Follow-up audit of investment planning in municipalities, towns and cities

Do municipalities, towns and cities plan investments pursuant to law and make them according to plans?

Report of the National Audit Office to the Riigikogu, Tallinn, 25 November 2013

Summary of audit results

In 2007 the National Audit Office carried out the audit 'Investments of Local Authorities' and found many omissions in the manner in which local authorities plan their investments. During this audit, the National Audit Office investigated whether there were any improvements in how investments are planned or whether new problems had emerged instead. Planning and implementation of investments by municipalities, towns and cities from 2010-2012 was reviewed. The follow-up audit covered 13 of the 30 local authorities that were audited in 2007. The Ministry of Finance and the Ministry of the Interior (area of government of the Regional Minister) were also included among the auditees in addition to local authorities.

In 2012 Estonian local authorities invested 217.6 million euros in total, which is approximately 30% of the tax revenue of local authorities. In order to invest such large amounts of money, the relevant activities must be well planned to ensure that the implementation and management of the investment is sustainable. It is also important that the investments made are those considered important by local taxpayers.

What did we find and conclude on the basis of the audit?

As a result of the audit the National Audit Office found that while local authorities made *ca* 70% of their investments using their own money five years ago, this figure had dropped to 36% by 2012. The European Council has stipulated that in order to guarantee actual economic effect, the contribution of structural funds may not replace the public sector expenditure of the Member States. In other words, structural funding must complement the state's own contribution to repairing roads or building infrastructure which were supposed to be streamlined or established many years later. However, the EU Structural Funds have now become the main source of money from which essential local investments are covered.

Many of the recommendations made in the course of the 2007 audit have been implemented in the Local Government Organisation Act and the Local Government Financial Management Act. The most important amendment that concerns investment planning among these is the requirement that as of 2012, all local authorities must establish a budget strategy that is related to the development plan and covers the next four years, and the strategy must also set out the most important investment priorities and the possible sources from which they will be covered.

However, there remain many problems in the planning and implementation of investments by local authorities, which were also pointed out by the National Audit Office in the previous audit. The most significant of these are as follows:

■ **the agencies that distribute investment support have no overview of the priorities or financial capacity of local authorities.** Although the Ministry of Finance now has these data in the form of the budget strategies of local authorities, the data have not been systematised in a manner that would allow the agencies that distribute investment support to use them for the improvement of their work. The audit revealed that seven of the thirteen audited local authorities have received the state's support for investments that were not planned in the investment chapters of their development plans;

■ the **system of development documents of local authorities has not been thought through,** which has given rise to a situation where the investments included in sectoral development plans are not planned in the general development plans and local authorities make investments that are not recognised in the investment chapters of their general development plans. The audit revealed that the majority of the thirteen audited local authorities had invested more than 20,000 euros once or more from 2010-2012, which was not recognised in the investment chapters of their development plans;

■ **financial planning in local authorities is weak.** Municipalities, towns and cities analyse the cost-effectiveness and feasibility of investment objects and future expenditure only if this is required by the financier. Local councils therefore make investment decisions without having the necessary detailed financial information: financial calculations, final cost of investment, how the entire investment is funded etc.

New investment-related problems have since emerged in local authorities, which the National Audit Office would like to point out in this audit report. The most important of these is the observation **that even though the financial independence of local authorities has decreased, the state demands strategic planning at a level that would be justified if the investments were mainly made with own money rather than support.** At the same time, improving the financial capacity of local authorities has not been set as a goal at the level of the state.

The National Audit Office found omissions in the planning and implementation of investments in all of the audited local authorities. As a result of the audit, the National Audit Office makes several recommendations for planning and implementing the investments of local authorities. The main recommendations made by the National Audit Office are as follows:

■ the National Audit Office advises the Minister of Finance to analyse the investment and financial capacity of local authorities and performance of the complementarity principle. The local government funding system should, if necessary, be changed in such a way that their financial sustainability and the performance of the complementarity principle arising from European Union law are guaranteed;

■ the National Audit Office advises the Regional Minister and the Minister of Finance to jointly form positions on the future plans of the local government funding policy and start working on the joint development of the area as a whole;

■ the National Audit Office advises the Minister of Finance to stipulate the preparation of a budget strategy as part of the development plan to make the development plans of local authorities and the investment chapters of the budget strategies comply with each other and to process any amendments to these two documents jointly.

Responses of auditees

The Minister of Finance generally agrees with the conclusions made by the National Audit Office and confirmed that the development of local government funding principles must be approached and the financing capacity of local authorities must be considered in the distribution of support. The Minister also agreed that the future fixed costs of investment objects must be recognised in the budget strategies of local authorities.
The Minister of Finance disagrees that the contributions made by local authorities in addition to European Union support have continually decreased and that acting in this way does not comply with the so-called complementarity principle. The Minister says that the complementarity principle is constantly monitored and that Estonia has had no problems complying with this principle. The Minister also finds that stipulating the establishment of a budget as part of the development in law is not necessary.

Local authorities and the Regional Minister generally agreed with the conclusions and recommendations made by the National Audit Office.

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