of public assistance and grants where a fuller evaluation agenda can be observed as a result of the obligations frequently imposed by the sponsoring governments.

Even so, many local governments are still starting at zero to develop new assistance programs without a process of internal reflection on the results and impact of previous programs.

#### V.3.4. Best practices linked to the management of grants.

##### ■ **GS Practice I: Analysis and redesign of procedures for the management of public assistance.**

The observation of low levels of performance in programs of public assistance, the growing public demand for the improvement of the quality of services rendered and the need to redirect certain lines of assistance are some of circumstances that give rise to the opportunity to analyze and redesign procedures for the granting of grants at the local level.

Analysis of the management of grants must take be approached from a two-fold perspective;

Regulatory analysis: Involves verifying if the regulations, in effect, impede procedural implementation, identifying the available scope of discretion for introducing regulatory reforms that may make it possible to overcome certain dysfunctions in the implementation of procedures.

Procedural analysis, which is to be undertaken on the basis of an exact description<sup>19</sup> of the dynamics of the process in order to ferret out dysfunctions at each stage of the management process. This analysis may be supplemented by carrying out “processing performance tests.”

The purpose of “processing performance tests” is to ascertain the total amount of time spent in the processing of a given line of grants and the time spent on each stage of the process. Estimates are calculated on the basis of a significant sampling of files for each one of the lines of grants. This technique makes it possible to determine whether on average regulatory deadlines for issuing decisions and giving notice of different actions are met, finding out in what phases the most amount of time is spent, and ascertain the key problems in processing.

At the end of the project, the local government may have at its disposal:

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<sup>19</sup> The use of flow-charting techniques is recommended.



- Processing guides or manuals that unify standards, streamline processes and simplify those elements that do not add value to procedures. Such guides, of great utility for processing staff, are also most useful when new staffing arrangements are made, and as an indispensable basis for implementing electronic processing.

- **Specific measures or improvement and simplification.**

An exact description of the way to conduct processing of grants allows managers skillfully to visualize points for improvement and effectively implement corrective measures. The application of such measures often takes place immediately without awaiting their final appearance in the procedural manual or processing guide. **Among possible activities at the disposal of managers** undertaking a program of procedural improvement are the following:

- Selective distribution of the calendar of calls for applications among the interested communities.
- Simultaneous performance of processing and activities, preventing managements from seeing processing in isolation.
- Suppressing those activities that do not add value (for example, internal registries, notes, ...)
- Reduce the amount of qualifying documentation needed to apply for grants where unnecessary, and involving a burden that applicants and beneficiaries can be spared.

#### **Reduce file turnover time.**

- Streamline schedule for awarding of grants.
- Foster the use of all media among interested parties and beneficiaries, without overlooking the traditional notification procedures.
- To promote electronic submission of applications and support electronic processing of files.
- Reduction of evaluation times through organizational adjustments that make it possible to allocate resources dynamically.
- Administrative separation of economic justification from technology, with specialists for each area.
- Encourage active distribution of instructions for justifying grants and make known the consequences of improper justification.



The success of a program of analysis and procedural improvement depends to a great extent on the organization's commitment to putting into practice the actions proposed in the appraisal. The involvement of managers and political officials in the project must be able to overcome resistance from particular officials to divulging specific information about their performance.

### ■ **GS Practice II: Processing in advance.**

The system of advance processing makes it possible to bring forward the processing of the call for applications into the year before settlement as long as the expense involved is entered in the same annual period in which the grant is made. >> In this way, it is possible to speed up management of procedures in competitive bidding, which makes it possible to manage time and administrative resources appropriately.

Advance processing will be subject to the availability of proper and sufficient credit in the approved Draft Budget corresponding to the fiscal year following the one in which the funds are committed as a result of settlement of the award. This circumstance assumes that the maximum total amount allocated to the program designated in the call for applications is an estimate. In view of this, it is advisable to record in the call for applications that the awarding of grants is subject to the availability of proper and sufficient credit at the time the award is made.

### ■ **GS Practice III: Application of ICT's. Electronic processing and the Integrated Management System.**

In the search for efficient management in this area, a Comprehensive System for the Management of Assistance and Grants should be a final goal. Nonetheless, the process of identifying best practices has shown us that for the most part, local governments are still far from undertaking initiatives of this scope. The application of ICT's to the full management process, from the application through to the award and subsequent justification of the grant, constitute an indispensable step towards success for this kind of project.

Among the reasons that might explain the "technological backwardness" in grant management by local governments compared to government at other levels, the following emerge:

1. The volume of grants managed is relatively small, as well as the number of players involved.
2. There is a greater diversity of lines of assistance placed at the disposal of economic agents in regional and central governments.

The impact of applying Information and Communication Technologies (ICT's) to grant management may be great, but ***it may only occur in isolated instances that are equally beneficial in terms of improving efficiency and management transparency.***

- **Facilitating the electronic dissemination of grant programs via the Internet.** This has to do with providing basic information in advance such as calls for applications, amounts, date of publication, possible interested parties, etc. Furthermore, in those instances where local governments offer a wide array of assistance programs to various economic agents, it may be of interest to offer services of selective distribution geared to the specific profiles of interested parties.
- **Electronic application.** The requirement to submit applications in electronic format has a positive effect in reducing paper work associated with processing, and improving efficiency when it comes to passing “documents” among departments and saving the space set aside for filing.
- **Electronic registry.** The availability of an electronic registry which frees applicants who have previously participated in grant programs from having to submit various qualifying documents entails an immediate advantage in terms of opportunity costs for the public and for firms that apply for grants. Often the abundant documentation required and the cost of submitting it repeatedly may work as a disincentive to submitting new applications and end up reducing the level of budget allocations.
- **Electronic processing.** The electronic case file has as its chief advantage the reduction or elimination of the paperwork involved in processing. Even so, comprehensive electronic processing of assistance management requires as preliminary steps such as making arrangements for signatures, invoicing and electronic collation of originals. Expedious online notification of applicants of government decisions also involves a best practice. However, the regulatory framework for grants should indicate which procedures can be fulfilled electronically, by software or online.
- **Interactive portal and comprehensive service for interested parties and beneficiaries** Improving the relationship between economic agents and citizens, on one hand, and local government that provides funding, on the other, may be undertaken by setting up interactive portals that address the specific needs of applicants and beneficiaries. Among the services a portal on assistance and grants might include are the following:
  - Qualified dissemination of all calls for applications.
  - Compilation of information on all grants included in programs.
  - Simulation programs to estimate the probability of receiving assistance.
  - Relevant information concerning projects already completed.
  - Submission of required documents to grantees (justifications of payments and expenditures, invoices, etc.)
  - Multi-channel communication, by phone, e-mail, SMS and web pages, with rapid-response phone operators.



- Personalized information structured by sectors and adapted to the needs of applicants.

#### ■ **GS Practice IV: Mechanism for identifying overlapping assistance.**

One of the most common limitations placed on individuals seeking access to grant programs is the restriction that there should not appear other forms of assistance granted by another government agency for the same activity that overlaps with the program. Given the difficulties of administrative coordination for the exchange of information among different levels of government (and within the framework of the same level of government), setting up mechanisms to help identify overlap of assistance in the same initiative or project constitute a best practice still waiting to be implemented in many countries.

In practice it is common to require a sworn statement by the applicant that it has not received any other type of assistance for the activity in question. However, having the use of a national database that offers information on all grants awarded could serve to improve effectiveness, monitor the accumulation and overlap of assistance, and facilitate planning, follow-up and oversight activities. Even so, the main difficulty is that this initiative is beyond the reach of local governments and its effectiveness depends upon central government taking the initiative.

#### ■ **GS Practice V: Registry of grant applicants.**

The creation of unique registries for grant applicants by governments providing funding expedites the work of supporting assistance seekers. It entails bringing together only once the qualifying documentation of the ability to function and legal personality, as well as other additional documents needed. Entering applicants into these registries should be voluntary and should be subject to periodic updates, and whenever there are modifications or changes that affect the data entered.

Furthermore, there should be coordination among different registries of local governments, and these should coordinate with regional and central governments if there are any, in such a way as to reach the ultimate goal of having a single registry.

#### **Success story: Registry of Recipients of Public Funds. Government of Chile.**

##### **Initial situation**

Although this initiative originates in the central government and is regulated by general standards, municipalities that are included are obliged to maintain a registry of institutions that receive public funds from their particular treasuries.

##### **Aims of the practice:**

The aim is to create transparency with respect to those companies and public institutions that receive public funds not subject to repayment. Thus, the registry facilitates repeated submission by recipients in response to new calls for applications.

##### **Description of the practice**

Pursuant to regulatory Law No. 19.826, public agencies and services included in the Budget Law and municipalities that make transfers are obliged to maintain a registry of institutions that receive public funding. For institutions that receive public funds drawn from the budget category Public Outlay, the obligation to maintain the registry depends on the institution that approves the transfer or endorses the allocation of the funds in question.

Recipients of transfers or donations should keep **permanently updated** the information that is required of them.

The information contained in this registry is as follows:

- Company Tax Identification Number that appears in the company's articles of incorporation and its certificate of good standing.
- Name of company
- Company's most recent statement of net worth.
- Company capital (municipalities do not have to fill in this field)
- Fiscal Year result according to the most recent tax returns.
- Company purpose.
- Information about the Director: Tax Identification Number of Director and general information.
- Basic information on each legal representative.

The validity of this information is contingent upon the inclusion in the registry of the documents that corroborate such data. The documents requested are as follows: Certificate of Good Standing, Articles of Incorporation or modification and/or mandate, Minutes of Assembly, Board of Shareholders or Board of Directors, Photocopy of Tax ID number, Balance Sheet and Form 22 (Tax Returns).

The system provides information on each one of the institutions that receives transfers and on whether the information has been validated, that is, has been checked against the required documents that have been submitted. In this way, any physical or juridical person can have access to the individualized information each registered institution has put into the system.

#### **Results obtained**

At the end of August 2006, the number of entries in the system rose to 4,613, of which 2,523 had been validated (54%). The statistical data is broken down by region, with Region 13 offering a greater number of entries, at 1,282 (27%), with a validation rate of 49%.

### ■ **GS Practice VI: Strategic plans for grants.**

Strategic plans for grants are profiled with a planning instrument for public policies whose purpose it is to foster activities of public utility or social improvement. They are also a splendid tool for inter-administrative coordination and for maximizing the effectiveness of public action underwritten by grants.

These strategic plans should be in tune with multi-year budget programs, which are explained in this chapter. A strategic plan for grants might include the following elements:

**Table 2. Contents of a Strategic Plan for Grants**

<b>Elements to include in the Strategic Plan</b>	<b>Description</b>
Strategic objectives	Should describe the expected impact of the public program during the period while the plan is in effect, and should be linked to objectives established in budget programs.



Funding lines supporting the program of action	For each funding line the following should be included: Sector to which assistance is allocated, results expected from the allocation, time needed for execution, foreseeable costs and sources of financing, mechanisms for making use of funding lines.
Ongoing follow-up and evaluation regime applied to funding lines	A set of indicators related to Plan objectives should be stated explicitly for each funding line so as to provide information on the current status and progress achieved.
Results of evaluation of previous strategic plans.	Here the contents of the reports issued should be included.

Updating and follow-up on information contained in the plans should be carried out periodically. If as a result of this follow-up, instances of non-compliances are discovered in expected results, this tool makes it possible to modify or replace the funding lines in question for others that are more effective, or even to remove them altogether.

Implementing this best practice entails an improvement in processes of analysis and internal reflection when assistance programs are designed, and avoiding having to start from scratch when a new program or funding line is developed.

**■ GS Practice VII: Integration of social objectives into programs of economic activity.**

Some funding lines for which calls for applications are issued by municipalities intended to stimulate and revive the municipal economic fabric are linked to the revitalization of marginal neighborhoods characterized with a particular set of social problems. In these cases, one of the key prerequisites in order for assistance to be effective involves incorporating earlier initiatives and measures that act upon the social fabric of the neighborhood or district to make it possible to discover talents and ideas, and foster an entrepreneurial spirit. It is also interesting to include among evaluation criteria certain standards based on public interest, such as the innovative nature of the projects, the creation of new jobs and the assimilation of immigrants. In this light, the experience of the Commune of Rome in its line of assistance for the self-promotion of companies stands as a point of reference.

**Success story: Self-promotion of companies in the Commune of Rome.**

Aims of the practice:  
 The priority aim of the initiative is to revitalize the economy of the marginal neighborhoods of Rome. The program assumes an earlier phase devoted to working with the social fabric of the neighborhood, which is deemed indispensable in order for the administration subsequently to support entrepreneurial projects that are economically viable.

**Description of the practice**  
 The activities included in the program of enterprise self-promotion are as follows:

1. Stimulation at ground-level: Setting up “neighborhood laboratories” in which existing associations participate. The purpose of this phase is to discover ideas and projects and consider the possibilities of putting them into practice.
2. Training activities: Training activities are organized to update the economic and financial know-how linked to specific activities.
3. Publicity campaign: The purpose of this phase focuses on publicizing the projects that have been discovered through various media, stimulating new entrepreneurs and making possible the expansion of the business of initiatives under way.

If viable initiatives of interest to the community should present themselves, these additional

services are offered:

4. Service Centers, that offer advice to new entrepreneurs. Managers ascertain the viability of projects and organize days of training at the centers. If the initial ideas match up with projects of interest, project details are hammered out in the workshops.
5. Office of Social Self-promotion. This phase entails review of project viability by the *ad hoc* Committee to see if it satisfies a series of standards. If it does, the project may receive two types of assistance:
  - a. Insertion into the enterprise incubator: Dedicated in particular to those initiatives that do not require machinery but do, on the other hand, need intense engagement of human resources. Entrepreneurs are offered a particular space for carrying out their activities for a maximum of two years . At present, there are five incubators devoted to specific activities: Shows, social economics, non-proprietary software (freeware), multimedia, or else linked to a particular neighborhood.
  - b. Economic assistance for companies needing investment. The maximum amount that can be made available is 100,000 euros. 50% of the investment must be financed by input of the entrepreneurs and 25% is designated as a loan. The disbursement of grant funds occurs after the submission of paid invoices.

Companies have other assistance, such as availability of credit and a center for advice on social responsibility of business. Furthermore, specific borrowing arrangements have been created to prevent usurious practices.

#### **Continuity of the project and changes introduced**

The need to maintain ethical conduct among applicants and prevent falsification of data provided via the Internet to seek such assistance encourages opportunities for direct contact between officials and applicants. Such contact takes place in the interviews conducted by the Evaluation Committee.

### **V.3.5. Best practices in financial assistance to families.**

Although the focus of assistance and grant departments has centered on transfers made to physical and juridical persons in order to promote particular activities of public or social interest, it is true that local governments acting within the framework of social policy, allocate large amounts of funding to improve family income in cases of serious distress.

However, it is important to point out that the eminently social purpose that governs the awarding of such assistance determines that the principles set forth at the beginning of this chapter modify its relative importance. In this regard, efficiency loses importance in favor of ethical and social values that underscore the principle of equality and impartiality of access. The effectiveness of assistance<sup>20</sup>, avoiding falsification of documents in applications and their fraudulent use by beneficiaries, and improving the integration of such assistance into other programs of a social nature addressed to families are the purposes that should guide the adoption of activities and measures for improvement in program management.

In this sense, the assistance plan put forward by the City of Buenos Aires for improving the economic situation of the indigent population and citizens on the threshold of poverty provides an instance of a best local practice. The purpose

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<sup>20</sup> Among the indicators of effectiveness the following could be listed: Coverage of the target population, basic needs covered with average assistance granted, etc.



of the program is to strengthen family income, generally covering 75% of the Basic Basket, an amount estimated at 400 Argentine pesos for a standard family of two adults and two children. This system incorporates the use of a prepaid card that does not allow withdrawal of money, which prevents the card being used for purposes other than acquiring basic goods and services. This card can only be used by their holders for payment at particular businesses determined by the City of Buenos Aires. This condition involves in turn a measure intended to strengthen the city's small and medium businesses. The linkage of the program to oversight of school attendance and health of children is given special importance, and infractions may result in loss of the card. Some of the details of this best practice are explained below:



### **Success story: Citizenship of Buenos Aires with all rights.**

Buenos Aires Citizenship – With All Rights, is based on the implementation of a strategy of social policy predicated on the citizen's right to an assured minimum income, and that fosters equality of opportunity for its development.

Its services seek to guarantee the resources necessary to ensure adequate nutrition for the households involved, but should also encourage and facilitate improvements in government health and education services, in accordance with regulations and terms in force, on the basis of an effort at inter-institutional coordination with the departments in question.

#### **Aims of the practice:**

The general aim is to eliminate poverty in the Autonomous City of Buenos Aires, establishing an automatic mechanism that is transparent and direct for the transfer of income to homes facing poverty or social fragility, expanding opportunities and abilities for women, children, teens, youth and other socially vulnerable groups such as the elderly and the handicapped, promoting co-responsibility of households in matters relating to health and school attendance of their members. Buenos Aires Citizenship – With All Rights is intended for all households touched by poverty in the Autonomous City of Buenos Aires.

#### **Description of the practice**

The potential demand stands at around 100,000 households. The benefit consists of a monthly grant of no fixed amount, calculated on the basis of family composition, considering the value of the Basic Nutritional Basket estimated by adult equivalents as a parameter for estimation.

In addition, the acceptance of the household as a beneficiary is contingent upon satisfying certain minimum educational and sanitary conditions. In this regard, Law no. 1.878 creating the program, in its Article 7, establishes among other things the following requirements for receiving assistance:

1. Verification of the certificates of matriculation or attendance at school in cases where there are family members between five and eighteen years of age.
2. In the case of pregnant women, a medical certificate issued by the public health system must be submitted.
3. In households with persons with special needs, it is also required to present a certificate of disability issued by a competent national or provincial authority, or documentation showing that such a document has been applied for and is in process.

