Follow-up audit of investment planning in municipalities

Do rural municipalities and cities plan their investments pursuant to the law implement them according to plans?

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

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Summary of audit results

What did we audit?

In 2007, the NAO carried out the audit titled "Investments of local authorities" and identified a number of shortcomings in the investment planning of local authorities. During this audit, the NAO investigated whether there were any improvements in how investments are planned or whether new problems had emerged instead. Planning and implementation of investments by rural municipalities and cities in 2010-2012 was audited. The follow-up audit covered 13 out of the 30 municipalities which 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 audited entities.

Why is this important for the taxpayers?

In 2012, Estonian local authorities invested EUR 217.6 million in total, which is approximately 30% of their tax revenue. 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 as a result of the audit?

As a result of the audit the NAO found that five years ago the local authorities made about 70% of their investments using their own resources, whereas by 2012 this figure had dropped to 36%. The Council of the European Union has stipulated that in order to ensure real economic effect, the contribution from 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 planned to be streamlined or established a number of years later. However, the EU Structural Funds have now become the main source of financing for essential local investments.

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 is the requirement that as of 2012, all local authorities must establish a budget strategy which is related to the development plan and covers the next four years, and that the strategy must also set out their most important investment priorities and the potential sources of financing.

However, there are still many problems in the planning and implementation of investments by local authorities, which the NAO

pointed out already 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 access to this data in the form of budget strategies of local authorities, the data have not been systematised in a manner that would allow the agencies distributing investment support to use them for streamlining their work. The audit revealed that seven out of the thirteen audited local authorities have received state support for investments which were not envisaged in the investment chapters of their development plans;

- **the system of development documents of municipalities is not well structured**, giving rise to a situation where the investments included in sectoral development plans are not envisaged in the general development plans and local authorities make investments which are not reflected in the investment chapters of their general development plans. The audit revealed that, in 2010-2012, the majority of the thirteen audited local authorities had either once or on multiple occasions invested amounts exceeding EUR 20,000 which were not reflected in the investment chapters of their development plans;

- **financial planning in municipalities is weak.** Rural municipalities and cities analyse the cost-effectiveness and feasibility of investments and future expenditure only if required by the donor. Therefore, local councils make investment decisions without having the necessary detailed financial information: financial calculations, final cost of investment, methods of financing the entire investment etc.

New investment-related problems have since emerged in municipalities, which the NAO would like to point out in this audit report. The most important of these is the observation that **even though the financial independence of municipalities has dropped, the state demands strategic planning at a level which would be justified if the investments were mostly made out of own funds rather than aid amounts.** At the same time, improving the investment capacity of municipalities has not been set as a goal on the national level.

The NAO identified shortcomings in the planning and implementation of investments in all of the audited municipalities. As a result of the audit, the NAO makes several recommendations for planning and implementing the investments of local authorities. The main recommendations made by the NAO:

- the NAO advises the Minister of Finance to analyse the investment and financial capacity of local authorities and compliance with the complementarity principle arising from EU legislation. The local government funding system should, if necessary, be changed so as to ensure their financial sustainability and compliance with the complementarity principle arising from EU legislation;

- the NAO advises the Regional Minister and the Minister of Finance to formulate joint positions on the perspectives of local government funding and start working on the joint development of this policy area;

- the NAO advises the Minister of Finance to require the preparation of a budget strategy as part of the development plan so as to align the development plans of local authorities with the investment chapters of their budget strategies and consider any amendments to these two documents jointly.

Replies from audited entities

The Minister of Finance agrees overall with the NAO's conclusions and recommendations, and confirms that the development local government funding principles must be addressed and that the financial capacity of local authorities must be considered in the distribution of support. Further, the Minister agrees that the future fixed costs arising from investments must be recognised in the budget strategies of local authorities.

The Minister of Finance disagrees that the contributions made by local authorities to complement EU support have constantly declined and that such developments would not compatible with the so-called complementarity principle. The Minister assures that compliance with the complementarity principle is constantly monitored and that Estonia has no problems in complying with this principle. Furthermore, the Minister finds that requiring the establishment of a budget strategy as part of the development plan is not strictly necessary.

The local authorities and the Regional Minister agreed in most cases with the NAO's conclusions and recommendations.

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Sector overview

1. Local governments have made development plans already since 1989 when the requirement to have a development plan was set out in the Local Government Fundamentals Act. The said Act provided that in order to apply for the status of local government, a development plan must be drawn up. Further, the requirement to draw up development plans was included already in the original wording of the Local Government Organisation Act (LGOA) adopted in 1993.

Investment means, for the purposes of this report, acquisition and renovation of tangible fixed assets where the total investment exceeds EUR 20,000.

2. Initially, the purpose of the requirement to have development plans was to obtain an overview of the priority policy areas of local governments. Investment planning was secondary because the local authorities had no money for investments back then. When the donors established the requirement of development plans (having a development plan became an eligibility criteria), most municipalities established a development plan.

3. Although, pursuant to the LGOA, the development plan was supposed to be the basis for planning investments of municipalities, there were no substantial or formal requirements for it established by law. More specific regulation of planning the investments of municipalities began when the Local Government Financial Management Act (LGFMA) entered into force in 2011.

4. In 2007, the NAO organised the audit "Investments of Local Authorities", which evaluated how investments are planned in municipalities and the compliance to plans of investments carried out. In the course of that audit, the NAO gave the Minister of Finance and the Regional Minister several recommendations (see annex B), some of which were taken into consideration when amending the LGOA and developing the LGFMA enforced in 2011.

Budget strategy is a financial plan together with explanations arising from the development plan

LGOA, § 37^1 (1)

5. The most important amendment that concerns investment planning is the requirement that as of 2012, all local authorities must establish a budget strategy which is related to the development plan and covers the next four years, and that the strategy must also set out their most important investment priorities and the potential sources of financing. All local authorities must submit their budget strategy to the Ministry of Finance, who gives the state the possibility of consolidating and analysing the submitted information in a comparable form.

6. However, several recommendations of the previous audit of the NAO were not taken into consideration, while the NAO still considers them important. The most important of those recommendations are the following:

- **The Ministry of Finance has not developed an information technology solution for national level financial planning**, as a way to gather and analyse information about the financial planning (including investments) of municipalities;

- **The Regional Minister has not analysed the necessity of development plans of different fields**. Different legislative acts have imposed on municipalities the obligation to prepare nine sectoral development plans. Aside from these, by now, many Ministers have issued regulations to impose the obligation to prepare sectoral development plans in the sector of importance to the Minister to get funding from European Structural Funds.

7. In comparison to 2007, the investments of municipalities have decreased significantly – this due to the economic crisis and the decrease of the proportion of individual income tax allocated to municipalities in 2009 and 2010. Investments have begun to increase again since 2012 (see Table 1).

Support measure is a monetary measure of the state to support activities of high priority to the state. Conditions and principles for distributing the money have been developed.

8. The absolute total amount of earmarked investment support by the state to municipalities remained on the same level from 2007 to 2010 (see Table 1), then increasing by nearly 10% in 2011 in comparison to the previous year, and by 50% in 2012. The increase in the investments can be explained by the desire to make a decision by the end of 2013 as to what the funds allocated for support measures for the European Union programme period 2007-2013 should be used for, as these funds could not be used later.

9. The proportion of investments made from the own funds and loans of municipalities to the investments of all local authorities decreased continuously in 2007-2011, in 2012 this proportion increased a bit (see Table 1). While in 2007, municipalities made nearly 70% of investments with their own funds, in 2012, own funds covered only 36% of investments and 64% of the funds were received as earmarked allocations. These numbers show that the role of local authorities in directing own investments has decreased significantly in the last five years and planning investments is growingly more dependent on the types of investments, for which support is allocated.

Table1. Investments by local authorities (in EUR million)

Title of budget line	Year					
	2007	2008	2009	2010	2011	2012
Acquiring and renovating tangible assets and intangible assets (row 15)	259.0	277.0	196.2	135.7	137.0	217.6
Allocations for specific purposes for acquiring assets (row 3502)	80.8	89.2	81.4	84.0	92.1	138.3
Proportion of support (% of investments)	31%	32%	42%	62%	67%	64%

Source: Ministry of Finance (http://www.fin.ee/kov-eelarved-ulevaated)

Did you know that

Estonian cities and rural municipalities have received investment support from the state budget since 1995.

10. Earmarked investment support is allocated for nearly all sectors and this support reaches local authorities through the ministries of the corresponding sector and the institutions in their area of administration or foundations founded by the state. Whereas this may be

- investment support directly allocated in the state budget;
- funds, which the state has allocated in their support measures and programmes, the distribution of which is decided upon by the ministry or state foundation

- funds, which the state receives for investments as foreign support and which is granted by ministries or the institutions or state foundations in their area of administration. Aside from EU funding, this includes the Estonian-Swiss cooperation programme, Norwegian and EEA Financial Mechanism and funds from the sale of emission allowance.

Table 2. Investment support granted to local authorities and their companies in 2004-2013 (as of 1 July 2013), broken down by institutions granting support (in EUR million)*

	National investment support	EU funding	Revenue from the sale of CO_2 emission allowance	Funds from other cooperation programs
Ministry of Education and Research	51.4	–	–	–
Innove	–	22.1	–	–
Ministry of Defence	1.7	–	–	–
Ministry of the Environment	18.5	165.0	–	0.4
Environmental Investment Centre[1]	114.5	57.8	27.3	–
Ministry of Culture	50.4	–	–	5.9
National Heritage Board	0.8	–	–	–
Ministry of Economic Affairs and Communications	158.3	–	–	5.9
KredEx	6.1	–	0.6	–
Information System Authority	–	0.7	–	–
Road Administration	2.3	1.6	–	–
Rescue Board	0.1	–	–	–
Agricultural Registers and Information Board	–	8.7	–	–
Ministry of the Interior	1.1	–	–	–
Enterprise Estonia	23.1	167.6	–	0.7
Ministry of Social Affairs	5.1	2.9	–	6.2
Ministry of Finance	–	–	41.6	–
Technical Surveillance Authority	0.3	4.0	–	–

* The table indicates only disbursed amounts.

Source: Ministry of Finance (http://www.fin.ee/kov-eelarved-ulevaated)

[1] **Comment from the Environmental Investment Centre**: According to the accounting records of the EIC, the correct accrual based expense amounts for investment support granted to local authorities and their companies by the EIC during the period 1.1.2004–31.6.2013 were as follows: national investment support: EUR 185.3 million; European Union support: EUR 524.8 million; CO_2 support: EUR 12.6 million.

Comment from the NAO: In the table, the NAO has presented only disbursed investment support, i.e. amounts disbursed for acquiring and renovating tangible fixed assets. The calculations of the EIC also include other support aside from investment support.

11. As since the audit organised by the NAO in 2007, the proportion of own funds of local authorities and foreign funds in investing has changed and (partially due to the audit of the NAO) legislation has been amended, the NAO saw the need to approach the topic of investment planning once again. For the follow-up audit, 13 of the 30 municipalities audited the last time were selected considering the volume of investments made by the municipalities, the size and location of the municipalities (see Table 3) The Ministry of Finance and the Ministry of the Interior (area of government of the Regional Minister) were also included among the audited entities.

Table 3. Audited municipalities

Municipality	County	Population as at 1 January 2013	Total budgetary expenditure* in 2010-2012 (in EUR million)
City of Pärnu	Pärnu County	42,034	120.4
Jõhvi Rural Municipality	Ida-Viru County	12,573	33.9
Türi Rural Municipality	Järva County	10,143	31.5
Mäetaguse Rural Municipality	Ida-Viru County	1,791	20.1
City of Elva	Tartu County	5,890	18.1
Märjamaa Rural Municipality	Rapla County	6,959	17.8
Suure-Jaani Rural Municipality	Viljandi County	5,657	17.3
Nissi Rural Municipality	Harju County	3,018	9.7
City of Loksa	Harju County	2,907	8.5
Käina Rural Municipality	Hiiu County	2,161	5.8
Muhu Rural Municipality	Saare County	1,908	5.2
City of Võhma	Viljandi County	1,450	4.0
Haanja Rural Municipality	Võru County	1,147	4.2

* Total of expenses on core activities and investment costs (except for loans).

Sources: Population Register; budgets and overviews of municipalities as per Ministry of Finance

Overall organisation of investment planning

The state does not have a uniform understanding for developing the investment policies of municipalities

12. As can be seen in Table 1, since 2007, the proportion of the state in financing the investments of local authorities has grown from nearly 30% in 2007 to 64% by 2012. Such an increase in the role of the state means that in comparison to 2007, the state has significantly more extensive options for directing the investments of local authorities.

13. The increase in the role of the state in the investment activities of municipalities is also shown by the analysis of the NAO, where the three largest investments made by every audited municipality from 2010 to 2012 were ranked. Only 15 % (in 2007, this percentage was 42) of those investments were made without foreign means. Whereas Mäetaguse Rural Municipality stood out from other audited municipalities as it receives stable income from environmental fees and was the only one to make all three larger investments (building a care home, renovating the basic school and renovating the community centre) with their own funds. Three audited municipalities had used both their own funds and also investment support and 9 of the audited municipalities had received support for all of their three larger investments.

Additional loan restriction – the restrictions that were applied from 1 March 2009 to the end of 2011 and which prohibited local authorities from taking loans and other obligations: bonds, finance lease obligations and other such long-term obligations, except for loans for covering the self- financing of foreign aid (see also Rural Municipality and City Budgets Act, section 6)

14. According to the assessment of the Ministry of Finance, changes in the investment capacities of local authorities have arisen due to the combined effects of three factors: the general economic situation (i.e. the effects of the economic crisis), additional loan restrictions enforced upon municipalities for 2009-2011 to ensure the budget balance of the public sector required by the European Union and the basis for developing the revenue base of a municipality.

Did you know that

According to the Nissi Rural Municipality, the current system of financing investments impedes preparing development plans “If there is no money, why do we have to prepare a development plan? In the development plan, it is not possible to include the actual plan of what has to be done and what the municipality would like to do. Investments are made from project funds and projects are carried out when money is received. What the local authority wants does not matter.”

15. Although the capacity of rural municipalities and cities to independently direct their investments has decreased in time and investments depend more and more on which investments can be carried out with external funding, the state’s requirements on the financial planning of local authorities have increased. In addition to the obligation to plan investments in the general development plan and sectoral development plans, since 2012, pursuant to LGFMA, local authorities also must establish a budget strategy.

16. The budget strategy has to be established for the next four budget years and it has to reflect major investments and the sources of their funding according to years. If at the moment of establishing the budget strategy, it is not known for sure whether funds will be received from the planned foundation, then, according to the specification of the Ministry of Finance, the investment has to be planned to the budget strategy from own funds, or in case there are no such funds, from loans. As the capacity of local authorities to take loans has been restricted by law and it is not allowed to plan into the budget strategy a loan which would exceed these restrictions, it is not always possible to plan an investment to the budget strategy before the state has made their funding decision.

17. In the opinion of the NAO, the current procedure of planning and carrying out investments would fulfil its purpose in the conditions of 2007, when a local authority was able to direct its investments itself, i.e. make most of its investments with its own funds. At the moment, when most of the investments of local authorities are funded by the state, i.e. the state gives the guidelines for planning investments and using funds, strategic planning in such a form is burdening for local authorities. The local authorities cannot foresee the state’s priorities and support measures, therefore are unable to find their way in planning investments and instead of long-term need-based planning, just try to get some funding from different foundations. The Ministry of Finance, who initiated making establishing budget strategies the obligation of local authorities, admits that preparing a budget strategy in the required extent would work better in a situation where local authorities would make most of their investments from their own funds.

18. However, at the same time, the Ministry of Finance states that there is no political objective of increasing the capacity of municipalities to finance investments from own funds. Although it has been discussed how to divide money in the new European Union programme period (2014-2020) in a way which would reduce the dependence of municipalities of support funds and at the same time to improve their investment capacity, the Ministry of Finance does not see a way to meet that objective until there is no uniform understanding in the matter of funding municipalities or redesigning the revenue base.

