EUROSAI
Task Force
Municipality Audit

AUDIT COMPENDIUM
"Municipality-owned companies"

Audit reports published between 2016 and 2019

May 2020

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OPENING WORD

Dear reader,

EUROSAI TFMA unites supreme audit institutions of 28 EUROSAI countries, which are interested in audits of municipalities. The chair of EUROSAI TFMA is the National Audit Office of Lithuania (NAOL) and it also hosts the Secretariat which coordinates the activities of the task force. The vision of EUROSAI TFMA is to become an active EUROSAI task force covering relevant questions in the sphere of auditing municipalities. The mission of EUROSAI TFMA is to create an open platform for sharing the best practice and experience on the municipality audit.

EUROSAI TFMA principles for effective work of the task force members:

- Showing Initiative and Taking Responsibility.
- Respect for Team Work.
- Enthusiasm and Seek for Innovation.

The TFMA keeps on creating the added value for municipal audit and the entire auditing system. Results of our activities enable the right decisions to be made in external municipal audits. We help to create the background for the improvement of external audit methodologies and to make the audit process easier.

EUROSAI TFMA activities, planned for the period of 2017-2020, established to seek the three strategic goals of the task force, will also be in line with the Strategic Goals from the EUROSAI Strategic Plan 2017-2023, especially with the first goal “Supporting effective, innovative and relevant audits by promoting and brokering professional cooperation”.

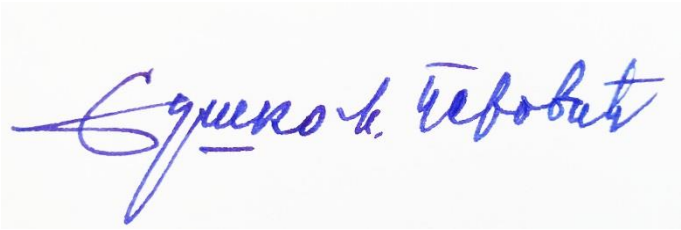
In this strategic period, the EUROSAI TFMA Secretariat initiated a new activity – to publish the EUROSAI TFMA Audit Compendium. This audit compendium, as a new type of product, should complement the audit results by raising awareness of recent audit work by the EUROSAI TFMA countries and would make the results of SAIs work more widely available. The topic of this first EUROSAI TFMA Audit Compendium “Municipality-owned companies” was approved by all members at the 2nd Annual Meeting held in November 2018 in Belgrade. The purpose of the EUROSAI TFMA Audit Compendium is to gather and systemize the audit results or practices of members in the field of municipality-owned companies in the period between 2015 and 2019. It should complement the audit results by raising awareness of recent audit work by the EUROSAI TFMA countries and make the results of SAIs work more widely available.

Accordingly, during the 2nd quarter of 2019 the Coordination group led by the State Audit Institution of the Republic of Serbia collected information about conducted audits or other useful information related to the Compendium topic from the EUROSAI TFMA members. Then, Coordination group analysed and systemized the gathered information, finalised the Audit Compendium and circulated it among EUROSAI TFMA members in 2020. This entailed a numerous consultations, exchange of e-mails and discussion. A web-based version of the

Audit Compendium will be available soon in the EUROSAI TFMA website, providing a more user-friendly consultation.

Specificities at national levels in different countries mean variety of experiences and practices and this variety makes the knowledge sharing and professional cooperation more valuable. Exchanging the best practice and experience helps to increase the knowledge and competence of all the members of EUROSAI TFMA. Moreover, TFMA expects the information provided in this Audit Compendium to be of use and interest to other SAIs as well.

We deeply thank all the members of the TFMA for their kind contributions to draft this Audit Compendium and particularly to the Chair of the TFMA, SAI of Lithuania, as well as the Coordination group consisting of SAIs of Italy, Serbia, Turkey and Ukraine for its preparation. By delivering this Audit Compendium to SAIs, we trust that the TFMA strived to its purpose to be useful and innovative when it comes to sharing the best practice and experience on the municipality audit. We very much hope it will add value to SAIs and their leadership and staff and, consequently, to the citizens they serve.



Mr Duško Pejović, PhD
President
State Audit Institution of the Republic of Serbia

EXECUTIVE SUMMARY

This Audit Compendium provides some background information on municipality-owned companies, legal bases, use of financial resources and etc. The Compendium also illustrates the main challenges the TFMA members are facing in this field. Municipality-ownened companies is a complex area to audit. Nevertheless, the large number of audits carried out in recent years reflects the great significance of this topic.

With this publication the EUROSAI TFMA aims to enhance communication of relevant audit messages to its stakeholders and the public in general. This first edition of the Audit Compendium is based on audit reports in the field of municipalities owned companies produced by 14 TFMA members between 2016 and 2019.

The first part of this Audit Compendium – financial audit summarizes the results of selected audits carried out by 4 EUROSAI TFMA member SAIs (Albania, Italy, Montenegro, and Republic of Serbia). These selected audits addressed essential aspects of financial issues focusing on the area of activity such as Water supply and Sewage in Albania, Montenegro and Republic of Serbia and other.

The second part of this Audit Compendium – compliance audit summarizes the results of selected audits carried out by 5 EUROSAI TFMA member SAIs (Hungary, Latvia, Republic of North Macedonia, Slovenia, and Spain). These selected audits addressed essential aspects of compliance issues focusing on the area of activity such as Waste, Forest, and Heat supply, and other.

The third part of this Audit Compendium – performance audit summarizes the results of selected audits carried out by 6 EUROSAI TFMA member SAIs (Croatia, Israel, Lithuania, Republic of Serbia, Slovakia, and Ukraine). These selected audits addressed essential aspects of preformance issues focusing on the different topics. The SAI of the Republic of Croatia conducted a performance audit on procurement of services in municipalities-owned companies; the SAI of Isreal on boards of directors of municipal corporations; the SAI of Lithuania on the governance of the municipality-ownened companies ensures effective and transparent activity; the SAI of Serbia on Appropriateness of Water Supply Network Management and on Availability and Safety of Drinking Water; the SAI of Slovakia on Management of ownership interests in commercial companies in municipalities; the SAI of Ukraine provided information on findings of audits of municipality owned companies, in particular: Obtaining by people the compensation for accommodation on the territory of nuclear power plants and Capital investments in infrastructure objects by the Vinnytsia region (oblast) municipality.

Annex of this Audit Compendium summaries SAIs' mandates for auditing municipality-owned companies. The audit mandate is classifed by types of audits (financial, compliance and performance audit), and includes contributions by 27 EUROSAI TFMA member SAIs (Albania, Austria, Azerbaijan, Bosnia and Herzegovina (Audit Office of the institutions in the Federation of Bosnia and Herzegovina), Bulgaria, Croatia, Estonia, Finland, Georgia, Greece, Hungary,

Israel, Italy, Latvia, Lithuania, Malta, Montenegro, The Republic of North Macedonia, Poland, Portugal, Romania, Republic of Serbia, Slovakia, Slovenia, Spain, Turkey, and Ukraine).

Sharing experience and good practice for auditing municipality-owned companies will help to improve the management of public funds, ensure the financial sustainability of municipalities, lawful and rational management of funds and property, and appropriate performance of functions assigned to municipalities.

We hope you will find the Audit Compendium as a useful source of information.

FINANCIAL AUDIT

Financial audit focuses on determining whether an entity's financial information ispresented in accordance with the applicable financial reporting and regulatory framework. This is accomplished by obtaining sufficient and appropriate audit evidence to enable the auditor to express an opinion as to whether the financial information is free from material misstatement due to fraud or error.

ALBANIA

The municipality-owned companies, mainly Water Supplies, are in the constant focus of the Albanian Supreme Audit Institution (ALSAI). In ALSAI, there is a dedicated Audit Department responsible for carrying audits on state-owned companies. Also, the Performance Audit Department is eligible to carry audits in these subjects. Municipalities manage several companies, but the most important one, due to the high budget and social impact, is the Water Supply and Sewerage.

In 2016, the audit focus on water supply companies and sewerage was the debt of the consummator that amounts to 7 million euros for 2016. ALSAI has assessed that in the Tirana Municipality company (UKT) this amount of debt comes as a consequence of ineffective management. The total debt to the UKT created and carried forward from 2008 till the end of 2016, resulted in a total value of 30 million euro. This includes service bill (regardless of the categories of beneficiaries) at 20 million euro, reflecting an additional debt for 2016 at the amount of 3 million euro, the accumulated interest rate at 3 million euro, and liabilities to local tax at 4 million euro. The highest level of debt is retained by household customers with an unpaid obligation of 16 million euro, increased by 23% in 2016.

Another audit carried in this period is that of the Water Supply and Sewerage Company of the Lushnja Municipality. The audit found that despite the commitment of this company to reduce the loss of revenue from the sale of water, the economic and financial situation of society is alarming because the capital status of the company has reached a negative value. This company resulted in a high deficit for the period 2012-2016 aggravated by the burden of a 6,401,626 euro loan, excluding the interests. From the audit were found economic damage of 352,000 euros and loss in revenue in the amount of 174,838 euros.

During 2017 ALSAI carried out audits in 6 companies owned by municipalities as follows:

1. Agency for Parks and Recreation (Tirana Municipality).
2. General Directorate no. 1, of City Workers (Municipality of Tirana)
3. Water Supply and Sewerage (Korça Municipality)
4. Water Supply and Sewerage (Vlora Municipality)
5. Water Supply Sewerage (Shkodra Municipality)

6. Water Supply and Sewerage (Durrës Municipality)

From the audits conducted in the municipalities owned companies, it was concluded that these companies encountered several problems and difficulties during the reorganization process under the law "On the approval of procedures for the transfer of rights and obligations, personnel, property, assets, archives and any other official documentation to local government units affected by the administrative-territorial reorganization," based to the law "On the administrative-territorial division of the units of local government in the Republic of Albania" of 2014.

The Albanian Supreme Audit Institution has recommended that the Administrators of the Companies, the Municipalities (single shareholder companies), and the Administrative Councils implement all administrative and legal procedures for completing the asset transfer process. The registration of the new assets has not been accomplished within the defined deadline. Water supplies should have registered the assets of the former municipalities, which were demolished with the new territorial-administrative reform creating thus a vacuum in delivering services in areas and populations that were on the jurisdiction of the former municipalities. Also, these structures should take measures and set up working groups to register the assets and inventories by specifically identifying the asset allocation through the physical inventory process.

In 2018, from the audits of the Water Utilities was found economic damage of 1 million euros and financial irregularities amounting to 1.7 million euros. Regarding the economic damage, the audit has found infringements in the procurement practices, calculating the limit fond, setting the technical specification, ratting and classification of biddings, and the implementation of the contract.

				Euro
Nr.	**Municipality**	**Financial irregularities in Euro**	**Economic damage**	**Public procurement infringements**
1	Water supply of Korça	1.1 million	100,000 euro	100,000
2	Water Suppy of Vlora	180,000	90,000 euro	200,000
3	Water Suppy of Tirana	150.000	800,000 euro	80,000
4	Water Suppy of Saranda	250,000	7000	1,500
	Total	1,680,000	997,000	395,000

In the annual plan 2019 by ALSAI has been planned to be audited the municipality-owned companies:

- ✓ Water Supply and Sewerage (Fieri Municipality)
- ✓ Water Supply and Sewerage Gjirokastra Municipality
- ✓ Water Supply and Sewerage (Lushnja Municipality)
- ✓ Water Supply and Sewerage (Berat/ Kuçovë Municipalities)

ITALY

The companies owned by municipalities or Regions are a source of concern for the Italian SAI (Corte dei Conti) as they are a major business organization and through them the municipalities try to avoid the SAI control system.

For example, the municipality does not directly organize school catering but sets up a company to provide this service. Generally, such companies are 100% owned by the municipality, but in the balance sheet, there is a single item of expenditure: payment to the company. So the entire activity is "reduced" in a single line of the balance sheet. Unlike this, the situation where the municipality decides to offer the activity to any company able to perform the said service is more appropriate. In this procedure (by public bid), the price may be lower (it is usually not cheaper when the company is 100% owned by a municipality).

The SAI pays special attention, expecially when the company is solely owned by one municipality (100% of the shares); such a system is deemed as have been conceived to elude controls and negatively affect competition. For their part, the municipalities maintain that this organization is both cheaper and convenient.

In some cases, the company is owned by two or more municipalities, especially when the services offered can be shared (public transfer, garbage treatment etc). In this case, the main factor is the cost of the service. Usually, public fares do not cover the cost. So the municipalities owners cover the losses at the end of the year.

In Italy, the law since 2013 strongly calls municipality council to cast off owned companies, especially when they are not fully operative (i. e. there are no employees but just the management) or they have suffered losses for 3 years or more. The SAI with territorial jurisdiction has the duty to control the dismantling program. In some regions (Lombardy) the number of companies has been decreased in recent years.

The SAI Sezione Autonomie (central chamber for local entities) publishes a report on municipality-owned companies every year.

These are the results of the latest report (published in 2018 data relating to 2016-2017).

The companies working in the field of local public services are few (37,21%) but they have the highest turnover (73,17%). Whereas those companies that provide general support and assistance to the daily work (instrumental activities such as data center, information technology. employees management) account the 63%.

3745 companies (on 5776 total) have revenue of 2.5 million and more than 28.000 employees (8 employees for the company on average).

Looking at the total number of companies owned by municipalities (5776) the workers are 327.807 (57 per company on average).

The main cost is for employees. When the revenue is higher, the cost of employees accounts for 28,51% of the general costs; on a general average, the cost of employees accounts for 20,20% of the total costs.

1194 companies have just one owner. In such cases, the transfer from the owners is highest than in the case of several owners.

375 companies have suffered losses for 4 years or more; 42% of municipality-owned companies that show an annual loss are totally owned by the public sector.

MONTENEGRO

In accordance with the Law, the State audit institution of Montenegro (SAI) conducts financial audit of the Annual financial statement and regularity audit of the operations of the public companies in which the local self-government unit is a majority shareholder or holds a majority stake.

The SAI carried out financial audit of the Annual financial statement and regularity audit of the Water supply and sewage Ltd Podgorica for 2017.

Water supply and sewage Ltd Podgorica performs communal activities of supplying the Capital City of Podgorica and urban municipalities with drinking water, collection and treatment of wastewater at the territory of the Capital City. The public company also performs other activities that are not of public interest as follows: installation of the systems for water supply and sewage, engineering activities, technical maintenance and analysis and collection, treatment and distribution of the water in bottles or vehicle – tanks.

As one of the main audit findings, the audit found that the public company did not undertake all legal measures for collection of the receivables which resulted in obsolescence of receivables and failure to collect overdue receivables.

The Company recorded the receivables in the amount of 8,253,081.00€ as at 31 December 2017. The largest proportion relates to the receivables from buyers based on water consumption invoices in the amount of 7,720,434.90€ and receivables from provided services in the amount of 389,385.46€, which resulted in a total value of 8,109,820.36€, i.e. 98.26% of the total receivables.

The largest amount of receivables from buyers based on water consumption invoices includes the buyers in the residential buildings in the amount of 2,779,940.32€ and buyers in the private households amounting to 2,700,845.56€ or 66.41% of the total receivables. The state and local authorities, sports associations and institutions created the total debt of 752,236.93€ as of 31 December 2017. The debt for construction connections amounted to 125,480.07€; 375,147.22 € for larger consumers (companies), 776,325.74 € for other buyers (retail stores), while the debt for services amounted to 389,385.46€.

The audit identified the amount of written off claims in the amount of 2,137,931.46€ including 177,465.66€ for the legal entities (written off claims due to obsolescence – year of 2014) and 1,960,465.80€ for physical persons (written off claims due to obsolescence – year of 2015).

