Accounting for context in assessing the financial sustainability of local governments: are rating agencies' approaches comprehensive enough?

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Abstract

Purpose – This study is motivated by a longstanding problem of "accounting for context" in public sector financial sustainability research, namely, the difficulty of capturing how institutional, legal and intergovernmental dimensions shape local governments (LGs) financial sustainability.

Design/methodology/approach – Given that rating agencies consider financial sustainability issues while assessing LGs credit risk, this research investigates the dimensions employed by major international rating agencies in their evaluation processes, analysing their scope relative to those emphasised in scholarly work and in international organisations' and standard setters' guidelines.

Findings – On this basis, we develop a conceptual framework combining financial and non-financial dimensions (institutional, legal and intergovernmental) relevant to assessing LGs' financial sustainability, which surfaces and systematises perspectives across three parallel streams – rating agencies, academic literature and international organisations and standard setters.

Originality/value – The resulting practice-informed framework constitutes an important contribution, inasmuch as, by systematising existing approaches to LGs financial sustainability, it extends and complements that of rating agencies. In this way, it provides a roadmap for rating analysts, LG managers, regulators, researchers and standard setters to better integrate institutional, legal and intergovernmental dimensions into the assessment, reporting and regulation of LGs financial sustainability.

Keywords Financial condition, Fiscal health, Institutional and legal context, Intergovernmental dimensions, Subnational governments, Municipalities

Paper type Research article

1. Introduction

Despite considerable research on the topic, assessing the financial sustainability of local governments (LGs) remains a complex and contested issue. While there is broad consensus that multiple dimensions should be considered when evaluating financial sustainability (Andersen

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and Mortensen, 2010; Levine *et al*., 2013), these approaches vary significantly – from basic accounting indicators and financial reporting ratios to qualitative assessments drawn from audit reviews and sophisticated statistical models (Kleine *et al*., 2003; Honadle *et al*., 2003; McDonald, 2018; Murray and Dollery, 2005). Additionally, many approaches developed over time are often rooted in national frameworks, which are difficult to compare across borders. There is a lack of literature concerning multi-country analysis (Iacuzzi *et al*., 2025).

As noted by Padovani *et al*. (2018), there is still no universally accepted framework for measuring LGs' financial sustainability, particularly for cross-country comparisons. Although certain key indicators of municipal financial distress are widely recognised (Groves *et al*., 2003; Hendrick, 2011; Jacob and Hendrick, 2012), and efforts have been made to harmonise measurement across different accounting systems (Padovani *et al*., 2018, 2021), these remain insufficient to grasp the different contexts where LGs operate.

As the fiscal health literature (e.g. Maher *et al*., 2023; McDonald and Maher, 2020; Gomez *et al*., 2024) shows, LGs' underlying financial condition is multi-dimensional and shaped by institutional and socio-economic factors. Administrative traditions (Jugl, 2025), institutional and legal structures (Ladner *et al*., 2023; Kuhlmann, 2010) and institutional contexts vary widely (Kuhlmann and Wollmann, 2019), creating a complex web of interdependencies among local, central and other levels of government. For example, the degree of local autonomy – a critical factor in understanding financial sustainability – cannot be fully captured by financial data alone, demanding more nuanced, qualitative approaches (Ladner *et al*., 2016). From this derives a first challenge/literature gap: "accounting for context" remains unresolved.

At the same time, LGs' context has been addressed through parallel streams beyond academic research. One comes from standards and guidelines, developed by international organisations and accounting standard setters. A second comes from risk analysis practice, especially from rating agencies, where credit assessments draw on both financial data and the broader institutional and fiscal setting. Given that these three streams address LGs' financial sustainability for different purposes – scholarly explanation, financial reporting transparency and comparability and credit risk assessment – a dialogue among them should be considered for identifying where relevant contextual dimensions are omitted, where the approaches offer complementary insights and where apparently similar terms refer to different constructs. An explicit conceptual alignment leads to an unambiguous mapping of the definitions, assumptions, units of analysis and measurement choices adopted by each stream.

International organisations prescribe standards to enhance cross-country comparability and treat context as disclosed assumptions and constraints rather than something to be evaluated (Schmidthuber *et al*., 2022). Because implementation is often adapted to local contexts, comparability depends on clarifying how context shapes both the application of standards and the resulting information (Manes Rossi *et al*., 2016; Polzer *et al*., 2022).

Although rating agencies routinely perform international assessments of LGs' creditworthiness, they have received remarkably limited attention in research on LG financial sustainability and financial resilience. Credit ratings matter for LGs' financial sustainability because they reflect debt-service risk and influence borrowing costs (e.g. Johnson and Kriz, 2005; Benson and Marks, 2014; Bastida *et al*., 2017). Nevertheless, public sector financial management scholarship has rarely examined rating agencies as institutional actors and producers of evaluative frameworks, and it may be questioned how they approach the analysis of specific contextual features. From this derives our second challenge/literature gap: the understanding of which LGs' contextual conditions rating agencies consider in cross-country assessments.

Thus, the current paper addresses a dual challenge in LGs' financial sustainability: the longstanding problem of "accounting for context" emphasised in research, and the practice-defined concern with how comprehensively major rating agencies incorporate institutional, legal and intergovernmental conditions when conducting international comparisons of LGs' financial sustainability. This calls for the development of a more robust, context-sensitive conceptualisation of LGs' financial sustainability, starting with an assessment of rating agencies' approaches against the literature and the guidelines of international organisations and standard setters. Accounting for

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context in assessing LGs' financial sustainability will not only enhance practiced methodologies, but also add to the literature, offering an important theoretical contribution.

Thus, this study answers the following research questions (RQs):

RQ1. What dimensions of the context do rating agencies incorporate into their methodologies for assessing LGs' financial sustainability?

RQ2. Do those align with the dimensions highlighted by the academic literature, international organisations and accounting standard setters' guidelines?

RQ3. How can the dimensions from rating agencies, academic literature and international entities' guidelines be combined in one framework to account for context (institutional, legal and intergovernmental dimensions) when assessing LGs' financial sustainability?

The study makes a twofold contribution. First, it brings rating agencies into public sector financial management research as consequential but insufficiently examined actors in the construction, measurement and governance of LGs' financial sustainability. In doing so, the paper extends a literature that has predominantly examined financial sustainability and resilience through the perspectives of governments, accounting systems, standard setters and academic models, while devoting comparatively limited attention to the organisations that translate fiscal and contextual information into internationally comparable credit judgements.

Second, the study develops a practice-informed framework that connects three streams that have largely evolved in parallel: rating-agency methodologies, academic research and international organisation and standard-setter guidance. Its originality lies not simply in combining existing lists of contextual factors, but in illuminating the criteria selected by different institutional actors, and how they operationalise the context of LGs' financial sustainability for different purposes. The framework therefore identifies areas of convergence, divergence and omission across the three streams and provides a basis for a broader research agenda on rating agencies within public sector and financial management.

The originality of the study stems from building a practice-informed framework that bridges theory and application. Its major contribution is combining contextual elements that have been discussed across academic research, rating-agency criteria and international/standard-setter guidance. The framework developed is intended as a conceptual and integrative mapping of contextual dimensions (other than financial, incorporating institutional, legal and intergovernmental matters) relevant to assessing LGs' financial sustainability in a comparative-international perspective. By capturing the institutional, legal and intergovernmental setting within which LGs operate, these dimensions can be integrated into models of financial sustainability and reporting across countries, in line with calls for research that informs standard-setting and regulation (Mechanick and Waymire, 2023; Davidyan and Waymire, 2025). Our research particularly contributes by identifying and structuring the dimensions treated differently across the three streams, and by highlighting where academic and international organisation/standard-setter perspectives point to additional or alternative elements. This yields an integrative framework that helps connect communities currently working in parallel. In doing so, it responds to Ferry *et al.*'s (2019) and Tucker *et al.*'s (2020) calls to narrow the research–practice gap in public sector accounting and to "take a stand" on practical relevance, offering implications for LGs' managers, regulators and the agencies themselves.

