



Management of municipal enterprises in the
Talsi Region: questionable quality of services,
increasing costs for residents, and risks of
long-term accessibility ...

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Audit Report

Management of municipal enterprises in the Talsi Region: questionable quality of services, increasing costs for residents, and risks of long-term accessibility...

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Compliance/ performance audit “Does the Talsi Regional Government manage municipal enterprises following the principles of the rule of law and best practices?”

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Dear Reader,

Any community likes the low municipal utilities fee, because then there is more money left in their wallet. In their turn, politicians leading a local or regional municipal council like the residents of a local or regional government who are satisfied with the low service fee, because then they are ready to show their satisfaction in the elections to the municipal council.

Such an idyllic situation is good if the service fee in a local or regional government is reasonably justified and is determined taking into account economic and long-term development-driven considerations. In its turn, if it is determined on political grounds, then it is no longer an idyllic situation but a deadlock.

The famous saying states, “There is no such thing as a free lunch.” It can refer to the services provided by local and regional governments to the population perfectly, as someone must cover the costs related to the service provision. If the service fee set by a local or regional council is so low for the population that it does not fully cover all costs and service providers are left without the necessary funds to perform the duties entrusted to them, the quality of services suffers, service providers need to look for earning some income in the area of private economic operators, resulting in the fact in general that service providers live “hand to mouth” or think only of today.

The way out of such a situation is found in the proper management of municipal enterprises based on good cooperation between a municipal political leadership or a council, the municipal administration, and the management of municipal enterprise.

The management of municipal enterprises are assigned to ensure the financial and accounting records that provide the shareholder with information for making decisions on the objectives of municipal enterprises, and on the actual costs of the services provided. Then the councillors to decide impartially and openly towards the population both on the fees to be charged to the recipients of services and on the amount and sources of additional funding in cases when municipal enterprises need additional funding to cover costs. In its turn, the municipal administration serves as a connecting element of those two players by safeguarding efficient circulation of information, regular assessment of the activities of municipal enterprises, and supervision of the implementation of the decisions adopted by the council.

We are confident that the audit report will provide extensive information to the leadership of the Talsi Regional Government and specialists to improve the management of municipal enterprises. We also invite the population of the Talsi Region to use this report as a source of information for requesting positive changes in the regional government.

We thank the councillors of the Talsi Regional Council and the employees of the Regional Council administration, and the employees of the Talsi municipal enterprises for the good cooperation during the audit and for the interest in improving the services provided to the population!

Respectfully yours,
Edgars Korčagins
Department Director

Summary

Shareholding of a public entity, including local and regional governments in public enterprises is a way to implement the task delegated by the public with private law tools. However, only in cases when one requires satisfying the needs of the population and achieving it in other ways is impossible, local and regional governments may establish municipal enterprises, that is, to run a business themselves.

When deciding in favour of shareholding in municipal enterprises, the local or regional government shall set its goals, tasks, and define performance indicators according to which one will assess the performance results of municipal enterprises. The local or regional government must also ensure regular monitoring of municipal enterprises to gain confidence that the municipal enterprises operate effectively, economically, and efficiently and meet the goals set by the local or regional government.

At the same time, the municipal enterprises must understand the operational objectives set for them themselves and act in such a way as to achieve those objectives without violating the scope of the delegation or delegation agreement. Municipal enterprises must assess regularly whether their activities contribute to financial and non-financial objectives and inform the shareholder of the results.

By operating economically, effectively, and efficiently, municipal enterprises must provide services to the population and the local or regional government at economically justified costs.

In its turn, in accordance with the principles of good management practices of municipal enterprises, the local or regional government must be able to ensure equal treatment of municipal enterprises and their competitors in the market and safeguard equal conditions of competition. The corporate governance system established by the local or regional government should promote the formation of a transparent and fair market, as well as ensure the efficient allocation of resources. It must comply with the rule of law and contribute to effective monitoring and enforcement¹. Thus, the decision of a local or regional government on shareholding in a municipal enterprise should both benefit the local population and not interfere with economic operators who wish to engage in commercial activities in the relevant local or regional government.

At the same time, the economic activity of municipal enterprises must be independent of the political processes taking place in the local and regional government, the proximity of elections, the interests of the political parties in the council position or opposition, the division of mutual power, etc. In the relationship among municipal enterprises and the local and regional government, one must provide that the municipal enterprise can act independently within its scope of responsibility, while the shareholder can make sure that the activities of the municipal enterprise safeguard the greatest possible benefit to the population of the residents of the local or regional government.



A local or regional government must ensure that a municipal enterprise implement the objectives and tasks set for them in the interests of the population.

