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WYDZIAŁ ZARZĄDZANIA, INFORMATYKI I FINANSÓW

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**Ceny transferowe  
w restrukturyzacji spółek komunalnych**

Streszczenie rozprawy doktorskiej w języku angielskim

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## Summary

From the beginning of the nineties of the last century, the enterprises created by local government units to implement public utility tasks began to play an important role in the Polish economy. Areas, where municipal companies operate, such as: water supply, sewage disposal, municipal waste management, heat distribution or public transport belong to the basic fields of proper functioning of each self-governing community.

Municipal companies in Poland have existed for more than twenty years. Before the economic transformation of 1989 they operated in a different organizational form. The capital structure of municipal companies is the result of actions performed by local governments units. That's why the rules of functioning of local authorities should be taken into account. in order to know their specificity.

In municipal companies, there are obligatory three bodies: the management board, the supervisory board and the shareholders' meeting or the general meeting of shareholders - in the case of a joint-stock company. It should also be added that the control over the proper functioning of municipal companies in accordance with the public interest is also exercised by bodies constituting local government units. Their task is not only to participate in the decision-making process regarding companies, but also to represent the interests of the local community, which is the main recipient of public services.

Therefore, there is a need to restructure municipal entities using methods of continuous improvement of management. This way, they can fulfil the criteria for high quality of services provided while incurring low costs. Municipal companies in the dominant scope cooperate with entities related by capital, which are: a commune, a poviat or companies formed by them.

In the subject literature, various types of price calculations, different processes of company shaping and introducing change are widely analyzed. Transfer prices as well as restructuring have been published in many publications in the world literature. However, there is a research gap regarding the impact of transfer pricing on the undertaken restructuring process in municipal enterprises. Between a capital company and a local government unit, or between two municipal capital companies, there are also transactions that need to be analyzed from the point of view of their marketability.

The doctoral dissertation consists of four chapters, preceded by an introduction and summarized by the ending. Each chapter for the transparency of the dissertation begins with general comments and summarize final remarks.

In the theoretical part of the doctoral dissertation, both primary and secondary sources of information will be used. The original ones include academic publications, statutory texts, official documents. Secondary sources include Polish and foreign literature in the field of transfer pricing and enterprise restructuring. Account will also be taken of the financial data published by the Ministry of Finance and the materials originating from the respective companies' websites.

Based on the collected sources, an analysis will be made to serve as a basis for further research in the empirical and analytical part of the work. In addition to the critical analysis of Polish and foreign literature and internal documentation of enterprises, the basic research methods used in this doctoral thesis include case study, inductive methods, as well as reasoning by analogy.

The processes of transformations taken by municipal companies, require an appropriate transaction valuation and the use of an appropriate transfer price. There are problems related to the use of transfer pricing in the restructuring of municipal companies in the areas of finance, accounting and taxation. Therefore, it is necessary to consider the impact of the relations between a municipal company and a related entity on their financial results. It's also essential to analyze how the entity's profitability ratios change in individual years under the influence of modification of the transfer price.

This thesis presents the impact of transfer pricing on the restructuring of municipal companies. It also discusses the complexity of this issue, its universality and, at the same time, its specificity, regardless of changes in legal regulations. This process, which can be found in every city-owned company, is often carried out differently from similar processes in other capital companies. This is due to the different functioning of municipal enterprises which have to perform public utility tasks as part of their statutory activity.

There are also similarities in the application of transfer prices in all capital companies. Such entities are limited by tax regulations because they cannot make transactions which are not justified from the point of view of their marketability.

This dissertation establishes that proper relations with shareholders are the most important factor for the functioning of municipal enterprises in Poland. They determine the existence of these companies, their future, as well as the restructuring processes which such companies undergo. The influence of local governments on municipal companies is limited to the area of municipal services which are offered by these companies (only in relation to the sphere of public utilities ).

According to current legal regulations, the rules of creating and joining local government units with commercial companies are strongly diversified depending on the region of Poland. The formula of a municipal company, as an economic entity, allows to achieve better economic results in the joint implementation of public services by local government units, often in cooperation with entities from the private sector.

The main thesis of this paper assumes the following:

Transfer prices applied by municipal companies have a significant influence on their financial results. In consequence, there are broad possibilities of using transfer pricing in the restructuring processes of these companies. The above thesis will be verified.

In achieving the intended goal it will be helpful to:

- define the scope, forms and measures of the restructuring effectiveness in municipal companies,
- describe methods of estimating transfer prices in municipal companies,
- examine the impact of transfer pricing on the restructuring effectiveness in municipal companies and their financial results,
- indicate certain accounting areas sensitive to transfer prices in municipal companies,
- present differences between financial and tax results due to the use of transfer pricing in municipal companies.