The remainder of the paper is organised as follows: Section 2 clarifies the link between rating agencies, financial sustainability and context assessment considered in the current study; Section 3 outlines the research design; Section 4 presents the findings regarding the dimensions and criteria adopted by the rating agencies (4.1), those identified in the literature review (4.2) and those included in the guidelines of international organisations and standard setters (4.3); Section 5 illustrates and discusses the proposed framework, derived from a cross-comparative analysis. Finally, Section 6 concludes the paper, highlighting its originality, theoretical contribution and practical value.

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2. Rating agencies, financial sustainability and context assessment

Financial sustainability in LGs can be defined as the ability to fund current service provision and meet financial obligations (including debt service) without compromising the capacity to meet future commitments (e.g. Bisogno *et al*., 2024; Rodríguez Bolívar *et al*., 2018). Closely related, but conceptually distinct, is the notion of financial resilience, which focuses on how LGs anticipate, absorb and adapt to fiscal shocks under austerity and crisis conditions (Barbera *et al*., 2017, 2020, 2023; Steccolini *et al*., 2017; Ahrens and Ferry, 2020).

Financial sustainability is connected to credit ratings because a core component of sustainability concerns solvency and the ability to service debt over time – precisely the dimension that capital markets price when LGs borrow (Johnson and Kriz, 2005; Benson and Marks, 2014; Bastida *et al*., 2017; Rodríguez Bolívar *et al*., 2018). Credit ratings issued by rating agencies are standardised judgements (on a rating scale) on the creditworthiness of an issuer or a specific bond/debt, with the aim of assessing credit risk (e.g. White, 2010). However, rating agencies also operate as a market coordination device, for example, through watch-listing and monitoring, which can shape expectations and issuer behaviour (Boot *et al*., 2006). To form their assessment, rating agencies consider qualitative, context-specific factors – such as the strength of the local economy, the quality of local management and the political/institutional environment (Martin, 1982; Landry and McCarty, 2007; Spiotto, 2012). They also combine other qualitative information, such as managerial ability, which is reflected in credit risk assessments and relates to spreads/financing costs (Bonsall *et al*., 2016), while the comparability of financial information reduces uncertainty and is associated with lower spreads and better debt-market outcomes (Kim *et al*., 2013). Finally, rating agencies are also connected to political economy arguments that reliance on debt markets can place democratic decision-making under market discipline, making the "context" embedded in credit assessments consequential for public governance debates (e.g. Streeck, 2011).

Furthermore, financial resilience is considered in rating agencies' assessments, as they do not look only at LGs' current conditions but also take into account the entity's exposure to future risks and its capacity to deal with potential crises (Ahrens and Ferry, 2020; Barbera *et al*., 2020). Such a capacity also affects the credit risk. In fact, local fiscal decisions affect LGs' borrowing costs (Capeci, 1994), and climate risk raises issuance costs in long-term municipal bonds – an effect that is stronger among lower-rated issuers (Painter, 2020). However, while markets already care about shock vulnerability, ratings may still under-capture some of it unless agencies add an explicit resilience lens (Tran and Uzmanoglu, 2024).

Moreover, rating agencies rate governments worldwide on a single scale and therefore conduct cross-country assessments. In doing so, they interpret each LG's profile within its specific context, and it may be questioned how they approach and weigh contextual, country-specific factors. In Italy, for example, rating agencies such as Moody's Ratings (2024) upgraded the ratings of several regional and LGs in 2024, as stronger fiscal rules, tighter central oversight and access to EU recovery funds supported sustained improvements in operating balances and debt reduction. In France, by contrast, the 2025 Finance Law introduced measures that reduced local revenue flexibility and increased expenditure pressures (e.g. a cap on shared VAT, new levies and higher pension contributions). Consistent with their focus on debt-service capacity, Moody's Ratings (2025) downgraded some regions, even where financial management remained sound. This illustrates that ratings embed country-level policy and institutional shocks, so similar ratings across countries may reflect different underlying fiscal contexts.

The evidence on rating agencies suggests that contextual dimensions are often captured only imperfectly, and sometimes in biased or inconsistent ways. In their study on credit rating agencies and the Australian state governments, Hayward and Salvaris (1994) argue that the criteria used are "rubbery and inappropriate" and applied inconsistently, showing how the political values of the agencies influence the assessment of government performance and thereby problematise the use (and abuse) of contextual measures. Laulajainen (1999), in their work on subnational credit ratings, discusses how such ratings are embedded in a "cultural

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haze”: the implicit weight assigned to evaluative principles varies according to the institutional context and social values, suggesting that the treatment of context by credit rating agencies is neither neutral nor fully transparent. Ioannou *et al.* (2021) show empirically that Moody’s Ratings, on average, assigns higher ratings to subnational governments that host a financial centre, even when fundamentals are similar, revealing a systematic context-related bias, hence questioning the fairness and consistency of rating methodologies. More recently, Columbano (2025) shows that the use of government accounting information and indicators in sovereign rating methodologies is partial and selective, raising doubts about the consistency between standards/guidelines and actual rating practice.

3. Research design

This study adopts a qualitative, multi-step research design to develop a conceptual framework, combining financial and non-financial (institutional, legal and intergovernmental) dimensions relevant to assessing LGs’ financial sustainability, which translates and systematises these dimensions across three parallel streams.

The pathway unfolds the following three main steps:

(1) Step 1 – Practitioner-grounded elements (rating agencies’ practice). In this step, we analyse the methodologies used by major international rating agencies for LGs to identify the variables they consider and the underlying non-financial dimensions implicit in those assessments (e.g. institutional frameworks, intergovernmental arrangements, governance and management). Specifically, we analyse the methodologies published by Moody’s Ratings, S&P Global Ratings and Fitch Ratings. These are the three dominant global rating agencies, often referred to as the “Big Three”, and occupy a central position in international financial markets (Alsakka and ap Gwilym, 2010; Ramírez-Rondán *et al.*, 2023). Their methodologies are publicly available and regularly updated (Marandola, 2021), making them particularly suitable for systematic, cross-country comparisons.

(2) Step 2 – Dimensions and variables cross-comparison and complement from authoritative sources, comprising (2a) literature review and (2b) international organisations’ guidelines.

- In Step 2a, we synthesise scholarly contributions from peer-reviewed literature on institutional, legal and intergovernmental arrangements related to LGs’ management.
- In Step 2b, we analyse the identified dimensions/criteria considered by the International Public Sector Accounting Standards Board – IPSASB (namely the *Recommended Practice Guideline 1: Reporting on the Long-Term Sustainability of an Entity’s Finances*), the Organisation for Economic Co-operation and Development (OECD), the International Monetary Fund (IMF) and the European Central Bank (ECB). These entities are widely recognised as either public sector accounting standard setters or oversight organisations that provide cross-country comparable frameworks and indicators on public finances (Caruana *et al.*, 2019; Bisogno *et al.*, 2024; Scannell and Tawiah, 2024).

