

OPINION

OPINION ON THE COMPLIANCE WITH THE FISCAL DISCIPLINE RULES OF MUNICIPAL BUDGETS DURING 2025– 2026

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No. BPE-4



IN 2025, ONE MUNICIPALITY FAILED TO COMPLY WITH THE FISCAL DISCIPLINE RULE, BUT IN 2026, THE BUDGETS OF ALL MUNICIPALITIES HAVE BEEN PLANNED IN COMPLIANCE WITH IT

The National Audit Office, as the Independent Fiscal Institution (hereinafter – IFI), submits its opinion to the Seimas on compliance with the municipal fiscal discipline rules (hereinafter – FDR) for 2025–2026. The opinion is submitted in accordance with the Law on Fiscal Governance of the Republic of Lithuania.

Compliance with municipal fiscal discipline rules contributes to the sustainability of public finances. The risks identified by the IFI's *ex ante* assessment regarding non-compliance with the FDR enable municipalities to self-assess and, where necessary, adjust their budgets before the end of the current year. The assessment also reveals how the figures for municipal balances are calculated, which municipalities can plan without breaching the limits set by legislation.

According to the *ex post* (actual) assessment, the budget of one municipality in 2025 did not meet the requirements of the fiscal discipline rule. According to the *ex ante* assessment, the initial budgets of all municipalities for 2026 met the requirements set for them. Data reliability issues are encountered annually during the assessments. To ensure the sustainability of public finances and growth in municipal investment, municipalities must address these issues, as non-compliance with the FDR restricts the application of the flexibility rule, which allows for greater borrowing.

A more detailed assessment of budget compliance with the rules can be found in the MS *Excel* spreadsheets provided alongside the opinion on the website <https://www.valstybeskontrolė.lt/LT/FiskalineStebeseną>.

Key messages of the opinion:

- **In 2025, one municipality's budget did not comply with the fiscal discipline rule.**
- **The reliability of municipal financial reports is not guaranteed: if the assessment were carried out using uncorrected data, the 2025 budgets of four municipalities would be deemed non-compliant with the fiscal discipline rules.**
- **The updated fiscal governance framework in 2026 expanded municipalities' borrowing capacity.**
- **When planning their 2026 budgets, all municipalities complied with the fiscal discipline rules.**
- **There is insufficient data to reliably assess the compliance of the 2027–2028 budget plans with the fiscal discipline rule.**

1. REVIEW OF LITHUANIA'S FISCAL GOVERNANCE

An updated fiscal governance system came into force in Lithuania in 2026. It aims to ensure more flexible, transparent and clear financial governance of the general government sector (GG), whilst maintaining its sustainability. The reform was implemented by amending the Constitutional Law on the Implementation of the Fiscal Treaty¹ (CL) and related legislation – the Fiscal Discipline Law (renamed the Fiscal Governance Law²), the Budget Structure Law³ and the National Audit Office Law⁴. These amendments align national rules with the updated EU fiscal framework by transposing the provisions of Directive (EU) 2024/1265 and establishing the procedures necessary for the application of Regulation (EU) 2024/1263.

Net expenditure has become the main indicator of GG discipline, with its annual growth not permitted to exceed the set limits. The trajectory of expenditure growth depends on the level of public debt and deficit, as well as the application of EU recommendations. The new system also provides municipalities with greater flexibility in budget planning and opportunities to implement investment projects. It should be noted that municipalities are an integral part of general government; therefore, in order to comply with the limits on net expenditure growth, as municipalities' expenditure grows more rapidly, expenditure in other subsectors must grow at a slower rate.

From 2026, municipalities are able to plan their budgets more flexibly. The new version of the CL provides for:

- **A single balance rule for all municipalities.** The requirements of the CL for the budgets of major cities and remaining municipalities have been harmonised. A rule has also been introduced for the municipalities of major cities whereby budget expenditure calculated on an accrual basis must not exceed revenue, except in years when the output gap is negative. In the latter case, the budget deficit may not exceed 1.5% of revenue.
- **Higher limits on debt and guarantees.** Under the previous version of the CL, state budget grants, EU and other international financial assistance were deducted from revenue. From this year onwards, the level of debt and guarantees is assessed in relation to total budget revenue. A larger revenue base allows for nominally higher debt. Furthermore, the limit on guarantees has been increased from 10% to 20% of revenue.
- **Greater flexibility.** The CL continues to allow municipalities, when assessing the compliance of their budgets with the fiscal discipline rule, to deduct from their appropriations those allocated to co-finance EU and other international aid, and to add to the current year's revenue the unused part of the accrued revenue from the municipal budget as at 31 December of the previous year (excluding unspent European Union and other international financial assistance funds) which is used for appropriations in the current year. A new flexibility provision will apply from 2026. Municipalities will be able to deduct from their appropriations those allocated to projects financed with funds borrowed from the Lithuanian National Development Bank.