To stay in the program, beneficiaries must uphold a series of obligations. These specifically involve the upholding of certain sanitary standards (especially in the case of pregnant women and children) and periodic verification of school attendance by the children.

The list of beneficiaries is published by Area Social Services at Centers for Management and Participation and other agencies of the City Government of Buenos Aires.

#### **Results**

The program began to operate in the 2006 fiscal year and has managed to incorporate 56,000 households as beneficiaries during the same fiscal year.

#### **Continuity of the project and changes introduced**

The goal for 2007 is to reach 90,000 households and eliminate poverty in the Autonomous City of Buenos Aires. Furthermore, the delivery of food baskets will continue for families that for various reasons were not previously able to join the Buenos Aires Citizenship – With All Rights program.



## **V.4. PUBLIC PROCUREMENT**

### **V.4.1. Initial considerations.**

Conscious of the influence that the specific regulations of each country have on the management of local government procurement practices, as a first step in identifying best practices, a number of sessions of the Working Group were dedicated to contrasting the similarities and differences among certain aspects which we consider key in setting up the regulatory framework for local government procurement. The aim was to identify the overall range of local autonomy to undertake best practices in the management of a procedure that is specially regulated.

A tentative comparative analysis of the regulatory framework in the various countries represented by the group of experts prompted the following conclusions :

1. In general, government procurement as a whole has its own regulatory framework to which local governments are subject. Nonetheless, there are some exceptions such as the City of Buenos Aires, whose procurement system is specifically regulated by Decree 5720/PEN/72, Law 13064 for public works and the Law on the financial administration of Buenos Aires<sup>21</sup>. In some countries different regions can elaborate the basic regulations with the approval of the central government in such matters.
2. In all cases one notes the presence of inspection and oversight agencies that seek to ensure compliance with the law.
3. The evaluation phase tends to be assigned to an office of contracting or commission of evaluation when contract amounts are high. Otherwise, the contracting agencies themselves undertake the evaluation of bids.
4. Generally speaking, with some variations among the participating countries, the following phases can be discerned in the contracting process: preparation, awarding, execution and oversight. Or else, as in the particular case of the City of Buenos Aires, it is possible to differentiate at least one pre-contractual phase and a subsequent contractual phase.
5. In most countries the settlement of disputes that may arise among contracting parties are subject to judicial review. In some cases civil litigation also becomes involved.
6. Generally speaking, countries usually have agencies of an advisory nature to deal with contracting, though in some cases they only have an authorizing role, as in the case of Italy.

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<sup>21</sup> This is a particularly obsolete framework, and therefore work is under way to draft a new law on purchasing, adjusted to the specific needs of the city.

7. The existence of a public register of contracts is a common attribute of public sector contracting. However, there are variations with regard to which agency manages such a register.
8. Standards for the awarding of contracts usually appear in bidding conditions or specific administrative articles, arranged by decreasing order of size. Some countries, such as Uruguay, have undertaken to regulate standards, establishing Quality, price, timetable and funding as basic considerations.

Comparing the basic aspects of regulatory frameworks for procurement among different countries permits us to conclude that, setting aside the considerable regulatory differences, local governments face common problems in their day-to-day management of public procurement. Furthermore, going deeper into the legal framework of each government helped to identify the first among the best practices in the area of public procurement. Chile's Purchasing Portal serves as an example which, although it involves an initiative driven by the central government, indicates a definitive step towards improving transparency in a procedure that is overly susceptible to irregular practices.

Nonetheless, over and above the differences, it becomes clear – as was expected – that local governments are scarcely able to intervene in the regulatory framework of public procurement, and their ability to institute best practices, and therefore their autonomy for doing so, is constrained by several things: their capacity for internal organization, the improvement of internal processes, providing access to complete information, and especially, promoting the effective use of ICT's that make it possible to expedite and maximize satisfaction of the business sector involved and of suppliers of the local government. In sum, the principles and values that should guide public procurement are the common point of departure for proposing recommendations and guidelines to follow in relations with bidders and suppliers.

#### **V.4.2. Principles and values.**

In this particular area, fulfilling the goals of transparency and impartiality that commonly guides standards limits the possibilities of achieving major progress in efficiency and versatility. This dilemma between legality and efficiency is the argument governments, including local governments, commonly adduce to “get away from administrative law.” This concerns a habitual practice among governments that, with the aim of promoting a hypothetical efficiency, end up causing dysfunction in the channel for public procurement and a deterioration in the government's public image, since the citizen may feel that the government itself is trying to avoid applying the rules.

Therefore, although the particular regulations of certain governments impose a cost relating to procedures that are too elaborate with respect to the amount of



the contract, the basic principle that inspires this guide is strict adherence to the established regulatory framework in the countries under consideration.

Based on this premise, the principles and values that should guide local government procurement are set forth as follows:

1. Investments made by government should answer to standards of **social productivity**, efficiency and necessity.

Inter-administrative cooperation in the determination of need and the promotion of networks of local governments taking part in civil society are activities that facilitate appropriate adjustments of investments geared to these standards.

2. Local governments should promote internally an **efficient use of current expenditures**.
3. The **transparency** of information on the public procurement process is to be fostered, ensuring public access through various channels, especially online. The clarity and reliability of information provided by government to interested parties throughout the procurement process must be ensured.
4. **Impartiality** as a key criterion in the awarding of public contracts. To this end, all possible safeguards should be established for the fulfillment of this principle. This impartiality through principles of public disclosure and competition. Decision making in the awarding of contracts will be based on impartial criteria and will ensure equality of opportunity for all interested third parties. In consequence, the principles deriving from neutrality or impartiality are as follows: **Public disclosure, competition, equality and non-discrimination**.
5. Local governments should establish mechanisms that ensure **quality control** in the execution of contracts.
6. It should put a premium on expediting processing, under a guarantee of scrupulous adherence to the principle of legality, through fostering an internal administrative culture based on efficiency and procedural improvement. The citizen and the contractor should perceive that government procurement is not subject to unjustifiable delays. The government should try to improve the attractiveness of public contracts among potential bidders and achieve greater competition among bids. This competition will benefit the citizen in the final instance, the end recipient of services provided by government.
7. Public ethics will be promoted through improved awareness of all officials. Local governments should act as **models of ethical values** in such a way as to promote the same activities among third parties (bidders, suppliers).



8. An appropriate allocation and assumption of responsibility throughout the procurement process, at all levels. Responsibility must be understood as a fundamental value. Decision making and activities undertaken should be backed up by a system of responsibility that covers everyone from elected officials to technical managers.
9. Foster the **use of ICT's**, pushing for electronic procurement.

#### **V.4.3. Areas that are especially sensitive to irregular conduct and losses of efficiency.**

The critical elements of local government procurement that, in all cases, are a source of dysfunction and loss of efficiency are as follows:

- Abusive use of certain contractual figures for the purpose of expediting management and/or evading requirements of public disclosure of the bidding:
  - Breaking down costs in order to make use of contractual procedures that are more flexible. A suitable means for limiting this type of practice is provided by a regulatory framework in which the amounts that are at the boundary between selecting one procedure or another for an award are in accordance with the cost of living. At times, these amounts persist in the national regulations in question even when price indexes have undergone considerable increases. Nonetheless, local governments generally do not have the legislative authority to change this framework.
  - Excessive justification of urgent processing as a consequence of prior selection of a bidder.
- Conflicts on the possibility of outsourcing services in discretionary cases.
- Overemphasis on price in the grounds for making an award. In the case of Spain, it is especially paradoxical to note the infrequent use of a bidding system based fundamentally on the criterion of price, when in open bidding processes a predominant weight is assigned to price. The limited trust of managers in the classification system of contractors leads the latter to make less use of the competitive bidding system.
- Excessive time spent from the start of the procedure in the management unit to the solicitation of bids.
- Delays in payment.
- Lack of oversight in the execution of contracts.
- Delay in the execution of contracts.



- Flaws in documentation during the execution of contracts.
- Numerous challenges by those who are not awarded contracts, that cause delays in the established timetable for the awarding of contracts, and that are sometimes initiated to slow down or paralyze the process of awarding a contract.

#### **V.4.4. Best practices associated with procurement.**

Based on the dysfunctions set forth above, the following areas of improvement or best practices, have been identified:

- Need to normalize and optimize the procedure; as well as to streamline the involvement of management units especially in the initial phase of the process.
- Ensure the qualifications of managers and processing staff.
- Promote electronic procurement, and in general, the use of ICT's and electronic signatures.
- Adaptation of administrative language for third parties.
- Search for efficiency through out-sourcing.
- Treating the internal user as a customer.

## ■ CON Practice 1: Procedural optimization and harmonization of activities in all municipal departments.

Delays in the payment of suppliers and the long time that elapses, on occasion, between the moment when the need for procurement arises and the publication of the call for bids<sup>22</sup> are signals that there is room for optimization of procurement processes in local government. Furthermore, when dealing with procedures that go across the entire institution, efficiency gains resulting from streamlining have an impact in all departments.

It should be borne in mind that, in general, the need for expenditure becomes known in the management unit, and therefore it is the latter that should initiate the process; even though the definition of the procedure falls within the purview of central government departments. In the absence of clear and consistent instructions for all managers, the equalization of legal and economic training in different municipal departments has the effect of making the way in which the procurement process begins in each management unit correspondingly diverse. Furthermore, in some cases, incorrect practices can be detected, i.e., that are not in keeping with the law, documentation submitted and/or provision of incomplete data<sup>23</sup>, or insufficient for the satisfactory processing of the contract in a subsequent phase.

Therefore, having clear and consistent instructions for all management units that guide their activities at the start of processing a case constitutes a best practice in internal local government management. In this way, departments that centralize procurement allocate less time to the possible cleanup of defects and direct exchanges with managers to add information concerning the need for the expenditure involved in the call for bids in question.

The work that is proposed as necessary to make uniform regulations of conduct available to personnel are set forth in the following order:

1. Diagramming and analysis of the procurement process.
2. Analysis of the procurement terms commonly used and regulations.
3. Drafting of the “manager’s guide” for procurement.
4. Training and internal information activities.
5. Application of ICT’s to the results obtained. The projects serves as a basis for future “electronic procurement.”

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<sup>22</sup> Bearing in mind that, when dealing with contracts for small amounts, almost all countries have procedures that allow for more flexible management (for example, negotiated procedures that make it possible to solicit bids from a limited number of firms without a need for public disclosure).

<sup>23</sup> A clear case of such dysfunctions are the weaknesses observed in financial/economic analyses when these are considered necessary (for example, a construction project is contracted, and the same project is then sub-contracted).



- **CON Practice 2: Central Purchasing Offices.**

The possibility of centralizing and unifying standards for purchasing of particular products for general use in local government makes it possible not only to get better prices from suppliers, but also to improve bids and above all, to expedite the process.

In Spain, apart from some initiatives undertaken by certain regional and local governments, the Centralized Procurement System (known by the Spanish acronym SAC) is used, which centralizes a large part of the purchasing of materials for the central government. Although its use is obligatory for officials of the General Government Administration, its autonomous agencies, state-run firms, the Autonomous Communities and City Governments can participate in the system through convenient agreements. As a result of its general use throughout the national territory, since 1997 a web page has been posted ([www.catalogopatrimonio.minhac.es](http://www.catalogopatrimonio.minhac.es)) with a view to increasing the system's effectiveness: Any government at any level can securely perform the different operations online through SAC . At present the service has signed up more than 2,200 institutions and operates with more than 350 firms that present their products laid out in various catalogs. Among the available catalogues are those for office furniture, copy services, computers, vehicles or professional services.

The main advantages gained from setting up this system arise from greater flexibility of processing, allowing for procurement times of less than 15 days. Furthermore, important savings have been made in monetary terms, up to a 10% reduction on average against market prices in purchases transacted by the agencies. The system makes it possible to execute all processes electronically, which contributes to transparency and security of procurement.

Also in Spain, in 2002, the "Connect to Assets" project was undertaken at the behest of the central government. Its purpose is to reduce time spent on procedures for the bidding and purchasing processes, facilitating access to all sorts of users. It is a program for bidding on public contracts through the Internet. Users can perform all operations online, from the submission of bids, the opening of escrow accounts, transactions with the procurement office, and so on, protecting the security of the system and seeking to offer the same legal guarantees as a traditional bidding process.

Not only has the central government supported centralization projects in purchasing processes, the local governments themselves have also initiated and managed centralized purchasing systems, especially in the case of large city governments with many different management units. On the other hand, the smallest local governments have also availed themselves of the advantages of centralized purchasing through association or cooperative integration with others. This has been the case with the Tierras de Medina Municipal Union in Spain. Its project consists in developing an integrated offering of services for all the municipalities comprising the Union, and in this way to obtain advantageous prices.

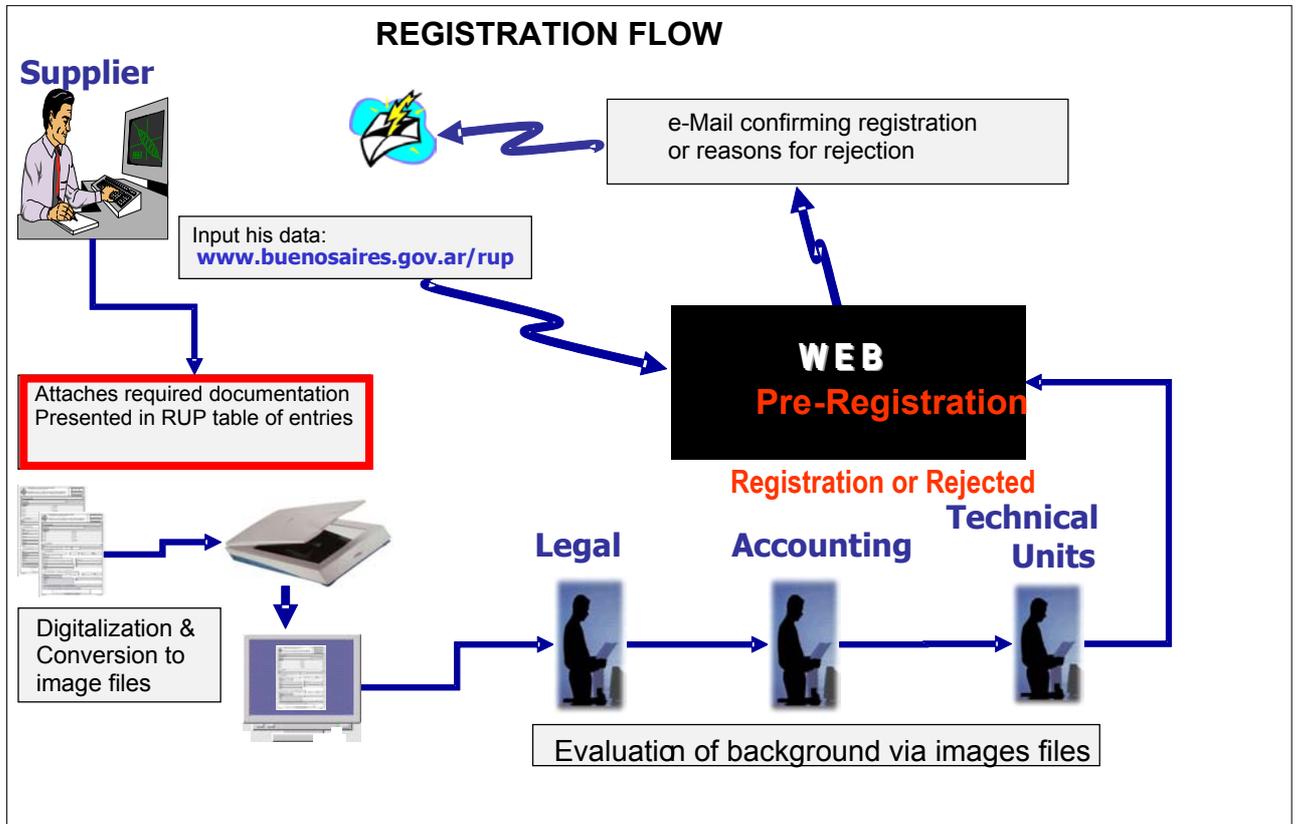


- **CON Practice 3: Registries of Suppliers**

This best practice is generally found as a component in comprehensive plans for improvement of procurement and public purchasing. Nonetheless, due to the benefits it brings to the relationship between government and third parties it can merit implementation on its own. Generally speaking, a Registry of Suppliers sets in motion a circuit of information that starts with a company inputting its basic data and the corroborating documentation requested. These data are evaluated by local officials to validate the registration. This process may be conducted online through digitized images. The company that is validated or approved by the system receives the appropriate certification that authorizes it to submit bids addressed to the local government in question. The main benefit of the system accrues to the supplier itself. With inclusion in the register, the company minimizes the preparation of documents needed to participate in successive calls for bids placed by the local government.

A key example is provided by the Unique Registry of Suppliers (RUP) implemented by the General Office of Purchases and Procurement of the City of Buenos Aires. The system in question is free and also allows for the submission of bids to the City of Buenos Aires, receiving invitations to take part in bids and/or procurement contracts notices of expiration of documents (fifteen days before expiration and on the day of expiration), and any sort of news concerning procurement that may be of interest considering the profile of each supplier. The RUP has more than 2,300 entries and has managed in the time since its implementation to reduce certification costs for suppliers, improve adherence to deadlines in bidding procedures, and maintain a permanent relationship between the City of Buenos Aires and its suppliers via e-mail. Furthermore, the Registry provides local government with very thorough information on the companies it works with which previously was neither centralized nor systematically organized.

Figure 6. Flowchart of registration in the Registry of Suppliers of the City of Buenos Aires.



