



# Municipal Spending and the Challenges of Digital Transformation in the Shadow of Incentives

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RIGA 2025



Latvijas Republikas  
Valsts kontrole

## Audit report

“Municipal Spending and the Challenges of Digital Transformation in the Shadow of Incentives”

Performance audit “Is the system of incentives implemented in local and regional governments effective?”

The audit was performed based on audit schedule No 2.4.1-56/2024 of the Fifth Audit Department of the State Audit Office of Latvia of 15 April 2024.

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Dear Reader,



The incentives granted by local and regional governments are an important tool for implementing public needs and strengthening local governance. However, this voluntary initiative, which is often implemented with good intentions, requires careful assessment both in terms of its impact on the municipal budget and the results achieved.

The audit results show that although local and regional governments allocate significant financial resources to various incentives, they often lack clearly defined objectives, performance indicators and economic justification. It makes assessing the actual impact of the incentives on the public and the development of the local and regional government different.

The broad scope and diversity of the incentive system inevitably create significant bureaucracy in their administration. The population often has to deal with an administrative burden such as complicated procedures, repeated communication and provision of information.

In this context, the role of digital transformation is particularly important. The creation of the Single Information System for Incentives (SISI) is a generally progressive innovation to ensure more effective, transparent and unified management of incentives across the country. However, the implementation of the SISI is a complicated process that requires both technical solutions and a clear strategy, sufficient funding and close cooperation among all parties involved.

I would like to emphasise that the successful operation of the SISI is not only the responsibility of the Ministry of Smart Administration and Regional Development, but also a shared responsibility, in which local and regional governments, the State Digital Development Agency (SDDA), participating businesses and other institutions also play a

significant role. Only coordinated action, clearly defined goals and mutual understanding and trust will allow us to achieve the main goal of establishing SISI, that is, to provide citizens with an accessible, understandable and effective system of incentives while using both state and municipal resources optimally.

We would like to thank the representatives of the Ministry of Smart Administration and Regional Development, the State Digital Development Agency, the Lavian Association of Local and Regional Governments and local and regional governments for their cooperation. I invite all participating institutions to use the conclusions of this audit as a basis for improvements and to work together to ensure that the system of incentives in Latvia becomes an example of effective action and good governance.

Respectfully  
Mr Oskars Erdmanis  
Department Director

## Summary and expected results after implementation of the recommendations

*Incentives granted by local and regional governments are very diverse and widely used but burdensome for the budget*

When ensuring autonomous functions and voluntary initiatives or implementing administrative tasks delegated to local and regional governments, local and regional governments are entitled to grant allowances, compensations, discounts, co-financing or other payments (hereinafter referred to as Incentives) to local residents, legal entities, non-governmental organisations and other private individuals.

Since local and regional governments grant the Incentives within the scope of their competence established by law by using significant budget funds annually, it is essential that the Incentives achieve the objectives set by the local or regional government. For instance, they can promote the attraction or sustainability of residents in the local or regional government, help develop businesses, reduce traffic intensity, support low-income residents, etc. Moreover, in accordance with the principles of good governance, it is desirable to verify whether the applied Incentives still achieve the intended objectives periodically, do not create disproportionate administrative costs and bureaucratic burdens for the beneficiaries, and whether changes are necessary.

Of course, the Incentives affect the municipal budget, as they lead to an increase in municipal expenses or a decrease in revenues. Since in 2024, many local and regional governments lacked funding to perform their functions, and international experts indicated<sup>1</sup> insufficient independent income from taxes and fees in local and regional governments as one of the reasons, as well as local and regional governments have had great challenges in balancing budget expenditure with appropriate revenues in recent years, the State Audit Office of Latvia has conducted an audit in six selected local and regional governments, that is, Tukums, Olaine, Ropaži, Bauska Regional Governments and Rēzekne and Jūrmala City Municipalities (hereinafter referred to as the sampled local and regional governments) and the Ministry of Smart Administration and Regional Development to assess the effectiveness of granting Incentives, as well as the current challenges in their administration when introducing the Single Information System for Incentives (hereinafter referred to as the SISI). The audit was not conducted for types of Incentives related to social services and social assistance, which are determined in laws and regulations as an obligation of local and regional governments rather than a free choice.