The procedures applicable in the event of a deviation from the rule have been amended. As before, if an actual assessment reveals that a municipality's balance is lower than permitted,

¹ Available online: <https://e-seimas.lrs.lt/portal/legalAct/lt/TAD/6be2c020699a11e48710f0162bf7b9c5/asr>.

² Available online: <https://e-seimas.lrs.lt/portal/legalAct/lt/TAD/TAIS.308935/asr>.

³ Available online: <https://e-seimas.lrs.lt/portal/legalAct/lt/TAD/TAIS.428/asr>.

⁴ Available online: <https://e-seimas.lrs.lt/portal/legalAct/lt/TAD/TAIS.18295/asr>.

the resulting deviation must be offset within two years. Failure to do so will result in the flexibility provisions no longer being applied when assessing the municipal budget. However, the procedures relating to the exceeding of guarantee or debt limits have been amended. If liabilities under guarantees exceed 20% of that year's revenue, the conditions for budgetary flexibility no longer apply until the municipality falls below this limit. If debt exceeds 60% of that year's revenue (75% for Vilnius City Municipality), the flexibility provisions also cease to apply and the municipal budget must be balanced or in surplus in the coming and subsequent years until the debt limit is no longer exceeded.

To strengthen accountability and transparency, the new fiscal governance framework stipulates that, in the event of a breach of the fiscal discipline rule, the mayor of the municipality must explain the reasons for non-compliance to the Seimas Committee on Budget and Finance and indicate how the deviation is planned to be offset.

2. ASSESSMENT OF COMPLIANCE WITH MUNICIPAL FISCAL DISCIPLINE RULES IN 2025–2026

In 2025, one municipality failed to comply with the fiscal discipline rule. Under the version of the CL in force in 2025, the budget deficits of the municipalities of Vilnius, Kaunas, Klaipėda and Šiauliai were not to exceed the values of the cyclical component⁵, whilst the appropriations of other municipalities were not to exceed their revenue by more than 1.5%, as the output gap was negative, i.e. the economy was operating below its potential level. All municipalities, with the exception of Rokiškis District Municipality, complied with the fiscal discipline rule.

The risk of this municipality failing to comply with the rule was identified in the *ex ante* assessment⁶, carried out by the IFI in 2025. Actual budget revenue collected was higher than planned, but appropriations were also slightly higher. In an *ex post* assessment, the deviation is smaller than in the *ex ante* assessment. According to Rokiškis Municipality's data, the deficit exceeding 1.5% was caused by the increased cost of an investment project, for the completion of which the municipality took out additional loans.

The correction mechanism will be applied for the first time. Under the CL, as Rokiškis Municipality failed to comply with the FDR, it must offset the €1.1 million deviation within two years⁷ or the flexibility rule will no longer apply. This means that its balance over the next two years must exceed the permitted limit by an amount sufficient to offset the 2025 deviation. According to Rokiškis District Municipality's 2026 budget plan, the deviation will be offset during this year.

It should be noted that compliance with the *ex post* fiscal discipline rules for municipalities is important not only because, if the deviation is not offset within two years, flexibility would no longer apply, but also because compliance with the rules is one of the conditions for the non-

⁵ The cyclical budget component is an indicator expressed in monetary units that shows the impact of the output gap on the municipality's balance indicator during the reporting period. The estimates of this indicator used for the assessment can be found on the Ministry of Finance's website. Available online: <https://finmin.lrv.lt/lt/veiklos-sritys/fiskaline-politika/informacija-savivaldybems-sodrai-ir-psdf/savivaldybiu-sodros-psdf-biudzetu-cikliniu-komponenciu-dydziai>.