19. The representatives of the Regional Minister, who is liable for developing the area of municipalities, found that demanding investment forecasts for four years from local authorities is justified and necessary. However, the Regional Minister has not interfered in developing requirements regarding the financial planning of municipalities, but has left these matters to be coordinated by the Ministry of Finance. Also the representatives of the Regional Minister had no standpoint as to which investments and in which extent should the municipalities ideally make from their own funds and in what extent they should receive investment support.

20. The NAO finds that the ministries have different objectives and they do not have an approach to the issue of municipalities across sectors, but that matters regarding the funding and financial planning of municipalities cannot be coordinated separately from developing other matters regarding municipalities.

21. In a situation, where a large part of the investments of rural municipalities and cities are made on state support, it is probably impossible to create a perfect system of planning investments. However, it could be decided already now, which would be the ideal investment capacity of municipalities. If the future plans foresee continuing to allocate most of the funding for the investments of rural municipalities and cities by the state and on project basis, demanding that local authorities submit long-term financial plans as detailed as they are now is not justified before the state has published its investment plans. Although preparing a budget strategy forces rural municipalities and cities to consider their own financial options carefully, not knowing whether a large investment will be funded by the state or nor, could invalidate the whole investment plan.

Principle of additionality (complementarity) – The funds of the European Union do not replace the state's own contribution, i.e. the European Union co-finances programs in addition to the budget of the member state and private sector. This means that the co-financing of the member state has to be at least as large as it was before the application of the support from the European Union (see also www.struktuurifondid.ee/sonastik)

22. Pursuant to the principle of additionality (complementarity) [2] applied in the European Union, the contribution by support funds cannot replace the expenses of the public sector of member states. The situation, where investment support allocated from support funds to local authorities has remained on the same level or has increased does not coincide with this principle.

23. **NAO recommendation to the Minister of Finance:** to analyse the investment capacity of municipalities and the fulfilment of the principle of additionality arising from the European Union law. If necessary, to change the system of financing local authorities to ensure the financial sustainability of rural municipalities and cities and the fulfilment of the principle of additionality arising from European Union law.

Reply from the Minister of Finance: During the period of 2009 – 2012, the ratio of investment support in the budgets of municipalities has increased due to the economic recession and extraordinary loan restrictions. When the economy recovers, the volume of investments made from own funds will increase. Therefore the conclusion made in the audit about the dependence of municipalities on foreign support cannot be extended to the coming years. Our estimates show that during the programming period of structural funds from 2014-2020, the investment capacity of municipalities will be higher. The principle of additionality of the contribution of the Estonian state is evaluated as a whole for the seven years, considering also the general economic situation. Estonia has no problems with complying with the principle.

24. **NAO recommendation to the Regional Minister and the Minister of Finance:** to formulate joint positions on the perspectives of local government funding and start working on the joint development of this policy area

Reply from the Regional Minister: I support the recommendation. We have begun dealing with this within the work of the workgroup of the duties and funding of municipalities created for making preparations of the municipalities' organisation reform. The duties of the workgroup also include developing solutions for possible changes in the organisation of funding. Also, for developing joint positions of the government level, it is planned to submit to the Government of the Republic an overview of the development possibilities and possible directions of the system of funding municipalities and to discuss the possibilities of reorganising the grounds for funding municipalities.

Reply from the Minister of Finance: we agree that the development of the financing principles of municipalities needs attention. For that there is constant cooperation between the legislator, ministries and associations of municipalities. In the draft for the State Budget Act we have organised the system of support allocated from the state budget.

[2] European Council Regulation (EC) No. 1083/2006 of 11 July 2006 laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund and repealing Regulation (EC) No 1260/1999; clause 29

Organisations granting investment support have no overview of the investment priorities or financial capacities of local authorities.

25. In their 2007 audit, the NAO found that objective information about the investment priorities of local authorities is necessary for other municipalities located in the same region and all institutions making decisions related to investments to ensure that important investments are made in a coordinated manner. Whereas it is also important to know the financial capacities of the local authorities to carry out these priorities.

26. As of 2012, local authorities have the obligation to establish a budget strategy for the next four budget years and to present its essential indicators in a unified format to the Ministry of Finance. The budget strategy brings out the analysis of the socioeconomic environment of the municipality, an overview and prognosis of the revenue base, prognosis of main operational expenses, planned investments, planned obligations and financial activities of dependent units.

27. Until now, the Ministry of Finance has analysed the indicators of budget strategies when necessary. Budget strategies are not analysed systematically. Although the Ministry of Finance analyses the data specified in the budget strategies of municipalities manually, according to the Ministry, it is planned to create a web-based system in the future, which would make it easier for local authorities to prepare budget strategies and for the Ministry to analyse them.

28. For both the Ministry of Finance and the NAO, the most important matter is how the information in the budget strategies would reach the institutions granting investment support to municipalities in the necessary analysed form, so that the institutions could plan their measures accordingly and to make sure that carrying out the funded investment object and its later management would be sustainable.

29. In the opinion of the NAO, the Ministry of Finance and institutions granting investment support to municipalities should agree on which information from the budget strategy of a municipality they would like to see to organise their work more efficiently.

30. In the opinion of the NAO, information gathered under such agreements should prevent a situation where the state supports building a part of an object without expressing interest in where the municipality will get funding in the coming years to complete the whole object and, should the municipality not find additional external funding, then whether its own financial capacity is sufficient for completing the whole object. In the previous year, such problems have arisen for example in case investment support granted by the Ministry of Culture for county-level cultural and sports objects. The NAO has also brought out these problematic areas in their previous audits[3].

31. Also a budget strategy analysis prepared on the basis of mutual agreements should give an overview of investment priorities according to larger regions. This would ensure that in one region, investment support would not be granted to several projects with the same purpose, if one

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[3] Investments allocated by the Ministry of Culture to municipalities: NAO report to the Riigikogu of 10 July 2006

planned object could also service the people of the municipality planning the other similar object.

32. In the opinion of the NAO, the Ministry of Finance has consolidated the budget strategies of all municipalities, but has so far not systematised, analysed them nor compared them with regard to investments to an extent which would enable taking priorities clearly specified in the budget strategy into account when granting investment support.

33. With regard to the constantly increasing role of the state in co-funding the investments of municipalities, it is even more important than in 2007 to gather uniform information about the investment priorities and financial capacity of local authorities.

34. NAO recommendations to the Minister of Finance:

- to create a uniform information technology solution for state-level consolidation of investment priorities and financial information specified in the budget strategies of municipalities. The solution should include the investment priorities of each municipality and also the main indicators of a long-term budget, which would confirm the financial capacity of the rural municipality or city to fulfil that plan;
- to agree upon with institutions granting investment support as to which information they would like to see in the budget strategy of a municipality in order to streamline their work and then to make presenting that information in the budget strategy obligatory;
- to supplement the legislation (Structural Funds Act) with the requirement that granting support would take into consideration the analysis prepared by the Ministry of Finance about the investment priorities and financial capacity of municipalities.

Reply from the Minister of Finance:

- All prioritised activities are planned in the development plan. The budget strategy of a municipality reflects only activities and investments with monetary coverage. If it would reflect all desired investments, it would impede evaluating what the municipality can carry out in accordance with their financial options, and how it affects their financial capacity.
- We agree with the recommendation to create an information technology solution for consolidating budget strategies.
- By using the budget strategy, is difficult to gather exhaustive information for donors granting investment support as each measure has their own specific rules. The creation of a permanent gathering format is impeded by sectors and support conditions changing when programming periods end and begin. An investment fund gathered on a national level must develop extensive usage as then the increase in the administrative workload of the municipalities may be justified.

- The Structural Funds Act cannot stipulate that ministries have to plan investment support on the basis of the analysis of investment priorities we have prepared. Ministries are liable for the use of means of their area of governance by specifying investment needs, setting priorities and allocating support. Support has to be allocated considering the financial capacity of local authorities. It is planned to enact such a requirement in the Local Government Financial Management Act.

Local authorities are not aware of the state's investment priorities

35. Previously, the Ministry of Finance has found that the purpose of the investment support allocated to municipalities from the state budget should be to ensure a regionally balanced infrastructure and availability of public services as evenly as possible. To ensure the transparency of granting support and reduce duplication, selecting projects and funding them through different measures has to take place on the basis of uniform principles.

36. The Ministry of Finance has discussed an option to base allocating investment support on the basis of a four-year investments plan approved by the Government of the Republic. It was found that the basis for preparing the plan should be county-level priority lists. Although at the moment, it is possible to develop investment priorities on the state level on the basis of the budget strategies of municipalities, the rural municipalities and cities still do not have information on which major investments the state plans to support when they are developing their strategic documents.

37. **NAO recommendation to the Minister of Finance and the Regional Minister:** if the state wishes to reorganise granting investment support to municipalities, a state investments plan should be developed and it should include investment projects which the state considers important. Local authorities, who in their budget strategy have planned investments which are not of priority according to the state investments plan, could then take that into consideration in their budget strategy.

Reply from the Regional Minister: I agree with the recommendation in the part regarding the need for uniformly planning the investment support of local authorities. I do not agree with the standpoint that granting investment support needs additional reorganising and that a plan of investments prioritised by the state should be developed for that.

Reply from the Minister of Finance: the competence of ministries and measure intermediate bodies includes selecting investments supported according to the measure conditions. As ministries have enacted different rules and decisions are made at different moments, the purposefulness of developing a unified list of investment projects of local authorities is doubtful.

The budget strategies of municipalities are not always comparable

38. Although the Local Government Financial Management Act provides several detailed requirements on the structure of the budget strategies of municipalities, it is allowed to communicate information related to investments in different ways.

39. The largest difference in the budget strategies of municipalities is the size of the prioritised investments. According to the representatives of the Ministry of Finance, the budget strategy should certainly reflect in detail the investments, which are so great that they could affect the financial situation of the public sector. Advisably the minimum cost of such investments should be EUR 64,000. If the local authority also wishes to show investments with a lower cost in detail in the budget strategy, they can freely do so.

40. At the moment, each local authority establishes the investments chapter of the budget strategy with the financial precision level they see fit. For example the City of Elva has shown investments starting from EUR 4000 in their budget strategy, Muhu Rural Municipality starting from EUR 19,000 and Jõhvi Rural Municipality starting from EUR 150,000. All the smaller projects of these municipalities have been consolidated under the row “Other projects not specified above” in the budget strategy. In the opinion of the NAO, such different presentations do not enable gaining a complete overview of prioritised investment objects of municipalities.

41. In addition, the NAO identified that the date of submitting budget strategies to the Ministry of Finance is too early (30 October) for the local authorities, as the current budget year still continues for a long time and planning future expenses for the next four years is complicated. Both the Ministry of Finance and local authorities agreed that the date for preparing a budget strategy should be postponed until later and matched, for example, with the date of submitting the budget draft. However, postponing the date may create the problem that during election years, the new council does not have enough time to pass a budget strategy by the end of the year.

42. **NAO recommendations to the Minister of Finance:**

- in the budget strategy of prioritised investment objects, to enact the amount from which investments have to always be shown on a separate row in the budget strategy;
- to postpone the date of submitting the budget strategy to the Ministry of Finance until later and to match it with the date of submitting the budget draft to the council.

Reply from the Ministry of Finance:

- By enacting a limit to the investments brought out separately in the budget strategy, the state would excessively interfere with the competence of local authorities. The priority of an investment is not determined only by its size. Each local authority decides which objects are important to be planned in the budget strategy.
- Postponing the date of passing the budget strategy depends on whether the date of electing councils is brought to the spring. On election years, it is improbable that a council only just commencing their work would be able to pass a budget strategy for four years within one month.

Planning investments on the municipal level

The development plans and budget strategies of municipalities are in controversy

43. Development documents of municipalities involving investments are the development plan, budget strategy and sectoral development plans. As of the 15 October of every year, the development plan and budget strategy must include at least four following budget years. While the obligatory parts of the budget strategy have been stipulated in great detail with the Local Government Financial Management Act, the obligatory parts have been not established for a development plan.

44. In the 2007 audit, the NAO found that the development plans of all municipalities cannot be constructed in the same detail as depending on the size of rural municipalities and cities, their geographical location and development phase, the development needs of municipalities are very different. However, to fulfil their wider purpose, the plans should include at least certain specific chapters, the information presented in which could be measured according to agreed indicators. The NAO found that one such part should be the budget strategy, which should be enacted as an obligatory part of the development plan.

45. However, when enacting the requirement for the budget strategy, the legislator found that the budget strategy could be both the part of the development plan and also an independent document related to the development plan. According to the Ministry of Finance, this was done as a compromise for the City of Tallinn as their system of development plans differs from other municipalities and they have no document to join the budget strategy with. The way of ensuring concordance between the development plan and budget strategy has to be provided by the local authorities themselves in the procedure of preparing the development plan and budget strategy.

46. In the course of the audit, the NAO discovered that most audited local authorities had enacted the budget strategy as a separate document, only Jõhvi Rural Municipality had their budget strategy as essentially a part of the development plan. However, in addition to the budget strategy, the development plans of many municipalities also included planned investments by years and expenses.

47. Most audited municipalities had not enacted such a procedure of preparing the development plan and budget strategy which would have shown how compliance between the development plan and budget strategy is ensured. Usually only provisions of laws were quoted in the procedures regarding the preparation of the budget. At several municipalities, a budget strategy and a development plan including an investments plan, which was in controversy with the budget strategy, were valid at simultaneously. This was mainly caused by the fact that as in the autumn of 2012, most audited local authorities were establishing their budget strategies for the first time, all attention went into that and the development plan was often not reviewed and unified with the budget strategy.

Did you know that

In 2009, the City of Võhma adopted, as a part of the development plan of the city, an investments plan for 2009-2012. The only time the council has reviewed the development plan was in 2010, when the new investments plan for 2010-2013 was adopted. As the amendment had not been published in Riigi Teataja, the representatives of the City of Võhma stated to the NAO that the version of the development plan adopted in 2009 is still valid.

Türi Rural Municipality plans investments in the activity plan of the development plan for only the next three budget years, stating that three years is the upmost limit, to which investments can be planned, as the rural municipality is highly dependent on foreign funds when planning their investments.

Did you know that

the part of the development plan that plans investments (the implementation section) has been given different names in the development plans of rural municipalities and cities such as investments plan, activity plan, and realisation plan.

48. Although most of the audited 13 local authorities reviewed their development plans in relation to enacting a budget strategy and amended the development plans, many of them had controversies regarding the objects planned in the budget strategy and in the investments chapter of the development plans (see Table 4). The table does not include the City of Võhma and Käina Rural Municipality, who in 2013 had a clearly controversial budget strategy and investments chapter of the development plan as they did not review the development plan when preparing the budget strategy.

Table 4. Comparison of amounts of objects specified in the development plan and budget strategy of the audited municipalities (in euros)

Municipality	Object	Amount in development plan	Amount in budget strategy	Difference of amounts (%)
Nissi Rural Municipality	Renovating the waste water collection areas, public water supply and sewerage systems of Nissi Rural Municipality	0	5,600 000	Completely new investment not included in earlier plans
	Reconstructing the Riisipere Pre-School	625,000	862,233	+38
Mäetaguse Rural Municipality	Road network	0	166,000	Completely new investment not included in earlier plans
	Renovating the Mäetaguse community centre	0	95,000	Completely new investment not included in earlier plans
Märjamaa Rural Municipality	Transferring the Märjamaa High School boiler house to pellet fuel	0	128,640	Completely new investment not included in earlier plans
	Reconstructing the Märjamaa Central Library	85,015	119,876	+41

Source: NAO, development plans and budget strategies of municipalities

49. As many institutions granting investment support to municipalities have requested from the applicant an extract of the development plan (where the corresponding investment has to be planned) not the budget strategy, then continuing the former practises may result in the state granting investment support also to such projects, which have been planned only in the outdated development plan, but which have not been planned in the valid budget strategy and about which information has not been submitted to the Ministry of Finance.

50. **NAO recommendation to the Minister of Finance:** to enact, as an amendment to the law, the obligation to prepare the budget strategy as a part of the development plan, to make sure that the development plan and budget strategy investments of a local authority are in concordance and that the amendments of these two documents would be processed together.

