Chapter 7

MUNICIPAL GOVERNMENT BUDGETING, INDEBTEDNESS, AUDIT REQUIREMENTS, AND FISCAL AGENTS

Revised January 2, 2009

MUNICIPAL GOVERNMENT BUDGETING

The Louisiana Local Government Budget Act [R.S. 39:1301-1315] applies to all political subdivisions, including municipalities, of the state with a general fund or a special revenue fund.

The act requires the chief executive officer, or the mayor, to prepare a comprehensive budget which presents a complete financial plan for the ensuing fiscal year for the general fund and each special revenue fund. The proposed budget must be completed and submitted to the municipal governing authority and made available for public inspection no later than 15 days prior to the beginning of each fiscal year.

The budget document must include:

- A budget message signed by the budget preparer which includes a summary description of the proposed financial plan, policies, and objectives, assumptions, budgetary basis, and a discussion of the most important features.

- A statement for the general fund, each special revenue fund, and any other budgeted fund, showing the estimated fund balances at the beginning of the year; estimates of all receipts and revenues to be received, itemized by source; recommended expenditures itemized by agency, department, function, and character; and, the estimated fund balance at the end of the fiscal year.

A budget proposed for consideration by the governing authority must be accompanied by a proposed budget adoption instrument, which in the case of a municipality, shall be an appropriation ordinance, adoption resolution, or other legal instrument necessary to adopt and implement the budget document. The total of proposed expenditures must not exceed the total of estimated funds available for the ensuing fiscal year.

A municipality with total proposed expenditures of $500,000.00 or more from the general fund and any special revenue funds must afford the public an opportunity to participate in the budgetary process prior to adoption of the budget. Upon completion of the proposed budget, the municipality must publish a notice stating that the proposed budget is available for public inspection. The notice also must state that a public hearing on the proposed budget will be held at the date, time, and place specified in the notice. Such notice must be published at least 10 days prior to the date of the first public hearing. Publication shall be made in the official journal of the political subdivision. No proposed budget may be considered for adoption until at least one public hearing has been conducted on the proposal.

The proposed budget of a municipality shall be available for public inspection at the office of the mayor or municipal governing authority.

All action necessary to adopt the budget must be taken in an open meeting and completed prior to the end of the fiscal year in progress. The adopted budget must be balanced with approved expenditures not exceeding the total of estimated funds available. Upon adoption, the chief executive officer, or the mayor, shall retain and file certified copies of the budget, adoption instrument, and any amendments thereto at the municipality's domicile.

The adopted budget forms the framework from which the mayor and members of the municipal governing authority shall monitor revenues and control expenditures. When the governing authority receives written notification from the mayor, or there has been a change in operations upon which the original adopted budget was developed, the municipal governing authority shall adopt a budget amendment in an open meeting to reflect such change.

The mayor must advise the governing authority in writing when:

- Total revenue and other sources in addition to projected revenues and other sources for the remainder of the year are failing to meet the total budgeted revenues and other sources by five percent or more.

- Total actual expenditures and other uses in addition to projected expenditures and other uses for the remainder of the year are exceeding the total budgeted expenditures and other uses by five percent or more.

- The actual beginning fund balance fails to meet estimated beginning fund balance by five percent or more and the fund balance is being used to fund current-year expenditures.

The written notification required by law and the resulting budget amendment shall only be required for a special revenue fund with anticipated expenditures equaling or exceeding $500,000.00.

The adopted budget, and any amendments thereto, shall constitute the authority of the mayor to incur liabilities and authorize expenditures from the budgeted funds during the fiscal year.

At the end of any fiscal year, if the appropriations necessary for the support of the municipality for the ensuing fiscal year have not been made, 50 percent of the amount appropriated in the appropriation ordinance for the last completed fiscal year shall be deemed reappropriated for the objects and purposes specified therein.

Nothing prohibits the expenditure of funds in cases of emergency -- for example, an unforeseen event which brings with it destruction or injury of life or property or the imminent threat of such destruction or injury.