⁶ Available online: <https://www.valstybeskontrole.lt/EN/Product/24345/opinion-on-the-compliance-with-the-fiscal-discipline-rules-of-municipal-budgets-d>.

⁷ The deviation is calculated by comparing the actual municipal deficit with the maximum deficit permitted under the fiscal discipline rule.

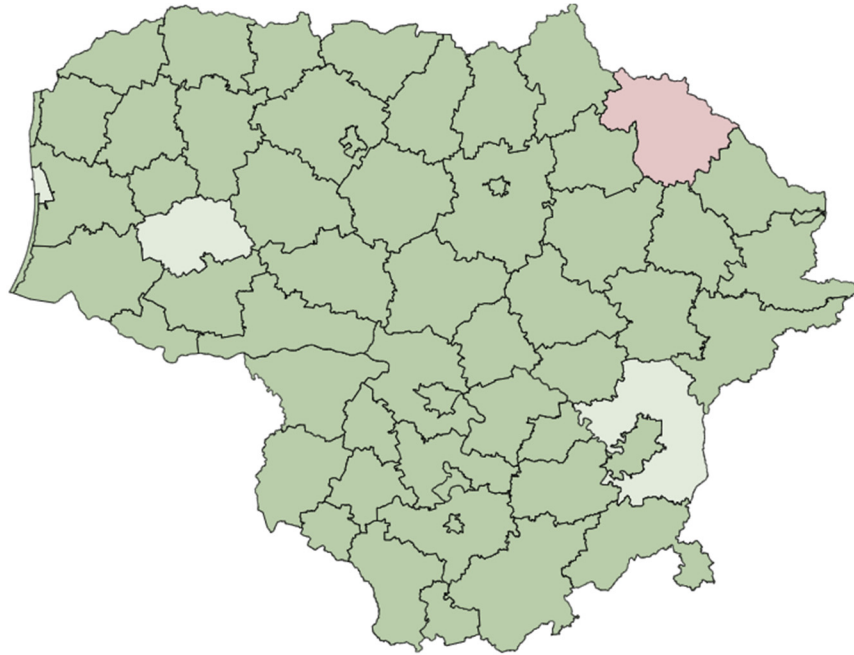
repayment of the grant, as specified in the Description of the Procedure for the Allocation and Repayment of Grants to Municipalities, approved by Order⁸.

The issue of inaccurate data, particularly regarding the unused part of the accrued revenue which is either not disclosed or inaccurately reported in the financial reports, is a recurring one. One of the provisions of the flexibility rule is the option for municipalities to add to the current year's revenue the unused part of the accrued revenue in the municipal budget as at 31 December of the previous year (excluding the unused part of the accrued revenue from EU and other international financial assistance funds) that is used for appropriations in the current year. When assessing fiscal discipline, the difference between the indicator's values at the beginning and end of the year is calculated. However, the rows required for IFI calculations are often left blank or filled in incorrectly in the reports. According to data from the Independent Fiscal Institution, almost half of the municipalities, when completing line 106 of the report in Form No. 1-sav of Order No. 1K-63 of the Minister of Finance, which specifies the unused part of the accrued revenue as at 31 December of the previous year, included this amount together with the unused part of the accrued revenue from EU and other international financial assistance funds, which should not be the case. Another common error is the failure to specify the co-financing amounts from the EU and other international financial assistance. It is important that municipal administrations and the control and audit services operating within them ensure the accuracy of the information provided in the reports. More detailed and publicly available guidelines from the Ministry of Finance on completing the reports could also contribute to ensuring the accuracy of the data.

If the assessment were carried out on the basis of uncorrected data, four municipalities would be considered to be in breach of fiscal discipline (Figure 1). On 25 May 2026, these municipalities were notified of non-compliance with the FDR and asked to inform the IFI of any potential data discrepancies. Upon including the corrected data in the assessment, it was found that three municipalities had complied with the FDR. The total deviation that they would have had to compensate for, had the corrected information not been included, would have amounted to €6.4 million. By failing to ensure the reliability of their financial reports and compliance with fiscal discipline rules, municipalities risk compromising their ability to invest.

