

COUNCIL OF EUROPE

COMMITTEE OF MINISTERS

**Recommendation Rec(2004)1
of the Committee of Ministers to member states
on financial and budgetary management at local and regional levels**

*(Adopted by the Committee of Ministers on 8 January 2004
at the 867th meeting of the Ministers' Deputies)*

The Committee of Ministers, under the terms of Article 15.b of the Statute of the Council of Europe,

Considering that the aim of the Council of Europe is to achieve a greater unity between its members for the purpose of safeguarding and realising the ideals and principles that are their common heritage and facilitating their economic and social progress;

Considering that this aim may be pursued *inter alia* through the adoption of common action in economic, social, legal and administrative matters;

Having regard to the provisions of the European Charter of Local Self-Government, which it adopted in the form of an international treaty on 15 October 1985 and which to date has been ratified by a large majority of Council of Europe member states;

Having regard to the following reports of the Steering Committee on Local and Regional Democracy (CDLR):

- Effects on the financial autonomy of local and regional authorities resulting from the limits set at European level on national public debt (2000);
- Methods for estimating local authorities' spending needs and methods for estimating revenue (2001);
- Risks arising from local authorities' financial obligations (2002);
- Recovery of local and regional authorities in financial difficulty (2002);
- Budgetary procedures and budget management at local authority level (2002);

Taking into account CLRAE Opinion 20 (2003) on the Committee of Ministers' preliminary draft recommendation to member states on financial and budgetary management at local and regional level;

Aware that local and, where it exists, regional self-government implies a degree of autonomy in financial and budgetary management, without which local and regional authorities cannot be accountable for, and control and manage the share of public affairs falling within their remit;

Believing it important that public spending is managed openly and in accordance with the law and that financial and budgetary management procedures play a vital role in this respect;

Considering that financial and budgetary management procedures must be tailored to the needs of local and regional communities for greater effectiveness,

Recommends that the governments of member states:

1. take inspiration for their policy on financial and budgetary management at local and regional levels from the following principles of:

- a. securing consistency with the macro-economic targets of the national economic policy;
- b. establishing and ensuring financial stability of local and regional authorities;
- c. looking for cost-effectiveness of services provided to the community;
- d. ensuring openness and accountability of decisions;

2. ensure that these principles are respected through the appropriate means, including the use of domestic law by changing, where necessary, the regulatory framework of financial and budgetary management at local and regional levels, and by drawing on the guidelines appended to the present recommendation;

3. involve local and regional authorities or their representatives in debate and in any reforms that might prove necessary in the area of financial and budgetary management at local and regional levels, and in the area of financial relations between levels of government, particularly as a follow-up to the present recommendation;

4. translate the present recommendation into their official language(s) and circulate it to their local and regional authorities and associations thereof, inviting them to take note of the guidelines intended for them set out in Part II of the appendix.

Appendix to Recommendation Rec(2004)1

Part I

Guidelines for central authorities

These guidelines are addressed to central authorities insofar as they are responsible for defining the legal framework and supervising the activity of local or regional authorities.

In certain federal states, these competences belong to the federated entities. In such cases, these guidelines are addressed to them. Central authorities are invited to bring these guidelines to their attention.

General principles

1. The local or regional authority should be entitled, within the framework of national economic policy, to foreseeable resources commensurate with its competences and responsibilities that would allow it to implement these competences effectively and of which it may dispose freely.

2. The overall system of local and regional finance should aim at striking a suitable balance between financial transfers, including grants and shares of nationally determined taxes on the one hand, and locally determined taxes and charges on the other. Such balance should provide discretion to adjust revenue and expenditure levels to local priorities, and also ensure that local services nevertheless reach minimum standards, whatever the local or regional fiscal capacities may be.

3. Higher-level authorities whose decisions impose additional costs on local and regional authorities should ensure that these costs are covered by new financial resources such as additional fiscal resources, evolving financial transfers or other financial means.

4. Legislation should establish rules for drawing up, approving and implementing local and regional budgets and for the supervision of their implementation, as well as for their healthy, balanced management in the long term.

5. It should not be possible to delegate the adoption of the budget and the approval of the accounts to a committee or a body other than the elected deliberative body of the local or regional authority.

6. Within the limits of the legislation, the local or regional authority should be able to independently adopt its budget and to adapt the operational rules applicable to its budget and to apply them to its specific situation.