- **CON Practice 4: Purchasing Portals.**

With the priority aim of improving transparency in the procurement process and making available with free public access all relevant information on what local government buys and from whom it purchases these products and/or services, the creation of a purchasing portal brings together upholding the principle of transparency with efficient access to information. A purchasing portal consists of an channel with access to relevant information on the public procurement operations of a local government: What it needs, what it buys, at what prices is it willing to buy it, what requirements must potential suppliers satisfy, and what companies are finally awarded with contracts.

In this line of endeavor, the experiment started a number of years ago by the Government of Chile merits highlighting. Although, as in other cases included in this guide, this best practice is the result of a central government initiative, we believe that the benefits it provides in the way of transparency in local financial management in Chilean municipalities justifies its inclusion in this manual.

**Success story: Regulation of Public Purchasing. Chile – Purchasing. Government of Chile (I/II)**

Chile's System of Public Purchasing, or Chile – Purchasing, has as its mission to develop policies and initiatives aimed at making things transparent and creating value in the market for public purchasing, through the use of ICT's and Excellence Management.

**Priority aims**

- To consolidate a transparent and widely accessible system of public purchasing, installing channels of information to enable suppliers and the general public to participate fully in all opportunities and results of the procurement process by Chilean government agencies.
- To increase savings and efficiency in public expenditures, getting the best prices and terms available in the market, in addition to reducing operating costs in the management of procurement.

**Intermediate aims**

- To favor electronic business and government, providing incentives to use the Internet and integrating the purchasing platform with other systems of business and public agencies.
- To ensure the quality of the supply of goods and services, by getting the most suitable inputs for the provision of excellent public services to businesses and the public.
- To support the competitiveness of Chilean businesses, supporting projects of innovation through the purchase of certain goods and services.

**Success story: Regulation of Public Purchasing. Chile – Purchasing. Government of Chile (II/III)**

**Description of the practice**

The Information System consists of an electronic infrastructure administered by the Office of Purchasing and Public Procurement of the Ministry of the Treasury of the Government of Chile, that makes it possible to transact purchasing and procurement processes.



The purpose of Chile – Purchasing is to enable all public procurement in Chile to be conducted through this system. Any user who enters the portal can learn what services and products are acquired by any Chilean government agency. In addition, the system offers information on the state of each bidding process (published, closed, awarded). It is mandatory for all information requirements involving third parties and requiring physical submission of documents to be explicitly stated in the portal.

Contracts involving public works and infrastructure projects, consulting services and technical specifications and those relating to security are excluded from the system.

#### **Continuity and sustainability of the practice**

The system has progressively improved with the incorporation of an electronic Register of Suppliers. For those third parties who have already registered, the portal facilitates responses to new calls for bids. The use of this option substantially reduces the requirements for document submission.

- **CON Practice 5: Electronic procurement.**

From the perspective of public spending, a good part of the relationship between local government and third parties focuses on processes of public procurement, from the provision of supplies, goods and services to the contracting of public works and infrastructure.

Therefore, if the municipality wishes to perform as a dynamic agent in the context of the local economic life, it must undertake initiatives that transform it not only into another actor in the local productive fabric, but also into a promoter and role model in the way it relates to the business sector. The keys to this relation must revolve around maximization of efficiency, in such a way that the government does not pose an obstacle to the development of productive business activity, as well as transparency, ensuring, as already noted, public disclosure and competition with respect expenditures. In this sense, all related best practices – procedural optimization, supplier registries, purchasing portals, and so on – should converge, as a final objective in the creation of an electronic procurement service. A project with these attributes, with a distinct trans-departmental character encompassing the entire organization, requires as a prerequisite a path of improvement geared to streamlining procedures. Furthermore, it requires significant prior development of ICT's and their integration into the day-to-day management of local government. These previous requirements, together with the economic effort the project demands, explain why as of yet there are still few local governments that have implemented, or at least started, a project for electronic procurement.

Electronic procurement encompasses both competitive bidding as well as the processing of the contract. The system makes it possible to suppress excess paperwork and maintain an automatic connection with bidders and contractors who have received awards, with major advantages for relations between government and third parties.

The Madrid City Government has undertaken a project known by the acronym *PLYCA* to implement electronic procurement that can serve as a model for Spanish local government. Ample experience in streamlining related



processes laid the groundwork for starting the project. Among other activities, work on normalization of documents and ordinary procedures was done, processing manuals were made available and certain improvements geared towards procedural simplification were implemented. The aims set by the City Government with the startup of PLYCA are as follows:

1. **Automation:** The normal processing of case files will be undertaken automatically with the system taking control and executing procedures, linking them together until the case file is closed.
2. **Flexibility:** The application will facilitate manual processing of part of a case file so that the manager can initiate the necessary procedures at each stage. Furthermore, managers are allowed to perform the process manually, though as a general rule such cases will be exceptional.
3. **Efficiency:** facilitates preparation of documents without having to wait for the task to be done.
4. **Simplicity:** Data are added only once into the system.
5. **Transparency:** All agents involved in the case file have access to all related documents and procedures.

The “integrated system” that the implementation of the PLYCA project entails requires the definition of various user profiles: Contractors, procurement units, expense managers, procurement department, expense approval department, legal services and enforcement. These users can be classified as two generic types: The processor, who processes documents, and the signer, who processes, signs and validates. The system permits the following functionalities:

1. *Automation of procedures.*  
This involves the electronic management of workflows and processing of the procurement case file from the beginning to the termination of the contract.
2. *Document management.*  
Document management built into the system requires distinguishing three types of documents:
  - a) Structured documents or files: These are documents with a predefined structure that cannot be modified.
  - b) Non-structured or templates: Models for documents are created from templates and the system incorporates the data that belong to the case file.
  - c) Semi-structured: These are mixed documents that contained structured and non-structured parts (bids, invoices, etc.)



The system also takes into account the need to include in the case file documents generally created by persons not involved in processing (i.e., technical reports, memoranda, etc.)

3. *Budget management.*

The management of expenditures is carried out from PLYCA system itself, providing for the development of an “interface” that will connect directly with the accounting system.

4. *Automatic transmission of data to the Register of Contracts.*

5. *Management of reports and statistics.*

Arrangements are made for the system to make available to managers a series of pre-established reports.

6. *Future electronic bidding.*

Once the stage of implementing electronic processing is completed, the next step will be electronic bidding, offering an automatic connection with bidders through the creation of a procurement portal.

The necessary inclusion in the system of the electronic signature has been carried out in the Madrid City Government through an advanced electronic signature based on a recognized certificate and generated by a signature-creating device.

Two phases have been proposed for this project. The first is a pilot project ending at the beginning of 2006. The second phase involves rollout to the entire Madrid City Government and its autonomous agencies at the end of the same year.

## **V.5. BUDGET MANAGEMENT.**

### **V.3.1. Initial considerations.**

In this chapter the principles, values and experiences are considered that must provide the frame of reference for budget management in local government. The aim that guides this section is to transform the budget into an authentic information, oversight and management tool.

Strictly speaking, the budget document indicates the maximum limit of expenditures the local government may transact during the fiscal year. This traditional vision of the budget defines it as a tool for short-term planning and oversight of the activities of local government.

As far as techniques for drafting budgets are concerned, due to the general way this is carried out in the local government setting, the incremental approach stands out. This technique is based on estimating expenditures for each year on the basis of those approved in the preceding year, and to add to these a growth



percentage after the inclusion of adjustments due to changes expected in investor behavior, management of services, and so on.

Nonetheless, it is necessary to go beyond these budgeting techniques, to new methods for drafting a budget that ascribe to it an important role as a management tool. The budget should be structured as the principal document incorporating planning of public sector activities and the results of their execution, and contains the information necessary for predicting and/or controlling possible departures from planned activity.

The experiments conducted by various agencies in this field reveal the guidelines that local governments should follow to make this new vision of budget management into a reality.

### **V.5.2. Principles and values.**

The theoretical debate taking place on the role of government budgets, as well as the best practices developed by certain governments in this area have made it possible to identify the following principles and values in budget management:

#### **1. The budget is a basic management tool.**

The budget includes all the activities anticipated for the coming fiscal year. The definition and choice of these activities is the result of public debate. In this sense, the budget is the result of political agreements reached concerning the activities that the municipal government should undertake. The adoption of these decisions by the local government finds the necessary technical support from departmental or cost center managers.

The process of drafting the budget should dispense with incremental techniques, considering that these entail a lack of any genuine reflection on activities to be conducted in the near future. In this regard, the most suitable budgeting techniques are those related to goals and/or programs.

#### **2. The regulations governing budget implementation seek to ensure a flexible and efficient procedure, adapted to the structure of the organization.**

The procedures to be followed in budget implementation should be gathered from specific regulations of a general nature, in which a premium is placed on flexibility and efficiency in the management of the municipal treasury. Among the elements that should govern the specific regulations are:

- Restrictions on making changes to the budget to avoid discretionary variations in expenditures which qualitatively or quantitatively undermine the reliability of the figures approved for the initial budget.



- Situations that allow for extending phases for making expenditures.

### **3. The budget cycle is perfectly planned.**

Local governments should approve a calendar in which the deadlines are set forth that the process of drafting the budget must adhere to strictly. The purpose of this calendar is to ensure that the budget is approved before the respective fiscal year commences.

Appropriate planning of the process of budget drafting and adhering to the plan minimize the risk of starting the new budget year with an extension of expenditures from the budget from the preceding year.

In any case, not only must the initial budget be submitted by the deadline, but also the date for its closing is set forth in the same calendar, since budget liquidation must be reported within a reasonable period after the last day of the fiscal year.

### **4. The annual budget is approved within a multi-year planning framework.**

The budget for each new fiscal year is drafted with a planning time horizon that the local government has established for its medium-term activities, establishing it on a more solid foundation that facilitates the design of government's fiscal policy.

Multi-year planning of municipal activities is done by identifying the different programs that are going to be executed. This projection makes it possible to introduce greater discipline into the management of public expenditures.

### **5. The most important budget programs are accompanied by indicators.**

The availability of indicators for budget programs fosters a need for more effective and efficient performance by government since they make it possible to evaluate the results of public activities.

### **6. Budget information is transparent.**

Budget information is presented simply and clearly, so that it will be understandable and timely to managers of various departments, responsible officials and to the public.

This principle is not only concerned with the clarity of information provided but also with its regularity (timeliness). Cost center managers in particular must have periodic updates on the status of budget execution managed by that center. Thus, transparency encompasses the drafting of the budget through to its definitive liquidation.

Among other desired results, budget transparency leads to greater fiscal discipline and to making available to taxpayers the information necessary to



evaluate costs and benefits of local government decisions concerning taxes and expenditures.

Considering the volume of information supplied by the budget, it is necessary to include efficiency standards as adapted to the profile of each user. This is in order to avoid a tendency towards excessively abundant and unnecessary detail when such information is shared with the public and with businesses.

**7. The economic framework taken into account for the estimation of expenses is explicitly stated.**

Estimating expenses that make it possible to anticipate the volume of government expenditure is determined by forecasts concerning GDP, the Consumer Price Index, urban development, etc. This projection must be carefully thought through so that the degree of prudence applied when revenue estimates were made can be assessed.

Furthermore, in the budget's supporting documentation the fiscal consequences within this framework should be explicitly stated.

**8. Cost centers have assigned budget responsibilities.**

Endowing management units with responsibility in budget drafting and execution introduces an important incentive for efficient management.

**9. Budget information must be very accessible.**

Citizens must have easy access to budget information, especially online. It would be appropriate to extend this practice to include information about the closing of the budget – budget liquidation – so that citizens and, more generally, any other stakeholder can determine the degree of compliance with respect to the budget.

**10. Citizens participate in the drafting of the budget.**

As the users of municipal services and infrastructure, citizens express their preferences over what programs the city government should undertake and what their priorities are in this regard. These preferences should appear in the local government's budget.

**11. The budget includes everything.**

The budget and its liquidation present the information concerning the actual government and each one of its agencies and departments, including publicly owned firms.

In this way, it incorporates the information indicated for the entire consolidated local sector, so that no possible municipal budget deficit can be transferred to one of its departments.



## **12. There is oversight of budget execution.**

The local government should inform the different stakeholders (government employees, citizens, oversight agencies, etc.) of the results obtained once the fiscal year is closed. These results should be presented with analytical budget and financial indicators, regardless of those already established for each budget program.

The result of the budget execution that is provided to internal and external oversight agencies should be submitted in a format stipulated by the latter, even when this is not expressly called for by regulations.

Oversight of program indicators involves making progress in economic/financial oversight and involves a step towards policy evaluation, a general goal of governments that is explored in the following chapter.

### **V.5.3. Areas that are especially sensitive to irregular conduct and losses of efficiency.**

The budget experience of municipal governments makes it possible to highlight as the most sensitive areas those related to the drafting of the budget and the presentation of results.

As far as the drafting of the budget is concerned, the following dysfunctions can be indicated as the most common:

- Abuse of budget extensions, as a result of not approving budgets within the deadline established by law.
- Inadequate implementation of modern techniques for budget drafting based on the usual practice of submitting budgets derived from incremental techniques.
- The submission of the budget with jargon that is scarcely intelligible to the public.
- Insufficient information provided about the budget.

As far as the presentation of results obtained after the execution of the budget is concerned, the following negative elements should be noted:

- Results from the liquidation of the budget are either not made public or are disclosed after considerable delays.
- Insufficient importance attached to the execution of the budget in public debate.



- Limited analysis of the efficiency and effectiveness achieved in each budget program.
- Expenditures are made without being duly identified as budget items.
- Delays occur in the management of investment outlays, often caused by the procurement procedure and actual nature of the expenditure.
- In some categories for revenues and expenditures lower percentages of collection and payment are achieved, respectively.

The application of the principles and values stated above will make it possible to overcome these weaknesses and enable the budget process to attain the desired levels of effectiveness and efficiency.

#### **V.5.4. Best practices associated with the budget process and oversight of economic and financial information.**

Any improvement in the local budget system should take into account the following improvement goals:

- a) To improve the understanding of the economic and financial reality being created, and with what results.
- b) To improve budget knowledge of the different administrative departments and the political hierarchy.
- c) To improve the description of activities, programs, etc.
- d) To improve the ability to design alternatives for resource allocation.
- e) To improve the ability to prioritize needs that must be covered.
- f) To improve security in the design of oversight systems.
- g) Creation of a common language that facilitates coordination.

The budgeting practices and follow-up and evaluation techniques for local economic activity that are set forth below are geared to achieving these objectives and to the development of a local organizational culture based on transparency and improving the allocation and management of resources.

While some of the best practices identified over the course of the project have a general effect on the whole budget process (drafting, execution and follow-up), others are tied more specifically to one of the budget phases or the work of budget follow-up, or the improvement of the economic/financial and budget information system.



#### *V.5.4.A. Best practices associated with the budget process.*

##### ■ **PE Practice I: Budget implementation by program, goal and indicator.**

This budgeting technique requires that management units define the budget programs executed under their responsibility. Each budget program is defined through a set of activities geared towards accomplishing a mission and some specific objectives with anticipated results that must be quantified. This budget information system constitutes a powerful tool available to budget planning managers, for follow-up and oversight of the efficient allocation of public funds, and endows the budget with greater transparency.

The fundamental features of program budgeting are as follows:

- a) Definition of spending programs based on an evaluation of the initial situation (diagnosis) that justifies the execution of each program (its mission)
- b) Determination of the strategic objectives (anticipated result in the medium term) and the operational objectives (specific aims and benchmarks geared towards concrete results) for each program.

This work of forecasting involves an additional effort by the manager since for each program he must determine the necessary financial resources, the accompanying functional expenses, the need for human and technical resources, setting timetables and the expected social impact.



### *Anticipated results of program budgeting*

The effective implementation of this budgeting technique makes it possible to:

1. Resolve the lack of information to which traditional budgets are subject, ensuring the structuring of resources to fit aims, generally speaking, and meeting legal requirements, but impeding the interpretation of local government activities in budget terms.
2. Have a more rational allocation of resources, considering that it obliges the manager to analyze program costs and various alternatives for their implementation. Furthermore, programs are included in the budget based on whether they have met the targets set in earlier fiscal years.
3. Improve the transparency of local government activities: provides a comprehensive overview of the goods and services offered to the public to satisfy their needs, and facilitates analysis and oversight of results through indicators defined for each program in accordance with the targets that have been set.
4. Improve information available for decision making during the process of budget execution through a greater appreciation of the cost of the activities being implemented.
5. Limit the common practice by managers of exhausting the allocated budget credit, as well as the reactions of departments responsible for the budget that tend to contain costs in general terms without applying objective standards of effectiveness and efficiency that distinguish between different cost centers.
6. Reduce the risks of incremental budgeting.
7. Transform the budget into a real tool for planning and monitoring the achievement of goals.

### *Constraints on program implementation and risks*

The theoretical outlook for this technique adjusts to the goals of improving transparency and efficiency of allocation. In many instances, however, putting it into practice has been a failure since its application has been limited to a **mere drafting of budget accounting procedures** from a strictly formal perspective. The key to overcoming this dysfunction resides not only in seeking organizational changes and mechanisms to overcome management inertia, but also in undertaking a process of organizational modernization and the fostering of an internal culture of service.

On the other hand, some applications of program budgeting have caused certain rigidity, preventing government departments from **flexibly adapting to changes in their environment**. Some governments have been keeping in their budget programs that are not yielding results, and have failed to do so in the past due to incorrect definitions that were not subsequently detected. Because of this, some experts propose as an alternative the application of other budgeting techniques such as **managing by goals**. This technique consists in making available to the management unit the resources necessary to achieve the indicated goals, leaving the method for doing so up to discretion of the unit. This system makes the unit responsible for achieving the desired results.

