



How does Alūksne Regional Government work?

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Audit report

“How does Alūksne Regional Government work?”

Compliance audit “Regularity and efficiency of the Alūksne Regional Government's actions with financial resources and property by ensuring the fulfillment of the municipal autonomous functions”

18 May 2022

The audit was performed based on audit schedule No 2.4.1-7/2021 of the Fifth Audit Department of the State Audit Office of 30 April 2021.

The cover design includes a photo from the personal archives of the auditors.

Summary

Motivation

The activities of each local or regional government must be organized in a planned manner, property and financial resources must be handled efficiently and under the requirements specified in laws and regulations, including respecting both its rights and obligations. The activities of the local or regional government must also be organised following the goals specified in the development-planning documents by setting specific tasks to be performed and allocating funding in the budget for their implementation.



The audit was performed to help Alūksne Regional Government improve its operations.

The activities of the Alūksne Regional Government (hereinafter referred to as the Regional Government) are related to the performance of functions essential to the population in socially and economically sensitive areas. Therefore, when planning the development of the region, the Regional Government must identify and assess the resources at its disposal, offer a clear vision and solutions for their effective use.

Although the geographical location and the relatively long distance to the Latvia's capital, Riga, of 200 km are likely to have an impact on the economic activity, financial benefits and availability of resources of the Regional Government for both population and businesses, the main preconditions for attractive and high-quality living in the region are under the responsibility of the Regional Government to the greatest extent.

The development-planning of the Regional Government, as well as the expenditures for the provision of functions, affect the daily life of the regional population and certain areas, especially regarding certain projects implemented by the Regional Government and the use of finances for the development on infrastructure, which result in some public dissatisfaction and complaints received about them.

While performing the functions specified by law, the Regional Government handles the money paid to the municipal budget by the residents of its region (taxpayers), thus the regional population has the right to expect that the Regional Government handles its property and financial resources as a diligent and decent owner.

The State Audit Office has performed several audits in local and regional governments, within the framework of which the compliance of the performance of certain autonomous functions of local and regional governments with the requirements of laws and regulations has been verified. The audit results show that several systemic problems are still being identified in local and regional governments, which must be addressed for local and regional governments to manage their funds both legally and efficiently and economically.

Insufficient understanding of the development of local or regional government and the possibilities of fulfilling its functions has often been found in local and regional governments. The latter do not include their issues in the relevant planning documents, so that they can be used in practice as management tools for the fulfillment of the set tasks and achievement of the set goals.

The audit was carried out to draw the attention of the Regional Government to the tasks, activities to be performed, and responsibilities while performing its autonomous functions, implementing the development planning of the region and handling financial resources in the interests of all the residents of the region while implementing the plans.

Main conclusions

When performing the functions specified by law, the Regional Government must observe the principles of transparency, equality and act for the benefit of the regional population. In addition, the local or regional government's action with the money paid in personal and business taxes and allocated from other local and regional governments and state institutions must aim at achieving the goals set by the local or regional government and at the lowest possible costs.

From 2019 to 2021 covered by this audit, the decisions and actions taken by the Regional Government were not always founded on the population needs-based targets and were not always traceable and transparent. This is evidenced by the long-term operation without the basic documents of medium-term development planning and the implementation of projects that were not included in them. It is possible that the drawbacks in the conceptual vision of the development of the Regional Government make it difficult to obtain the potential return from the investments made by the Regional Government. Thus, for example, in six projects implemented by the regional government to support entrepreneurship, for the implementation of which the ERDF funds and the own municipal budget funds have been allocated, which were thoroughly assessed during the audit out of more than 7.5 million euros or spent on the projects/ activities (that is 44% of 17 million euros spent for the projects/ activities during the audited period). If the situation does not change, financial return is expected to be only less than 1.4 million euros during the life cycle of these projects.

Significant irregularities have been made in determining the remuneration of the employees of the Regional Government administration, as the total amount of 154,244 euros spent without traceable substantiation in several cases, including 50,848 euros in bonuses and 103,396 euros for the time of performing the main job during which the employee has worked in the committees established by the Regional Government.