Significant financial resources are allocated to various Incentives in local and regional governments. However, the audit found that not all necessary prerequisites had been created in the process of determining, granting and administering these support measures. Consequently, local and regional governments do not always have the opportunity to assess impartially whether the Incentives granted achieve the intended goals and affect the specified target groups of residents.

In the sampled local and regional governments, from 35 to 55 Incentives are granted (for example, compensation for transportation expenses, allowance for the purchase of clothing, etc.), with the largest number of the Incentives being in the Jūrmala City Municipality in 2024.

<sup>1</sup> <https://lvportals.lv/dienaskartiba/368805-pec-izpetes-starptautiskie-eksperti-konstate-stabila-finansejuma-trukumu-latvijas-pasvaldibam-pamatfunkciju-veiksanai-2024> (accessed on 22 May 2025).

When analysing the information in the annual reports of the sampled local and regional governments for 2022, 2023 and 2024, only the social assistance-related Incentives determined by the local and regional governments in the amount of 16.5 million euros can be identified. However, the evidence obtained during the audit shows that the actual amount of voluntary Incentives that affect the budgets of local and regional governments by increasing expenses or reducing revenues is significantly higher and reaches 88.7 million euros or 7% of total expenditure. One should stress that the financial impact of various Incentives is not intended to be presented in the annual report as a whole, and this must be taken into account by the responsible decision-makers in local and regional governments when approving budgets or deciding on new Incentives, so as not to create an additional burden on the municipal budget and the ability to perform municipal functions.

The audit has concluded that the sampled local and regional governments plan the necessary funding for granting the Incentives based on the actual performance of the previous year basically without linking it to an assessment of the achievement of their objectives or the impact on the performance of autonomous functions or delegated state administration tasks, as determined by the Law on Local and Regional Governments<sup>2</sup>.

Although the objectives of a specific or several similar Incentives may result from the development planning of the local or regional government or other documents, after assessing the Incentives of the sampled local and regional governments, the documents accompanying the decisions to determine them and after interviewing the responsible officials of the sampled local and regional governments one can conclude that the local and regional governments can facilitate good practice and more responsible handling of financial resources, including by determining more specific Incentive objectives and funding priorities as well as reviewing periodically whether all Incentives are still relevant and have the planned impact.

However, this may not be possible in cases where the objectives are set in general terms and are not characterised by performance indicators, as the auditors have established that only 13 or 9% out of the 149 incentives from the sampled local and regional governments have performance indicators set, such as the increase in the number of declared residents, the proportion of the number of students and the reduction of emissions.

During the audited period, the Rēzekne City Municipality, Bauska and Olaine Regional Governments refused to grant a total of 13 Incentives (for instance, *an allowance for a significant wedding anniversary, an allowance for the care of a newborn, support for a guardian*), without linking it to an impact assessment of specific Incentives on the achievement of the municipal goals. The local and regional governments justified this only with the optimisation of budget expenditure.

Another important aspect that affects both the effectiveness of a specific Incentive and the budget of local or regional government is the precise determination of the target group of the Incentive. To assess the impact of the granted Incentives on the municipal budget impartially when deciding on the determination of an Incentive, it is essential to identify the target group of beneficiaries of the relevant Incentive and its amount. However, only 51% of the 149 Incentives reviewed in the audit identify the actual size of the target group (e.g. students, retired, large families, low-income and needy persons).

In the case of determining an excessively narrow target group, a circle of persons will arise who will not receive the relevant Incentive while determining an excessively broad target

<sup>2</sup> Section 5, Part Three of the Law on Local and Regional Governments.

group will create unnecessary expenses for the municipal budget. The audit has concluded that in 43 out of 149 Incentives or 29% of cases in the sampled local and regional governments, the Incentives are granted without verifying that their recipients have a need for the relevant Incentive. During the audited period, the sampled local and regional governments have spent a total of 7.3 million euros on granting such Incentives (for example, an allowance for the purchase of individual school supplies for children, an allowance on a significant life anniversary, an allowance on national holidays, etc.). For instance, during the audited period, the Olaine and Ropaži Regional Governments have spent a total of 708,000 euros on the Incentives for compensating for transport expenses without verifying whether everyone to whom this Incentive is granted really needs it.