The **complexity of budgeting by program, objective and indicator** is a factor that makes its proper implementation difficult, so that only a minority of governments have applied it satisfactorily. A frequent error in its application consists of reducing the project to issuing instructions to management units without providing them with a permanent and comprehensive plan of assistance and support: They are asked to define and specify goals and indicators, and fill out the budget forms designed for such purpose, without working out the details of what characteristics they should have, and without direct support for the management in defining its own budget programs. The provision of an effective program of assistance and actual “accompaniment” for management units throughout the process of budget drafting therefore becomes a key factor in Program Budgeting. For this reason, making available a reference guide to define goals and indicators and a plan for tutoring provided by the Madrid City Government in implementing this technique, which is described below, constitutes a model program.

Among other constraints on the actual implementation of Program Budgeting, are the following:

- Lack of political support and leadership on the part of the political and technical officials responsible for its implementation.
- The lack of systematic and accessible implementation strategies that becomes apparent with the evaluation of activities programmed to prepare



the personnel involved and the information systems provided to support the process.

- The lack of motivation of government employees who may look upon the process as an expansion of the systems of control and centralization of information by the departments responsible for the budget.
- Conceptual difficulties associated with the actual definition of goals and the structuring of programs.
- Limitations imposed in some cases by accounting information systems with insufficient accounting management capacity.

### *Recommendations*

The main recommendations that may make it possible to overcome the limitations described above are as follows:

- The budgeting process should be **focused on results** and not on what resources should be used.
- The prior availability of **strategic plans** that allow the institution to have a diagnosis of local reality and design development strategies. These plans entail a major advance in initial reflection on the situation of need that requires action. Although this condition is not indispensable, it does make it possible to order local government goals and objectives more effectively.
- **Changes in the culture of those who participate** in the budgeting process through the use of analysis and evaluation as a point of departure in any budget negotiation.
- **Adaptation of legislation in force to the results of the new budget process**, with respect to budget accounting management and human resources.
- **Gradual implementation of program budgeting offering technical assistance and training to the public employees involved** – not only those with links to budget offices or those directly responsible for the budget but also managers responsible for services. Some concrete measures that would reinforce assistance and support for management units are as follows:
  - Preparation of a working plan for the new process of budgeting by program and by goal.
  - Clear definition of the role of the management unit and budget managers.



- The creation of a unit responsible for implementation that designs precise normalized procedures, especially those that have to do with following up on goals and the information that should be included in the Report of Revenues and Expenditures.
  - To analyze in advance the starting situation of budget programs that are defined as priorities.
  - Training activities for managers of department units.
  - Making available practical orientation guides and manuals to define programs, determine goals and design indicators.
  - Permanent assistance and guidance throughout the process.
- **Constant support, leadership and model behavior** from the agency that organizes the budget.
  - **Ongoing evaluation** of the process of change that is being undertaken through verification of the results achieved and comprehensive analysis of possible departures from the original intentions. This evaluation should bring together validation of the needs and effectiveness of programs in execution with the future justification for keeping it in the budget.
  - **Avoid actions based strictly on written instructions** on how to draft a budget without a comprehensive support plan.
  - **Keep track of the Budget by Program and Goal of a system of management or evaluation of human resources by goal**, which would imply introducing new management tools, identifying responsibilities and establishing compensation mechanisms for staff based on performance and goals attained.

In the near future, budget information should be framed in plans of medium and long-term public policies and in terms of the supply of public services. Liquidation should take place as a result of reaching the anticipated goals, the improvement of services and the degree of effectiveness and efficiency in the provision of services. The next step will be a budget that is set up as a valid tool for monitoring of public policy and the evaluation of results.

### **Success story: Implementation of a method for determining goals, activities and indicators for budget programs in the Madrid City Government (I)**

The Budget of the Madrid City Government for the 2006 fiscal year was the result of a project to implement a method based on the formulation of Goals, Activities and Indicators that began in April, 2005 and is expected to finish in September, 2006.

#### **Initial situation**

The project was in response to recognition of the need to establish a method that would make it possible to give continuity to an effort begun in 2004 to define goals, activities and indicators for budget programs and carry forward improvements of the internal culture of budget modernization and the quality of economic information and municipal management. With the intention of planning the project appropriately, an assessment of the initial situation was conducted that consisted of evaluating the definition of goals, activities and indicators for budget programs with the greatest impact among civilians (61 programs in Government Areas), the identification of practical improvements and areas for improvement in programs with greater citizen involvement and the holding of interviews with responsible parties for various budget programs.

#### **Aims of the practice:**

- To bring a new focus to the General Budget of the City Government, extending identification and satisfaction of citizen needs and demands, promoting a culture of management focused on the beneficiaries of services (Service Charters) and improving the evaluation of public policies.
- To improve communication of economic and financial results through an Observatory of Municipal Management.
- To improve planning of economic-financial processes thanks to the availability of a System of Management Indicators.

#### **Description of activities undertaken**

- Critical review of Rules for the drafting of the General Budget of the City Government for the 2005 fiscal year.
- Drafting and approval of the Rules for the drafting of the General Budget for 2006.
- Drafting of a methodological Guide on determining goals, activities and indicators providing management units with a Catalogue of indicators organized by category and sub-category.
- Presentation of the methodological Guide to all program managers.
- Advising on drafting Program Memos and Statements of Objectives for Budget Programs through training activities, phone service and through e-mail for tutoring and answers for all queries concerning the drafting of budget statements.
- Review of initial formulation of Program Memos and Goal Statements drafted by Program Budget Managers.

#### **Results obtained**

- Approaching the culture of managing for citizens
- Increasing correlation between defined lines of action and the provision of services for citizens.
- Redefinition of goals, activities and indicators with respect to previous fiscal years.
- Same number of object defined for each program. The total number of goals in the municipal budget has gone up to 1,713 with an average of 5 goals per program in the areas of government and 4 in the Districts.
- Sameness of indicators defined for each goal: Sufficient for subsequent evaluation and of different kinds. The total number of goals in the municipal budget has gone up to 7,370 with an average of 21 goals per program in the areas of government and 4 in the Districts.

### **Success story: Implementation of a method for determining goals, activities and indicators for budget programs in the Madrid City Government (II)**

### Continuity and sustainability of the practice

With system implementation under way, the project has continued providing oversight and support so it will remain effective and not be derailed. To this end, continuous attention has been given to the needs that management units have been presenting. Thus, with the aim of facilitating work for managers who share the same competencies and the same budget program structure, although in different territory (districts), a Guide has been drafted with templates in which concrete goals and indicators have been defined, giving rise to what has been called the “**Dictionary of Indicators.**” In this manual, for each one of the indicators included in the templates, a series of fields have been defined (size, measuring unit, type, formula, source of information, etc.) so as to ensure consistency in their interpretation and calculation methods. Both the templates and the Dictionary have been validated in working groups made up of managers or direct service providers (sports coaches, social assistants, etc.), budget managers and technicians in quality control and customer service systems. In tandem with each of these things the respective software tools have been developed.

### ■ PE Practice II Multi-year planning: Preparing Multi-year scenarios.

Multi-year planning involves an effort on the part of local government to perform a strategic analysis that provides an additional mechanism for improving the efficiency of public service. The possibilities raised by the multi-year perspective of setting goals in a framework of probable resource availability in the medium term allows for improvement in budgeting functions.

**Multi-year scenarios** should provide the framework in which the drafting of each annual budget is undertaken. They should include basic budget numbers, such as savings and deficit, and should consider both the anticipated evolution of revenues as well as the resources allocated for spending policies. The allocation of resources should be carried out in response to strategic goals of spending policies and spending commitments already undertaken.

The main guidelines for preparing multi-year scenarios are as follows:

- **The scenarios will set the quantitative limits** to which ensuing annual budgets will have to be adjusted, and will be determined by forecasts of revenues and such goals of stability as may be established.
- **Multi-year scenarios should include at a minimum** the following elements:
  - Multi-year goals to be reached during the period, broken down by program.
  - Activities to be undertaken to reach the goals.
  - Economic, material and personnel resources as expressed in the respective credits that will be necessary to reach the annual goals.
  - Real and financial investments.



- Benchmarks that will make it possible to measure the results associated with each goal in terms of effectiveness, efficiency, economy and quality.
- **The procedure for drafting scenarios can be similar to the one for drafting the annual budget.** Each section will draft its own scenario, which will contain the programs of all the cost centers that are dependent on it. For multi-year sector programs, the head of the treasury should put together the multi-year scenarios.
- The work of planning is closely associated with setting goals and their evaluation, so that **budget allocations to cost centers** should be made **bearing in mind**, among other things, **the degree to which goals were reached in earlier fiscal years.**

### Constraints

It should be noted that the work of setting goals for public sector activities is a complicated matter. In the first place, there are simply technical difficulties, setting meaningful goals for public sector performance is very often complex. On the other hand, the determining goals and indicators and setting up systems for following up and evaluating results involves a substantial workload for the manager and makes no sense if it only has an influence on resource allocation in subsequent years. But the main difficulties arise on the political level: To commit to clear, measurable and verifiable goals is looked upon from a government perspective as a risk that it is difficult to assume.

On the other hand, scenarios run the risk of remaining merely tools for limiting overall expenditures on the basis of anticipated revenues, presenting itself overall as a mechanism for ensuring the goal of stability. It would be a lost opportunity if that were the case, since the rationalization of public expenditures must go through a process of discussing priorities and evaluating the results obtained from each funding line or spending policy, a process that it is practically impossible to engage in if there is no proper determination of goals and indicators, and if program managers who perform effectively are not compensated in budgetary terms.

### ■ PE Practice III: Participatory budgets.

Participatory Budgets are a formula for resource allocation characterized to a greater or lesser extent by citizen participation. The degree of citizen participation may vary as a result of two considerations:

- a) The percentage of budget expenditure subject to popular determination, which may range from less than 1% to the entire budget.
- b) The degree of citizen participation throughout the budgeting process: In the allocation, execution and oversight of the budget item that is approved.



Most experiments concentrate citizen involvement in the phase of drafting the budget, as previously explained. Nonetheless, there are initiatives, for example in Porto Alegre, Brazil, that engage citizens in the oversight of the projects approved through the participatory process through the so-called “Participatory Budget Councils” that assume supervisory functions throughout the bidding and follow-up phases.

Setting up a process of participatory budgeting should go through the following phases: Identification of participants, training activities geared toward their technical preparation, technical evaluation of alternatives and priorities, and concluding with the negotiation of agreements in the budget drafting phase. The rendering of accounts to all parties involved would be the final step in the process that would be undertaken in the execution and budget follow-up phases.

Notwithstanding the high degree of similarity among experiments included under the heading of “Participatory Budgets,” it is necessary to break them down into categories<sup>24</sup>:

1. “Minimalist” experiences in which less than 2% of the overall budget is open to debate. A large number of the local governments that began to try out these kinds of projects fall into this group, especially the European cities.
2. Local governments that debate a significant part of their budget for investment, between 20% and 100%.
3. Local governments that submit to popular decision not only the investment budget but also the management of personnel and operating expenditures. However, the initiatives in the domain of this group are still very few.

#### *Expected benefits*

1. Entails an advance in the development of democratic principles and the extension of rigid margins of formal political participation, commonly reduced merely to exercising the right to vote.
2. May be an instrument for rationalization and conflict resolution in municipal management faced with the growing complexity of local problems.
3. As an eminently urban phenomenon, at the local level participation finds its most suitable venue, since it is the domain in which citizens live together, have relationships and defend their interests.
4. The participatory budgeting system has a high potential for bringing about a greater redistribution of public funds.

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<sup>24</sup> The classification was developed by Yves Cabanes (2004) in his article, “Tendencias recientes y perspectivas de los presupuestos participativos [Recent trends and perspectives in participatory budgeting]” in *La Era Urbana*, Quito, on the basis of a study presented in the framework of the URB-AL initiative that analyzed up to 25 different experiments.



5. Causes organizational changes in the government's internal structure and contributes to greater connectivity with the citizenry.
6. The system allows for instructing citizens in limitations of public funding and the need to decide between distinct alternatives for the allocation of expenditures. It is also an appropriate instrument for introducing other key elements in budget decision making such as the quantification of maintenance costs for planned investments beyond the fiscal years in which they occur.

### *Constraints*

Although there is no substantial literature explaining the economic and financial situation of governments using this budgeting system, some experts note that financial difficulties may limit their use. In fact, the financial deterioration of municipalities commonly involves a contraction of the budget allocated for investment and social expenditures, so that these local governments have less discretion for channeling citizen participation.

Another obstacle to the application of participatory systems is the recognized phenomenon of “fiscal illusion” which translates as the inability of taxpayer-citizens to perceive the real cost of public services, either because they are led astray by prices as a result of revenue collection at the source, or else due to the actual complexity of the fiscal system. Furthermore, financing of public services through borrowing may cause even greater confusion among voters as they fail to associate today's debt with the requirement for greater taxes in the future.

A significant difficulty that emerges in the practice of participatory budgeting is due to the lack of accounting knowledge by the majority of citizens (even when the participation is conducted through associations) for evaluating future budget charges resulting from spending decisions made in the current fiscal year.

Some pioneering experiments in Spain in the quest for participatory budgets have made it possible to identify the main difficulties when it comes to launching such a project. The greatest risk lies in the lack of implementation of decisions taken by popular involvement, which leads to mistrust on the part of the public and a subsequent reluctance to take part in alternative participatory processes. The strategy adopted by the municipality to overcome this problem has been based on the development of systems that allow for consolidation of the comprehensive participatory model and improvement of citizen receptiveness, deferring the application of participatory budgets until the new models attain the stability and permanence necessary for debate.

### *Recommendations*

- Make budget execution flexible and recognize that assigning responsibility to cost centers has positive effects on the responsiveness of the process of allocating expenditures, bringing it closer to the managers and therefore, to the citizen, which facilitates application of the participatory system.

- **Design of a participatory methodology in the definition of budgets that participatory agencies submit to the government.** This involves defining processes of citizen participation that enable associations and interested citizens to approach the analysis of reality to identify possibilities for transformation of the municipality.
- **Normalization of the process of participation through specific regulations.** It is appropriate before the application of participatory budgeting for the municipality to develop a policy of citizen participation consolidated and normalized, preferably through specific regulations. The process of participation should be clearly defined, especially in the following respects:
  - **The roles of the actors** involved should be clearly **described**.
  - **The rules of the game** (methodology, process, documentation to be filled out) should be exhaustively **designed** and be accessible to the citizen.
  - The degree to which citizen decisions are binding upon government departments and social agents should be clarified, since their decisions can have either a **binding** or **advisory** character. Regardless of the decision the government takes in this context, it is necessary that this point be made clear prior to the start of the process, to avoid false expectations. This question involves a good part of the current debate over citizen participation. The risks associated with starting the project and the challenge of making participants aware of the need to choose between alternatives in allocating scarce resources are factors that suggest an advisory role, at least in the first years, so as to prevent negative effects on the municipal financial situation. Only in cases of consolidated projects should it be stipulated that decision making should be binding, as long as the percentage of the budget is limited, and the choice is between alternatives whose viability has been subject to a thorough technical appraisal.
- **Training citizens** – and associations taking part in the participatory process – in economic budgeting criteria for the allocation of public funds.
  - Training activities should avoid any political conditions so that citizens can exercise their right of choice of the options presented using impartial economic evaluation tools.
  - The active involvement of local government technical managers in training activities and preparation of impartial evaluation tools facilitates exchanges between government and citizens, expedites the participatory process and especially its integration with the local government's own information systems.
  - Among the economic and financial criteria, at least the following should be taken into account:



- Sustainability of investment through identification of the costs of future operations.
  - Capacity for self-financing of investments.
  - The degree of coverage of the investment cost with transfers from other levels of government.
  - Funding derived through other financing alternatives.
- To combine economic criteria with others of a socio-economic nature that make it possible to identify by neighborhood and district the circumstances of poverty affecting access to public goods and services, and the size of the population that benefits from investments of social expenditures. It is worth pointing out that the inclusion of criteria of economic rationality should not exclude the relevance of social criteria.
  - **The evaluation of citizen proposals** should be based on criteria of: Profitability, sustainability, creation of future jobs, percentage of beneficiary population, impact on specific communities, improvement of access to services to those in marginal situations.
    - To include in the evaluation specific indicators or ratios that should be incorporated into the rules governing the process, which will be conducive to more impartial evaluations of alternatives.
    - Have the active participation of municipal technicians in the information process of proposals.
  - Citizen participation is recommended in the execution and follow-up phases in those local governments in which the **oversight mechanisms** for government activities are less developed or there are clear risks of irregular conduct.
  - **Avoid media campaigns** that create false expectations about the process.

**Success story: Participatory formulation of the 5-Year Budget Superintendancy of Montevideo.**

This initiative involves having citizens participate in strategic planning for area development. One of the key elements in the process is the “Management Earmarks” that involves the assignment of specific amounts by area for citizens to allocate. These earmarks are documented, published and, in the hands of local actors, help to carry out follow-up and community oversight of management.

**Description of the practice**

Phase I. Determination of the amounts that are to be distributed as Management Earmarks.

The government remits to the legislature a fixed amount that will be subsequently allocated at the time of the submission of projects. The process goes forward with consultation with Neighborhood Councils that residents attend with specific proposals. In some settings, such as with cultural matters, participation through specific commissions is especially intense. The Executive submits the priority lines of action to the local actors. In the Public Assembly the budget is presented which is negotiated in the specific area.

Phase II. Coordination of proposals.

The Executive coordinates the proposals submitted in the preceding phase and responds to the local actors concerning them. These responses are sent to the Neighborhood Councils and



constitute the first agreements about the public works and policies that will provide the basis for management in the following fiscal year.

Phase III. Management Earmarks are determined.

This involves the final negotiation between central policy offices and Neighborhood Councils, constituting the total of Administrative Earmarks.

Phase IV. Communication and Management Plan.