Caruana *et al.* (2019) identify the IPSASB RPG 1 as a conceptual reference point for long-term financial sustainability in the public sector. Barta (2015) critically discusses how the notion of fiscal sustainability has been constructed and operationalised in supranational policy frameworks, showing the central role of the benchmarks and analytical tools developed by the European Commission and the IMF (and, to a lesser extent, the OECD) in shaping reforms of European welfare states. Moreover, studies on fiscal sustainability in European countries (e.g., Paniagua *et al.*, 2017) show that the indicators and time horizons employed are those

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derived from or discussed by the IMF, the OECD, and the ECB, reinforcing the view that these organisations define the dominant practice for analysing fiscal sustainability.

(3) Step 3 – Framework development. In this step, we integrate and revise the rating-agency variables (Step 1) with results from the literature and guidelines from international entities (Step 2) to specify a coherent framework.

Table 1 summarises the documents analysed in Steps 1 and 2b.

To our knowledge, no existing study systematically starts from rating agencies' methodologies, explicitly triangulates them with both academic literature and international organisations' guidelines, and then develops a unified conceptual framework to assess LGs' financial sustainability in an international perspective. Yet, the extrapolation of abstract dimensions from the literature into operational frameworks has been a common practice.

Table 1. Rating agencies' methodologies and international institutional sources analysed in Step 1 and Step 2b

Organisation	Title
Fitch Ratings	Fitch Ratings (2024). *International local and regional governments rating criteria (Master Criteria)*, Public Finance Local and Regional Governments Global - Non-US, 16 August; available at: https://www.fitchratings.com/research/international-public-finance/international-local-regional-governments-rating-criteria-03-09-2021 (accessed 8 August 2025)
Moody's Ratings	Moody's Ratings (2024). *Rating methodology: Regional and local governments* (Sub-sovereign rating methodology), May 28; available at: https://www.moodys.com/research/Rating-Methodology-Regional-and-Local-Governments-Rating-Methodology–PBC_1393150 (accessed 8 August 2025)
S&P Global	S&P Global (2024). Criteria | Governance | International Public Finance: *Methodology for rating local and regional governments outside of the US;* July 26; available at: https://www.spglobal.com/ratings/en/regulatory/article/-/view/sourceId/10969943 (accessed 8 August 2025) S&P Global (2024). *Institutional framework assessments for local and regional governments outside of the U.S.*, updated April 8; available at: https://www.spglobal.com/ratings/en/regulatory/article/-/view/sourceId/13062039 (accessed 8 August 2025)
IPSASB	IPSASB (2025)0.*2025 Handbook of International Public Sector Accounting Pronouncements (Vol. III).* May 5, 2025 Edition, International Federation of Accountants; available at: https://www.ipsasb.org/publications/login/76902 (accessed 8 August 2025)
ECB	Olsson, H., & Catz, J. (2023). *A closer look at subnational government finances*. European Central Bank Statistical Paper Series No. 42; available at: https://www.ecb.europa.eu/pub/pdf/scpsps/ecb.sps42~84e9783492.it.pdf?2d6e72d94b676b532ab60cdc721b1eac (accessed 8 December 2025)
OECD	OECD (2024). *Going granular with regional and municipal fiscal data*. *OECD and EU countries*. OECD Centre for Entrepreneurship, SMEs, Regions and Cities, OECD Publishing; available at: https://www.oecd.org/en/publications/going-granular-with-regional-and-municipal-fiscal-data_8a17c019-en.html (accessed 8 December 2025)
IMF	IMF (2025). *Fiscal monitor: Fiscal policy under uncertainty*, International Monetary Fund, May 12; available at: https://www.imf.org/en/publications/fm/issues/2025/04/23/fiscal-monitor-april-2025 (accessed 8 December 2025) Lledó, V., Gbohoui, W., & Ncuti, C. (2022). *The IMF Fiscal Decentralization Dataset*. International Monetary Fund; available at: https://data.imf.org/en/datasets/IMF.STA:FD (accessed 8 December 2025)

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As depicted in Table 2, which reviews studies employing the components related to this research design, the study by Cabaleiro *et al*. (2012) is the closest precedent. These authors base their method for assessing municipal financial health on both the Canadian Institute of Chartered Accountants' (CICA) framework and the Governmental Accounting Standards Board's (GASB) guidance, as international frameworks such as IPSASB were not available at that time; they also draw on Fitch Ratings' methodology for local and regional governments as a background reference. They conceptualise municipal financial health as a multidimensional construct, influenced by dependence on higher levels of government and by institutional arrangements; also, they develop a Standardized Financial Health Index. However, their model does not treat rating agencies as the primary conceptual anchor, and does not explicitly unpack non-financial institutional, legal and intergovernmental dimensions or map them against international public sector standards.

Other contributions employ specific components of the research design applied in the present study. Zafra-Gómez *et al*. (2008) anchor their model of the financial condition of Spanish municipalities in the literature and standards such as CICA and GASB that operationalise those ideas, showing that LGs' financial positions cannot be understood without considering service quality and the socioeconomic environment. Lara-Rubio *et al*. (2017) use the classifications of S&P Global and Moody's Ratings as one of the inputs for selecting explanatory variables in their empirical model of credit risk, demonstrating that macro-level and contextual variables related to the broader environment materially affect LGs' financial trajectories. Coy and Dixon (2004) derive disclosure items for the Public Accountability Index for New Zealand universities from existing reporting practices and regulatory requirements before theorising them. Hooks *et al*. (2012) construct an index of best-practice performance reporting for Malaysian local authorities, starting from what national and international best-practice guidance expects to be reported. Galane *et al*. (2025) likewise conduct a systematic and integrative review of frameworks and standards when developing their compliance index for South African state-owned enterprises. More generally, Arianpoor and Borhani (2025) demonstrate how International Financial Reporting Standards (IFRS) can serve as a reference point when designing conceptual frameworks to examine the interaction between blockchain technology and the audit process.

However, none of these works integrate multiple authoritative institutional sources, rating-agency methodologies and scholarly literature into a unified mapping of financial and non-financial institutional, legal and intergovernmental dimensions, as is undertaken in the present study. Therefore, our research design can be viewed as a coherent synthesis and extension of practices that have been applied separately in different strands of the literature to date.

In line with recommendations for team-based qualitative research (Guest and MacQueen, 2008), Steps 1 and 2b were conducted by Researchers A and B, and Step 2a was conducted by Researchers C and D independently, ensuring that the identification of dimensions in each step was not influenced by the findings of the other. This choice follows Miles *et al*. (2014), who underline the value of independent coding for reducing researcher-driven bias, and Krippendorff (2019), who emphasise the importance of independent analytical work for strengthening the reliability and trustworthiness of qualitative analyses. In both steps, the identification and coding of variables and dimensions were based on a systematic reading of the relevant documents, allowing categories to emerge from the material rather than from a predefined extraction grid, in line with established approaches to inductive document analysis and qualitative coding (Bowen, 2009; Saldaña, 2013). In Step 1, the search implied an overall reading of the reports to find context-related financial risk assessment dimensions and criteria used in the rating agencies' methodologies. From a cross-comparative analysis in Excel files, several dimensions emerged from commonalities.

