



**Summary**  
**of the Audit on the Financial Situation of the**  
**Local Government of Town Kaposvár with County Status (1137)**

**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 Kaposvár with county status**

Of its operational budget expenditures amounting to HUF 16.8 billion in 2010, the local government spent HUF 14.1 billion (84.1%) and HUF 2.7 billion (15.9%) on the performance of obligatory and voluntary tasks. In 2007-2010, the proportion of voluntary tasks decreased by 0.8 percentage points in the budget of the local government. On 31 December 2010, the local government carried out its tasks with the assistance of 34 budgetary institutions and 15 of its economic enterprises. As a result of the mergers, reorganisations, assignment of tasks realised in order to ensure the performance of tasks, the number of institutions decreased from 57 to 34, i.e. by 40% in the audited period. The role of economic enterprises in the performance of public utility tasks was dominant, the influence

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of economic enterprises on the budgetary equilibrium of the local government is considerable due to their number and its ownership share therein.

The debt of the local government increased significantly in the audited period. The total debt increased from HUF 8.1 billion to HUF 18.8 billion between 2007-2010. The current budgetary balance of the local government showed a surplus in terms of operating resources between 2007-2010, amounting to a total of HUF 2.5 billion. In 2008 and 2010, operational savings could cover the repayment obligations arising in the subject year. In the audited period, the local government realised investments in the amount of HUF 11.9 billion. In order to complete the development tasks ongoing on 31 December 2010, expenditures in the amount of HUF 7.1 billion were effectuated. For this purpose bond revenues of HUF 1.1 billion (16.0%) and credits worth HUF 3.6 billion (49.9%) were allocated. The balance of the cumulative budget was continuously negative, resulting in a lack of cumulative resources amounting to altogether HUF 14.8 billion between 2007-2010.

The preservation of the budgetary balance could be ensured with the involvement of external resources. Despite the positive current budgetary balance, the local government was constrained to borrow current account and wage credit in order to manage temporary liquidity problems. The lack of development resources was managed by means of long-term development credits and issuance of bonds. With the continuous increase in its loans outstanding, also the interest costs burdening the local government increased until 2008, and following that, they decreased.

On 31 December 2010, the bank liabilities of the local government amounted to HUF 11.1 billion and CHF 34.5 million, the arrears to suppliers were HUF 1.3 billion, companies were purchased in the amount of HUF 1.2 billion. The expected amount of the liabilities due in 2011-2013 is HUF 4.0 billion and CHF 7.2 million. For the fulfilment thereof, HUF 1.2 billion of receivables recorded in the balance sheet and HUF 10.5 billion of negotiable immovable assets recorded in terms of estimated value can be taken into account, out of which HUF 0.7 billion is mortgaged in relation to bank liabilities. The expected amount of the liabilities due after 2013 is HUF 13.3 billion and CHF 31.1 million. The local government plans to finance liabilities by selling tangible immovable assets and from its net operating income arising in the period of repayment.

The local government's arrears to suppliers amounted to HUF 1.3 billion at the end of 2010, of which the amount of overdue arrears was HUF 0.3 billion.

As a result of the active tendering activity, following the year 2010 the local government undertook commitments in the amount of HUF 11.0 billion, which

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were planned to be funded from bonds, by EU and domestic subsidies, as well as from own resources of HUF 1.7 billion.

Besides the increase in local government liabilities, the liabilities of companies of qualified majority ownership can also influence the financial balance of the local government. From 2011, the companies have to repay bank liabilities of HUF 262 million, leasing debt of HUF 10 million, CHF 4.670 thousand and EUR 53 thousand, as well as arrears to suppliers of HUF 227 million. It poses a risk if, as a result of not settling these liabilities, the Court – taking into account the disadvantageous business policy pursued by the local government towards the debtor company – establishes the unlimited and full responsibility of the local government.

In the years 2007-2010, the local government accounted for a total depreciation of HUF 6.0 billion after the tangible assets according to its statements. In 2007-2010, renovations were accounted for in an amount equal to the 80% of the accounted depreciation, i.e. HUF 4.8 billion.

In order to improve the current financial situation, the local government took measures increasing its revenues and reducing its expenditures (utilisation of free capacities, lending out and selling real estates and other assets, increasing fees, reorganising the institution and its tasks resulting in staff cut-backs and other austerity measures). The simultaneous impact of these measures improved its financial situation by HUF 3.9 billion.

The recommendation concerning expediency aiming at the improvement of financial balance and made in the course of the former SAO audit was utilised.

**In summary**, it can be concluded that the results of the measures taken by the local government offset the impact of the central measures aiming at the reduction of the revenues of the local government. The local organisational measures of 2011 improved the financial balance of the local government by approximately HUF 0.4 billion.

Between 2007-2010, the current budgetary balance of the local government showed a surplus in terms of operating resources, however, the local government was constrained to borrow current account and wage credit in order to manage temporary liquidity problems. The coverage (credits, EU and domestic subsidies, own resources) is available for the payments to be effected in the future, related to the development commitments, therefore it did not imply cumulative risk. The risk can be reduced by the fact that the tangible immovable assets of the local government can be utilised, if necessary, for the repayment of debt service.

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Consequently, the financial balance of the local government is ensured on the short term.

### **Recommendations for the Mayor**

- To submit an action plan to the General Assembly, which aims to restore the financial balance of the operation on the medium term and ensure the long-term sustainability thereof. The action plan should contain the exploration of possibilities of collecting revenues, the comprehensive review of the investments in progress and those planned, the overview of the structure of debt service, the review and reorganisation of the institutional financial management and structure, besides ensuring the priority of the implementation of obligatory tasks.
- To present to the General Assembly the current financial situation of the local government and its economic enterprises in qualified majority ownership, the claims of the local government on its economic enterprises, 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, the risks influencing the financial balance of the local government and the measures aiming to reduce these risks.

### **Recommendations for the Town Clerk**

- To follow continuously the foreign exchange, interest and repayment risks to be expected in the future, the commitments of business associations in qualified majority ownership and the influence thereof on the local government's liquidity, financial situation and equilibrium, the risks of the guarantee commitment and to inform the General Assembly at least every half year about the developments thereof.
- To ensure that in the future the proposals of the General Assembly on the commitments generating debt contain the resources of repayment, as well as the effects of interest rate and foreign exchange risks to be expected.