According to the Law on obligations, the claims for the charges for water supply expire due to the statute of limitations after two years, if the supply or service is effected for

household, while the mutual claims of legal persons from contracts, as well as claims relating to reimbursement of expenses made in connection to such contracts, expire due to the statute of limitations after a three year period. Rulebook on accounting policies of the Company defines that the claims of three years for legal persons and two years for physical persons are written off and kept in the off-balance records. During the audit process, it was determined that the Company for 2017 wrote-off claims in the amount of 2,137,931.46€ (account 592) and kept the off-balance records of such claims.

During 2017, the Company initiated enforced collection of claims in 4368 cases, out of which the debt from 176 physical persons in the amount of 78,341.36€ and 729,560.62€ from 106 legal entities. Out of the total value of sued claims, it was collected 4,965.85€ for physical persons and 341,987.80 € for legal entities.

The State audit institution recommended that the Company should prepare the Strategy and Action plan for collection of receivables including measures, activities, responsible persons and deadlines for periodical reporting to the Board of directors on achieved results.

The Company made 21 amendments to the Public procurement plan for 2017 which increased the value of the Plan for 2,216,000.00€, i.e. for 44.10**%** in relation to the initial plan. The Company procured goods, services and works in the amount of 3,765,921.30 € (with VAT) out of the total value of planned procurements of 7,240,500.00 €, i.e. 52.01% of the Plan, which indicates weaknesses in planning public procurements.

The audit of the Annual financial statement of the Water supply and Sewage Company of Podgorica for 2017 also identified significant deviations and non-compliance cases with the Law on public internal financial control, Labor law, Law on personal income tax, Instruction for gross salaries calculation and Rulebook on the Chart of Accounts and Content of Accounts for Corporate and other legal entities.

The State audit institution expressed qualified opinion on financial audit of the Annual financial statement and qualified opinion on regularity audit of the Water supply and Sewage Company of Podgorica for 2017.

Sector V in the State audit institution of Montenegro is responsible for carrying out audits of the annual financial statements of the companies founded by the state or local self-government units and audits of the municipalities.

SERBIA

In accordance with law, the Suprime Audit Institution may audit of public companies, companies and other legal entities that have been established by users of public funds of local authorities or entities where users of public funds of local authorities have participated in the capital or management.

During 2016, 23 audits of the financial statements and regularity of operations were implemented. In the table below are opinions expressed:

type of opinion	on the financial statements	on the regularity of operations
Unqualified Opinion	3	1
Qualified Opinion	18	20
Adverse Opinion	/	1
Disclaimer of Opinion	2	1
In total:	**23**	**23**

During 2017, 33 audits of the financial statements and regularity of operations were implemented. In the table below are opinions expressed:

type of opinion	on the financial statements	on the regularity of operations
Unqualified Opinion	/	2
Qualified Opinion	32	30
Adverse Opinion	1	/
Disclaimer of Opinion	/	1
In total:	**33**	**33**

During 2018, it was implemented:

1) ***13 audit of the regularity of operations*** of public enterprises, companies and other legal entities that have been established by users of public funds of local authorities or users of public funds of local authorities have participated in the capital or management of those entities. The subject of the audit of the regularity of operations was the application of the regulations governing the calculation and payment of salaries with public utility companies. No opinions were issued for these audits, but a conclusion was given.
2) ***21 audits of financial statements and regularity of operations*** of public companies, companies, and other legal entities that have been established by users of public funds of local authorities or users of public funds of local authorities have participated in the capital or management of that entities. In the table below are opinions expressed:

type of opinion	on the financial statements	on the regularity of operations

Unqualified Opinion	2	1
Qualified Opinion	18	20
Adverse Opinion	/	/
Disclaimer of Opinion	1	/
In total:	**21**	**21**

In 2019 the implementation of:

- ***1 audit of financial statements and regularity of operations***
- ***14 audit of financial statements, and***
- ***8 audit regularity of operations***

of operations of public enterprises, companies, and other legal entities that have been established by users of public funds of local authorities or users of public funds of local authorities have participated in the capital or management of that entities.

COMPLIANCE AUDIT

Compliance audit focuses on whether a particular subject matter is in compliance with authorities identified as criteria. Compliance auditing is performed by assessing whether activities, financial transactions and information are, in all material respects, in compliance with the authorities which govern the audited entity. These authorities may include rules, laws and regulations, budgetary resolutions, policy, established codes, agreed terms or the general principles governing sound public-sector financial management and the conduct of public officials.

HUNGARY

ÁLLAMI SZÁMVEVŐSZÉK
State Audit Office of Hungary

According to the modified Act on the State Audit Office of Hungary (SAO), as approved by the Parliament in 2011, the audits of the SAO also cover business associations in majority ownership of municipalities. Following audits on transport companies and theatres, SAO launched its audits on distant heating and waste management companies in 2014.

The SAO has audited several companies owned by local governments every year.This Compendium provides key information on reports issued in recent years.

Local government-owned companies - published reports	2013	2014	2015	2016	2017	2018
	3	21	41	76	51	94

Year 2016 - Business associations owned by local governments.

In 2016, the SAO published 80 reports on the audit of business associations majority-owned by local governments, including four follow-up audits. The reports supplemented the audit experiences gained during the audit of 49 companies majority-owned by local governments in the period between 2011 and 2015.

According to the audit experiences, the financial management of business associations owned by towns with county rights is more regulated and more regular than that of companies owned by smaller local governments. Adequate planning is indispensable for the efficient and sustainable operation of companies majorityowned by local governments. In our view, there is a need to define certain requirements and criteria that ensure the measurability and rating of services.In order to meet the objectives expected of the service providers, clear requirements should be set for the management of the companies, and their ability to meet the requirements should be continuously monitored and their execution evaluated. The owner local governments, on their part, should reinforce ownership control primarily by requiring more substantiated annual planning and business

plans supplemented by meaningful criteria and by requesting professional reports in addition to accounting reports for an analysis-based evaluation.

Year 2017 - Audit and analysis of local government-owned companies

A key objective of the State Audit Office of Hungary is to ensure, by uncovering the financial risks inherent in the financial management of local governments, and by auditing the state subsidies provided outside the state budget and the free grants of assets and the task performance systems operating outside the state budget, that public funds are used by the organisations transparently and in a regulated manner. In Hungary, institution-oriented task performance is typical, but extra-budgetary task performance is increasingly gaining ground. Local government-owned companies are important players in this process. As a consequence of the local government's autonomy in restructuring, business associations received a significant role in the performance of both mandatory and voluntary tasks.

In 2017 the SAO continued to conduct audits among the companies majority-owned by local governments in the context of thematic audits, focusing on their financial management in the periods of 2011–2014 and 2012–2015. In 2017, the SAO published two studies analysing the financial management, operational and asset management risks of business associations in majority local government ownership and the owner local governments.

The audited local government-owned business associations provided services in the areas of municipal operations and management, real estate development, cultural, social and health-care services.

SAO's proposal based on its audits' findings:

In the case of local government-owned business associations, an indicator system should be developed to measure public task performance and the provision of public services.

Year 2018 – aduit of local government-owned business associations

The local governments of Hungary, in the course of performing their obligatory and voluntary duties, employ task performance using non-budgetary funds more and more widely, thus – in addition to non-profit organisations – local government-owned business associations have gained a key role. The key objective of the SAO is to contribute to the use of public funds also by organisations operating outside public finances, in a transparent and orderly manner by revealing the financial risks inherent in the management of local governments, budget support outside public finances and free asset allocations, as well as audits of the performance systems operating outside the state budget. The SAO has deemed the auditing of business associations under majority local governmental ownership to be particularly important for the protection, preservation of state property.

In 2018, following the completion of audits conducted at business associations under majority local governmental ownership and the local governments acting as proprietors, the SAO has published a total of 94 reports. Our audits were conducted with the purpose of utilising the recommendations drawn up based on the findings to eliminate revealed discrepancies.

The audited period was the years 2013-2016 in case of 97% of business associations, the years 2012-2015 in case of 3% of business associations. 80% of audited businesses were owned solely by local governments, 20% of them were under majority local governmental ownership. 21% of businesses held shares of other business associations. 15% of businesses

had assets under trusteeship. 89% of audited business associations performed public functions, typically in addition to other activities, on a contractual basis. 58% of business associations performing public functions carried out health care, cultural and social assignments, 31% municipal development, municipal operation, housing and space management related assignments, 11% waste disposal, water utility services.

SAO's proposal based on its audits' findings:

The strengthening of the activity of exercising proprietary rights is worth considering in terms of continuous presence of proprietors, control, audit, continuous monitoring of business associations, planning and implementation of the activities of companies and also in terms of accounting for implementation.

The press releases of the audit reports of the State Audit Office of Hungary are available on the English-language website (www.asz.hu/en) Further relevant information can be found on the News Portal (www.aszhirportal.hu/en/news) about audits and other activities of SAO."

LATVIA

State Audit Office
Republic of Latvia

In the 2016-2018 period, the State Audit Office of Latvia carried out three audits which directly concern municipaliy-owned companies:

1) the audit report 'Does Ltd. "Rigas Mezi" manage the municipal forest in compliance with legal requirements?'. The audit concludes that by becoming involved in the production of sawn timber, the municipal company of the Riga City Council "Rigas mezi" conducts business that is unjustified and distorts competition.
2) the audit report 'Management of Saldus District Municipality companies - efficiency and compliance with legal requirements". The audit concludes that a total of 495,199 euros have been spent unreasonably and ineffectively, and the municipality should improve the management of its companies.
3) the audit report 'Compliance of the operation of a municipal joint-stock company "Daugavpils siltumtikli" with the planned goals and legal requirements'. The audit concludes that by violating procurement regulations, the municipal joint-stock company "Daugavpils siltumtikli" raises concerns regarding the long-term stability of thermal energy tariff.

The audit topic: Does Ltd. "Rigas Mezi" manage the municipal forest in compliance with legal requirements?

The Riga City Municipality (hereinafter - the Municipality) is one of the biggest forest owners in Latvia.

The forest and underlying ground are one of the main natural resources in Latvia. Production of wood products makes a significant part of the national economy, and the forest sector is one of the most important sectors of the national economy.

The forest, with its products and services, is also one of the most important sources of public welfare. The forest provides timber for construction and furniture, and woody biomass for energy production, place for living and food. It protects water resources and soil from erosion, provides a place for living for a significant part of the biological diversity. Besides, the forest is also a source of income for people, as well as it offers recreational facilities.

Due to the variety of the utulisation of forest opportunities, as the needs of the society change, the forest policy and forest management should also change at the global, national and regional levels.

In previous audits, the State Audit Office has pointed to deficiencies in the records of forest stand and shortcomings in the records of forest management activities carried out in the forest management related to both the management of the Municipal forest and the

management of the Latvian state forest, as well as to shortcomings in the management of municipality-owned companies.

As a result of the audit the society was informed about the compliance of the activities carried out by Ltd. “Rigas Mezi” (hereinafter — the Company) with the legal requirements while managing the Municipal forest, as well as effective management of the Company and suspension of unjustified commercial activities carried out by the Municipality was promoted.

Main Conclusions

The Municipality has tolerated the operation of the Company which was principally oriented towards the implementation of Company’s economic interests — a wish to get maximum revenue from its economic activity — rather than systematic management of Municipality’s forest area. During the audited period the Municipality did not ensure a proper management of the Company since the implementation of the tasks delegated to the Company were not effectively supervised.

Although the main precondition for sustainable forest management is development and implementation of a forest management plan, the Capital Company did not ensure that the logging of felling sites complied with the forest management plan 2012-2016, meanwhile in 2017, the fund of felling sites was developed without approved forest management plans.

In order to obtain additional profits in 2013, the Company expanded its operation beyond the task delegated by the Municipality — to manage the forest area. Instead, it participated in commercial activity in the timber industry, creating a structural unit — a sawmill “Norupe”. In the view of the State Audit Office, such an action is not justified by those legal requirements stipulating the circumstances when the municipality is allowed to participate in a commercial activity, for example, to fill a market gap or to create goods of strategic importance for the development of municipality’s administrative territory or national security.

In our view, the participation of the Company in commercial activity in the timber industry distorts competition, based on the following conditions:

- since 2003 the Company did not sell the sawlogs (roundwood) derived from the Municipality’s forest management to private companies operating in the timber industry, but consistently performed the processing by itself constantly increasing amounts, indicating 100% processing of all timber as its main challenge in the future. As a result, in 2015 and 2016 it processed in total 91 thousand m^3 of sawlogs (roundwood) thus reducing the amount of available raw materials in the free market and restricting the possibilities for private companies to increase their timber processing capacity and gain additional revenue;
- by processing the sawlogs (roundwood) derived from the Municipality’s forest management, the Company obtained raw materials for saw timber production three times cheaper than any other company of the timber processing industry in the free market. Besides, without the existing advantage, the roundwood processing costs for the Company would have been higher than the income from the sale of the saw timber.

Although the participation of the Company in commercial activity in the timber industry was aimed at gaining addition profits, it had decreased the profit rather than increased it.

Despite the three times cheaper raw materials, Company's saw timber production costs did not allow to obtain added value from the sawlog (roundwood) processing. In the view of the State Audit Office, the participation of the Company in commercial activity — saw timber production — does not comply with the requirements of the State Administration Structure Law and distorts competition. Threfore, eligibility of Company's saw timber production costs was not assessed in detail. During the audit, it was concluded that if the Company had sold the sawlogs (roundwood) derived from the Municipality's forest management to the companies operating in the timber industry rather than had carried out their processing, its profit in 2015 and 2016 would have likely increased in total by more than 3 000 000 euros.

Since the Company had also been entrusted with the management of Municipality's gardens and parks, for which a Municipality's subsidy and resources gained from the commercial activities of the Company are allocated, the possible allocation of Company's profits from the forest management to the management of gardens and parks could have decrease the amount of the Municipality's subsidy, thus leaving at the disposal of the Municipality more financial resources available for other needs of the citizens.

Also, the procedure for granting the annual subsidy to the Company for the management of gardens and parks in the amount of almost 2 000 000 euros should have been improved significantly, because the subsidy was granted without setting the exact amount of the work to be done and without follow-up quality control of the performed work. The audit found that, for example, in 2016 the Company had submitted to the Municipality an estimate of its garden and park management costs in the amount of 5 051 313 euros, the Municipality granted a subsidy in the amount of 1 931 888 euros, but the Company planned in its budget for 2016 the expenditure for this goal in the amount of 2 748 100 euros. The existing procedure for granting and supervision of the grant for the garden and park management did not give a clear picture of the work that the Company planned to do and the scope of work that the Municipality granted the money to the Capital company for.

Main Recommendations

Based on the findings of the compliance audit and our conclusions, the State Audit Office asked the Municipality in cooperation with the Company to address the incompliances in the Municipality's forest management and performance of the tasks delegated to the Company and to ensure:

- timely development of the forest management plan and control of its implementation;
- participation of the Company in a commercial activity only in compliance with the requirements of the State Administration Structure Law;
- control over the performance of the management tasks delegated to the Company;
- transparent financing of the Municipality's gardens and parks, i.e., separated accounting of respective expenses and traceable link between the financing and the tasks to be performed;
- setting criteria to determine the most advantageous way for the receipt of the services necessary for ensuring the economic activity of the Company.

The Audit Topic: 'Management of Saldus District Municipality companies - efficiency and compliance with legal requirements

The Municipality of Saldus District has shares in five capital companies: Ltd. "Saldus namu parvalde", Ltd. "Saldus komunalserviss", Ltd. "Saldus siltums", Ltd. "Saldus tirgus", and Ltd. "Saldus medicinas centrs".