Step 3 was then carried out collectively by all four researchers through joint discussions and refinement of the emerging framework, thereby implementing investigator triangulation, which is understood as collaborative analysis and consensus-building among multiple researchers to enhance validity and trustworthiness (Denzin, 2009; Guest and MacQueen,

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Table 2. Comparison of methodological components in related studies to this study's research design

Study	Domain	S1 – Grounded on rating agencies methodologies	S2a – Dimensions derived from literature	S2b – Dimensions derived from international organisations' guidelines	S3 – Model (output)	Methodological alignment and divergence relative to this study
Coy and Dixon (2004)	✕Public universities (NZ) – accountability reporting	✕ Practice-based: existing reporting practices and regulatory requirements	✓ Substantial review on public accountability and disclosure	✕ National reporting guidance/statutory requirements as reference	✓ Public Accountability Index (parametric disclosure index)	✓ S2a + S3 ✕ No S1; No S2b; Non-LG domain
Zafra-Gómez *et al.* (2008)	✓ LGs (Spain) – financial condition	✕ Practice-oriented frameworks as starting point	✓ Reviews concepts of financial condition and fiscal stress	△ Aligns with CICA/GASB-type guidance on financial condition	✓ Multi-dimensional financial condition model	✓ S2a + Partial S2b + S3 ✕ No S1
Hooks *et al.* (2012)	✓ Local authorities (Malaysia) – performance reporting	✕ Practice-based, referring to rating of financial management by the Auditor General and ratings derived from reports by the President/ Treasury	✓ Review on accountability and performance reporting	△ National codes of practice and best-practice guidelines	✓ Best-practice performance reporting index	✓ S2a + Partial S2b + S3 ✕ No S1; Partial domain (performance reporting of LGs)
Cabaleiro *et al.* (2012)	✓ LGs (Spain) – municipal financial health	△ Fitch Local and Regional Governments methodology as conceptual base	✓ Draws on literature on municipal financial health and related indicators	△ Anchored to CICA/GASB frameworks	✓ Standardized Financial Health Index	✓ Partial S1 + S2a + Partial S2b + S3 & domain ✕ Rating agencies as a conceptual base

(*continued*)

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Table 2. Continued

Study	Domain	S1 – Grounded on rating agencies methodologies	S2a – Dimensions derived from literature	S2b – Dimensions derived from international organisations' guidelines	S3 – Model (output)	Methodological alignment and divergence relative to this study
Lara-Rubio *et al.* (2017)	✓ LGs (Spain) – credit risk	✓ S&P & Moody's classifications to guide variable selection	✓ Builds on literature on indebtedness, default and credit risk	△ Contextual references to EU environment, but not structured standards mapping	✓ Statistical model of default probability	✓ S1 + S2a + S3 and domain
Galane *et al.* (2025)	✕State-owned enterprises (South Africa) – compliance/ Public Financial Management	✕ Grounded in existing frameworks and practice on performance/governance	✓ Systematic and integrative review of frameworks	✓ Multiple governance/ performance frameworks and standards	✓ Compliance index	✓ S2a + S2b + S3 ✕ No S1; Non-LG domain
Arianpoor and Borhani (2025)	✕Corporate/private-sector accounting and audit	✕ No	✓ Meta-synthesis of prior studies	✓ International financial reporting standards	✓ Interaction framework of Blockchain, audit and international reporting standards	✓ S2a + S2b + S3 ✕ No S1; Non-LG domain

Note(s) ✓ *Explicitly used/Fully aligned*: The study explicitly incorporates this component as defined in this research design
✕*Not used/Not applicable*: The study does not employ this component, or it falls outside the scope adopted in our research
△ *Indirect or partial use*: The component is drawn on only in part, indirectly, or at a conceptual/background level, but is not fully or systematically operationalised in the study
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2008; Miles *et al.*, 2014). Divergences were reviewed and resolved through collective discussion until analytic convergence was reached. A key feature of this research design is cross-comparison across sources and researchers.

4. Findings

This section summarises the findings of our analysis, compiling evidence gathered from qualitative content analysis (Hsieh and Shannon, 2005) of rating agencies' reports (Step 1), academic literature (Step 2a) and international organisations and standard setters' guidelines (Step 2b).

4.1 Dimensions and criteria adopted by rating agencies

The analysis of the methodologies applied by the rating agencies, namely Moody's Ratings, S&P Global and Fitch Ratings, to assess financial risks and sustainability of LGs, enabled the collection of evidence summarised in Table 3, which focuses on contextual dimensions.

All agencies recognise the importance of the macro scenario. Moody's Ratings and S&P Global allocate specific percentages in their assessment grids for this dimension, even though it is broadly assessed.

Regarding the institutional framework and governance issues, for S&P Global, the former embraces formal rules and laws, as well as practices, customs and precedents that shape LGs' institutional arrangements and influence their policies in public finance. Fitch Ratings designates this as the "operational environment," which is shaped by the rules and circumstances that reflect the wider country-specific context and institutional framework in which the rated issuer operates. Moody's Ratings does not present any particular definition. Even if not explicitly, governance issues are embraced by what the agencies consider the LG institutional framework, inasmuch as issues such as governing powers and responsibilities, tax autonomy and intergovernmental relations are contemplated.

Rules, policies and regulations concerning the accounting and financial reporting system are broadly considered by S&P Global and Fitch Ratings, even if either included in the institutional framework or as "Additive Risk Considerations"; Moody's Ratings does not make any explicit references to those, despite referring to fiscal controls, transparent accounts and in-year monitoring and reporting as included in their institutional framework. None of the agencies specifically refer to either cash *versus* accrual accounting or the International Public Sector Accounting Standards (IPSAS).

A dimension of assessment central to all agencies addresses the LGs' risk profile, involving criteria relating to the vulnerability of expenditures and revenue, debt and interest burden, risk mitigants and cash and financial management capacity.

4.2 Dimensions and criteria emerging from the literature

No universally accepted framework currently exists in the literature for assessing LGs' financial sustainability across countries (Padovani *et al.*, 2018). While financial distress indicators are relatively standardised (Groves *et al.*, 2003; Hendrick, 2011; Jacob and Hendrick, 2012), measurement systems struggle to account for the distinct institutional and administrative contexts in which LGs operate (Padovani *et al.*, 2018, 2021).

Indeed, as prior literature considered in the section above shows, existing empirical models of municipal financial condition and credit risk (e.g. Cabaleiro *et al.*, 2012; Zafra-Gómez *et al.*, 2008; Lara-Rubio *et al.*, 2017) and disclosure-based approaches to performance reporting (e.g. Hooks *et al.*, 2012) only partially incorporate these contextual features, typically treating socio-economic or institutional variables as controls or background conditions rather than as core dimensions of LGs' financial sustainability. On the other hand, some literature (e.g., Iacuzzi *et al.*, 2025) consistently underscores that LGs' financial sustainability cannot be understood in isolation from the broader institutional, legal and intergovernmental context.

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Table 3. Rating agencies' assessment dimensions and criteria for context when assessing financial risks and sustainability of LGs

Dimensions	Criteria
Macro environment context	• Country's/Region's overall income, economic growth and economic diversification (Moody's) • Wealth and income levels – GDP per capita with local qualitative adjustments (S&P) • Economic stability (Fitch) • Financial market development, affected by endogenous, exogenous and specific-sector factors (Fitch) • ESG-related factors (Fitch) • Sovereign rating (Fitch)
Institutional framework and governance issues	• Rules and procedures about governing powers and responsibilities (robust and clearly defined in the law; transparency in any change) (Moody's) • Fiscal planning and budget management; fiscal policies such as debt and deficit ceilings (Moody's, S&P) • Fiscal controls, transparent accounts and in-year monitoring and reporting (Moody's) • Adequacy of the revenues to the expenditures (S&P) • Predictability (frequency, implementation and outcomes) of the reforms affecting the division of responsibilities and revenues between levels of government (S&P) • Operational environment, which includes the revenue mix, tax autonomy, intergovernmental relations, funding and any equalisation mechanisms, expenditure profile, level and mix of responsibilities and bankruptcy regime (Fitch) • Easy access to funding (domestic capital market, banks, public sector funding) (Moody's) • Rescue mechanisms and exceptional support from Central government (Fitch, S&P) • External support (bank and *ad hoc* loans from government (Fitch)
Accounting and reporting system	• National regulation of public-sector accounting systems and standards of financial reporting and planning, in the transparency and accountability sub-dimension (S&P) • Sector-wide accounting and reporting policies for borrowing, and control and monitoring (Fitch) • Accounting policies, reporting and transparency (Fitch)
Risk profile	• Financial management ability – political and managerial strength, affecting financial planning and implementation; and liquidity, debt and contingent liabilities management (S&P) • Cash flow capacity (revenue and expenditure structure), stable debt service (financial commitments) with adequate liquidity and contingent liabilities (Fitch) • (Debt and investment) risk mitigants (included in the IF by Moody's; Fitch) • Revenue and expenditure flexibility, included in the IF (Moody's) • Volatility of expected cash flows, from operations and investment activities (Fitch)

Source(s): Authors' own work

Finally, despite efforts to harmonise financial sustainability measurement tools internationally, there is still a dearth of comparative multi-country studies (Jacob and Hendrick, 2012; Padovani and Scorsone, 2011; Padovani *et al*., 2021).