Reply from the Minister of Finance: the budget strategy may be a separate document from the development plan as some of the larger municipalities have a development plan which is a general vision document. Strategic planning is done through the budget strategy. Subsection 37[1] (1) of the Local Governments Organisation Act ensures the integrity of the development plan and budget strategy

Comment from the NAO: The NAO keeps to their standpoint. The results of the audit enable stating that the referred requirement of law does not ensure the integrity of the development plan and budget strategy. This could only be ensured by enacting the budget strategy as a part of the development plan.

Sectoral development plans are not in concordance with the general development plan

51. In addition to a general development plan, different laws require that local authorities enact several sectoral development plans, which cannot be in controversy with other development documents (see Table 5). The required sectoral development plans include such development plans (e.g. public water supply and sewerage system development plan), which are the basis for extensive financing decisions and applying for support.

Table 5. Sectoral development plans

Development plan	Basis
Waste management plan *as a part of the development plan of the municipality*	Waste Act (§ 39, § 42)
Public water supply and sewerage system development plan	Public Water Supply and Sewerage Act (§ 4)
Public transport development plan	Public Transport Act (§ 5)
Municipal performing arts institution development plan	Performing Art Institution Act (§ 9)
Municipal school development plan	Basic Schools and Upper Secondary Schools Act (§ 67)
Municipal pre-school child care institution development plan	Pre-School Child Care Institutions Act (§ 9[1])
Social welfare development plan *as a part of the development plan of the municipality*	Social Welfare Act (§ 8 (1))
Youth work priorities, *the tasks necessary for achieving which will be provided in the development plan of the municipality*	Youth Work Act (§ 8 (1))
The development plan of an island rural municipality and a municipality, a part of which is on an island, has to cover the development of all small islands within the rural municipality	Permanently Inhabited Small Islands Act (§ 7)

Source: NAO

52. In addition to the sectoral development plans required by laws or regulations, each local authority may enact as many different sectoral development plans as they see fit, but all these plans must be in concordance with the general development plan of the rural municipality or city. Although some laws (Waste Act, Social Welfare Act) see the sectoral development plan as a part of the general development plan, most local authorities have (sometimes on the basis of the standpoint of the ministry or project donor) an understanding that a sectoral development plan has to be prepared as a separate document. Therefore one municipality may have, only on the basis of laws themselves, a total of 9 sectoral (see Table 5) and 1 general development plan.

53. In the course of the audit, the NAO discovered that in addition to the lack of a procedure of preparing the development plan and budget strategy, most of the audited municipalities also did not have a document, which would have specified how concordance between sectoral development plans and the general development plan (and budget strategy) with regard to planned investments is ensured. Moreover, most local authorities stated that they do not review sectoral development plans annually and the public water supply and sewage system development plan and waste development plan are usually prepared once and on project basis.

Did you know that

The investments specified in the road maintenance plan and general development plan of **Mäetaguse Rural Municipality** differ because the road maintenance plan only specifies the own funds included in the investment. Therefore the amounts of the investments in the two documents may differ up to 90%.

According to the **Suure-Jaani Rural Municipality**, their road maintenance plan specifies smaller investments, which are not included in the development plan and which they plan to actually implement.

54. Such an attitude has created a situation where only five of the thirteen audited municipalities (City of Elva, Käina Rural Municipality, City of Võhma, City of Loksa and Mäetaguse Rural Municipality) had coordinated the investments specified in the sectoral development plans with the general development plan and in case of three of the audited municipalities, the investments in the development plan and in the sectoral development plans were not in concordance (see Table 6). Five of the audited local authorities had not specified the amounts of the investments in the development plans and therefore it could not be evaluated whether the investments of the sectoral development plan are in compliance with the general development plan.

Table 6. Some examples of differences between the investments specified in the general development plan and sectoral development plans of the audited municipalities (in euros)

Municipality	Name of the investment	Amount in sectoral development plan	Amount in general development plan
Haanja Rural Municipality	Developing the Recreation and Sports Centre	2,149,029	none
	Constructing public water supply facilities to the villages of Risttee, Uue-Saaluse, Plaksi and Villa	704,000	none
Jõhvi Rural Municipality	Extending and renovating the public sewerage in Tammiku, constructing a pressure pipeline	876,000	none
	Cleaning and reconstructing the Edise-Aiandi pump room	212,000	none

Did you know that

according to the explanations given by the representatives of audited entities, the most common reasons for controversies between development plans were the following:

- the sectoral development plan has been prepared due to a requirement arising from law and there are no funds to implement the sectoral development plan;
- there is no workforce who would be able to coordinate matters related to development plans, including ensuring compliance of sectoral development plans to the general development plan.

Türi Rural Municipality	Renovating the public water supply system at the village of Kahala	8,575 000	none

Source: NAO

55. The NAO finds that the controversy of sectoral development plans with other development documents may actually become a problem if the institutions granting investment support to municipalities base their financing decisions only on the sectoral development plan (e.g. if in the case of water and sewage projects, only the public water supply and sewerage system development plan is taken as the basis), but actually the local authority has not taken this investment into consideration in the general development plan or in the budget strategy and has not planned the self-financing for carrying out this investment. Now, if the local authority receives funding for carrying out an unplanned investment, then in the worst case, this could have severe financial consequences for the municipality. The NAO finds that institutions granting funds should base their decisions on the investment priorities planned in the budget strategies.

56. In the opinion of the NAO, it is necessary to review annually, along with the general development plan and budget strategy, also the sectoral development plans which include investments, to note which of the planned investments will be carried out by the municipality or a company owned by the municipality and to specify the possible cost of future investment objects.

57. As a result of the 2007 audit, the NAO recommended the Regional Minister to analyse the necessity of sectoral development plans of municipalities required by law (including the requirements on the content of sectoral development plans) and to make proposals for differentiating or abolishing the corresponding requirements based on the size of the municipalities or the volume of investments planned in the area. Back then, the Regional Minister withdrew from executing this recommendation and still finds that establishing the requirements of sectoral development plans is within the competence of sectoral ministries.

58. Although in comparison to 2007, requirements for preparing new sectoral development plans have been added to laws, different ministers have enacted regulations for applying for funding from support funds, which foresee that in order to apply for funding, there have to be different development plans (e.g. health profile[4]).

59. **NAO recommendation to the councils of local authorities:** to provide the system of preparing and reviewing strategic documents in their procedures regarding development documents in such a way that it would also be followed later, it would be understandable for the public, and that sectoral development plans, general development plan and budget strategy would be in concordance with each other at all times.

[4] Clause 11(2)2) of the Regulation of the Minister of Social Affairs No. 60 of 2 September 2010 Regulation of granting support in open application “Promoting healthy choices and lifestyles” and supervision over the use of support

Jõhvi Rural Municipality Council, **Mäetaguse Rural Municipality Council** and **Türi Rural Municipality Council** agree with the recommendation.

Elva Rural Municipality Council attempts to ensure consistency in preparing, reviewing the strategic documents of the city and to follow their mutual concordance.

Haanja Rural Municipality Council agrees with the recommendation and preparing and enacting procedures regarding development documents will be left as a task to the rural municipality council elected in 2013.

Märjamaa Rural Municipality Council agrees with the recommendations and will take them into account in the future when planning investments and preparing the development plan and budget strategy.

On 18 October 2012, **Pärnu City Council** passed regulation No. 26 *Procedure of Processing the Development Documents of the City of Pärnu* which stipulates the types of development documents of the City of Pärnu, the procedure of initiating their preparation, their preparation, publication, funding, supervision, monitoring and amendment. Following the aforementioned procedure will ensure concordance between sectoral development plans, the general development plan and budget strategy.

60. **NAO recommendation to the Regional Minister:** to analyse the necessity (including requirements for the content of sectoral development plans) of the sectoral development plans of municipalities required by law and to, if necessary, make proposals for differentiating or abolishing such requirements based on the size of the municipality or the volume of investments planned in the sector. Not to coordinate the requirement for new sectoral development plans in laws and regulations if the developmental directions of the sector can also be covered within the general development plan of the municipality.

Reply from the Regional Minister: I have also stated before that by obligating municipalities to prepare sectoral development plans, the state can help to guide municipalities operating independently on lawful grounds. In case of several sectoral development plans, the local authority can decide whether to prepare them as a separate sectoral development plan or as a part of the development plan, whereas subsection 37(4) of the Local Governments Organisation Act has to be considered, pursuant to which the local authority has to ensure concordance of sectoral development plans to the development plan.

Development planning documents are not always fully published on web pages

61. Pursuant to the Local Governments Organisation Act, the development plan, along with the budget strategy and the minutes of council and council committee meetings regarding processing the development plan and budget strategy, have to be published on the web page of the rural municipality or city. It is important for notifying the public of the development priorities of the municipality and of the use of the tax payers' money.

62. The audit revealed that during the audit procedures, the City of Võhma and Mäetaguse Rural Municipality had not published on their web page the investment plan approved by the council which is an annex to the development plan. This means that the development plan as a complete document had not been published on the web page. In addition, several audited municipalities had not published on their web pages the sectoral development plans and/or procedure documents of development plans. If the procedure documents have been published via the document register, the development plan materials should include a reference to their location in the document register.

63. The NAO considers it important to emphasise that, in order for relevant institutions and the public to be able to examine the development plan and budget strategy and the investment priorities included in these documents on time, the local authorities have to publish the valid development plan along with all existing annexes on their web page and the amendments to the development plan have to reach the web page in seven days as of passing the decision, at the latest.

64. **NAO recommendation to the rural municipality or city authority:** to add to the development documents uploaded on the homepage of the municipality a link to procedure documents in the document register.

Jõhvi Rural Municipality and **Türi Rural Municipality** agree with the recommendation.

Haanja Rural Municipality agrees with the recommendation of the NAO. Documents regarding the processing of the general development plan have been available on the homepage of the rural municipality with the development plan, by now, we have added the activity plan and budget strategy processing documents to the homepage.

Muhu Rural Municipality: as final documents, the development plan and budget strategy of the rural municipality have been published on the homepage, also the minutes of the council are available in the document register. We agree with the recommendation of the NAO and in the future will show the corresponding references to the procedure documents (minutes of the council and council committees) with the development documents.

Märjamaa Rural Municipality agrees with the recommendation and will take it into consideration when planning investments and preparing the development plan and budget strategy in the future.

Nissi Rural Municipality agrees with the recommendation and will implement the recommendation with regard to development documents prepared in the future.

City of Pärnu: at the moment, procedure documents are available at the document register. At the moment, a link has not been created between development documents and procedure documents. The links will be made.

Suure-Jaani Rural Municipality agrees with the recommendation of the NAO and will add a link to documents in the document register to the development documents uploaded to the homepage of the rural municipality.

City of Võhma has taken the recommendation of the NAO into account. We will soon add a link to the procedure documents in the document register by the development plan uploaded to the City of Võhma homepage.

Investments specified in the budget and the budget strategy are in controversy

65. According to the Local Governments Organisation Act, the development plan and budget strategy are the basis for preparing the rural municipality of city budget and planning investments. To evaluate whether carrying out the investments planned in the development plan comply with the plans and the transparency of the budget, it should be possible to differentiate investments from other expenses in the budget.

66. In the course of the audit, the NAO discovered that six of the audited (Haanja Rural Municipality, Käina Rural Municipality, Muhu Rural Municipality, Mäetaguse Rural Municipality, Märjamaa Rural Municipality, Suure-Jaani Rural Municipality) municipalities had included in the procedure of preparing the budget, or some other legislative act regulating the preparation of the budget, a provision, pursuant to which investments have to be differentiated from other expenses in the budget. Other audited local authorities stated that the planned investments can be found from their development plan or budget strategy. However, for example Suure-Jaani Rural Municipality had not differentiated investments in the budget, although the procedure of preparing the budget of the rural municipality requires doing so. The investments of the rural municipality were specified separately in the explanatory note of the budget.

67. In case of several local authorities, who had differentiated investments in the budget, these investments were not in concordance with the development plan or the investments section of the budget strategy (see Table 7) and in some cases, the amounts differed by more than 60%: In addition, several local authorities had included in their budget an investment, which had not been noted in the budget strategy, i.e. money had not been planned for the investment.

Table 7. Major differences between investments reflected in the budget strategy and the budget (in euros)

Municipality	Object	Investment amount in budget strategy	Investment amount in budget	Difference (%)
Mäetaguse Rural Municipality	Barn-handicraft house	415,263	901,000	+117
Muhu Rural Municipality	Water transportation development project (power supply on Kesse)	0	71,333	Completely new investment not included in earlier plans
Suure-Jaani Rural Municipality	Renovating the Suure-Jaani culture centre	86,772	100,000	+15
	Renovating the Suure-Jaani Youth Centre	0	730,108	Completely new investment not included in

				earlier plans
	Co-financing the geothermal heating of Vastemõisa Community Centre	0	57,783	Completely new investment not included in earlier plans
Haanja Rural Municipality	Reconstructing the water supply and sewerage systems in Ruusmäe village	305,000	566,667	+86
Märjamaa Rural Municipality	Hobulaiu recreation base	0	50,000	Completely new investment not included in earlier plans
	Sipa-Laukna pre-school	0	156,098	Completely new investment not included in earlier plans
Käina Rural Municipality	Orjaku port development	20,000	25,170	+26
	Housing	0	33,270	Completely new investment not included in earlier plans

Source: NAO

68. The difference in the amounts of investments planned in the budget strategy and the budget or not planning investments may create a situation where the public and also the local council have no overview of how the money is used for meeting the development priorities of the municipality.

69. In the course of its audits, the NAO has stated several times that the budget has to be transparent not only for the local authority bodies, institutions and officials, but also for the public. Planned investments should be differentiated by objects according to all sectors (including streets-roads), not only partially. In some cases, where investments have not been planned to the budget, the NAO sees it necessary to note this in the budget or explanatory note.

70. NAO recommendation to the rural municipality or city authority: to reorganise their procedure of preparing the budget in a way so that the investments planned in the budget strategy would be shown separately in the budget or explanatory note to the budget and would be differentiated from other expenses transparently for the public.

Jõhvi Rural Municipality, **Mäetaguse Rural Municipality**, **Nissi Rural Municipality** and **Türi Rural Municipality** agree with the recommendation of the NAO.

Haanja Rural Municipality agrees with the recommendation of the NAO. In our budget strategy, we have shown investments planned from own funds separately and in a differentiated manner before, both in the budget and the explanatory note to the budget, where the investments of the coming budget year are also shown more precisely according to objects. The investments shown in the budget strategy, the execution of which mainly depends on the allocation of investment support, are not shown in the budget before there is a positive decision / the investment is actually executed. The budget strategy plans the approximate investment amounts, but the budget considers already the extent of investment expenses according to the execution/tender of a specific procurement (this causes some differences in the amounts).

Muhu Rural Municipality: at the moment, Muhu Rural Municipality has separately specified in its budget the investments planned in the budget strategy and the procedure of preparing, passing, executing and amending the budget of Muhu Rural Municipality includes a provision, pursuant to which investments have to be differentiated from other expenses in the budget. As the valid procedure of preparing, passing, executing and amending the budget of Muhu Rural Municipality has been enacted on 17 April 2012 and has not been updated according to the Local Government Financial Management Act, we see a need to supplement it with provisions regarding the preparation, processing and submission of the budget strategy.

Märjamaa Rural Municipality agrees with the recommendation and will consider it when planning investments and preparing the development plan and budget strategy in the future.

City of Pärnu: we agree to add a reference to the budget strategy to the investments specified in the explanatory note to the budget.

Suure-Jaani Rural Municipality agrees with the recommendations of the NAO and will show investments separately in the budget in the future.

Võhma Rural Municipality has taken the recommendation of the NAO into consideration. In order to amend the procedure of preparing, passing, fulfilling and reporting to the budget of the City of Võhma, we will initiate a council draft to ensure that the investments planned in the budget strategy would be separately shown in the budget or explanatory note to the budget.

Upper limit on net debt is the difference between the amount of the following debt obligations and the liquid assets of a municipality:

- loans taken
- finance lease and factoring obligations
- bonds issued
- obligations not performed within the term
- obligations to repay received support
- advance payments received for support;
- obligations to grant support;
- long-term debts to suppliers;
- obligations arising from service concession agreements;
- other long-term obligations requiring future payments.