7. The local or regional authority should be able to allocate credit balances carried over from a budget year to non-recurrent expenditure (for example, self-financing from investments, the reduction of public borrowing, setting up provisions or reserves, etc.) and carry over debit

balances in order to rectify the situation by allocating funds from subsequent budgets to write them off.

Limitations on the financial autonomy of local and regional authorities

8. The state or legally established supervisory authority may take measures to restrict the financial autonomy of a local or regional authority or to limit or reduce the amount of funding transferred to it. Such measures should be taken within the framework defined by statute and should not be excessive or threaten the principle of local autonomy.

9. Such restrictive measures may be general (applied to all authorities) or specific (applied to a limited number of authorities, having regard to their particular situation). Their aim should be to:

- ensure a healthy macro-economic policy at state level, on the one hand, and
- ensure sound and safe management, while observing the rules laid down by statute and administrative law, and overcome financial difficulties or deal with exceptional situations encountered within those local and regional authorities subject to the restrictions, on the other hand.

10. The limitations which may be imposed by the state on the financial autonomy of local and regional authorities should be established by law. Limitations should be based on objective, transparent and verifiable criteria, applied fairly and in such a way as to avoid accounting devices that obscure the truth.

11. The local or regional authority should be consulted, following appropriate procedures, prior to any measure to restrict its financial and budgetary autonomy, and it should be notified of the application and consequences of any such measure. Institutional mechanisms of regular dialogue, consultation and co-operation between the different levels of government could be created.

12. Regular checks should be made by the central authority to gauge whether the limitations are necessary and effective.

13. Specific measures restricting the financial and budgetary freedom of certain local or regional authorities should be short-term and lifted once they have achieved their aim.

14. The limitations imposed on each authority should be clear, objective and quantifiable.

15. The limitations should be proportionate to the desired aim and be free of any punitive nature.

16. Measures having a substantial impact on the financial autonomy of a local or regional authority, such as the general and rigid capping of spending and taxation rates, should be avoided if other, softer, measures such as incentives and flexible limitations (which vary in time and take account of the situation and of the average spending and taxation rates for a certain type of community) could be used.

Methods of financial estimation

17. Evaluations of the evolution, at the national level, of local and regional authority spending needs and provisional receipts, of financial transfers and of criteria for sharing these transfers should be prepared and published. These are to be considered as provisional evaluations; they should be subject to adjustment at regular intervals. They should be based on calculation formulae that are transparent, stable, fair and objective.

18. The purpose of these evaluations should be to provide information on changes in the macro-economic situation and the foreseeable amount of transfer funding that could be granted by the central authority to local and regional authorities, and they should allow, where applicable, for transfers to be shared fairly between authorities.

19. Where appropriate, the state should promote the setting up of standards for essential local and regional services and should develop outline procedures for financial estimations relating to spending needs at local and regional levels.

Assessment and management of financial risk

20. The assessment of financial risk should comprise prior monitoring and warning mechanisms (such as tables presenting the evolution of revenue and expenditure, of indebtedness and interest rates, of the main tax bases, etc.) as well as intervention and supervisory procedures. An approach of overall regulation should be preferred to that of control of individual activities.

21. Speculative investment by local and regional authorities should be prohibited. If the local or regional authority wishes to invest on the equity market, such investment should be managed professionally.

22. Any financing techniques which have the object or the effect of concealing the level of debt of the local or regional authority should be prohibited. All financing techniques should be subject to conditions that ensure or restore the transparency of the financial situation or limit the risks involved.

23. Legislation should exclude or limit the possibility of using buildings and assets indispensable to the fulfillment of the local or regional authority's mandatory or related tasks as collateral for guaranteeing borrowing.

24. In general, local and regional authorities should have the right to incur debts only for the funding of investment expenditure and not for current expenditure. The level of debt could be established in relation to the volume of the authority's own resources, their extent, stability and foreseeable development.

Local elected representatives and employees

25. The quality and accuracy of the financial and budgetary information issued by the local or regional authority should be guaranteed by the mayor, the chief executive or any other elected representative or executive body designated by law, who assumes responsibility.

26. Officials responsible for collecting local or regional tax revenue and/or committing local or regional expenditure and enjoying a degree of independence in the exercise of their duties should be personally accountable for their acts of management, in accordance with the law.