The Talsi Regional Government owns 100% of shares in three municipal enterprises and some shares in the capital of two municipal enterprises:

- ☺ “TALSU NAMSAIMNIEKS” Ltd provides real estate management services;
- ☺ “TALSU ŪDENS” Ltd provides water supply services;
- ☺ “TALSU TELEVĪZIJA” Ltd informs the population on the current news;
- ☺ “Atkritumu apsaimniekošanas sabiedrība “PIEJŪRA”” (waste management company) Ltd provides waste management services;
- ☺ “Ziemeļkurzemes reģionālā slimnīca” Ltd (North Kurzeme Regional Hospital) provides healthcare services.

Main Conclusions

Management and operation of municipal enterprise - where are we?

When managing municipal enterprises, the regional government has not acted effectively and pursuant to the statutory requirements and the principles of good governance practices. It has directly affected the fact that the activities of municipal enterprises are not economic and efficient and do not comply with the requirements of laws and regulations². The auditors' analysis of the annual financial statements of the largest³ municipal enterprises shows that municipal enterprises have low liquidity ratios, operate at a loss, have low return on fixed assets, and are not able to fully cover their short-term liabilities from current assets. In this situation, the population cannot rely on the services they need in the long run. Without changes in the management and operation of municipal enterprises, the “wallet” of municipal enterprises will become empty. In their turn, residents will be forced to pay more and more for that “wallet be full”.

Population does not receive quality services at economically reasonable prices

The population cannot rely on the fact that municipal enterprises offer them the top-quality services. Neither the Regional Government nor the municipal enterprises have carried out purposeful satisfaction assessments of service recipients aiming to identify the satisfaction of the population or problems in the availability and quality of services.

The municipal enterprises⁴ do not collect and review applications and complaints received from the population constantly to find out the most common problems and identify areas for improvement in the availability and quality of services.

The accounting of municipal enterprises also did not provide sufficient and substantiated information to make a full and detailed assessment of the reasonableness of the costs of services provided to the population and the regional government. Nevertheless, the auditors have identified significant inconsistencies.

According to the balance sheets of dwelling houses⁵ as of 30 December 2019, the municipal enterprise has received 860,335 euros more from the apartment owners for the management of residential houses than it has spent on maintenance and management activities of dwelling houses. “TALSU NAMSAIMNIEKS” Ltd explains that the municipal enterprise has spent this money for other purposes such as the renewal of the heat supply infrastructure owned by the regional government.

In addition, the residents who have entrusted the management of their dwelling houses to “TALSU NAMSAIMNIEKS” Ltd cannot be sure that their house is managed so as to ensure the safe operation of the house and engineering networks. The house files do not provide all the information specified in laws and regulations⁶, which would allow residents to ascertain that management duties are performed in full and as per the costs provided for in the estimates. Not all house files included in the sample have house inspection reports available indicating to the fact that neither the residents nor the municipal enterprise is informed about the technical condition of the house. The municipal enterprise employs only one part-time house manager of corresponding qualification, who can devote a little more than 2 hours a year to one house, which is not enough to manage a multi-apartment dwelling house of proper quality, such as inspecting a house, identifying the amount of work to be done, and verify the amount and quality of the work done.

There are deficiencies also identified in the tariffs for water management services provided to the residents of Talsi, which have been increased due to the type of accounting for fixed assets. The residents using the services of “TALSU ŪDENS” Ltd would pay for water supply services at least 63,316 euros (including VAT of 10,989 euros) less and 82,161 euros (including VAT of 14,259 euros) less in a year if the Regional Government had chosen the method of transfer of fixed assets in order to meet the principle of double non-financing, because the calculation of tariffs included depreciation from fixed assets financed within the framework of EU fund projects and which would not be included in this calculation.

Although “TALSU ŪDENS” Ltd sets its goal to reduce water losses, the actions taken do not result as planned. The water losses of “TALSU ŪDENS” Ltd in water supply networks were 29% in 2018, which was almost two-fold than average water losses in the water supply sector⁷, that is, 16%. In some areas, water losses in water supply networks reached even 80%, for example, 80% in Roceži of Laidze Rural District, 53% in Sārcene, 65% in Cīruļi of Valdgale Rural District⁸.

When justifying the increase in the tariff, “TALSU ŪDENS” Ltd stated that the cost of water losses had increased by 91%⁹ and that water losses accounted for 14% of the costs included in the water tariff. The municipal enterprise mentions unauthorised connections as one of the reasons for the extensive water losses. Although reducing the number of unauthorised connections is one of the main non-financial objectives¹⁰ of a municipal enterprise, their number is not decreasing. Consequently, the municipal enterprise is unable to meet the set non-financial objectives. This situation is a direct consequence of an inefficient internal control system in the municipal enterprise. Hence, residents who are using the services provided by “TALSU ŪDENS” Ltd and paying their bills in good faith must pay for water losses that occur as a result of improper control and unauthorised connections.