LGFMA, 34(2)

In addition to the on-balance sheet debt obligations, lease obligations of the following periods arising from non-cancellable operational leasing contracts with a non-cancellable period of more than one year recorded in off-balance sheet items shall be taken into account in the net debt. LGFMA, 59(8)

Showing loans, guarantees and other future obligations in the development documents does not enable to evaluate the actual financial capacity of the municipality

71. Pursuant to the LGOA, the development plan and the budget strategy provide the basis for the preparation of the budget of a municipality, assumption of obligations, carrying out of transactions related to property, planning of investments and application for support for investments. The budget strategy form for local authorities enacted by the Minister of Finance stipulates showing long-term obligations so that the ministry could take them into consideration when calculating the net debt rate. The latter is necessary for specifying the financial capacity of the municipality.

72. The audit revealed that in their budget strategy table, rural municipalities and cities mainly showed loans taken and financial leases. None of the audited local authorities, who aside from loans and financial leases had also assumed other long-term obligations, which require disbursing money in the future (e.g. obligations to grant support, non-cancellable operational leasing for more than one year) did not show these neither in their budget strategy nor in their development plan (see Table 8).

Table 8. Long-term obligations not shown in the development documents of audited municipalities (as at 31 December 2012; in euros)

Municipality	Long-term obligation not shown in development documents	Total long-term obligations of the municipality	Amount not shown in development documents	Obligations not shown (%)
City of Elva	Obligations to grant support; lease obligations assumed, non-cancellable operational leasing obligations with a period of more than one year	1,429,420	358,457	25
Käina Rural Municipality	Lease obligations assumed	487,160	15,554	3
City of Loksa	Lease obligations assumed, non-cancellable operational leasing obligations with a period of more than one year	2,937,424	37,948	1
Muhu Rural Municipality	Loans; finance lease; lease obligations assumed; other concluded procurement contracts	142,146	142,146	100
Märjamaa Rural Municipality	Other procurement obligations concluded; other obligations assumed; lease obligations assumed; non-cancellable operational leasing obligations with a period of more than one year	2,368,402	119,246	5
Suure-Jaani Rural Municipality	Lease obligations assumed; obligations to grant support	2,336 112	410,448	18
Türi Rural Municipality	Obligations to grant support; concluded procurement contracts	4,644 748	176,658	4
City of Võhma	Loans; lease obligations assumed	196,287	196,287	100

Source: NAO, accounting data of local authorities

73. The NAO finds that if local authorities do not show in their development plans and budget strategies all long-term obligations or some of them, which the Ministry of Finance should take into consideration when calculating their financial capacity, the calculations might not be based on precise information. Also the financial plans of a local authority will be incorrect if they do not take into consideration the funds, which are spent in the future on obligations not shown in the development documents. Such decisions of granting investment support by the state and decisions to invest made by local authorities, which are based on incomplete calculations, may cause the municipality to be unable to fulfil its obligations and also to be unable to complete the investment.

74. In the opinion of the NAO, it is necessary to present a complete overview of all long-term financial obligations of a municipality to specify the investment capacity of the rural municipality of city. In the opinion of the NAO, not publishing information about a significant financial obligation (including financial obligation that arises in the future on the basis of a concluded contract) makes it impossible to evaluate the investment capacity of a municipality. In addition, it is important for the public to know when funds, which in the near future are used for fulfilling the municipality's obligations, will open up for new investments.

Investments during 2010 – 2012

Audited municipalities have made investments, which did not arise from their development plans

75. In 2007, the NAO found that half of the audited municipalities had made one or several investments, which were not shown in their development plan. In 2010-2012, the situation was almost the same – in total the audited municipalities have invested EUR 44.4 million, but some of the investments cannot be found from the development plan (see Table 9).

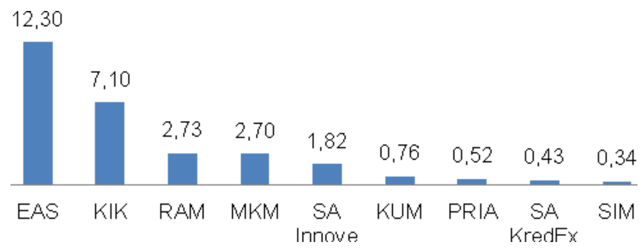
Table 9. Investments of audited municipalities in 2010-2012 (in EUR million)

Municipality	2010	2011	2012
City of Pärnu	6.5	2.1	2.6
Jõhvi Rural Municipality	2.6	1.0	1.4
Türi Rural Municipality	3.0	2.9	2.5
Mäetaguse Rural Municipality	2.8	1.4	3.6
Märjamaa Rural Municipality	0.2	0.9	0.9
City of Elva	0.2	1.9	0.8
Suure-Jaani Rural Municipality	0.2	1.6	1.6
City of Loksa	0.3	0.03	0.05
Nissi Rural Municipality	0.07	0.06	0.2
Muhu Rural Municipality	0.4	0.2	0.2
Käina Rural Municipality	0.08	0.4	0.3
City of Võhma	0.4	0.1	0.01
Haanja Rural Municipality	0.4	0.4	0.3
Total	**17.2**	**12.9**	**14.5**

Source: budget implementation reports, line 15 "Acquisition and renovation of tangible and intangible fixed assets"

76. During the period of 2010-2012, the audited municipalities received EUR 29.5 million of support for investments. Most of the funds were allocated by Enterprise Estonia, Environmental Investment Centre, Ministry of Finance, Ministry of Economic Affairs and Communications, SA Innove and Estonian Agricultural Registers and Information Board (see Figure 1)

Figure 1. Total investment support granted to audited municipalities in 2010-2012, broken down by major donors (in EUR million)



EE – Enterprise Estonia, the EIC – Environmental Investment Centre, MF – Ministry of Finance, MEAC – Ministry of Economic Affairs and Communications, MC – Ministry of Culture, ARIB – Agricultural Registers and Information Board, MI – Ministry of the Interior

Source: NAO analysis based on budget implementation reports submitted to the Ministry of Finance

Did you know that

such investment support, granting which is decided, pursuant to a list presented by the Government of the Republic, by the Riigikogu I the course of processing the state budget, is also called **tribute money**.

77. The NAO found that during 2010-2012, seven (Käina Rural Municipality, City of Loksa, Muhu Rural Municipality, Märjamaa Rural Municipality, Nissi Rural Municipality, City of Pärnu and Türi Rural Municipality) of the thirteen audited municipalities have made at least one investment of more than EUR 20,000, which was not associable with the plans made in the investments chapter of their development plans. The reasons differed: supplementary budget enabling the investment (City of Pärnu), unexpected funds from selling the CO_2-quota (Käina Rural Municipality, City of Pärnu, Nissi Rural Municipality) or other means (electric car in Märjamaa Rural Municipality).

Did you know that

so called **tribute money** in amounts starting from EUR 20,000 has been received by the following municipalities:

City of Elva for renovating the roof of the Elva Muusikakool, insulating the building's attic and replacing exterior doors (EUR 20,000);

Türi Rural Municipality for the security and heating system and washroom of Türi Põhikool; renovations of the bui9lging of Türi Ühisgümnaasium (EUR 65,000).

78. Aside from that, nine of the audited municipalities have received state support for investments not planned for the corresponding year in the investments chapter of the development plan of the municipality, but were included in the list of investment and were planned to be executed in, for example, five years. Primarily these cases were allocations of so called tribute money. In 2012, the state allocated a total of about three million euros of tribute money, which constitutes approximately 1.4 per cent of investments made by municipalities in 2012.

79. In the course of the audit it was revealed that in case of receiving such unplanned support (tribute money) the main issue is that funds are allocated for an unplanned investment in an amount, which covers only a small part of the funds needed for the whole object. The municipality has to find the rest on their own, although they have not planned funds for it. Also the State Budget Act draft being prepared at the Ministry of Finance does not solve this issue. Although such reorganisation of funds may turn out to be difficult for the municipality and often the missing part is taken from investments already planned, the NAO is not aware of any precedence where the municipality would have refused accepting unplanned investment support.

80. **NAO recommendation to the Minister of Finance**: when preparing the State Budget Act draft, to provide that the investments added to the budget in the course of processing the state budget at Riigikogu would be based on the investments provided for the same year in the budget strategies of municipalities.

Reply from the Minister of Finance: in the State Budget Act draft we have provided the principle that all investments supported from state funds would arise from the development plans of local authorities. If after the beginning of the budget year, the local authority receives support for an investment not planned in the budget strategy for using during the current year, the change has to be provided in the annual budget. The budget strategy is a financial framework for the next four years and therefore the numbers for the current year do not have to be changed in it after the beginning of the new year.

Local authorities carry out cost-benefit and feasibility analyses and future expenses analyses only upon the demand of the donor

81. In the opinion of the NAO, only sustainable investments should be planned to ensure that the investment object can be used purposefully also in the long run. It is particularly important in case of objects invested with the support of the European Union as otherwise the support has to be refunded. Whereas, before investment, it is necessary to analyse, aside from the cost of the investment, also the fixed costs of the constructed or reconstructed object.

Did you know that

only Mäetaguse Rural Municipality, who during the audited period has made all three larger investments from their own funds, stared that preliminary investigations precede all larger investments either within the project carried out, as a separate task (e.g. construction the Mäetaguse Manor Hotel) or a part of sectoral development plans (e.g. within the business development plan of the Mäetaguse Rural Municipality, tourism development plan of the Mäetaguse Rural Municipality).

82. In the course of the audit, the NAO found that most of the audited municipalities do not analyse the feasibility or cost-effectiveness of the investment and do not evaluate its future fixed costs before they decide to include the investment in the development plan or budget strategy. Expenses involved with investments are usually analysed only in case of a new construction or if project-based support is applied for to make the investment and the donor demands an analysis of fixed costs. The local authorities see no need to carry out analyses for reconstructed or renovated objects. This means that the councils of cities and rural municipalities plan investments and decide upon carrying out investments without having relevant information (financial calculations, final cost of the investment, financing the whole investment etc.).

83. The NAO finds that such not planning or not analysing investment expenses may create financial difficulties for the rural municipality or city. In the opinion of the NAO, planning every larger investment should be preceded by an analysis including the construction/renovation expenses of the investment object, sources of financing (if the investment is covered with a loan or support, then the so called total cost of the loan or support, future maintenance income and expenses of the object until the end of the depreciation period).

Fixed assets mean acquisitions amounting to EUR 2,000 or more.

Source: General Rules of State Accountancy

84. The NAO recommends analysing the specified aspects in case of all investment objects, which pursuant to the General Rules of State Accountancy are classified as acquiring fixed assets or renovations. It is important that the analysis would be carried out in an understandable way. The purpose of the whole analysis is that it would be clear to the council of the municipality and the public how much will the planned investment actually cost, before the investment decision is made.

85. **NAO recommendation to the Minister of Finance**: to supplement the requirements for preparing the budget strategy so that the budget strategy would show the estimated fixed costs of the planned investments starting from investments which such a size, which could affect the financial capacity of the municipality and/or the financial situation of the state.

Reply from the Minister of Finance: the budget strategy has to consider fixed expenses related to investments. Such a guideline is provided in the financial management manual.

86. **NAO recommendation to the councils of municipalities** to enact a procedure, pursuant to which the feasibility and cost-effectiveness and/or future expenses of an object have to be analysed in order to get an approval from the council for larger investments. Such analyses should be the basis on which the council decides whether to finance an object or not. Therefore it is important to carry out the analyses before the council decides to add the investment object to the development plan and budget strategy.

Haanja Rural Municipality Council, **Jõhvi Rural Municipality Council**, **Mäetaguse Rural Municipality Council** and **Märjamaa Rural Municipality Council** agree with this recommendation.

Elva City Council provides in the Statutes of the City of Elva a procedure of how the feasibility and cost-effectiveness of objects needing investments have to be analysed in order to get the city council to approve larger investments.

Pärnu City Council considers it very important that the feasibility and cost-effectiveness analyses and future expenses analyses of investments are carried out before the investments are included in the development documents. The City of Pärnu has not enacted a procedure of carrying out cost-effectiveness and feasibility analyses, but we are working towards having a thorough analysis precede including investments to the development plan.

Türi Rural Municipality Council agrees with the recommendation. Planning a specific investment, primarily in case of constructing new buildings, has to be based on evaluating the feasibility and cost-effectiveness and/or future expenses of the object, either as a part of the project or as a separate analysis.

With obligations taken, the state restricts the freedom of investing of municipalities

87. In 2009, the Ministry of Finance and Environmental Investment Centre (hereinafter the EIC) concluded a contract, pursuant to which the Ministry of Finance lends to the EIC for re-lending to municipalities or their water and sewage companies EUR 130 million, to ensure the self-financing of water projects funded from the European Union Cohesion Fund.

Did you know that

municipalities take loans from the Environmental Investment Centre also for the following reasons:

Nissi Rural Municipality: "The EIC loan interests are the most favourable. In addition, only the loan taken from the EIC enables exceeding the 60% limit of net loan burden."

Suure-Jaani Rural Municipality: "the EIC interest rate is very favourable, i.e. lower than at banks, and in case of an EIC loan, the rural municipality has lower interest costs."

88. From 2010 to 2012, a total of six of the audited municipalities (Jõhvi Rural Municipality, Suure-Jaani Rural Municipality, Nissi Rural Municipality, Türi Rural Municipality, City of Elva and City of Loksa) had taken a loan from the EIC to cover the self-financing of constructing or reconstructing public water supply and sewerage systems.

89. The contract concluded between the Ministry of Finance and the EIC provided that when granting a loan to rural municipalities and cities, the EIC has to require that the municipalities would adhere to the restrictions on the assumption of debt obligations set by law. However, the EIC had granted a loan to the City of Loksa, although the net debt rate of the city already exceeded the limit at the moment of granting the loan. In the loan contract concluded with the City of Loksa, it was provided that the net debt rate for the purposes of LGFMA cannot exceed, by the end of 2011, 123 per cent; by the end of 2014, 118 per cent; by the end of 2015, 112 per cent; by the end of 2016, 107 per cent; and only by 2027, the net debt has to be under 60 per cent, which complies with the debt rate requirement set by the Ministry of Finance.

Comment from the Environmental Investment Centre: pursuant to the conditions of the Regulation of the Minister of the Environment of 1 July 2009 No. 34 "Developing the Water Economy Infrastructure" enacted pursuant to the Structural Funds Act for the period of 2007-2009, the EIC has allocated European Union structural support for carrying out the water economy project of the waste water collection area of the City of Loksa. When planning the self-financing funding plan of the project, it became apparent, that both the local water company and the City have to participate in funding the self-financing. Both self-financing donors use the project financing loan from the EIC. Without the participation of the City of Loksa, it would have been impossible to carry out this project and this could have caused a financial penalty for the state, as the requirements arising from EU directives would not have been met in the region and people would have been left without clean drinking water and proper sewage treatment.

Comment from the NAO: although pursuant to section 34 of the LGFMA, the limit for the net debt burden of a municipality is 60% of the operating revenue of the reporting year, an exception has been established for the EIC loans: pursuant to subsection 59(7^3) of the LGFMA, a city or rural municipality may exceed the established net debt rate until 2015 and in the amount necessary for funding the self-financing of projects carried out for meeting the requirements concerning urban waste water treatment the quality of water intended for human consumption. But this only if for these projects a loan is granted by the EIC from the credit allocated to them. The LGFMA does not provide any restrictions on the size of the net debt at the moment of taking such a loan.

Did you know that

starting from 2009, the Environmental Investment Centre has imposed fines on five credit receivers, four of whom were municipalities. Of the audited municipalities, a fine of EUR 600 was imposed on Türi Rural Municipality, who had not coordinated singing a new loan contract with the Environmental Investments Centre.

Did you know that

The opinion of the representatives of the Cities of Elva and Loksa to the restrictions arising from loan contracts concluded with the EIC was the following:

City of Elva: "The law enacts specific criteria for taking loans and other such obligations, but the EIC finds that these restrictions should be more specific. This in turn restricts the investment options of municipalities even more and may give rise to a situation where budget strategies no longer reflect the actual situation, but present data in a way favoured by the EIC. I know that the EIC has advised some municipalities to review their budget strategies to that the loan repayments would fit into the operating result."

