Investments of local governments

Do rural municipalities and cities plan investments and make these according to the plans?

Report of the National Audit Office to the Riigikogu; Tallinn, 30 August 2007

Summary of audit results

The National Audit Office assessed planning of investments by local governments and the consistency of their investments made in the first three quarters of 2006 with the plans. For that purpose, the quality of investment planning was assessed as well as whether their budget and the investments made were based on the development plan. In addition, the practices of requesting and reporting investments were assessed.

The audit sample included 30 cities and rural municipalities which differed as regards budget volume, financial situation and geographical location.

The cities and rural municipalities of Estonia made about 4 billion kroons of investments in 2006 according to their reports. In addition, there are investments which are made within financing schemes which are not mentioned in reports. In 2006, local governments received 1.2 billion kroons of single-purpose investment support from outside the local government. Due to using the appropriations of support to Estonia in the EU budgetary period 2007-2013, the investment volume of local governments will increase considerably in the coming years. In order for the investments to be made in a coordinated fashion in places where these are needed the most and in order for the local governments not to run into financial difficulties while waiting for too much financial support, the investments have to be based on development plans which allow for the planning of these.

On the one hand, the people of the rural municipalities and cities and the economic entities operating on the territory of rural municipalities and cities need to know information which is as objective as possible as regards priority actions of the rural municipalities and cities in order for them to make choices regarding their future living and operating environment. On the other hand, objective information on the priorities of a local government is important for all institutions who make decisions regarding investments in order to ensure balanced development of the local government, the county and the whole state (including important investments made in a coordinated way). At the same time, it is important to know the financial possibilities of a local government for realising the priorities. For taxpayers to be able to make well-advised decisions, planning and making investments, requesting and receiving support for realising these have to be transparent and based on uniform principles.

The National Audit Office is of the opinion that a situation where the criteria described in the audit characterisation (see p. 45) have been met is the prerequisite of the continuous and balanced development of a local government.

As a result of the audit, the National Audit Office found that the legal acts on investment planning and investment planning itself need considerable improvements in order to ensure sustainable development of local governments.

The most important assessments and conclusions of the National Audit Office are as follows:

- **The development plans of local governments are not comparable as regards investment planning because the legal requirements for development plans are of a formal nature.** Therefore, the public has an inadequate overview of the priorities of local governments. Less than one third of audited development plans of local governments could be used as a basis for investment planning as of 30 September 2006. The positive examples of investment planning included not only big fast-growing local governments but also for example Haanja Rural Municipality in Võru County, Käina Rural Municipality in Hiiu County and Sindi City in Pärnu County.
- **Investments planned in various development plans of local governments are not always in agreement.** In addition to an overall development plan, local governments have enacted various development plans for some specific field or municipal institutions which are required in various legal acts, but the investments planned for a specific field are not equal to the finances planned for the development of the field in the overall development plan.

- **Nobody in the state has an overview of all the priorities of local governments which could be taken as a basis for nationwide investment planning.** One third of audited local governments had not publicised their full development plan on their webpage and the requirement to send their development plan to the county governor and the Ministry of the Interior is fulfilled to a varying extent. Furthermore, none of the local governments who were operating on the basis of a reorganisation plan had publicised their full reorganisation plan on their webpage.
- Almost half of the audited local governments should make their investments considerably more transparent in their budgets.
- Half of the audited local governments had made one or more investments exceeding 100,000 kroons in the first three quarters of 2006 which were not covered in the investment part of the development plan of the local government.
- The audited local governments have taken out loans and used financial leases mostly for investments specified in their development plans.
- **Financial planning is weak in local governments.** Therefore, the public does not know whether the local governments are able to realise the investments planned.
- **Making appropriations for investment support for local governments by the state is not transparent to a large extent.** This makes investment planning at the local level considerably more difficult. There are no uniform criteria for giving investment support and it is not possible to get any overview of how much investment support local governments receive altogether.

Responses from the auditees and the Ministers of Regional Affairs and Finance:

In their responses to the audit report, both the Minister of Finance and the Minister of Regional Affairs agreed to most of the suggestions made by the National Audit Office and promised to take most of these into account in the Financial Management of Local Governments Act and Insolvency of Local Governments Act.

A total of 25 audited local governments and cities sent their positions regarding the observations, assessments and suggestions in the audit. 18 of them agreed to the suggestion of the National Audit Office to make investments more transparent in the budgets and 7 did not form a position regarding this suggestion.

The rural municipalities of Avinurme, Koonga, Orava and Peipsiääre and the City of Pärnu did not send any reply to the draft audit report.

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