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The consolidated debt of local government units in Poland

Introduction

The indebtedness of public finance entities (LGUs) has attracted the broad interest of researchers and publishers. So far, scientific studies have examined the scope and quality of information on indebtedness, as presented in LGU's financial reports, to a limited extent. Thus, there is a shortage of studies providing a comprehensive analysis of LGU indebtedness, including not only the budget debt level but also debt in all LG subordinate units having their own legal personality and companies which have been set up or owned by LGUs. We should remember, however, that the public sector with its special form and activity is subject to specific laws, i.e. the Public Finance Law, whereas accounting and bookkeeping principles and plans of accounts are defined in the Regulation of the Minister of Finance (Turyna, Koeppl-Turyna, 2018). Public sector financial reporting in general, and LGUs reporting in particular, has been evolving to become similar to the financial reporting used in the commercial sector. This is a result of the shift from the administration of public funding to the management of funds and, consequently, the growing demand for reporting financial information (Kaczurak-Kozak, 2016).

The goal of the paper is to examine the entire population of Polish LGUs, in particular large cities, as regards their consolidated debt level, and to compare the scale of the consolidated debt with the budget debt, especially that the latter is subject to statutory restrictions. An auxiliary goal is to define the risks related to the consolidated LGU debt. The 2006–2016 consolidated LGUs balance sheets and budget financial reports made available by the Ministry of Finance (Ministerstwo Finansów, 2018). provided the analytical material for the study.

1. Debt and debt limits in LGUs reports and budget documents

The LGU debt is shown in the Rb – Z Report (a quarterly report on liabilities by debt titles and guarantees and warranties). In the report, LGUs disclose their debt related to securities, credits and loans, deposits and liabilities due. The Rb – Z report includes the nominal debt value at the end of the reporting period broken down by debt titles. The LGU debt at the end of a year is also presented as a financial liability in the balance sheet pertaining to the performance of the budget, and the value of the debt should be calculated based on the adjusted purchase price, understood as the purchase price at which the financial asset was first recorded in the accounting books (fair value), reduced by the repayment of its nominal value (capital) adjusted by the aggregate discounted difference between the initial value of the asset and its value on maturity calculated using the effective interest rate and reduced by write-downs. This may lead to generating a different LGU budget debt, in other words, there might be differences in the figures included in the Rb – Z Report and the balance sheet on the LGU budget performance. The difference may occur since the valuation based on the nominal value and presented in the Rb – Z Report vary from the valuation based on the adjusted purchase price shown in the balance sheet. According to the analysis of the LGU regulations pertaining to the presentation of figures in the LGU budget resolution and budget performance report, the valuation is not a mandatory item to be presented in both documents. The annual budget performance report includes revenue and expenditure items at the closing of budget accounts at the same level of detail as presented in the LGU budget resolution, whereas the budget resolution comprises plans of revenue, expenditure, income and disbursements, as well as appendices that include budget subsidies, education accounts, income and cost projections for budgetary establishments and EU funded projects. In practical terms, an LGU provides information about its debt in the descriptive part (introduction) of the budget or the annual budget performance report. However, the Multi-Year Financial Projections (MFP) requires the amount of the LGU debt to be presented together with the manner in which the debt is going to be repaid. The MFP is developed for the same period as the current or expected debt maturity. The WFP form includes such items as the debt amount, complementary information about the debt and its repayment which specifies the amount to be repaid, payment of liabilities due from previous years, and payments related to guarantees and warranties at their maturity. LGUs are required to present information related to the MFP (for supervisory bodies) in its electronic version using BeSTi@. Moreover, LGUs have to use the same application to transfer reports on revenues, expenditures, receivables, and liabilities (i.e. RB reports). For control purposes, the BeSTi@ system contains functionalities examining data included in budget performance reports.

Since 2014, the possibilities for funding LGU activity using debt have changed. The permitted indebtedness of 60% of the LGU revenue was replaced by separately calculated indices determining the annual spending on debt servicing (Dylewski, 2014). Thus, the local council cannot approve a budget which, in a given budget year and following years, may cause that the ratio of debt servicing (capital and interest), guaranties and warrantees and the revenue exceeds the ratio between the arithmetic mean of current revenues plus asset sales income and current expenditure and the revenue for three years preceding a given budget year. While calculating the ratio, certain exemptions are taken into consideration as well, such as redemption of securities, payment of credit and loan instalments together with interests due and discounts, both issued or contracted according to the debt finance programme, and projects or tasks for which at least 60% of the cost is funded by the EU.

