



Summary
of the Audit on the Financial Situation of the Local Government of
Town Dunaújváros with County Status (1131)

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 Dunaújváros with county status

Besides the 28 budgetary institutions, on 31 December 2010 also 14 economic enterprises (9 of them of qualified majority ownership,¹ out of which 5 enterprises of a 100% ownership) assisted the local government in the performance of its widespread tasks. The economic enterprises performed tasks related to the operation of real estates and property, water theme parks, the maintenance of public areas, cemeteries, the rehabilitation of the town centre, inpatient and

¹ In compliance with Section 52 of the Act on Business Associations, 'qualified majority ownership' shall mean when the local government holds, directly or indirectly, 75 per cent or more of the voting rights in the controlled economic enterprise.

outpatient health care, coastal defence, communication, public education, tourism and wastewater treatment. The importance of the economic enterprises' participation in the local government's task performance is also highlighted by the fact that the affiliated companies of two enterprises of a 100% ownership carried out mandatory activities, too (supply of water, sewage conduit and heat; the maintenance of roads; waste treatment and shipment). As of 1 January 2006, inpatient and outpatient health care had been performed by an economic enterprise of 100% ownership until 2011, when the local government decided upon organisational changes. As a result, from 1 July 2011 these tasks are being carried out in the form of a budgetary institution².

The current budgetary balance showed a surplus of a declining volume (dropping from HUF 0.7 billion to HUF 0.1 billion) in terms of operating resources between 2007-2008, while in 2009 and 2010 there was a deficit in the local government's operating resources. In the years 2009-2010 the operational balance was not ensured, the yearly current revenues did not provide cover for the current expenditures related to the performance of mandatory and voluntary tasks, as well as for the repayment obligations; for that purpose, it was necessary to utilise other funding resources (loans, bond revenues). In 2009 there was a deficit in operating resources amounting to HUF 1.1 billion, while in 2010 it was HUF 1.4 billion. It also had a negative impact on the financial balance that between 2007-2010 the balance of the cumulative budget was continuously negative, which resulted in a deficit in cumulative resources amounting to altogether HUF 6.1 billion. The worsening of the financial balance was also due to the fact that out of the local government's main revenues the incomes from local taxes – surcharges and penalties inclusive – dropped from HUF 4.6 billion in 2007 to HUF 3.3 billion in 2010 (that is HUF 1.3 billion, equalling 29%), which resulted from the decline of local business tax revenues. Moreover, the decrease in state subsidies and duty revenues resulted in another resource gap of HUF 0.2 billion.

The sustenance of the budgetary balance could be ensured with the involvement of external resources, therefore the debt of the local government significantly increased in the audited period. The bank liabilities increased from HUF 1.7 billion to HUF 16.3 billion between 2007-2010. The deficit in operating resources was funded by means of wage credit, current account credit, as well as bond issuance for operational purposes (worth HUF 5 billion). The lack of development resources was managed by means of long-term development credit and in two cases of bond issuance for development purposes (foreign currency indexed bonds

² As of 1 July 2011, the local government performs hospital care via its own founded budgetary institution, which is the legal successor of the economic enterprise providing the same public service only in terms of task performance.

worth HUF 39.8 million). With the continuous increase in its loans outstanding, also the interest costs burdening the local government escalated.

In the period 2007-2010 HUF 3.1 billion was spent on the developments completed, circa one third (29%) of which was funded by financial institution resources (HUF 0.7 billion revenues from bonds and credits borrowed in the amount of HUF 0.1 billion). In order to complete the ongoing development tasks, expenditures in the amount of HUF 1.0 billion were effectuated. For this purpose HUF 0.5 billion bond revenues and credits worth HUF 0.1 billion were allocated. To implement the developments in question, following the year 2010 the local government undertook commitments in the amount of HUF 3.9 billion, which are planned to be funded by bonds, EU subsidies, as well as HUF 0.4 billion own resources. 85% of the developments planned (that is, HUF 3.3 billion) are commitments concerning the operation (structural reorganisation) of the Hospital, funded by EU resources. However, the present financial situation of the local government does not justify the future availability of the own resources planned. Moreover, EU grant schemes are ex post financing arrangements, which poses higher risk in terms of the future financeability of developments undertaken.