City of Loksa: "Our budget strategy has been prepared more for the EIC than for ourselves"

In the opinion of the NAO, such a permit or exception is void, because it has not been provided who decides how much a municipality may exceed the established net debt and at what point the municipality may fall into difficulty with repaying their loans on time. Although, based on the exception provided by law, the net debt rate may exceed 60% until 2015, the contracts between the EIC and the City of Loksa allow the City of Loksa to exceed the lawful net debt also after 2015.

90. Pursuant to the contract concluded between the Ministry of Finance and the EIC, the EIC is obliged to monitor the general economic situation of the municipality having received a loan, the compliance of their accounting to requirements, their solvency, and the volume and impact of obligations taken. As a result, the following requirements have been set for municipalities in the contracts and a fine will be imposed upon violating these requirements:

- the credit receiver will not take nor grant any loans, not take any other obligations (including changing the repayment schedules of existing loan contracts) nor pledge any assets belonging to them without a previous written approval of the credit provider (i.e. the EIC);
- the local authority has to notify the EIC upon any changes in the membership of their council or managerial bodies;

91. With the loan granted for ensuring the self-financing of water projects funded from the Cohesion Fund, the state has begun to ensure the objectives it has set for the development of water economy. As for municipalities, the cost of water economy projects is very high, it should be taken into consideration whether the municipalities receiving funds for self-financing will need to make critical investments also in other sectors in the coming years, but the EIC has not analysed this when granting loans to municipalities.

Comment from Environmental Investment Centre: the EIC emphasises that the alternative to not granting a loan would be not executing the whole water project and not fulfilling the obligations taken by the state.

92. The NAO finds that the LGFMA enacts sufficiently precise requirements for municipalities with regard to taking loans and other obligations. If the EIC requirements to make additional restrictions limit the investment capacities of municipalities even more, this may give rise to a situation where local authorities no longer reflect actual financial forecasts in their budget strategy, but present numbers in a way to correctly meet the conditions of the contracts concluded with the EIC. This may result in underplanning or overplanning financial means and jeopardising the municipality's financial capacity.

Comment from the EIC: if, in the course of regular supervision, the EIC discovers deficiencies or controversies in the municipality's budget strategy, the EIC will ask the municipality to correct the strategy to be more realistic in order to proactively lower the risks of possible unsustainability of the municipality and to ensure creditworthiness better. By that, the EIC assists the municipality in financial management.

Comment from the NAO: as the EIC sees themselves as the supervisor of budget strategy and financial management assistant of municipalities, this may give rise to a situation where municipalities prepare their budget strategy based on the EIC requirements and not actual financial forecasts.

93. The audit revealed that the city or rural municipality government had not asked the standpoint of the council about specific credit conditions, which restricted the activities of the municipality (including coordinating new taken loans with the EIC; selling the municipality's assets), i.e. the council had not been notified of restricting conditions. As a rule, the city or rural municipality council had only passed the decision to take a loan and set the purpose of the loan, its amount and maturity.

94. **NAO recommendation to the Minister of Finance:** To review, in cooperation with the Members of the Management Board of the EIC, the loan contracts concluded between municipalities and the EIC and not to conclude contracts which are not in concordance with laws and the contract concluded between the EIC and the Ministry of Finance.

Reply from the Minister of Finance: we agree with the recommendation that the re-lending contracts concluded by the Environmental Investment Centre must be in compliance with laws and the contract concluded with the Ministry of Finance.

NAO opinion

Table 11. Criteria, on the basis of which it was evaluated whether municipalities fulfil their obligation to prepare strategic documents, whether these documents comply with the formal requirements provided by law and whether the strategic documents are in compliance with each other with regard to investments

Criteria	City of Elva	Haanja Rural	Jõhvi Rural	Käina Rural	City of Loksa	Muhu Rural	Mäetaguse Rural	Märjamaa Rural	Nissi Rural	City of Pärnu	Suure-Jaani Rural	Türi Rural	City of Võhma
1.1. a) the development plan has been prepared for at least the next for budget years (LGOA, 372(3)).	YES	YES	YES	YES	YES	YES	NO	YES	YES	YES	YES	YES	NO
1.1. b) The development plan provides information about long-term obligations.	YES	NO	YES	YES	YES	NO	0*	YES	NO	NO	YES	YES	NO
The development plan includes an investments plan or budget strategy as a part of the development plan, where the planned investments can be differentiated by years and in foreseen amounts?	YES	NO	YES	YES	YES	NO	YES	YES	YES	YES	YES	YES	YES
1.1. d) The development plan is available on the web page of the municipality along with proper minutes of the council and council committees about processing the development plan (LGOA, 37^2(8)).	NO	NO	YES	YES	YES	YES	NO	YES	YES	YES	NO	YES	NO
1.1. e) a decision of the council with regard to reviewing the development plan has been passed in 2012 and its explanatory note or additional materials show that substantial discussions have preceded this decision.	YES	NO	YES	NO	YES	YES	NO	YES	YES	YES	NO	YES	NO
1.2. The management report of the 2012 annual report gives an overview of the implementation of the development plan, which was the basis for planning investments.	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES
1.3. Sectoral development plans comply with the general development plan with regard to planned investments.	YES	NO	NO	YES	YES	0*	YES	0*	0*	0*	0*	NO	YES
1.4. Regional Minister is able to present an analysis of the need for sectoral development plans.	NO												
1.5. a) The budget strategy has been prepared for the next four budget years.	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES
1.5. b) The budget strategy includes the required section on investments by years along with the forecasted costs of the investments, foreseen sources and volume of financing.	YES	YES	YES	YES	NO	YES	YES	YES	NO	NO	YES	YES	YES
1.5. c) The budget strategy complies with the development plan with regard to investments.	NO	YES	YES	YES	YES	YES	YES	NO	NO	YES	YES	NO	NO
1.5. d) The budget strategy has been submitted to the Ministry of Finance on time.	YES	YES	YES	YES	NO	YES	YES	NO	YES	YES	YES	YES	YES

0* – opinion not applicable

Table 12. Criteria, on the basis of which it was evaluated whether the investments made and loans taken are based on the development plan

Criteria	City of Elva	Haanja Rural Municipality	Jõhvi Rural	Käina Rural	City of Loksa	Muhu Rural	Mäetaguse Rural	Märjamaa Rural	Nissi Rural	City of Pärnu	Suure-Jaani Rural	Türi Rural	City of Võhma
2.1. a) If the investment amount per one object during 2010-2012 has been more than EUR 20,000, the investment was shown (along with its cost) in the investments chapter of the development plan or some other similar section of the development plan.	YES	YES	0*	NO	NO	NO	YES	NO	NO	NO	YES	NO	YES
2.1. b) If the procedure of preparing the budget of the audited municipality stipulates differentiating investments costing over EUR 20,000, then the investments costing over EUR 20,000 that are planned to the 2013 budget have been based on the investments chapter of the development plan or some other similar section of the development plan.	0*	YES	0*	NO	0*	NO	NO	YES	0*	0*	NO	0*	0*
2.1. c) Loans of finance leases taken during the period of 2010-2012 that exceed EUR 20,000 have been taken for investments based on the investments chapter of the development plan or some other similar section of the development plan.	YES	0*	0*	0*	0*	YES	0*	YES	YES	NO	YES	NO	0*
2.2. a) The decisions to participate in investment projects of the period of 2010-2012, where the total cost of the investment is more than EUR 20,000, have been based on the investments chapter of the development plan or some other similar section of the development plan.	YES	0*	0*	0*	0*	0*	0*	YES	0*	0*	NO	NO	0*
2.2. b) The decisions to participate in investment projects of the period of 2010-2012, where the total cost of the investment is more than EUR 20,000, include additional materials, where the later fixed costs of the investment have been analysed.	NO	0*	YES	0*	0*	0*	0*	YES	0*	0*	YES	NO	0*
2.2. c) Investment support from the state has been allocated to investments arising from the development plan of the municipality.	NO	NO	0*	NO	NO	NO	YES	NO	YES	NO	NO	NO	YES

0* – opinion not applicable

Table 13. Criteria, on the basis of which it was evaluated whether the state has an overview of the investment priorities of a municipality

Criterion	Ministry of Finance
The Ministry of Finance has the budget strategies of all municipalities, has systematised them, analysed them and has comparable data about the investments of municipalities.	NO

/signed digitally/

Airi Mikli Local Government Audit Department

NAO recommendations and replies from the audited entities

On the basis of the audit, the NAO gave several recommendations to the municipalities, Ministry of Finance and area of government of the Regional Minister of the Ministry of Internal Affairs. The Minister of Finance and Regional Minister and municipalities sent their replies to the recommendations of the NAO by 15 November 2013.

General comments about the audit report

Elva City Council: To the recommendation of the NAO to provide the system of preparing and reviewing the strategic documents of the City of Elva in procedures regarding development documents in a way so that it would be followed constantly and that the development plans and budget strategy would be in concordance with each other at all times, the City council replies as follows:

The City of Elva has a development plan for the period of 2012-2020. The development plan of the City of Elva provides that the development plan specifies a plan for activities, which will be funded on the operative level pursuant to the budgetary options, and that the execution of the activity plan is evaluated twice a year, in February and August.

As the plan of investments is the basis for preparing the budget and its execution is reflected in the budget, the plan of investments is reviewed once a year and submitted to the City Council for approval.

In 2013, this stipulation was implemented and on 30 September, the City Council approved, pursuant to the amendments, the investments plan for 2014-2017.

The City Council approved the budget strategy of the City of Elva for 2013-2016 on 24 September 2012 as a document related to the *Development Plan of the City of Elva for 2012-2020*.

On 17 December 2012, the Elva City Council has enacted the procedure of preparing, adopting, implementing the budget of the City of Elva, submitting reports and using the reserve fund. The aforementioned procedure also provides the organisation of preparing, submitting and publishing the budget strategy.

This year, before approving the budget, the City Council passed the budget strategy of the City of Elva for 2014-2017. The valid regulation stipulates that the budget strategy connects the fulfilment of the strategic objectives specified in the development plan and the corresponding activities and investments with actually existing resources.

Haanja Rural Municipality: Haanja Rural Municipality Council agrees with the recommendation, preparing and enacting procedures regarding development documents will be left as a task for the new rural municipality council.

Käina Rural Municipality: I will reply to your inquiries by clauses:

- 48. Although most of the audited 13 municipalities reviewed their development plan with regard to enacting the budget strategy and amended it, many of them had controversies with regard to objects planned to the budget strategy and in the investments plan of the development plan (see Table 4). Of them the City of Võhma and Käina Rural Municipality had clearly controversial budget strategy and development plan investments plan in 2013.

Reply – measure: in 2013, a development plan and budget strategy were passed as a single document and the controversy has been eliminated.

- 68. The difference in the amounts of investments planned in the budget strategy and the budget or not planning investments may create a situation where the public and the municipality council have no overview of how funds are used for fulfilling the development priorities of municipalities.

Reply – measure: Käina Rural Municipality, developing the Orjaku port in 20,000 in strategy, 25 170, +21% in the budget. At the moment of preparing the strategy, final price tenders were not yet known.

Housing 0 in strategy, 33,270 in the budget. This was a reconstruction of street lighting. It has been shown and planned in the budget as an investment. It was not included in the development plan as the investment was executed along with renewing the new lines of Eesti Energia (cheaper for the municipality) and it could not have been planned a year in advance.

- 77. The NAO found that during 2010-2012, seven (Käina Rural Municipality, City of Loksa, Muhu Rural Municipality, Märjamaa Rural Municipality, Nissi Rural Municipality, City of Pärnu and Türi Rural Municipality) of the thirteen audited municipalities have made at least one investment of more than EUR 20,000, which was not associable with the plans made in the investments section of their development plans. The reasons differed: supplementary budget enabling the investment (City of Pärnu), unexpected funds from selling the CO_2-quota (Käina Rural Municipality, City of Pärnu, Nissi Rural Municipality) or other means (electric car in Märjamaa Rural Municipality).

Reply – measure: when unexpected financing options with a strict purpose open up, then these will be implemented in the interest of citizens and the community. This reduces the need for investments in the coming years and immediately reduces economic expenditure. Everything cannot be planned in advance.

Loksa City Government: The circumstances, observations and opnions regarding the City of Loksa are true.

Muhu Rural Municipality: Muhu Rural Municipality Government has examined the draft of the audit report "Follow-up audit of investment planning in rural municipalities and cities". Below we are communicating some of our opinions and positions:

- we agree with the position of the NAO that the preparation of a budget strategy should be enacted as a part of the development plan. This would ensure that the documents are processed (amended) together and that the investment chapters in the development plan and the budget strategy would be in concordance.

- the development plans of municipalities have very different structures and do not have a uniform format. In the interest of better readability and providing a clearer overview for the public, it would be reasonable to also enact obligatory annexes to the development plan;
- in order to plan investments better, municipalities certainly need to know the more specific time schedules of investments by the state. As an example, it is possible to bring out the cycle and pedestrian track construction schemes, where municipalities work with the Road Administration. If the Road Administration provides a more specific and trustworthy time schedule, the municipality can plan their investments more precisely and correctly.

Mäetaguse Rural Municipality Mayor: the draft report brings out important matters regarding the situation of municipalities both with regard to developments and financial strategies, to which municipalities have turned attention for years. Essentially non-existent financial independence and planning developments on project-basis has lasted for a long time and municipalities have tried to do their best in this situation. Mäetaguse Rural Municipality is one of the few exceptions where the municipality has currently enough financial means to execute their development plans. But this could easily change tomorrow by just a decision to take away all the so-called resource funds.

The need to change the system of financing and the revenue base is being discussed, discussed, discussed… Endlessly. However, until now the municipalities can exercise minimal discretion over their revenue.

One proposal would be to divide the individual income tax as the main source of income of municipalities into two, state revenue and local revenue. And to set limits on the local tax (e.g. 11-13% of gross revenue), where then the municipality could change it when necessary. This would enable to actually discuss matters in the community.

This naturally requires amending the Population Register Act so that the actual place of residence would be listed in the Population Register.

Until now, we have to settle for the opinion of Nissi Rural Municipality that those activities, for which funding is received, are completed, but not the activities, which would actually have to be done.

I hope that this audit will push us forward and something will begin to actually change.

Mäetaguse Rural Municipality Council: Mäetaguse Rural Municipality Council has reviewed the development plan and budget strategy by 15 October every year. As the development plan and budget strategy have to include at least four following budget years as of 15 October every year, on the basis of the fact that the budget strategy for the previous year had been prepared for four years, the activity plan was not updated to avoid duplication. The documents passed by the council were available in the document register on the web page of the rural municipality.

As the new development plan document was completed by December 2012, the information about discussions that preceded its preparation was not in the old 2008-2013, but in the new 2014-2020 document.

Nissi Rural Municipality: Nissi Rural Municipality Council is unable to take a position with regard to the recommendations given to them in such a short deadline. This matter was not included in the agenda of the last meeting of the previous membership on 17 October. Whether the ordinary rhythm of work of the rural municipality council has been restored by 21 November, when the next regular council meeting should take place, it not known yet.

Pärnu City Government: we would like to draw attention to the fact that in Table 8 of the draft "long-term obligations of municipality" the amount specified (EUR 22,179,779), does not reflect the amount (EUR 43,888) on the account 253690 (Other long-term obligations) nor the loans to be repaid and financial lease payment amounts to be made in 2013 (EUR 5,034,524). At the same time, the column “Amount not reflected in development documents" (EUR 177,759) reflects the rent and lease payments to be made in 2013. Also the aforementioned amounts include payments of cancellable operational lease contracts and payments of operational leases concluded before 2012. Pursuant to subsection 59(8) of the LGFMA, net debt includes non-cancellable operational lease contracts concluded after 1 January 2012. (Comment from the NAO: table 8 has been corrected).

Võhma City Government communicates the recommendations of the NAO to the newly elected council to be discussed and processed.

