

## Summary



### 1.1. Research question

In the last 10-15 years, municipal organisation in Norway has become increasingly diverse. The municipalities have moved some of their service provision from the part of the municipality administered by the chief municipal executive (“the municipal treasury”), to municipal enterprises, inter-municipal cooperation and/or companies and municipal limited liability companies. In short, the municipalities have become “municipal groups”.

The research question for this project is whether there is sufficient control over these municipal groups. Statistics Norway (SSB) defines the municipal group as the municipal treasury, municipal enterprises (KF) inter-municipal partnerships (IKS) and inter-municipal cooperation, as described in Section 27 of the Norwegian Local Government Act, with its own separate accounts.

There are currently no rules governing reporting at the municipal group level to the municipal council, nor are there any requirements concerning preparation of a budget for the municipal group. The only requirements concern budgeting and reporting to the municipal treasury.

Management of these groups is a major concern for the municipalities. This project is limited to the administration by elected representatives of the municipal finances through financial plans and annual reports and/or annual financial statements. This report describes how group data is currently used in the municipalities’ governing documents and compares the current administrative practices with what we regard as best practice. In addition, the report also discusses the ways in which the municipal group ought to be delimited and the requirements concerning management of the group that ought to be specified to the municipalities. The regulations in Norway are compared with those in our neighbouring countries.

The use of the consolidated financial statements is the main topic of this project. The report does not consider the technical aspects of accounting that may arise in the production of consolidated financial statements in municipalities.

### 1.2. Methodology

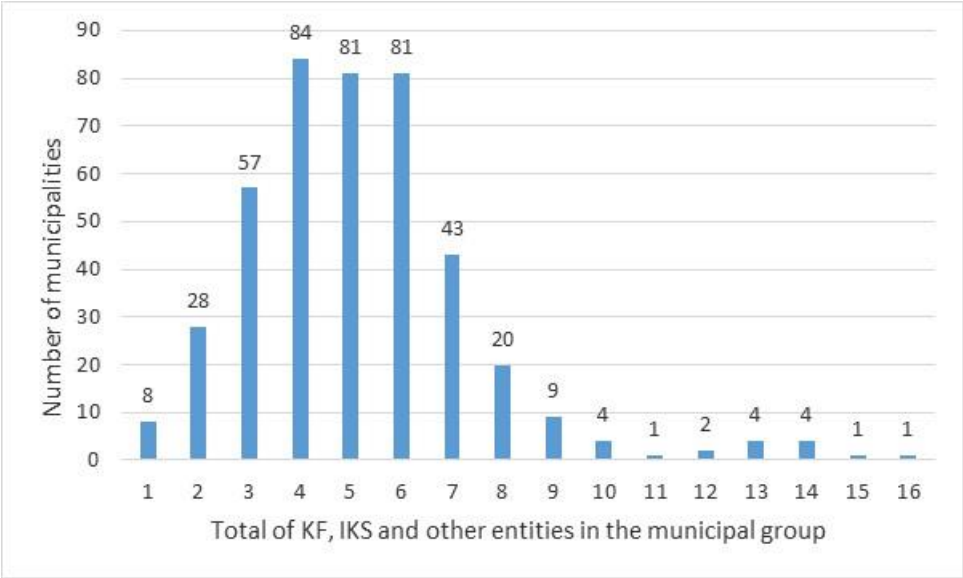
The annual report and financial statements for 2014 have been reviewed in 30 municipalities, and we have examined whether the municipalities present relevant administrative data in these documents, for both the municipal treasury and the municipal group. We expected that municipalities with good financial management would use the most common key financial figures and unit prices. The use of key figures for operating margin, debt-equity ratio, distributable reserves as a percentage of operating revenue and net operating expenses per inhabitant have been surveyed. We also expected that the municipalities that ought to use municipal group data in their administration should be the largest municipalities with the most economic expertise, and the municipalities with the greatest deviation between key figures for the municipal treasury and those for the municipal group.

In addition to the review of documents, we have conducted interviews in eight municipalities (case study municipalities) about administrative techniques and the ways in which the consolidated financial statements are presented. These in-depth studies have covered the municipalities of Oslo, Bergen, Stavanger, Sandnes, Molde, Ålesund, Moss and Drammen.

At the national level, we have studied how much activity the municipalities have placed outside of the municipal treasury.

**1.3. Main findings**

The examination of corporate data and the municipal financial statements for 2014 revealed the need for consolidated financial statements in Norwegian municipalities. All of the municipalities are organised into a group structure in accordance with Statistics Norway’s definition, and all of the municipalities are co-owners of at least one inter-municipal partnership. In addition, a third of the municipalities have established one or more municipal enterprises. The number of “subsidiaries” in the municipalities varies from one to sixteen, cf. the figure below.



**Figure 1: Illustration of the number of municipalities with 1 – 16 “subsidiaries” in the municipal group. Source: Prepared by BDO based on selected data from the Register of Business Enterprises and data received from Statistics Norway.**

Corrected gross operating expenses in business enterprises outside the municipal treasury constitute five per cent of the total expenses in the municipal groups. A steadily increasing share of the loan debt has been transferred out into subsidiaries in the past ten years. One out of ten municipalities has major differences between key figures for its municipal treasury and municipal group.

The examination of the annual financial statements for 2014 in 30 municipalities shows that most of the municipalities use key financial figures in their governing documents. This makes the financial material more comprehensible to the elected representatives. Only two of the thirty municipalities included none of the four selected key financial figures.

