

Auditing the economic activities of municipalities in the federal state of Salzburg

Annemarie SAM and Matthias STÖCKL

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The federal state of Salzburg



Population (1.1.2013): 531.898

Surface: 7.154 km²

GDP per capita 2012: 42.100 Euro

Statutory framework for audits of municipalities

The federal court of audit has the authority to audit ...

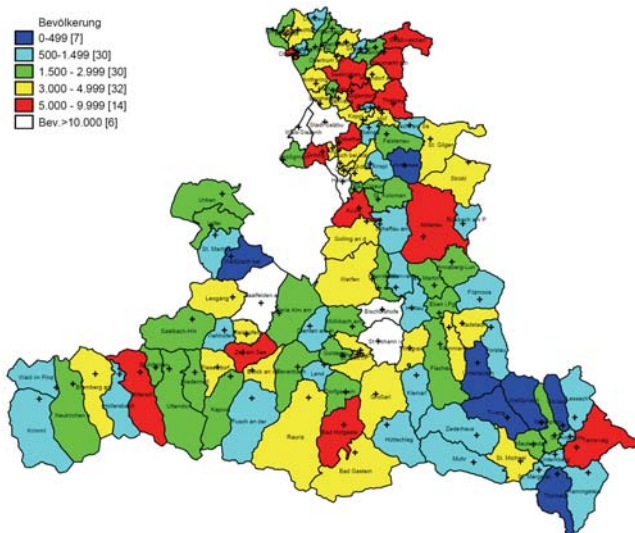
- ▶ Municipalities with less than 10.000 inhabitants and their
 - ▶ Corporations under public law and
 - ▶ Majority-owned corporations (i.e. municipality holds at least 50 % of initial capital)

Some limitations exist:

- ▶ Maximum number of audits: 2 municipalities per year
- ▶ The selection of municipalities to be audited has to follow certain guidelines which the director of the federal court of audit has to issue.

The federal court of audit has the authority to audit municipalities since 2012.

Municipalities in Salzburg, grouped by population in 2011



Organizational forms of economic activities

Corporations under public law

- ▶ Funds and trusts
- ▶ Owner-operated municipal enterprises
- ▶ Market units according to ESA 1995/2010

Corporations

- ▶ Business partnerships (e.g. private limited partnership)
- ▶ Corporations (e.g. limited liability company)
- ▶ Atypical organizational forms (e.g. limited partnership with a limited liability company as general partner)

Corporations are independent legal entities and, thus, are not included in the accounts of municipalities.

Market units according to ESA 1995/2010 I

Requirements

- ▶ Market-orientated economic activity of a certain size
- ▶ The market unit shall cover at least 50 % of its costs by its sales
- ▶ Use of tangible assets and employees to pursue purpose of the entity
- ▶ Market units are part of the municipal accounts and displayed separately

Examples

- ▶ Drinking water supply and sewage disposal
- ▶ Waste disposal
- ▶ Operation of retirement homes and real estate management

Market units according to ESA 1995/2010 II

Characteristics:

- A: Market units are dependent entities
- B: Possess their own accounting system within the municipal accounts
- C: Legal requirement to set up its own balance sheet including all assets and liabilities
- D: Unlimited liability of municipality
- E: Supervision and audits through municipal council, regulation authorities and courts of audit
- F: Need to set up bylaws including
 - ▶ Definition of business objectives and goals
 - ▶ List of all organs and specification of their functions
 - ▶ Business plan, budget and cost accounts

Market units according to ESA 1995/2010 III

Issues identified by the federal court of audit

- ▶ Bylaws do not exist or show severe deficits
- ▶ Balance sheets partially incomplete (e.g. tangible assets)
- ▶ Incomplete summary of tangible assets and partly falsely valued
- ▶ Cost accounts not in correspondence with the state-of-the-art
- ▶ Fees and charges are not adjusted to changes in the cost structure
- ▶ The charged fees are not in accordance with cost calculations
- ▶ Some market units illegally generated remarkable profits
- ▶ Profits were used in contradiction to legal requirements

Majority-owned corporations I

Advantages:

- ▶ Input tax reduction (until 2012)
- ▶ Excluded from municipal accounts

Disadvantages:

- ▶ Constrained decision-making and control authority of municipal council
- ▶ Budgetary risks for municipalities (e.g. through assumption of liabilities for loans of the corporation)

⇒ Amendments of national and EU-laws are aimed to promote transparency via increased reporting requirements (e.g. debt and liabilities)

Majority-owned corporations II

Issues identified by the federal court of audit

- ▶ Incompatibility of functions
 - ▶ Mayor acts as managing director of corporation (e.g. transferring liabilities from the corporation to the municipality)
 - ▶ Although being the same person, the mayor formally approved the action of the managing director
 - ▶ Insufficient legal regulations in municipal codes
- ▶ Severe control-deficits (e.g. dual control principle not met)
- ▶ Obligatory annual general assemblies were not conducted
- ▶ No obligatory supervisory board
- ▶ No bylaws issued
- ▶ Considerable information deficits towards municipal council
- ▶ Decisions concerning the corporation were made by non-responsible authorities

Majority-owned corporations: Recommendations

- ▶ The installation of an advisory board should be codified in the articles of incorporation
- ▶ General assembly
 - ▶ The members of the municipal council should act as representatives of the shareholder in the general assembly
 - ▶ Legal requirements concerning the annual general assemblies should be met
 - ▶ The formal approval of the action of the managing director lies in the hands of the general assembly
- ▶ The annual financial statements of municipally-owned corporations should be part of municipal accounts
- ▶ Incompatibility of functions must be avoided, if necessary by codification
- ▶ Dual control principle should be established in the bylaws of the corporation
- ▶ Corporations should provide annual budgets which should be part of the municipal accounts

Summary

- ▶ The reported results stress the need to audit the economic activities of municipalities
- ▶ The federal court of audit documented in detail severe shortcomings with respect to legitimacy, transparency and profitability
- ▶ Economic considerations still play a minor role in corporations and market units according to ESA 1995/2010
- ▶ The audits of the federal court of audit expand existing controls of other authorities and generate considerable value-added.