Based on the MFP applicable to LGUs as of 31 March 2018, the arithmetic mean is calculated for statutory debt servicing limits (including statutory exemptions). In 2018 the resulting figure was 9.99% of LGU revenue (limit), whereas the arithmetic mean of the total debt and liability servicing after taking into account 2018 exemptions was 3.47% of LGU revenues (indicator). This means that Polish LGUs have used one third of their statutory debt limit in 2018. The situation has been determined by a number of factors such as the lowest interest rates ever, growing LGU current revenues which translate into a current surplus and the periodically lower demand for returnable financing.

2. Financial liabilities in LGU consolidated balance sheet

Financial reports present LGU property and financial standing and are used as the basis to examine compliance of reported data with those presented by LGUs in their budget performance statements (Adamek-Hyska, 2016). Debt regulations applicable to LGUs do not cover all types of debt contracted that finally contribute to the level of indebtedness. Therefore, the indebtedness of the sub-sovereign level is higher than the official figures (Langer, 2014). It should be emphasised that some LGUs tend to use legal and financial arrangements to reduce the debt burden on their budgets and resort to financial operations that do not bring any funds but generate long-term financial liabilities (Jastrzębska, 2017). For example, while preparing for EURO 2012, the City of Wrocław decided that some investment would go through municipal companies. The decision resulted in the increased debt of those companies and indirectly boosted Wrocław's exposure, since the city had to use its budget to increase capital in its municipal companies (Ładysz, 2012). In this context, it is worth noting that the analyses and studies on LGU indebtedness neglect the issue of LGU consolidated balance sheet in general, and in particular the scope of debt information included in the consolidated report.

It is also important that only two of the largest LGUs in Poland published their consolidated balance sheets (see Table 1).

Table 1.

The largest LGUs in Poland that published their 2016 financial reports (November 2017)

City	Financial report published	Consolidated balance sheet published
Białystok	–	–
Bydgoszcz	–	–
Gdańsk	+	–
Katowice	+	–
Kraków	–	+
Lublin	+	–
Łódź	+	–
Poznań	+	–
Rzeszów	+	–
Szczecin	+	–
Warszawa	+	+
Wrocław	–	–

Source: own material based on BIP JST.

The LGU consolidated balance sheet form, which is a part of the LGU financial reporting, was introduced in Poland in late 2001. It was not required, however, to be published or transferred to the local council or a supervisory body. As late as 2006 the legislation required the consolidated balance sheet to be submitted to the Regional Chamber of Audit, a supervisory body. The consolidated balance sheet shows the assets and finance of the LGU as a dominating party, as well as the financial figures from the balance sheets of the following organisational units: budget entities, including the LGU administration office, budget establishments, cultural institutions answerable to the LGU, independent public health care establishments answerable to the LGU, and commercial law companies in which the LGU is a shareholder. Financial figures included in the LGU consolidated balance sheet can be consolidated using full and equity methods. In the case of full consolidation, figures attributable to the dominating units are consolidated with those of subordinate organisational units by adding full values of particular balance sheet items, which is then followed by adjustments and exclusions applicable. The goal of the latter is to eliminate the financial consequences of mutual commercial settlements, i.e. mutual receivables and liabilities between LGU organisational units, shares in companies and write-down adjustments to LGU owned shares, dividends from companies under full consolidation, and the value of land between the LGU and independent public health care establishments and cultural institutions, and the settlement of the perpetual usufruct of land between the LGU and companies,

and the unrealised profit from the sales of fixed assets between units under full consolidation. The equity method may cover shares in companies where the LGU is a minority shareholder. Most importantly, as regards the LGU indebtedness, the consolidated balance sheet includes an item of long-term financial liabilities and short-term financial liabilities which consolidate budget debt levels of the LGU administration office and all budget units, budget establishments, cultural institutions, all public health care establishments and commercial law companies to which the LGU is a shareholder.

Table 2.
Audit of 2016 financial reports from the largest cities in Poland

City	Audit of financial report	Audit of consolidated balance sheet
Białystok	+	–
Bydgoszcz	+	–
Gdańsk	+	–
Katowice	+	–
Kraków	+	–
Lublin	+	–
Łódź	+	–
Poznań	+	–
Rzeszów	+	–
Szczecin	+	–
Warszawa	+	+
Wrocław	+	–

Source: own material based on BIP JST.

Despite the wide range and importance of the figures included, the LGU consolidated balance sheet is not a part of the reports subject to analysis, debate and approval of the local council. According to information in Table 2, only the Capital City of Warsaw decided to have a full external audit of their financial reports, including the audit of their consolidated balance sheet and the relevant opinion of a certified accountant.