⁸ Order No. 1K-213 of the Minister of Finance of 26 May 2016 'On the Approval of the Description of the Procedure for the Allocation and Repayment of Grants to Municipalities'. Available online: <https://e-seimas.lrs.lt/portal/legalAct/lt/TAD/a33ab890276a11e6a222b0cd86c2adfc/WqkDOTKOoe>.

Figure 1. In 2025, one municipality did not comply with the fiscal discipline rule



Did municipal budgets comply with fiscal discipline rules in 2025?

● Yes ● Yes, after corrections ● No

Source: <https://lietuvosfinansai.lt/>, State Data Agency, calculations by the Independent Fiscal Institution

According to the planned 2026 budgets, all municipalities are complying with the fiscal discipline rule. Under the new version of the CL, when the economy is below its potential level⁹, municipalities must ensure that budget expenditure does not exceed revenue by more than 1.5 % on accrual basis. **Based on initial financial reports' data, the 2026 budgets of two municipalities would be considered non-compliant with fiscal discipline rules.** On 2 June 2026, the IFI notified these municipalities of the risk of non-compliance with the FDR and requested information on any potential data discrepancies. After incorporating corrected information on appropriations for co-financing international financial support into the assessment, it was established that the municipal budgets had been drawn up in accordance with the FDR. However, it is important to note that co-financing data is crucial when assessing compliance, as it is part of the flexibility rule. When municipal documents submitted to the Ministry of Finance do not specify plans or specify them based on current implementation, it is not possible to properly assess the compliance of budget plans with the fiscal discipline rule.

Under the Budget Structure Law, municipal councils were required to approve their 2026 budgets within two months of the adoption of the Law on the Approval of Financial Indicators of the State Budget and Municipal Budgets for the current year. Municipalities adjust their budgets during the course of the year. The Independent Fiscal Institution analysed the initial municipal budgets approved by municipal councils as part of an *ex ante* assessment. Actual compliance with fiscal discipline rules in the 2026 municipal budgets will be assessed in 2027¹⁰.

When assessing compliance with municipal fiscal discipline rules, the Independent Fiscal Institution takes into account the impact of European Union and other international financial assistance on the balance. The impact of European Union and other international financial

⁹ In the Ministry of Finance's report published on 31 March 2026, "On the Potential Gross Domestic Product and the Output gap from Potential for 2025–2029", the estimated output gap from potential for 2026 stood at –0.4% of GDP. Available online: https://finmin.lrv.lt/public/canonical/1774952823/27036/Pranesimas_del_potencialaus_2026_kovas.pdf.

¹⁰ In accordance with the National Audit Office Law, the IFI submits to the Seimas, by 20 June of each year, the opinion specified in Article 10 of the Fiscal Governance Law regarding the compliance of municipal budget indicators with the municipal budget fiscal discipline rule.

