Aspects of The Financial Position of The Bulgarian Municipalities

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Abstract: The work of the municipalities is a separate subject of financial management. In this context, it is a separate subject of the analysis and therefore it depends on multiple and varied factors. Furthermore, the work of the municipalities has direct effect on their financial position. The stable financial position of the municipalities is a key factor for the successful social and economic development of the regions in Bulgaria. By achieving and maintain financial stability, the municipalities are able to manage the public resources at local level transparently and efficiently.

This study highlights the financial position of municipalities considered as a set of interrelations and dependences between its components. The use of the system of indicators for analysis of the Bulgarian municipalities’ financial position allows us to evaluate the financial independence, the financial stability (budget stability), the investment activeness and the efficiency of financial resources use (own resources and borrowings) at local level.

The subject matter of this study is the application of the system of indicators for analysis and evaluation of the municipalities’ financial position.

The study is aimed at achieving a justified and applicable methodology for analysis of the Bulgarian municipalities’ financial position.

Key words: financial, methodology, analysis, municipalities, stability

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1. Introduction

The financial position of municipalities is a result of their work. It is formed under the effect of the manner of use of own and external sources of funds for ensuring the work of the municipalities at local level, and as a result of their ability to adapt to the changes within the environment they operate.

In 2013, the Ministry of Finance of the Republic of Bulgaria adopted methodology to evaluation the financial position of municipalities. Based on this methodology provide metrics to analysis and evaluation the financial situation of municipalities in Bulgaria.

2. Scorecard Analysis

The analysis of the municipalities’ financial position is performed by using a system of indicators grouped in different directions that thoroughly encompass their work.

To our opinion, the following groups of indicators may be used in the system of indicators for analysis and evaluation of municipalities’ financial position:

1) Indicators for financial independence.
2) Indicators for financial stability.
3) Indicators for the structure of expenses.
4) Indicators for efficiency.

With the help of the indicators for analysis of the financial independence of the municipality we can describe the revenue and expenses part of the budget that is allocated to the municipality to be managed at its own responsibility. Based on the values of the indicators, we can analyze and evaluate the municipality’s ability to independently cope with the responsibilities it has at local level.

We can use the following indicators for analysis and evaluation of the financial independence of the municipalities:

1) Financial independence coefficient (budget autonomy).
2) Financial dependence coefficient.
3) Coefficient of covering expenses for local activities with own revenue.

The financial independence coefficient is calculated as a ratio of the net amount of own revenue to total proceeds for the budget period. The net amount of the municipality’s own
revenue is formed by deducting the one-time aids and grants from abroad and the transfers to the municipalities from the total amount of own revenue. This coefficient describes the level of financial independence (non-dependence) of the municipality from external proceeds and financial resources (governmental, public-private partnerships, European Union programs and funds, etc.).

If the financial independence coefficient is bigger than 0.70, the municipality is financially independent and thus the central authorities’ supervision is limited. If the value of the coefficient varies within the range 0.5 and 0.7, the municipality’s financial position is characterized with relative financial independence.

**The financial dependence coefficient** is calculated as a ratio of external financial proceeds to the total proceeds for the budget period. The use of external sources for funding municipality’s activities may to some extent be a profitability factor. This is because the rate of return of funds invested in different assets of the municipality is in most cases higher than the interest rate of loans it would receive to fund its activities at local level.

Taking in consideration that the financial dependence coefficient has values less than or equal to 0.3, this means that the municipality is financially independent that has positive impact on its financial stability. If the value of this coefficient is greater than 0.7, the level of financial dependence of the municipalities on external sources for funding its activities is high, and thus the level of financial risk also increases.

The coefficient of **covering the expenses for local activities** with own revenue is calculated as a ratio of the net amount of own revenue to the expenses for performing the municipality’s work at local level. If the value of this coefficient is equal to or greater than one, the net amount of own revenue fully covers the expenses for the work of the municipality at local level. In this case the municipality is financially independent, which means that it may settle the expenses for its work with its own revenue. In case the coefficient is lower than one, the municipality has some financial difficulties when carrying out its work at local level, and thus the need of external funding of local activities occurs.

By means of the indicators for **financial stability** we can evaluate the stability of municipalities within the environment they operate.

In general, stability (or durability) is defined as the property of a system to preserve its main characteristics in case of relatively small change of a specific parameter.\(^1\) The financial stability is an economic category that is aimed at ensuring a balance among the internally inherent characteristics of the system – of the municipality, in this particular case. This means that the municipality is able to operate under conditions of different types of risks and dynamic internal environment, by recovering and maintaining its internal characteristics.

We can use the following indicators for analysis and evaluation of municipalities’ **financial stability:**

1) Budget balance coefficient.

2) Estimate coefficient of long-term borrowings.

3) Estimate coefficient of overdue liabilities.