Reply from the Regional Minister: from the area of government of the Regional Minister, we submit again the comments submitted in the course of preparing the audit, which should be taken into consideration in the final version of the audit:

- EU structural funds are shown in the budget on expense basis, i.e. on the basis of expense disbursements of the support recipient. Therefore, the state budget of 2011 and later years shows objects, which were planned, designed and constructed since the period began in 2008 as depending on the project, the project cycle is 2-5 years. Decisions regarding the end of the period are made at the moment and their disbursement may also fall to 2015 (paragraph 8).
- Making comparisons only to years 2007-2009 is not the most correct way. These were the peak years of economic growth and also the budget receipts of municipalities extraordinarily exceeded the level of fixed costs, during the recession, the income decreased drastically and often were lower than the level of fixed costs, which did not enable making investments. Also in the earlier years, most investments of municipalities have been made from funds from the state budget. At the budget negotiations which took place between the state and municipalities during the period of 1995-1998, it was agreed that municipalities’ revenue base funds are not provided for investments into and the maintenance of fixed assets and these shall usually be allocated from the state budget. During the period of 1997-2003, investments of municipalities were supported by different versions of the State Budget Investments Program. When EU funds were added since 2004, these support funds were partially, and since 2007 for the most part, replaced with EU funds (paragraph 9).
- Table 2 should be made more systematic: Supports mediated by Enterprise Estonia are shown in the Ministry of the Interior row, the same relationship applies to the Ministry of the Environment and Environmental Investment Centre (the EIC) and others as measure intermediate bodies and implementation units, wherefore EU funds should not be divided between them, but should be shown together.
- At the moment, you are stating in paragraph 21 of the audit that: “If the future plans foresee continuing to allocate most of the funding for the investments of rural municipalities and cities by the state and on project basis, demanding that local authorities submit long-term financial plans as detailed as they are now is not justified before the state has published its investment

plans." However, referring to earlier audits, you accept that objective information about the investment priorities of municipalities is necessary to ensure that important investments are made in a coordinated manner and you are on a standpoint that a management instrument is necessary in the budget strategy theory (paragraph 25). Also the area of government of the Regional Minister is on the standpoint that a system of municipality planning documents is necessary and even more than necessary if funding for many objects depends on foreign means. Therefore, we advise you to review the wording of paragraph 21 "the current system is not justified" (moreover that in the following clauses you yourselves bring out positive qualities of the system) and to try to replace it with a more constructive wording, which would be directed at development options – for example that alleviating, reviewing the current requirements could be considered so that the financial plans would function as a management instrument of a municipality, not only as a reporting instrument etc.

Environmental Investment Centre: our replies have been worded according to topics, pursuant to the numeration of descriptions and observations presented in your report draft. As factual specifications from the EIC have not been included in the text of the NAO's report, we ask that the replies from the EIC would be fully included in the audit report.

- **Topic 1**: investment support according to institutions granting investments, Table 1, page 7

The EIC draws attention to the fact that the costs of investments presented in the table are not factually correct with regard to the EIC. According to the EIC accounting data, the correct accrual based expense amounts of investment support granted by the EIC to municipalities and their companies during the period of 01.01.2004-31.06.2013 are the following:

1) National investment support: EUR 185.3 million;
2) European Union support: EUR 524.8 million;
3) CO_2 support: EUR 12.6 million.

The EIC notified the NAO of the factual errors already on 1 October 2013, but unfortunately the NAO did not take the information from the EIC into account.

- **Topic 2:** Loan contract concluded between the Ministry of Finance and the EIC, see paragraph 90.

The EIC is on the standpoint that the EIC has concluded no loan contracts with municipalities which would not be in compliance with laws or the loan contract concluded between the Ministry of Finance (MoF) and the EIC.

Below, we are presenting an overview of the legal basis for funding the self-financing part of the water project carried out in the City of Loksa.

Pursuant to clause 1.2 of the loan contract concluded between MoF and the EIC, the purpose of using the credit amount is funding the self-financing of water projects funded from the European Union Cohesion Fund.

Pursuant to the conditions of the Regulation of the Minister of the Environment of 1 July 2009 No. 34 "Developing the Water Economy Infrastructure" enacted pursuant to the Structural Funds Act for the period of 2007-2009, the EIC has allocated European Union structural support for carrying out the water economy project of the waste water collection area of the City of Loksa.

When planning the self-financing funding plan of the project, it became apparent, that both the local water company and the City have to participate in funding the self-financing. Both self-financing donors use the project financing loan from the EIC. Without the participation of the City of Loksa, it would have been impossible to carry out this project and this could have caused a financial penalty for the state, as the requirements arising from EU directives would not have been met in the region and people would have been left without clean drinking water and proper sewage treatment. The EIC emphasises that the alternative to not granting the loan would have been not carrying out the whole water project and the state not performing taken obligations.

Chapter 6 of the Local Governments Financial Management Act provides the measures of ensuring financial discipline for local authorities. Pursuant to section 34 of the LGFMA, the upper limit on net debt of a municipality is usually 60% of the operating revenue of the corresponding accounting year and subsection $59(7^1)$ of the LGFMA prohibits local authorities from increasing the total amount of debt burden during the period of 1.1.2012–31.12.2016, fit the net debt burden of the municipality has exceeded the upper limit as of the beginning of the accounting year, except in the case specified in subsection $59(7^3)$ of the LGFMA.

Pursuant to subsection $59(7^3)$ the net debt may exceed the upper limit on net debt established by subsections 34(3) and 34(4) of the LGFMA during the period from 1 January 2011 until 31 December 2015 in order to comply with the requirements of the Council Directive 91/271/EEC concerning urban waste water treatment and the Council Directive 98/83/EC on the quality of water intended for human consumption by the total amount of debt obligations assumed to cover self-financing of the projects which are being implemented if the loan for such projects is granted by the person specified in subsection 56 (1) of the Environmental Charges Act (i.e. the EIC) from loan funds allocated to them.

Essentially, the legislator has created one exception in comparison to the restrictions provided by the general measures ensuring the financial discipline of a municipality. Pursuant to that exception, a loan granted for funding the self-financing of a water economy project is not included into the net debt calculation until 1 January 2016. The requirements provided in the LGFMA do not prohibit a local authority from taking a loan from the EIC for funding the self-financing of a water project carried out for meeting the requirements of directives which is funded from structural support. The LGFMA does not set any restrictions on the actual net debt rate of a municipality at the moment of taking such a loan. Therefore, the EIC granting such a loan to the City of Loksa does not create a legal controversy with the restrictions set on the net debt of a municipality.

The EIC thoroughly evaluates the creditworthiness of each loan applicant and receiver, and substantially weighs granting each loan. Pursuant to the Law of Obligations Act, the loan contract provides such special conditions, which presumably contribute to ensuring the financial discipline requirements provided in the LGFMA.

We would like to separately emphasise the fact that the net debt rates (see clause 9 of the NAO report) shown in the special conditions provided in the loan contract concluded between the EIC and the City of Loksa are only minimum requirements, upon violating which, the credit receiver is obviously incapable of performing their loan obligations ,which do not forbid or impede in any way the City of Loksa from achieving compliance with the requirements of LGFMA, which here are stricter and undoubtedly primary. The EIC is convinced that other special conditions in the same loan contract additionally contribute to the City of Loksa being able to repay the loan as soon as possible. For example, on the suggestion of the City of Loksa itself, the contract stipulates the obligation of repaying a significant part of the loan from income received from the sale of real estate objects by 31.12.2015, at the latest. In addition, it is not possible to unilaterally increase the debt later, which inevitably brings along the loan volumes being reduced gradually. In our opinion, the net debt level of the City of Loksa along with the loan taken from the EIC as of 31.12.2015 is certainly significantly lower than the current level, which is calculated on the basis of such loan obligations of the City of Loksa, which do not include the EIC credit amount. The EIC shall do everything in their power for the City of Loksa to achieve the net debt level required by the LGFMA by 31.12.2015.

Still, the precise results of the corresponding activities of the credit receiver will become apparent in 2016. Calculations made before that are just indicative forecasts, not actual data, which would enable identifying controversies with legal norms.

- **Topic 3:** contractual penalties, see paragraph 91

Paragraph 91 of the report may leave a misleading impression that in case of each violation, the EIC implements a monetary fine as an automatic sanction. The EIC does not implement a monetary fine as an automatic sanction in case of any violations.

Below, we will thoroughly explain sanctioning upon a violation of an obligation.

The loan contract concluded between the EIC and the municipality provides the obligations of the credit receiver, which are based on, inter alia, the requirements described in clause 6.1 of the loan contract concluded with the Ministry of Finance. The obligations of the credit receiver are expressed as general and special conditions in the loan contract, which protect the credit provider of the debtor's acts or omissions, which may cause the position of the credit provider to deteriorate with regard to the debtor. The EIC finds that such a contractual penalty is in compliance with the relevant principles and provisions of the Law of Obligations Act.

Should the EIC find that a municipality has not performed their obligation provided by the loan contract, this is considered to be a violation of the loan contract, the circumstances of which shall be thoroughly weighed by the EIC credit committee and the committee shall decide what effect the specific violation has on the EIC: The former practice has been 100% as follows: The EIC has presented a fine claim for the violation of credit conditions to the credit receiver only if the latter has significantly violated the contract and/or clearly endangered their future financial capacity and therefore created an additional risk with regard to their capacity to repay the loan. The EIC does not implement any sanctions automatically. For example, the EIC has not presented a monetary fine claim if the municipality has not notified them of changes in their managerial bodies or in any other unsubstantial cases. If a contractual penalty would not be provided or if it would not be applied also in the case of significant contract violations, the relevant obligations would essentially by incomplete obligations, violating which entails no consequences. Therefore, the position of the EIC is that providing a contractual penalty in the contract and applying this fine in case of significant violations is justified to ensure that contractual obligations are performed.

- **Topic 4:** restrictions on taking loans and obligations, see paragraph 93

Paragraph 93 of the report draft brings out a statement that the EIC's claims endanger the financial capacity of a municipality, which is misleading and does not concord with other conclusions of the report draft.

Paragraphs 74 and 83 of the report draft bring out the most important reasons, why the financial capacity of a municipality could actually be significantly endangered. When managing loans, the EIC has identified these reasons in the budget strategies of many municipalities.

The EIC is guided by the loan contract concluded with the Ministry of Finance and good practices of loan management, pursuant to which special conditions lowering the risks of creditworthiness are agreed upon with the credit receiver and efficient supervision over the fulfilment of these conditions is executed. Should the EIC identify in the course of ordinary supervision any deficiencies or controversies in the budget strategy of a municipality, the EIC requests that the strategies would be adjusted to be more realistic, to proactively lower any unsustainability risks of the municipality and to better ensure creditworthiness. By that, the EIC assists municipalities in financial management. It is undisputable that all municipalities must follow financial discipline equally with regard to all credit providers/financing entities and budgetary sectors. The EIC is not demanding anything excessive from the municipalities. The EIC re-lends a loan from the European Investment Bank received from the Ministry of Finance and has to ensure the repayment of the loan to the Ministry of Finance and EIB in a manner and with measures appropriate for a financial institution. The fact that realising water economy projects requires a lot of funding, due to which municipalities would like to have financial discipline relieved for funding other objectives is a larger matter in state administration. The EIC cannot be blamed for appropriate and efficient work in performing its duties.

NAO recommendations	Replies from audited entities
The state does not have a uniform understanding for developing the investment policies of municipalities 23. Recommendation to the Minister of Finance: to analyse the investment capacity of local authorities and compliance with the complementarity principle arising from EU legislation. Where necessary, change the local government funding system so as to ensure the financial sustainability of rural municipalities and cities and compliance with the complementarity principle arising from EU legislation.	**Reply from the Minister of Finance:** during the period of 2009-2012, the ratio of investment support in the budgets of municipalities has increased due to the economic recession and extraordinary loan restrictions. When the economy recovers, the volume of investments made from own funds will increase. Therefore the conclusion made in the audit about the dependence of municipalities on foreign support cannot be extended to the coming years. Our estimates show that during the period of structural funds from 2014-2020, the investment capacity of municipalities will be higher. The principle of additionality of the contribution of the Estonian state is evaluated as a whole for the seven years, considering also the general economic situation. Estonia has no problems with complying with the principle.

NAO recommendations	Replies from audited entities
(paragraphs 12 to 22)	
24. Recommendation to the Regional Minister and the Minister of Finance: to formulate joint positions on the perspectives of local government funding and start working on the joint development of this policy area. **(paragraphs 12 to 22)**	**Reply from the Regional Minister:** I support the recommendation. We have begun dealing with this within the work of the workgroup of the duties and funding of municipalities created for making preparations of the municipalities' organisation reform. The duties of the workgroup also include developing solutions for possible changes in the organisation of funding. Also, for unifying the positions of the government level, it is planned to submit to the Government of the Republic an overview of the development possibilities and possible directions of the system of funding municipalities and to discuss the possibilities of reorganising the grounds for funding municipalities. **Reply from the Minister of Finance:** we agree that the development of the financing principles of municipalities needs attention. For that there is constant cooperation between the legislator, ministries and associations of municipalities. In the draft for the State Budget Act we have organised the system of support allocated from the state budget.
Organisations granting investment support have no overview of the investment priorities or financial capacities of local authorities 34. Recommendations to the Minister of Finance: ▪ to create a uniform information technology solution for state-level consolidation of investment priorities and financial information specified in the budget strategies of municipalities. The solution should include the investment priorities of each municipality and also the main indicators of a long-term budget, which would confirm the financial capacity of the rural municipality or city to fulfil that plan; ▪ to agree upon with institutions granting investment support as to which information they would like to see in the budget strategy of a municipality in order to streamline their work and then to make presenting that information in the budget strategy obligatory; ▪ to supplement the legislation (Structural Funds Act) with the requirement that granting support would take into consideration the analysis prepared by the Ministry of Finance about the investment priorities and financial capacity of municipalities. **(paragraphs 25 to 33)**	**Reply from the Minister of Finance:** ▪ All prioritised activities are planned in the development plan. The budget strategy of a municipality reflects only activities and investments with monetary coverage. If it would reflect all desired investments, it would impede evaluating what the municipality can carry out in accordance with their financial options, and how it affects their financial capacity. ▪ We agree with the recommendation to create an information technology solution for consolidating budget strategies. ▪ By using the budget strategy, is difficult to gather exhaustive information for donors granting investment support as each measure has their own specific rules. The creation of a permanent gathering format is impeded by sectors and support conditions changing when programming periods end and begin. An investment fund gathered on a national level must develop extensive usage as then the increase in the administrative workload of the municipalities may be justified. ▪ The Structural Funds Act cannot stipulate that ministries have to plan investment support on the basis of the analysis of investment priorities we have prepared. Ministries are liable for the use of means of their area of governance by specifying investment needs, setting priorities and allocating support. Support has to be allocated considering the financial capacity of local authorities. It is planned to enact such a requirement in the Local Government Financial Management Act.
Local authorities are not aware of the state's investment priorities 37. Recommendation to the Minister of Finance and the Regional Minister: if the state wishes to reorganise granting investment support to municipalities, a state investments plan should be developed and it should include investment projects which the state considers important. Local authorities, who in their budget strategy have planned investments which are not of priority according to the state investments plan, could then take that into consideration in their budget strategy. **(paragraphs 35 to 36)**	**Reply from the Regional Minister:** I agree with the recommendation in the part regarding the need for uniformly planning the investment support of local authorities. I do not agree with the standpoint that granting investment support needs additional reorganising and that a plan of investments prioritised by the state should be developed for that. **Reply from the Minister of Finance:** the competence of ministries and measure intermediate bodies includes selecting investments supported according to the measure conditions. As ministries have enacted different rules and decisions are made at different moments, the purposefulness of developing a unified list of investment projects of local authorities is doubtful.
The budget strategies of municipalities are not always comparable 42. Recommendations to the Minister of	**Reply from the Minister of Finance:** by enacting a limit to the investments brought out separately in the budget strategy, the state would excessively interfere with the competence of local authorities. The priority of an investment is not determined only by its size. Each local authority decides