According to the auditors' estimates, assuming that “TALSU ŪDENS” Ltd. would reduce the amount of water losses to the industry average by decreasing the number of unauthorised connections and maintaining water consumption at the previous level, the municipal enterprise would increase the annual amount of water sold by 141,336 m³. With the scope of the service provided changing, the tariff for water supply service would also change from the existing 1.18 euros per 1 m³ of water¹¹ it could decrease by 19.5% to 0.95 euros per 1 m³ of water.

In its turn, “Atkritumu apsaimniekošanas sabiedrība “PIEJŪRA”” Ltd (waste management company) has not implemented the planned objective of ensuring separate waste collection in household. Waste

sorting would allow the population to pay less for waste disposal, as certain types of sorted waste are removed free of charge. Therefore, the amount of unsorted waste that one must pay for has decreased. At the same time, the promised benefit when entrusting the provision of services to its municipal enterprise, that is, a lower tariff that will not be increased during the term of the contract, has not been implemented. The tariff has already been increased several times¹².

Uneconomical service provision and financing model

The Regional Government has not carried out an impartial assessment of the most economical way to safeguard fulfilment of administrative functions whether by entrusting it to a structural unit of the Regional Government, by delegating it to an individual, or by the Regional Government running a business itself. Unfortunately, one has not organised the accounting of the municipal enterprises of the Talsi Region in such a way as provide the Regional Government with sufficient information on the costs of all services to assess which model of performing the tasks entrusted to the Regional Government and which service is most advantageous to the Regional Government.

In addition, the Regional Government has chosen an inappropriate and uneconomic financing model in cases when the Regional Government receives services from its own municipal enterprises. As these are services arising from municipal functions, the provision thereof is possible within the framework of a delegation agreement by paying grants. In this case, value added tax is not calculated, and it allows reducing the expenses of the Regional Government.

By performing the necessary actions for the improvement of accounting and concluding a delegation agreement, the Regional Government could pay at least 132,484 euros less for two services received (cemetery management, Regional Government-owned real estate management) in the reported period and could also save at least 62,204 euros every year henceforth.

Uncertainty about shareholdings in municipal enterprises and their activities beyond the scope of delegation

The establishment, management, work organisation, and operation of a municipal enterprise is a set of several complicated measures that require significant investments of financial and other resources from a local or regional government.

To ascertain that those resources are invested and used economically and effectively, the Regional Government must carry out an assessment at least every five years in order to find out the answer: is the investment of public funds in municipal enterprises still in the interest of population so that services are provided to them exactly through municipal enterprises?

However, the Regional Government does not assess or re-evaluate the necessity and justification of its shareholding in municipal enterprises unbiased: is this the most effective option to provide the population with the necessary services? The assessments performed by the Regional Government are not substantiated, are not based on data analysis and calculations, financial and non-financial indicators of municipal enterprises, forecasts for the operation of the segment in the medium and long term are not analysed.



The residents of Talsi Regional Government are interested in receiving quality services in the long run; therefore, it is necessary to significantly improve the management of municipal enterprises.

Moreover, the assessments do not cover all areas of activity of municipal enterprises, which would provide the population with confidence that the Regional Government makes efficient use of the financial resources entrusted to it by engaging in commercial activities and does not hinder business development in the region.

Thus, municipal enterprises offer services beyond the functions delegated to them. Municipal enterprises also provide such paid services that private companies already offer on the market. For example, the Regional Government has not assessed why “TALSU NAMSAIMNIEKS” Ltd is involved in the sale of funeral accessories (coffins, towels, candlesticks, etc.), why it rents vehicles and drones, performs repair works or provides landscaping services (lawn mowing, tree planting) to individuals.

The Regional Government has also not verified whether its activities do not affect the business environment in the administrative territory of the Regional Government adversely. The assessments do not include information that would allow the population to ascertain that the actions of the Regional Government do not reduce the opportunities for the residents to establish new companies and create new jobs themselves. In its turn, the lack of competition has a negative impact on the population, as only one service provider is not interested in providing a higher quality and cheaper service because the population has no choice.

Uneconomic and illegal expenses in municipal enterprises

In municipal enterprises, whose shares belong to the Regional Government, cases have been identified during the audit when the Members of the Board of municipal enterprises have been issued a procedure for determining and reviewing remuneration not provided for in laws and regulations and higher remuneration paid than the laws and regulations permit¹³. Remuneration of at least 145,400 euros was paid to the Members of the Board of municipal enterprises in compliance with the procedure specified in the laws and regulations¹⁴. The Members of the Board have also received various benefits that were not included in the delegation agreements, such as annual leave days and severance pay.

The documents justifying the use of transport by municipal enterprises do not indicate reliable odometer readings and fuel consumption norms, and the reasons and routes of specific trips are not indicated correctly. For instance, the car of the Member of the Board “TALSU ŪDENS” Ltd is not equipped with GPS and the documents justifying the use of the car do not include information about the purpose of the trips.