During the audit it was established that a total of 495,199 euro had been spent unjustifiably and ineffectively. These Companies, just like the municipality-owned companies of a number of other municipalities, had paid unjustified premiums and bonuses for additional work or replacement, higher salary to employees than the allowed one, had gone to doubtful business trips, used transport and paid fuel for private purposes, violated requirements of procurement laws and regulations.

The Municipality of Saldus District had not assessed whether it needs the Companies and also whether involvement in a commercial activity is truly justified, as well as it had not defined specific tasks that such Companies have to perform. This condition may have allowed the companies to express themselves creatively and include in their by-laws of the following businesses: Ltd. "Saldus komunalserviss" — trade of car spare parts, freight transportation, translation, car rental and leasing, Ltd. "Saldus siltums" — freight transportation, Ltd. "Saldus medicinas centrs" — technical maintenance, repairs, and rental of cars. Laws and regulations stipulate that the municipality may only engage in a commercial activity by establishing the municipality-owned companies with an aim to provide services that derive from the municipality's autonomous functions and that are required for residents, without distorting the market and restricting private companies.

If the Companies have no clear tasks, they certainly have no definite objectives and effective indicators, and thus no performance assessment is ensured. The Companies of Municipality of Saldus District had the same and general economic activity's evaluation criteria. Their inspection was within the competence of the Executive Director, however, the Companies had neither made nor submitted reports, since the municipality had not requested such action.

Auditors indicated that the operation of the Companies should also be improved. Ltd. "Saldus namu parvalde" indicated debts of residential houses in the amount of 135,889 euro; still there were no justification documents that could prove that this is the amount spent on work that was agreed with apartment owners. The Company had applied a discount of the management fee in the total of 12,832 euro to some apartment owners of the particular house who had expressed the above agreement; however, there was no mechanism for other apartment owners to compensate this margin.

The average heat losses in distribution in Latvia is 12-18%. The heat loss of Ltd. "Saldus siltums" in 2014 exceeded 21.7%. Such a situation had existed for years. At the same time, the Company, opposite to the order set inlaws and regulations, had applied a lower tariff (than the approved one) in contracts with some consumers of heat energy, thus not gaining an income in the amount of 141,094 euro that was likely covered by Saldus residents

Ltd. "Saldus komunalserviss" for a long period of time had not prevented significant water loss that in 2014 reached even 48%. Besides, the residents had paid for water according to a tariff that was induly increased due to incorrect calculations. According to estimates of the auditors, from 1 January 2009 to 31 December 2014, recipients of the service had overpaid at least 110 thousand euro. Contrary to the requirements of laws and regulations, the capital company still had not developed new water management tariffs, although the

actual costs of water supply were by 28% lower in 2013 and 2014, while the costs of sewer were by at least 14% lower than those included in the approved tariff calculations.

After the audit, the State Audit Office received a confirmation from the Saldus District Municipality that all 22 recommendations issued in the result of the audit were clear and that they would help to improve the management of the Companies. The municipality acknowledged that the audit had allowed to have a look at the operation of Companies from another perspective and it had already started to address these deficiencies during the course of audit.

The Audit Topic: Compliance of the operation of a municipal joint-stock company "Daugavpils siltumtikli" with the planned goals and legal requirements

Provision of heat supply services

A city development plan in the heat supply area for 2004 - 2015, was approved in 2005 by Daugavpils City Council in the long-term development planning document: Concept for Development of Daugavpils Centralised Heat Supply System.

Municipality joint-stock company "Daugavpils siltumtikli" (hereinafter referred to as MJSC "Daugavpils siltumtikli") established by Daugavpils City Council, responsible for providing heat supply services in the city of Daugavpils, by implementing various development projects performed actions that had not been foreseen neither within the concept, nor other planning documents and that cannot be justified by the assessment of the impact of the decisions made. Moreover, Daugavpils City Council had coordinated these activities with MJSC "Daugavpils siltumtikli."

For example, even though the concept implied the closure of one of the heating plants (HP2) used for production of thermal energy, yet the company had not implemented this decision made in 2005; to the contrary, in 2013, by coordinating the action with Daugavpils City Council, a new hot water boiler was installed in HP2. During the audit, MJSC "Daugavpils siltumtikli" could not submit documentation that would support the economic profitability of this decision.

From 2007 to 2012, MJSC "Daugavpils siltumtikli" concluded six agreements with companies regarding construction of thermal energy production sources and procurement of thermal energy, thus gradually reducing the amount of thermal energy produced by MJSC "Daugavpils siltumtikli", while at the same time increasing the dependency on private producers, i.e., from 2012 to 2015 the amount of thermal energy produced by the company itself has reduced by 48%. This action was coordinated with Daugavpils City Council as well. Audit did not provide assurance that MJSC "Daugavpils siltumtikli" had assessed how this process and circumstances would affect the heat supply tariff in the long term or whether it had identified the risks that may occur after the expiry of the terms of agreements.

A plan to develop heating plant No. 3 by reconstructing it and constructing a heating source with a cogeneration power unit powered by wood biomass, as approved in the action plan for execution of delegation agreement, was also not implemented. In order to implement the project, MJSC "Daugavpils siltumtikli" on 24.05.2011. received the rights to sell the electric energy generated by the cogeneration power plant within the framework of the mandatory procurement. Yet, unable to fulfill in due time the requirements of the acquisition of the rights, MJSC "Daugavpils siltumtikli" lost the obtained rights at the

beginning of 2014. Therefore, financial resources in the amount of 23,762 *euro* (excluding VAT) used for the development of the reconstruction project were uselessly wasted. It is important to emphasize that in this way, MJSC "Daugavpils siltumtikli" did not receive income from the sale of electric energy within the framework of the mandatory procurement, that possibly would have allowed to reduce the thermal energy tariff for the residents.

When examining the agreements on construction of thermal energy production sources and thermal energy provision, the audit discovered significant violations of regulations for public service provider procurements approved also by the Procurement Monitoring Bureau.

Even though MJSC "Daugavpils siltumtikli" received thermal energy produced by the companies for a price that was lower than the price of the thermal energy produced by the Company itself, that way ensuring a low thermal energy tariff, it does not justify the action of MJSC "Daugavpils siltumtikli", creating especially favorable conditions and advantageous circumstances for execution of the agreements by these companies. Moreover, these circumstances were created by violating the public procurement legal requirements, namely:

- by failing to comply with the principles of transparency and free competition, MJSC "Daugavpils siltumtikli" concluded an agreement without applying procurement procedures; provided misleading information regarding the type of procurement agreement and procurement subject in procurement notifications on selection of partners for providing thermal energy; without justification recognized as a winner of the procurement procedure a tenderer who did not correspond to the requirements set out in the procurement documents;
- by failing to comply with the principle of equal and fair treatment, both when concluding agreements and during the effective period of agreements agreed to make significant amendments to the agreements. Moreover, in cases when agreements were to be terminated, they continued the agreements after making significant amendments, for example, extended deadlines for commencing the execution of agreement; concluded lease agreements for a longer term than provided by agreements regarding construction of thermal energy production sources and provision of thermal energy; included a condition on an automatic extension of the agreement; excluded a clause of agreement regarding the right to reduce the amount of procured thermal energy in case if any producer of thermal energy offers a cheaper thermal energy; increased the area of land lease, but decreased the rent, thus not generating income of 25,966 *euro* (excluding VAT);
- during the effective term of agreements, provided permits for the involvement of subcontractors, thereby allowing that agreement is executed and, within the framework of mandatory procurement income for generated and sold thermal energy, is received by five more companies who have not been selected in the open tender. By acting this way, MJSC "Daugavpils siltumtikli" has at the same time accepted distribution of energy of cogeneration plants among several companies, thereby allowing that the companies to use the advantages provided for the small producers of electric energy in the legal acts to receive from the state a higher compensation for the produced electric energy within the framework of mandatory procurement. For example, by distributing the execution of the agreement concluded with MJSC "Daugavpils siltumtikli," two private companies each producing electric energy up to 4 MW, in 2015 had received income of 2,960,646 *euro* for the electric

energy sold within the framework of the mandatory procurement, and it exceeded in double the amount received if the execution of the agreement would had been performed according to the provisions of the agreement: when one company would produce the energy with the electric power of 8 MW. Moreover, it should be considered that by increasing state aid to the companies, the amount of the mandatory procurement component to be covered by the end-users of the electric energy also increases. Conclusions of the auditors were also confirmed by the Ministry of Economics.

By assessing above-mentioned actions of MJSC "Daugavpils siltumtikli", it should be taken into consideration that employees of the company whose official duties are related to ensure the production of heat supply and electricity had been (and two of the employees during the course of the audit still were) in an employment relationship with several companies who provide a supply of thermal energy to the public. Even though neither MJSC "Daugavpils siltumtikli", nor Daugavpils City Council recognized the existence of risks regarding ethics or conflict of interests, auditors believed that in such circumstances there were doubts regarding the protection of interests of MJSC "Daugavpils siltumtikli".

At the same time, auditors turned attention to assessing whether the actual action of MJSC "Daugavpils siltumtikli" that had been coordinated with Daugavpils City Council, corresponded to the long-term interests of the residents of Daugavpils city. Likewise, it should be considered that from 2019 to 2022 for the companies supplying thermal energy to MJSC "Daugavpils siltumtikli" the state support period for the produced electricity within the framework of the mandatory procurement will end, so the income of the companies will decrease significantly, and, possibly, execution of agreements concluded with MJSC "Daugavpils siltumtikli" will no longer be profitable for them.

Yet, neither MJSC "Daugavpils siltumtikli", nor Daugavpils City Council strategically assessed further development perspectives of the company in the context of the particular circumstances and had not determined measures in order to provide to the residents continuous high-quality heat supply service by maintaining the tariff stability.

Thermal energy supply service tariff

State Audit Office did not detect discrepancies in the calculations of the tariff, yet it pointed out the trends that indicated on ineffective use of resources in MJSC "Daugavpils siltumtikli" that could in the future lead to increased tariffs for the city of Daugavpils.

As previously mentioned, MJSC "Daugavpils siltumtikli" annually reduces the amount of thermal energy produced by the company itself, namely, in 2015 in comparison with 2012, it had reduced by 48%, as an effect of the increased procurement of thermal energy amount from external services. But constant production costs of MJSC "Daugavpils siltumtikli" have reduced only by 3%. Considering the connection, that, in the event of reduction of the amount of thermal energy to be provided to the users, the constant costs will increase the thermal energy tariff, the auditors argued that MJSC "Daugavpils siltumtikli" should undertake measures to ensure the efficiency and economic justification of costs included in thermal energy supply service tariff. These measures should be undertaken, considering the goals

determined for MJSC "Daugavpils siltumtikli" in the long-term development planning documents of Daugavpils City Council, as well as the tasks to be performed in order to reach the goals.

Ensuring day-to-day activity processes

Day-to-day activity processes of MJSC "Daugavpils siltumtikli" were regulated and ensured in compliance with the requirements of the external and internal legal acts. The audit, by examining such activity processes as salary payment system, management, and supervision of debt recovery, organization of accounting, determination of thermal energy supply service tariff did not discover discrepancies.

Other facts discovered by the audit

Even though the goal of the audit was not to assess the action of Daugavpils City Council as the shareholder of MJSC "Daugavpils siltumtikli" in supervising the established company, the audit identified several cases when the action of Daugavpils City Council did not comply with good governance principles and did not demonstrate a professional and strategic supervision of its company. It may be proved by the fact that Daugavpils City Council had approved several significant decisions related to the development of MJSC "Daugavpils siltumtikli" that were contrary to the development direction adopted by the Council itself, and hds given approval to such decisions that may not have been thoroughly assessed in advance. Therefore, the auditors turned their attention to the fact that in connection with the findings of the audit, liability should be assumed also by the shareholder of MJSC "Daugavpils siltumtikli" - Daugavpils City Council.

Recommendations provided during the audit

During the audit, the State Audit Office provided four recommendations to MJSC "Daugavpils siltumtikli":

- to plan the activity and develop the activity documents in compliance with those development directions determined by the development planning documents of Daugavpils City Council;
- to review the structure of expenses in order to ensure effective use of financial resources and efficiency and economic justification for costs included in thermal energy tariff;
- in cooperation with Daugavpils City Council to undertake measures in order to reduce the risks of ethics and conflict of interests;
- to comply with the legal requirements for public procurement.

THE REPUBLIC OF NORTH MACEDONIA

In the Republic of North Macedonia, there are about 150 public enterprises operating at the local level.

In accordance with the 2016 Annual Work Program, the SAO of North Macedonia conducted regularity audits on two public enterprises at the local level: PE “Streets and Roads” of the City of Skopje and PE “Parkinzi” of the Municipality of Centar.

The PE “Streets and Roads” performs the following activities: maintenance and reconstruction of roads in the jurisdiction of the City of Skopje, pedestrian and bicycle paths and public recreational areas, maintenance, design and execution of light, horizontal and vertical traffic signalization and maintaining of streets in winter conditions, on the territory of the City of Skopje.

The primary activity of the PE “Parkinzi” of the Municipality of Centar is organization, management, arrangement, and maintenance of the public parking lots on the territory of the Municipality of Centar.

With the audit on these enterprises, the auditors identified the following common shortcomings:

- Audited entities have not registered the principal in the trade register. Both enterprises have not established the market value of the assets and liabilities, so the principal has only book value, i.e., capital estimation has not been done. The estimated value of capital is particularly important when setting up public, private partnership, borrowing and determining credit rating;
- Incomplete inventory of intangible and tangible assets (fixed assets) and unspecified sources thereof, and the age structure of claims and liabilities.

Auditors point out that competent authorities need to take measures and activities for setting up proper accounting records of suspicious and contested claims and to perform quality inventory in accordance with the legislation so as to determine the actual value and to provide supporting information for writing-off some of the claims.

In accordance with the 2017 Annual Work Program, the SAO of North Macedonia conducted regularity audits on three public enterprises at the local level: PE "Parkovi I zelenilo" of the City of Skopje, Public Utility Company "Komunalec" Kicevo and Public Utility Company "Komunalec" Gevgelija.

Public utility enterprises are founded to perform communal activities of public interest in the municipalities: collection, processing and supply of water, sewage disposal, collection and disposal of waste, remediation and other services such as: waste management, civil

engineering, warehousing and auxiliary transport activities, services related to maintenance of buildings and activities for landscaping and maintenance of the environment and nature.

The basic activity of PE "Parkovi i zelenilo" is landscaping and maintenance of the public green spaces.

With the audit on PE "Parkovi i zelenilo" the auditors identified the following shortcomings:

- lack of control procedures and mechanisms for calculating and payment of salaries of employees and lack of adopted written procedure;
- calculation and payment of salaries of employees is done on the basis of rulebooks on organization and systematization of jobs and a rulebook on salaries , which are not mutually harmonized and are not harmonized with the Statute and the Law on Labor Relations; lack of internal act passed by the Board of Directors on the value of salary points;
- the inventory of short-term credits and loans from affiliated companies in the country and investments in subsidiaries is not performed in accordance with legal regulations;
- in relation to the construction objects, no complete inventory has been performed in line with legal regulations; legalization procedure is in progress for some construction objects that have status of illegally constructed facilities; most of the facilities do not fulfill conditions and criteria to be categorized as buildings;
- the manner of financing activities for regular maintenance of public city greenery is carried out in line with a Decision adopted as a temporary solution but it is still applied;
- receivables and revenues from affiliated companies are recorded in the accounting records, value adjustment of these receivables, as well as expenditures and revenues based on the value adjustment and collection of written off claims, for which there is no written act signed by both entities;
- the principal, recorded and presented in the business books and financial statements, is not registered in the Central Registry of the Republic of North Macedonia as a monetary or non-monetary deposit of the public enterprise, i.e. there is no registered and paid state-owned capital in the name of the founder - the City of Skopje;
- in the period from 2001 to 2016, funds in the form of financial assistance were paid to two LTDs, founded by PE "Parkovi i zelenilo". There is no written document for these payments, except for the signed loan agreements in 2015 and 2016, with a return period of one year. Up to the completion of the audit, the funds were not returned to the account of the public enterprise;
- PE "Parkovi i zelenilo" as a founder / owner and sole shareholder, has not brought a decision in the past period for covering the loss expressed in the annual accounts and annual financial statements of the two above mentioned LTDs. Thus the PE acted contrary to the founding acts and the legal regulations; and
- the manner of obtaining funds for financing communal activity – building (construction) and maintaining public greenery is regulated with the provisions of the Law on Communal (Utility) Taxes and the Law on Greenery, but it has not been applied in line with the legal regulations.