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Nevertheless, from the literature, as outlined below, it emerges that comparative analyses must consider:

(1) Administrative traditions, which define the institutional arrangements and the scope of LGs;

(2) Legal constrains, which affect local discretion and define debt management procedures;

(3) Accounting systems and adoption of international standards, which influence measurement and comparability;

(4) Supervision, auditing and accountability mechanisms, which enforce compliance and transparency; and

(5) (De)centralisation and coordination, which structure intergovernmental arrangements and the dependency of LGs from higher levels of government.

Collectively, these dimensions reveal that financial sustainability is not merely a financial condition dependent on LGs' performance on some key financial criteria, but a multidimensional construct embedded within each country's institutional, legal and intergovernmental fabric.

4.2.1 Administrative traditions. A country's administrative tradition profoundly affects its institutional framework and hence the structure, autonomy and performance of its LGs (Kuhlmann, 2010; Kuhlmann *et al*., 2025; Ladner *et al*., 2023). Administrative traditions influence governance patterns, decision-making logics and the implementation of fiscal and accounting systems (Jugl, 2025). Drawing on new institutional theory, Lounsbury (2008) emphasises that shared cultural beliefs and rules shape organisational decision-making and thus affect how financial sustainability is perceived and pursued.

Kuhlmann *et al*. (2025) propose six distinct European administrative profiles – Continental European Napoleonic, Continental European federal, Nordic, Anglo-Saxon, Central Eastern European and Southern Eastern European – each with differing legalistic traditions, decentralisation levels and LG autonomy. In Napoleonic systems, whether with a centralised administrative structure like in Portugal and Greece or more decentralised like in Italy, a legalistic and hierarchical culture constrains local discretion, while federal systems combine legalistic frameworks with stronger decentralisation and LGs. Nordic, i.e., Scandinavian countries, also have a strong law tradition in unitary, though decentralised states, but combine it with transparency in recruiting and public career systems and the explicit accessibility of the public administrations by citizens. Anglo-Saxon systems stem from a public interest culture and emphasise pragmatism, managerial flexibility and functional responsibility. Central Eastern European systems saw the reestablishment of the rule of law but are still characterised by a socialist cadre administrative heritage within unitary states with strong LGs, whereas Southern Eastern European systems, also transitioning from socialist legacies, display weaker LGs' administrative capacity and more centralised administrative control. Nevertheless, not every country which would naturally be identified with these models will follow all their characteristics.

Using a different perspective, which includes all countries, not only European ones, Jugl (2025) identifies two underlying dimensions of administrative traditions, namely citizen orientation and structural concentration. These dimensions characterise four possible ideal settings, i.e., extreme and theoretically pure types to which empirical cases can be more or less closely aligned. They are: a "providing public administration" that is structurally concentrated with the (central) state as core player to deliver public services in line with citizens' needs, such as are Denmark, Iceland and the Netherlands; a "liberal public administration", which is equally oriented towards citizens' needs but much more dispersed structurally to allow for more diversity within administrative and governance practices, such as in Canada and New

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Zealand; a "detached public administration", an administrative system that is dispersed horizontally and vertically and revolves around itself and the preferences of politicians and bureaucrats such as in Bangladesh, Bosnia and Herzegovina or India; finally, a "dominant public administration" that gives those in power vast control over a centralised and influential bureaucracy allowing them to force the will of the governing on citizens as in Hungary, Serbia and Turkey.

Regardless of the framework considered, the differences among the various types of LGs highlight how administrative traditions condition the institutional power and financial sustainability outcomes of LGs.

4.2.2 Legal constraints. Legal factors, including fiscal rules, debt limits and insolvency procedures play a decisive role in shaping local financial sustainability. Central governments typically define these frameworks, influencing local discretion over borrowing and spending (Allers and de Natris, 2021; Sutherland *et al.*, 2018). Fiscal rules determine permissible levels of indebtedness and the extent of intergovernmental transfers, thereby constraining local fiscal autonomy and independence. National insolvency and bailout procedures also differ in effectiveness and legal design (Canuto and Liu, 2013; Person, 2021; Padovani and Scorsone, 2011), affecting how LGs manage financial crises (Padovani *et al.*, 2021).

The diversity of fiscal and legal settings underscores that evaluating LGs' financial health cannot rely solely on financial performance criteria; rather, contextual legal frameworks must be incorporated into comparative analyses of fiscal indexes, such as fiscal autonomy (Ladner *et al.*, 2016).

4.2.3 Accounting systems and the adoption of global financial reporting standards. Accounting systems determine how LGs' financial health is measured and communicated, which in turn can influence financial sustainability. The adoption of global accounting standards and practices, such as accrual accounting and the IPSAS, has contributed to greater comparability across jurisdictions (Jorge *et al.*, 2019). However, despite efforts toward harmonisation (Schmidthuber *et al.*, 2022), significant divergences persist (Polzer *et al.*, 2022), even within the European Union (European Commission, 2020).

These differences influence not only how financial data are reported but also how LGs perceive their fiscal position and make policy decisions (Donatella and Karlsson, 2025). National accounting systems reflect broader institutional legacies and administrative cultures (Meyer and Hammerschmid, 2010; Nobes and Parker, 2016), reinforcing the view that financial sustainability assessments are embedded in country-specific institutional settings.

Beyond the abovementioned issues related to financial reporting, the non-financial dimension of accounting is also critical. As a key component of financial health, service solvency – defined as the ability of a government to provide the services its citizens require and desire (Groves *et al.*, 2003) – plays an essential role in evaluating the financial condition of (local) governments (IPSASB, 2025). Increasingly, the literature recognises the strong interdependence between service solvency and financial health as captured by accounting information.

Within the context of the Sustainable Development Goals' (SDGs) non-financial framework, empirical evidence highlights a complex interdependence between financial and non-financial accounting information in the implementation of the SDGs (European Commission, 2025). Benito *et al.* (2023) and Ríos *et al.* (2024) demonstrate that stronger engagement with the SDGs improves stakeholder-related outcomes but often coincides with lower fiscal surpluses. In contrast, greater financial autonomy supports sustainability actions. Bisogno *et al.* (2024) and Cuadrado-Ballesteros *et al.* (2014) further demonstrate that financial sustainability enables broader social and environmental outcomes. At the same time, Alonso-Morales *et al.* (2024) reveal SDG-specific financial trade-offs, and Gil-García *et al.* (2024) stress that effective SDGs performance depends on efficient, impact-oriented budgeting rather than funding allocations alone.

Finally, the non-financial side of accounting has become increasingly important for public-sector risk management (Gourbier *et al.*, 2025) and may hinder effective resource use if it is not properly embedded within internal control mechanisms (Padovani *et al.*, 2021).