NAO recommendations	Replies from audited entities
Finance: ▪ in the budget strategy of prioritised investment objects, to enact the amount from which investments have to always be shown on a separate row in the budget strategy; ▪ to postpone the date of submitting the budget strategy to the Ministry of Finance until later and to match it with the date of submitting the budget draft to the council. (paragraphs 38—41)	which objects are important to be planned in the budget strategy. Postponing the date of passing the budget strategy depends on whether the date of electing councils is brought to the spring. On election years, it is improbable that a council only just commencing their work would be able to pass a budget strategy for four years within one month.
The development plans and budget strategies of municipalities are in controversy 50. Recommendation to the Minister of Finance: to enact as an amendment to the law the obligation to prepare the budget strategy as a part of the development plan, to make sure that the development plan and budget strategy investments of a local authority are in concordance and that the amendments of these two documents would be processed together. (paragraphs 43—49)	**Reply from the Minister of Finance:** the budget strategy may be a separate document from the development plan as some of the larger municipalities have a development plan which is a general vision document. Strategic planning is done through the budget strategy. Subsection 37[1] (1) of the Local Governments Organisation Act ensures the integrity of the development plan and budget strategy. **Comment from the NAO**: The NAO keeps to their standpoint. The results of the audit enable stating that the referred requirement of law does not ensure the integrity of the development plan and budget strategy. This could only be ensured by enacting the budget strategy as a part of the development plan.
Sectoral development plans are not in concordance with the general development plan 59. Recommendation to the councils municipalities: to provide the system of preparing and reviewing strategic documents in their procedures regarding development documents in such a way that it would also be followed later, it would be understandable for the public and that sectoral development plans, general development plan and budget strategy would be in concordance with each other at all times (paragraphs 51 to 58)	**Elva Rural Municipality Council** attempts to ensure consistency in preparing, reviewing the strategic documents of the city and to follow their mutual concordance. **Haanja Rural Municipality Council** agrees with the recommendation and preparing and enacting procedures regarding development documents will be left as a task to the new rural municipality council. **Jõhvi Rural Municipality Council agrees with the recommendations of the NAO.** **Mäetaguse Rural Municipality Council agrees with this recommendation.** **Märjamaa Rural Municipality Council** agrees with the recommendations and will take them into account in the future when planning investments and preparing the development plan and budget strategy. On 18 October 2012, **Pärnu City Council** passed regulation No. 26 *Procedure of Processing the Development Documents of the City of Pärnu* which stipulates the types of development documents of the City of Pärnu, the procedure of initiating their preparation, their preparation, publication, funding, supervision, monitoring and amendment. Following the aforementioned procedure will ensure concordance between sectoral development plans, the general development plan and budget strategy. **Türi Rural Municipality Council agrees with the recommendation.**
60. Recommendation to the Regional Minister: to analyse the necessity (including requirements for the content of sectoral development plans) of the sectoral development plans of municipalities required by law and to, if necessary, make proposals for differentiating or abolishing such requirements based on the size of the municipality or the volume of investments planned in the sector. Not to coordinate the requirement for new sectoral development plans in laws and regulations if the developmental directions of the sector can also be covered within the general development plan of the municipality. (paragraphs 51 to 58)	**Reply from the Regional Minister:** I have also stated before that by obligating municipalities to prepare sectoral development plans, the state can help to guide municipalities operating independently on lawful grounds. In case of several sectoral development plans, the local authority can decide whether to prepare them as a separate sectoral development plan or as a part of the development plan, whereas subsection 37(4) of the Local Governments Organisation Act has to be considered, pursuant to which the local authority has to ensure concordance of sectoral development plans to the development plan.
Development planning documents are not always fully published on web pages 64. Recommendation to the rural municipality or city authority: to add to the development documents uploaded on the homepage of the municipality a link to procedure documents in	**Haanja Rural Municipality** agrees with the recommendation of the NAO. Documents regarding the processing of the general development plan have been available on the homepage of the rural municipality with the development plan, by now, we have added the activity plan and budget strategy processing documents to the homepage. **Jõhvi Rural Municipality** agrees with the recommendation.

NAO recommendations	Replies from audited entities
the document register. **(paragraphs 61–63)**	**Muhu Rural Municipality:** as final documents, the development plan and budget strategy of the rural municipality have been published on the homepage, also the minutes of the council are available in the document register. We agree with the recommendation of the NAO and in the future will show the corresponding references to the procedure documents (minutes of the council and council committees) with the development documents. **Märjamaa Rural Municipality** agrees with the recommendation and will take it into consideration when planning investments and preparing the development plan and budget strategy in the future. **Nissi Rural Municipality** agrees with the recommendation and will implement the recommendation with regard to development documents prepared in the future. **City of Pärnu:** at the moment, procedure documents are available at the document register. At the moment, a link has not been created between development documents and procedure documents. The links will be made. **Suure-Jaani Rural Municipality** agrees with the recommendation of the NAO and will add a link to documents in the document register to the development documents uploaded to the homepage of the rural municipality. **Türi Rural Municipality agrees with the recommendation.** **City of Võhma** has taken the recommendation of the NAO into account. We will soon add a link to the procedure documents in the document register by the development plan uploaded to the City of Võhma homepage.
Investments specified in the budget and the budget strategy are in controversy 70. Recommendation to the rural municipality or city authority: to reorganise their procedure of preparing the budget in a way so that the investments planned in the budget strategy would be shown separately in the budget or explanatory note to the budget and would be differentiated from other expenses transparently for the public. **(paragraphs 65 to 69)**	**Haanja Rural Municipality** agrees with the recommendation of the NAO. In our budget strategy, we have shown investments planned from own funds separately and in a differentiated manner before, both in the budget and the explanatory note to the budget, where the investments of the coming budget year are also shown more precisely according to objects. The investments shown in the budget strategy, the execution of which mainly depends on the allocation of investment support, are not shown in the budget before there is a positive decision / the investment is actually executed. The budget strategy plans the approximate investment amounts, but the budget considers already the extent of investment expenses according to the execution/tender of a specific procurement (this causes some differences in the amounts). **Jõhvi Rural Municipality agrees with the recommendation.** **Muhu Rural Municipality:** at the moment, Muhu Rural Municipality has separately specified in its budget the investments planned in the budget strategy and the procedure of preparing, passing, executing and amending the budget of Muhu Rural Municipality includes a provision, pursuant to which investments have to be differentiated from other expenses in the budget. As the valid procedure of preparing, passing, executing and amending the budget of Muhu Rural Municipality has been enacted on 17 April 2012 and has not been updated according to the Local Government Financial Management Act, we see a need to supplement it with provisions regarding the preparation, processing and submission of the budget strategy. **Mäetaguse Rural Municipality agrees with the recommendation.** **Märjamaa Rural Municipality** agrees with the recommendation and will take it into consideration when planning investments and preparing the development plan and budget strategy in the future. **Nissi Rural Municipality** agrees with the recommendation, but notes that investments planned in the budget strategy of Nissi Rural Municipality have been reflected separately and are differentiated from other expenses both in the rural municipality budget (column Investment activities expenses) and the explanatory note to the budget (chapter 3. Investment activities). **City of Pärnu:** we agree to add a reference to the budget strategy to the investments specified in the explanatory note to the budget. **Suure-Jaani Rural Municipality** agrees with the recommendations of the NAO and will show investments separately in the budget in the future. **Türi Rural Municipality agrees with the recommendation.** **City of Võhma has taken the recommendation of the NAO into account.** In order to amend the procedure of preparing, passing, fulfilling and reporting to the budget of the City of Võhma, we will initiate a council draft to ensure that the investments planned in the budget strategy would be separately

NAO recommendations	Replies from audited entities
	shown in the budget or explanatory note to the budget.
Audited municipalities have made investments, which did not arise from their development plans 80. Recommendation to the Minister of Finance: when preparing the State Budget Act draft, to provide that the investments added to the budget in the course of processing the state budget at Riigikogu would be based on the investments provided for the same year in the budget strategies of municipalities. **(paragraphs 75–79)**	**Reply from the Minister of Finance:** in the State Budget Act draft we have provided the principle that all investments supported from state funds would arise from the development plans of local authorities. If after the beginning of the budget year, the local authority receives support for an investment not planned in the budget strategy for using during the current year, the change has to be provided in the annual budget. The budget strategy is a financial framework for the next four years and therefore the numbers for the current year do not have to be changed in it after the beginning of the new year.
Local authorities carry out cost-benefit and feasibility analyses and future expenses analyses only upon the demand of the donor 85. Recommendation to the Minister of Finance: to supplement the requirements for preparing the budget strategy so that the budget strategy would show the estimated fixed costs of the planned investments starting from investments which such a size, which could affect the financial capacity of the municipality and/or the financial situation of the state. **(paragraphs 81 to 84)**	**Reply from the Minister of Finance:** the budget strategy has to consider fixed expenses related to investments. Such a guideline is provided in the financial management manual.
Local authorities carry out cost-benefit and feasibility analyses and future expenses analyses only upon the demand of the donor 86. Recommendation to the councils municipalities: to enact a procedure, pursuant to which the feasibility and cost-effectiveness and/or future expenses of an object have to be analysed in order to get an approval from the council for larger investments. Such analyses should be the basis on which the council decides whether to finance an object or not. Therefore it is important to carry out the analyses before the council decides to add the investment object to the development plan and budget strategy. **(paragraphs 81 to 84)**	**Elva City Council** provides in the Statutes of the City of Elva a procedure of how the feasibility and cost-effectiveness of objects needing investments have to be analysed in order to get the city council to approve larger investments. **Haanja Rural Municipality Council** agrees with the NAO recommendations to the councils of rural municipalities. **Jõhvi Rural Municipality Council** agrees with the recommendations of the NAO. **Mäetaguse Rural Municipality Council** agrees with this recommendation. **Märjamaa Rural Municipality Council** agrees with the recommendations and will take them into account in the future when planning investments and preparing the development plan and budget strategy. **Pärnu City Council** considers it very important that the feasibility and cost-effectiveness analyses and future expenses analyses of investments are carried out before the investments are included in the development documents. The City of Pärnu has not enacted a procedure of carrying out cost-effectiveness and feasibility analyses, but we are working towards having a thorough analysis precede including investments to the development plan. **Türi Rural Municipality Council** agrees with the recommendation. Planning a specific investment, primarily in case of constructing new buildings, has to be based on evaluating the feasibility and cost-effectiveness and/or future expenses of the object, either as a part of the project or as a separate analysis.
With obligations taken, the state restricts the freedom of investing of municipalities 94. Recommendation to the Minister of Finance: To review, in cooperation with the members of the board of the EIC the loan contracts concluded between municipalities and the EIC and not to conclude contracts which are not in concordance with laws and the contract concluded between the EIC and the Ministry of Finance. **(paragraphs 87 to 94)**	**Reply from the Minister of Finance:** we agree with the recommendation that the re-lending contracts concluded by the Environmental Investment Centre must be in compliance with laws and the contract concluded with the Ministry of Finance.

Description of audit

Compliance audit terminology

Audit report – a written report prepared at the end of the audit, which specifies the results of the work done. The audit report is addressed to the Riigikogu and the public and therefore preparing the report is based on the principle that its way of presenting information would be understandable and that important background information about the audited sector would be given.

The NAO is free in designing the format of the audit report. This audit report includes content chapters, which cover the results of the work carried out by the NAO along with references to legislative acts; descriptions of operations; circumstances identified; opinions given on the basis of the set criteria; recommendations and other observations worth of bringing out and a summary of the audit report. In the left-hand margins of the audit report, definitions, interesting information about the sector, illustrating examples not including opinions or recommendations are given.

Summary – a short presentation of the most essential information, which does not include information separate from the audit report. The summary is addressed to a wider readership and its objective is to give a general explanation of the messages of the audit report in simpler language.

Criterion – basis for giving an opinion. A criterion is used to compare the actual situation to the required or desired situation. Audit criteria may include compliance requirements, standards, norms and practices (practice refers to a larger collection of norms and standards such as the good practices of accounting) expressed in legislation and other procedures, also the procedures of the audited entities themselves.

Observation – a description or acknowledgement of a circumstance, problem, fact identified in the course of the audit, pursuant to which an opinion is given to the activities of the audited entity, or some other information related to the objective of the audit, which should be published in the opinion of the NAO. When making observations, the interest of the public, level of complexity of the field and the needs of the target group are taken into consideration. Publishing observation is based on the professional discretion of the auditor and the level of detail of preparing the audit report. The audit report may include also observations, which were not directly related to the audit opinion, but were identified in the course of the audit.

Opinion – answer to the audit question based on the audit criteria. A compliance audit assesses the compliance of the activities of the audited entity with the legislation, the legal instruments of the audited entity, and other regulations. Also, the internal control system of the audited entity and its functioning are assessed.

Internal control system – a tool of the management which helps to fulfil the objectives of the institution. Includes an integral process, including a well-considered organisation of work, rules of conduct, adherence to laws, reporting and auditing, and this is implemented by both the management and employees.

Recommendation – a suggestion to implement a measure, which in the opinion of the auditor would help to eliminate the identified deficiencies or to prevent them in the future. The recommendations have to be relevant, executable, their fulfilment measurable and it is recommended that they would be related to specific deadlines. However, at the same time the auditor's recommendation cannot be too detailed, because then the auditor would interfere with the management decisions of the institution. The receiver of the recommendation can decide whether they will consider the NAO recommendations.

Reply from an audited entity – a written opinion from the institution, with regard to whom there are opinions and/or recommendations in the audit report. The audit report is submitted to the audited entity for replying before it is signed. The replies present a written opinion about the recommendations regarding the institution and the implemented measures. The reply of the audited entity will be published with the audit report.

Audit objective

The objective of the audit is to give an opinion as to whether local authorities perform their lawful requirements regarding planning the development, to specify the reasons why these requirements are not met and, as a result, to make recommendations to the state for reorganising the legislative framework related to planning the investments of municipalities. Also an objective is to give an opinion whether the investments made by local authorities comply with the local strategic documents and to specify the reasons of non-compliance. An additional objective is to evaluate whether the system of information gathered by the state is efficient for having an overview of the investment priorities of municipalities.

The main questions of the audit were the following:

- Do municipalities fulfil the obligation of preparing strategic documents, do these documents comply with the formal requirements provided by law and whether strategic documents are in compliance with each other with regard to investments?
- Whether the investments made and loans taken are based on the development plan?
- Does the state have an overview of the investment priorities of municipalities?

Assessment criteria

The NAO considers the following situation to be the prerequisite for consistent and balanced development of municipalities:

- the investment chapters of the development plan and budget strategy prepared by municipalities have been prepared according to the requirements set by law and are in compliance with each other and also sectoral development plans (subsections 37(1)-(4), 37^1(1)-(3), 37^2(1)-(3)(7)-(8) of the LGOA; subsections 20(1)(3), 29(3) of the LGFMA; sections 39 and 42 of the Waste Act; section 4 of the Public Water Supply and Sewerage Act; section 67 of the Basic Schools and Upper Secondary Schools Act; section 9^1 of the Pre-School Child Care Institutions Act; subsection 8(1) of the Social Welfare Act; subsection 8(1) of the Youth Work Act)
- The loans taken and investments made by municipalities are not based on the general development plan (LGOA 37^1(2))
- the state has an overview of the investment priorities of municipalities (LGFMA 30(3) , clause 4 of the Statutes of the Local Governments Financial Management Department of the Ministry of Finance)

Scope of audit and approach

The NAO carried out the audit in concordance with the audit standard guidelines ISSAI 4100 – Compliance Audit Guidelines for Audits Performed Separately from the Audit of Financial Statement of INTOSAI (International Organization of Supreme Audit Institutions). Pursuant to the standard, the audit has to be planned and carried out in a way, which enables to give sufficient security within the audited scope that errors and irregularities in the activities of the audited entity and illegal actions will be discovered. In the course of the audit, sufficient evidence was gathered to make sure whether the information regarding the specific field is in compliance with the audit criteria and also supports the observations made. The NAO finds that the audit gives a sufficient basis for evaluating the lawfulness of the activities and transactions of every audited entity.

The entities to be audited were sample of municipalities, the Ministry of Finance and the Ministry of the Interior (Regional Minister Office). As this is a follow-up audit, then in order to maintain the comparability of the two audits with regard to the investments of the municipalities, the sample was specified on the basis of the sample of the previous audit, which was reduced from 30 municipalities to 13. The list of municipalities included in the sample has been shown in annex A to the report.

