



GFOA Best Practice

Adopting Financial Policies

Background. Financial policies are central to a strategic, long-term approach to financial management. Some of the most powerful arguments in favor of adopting formal, written financial policies include their ability to help governments:

1. Institutionalize good financial management practices. Formal policies usually outlive their creators, and, thus, promote stability and continuity. They also prevent the need to re-invent responses to recurring issues.
2. Clarify and crystallize strategic intent for financial management. Financial policies define a shared understanding of how the organization will develop its financial practices and manage its resources to provide the best value to the community.
3. Define boundaries. Financial policies define limits on the actions staff may take. The policy framework provides the boundaries within which staff can innovate in order to realize the organization's strategic intent.
4. Support good bond ratings and thereby reduce the cost of borrowing.
5. Promote long-term and strategic thinking. The strategic intent articulated by many financial policies necessarily demands a long-term perspective from the organization.
6. Manage risks to financial condition. A key component of governance accountability is not to incur excessive risk in the pursuit of public goals. Financial policies identify important risks to financial condition.
7. Comply with established public management best practices. The Government Finance Officers Association (GFOA), through its officially adopted Best Practices endorsement of National Advisory Council on State and Local Budgeting (NACSLB) budget practices and the GFOA Distinguished Budget Presentation Award Program, has recognized financial policies as an essential part of public financial management.

Recommendation. GFOA recommends that governments formally adopt financial policies. Steps to consider when making effective financial policies include (1) scope, (2) development, (3) design, (4) presentation, and (5) review.

Scope. There are some basic financial policy categories (but not limited to) that all governments should consider adopting.

1. *General fund reserves.* Policies governing the amount of resources to be held in reserve and conditions under which reserves can be used.
2. *Reserves in other funds.* Policies for other funds (especially enterprise funds) that serve a similar purpose to general fund reserve policies.
3. *Grants.* Policies that deal with the administration and grants process.
4. *Debt.* Policies that govern the use of government debt, including permissible debt instruments, conditions under which debt may be used, allowable levels of debt, and compliance with continuing disclosure requirements.
5. *Investment.* Policies that provide guidance on the investment of public funds, including permissible investment instruments, standards of care for invested funds, and the role of staff and professional advisors in the investment program.

6. *Economic development.* Policies that address a local government’s use of subsidies or other incentives to encourage private development.
7. *Accounting and financial reporting.* Policies that establish and guide the use of an audit committee, endorse key accounting principles, and that ensure external audits are properly performed.
8. *Risk management and internal controls.* Policies that address traditional views of risk management and internal control, as well as more modern concepts of "enterprise risk management."
9. *Procurement.* Policies that are most essential for adoption by the governing board in order to encourage efficient, effective and fair public procurement.
10. *Long-term financial planning.* A policy that commits the organization to taking a long-term approach to financial health.
11. *Structurally balanced budget.* Policies that offer a distinction between satisfying the statutory definition and achieving a true structurally balanced budget.
12. *Capital.* Policies that cover the lifecycle of capital assets, including capital improvement planning, capital budgeting, project management, and asset maintenance.
13. *Revenues.* Policy guidance through the designing of efficient and effective revenue systems that guarantee the generation of adequate public resources to meet expenditure obligations.
14. *Expenditures.* Policies addressing a range of issues around how the money is expended, including personnel, outsourcing, and funding long-term liabilities.
15. *Operating budget.* Policies that describe essential features of the budget development process and form, as well as principles that guide budgetary decision making.

Development. The following steps should be considered in the development of effective policies.

1. Define the problem the policy will address.
2. Draft the policy. Be aware of legal requirements and consider public comments. Look at the experience of peer governments.
3. Review and present the policy to government officials.
4. Formally consider and adopt policy.
5. Implement policy making sure that staff and government officials are aware of policies.

Design. Effective polices have a number of design features in common.

1. Policies must exist in written form.
2. Policies should be expressed in a manner that is understandable to the intended audiences.
3. Policies should be made available to all stakeholders, and be published in more than one medium with multiple means of access.
4. Policies should address all relevant issues and risks for that specific policy in a concise fashion.

Presentation. Effective financial policies share some of the following traits.

1. All of the financial policies are placed in the same section of the budget document.
2. The original and revision dates are shown on the individual policies.

Review. Financial policies are most successful when they are reviewed after being enacted.