"Komunalec" Kicevo and "Komunalec" Gevgelija are a public enterprise that covers all public utilities. With the audit, the auditors identified the following:

- lack of signed agreement between the Mayor of the Municipality of Kicevo and the PE Director for regulating the rights, obligations, and responsibilities;
- lack of reports on the PE operations with data on the type and scope of work performed, which should be submitted to the Mayor;
- public cleanness services are performed without proper records for what has been done. The invoices are not prepared in the amount for the performed works and are not delivered to the municipality;
- the fee for using drinking water and discharge of wastewater is not paid in the Budget of the Republic of North Macedonia;
- a large percentage of technical and commercial water loss is recorded, and the invoices for water consumption are charged per household member (lump sum);
- there is no complete record of the users at the city market;
- works by freight motor vehicles are carried out without complete records who has given the job order, where and for which purpose the vehicle will be used;
- presented receivables from buyers do not give a realistic picture of the number and value of sued claims, the possibility for collection of receivables, as well as the receivables from buyers, which are in liquidation or bankruptcy process; and
- deadlines for bids in the implementation of public procurement procedures are extended without amending or supplementing the tender documentation.

In order to improve the conditions identified with the audit, the auditors made recommendations for taking measures and activities in relation to:

- harmonization of statute provisions with the legislation;
- deployment of public servants in line with the foreseen points for each job post and determining the amount of salary points for calculating salaries of public servants;
- adopting accounting policies for regulating specific principles, rules and practices applied by the public enterprise in the preparation and presentation of financial statements;
- setting up and recording the equity in the Central Registry of the Republic of North Macedonia as a state-owned capital on the name of the founder;
- continuation of initiated activities for determining the status of facilities used for performing PE activity;
- assessment of the collectability of receivables at the end of each reporting period and actual presentation thereof in business books and financial statements;
- removing factors that contribute to water loss in the water supply system, for the purpose of realistic and objective invoicing and charging for used water quantities.

With reference to other-matter, the auditors emphasized the need to re-examine certain shortcomings of importance for the operation of the public enterprise, which refer to the competent authorities:

- adoption of bylaws envisaged in the Law on determining prices of water services, in order to establish an efficient system for determining prices of water services; and
- reviewing provisions of the Law on Enforcement Procedures and the Law on Notary in the sections that regulate the procedure for collection of the debt for communal service.

SLOVENIA

REPUBLIC OF SLOVENIA
COURT OF AUDIT

In the Republic of Slovenia, a municipality may, for the purposes of performing public services and services of public interest, organize local government-held assets in the form of:

- public institutes;
- public utility institutes;
- public enterprises;
- public funds and
- agencies.

The legislation also states that a municipality may decide to purchase shares or equity holdings in a (private) company if funds have been earmarked for this purpose in the budget and if this serves the national or local government interests.

Slovenian municipalities (212) are currently participating in the capital of approximately 480 public enterprises, public utility institutes, and private companies.

The Court of Audit of the Republic of Slovenia (SAI Slovenia) has two departments that deal with municipally owned companies:

- a department that covers commercial public services providers and companies with majority ownership held by the Republic of Slovenia or local communities and
- a department responsible for auditing local self-government that focuses on the business operations of the municipalities that are related to obtaining and managing capital investments.

For the purpose of the compendium, we will focus on our activities that dealt with private companies that are owned by municipalities.

1. Opinion on obtaining and managing capital investments (2015)

Due to an increased number of capital investments into privately-owned companies (by municipalities), related to an incorrect interpretation of legislation, SAI Slovenia issued an opinion on obtaining capital investments by municipalities. SAI Slovenia took a negative view of acquiring capital investments in companies where there is no legal basis for determining a local government interest. SAI Slovenia considers that municipalities can only identify local government interest, but cannot establish it. A legal basis for local government interest must be given in order for a municipality to identify it. In any case, municipalities cannot establish it in areas where the legal basis for this is not ensured.

2. Audit work

SAI Slovenia has issued the following audit reports in relation to municipalities owned (private) companies:

- Management of capital investment in company Mlinotest by Municipality of Ajdovščina (3. 1. 2017)

- The audit goal was to express an opinion on the regularity and efficiency of Municipality of Ajdovščina in the field of obtaining and managing capital investments, i.e., shares of the company Mlinotest;
- in 2015, Municipality of Ajdovščina obtained 929.997 euros worth of shares of the company Mlinotest, that produces and sells bread, pastry, and pasta. The municipality stated that the local government interest in obtaining the shares was to maintain employment that the company provides to its citizens;
- In the audit, SAI Slovenia found that the statutory condition of serving the local government interest was not met because the municipality had no legal basis for determining such a local government interest. SAI Slovenia expressed a negative opinion about the compliance of the business operations of the Municipality of Ajdovščina and assessed the performance of its business operations as partly efficient.

- The regularity of a part of operations of Municipality of Litija (21. 12. 2015)
  - The audit goal was among others to express an opinion on the regularity of the operations of the Municipality of Litija in the field of establishing and managing capital investments and debt;
  - in 2009 the municipality of Litija formed a private company called SVC for the purpose of constructing a building, that would incorporate a retirement home, sheltered housing for the elderly and facilities for other public services (elementary school, kindergarten…). The municipality co-signed for the company so that it could get a loan. The company was not doing well, so the municipality had to increase its share capital a number of times;
  - In the audit, SAI Slovenia found that the company was formed because the Municipality of Litija had reached the legally prescribed maximum for debt and had no financial means to build the retirement home by itself. The municipality had no legal basis for co-signing for the loans to the company and was exposed to risks of a large increase in debt and insolvency. It was also found that the company was founded without identifying the local government interest;
  - among other things, SAI Slovenia demanded that the municipality investigates the possibility of closing the company and the co-signer relationships.

- Forming of companies by the Municipality of Mirna Peč (4. 12. 2013)
  - The audit goal was to express an opinion on the effectiveness of the Municipality of Mirna Peč in the field of forming companies;
  - in 2007 the municipality Mirna Peč and two other companies founded a company called PLC Mirna Peč for the purpose of buying land, designing and building of communal infrastructure and selling of property in a commercial zone;
  - in the audit SAI Slovenia found that the municipality did not have a strategy that would be the basis for the decision of founding a company, the municipality did not have a register of its financial investments, the statutory condition of serving the local government interest was not met, the process for managing of the newly formed company was unsystematic and the municipality did not have the data that would enable it to manage the company effectively;
  - among other things, SAI Slovenia demanded that the municipality adopts a strategy for its financial investments, establishes a register of financial investments, prescribe the methods of performing the owner's functions and the methods of performing the

manager's functions.

- The regularity of a part of operations of Municipality of Postojna (12. 10. 2012)
  - The audit goal was among others to express an opinion on the regularity of the Municipality of Postojna in the field of managing capital investments;
  - in 2010, the municipality of Postojna founded a private company called Postojnska jama with an initial share capital of 7.500 euros for the purpose of buying a private company called Turizem Kras that had a concession on Postojna cave, a national natural heritage site in Slovenia. The municipality increased the capital with a financial injection of 510.000 euros and a contribution in kind in the amount of 3.495.929 euros;
  - in the audit, SAI Slovenia found that the statutory condition of serving the local government interest was not met because the municipality had no legal basis for determining a local government interest that would allow the foundation of a private company. Also, it caused an additional risk for the value of the assets that were transferred to the private company;
  - because of this SAI Slovenia demanded that the municipality must perform all necessary activities for the harmonization of its activities with the applicable legislation.

SPAIN

TRIBUNAL DE CUENTAS

The Plenary Session of the Court of Audit, in its session of 25 October 2018, approved the *"Audit Report on Municipalities-owned companies in the local public sector in the situation of financial imbalance" (Informe de fiscalizacion de las sociedades mercantiles del sector publico local en desequilibrio financiero).*

The audit is aimed at evaluating the way in which the reform operated by the Law of Rationalization and Sustainability of Local Administration (LRSAL) of 2013, which modified the Ninth Additional Provision (DA) of the Law Regulating the Bases of the Local Regime (LRBRL) was applied, with regard to the requirement to correct the financial imbalances existing as at 31 December 2013 (date of entry into force of the LRSAL) in the local authorities' subsidiary companies, as well as the provision for the dissolution of these commercial companies.

This is a horizontal compliance audit, the specific objectives of which are as follows: to analyze the financial situation of the audited companies at the time when the LRSAL came into force; to verify compliance with the provisions of the Ninth Additional Provision (DA) of the LRBRL, both in section 2, referring to the elimination of financial imbalances in the companies, and in section 4[1], relating to their direct affiliation to a local, territorial entity or to its autonomous bodies, as well as compliance with the legal provision for the dissolution of those companies that did not comply with said requirements; and to evaluate, at a global level, the restructuring of the local public business sector, with regard to the number of commercial companies subject to audit and their financial situation as at 31 December 2016.

Likewise, the observance of the regulatory regulations on the transparency of public information has been verified, in everything that, in accordance with the same, could be related to the object of the audit tasks.

The subjective scope of this audit is constituted by mercantile companies wholly owned by local public sector entities.

Its objective scope refers to the economic-financial situation of the companies audited, with the aim of determining the existence of financial imbalances, verifying the adoption of the measures foreseen in the regulations aimed at achieving their financial balance or, failing that, their dissolution.

With regard to the temporal scope, it includes the period between the date of entry into force of the LRSAL (31 December 2013) and 31 December 2016, the closing date of the last financial year with accounts rendered in the course of the audit work.

Based on the main results of the audit, the conclusions included in the Report are

[1] Those entities, companies, consortiums, foundations, units and other entities which, at the entry into force of this Law, are not in a situation of surplus, equilibrium or positive operating results must be directly attached to, linked to or dependent on the Local Entities in article 3.1 of this Law (LBRL), or be dissolved.

structured in four sub-sections: financial situation of mercantile companies in situation of imbalance as at 31 December 2013; compliance with sections 2 and 4 of the Ninth DA of the LRBRL; restructuring of the local public business sector until 31 December 2016; and compliance with legal provisions in relation to the regulations on transparency of public information.

CONCLUSIONS REGARDING THE FINANCIAL SITUATION OF COMMERCIAL COMPANIES IN THE SUBJECTIVE SCOPE OF THE AUDIT AS AT 31 DECEMBER 2013

As of 31 December 2013, there were a total of 1,198 mercantile companies wholly owned by a local entity, of which 1,095 corresponded to town councils, predominating especially in those with more than 5,000 inhabitants.

With regard to the operating results for the 2013 financial year of the 1,055 mercantile companies for which information was available, it was observed that 54% of them had profits, with an aggregate operating profit of 255 million euros, somewhat lower than the aggregate operating losses of the rest, which amounted to 269 million.

The largest proportion of companies with operating losses was in the local entities of La Rioja, Aragon, Cantabria and the Principality of Asturias, in which they exceeded 50% of the total of their dependent companies. By sector of activity, those with the highest proportion of loss-making companies were agriculture, livestock and fishing (50%), urban passenger transport (48%) and urban planning (47%).

Considering their assets and liabilities, 31% of the companies presented some type of imbalance, as they had a net asset figure lower than that of the share capital. Of these, 9% had a net worth greater than two-thirds of the capital, which prevented the distribution of profits, while the remaining 22% had significant imbalances, the net worth being less than this proportion of capital.

CONCLUSIONS REGARDING COMPLIANCE WITH THE PROVISIONS OF PARAGRAPHS 2 AND 4 OF THE NINTH ADDITIONAL PROVISION OF THE LAW REGULATING THE BASES OF THE LOCAL REGIME

At the end of 2013, the date on which LRSAL came into force, a total of 313 companies showed signs of financial imbalance, as defined in DA Novena of LRBRL: 72 of them were classified as public authorities for the purposes of the European System of Accounts (ESA) and had financing requirements in 2013; and the other 241 had negative operating results in the two previous years, 2011 and 2012.

Of the sample of 61 mercantile companies analyzed, a total of seventeen companies presented circumstances that made the Ninth DA of the LRBRL not applicable, either because they were in dissolution or bankruptcy, or because they were not ineffective imbalance.

Of the five companies that had a second level of dependency and were in a situation of imbalance, only two became directly dependent on a local entity, and the other three failed to comply with the legal obligation to dissolve.

In the case of the remaining 39 mercantile companies, nine of them did not apply the provisions of the Ninth DA of the LRBRL, considering that their respective local entities were not in a situation of imbalance at the end of 2013, although the evaluation criteria used differed from those foreseen in the aforementioned provision.

In short, the analysis focused on the 30 mercantile companies directly assigned to a

local entity and in a situation of imbalance, recognized by the latter, as well as on two others that were directly assigned afterward.

In conclusion, of the 32 companies that were in a situation of financial imbalance recognized by their own local entity, fifteen had corrected it on the evaluation date, nine had been dissolved or had ceased in their activity, and the remaining eight had not corrected their imbalance, nor had any action been taken to dissolve them, in breach of the legal mandate.

CONCLUSIONS REGARDING THE RESTRUCTURING OF THE LOCAL SECTOR DURING THE PERIOD AUDITED, AS REGARDS THE NUMBER OF COMPANIES IN THE SUBJECTIVE SCOPE OF THE AUDIT AND THEIR FINANCIAL SITUATION AS AT 31 DECEMBER 2016

It has been verified that, during the period under review, there was a net decrease of 101 mercantile companies from the full ownership of a local entity. Of the 1,097 companies registered as on 31 December 2016, 41 were inactive and another 63 were in the process of being dissolved.

By activity sectors, it is worth highlighting the high percentage of extinct companies dedicated to agriculture, while the lowest degree of dissolution occurred in the sectors of solid waste collection and treatment, urban passenger transport and water supply and sanitation, sectors which are considered essential.

In contrast to the situation at the end of 2013, when there was a slight majority of profit-making companies, in 2016 the number of profit-making companies was more than double the number with losses, with aggregate operating losses have fallen from 269 million euros in 2013 to 167 million.

With regard to the situation of equity imbalance, companies whose net worth was less than two-thirds of the share capital had fallen below half, from 234 companies at the end of 2013 to 109 in 2016.

With regard to the evolution of their financial situation, one-fifth of the companies that showed signs of being out of balance in 2013 were in dissolution or already extinct at the close of the fiscal year 2016.

CONCLUSIONS REGARDING COMPLIANCE WITH LEGAL PROVISIONS IN RELATION TO THE LAW ON TRANSPARENCY, ACCESS TO PUBLIC INFORMATION AND GOOD GOVERNANCE

It can be observed that 39% of the local entities did not report publicly on their ownership of all or some of the sampled companies in which they participate; not having a transparency portal in 11% of the cases, despite it being obligatory.

Likewise, economic, budgetary and statistical information was not published for a total of fifteen companies in the sample, dependent on twelve local entities.