Any public official or officer who violates, either knowingly or intentionally, the requirements of the act that the total of proposed expenditures shall not exceed the total of estimated funds available for the ensuing fiscal year [R.S. 39:1304(E)] -- through adoption of an original budget or amendment to an adopted budget -- shall be in violation of R.S. 14:134 (malfeasance in office) and subject to the penalties contained therein. In addition, any person may sue in the parish in which the municipality is domiciled for mandamus, injunctive, or declaratory relief to require compliance with this act.

Application to Lawrason Act Municipalities. R.S. 33:406(B)(2) requires Lawrason Act municipalities to publish the title of all proposed ordinances, including a budget ordinance, once in the municipality's official journal. This publication should include the notice of availability and summary publication requirements set out herein.

INCURRING OF INDEBTEDNESS

Local governments in Louisiana are empowered to borrow money and encumber resources and revenues to finance capital improvements. Additionally, "budgetary loans" are authorized to allow local government flexibility in cash management. Major sources of revenue include ad valorem taxes, revenues of enterprise funds, sales tax revenues, and in some cases, the general revenues of the entity. The decision to finance projects, rather than use pay-as-you-go ("PAYG") sources of funding, impacts the future financial status of the entity. Proper debt management, therefore, is an important tool in the administration of local government.

The State of Louisiana provides a unique resource to local government through the State Bond Commission, which provides technical assistance to local governments in addition to its responsibilities for review and approval of local bond issues.

The goal of this section is to furnish local government officials with sufficient information to provide a basic understanding of the following:

- The decision to borrow
- Financing options
- Overview of the State Bond Commission

The Decision to Borrow

Before any decision to borrow is made, an entity should develop a long range plan and prioritize major capital improvements. However, it is recognized that some entities may have situations which require immediate attention. Therefore, borrowing is contemplated in four types of situations:

Long-Term Borrowing (loans extending past fiscal year end): Long-term borrowing is justified for the acquisition, construction, replacement, or major repair of public buildings and other facilities used to provide local government services. These facilities are characterized by a long useful life and any financing should correspond with the useful life of the asset being financed. Such capital improvements should be non-recurring, one-time expenditures. Expenditures for capital items which are almost as recurrent as regular operating expenditures, such as office and operating equipment, should not be considered for debt financing if another alternative is available.

Short-Term Borrowing (loans repaid by the end of the current fiscal year): Louisiana statutes allow local governments to borrow short-term to finance cash flow deficits, and for interim financing of major capital assets. Cash flow borrowings, or budgetary loans, are allowed to meet ongoing obligations which when delayed would be detrimental to the community.

Refinancing: Refinancing of current debt obligations is an important tool in debt management. Refinancing is justified to: (a) reduce the interest rate on current outstanding debt, thereby improving cash flow or reducing the tax rate to the taxpayer; (b) restructure existing debt to approximate the useful life of the original asset; or, (c) eliminate restrictive covenants in existing bond documents.

Emergencies: Borrowing is justified when natural disasters or other emergencies dictate that debt be incurred to protect the health and safety of the citizens.

Financing Options

Local governments have two options to finance capital improvements: pay-as-you-go ("PAYG") funding and bond financing. Neither approach is inherently superior to the other. Bond financing can provide inflationary savings by allowing the project to be completed more quickly while affording limited investment opportunity through the investment of idle funds. However, the total cost (including debt service) of paying for the project with borrowed money may exceed the total cost of paying for the project with PAYG funding. The most prudent course of action would be a combination of both approaches. *For example:* A municipality might utilize bond-financing for the purchase, acquisition, or construction of a public building and PAYG funding for the equipment and furnishings. The financing decision should not only contemplate the effect of the program on future budgets but also how much and what type of debt the entity is <u>able and willing</u> to bear.

The following briefly describes the various types of debt which can be issued by a local government. The debt limitations emphasized in these descriptions provides guidance in the determination of "how much debt is too much?"

General Obligation Bonds

Definition: A General Obligation Bond ("G.O. Bond") is a debt instrument secured by a pledge of the issuer's full faith and credit and/or taxing power.