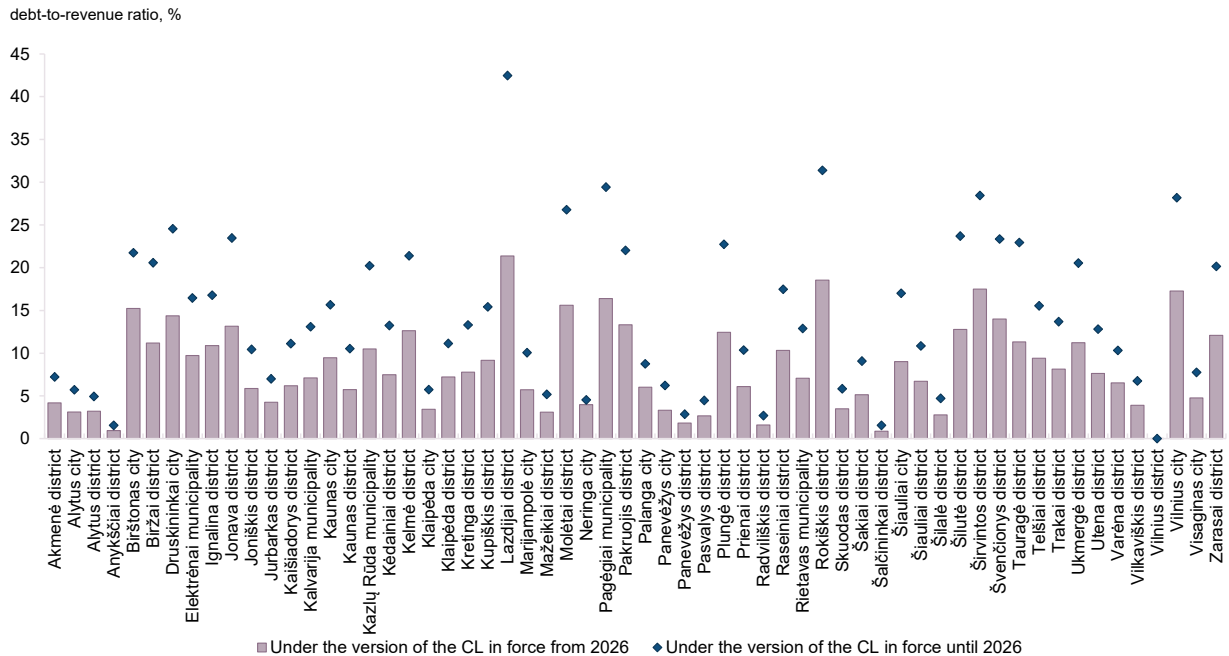
assistance (excluding co-financing) on the general government balance must be neutral, as it constitutes an external source of revenue. For this reason, the IFI has made the appropriate adjustment to ensure that these funds do not affect the calculation of municipal balances on an accrual basis. As in 2025, municipalities were asked to complete a survey on EU and other international financial support in their 2025 budget implementation data and 2026 budget plans. It should be noted that this information cannot be identified from the financial reports submitted by municipalities, which is why a survey was chosen. This issue has been partially resolved, as the forms for reporting municipal budget revenue and expenditure were amended in 2026; consequently, when preparing the assessment in 2027, it should be possible to find all the information required to calculate the accrual adjustment *ex post*. Nevertheless, consideration should be given to the possibility of making the budget plan data required for the *ex ante* assessment of fiscal discipline available in official sources.

3. MUNICIPAL DEBT AND GUARANTEES IN 2025

No municipality exceeded the debt limit in 2025. The assessment of municipal debt compliance with the requirements of the CL was based on the version of the law in force in 2025. It stipulates that the debt of all municipalities may not exceed 60% (75% for Vilnius City Municipality) of municipal budget revenue, excluding grants from the State budget, the EU and other international financial assistance. In 2025, no municipality exceeded this limit (Figure 2).

The IFI also assessed the debt level in accordance with the new version of the CL. It stipulates that if the debt for the most recent completed year exceeded the set limit, the municipal budget must be in surplus or balanced (without applying flexibility provisions) in the coming and subsequent years until the debt-to-revenue ratio no longer exceeds the set limit. As a larger revenue base is used when assessing the debt level under the new version of the law, i.e. total budget revenue, debt-to-revenue ratios have decreased.

Figure 2. No municipality exceeded its debt limit in 2025



Source: <https://lietuovsfinansai.lt/>, State Data Agency, calculations by the Independent Fiscal Institution