27. The central authority should ensure that local or regional officers and elected representatives receive appropriate professional training. If such training is not provided by the local or regional authority itself or its association, the central authority could, for example, set up standards in this respect, organise such training and help the local or regional authority and its association to organise training for their elected representatives and officers.

Control

28. The external supervisory procedure should be laid down by law and should be balanced and fair. The procedure should be limited to an examination of the legality of decisions. In the case of a disagreement, the procedure should provide the supervising authority with the possibility of recourse to the competent jurisdiction.

29. In general, control after the event should be preferred to prior approval or authorisation.

30. Failing this, where prior approval is required, particularly for the exercise of delegated powers, a reasonable time limit should be set by law for the supervisory authority to give its approval, which shall be deemed granted if no reply is forthcoming within the time limit set.

31. There should be a legal deadline for the adoption of local and regional budgets and

mechanisms to ensure the continuity of public services if the budget is not adopted in due time, or if the local or regional authority fails to fulfill its obligations (such as omission from the budget of expenses that are legally or contractually binding, inaccuracy of budgetary entries, gross violation of budgetary procedures, etc). Such mechanisms may provide for the intervention of the central authority, of the controlling body or of an independent administrative body in order to redress the situation, while at the same time guaranteeing that the intervention is proportional to the cause, is neither political nor excessive, does not endanger local or regional self-government and is not prolonged beyond what is needed to redress the situation or to tackle the deficiencies observed.

32. There should be statistical and comparative analysis of budget implementation, spending and the rate of spending in order to detect any anomalies and trigger the relevant warning procedures, rather than a series of successive authorisations that provide no dynamic overview.

33. The central authority should ensure that arrangements are made for drawing up comparisons of budgets and performance for local or regional authorities of comparable size and socio-economic characteristics that are widely accessible (through publications or Internet site postings) and accompanied by explanatory texts (such as the meaning of indicators used, etc.).

Recovery of local and regional authorities in financial difficulty

34. As a general principle, the central authority should not guarantee the borrowings of a local or regional authority.

35. Current expenditure of the local and regional authority should be financed out of current revenue and non-earmarked reserves, except in exceptional cases of cash advances and short-term loans.

36. The state or supervisory authority should establish procedures for monitoring the financial situation of local and regional authorities by gathering financial information and making it public. This information should enable citizens, the local and regional authority and the government to be aware of the financial situation of a given authority, to compare it with that of other authorities with similar characteristics and to take appropriate measures, where necessary and according to law, to avoid any financial difficulties arising.

37. Procedures should exist enabling the local or regional authority to handle a localised and short-term financial crisis without requesting assistance from the next highest level of authority or the state. Such procedures could be established, for example, under a bankruptcy and insolvency code for local and regional authorities.

38. The state or supervisory authority should establish and observe clear rules for intervention to assist a local or regional authority in financial difficulty.

39. These rules of intervention should pursue the aim of financial recovery of the local or regional authority concerned while making elected representatives and officers responsible for their acts. There should be provisions aimed at discouraging and avoiding perverse effects such as local or regional authorities becoming accustomed to assistance or becoming careless in their financial management or competing for state aid.

40. In cases where the financial difficulty arises from a structural income deficit, the central authority should not only provide financial assistance but should also intervene to eliminate the causes of that structural deficit.

41. The central authority should make provision for special financial resources in order to help local and regional authorities that are in an emergency situation, or victims of natural disasters or affected by sharp economic decline.

42. Financial assistance should be granted following dialogue with the given local or regional authority and on the basis of an economic recovery plan that includes financial contributions and undertakings from the authority itself.

43. Financial assistance should be adjusted according to the local or regional authority's wealth and medium-term economic and fiscal potential.

Part II

Guidelines for local and regional authorities

Local and regional authorities are invited to take into account the following measures when designing their policies in the field of financial and budgetary management, insofar as they fall within their competence.

General principles

44. It would be desirable for newly elected local or regional executives to present a programme at the beginning of their term in office setting out aims, priorities and measures with an indication of the time-table of implementation and of the relevant budget resources.

45. The local or regional authority should draw up pluri-annual budget plans (covering the two to four years following the current year) setting out the overall budget objectives, an indication of the cost of pursuing the policies and undertakings subscribed to, and future budgetary consequences of decisions taken or to be taken.

