

GETTING THE LOCAL COMMUNITY PUBLIC DEBT “ON LEASH”
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Slovenia will have 210 municipalities by the end of 2006. The Public Finance Act and The Act on Financing of Municipalities impose a limit for municipalities to incur debts. Auditing the debt of local governments is continuous mission for the Court of Audit where we on one hand audit municipalities and on the other hand make recommendations to legislative body – parliament – on tightening legal frame in order to perform our active role which is “*watching over public money*”.

In the presentation the following will be presented:

1. Development of the legal framework concerning public debt – local government

Presentation will highlight the most important elements of the development of laws concerning local self – government on the area of public debt. It is important to stress that the development of the legal framework was the result of the fact that municipalities tend to incur debts and are very inventive in finding new methods for avoiding limits imposed by the law. The main steps in the development were:

- **BEFORE THE REFORM OF THE LOCAL SELF GOVERNMENT** there were 62 municipalities – and no limit to which debts may be incurred. As a result municipalities were issuing bonds and in the years to follow they were unable to pay their obligations.
- *The Adoption of the Constitution of Republic of Slovenia (1991)* was followed by the **REFORM OF THE LOCAL GOVERNMENT:**
 - *The Local Self – Government Act (1994)* was adopted and resulted in establishment of 152 municipalities in 1995, additional 41 in 2002 and soon additional 17 municipalities will be established resulting in 210 municipalities all together by the end of 2006;
 - *The Act on Financing of Municipalities (1994)* was adopted and imposed limits which regulate incurring of the debts;
 - *Public Finance Act (1999)* introduced a) procedure which municipalities must follow when they decide to indebt themselves b) obligatory permission issued to a municipality by the Ministry for Finance for incurring a debt;
 - *The Act on Financing of Municipalities* was changed in 2005 and loosened the limits to which debts may be incurred but broadened elements which are limited.

2. The Legal framework concerning public debt – local government

Two main acts regulate limits to which public debt may be incurred by municipalities:

- *Public Finance Act*
 - Procedures of incurring debt
- *The Act on Financing of Municipalities.*

Main element of the system:

- accounting system: modified cash based accounting;
- limits imposed by the law;
- planning (special account - balance sheet which is part of the budget, municipal council sets the annual limit for incurring a debt and issuing guarantees);
- special requirements (certain procedure must be followed, The Ministry of Finance must issue a permission to incur debt);
- reporting (the special account - balance sheet which is part of the final account, obligatory reporting to The Ministry of Finance on debt status of a local community).

3. Some figures and milestones

In this presentation some figures will be presented which will highlight tendencies and problems of public debt of municipalities:

- flows of public debt – borrowing and paying back;
- balance sheet – long term obligations arising from loans and other;
- balance sheet – short term obligations.

4. Public debt Audit

Auditing debt of the local government is continuous mission for the Court of Audit. Most common audit of the local government practiced by Court of Audit in recent years consists of four areas – debt incurred and paid back being one of them. A special audit program is developed for special account “account of financing” - for checking on all by law prescribed elements:

- amount borrowed,
- amount paid back,
- total amount of the debt,
- level of short term debt thought the year,

and links with other areas of audit to assess whether municipality entered in other contractual relations which in fact mean incurring debt (for example accrued expenses...).

Elements prescribed by law usually do not present a particular audit problem. Problems appear when auditors must make a judgment whether some actions of municipality resulted in public debt or not.

In 2005 we planed to perform cross audit of public debt incurred by municipalities, but we postponed it since new legislation was adopted in 2005 and we would not be able to give up-to-date recommendations based on audit results.

As far as audit of public debt is concerned the cooperation with:

- The Ministry of Finance (data of public debt, legislation, opinions),
- The Government Office for Local Self – Government and Regional Development (opinions, legislation)

is particularly important. Recent example: The Ministry of Finance alerted us when they noticed that a municipality incurred debt that supposed to be beyond limit set by the law. We checked the data and decided to audit it.

5. Audit results

- Findings of the audit published in audit reports: case studies of three municipalities;
- Important findings were highlighted in the Court of Audit annual report;
- Recommendations during the adoption of new legislation which were mainly accepted;
- Cooperation with the Ministry of Finance, the Government Office for Local Self – Government and Regional Development;
- Recommendations to municipalities – seminars, conferences.

6. Problems

- cash based accounting – how to capture all elements that are part of public debt;
- pressures on municipalities to invest – reform of primary school system (transition from 8 to 9 year system – increasing school capacities), environmental legislation – that causes problems with small municipalities;
- municipalities inventing new ways of incurring debt;
- elections – tendency to incur debt increases;
- a lot of mayors are also members of the Parliament – pressures to loosen legislation so that municipalities would be able to borrow more.

7. Conclusion

The Court of Audit audit practise shows that it is important to build sound legislative framework to:

- encompass all elements that could have the nature of public debt;
- control public debt incurred by the municipalities

but it also shows that we lack proper leverages to fully impose the law (proper sanction for violators – mayors) and contingency plan – sequestration when a local community goes over the edge and fails to service debt – debt crises.