The works projects agreed upon in the process give rise to the Management Plan. This involves a tool that contains knowledge of all the actors and is used for follow-up on the execution and community oversight of management.

#### **Continuity and sustainability of the practice**

The incorporation of a budget item each year that is Freely Available, growing in size, and the same for the 19 District's into which Montevideo is divided, has had a very positive impact.

A key aspect of the process has been transparency in the regional distribution of funding. This transparency forms part of a permanent dialogue between municipal managers and the local areas (the managers appear before the citizens in their neighborhoods to answer questions three to four times a year). For this purpose four zones have been demarcated in the municipality of Montevideo: A (less than 20% of the population is below the poverty line), B (between 21% and 30%), C (between 31% and 40%) and D (more than 40% of the residents are below the poverty line). The information on expenditures made by zone is stated in terms of resources received and disbursed.

### **Success story: The Participatory budget of the Albacete City Government**

In Spain, the experience of Participatory Budgeting of the Albacete City Government is an example of sustainability and consolidation since 2002, when the first meeting of the Participation Forum was held. In the course of the ensuing fiscal years, the project has been adapting to changes in the environment and has introduced technical and procedural improvements that have made it possible to maximize the participation of social agents and citizen satisfaction with the proposed system. The Participation Forum is organized at a Plenary Assembly – the highest body for channeling citizen proposals, made up of associations, organizations and individual citizens – and the Forum Council – a body that collects, prioritizes, submits and defends the proposals before the City Government in order for the latter to incorporate them finally into the Municipal Budget. The areas for participation are defined each year and deal with social programs and facilities, notably: The elderly, the handicapped, youth, culture, sports, environment, and so on. The process for adopting proposals is reviewed each year. In the drafting of the 2007 budget, the Forum Council proposed a table of themes and activities in which the subjects to be dealt with are determined when a form is created which is distributed to all the associations. This form includes needs from earlier fiscal years and leaves space for the adoption of new demands that have not been anticipated. At the same time a prioritization of proposals is performed, and the association duly forwards the completed questionnaire to the Council Forum which performs the task of assimilating the input. The final list is sent to the City Government for its technical assessment. All proposals are assessed for their legal, technical and economic viability, as well as the time required for their execution. The document, accompanied by the relevant technical report, is returned to the Forum Council. The Forum Assembly must approve the prioritized proposals that are subsequently negotiated with the City Government. The result is communicated to all participants, who are given periodic updates on the budget follow-up of the adopted proposals.

It may be surmised that the keys to the success of this process of implementation have been the following: The consultative nature of the process, at least in the stage of initiation and consolidation, the involvement of City Government technical managers in the evaluation and exchanges with the participants, and the development of a participatory methodology for the analysis of local realities prior to the drafting of proposals.

- **PE Practice VI: Quantification of the costs of local public services.**

Concern is growing to implement management tools that help to improve the deployment of public funding. In Spain, in recent years there has been a widening of interest in presenting the results of activities showing studies of costs and indicators. The aim of this practice is to justify the rationalization of funds deployed and the performance obtained in public services.

Efficiency analysis can be brought to bear as a suitable tool. It is based on calculating costs and the definition of indicators. While effectiveness validates the relationship between services and results, efficiency is concerned with the relationship between consumption (of inputs) and the services made available to citizens. Since the demand for services has not stopped growing and the allocation of resources to satisfy it is increasingly limited, maintaining the quality of services provided requires using tools that help to rationalize the use of resources, avoiding idle capacity and ensuring redistribution.

Nonetheless, in spite of the interest that has given rise to this practice, it has scarcely been adopted in the local public sphere. One of the main reasons has



to do with the lack of an agreed upon methodology that can be generally applied to the sector as a whole.

In this light, governments must avail themselves of a **consistent method for calculating costs and indicators**, with a view to assessing their results and development, both internally and externally by making comparisons with other institutions in the same area.

The aim of the studies of costs is to identify all the resources consumed in the provision of services, regardless of the budget expenditure linking a particular departmental unit to whatever accounting program may have been assigned to it. Not only will those expenditures controlled by the departmental unit in question that is responsible for the service have to be taken into consideration, but also any expenditure contributing to the provision of the service, even if it comes from a program or cost center associated with another area. In sum, all processes that contribute to the provision of the service must be taken into account.

**Municipalities and Provinces** have undertaken an innovative project concerned with defining a consistent methodology for calculating the costs of municipal services that make it possible to overcome the numerous inconveniences created by traditional techniques for calculating costs. This system makes it possible to compare costs disbursed by different local governments for the provision of their services. The novel character of this project and its viability tested in a number of Spanish city governments transform the methodological focus used in a model practice with a high degree of transferability to the specific circumstances of other European and Latin American municipalities.

### ***The design of a consistent methodology for quantifying costs of municipal services.***

As a point of departure, the methodological focus of the project takes into account the complexity and diversity of the organizational structure of the city governments. The need to simplify this situation leads to the elaboration of the following hypotheses on the organization of municipal service provision:

- The departmental units to which the provision of services is linked receive support in coordination and planning from a specific part of the municipal government.
- On the other hand, the provision of the service occurs thanks to the support of programs, departments or units.

As a consequence, the different programs or departments in the city government's organizational structure are classified in the following categories:

- a. *Programs or cost centers of the techno-structure*, whose mission it is to coordinate, plan and disseminate the municipal corporation's strategies. These programs are usually grouped into macro-areas, which are in turn



broken down into general departments whose cost centers have as their purpose the monitoring of the units responsible for providing the service to citizens.

- b. *Programs or centralized management units* whose purpose is to address the needs of the selected programs responsible for the provision of services. The purpose of these support units is to achieve a greater yield from funding, avoiding duplications of costs. For example, the creation of a central computer services unit, whose main function would be to respond to all requests for information, user support and management of municipal software, fits into this classification. These centers are called “transverse cost units,” whose organizational structure is horizontal since the activities they perform engage the city government’s management units.
- c. *Programs responsible for the final delivery of the service*, which attend to the provision of service to the citizen. The managers of these programs are the main beneficiaries of a system for calculating the costs of the services they manage.

Based on this program classification, the guidelines to be followed for approaching the quantification of service costs should be as follows:

- ***Design of the processes that identify the provision and management of the service whose cost is to be calculated.***

The processes themselves become cost items so that cost is no longer assigned to centers or accounting programs. This vision calls for the designing of an organizational structure for service management with **collaboration from managers**. This support is essential for getting to know in its totality the full range of resource use involved the provision of services.

Designing these processes goes beyond the barriers of organizational structure on which accounting programs are based and, where applicable, the functional spending units that sustain these programs.

- ***Preparing the list of activities that identifies each process.***

The cost system proposed not only makes it possible to arrive at the final cost based on the processes involved, but also to calculate the cost from the description of the activities that make up each process. The definition of the activities involved in each process becomes a management tool that is easily understood by managers: The list of activities presents itself as an accurate snapshot of the activity performed in each one of the processes.

- ***Allocation of resources to processes and calculation of unit cost of service.***

Once the processes are designed and, thereby, the activities of which the management and execution of the service consist, the calculation of costs is



simplified. With the proposed system, endless breakdowns of indirect costs involving the use of particular inputs are avoided, which are now rendered as direct costs of the processes and of the set of activities that identify them.

Determining the final costs of the service involves no more than knowing what are the processes that are associated with the performance of the service whose cost is to be calculated. Thus, it becomes possible to identify the roadmap that identifies the cost of the service through a combination of the processes needed to manage and execute the service in question. This roadmap is given the name, “service cost breakdown.”

The unit cost of the service is determined on the basis of the volume of services provided.

### *Benefits of the proposed cost system.*

The proposed cost system is a hybrid that makes it possible to:

1. *Improve the traditional system of full cost cascading.*

The proposed system does without having to share common costs using criteria that are ultimately rendered unfeasible by the complexity of management and the diversity of services associated with a single accounting program. The proposed focus is based on a more analytical methodology that accurately reflects both the service management structure and the volume of activity that services generate.

Separating expenses from programs to assign them instead to services as a function of resources consumed, regardless of their location in the accounting scheme and allowing for the organizational structure of the departmental units, vastly clarifies management and the attribution of resources to services performed. Furthermore, it allows certain costs not to remain unassigned to the services that consume them.

2. *To perform rational managements of fixed costs, which is of particular importance in the public sector*

The methodology of cost analysis set forth makes it easier to undertake studies on the yield and efficiency of services provided that would not be feasible if traditional cost analysis methods were being applied.

This system provides the necessary assurance for dealing correctly with cost data needed to provide data for the Complete Scorecard and contributes the necessary foundation for appropriate decision making about the cost-effectiveness of services performed.

3. *It helps in planning financing needs for the services performed.*

Identifying the activity and the costs involved in each process connected with the performance of the service makes it possible to develop plans on future needs for replenishment of resources to maintain an appropriate level of quality.



4. *It facilitates the objective calculation of rates and public prices that are only determined with difficulty by the traditional complete costing system.*

Let us recall that the traditional costing system does not include an analysis of all resources consumed in the provision of the service in question, and in the attempt to put together the total costs of the unit makes use of attribution criteria that do not represent the service's management structure.

**Success story: Definition of a consistent methodology for calculating the cost of municipal services. Federación Española de Municipios y Provincias.**

#### **Objective**

The *Federación Española de Municipios y Provincias* [Spanish Federation of Municipalities and Provinces] has conducted a program to offer local institutions a common methodology and specific costing system for its application to the generalized need to calculate the cost of municipal services.

#### **Project Development**

The project began in January 2003. The work is performed with the participation of a certain number of Spanish city governments and a group of university professors who are experts in public accounting and costs from nine different academic institutions.

#### **Results**

At the end of the 2005 fiscal year the first results were presented. They concerned cost studies carried out on a series of municipal services from 11 city governments from all over Spain.

Based on the results and the adjustments made to the predefined method, and using these as a point of departure, participants have attempted to create a specific methodology that is measured in its application.

### ■ PE Practice V: Control of current expenses.

The local government, like other levels of government, has a limited amount of income that it must manage efficiently in order to obtain the highest possible yield. To do this, it is essential to perform comprehensive oversight of expenditures.

Government should constantly work on analytical instruments that make it possible to identify pockets of expenditure whose management could be optimized, introducing techniques of efficiency and effectiveness.

Identifying possible savings in current expenses can be done by applying the following techniques, among others:

- a) Technical analysis groups.
- b) Budgeting workshop
- c) Changes in management of public services
- d) Administrative reorganization.



Each of these methodologies, or a combination of them, make it possible to undertake measures aimed at reducing the current expenses of local government. Regardless of the methodology that is ultimately applied, the guidelines that local governments should follow to reduce current expenditures by efficiency criteria are as follows:

- Rationalize municipal expenditure, reducing costs and eliminating points of waste.
- Establish quantifiable goals for reduction of expenditures.
- Foster internally a culture of efficiency.
- Develop management systems that make it possible to undertaken projects to rationalize expenditures.

**Success story: Identification of pockets of current savings. Proyecto Sant Cugat Eficiente.**

The “Efficient Sant Cugat” project has as its purpose the optimization of the resources of the City Government, within a framework of municipal activity committed to ongoing modernization and improvement of the institution. The project has a three year timetable (2004-2007) and is being implemented with the help of a consulting firm.

**Aims of the practice:**

- The goal that has been set is a reduction of expenditures between 5% and 10% of the starting level, maintaining in each case the level of services provided.
- To involve personnel in the culture of rationalization of spending and efficiency.

**Description of activities undertaken**

The project is based on three foundations:

- Creation of improvement teams, as a channel for the organization’s active participation.
- Definition and implementation of a methodology for the analysis of spending as a basis for the continuity of the process.
- Application of the methodology of budget control as a means of ensuring its sustainability in the organization through measurement and oversight of the proposed actions.

The project is implemented gradually and incrementally, following three phases:

- a. Study, identification and analysis of expenditures.
- b. Strategic development.
- c. Consolidation and maintenance of the program.

**First results**

The main achievements since the start of the project are as follows:

- Implementation of analytical accounting.
- Definition of circles of efficiency, managing to reduce consumption of electricity and phone service.
- Online purchasing.
- Optimization of procurement.
- Introduction of sponsorship and co-payments.
- Optimization of human resources. Overtime is eliminated, staff turnover reduced, etc.
- Review of the decision making system, including the technicians involved.
- Fostering participation and a spirit of efficiency within the organization.
- Making managers responsible for what they manage.
- Development of communication activities directed at both the government and the public.
- Control and internal oversight, defining efficiency indicators and introducing tools for budget discipline.

*V.5.4.B. Best practices for improving the economic / financial and budget information system*

**■ PE Practice V: Implementation of the Balanced Score Card.**

The Balanced Score Card (BSC) is a decision making instrument, based on learning about the fulfillment of goals defined by the organization, through measurement of the management benchmarks that have been set.



The Score Card is based, fundamentally, on the development of a strategic map in which strategic goals and objectives are reflected, and in the selection of indicators that allow for measurement of the achievement of goals.

The key elements of BSC are:

1. *The vision and mission of the organization.*

Vision requires an organization to reflect on its aspirations. The mission is identified with the activities that must be undertaken to achieve the vision.

2. *Strategic objectives*

Strategic objectives are defined for the medium and long term, and are associated with the strategic positioning of the institution. In the process of developing the BSC, such objectives are related with four areas of results or categories: Finance, customers, internal processes and training<sup>25</sup>. These four dimensions are inter-related in such a way that an improvement in the organization's resources has a positive impact on its internal processes, which in turn benefits the customer. If the customer is more satisfied, the economic results of the institution are also better. Therefore, the category of resources goes on the bottom of the strategic map, and above it, in ascending order, these three: Internal processes, customers/beneficiaries/users and financial.

3. *Indicators.*

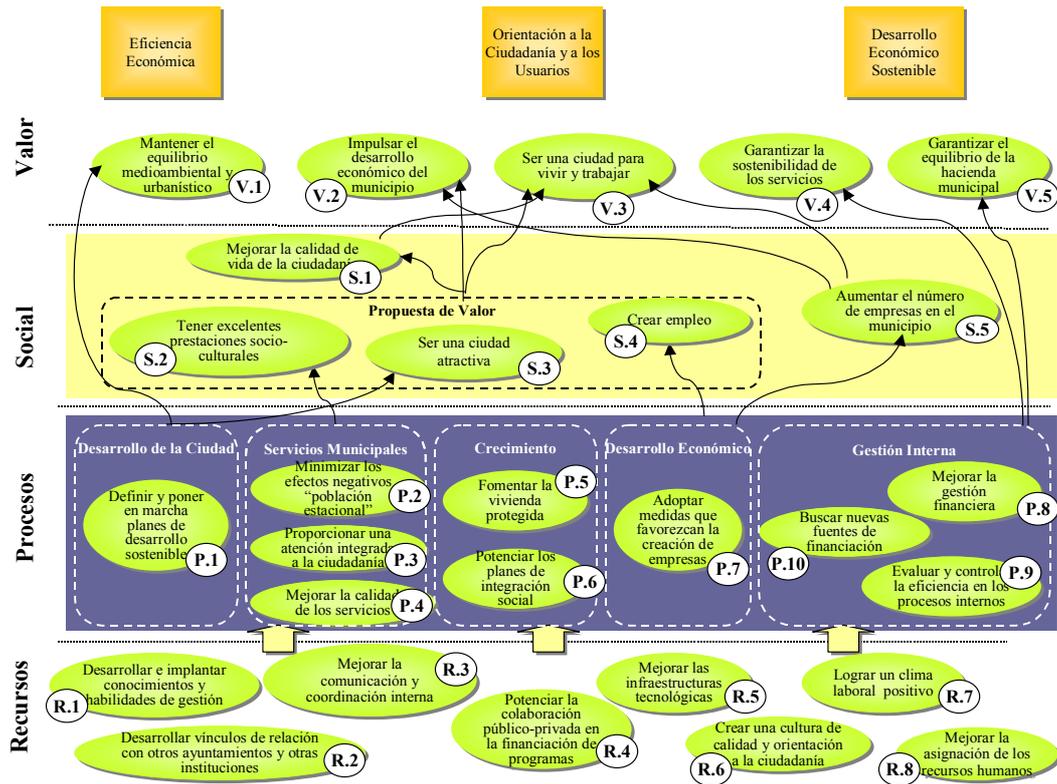
Monitoring of objectives is done through indicators. For each one of them, an objective value is determined that makes it possible to monitor the degree of fulfillment of the various goals that have been set. Indicators must be clear, simple, coherent and appropriate to the objective with which they are associated.

The two first elements listed are shown in the so-called Strategic Map. The map brings together the set of missions and strategic objectives and the cause-and-effect relationships arising between the three categories.

**Figure 7. BSC strategic map adapted to a local government. Project of the Department of Local Administration of the Council of Andalusia.**

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<sup>25</sup> Other terms can be found that are equivalent to these dimensions in the process of developing the BSC: Values, social considerations, processes and resources.



[Economic efficiency]

[Guidance for citizens & users]

[Sustainable Economic Development]

**Value**

- V. 1 Maintain urban and environmental balance
- V. 2 Stimulate economic development of municipality
- V. 3 Be a city to live and work in
- V. 4 Guarantee sustainability of services
- V. 5 Guarantee balance of municipal treasury

**Social**

- S. 1 Improve quality of life for citizens
- S. 2 Have excellent socio-cultural facilities
- S. 3 Be an attractive city
- S. 4 Create jobs
- S. 5 Increase the number of businesses in the municipality

**Processes**

**Development of the City**

- P. 1 Define and set in motion plans for sustainable development

**Municipal Services**

- P. 2 Minimize negative effects of “seasonal population”
- P. 3 Provide comprehensive service to citizens
- P. 4 Improve the quality of services

**Growth**

- P. 5 Support residential protections
- P. 6 Support plans for social integration

**Economic Development**



- P. 7 Adopt measures that favor the creation of businesses

**Internal Management**

- P. 8 Improve financial management  
P. 9 Evaluate and monitor efficiency of internal processes  
P. 10 Seek new sources of financing

**Resources**

- R. 1 Develop and implement management knowledge and skills  
R. 2 Develop links with other municipal governments and institutions  
R. 3 Improve internal communication and coordination  
R. 4 Support public-private collaboration in financing of programs  
R. 5 Improve technological infrastructure  
R. 6 Create a culture of quality and providing guidance to citizens  
R. 7 Establish a positive labor climate  
R. 8 Improve the allocation of human resources

*Benefits of the practice:*

Application of the Balanced Score Card in the local government sector presents a series of advantages and highly interesting possibilities.