The business trip reports of municipal enterprises¹⁵, do not indicate information on the deliverables of a business trip, knowledge gained during the business trip so that one can use the knowledge for improving the work of municipal enterprises, for example, “TALSU NAMSAIMNIEKS” Ltd has not recorded the business trip expenses separately and did not submit all reports on the deliverables of the business trips.

In a situation where municipal enterprises operate at a loss and require additional financial resources to ensure the operation of municipal enterprises, alcoholic beverages are purchased and employee leisure activities are paid for at the expense of municipal enterprises, such as boat trips. “TALSU ŪDENS” Ltd presents gifts to the employees of the Regional Government whereas “TALSU NAMSAIMNIEKS” Ltd has not even established a procedure for controlling representation expenses.

How did municipal enterprises get into such a situation?

Ineffective internal control systems

Municipal enterprises do not have effective internal control systems and nobody elaborates complete and reliable supporting documents to obtain assurance that the financial resources of municipal enterprises have been used economically, effectively, and legally.

Municipal enterprises have not implemented the recommendations provided by the internal auditor on the improvement of accounting and economically justified pricing of services, which is a prerequisite for obtaining data for making economically sound decisions, for a long time.

Drawbacks in the monitoring and exchange of information are the reason why the decisions made by the Regional Government regarding municipal enterprises cannot be based on unbiased information, they are not transparent, and it is impossible for anybody to ascertain their validity.

Both development planning documents, shareholding assessments, and agreements with the Regional Government include the objectives set for municipal enterprises. To verify that those objectives are met, the Regional Government has established a control procedure, but it does not work. For example, municipal enterprises are required to report to the Regional Government on their activities and achievement of objectives quarterly. However, municipal enterprises do not submit all reports with complete information on the performance of the municipal enterprises to the Regional Government.

In addition, when examining the reports, the auditors found that the reports incorporated, for example, information on operating income and expenses, day-to-day operations and planned work, but they did not include information that would allow an impartial assessment of whether municipal enterprises are meeting their objectives, what risks exist and could occur, which hinder the achievement of the objectives set for municipal enterprises to ensure the stability of the activities of municipal enterprises, as well as ensure high-quality services to the Local Government and the population at economically justified costs.

According to the information provided by “TALSU TELEVĪZIJA” Ltd and “TALSU NAMSAIMNIEKS” Ltd, the degree of achievement of the objectives set to the municipal enterprises and the work performed are evaluated by preparing a presentation to the Regional Government on the current annual statement. However, the presentations prepared by the municipal enterprises on the annual reports for 2018 and 2019 do not include information on the activities performed for the implementation of the objectives and tasks specified in the development planning documents, the progress, and the factors that have prevented the municipal enterprises from performing the planned tasks.

During the audit, “TALSU ŪDENS” Ltd indicated that it would perform an assessment of the medium-term operational strategy¹⁶. In the strategy, the municipal enterprise¹⁷ has presented the investments made by the Regional Government, changes in the territory of its operation, described the water management infrastructure at its disposal, presented revenues, expenses, and services for three years, indicated problems in its operations, provided information on implemented and planned measures, presented objectives and tasks set in the reported period, but it has not provided an assessment of the performance of the municipal enterprise for the previous period (2017 - 2019) by indicating the impact of the performed or non-performed activities on the quality of services, prices, and the capability of the municipal enterprise to provide the service in the long term.

For example, the measure “Development of water management infrastructure in the Lībagi Rural District” provided for construction of 20 connections of private houses to the district water supply and sewerage networks, but only three houses were connected, as the connection costs (up to 70 m) could reach 8000 euros¹⁸. “TALSU ŪDENS” Ltd does not state what amount of services was not obtained, how it affected the service costs, what risks emerge for “TALSU ŪDENS” Ltd (the amount of concentrated wastewater in treatment plants will not be reduced, endangering the compliance with environmental requirements; the planned outcomes of the project will not be achieved, and the co-

financier may claim back funding allocated to the project). “TALSU ŪDENS” Ltd also does not point what measures it has taken and to take to implement in order to encourage homeowners to connect to the district water supply and sewerage networks.

The regulations of the Regional Government¹⁹ stipulate that the representative of the shareholder shall, if necessary, decide on further actions to ensure the achievement of the objectives set in the medium-term operational strategy in the interests of the population when assessing the progress in the implementation of the objectives.

Such decisions were not submitted to the auditors, which allows us to conclude that the Regional Government does not follow the procedures established by it for the supervision of municipal enterprises in practice, most probably because the municipal enterprises do not provide an assessment of the progress in achieving the strategic goals in the quarterly reports and have not provided up-to-date information for the analysis of their economic activity.

No analysis of economic activity and achievement of objectives performed

The internal procedures of the Regional Government²⁰ envisage evaluating municipal enterprises also in terms of profitability, quality of executing delegated tasks and financial indicators, observance of good management principles, attraction of financial resources from EU funds, improvement of internal management processes, and other criteria depending on the set tasks and objectives. However, this type of analysis is not included in the accounts and, consequently, the supervision of municipal enterprises is formal.

