

SUMMARY in English

The State Audit Office of Hungary (SAO) constantly monitors the regularity of the financial and property management of local governments. However, under the law, the SAO has only had the right to fully audit local government-owned companies since 1 January 2011, and it has exercised this right, auditing companies in several sectors.

The justification thereof is substantiated by the fact that in the period of 2011–2014, the consolidated cash basis expenditure of the local government subsystem of public finances accounted for nearly/approximately 16% of the GDP, amounting to five thousand billion Hungarian Forints. At the end of 2014, the share of local governments in the nearly three thousand companies established by them valued at 490 billion Hungarian Forints.

The aim of the present analysis is to explore the risks behind the financial equilibrium of local governments, the risks inherent to the financial management of companies, and the conclusions that may be drawn, based on the audit experiences of the SAO.

The main focus areas of the audits included in the analysis were municipal decisions concerning the organisation of public task performance, the evaluation of the compliance of the exercise of proprietary rights, the assessment of how the financial equilibrium was ensured, and the evaluation of the property management of companies.

The analysis is based on audit reports on 178 municipalities and 106 companies regarding the 2011–2014 period. The analysis provides an overview of audit experiences and the correlations between the task performance of local governments and the operation of the companies in their majority ownership¹ that can be organised based on audit reports. This is followed by an overview and aggregate evaluation of the identified risks, by prioritised focus areas and by groups defined according to municipality size.

A large number of companies majority-owned by local governments were included in the analysis. These companies provide public services—typically waste management and district heating—, and since 2013, they have been required by law to implement utility cost reduction measures. With one exception, the companies complied with legal requirements. The companies implemented the utility cost reduction measures and responded to changes flexibly. However, a negative trend is also detectable in the financial management indicators, especially in medium-sized district heating providers.

The hypothesis of the analysis was that the operation of local government-owned companies and the related risks are substantially determined by the operation of the owner local governments and the risks involved in their operation. This means that the risks of local governments directly affect the operation of the companies.

Four risk areas were defined for the analysis, taking 19 aspects and the specificities of Hungary's settlement patterns into consideration. The four areas were the following: performance of public tasks, exercise of proprietary rights, financial stability of local governments, and short and medium-term stability of the financial management of companies.

In the risk area 'public task performance,' we have found that the proportion of at-risk local governments decreased in the analysed period. This has also revealed that the risk-based selection methodology used in SAO audits worked adequately.

¹ I.e., where the owner local government has majority stake.

The analysed data show that the risks related to the exercise of proprietary rights increased in the period concerned. This was partly due to the fact that the proportion of small towns considered at-risk from the aspect of the exercise of proprietary rights more than doubled.

In the risk area 'financial stability of local governments,' the proportion of at-risk municipalities among large cities continuously decreased in the analysed period. With the exception of the smallest towns, positive trends were detected in all the other groups, too. This was partially due to the effects of debt consolidation, the first two stages of which had been implemented by 2013.

In the risk area 'sustainability and short and medium-term stability of the financial management of companies,' it can be established in general that the lower the population, the higher the proportion of at-risk local governments. Experience has shown that the liquidity, indebtedness, and profitability indices of specific companies had changed substantially from one year to the next, which was to the detriment of balanced financial management.

The recommendations presented in the reports were consistent with the findings and supported the processes of financial management.

By adding to the owners' toolkit, the warning letters sent to the local governments as the entities exercising proprietary rights contributed to the improvement of the conditions for a more transparent, more measurable, and more efficient financial management.

In addition to trends and tendencies, it is also true that individual specificities and other local factors also have a substantial role.

Risks may be decreased by strengthening the exercise of proprietary rights if the owner local government defines—in an agreement, a business plan, or otherwise—a set of criteria for the company that is suitable for measuring the activities, and within this, it defines indices to measure the economy and efficiency of the performance of professional tasks to ensure that the operation and task performance of the company are measurable and transparent. Only half of the audited local governments opted for this opportunity. The reason for this may be that even though it seems appropriate to define such criteria under the responsibility of the owner or to use a business plan in the operation of a company in general, it is not required by law.

The lack of criteria and/or a business plan substantially limits the value of the fact that in 75% of the companies, the management were requested to report to the owner. If there is no well-defined and enforceable set of requirements and goals set in advance, reporting to the owner is less objective for planning or corrections that might be necessary.

¹ I.e., where the owner local government has majority stake.