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4.2.4 Supervision, auditing and accountability mechanisms. Auditing and supervision practices constitute another critical institutional dimension affecting LGs' financial sustainability. These mechanisms vary widely across countries in terms of independence, frequency and enforcement power (Geissler and Wegrich, 2021; Ferry and Ruggiero, 2022). In some contexts, auditing systems serve primarily a compliance role, while in others they foster transparency and performance-based accountability (Jorge *et al*., 2023).

The design of these systems reflects the balance between administrative control and managerial autonomy (Ferry *et al*., 2023), influencing how effectively LGs can maintain fiscal discipline and respond to early warning signals of financial distress.

4.2.5 (De)centralisation and coordination. Intergovernmental dynamics, particularly the degree of decentralisation and the extent of supervision and regulation by higher tiers of government, may play a vital role in shaping LGs' financial sustainability. The vertical distribution of authority affects both resource allocation and fiscal responsibility (Pollitt and Bouckaert, 2017; Geissler *et al*., 2019). Pollitt and Bouckaert (2017) identify two basic dimensions: the degree of vertical dispersion of authority, i.e., how far authority is shared between different levels of government, where some countries are highly centralised, with most significant decisions concentrated at the top level, while some are much more decentralised; and the degree of horizontal coordination at central government level, i.e., how far central executives work in a coordinated or fragmented fashion. Moreover, in federal countries, intermediate governments (states or regions) often define local fiscal frameworks, adding an additional subnational layer of institutional complexity (Wang and Scorsone, 2020).

Patterns of vertical coordination may enhance local fiscal capacity or reinforce dependency on central government transfers. The structure of intergovernmental relations, including shared tax bases, grants and supervision mechanisms, thus critically conditions LGs' financial sustainability (Padovani *et al*., 2021). Moreover, as for the central level, horizontal coordination at the local level may influence financial conditions and responses to crises (Bocchino and Padovani, 2021).

All in all, the preceding review has revealed specific dimensions and/or criteria, which can be used to explain an LG's context in the assessment of financial sustainability, which are summarised in Table 4.

4.3 Dimensions and variables from international organisations and standard setter guidelines

Table 5 displays the dimensions derived from cross-analysing guidelines and reports from international organisations, namely the OECD, IMF and ECB, which assess countries' and governments' financial sustainability in comparative approaches. In addition, we also considered the IPSASB's RPG 1 for public sector entities to report (financial and non-financial information) about their long-term financial sustainability. Despite addressing and defining several measurement criteria, it is curious that none of the analysed documents presents an explicit definition of financial sustainability.

Among the criteria to assess subnational governments' financial sustainability and risks, international organisations appear to distinguish between the countries' context and the macro international economic and social scenario. Issues related to inflation and interest rates are also considered, notably by the IMF, which oversees monetary policy. The IMF also differentiates from the other analysed organisations by considering political criteria (which may be part of the institutional framework) such as the electoral cycle, and government accountability and communication strategies to build trust among citizens.

Regarding the accounting and reporting systems, while international organisations primarily base their systems on fiscal and national statistics figures (GFS and ESA), which rely on cash-based information with some accruals, the IPSASB clearly supports accrual-based financial accounting and reporting. The OECD also recognises the importance of accrual accounting and reporting systems in enhancing information comparability and transparency.

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Table 4. Aspects that shape the financial context in which LGs operate according to literature

Dimension	Model/criteria
Administrative traditions	Kuhlmann *et al*. (2025) • Continental Napoleonic • Continental Federal • Nordic • Anglo-Saxon • Central Eastern European • South Eastern European Jugl (2025) • citizen orientation • structural concentration
Legal constraints	No model clearly emerges from the literature, but an assessment should include at least fiscal rules, debt limits and insolvency procedures. (Geissler *et al*., 2021)
Accounting systems and adoption of international standards	• Accrual accounting *vs* others • Adoption of IPSAS • Non-financial information
Supervision, auditing and accountability mechanisms	No model clearly emerges from the literature, but an assessment should include at least (Geissler and Wegrich, 2021) • frequency • enforcement power • compliance *vs* transparency and performance-based accountability • independence, e.g. administrative control *vs* managerial autonomy
(De)centralisation and coordination	Pollitt and Bouckaert (2017) • degree of vertical dispersion of authority • degree of horizontal coordination

Source(s): Authors' own work

5. Comparative-integrated analysis: a framework proposal

In order to propose a framework that integrates several contextual dimensions (institutional, legal and intergovernmental) to evaluate LGs' financial sustainability across countries worldwide, the results of each step in the previous section were systematised in a criterion-level traceability matrix, represented by Table 6. It codes candidate dimensions/criteria from rating agencies (Step 1), the literature (Step 2a) and international organisations (Step 2b), incorporating them in one final framework, where these criteria are then grouped in sub-dimensions and dimensions.

This framework portrays four dimensions for evaluating the context in which LGs operate when assessing their financial sustainability from a global perspective: (0) administrative traditions, (1) international and national macroeconomic, political and financial operating environment, (2) institutional, fiscal, governance and intergovernmental environment and (3) accounting and reporting system. While dimensions 1, 2 and 3 are subject to change over time, dimension 0 remains relatively stable and, to a certain extent, defines the cross-national context in which LGs operate – a sort of institutional culture shaping administrative behaviour, decision-making and accountability practices. Also, administrative traditions are not considered by rating agencies nor international organisations' frameworks and standards. Each of dimensions 1, 2 and 3 is further divided into sub-dimensions, representing homogeneous groups of criteria.

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Table 5. LGs' financial sustainability issues as considered by international organisations and standard setters when assessing the context shaping their financial management

Dimension	Criteria/dimensions
Macroeconomic factors and social conditions	• Growth, inflation, interest rates, currency depreciation (IMF) • Economic and political uncertainty and risks (IMF and IPSASB) • Oil prices (IMF) • Population ageing (IMF and IPSASB)
Country's context	• Future economic and demographic conditions (IPSASB) • Assumptions about country and global trends (e.g. productivity, competitiveness, population age, income, educational level and workforce participation) (IPSASB) • Purchasing Power Parities (OECD) • Population, GDP (OECD and ECB) • Citizens and other stakeholders' sentiments and reactions (IMF)
Institutional framework	• Nature of the entity and regulatory environment (IPSASB) • Revenues shared with the central government vs local discretionary revenues (IMF) • Key institutional characteristics, such as government accountability and governance, to build trust (IMF) • Electoral cycles (IMF) • Transparency and effective communication strategies for fostering public trust (IMF) • Transfer dependency and vertical fiscal imbalances (IMF)
Accounting and reporting system	• Comparison of fiscal reality on a cash basis (OECD) • Accrual basis and international standards essential to improve the comparability and transparency of government financial reports (IPSASB and OECD) • ESA2010 (ECB) • Government Financial Statistics (GFS) – cash or non-cash (a spectrum of recording basis other than cash, including accrual) information (IMF)

Source(s): Authors' own work

From a practical standpoint, this combined analytical framework provides practitioners with a comprehensive and integrated set of elements to be considered when assessing the contextual conditions in which an individual LG operates. At the same time, the framework has important theoretical implications. Given that rating agencies are currently the primary actors conducting cross-country comparative assessments of LGs' financial health – implicitly assuming the comparability of LGs across national systems – this framework highlights several contextual aspects that are not systematically considered in rating methodologies.