The **budget balance** coefficient is calculated as a ratio between the budget balance and the actual incoming financial resources in the municipality for the budget period. It describes the financial stability of the municipality for the formation and expenditure of the funds provided in the local budget. The budget balance is formed as a difference between the total proceeds and the total expenses of the municipality within the frames of the budget period. It may be a budget excess or a budget deficit. If the sum of total proceeds is bigger than the sum of total expenses, the municipality has a budget excess. In this case, the budget balance coefficient is a positive value and has positive effect on the municipality’s stability. In case of budget deficit, the coefficient is of negative value and has an adverse effect on the level of financial stability of the municipality.

The estimate **coefficient of long-term borrowings** is equal to the ratio between the amount of long-term debt and the planned net amount of own revenue. It describes the municipality’s ability to repay its long-term liabilities with its own revenue within the frames of the budget period.

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\(^1\) [http://bg.wikipedia.org/wiki/%D0%A3%D1%81%D1%82%D0%BE%D0%B9%D1%87%D0%B8%D0%B2%D0%BE%D1%81%D1%82](http://bg.wikipedia.org/wiki/%D0%A3%D1%81%D1%82%D0%BE%D0%B9%D1%87%D0%B8%D0%B2%D0%BE%D1%81%D1%82)
The estimate coefficient of overdue liabilities is calculated as a ratio of the municipality’s overdue liabilities to the planned net amount of own revenue, increased with the reconciliation subsidy. With the help of this coefficient we can analyze and evaluate the municipality’s ability to cover its overdue liabilities within the frames of the budget period.

The group of indicators that describe the structure of expenses may comprise the following indicators:

1) Share of expenses for salaries and social security of administrative staff in the total expenses of the municipality for local activities.
2) Coefficient of investment activity that describes the relative share of expenses for investments in base infrastructure in the total expenses of the municipality for local activities.

With the held of the efficiency indicators we can evaluate not only the efficiency of municipalities’ expenses and proceeds when operating at local level, but also the efficiency of the administrative services for the local population. For this purpose we can use the following indicators:

1) Expenses efficiency coefficient.
2) Proceeds efficiency coefficient.
3) Administrative load coefficient.
4) Administrative service coefficient.

The expenses efficiency coefficient is calculated as a ratio of total proceeds to the total amount of expenses incurred by the municipality for local activities. It describes the amount of proceeds per 1 BGN local expenses of the municipality.

The proceeds efficiency coefficient is the ratio between the expenses for local activities and the total proceeds of the municipality. It shows the expenses for local activities per 1 BGN total proceeds of the municipality.

The administrative load coefficient can be calculated in two ways. First, the value of this coefficient is calculated as a ratio between the number of the population and the number of the administrative staff of the municipality. It shows the number of inhabitants that are served by one municipal employee. Second, the coefficient may be calculated as a ratio of the number of issued documents and the number of the municipality’s administrative staff. In this case the coefficient shows the number of documents issued by one member of the municipality’s administrative staff.

The administrative service coefficient is calculated as a ratio of the number of the administrative staff to the number of inhabitants of the municipality. It shows the number of administrative staff that serves one inhabitant of the municipality.

On the basis of the values of the indicators from the four groups we can analyze and evaluate the financial position of the respective municipality. For this purpose we may classify the municipalities in five groups that can be described as follows:

1) First group. The financial position of the municipalities that are classified in this group is characterized with the following features:
   - High level of financial independence;
   - Stable fiscal policy;
   - Ability to cover their expenses with their own funds;
   - High level of reliability and transparency of financial information in the municipalities’ financial statements.

2) Second group. The financial position of the municipalities is described as follows:
   - High level of financial independence;
   - Stable fiscal policy;
   - Short-term fluctuations when balancing proceeds and expenses for local activities.

3) Third group. The main characteristics of the financial position of the municipalities within this group are as follows:
   - The amount of own revenue is insufficient to cover infrastructure expenses;
   - Accumulation of moderate debt can be witnessed in the municipalities;
   - The municipalities’ financial statements are not detailed and full;
Good level of reliability and transparency of the financial information in the municipalities’ financial statements.

4) Fourth group. The specific features of the financial position of the municipalities in this group are as follows:

- The municipalities’ revenue does not cover the expenses incurred for local activities;
- As a result of increasing municipalities’ liabilities, the level of risk when implementing their fiscal policy is also increased;
- Low level of transparency of financial information in the municipalities’ financial statements;
- Inefficient control on municipalities’ expenses incurred for their work at local level.

5) Fifth group. The financial position of the municipalities in this group is characterized by the following features:

- The municipalities’ revenue does not cover its expenses incurred for local activities;
- There is a trend of increasing the municipalities’ indebtedness, as well as of increasing the overdue liabilities in mid- and long-term aspect;
- Presence of inefficient system for internal control on proceeds, expenses and work of the municipalities;
- We can see inefficient use of financial resources.

The overall evaluation of municipalities’ financial position is made on the basis of the values of indicators in the five groups of indicators.