The most significant problems in the management of municipal enterprises: the principles of good corporate governance not observed and unsatisfactory financial management²¹ of municipal enterprises. The negative consequences thereof include the decisions of both the shareholder and the Board do not rely on precise calculations and comprehensive economic analysis²², which does not allow identifying problems in municipal enterprises and preventing negative consequences for the population as service recipients.

The analysis of economic activity before making important decisions substantiates the decisions and actions of managers, as well as ensures the impartiality and efficiency of the decisions made. The leader may not rely solely on his or her intuition. However, the accounts of municipal enterprises do not include a complete performance analysis and a fact-based forecast of operations.

Without a comprehensive and holistic analysis of financial indicators, one does not assess and analyse information on the corporate operations impartially, does not identify risks and weaknesses in the operations of municipal enterprises. That is the main precondition for improving the financial stability, long-term predictability, and ability of municipal enterprises to provide high-quality services to the population at economically reasonable costs.

The auditors analysed the financial statements²³ of “TALSU NAMSAIMNIEKS” Ltd and “TALSU ŪDENS” Ltd by calculating and estimating the following groups of ratios: liquidity, solvency, turnover, and profitability (See Annexes 2, 3). The result of the analysis of financial statements of municipal enterprises, which is obtained from publicly available information, confirms the audit findings and conclusions that there are significant problems in financial management and operations of municipal enterprises, as well as analysis of financial statements of “TALSU ŪDENS” Ltd confirms risks of long-term problems directly.

For example, “TALSU NAMSAIMNIEKS” Ltd had included the planned financial indicators²⁴ in the medium-term operational strategy 2017-2019. The municipal enterprise has not assessed the

achievement of the set indicators, but the data of the analysis performed by the auditors confirm that the planned indicators were not achieved.

In addition, when reporting the results of financial activities in 2018, the municipal enterprise showed a presentation to the Regional Government, in which it presented a better situation than it actually was. According to the information provided in the annex to the financial statements²⁵ of “TALSU NAMSAIMNIEKS” Ltd, significant accounting errors have been identified in 2019, which have also been corrected in relation to the data of 2018.

In fact, the economic performance of the municipal enterprise has been deteriorating since 2017²⁶, as indirect costs are growing faster than directly eligible costs, thus the municipal enterprise is not able to fully cover its short-term liabilities with its current assets, is not able to cover interest expenses from operating profit, which poses a risk of non-repayment of borrowed funds. The municipal enterprise finished the year 2019 already with a loss.

In its turn, the capital increase of “TALSU ŪDENS” Ltd is related to the increase of the share capital (taking over the water management infrastructure of the rural district administrations) and not to the ability of the municipal enterprise to generate a sufficient amount of income. There is a significant increase in the accruals, which indicates the risk of inefficient work with debtors. In the future, the Regional Government will have to assess the ability of the municipal enterprise to pay its liabilities and to cover interest payable from operating income. Low rates of return on fixed assets indicate that fixed assets are used inefficiently. For example, the capacity of Jaunpagasts wastewater treatment plant is 200 m³ a day, but the volume of wastewater discharge to it was only 31.89 m³ a day, that is, at least five times less. In its turn, in Lēdi wastewater treatment plant in Virbi Rural District, one uses only 4.51% of the designed capacity²⁷ of the plant for wastewater treatment. Thus, the municipal enterprise uses financial resources to maintain the plants whose capacity exceeds the needs of the population, but the recipients of services will pay those costs.

The sales profitability of the municipal enterprise is negative and tends to decline significantly, which one assesses as a significant threat to the financial stability of municipal enterprise. As a result, the municipal enterprise might not have enough money to provide high-quality services to the population on a daily basis, such as the supply of clean water or proper wastewater treatment.

“TALSU ŪDENS” Ltd is already not able to ensure full-fledged operation of wastewater treatment plants now, which results in the environment pollution. According to the findings of the State Environmental Service²⁸, “TALSU ŪDENS” Ltd had not eliminated the consequences of the accident at the Pastende wastewater treatment plant and had not developed a sufficient action plan to prevent the risk of environmental pollution and had not implemented it²⁹.

Incomplete accounting

During the audit, one has established that the residents of the Talsi Region do not receive services in proportion to their real costs. The methodology for calculating service prices is developed for only one municipal enterprise³⁰.

One of the main reasons for incorrect service costs is the lack of detailed cost and revenue accounting for actual service costs.

For instance, the accounting of “TALSU NAMSAIMNIEKS” Ltd shows that the management of dwelling houses causes losses to the municipal enterprise. However, those accounts do not provide true information, as according to the balance sheets³¹ of those dwelling houses, the municipal enterprise has

received 860,335 euros more from apartment owners for the management of dwelling houses than it has spent on maintenance and management activities of the dwelling houses by 30 December 2019.