1. It favors a strategic alignment in management of the different functional levels and helps to focus the municipal government on the key strategic objectives.
2. It allows the key officials -- politicians and technicians -- to analyze the information the city government has, both internally and externally, determining what must be done to make such information serve the ends in view.
3. One of the chief factors for the success of the implementation is the correct definition of responsibilities in oversight and management of the Balanced Score Card in the organization. The BSC helps to determine who is responsible or what department should assume the task of gathering, processing and distribution of such information.
4. The principles on which the preparation is based are simplicity, common sense and flexibility, alongside more rigorous tools that afford less ability to visualize results and achievements dynamically. The instrument enables city governments to overcome problems arising from inconsistency in the definition of indicators for services, and the traditional difficulty of integrating them in a single system with consistent standards for retrieval.
5. Allows for a single system of relational data, in which the strategic objectives of the city government are achieved based on actions and measures that are planned and executed by different services or departments and which, otherwise, would continue present themselves from a partial and isolated perspective. This tool has sufficient potential to overcome the organizational tendency of municipal governments towards departmentalization and management by "watertight compartments" and allows for the adoption of a



comprehensive overview that balances the objectives of the different services, as well as the short and long-term goals.

6. It makes it possible to clarify the Mission / Vision of the city government and the array of operational objectives. It is very useful for communicating the mission to the whole organization. At times it can be complex for public officials to enact in their daily tasks the institutional mission. Therefore the work of dissemination and communication of strategy is important, and the BSC becomes an effective system for motivation and training.
7. The traditional structuring of indicators in key categories such as growth and learning/resources, customers/citizens/social concerns, internal processes, economic and financial results/value is perfectly applicable to city governments. For this reason, greater importance is assigned to objectives included in the category of social concerns, and less weight is given to economic and financial results that, rather than constituting an end in themselves, should be understood as constraints that must be optimized.
8. It facilitates the modernization of management and a more positive attitude towards change. In identifying the key factors for the success of an organization, BSC can provide models to support process re-engineering and continuous improvement. Because of this close review of the relationships among indicators measuring key success factors makes it possible to recognize opportunities for improvement.
9. It permits city governments to make use of a tool that obliges them to review their strategy periodically. Changes of environment observed through measurements, can bring about a modification of objectives or their redefinition. In this way, BSC can help local governments to adapt better to municipal realities and their dynamics.
10. BSC is a tool that facilitates evaluation and training of human resources, since it improves communication and teamwork, increases motivation and promotes people's sense of commitment, strengthening personal competencies that are essential to the organization.

These advantages and characteristics only highlight the potentials of implementing BSC in local government. Among projects that have been undertaken in the sphere of local government, the project of the Council of Andalusia launched in the 2003 fiscal year deserves special mention, for designing and implementing a Balanced Score Card adapted to Andalusian municipalities of less than 50,000 residents. The objective established by the Council was to make available to local officials a valid and effective instrument for decision making. On the other hand, the municipality of Los Prados, Chile is one of the pioneering figures in the application of a Balanced Score Card.

■ **PE Practice VI: Municipal systems of economic – budgeting information.**



Making information available to different agents in municipal systems – comprehensive economic budgeting information through portals or web pages – ensures greater transparency and access to public data. However, it needs to be borne in mind that difficulties arising from the periodic introduction of the same kind of information by different municipalities with sufficient assurance of on-time execution make it advisable to undertake this sort of initiative with supra-municipal, national or regional governments.

Generally speaking, these information systems are created by municipal officials pooling economic, budgeting and management data concerning services within their jurisdiction, which provide the basis for developing an array of indicators.

#### *Benefits of the practice:*

1. These variables and ratios help to improve financial transparency and provide standards of comparison among municipalities, which makes possible a greater understanding of the local reality through observing it from different perspectives to ensure strengthening of a comprehensive vision and performance.
2. A system with these characteristics has an effect on all actors involved in the local sphere, providing a set of data that is easy to understand, promoting equality of access to public information.
3. It gives central and regional governments a set of data that can be assimilated into evaluation processes, upgrading resource allocation and implementation of policies, plans and programs. The system has major potential as an instrument of cooperation and monitoring SEGUIMIENTO among different levels of government.
4. Makes it possible to give an account of the status of local governments in the areas containing the system and supplements information originating from other sources.
5. Promotes the development of democracy as it enables the citizen to play an active role in local political life through new forms and spaces of participation.

#### *Constraints*

The principal limitation of the system derives from its operability. It is necessary to have a higher level of government assume the role of promoter and coordinator of the initiative. Some of the issues the responsible agency should address are the following:

- To seek to ensure the **consistency** of information. Any individual alteration or interpretation of information that may be supplied will entail a flaw in the comparability and reliability of the final variables and indicators that are supplied to users. This consistency must be applied to the sources of



information used, the moment of reference to each piece of information and the manner of establishing different ratios.

- To see to **fulfillment** of the deadlines for the submission of required data and be careful about the integrity of the information requested.
- This concerns information with a high potential for designing and setting in motion dynamics of improvement in municipal management. However, if the sponsoring governmental agency does not include in the system a support program on the effective use of indicators for organizational improvement and of the management of local services, the system may be confined to making available a **thorough knowledge of local reality without having an impact on effective financial management.**

One of the experiences that provides a model for the systematic organization of comprehensive municipal information is the National System for Municipal Indicators (known by its Spanish acronym, SINIM), a program of the Chilean government that affects all the municipalities in the country.

### **Success story: Sistema Nacional de Indicadores Municipales (SINIM).**

SINIM is a program that compiles, organizes, processes and makes available to the public scattered information from the local and municipal sphere for various areas. The system is conceived as a flexible tool that incorporates periodic updates. Because of this, cycles of revision of indicators, operational procedures and system applications are anticipated in the future.

#### **Background**

In 1999, a pilot project was begun called Program for Institutional Municipal Strengthening (PROFIM) by the Division of Municipalities (SUBDERE), financed through a Loan Agreement between the government of Chile and the World Bank. This comprehensive program presents two components focused on:

Strengthening municipal management.

Strengthening national management (national studies)

As part of the second component, a study is being conducted called the National System of Indicators (SINIM) to support the most important areas of municipal management.

#### **Objectives**

- To make available to all citizens and actors involved with municipal affairs a simple, easy-to-manage package of information that promotes transparency and accessibility of public information.
- To improve information on local realities through a comprehensive overview of municipalities.
- To empower Chileans to develop opinions and exercise the citizen control that is due them, in an informed way as a basic condition for the full exercise of democracy.
- To satisfy the growing demand for local public information, especially by candidates in election years.

#### **Description of the practice**

SINIM takes data directly from the municipalities and also from other government agencies. It compiles this data just once a year, at the Municipal Information Unit, and transforms it into relevant information for officials, municipal managers and the general public. The system covers the following areas of municipal management: Education, Health, Social and Community Affairs, Land Use, Administration and Finance, District and Gender Breakdown. Specifically, the area of Administration and Finance, deal with revenue, expenditures and human resources. Some of the available indicators include: Executed municipal budget, Percentage of permanent own revenues against Total Revenue, Percentage of Common Municipal Fund against Total Revenue, Percentage of revenue by Transfers in Total Revenue, Total accrued municipal expenditures, Percentage of Current Expenditures against Total Expenditures, Percentage of Investment against Total Expenditures, Percentage of Investment with own funds against Total Expenditures, etc.

#### **Results**

This information system of national scope brings together a set of variables and indicators (more than 130) in time, relating to municipal affairs and management and makes them publicly available. At present, SINIM delivers information about different management areas for a period of six years (2000-2005). The information is available on the web at this address: <http://www.sinim.gov.cl>

#### **Continuity**

The main challenges for SINIM are the following:

- To perfect these instruments, making them more and more efficient in meeting their aims.
- To institutionalize their knowledge, dissemination, participation and familiarization so there will be increasingly better, more efficient and more transparent municipalities at the services of the real interests of the citizenry.
- To promote their use and discussion as the only way to achieve their definitive consolidation, not as a tool of centralizing control over municipalities but rather as a way of opening spaces



## Recommendations

Success in making available a complete system of information on budget, finance and municipal management of all the local governments in the country is contingent on the following circumstances:

- The initiative must originate from a supra-municipal authority with the aim of facilitating coordination of the program, set standards and even draft and approve regulatory standards for procedures concerning the information system.
- To provide municipal officials with ways to comply with these system requirements: Clarity of instructions, support staff for the municipal manager in charge of the system, normalization of processes, computerization.

### **Success story: System for Budget Management Oversight. City of Buenos Aires.**

#### **Initial situation**

Budget oversight for the 2000-2001 cycle revealed major dysfunctions: Different results as a result of volume and quality of information presented and reduced credibility of data. As a consequence, oversight results were not used for decision making by the officials for these areas.

#### **Aims of the practice:**

1. Provide information for making decisions
2. Design public policies in a more consistent fashion
3. Establish a base for the comprehensive evaluation of public activities.

#### **Strategic objectives**

- Make key information available for decision making
- Evaluate performance in the overall management of the government
- Have a base for developing management by results in a complete and integrated manner.
- Foresee budget priorities
- Seek greater legitimacy for public activities and make management more transparent

#### **Operational objectives**

- Identify management problems and seek the tools needed to resolve or mitigate them
- Turn it into a necessary product for the planning of the next budget cycle.
- Evaluate implementation and results achieved for each public service.
- Allow for accountability by results.

#### **Results**

As a result the budget oversight system generates a series of reports of varying contents and frequencies.

- **Synthesis reports** delivered to the Head of the Government, Head of the Cabinet and Secretaries. This report contains evaluation of response, physical and financial execution and problems in management. It is issued quarterly and the estimated date of delivery is 30 days after the end of the quarter.
- **Jurisdiction reports** delivered to the Head of the Government, Head of the Cabinet the respective Secretary of Jurisdiction. The content deals with evaluation of response, context and problems of management and critical analysis of public services. It is issued quarterly and delivered 30 days after the end of the quarter.
- **Annual Report for the Investment Account**, which is addressed to the Head of the Government, Head of the Cabinet, Legislators and Citizens. This report contains physical and financial information with qualitative evaluation by managers. It appears annually and is estimated time of delivery is in April of the following year.



#### *V.5.4.C. Best practices in the application of ICT's to economic and budget management*

The application of Information and Communications Technologies (ICT's) in the context of budgeting can bring about major changes in the processes and habits of traditional budget work. Some of the potential advantages of the implementation of ICT's are as follows:

- Reduction of paperwork and freeing up of filing space.
- Reduction of time spent in processing
- More fluid exchange between central government departments and cost centers.
- Expedited circulation of data.
- Internal exchange of budget documents:
  - o Budget requisition forms that are compiled for the drafting of the budget.
  - o Authorizations needed in the various phases of transacting expenditures.
  - o Information documents on budget execution provided to each cost center; Indicators, credit spent, available credit, etc.
  - o Citizen demands arising in the context of participatory budgeting.

At the same time is it necessary to emphasize the important role ICT's can play in improving information transparency, since they ensure a more efficient transmission and a broad range of possibilities for more active interchanges.

### **V.6. EVALUATION OF PUBLIC POLICIES AND PROGRAMS.**

#### **V.6.1. Initial considerations.**

Evaluation is an activity that brings together a desire to optimize the use of public funds with the wish to render an accounting of public activities to citizens.



This combination of efficiency and transparency transform the work of evaluation into a best practice in itself in the context of local financial management.

The impact of evaluation activities on the achievement of greater transparency in financial management of local government has led us to include it as one more area of practice. However, the process of identifying best practices confirms that the degree of implementation of evaluation of public policies and programs is distinctly uneven among the various countries, and that its effective implementation is still overdue at the local level.

The tradition of evaluation at the local level is especially concentrated in those sectors where evaluation is expressly mandated as a requisite for receiving funding for certain programs, whether they are social, educational, or sanitation programs. Because of this, one wonders if the delay in a general implementation of evaluation as a function more of local management is owing to the fact that an overall evaluation system has not been institutionalized in the different countries. In this regard, and aware that decisions on these matters are not in the hands of local governments, we reflect in one of the sections of this chapter on a possible critical factor concerning the lack of regular evaluations in municipalities.

On the basis of this appraisal of the current situation, several different questions arise: What does evaluation consist of? What does it contribute to local financial management? And how should it be undertaken so that it is useful and effective for local government? In connection with this last point, the recommendations of the OECD concerning evaluation have served as a reference, as compiled in the document, *“Best Practice Guidelines for Evaluation”* No. 5 of the PUMA Policy Brief series published by their Public Management Service. These guidelines, originally addressed to the government sphere as a whole, have been adapted in this guide to the specific needs of local government.

Finally, as has been the practice in the preceding chapters, there are included a number of cases of best practices in the evaluation of public services and policies at the local level that serve the audience for this guide as a reference on getting started with new initiatives.

### **V.6.2. Why evaluate?**

Evaluation constitutes a key function in public administration since it makes it possible to review on the basis of new information the efficiency, effectiveness and results of public policies, helping to provide managers with a critical perspective of policies of innovation and improvement.

The concrete advantages contributed by evaluation of local government policies and programs that transform it into a best practice in its own right in local financial management are as follows:

1. ***It increases the citizens' trust in public management:*** A government that reflects on its performance and communicates the results with objective criteria sees its credibility reinforced in the eyes of the citizenry, as well as strengthening the business and economic fabric upon which it operates.
2. It serves as an instrument of **good governance** making it possible to know whether the programs executed match up with real, identified needs of the public.
3. Evaluation, unlike other tools and techniques for improvement that have emerged in the context of the private sector which it complements, has been especially developed **for and by government.**
4. Faced with the growing complexity of the public sector and overlapping activities by different levels of government and their individual units, evaluation provides an **information system** that is complete and relevant, guaranteeing an optimization of the results of public programs and facilitating **organizational learning.**
5. The information system it provides allows managers to get to know and **analyze the impacts** of public policies and programs, as well as the quality of services delivered.
6. Managers can make use of the results obtained from the evaluation to **rationalize** the use of resources and **improve productivity.** Evaluation therefore has relevance to budgeting since it provides criteria for the allocation of resources to different programs or the suppression of some programs that have not achieved their set objectives.
7. It improves the image and **quality of the institution.**
8. It makes possible the **participation, transparency, clarification of objectives and accountability** that are increasingly demanded by the public. More and more, in research processes, techniques for evaluation constitute a set of perspectives and qualitative analyses that are more extensive than evaluations of a strictly scientific focus (for example, participatory, or "4<sup>th</sup> generation" evaluation). Citizen participation focuses citizen interest on evaluations and facilitates the process of accountability.

These are the reasons that explain why evaluation needs to have a space of its own in the public sphere, and a privileged place in institutional agendas, in decision making and in the management cycle of organizations.

### **V.6.3. Critical aspects of the evaluation process: Reason explaining its limited effective implementation.**



In earlier chapters of this guide, there has been an effort to break down the general process of the subject before us into its component parts (for instance, management of taxation, grants, budgets, etc.) to identify those aspects that are especially susceptible to losses of efficiency or that provide incentives for conduct that are not in accord with commonly accepted ethics. Nevertheless, as far as evaluation activities are concerned it is our understanding that in the present situation the chief concern of local governments is not so much about the conducting and subsequently benefiting from evaluations, but rather about actually getting such initiatives off the ground. Once evaluation has been accepted as one more task of local government and is applied to the institution as a whole, it will be time for the government to stop and think about the critical points of its administration, which does not imply abandoning such elements, but quite the contrary: The subtitle of this chapter is intended to provide a series of recommendations for direct application in those local governments that have already undertaken evaluations or that have chosen to initiate this activity in one of the areas they manage.

The following can be proposed as factors responsible for the scanty implementation of evaluations at the local level:

1. ***Excessive concern about the legality and control of public conduct.***

The main concern of governments has been making sure public activities are in accord with the law, which has made oversight the overriding priority of the institution. Supervisory departments, in turn, have basically focused on supervision of public accounts without arriving at value judgments on the validity and timeliness of actions undertaken.

Therefore, this delay may be a logical consequence of the slow progress of local governments along the road towards evaluation. Although the point of departure consists in conceiving of an analysis of public performance from the strict standpoint of legal oversight, the next step should include an analysis of management oversight in which the results obtained are appraised in the light of standards of good management. Getting past this stage would make it possible to lay the groundwork for initiating program evaluation, which also involves quantifying and analyzing the impact of public performance and assessing citizen satisfaction with it.

2. ***Small demand for evaluation and small supply of professionals equipped with knowledge of the specifics.***

3. ***A mistaken view of evaluation within organizations.***

The tendency to perceive that the importance of analysis of public management has to do with oversight has prompted some managers to think that evaluation consists in a process of looking for mistakes and hunting down the guilty parties. This mistaken view on the purposes of evaluation gives rise to a serious resistance on the part of those chiefly involved to setting up evaluation procedures, since they believe that it



they are only concerned with retrospectively finding failures in programs, which thwarts their potential for promoting institutional learning.

