



Summary
of the Audit on the Financial Situation of the
Local Government of Town Nyíregyháza
with County Status (1136)

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 Nyíregyháza with county status

The debt of the local government increased significantly in the audited period. The total debt increased from HUF 7.1 billion to HUF 18.3 billion between 2007-2010. The current budgetary balance showed a surplus in terms of operating resources between 2007-2009, while in 2010 it showed a deficit in operating resources amounting to HUF 0.2 billion in 2010. In 2010, current revenues did not cover current expenditures, the operational balance was not ensured. In the audited period, the local government spent HUF 9.3 billion and HUF 3.4 billion on the implementation of completed development tasks and those in progress, respectively. The balance of the cumulative budget was continuously negative,

resulting in a lack of cumulative resources amounting to altogether HUF 8.2 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 and current account credit. The lack of development resources was managed by means of long-term development credits and issuance of bonds for development purposes. With the increase in its loans outstanding, also the interest costs burdening the local government escalated. The repayment of the foreign currency credits and decrease in the average interest rate resulted in a reduction of interest costs in 2010.

The bank liabilities of the local government at the end of 2010 originated from the issuance of bonds for development purposes amounting to HUF 9.2 billion (CHF 47.5 million, 49.7%), the borrowing of long-term credits for development purposes amounting to HUF 5.9 billion (32.2%), as well as current account credits outstanding at the end of the fiscal year, amounting to HUF 3.3 billion (18.1%). As a result thereof, the local government has to repay capital and pay interest in the amount of HUF 6.7 billion and CHF 12.0 million in 2011-2013.¹ The local government's arrears to suppliers amounted to HUF 2.8 billion at the end of 2010. The sale of tangible immovable assets and the resources resulting from the collection of receivables provide a cover for approximately 69% of the total liabilities. Further bank liabilities due as of 2014 amount to HUF 3.1 billion and CHF 43.5 million, the resources to be considered for the repayment thereof are not known.

As a result of the active tendering activity, following the year 2010 the local government undertook commitments in the amount of HUF 17.8 billion, which were planned to be funded from bonds, credits for cumulative purposes, by EU and domestic subsidies, as well as from own resources of HUF 2.5 billion.

In order to improve the current financial situation, the local government took measures increasing its revenues and reducing its expenditures (lending out and selling real estates and other assets, increasing fees, reorganising the institution and its tasks resulting in staff cut-backs, as well as other austerity measures). As a result of these measures, the local government showed a revenue surplus of HUF 0.2 billion and expenditure saving of HUF 1.4 billion, which improved its financial situation by HUF 1.6 billion.

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

The recommendation concerning regularity and the one regarding expediency aiming at the improvement of financial balance and made in the course of former SAO audits were utilised; one further recommendation concerning regularity was utilised partly. The local government showed the revenues from the financial operations aiming to finance the long-term deficit as liquid credits in its accounting balance sheet.

Regarding the financial risks arising at the local government, it can be concluded that the operational revenues did not cover the operational expenditures and debt service in 2009-2010 despite the fact that the local government offset the revenues lost as a result of central measures with its arrangements to reduce expenditures and increase revenues. In 2007-2010, the operational risk of the local government was increased by the negative net operating income. The significant amount of overdue arrears to suppliers and the financing of the expenditures for operational purposes of the local government caused continuous tension, as it could ensure operation only by drawing current account credit and wage credit continuously. The economic enterprises of the local government played a dominant role in the performance of public tasks, one of these enterprises increased the financial risk of the local government.

The financing of investments following 2010 might be jeopardised by the difficulties in ensuring own resources, the additional expenses of pre-financing EU funds and the obligations due to the debt service of credits already taken out. 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 coverage for the repayment of liabilities to be expected in 2011-2013 and following 2014 was indicated – when these obligations arose – in terms of the revenues planned in the budget, and the resources of the repayment thereof were not quantified. The risk can be reduced by the fact that the 2010 receivables and the tangible immovable assets of the local government can be utilised, if necessary, for the repayment of debt service.

Consequently, financial risks jeopardise the financial management of the local government, and immediate measures need to be taken in order to rapidly restore the financial balance and maintain its long-term sustainability.

Recommendations for the Mayor

- To take measures for the elaboration of an action plan to rapidly restore the financial balance of the operation and ensure the long-term sustainability thereof. The action plan should contain the exploration of possibilities increasing revenues, the comprehensive review of the

investments planned and those in progress and other expenditure obligations, as well as the overview of the structure of debt service.

- To present to the General Assembly every half year the current financial situation of the local government and its economic enterprises in qualified majority ownership, as well as a financing plan on the whole scope of liabilities for at least three years with the quantified indication of resources.
- 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, 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 proposals on the commitments generating debt contain the resources of repayment, as well as interest rate and foreign exchange risks to be expected. To follow continuously the commitments of economic enterprises in qualified majority ownership and the influence thereof on the local government's liquidity, financial situation and equilibrium.