In relation to the right of access to public information, only 27% of the entities in the sample had implemented electronic means for submitting requests for information, despite this being the system that must be enabled by default.

In view of the findings of the audit report, the Court of Audit makes various recommendations addressed to the governing bodies of the local entities, to the Legislator and to the General Intervention of the State Administration (IGAE in Spanish), according to their respective responsibilities:

- ✓ Local entities should review the structure of their public business sector in accordance

with criteria for improving public management, efficiency, stability, rationality and sustainability. In particular, they should establish continuous control over the financial equilibrium of their dependent mercantile companies, in accordance with the principles of legality, stability and budgetary sustainability. Appropriate measures should also be adopted for the effective liquidation and wounding up of those companies for which dissolution has been agreed.

- ✓ It would be advisable for the Legislator, with the due guarantee of the local autonomy, to foresee criteria aimed at the revision and permanent control of the financial equilibrium of the entities that make up the local public business sub-sector.
- ✓ Finally, the IGAE, as the managing and executive center of public accounting, should study the best way to integrate, in the annual accounts of local public sector entities, information on the most relevant national accounting indicators with respect to the economic situation and results of public entities.

The full content of this Report (no. 1,293) is available, in Spanish, on the website of the Court of Audit (www.tcu.es).

PERFORMANCE AUDIT

Performance audit focuses on whether interventions, programmes and institutions are performing in accordance with the principles of economy, efficiency and effectiveness and whether there is room for improvement. Performance is examined against suitable criteria, and the causes of deviations from those criteria or other problems are analysed. The aim is to answer key audit questions and to provide recommendations for improvement.

CROATIA

STATE AUDIT OFFICE

The Audit topic: Performance audit on procurement of services in municipalities-owned companies

Supreme Audit Institution of the Republic of Croatia (hereinafter: SAI) conducted a performance audit on procurement of services in municipalities-owned companies.

Audit scope were activities of municipalities-owned companies in the period from 2015 to 2017 concerning procurement of services. Auditees were 33 municipalities-owned companies.

Audit goals were:

- to assess whether municipalities-owned companies use contracted services effectively and economically
- to assess whether the procurement needs were justified or not
- to assess whether the principle of achieving the best value for money was invested or not in the most favorable tender
- to assess whether procurement goals were achieved or not.

Audit areas were:

- determination of needs for procurement of services
- selection of the most favorable tender
- achievement of planned procurement goals.

Audit criteria were prerequisites contained in the following documents:

- ISSAI 3200 Guidelines for the performance auditing process
- INTOSAI GOV 9160 Enhancing Good Governance for Public Assets
- ISSAI 5700 Guideline for the Audit of Corruption Prevention
- Anti-corruption strategy for the period from 2015 to 2020
- Public procurement development strategy in the Republic of Croatia.

The audit objectives were formulated as audit questions and broken down into sub-questions.

The main audit question was:

Has the municipality-owned company use contracted services effectively and economically?

The main question was broken down in three sub-questions:

- Has procurement needs justified?
- Has the principle of achieving the best value for the money achieved by choosing the most favorable tender in which they invested money?
- Were procurement goals achieved?

SAI assessed that two municipalities-owned companies have used contracted services effectively and economically. Further, 30 municipalities-owned companies have used contracted services effectively and economically, but there is still room for improvements, whilst one municipality-owned company used contracted services not effectively nor economically, so there is an important room for improvements.

SAI gave the following recommendations regarding contracted services:

- in cooperation with their owner, reassess the justification and effectiveness of contracted services regarding the business core of municipalities-owned companies
- to determine the number of contracted services in terms on their nature using indicators in the annual business plan
- to cite data on realized quantities of contracted services in an annual business report to compare with quantities in business plan
- to track revenues and expenses according to business activities
- to explore the market before public procurement procedures
- to track and analyze public procurement plan execution
- to track public procurement contract execution quantity and value
- to enable the high competitive level in the public procurement process
- to promote transparency and competitiveness
- to determine public procurement procedures by a general act of municipality owned-company
- other recommendations for public procurement system improvement.

SAI gave an opinion that the implementation of given recommendations would bring to more effective and economical usage of contracted services. Implemented recommendations would bring to lower corruption levels and higher effectiveness of the company business operations. Public procurement procedures improvement would bring to the possibility to reduce the expenses and higher productivity of municipalities-owned companies.

The Audit topic: Performance audit on supervisory bodies work in municipalities-owned companies

Supreme Audit Institution of the Republic of Croatia (hereinafter: SAI) in 2016 conducted a performance audit on supervisory-bodies work in municipalities-owned companies.

Audit scope was supervisory-bodies work in municipalities-owned companies. Auditees were 99 municipalities-owned companies.

Audit goals were:

- to assess the effectiveness of activities on business operations of municipalities-owned companies carried out by supervisory-bodies
- to assess the establishment of prerequisites for successful work of supervisory-bodies
- to assess the performance of the strategic and advisory role of supervisory-bodies
- to assess the performance of the control role of supervisory-bodies.

Audit areas were:

- prerequisites that supervisory-bodies work should meet
- strategic and advisory role of supervisory-bodies
- control role of supervisory-bodies.

The audit objectives were formulated as audit questions and broken down into sub-questions.

The main audit question was:

Whether supervisory-bodies have supervised the business activities of municipalities-owned companies effectively?

The main question was broken down in three sub-questions:

- Have prerequisites for successful work of supervisory-bodies been established?
- Whether supervisory-bodies have performed their strategic and advisory role or not?
- Whether supervisory-bodies have performed their control role?

SAI has assessed that supervisory-bodies of 29 municipalities-owned companies have supervised their business activities effectively, 65 of them have supervised effectively their business activities, but there was still room for improvement, whilst four of them have not supervised effectively their business activities, and significant improvements have to be done. Supervisory-body of one municipality-owned company has not performed its role.

SAI gave recommendations regarding supervisory-bodies work as follow:

- to determine written procedures concerning role, mandate, and responsibilities of supervisory-bodies
- to determine criteria and rules in giving a mandate to members of supervisory- bodies
- to give a mandate to members of a supervisory-body under the core business activities of a municipality-owned company
- to determine rules with the aim to avoid a conflict of interest of a company management
- to determine the criteria and rules to appointing the management of the municipality-owned company
- to determine the appropriate level of the wage for members of supervisory- bodies
- to involve the supervisory-body in strategic planning
- active contribution of supervisory-body in determining and conducting of development plans and programs

- to discuss the success of management of the municipality-owned company in regard to planned and achieved results
- to report supervisory-bodies on rentability on business activities
- other recommendations to make supervisory-bodies work more effective.

SAI gave an opinion that implementation of recommendations given would bring to a more effective control system on business activities on municipalities-owned companies. Implementation of the highest standards of corporate management should bring to protect the interests of owners, management, employees, buyers, suppliers, and the local community. The purpose of given recommendations is to establish prerequisites for supervisory-bodies work and more effective supervision on business activities of municipalities-owned companies.

During 2018 and 2019, SAI has conducted a follow-up audit on supervisory-bodies work in 35 municipalities-owned companies. SAI gave an opinion that satisfactory improvement has not achieved, but there is a positive impact on supervising on business activities of municipalities-owned companies.

ISRAEL

OFFICE OF THE STATE COMPTROLLER AND OMBUDSMAN OF ISRAEL

The Audit topic: Boards of Directors of Municipal Corporations

In recent decades, the areas in which local authorities are active have expanded, and the services that they provide to residents have increased; this has occurred because of the currently accepted view that a local authority has overall responsibility for the welfare of the residents and the development of the locality. This trend has led many local authorities to establish – pursuant to their authority – various municipal corporations which act as the long arm of the local authority that created them. According to the Ministry of the Interior's data, there are 492 municipal corporations: 262 of them are municipal companies, and 230 are non-profit organizations; [2] the annual turnover of the corporations is estimated at NIS 8 billion[3] and their accumulated losses are estimated at NIS 178 million per year. [4]

In recent years, there has been greater recognition of the importance of implementing the principles of good corporate governance within corporations' management. The purpose of these principles is to improve the management of the corporations and to ensure proper monitoring and supervision of their activities, with reference to an ethical code and the principle of imposing personal responsibility on corporate officials. During recent decades, legislation and judicial case law have developed a perspective regarding the function of the board of directors as the party that outlines the corporation's policy and supervises its implementation, thereby playing a major role in implementing the principles of good corporate governance. This report focuses on the functioning of the boards of directors of municipal companies.

Scope of Audit

During the months of September 2016 through February 2017, the Office of the State Comptroller examined aspects of the functioning of the boards of directors of ten municipal companies. A supplementary review was carried out by the Municipal Corporations Department at the Ministry of the Interior, and at the Committee for Examining the Qualification and Suitability of the Municipalities' Candidates for Service on the Boards of Municipal Corporations, which is also a part of the Ministry of the Interior (hereafter: "the Appointment Committee").

[2] The data are accurate as of November 2016.
[3] 1 EUR ≈ 4 NIS.
[4] Pursuant to the data of the Ministry of the Interior, based on the partial assessment of the 2014 Financial Statements

Main Findings

Lack of general regulation of the activities of municipal companies

The municipal companies have clear public corporation characteristics, but despite this, their legal status pursuant to the Companies Law 5759-1999 (hereafter: "the Companies Law") is that of private companies. They are therefore not subject to duties that suit their public nature – for example, with respect to supervision and reporting duties. It is true that some of the Ministry of the Interior's Director-General's Circulars indicate that there has been a partial solution regarding the public aspects of the functioning of the municipal companies and governmental supervision of them. But this is not a comprehensive statutory regulation of the issue.

A comparison of the normative framework that applies to national-level government companies and the normative framework that applies to the municipal companies also indicates that the boards of directors of the municipal companies have fewer reporting and supervision duties. For example, the board of directors of a government company is required to hold directors' meetings at least once every two months, while the board of directors of a municipal company has an obligation to meet only once each year, and at additional times in accordance with the company's needs; the government companies are required to appoint an internal auditor and an audit committee, while the municipal companies do not have any such obligations.

Defects in the composition of the board of directors and in the procedures for the appointment of the directors

We found defects in the composition of some of the boards of directors and the proceedings for appointing some of the directors. For example: on some boards, there were directors who remained in office although their terms had expired; there is an absence of proper representation of women; some corporations have not nominated representatives from the public, as required; and in some cases, directors serve on boards, despite not having received the approval of the Appointments Committee.

Procedural defects in the board of directors' meetings

We found procedural defects in the meetings of some of the boards of directors, such as the holding of meetings without a legal quorum; deliberations when the meetings do not have the proper mix of members present; infrequent meetings of the board of directors and even situations in which the board of directors had not met at all during a specific year; and the regular absence of certain directors from board meetings.

Deficiencies in the functioning of the board of directors

Non-approval of a work plan: At many of the companies, the directors have not adopted annual work plans for the company's activity for any of the years 2014-2016.

Non-approval of the budget: At many of the companies, the directors have not established a budget for the company's activity during the years 2014-2016. In one of the companies, the directors had not established a budget for 2016, even though it had done so in 2014-2015. We also found that even among those boards of directors of municipal companies that had deliberated the matter of the company's budget, some of them had approved the budget only during the course of the year covered by the budget.

Discussion of the financial statements and deficiencies in the supervision of the company's financial situation: The transcripts of the meetings of the boards of directors at many companies do not reflect that the board of directors held any deliberation at the time they approved the financial statements. In some of the cases, substantive comments were made by the company's certified accountant regarding the company's financial situation and its financial statements, but there is nevertheless no documentation indicating that the board of directors expressed any opinion regarding these comments or asked for any clarifications from the company's management.

Improper resolutions adopted by the boards of directors

Approval of a larger contract: We found that the board of directors of one of the companies approved an increase in the scope of a contract, in the amount of some 5.4 million NIS, without any deliberation whatsoever – without discussing the substantial issues that arose in the legal opinion that had been presented to it, without examining the nature of the work that was the subject of the contract, and without examining the economic viability of not conducting a tender process.

Institutional conflict of interest: In 2011, the board of directors of one company approved the appointment of a person, who served as a director of the company – to serve as its director-general, while he was serving as the director-general of the relevant local authority. The parallel service in both positions is a violation of the law and of the position taken by the Ministry of the Interior, and it places the board of directors in a situation in which there is a substantive concern regarding a conflict of interest. This could adversely affect the board's proper functioning as a supervisor of the company's management because – inter alia – some of its members are subject to the municipality's director-general. Additionally, when the company's director-general also serves as the municipality's director-general, he cannot devote all his time to the company only – nor can he devote the proper time needed for carrying out his function at the municipality.

Approval of the distribution of free tickets: Even though the receipt of free tickets necessarily involves a misdeed of receipt of a benefit, and is prohibited pursuant to the guidelines of the Ministry of the Interior and the Attorney General – the board of directors of one company approved, in September 2014, the entry of directors, without pay, into events produced by the company. The members of the board of directors also gave their consent to having the company purchase, for its senior corporate officials, a season pass to basketball games.

Flaws in the proceedings regarding the adoption of resolutions

Company A: Most of the meetings of the board of directors in the years 2015-2016 were held as telephone conferences. A review of the telephoned meetings transcripts indicates that they were very short and laconic and that no deliberation was held during these meetings, even though – in the framework of these meetings – the board adopted several important resolutions relating to the company's financial condition.

Company B: Despite the filing of an indictment against the company's director-general and despite him having been convicted of a crime, the chairman of the board of directors – the mayor – did not present this matter to the board of directors immediately after its occurrence. The board of directors did not at the time discuss whether the actions for which

the company's director-general was convicted should prevent him from continuing to be employed by the company, or whether it would be appropriate to receive a salary for the months during which he was serving his sentence by doing community service, and was not present at his place of work for a significant part of the workday.

We also found that the company's board of directors approved the construction of photo-voltaic energy modules (solar cells) on the roofs of educational institutions in the city, without deliberating the possible risks of the project and without examining the economic viability and consequences of taking a loan to finance it.

Company C: The minutes of each meeting of the board of directors in the years 2014-2016 do not reflect that the board of directors held any deliberations at the time that they approved significant financial resolutions such as the purchase of lands, the taking of a loan and the purchase of equipment.

Supervision and the audit of deficiencies in the municipal companies

Some of the companies manage an annual financial turnover of millions of NIS each, and nevertheless do not carry out any internal audits of the company, and do not have an internal auditor or audit committee. As already stressed, there is no legal obligation to appoint them, although such appointments are necessary in light of the public characteristics of these companies.

Some of these companies do have audit committees, but those committees have not met since they were created through the end of our audit in February of 2017.

We found that none of the municipal companies that we audited had mapped out – in the framework of the board of directors meetings – the possible risks involved in the company's activity, its weaknesses, and the ways in which these risks could be avoided.

Main Recommendations

The Ministry of the Interior needs to reexamine the arrangements that apply to municipal companies, taking note of their public character and the importance of the implementation of the principles of good corporate governance. The Ministry should consider regulating, through legislation, all the aspects of their activity in a complete, uniform, and organized manner – similar to the normative arrangement that applies with respect to national-level government companies, taking into consideration necessary distinctions.

The boards of directors in municipal companies need to function as an active and prominent element that is regularly involved in the outlining of the company's policy and the supervision of its management. They must also establish – each year – the company's work plan and its budgetary framework for its activity in the following year, and this needs to be done at a time close to the end of each year.

The directors need to be very familiar with the company's financial statements; they need to ask questions, to conduct an in-depth discussion of the opinions of the accountant and the internal auditor, and hold in-depth deliberations of the company's financial condition and the trends that are indicated in the reports.