#### 4. ***The lack of institutionalization of a comprehensive evaluation system.***

Diversity of approach constitutes a common characteristic not only in the effective implementation of evaluation in the different countries, but also in the definition of the system before programs of evaluation are launched in each one of them. However, experience confirms that those countries that have intervened more directly in the creation of a “national system of evaluation” have achieved more in this area.

Furthermore, evidence is emerging of the positive relationship between institutionalization and implementation of evaluation on the European scale: The fact that evaluation constitutes a requirement for the control of fund for community assistance has made it possible to move evaluation programs forward in some of the member countries characterized by slower development in this regard.

Logically enough in decentralized governments where the conduct of public programs involves some degree of overlap among various levels of government, the arguments in favor of institutionalizing evaluation are plainly strengthened. The appropriate analysis of transverse public policies requires an overall framework in which all government levels can be accommodated, and the necessary elements are available to facilitate consensus on methodological and practical matters.

Other arguments that generally support the need for institutionalizing evaluation are as follows:

- Evaluating activities should not occur as a result of an externally imposed requirement but rather, as explained earlier, should constitute a function that becomes part of the government itself. Nonetheless, the local level is still far from accepting the practice of evaluation as one more of its administrative duties, so that institutions now have before them a key role in **fostering a culture of evaluation** among local governments and in establishing the standards for a common language.
- Each organization designs and develops its own management indicators, which in consequence are not comparable with those of other institutions offering similar services or executing the same public policies. The availability of a **consistent information system** that provides comparability among institutions is an objective that could be attained through institutionalization of evaluation.
- Technical difficulties and the lack of resources that often characterize **smaller local governments** make it necessary for institutions to take responsibility for **providing sufficient support** through guides



and references for evaluation; as well as making available to them the methodologies most suited to their circumstances.

- The existence of a national system of evaluation can make possible the development of **evaluation plans** in consensus with all governmental entities. Such coordination favors transparency, democratic governance and accountability through the clear exercise of responsibilities and the generation of knowledge among all public offices.
- The institutionalization of evaluation provides an opportunity to evaluate the **quality of public spending** at all administrative levels; and give the government a role as an active agent in its environment, concerned with the improvement of competitiveness.

#### **V.6.4. Best practices in the evaluation of public policies.**

Before considering the best practices for guiding the development of evaluations of local public policies and services, it is essential to emphasize two elements that should characterize its actual implementation in the local setting. In the first place, evaluation should not be delegated to a single nucleus of the organization, which would pose an obstacle to organizational learning; instead it should be an asset for of the administration as a whole. Evaluation should constitute a present capacity in all the people and processes in the municipality.

In the second place, the performance of evaluations should not be an activity exclusively tied to the conclusion of a program, but instead such techniques and indicators should be assimilated at the beginning of each process. This entails instituting evaluations *ex ante*, that is, at the outset of public activities and maintaining the dynamic of evaluation throughout the execution of the processes.

Belated and limited implementation of evaluation in local governments obliges those organizations and institutions that have been assigned duties in this area to foster a culture of evaluation, at times provoking changes in the internal vision of this subject. The idea is to eradicate the concept of evaluation as a system for finding failure and blame and replace it with an activity that makes it possible to guide public activities in decision making, and that represents an opportunity to learn from experience and seek to apply its conclusions to other programs and policies.

The criteria for best practices for evaluation suggested by the OECD in its document "*Best Practice Guidelines for Evaluation*," N° 5 in the PUMA Policy Brief series, conveniently adapted to the specific conditions of local government, are as follows:

##### **A. Criteria for getting maximum efficiency from evaluations:**



A.1. *With regard to the concept of activities of evaluation and the setting of specific objectives for each evaluation:*

- Evaluations should be thought of as **analytical assessments** addressing results of policies and programs, and special attention should be given to an analysis of the reliability and utility of the achievements in view.
- The priority objective that local governments should pursue in their evaluations should be to **improve the information system**. Any achievement in this regard has a positive effect on the optimization of decision-making processes, possibilities for reallocation of resources and the quantification and accounting of programs and policies.
- An effective evaluation should not be thought of as an isolated occurrence but rather should form part of a **substantial management system geared to results**. Performing evaluations can supplement or reinforce this system but never replace it.

A.2. *With respect to identify the participants in the evaluation:*

Successful evaluations are based on **collaboration** between key participants. The OECD defines the following as key participants:

- *Commissioners:* Commissioners are organizations that commission evaluations. The commissioner plans the evaluation, monitors its progress, receives the evaluation report and makes decisions about further action. Commissioners may be ministries or central government agencies. In some cases, the commissioner may also be the evaluator.
- *Evaluators:* Evaluators are those organizations or individuals collecting and analyzing data and judging the value of the evaluated subject.
- *Users:* Anyone interested in the information provided by the findings of the evaluation. Possible users of the evaluation include: Policy-makers<sup>26</sup>, the budget office, auditors, program managers, staff and users of services.
- *Stakeholders:* Stakeholders are those individuals or organizations that have a specific interest in evaluating a particular public policy and in knowing the findings of the evaluation. For example, housing contractors may have a special interest in the evaluation of the public policy for housing.

A.3. *As far as assessing the benefits and costs accompanying evaluation:*

Experience shows that evaluations are often costly and excessively time-consuming compared to their real use and final impact on public policies. There is also a risk of evaluations being used to slow the process of decision-making and justify inaction. The OECD recommends that those in charge of the evaluation make sure that the benefits derived from the actual evaluation

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<sup>26</sup> People with the authority to make decisions.



outweigh the associated costs and possible constraints. It should be noted that careful management of evaluations and choosing the appropriate evaluators and technicians can be determining factors in the costs and benefits that result.

## ***B. Criteria for the organization and management of evaluations:***

### *B.1. On the need to foster an evaluation culture:*

Apart from the prior activities that should be undertaken in countries with limited implementation of evaluation where it is necessary to promote a general awareness of the benefits of evaluation, it is in any case recommended to observe the following guidelines:

- To have the **commitment** of politicians, managers and central agencies to work with the results of the evaluations.
- Demand for evaluation needs to be generated, specified and articulated by internal and external stakeholders. Evaluations without “ownership” by stakeholders are unlikely to have an effect.
- Internal resistance to evaluation activities can be overcome through consultations conducted with those involved **prior** to the drafting of the evaluation and through fostering mutual trust among the participants.
- The local government itself must play an **active role to foster evaluation culture**, encouraging innovation and stimulating the organization to adapt to a changing environment. Indeed, if local governments wish to stay relevant in local economic life, they must develop their capacity for organizational learning through ongoing analysis of the results obtained from public policies that have been executed.

Among the factors that the OECD suggests as key in fostering evaluation culture are the following: Training and professional exchanges, the competency of evaluators, well-informed commissioners and the involvement of users in the process.

### *B.2. On strategic management of the activities forming part of the evaluation:*

- Organization of evaluation should correspond to needs and priorities in different policy areas.
  - It is advisable to systematize and institutionalize evaluations in key policy areas where the cost of collecting data is high and information limited.
  - In some cases a more flexible approach is advisable to optimize results and prevent evaluations from becoming mere paperwork exercises.



- Special attention should be given to evaluation of activities that cut across several organizations.
- Organizations should develop evaluation skills and techniques to ensure that they have an ample range of evaluation methods to bring to bear. It should be borne in mind that each evaluation needs to be designed in accordance with a unique set of values concerning the objectives, approach, credibility and intended use that may govern the choice of one or another evaluation technique.
- The availability of specific funds from higher levels of government may provide an important incentive for undertaking evaluations; however, they may also serve to encourage the use of evaluation when a different kind of approach may be more appropriate.

### *B.3. On the credibility of evaluation results:*

Lack of credibility undermines the use of evaluation findings. Political commitment to make use of evaluation findings is notable as a key factor that affects the reliability of the evaluation.. Other factors the OECD thinks have an effect on credibility are: The competence and credibility of the evaluator, mutual trust between the evaluator and those evaluated, consultation and involvement of stakeholders, processes for communication and transparency about findings.

The OECD believes that the following measures have a positive effect on the credibility of evaluations:

- Having professional and ethical standards.
- high degree of methodological quality in preparing the evaluation. Data meet relevant criteria and are sufficient, findings are clear and reliable .
- Maintain a permanent, open and frank dialogue among participants.
- Communicate evaluation findings and be transparent about constraints and possible adjustments made during its preparation.

### ***Criteria for building effective evaluations:***

#### *C.1. Ensure links to findings with decision-making processes:*

- Effective evaluations obtain results that are relevant to political, budgetary, management and other strategic decision-making
- Evaluation findings are key to improving the quality of public performance and budgetary processes. In this latter respect, data provided by evaluations make it possible to optimize decisions on assigning priorities and planning possible savings.



- The final use of the evaluation should be clearly defined in advance. The objectives set will determine the location, methodology and use of the evaluation.
- Planning improves the management and quality of evaluation. Nevertheless, it should be borne in mind that at times the decision-making cycle is unpredictable and decisions are often taken before evaluations have been finalized.

### *C.2. Choose the right evaluator:*

Evaluations may be carried out by internal evaluators (self evaluation), by trans-departmental oversight units and by external evaluators.

- **Self evaluation** is appropriate when the objectives are organizational learning and improved program or policy implementation. However, the time and skills of staff may be insufficient, which can impair the range of the evaluation and the credibility of its findings.
- **Evaluation by trans-departmental units** is appropriate when the priority objective is improving the assignment of budget priorities and when it is important that the evaluator has close links with decision-making processes.
- **External evaluation** is appropriate when the objective is to provide new perspectives on public policies or improve transparency, and when there is a need for specialized skills that the organization lacks. The main risk of external evaluation is that it may fall prey to an excessively theoretical approach.

### *C.3. Involve stakeholders and communicate findings openly.*

Participatory evaluation methods may be used to promote consensus among those involved in the evaluation (staff, stakeholders, users, etc.), and ownership of change processes emerging from the findings. Dialogue among the different participants improves understanding and responsiveness to needs and priorities. Participation of third parties in the preparation of the evaluation should be managed in accordance with the available budget and time constraints concerning the availability of results.

Presenting evaluation findings transparently increases credibility and creates pressure for the government to act upon findings, which transforms communication into a powerful mechanism for oversight of public administration.

#### **Success story: Service contracts and the Social Balance Sheet in the Rome Commune.**

The Commune of Rome has made progress in its practice of evaluation through specific practices: Service Contracts and Social Balance Sheets.

##### **Evaluation in Service Contracts.**

*Initial situation and objectives*

Evaluation took hold in the municipality as a result of out-sourcing of services and the initial need to control payment of invoices. This process has ended with supervision of the quality of services provided by the firms contracted. In this way, the service contract has been developed as a key tool in the evaluation culture of the Commune of Rome since it formally encompasses the relationship between the city government and the party that undertakes to provide the service. One of the issues in particular that is assessed in these contractual relations is the assimilation of environmental concerns.

*Continuity of the practice:*

The importance that this issue has acquired in the Commune has made it possible to distinguish the performance of two departments in relation to the contract: One takes charge of formal aspects of the relationship, and the other takes over with contract evaluation and quality mgt.

*Results*

Setting in motion this evaluation dynamic has an effect on the actual assessments, and in cases of serious irregularities causing the termination of the contract.

**Social Balance Sheet of the Comune di Roma**

*Objectives*

In April 2006, the Commune of Rome presented its first social balance sheet for the municipality. All social actors have played a role in mapping out this balance sheet and it has been the fruit of the consensus of all of them. This work brings to bear an ample battery of indicators that seek to estimate the socio-economic impact of municipal programs; in particular of policies geared to social strengthening and programs aimed at improving social cohesion. The key indicators included in the system are, in some cases, exclusively economic, and in others, an important social dimension is added (especially in cases where a new service is inaugurated or a specific plan for improvement implemented).

The Social Balance Sheet “feeds” on the findings obtained and becomes a key input in social development.

*Description of its inauguration.*

The process of building the Social Balance Sheet starts with the definition of the intended objective, the allocation of resources and the estimation of the output to be gained. This first step constitutes the General Balance Sheet. On the basis of this intermediate result, other elements are added, such as user satisfaction and what externalities result. Furthermore, the analysis includes the effect of the activities on the organization itself. The system as a whole allows for a real evaluation in which both internal and external parties are included as participants. The estimate is for April of the following year.

## **V.7. THE USE OF INFORMATION AND COMMUNICATIONS TECHNOLOGIES (ICT'S) IN LOCAL FINANCIAL MANAGEMENT.**

The identification of best practices in various settings of local financial management is characterized by a common feature: The application of ICT's in local management constitutes a decisive factor in making progress on the road to efficiency and transparency. The potential of ICT's in the generation of information systems, the creation of new communication channels with third parties, and the possibilities that they open to citizens for active participation in public administration are present in most of the reference cases that have been discussed.

However, although some governments seem to have set out on a fast road in using ICT's, other are still anchored in forms of work and procedures that have nothing to do with their modernizing capacity. Because of this, and with the consensus of the project participants, one of the round tables convened in Buenos Aires undertook to provide an overview of the current state of ICT's in the local government landscape, to debate the reasons explaining uneven development among different local venues, to explore possible solutions and



recommendations that make it possible to achieve more consistent and coordinated progress and to build upon the advantages and opportunities that they represent in local financial management.

### **Overview of the implementation of ICT's in local government. Obstacles and solutions.**

The analysis of the current overview of the implementation of ICT's undertaken by municipal experts from the URB-AL initiative revealed a double reality: That of large scale city government and that of medium and small-sized municipalities of the various countries participating. Using the structure from the 2004 IRIA Report<sup>27</sup>, the following elements were touched upon: Level of public expenditure on ICT's and their distribution, policy adopted by different municipalities with respect to non-proprietary software, expenditures on specialized personnel and training, level of development of work on network and degree of achievement in electronic administration.

As for the quantification of the level **municipal expenditures on ICT's**, the group of experts confirmed the difficulty of reaching an estimate as a result of the high degree of budgetary decentralization that tends to characterize its management in many municipalities; though the largest expenditures, in relative terms, do occur in the big cities. As for the distribution of this expenditure, it has gone mainly to hardware, allowing the participating cities to have an optimum level of equipment. However, the major shortfall continues to be the availability of qualified personnel. Salaries in the labor market for software experts do not allow Latin American governments to offer sufficiently attractive pay to avoid a high degree of turnover in these municipal positions. The option governments with smaller budgets are choosing is to contract recent college graduates and train them over a period of several months. Others, such as the Superintendancy of Montevideo, have chosen to outsource the service.

As for **training of local public employees in ICT's**, in general, local governments do not have specific facilities and mostly link training activities to the need to train new users in financial management and accounting applications.

On the other hand, most work by public employees of the municipalities participating in the project take place **on the network**, through which users can access management applications for budgeting, accounting, registers, social assistance, official bulletins and systems for monitoring different management units. It remains to emphasize Commune of Rome's initiative, which has developed a system of indicators that are valid for all municipal departments, and which allows any employee on the network to retrieve data from his management unit, and guarantees automated access to indicators for other services.

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<sup>27</sup> The Informe IRIA [IRIA Report] is published annually by the Superior Council of Public Administrations in Spain. The analysis concerns the implementation of Information and Communications Technologies in government.



Nonetheless, the main challenge facing local governments is to press ahead with **e-administration**, as citizens demand a greater number of procedures from city government than of any other level of government throughout its time of operation. In this regard, major differences were discerned between the ample offering of services currently provided by municipalities of a certain size and smaller city governments, that limit their services through the web page to local employment and the promotion of tourism. Among the activities highlighted in electronic administration, it is worth mentioning the progress made by the City of Buenos Aires in integrating economic, financial and tax information with Geographic Information Systems (GIS), with considerable improvements in the information provided to citizens. Furthermore, a major effort has been made to develop an online system for suppliers, so that contractors can consult the status of their invoices through the network. At the Madrid City Government, the implementation of electronic procurement merits mention as a pioneering initiative in Spanish local government with major benefits accruing in the efficiency of relations with third parties and management transparency. In Uruguay, advances made in electronic administration are enmeshed in a nationwide strategy that makes it possible to reinforce possible results from local initiatives.

As for identifying the reasons justifying the fact of two different rhythms in the uptake of ICT's, a clear consensus has been reached concerning the main sources of resistance: The internal organizational culture, the rigidity of pay scales and the constraints imposed by adding specialized personnel. Overcoming these obstacles must come from improving staff motivation through better training and instruction, as well as the introduction of elements and systems of personnel management that allow for traditionally rigid structures flexible.

These kinds of resistance are exacerbated when they coincide with external problems that are hard to solve, such as the low population density of large territories and added geographical difficulties as is the case with Chile. These obstacles can only be overcome through administrative coordination and the support of central and regional governments, which in these contexts demand a greater effort to make possible the effective use of ICT's in small municipalities.

### **Advantages and opportunities of implementing ICT's in local financial management.**

The opportunities and benefits that the application of ICT's brings to public management are very well known and have been the subject of a substantial literature. At present, and especially in big cities, the challenge of "not getting left behind" has taken the place of the initial difficulty of using the new technologies. In fact, at times, the pace imposed by the new capabilities afforded by ICT's is way beyond a government's ability to absorb the changes; although often, the urgency manages to prevail.



In this regard, and given the mixed situation that we have found everywhere in the realm of local government as far as the level of ICT use is concerned, it is especially important to identify what is the opportunity cost for that large majority of municipalities that still have not taken off.

The main advantages that the effective application of ICT's bring to local financial management are translated into savings. These savings can be assessed from both an internal and external perspective.

- **Savings for agents relating to local government.**

In general, all agents relating in any way to local government under all possible profiles are benefited by the use of Information and Communications Technologies (ICT's):

1. ***The Citizen.***

The main opportunity deriving from the implementation of ICT's in local financial management appears in the savings afforded to citizens through the use of online services. In this regard, government, as a whole, should assume the function of guarding the security of the system and maintaining the necessary controls that provide citizens with adequate safeguards for its use.