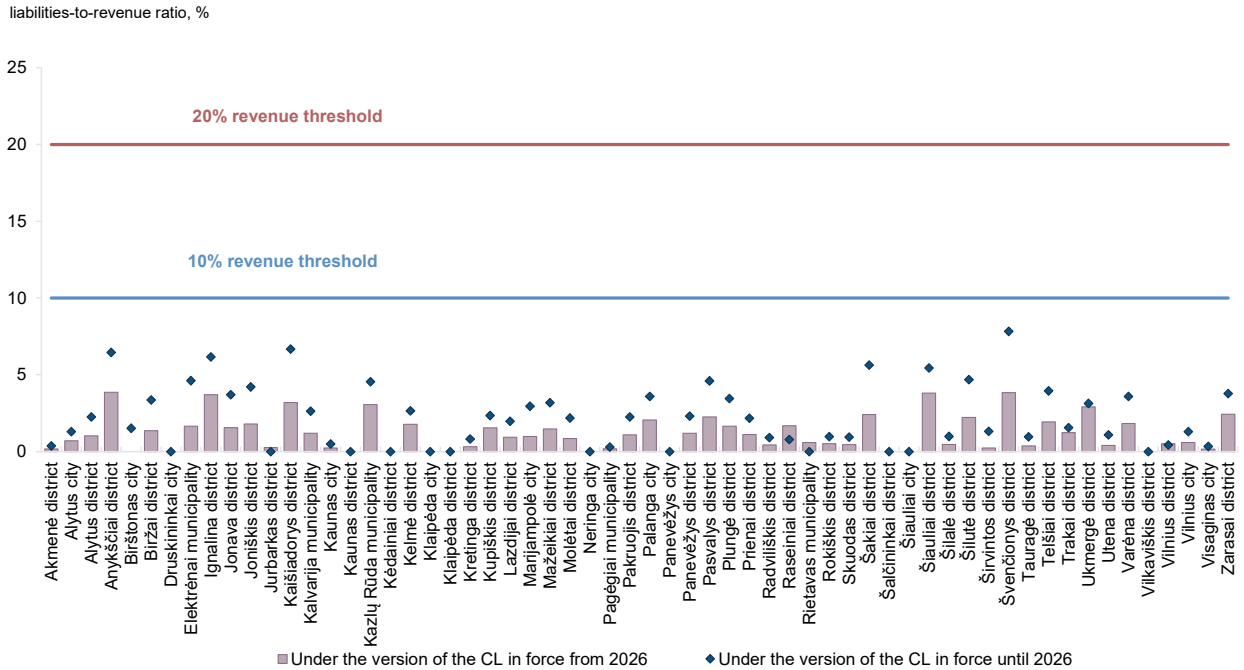
In 2025, no municipality's liabilities under guarantees exceeded the 10% revenue limit.

Under the version of the CL in force until 2026, municipalities' liabilities under guarantees could not exceed 10% of the municipal budget, excluding grants from the State budget, EU and other

international financial assistance. In 2025, all municipalities complied with this requirement (Figure 3).

The new version of the CL, as in the case of debt, provides for a broader revenue base and an increased limit of up to 20% for liabilities under guarantees. Exceeding this limit would result in the non-application of flexibility provisions, the application of which is particularly relevant for accessing broader investment opportunities.

Figure 3. In 2025, no municipality's liabilities under guarantees exceeded the 10% and 20% revenue limits



Source: <https://lietuovsfinansai.lt/>, State Data Agency, calculations by the Independent Fiscal Institution

4. ASSESSMENT OF COMPLIANCE WITH MUNICIPAL FISCAL DISCIPLINE RULES IN 2027–2028

From 2026, the compliance of municipal budget plans with the fiscal discipline rule will be assessed not only for the current year but also for the following two years; however, there is insufficient data to carry out the assessment properly. Pursuant to Article 10 of the Fiscal Governance Law, “The compliance of municipal budget indicators with the municipal budget fiscal discipline rule shall be determined on the basis of the data in the municipal budget implementation report and the municipal budget indicators for the current year approved by municipal councils, as well as the municipal budget indicators projected for the two years following the current year.” When approving the 2026–2028 municipal budgets, municipalities submit detailed plans for 2026, but for the 2027–2028 period they specify only the total amounts of revenue and expenditure. Such detail is insufficient to carry out a comprehensive assessment of compliance with the FDR. For this reason, when conducting the assessment, the Independent Fiscal Institution assumed that no accrual adjustments were required when evaluating revenue and expenditure figures, and that flexibility was not utilised. In this case, 26 municipalities would not comply with the FDR in 2027, and 23 municipalities in 2028. However, it is highly likely that some of the expenditure approved by municipalities will not be included when calculating *ex post* compliance with the FDR, as the flexibility provided for in the CL will be utilised. In future, arrangements should be made to enable the IFI to obtain the data required for

the assessment of fiscal discipline from official sources. To ensure a more realistic assessment of three-year plans, the forms of municipal budget plan reports should be amended to include projections of the indicators required for FDR assessment.

The National Audit Office of the Republic of Lithuania, as the Independent Fiscal Institution, in monitoring compliance with fiscal discipline rules and fiscal governance, assessed the compliance of municipal budgets with the municipal fiscal discipline rule and prepared an opinion. In accordance with Article 10 of the Law on Fiscal Governance of the Republic of Lithuania and Article 8(7)(5) of the Law on the National Audit Office, the National Audit Office submits its opinion to the Seimas of the Republic of Lithuania.

Head of the Fiscal Monitoring Centre

Jurga Rukšėnaitė