The directors must take care to act as independent parties and avoid any conflicts of interest; they must take care with respect to the propriety of the process through which

resolutions are adopted and to obtain background material regarding the resolution in advance of the deliberation. They must discuss all aspects, examine alternatives, and consider the need for obtaining outside advice – and they must properly document their meetings. All of this is necessary so that decisions are reached in a considered and thorough manner, in accordance with the directors' duties as established by law.

The public character of a municipal company means that it is necessary for its activity to be internally audited. Consequently, the board of directors needs to deliberate the company's audit plan and to discuss the findings of the audits and take measures to ensure the correction of any deficiencies. The Ministry of the Interior must consider instructing the municipal companies to integrate into their activity, control and risk survey systems.

Conclusion - Summary

In this report, we have presented significant deficiencies in the functioning of the boards of directors of municipal companies, which manage substantial amounts of public monies and deal with key areas of the activity of the local authority. We found deficiencies in the processes followed regarding the appointment of directors, as well as boards of directors that were partial or not properly composed of representatives of various sectors. Some boards suffered from a lack of balance in their composition; there were also boards whose members functioned improperly, including by adopting inappropriate resolutions and displaying serious flaws in the decision-making process. These deficiencies are not consistent with the applicable statutory provisions or with the need to strengthen the principles of good corporate governance at municipal companies. The directors at the municipal companies are the guides and gatekeepers of the corporation, and it is their job to establish goals and objectives for the companies and to supervise their management. A failure to carry out this function, or partial functioning, on the part of a board of directors, will harm the system of checks and balances within the company and its operations, and can thus cause a financial crisis for the company and do significant damage to the public interest for which the company was established. Moreover, a financial crisis at a municipal company could bring about a situation in which the local authority is forced to cover the company's losses out of its own resources.

The findings in the report indicate that there are boards of directors of municipal companies that do not function as an active and prominent element that is regularly involved in the outlining of the company's policy and the supervision of its management. This conduct is not consistent with the growing movement toward the imposition of personal liability on corporate officials and directors who do not carry out their functions properly and do not carry out their duties in accordance with the standards of a reasonable corporate officer.

The principles of good corporate governance within municipal companies are not strong enough, and they are not well anchored in clear norms with regard to the functions and modes of operation of the board of directors. This is very different from the situation that prevails regarding the national level government companies, which are regulated through the Government Companies Law. In light of the broad scope of the activity of the municipal companies, and in light of their public character, an overall regulation of their activities should be considered, paying special attention to their size and financial scope; such regulation should be modeled on the framework that applies to national-level government companies, taking into consideration necessary distinctions.

The municipal companies that we reviewed must work to correct the deficiencies that were found in this report. Because of the importance of the subject and the economic size of most of the municipal companies, the findings of the report should serve as a trigger for drawing conclusions regarding all the municipal companies, until the matter is regulated through legislation.

LITHUANIA

NATIONAL AUDIT OFFICE OF LITHUANIA

The establishment of municipality's controlled companies (CCMs) is one of the functions of the municipality, by which it is ensured that all of the residents of the municipality be able to use public services, and these services would be continually provided. The municipality establishes new public services providers only in those cases when other providers do not provide public services or they can't provide them to the citizens economically and in good quality. These companies are established from the taxpayers' funds and when there are not enough own funds, the investments are made and losses compensated from these funds. The CCM is the property of all the people in Lithuania. This is why it is not only important to ensure the continuous provision of public services, but the results of the companies should benefit all.

One of the conditions in order for Lithuania to become a member of the Organization for Economic Co-operation and Development is the requirement to increase the effectiveness and transparency of the state-controlled companies' activities. In order to achieve this, in 2010, a reform of these companies has started to be implemented. It was decided to apply to these companies those legal norms and standards, which are in accordance with the OECD Guidelines on Corporate Governance of State-Owned Enterprises.

The European Commission evaluated the progress, which was achieved in this sphere since 2010, and highlighted that it would be wise to use the current situation of active progress and expand the reform of the companies in such a way that the innovative governance principles would be implemented to the CCM. In the OECD Guidelines on Corporate Governance of State-Owned Enterprises, it was noted that they fit for municipalities' controlled companies.

The primary recipients of the services, which are provided by CCMs, are citizens, also private economic subjects provide a part of the services. The Competition Council, not one time acknowledged that the privileges provided by the CCM do not ensure honest competition and adherence to the provisions of the Law on Competition. This is why the effective and transparent activity of the CCM is just as important as state-owned companies.

It is not mandatory to apply these guidelines, but it is useful in order to be a progressive part of the organization of countries. Some of the municipalities, e.g., the city of Vilnius, after seeing the benefits of changes started the CCMs reform and they intend to implement the in the OECD guidelines enshrined principles.

Because Lithuania wants to become a member of the OECD, a lot of attention is paid to the reform of state-owned companies, but the governance of them, up until now, was not evaluated systematically. There are many discussions in the public space about the necessity to better the results of these companies and to increase the transparency of their governance. These reasons lead to the fulfillment of the activity's audit.

We have concluded the audit by envisioning its objective - to evaluate, whether the governance of the CCM ensures effective and transparent activity. We have concluded the analysis of financial indicators of all CCMs in Lithuania, also in the chosen eight municipalities and thirty-two companies controlled by the municipalities we evaluated the governance of the companies: the means, which are applied by the municipalities in order to achieve a more professional governance, better strategic planning and management, financial and social results and strategic objectives of municipalities in these companies. We audited the 2013 - 2015 data and in order to evaluate, analyze tendencies and changes fully we used data from other periods.

The state in order to increase the effectiveness and transparency of the state-owned companies has improved the governance of them by adopting the needed statutes of law and governance guidelines of the state-owned companies, which are based on good governance principles. Furthermore, state institutions and their companies (Ministry of Economy, GCC etc.) have valuable information in the company governance sphere. We missed the help from the state in order to improve the governance of the CCM - the guidelines and consultations by the GCC are meant for the state-owned companies. This is why, at the moment, a common methodology is absent for the municipalities and the CCM, which would be prepared by having regard to the peculiarities of the CCM activities.

The principles of good governance practice of the companies in the municipalities are not applied or are only in part applied; there is a lack of consistent and comprehensive view towards the control of the companies. There is a lack of initiative for the municipalities to separate commercial and non-commercial CCM activities, determine certain objectives for the companies and to control whether or not the companies reach them. Not in all cases the municipalities strive to achieve, that independent persons unrelated to the activities of the company be included to the composition of the boards, not all important information about the CCM is made public and the reward systems for the managers of the companies and control bodies are not sufficiently increasing the effectiveness.

Upon evaluating the effectiveness of the CCM activities, we analyzed the financial indicators (the return on equity, return on assets and net profitability), the dividends earned by the CCM and the profit part allocated to the municipality's budget. The non-application of the good governance practice and a popular view that the sole purpose of the CCM is meeting the public interest without any regard to the budgets of the municipalities have an impact on the results of the CCM. Dividends and profit installments are used to realize the municipalities' programs and contribute towards the reduction of the deficit of the municipalities' budget. Not all of the CCM can strive to achieve profitability and the yield of bonds. However, as we have ascertained, even those companies, which carry-out non¬commerce functions, are not governed in order to achieve financial sustainability because only financially able CCMs can renew the depreciated assets of the company, plan expansion, improve the quality of services and reduce the price for consumers of the services.

The activity results vary: part of companies are tendentiously making losses, however, there are profitable companies, which generate a return for the municipalities. Common results of the CCM portfolio are not good. In the year of 2015, the CCM portfolio's return indexes were negative. In this situation, there is a threat that the financial sustainability of the companies' portfolio in the future will not be ensured.

At the end of 2015, there were 271 CCMs active in the country; common value of capital amounted to 1 257 M of Euros. About 10% of CCMs carry-out economic activity unrelated to the functions of municipalities. The current changes in the Law on Local Self-Governance shall limit the possibility of municipalities to establish new controlled companies, which carry-out economic commerce activity. However, by using criterions fixed in this Law, it is also important to evaluate the necessity of the now acting companies. The municipalities should periodically discuss the necessity to have controlled companies, because the initiative to improve the CCM portfolio is not enough - the CCM should be waived when private economic subjects provide economically and good quality services. Even though there are CCMs conducting similar activity, the municipalities establish the joint ventures only in exceptional cases and even more seldom they entrust the functions of providing public services to another company controlled by another municipality.

In order to use the accumulated experience of the state owned companies, it would be useful, by incorporating the municipalities, to prepare and affirm the CCMs governance's recommendation type guidelines and, based on competence, provide methodical help to the municipalities on how to effectively implement the rights of owners towards the CCMs and achieve better activity results. By mutual cooperation and cooperating with the institutions responsible for the reform of state owned companies, a consistent and focused implementation of common modern governance principles in all municipalities would be ensured. By experiencing least expenditures, the biggest benefit would be created. The common CCM governance policy would provide means to establish objectives to the companies according to same criteria and evaluate their activity results, the help from GCC would increase the competence of municipalities and CCM in the spheres of board's formation, strategic planning and increase of transparency. The municipalities, by using the experience of good governance practice in the state owned institutions, should show initiative and implement the principles of innovative governance in the controlled companies. It would have a positive effect to the budget of municipality and the quality of the services provided to the residents, would form a positive society's opinion on the municipality.

After evaluating the evidence gathered during the audit (by applying the analysis of statutes of law, documents and data, calculation and comparison methods), we provide the results of the audit. If the laid down recommendations would be properly carried-out, an effective municipalities controlled companies' resultative governance and transparent and effective activity basis would be created, and the results of the companies would give a bigger benefit to the society.

We have formulated the conclusions of the audit after researching national statutes of law regulating the establishment, governance of the CCM, documents regulating the work of institutions implementing ownership rights, OECD company governance guidelines, statistical and research data of Lithuania.

CONCLUSIONS

1. The state, in order to increase the effectiveness of the state owned companies' activities and transparency has adopted the necessary statutes of law, the guidelines of governance of the state controlled companies, which are based on the principles of good governance. However, the carried-out governance analysis of the CCM has

shown that good governance practice principles are not applied in the municipalities or they are applied only in part, there is a lack of consistent and comprehensive view towards the governance of companies:

- the municipalities do not advance common objectives for the controlled companies, create a clear and objective evaluation system of companies' activities indicators, ensure the formation of strong boards, there are no objectives to enhance the effectiveness in the CCM strategies and the managers of the companies are not motivated to achieve better results in the CCM;
- the publication of vital information about the CCM is not sufficiently defined, which is why the information is provided inconveniently, at different places and fragmented - different information is provided about different CCMs;
- the CCM indicators analysis is not prepared to be summarized on the state level and the report of activities result is not prepared, which is why the possibility to objectively evaluate and compare the results on a country's scale and to spread the good practice is lost.

2. The municipalities do not periodically discuss the need to have controlled companies. About 10% of CCMs carry-out activities unrelated to the functions of municipalities. There is not enough initiative to optimize the CCM portfolio, which is why even if there are those CCMs, which carry-out similar activity, the municipalities establish joint ventures only in exceptional cases and even more seldom entrust the provision of public services function to the company, which is being controlled by another municipality.
3. There is a popular view that the sole purpose of the CCM is meeting the public interest. Only financially capable CCMs can renew depreciated company assets, plan expansion, improve the quality of the provided services and reduce the price for consumers. However, the financial activity indicators of the CCM are poor:
    - in the year of 2015, the return of the own equity of the portfolio was -0.42% (the average of Lithuania in 2015 was 9.2%; state-controlled companies - 4.4%);
    - in the year of 2015, the return on assets was -0.18% (the average of Lithuania in 2015 was 6.4%; state-controlled companies - 2.5%);
    - in the year of 2015, the net profitability was -0.69% (the average of Lithuania in 2015 was 5.2%; state-controlled companies - 10%);
    - In the year of 2015, 34% of all CCMs made losses and 25% of all CCMs gained less than 15 thousand Euros of profit, which is why their financial sustainability may not be enough in the future in order to renew the depreciated company's assets, plan the expanse of the company, improve the quality of the provided services and reduce the price of them to the services consumers;
    - small part of all CCMs generates a return for municipalities: 2% of controlled companies in the year of 2015 made 75% of all dividends and profit installments. The total sum of the dividends and part of the profit of the CCMs in the year of 2015 was 6.57 m Euros (if there would be an average 9.2% return on own equity norm in Lithuania, the likely net profit of these companies would be 115 M EUR). This is why the municipalities do not use-up the possibilities to decrease the municipalities' budgets deficit with dividends and profit installments and to use them in implementing the municipalities' programs.
4. The municipalities in comparison to the state often have more limited human and financial resources to implement the good governance practice, which is why it is very

important for them to use the experience of the state in creating the guidelines of the CCM governance. A better CCM governance shall have a positive effect on the budget of the municipality, form a positive society's opinion about the municipalities and the quality of services, help focus to achieve more professional governance, better strategic planning and management, financial and social results, as well as the objectives of the municipalities.

RECOMMENDATIONS

To the Government of the Republic of Lithuania

1. By including the municipalities, to prepare and affirm the amendments of statutes of law regulating the CCMs by implementing in the implementation of property and non-monetary rights the principles applied by the state-owned companies and the CCM governance guidelines (recommendations), to:
   - unify the CCM and property and non-monetary rights implementation in the state-owned companies by adhering to the self-governance principles;
   - recommend for the municipalities how to differentiate commerce and non-commerce activities, form management bodies, etc.;
   - define the publication of vital information about the CCM: in order to ensure the uniform spread of information, the municipalities should make public least of all information on CCM activities and results of the last three years;
   - evaluate periodic CCM necessity evaluation and criterions based on which the municipalities would carry-out the evaluation in order to be able to optimize the CCM portfolio and its management - to waive non-effective and non-necessary companies.

To the Ministry of Economy of the Republic of Lithuania

2. In order to achieve greater publicity and transparency of the CCM activity, to discuss the possibility of entrusting the SE 'Turto banks' (Governance Coordination Centre) with:
   - preparation of annual summarized analysis of CCM activity indicators;
   - provision of methodical help for municipalities on the issues of determining the objectives and indicators of companies, preparation of strategies, evaluation of pursuit of objectives, the selection of independent members of the management boards and on other issues related with the governance of companies;
   - preparation of form regarding the municipalities' publicized information on the activity and results of the CCM. The information should be provided in the same format as benevolent for the analysis in order to compare the data.

SERBIA

The Audit topic: Appropriateness of Water Supply Network Management in Local Self-Governments

Public water supply represents a public interest and has a higher priority over other forms of water usage. One of the biggest problems in water supply network management is water losses in water supply systems, which have received audit attention due to economic, technical, social and ecological impact on sustainable development and water supply. Resolving the issue of water losses, as one of the significant problems, may ensure the improvement of the water supply system in Serbia.

After significant investments from the 1950s until the 1980s, the previous decades saw a significant decrease of investments into water supply infrastructure, which resulted in large water losses in the network, coupled with operating problems in water supply enterprises. The last official statistical data for 2018 show that 230 million m^3 of drinking water was lost in the distribution in Serbiaj, and/or over 35% of produced drinking water was not delivered to the consumers. The same sources point to the fact that in public water systems in Serbia, an average annual loss amounts to more than one-third of water, and in 20% of public water systems, losses exceed 50%. There is an estimate that, on average, over 10 billion dinars are lost annually in revenues of the enterprises. Network losses may be decreased by investments into reparation and construction of the water supply network, which requires, according to government estimates, 800 million euros worth investments.

State Audit institution conducted a performance audit "Appropriateness of Water Supply Network Management."

Having conducted the performance audit, we determined the following:

Water supply infrastructure management and/or successful and sustainable reduction of water losses, requires a systemic approach at the national level, but also better engagement of local authorities and water enterprises because implemented measures and activities have not contributed sufficiently to appropriate management and reduction of water losses.