At the end of 2010 the bank liabilities of the local government amounted to HUF 5 billion and EUR 40.6 million. Out of that HUF 4.9 billion (97.9%) originated from bond issuance for operational purposes, while HUF 0.1 billion (2.1%) from long-term credits for development purposes. Out of the liabilities due in foreign currency EUR 39.8 (98.0%) million originated from bond issuance for development purposes, EUR 0.8 million (2.0%) from long-term credits for development purposes. In the years 2011-2013 the local government has to effectuate a capital repayment and interest payment³ of HUF 1.4 billion and EUR 10.2 million. This amount includes also the repayment obligation (HUF 0.2 billion) related to credits for the advance payment of subsidies borrowed in the first quarter of 2011. The local government's arrears to suppliers amounted to HUF 0.7 billion, out of which the amount of overdue arrears was HUF 0.1 billion. The worsening of the local government's financial situation is also characterised by the fact that on 31 March 2011 overdue arrears already amounted to HUF 0.9 billion and 41.6% of them were overdue more than 91 days. The revenues from the bonds not yet utilised and the interests thereof (HUF 3.5 billion), the sale of not mortgaged tangible immovable assets (HUF 1.5 billion), as well as the resources from the collection of debts (HUF 1.0 billion) can provide cover for all liabilities. Further bank liabilities due as of 2014 amount to CHF 5.1 million and

³ Taken the extent of the interest of the first quarter of 2011 as a basis.

EUR 39 million. The resources to be taken into account for the repayment thereof are unknown.

Besides the increase in the local government's liabilities, the liabilities of companies of qualified majority ownership – especially that of the Hospital economic enterprise – also pose a risk, if – in case of non-payment or the possible liquidation of the economic enterprises – the Court establishes the unlimited and full responsibility of the local government. From 2011, the enterprises have to repay bank liabilities of HUF 226 million, leasing debt of HUF 4 million and arrears to suppliers in the amount of HUF 1.4 billion. Upon the establishment of the budgetary institution, the local government did not decide upon the way and resources of the settlement of debts accumulated by the Hospital economic enterprise of 100% ownership. Out of the post 2011 liabilities of the economic enterprises of qualified majority ownership, the debts of the Hospital resulting from development credits amount to HUF 0.1 billion, while the arrears to suppliers amount to HUF 1.1 billion (overdue arrears totalling HUF 1.0 billion).

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 2.1 billion after the tangible assets, while it spent only circa one-third thereof, HUF 0.7 billion, on renovation.

In order to improve its financial situation, the local government took measures reducing its expenditures (cut-backs in staff, other austerity measures). According to the local government's own statements, the simultaneous impact of these measures improved its financial situation by HUF 0.5 billion. The recommendations concerning the improvement of financial balance and made in the course of former SAO audits had been utilised. The order of accounting for liquid credits, the criteria for meeting long-term commitments and reporting obligations had been regulated.

In terms of financial risks, it can be concluded that the local government could manage to counterbalance the set-back of revenues due to central measures by its own measures reducing expenditures, however the significant decrease in local tax revenues increased the risk of financial management. The local government could ensure the funding of its expenditures for operational purposes only by means of borrowing current account credit and wage credit, as well as by the utilisation of bond resources. Further risk was posed by the continuous financial deficit of the cumulative budget. The amount of overdue arrears to suppliers also increased. Due to the bond issuances, the long-term bank liabilities of the local government increased dramatically (nearly decupled) compared to 2007, and the post 2010 funding resources thereof had not been quantified for the years 2011-2013 or afterwards. The role of economic enterprises in the provision of public

utility tasks was dominant, the economic enterprise of qualified majority ownership did not produce any dividend revenues. Their indebtedness, with special regard to the fact that the total debt of the Hospital economic enterprise – which, based on the decision of the local government taken in May 2011, was to be terminated by final settlement – had not been repaid, increased the financial risk.

Further indebtedness of the local government increases the risks of financial management, the performance of mandatory tasks and the funding of ongoing developments; moreover, another significant risk factor is the provision of necessary resources to the obligatory repayment of the bonds for operational purposes worth HUF 5 billion in one sum at the end of 2014.

Consequently, the financial management of the local government is endangered by the financial risks; the restoration of the financial balance and the short- and long-term sustenance thereof requires immediate measures.

Recommendations for the Mayor

- To constantly inform the General Assembly about the implementation of the programme aimed at the immediate improvement of the financial situation, as well as about the results thereof; to provide for the availability of funds assisting the fulfilment of bank liabilities, as well as the operation and sustainability of facilities established in the course of the developments implemented.
- To present to the General Assembly – every half year at least – the current financial situation of the local government and its economic enterprises in qualified majority ownership; as well as to put forward a proposal regarding the way and resources of settling liabilities of the economic enterprise providing health care tasks and – upon the decision of the local government – being terminated with final settlement.

Recommendations for the town clerk

- To ensure that in the future proposals substantiating the decisions of the General Assembly upon the commitments generating debt contain information on the resources for the repayment of such commitments, as well as present the interest rate and foreign exchange risks, and the possibilities of handling them.

To provide for the settlement of overdue debts as soon as possible and 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.