The differences identified across the three streams primarily reflect their distinct purposes and analytical lenses. Rating agencies prioritise credit-material factors and comparability across issuers, whereas public management scholarship and international standard-setting frameworks consider a broader range of institutional, governance, service-delivery and reporting conditions. More broadly, much of the literature informing comparative assessments of LGs originates from public administration and public (financial) management research, whereas rating agencies primarily adopt a banking and finance perspective. For instance, administrative traditions (dimension 0) illustrate this complementarity. Although they are not explicitly treated as a cross-country contextual variable in rating methodologies, they can help explain differences in governance arrangements, accountability mechanisms and service-delivery models that may affect the interpretation of LG financial health. Our proposal,

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Table 6. Accounting for context in LGs' financial health analysis: the comparative-integrated analytical model

Step 1 rating agencies Criteria	Step 2a Literature review Criteria	Step 2b Guidelines and standards by international setters Criteria	Final framework Criteria, grouped in sub-dimensions	Dimensions
	S2a.1. Administrative traditions: (Continental Napoleonic; Continental Federal; Nordic; Anglo-Saxon; Central Eastern European; South Eastern European) (Kuhlmann *et al*., 2025) S2a.2. Citizen orientation/structural concentration (Jugl, 2025)		0.1. Administrative traditions (administrative traditions, citizen orientation/structural concentration – persistent nationwide attributes) [S2a.1; S2a.2]	*0. Administrative traditions*
S1.1. Country's/Region's overall income, economic growth and economic diversification (Moody's) S1.2. Wealth and income levels – GDP per capita with local qualitative adjustments (S&P) S1.3. Economic stability (Fitch) S1.4. Financial market development, affected by endogenous, exogenous and specific-sector factors (Fitch) S1.5. Sovereign rating (Fitch)		S2b.1. Growth, inflation, interest rates, currency depreciation (IMF) S2b.2. Economic and political uncertainty and risks (IMF, IPSASB) S2b.3. Oil prices (IMF) S2b.4. Population ageing (IMF, IPSASB) S2b.5. Future economic and demographic conditions (IPSASB) S2b.6. Assumptions about country and global trends (e.g., productivity, competitiveness, population age, income, educational level and workforce participation) (IPSASB) S2b.7. Purchasing Power Parities (OECD) S2b.8. Population, GDP (OECD, ECB) S2b.9. Citizens and other stakeholders' sentiments and reactions (IMF)	*1.1. Sovereign risk, political conditions and policy environment* (sovereign creditworthiness, political stability and macro-policy credibility) 1.1.1. Sovereign credit rating and perceived credit risk [S1.5] 1.1.2. Economic and political uncertainty, governance and risk factors [S2b.2] 1.1.3. Forward-looking policy and global trend assumptions (productivity, competitiveness, etc.). [S2b.6] 1.1.4. External comparability and international positioning (purchasing power parties, population/GDP scale, country and global trends) [S2b.7; S2b.8; S2b.6] *1.2 Financial system characteristics and market conditions* (depth, functioning and vulnerability of financial markets) 1.2.1. Financial market development and sector-specific conditions [S1.4] 1.2.2. Market-sensitive macro-financial factors (interest rates, inflation expectations, exchange rate dynamics) [S2b.1] 1.2.3. Exposure to commodity price fluctuations, particularly oil [S2b.3] *1.3. Macroeconomic strength, structure and performance (local level)* (core indicators of economic capacity, stability, income levels and structural characteristics) 1.3.1. Overall economic size, income level, growth performance and diversification [S1.1; S1.2; S2b.8] 1.3.2. Economic stability and macro-financial resilience (inflation, interest rates, currency depreciation) [S1.3; S2b.1] 1.3.3. Structural long-term economic outlook (demographics, productivity, competitiveness) and citizens/stakeholders' sentiments and reactions [S2b.4; S2b.5; S2b.6; S2b.9]	*1. International and national macroeconomic, political and financial operating environment*

(*continued*)

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Table 6. Continued

Step 1 rating agencies Criteria	Step 2a Literature review Criteria	Step 2b Guidelines and standards by international setters Criteria	Final framework Criteria, grouped in sub-dimensions	Dimensions
S1.6. Rules and procedures about governing powers and responsibilities (robust and clearly defined in the law; transparency in any change) (Moody's) S1.7. Fiscal planning and budget management; fiscal policies such as debt and deficit ceilings (Moody's, S&P) S1.8. Fiscal controls, transparent accounts and in-year monitoring and reporting (Moody's) S1.9. Adequacy of the revenues to the expenditures (S&P) S1.10. Predictability (frequency, implementation and outcomes) of the reforms affecting the division of responsibilities and revenues between levels of governments (S&P) S1.11. Operational environment, which includes the revenue mix, tax autonomy, intergovernmental relations, funding and any equalisation mechanisms, expenditure profile, level and mix of responsibilities and bankruptcy regime (Fitch) S1.12. Easy access to funding (domestic capital market, banks, public sector funding) (Moody's) S1.13. Rescue mechanisms and exceptional support from Central government (Fitch, S&P) S1.14. External support (bank and ad hoc loans from government (Fitch)	S2a.3. Legal constraints - an assessment should include at least fiscal rules, debt limits and insolvency procedures (Geissler *et al*., 2021) S2a.4. Supervision and accountability mechanisms: No model clearly emerges from the literature, but an assessment should include at least: frequency, enforcement power, compliance vs transparency and performance-based accountability, independence, e.g. administrative control vs managerial autonomy (Geissler and Wegrich, 2021) S2a.5. Intergovernmental arrangements: degree of vertical dispersion of authority, degree of horizontal coordination (Pollitt and Bouckaert, 2017)	S2b.10. Nature of the entity and regulatory environment (IPSASB) S2b.11. Revenues shared with the central government vs local discretionary revenues (IMF) S2b.12. Key institutional characteristics, such as government accountability and governance, to build trust (IMF) S2b.13. Electoral cycles (IMF) S2b.14. Transparency and effective communication strategies, for fostering public trust (IMF) S2b.15. Transfer dependency and vertical fiscal imbalances (IMF)	*2.1. Institutional framework, governance quality and legal foundations* (fundamental rules, legal structures and governance mechanisms that shape how the public sector operates) 2.1.1. Legal framework, governing powers, responsibilities and institutional clarity [S1.1; S2a.1; S2a.3] 2.1.2. Governance quality, accountability, supervision and enforcement mechanisms [S2a.2; S2b.3] 2.1.3. Transparency, communication and institutional trust-building [S1.3; S2b.5] 2.1.4. Regulatory and operational environment of the entity [S1.6; S2b.1] *2.2 Fiscal management, budgetary performance and financial controls* (how effectively a government plans, manages, controls and monitors its fiscal position) 2.2.1. Fiscal planning, budgeting discipline and policy frameworks [S1.2; S2a.1] 2.2.2. Fiscal controls, monitoring and reporting quality [S1.3] 2.2.3. Revenue adequacy relative to expenditure responsibilities [S1.4; S2b.2] 2.2.4. Predictability and stability of reforms affecting responsibilities and revenues [S1.5] *2.3. Financing capacity, access to funding and support mechanisms* (the ability to secure financing and the role of higher-level support mechanisms) 3.1. Access to funding and liquidity sources [S1.7; S1.9] 3.2. Intergovernmental support and rescue mechanisms [S1.8] *2.4. Intergovernmental relations and structure of powers* (how authority, responsibilities and resources are shared across levels of government) 4.1. Intergovernmental arrangements, revenue-sharing and coordination mechanisms [S1.6; S1.5; S2b.2; S2a.3] *2.5. Political dynamics and cyclical influences* (political factors that shape budgetary behaviour, trust and institutional stability) 5.1. Electoral and political cycles influencing fiscal decisions [S2b.4] 5.2. Citizen and stakeholder trust, expectations and engagement [S2b.3; S2b.5]	*2. Institutional, fiscal, governance and intergovernmental environment*

