Article Title: Criteria | Governments | U.S. Public Finance: Financial Management Assessment Data: (EDITOR'S NOTE: —On July 29, 2021, we republished this criteria article to make nonmaterial changes. See the "Revisions And Updates" section for details.) The rigor of a government's financial management practices is an important factor in S&P; Global Ratings' analysis of that government's creditworthiness. Managerial decisions, policies, and practices apply directly to the government's financial position and operations, debt burden, and other key credit factors. A government's ability to implement timely and sound financial and operational decisions in response to economic and fiscal demands is a primary determinant of near-term changes in credit quality. S&P; Global Ratings will now offer a more transparent assessment of a government's financial practices as an integral part of our general obligation and appropriation credit rating process. Assessing Financial Practices Major elements of governmental financial management include economic analysis, revenue forecasting, risk management, accounting practices, financial strategies, cash and liquidity administration, and debt management. All of these elements have an impact on a government's bottom line, and, as a result, on its credit quality. If a government is unable or unwilling to employ its authority in a timely manner to address events that impact its budget and financial condition, its credit rating can be adversely affected. Many finance directors and other local government officials take pride in the managerial policies, practices, and structures they have established to ensure efficiency and quality of service, and to promote innovation and security. While credit ratings incorporate financial management as one of many factors, the impact of financial management on the rating may not be readily apparent because other factors may counterbalance, or even outweigh it. Examples of such factors include local economic conditions, debt levels, and statutory limitations. By focusing special attention on the assessment of financial practices, S&P; Global Ratings will more fully recognize governments' efforts in this important area. S&P; Global Ratings assigns a Financial Management Assessment (FMA) only to general government tax-backed and annual appropriation-backed issues. We won't assign an FMA to tax increment financings (TIFs), municipal utility district (MUDs), and special tax districts (see "Credit FAQ: Financial Management Assessment In U.S. Public Finance," published on June 27, 2006). Analytical Framework S&P; Global Ratings has established an analytical methodology that evaluates established and ongoing management practices and policies in the seven areas most likely to affect credit quality. These areas are: Revenue and expenditure assumptions Budget amendments and updates Long term financial planning Long term capital planning Investment management policies Debt management policies Reserve and liquidity policies The evaluation of each area focuses on best practices and policies that are credit-important in most governments rather than policies that address issues that are fairly unusual or unique to the government. The nature of the policies and practices considered are those that governments may use in some manner regardless of the size or type of government. Issuers that rank well in the evaluation should be those whose policies help reduce the likelihood of credit deterioration, or enable them to benefit more from changing conditions, whether they are economic, budgetary, statutory, or personnel related. Users of the FMA, however, should also realize its limitations. By focusing on a government's policies and practices, the FMA is not an evaluation of the competency or aptitude of individual finance professionals; nor is it an evaluation of a finance department's ability to handle unique challenges. Moreover, the nature of the entity's governing body, the effectiveness of its governance practices, and issues of public policy pursued by the government are beyond the scope of this analysis. Although S&P; Global Ratings considers in its analysis any material information that provides relevant context or influences financial management, it is important to note that this assessment of financial practices is based primarily on the existence and implementation of management practices, and not necessarily the results achieved by such practices. Results—both positive and negative—are assumed to manifest themselves in other visible ways. The purpose of the focus on policies and practices is to evaluate the potential for credit quality to move away from those currently indicated by results. The following tables detail each of the seven financial practice areas examined by S&P; Global Ratings. Table 1 Revenue And Expenditure Assumptions ARE THE ORGANIZATION’S FINANCIAL ASSUMPTIONS AND PROJECTIONS REALISTIC AND WELL GROUNDED FROM BOTH LONG-TERM AND RECENT TREND PERSPECTIVES? STRONG FORMAL HISTORIC TREND ANALYSIS IS PERFORMED AND UPDATED ANNUALLY FOR BOTH REVENUE AND SPENDING; REGULAR EFFORT IS MADE TO DETERMINE WHETHER REVENUES

