



Report on a System for Monitoring the Fiscal Health of Local Government Units

INTERIM REPORT

Presented to the North Carolina General Assembly

By the North Carolina Department of State Treasurer

February 1, 2022

SECTION 1. INTRODUCTION

North Carolina Session Law 2021-180 (enacted on November 18, 2021) Part XXXVI, Section 36.1.(a) requires:

The Department of State Treasurer, State and Local Government Finance Division, in consultation with the Local Government Commission (hereinafter "Commission"), shall evaluate the State's current system for monitoring the financial operations of local government units (hereinafter "unit" or "units") and approving their requests to issue new debt and amend current debt. For purposes of this section, the term "unit" has the same meaning as in G.S. 159-7(b)(15). The Department shall develop a plan to transition to a system for monitoring the financial operations of units that does all of the following:

- (1) Uses a "value added" approach to reviewing the State's current practices and policies.
- (2) Directs current Commission staffing resources to the units in greatest need and away from units with adequate governance, staff, resources, and technical expertise.
- (3) Implements a schedule of reporting to the Commission based on a unit's financial health.
- (4) Standardizes training of unit officials and staff, as deemed appropriate by the Commission.
- (5) Authorizes the Commission to compel units to comply with Commission directives.
- (6) Incorporates a clear definition of the term "fiscal distress."
- (7) Implements a new fiscal warning system for units at risk of fiscal distress.



(8) Expands the criteria and parameters for measuring a unit's fiscal health to incorporate economic and demographic factors.

(9) Incorporates factors impacting a unit's fiscal health, including changes in population, tax base, and business and economic indicators.

This interim report, due February 1, 2022, will be followed by a final report and plan on May 1, 2022 and will be submitted to the Joint Oversight Committee on General Government, Senate Appropriations Committee on General Government and Information Technology, House Appropriations Committee on General Government, and Fiscal Research Division, pursuant to Section 36.1.(b)

Sections II and III below summarize the current system for monitoring the financial operations of local government units and for approving their requests to issue and amend debt, respectively. The final report, due to the General Assembly on May 1, 2022 will include comprehensive plan for the transition to a new system including specific strategies for implementing requirements (1) through (9) as needed, as well as recommendations for legislation required to implement the proposed system.

SECTION II. CURRENT SYSTEM FOR MONITORING THE FINANCIAL OPERATIONS OF LOCAL GOVERNMENT UNITS

Local Government Commission (LGC) staff currently utilize a number of processes and tools to monitor financial operations and fiscal health of units of local government. Each provides LGC staff with insight into units' fiscal health and their need for any additional support, resources, or guidance, and helps to alert LGC staff if a unit is in danger of fiscal distress.

- 1) Review of Annual Audit.** N.C. Gen. Stat. §159-34 requires each unit of local government to have its accounts audited annually and to file a copy of the audit report with the LGC. Pursuant to North Carolina Administrative Code (20 NCAC 03 .0502), data from the audited financial statements is used to calculate Financial Performance Indicators and identify Financial Performance Indicators of Concern which may indicate inadequate financial conditions or fiscal management concerns within the local government unit. If the audited financial statements include one or more significant deficiencies, material weaknesses, or other findings, or if Financial Performance Indicators of Concern were identified, then the governing body must submit a response to the Secretary of the LGC providing a plan to address each Financial Performance Indicator of Concern. Audit reports also are reviewed by LGC staff to ensure the audits are performed in accordance with the



applicable auditing standards based on the units' expenditure of federal and State financial assistance.

- 2) **Review of Semiannual Report on the Status of Deposits and Investments.** N.C. Gen. Stat. § 159-33 requires each unit of local government to report by January 25 and July 25 of each year the amounts of cash, deposits, and investments held by the local government. LGC staff utilize the data submitted in these reports to identify units that may be out of compliance with the statutes governing the deposit and investment of funds.
- 3) **Unit Assistance List.** The Unit Assistance List (UAL) developed by LGC staff serve as a tool for directing staff resource to units needing additional assistance and monitoring based on an assessment of their financial health and fiscal management practices. The list utilizes data from audited financial statements of local governments and identifies units with internal control issues, financial issues in the general fund, and financial issues in the water/sewer fund (if applicable). The UAL also includes units that have not submitted an annual audit report timely. An annual audit report provides essential information on the financial condition of a unit to LGC staff, and to the unit's governing body, officials, and citizens. Failure to submit an annual audit timely may indicate financial management weaknesses and precludes an assessment of the unit's financial health by LGC staff.
- 4) **Fiscal Accountability Agreements.** Fiscal Accountability Agreements (FAAs) are formal agreements entered into between the governing bodies of local governments and the Secretary of the LGC that identify areas of concern regarding the units' fiscal management practices or internal controls and outline clear and measurable goals to implement best practices, ensure compliance with statutes, and strengthen their financial position. FAAs are used to implement enhanced monitoring and are not punitive in nature but are intended to help units address and remedy financial or fiscal management challenges.

