



ÁLLAMI
SZÁMVEVŐSZÉK

Summary
of the Audit on the Financial Situation of the
Local Government of Town Hódmezővásárhely with
County Status (1135)

Relevance of auditing the local governments of towns with county status

The actual economic difficulties of Hungary can be attributed mainly to the disorder of public finances in former periods and 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 deficit on a cash basis, as well as the dangers resulting from indebtedness in the local government system, the State Audit Office of Hungary decided to audit the financial situation of local governments. The risk analysis carried out by the State Audit Office of Hungary (SAO) showed that firstly the audit of local governments operating at the middle level – mainly those of counties and towns with county status – is justified.

The audit objective was to evaluate whether the local governments of towns with county status ensured long-term financial balance, whether the recommendations concerning regularity and expediency aiming to improve the financial balance, made in the course of the former audit of the financial management system were utilised. The audit covered the period of 2007-2010 and, if possible, we also tried to include the period until the last quarter before the on-site audit.

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

The outstanding total debt of the local government increased from HUF 16.3 billion at the end of 2006 to HUF 20.7 billion at the end 2010. Its current budgetary balance showed a lack of resources in 2007, which turned into a surplus between 2008-2010. Altogether the operating income was HUF 1.5 billion in the audited period. In 2007-2009, operational savings did not cover the repayment obligations due in the subject year, thus the financial capacity (net operating income) of the local government was negative. As a result of rescheduling the due repayment of bonds and the payment of interests to the

following year, the financial capacity was positive in 2010. The local government's arrears to suppliers amounted to HUF 2.2 billion at the end of 2010, of which the amount of overdue arrears was HUF 1.7 billion. 34% of overdue arrears (i.e. HUF 0.6 billion) exceeded 91 days. Between 2007-2010, the local government performed development tasks of an acquisition value amounting to HUF 10.3 billion. For the performance of development tasks in progress on 31 December 2010, HUF 1.2 billion was paid until 31 December 2010. The balance of the cumulative budget was continuously negative, resulting in a lack of cumulative resources amounting to altogether HUF 6.9 billion between 2007-2010.

The preservation of the budgetary balance could be ensured with the involvement of external resources. The deficit in operating resources was funded by means of wage credit, current account credit, as well as other liquid credits. The lack of development resources was managed by means of long-term development credits and issuance of bonds for development purposes.

The bank liabilities of the local government amounting to HUF 20.7 billion at the end of 2010 were constituted by bonds of CHF 69.4 million, long-term credits of HUF 1.8 billion and EUR 3.7 million, credits for the advancement of wages and salaries of HUF 0.2 billion, other liquid credits of HUF 0.6 billion and current account credits of HUF 1.5 billion. As a result thereof, the local government has to repay capital and pay interest in the amount of HUF 3.1 billion, CHF 15.5 million and EUR 2.6 million in 2011-2013.¹ At the end of 2010, the local government's arrears to suppliers amounted to HUF 2.2 billion, its liabilities due to the PPP investment were HUF 1.1 billion, and its obligations due to the failure to effect other expenditures and its obligations to repay the utilised loans amounted to HUF 0.7 billion. For the fulfilment of the liabilities to be expected in 2011-2013, the revenues received as a result of the collection of the receivables recorded in the balance sheet amounting to HUF 1.1 billion and the sale of not mortgaged tangible immovable assets of a net value of HUF 3.1 billion can be considered. The bank liabilities due from 2014 amount to HUF 2.0 billion, CHF 72.9 million and EUR 1.2 million, the resources to be considered for the repayment thereof are not known. The local government undertook absolute guarantee for its business associations, institutions, the micro-regional association and condominiums. The guarantees due on 31 December 2010 amounted to HUF 1.7 billion.

Besides the increase in local government liabilities, the liabilities of business associations of qualified majority ownership can also influence the financial

¹ Taken the extent of the interest of the first quarter of 2011 as a basis.

balance of the local government. From 2011, business associations have to repay bank liabilities of HUF 0.6 billion, EUR 0.1 million and CHF 40.6 million, arrears to suppliers of HUF 0.7 billion and debts of HUF 0.4 billion. It poses a risk if as a result of non-payment – in case of a possible bankruptcy and liquidation procedure – the Court establishes the unlimited and full liability of the local government. Between 2007-2010, the local government transferred funds for operational purposes for its business associations in the amount of HUF 1.3 billion, of which HUF 0.3 billion originated from the central budget.

As a result of the active tendering activity, following the year 2010 the local government undertook commitments in the amount of HUF 3.6 billion, the 83% which (HUF 3.0 billion) were planned to be funded from EU and domestic subsidies, while HUF 0.6 billion from own resources.

The local government did not examine what kind of obligations the replacement of depreciated assets might cause. 50% of the depreciation amounting to HUF 2.8 billion between 2007-2010, i.e. HUF 1.4 billion was spent on the replacement of assets (reconstruction, renovation).

In order to improve the current financial situation, the local government took measures increasing its revenues and reducing its expenditures. As a result of the measures taken in 2007-2010, a revenue surplus of HUF 1.4 billion and an expenditure saving of HUF 2.2 billion was shown, which replaced the missing resources and improved the financial situation of the local government. 85% of the expenditure savings was a result of staff reduction. The measures aiming to increase revenues are linked to the facts that local tax rates were increased, services were made subject to fees, and temporarily liquid assets were placed in deposit.

The recommendation concerning expediency, aiming at the improvement of the financial balance and made in the course of the former SAO audit was utilised. Taking into account the indebtedness of the local government, the General Assembly was informed on the circumstances under which the local government can fulfil its obligation regarding capital repayment and interest payment arising from its long-term commitments generating debt.

Regarding the financial risks arising at the local government, it can be concluded that the local government offset the revenues lost as a result of central measures with its arrangements to reduce expenditures and increase revenues; however, it was not sufficient to ensure financial balance. In 2007-2010, the operational risk of the local government was increased by the negative net operating income and the significant amount of overdue arrears to suppliers. In 2007-2009, current revenues did not cover operational expenditures and the financing of debt

service; liquidity was ensured by means of current account credit, credits for the payment of advanced wages and other liquid credits. The long-term bank liabilities of the local government increased. The risk of fulfilling bank and other liabilities was increased by the fact that the resources of the repayment of liabilities due on 31 December 2010 were not quantified. The revenue received as a result of the collection of receivables and the sale of tangible immovable assets can be taken into account as resources. The indebtedness of business associations increased the financial risk of the local government.

Financial risks jeopardise the stability of the financial management and the financial balance of the local government, and immediate measures need to be taken in order to maintain the short-and long-term sustainability of financial balance.

Recommendations for the Mayor

- To inform regularly the General Assembly on the implementation of the programme aimed at the immediate improvement and long-term sustainability of the financial situation, including the implementation of measures increasing revenues and reducing expenditures and the results thereof.
- To present at least every half year the current financial situation of the local government and its business associations in qualified majority ownership.
- To provide for the consideration of the possibilities of financing bank liabilities and for the availability of funds assisting the operation and sustainability of facilities established in the course of the developments in progress and those planned.

Recommendations for the Town Clerk

- To ensure that in the future the proposals on the commitments generating debt, substantiating the decisions of the General Assembly, contain the resources of repayment, the obligations to be expected to pay interests and other costs and repay capitals, as well as interest rate and foreign exchange risks to be expected at least in the following three years and the possibilities of managing these.
- 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.

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- To ensure that the reasons for overdue arrears to suppliers are revealed, the necessary measures are taken and overdue arrears are paid as soon as possible in order to minimise risks.