#### *A progressive tool with challenges: the role of SISI in the municipal system of incentives*

So far, the Incentives determined in the sampled local and regional governments have been administered differently. In most cases, information systems such as the SOPA (social assistance and social service administration software) and the NINO (real estate tax administration software) are used to administer social Incentives. For other types of Incentives such as student catering and public transport services, different administrative practices have been introduced in local and regional governments depending on whether the service is organized by the local or regional government itself or by a private economic operator.

Precisely with the aim of reducing the administrative burden in the administration of state and municipal Incentives, improving budget planning, as well as **conducting an analysis of the implementation of existing state and municipal policies and the goals achieved**, the Ministry of Smart Administration and Regional Development launched an ambitious project of creating the SISI in 2018.

The SISI is specifically mentioned in the Government Action Plan as a tool for optimising incentive management<sup>3</sup>. Its implementation is closely linked to several priorities of the MSARD Action Strategy 2024-2027<sup>4</sup> in the field of digital transformation. For instance, “digital self-service and accessibility”, which includes the availability of services anywhere and at any time, including digitally, and “development and interoperability of service platforms”, and the SISI is being developed as a shared state administration platform that is interoperable in both the public and private sectors.

By improving communication between providers and recipients of incentives, greater transparency and accuracy in the granting and control of incentives will be achieved by safeguarding that only those who are entitled to it receive the incentive while population will have the opportunity to manage incentives they have applied to in one place<sup>5</sup>.

The possibility of ensuring the use of data in state information systems in other state and municipal institutions without requiring data subjects to submit them repeatedly was mentioned as an equally important benefit, thus people will have the opportunity to receive municipal services with a discount without presenting letters of reference, certificates and other documents confirming social status.

<sup>3</sup> Cabinet Order No 55 on the Government Action Plan for the Implementation of the Declaration on the Intended Activities of the Cabinet of Ministers Led by Ms Evika Siliņa of 20 January 2024, Annex “Government Action Plan”, Part II “Latvian and Inclusive Latvia”, Task 019, Measure 19.7.

<sup>4</sup> Strategy of the Ministry of Environmental Protection and Regional Development for 2024-2027 (approved by Order No 1-2/11 of 26 January 2024).

<sup>5</sup> Cabinet Regulation No 871 “Regulations on the Single Information System of Incentives” of 21 December 2021, Sub-article 2.1 and 2.2 and the annotation, Section 7 of the Law on the Single Information System of Incentives.



The use of SISI is not a voluntary choice of local and regional governments because the provider of incentive who grants or administers an incentive from the state or municipal budget, has a mandatory obligation in accordance with the Law on the Single Information System of Incentives (hereinafter referred to as the SISI Law) from the end of 2024. Therefore, taking into account the broad definition of the concept of “Incentive” in the SISI Law, a total of at least 47 Incentives related to the use of services (goods) had to be administered via the SISI in the sampled local and regional governments.

*The SISI is mandatory but unusable: local and regional governments lack support and funding*

2.7 million euros have already been invested in the creation of the SISI system, but local and regional governments are not actually using it. At least 460,000 euros will be needed from the state budget annually to maintain it, and the implementation support offered by the state to local and regional governments totalling to 2.9 million euros from the RRF funds is insufficient, as applications from 12 local and regional governments already account for 96% of this amount. In addition, contrary to the initially expected savings, local and regional governments will have to cover significant additional costs in order to start using the SISI because integration of one incentive can cost up to 478,000 euros per local or regional government.

Without significant changes in the implementation of SISI and support mechanisms, there is a high risk that further investments will also become an example of unsuccessful investments, not achieving either the planned savings of 4.6 million euros in 2024 and 2025, or the long-term savings of 30.4 million euros over 10 years.

Although the SISI has been identified as an important tool for optimising the management of incentives and is closely linked to the strategic goals of the MSARD in the field of digital transformation, the MSARD and the SDDA have not developed a long-term plan for how the system will develop after the initial implementation, how its maintenance and expansion will be financed, and the deadline for the system to be fully functional and the criteria for its evaluation have not been set. This poses a significant risk that the main goal of SISI, that is, effective and transparent management of incentives across the country, will not be achieved.

