Activities of county associations of local governments and functionality of internal control system

What are the activities of county associations of local governments, have the associations organised their economic affairs legitimately and used appropriate internal control measures to guarantee legitimacy?

Report of the National Audit Office to the Riigikogu, Tallinn, 26 April 2012

Summary of audit results

The audit focussed on the activities of county associations of local governments from 2008 to 2010. Every county in Estonia has an association of local governments, which operates as a non-profit organisation. The National Audit Office assessed the correspondence of economic activities to the most important laws and whether all of the measures permitted by law had been taken to guarantee the legitimacy of economic activities. The activities of the associations were assessed on the basis of the Non-profit Associations Act, Public Procurement Act, Public Service Act and Anti-corruption Act, but also on the statutes of the associations (see pp. 36-37 for the assessment criteria and the compliance of the auditees' activities to these criteria).

The audit also examined the objectives of the associations during the period, how much labour and money had been used to achieve them, which activities did the associations undertake and in which areas, and what were the problems they encountered in organising their work. The National Audit Office has not given an opinion of the associations with regard to these issues due to the limitation of its competency, but only presented an overview of this in the first chapter of the report.

The activities of the associations are mostly financed from the budgets of the local authorities that belong to the associations, which is why their activities are indirectly based on the taxes collected from local people. The legitimate use of this money is in the interests of taxpayers irrespective of the fact that the revenue of county associations has been rather small until now (from 2008-2010 all associations together received *ca.* 21 million euros from different sources).

The importance of county associations of local governments for the population of a county must be seen as something broader than just interest in the proper use of the money entrusted to the associations. Associations make it possible for local authorities to organise the performance of their functions together, and this should also improve the accessibility and quality of the public services provided to the population.

County associations of local governments are similar in terms of their goals, but relatively different in terms of the manner in which they achieve these goals. Some associations have hired specialists who give professional advice and help to the local authorities that belong to the association, some participate in societies whose goals are the same as the association's, some stand out for their active use of EU funds, etc. The associations also differ from each other in terms of the money that they can spend on their activities. The main reason for this is that the number of association members is different in different counties.

The problems found in the economic activities of county associations are the same that the National Audit Office noted in its earlier audits of municipalities, towns and cities. There are omissions in the budget discipline, the legitimate organisation of purchases, payment of remuneration, etc. The reason for this is that the associations and local authorities are managed by the same people, and as public sector entities, associations and local authorities both have to proceed from the same requirements, the reasons why they err against them are also the same. Municipality, town and city mayors as well as representatives of the councils of local authorities belong to the managing bodies of the associations as non-profit organisations, and the National Audit Office believes that the key issue in the performance of their tasks and exercise of their rights under the management of the associations is to avoid the errors ascertained in the course of the audit. The National Audit Office finds that:

■ county associations of local governments have often not adhered to legislation in the organisation of their economic affairs from 2008-2010. Facts that point at conflicts of interest in the activities of the managers of associations were found in four counties. There were cases where association managers had made the decision to buy goods or services from companies associated with themselves, or to allocate support to companies associated with themselves (the total amount of transactions was *ca.* 4000 euros). Both the Anti-corruption Act and the Non-profit Associations Act stipulate that conflicts of interest must be prevented;

■ remuneration or compensation had been paid to management board members, managing directors or employees without a resolution of a competent managing body or the managing director in seven county associations. This is in contravention to the Non-profit Associations Act, and the Public Service Act that applies to the employees of the association. The total amount of remuneration and compensation paid out in such a manner during the audited period was *ca.* 60,000 euros. In four counties the executive management of the association had paid out more money than the highest managing body of the association had prescribed in the budget. There was enough money to cover the expenses, but the general meeting had not decided how the money will be used. Budget expenditure was exceeded almost twice in some associations. Another shortcoming is the failure to adhere to the good procurement practice arising from the Public Procurement Act in the organisation of public procurements, and the effort to find several tenderers in order to obtain the best purchase terms had often not been made. The National Audit Office found this problem in the associations of seven counties;

■ there is plenty of room for development in improving the functionality of internal control in the county associations. The general meetings of the highest managing bodies have been granted the right to carry out reviews, which is an efficient way to inspect the executive management, but this right is not properly used in the associations. Controllers and audit committees act at their own discretion and the general meetings have not tried to guide their activities. The problems pointed out by the National Audit Office in the audit have not been highlighted in the course of the reviews. The audit also indicated that the division of the tasks of the management boards of the associations and the managing directors of their bureaus is not always clear in order to prevent conflicts of interest in the activities of managing directors. For the same purpose, the associations should also have an overview of the economic interests of their leaders, but the majority or eleven associations do not collect declarations of economic interests.

In its overview of the associations, the National Audit Office finds that the cooperation of local authorities within the scope of the county association's activities has been largely project-based, and cultural, sports and education events stand out in this cooperation. Associations have not been trusted with the organisation of the most important functions. The National Audit Office also found that many associations have not considered it necessary to prepare a long-term action plan that would express their common opinions of what should be done in the coming years and what are the goals of these activities. This shows that even in the present conditions, associations have not taken advantage of the opportunities they have, which means that it is necessary to find ways of making mutual agreements more durable.

Leaders of associations of local governments say that reaching agreements is a problem and political differences also make cooperation difficult. This is why the leaders of associations of local governments have raised the issue of the county association’s status in public administration. Public functions can currently be assigned to the associations pursuant to law, but they are legal entities governed by private law and being a member of an association of local governments is not mandatory for local authorities. Looking forward, the leaders of associations of local governments see county associations as legal entities governed by public law, and being a member of an association like this is mandatory for local authorities. The leaders of local government associations also noted that the role of the association overlaps partly with the role of county governments that also have to ensure the balanced development of counties. The heads of associations say that both county governments and the associations have activities whose goals are the same (e.g. in the areas of culture, sports and education), and this is not practical in their opinion.

However, the volume of the activities of county associations is small when measured in money and compared to county governments, and the National Audit Office believes that the extent of the conflict in roles cannot be big from the viewpoint of public interest. The more important question in the big picture is how to utilise the associations better in the future, so that local authorities start cooperating more in the performance of their functions. The leaders of the state have also said that cooperation between local authorities should be more extensive when improving the nationwide accessibility of public services has been discussed. The Ministry of the Interior has also assessed the present cooperation between local authorities as insufficient when it analysed the trends of regional development from 2005-2011. The National Audit Office believes that the future of associations of local government sas the oldest format of cooperation between local authorities requires discussion and a clear and understandable basis. The National Audit Office finds that the “Regional Development Strategy until 2022”, which is being developed at the initiative of the Minister of Regional Affairs, offers a good option for this.

The National Audit Office would like to emphasise that prevention of the errors found in the economic activities of the associations depends on the better organisation of their work and knowledge of laws, and it is not associated with questions about the status and role of the associations in the performance of public functions in the future. The National Audit Office made several recommendations to county associations in order to strengthen their internal control system and avoid errors in economic matters.

Responses of the auditees

The responses to the report indicate that the associations intend to take most of the recommendations on board. The National Audit Office advised the Minister of Regional Affairs to specify in the next regional development strategy what the state expects from county associations of local governments in guaranteeing regional development and providing public services, and to list the activities that need to be carried out in order to strengthen the associations. The Minister agreed with the recommendation in part and found that the regional strategy could also reflect the role of county associations of local government in regional development in addition to other organisations. However, the Minister pointed out that the regional development strategy is not the kind of document where a broader explanation of the roles of different agencies in the provision of public services should be given.

Airi Mikli
Local Government Audit Department