At “TALSU ŪDENS” Ltd, there is income accounting by types of services provided, but expenses are not separated by types of services. The accounting of “TALSU NAMSAIMNIEKS” Ltd does not provide for the accounting of income and expenses by types of services, therefore the municipal enterprises do not accumulate data for determining economically justified service prices.

In order to ensure economically sound decision-making and the operation of municipal enterprises, introducing of more detailed accounting is required in accordance with the principles of sound financial management. For example, “TALSU NAMSAIMNIEKS” Ltd must separate the accounting according to the directions of its activities in order to determine which activities cause losses so that as to resolve the situation accordingly.

Sound financial management also includes proper budget planning of municipal enterprises, but it is organised in the municipal enterprises as to ensure the day-to-day operations and spending of municipal enterprises in the short term rather than aimed at maintaining and developing infrastructure in the long term. In such circumstances, it is not possible to predict whether the services will be provided to the population continuously and will be available in the long run.

Uncoordinated and unconstructive cooperation among the actors involved in management

The principles of good corporate governance and laws and regulations are not observed in the mutual relations of the entities involved in the management of municipal enterprises, that is, the representative of the shareholder, the Board, and the Regional Council, in the exchange of information and decision-making processes. Although the laws and regulations³² stipulate that the representative of the shareholder makes decisions crucial for the operation of municipal enterprises, decision-making crucial for municipal enterprises is often related to undesirable political influence in the Regional Government.

The Regional Government does not have a procedure for exchanging information that would reduce the undesired political influence of the councillors of the regional government, bypassing the representative of the shareholder and causing undesirable political pressure on the Board and employees in charge of the municipal enterprise.

For example, “TALSU NAMSAIMNIEKS” Ltd has indicated even in its annual financial statement for 2017 that the dependence on the political decisions of the Talsi Regional Council regarding the range of services provided by the municipal enterprise is one of the factors that could affect the corporate performance in the future. As a result, the enterprise was unable to plan and predict the cash flow and the extent of work.

Conversely, “TALSU ŪDENS” Ltd has calculated that the costs of the municipal enterprise are 222,923 euros more than the revenues by taking over the provision of water management services from the rural district administrations and the Regional Council deciding not to make changes in the applied tariff.

Access to information is not granted

The National Development Plan³³ provides citizens with the right to civic participation as one of the tools to achieve the plan. Such rights are included in both the basic principles of public administration and laws and regulations. Civic participation provides an opportunity for citizens to participate in decision-making, which, in its turn, ensures the development of the state including local and regional

governments in accordance with the interests of the population. Therefore, a citizen must have access to sufficient information to be able to participate in decision-making.

Both the Regional Government and municipal enterprises are obliged to publish information on the activities, economic indicators, Members of the Board, and annual financial statements of the municipal enterprises for the population to ascertain that municipal enterprises operate in their interests and that they will receive the benefits promised by the Regional Government. The internal procedures of the Regional Government also provide for the duty of the Regional Government to publish the information.

However, full disclosure of the information specified in the laws and regulations on the websites of the Regional Government and municipal enterprises is not ensured. For example, “TALSU NAMSAIMNIEKS” Ltd has not published the interim and annual financial statements unaudited by a sworn auditor³⁴. “Atkritumu apsaimniekošanas sabiedrība “PIEJŪRA”” Ltd has not published the Articles of Association of the municipal enterprise³⁵ and information about a Member of the Board of the municipal enterprise³⁶. In its turn, “TALSU TELEVĪZIJA” Ltd has not published the interim and annual financial statements unaudited by a sworn auditor³⁷ and information on the Members of the Board of the municipal enterprise³⁸.

Thus, population and businesses are deprived of the opportunity to obtain complete information about the activities of municipal enterprises and to ascertain the good faith of the Regional Government and municipal enterprises when making decisions that directly affect them, such as creating competition for businesses and providing information on the performance, costs of the municipal enterprises, and their effect on the service prices and tariffs.

An independent and unbiased municipal media would be a tool for informing and involving the residents and businesses of the Regional Government in municipal activities. However, “TALSU TELEVĪZIJA” Ltd operates in the conditions causing a risk of bias in the coverages produced by the municipal enterprise about the activities of the Regional Government, because the Regional Government owns all capital shares and orders specific coverages, there is settlement of accounts as per particular coverages rather than financing allocated for the production of unspecified coverages. The National Electronic Mass Media Council also provides the opinion³⁹ that the impartiality of an electronic media 100% owned by a local or regional government might be affected, for example, by not reporting negative information about a particular local or regional government.

How one can improve the existing situation?