In our opinion, the information can be systematized in Table 1.

Indicators analysis and assessment of the financial situation of municipalities

Remark:

- First group (I group) of municipalities. Financially independent and well balanced.
- Second group (II group) of municipalities. Financial balancing.
- Third group (III group) of municipalities. Thriving financially.
- Fourth group (IV group) of municipalities. Poorly balanced financially.
- Fifth group (V group) of municipalities. Unbalanced poor financial situation.
Table 1

<table>
<thead>
<tr>
<th>Indicators</th>
<th>I group</th>
<th>II group</th>
<th>III group</th>
<th>IV group</th>
<th>V group</th>
</tr>
</thead>
<tbody>
<tr>
<td>I. Indicators for financial independence:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Financial independence coefficient</td>
<td>Cfi &gt; 0,8</td>
<td>Cfi &gt; 0,7</td>
<td>0,5 &lt; Cfi &lt; 0,7</td>
<td>Cfi &lt; 0,5</td>
<td>Cfi &lt; 0,3</td>
</tr>
<tr>
<td>2. Financial dependence coefficient</td>
<td>Cfd &lt; 0,2</td>
<td>Cfd &lt; 0,3</td>
<td>0,5 &lt; Cfd &lt; 0,7</td>
<td>Cfd &gt; 0,5</td>
<td>Cfd &gt; 0,7</td>
</tr>
<tr>
<td>3. Coefficient of covering expenses for local activities with own revenue</td>
<td>Cce &gt; 1,0</td>
<td>Cce = 1,0</td>
<td>Cce &lt; 1,0</td>
<td>Cce &lt; 0,7</td>
<td>Cce &lt; 0,3</td>
</tr>
<tr>
<td>II. Indicators for financial stability:</td>
<td></td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Budget balance coefficient</td>
<td>Cbb &gt; 0</td>
<td>Cbb &gt; 0</td>
<td>Cbb &gt; 0</td>
<td>Cbb &lt; 0</td>
<td>Cbb &lt; 0</td>
</tr>
<tr>
<td>2. Estimate coefficient of long-term borrowings</td>
<td>Kld ≤ 0,33</td>
<td>Kld &lt; 0,5</td>
<td>Kld = 0,5</td>
<td>Kld &gt; 0,5</td>
<td>Kld ≥ 0,8</td>
</tr>
<tr>
<td>3. Estimate coefficient of overdue liabilities</td>
<td>K1 = 0</td>
<td>K1 = 0</td>
<td>K1 &gt; 0</td>
<td>K1 &gt; 0</td>
<td>K1 &gt;&gt; 0</td>
</tr>
<tr>
<td>III. Indicators for the structure of expenses:</td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Share of expenses for salaries and social security of administrative staff in the total expenses of the municipality for local activities</td>
<td>Ses = 0,3</td>
<td>Ses = 0,4</td>
<td>Ses = 0,5</td>
<td>Ses = 0,7</td>
<td>Ses = 0,8</td>
</tr>
<tr>
<td>2. Share of expenses for investments in base infrastructure in the total expenses of the municipality for local activities</td>
<td>Sei = 0,5</td>
<td>Sei = 0,4</td>
<td>Sei = 0,3</td>
<td>Sei = 0,1</td>
<td>Sei = 0,0</td>
</tr>
<tr>
<td>IV. Indicators for efficiency:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Expenses efficiency coefficient</td>
<td>Ke &gt; 1,2</td>
<td>Ke &gt; 1,0</td>
<td>Ke = 1,0</td>
<td>Ke &lt; 1,0</td>
<td>Ke &lt; 0,8</td>
</tr>
<tr>
<td>2. Proceeds efficiency coefficient</td>
<td>Kep &lt; 0,8</td>
<td>Kep &lt; 1,0</td>
<td>Kep = 1,0</td>
<td>Kep &gt; 1,0</td>
<td>Kep &gt; 1,2</td>
</tr>
<tr>
<td>3. Administrative load coefficient</td>
<td>Kal &gt; 1,0</td>
<td>Kal &gt; 1,0</td>
<td>Kal &gt; 1,0</td>
<td>Kal = 1,0</td>
<td>Kal &lt; 1,0</td>
</tr>
<tr>
<td>4. Administrative service coefficient</td>
<td>Kas = 1,0</td>
<td>Kas = 1,0</td>
<td>Kas = 1,0</td>
<td>Kas &gt; 1,0</td>
<td>Kas &gt; 1,0</td>
</tr>
</tbody>
</table>

3. Conclusion

The use of the system of indicators in the overall methodology for analysis of the Bulgarian municipalities’ financial position enables us to evaluate the financial independence, the financial stability, the investment activity and the efficiency of the use of financial resources (own and external) at local level.
References

1. Methodology for evaluation of Bulgarian municipalities’ financial position, file:///C:/Users/UNSS/Downloads/_Methodology_Classif_LocalGov-08_08_2012_5_.pdf_.pdf