Local public debt audit in France

Cour des comptes

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Overview

- **Local public debt: outstanding debt still limited but significant change since 2004**

	2004	2005	2006	2007	2008	2009	2010	2010/2004
€ billions	111.5	117.9	125.6	135.5	146.3	155.2	160.6	44%
% of total public debt	10.3	10.3	10.9	11.2	11.1	10.4	10.1	-0.2 pt
% of GDP	6.7	6.9	7	7.2	7.6	8.2	8.3	+1.6 pt

Overview (continued)

- **The local authorities are free to borrow….**

  - Free to choose the loan (maturity, type, hedging instruments, cash credits)

  - Free to choose the lender

Overview (continued)

- ….but under certain conditions
  - Legal (authority lies with the deliberative assembly, which can delegate to the executive branch)
  - Budgetary and financial:
    - The loan must be factored into the budget as investment revenues
    - The authority must be able to pay the loan back with its own resources

Overview (continued)

- **Local authorities are prohibited from investing their cash assets:**
  - Required to deposit funds in the Public Treasury
  - Target of a “zero” cash balance through a combination of loans and cash credits

Overview (continued)

- The regional chambers of accounts have worked together on the issue of local debt management, culminating in the publication of a public report in July 2011
- This presentation is based on that work and is divided into three sections:
  - Review
  - Observations
  - Recommendations

Review

- **1. Overall approach: the authority's debt and financial position**
  - Debt level: comparisons, change
  - Repayment burden: debt payback ratio
  - Forward-looking financial analysis

Review (continued)

- **2. Allocation of powers and responsibilities with respect to debt management**
  - The deliberative assembly's delegation of power to the executive branch: verify the terms of the resolution(s) of the deliberative assembly delegating the power to contract loans to the executive authority. Is this limited to certain categories of loans or capped at a predetermined loan amount?
  - Examine how this delegation of power is implemented: have its limits been respected? How did the executive authority report to its deliberative assembly on the procedures for implementing its delegation of power?

Review (continued)

- **2. Allocation of powers and responsibilities with respect to debt management:**
  - <u>The support function with respect to debt and cash management</u>
    - <u>The resources employed by the authority itself</u>: examine the organization of the finance branch, its resources, each employee's responsibilities with respect to debt and cash management. Endeavor to assess the officials' expertise. Verify that the organization selected is structured so as to take into account the different aspects of debt management (management of the outstanding cash balance)
    - <u>Use of external resources</u>: does the authority use the expertise of one or more independent outside advisors?

Review (continued)

- **3. Borrowing strategy**
  - Verify how the strategic debt management policies are defined: are they the subject of debates and of specific reports in conjunction with the budget debate or other debates organized specifically during sessions of the deliberative assembly?
  - Verify that the cash optimization targets have been taken into account: what tools has the authority put in place to manage its cash? Do these tools allow for an evaluation of financing needs on a day-to-day basis or, if not, with what frequency? Verify the daily cash position records

Review (continued)

- **3. Borrowing strategy**
  - Verify implementation of the debt strategy with the authority's administrative departments: did the authority explain its debt management objectives via a directive or internal reference document? (breakdown of outstanding debt between fixed and variable rates, breakdown of outstanding debt based on amortization terms, analysis of needs in terms of smoothing the future annual loan repayment burden, etc.). How does it keep abreast of changes in the offers available on the loan market?
  - Competition among lenders: Does the authority define the specifications before consulting with the lending institutions?

Review (continued)

- **4. Analysis of outstanding debt**
  - Analysis of the debt by type of loan
  - Debt extinguishment profile: what is the maturity, how has it changed?
  - Debt management “performance”: interest/outstanding debt? (identification of structured loans)
  - Review of loan agreements (renegotiations/new loans)

Review (continued)

- **5. “Rendering account” of the outstanding debt and prudential policies**
  - The information provided in the notes to the financial statements and to the budgets
  - Risk provisioning

Review (continued)

- **6. Loan guarantees and sureties**

Measure the quality of the management and monitoring of the guaranteed debt:

- What type of administrative organization has the authority put in place to monitor its guaranteed debt?
- Are there indicators for this?
- Does the authority in fact collect accurate and updated data (in particular, annual balance sheet and operating statements) on the financial position of the organizations whose debt is guaranteed?

Key observations made

- **Mask a deteriorating financial position**
  - Mask a deficit (posting of revenues to be realized whereas contracts have not been entered into),
  - Make the financial position look better (increase net cash flow by postponing payments).

- **Lack of strategic thinking**
  - no discussion, no formalization, no future planning,
  - financial institutions and the structure of the outstanding debt by type of interest rate not sufficiently diversified, maturities not properly smoothed,
  - Insufficient role for the deliberative assemblies, poorly informed.

Key observations made (continued)

- **Costly renegotiations:**
  - repayment period extended to reduce the annual payments but additional costs (indemnities and fees, higher rates)

- **No separation of the roles of lender and advisor**

  The primary lender often plays an advisory role, insufficient use of independent advisors

- **Absence of competition in most cases and specifications not defined**

Key observations made (continued)

- **Risk-taking on the rise with structured loans**
  - Represent approximately 30% of outstanding debt with rates as high as 14% or even 20%,
  - forging ahead regardless,
  - insufficient internal expertise
- **Insufficient oversight of guaranteed debt**

Key recommendations

- **Provide better information on the debt risks:**
  - Encourage the use of solvency ratios
  - Make it mandatory to record provisions for debt-related risks
  - Establish a nationwide system to track statistics on the structure of the local debt

Key recommendations (continued)

- **Encourage diversification of the loan offer**
  - Make competition among financial institutions systematic
  - Seek an even distribution among bank creditors
  - Examine the feasibility of creating a financing agency for the local and regional authorities

Key recommendations (continued)

- **Help the local authorities that find themselves in a difficult position**
  - Establish units where small communities can pool their debt management
- **Improve best practices in borrowing**
  - Encourage a “zero” cash management policy
  - Reject risky loans based on non-eurozone currency spreads or that have multipliers