(*continued*)

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Table 6. Continued

Step 1 rating agencies Criteria	Step 2a Literature review Criteria	Step 2b Guidelines and standards by international setters Criteria	Final framework Criteria, grouped in sub-dimensions	Dimensions
S1.15. National regulation of public-sector accounting systems and standards of financial reporting and planning, in the transparency and accountability subdimension (S&P) S1.16. Sector-wide accounting and reporting policies for borrowing and control and monitoring (Fitch) S1.17. Accounting policies, reporting and transparency (Fitch)	S2a.6. Accrual accounting vs others S2a.7. Adoption of IPSAS S2a.8. Non-financial information	S2b.16. Comparison of fiscal reality in cash basis (OECD) S2b.17. Accrual basis and international standards essential to improve the comparability and transparency of government financial reports (IPSASB, OECD) S2b.18. ESA2010 (ECB) S2b.19. Government Financial Statistics (GFS) – cash or non-cash (a spectrum of recording basis other than cash, including accrual) information (IMF)	*3.1. Governance, regulation and transparency of public-sector accounting* (rules, oversight systems and governance mechanisms that ensure financial reporting integrity, monitoring, transparency and control in the public sector) 3.1.1. Regulatory framework for public-sector accounting, reporting, borrowing and monitoring [S1.15; S1.16; S1.17] *3.2. Accounting basis, standards adoption and international reporting frameworks* (the conceptual foundation–basis of accounting, alignment with international standards and statistical/reporting frameworks enabling comparability and high-quality public-sector information) 3.2.1. Accounting basis and methodological foundations (cash, accrual, hybrid; GFS classifications) [S2a.6; S2b.15; S2b.18] 3.2.2. Adoption of international financial reporting standards (IPSAS, OECD, ECB frameworks) [S2a.7; S2b.16; S2b.17] 3.2.3. International comparability and harmonised reporting frameworks [S2b.15; S2b.16; S2b.17; S2b.18] *3.3. Accounting for non-financial dimensions* 3.3.1. Integrated, sustainability and non-financial reporting requirements (ESG, SDG, IR) [S2a.8]	*3. Accounting and reporting system*

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therefore, does not seek to replace one perspective with another. Rather, it makes their underlying assumptions more explicit and identifies complementarities, tensions and omissions across them. The proposed framework should consequently be understood as a situated synthesis rather than as a neutral or universally applicable representation of LGs' financial sustainability. Several of the administrative typologies and theoretical contributions on which it draws were developed primarily in European and North American democratic-state contexts, while international standards and the SDGs reflect particular institutional and policy commitments. Their relevance and interpretation in other political and administrative settings should therefore be examined empirically rather than assumed (e.g. Liu *et al*., 2024).

Another relevant contextual factor that appears to be under-considered is citizens' perceptions, trust and engagement within the institutional framework, despite their importance for fiscal legitimacy, compliance and long-term financial sustainability. These factors shape credibility and public accountability, reduce uncertainty and risk premia, which in turn influence financing conditions and fiscal discipline (e.g. Bastida *et al*., 2017). Stronger fiscal and administrative institutions constrain opportunistic behaviour and help sustain financial performance; markets and bond raters reflect this institutional strength in credit assessments and borrowing costs (Johnson and Kriz, 2005). Historical analysis similarly suggests that fiscal viability depends not only on debt levels but also on the trust underpinning relations among the state, taxpayers and creditors. In his study of Britain in the 19th century, Daunton (2007) shows how confidence in fiscal rectitude, fairness and constitutional control supported the state's capacity to tax and borrow. Although developed with reference to the central state, this historical insight reinforces the broader argument that perceptions of legitimacy and trust constitute financially consequential contextual conditions.

More broadly, much of the literature informing comparative assessments of LGs originates from public administration and public management research, whereas rating agencies primarily adopt a banking and finance perspective. For example, administrative traditions (dimension 0) are not treated by rating agencies as a cross-country contextual variable influencing LG financial health, even though they shape governance arrangements, accountability mechanisms and service delivery models. By integrating insights from public administration and public management, the framework we propose broadens the analytical spectrum beyond the dominant financial lens, offering a more context-sensitive and theoretically grounded field for comparative-international assessment of LGs' financial health.

6. Conclusion

This research contributes to the assessment of LGs' financial sustainability by highlighting non-financial and non-accounting criteria that previous studies have often overlooked or treated indiscriminately. Our framework systematises institutional, legal and intergovernmental dimensions to be considered in evaluating financial sustainability across LGs internationally, thereby complementing strictly financial approaches.

The integration of those dimensions enhances the capacity for both cross-country comparisons and intra-country analyses, enabling a more comprehensive understanding of financial sustainability when combined with existing theoretical frameworks, such as financial vulnerability (Padovani *et al*., 2021).

Additionally, this study bridges "siloed" literature and practices across rating agencies' methodologies (rooted in a banking and finance lens), public management scholarship (often overlooked by rating agencies) and international guidelines (which may overlook rating agencies), that have largely developed in parallel, and identifies areas of conceptual convergence and complementarity among them, thereby addressing disciplinary misalignment by identifying a point of convergence.

Furthermore, this paper explicitly addresses a problem defined in practice: understanding which contextual conditions rating agencies consider in LGs' assessments. Rather than criticising this practice, our research complements it, while making the underlying contextual assumptions explicit and analytically comparable. By examining rating agencies' assessment practices and

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deriving implications for local managers, regulators and rating agencies themselves, the study seeks not only to describe existing arrangements but also to inform and potentially change them. Therefore, this paper not only speaks to practitioners and rating agencies, but also provides insights that can support public sector standard setters and regulators in designing financial reporting requirements, as advocated by Mechanick and Waymir (2023). Understanding how rating agencies incorporate (or fail to) certain information is relevant for regulators and standard setters when deciding what to require in financial statements and financial sustainability disclosures (Davidyan and Waymire, 2025). In doing so, this paper answers Ferry *et al*. (2019)'s call to narrow the research–practice gap in public sector accounting and contributes to the debate on the policy relevance of academic work. Also, it aligns with Tucker *et al*. (2020)'s call to "take a stand" on the practical relevance of public sector accounting research.

The resulting framework holds practical relevance, particularly for international stakeholders – such as rating agencies, multinational firms and banks – by providing a structured approach to evaluating the financial sustainability of LGs across diverse institutional and legal environments. Also, it can be used by researchers (to operationalise context in comparative studies), by LGs' managers (to structure contextual diagnosis) and by regulators/standard setters and rating analysts (to improve the transparency and coverage of contextual assumptions in sustainability-related assessments and disclosures).

Certainly, this study has some limitations. For example, our analysis relies on rating agencies' publicly available methodologies; these documents may be incomplete representations of rating practice, because proprietary models, committee deliberations, case-specific judgements and other internal processes are not observable. Moreover, as in any qualitative content analysis, our coding and interpretation necessarily involve an element of subjectivity and researcher judgement (Neuendorf, 2017; Krippendorff, 2019). Finally, our framework is conceptual in its design; more practical application further requires to operationalise the elicited dimensions, sub-dimensions and criteria. Such operationalisation could be addressed in future research, potentially through separate studies for each dimension and sub-dimension, given the extensive body of literature that could be systematically reviewed or meta-analysed. Also, quantitative or qualitative analyses can be conducted to test specific KPIs. More broadly, the study points to an underdeveloped research agenda in public sector accounting and financial management: the role of external evaluators in defining and governing financial sustainability. This means, therefore, that the study in this paper represents a promising avenue for future research.

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