1. Policies should be monitored, reviewed, and updated as needed in a systematic way.
2. Analyze the reasons if specific policies are not being followed.

Note: References listed below will be arranged separately on the GFOA website.

References to Some of GFOA Best Practices on Financial Policies

Financial Policy	GFOA Best Practice Link
------------------	-------------------------

General Fund /Other Fund Reserves	<ul style="list-style-type: none"> ▪ <u>Determining the Appropriate Level of Unrestricted Fund Balance in the General Fund</u> ▪ <u>Replenishing General Fund Balance</u> ▪ <u>Determining the Appropriate Level of Working Capital in Enterprise Funds</u>
Grants	<ul style="list-style-type: none"> ▪ <u>Establishing an Effective Grants Policy</u> ▪ <u>Establishing a Grants Administration Oversight Committee</u> ▪ <u>Administering Grants Effectively</u>
Debt	<ul style="list-style-type: none"> ▪ <u>Debt Management Policy</u> ▪ <u>Analyzing and Issuing Refunding Bonds</u>
Investment	<ul style="list-style-type: none"> ▪ <u>Local Government Investment Pools</u> ▪ <u>Investment of Bond Proceeds</u>
Economic Development	<ul style="list-style-type: none"> ▪ <u>Evaluating and Managing Economic Development Incentives</u> ▪ <u>Coordinating Economic Development and Capital Planning</u> ▪ <u>Monitoring Economic Development Performance</u> ▪ <u>Developing an Economic Development Incentive Policy</u>
Accounting & Financial Reporting	<ul style="list-style-type: none"> ▪ <u>Documenting Accounting Policies and Procedures</u> ▪ <u>Encouraging and Facilitating the Reporting of Fraud and Questionable Accounting and Auditing Practices</u> ▪ <u>Audit Committees</u> ▪ <u>Basis of Accounting versus the Budgetary Basis</u>
Risk Mgmt. & Internal Controls	<ul style="list-style-type: none"> ▪ <u>Practical Steps to Avoid, Limit, or Eliminate Internal Control Deficiencies Identified in an Audit</u> ▪ <u>Business Preparedness and Continuity Guidelines</u> ▪ <u>Creating a Comprehensive Risk Management Program</u>
Procurement	<ul style="list-style-type: none"> ▪ <u>Purchasing Card Programs</u> ▪ <u>Electronic Payment and Collection Systems</u>
Long-Term Fin. Planning	<ul style="list-style-type: none"> ▪ <u>Long-Term Financial Planning</u>
Balanced Budget	<ul style="list-style-type: none"> ▪ <u>Achieving a Structurally Balanced Budget.</u>
Capital	<ul style="list-style-type: none"> ▪ <u>Capital Planning Policies</u> ▪ <u>Incorporating a Capital Project Budget in the Budget Process</u> ▪ <u>Multi-Year Capital Planning</u> ▪ <u>Establishing Capitalization Thresholds for Capital Assets</u> ▪ <u>Determining the Estimated Useful Life of Capital Assets</u>
Expenditures	<ul style="list-style-type: none"> ▪ <u>Inflationary Indices in Budgeting</u> ▪ <u>Effective Budgeting of Salary and Wages</u> ▪ <u>Strategies for Managing Health-Care Costs</u> ▪ <u>Measuring the Full Cost of Government Service</u>
Revenues	<ul style="list-style-type: none"> ▪ <u>Establishing Government Charges and Fees</u> ▪ <u>Financial Forecasting in the Budget Preparation Process</u> ▪ <u>The Use of Trend Data and Comparative Data for Financial Analysis</u> ▪ <u>Revenue Diversification, Use of One-Time Revenues, and Use of Unpredictable Revenues</u>
Operating Budget	<ul style="list-style-type: none"> ▪ <u>A Systematic Approach to Managing Performance</u> ▪ <u>Making the Budget Document Easier to Understand</u> ▪ <u>Public Participation in Planning, Budgeting, and Performance Management</u> ▪ <u>Presenting Official Financial Documents on Your Government’s Website</u>

Committee: Budget (2001, 2015)

References.

- GFOA Best Practice, “Recommended Budget Practices from the National Advisory Council on State and Local Budgeting.” 1998.
- GFOA Publication, “Financial Policies,” 2012 (Shayne Kavanagh).