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ScienceDirect

Procedia Engineering 192 (2017) 142 – 147

Procedia Engineering

www.elsevier.com/locate/procedia

TRANSCOM 2017: International scientific conference on sustainable, modern and safe transport

Suggested credit score of municipalities as a tool for more efficient city management

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Abstract

In this paper we suggest a way how to make the management of city more efficient. Forecasting the financial situation of the organization is an important part of the company practice. The economy of cities and municipalities works on the same principle however relations balance-sheet data are not so explicit. Minimal attention is attributed to many correlations as the sense of forecasting balance-sheet data of municipalities is not considered to be an interesting part of the financial-economic analysis. The methodology of forecasting of the future financial state using our suggested credit score expressed through trading income per habitant absents. Credit score is one of ways how to determine the total financial situation of the organization. The goal of the paper is to propose methodology for taking into account relations and correlations of the basic financial and economic data in order to determine financial condition and solvency of municipalities. The determination of this credit score would be useful for citizens of the city, the government of the city as well as for banking institutions. The use of these relations would be a simple manual how to get the situation about financial economy of the cities. Finally, the implementation and use of these characteristics could be useful in making the city management more efficient. By doing this, municipalities and cities would have financial resources, either from surplus or provided low bank credits, to finance important areas such as public transport and infrastructure.

Peer-review under responsibility of the scientific committee of TRANSCOM 2017: International scientific conference on sustainable, modern and safe transport

Keywords: Credit score; municipality; city; transport; financial indicators; trading income per habitant.

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Peer-review under responsibility of the scientific committee of TRANSCOM 2017: International scientific conference on sustainable, modern and safe transport
doi:10.1016/j.proeng.2017.06.025

1. Introduction

The municipality is the base of the territorial local government of every country. Slovakia defines the municipality in the law as: “The municipality is autonomous self-governing unit of the Slovak republic; it aggregates citizens who have permanent address on its territory. The municipality is the legal person who, according to conditions defined by the law, manages its own equity using its financial sources.” [1] Local finances are part of public finances. This fact is the reason why local finances influence very significantly the public ones. For example, when the instability of local finances can cause instability of all public finances. “The base of financial management of municipality is the municipality budget created according to particular rules.” [2] This budget is created exclusively on particular year as the law does not define economic year. “The budget contains revenues and expenditures where financial relations between the municipality and legal and physical person (entrepreneurs operating on the municipality territory) are defined [3]. Multiple budget is a condition of fair fiscal process. This fiscal process is the economic tool of the municipality which defines intentions of municipality and needs of their citizens. The local budget is divided into regular budget, capital budget and financial operations. The regular budget contains such revenues and expenditures which are related to one fiscal year. In contrast, revenues and expenditures of capital budget have long-term investment character, i.e. the term of their pay-off is more than one year. According to [4] the fiscal process has several phases: “the phase of proposal, discussion and approval, realization phase, control phase, phase of summarizing results of fiscal management.” According to [5] the budget of municipalities and VUC is internally divided into regular revenues and expenditures, capital revenues and expenditures and financial operations. Regular revenues and expenditures are considered to be actions which are not investments. The most common regular revenues and expenditures are used for ensuring activities of municipalities. Capital revenues and expenditures are accounted from investment activity, e.g. revenues connected with development program or city or intercity transport. The transport is very important part of municipality management and is used to increasing the satisfaction of citizens. The construction of new infrastructure and reconstruction of roads is one of the main tasks of municipalities. Financial operations are transfers of finances from money funds in order to get returnable sources of financing. The construction of new infrastructure is financed in this way very often.

2. Financial indicators

The summary of financial and economic indicators is called financial-economic analysis. The base task of this analysis is to know financial health of the subject to be able to predict its conditions in the future. The result of financial analysis is to provide information which approve results of describing the state of financial health of analyzed organization. To be able to perform this analysis fitting up of financial claims is the necessary condition. The claims are the information basis. Statement of finances is another necessary source for performing this analysis. This statement is composed of three parts: balance sheet, profit and loss statement and notes. Cash flow is the part of notes section. The balance sheet is one of the base statements which contains all assets and liabilities of the organization. The balance sheet uses horizontal and vertical analysis; on base we are able to predict the future development of particular balance-sheet items. In opposite to balance sheet of business subjects, the balance sheet of municipalities of cities is enriched by following items: clearance among subjects of public administration, provided returnable financial help outs (short-term or long-term), evaluated differences and relations to accounts of state repository clients.

Financial analysis makes the difference between several proportion financial indicators. Basic indicators used in business are liquidity, activity, liability, rentability and indicators of market value. Liquidity of the company, as well as liquidity of municipalities, is commonly defined as: “The ability of business to cover its payment liabilities on time.” [6] Liquidity is commonly divided into three types: quick ratio (first order), cash ratio (second order) and total or current ratio (third order). The efficient liquidity, also called as quick ratio, defines the ability to pay for short-term liabilities with the most liquid part of the equity. The cash ratio has in mathematical formulation the numerator expanded by short-term debtor’s statements. Current ratio has the numerator expanded by the sum of inventories. All three types of liquidity are simply usable for needs of financial analysis of municipalities and cities. This is due to the structure of balance sheet which is comparable with the balance sheet of companies of market economics. Basic assets ratios are as follows: inventory turnover, debtor’s statements turnover, time for liabilities pay off, turnover of stable and total assets. In every of these indicators incomes and costs are an important information. However, for