2. ***Bidders and suppliers.***

In the same way, giving bidders the possibility of placing their bids via the Internet, as well as contracting electronically with the government entails a substantial savings for economic agents and suppliers who deal with the government. The possibility of offering an electronic contracting service entails improvements in the management process, meets program needs and in many cases prevents bid offers from going unattended.

3. ***The Taxpayer.***

The government facilitates payment during the voluntary period. As explained in the section on management of taxation and public revenue collection, the objective is to "facilitate tax payments for citizens." Different payment methods, clarity regarding taxes owed, Internet communication, access to more efficient systems for complaints, etc. are only a few of the best practices that were identified in the chapter on this subject. Furthermore, it could help to call attention to those practices geared towards helping citizens avoid falling into "arrears" in their tax obligations. In this regard, one should mention experiments such as the "*Agreement between notaries and the Tax Administration of Madrid,*" which makes registration in Registry of Property subject to payment of value added tax.

- **Savings for local government.**



The application of new information systems entails savings in the internal management of processes by reducing errors and duplications. Therefore, greater precision is achieved which in most cases brings with savings in monetary terms. This has been the result of practices such as “*Centralized payment for supplies in the City of Buenos Aires.*” This experiment requires having the use of a data system with all the municipal property for which all supply invoices are processed. >>The system combines information on invoices and municipal property which made it possible to detect expenses that did not correspond to real benefits.

Valparaíso has corroborated the benefits to local internal management of document management applications. Their application has made it possible to achieve a savings of up to 10% of their budget. Other best practices, such as automation of the information system for social programs, thanks to which duplications of benefits were detected, bringing about a 5% savings of the budget. Furthermore the incorporation of a Geographic Information System (GIS) in the management of urban solid waste has brought about a substantial reduction of payment delinquency through geographic “tracking” of receipts.

Finally, we must not forget the savings in terms of time afforded by the application of ICT’s, since they allow for a freeing up of resources and provide greater space for developing strategic management. These savings are estimated on the basis of monitoring and improvement of indicators such as average employee output, reduction of personnel costs, etc.

- **Freeing up of space.**

There are a number of projects in the context of ICT’s that provide immediate benefit through reducing the need for space in city governments. Prominent among them are digitization of images and electronic case files.

### **Catalogue of services of digital financial administration.**

Finally, we have found it appropriate to prepare a best catalogue of services offered by economic and financial departments of municipalities that a model municipality should be able to offer online:

#### **Online Local Financial Administration<sup>28</sup>**

- Automated register of suppliers that ensures their validity in other government venues, through appropriate agreements with other localities.
- Registry of grant recipients.

<sup>28</sup> Those services that might be considered more closely related to general administration than financial management in the strictest sense are marked with an asterisk (\*).

- Census management.
- Printing of documents and management of processing.
- Online consultation in bidding processes.
- Review of any type of administrative file that is active with the government, apart from those that are strictly economic.
- Review of taxpayer's tax and census situations
- Review and payment of tax obligations, with guaranteed printing of documents and receipts.
- Facilitate invoice payment for suppliers.
- Publication of the economic and financial situation of the local government with due timeliness and in a language that is accessible to the public.
- Electronic bidding.
- Automation and general use of electronic signatures for all citizens and economic agents dealing with the government.
- Information and management for the startup of a company, expediting processing with the local administration and other government offices.

## **VI. CONCLUSIONS.**

An ethical and efficient financial management by local governments requires that officials and technicians observe the following recommendations of standards of conduct:

1. Whenever possible, coordination between governments and attempts to pool resources should be promoted, especially among smaller local governments in all economic and financial settings. Unified or coordinated action brings with it efficiency improvements both in obtaining public revenues and in the financial management of other public services.
2. The budget should be looked upon as a tool for planning, evaluation and communication. Furthermore, local governments should make use of multi-year scenarios in which the annual budget would need adjustments to fit the fiscal year in question.
3. Accountability should take on a major role in local life. Governments should see to it that the social debate does not become exclusively focused on the process of budget preparation, but also that budget execution should acquire greater weight in the load of citizen information demand.
4. Departments that are competent in budget matters should assume a role of management, coordination, providing financial information and helping out with annual planning and program development for other departments.
5. Local governments should not only consider citizen participation in budget preparation, but should also foster a municipal awareness among residents.
6. Evaluation should be understood as an activity present in all persons and processes of the local government, independently of a central unit acting as supervisor and support in evaluations of polices and programs. The benefits that evaluation brings to local financial management have a particular effect on the improvement of participation, transparency and the ability to rationalize and optimize the allocation of resources.

Local governments should promote an active exchange with their taxpayers, by supplying clear information on tax procedures in understandable language through various channels of communication, facilitating dialogue with taxpayers through such institutions as may be necessary, especially for the purpose of ensuring their rights, and providing them with a wide range of means of payment to settle their tax debt. It should be the objective of local governments to seek all means within their reach to “make it easier” for taxpayers to fulfill their tax obligations.

7. The management of local government financial resources should be understood from a comprehensive perspective, without getting stuck on the isolated individual management of each one of the operations in the



portfolio as solitary elements of administration. Furthermore, it will be necessary to define a series of indicators that make permanently possible a dynamic analysis of the debt portfolio.

8. Local governments should seek the definition of flexible procedures in all areas relating to financial management and especially in those processes affecting the relationship between government and citizen, and those of coordination among different government venues. Thus, managers should take care to suppress unnecessary procedures, eliminate the demand for identifying documentation that would have been required in earlier procedures, etc.
9. The application of ICT's to local financial management is an obligatory step not only to achieve greater efficiency in management, but as a means that makes possible transparency, access to financial and economic information, and active interchange with citizens. In this regard, local governments should work to provide on a permanent basis clear, timely indicators concerning budget, taxes, finance and the management of services that are easily understandable to all citizens. However, if it is not possible to reach all communities, local governments should work to provide equality of access to such information, with the support of supra-municipal government bodies.

**Annex 1. Proposed indicators that comprise the minimum economic and financial information a model local government should provide to its citizens.**

**Tax indicators**

Indicator	Category	Description and calculation	Remarks
<b>Financial pressure on GDP:</b>	Contribution by taxpayers to local revenues in relation to the municipality's overall income.	Tax Revenues / Municipal GDP (%)	Allows for comparison with other municipalities. However, it is only applicable if municipal GDP data are available.
<b>Fiscal pressure per resident:</b>	Average payment per resident in taxes and fees to local treasury.	Tax Revenues / Number of residents (by standard given date or census) (in monetary units)	Should be broken down for each tax and by rates.
<b>Effectiveness of revenue collection in the voluntary period<sup>29</sup>:</b>	Effectiveness of local tax authority in voluntary tax filing. Taxpayer willingness to pay. Citizen awareness of the cost of public services.	Liquidated Fees / Net Recognized Fees (%)	
<b>Own revenue versus total revenue<sup>30</sup>:</b>	Degree of municipality's tax autonomy	Taxes and Fees of local origin / Total Revenue (%)	
<b>Share of National revenue versus total revenue<sup>31</sup>:</b>	Financial dependence on national government resources / municipality's share of national revenues	Share of National revenue versus total revenue:	It is advisable that this indicator be associated with those of tax pressure and tax revenues vs. total revenues. Visualizing them together may explain the need for greater tax pressure in cases of lower shares of national revenue.
<b>Index of coverage of public services</b>	Capacity of a public service to generate related income via fees or public prices	Income from fees or public charges for service provided / cost of service (%)	The difficulty lies mainly in estimating service cost.
<b>Financial benefit vs. total tax revenue:</b>	Reduction of tax revenue due to application of discounts and exemptions to particular communities (tax expenditure).	Discounts, rebates, exemptions / Tax Revenue (%)	

<sup>29</sup> Other possible renderings proposed: Amount collected vs. amount due, or Percentage paid in voluntary period of total due.

<sup>30</sup> Other possible rendering: Degree of financial autonomy.

<sup>31</sup> Other possible rendering: Degree of dependency



## Financial indicators

Indicator	Category	Description and calculation	Remarks
<b>Municipal debt per resident (long and short-term)</b>	Average municipal debt per resident, both long and short-term.	<p>Long-term Outstanding debt / Number of residents</p> <p>Short term Outstanding debt / Number of residents</p> <p>(in monetary units)</p>	<p>Debt data to be gotten from balance sheet and population census or tax register</p> <p>Comparability of these data with municipalities of similar population size. The evolution of the indicators will be studied.</p>
<b>Total debt vs. Current revenue</b>	Ability to retire debt with current revenue	Outstanding total debt / Current or ordinary revenue. (%)	<p>In some countries (i.e., Spain), there are threshold amounts above which the municipality must seek authorization to borrow more: 110% of outstanding debt vs. Current revenue</p> <p>Comparison through averages and analysis of evolution over time are proposed.</p>
<b>National Government Transfers per resident</b>	Financing received from National Government per resident.	Current transfers and of capital received from National Gov't / Number of residents (in monetary units)	
<b>Share of National revenue versus total revenue:</b>	Financing not dependent on municipality subject to certain criteria.	Share of national revenue / total revenue (%)	In Chile, these transfers are decided upon every two years and are subject to fulfillment of certain management goals.
<b>General financial dependence</b>	Portion of expenditures financed by outside funds	(Transfers received + Composition of debt / Total expenditures (%))	
<b>Financial costs accruing on current revenue</b>	This entails the payment of interest on ordinary annual income.	Interest payments / Current revenue (%)	



## Economic-budgetary Indicators

Indicator	Category	Description and calculation	Remarks
<b>Execution revenues of</b>	Effective level of resource capture vs. expected	Net Recognized Fees / Total Net Budget Revenue (%)	Derived from initial budget and closing of accounts.
<b>Execution expenditures of</b>	How much of maximum authorized limit of spending has actually been spent.	Net Recognized Obligations / Total Net Budget Revenue (%)	Derived from initial budget and closing of accounts.
<b>Amount paid<sup>32</sup></b>	How much has been paid of obligations assumed.	Total liquid payments / Total Net Recognized Obligations (%)	Data obtained from the treasury and financial programs.
<b>Revenue Collection Effectiveness</b>	How much has been collected of what should be received.	Total Net Recognized Fees Due / Total Net Recognized Fees (%)	Derived from tax levy and tax and non-tax collections
<b>Financial charge per resident</b>	What is involved in retiring outstanding debt each year (amortization and interest) per resident.	Spending on interest and amortization / Number of residents (in monetary units)	Obtained from borrowing program, budget, census and closing of accounts.
<b>Level of personnel spending</b>	Weight of payroll on total budget. Budget rigidity. Relation number of public employees	Net Recognized Obligations for personnel / Total Recognized Obligations (%)	Obtained from budget liquidation and closing of accounts.
<b>Investor effort</b>	Relative expenditure on direct and indirect investment	Net Recognized Obligations in real investments and capital transfers / Total Recognized Obligations (%)	Obtained from budget liquidation and closing of accounts.
<b>Gross Savings</b>	Ability to generate own funding to undertake investments	Current revenues minus current expenditures (in monetary units)	Obtained from budget liquidation and closing of accounts.
<b>Capacity or need for financing</b>	Capacity to cover public expenditure without having to borrow	Non-financial revenues minus non-financial expenditures <sup>33</sup> (in monetary units)	Obtained from budget liquidation and closing of accounts.

<sup>32</sup> Other renderings: Age of obligations. Rotating payments

<sup>33</sup> In member states of the European Union, the budget calculation of the capacity or need to finance is subject to adjustments imposed by the European System of Accounting (SEC 95) -- a standard applied for the purpose of rendering consistent the results of various member countries to control the public deficit and the fulfillment of procedures set forth in the Pact for Stability and Growth.



## GLOSSARY

**Bond:** Financial instrument of explicit or implicit yield with an initial maturity period greater than 18 months, issued for the purpose of securing financing directly for the end investor.

**Bond rating:** Indicator of solvency or ability to pay of an issuer. The credit rating is an independent opinion, prepared by a specialized agency on a borrower's credit risk, expressed in a rating that is easily identified by the market.

**Bond rating agency:** Institutions that based on analysis of a borrower, issue findings on the borrower's solvency or of a particular financial instrument, assess the probability of default by the issuer, either of its financial obligations in general or of the payment of a particular debt or fixed income obligation.

**Budget estimates:** Advance estimate that the government undertakes of the expenditures and revenues it considers necessary to carry out the purposes it has established.

**Budget extension:** This occurs when a fiscal year begins and the corresponding budget has not yet become operational. In this case it is considered that the budget of the preceding fiscal year is automatically extended.

**Budget Liquidation / Execution:** This is the financial statement that shows, duly broken down, how credits have been assessed for expenditures that were approved in the budget and the revenues earned in comparison with budget provisions committed.

**Budgetary program:** This is the lowest unit of breakdown in the functional budget classification of expenses, encompassing a series of activities to be carried out for the purpose of achieving a set of given objectives.

**Budget result:** Difference between budget expenditures transacted with revenues of the same kind received, determining to what extent the latter have been sufficient to finance local government activities.

**Capital expenses:** Expenditures to finance gross capital formation, whether directly through local government investment (real investments) or through capital transfers.

**Capital expenses:** Transfer of capital which is granted subject to being allocated to investment expenditures.

**Competitive bidding:** The practice whereby the award of a contract is bestowed on a bidder who, all things considered, presents the most



advantageous bid, taking into account not only the bid or price tendered, but also certain objective criteria.

**Credit adjustment:** Procedure that involves an alteration of budget allocations of revenue or expenditures that have been initially approved.

**Current expenses:** Expenditures transacted in the current fiscal year. This includes spending on personnel, current goods and services, current financial costs and transfers.

**Current fiscal year:** Accounting designation referring to transactions of revenues and expenditures applied in the current fiscal year.

**Current revenues:** Revenue category that includes direct taxes (on income, capital, economic activities), indirect taxes charged to taxpayers, fees and other income, current transfers and capital revenues.

**Current transfer:** Transfer of capital which is granted subject only to being allocated to finance current expenses of the recipient.

**Debt half-life:** Projected sum of flows for an operation or portfolio by the number of years since the beginning or the date of calculation until its actual payout between the face value of the operation or the total of the portfolio. Debt management procedures that calculate the average period for debt amortization.

$$Vm = \frac{\sum_{i=1}^n F_i * a_i}{No \text{ min } a_i}$$

**Debt portfolio:** Combination of financing operations, independent of the instrument and source of financing, formalized by an institution.

**Default:** Failure to keep up with payments, or failure to do so within the stipulated period of time.

**Definitive forecast:** Result of adding the initial revenue forecast of the budget the revisions made during the fiscal year for the purpose of maintaining the initial balance in the budget between revenues and expenditures.

**Derivatives:** Instruments for products that derive from other financial products intended to cover possible risks that occur in any financial operation, stabilizing and therefore substantiating the real financial cost of the operation.

**Grant:** Transfer of capital drawn on public funds, without payment, contingent upon the satisfaction of a particular purpose or the existence of prior requirements of the recipient. In this guide it has been decided to define in the context of public grants, the category of **assistance**, which are granted for an eminently social purpose to support individuals and families with income below a minimum threshold that guarantees covering basic household necessities.

**Gross Savings:** The difference between current operating revenues and expenses in a given period.

**Hedge:** Formalization of an instrument that makes it possible to minimize risks affecting the debt portfolio, whether due to interest rates, the market, or exchange rates.

**Implicit interest rates:** Future interest rates that make current interest rates compatible and coherent with the interest rate curve. These are market expectations regarding interest rates expected by the market in the future, plus a risk premium.

**Initial forecast:** Amount of revenues entered in budgets corresponding to those revenues that the government hopes to generate during the fiscal year to cover its costs.

**Local government institutions:** Public institutions fully endowed with legal capacity to fulfill their functions. Among institutions comprising the local public sector are: the municipality, the Province, the Islands, other sub-municipal



institutions, and various supra-municipal institutions such as counties, metropolitan areas and municipal unions.

**Market discount:** Opportunity cost, in a given period, of capital expended on a project. Financing cost to pay for receiving in advance a future inflow that is pending.

**Market risk:** Risk of losses by maintaining positions in markets as a result of adverse movement of financial variables – risk factors (interest rates, exchange rates, stock prices, commodity prices) – that determine the market value of such positions.

**Multi-year expenses:** Although generally speaking credits committed in a budget are to take effect during the fiscal year for which they are approved, there are certain types of expenditure whose execution cannot be completed in a single fiscal year, and it is necessary to be sure that in ensuing fiscal years there will be sufficient endowment of funds for the execution of the project or service in question.

**Municipal Union:** Association of municipalities united for the joint performance of projects and services within their competency.

**Municipality:** Basic local unit of territorial organization within a country. For the management of its interests and within the domain of its competencies, the municipality, specifically the City Government, as governing and administrative body of the local unit, may engage in all sort of activities and provide as many public services as may serve to satisfy the needs and aspirations of its residents.

**Offering:** A method of issue whereby awards are determined by price bids and the volume of bidders, in the case of competitive or only by volume, and in non-competitive instances, when the award price is known. That method of awarding contracts based solely on the lowest price offered by bidders.

**Participatory budget:** Citizens take part in budget preparation, declaring their priorities for using the available resources.

**Recognized fees:** Revenues liquidated and debited to budgets of the current year regardless of whether or not they are collected.

**Recognized obligation:** Stage in the procedure of executing an expenditure and of budget accounting consisting of the approval of the right of the creditor to collect and the duty of the government to pay.

**Shortfall:** Excess of non-financial expenditures against non-financial revenues for the fiscal year.

**Spread or differential:** Measure the credit risk, the risk of default that, according to the lender, the borrower has at the moment of formalizing the operation, with respect to the asset without any risk. The credit spread



represents the risk of loaning money to the borrower, so that the greater the risk is, the greater the spread.