Security: Local government G.O. bonds in Louisiana are primarily secured by unlimited ad valorem taxes. Ad valorem comes from the Latin "to the value added" and represents a tax based on the value (or assessed value) of property. An unlimited ad valorem tax is imposed, without limit as to rate or amount, on all taxable property within the boundaries of the municipality in an amount sufficient to pay debt service (principal and interest) on the bonds. Louisiana statutes provide that if the municipality fails to levy a tax sufficient for debt service, the state may step in and impose the tax [R.S. 39:569(C)].

Uses: G.O. bonds are primarily used to finance the acquisition, construction, or improvement of public property. Public property may be defined as a municipal building or facility, title to which shall be in the public.

Debt Limitation: Louisiana statutes limit the issuance of G.O. bonds for municipalities and parishes to 10 percent of their assessed valuation per purpose. This limitation is excepted if the aggregate for all purposes determined at the time of the issuance of the bonds does not exceed 35 percent of the assessed valuation of the issuer [R.S. 39:562(B)]. *For example:* A city with an assessed valuation of $50,000,000.00 can issue up to $5,000,000.00 of G.O. bonds for each purpose such as public buildings, streets, and so on. However, if the city's total G.O. debt does not exceed $17,500,000.00, or 35 percent of its assessed valuation (including the proposed issuance), the 10-percent limitation can be exceeded for any one purpose. School boards can issue up to 35 percent of their assessed valuation in G.O. bonds. For special districts and other entities, reference is made to the statutes.

Approval: G.O. bonds must be approved by a majority of the qualified voters. The proposition presented to voters must include the total amount of the debt proposed, the term of the debt, the maximum allowable interest rate, and the purpose for which the debt is to be incurred. Bond Commission approval is also required to hold the election and incur the debt.

Limited Tax Bonds

Definition: A Limited Tax Bond is secured by a special ad valorem (property) tax which is fixed in amount, unlike G.O. bonds, which are secured by unlimited ad valorem taxes.

Security: Limited tax bonds are secured by limited ad valorem (property) taxes.

Uses: Limited tax bonds may be used to finance the acquisition or improvement of public property, limited to the type of property authorized by the tax which secures them.

Debt Limitation: Although there is no statutory debt limitation on limited tax debt, the lenders (or "bondholders") may provide in the financing document ("bond resolution") that only a certain percentage of the tax may be funded into debt. If the tax is being levied to maintain, for example, police services and a municipality is looking to build a new police station, consideration must be given to what portion of the tax is to be used for other police-related costs.

Approval: Limited tax must be approved by a majority of qualified voters. Election is required to levy the tax, but not to issue bonds. State Bond Commission approval is also required to hold the election and to incur debt.

Revenue Bonds

Description: Revenue Bonds are bonds or debt obligations payable from and secured by a pledge of the income and revenues derived from fees, rates, rentals, tolls, charges, grants, or other receipts from any revenue-producing properties or facilities belonging to a public entity. The facilities are known as public enterprises (i.e. water, sewer, gas, or electric systems, hospitals, toll roads, airports, and so on).
Security: Revenue bonds are payable from the "net revenues" of the public enterprise after payment of all ordinary expenses of operation and maintenance of the enterprise. The bond resolution will contain a covenant that rates and charges be maintained at a level which will keep the system operational, pay debt service, and maintain some margin of safety ("coverage"). Coverage is computed as follows:

$$\frac{\text{NET REVENUES}}{\text{DEBT SERVICE}} = \text{COVERAGE}$$

Debt Limitation: The amount of revenue bonds which can be issued are not limited by statute. The bond resolution will set forth the amount of coverage which will determine the amount of debt a system can reasonably support. For example, the industry standard for utility revenue bonds is 1.25 x coverage. This means that a utility system must produce revenues equal to 1.25 x debt service. If a facility generates $1,000,000.00 in annual net revenues then it could reasonably support about $800,000.00 in annual debt service. Coverage tests also apply on future debt issuances. Such tests are called parity tests. When issuing new debt with outstanding old debt, a parity test must be completed and complied with.

Uses: The proceeds of revenue bonds may be used to finance improvements to the particular revenue-producing public enterprise.

Approval: A public hearing must be held to allow response to the proposed revenue bond issue. If a petition is filed, signed by at least five percent of the voters voting at the last election, an election is required. Preliminary State Bond Commission approval must be received prior to the public hearing, and final approval upon the issuance of the debt.