46. Budget projections and proposals should be prepared with the involvement of in-house experts (for example, receiver, treasurer, internal auditor) and outside opinions (such as economists, independent auditors, etc.), particularly in the event of public debate (hearings before the relevant committees, the local or regional council, etc.).

47. Whenever a decision is taken by the executive or the local or regional council, the budgetary expenditure for the current year and the following financial years should be clearly explained.

48. As a general rule, the proceedings of committees dealing with budget matters should be open to the public and their documents should be published and accessible to the public.

49. The elected representatives and officers of local and regional authorities should be offered and benefit from appropriate training in budgeting, both basic and advanced, that enables them to understand the documents submitted to them and to take appropriate, informed decisions. Incentives for training such as a closer link with promotion criteria should be implemented for officers.

50. Any activity of a local or regional authority that may result in public debts or entail significant financial risk should be primarily agreed upon and authorised by the elected deliberative body concerned.

Information and openness

51. Budget and accounting documents should be easily readable, providing both a clear and comprehensible overview of the budget (including main balances, issues and priorities, key data, etc.) and sufficient detail to analyse the content of the budget and make relevant comparisons (with other financial years, other authorities, etc.).

52. Published documents, for example via the Internet, should be accompanied by a suitable explanation making them more easily comprehensible to a lay public.

53. Expenditure and receipts should be presented by type and by function in budget documents, identifying as far as possible the different sectors of local and regional government involved so that the sharing of resources between fields of activity may be gauged.

54. Information on the performance of the local or regional service management (financial indicators, output and impact indicators, comparisons with the performances of other local or

regional authorities and the interpretation of such information) should, where appropriate, be appended to budgetary documents.

55. The local or regional authority should stimulate participation by citizens and social partners in public affairs by regularly consulting them and should ensure that objective information is provided on the financial aspects of the issues under consultation.

56. The local or regional authority should make it possible for citizens to be informed of draft budgets as soon as these are forwarded to local or regional councillors for final approval. When a budget has been adopted, its outlines and consequences for the community should be made public; for example by explaining changes in taxation or priority allocation of the authority's funding, and mentioning services ready to provide the public with further details.

Preparation of the budget

57. Preparation of the budget should be the responsibility of a specialised unit of the local or regional authority with a good knowledge of the authority's operational departmental costs and budget consumption so that it can propose different options to the executive and prepare internal arbitration before arbitration at a later stage.

58. Budget proposals should be discussed by the authorities and persons responsible for the domain concerned and then by those responsible for finance, who should consider overall balances, overall income, borrowings and any problems raised.

59. Choices between different investment projects should be made more objective, for example by using a "scoring" system based on several criteria. When the size of the proposed investment justifies it, a participatory process involving the local community should be envisaged; if this occurs, procedures should be set up in order to guarantee that the exercise is properly run.

60. The budgetary consequences of a local or regional authority's links with the commercial sector (for example, income and expenditure linked to shareholding, execution of guarantees given, etc.) should be carefully assessed in accordance with the rules and procedures for assessment used in the private sector.

Assessment and management of financial risk

61. The presentation of the budget and accounts must give as complete and objective a picture as possible of the local or regional authority's financial situation. The local or regional authority should work towards drawing up consolidated accounts, integrating the results and showing the risks and obligations of the different satellite agencies.

62. Where the consolidation of the accounts is not possible, the local or regional authority should present an overview of its participation or involvement in any external organisation and possible risks to which the organisation may be exposed in which the local or regional authority is a financial stakeholder.

63. The presentation of the budget should be accompanied by an analysis of the financial risks to which the local or regional authority is exposed: the quantifiable risks should give rise to setting up reserves, while the degree of exposure to non-quantifiable risks should be estimated.

64. In those countries where the local or regional authorities are at liberty to deposit their funds at the banks that they deem appropriate, a system of insurance or re-insurance is needed to protect the local or regional authorities against the loss of some of their assets in the event of bankruptcy of their bank.

65. Guarantee or guarantee deposit obligations should be published, with a distinction being made between the obligations during the financial year, the loans outstanding and the costs arising from these guarantees; the use of risk-assessment ratios to limit these risks is to be recommended.

66. Establishing or managing commercial enterprises and participation in such enterprises should be limited, in principle, to public service activities or to activities in which there is no competitive market or activities that are aimed at economic promotion (such as housing developments, creation of business parks and start-up activities, promotion of employment, etc.).