For the improvement of the current situation in the management of municipal enterprises, the Regional Government and municipal enterprises must eliminate the deficiencies and weaknesses identified during the audit, in particular by improving financial management, introducing more detailed accounting to analyse operating costs, providing services at economically reasonable prices to both the Regional Government and the population. They must determine and follow the procedure for managing and supervising municipal enterprises by coordinating the co-operation between the representative of the shareholder and the Boards of municipal enterprises professionally pursuant to the provisions of laws and regulations⁴⁰ inter alia that an executive director or an individual specified by order shall be liable for the municipal enterprises, incl. by clearly defining the responsibilities of both the executive director and the Members of the Board of municipal enterprises for the activities of municipal enterprises among

them the performance indicators of municipal enterprises and their ability to provide high-quality services to the population in the long term.

Should one fail to make changes in the management of municipal enterprises, the financial indicators of municipal enterprises will only worsen, the quality and availability of services will decrease, problems will be solved at the expense of increasing service tariffs and payments received from the population or inefficient municipal investments in municipal enterprises thus tearing the financing away from the implementation of other functions of the regional government that are expedient for the population.

Major Recommendations

Based on the audit findings, there were recommendations⁴¹ provided to the Regional Government aiming to establish an effective and corporate governance principle-compliant system to manage the municipal enterprises and economic and effective performance of municipal enterprises with the purpose of providing the population with high-quality services at economically reasonable prices, including:

- ☑ Carry out full and reasoned shareholding assessments to identify the most effective ways of organising the provision of services to the population;
- ☑ Ensure the availability of information so that the population can verify that municipal enterprises are managed in the interests of the population and that decisions are made based on sufficient and comprehensive information;
- ☑ Upgrade the management of municipal enterprises in accordance with the best management practices to create preconditions and environment for achieving the set objectives.

To pursue the interests of the population, the Regional Government must safeguard that the municipal enterprises:

- ☑ Perfect the accounting of municipal enterprises aiming to provide the Regional Government and the population with complete, true, and detailed information on the direction of activities of municipal enterprises and the costs of providing services in order to determine economically justified prices for the services accordingly;
- ☑ Assess regularly and perfect the quality of services provided by municipal enterprises continuously;
- ☑ Provide the effective operation of internal control systems in municipal enterprises by preventing the possibility of uneconomic and illegal costs.

References

- ¹ G20/OECD Principles of Corporate Governance, p. 9.
- ² For example, the Law on the Management of the Shares and State-owned or Municipal enterprises of a Public Entity, the Law on the Structure of Public Administration, the Law on Local and Regional Governments.
- ³ “TALSU NAMSAIMNIEKS” Ltd, “TALSU ŪDENS” Ltd.
- ⁴ Except “Ziemeļkurzemes reģionālā slimnīca” Ltd.
- ⁵ The summary of the balance sheets of dwelling houses submitted in the e-mail letter by “TALSU NAMSAIMNIEKS” Ltd on 18 February 2020.
- ⁶ Article 8.2 of the Law on the Management of Dwelling Houses; Article 11, 13, 21-25 of Cabinet Regulation No 908 “The Rules for Keeping and Updating a House File” of 28 September 2010.
- ⁷ Water supply sector, whose operation the Public Utilities Commission regulates.
- ⁸ Draft calculation of the tariffs for water management services by “TALSU ŪDENS” Ltd.
- ⁹ Draft tariff for water management services by “TALSU ŪDENS” Ltd, the hearing, slide No 11, https://www.sprk.gov.lv/sites/default/files/editor/Sabiedribas_lidzdaliba/UAPD_kopsavilkumi/TU%20prezentacija%20SabApspr%2031102019.pdf, viewed on 19 March 2020.
- ¹⁰ Medium-term operational strategy for 2020-2022 of “TALSU ŪDENS” Ltd, p. 43-44.
- ¹¹ <https://infogram.com/sia-talsu-udens-1h7z4ok8d0332pw?live>, viewed on 16 June 2020.
- ¹² For example, the Waste Management Contract No 9-23/12/2018 of 31 January 2018, Article 1 of Agreement No 3 of 1 August 2019 to the Waste Management Contract No 9-23/12/2018 of 31 January 2018.
- ¹³ Article 79 of the Law on the Management of the Shares and State-owned or Municipal enterprises of a Public Entity, Annex to Cabinet Regulation No 791 “Regulations on the Number of Members of the Board and Council of State-owned or Municipal Enterprises of a Public Entity and Public Private Partnerships According to the Indicators Characterising the Size of a State-owned or Municipal Enterprise, Maximum Amount of Monthly Remuneration of Members of the Board and Council” of 22 December 2015.
- ¹⁴ Article 79 of the Law on the Management of the Shares and State-owned or Municipal enterprises of a Public Entity, Annex to Cabinet Regulation No 791 “Regulations on the Number of Members of the Board and Council of State-owned or Municipal Enterprises of a Public Entity and Public Private Partnerships According to the Indicators Characterising the Size of a State-owned or Municipal Enterprise, Maximum Amount of Monthly Remuneration of Members of the Board and Council” of 22 December 2015.
- ¹⁵ Except “Ziemeļkurzemes reģionālā slimnīca” Ltd.
- ¹⁶ Medium-term operational strategy for 2020-2022 of “TALSU ŪDENS” Ltd (Approved by decision No 18/2019 of the representative of the shareholder of 30 December 2019).
- ¹⁷ Medium-term operational strategy for 2020-2022 of “TALSU ŪDENS” Ltd (Approved by decision No 18/2019 of the representative of the shareholder of 30 December 2019).
- ¹⁸ Medium-term operational strategy for 2020-2022 of “TALSU ŪDENS” Ltd (Approved by decision No 18/2019 of the representative of the shareholder of 30 December 2019), p. 35.
- ¹⁹ Article 32 of Talsi Regional Council Regulation No 6 of 28 December 2015 (Item 9, Minutes No 30, Decision No 578) “Procedure for the Management of Municipal Enterprises and Shares of the Talsi Regional Government”.
- ²⁰ Article 36, 46, and 47 Talsi Regional Council Regulation No 6 of 28 December 2015 (Item 9, Minutes No 30, Decision No 578) “Procedure for the Management of Municipal Enterprises and Shares of the Talsi Regional Government”.
- ²¹ Financial management is a system, a set of activities, how to use capital more rationally and efficiently. Rurāne M. “Financial Management”, Riga International School of Economics and Business Administration, Riga, 2006, p. 9.
- ²² The guidelines of the Cross-sectoral Coordination Centre for the development of medium-term strategies for state-owned and municipal enterprises also indicate that an analysis of financial indicators is necessary in order to promote good governance practices in state-owned and municipal enterprises. http://www.valstskapitals.gov.lv/images/userfiles/vid_term_darb_strat_vadlinijas_28082018.pdf
- ²³ Horizontal and vertical analysis of the balance sheet and profit or loss account; analysis of notes to the financial statements; calculation and analysis of generally accepted financial ratios; evaluation of the medium-term development strategy of municipal enterprises. The analysis was performed regarding “TALSU NAMSAIMNIEKS” Ltd between 2015 and 2019 (that is, 5 years); “TALSU ŪDENS” Ltd between 2015 and 2019 (that is, 5 years).
- ²⁴ Data from Medium-term operational strategy for 2017-2019 of “TALSU NAMSAIMNIEKS” Ltd (Available at <https://www.talsunamsaimnieks.lv/par-mums/dokumenti/>).
- ²⁵ Annual financial statement for 2019 of “TALSU NAMSAIMNIEKS” Ltd, p. 10.