OR EXPENDITURES WILL DEVIATE FROM THEIR LONG-TERM TRENDS OVER THE NEXT COUPLE OF YEARS; EVIDENCE OF INDEPENDENT REVENUE FORECASTING EXISTS(WHEN POSSIBLE). Standard Optimistic assumptions exist that, while supportable, add risk; assumptions are based on recent performance, but little evidence of questioning or validating assumptions exists. Vulnerable Assumptions neglect likely shortfalls, expenditure pressures or other pending issues; assumptions exist which enjoy no prudent validation. Table 2 Budget Amendments And Updates ARE THERE PROCEDURES FOR REVIEWING AND AMENDING THE BUDGET BASED ON UPDATED INFORMATION AND ACTUAL PERFORMANCE TO ENSURE FISCAL TARGETS ARE MET? STRONG AT LEAST QUARTERLY BUDGET SURVEILLANCE IS MAINTAINED TO IDENTIFY PROBLEM AREAS AND ENABLE TIMELY BUDGET ADJUSTMENTS; MANAGEMENT EXHIBITS ABILITY AND WILLINGNESS TO ADDRESS NECESSARY INTRA-YEAR REVENUE AND EXPENDITURE CHANGES TO MEET FISCAL TARGETS. Standard Semiannual budget reviews exist; management identifies variances between budget and actual performance. Vulnerable No formal process exists for regular review and timely updating of budget during the year. Table 3 Long-Term Financial Planning DOES MANAGEMENT HAVE A LONG-TERM FINANCIAL PLAN THAT ALLOWS THEM TO IDENTIFY FUTURE REVENUES AND EXPENDITURES AS WELL AS ADDRESS UPCOMING ISSUES THAT MIGHT AFFECT THESE? STRONG A MULTI-YEAR FINANCIAL PLAN EXISTS WHERE FUTURE ISSUES ARE IDENTIFIED AND POSSIBLE SOLUTIONS ARE IDENTIFIED, IF NOT IMPLEMENTED; REVENUE AND EXPENDITURE DECISIONS ARE MADE PRIMARILY FROM A LONG-TERM PERSPECTIVE. STRUCTURAL BALANCE IS A CLEAR GOAL. Standard Multi-year projections are done informally; multi-year projections are done, but without discussion of pending issues, so that issues are not addressed; some one-shot actions exist, but the long-term consequences of these actions are acknowledged and communicated. Vulnerable No long-term financial planning exists; operational planning is done on a year-to-year (or budget-to-budget) basis; one-shot budget fixes are used with little attention to long-term consequences. Table 4 Long-Term Capital Planning HAS THE ORGANIZATION CREATED A LONG-TERM CAPITAL IMPROVEMENT PROGRAM? STRONG A FIVE-YEAR ROLLING CIP WITH FUNDING IDENTIFIED FOR ALL YEARS EXISTS AND IS LINKED TO THE OPERATING BUDGET AND LONG-TERM REVENUE AND FINANCING STRATEGIES. Standard A five-year CIP is done, but is generally limited to projects to be funded from the current budget plus a four-year wish list; some funding for out-year projects is identified, but not all. Vulnerable No five-year CIP exists; capital planning is done as needs arise. Table 5 Investment Management Policies HAS THE ORGANIZATION ESTABLISHED POLICIES PERTAINING TO INVESTMENTS, SUCH AS THE SELECTION OF FINANCIAL INSTITUTIONS FOR SERVICES AND TRANSACTIONS; RISK ASSESSMENT; INVESTMENT OBJECTIVES; INVESTMENT MATURITIES AND VOLATILITY; PORTFOLIO DIVERSIFICATION; SAFEKEEPING AND CUSTODY; AND INVESTMENT PERFORMANCE REPORTING, BENCHMARKING, AND DISCLOSURE? STRONG INVESTMENT POLICIES EXIST AND ARE WELL DEFINED; STRONG REPORTING AND MONITORING MECHANISMS EXIST AND ARE FUNCTIONING. Standard Informal or non-published policies exist; policies are widely communicated and followed. Vulnerable Absence of informal or non-published policies Table 6 Debt Management Policies HAS THE ORGANIZATION ESTABLISHED POLICIES PERTAINING TO THE ISSUANCE OF DEBT, SUCH AS PROJECTS THAT MAY OR MAY NOT BE FUNDED WITH DEBT (INCLUDING ECONOMIC DEVELOPMENT PROJECTS); MATURITY AND DEBT SERVICE STRUCTURE; USE OF SECURITY AND PLEDGES, CREDIT ENHANCEMENT, AND DERIVATIVES; AND DEBT REFUNDING GUIDELINES? STRONG DEBT POLICIES EXIST AND ARE WELL DEFINED; STRONG REPORTING AND MONITORING MECHANISMS EXIST AND ARE FUNCTIONING. IF SWAPS ARE ALLOWED, A FORMAL SWAP MANAGEMENT PLAN HAS BEEN ADOPTED (SEE “CONTINGENT LIQUIDITY RISKS IN U.S. PUBLIC FINANCE INSTRUMENTS: METHODOLOGY AND ASSUMPTIONS," PUBLISHED ON MARCH 5, 2012). Standard Basic policies exist; policies are widely communicated and followed. If swaps are allowed there is a swap management plan in place, but it does not follow S&P;’s guidelines. Vulnerable Absence of basic policies or clear evidence that basic policies are followed. Swaps are allowed but there is no swap management plan in place, and/or there is no local (non-FA) knowledge about the swap. Table 7 Reserve And Liquidity Policies HAS THE