In the course of the audit, the auditors analysed the documents of municipalities (including the municipalities' general development plan and its amendment decisions, sectoral development plans, 2013 budget, legislative acts of the council for taking loans, loan and financial lease contracts and budget strategy), accounting data (including monthly reports about implementation with regard to acquiring and renovating tangible fixed assets), information published on the web page and interviewed all representatives of the audited entities.

Time of completing the audit

The audit was completed in November 2013.

Audit team

The audit was conducted by Audit Manager Illar Tõnisson, and auditors Annika Jaansoo and Kristel Makus.

Contact particulars

For further information on the audit, please contact the NAO Communication Service by phone: +372 640 0704 or +372 640 0777, or e-mail: riigikontroll@riigikontroll.ee

The electronic version of the audit report (pdf) is available on web site www.riigikontroll.ee.

The summary of the audit report is available in English also.

The reference number of the audit report in the NAO records system is 2-1.9/13/50060/47.

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NAO's previous audits concerning the investments of local authorities

20.1.2012 – **The use of EU funds in development of the social infrastructure of rural municipalities and cities**

29.9.2009 – **Solvency problems of rural municipalities and cities in autumn 2009**

7.08.2008 – **Overview of applying for and using European Union support in rural municipalities and cities**

30.8.2007 – **Investments of municipalities**

25.10.2006 – **Overview of the use and preservation of state assets in 2005**

10.7.2006 – **Investments allocated to municipalities by the Ministry of Culture**

9.8.2005 – **Allocating and utilising funds for investments of regional programmes from the receipt of gambling tax**

20.9.2004 – **Planning of state investments for general education schools and the utilisation of such resources**

All reports are available on the NAO web site www.riigikontroll.ee

Annex A. Municipalities included in the sample

The entities to be audited were a sample of municipalities, the Ministry of Finance and the Ministry of the Interior (Regional Minister Office).

As this is a follow-up audit, then in order to maintain the comparability of the two audits with regard to the investments of the municipalities, the sample was specified on the basis of the sample of the previous audit organised in 2007 by reducing the sample from 30 municipalities to 13 municipalities.

To develop the sample of the previous audit, municipalities were listed by counties according to the 2006 annual budget. Tallinn was left out of the sample as due to its size and budget volume, including Tallinn to the list of the audit sample would give a distorted image of the whole state. Municipalities were divided into four groups according to budget volume – budget over 6.4 million, budget from 3.2 to 6.4 million, budget from 1.3 to 3.2 million and budget under 1.3 million euros. Of all the four groups, the auditors decided to include in the sample a similar number of municipalities (7-8). If the selection would have been made with the total volume ratio of the budget, the audit would have focussed on too large; if according to the number of municipalities, then on too small units.

Then it was calculated what is the ratio of the budget totals of municipalities of a certain county from the total budgets of the municipalities of Estonia as a whole. A different number of municipalities was included to the sample in proportion with that ratio.

Selecting audited entities to this audit was done pursuant to the aforementioned rules – municipalities were chosen from each of the aforementioned groups. The municipalities included in the sample have been divided into four groups in the table below according to the implementation of total budgetary expenditure of 2011.

Table 10. Audited entities

Total budgetary expenditure (implementation) in 2011			
Less than EUR 1,3 million	EUR 1.3-3.2 million	EUR 3.2-6.4 million	More than EUR 6.4 million
City of Võhma	Haanja Rural Municipality	Märjamaa Rural Municipality	City of Pärnu
	Käina Rural Municipality	Mäetaguse Rural Municipality	City of Elva
	City of Loksa	Nissi Rural Municipality	Jõhvi Rural Municipality
	Muhu Rural Municipality	Suure-Jaani Rural Municipality	Türi Rural Municipality

Source: NAO

In addition, within the work carried out in the course of preliminary analysis, it was made sure that the sample would not include municipalities where a NAO audit was already in progress (e.g. Viimsi Rural Municipality) or which have been visited repeatedly in the last couple of years (e.g. City of Narva). In addition, when preparing the sample, it was made sure that the sample would include municipalities of different sizes, different efficiency in planning development and different financial capacity.

Annex B. NAO recommendations and replies from the Minister of Finance and the Regional Minister included in the audit report on "Investments of local authorities"

NAO recommendations	Replies from the Minister of Finance and the Regional Minister	Current situation according to the auditors
Investment plan		
NAO recommendation to the Regional Minister in cooperation with the Minister of Finance: To initiate a law amendment, which would obligate local authorities to prepare an investment plan as a part of the development plan at least for the period of the state budget strategy and would set minimum requirements for the content of the investments plan.	**Reply from the Regional Minister**: We support the recommendation. These requirements are planned to be enacted in the draft of the Local Government Financial Management Act (hereinafter LGFMA), which is being prepared by the Ministry of Finance. **Reply from the Minister of Finance**: In the draft of the Local Government Financial Management Act, we plan to establish a requirement that at any budget year, the valid development plan has to include at least the four next budget years, which would be equal to the state budget strategy. As a part of the development plan, we require that municipalities have to establish their own budget strategy, a part of which naturally is an overview of planned investments.	Requirements have been enacted in the LGFMA.
Period covered by the development plan		
NAO recommendation to the Regional Minister in cooperation with the Minister of Finance: To initiate a law amendment, which would replace the requirement that the part of the development plan reflecting proprietary obligations would be planned for the period of validity of the proprietary obligations with the requirement that the development plan has to include information about long-term proprietary obligations.	**Reply from the Regional Minister**: We support the recommendation. In the LGFMA draft being prepared by the Ministry of Finance, this recommendation has been taken into consideration. **Reply from the Minister of Finance**: The LGFMA draft has taken this recommendation into account, i.e. if the municipality has long-term proprietary obligations or proprietary obligations are planned for a longer period, the development plan has to include information about the proprietary obligations exceeding the validity of the development plan.	Relevant amendment has been made to the LGOA
Development plan upon the merger of municipalities		
NAO recommendation to the Regional Minister: To initiate a law amendment which would set a deadline for establishing the development plan of a municipality formed by merger.	**Reply from the Regional Minister**: Section 9' of the Promotion of Local Government Merger Act provides that upon the merger of municipalities, the councils of the merging municipalities will organise the preparation of a merger contract, which will also stipulate the validity of the development plans of the merging municipalities. Therefore the requirement for a development plan provided in section 37 of the LGOA has been ensured and the new municipality has to ensure adopting a document defining its development objectives and the options for realising these objectives within the time limits provided.	Law amendment has not been initiated.
Submission of development plan to County Governor and Ministry of the Interior		
NAO recommendation to the Regional Minister: To initiate a law amendment, which would declare invalid the obligation of a municipality to submit their development plan to the County Governor and Ministry of the Interior.	**Reply from the Regional Minister**: We are on the standpoint that pursuant to subsection 37 (6) of the LGOA, the development plan of a municipality is a document to be published on the web page of the rural municipality of city and therefore is available to the county government and the Ministry of the Interior. Pursuant to clause 84(1) of the Government of the Republic Act, which makes it the duty of the County Governor to care for the comprehensive and balanced development of the county, including evaluating the compliance of different projects to the development plans of municipalities, it is important for	Informing the Ministry of the Interior and the County Governor of adopting or amending the development plan is no longer required by the LGOA.

	the County Governor to be up to date with the current situation of the development plans of municipalities. Such information is important for planning the development of the county and exercising supervision. We regard important the obligation to inform the County Governor of amendments to and enactments of development plans along with a link to the document's location in the web.	
	In his reply, the **Minister of Finance** noted that the draft for the LGFMA has taken into consideration the recommendation made to the Regional Minister in the audit report to initiate a law amendment, which would invalidate the obligation of a municipality to submit the development plan to the County Governor and the Ministry of the Interior.	
Monitoring of development plan implementation		
NAO recommendation to the Regional Minister in cooperation with the Minister of Finance: To initiate an amendment of legislative acts, which would declare invalid the obligation of local authorities to adopt a decision about the implementation of the development plan by 1 October and which would obligate the local authority to submit an report on development plan (investments plan) implementation within the annual financial report.	**Reply from the Regional Minister**: We agree with the recommendation. The draft to the LGFMA being prepared by the Ministry of Finance provides that the management report will include an overview of the fulfilment of the objectives set in the development plan for the corresponding budget year.	Amendment has been made to the LGFMA.
	Reply from the Minister of Finance: The LGFMA draft abolishes the obligation to adopt a decision about the implementation of the development plan and provides that the management report of the annual financial report will give an overview of the fulfilment of the objectives provides for the corresponding budget year in the development plan, including the most important investment.	
Sectoral development plans		
NAO recommendation to the Regional Minister: To analyse the need for sectoral development plans of municipalities required by law (including requirements on the content of the sectoral development plans) and, if necessary, to make proposals to differentiate or abolish these requirements based on the size of the municipality or the volume of investments planned in the sector. Not to approve the requirement for new sectoral development plans provided in laws, if the developmental directions of the sector can be covered within the general development plan of the municipality.	**Reply from the Regional Minister**: Through the obligation of preparing sectoral development plans, the state guides municipalities that are operating independently on the basis of laws. Pursuant to the development plan of the area of governance of the Ministry of the Interior we have planned to analyse and update legislative acts regarding municipalities during the years of 2008-2009 by involving research institutions and experts.	Analysis has not been performed.
Compliance of the recovery plan with the development plan		
NAO recommendation to the Regional Ministerin cooperation with the Minister of Finance: To initiate a law amendment which wouldspecify, in case of rehabilitated municipalities, the relations between the recovery plan and development plan, would specify the procedure of reviewing the recovery plan and reporting on its implementation and would enact an obligation to publish the recovery plan fully on the web page.	**Reply from the Regional Minister**: We support the recommendation. The draft of the Local Government Insolvency Act being prepared by the Ministry of Finance has taken this recommendation into account.	Amendment has been made to the LGFMA
	Reply from the Minister of Finance: The draft of the Local Government Insolvency Act has taken this recommendation into account.	
Separating capital and operating budgets		
NAO recommendation to the Minister	**Reply from the Minister of Finance**: The Ministry of	Analysis has not been

of Finance: To analyse the purposefulness of separating the capital, i.e. investments budget from the operating budget of the municipality and to publish the results of this analysis.	Finance does not see a need to separate the capital, i.e. investments budget from the operating budget. The necessary information about investments is available from the budget documentation and budget implementation reports. In explanatory notes to budgets, many municipalities have specified projects for acquiring fixed assets along with sources of financing. In case of some municipalities, the number and volume of investment projects is small and for those municipalities, obligating them to prepare a capital budget would put additional administrative burden on them. With regard to those municipalities, a capital report would give no additional information to the public.	performed.
Budget strategy		
NAO recommendations to the Ministry of Finance: to submit the draft of the Local Government Financial Management Act to the Government of the Republic with the aim of enforcing an obligation of the local authorities to adopt a budget strategy.	**Reply from the Minister of Finance**: In the draft of the LGFMA, adopting a budget strategy as a part of the development plan has been made obligatory to local authorities. The state prepares a state budget strategy for the following four years and the strategy includes all measures aimed at municipalities. Therefore there is no need for making additional forecasts regarding measures planned for municipalities in the state budget. .	Amendment has been made to the LGFMA.
To provide municipalities of a forecast of the extent to which the state plans to support municipalities for the period for which the municipality has to prepare a budget strategy so that the local authority could adopt a budget strategy.		This forecast is not provided.
Financial planning		
NAO recommendation to the Minister of Finance in cooperation with the Regional Minister: To organise creating an information technology solution for financial planning.	**Reply from the Minister of Finance**: Organising the creation of information technology solutions is in the area of governance of the Ministry of Economic Affairs and Communications. In addition, we consider it to be right in principle that in the future, with regard to support functions, central support for municipalities would be provided by municipality associations.	Has not been organised.
	Reply from the Regional Minister: The recommendation will be taken into consideration when preparing the development plan of the municipality information society.	
Overview of investment support		
NAO recommendations to the Minister of Finance: to prepare a manual for the uniform reflection of investment support in the cash based budget implementation monthly report, including establishing a requirement that in their budget implementation reports, the municipalities would also reflect support, which the donor paying directly to the contractor under a contract concluded with the municipality.	**Reply from the Minister of Finance**: This year, we have begun working on an overview of investment support allocated from the public sector to municipalities. Also we agree with the need for an additional manual to ensure an increase in the quality of data presented about the implementation of a cash based budget submitted through a monthly report. The draft of the LGFMA provides that reporting has to include such transactions, in case of which the donor directly makes the payments for the investments of municipalities.	Amendment has been made to the LGFMA.
Granting of investment support		
NAO recommendation to the Minister of Finance: To introduce to the process of granting investment support to municipalities by the state the principle, that national-level priorities are carried out through programmes, which have specific	**Reply from the Minister of Finance:** We have set an objective to reorganise the principles of allocating investment support to municipalities in cooperation with ministries, within whose areas of government the investments are provided.	Has not been organised.

objectives (considering the balanced development of the state) and which have been coordinated with municipalities, and that other allocations (essentially investments meant for supporting the local revenue base) are divided according to a specific formula, considering foe example the population, revenue base, earlier investments etc. To ensure that the programme with a specific objective supports an object, which is included in the investments plan of the municipality.		

Annex C. Interviews conducted during the audit

Date	Audited entity	Participants
24/01/2013	City of Elva	Heiki Hansen (Deputy Mayor), Eve Nõmmemaa (Chief Accountant), Inna Rebane (Financial Specialist)
20/02/2013	Suure-Jaani Rural Municipality	Aino Viinapuu (Development Adviser), Elle Tints (Head of Financial Department), Tõnu Aavasalu (Rural Municipality Mayor)
21/02/2013	City of Võhma	Avo Põder (City Mayor), Tiina Ranne (Chief Accountant)
20/03/2013	Käina Rural Municipality	Omar Jõpiselg (Rural Municipality Mayor), Tiivi Lipp (Deputy Mayor), Aiki Maivel (Financial Director & Chief Accountant)
21/03/2013	Muhu Rural Municipality	Raido Liitmäe (Rural Municipality Mayor), Karl Tiitson (acting rural municipality secretary), Lea Valk (Chief Accountant)
15/04/2013	Jõhvi Rural Municipality	Tauno Võhmar (Rural Municipality Mayor), Vello Juhkov (Deputy Mayor), Rein Luuse (Development Adviser), Küllike Olup (Financial Director), Ellu Blok (Vice-Financial Director), Niina Kulakova (Accountant)
15/04/2013	Mäetaguse Rural Municipality	Luule Salla (Chief Accountant), Jana Pavlenkova (Development Adviser)
19/04/2013	Märjamaa Rural Municipality	Lea Laurits (Head of Finance Department), Enna Ots (Chief Accountant), Triin Matsalu (Deputy Mayor), Eero Plamus (Rural Municipality Mayor)
23/04/2013	City of Pärnu	Grete Kukk (Senior Specialist of City Development), Karin Holland (Chief Accountant – Head of Service), Eve Vihmaru (Financial Director – Head of Service)
24/04/2013	Nissi Rural Municipality	Peedo Kessel (Rural Municipality Mayor), Reet Sandvik (Financial Director)
29/04/2013	Haanja Rural Municipality	Juri Gotmans (Rural Municipality Mayor), Kersti Kaaver (Chief Accountant)
07/05/2013	City of Loksa	Laivi Kirsipuu (Development and Environment Adviser), Ljudmilla Tursk (Chief Accountant)
06/05/2013	Türi Rural Municipality	Tähve Milt (Head of Finance Department), Ene Irman (Chief Accountant), Üllar Vahtramäe (Head of Development)
17/06/2013	Ministry of Finance	Sulev Liivik (Head of the Local Governments Financial Management Department)
25/06/2013	Ministry of the Interior	Ave Viks (Adviser), Aivo Vaske (Adviser of the Regional Minister), Madis Kaldmäe (Adviser in the Regional Policy Office), Priidu Ristkok (Head of the Regional Development Department), Liis Lepik (Adviser of the Department of Local Governments and Regional Administration)
26/06/2013	Environmental Investment Centre	Andrus Kimber (Member of the Management Board), Maarika Kõrm (Loan Administrator)