Ministries in the area of communal activities and waters have not, within their competences, fully contributed to effective water supply infrastructure management and reduction of water losses in water supply systems, due to lack of systemic actions. In addition to the determined state of affairs and implemented measures regarding water losses, measures were not undertaken that would systemically contribute to the long-term reduction of water losses. Also, the efficiency of bearers of communal water supply activities has not been monitored adequately, based on defined indicators. Action plan for implementation of the Water Management Strategy has not been adopted. Hence the conditions were not created for regulating operations of enterprises providing services in the field of drinking

water supply and sewage, nor there are conditions for systemic and long-term reduction of water losses.

Role of the founders of the water supply enterprises in water infrastructure management regarding the reduction of water losses would have been more effective if required conditions were in place for the purpose of their development and improvement, as well as for long-term and short-term planning and reporting focused on performance. Founders of water enterprises have not monitored performance indicators regarding the reduction of water losses.

More efficient management of water supply infrastructure in water enterprises may be achieved by strategic orientation towards the reduction of water losses, planning based on measurable and achievable goals, and with adequate reporting. Measures and activities implemented have not been sufficient for long-term reduction of water losses.

Recommendations - State Audit Institution issued the following recommendations:

To Ministry of Construction, Transport and Infrastructure:

- To undertake measures or propose the Government of the Republic of Serbia to adopt regulations or take measures that would systemically contribute to long-term reduction of water losses;
- To propose the Government of the Republic of Serbia to define efficiency indicators forbearers of water supply activities, for the purpose of their adequate monitoring.

To Ministry of Agriculture, Forestry and Water Management:

- To propose the Government of the Republic of Serbia to adopt Action Plan for implementation of the Water Management Strategy, and thus create conditions for:
    - Systemic and long-term reduction of water losses;
    - Introduction of the regulatory function in the water management sector, and/or for regulating operations of enterprises providing services in the field of drinking water supply and sewage.

To the local government:

- To ensure required conditions for development and improvement of water supply network through the entry of water supply network in Cadastre;
- To adopt strategic guidelines;
- To use appropriate indicators during planning and reporting processes, in order to monitor performance and efficiency of investments into the reduction of water losses.

To municipality-owned companies:

- To adopt strategic guidelines for the development of enterprises;
- To make plans based on measurable and achievable goals and to report adequately;
- To take measures for efficient management of water losses, so that they: manage data, introduce measurements, make strategic and organizational orientation towards the reduction of water losses;
- To intensify activities for long-term reduction of real and virtual water losses.

The Audit topic: "Availability and Safety of Drinking Water"

State Audit Institution conducted a performance audit titled "Availability and Safety of Drinking Water", aiming to determine the effectiveness of measures undertaken by competent authorities in order to ensure a continuing supply of the population with safe drinking water and to check if there is room for improvement.

Having conducted the audit, we concluded that the measures taken by local governments and other competent authorities, in order to ensure continuous supply of safe drinking water, would have been more effective if the prescribed conditions existed for performance of the activity, along with regular control, assessment and monitoring of fulfillment of health safety standards of drinking water.

The above-mentioned was based on the following conclusions and findings:

1. **Local government units and city municipality - auditees have not ensured sufficiently effective management of supply of drinking water, because they have not ensured equal availability and treatment of drinking water to all citizens.**

Local government units and city municipality - auditees have defined obligations of public enterprises founded by them for providing drinking water, but they have not taken measures to ensure acquisition of licenses confirming fulfillment of required staff and technical capacities of public communal enterprises to which activity of supplying drinking water were delegated; intake of 77% of drinking water is done without acquired water permit; sanitary protection zones have not been defined for all wells; they have not regulated manner of acquiring citizens' opinion on quality of drinking water supply service and monitoring service quality. Established goals and indicators used for program activities of the budget are not aimed at assessment of effects of investments in improvement of water supply system, and projects were not implemented within deadlines; for those reasons public water supply is not equally available to citizens and there has not been significant change in drinking water quality delivered to the population from the public water supply system.

2. **Established system for controlling and reporting on the safety of drinking water does not ensure that the control is planned and implemented in all public water supply systems in the prescribed scope, nor it ensures that there is sufficient information provided to the citizens on quality and health safety standards of the drinking water.**

Bylaw defining in more detail conditions and obligations for taking measures in the field of public health has not been adopted. Local government units and city municipality - auditees have not assumed the obligation to make plans and they do not monitor whether the mandatory controls of the fulfillment of safety standards of drinking water are conducted within the prescribed scope. Due to the fact that local government units and city municipality - auditees have not established control, the fulfillment of safety standards of drinking water is not monitored in all public water enterprises, and in certain water, enterprises implemented the scope of mandatory controls is less than the prescribed one. Exchange of data on the fulfillment of safety standards of drinking water between implementers of water supply activities and their founders has not been defined precisely, which leads to the risk of incomplete information that is provided to the citizens. Collection of data and reporting on safety standards of drinking water from public water enterprises is done based on several

criteria, and there is no unified methodology for collection of such data, which may affect completeness and comparability of data being reported to competent authorities and citizens. Reports on the safety of drinking water contain a significant volume of data on hygienic safety of drinking water. Drinking water that does not fulfill prescribed conditions regarding health safety represents the risk that diseases transferred via water may affect the health of the population.

3. **The same measures are not implemented when assessing safety of the drinking water sample that is submitted to sanitary inspectors for the purpose of taking measures to limit water usage, and with time elapsed since introducing water restriction, the risk is increasing for using water from the public water supply system that is not safe for drinking purposes and for food preparation.**

The same measures are not implemented when assessing the safety of the drinking water by the institute of public health, and for that reason, professional opinion on the usability of drinking water is not included in all reports on results of the analyses submitted to sanitary inspectors. Lack of safety of drinking water coming from the public water supply system leads to additional costs and reduction of income, which, depending on the duration thereof, may be significant. The time during which water is not safe for drinking and lack of alternative sources of water supply may contribute to increased risk of using water for drinking purposes and for food preparation from the public water supply system, which does not fulfill safety standards.

Having completed the audit titled "Availability and Safety of Drinking Water" the State Audit Institution has issued **the following recommendations:**

To local government units and city municipality - auditees:

1) To ensure that water is used based on and pursuant to water permits, defining the permissible volume of usage of wells for the purpose of drinking water supply;
2) To acquire decisions from the competent authority confirming the sanitary protection zones of the wells, being used for the purpose of drinking water supply;
3) To undertake measures for ensuring activities of drinking water supply via public waterways system operated by public enterprises, and/or other legal entities possessing a license for performing such activities;
4) To determine the manner of obtaining on-going information from users on the quality of provided communal services and that measures for improvement of quality of services are planned to bear in mind the results of assessment made by users regarding the quality of provided communal services of the public supply of drinking water;
5) To determine the number of public water supply systems at the territory under their competence, number of households and citizens being supplied by the water supply system managed by groups of citizens and local offices, and to determine measures in order to define obligations in managing such water supply systems, in accordance with the current regulations;
6) to determine goals via strategic documents regarding development of water supply, to estimate the required funds and, according to circumstance and priorities, determine deadlines for achieving such goals, in order to improve availability and health safety of drinking water;

7) In the process of planning and preparing program budgets and investment into improvement of water supply system, to use suggested program goals and activities regarding increase of coverage of beneficiaries and territory with high-quality services of water supply, and to use adequate indicators while conducting assessment of progress towards achieving goals during the reporting on spending of funds;
8) To undertake measures for the purpose of adopting a public health plan and separate programs relating to the control of health safety of drinking water;
9) To undertake measures for the purpose of adopting special programs relating to the control of health safety of drinking water;
10) Via public health plan and special programs of the safety of drinking water, to define number and type of mandatory controls of health safety of drinking water according to the sampling place;
11) To define in more detail manner of communication with communal service providers and to ensure timely and full information of service users regarding interruptions and disturbance in service provision, due to determined lack of fulfillment of safety standards of drinking water;
12) In case of limitation or prohibition to use drinking water from public water supply system, to ensure the provision of safe drinking water based on analyses and possibilities, taking into consideration also the availability of alternative sources of water supply;

To the Ministry of Health of Serbia:

1) To undertake measures in order to intensify activities on adoption of a bylaw, which defines in more detail conditions and obligations for taking measures in the field of public health, among others, the issues of financing, reporting and coordination in the public health care system.

To the Institute for Public Health "Dr Milan Jovanovic Batut“:

1) To determine the standardized methodology for the data collection on health safety of drinking water, which will define required volume and content of data being collected and exchanged, in order to ensure more efficient management of collected data and analyses of such data for the purpose of reporting and decision-making process regarding drinking water;
2) To adopt professional-methodological instruction for application of regulations when providing opinions on whether drinking water may be used or not, which will, in cooperation with the Ministry of Health and Provincial Secretariat for Health Care, define manner and deadlines for providing an opinion to the competent sanitary inspector.

SLOVAKIA

The Audit topic: Management of ownership interests in commercial companies in municipalities

The Supreme Audit Office of the Slovak Republic carried out an audit in which it investigated how the entities of territorial self-government managed its property participation in commercial companies. The reason for the audit was a large number of assets that municipalities reported as shares in commercial companies as well as serious deficiencies found during previous audits carried out by the Office in this area of municipal activity.

The audit was performed in 50 municipalities with ownership interests in 168 commercial companies.

The audit examined the long-term financial assets of the municipalities worth EUR 227.03 mil. The audited period was 2015, respectively, the period from 2013 to 2015 for selected, audited areas (activities of the company bodies and control activities).

Several areas were assessed when dealing with the municipality ownership interests, in particular: the exercise of the rights of the municipality as a business owner or co-owner and the correctness of conducting business-related activities, especially in establishing the company. The ownership interest of municipalities in individual commercial companies and the staffing of commercial companies were assessed. Particular attention was paid to the financial or non-financial contribution to the municipality stemming from the ownership of a company.

In addition, the reporting of the fair and real value of non-current financial assets in the financial statements of the municipality, including mandatory data in the notes to the financial statements, and the inventory of the above assets were reviewed. The given municipality control activity was assessed in terms of the application of control in commercial companies through the municipality chief comptroller and the supervisory board of the company as its controlling body.

The audit revealed the following most frequently detected shortcomings in the long-term financial assets, the correctness of reporting, processes and procedures dealing with municipality ownership interests in commercial companies and assessment of municipalities' control activities in commercial companies:

- Breach of procedures and processes laid by generally binding legal regulations when dealing with the ownership interests of municipalities in commercial companies; e.g., not approving the members of the corporations' bodies by the municipal council, the missing particulars in the documentation related to the establishment of the commercial company, or the changes in the company. At the same time in one municipality, there was a breach of financial discipline of EUR 2.52 million when the funds raised from a bank loan were used to reinforce the capital stock (according to

the rules, such a loan could only be used to cover capital expenditure, e. g. for the acquisition of tangible fixed assets).

- Incorrect financing of the companies´ activities when the municipality property was put into a company without raising its capital, a contribution has been provided to cover the loss of the company or violation of conditions for granting and settlement of subsidies provided from the municipal budget.
- Reporting the data about long-term financial assets have not been reliable or comparable in the financial statements of the municipality, particularly if the amount of the municipality's assets has not been reduced in cases where the actual value of the given assets was significantly lower.
- Inaccurate quantification of the economic result of the municipality in cases where financial transactions between municipalities and their own trading companies were incorrectly accounted for or when those transactions were incorrectly classified in economic classification.

The limited exercise of municipalities' ownership rights was found in cases when the company´s majority share was privately owned, and the municipality could not influence the decision-making due to its small share number in the voting rights and opinion differences existed between the partners regarding further business financing or management. This problem has been particularly significant if corporate loss eventuated. In one case, the municipality was expelled from business as a shareholder when, according to a court decision, the municipality (a shareholder with a minority share of less than 20%) did not contribute to the loss of the company that did not secure the municipal services in accordance with the resolution of the given company's General Assembly.

Persistent problems were also found in the area of control when commercial companies owned by municipalities were not subject to the control by the municipality´s chief comptroller, while non-compliance with the statutory duties of the supervisory board as a control body of the company was found.

The Supervisory Board is a control body in business companies, and its establishment was not compulsory in limited companies. In the cases of establishing the Supervisory Board, in 25 cases (50%), shortcomings were detected in the activities of the Supervisory Board breaching the Commercial Code. In particular, the shortcomings concerned the absence of any activity by the Supervisory Board, non-compliance with statutory obligations, respectively, their formal or unprovable fulfillment.

The Supreme Audit Office of the Slovak Republic, while auditing their activities in selected commercial companies in 2015, also found the formal performance of the activities by Supervisory Boards. Based on the findings, the municipalities´ internal control system in the area of long-term financial assets was assessed as ineffective.

The main objective of the business is to make a profit. For all years in the period from 2013 to 2016, 63 companies made a profit, while only 35 companies (20.83% of the total number) paid the dividends at least once, e. g. the ownership of the business was a financial benefit to the municipality. The above-mentioned companies most often managed the leased property of the municipality, respectively, they were in the heat production business.

In cases when the profit was not paid to its owners, the company´s equity value grew. At the same time, the property value of the municipalities owning such companies increased.

The asset benefit to the municipality, in the form of a higher real value compared to its book value over the period 2013 to 2016, was found in 89 companies (52.98%).

By analysing the ownership structure of the companies that posted a profit for all four years, it was found that the most profitable commercial companies were those that were fully owned by the municipalities.

As negative feature was established that 39 companies (23.21 %) recorded a loss in the period 2013 – 2016.

Companies that did not record any property or financial contribution to the municipality carried out their activities mainly in the media and sports. To a lesser extent, the companies established in 2013 to 2016, were engaging in municipal activities or were companies in which bankruptcy or liquidation was not completed.

Ownership of loss-making companies, which did not contribute financially or in property, was justified by municipalities through non-financial benefits, especially in the area of retaining employment, respectively security services that other suppliers were unable or unwilling to provide. At the same time, the loss of business was the cause of the decrease in the total value of the property of the municipalities that owned them.

After completed analysis of the established shortcomings, the SAI SR proposed **the following systemic recommendations:**

1. Establish a system of regular monitoring and evaluation of the management of companies with ownership by the municipality, including their financial contribution to the municipality.
2. Connect the monitoring system with other community activities, e.g. creation of the programming budget, its monitoring and evaluation.
3. Analyse the necessity of activities and how companies with a long-term loss-making effect are funded while performing out activities for the municipality. Based on the results of the analysis, which also takes into account the size of the municipality's ownership interest in the company and the influence of the municipality on its management, consider changing the company to another type of organisation, e.g. to a contributory organization, or to sell its business share, or to liquidate the company.
4. Consistently enforce property rights; to require the Supervisory Board, as a controlling body in the companies, to perform its duties through persons appointed by the municipality.
5. To take into account the importance of companies with the municipality ownership interest in the municipality chief comptroller´s activities plan.

UKRAINE

The Accounting Chamber
Supreme Audit Institution of Ukraine

In Ukraine, for the purpose of providing public services to the people of the community, they have the right to set up utilities on the basis of a separate part of communal property. These utilities are within the scope of their management. The legislation envisages that the property of such utilities is in communal ownership.

Municipalities create utilities mainly in the areas of health, housing, commerce, catering, consumer services, transport and communications. According to statistics, as of March 1, 2020, there are 14,000 utilities operating in Ukraine, or there are at least one such company in each locality.