On the other hand, few municipalities used consolidated figures in their annual report. Only four out of thirty municipalities included at least three of the selected key figures taken from the municipal group, and only eleven of thirty municipalities presented net operating result as a percentage of operating revenue for the group. It is our impression that many annual reports appear somewhat unstructured in that it is not clearly evident when they are using figures from the municipal treasury and when those figures are from the municipal group. Only two municipalities (Oslo and Moss) make a clear distinction in their annual reports between reporting for the municipal group and reporting for the municipal treasury.

In the largest municipalities, important key financial figures are budgeted. Seven of the eight municipalities in our case study budgeted one or more of the key figures for the municipal group in

the financial plan for 2016–2019. It is most common to budget net loan debt as a percentage of operating revenue.

The studies revealed that the administration in the municipalities is uncertain of its role as corporate management. Only five out of thirty municipalities had prepared any form of consolidated financial statement for 2014. Only one of the municipalities in our case study (Bergen) drew up a consolidated financial statement for 2014 in keeping with Statistics Norway's definition of the municipal group. Among the municipalities in our case study, only two have defined a clear role for a chief financial officer (Oslo and Bergen). These two municipalities have also drawn up reporting instructions, and responsibility has clearly been taken for quality control of the consolidated financial statements. In the other municipalities in our case study, the consolidated financial statements from Statistics Norway were used in economic analyses of the 2014 financial statements without checking the accuracy of the figures.

It is extremely uncertain whether the requirements in the regulations governing auditor certification of the conversion of financial statements from the Norwegian Accounting Act to the Norwegian Local Government Act are being complied with in inter-municipal partnerships and municipal enterprises. The municipalities in our case study had little overview of this, especially with regard to the inter-municipal partnerships that prepare their financial statements themselves.

If the municipalities were to be required to draw up consolidated financial statements, the municipalities in our case study think that this ought to be based on the delimitation that is utilised by Statistics Norway. The most natural entities to include in the municipal group are the municipal enterprises, the inter-municipal partnerships and inter-municipal cooperation with its own separate accounts. There is broad consensus that, strictly speaking, municipal limited companies ought to be included in the municipal group, but achieving this still appears to lie a long way ahead. In the municipalities in our case study, we only found one example where important municipal tasks have been delegated to a limited company, namely BIR AS (Bergen interkommunale renovasjonsselskap). The biggest challenge that the municipalities face in drawing up consolidated financial statements at present is the possibility of receiving accounting data from the separate entities in the municipal group in time to report the financial statements by 15 February.

The project cannot draw a clear conclusion about the costs of requiring the municipalities to draw up consolidated financial statements in accordance with Statistics Norway's definition. The City of Bergen is probably the only municipality that is doing this at present. The experiences from Bergen are that it requires some work to introduce good routines for gathering and performing quality control on the financial statements from municipal companies, but that thereafter the annual costs involved in consolidation are small. This is also our assessment. As long as the consolidation is based on defined types and chapters, the actual comparison of the municipal financial statements should not require many extra resources.

The examination of practices in our neighbouring countries showed that Finland and Sweden specify requirements with regard to consolidated financial statements. In Finland, the requirements for consolidated financial statements are the same for municipalities as for companies, and the municipalities also draw up their financial statements in accordance with the same rules that apply to the private sector. Thus, an equivalent account must be submitted for the municipal group as for the municipal treasury. In Sweden, municipalities are also required to submit consolidated financial statements, but according to separate municipal rules. Only large companies (with a turnover or balance amounting to at least five per cent of the municipal treasury) are supposed to be consolidated there.

#### 1.4. Recommendations

The project findings give grounds for several recommendations with regard to practices in the municipalities as well as improvements in the regulations. The recommendations shall provide better administration by the elected representatives in the municipalities. The most important recommendations are shown below, and a complete overview is presented in chapter 8.

*The municipalities should use key financial figures in the governing documents.*

We think that the municipal annual reports ought to include key financial figures, both for the assessment of their own financial status and so that they can be compared with other municipalities. This will improve the overall administration in which elected representatives play the main role. Use of key financial figures in the annual report should be required by laws or regulations.

*The municipalities should use the consolidated financial statements in their governing documents.*

The municipalities ought to base their administration on the consolidated financial statements when companies are established and municipal services are outsourced to them. The governing documents for the municipality should clearly distinguish between targets and results for the municipal group and for the municipal treasury. In this way, the governing documents may become a clearer tool for elected representatives' governance of these companies.

*Conversion of financial statements must be certified by an auditor.*

It is important that the conversion of financial statements from the Accounting Act to the Local Government Act be performed in a satisfactory manner. Municipalities with municipal undertakings or inter-municipal partnerships that prepare financial statements pursuant to the Accounting Act must ensure that the method for conversion of the financial statements is certified by an auditor. This ought to be required by laws or regulations.

*The municipalities themselves should draw up consolidated financial statements according to Statistics Norway's model.*

We consider that municipalities ought to prepare consolidated financial statements themselves, and the municipalities must take their own responsibility for the quality of their consolidated financial statements. Accounts and key figures from Statistics Norway must not be used as uncritically as they are today. Data must be presented for both the municipal treasury and the municipal group. The municipalities must define a clear role for the chief financial officer with authority to administer the reporting of financial statements in "the subsidiaries" by the deadline for reporting to Statistics Norway of 15 February. Preparation of municipal consolidated financial statements ought to be required by laws or regulations.

*Statistics Norway's delimitation of the municipal group is correct in the short term.*

Statistics Norway defines the municipal group as the municipal treasury, municipal enterprises, inter-municipal partnerships and cooperation with their own separate accounts as described in Section 27. This definition includes most of the municipal provision of services. It is a delimitation that provides good grounds for comparing municipalities with each other when it comes to key financial figures and unit costs. This is the most important objective of submitting consolidated financial statements.