The MSARD has not coordinated cooperation with local and regional governments on the development and implementation of SISI sufficiently, so that they can start using SISI in a timely, convenient manner and without significant financial investments within the time limit set by law. As a result, local and regional governments have difficulties in starting to use the SISI.

The MSARD has not taken sufficient action. Local and regional governments do not actually use this system and need significant financial resources to start using SISI instead of the planned savings.

First, one has not defined which of the Incentives determined by local and regional governments require mandatory use of SISI. The information obtained by the State Audit Office of Latvia shows that up to 20 Incentives in each Latvian local and regional government meet the definition of the SISI Law, and 35 to 55 Incentives in the local and regional governments included in the audit sample.

Therefore, the auditors consider that the requirement for mandatory use of SISI for the administration of municipal Incentives would be justified and useful only after identifying, assessing, prioritising all Incentives, determining the administration costs for the most resource-intensive Incentives, as well as standardising their administration processes.

Secondly, a single technical solution (module) has been created for integrating municipal benefits into the SISI system neither at the initial stage of SISI development, nor at present, which requires solutions and costs that fall on the local and regional governments. The SDDA is responsible for the transaction module, but municipal information technology specialists must think about the compatibility of the system with existing solutions in local and regional governments or create new solutions.

Instead, for example, with regard to student catering services in educational institutions, the administration of which many local and regional governments wish to start in the SISI, the SDDA should develop a single solution that can be used in all local and regional governments. The integration of just one type of Incentive, student catering services, into the SISI can cost from 40,000 euros to 478,000 euros for one local or regional government, and annual maintenance costs of an average of 4,300 euros will be required additionally.

The costs of implementing and maintaining SISI will be different for each local or regional government, as the amount of costs depends on several factors. For instance, if a local or regional government has its own means of identification, then the costs of programming and maintaining reading devices will depend on the type of means of identification (application, QR code, bank card, certificate with a chip, etc.). If a local or regional government has its own information system for administering incentives, then it is more convenient to integrate the existing system with the SISI system.

Moreover, the solution proposed by the state to finance the start of using SISI from the RRF funds in the amount of 2.9 million euros with the help of the project “Improvement of incentive management service and implementation support” is insufficient for all 43 local and regional governments because applications of 12 local and regional governments for the necessary funding (Incentives for student catering and/or public transport services) already amount to 2.7 million euros, which is 96% of the available RRF funding.

The use of the system is also not facilitated by the fact that a single means of identification of incentive recipients is not provided, as a result of which local and regional governments need significant financial resources, that is, up to 40,000 euros per year, for the creation and maintenance of their own individual local solutions. As one of the solutions to the situation, the MSARD sees the use of eID cards for a single identification of incentive recipients.

If the MSARD and the SDDA do not address the problems indicated above actively in cooperation with local and regional governments and other competent institutions, the planned savings of administrative resources in local and regional governments as a result of the implementation of SISI will most likely not be achieved, both 4.6 million euros in the short term in 2024 and 2025 and 30.4 million euros in the long term in 10 years in total because only one local government (Liepāja City Municipality) has started using SISI for one Incentive since January 2025, id est, fare reductions in public transport, which took more than two years to ensure the necessary processes for starting to use the SISI.

However, taking into account the variety and number of actually granted Incentives, up to 20 in each local and regional government in Latvia, differences in administrative practice and technical solutions, as well as the problems of human resources and cost accounting in local



and regional governments, one cannot determine the savings in administrative resources in local and regional governments precisely before these prerequisites are arranged.

Based on the findings and conclusions of the audit, the State Audit Office of Latvia has made two recommendations. By implementing them:

- ✓ Local and regional governments shall assess the justification for the need to grant the Incentives to a specific target group of residents when determining them so that they ensure targeted use of financial resources with a clear and understandable impact on the goals of the local or regional government, as well as identify Incentives for which process standardisation and administration in the SISI is possible;
- ✓ The Ministry of Smart Administration and Regional Development shall develop a long-term development plan for SISI in cooperation with local and regional governments by setting specific deadlines for the full use of the system, as well as determining sources of funding for the implementation, maintenance and improvement of the system, simplifying the work of local and regional governments in administering Incentives and using public resources optimally.