Municipal activities and budget planning

Although the Regional Government had already reached the targets and performance indicators set in the Development Program of Alūksne Region for 2011–2017 (hereinafter referred to as the Development Program 2011-2017) in 2017, it has not updated its programming documents, including the setting of new targets and performance indicators. Thus, the Regional Government did not fulfil the objective set in the Spatial Development Planning Law to ensure that the development of the territory was planned so as to increase the quality of living environment, use the territory and other resources sustainably, efficiently and rationally, and develop the economy purposefully and in a balanced manner.

From 2019 to 2021, the Regional Government had still planned its activities pursuant to the Development Program 2011–2017 based on the needs of the population identified more than a decade ago (studying the current needs of the population is an important factor in the development planning of the Regional Government, which is also confirmed by the current situation with the reorganization or termination of Alūksne schools). The Regional Government had also not taken into account the strategic settings binding for the Alūksne Region and stipulated in the Vidzeme Planning Region Development Program for 2015–2020 included in the framework of the medium-term priority “Public transport and roads”.

Only at the end of the 2021, the new Development Program of the Regional Government for 2022–2027 was approved by setting new targets and performance indicators characterising their achievement.

The audit established that during the audited period, the Regional Government based its development planning only on the Investment Plan, which was updated annually and indicated the projects to be implemented and the results to be achieved thereunder.

When assessing the implementation of the projects and activities included in the Investment Plan, one concluded that the Regional Government managed to implement 58% of the planned projects (which is 65% of the total funding spent on projects and activities).

The formation of the municipal budget is generally traceable, however, 1/5 of the projects planned in the budget of Regional Government for 2021 for the total amount of 124,289 euros cannot be found in the Investment Plan. As a result, neither the regional population nor the auditors of the State Audit Office can trace the principles according to which the projects not included in the Investment Plan but implemented by the Regional Government have been selected, for instance, “Ensuring the availability of high-quality engineering infrastructure (airing trail from Ozolu Street to Ezermalas Street along the Alūksne Lake)”.

Project implementation

The audit provided an in-depth assessment of six projects implemented by the Regional Government to support entrepreneurship, for the implementation of which more than 7.5 million euros were spent including 2.9 million euros or 39% of the Regional Government’s budget.

The Regional Government implemented the projects with the aim to promote business development and increase private investment with the projects resulting in the infrastructure suitable for business (manufacturing premises, roads, engineering communications) built, part of which was intended to be leased to economic operators. However, the Regional Government did not succeed in finding tenants. Out of the six implemented projects evaluated, in three projects:

- At one site (paved square on 1A Rūpniecības Street) one has not managed to find a tenant even after the organization of two auctions (no bidders applied);
- One site (production and warehouse buildings at 1A Rūpniecības Street) is leased to the only bidder who uses only a part of the leased site;

- One site (premises in the Multifunctional Service Building on Pilssala in Alūksne) is leased to the only bidder only one and a half years after the site was commissioned.

Although the laws and regulations allowed the Regional Government to clarify potential tenants already at the project development stage, the Regional Government had used such a practice in only one project.

In its turn, before the implementation of the project *“Improvement of the infrastructure for the development of the industrial territory in Jaunlaicene Village of Alūksne Region”*, the Regional Government has accepted the land plot necessary for the project as a gift from an economic operator. In the result of the project implementation, the Regional Government has made improvements to the territory and leased it. The audit has established that the economic operator who donated the real estate to the Regional Government and the economic operator who acquired the right to use the object constructed in the project has the same beneficiary. The above-mentioned indicates that the Regional Government did not need to accept a land plot as a gift to fulfil the functions of the Regional Government or to meet the needs of its population, whose intended use is an industrial and production territory and which, after being acquired by the Regional Government, is used for the economic activity of a wood processing company. Such actions taken by the Regional Government indicate that the purpose of accepting the gift of real estate was only to implement a project to create the necessary infrastructure for business in the interests of certain enterprises.

In addition, the above is reiterated by the fact that the Regional Government entered into an agreement of 23,527.24 euros for the design of the electricity supply connection in this real estate even before receiving the gift from the economic operator.