Sales Tax Bonds

Definition: Sales Tax Bonds are secured by the net revenues received from the imposition of a sales and use tax within the issuer's jurisdiction. To issue sales tax bonds, an issuer must have the power to impose a sales tax and to fund the sales tax into bonds. In Louisiana, this requires a majority vote of the electorate.

Security: Sales tax bonds are limited tax bonds secured by the net revenues of the sales tax, after paying the costs of collecting and administering the tax.

Debt Limitation: Louisiana law requires that not more than 75 percent of the avails or proceeds of the tax may be funded into bonds issued for public improvements [R.S. 33:2724]. The proposition or bond resolution authorizing the bonds may impose further restrictions on the amount of sales tax revenues available for debt service.
Note: Economic projections are a vital part of the analysis when contemplating sales tax bonds. In a poor economy, sales tax collections decline. Since the bonds have first claim on the sales tax revenues, this means that other vital governmental services may not be funded.

Approval: State Bond Commission approval is required to hold the election, and approval is required when bonds are issued.

Refunding Bonds

Description: Refunding is a procedure whereby an issuer refinances an outstanding bond issue by issuing new bonds.

Security: Refunding bonds are generally payable from the same source as the bonds being refunded, i.e., general obligations, enterprise revenues, sales tax revenues. In some cases, the security of the *refunding bond* may differ from the bonds being refunded.

Uses: Refunding bonds are usually issued either to (a) reduce the interest rates on current outstanding debt, thereby improving cash flow or reducing the tax rate to the taxpayers; (b) restructure existing debt to approximate the useful life of the original asset; or, (c) eliminate restrictive covenants in existing bond documents.

Debt Limitations: The Internal Revenue Code imposes very strict limitations on the use of refunding bonds. The statutes authorizing the existing debt may dictate further restrictions. For example, Article VI, Section 33(A) of the 1974 *Louisiana Constitution* states that general obligation bonds must be refunded at the same or a lower effective interest rate. The suitability of refunding should be determined by asking the following questions:

- What is the goal of the refunding? (To lower the tax rate or increase cash flow?)

- Does the refinancing extend the maturity of the debt substantially in excess of the life of the original asset? (Will the refinancing extend the debt to 40 years when the building will only last 20 years?)

- What is the present value savings? (A rule-of-thumb measure of five percent present value savings is the industry standard, as well as the State Bond Commission standard.)

Other Types of Debt Instruments

Other types of debt instruments include the following:

Revenue Anticipation Notes, or RANS for short, are issued for one year or less to finance anticipated cash flow shortages. *Example:* Ad valorem taxes are collected during the months of November, December, and January. An issuer may experience large cash balances during the first or second quarter of the year and shortages during the third quarter. RANs would be issued to cover the third-quarter shortfall and be repaid from tax collections in November and December. RANs are usually paid from "first money" or a pledge of anticipated revenues. RANs may only be used to finance cash-flow shortfalls due to cyclical collection of revenues.

Certificates of Indebtedness are debt instruments maturing typically within 10 years payable from the excess revenues of the general fund or the anticipation of the collection of special taxes. Certificates of indebtedness may be used to finance acquisition of or improvements to publicly-owned property and equipment.

Assessment Certificates, maturing over no more than 10 years, are payable from front-foot assessments levied against property which abuts the facilities being improved. The debt is secured by front-foot assessments levied against the property benefitted by the improvements, and further by a lien on such property. The lien precedes even prior-recorded mortgages.

Note: R.S. 39:1410.60 provides that no municipality or other political subdivision shall have authority to borrow money, to incur debt, or to issue bonds or other evidences of debt, or to levy taxes, or to pledge uncollected taxes or revenues for the payment thereof, without the consent and approval of the Louisiana State Bond Commission. These provisions do not apply to purchases made in the ordinary course of administration on terms of credit not to exceed 90 days. In addition, the term "debt" does *not* include a conventional lease of a movable if the lease contains a non-appropriation clause and does not contain an anti-substitution or penalty clause.