Limited FAAs are implemented with certain units that are on the Unit Assistance List (UAL). These FAAs provide a means for LGC staff to establish an ongoing, structured monitoring process and to provide enhanced assistance to these units with the goal of guiding the units to take the actions needed to allow removal from the UAL. Under Limited FAAs, LGC staff conduct a unit visit, provide training, and review the unit's proposed annual budget prior to its adoption by the unit's board; the governing board agrees to provide budget-to-actual reports to LGC staff on a schedule established in the FAA. LGC staff are currently entered into 42 limited FAAs.



Comprehensive FAAs are implemented with units that LGC staff identify as facing significant challenges to their fiscal health or financial management practices. These FAAs include all of the requirements of Limited FAAs plus clear and measurable goals to implement best practices, ensure compliance with statutes, and strengthen the units' financial position. LGC staff are currently entered into one Comprehensive FAA.

SECTION III. CURRENT SYSTEM FOR DEBT REQUESTS BY LOCAL GOVERNMENT UNITS

LGC staff provide resources, guidelines, and suggestions to help units seeking LGC approval of debt to expedite and streamline the application process. Guidance related to fiscal management practices, debt management practices, and statutory considerations is provided to units seeking to issue debt and is reviewed with units and their finance staffs, financial advisors, and others as requested. LGC staff have established the following process for units wishing to issue debt.

- 1) **Unit Inquiry.** A request for debt approval often begins with a phone call or email from a unit to LGC staff inquiring as to the need for LGC approval of debt and the application process. Not all debt requires LGC approval (depending on the amount financed, term of financing, and other factors) and LGC staff can provide appropriate guidance based on the details of the financing and statutory requirements.
- 2) **Pre-application Conference.** Units planning to issue debt that requires LGC approval are then scheduled to participate in a pre-application conference with LGC staff. This conference allows LGC staff to obtain background and details on the proposed application including financing amount and type, purpose, and timeline for the project and LGC approval. LGC staff also provide guidance to the units regarding factors the LGC may consider related to financial management (timely submission of annual audits, timely response to LGC staff concerns, etc.) and debt management (debt burden, financing amount and type, etc.).
- 3) **Analysis and Research.** – Following a pre-application conference, LGC staff perform research and analysis to identify any financial impacts of the request and to compile any relevant information needed by LGC members in their consideration of the request. Fiscal and debt management practices, citizen support or opposition, and pending or completed investigations of the unit are all researched in order to provide a complete assessment of the unit's ability to issue and repay debt without negative financial impact to the unit and allow staff to develop a recommendation for approval or denial to the LGC.



- 4) **Debt Application.** Following the pre-application conference, units are provided with an application that identifies the documentation needed and steps in the debt approval process. Completed applications must be received by LGC staff approximately one month before the LGC meeting at which the unit wishes to have its application considered; specific deadlines for each scheduled LGC meeting are provided to the units and are available on the LGC website. Financial analysts on LGC staff guide units through the application process, ensuring that all information necessary for the LGC to consider the application has been received.

It is important to note that not all inquiries necessarily lead to pre-application conferences and not all pre-application processes lead to requests for debt applications. In addition, some debt applications may be initiated and then placed on hold by the unit or LGC staff for a variety of reasons. Because of this variety of contact with units and the need to track the details, status, and progress of each, LGC staff utilize an internal system for tracking units who have initiated contact regarding issuing debt requiring LGC approval.

- 5) **LGC Consideration of Request.** After all information requested by LGC staff and required for the LGC to consider the application is received, the debt request will be presented to the LGC for consideration and vote. Following approval, LGC staff provide the unit with a letter of approval and also provides minutes and signature pages, as needed, for the debt's closing documents.
- 6) **Issuance of Debt Notices.** Following approval of debt, LGC staff has continuing responsibilities to monitor the repayment of the debt. N.C. Gen. Stat. §159-35 requires the Secretary of the Local Government Commission to notify units of debt service obligations both annually with a statement of debt service obligations for the coming fiscal year, and 30 days prior to a debt service payment via a statement including the amount of principal and interest due, the due date, and other information required by statute. Debt payments made by units on outstanding debt approved by the LGC must be reported to the Secretary of the LGC under N.C. Gen. Stat. § 159-136 and are tracked by LGC staff.

SECTION IV. CONCLUSION

The processes currently in place for monitoring the financial operations of local government units and approving their requests to issue debt have been developed based on decades of experience and improvements, LGC policies, and requirements under North Carolina statutes and administrative code. Through these processes, LGC staff seek to minimize the administrative burden on both units and its own staff and to offer streamlined and user-friendly interactions



between LGC staff and units. Areas for improvement exist, especially in applying technology and automation to further streamline processes, as well as considering legislative changes that better address the need for financial oversight and support of local governments. The final version of this report, to be issued May 1, will examine these opportunities and present specific recommendations for legislative changes.