In the opinion of the auditors, another project intended by the Regional Government has a risk of significant losses to the municipal budget. Although the Central Finance and Contracting Agency (CFCA) did not previously support one of the most ambitious investment projects of the Regional Government *“Establishment of a Health Promotion Services Centre”* indicating an overly optimistic view of the project, which does not correspond to the actual situation in the Regional Government, the Regional Government plans to implement it by including it in the Investment Plan of the new Alūksne Region Development Program 2022-2027. If the project, for which the CFCA has already refused to conclude an agreement on the implementation of the project, will not be implemented in the near future, then the financial resources already invested by the Regional Government in the project of 150,493.75 euros may have to be written off in losses.

Financial benefits from leased infrastructure sites

To ascertain the successes or failures of the projects implemented by the Regional Government and to gain valuable lessons for further work, it is important that the Regional Government monitors the achievement of the planned results within the projects. Unfortunately, it is not clear to the management and the responsible specialists of the Regional Government in general what the total benefit of the implemented projects for business support is, because the of the

Regional Government does not verify the actual fulfillment of the planned benefits calculated in the project applications.

As one of the most significant benefits because of the implementation of six projects, the Regional Government planned to create 90 new jobs in their life cycle and a corresponding increase in revenue of 2.8 million euros of personal income tax. However, according to the auditors' estimate, using the information received from the SRS, the Regional Government will receive no more than 1.7 million euros or 61% of planned revenue in the most optimistic scenario given that only the residents declared in the Regional Government are employed in all new jobs created by businesses.

To achieve the objectives of the project implementation, the Regional Government had concluded three lease agreements during the audited period, in which economic operators were obliged to create new jobs and make investments in their business in addition to the rent. However, it has been concluded during the audit that only one of the enterprises has fulfilled the requirements set out in the lease agreement regarding the creation of new jobs and investment in its business. As a result, 44 jobs were created from the planned 47 new jobs, but economic operators have invested 1.1 million euros in their business out of the planned 1.75 million euros.

In addition, the rent paid by economic operators does not cover even the depreciation of the leased sites, which, according to the auditors' estimates, will affect the return on projects negatively implemented by the Regional Government during the term of the lease (i.e., no investment will be repaid and one will overpay for the maintenance of built infrastructure) of 308,368 euros, including:

- 25,424 euros for the site built under the project *“Development of a multifunctional service building at Pilssala”*;
- 165,233 euros for the site built under the project *“The first stage of the development of the industrial building territory of Alūksne City”*;
- 117,711 euros for the site built under the project *“Improvement of infrastructure for the development of an industrial building territory in Jaunlaicene Village of Alūksne Region”*.

The fact that the rent of the sites, determined by using comparable market transactions and based on the income and cost approach applied by a certified appraiser does not cover even the depreciation of the constructed infrastructure during the operation of the sites, indicates that the construction of such lease sites at their own expense would be economically disadvantageous for economic operators.

Municipal costs for remuneration

In the period from 1 January 2019 to 31 December 2021, the Regional Government had spent 31.5 million euros including miscellaneous bonuses of 1.2 million euros.

When considering the justification for granting a bonus on a random basis, it has been concluded that the approach to granting the bonus does not create confidence in the justified

use of public funds, because the total amount of the bonuses granted of 50,848 euros without an evaluable justification, including:

- 30,723 euros for the personal contribution to the work and the quality of the work without evaluable justification;
- 15,226 euros for overtime work, although the amount of work performed cannot be traced;
- 4,899 euros for replacements for staff for whom no such bonus is payable, in accordance with their job description.

The executive director of the Regional Government instructed the institutions where overtime pay was paid to evaluate the organization of working time, including the job descriptions of employees and the need for replacement during the absence of employees already during the audit.

There are 12 committees established in the Regional Government, in which the appointed employees of the Regional Government are paid for the simultaneous performance of two jobs during work, that is, for full-time work and work in a committee, without ensuring accurate accounting of the time worked, and therefore one cannot trace when the time devoted for working in the committee has been worked at main job instead. According to the auditors' estimate, the Regional Government has spent a total of at least 103,396 euros on the remuneration of employees for the time worked at main job when they actually worked in the committee.

