

**WROCLAW SEMINAR**  
**19 May 2006**

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General topic: The indebtedness of local communities.

*Topic of intervention:* The indebtedness of local communities (regions, departments and municipalities) in France appears to be largely under control. Since 1982, legal regulations have introduced prudent measures, in respect of which the regional audit chambers play a significant role, which will be recalled in the presentation. The intervention will demonstrate, however, that problems sometimes arise, such as regarding the true awareness of the communities' indebtedness beyond how it appears in the accounts, as well as that of over-indebtedness, shown by the case of insolvent municipalities. The attitude of the banking community towards local public communities has contributed to the existence of some of these situations, and several factors could, in future, help towards a gradual reduction of indebtedness in certain local communities.

**PLAN**

**1 Solvency and general indebtedness of local communities. Their solvency is linked to prudent legal regulations that are quite strict.**

There is general consent that the solvency of French local communities is good, and that, following a few one-off incidents which surfaced in the early 1990s, they have consolidated their position overall.

One of the key causes of the local communities' relatively good health, and the reduction of their indebtedness, is no doubt down to the principle of balancing the budget, which is a legal obligation for local communities but not for the State. The ability to repay the capital on annual loans by means of their own resources is one of the legal conditions of balancing the budget for local communities.

**2 The Regional Audit Chamber intervenes to ensure these regulations are adhered to and to help gain transparency with regard to the indebtedness of local communities.**

In France, the regional audit chambers play an important role in checking that the budget balancing regulation is adhered to and in monitoring the level of indebtedness of local public communities. They intervene according to two procedures:

- in a monitoring capacity: matters are referred to the chambers by the representatives of the State, just after the local communities' budgets have been adopted, if these budgets do not balance (income/expense

deficit), if the repayment of borrowed capital cannot be ensured by the communities' own funds, if the evaluations are not genuine (notably expenses linked to debts).

- in their usual capacity as a posteriori auditors of accounts and management, whereby they can be led to state findings and issue critical comments in matters of indebtedness and accounting transparency.

### **3 The regional audit chambers have a knowledge tool about the financial situation of the local communities by means of a national database**

The debt knowledge tool at the disposal of the regional audit chambers: a few notes about the DELPHI database and its interrogation, sorting and multiannual simulation abilities.

### **4 The actual debt of the local communities is not always the same as that shown in their accounts**

As far as indebtedness is concerned, there are inevitably differences between the accounts figures and reality, particularly in those communities that are in difficulty. Here are some of the difficulties associated with establishing actual debt, over and above the raw figures: guaranteed debt, debt off the balance sheet, consolidated debt, reported debt. Special treatment of liquidity credits. On the other hand, the raw figures do not take account of repayments secured by guaranteed earnings (funds allocated to the repayment of debt, arising from subsidised rents or aids from different communities). There are risks of misinterpretation. This is shown by the case of a municipality considered by the administrative authorities to be in difficulty when it is really in a healthy situation.

Examples taken from audits of a large town in the region by the Regional Audit Chamber of Languedoc-Roussillon will be used to illustrate the problem of latent debt, which is not shown in the annual accounts.

### **5 The part played by the regional audit chambers in restoring the situation of over-indebted communities**

The part played by the regional audit chambers in sorting out a situation involving excess indebtedness often takes the form of drawing up multiannual remedial action plans. An example of particularly laborious remedial action in the case of two local authorities in the Languedoc-Roussillon region will be used to show the difficulties surrounding this type of intervention.

## **6 The attitude of the banking community towards the indebtedness of local communities has changed**

The communities' difficulties can be largely attributed to inadequate loan decisions by the banks. Several factors are worth mentioning, including the historic role of some protagonists who were initially associated with the public sphere. One should also mention the "Cooke ratio" and its disappearance following the MC DONOUGH reform. The banks regulatory framework has since been undergoing profound changes, with greater emphasis on risk evaluation on the lender's part. This development risks making it much more difficult for the weakest communities to access credit, as well as endangering the banking organisations' responsibilities towards communities.

## **7 What threatens the financial situation and the local communities' indebtedness in 2006?**

Some people believe there is a risk of a detrimental trend returning to local finances: they cite the huge transfer of powers by the State in the sectors with induced expenses such as welfare (departments), education (lower and upper secondary schools: *collèges* and *lycées*), public roads, the assumption by intercommunal organisations of large investments in environmental projects (waste reduction, protecting the water and air), in conurbations, public transport,)...

These views, together with the announced end of the cycle of interest rate cuts, lead to the belief that the local communities' overall debt will worsen in future, particularly at intercommunal level and in the departments.