3. LGU budget debt and consolidated debt in the balance sheet

The examination of Polish LGUs debt levels covered the period of 2006–2016. It included LGU figures from the budget performance reports in the same period. The data were collated with those included in the 2006–2016 consolidated balance sheets. The comparative analysis additionally included aggregate and individual

data attributable to specific groups of LGUs and selected large LGUs that enjoy county status. According to the examination, at the end of 2016 the consolidated debt of LGUs in Poland was PLN92,267,610,640. The amount exceeded their budget debt by PLN23,247,676,364, or by 33.7%. In the period concerned, the LGUs increased their budget debt from PLN24.9 bn to over PLN69.0 bn. In the same period, the consolidated debt grew from PLN32.4 bn to nearly PLN92.3 bn. The difference between the consolidated debt and budget debt was growing every year from PLN7.5 bn in 2006 to almost PLN15.6 bn in 2011 to reach nearly PLN23.3 bn at the end of 2016 (see Table 3). This means that the debt burden of Polish LGUs is more than one third larger than their budget debt; the latter has a statutory cap imposed based on the level of debt repayment and debt servicing cost.

Table 3.
Comparison of consolidated financial liabilities and budget debt in Polish LGUs
in 2006–2016

Year	Consolidated balance sheet – financial liabilities (1)	Budget performance report – budget debt (2)	Difference (1–2)	Ratio (1/2)
2006	32,464,834,137	24,949,121,870	7,515,712,267	130.1%
2007	35,228,509,666	25,876,097,086	9,352,412,579	136.1%
2008	38,243,892,463	28,774,694,104	9,469,198,359	132.9%
2009	51,755,918,904	40,294,344,286	11,461,574,618	128.4%
2010	71,296,526,579	55,093,871,830	16,202,654,749	129.4%
2011	81,327,072,757	65,756,468,387	15,570,604,370	123.7%
2012	86,854,380,552	67,834,514,978	19,019,865,574	128.0%
2013	89,458,230,636	69,159,111,886	20,299,118,750	129.4%
2014	93,985,398,078	72,109,871,088	21,875,526,990	130.3%
2015	96,251,243,789	71,634,679,846	24,616,563,943	134.4%
2016	92,267,610,640	69,019,934,276	23,247,676,364	133.7%
Mean	69,921,238,018	53,682,064,513	16,239,173,506	130.6%

Source: own material based on information from the Ministry of Finance.

The figures presented in Table 4 show that the consolidated debt in cities enjoying county status is proportionally higher than that of the entire group of LGUs in Poland. At the end of 2016 this was 144.0% of their budget debt. Nominally, the amount was nearly PLN47.3 bn, whereas the budget debt was PLN32.8 bn. The difference between the two figures reached its peak in 2015 with PLN15.8 bn or 47.7%.

Table 4.
**Comparison of consolidated financial liabilities and LGU budget debt levels
in cities enjoying county status in 2006–2016**

Year	Consolidated balance sheet – financial liabilities (1)	Budget performance report – budget debt (2)	Difference (1–2)	Ratio (1/2)
2006	14,114,475,326	11,296,200,347	2,818,274,979	124.9%
2007	15,509,503,209	11,258,690,371	4,250,812,838	137.8%
2008	17,414,052,959	12,775,288,120	4,638,764,839	136.3%
2009	25,391,208,436	18,729,819,106	6,661,389,329	135.6%
2010	34,127,624,761	23,437,522,580	10,690,102,181	145.6%
2011	37,880,905,740	28,074,897,002	9,806,008,738	134.9%
2012	42,335,942,687	29,578,688,547	12,757,254,140	143.1%
2013	44,173,267,256	30,884,557,948	13,288,709,308	143.0%
2014	46,508,602,376	32,446,426,109	14,062,176,267	143.3%
2015	49,057,326,744	33,210,279,513	15,847,047,231	147.7%
2016	47,268,005,303	32,821,721,504	14,446,283,800	144.0%
Mean	33,980,083,163	24,046,735,559	9,933,347,604	139.7%

Source: own material based on information from the Ministry of Finance.

At the end of 2016 the consolidated debt in cities that are members of the Union of Polish Metropolises (UPM) exceeded the budget debt by 43.0%. The difference between those parameters reached its peak in 2015 with PLN10.7 bn which accounted for 50.2% as presented in Table 5.

