



Summary
of the Audit on the Financial Situation of the Local Government of
Town Debrecen with County Status (1130)

Relevance of auditing the local governments of towns with county status

The current economic difficulties of Hungary can be attributed mainly to the disorder of public finances in former periods and to the high total debt. The year 2010 demonstrated that part of the risks is not connected to the central budget, but to the local level of public finances. Due to the financial management difficulties, the increase in the cash flow deficit, as well as the dangers resulting from indebtedness in the local government system, the State Audit Office of Hungary (SAO) decided to audit the financial situation of local governments. The risk analysis carried out by the State Audit Office of Hungary showed that firstly the audit of local governments operating at the middle level – mainly those of counties and towns with county status – is reasonable.

The audit objective was to evaluate whether the local governments of towns with county status ensured long-term financial balance and whether the recommendations concerning regularity and expediency to improve the financial balance – made in the course of the former audit of the financial management system – were utilised. The audit was carried out in respect of the years between 2007-2010 and, when possible, we also tried to cover the period until the end of the last quarter before the on-site audit.

The financial equilibrium of the local government of town Debrecen with county status

The debt of the local government more than tripled in the audited period. The total debt increased from HUF 8.3 billion to HUF 27.5 billion between 2007-2010. The current budgetary balance showed a surplus in terms of operating resources in each year between 2007-2010, amounting to a total of HUF 7.2 billion. In the audited period the local government allocated a total sum of HUF 29.4 billion to its development tasks in progress or already carried out. The two most significant development projects were aimed at the sewage disposal and treatment of Debrecen and its regions (HUF 23.4 billion) and at the development of the tramway network in Debrecen (HUF 17.6 billion). The balance of the cumulative budget was continuously negative, a deficit in cumulative resources amounting

to altogether HUF 16.7 billion emerged between 2007-2010. The liabilities of economic enterprises of qualified majority ownership did not jeopardise the financial balance of the local government.

The sustenance of the budgetary balance could be ensured with the involvement of external resources. The deficit in operating resources was funded by means of current account credit, in the years 2007-2008 credits for the payment of advanced wages, as well as a short-term credit. The lack of development resources was managed by means of long-term development credit and issuance of bonds for development purposes. The bonds were repaid in 2009. With the continuous increase in its loans outstanding, also the interest costs burdening the local government escalated.

The bank liabilities of the local government at the end of 2010 originated from the borrowing of long-term credits for development purposes in the amount of CHF 84.3 million and EUR 20.6 million, as well as other liquid credits amounting HUF 3.0 billion (that were repaid in 2011). Consequently, the local government has to effectuate a capital repayment and interest payment of CHF 30.7 million and EUR 5.8 million in the period 2011-2013, taken the extent of the interest of the first quarter of 2011 as a basis.¹ The local government's arrears to suppliers amounted to HUF 2.3 million and EUR 0.8 million at the end of 2010. The amount of residue, the sale of tangible immovable assets and the resources resulting from the collection of receivables provide a cover for the liabilities. Further bank liabilities due as of 2014 amount to CHF 57.7 million and EUR 20.7 million. According to the information given by the local government, local taxes can be considered as resources for the repayment thereof in the coming years. In SAO's opinion, the increase in local taxes can be taken into account in the course of the fulfilment of obligations, however the measure taken in 2011 for the increase does not provide the sufficient surplus of resources. Therefore we did not accept the remark made by the Mayor to the draft report, referring to the local tax revenues as the source of the fulfilment of obligations.

As a result of the active tendering activity, following the year 2010 the local government undertook commitments in the amount of HUF 23.9 billion, which were planned to be funded by EU and domestic subsidies, as well as on credit. Out of the developments planned, the commitment concerning the construction of tram line 2 amounts to HUF 17.1 billion.

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The local government did not examine what kind of obligations the replacement of depreciated assets might cause. In the years 2007-2010, the local government accounted for a depreciation of HUF 10.3 billion after the tangible assets, while it spent only a fraction thereof, HUF 2.5 billion, on the replacement of assets.

In order to improve its financial situation, the local government took measures increasing its revenues and reducing its expenditures (investing temporarily liquid assets, lending out real estates and other assets, as well as reorganising the institution and its tasks resulting in staff cut-backs, and other austerity measures). According to the information given by the local government, the simultaneous impact of these measures improved its financial situation by HUF 5.0 billion.

The recommendations concerning regularity and expediency aiming at the improvement of financial balance and made in the course of former SAO audits had been utilised.

In summary, it can be concluded that the local government could ensure the funding of its expenditures for operational purposes only by borrowing current account credit and – in the years 2007-2008 – credit for the payment of advanced wages. The long-term bank liabilities of the local government increased, the necessary cover for the funding thereof was available in the following three years. As regards the further years' long-term commitments, based on the data provided by the local government, the funding resources are not ensured.

The financial balance of the local government is ensured on the short and medium term. The local government has to prepare for the long-term sustenance of its financial balance.

Recommendations for the Mayor

- To take measures for the elaboration of an action plan supported by business administration calculations towards the long-term sustainability of financial balance. To inform the General Assembly about the implementation and results of the action plan; moreover – if necessary – to provide for the amendment of the action plan.
- To examine the availability of internal and external resources necessary for the developments in progress and those planned by the local government and from this aspect evaluate the investments of the local government, and provide for the inclusion of resources ensuring the operation of facilities established by means of investments in regulations on the budget.

Recommendations for the town clerk

- To ensure that in the future the resources of the commitments generating debt, as well as the interest rate and foreign exchange risks thereof are presented during the preparation of decisions. To follow continuously the commitments of business associations in qualified majority ownership and the influence thereof on the local government's liquidity, financial situation and equilibrium.