67. If the local or regional authority has the right to invest on the financial market, it should, in principle, limit such investment to the bond market. Any other financial product should be the subject of specific ratios for assessing their volatility and risk and in every case be subject to professional management.

68. Follow-up systems and ratios should be set up, the most important of which must be made public so as to enable the financial situations to be compared and the divergences to be analysed and to prevent risks.

69. Local and regional authorities should acquire, individually or collectively, the expertise necessary to manage risks arising from their financial obligations; that expertise may imply training financial executives of local administrative bodies or involving the state services or independent public consultancy bodies, the associations of local authorities and the private sector on a commercial basis. Consultancy and supervisory functions should not be exercised by the same body.

70. Horizontal and vertical co-operation between authorities should be encouraged to facilitate the completion of major projects, in such a way as to share the expenses and the risks.

71. Estimates of investment-project costs should not overlook recurrent subsequent costs (such as staffing, operation, maintenance, etc.), which should logically be incorporated into pluri-annual budget programming.

72. In public-private partnerships, the risks should be shared out realistically and the local or regional authority should avoid, by its intervention, taking on the role of guarantor of risky private investment. In particular, an explicit public guarantee is preferable when the nature of the structure or service is such that the authority may find it difficult, to put its future in the hands of the user.

Approval of the budget

73. A budget strategy debate should be organised at the beginning of the budgetary procedure, permitting initial discussion of the overall objectives to be adopted for the year and possibly the years to come.

74. The local or regional authority should set sufficient time limits in which councillors may read and analyse the budget documents issued.

75. If the elected representatives consider the information received to be inadequate or unclear, they - individually or collectively (for example in the competent committees) - should be able to request further information, question the relevant officers and, where necessary, hear the experts of their choice.

Implementation of the budget

76. Where appropriate, a debate on the implementation of the budget should be held mid-year, in order to put budget changes into perspective and to review the changes in the economic, budgetary and social context, and after the end of the financial year.

77. The council should receive regular updates (for example, every three or four months) on the monitoring of the budget. If budget adjustments prove necessary, it would be advisable to group them in one or two "sets" per annum, accompanied by an overview or even a debate on the state of budget spending.

78. Budget adjustments should be limited in number and in scope in order to avoid diverting the

aims of initial budgetary objective. Adjustments should be organised in such a way as to give a clear view of the changes suggested and on their importance, and they should be given the same level of transparency, publicity and conditions of democratic control as the initial budgets.

Budget accounts

79. The accounts (for financial year n) should be submitted to the council within a reasonable time, and certainly before the holding of the debate on budget implementation for the following year ($n + 1$) and before the budget for the year after that ($n + 2$) is drawn up.

80. Approval of the accounts should be properly debated, in committee and then in the council, in the light of an outside opinion (for example an external audit).

81. The executive of the local or regional authority should ensure that the reports of committees and the council concerning the budget are published (allowing public access or on-line consultation).

Control

82. The local or regional authority should establish and put into general practice a framework for internal auditing (for example a code of ethics, independence measures, a right of initiative, conditions of intervention, notification of the council, follow-up, publishing of reports, etc.) and organise support for such internal auditing (recommended methodology, outside technical back-up).

83. Without prejudice to any existing legal obligations, the local or regional authority should make systematic use of annual external auditing (in whatever form) to certify accounts and check their compliance with the law (including measures combating fraud and corruption).

84. The local or regional authority should assess the efficiency of its management at regular intervals, for example by making use of external audit.

Financial difficulty

85. The local or regional authority should not request financial aid from the state or supervisory authority if it is able to redress its financial situation through other means.

86. As soon as it finds itself in financial difficulty, the local or regional authority should devise and set up a financial recovery plan, if necessary with assistance from the state or supervisory authority, independent administrative authorities or private auditing firms.

87. The recovery plans should be debated and adopted by the council or assembly in public sittings. The plan should set out the necessary data and the undertakings on which the following budgets are to be based. The plan may be contractual, depending on legislation, vis-à-vis the body providing financial support to the local or regional authority concerned.

Related Documents

Meetings

[867th meeting of the Ministers' Deputies](#) / 08 January 2004

Other documents

[CM/Del/Dec\(2004\)867/10.1E](#) / 09 January 2004 