VALSTYBĖS KONTROLĖ
BUDGET MONITORING

To the Seimas of the Republic of Lithuania

OPINION ON THE COMPLIANCE WITH THE FISCAL DISCIPLINE RULES OF MUNICIPAL BUDGETS DURING 2023–2024

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Vilnius

IN 2023-2024, MUNICIPAL BUDGETS COMPLIED WITH THE FISCAL DISCIPLINE RULES, BUT PROBLEMS WITH FINANCIAL REPORTING REMAIN

The National Audit Office, implementing the functions of the fiscal institution (hereinafter – NAO FI), submits to the Seimas an opinion on the assessment of compliance with the rules of fiscal discipline (hereinafter – FDR) municipal budgets attributed to the general government sector, in accordance with the Constitutional Law on the Implementation of the Fiscal Treaty of the Republic of the Republic of Lithuania (hereinafter – the Constitutional Law).

Fiscal discipline rules of municipalities, which are part of the general government sector, contribute to the sustainability of public finances. The *ex-ante* (preliminary) assessment of the NAO FI aims to identify the risks of non-compliance with the FDR, and to enable the municipalities to assess and, if necessary, to adjust their budgets before the end of the current year in order to avoid non-compliance at the time of the *ex-post* (factual) assessment.

The ex-post evaluation shows that in 2023, the budgets of all municipalities were found to have been implemented in line with their requirements. The initial budgets adopted by the municipal councils in 2024 were also in line with their requirements. However, the reliability of data continues to be an issue, given that during the assessment it was evident that not all information provided by municipalities is accurate.

FISCAL DISCIPLINE RULES WERE RESPECTED BY ALL MUNICIPALITIES IN 2023 AND 2024

In 2023, all municipalities complied with their fiscal discipline rules. As the municipal budgets of the cities of Vilnius, Kaunas, Klaipėda and Šiauliai had positive budget balances and the appropriations of the other municipalities did not exceed their revenues by more than 1.5%, the budgets of all the municipalities were implemented in accordance with the rules for the budgets attributable to general government sector in 2023[1] . The balance of the local government sub-sector was positive at 0.2% of GDP in 2023, despite the fact that municipalities may have had deficits in the face of a negative estimate of the output gap[2].

According to the Law on Budgeting, municipal councils had to approve their budgets for 2024 within two months of the adoption of the Law on Financial Indicators of the State Budget and Municipal Budgets for the current year. During the year, municipalities adjust their budgets. The NAO FI carried out an *ex-ante* evaluation by analysing the initial budgets approved by the municipal councils. The actual compliance of municipalities with the fiscal discipline rules in their 2024 budgets will be assessed in the first half of 2025.

All municipalities' 2024 budgets comply with their requirements. According to Article 4(2) and (4) of the Constitutional Law, when the economy is below potential[3], the municipalities of Vilnius, Kaunas, Klaipėda and Šiauliai were allowed to plan deficits the size of the cyclical component[4], while the remaining municipalities were required to ensure that appropriations did not exceed revenues by more than 1.5%.

When assessing the compliance of municipalities with the rules of fiscal discipline, the NAO FI takes into account the impact of the European Union and other international financial assistance on the balance. The impact of EU and other international financial aid (excluding co-financing) on the general government balance should be neutral, as it is an external revenue source financed by the EU budget. However, a situation may arise where EU funds have an impact on a municipality’s budget balance. Normally, when a municipality prepares and implements its budget, the unused part of the EU aid is considered as expenditure. As this unused part of the EU aid is not added to revenue for the purpose of assessing fiscal discipline, this has a negative impact on the municipality’s budget balance, which should not be the case. For this reason, the NAO FI has made an additional correction of EU funds to neutralise this effect of EU aid. The municipalities were asked to complete a survey on the European Union and other international financial aid without co-financing in the budgets implemented in 2023 and in the budget plans for 2024. It should be noted that this information could not be identified from the financial reporting documents provided by the municipalities, which is why it was decided to carry out a survey.