ORGANIZATION ESTABLISHED A FORMALIZED OPERATING RESERVE POLICY, WHICH TAKES INTO ACCOUNT THE GOVERNMENT'S CASH FLOW/OPERATING REQUIREMENTS AND THE HISTORIC VOLATILITY OF REVENUES AND EXPENDITURES THROUGH ECONOMIC CYCLES? STRONG A FORMAL OPERATING RESERVE POLICY IS WELL DEFINED. RESERVE LEVELS ARE CLEARLY LINKED TO THE GOVERNMENT'S CASH FLOW NEEDS AND THE HISTORIC VOLATILITY OF REVENUES AND EXPENDITURES THROUGHOUT ECONOMIC CYCLES. MANAGEMENT HAS HISTORICALLY ADHERED TO IT. Standard A less defined policy exists, which has no actual basis but has been historically adhered to it. Vulnerable Absence of basic policies or, if they exist, are not followed. Assessment Methodology S&P; Global Ratings evaluates and assigns each of the seven areas a qualitative ranking, based on the above framework. In determining the overall assessment, the revenue and expenditure assumptions, budget amendments and updates are given a relatively higher importance; long-term financial planning and liquidity policies are given an average importance; and capital planning, debt policies, and investment policies receive relatively less weight. The difference in degrees of importance is limited, however, so that each factor's contribution to the assessment is meaningful. Overall assessments are communicated using the following terminology: The term "good", in addition to the terms "strong", "standard", and "vulnerable", is used to further differentiate governments with a mix of strong and standard practices. "Strong" A Financial Management Assessment of 'strong' indicates that practices are strong, well embedded, and likely sustainable. The government maintains most best practices deemed critical to supporting credit quality and these are well embedded in the government's daily operations and practices. Formal policies support many of these activities, adding to the likelihood that these practices will be continued into the future and transcend changes in the operating environment or personnel. "Good" A Financial Management Assessment of 'good' indicates that practices are deemed currently good, but not comprehensive. The government maintains many best practices deemed as critical to supporting credit quality, particularly within the finance department. These practices, however, may not be institutionalized or formalized in policy, may lack detail or long-term elements, or may have little recognition by decision makers outside of the finance department. "Standard" A Financial Management Assessment of 'standard' indicates that the finance department maintains adequate policies in most, but not all key areas. These policies often lack formal detail and institutionalization, and may not include best practices. "Vulnerable" A Financial Management Assessment of 'vulnerable' indicates that the government lacks policies in many of the areas deemed most critical to supporting credit quality. The 'vulnerable' designation suggests a high degree of uncertainty regarding a government's ability to effectively adapt to changing conditions that could threaten its long-term financial position. Analytical Process And Supporting Documentation To perform its analysis of local government financial practices, S&P; Global Ratings will rely on documentation provided by the government and discussions with the organization's management. Relevant documents include, but are not limited to, audited financial statements and accompanying notes, budget documents, financial plans, management policy statements, procedure manuals, and periodic reports. Discussions provide an important opportunity for management to elaborate on the factors listed above, as well as answer specific questions, so as to enable S&P; Global Ratings' analysts to assess the factors as thoroughly as possible. Revisions And Updates This article was originally published on June 27, 2006. Changes introduced after original publication: Following our periodic review completed on Feb. 5, 2016, we updated our contact information. In addition, we included the reference to the article titled "Credit FAQ: Financial Management Assessment In U.S. Public Finance," published on June 27, 2006, including a clarification regarding the applicability of these criteria. Finally, we added the "Related Criteria And Research" section. Following our periodic review completed on Feb. 3, 2017, we updated the contact information. Following our periodic review completed on Feb. 1, 2018, we added the "Revisions And Updates" section. On March 23, 2021, we republished this criteria article to make nonmaterial changes to clarify the "Assessing Financial Practices" section. On July 29, 2021, we republished this criteria article to make nonmaterial changes to update contact information. Related Criteria And Research Related Criteria U.S. State Ratings Methodology, Oct. 17, 2016 U.S. Local Governments General Obligation Ratings: Methodology And Assumptions, Sept. 12, 2013 Contingent Liquidity Risks in U.S. Public Finance Instruments: Methodology And Assumptions, March 5, 2012 Principles Of Credit Ratings, Feb.

16, 2011 GO Debt, Oct. 12, 2006 Related Research Credit FAQ: Financial Management Assessment In U.S. Public Finance, June 27, 2006