Table 5.
**Comparison of consolidated financial liabilities and budget debt
in the twelve biggest cities in Poland (UPM) in 2006–2016**

Year	Consolidated balance sheet – financial liabilities (1)	Budget performance report – budget debt (2)	Difference (1–2)	Ratio (1/2)
2006	8,406,928,223	7,258,251,302	1,148,676,921	115.8%
2007	9,400,810,634	7,090,002,296	2,310,808,338	132.6%
2008	10,524,776,997	8,283,498,201	2,241,278,796	127.1%
2009	16,313,032,815	12,560,605,758	3,752,427,056	129.9%
2010	22,496,664,646	15,428,454,672	7,068,209,974	145.8%
2011	24,897,180,891	18,679,123,821	6,218,057,070	133.3%
2012	27,713,095,747	19,482,962,670	8,230,133,078	142.2%
2013	28,580,978,401	20,059,491,278	8,521,487,123	142.5%
2014	30,092,938,211	20,816,246,896	9,276,691,315	144.6%
2015	31,908,192,709	21,241,907,176	10,666,285,532	150.2%
2016	29,967,500,071	20,956,603,838	9,010,896,234	143.0%
Mean	21,845,645,395	15,623,377,083	6,222,268,312	137.0%

Source: own material based on information from the Ministry of Finance.

Table 6 shows the differences between the budget debt and the consolidated debt in the twelve biggest Polish cities at the end of 2016. The consolidated debt was relatively higher in Poznań and Gdańsk, respectively 192.3% and 188.9% of budget debt. It is an interesting fact that Katowice had their consolidated debt more than PLN1.5 m lower than the budget debt, whereas Białystok does not show any difference between their budget and consolidated debt.

Table 6.
Debt and consolidated financial liabilities in selected Polish cities at the end of 2016

City	Budget debt (1)	Financial liabilities (2)	Difference (2-1)	Ratio (2/1)
Białystok	580,512,499	580,512,499	0	100.0%
Bydgoszcz	1,068,632,429	1,805,785,968	737,153,539	169.0%
Gdańsk	925,443,365	1,747,743,604	822,300,239	188.9%
Katowice	656,123,499	654,569,683	-1,553,815	99.8%
Kraków	2,222,577,546	3,366,159,325	1,143,581,779	151.5%
Lublin	1,275,192,804	1,590,473,697	315,280,893	124.7%
Łódź	2,745,920,924	3,843,332,832	1,097,411,909	140.0%
Poznań	1,376,579,187	2,646,764,129	1,270,184,943	192.3%
Rzeszów	606,729,585	712,177,901	105,448,316	117.4%
Szczecin	1,057,556,631	1,062,871,416	5,314,785	100.5%
Warszawa	5,677,258,765	7,900,200,722	2,222,941,957	139.2%
Wrocław	2,764,076,605	4,056,908,294	1,292,831,689	146.8%
Razem	20,956,603,838	29,967,500,071	9,010,896,234	143.0%

Source: own material based on information from the Ministry of Finance.

Conclusions

In Poland, LGUs directly or indirectly account for a debt of PLN92.3 bn. The amount is PLN23.3 bn higher than the regulated sub-sovereign budget debt. The additional indebtedness may, but does not have to be a source of risks, including the formal or political responsibility of LGUs for the timely servicing of the debt. If the repayment of the extra budgetary debt involved directly or indirectly transfers from the LGU budget, the additional debt should be disclosed and monitored by the LGU itself and subjected to a public debate. According to the studies, a drawback of the current LGU reporting system is that it completely ignores the role of the legislative body as regards the assessment and approval of the consolidated balance sheet. Figures that are crucial for the LGU stability and financial security included in the consolidated balance sheet, are neither publicised by the LGU nor audited. Finally, they are not subject to public opin-

ion and scientific research. One of the recommendations should be to establish a mandatory audit of consolidated balance sheets in the largest LGUs in Poland. The extended audit of financial reports in the public sector should improve the efficiency and effectiveness of public spending (Bucior, 2013). The fact that the financial report audit is not mandatory in the public sector diminishes the LGU responsibility for the management of funds (Adamek-Hyska, 2011). The above is particularly important in the light of the doubtful quality of data included in the financial reports in question (Bielak, 2017).

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The consolidated debt of local government units in Poland

Summary

All local government units in Poland have been analysed regarding their consolidated debt. The consolidated debt was compared with the budget debt which is subject to monitoring and statutory restrictions. The scale of extra-budgetary debt has been revealed as recorded in the balance sheet of a local government unit, a parent entity. In practice, the consolidated balance sheet and debt presented in it are not subject to debates and analyses. Local governments refrain from auditing and publicising of the consolidated balance sheet. The article describes the risks related to unlimited local government debt.

Key words: consolidated balance sheet, debt burden, local government units