A more detailed assessment of the rules can be found in the *MS excel* workbooks provided with the opinion.

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[1] A detailed assessment of compliance with the rules can be found in the *MS Excel* workbook provided on the website along with this opinion. Available online: https://www.valstybeskontrole.lt/EN/BudgetMonitoring.

[2] The Ministry of Finance's announcement on 25 March 2024 on the "Potential Gross Domestic Product and Output Gap 2023–2027" estimated the output gap in 2023 at –2.0% pot. GDP. Available online: https://finmin.lrv.lt/media/viesa/saugykla/2024/3/YeDyCuiYgTE.pdf.

[3] The Ministry of Finance's report "On the Potential Gross Domestic Product and Output Gap between 2022 and 2026", published on 29/12/2023, estimated the output gap in 2024 at –2.4% pot. GDP. Available online: https://finmin.lrv.lt/media/viesa/saugykla/2024/1/upjEGDhVBmA.pdf.

[4] The cyclical component of the budget is an indicator expressed in monetary units that shows the impact of the output gap on the municipality's balance over the reference period. Estimates of this indicator used for the assessment can be found on the website of the Ministry of Finance. Available online: https://finmin.lrv.lt/lt/veiklos-sritys/fiskaline-politika/informacija-savivaldybems-sodrai-ir-psdf/savivaldybiu-sodros-psdf-biudzetu-cikliniu-komponenciu-dydziai.

MUNICIPALITIES' FINANCIAL REPORTING DOCUMENTS ARE STILL NOT RELIABLE

Based on the financial statements and not taking into account revisions, the 2024 budgets of 5 municipalities would have been identified as non-compliant with fiscal discipline rules. On 22/05/2024, the municipalities were informed of the risk of non-compliance with the FDR and asked to inform the NAO FI of possible data discrepancies. It was noted that the municipalities that were initially assessed as non-compliant with the fiscal discipline rules did not report the unused part of revenue on line 105 of the form 1-SAV. Following the submission of revised information on the unused part of revenue by the municipalities and the examination of the budgets adopted by their councils, the NAO FI included this revised information in the assessment. In view of this, no risk of non-compliance with fiscal discipline rules was identified for these municipalities. The problem of unstated or inaccurately reported unused part of revenue in the financial statements is a recurrent issue, but this year the number of inaccuracies is lower than in previous years' assessments. It is important that municipal administrations and their control and audit services ensure the accuracy of the information provided in the accounts.

Not all municipalities provide accurate information on estimated accounts payable. According to the Law on Budgeting, municipal councils are required to approve the planned annual change in arrears (accounts payable, except for repayment of loans). Information on the planned accounts payable can be found in the explanatory notes of the budgets of all municipalities, but a few did not provide this information accurately. For example, one municipality's budget explanatory note states: "The planned annual change in arrears (accounts payable, except for repayment of loans) at 31 December 2024 is set at no more than the amount at 31 December 2023." This description does not indicate the exact amount forecast. In the opinion of the NAO FI, the amount of the change to be approved should be precise or, if no increase in arrears is planned, should be shown as zero at the time of approval.

The National Audit Office, implementing its functions of the budget policy monitoring institution, is responsible for the monitoring of the compliance with fiscal discipline rules established in the Constitutional Law on the Implementation of the Fiscal Treaty of the Republic of Lithuania, as well as for monitoring the implementation of the assignments and is authorised to prepare and present independent opinions to the Seimas of the Republic of Lithuania on the compliance with fiscal discipline rules and macroeconomic developments. Pursuant to Article 4(2), (4) to (7) of the Constitutional Law on the Implementation of the Fiscal Compact of the Republic of Lithuania and Article 8(7)(7) of the Law on the National Audit Office, the National Audit Office shall submit a conclusion to the Seimas of the Republic of Lithuania.

Head of Budget Monitoring Department Jurga Rukšėnaitė