AUDIT REQUIREMENTS

R.S. 24:513 establishes audit standards for municipalities based on the amount of revenues and other sources that a municipality receives during a fiscal year. These requirements do not change any obligation that the municipality may have to a federal agency or state grantor.

Revenues and Other Sources	Audit or Other Reporting Frequency
$50,000 or less	Any local auditee that receives fifty thousand dollars or less in revenues and other sources in any one fiscal year shall not be required to have an audit, but must file a certification with the legislative auditor indicating that it received fifty thousand dollars or less in funds for the fiscal year. Monies received from urban or rural development grants shall not be used in fiscal year computation of revenue amounts requiring an audit. The auditee shall annually file with the legislative auditor sworn financial statements as required by R.S. 24:514. However, the legislative auditor, at his discretion, may require said local auditee to have an audit of its books and accounts.
Between $50,000 and $200,000	Notwithstanding the provisions of R.S. 24:514, any local auditee that receives more than fifty thousand dollars in revenues and other sources in any one fiscal year, but less than two hundred thousand dollars, shall cause to be conducted an annual compilation of its financial statements, with or without footnotes, in accordance with the Louisiana Governmental Audit Guide. However, the legislative auditor, at his discretion, may require said local auditee to have an audit of its books and accounts.

Between $200,000 and $500,000	Any local auditee that receives two hundred thousand dollars or more in revenues and other sources in any one fiscal year, but less than five hundred thousand dollars, shall cause to be conducted an annual review of its financial statements to be accompanied by an attestation report in accordance with the Louisiana Governmental Audit Guide. However, the legislative auditor, at his discretion, may require said local auditee to have an audit of its books and accounts.
$500,000 or more	Any local auditee that receives five hundred thousand dollars or more in revenues and other sources in any one fiscal year shall be audited annually.

** the above is in accordance with Act 548 of 2004 Regular Session

With regard to governmental audits, elected municipal officials should keep in mind the following:

- The above-referenced audit requirements are minimum requirements. Other factors, such as receipt of federal funds, revenue-producing properties, or bond covenants may impose more stringent audit frequencies.

- Financial statements of municipalities must be audited or reviewed by licensed certified public accountants, but may be audited by the Legislative Auditor in certain cases, in particular, where the local auditee, after requesting proposals for audit services, receives less than three proposals from CPAs, or where the local auditee receives three or more proposals but rejects all proposals for cause, including excessive costs.

Under the Lawrason Act [R.S. 33:463], the mayor and board of aldermen are required to produce an annual financial statement in accordance with generally accepted accounting principles, a copy of which must be transmitted to the Legislative Auditor within six months of the close of the fiscal year.

SELECTION OF THE FISCAL AGENT

The selection of the fiscal agent is an important matter for the municipality, with legal and functional ramifications. Pursuant to R.S. 39:1213, the fiscal agency in which municipal funds are deposited shall be a bank organized under the laws of the state or of any other state of the United States, as may be selected by the depositing authority.

Fiscal Agency Agreements. With regard to invitation to bids for fiscal-agency agreements, a municipality shall, within 30 days prior to the expiration of any contract that may be entered into under the fiscal agency provisions, give written notice to each of the banks located in the parish in which the municipality is domiciled, setting forth the intention of the municipality to select a fiscal agent. This notice shall specify the time period for which the fiscal agency contract shall be made and the conditions and terms of the proposed fiscal agency contract.

A copy of the notice shall be published in the official journal of the depositing authority at least three times, the first notice to be published at least 15 days preceding the date for the selection of the fiscal agency [R.S. 39:1214].

Fiscal agency agreements also may be entered into on a negotiated basis as long as all applicable state statutes are complied with by both the municipality and the fiscal agent bank. However, bidding should produce the best services at the lowest cost. Cost is an important consideration, since financial institutions offer slight variations in interest, reserve requirements, and service fees.

It is possible for one bank to service the municipality's primary savings and checking accounts and for other banking institutions to offer services for specific loans or investment instruments. It is prudent practice to determine a bank's or fiscal agent's special services and their costs, such as coupon redemption, armored-car pickup, overnight/weekend investment, security lockboxes, bill collection lockbox, computerized accounting of payroll, utilities, accounts payables, account receivables, and so on.