Currently, the Accounting Chamber of Ukraine does not have the authority to carry out specific financial audits and performance audits of use of funds by utilities set up by municipalities (except for such request in the form of a decision from the municipality itself). At the same time, while performance auditing the use of subventions funds (targeted transfers) allocated from the state budget to the budgets of municipalities, SAI of Ukraine audits the use of budget funds by utilities for the purposes and measures defined in the decisions of the Government of Ukraine and municipalities.

It should be noted that the peculiarity of a budgetary system development in Ukraine is that the subvention funds allocated from the state budget to the budgets of the municipalities are their revenues, and they are used according to the classification of expenditures of local budgets, that is, in essence, the property of the municipalities and accordingly these bodies are responsible for the efficiency and legality of their use.

Within the structure of the Accounting Chamber of Ukraine there is a Public Administration and Inter-budgetary Relations Control Department, which consists of Public Administration Audit Unit, Inter-budgetary Transfers of Social Aid Audit Unit and Investment Projects and Regional Development Audit Unit.

The Accounting Chamber of Ukraine approved the following reports, which provide information on findings of audits of municipality owned companies, in particular:

- **Obtaining by people the compensation for accommodation on the territory of nuclear power plants**

The purpose of the audit was to certify the activity efficiency of the municipalities and the utilities they set up in terms of compensating people for the risk of their residence in the area of the surveillance zone, that is, in the territory where the radiation exposure of the nuclear installation and facilities intended for radioactive waste management is possible.

The audit revealed that one of the municipal owned companies – the central local hospital used five buildings and structures of healthcare facilities with a total area of 8.8 thousand square meters. The value of the property was EUR 163 thousand, the ownership of which was not registered, which is a violation of the law. In this case, it may be assumed that

this is only a violation of the procedure, in fact in this violation lies a certain motive. After all, if the ownership of the property is not registered, then it doesn't exist, in fact there is a building, but according to the documents there isn't. As a result, major overhaul of such buildings can be spent, but not accounted, which is an example of a municipality's mismanagement of property management.

- **Capital investments in infrastructure objects by the Vinnytsia region (oblast) municipality**

The purpose of the audit was to ascertain whether the condition of the social infrastructure facilities, the level of their material and technical equipment and the quality of public services provided to people of the region had been improved.

The auditors revealed that two municipal enterprises (Children's Hospital and Oncology Center), which were the developers on overhaul and reconstruction of their premises, made expenditures for the works and purchase of medical equipment, which was not envisaged by approved design and budget documentation with expert documentation. According to the results of reconstruction of the Urology Department the Oncology Center paid the contractor EUR 85 thousand for delivered medical equipment (video endoscopic complex and electrosurgical apparatus), which was not envisaged by the project documents.

Various conclusions can be drawn from these facts: Firstly, there was the violation of procedure by non-implementation of measures for revision of the design and budget documentation; secondly, there is an immediate interest of municipal owned companies to act in favor of contractors. The Office of the Prosecutor General will examine this issue in more detail as a result of the information provided by the SAI of Ukraine.

ANNEX - SAI's mandate for auditing municipality-owned companies

The diversity of mandates for auditing municipality-owned companies within the Supreme Audit Institutions (SAIs) of the EUROSAI TFMA is large. Depending on their mandate, SAIs may conduct *ex-ante* or *ex-post* checks to assess the legality and regularity of revenue and expenditure, as well as the economy, efficiency, and effectiveness of policies, programs and measures, or the functioning of the public administration.

The table below illustrates this by countries and types of audits. For example, what is the possibility of SAIs to audit (including municipality-owned enterprises and other entities) according to the law, and what is the approximate number of audit entities in these audits per year?

Country name	Financial audit	Compliance audit	Performance audit
Albania	Municipality owned enterprises, on which state has 50%+1 of the share holds, like Water supply companies	Municipality-owned enterprises and other entities	
Austria	Municipality-owned enterprises (and likewise legal forms) which are either owned (at least 50% ownership held by municipalities alone or together with other institutions the SAI may audit) or controlled by municipalities		Municipality-owned enterprises (and likewise legal forms) which are either owned (at least 50% ownership held by municipalities alone or together with other institutions the SAI may audit) or controlled by municipalities
Azerbaijan	x	x	x
Bosnia and Herzegovina (Audit Office of the institutions in the Federation of Bosnia and Herzegovina)	SAI may audit enterprises, institutions, and funds owned by municipalities (all budget institutions that are directly financed from the budgets adopted by parliamentary assemblies of cantons and municipal councils, and companies in which the state has a stake over 50%)	SAI may audit enterprises, institutions, and funds owned by municipalities (all budget institutions that are directly financed from the budgets adopted by parliamentary assemblies of cantons and municipal councils, and companies in which the state has a stake over 50%)	The Audit Office has the right, by the law, to review, or examine (audit performance) a particular aspect of the business of all or part of an institution, program, or activity in terms of the economy, efficiency and effectiveness with which that institution uses its resources. The types of entities that are in the jurisdiction of the SAI FBiH and which are defined by the Law

Country name	Financial audit	Compliance audit	Performance audit
			are listed in the preceding chapters. A performance audit can also be carried out in cantons (and enterprises, institutions and funds owned by cantons and Federation of B&H)
Bulgaria	BNAO may perform an audit on municipality-owned enterprises and municipal corporations, for example, ecological corporations	Private enterprises with municipal funding of 50 percent or a higher share of its capital	BNAO may carry out audits on municipal enterprises
Croatia	Legal entities founded by a local and regional self-government unit and enterprises and other legal entities where a local or regional self-government unit is a majority shareholder or holds a majority stake	Legal entities founded by a local and regional self-government unit and enterprises and other legal entities where a local or regional self-government unit is a majority shareholder or holds a majority stake	Legal entities founded by a local and regional self-government unit and enterprises and other legal entities where a local or regional self-government unit is a majority shareholder or holds a majority stake
Estonia	Foundations and non-profit associations founded by LGs or whose members include an LG; Companies where LG exercises dominant influence and subsidiaries of the abovementioned companies	The mandate includes the right to audit in addition to municipalities as well foundations and non-profit associations founded by LGs or whose members include an LG; companies, where LG exercises dominant influence and subsidiaries of the abovementioned companies	
Finland	x	x	x

Country name	Financial audit	Compliance audit	Performance audit
Georgia	SAI may audit: Municipality owned enterprises, non-entrepreneurial (non-commercial) legal entities established by municipalities. The spending and use of funds and assets of legal entities under public law. Activities of the legal entities under private law if they use in any form, the property of local self-government units	According to the law, SAI may audit: municipality-owned enterprises, non-entrepreneurial (non-commercial) legal entities established by municipalities The spending and use of funds and assets of legal entities under public law. Activities of the legal entities under private law if they use in any form, the property of the State, of the autonomous republics and local self-government units, concerning the use of this property	According to the law, SAI may audit: municipality-owned enterprises, non-entrepreneurial (non-commercial) legal entities established by municipalities The spending and use of funds and assets of legal entities under public law. Activities of the legal entities under private law if they use in any form, the property of the State, of the autonomous republics and local self-government units, for the use of this property
Greece	SAI may audit: municipalities and regions legal entities governed by public law, as well as public utilities, sewerage water companies, and municipal public limited companies	SAI may audit: municipalities and regions legal entities governed by public law, as well as public utilities, sewerage water companies, and municipal public limited companies	SAI may audit: municipalities and regions legal entities governed by public law, as well as public utilities, sewerage water companies, and municipal public limited companies
Hungary	SAI may audit: municipalities; all local government entities on the municipality or county level	SAO of Hungary is entitled to audit any local government entities on municipality or county level (Body of local representatives, county Assembly, Mayor's offices, municipality institutions, municipality associations, municipality-owned enterprises, etc.)	SAI of Hungary is entitled to audit all local government entities on municipality or county level (Body of local representatives, county Assembly, Mayor's offices, municipality institutions, municipality associations, municipality-owned enterprises, etc.)

Country name	Financial audit	Compliance audit	Performance audit
Israel	The State Comptroller Law of Israel (The Law) provides that every local authority shall be subject to the audit of SAI Israel. The law adds that every enterprise, institution, fund or another body in the management of which a local authority has a share; and every enterprise, institution, fund or other body supported, directly or indirectly, by a local authority - shall also be subject to the audit of SAI Israel	Every enterprise, institution, fund or another body in the management of which a local authority has a share; and every enterprise, institution, fund or other body supported, directly or indirectly, by a local authority	Every enterprise, institution, fund or another body in the management of which a local authority has a share; and every enterprise, institution, fund or other body supported, directly or indirectly, by a local authority
Italy	All regions and municipalities, including publicly owned enterprises and public entities	The Corte dei Conti can audit regions and local entities, including municipality-owned enterprises	The Corte dei conti can carry out performance audit on regions and local entities including municipality-owned enterprises
Latvia	SAI may audit: • Municipally owned enterprises and enterprises where municipalities own part of shares or stocks; • Other enterprises, societies, foundations, and natural persons if a) they have municipal resources at their disposal or in their keeping; b) their activities are financed from municipal resources of resources guaranteed by municipalities; c) they carry out municipal procurement; • Users of resources allocated by the European Union and	In the sphere of local government, the State Audit Office may audit: • Municipally owned enterprises and enterprises where municipalities own part of shares or stocks; • Other enterprises, societies, foundations, and natural persons if a) they have municipal resources at their disposal or in their keeping; b) their activities are financed from municipal resources of resources guaranteed by municipalities; c) they carry out municipal procurement;	SAI may audit: • Municipally owned enterprises and enterprises where municipalities own part of shares or stocks; • Other enterprises, societies, foundations, and natural persons if a) they have municipal resources at their disposal or in their keeping; b) their activities are financed from municipal resources of resources guaranteed by municipalities; c) they carry out municipal procurement; • Users of resources allocated by the European Union and

Country name	Financial audit	Compliance audit	Performance audit
	other international organizations or institutions, which are included in municipal budgets	• Users of resources allocated by the European Union and other international organizations or institutions, which are included in municipal budgets	other international organizations or institutions, which are included in municipal budgets
Lithuania	SAI may perform audits in municipality-owned enterprises and other legal entities (public or private), to which the municipal institution has allocated funds or transferred property	SAI may perform audits in municipality-owned enterprises and other legal entities (public or private), to which the municipal institution has allocated funds or transferred property	SAI may perform audits in municipality-owned enterprises and other legal entities (public or private), to which the municipal institution has allocated funds or transferred property
Malta	x	x	x
Moldova			
Montenegro	SAI may audit all municipalities and enterprises and institutions which are founded by the municipality	The State audit institution performs an audit of the local self-government units and public companies that are founded by the municipality	
The Republic of North Macedonia	SAI may audit public enterprises	SAO performs compliance audits in public enterprises and users of municipality budget funds	SAI performs performance audits in municipalities, public enterprises, and users of municipality budget funds
Poland	SAI may audit: local government organizational units (including also municipal companies) at all levels (municipality, district, province)	NIK may audit the activity of local government bodies, local government legal persons and other local government organizational units at all levels (municipality, district, province), including also municipal companies, as well as inter-	NIK may audit the activity of local government bodies, local government legal persons, and other local government organisational units at all levels (municipality, district, province), including also municipal companies, as well as inter-municipal, district-municipal unions

Country name	Financial audit	Compliance audit	Performance audit
		municipal, district-municipal unions	
Portugal	SAI may audit: all local public entities (municipalities, civil parishes, municipality owned enterprises, local public associations or any other public institutions controlled by the municipality) private entities that manage or use public money	All local public entities (municipalities, civil parishes, municipality owned enterprises, local public associations or any other public institutions controlled by the municipality) or private entities that manage or use public money	All local public entities (municipalities, civil parishes, municipality owned enterprises, local public associations or any other public institutions controlled by the municipality)
Romania		SAI may audit Municipality owned enterprises (the commercial companies where the administrative and territorial units, the public institutions or the autonomous administrations own entirety or more than half of the social equity)	SAI may audit Municipality owned enterprises (the commercial companies where the administrative and territorial units, the public institutions or the autonomous administrations own entirety or more than half of the social equity)
Serbia	SAI may audit: all direct and indirect budget fund beneficiaries, territorial autonomies and local authorities, in accordance with regulations governing budget system and public revenues and expenditure system	In compliance with the law, the SAI may audit all direct and indirect budget fund beneficiaries, territorial autonomies and local authorities, in accordance with regulations governing budget system and public revenues and expenditure system	SAI may perform an audit of all direct and indirect budget beneficiaries. So far, the SAI has included local government units only within one performance audit (that covered the public sector)
Slovakia	SAI may audit: • legal entities with the participation of municipalities • legal entities established by municipalities	SAI may audit (according to the law): • municipalities, • legal entities with the participation of municipalities, • legal entities established by	SAI may audit (according to the law): municipalities, (higher territorial units), legal entities with the participation of municipalities (and higher territorial units),

Country name	Financial audit	Compliance audit	Performance audit
		municipalities e. g. budgetary and contributory organizations like schools, municipal service enterprises • other legal entities (public or private) to which the municipality has allocated funds or has entrusted a property to the administration	legal entities established by municipalities (and higher territorial units) e. g. budgetary and contributory organizations like schools, municipal service enterprises
Slovenia	SAI may audit: 1- any legal entity of public law or a unit thereof; 2- any legal entity of private law provided that one of the following applies: • it has received financial support from the budget of the European Union, state budget or local community budget; • it performs public services or provides public goods on a concession basis; • it is a commercial company, bank or insurance company in which the state or a local community holds the majority share; 3- any physical person provided that one of the following applies: • he/she has received financial support from the budget of the European Union, state budget or local community budget; • he/she performs public services or	SAI may audit the business operation of users of public funds, which are defined as: 1- any legal entity of public law or a unit thereof; 2- any legal entity of private law provided that one of the following applies: • it has received financial support from the budget of the European Union, state budget or local community budget; • it performs public services or provides public goods on a concession basis; • it is a commercial company, bank or insurance company in which the state or a local community holds the majority share; 3- any physical person provided that one of the following applies: • he/she has received financial support from the budget of the European Union, state budget or local	SAI may audit the business operation of users of public funds, which are defined as: 1- any legal entity of public law or a unit thereof; 2- any legal entity of private law provided that one of the following applies: • it has received financial support from the budget of the European Union, state budget or local community budget; • it performs public services or provides public goods on a concession basis; • it is a commercial company, bank or insurance company in which the state or a local community holds the majority share; 3- any physical person provided that one of the following applies: • he/she has received financial support from the budget of the European Union, state budget or local community budget;

Country name	Financial audit	Compliance audit	Performance audit
	provides public goods on a concession basis	community budget; • he/she performs public services or provides public goods on a concession basis	• he/she performs public services or provides public goods on a concession basis
Spain	SAI may audit: municipality owned enterprises	SAI may audit: municipality owned enterprises	SAI may audit: municipality owned enterprises
Turkey	SAI may audit: all types of organizations, institutions, associations, enterprises and companies affiliated to, or founded by the local goverments (where the public share is more than half of the total share)	Turkish Court of Accounts carries out compliance audits in municipality affiliated entities, municipality-owned enterprises, joint stock companies established by special laws and with more than 50% of its capital directly or indirectly owned by the Local governments	Turkish Court of Accounts carries out performance audits in local governments and municipality affiliated entities. A performance audit shall be carried out through measuring the activity results related to the objectives and indicators determined by administrations within the framework of accountability
Ukraine	The SAI may carry out: financial audit of the use of local budget funds regarding expenditures determined by the state functions and outsourced to the municipalities, as well as audits at the municipalities' requests of the respective local budgets and the activities of the entities requested.	X	The SAI may carry out: performance audit of the use of local budgets regarding expenditures determined by the state functions and outsourced to the municipalities, as well as audits at the municipalities' requests of the respective local budgets and the activities of the entities requested.