²⁶ When analysing liquidity (the ability of a company to cover its short-term liabilities with current assets), one can conclude that the municipal enterprise is not able to fully cover its short-term liabilities with its current assets in all reported financial years.

²⁷ “TALSU ŪDENS” Ltd report on water management in Virbi Rural District, Talsi Region, chapter IV “Wastewater Treatment”, p. 10.

²⁸ Decision No 676-047/2019 of the State Environmental Service of 18 June 2019 “On the actions to be taken to eliminate non-compliances”.

²⁹ 22.05.2019. Report on test results No 676-016/2019 of the State Environmental Service of 22 May 2019 for Talsi Region wastewater treatment plant in Pastende.

³⁰ “TALSU NAMSAIMNIEKS” Ltd.

³¹ The summary of the balance sheets of dwelling houses submitted in the e-mail letter by “TALSU NAMSAIMNIEKS” Ltd on 18 February 2020.

³² Article 65.2, 66.1 of the Law on the Management of the Shares and State-owned or Municipal enterprises of a Public Entity, Article 21.1.8.4, 86, 69.1.5 of the Law on Local and Regional Governments.

³³ National Development Plan for 2014–2020 (Approved at the Saeima sitting on 20 December 2012).

³⁴ Sub-paragraph a) and b) of Article 58.1.2 of the Law on the Management of the Shares and State-owned or Municipal enterprises of a Public Entity.

³⁵ Sub-paragraph f) of Article 58.1.3 the Law on the Management of the Shares and State-owned or Municipal enterprises of a Public Entity.

³⁶ Sub-paragraph h) of Article 58.1.3 of the Law on the Management of the Shares and State-owned or Municipal enterprises of a Public Entity.

³⁷ Sub-paragraph a) and b) of Article 58.1.2 the Law on the Management of the Shares and State-owned or Municipal enterprises of a Public Entity.

³⁸ Sub-paragraph h) of Article 58.1.3 of the Law on the Management of the Shares and State-owned or Municipal enterprises of a Public Entity.

³⁹ Letter No 4-4/334 of the National Electronic Mass Media Council of 14 April 2020 referring *provision of the opinion*.

⁴⁰ Article 14 of the Law on the Management of the Shares and State-owned or Municipal enterprises of a Public Entity (Wording of 1 January 2020).

⁴¹ The recommendations are mainly provided to the Regional Government and municipal enterprises where the Regional Government owns 100% of the shares.