All employees in the Regional Government are evaluated every year. However, under equal conditions of the highest rating obtained, only the employees of the Regional Government administration and heads of institutions have had their monthly salary increased during the audited period, which is approximately 60 out of 300 employees who have received the highest rating. In addition, the practice established in the Regional Government to increase the monthly salary for one year instead of setting a bonus based on the evaluation results, does not correspond to the essence of the remuneration distribution in the opinion of the State Audit Office, id est, the fixed part - monthly salary, variable part - bonuses, premiums, and cash prizes.

Disposal of real estate

In accordance with international trends in real estate management, the Regional Government must manage the real estate that is necessary for the implementation of its functions. On the other hand, that real estate, which is not necessary for the implementation of its functions during the relevant period, but has prospects for future use, should be leased, but non-viable real estate should be expropriated so as not to cause losses to the Regional Government.

Unfortunately, the Regional Government does not define its property evaluation criteria, decision matrix and process map, which would help to evaluate the potential of real estate use in relation to the objectives and criteria set by the Regional Government itself such as quality, suitability, cost-effectiveness, etc. Moreover, the Regional Government has not accumulated adequate data to make informed decisions on the management of real estate sites.

Consequently, the Regional Government has not ensured all preconditions so that the real estate necessary for the provision of its functions is not transferred for expropriation, as there are no clear criteria for determining whether the real estate is to be expropriated. The assessments of the necessity of real estate do not indicate the justification, but only the final conclusion is indicated - *it is not necessary to ensure the functions of the Regional Government*. The situation when most of the Regional Government's apartments are expropriated by citing their poor technical condition as a reason, is also assessed critically, as the functions of the Regional Government include providing assistance to residents in resolving housing issues. According to the information provided by the Regional Government, there are currently more than 100 residents of the Regional Government on the waiting list for the Regional Government's apartments.

At the same time, the Regional Government is one of the few regional governments in Latvia that has posted information on its website about real estate to be expropriated, which can be considered as an example of best practice.

Still, there are deficiencies in the organization of the real estate expropriation process. The Regional Government applies a different approach to the inclusion of expropriation costs in a determined price, which results in unequal treatment of people who purchased the Regional Government's real estate.

The timely publication of information on the organization of auctions in newspapers is also not always provided, thus raising awareness of the broadest possible public about the organized auctions is not promoted.

Transport and fuel costs

The audit has concluded that the Regional Government has paid 32,700 euros for fuel during the audited period by concluding annual road transport lending agreements with its employees, without specifying any duties for which a vehicle was required.

When assessing justification documents, which show the substantiation for the kilometres travelled, has led to the conclusion that the purpose of the trips is general or not indicated at all. In addition, just enough mileage to write off the fuel is shown, and different mileage (up to twice) is shown on the same routes. For example, the route from Dārza Street to Alūksne Manor Park, from Alexander Pavilion to Dārza Street 11 can be covered by driving 14 km or 28 km.

When examining the documents regarding the organization of the purchase of goods and services and, assessing the compliance of the spending with the requirements of the Public Procurement Law during the audit, no significant irregularities have been established.

Key recommendations

Based on the findings of the compliance audit and our conclusions, we invite the Alūksne Regional Government to eliminate the irregularities identified during the audit.

To further ensure the development planning and implementation of the planned projects, as well as the activities of the Regional Government compliant with the laws and regulations, the State Audit Office recommends the Alūksne Regional Government to perform the following activities:

- Ensure the traceability of actions with public funds by developing the budget in connection with what is indicated in the development-planning documents;
- Improve the project/ activity management system;
- Safeguard compliance with the legal requirements when determining and calculating the remuneration, including by indicating an evaluable justification in the case of granting bonuses;
- Ensure compliance with the legal requirements upon expropriation of real estate, including by establishing clear criteria according to which one shall determine whether real estate is to be transferred for expropriation;
- Assess the need to enter into lending agreements with employees regarding the use of a personal vehicle for the performance of job responsibilities.



To eliminate the deficiencies and inconsistencies identified during the audit, the Regional Government must implement several recommendations.