Particular chapters of the thesis provide answers to different questions:

- What is the impact of transfer pricing on restructuring processes implemented in municipal companies by their owners, i.e. local government units?

And secondly:

- What types of activities should be undertaken by a municipal company to become more competitive on the market and to maintain a positive financial results?

Regardless of the reasons for restructuring, this process should be carried out in accordance with the applicable legal provisions on transfer pricing.

This paper also attempts to compare certain restructuring processes in municipal companies to similar processes carried out on the capital market. However, due to the unique character of restructuring transactions concluded within groups of related entities, it is impossible to identify such analogous transactions on the market.

Nevertheless in order to present the influence of transfer pricing on the restructuring process, it is necessary to conduct an economic analysis which proves that the restructuring process is based on rational market conditions.

On the basis of the analysis of profitability ratios, it was noticed that municipal enterprises in Poland achieve worse results in the situation of an incorrectly calculated transaction price. However, the stability of operations for these entities ensures permanent long-term contracts and the implementation of local government orders. This leads to the conclusion that restructuring itself is not a sufficient premise to improve the operation of a municipal enterprise and to rationalize its costs.

It is necessary to execute this process with the use of appropriate prices in the transactions carried out, and in particular transfer prices between related entities. For practical reasons, enterprises try to adapt the formulas for adjusting transfer pricing to tax regulations which require additional documentation to illustrate calculations between related entities.

Tax documentation should contain mandatory elements, which are in art. 9a paragraph 1 of the Corporate Income Tax Act, such as:

- 1) list of the functions to be fulfilled by entities participating in the transaction (taking into account the assets used by them and the risk taken),
- 2) specification of all anticipated costs related to the transaction and form and date of payment,
- 3) the method of calculating profits and determining the price of the subject of the transaction,
- 4) defining the economic strategy and other activities within it – if the transaction value was influenced by the strategy adopted by the entity,
- 5) indication of other factors,
- 6) benefits in the case of contracts concerning services (including services of an intangible nature).

Restructuring process which is carried out in accordance with tax regulations can be a tool enabling taxpayers to increase the tax costs of operations, increase revenues by controlling new markets, minimizing the risk of possible bankruptcy of the company. In order to improve the efficiency of restructuring in municipal companies, it is recommended that local governments develop corporate governance procedures and use legal and economic analysis to create and manage municipal companies. Local governments should pay more attention to reliable and professional preparation of projects entrusted to municipal companies. They also should supervise their implementation more effectively.

In the process of ownership supervision, accounting plays a key role. Information coming from the accounting system is a significant support in making many supervisory decisions - these decisions must be taken by properly informed persons. The areas of supervision that should be supported by information from the accounting system include:

- assessment of the company's financial statements - reliable information included in reporting is the basis for assessing the quality of management,
- issuing opinions on the operational and strategic plan of the company - such an opinion may be expressed only after the analysis of key assets and liquidity of the company,
- reviewing the company's pricing policy - decisions regarding the increase in the prices of services should be preceded by an analysis of the achieved financial result and appropriate simulations of the result after a hypothetical change in prices,
- authorization of activities related to the company's assets - it is also not possible without reliable information about the assets owned by the company.

The accounting system plays a supporting role in the decision-making process. Thanks to the information contained in this system, municipal enterprise can evaluate different decision options - it can forecast the financial impact of individual options in the near future. However, the decision must also take into account social effects that cannot be assessed solely on the basis of information from the accounting system.

Financial analysis is an integral part of accounting. The basic objective of the financial analysis is to assess the financial situation, financial position and financial results achieved by the economic unit. In municipal companies, as in other capital companies, the financial analysis is important from the point of view of business management, because it allows for understanding and proper economic interpretation of processes taking place in the enterprise, it also facilitates making the right economic decisions.

- The information from the financial analysis provides answers to such questions as:
- Was the company's activity effective during the period considered and whether its efficiency will improve or deteriorate in the future?
  - Is the accumulated material and team of employees rationally used and do they guarantee the performance of current tasks and the future development of the company?
  - What are the impact of internal factors on the company's financial results, and what is the influence of external factors?
  - Does the financial condition of the company guarantee timely execution of current payments?
  - What are the strengths and weaknesses of the company's financial economy?
  - What are the barriers to enterprise development and what are the possibilities to overcome them?

The assessment of the financial standing of the municipal company is very important. It includes the presentation of the level of indicators resulting from the financial statements.

It also characterizing the company's operations and results, profitability and the property and capital situation, including solvency. The analysis should cover the current year - in comparison to two or more years preceding - taking into account the impact of inflation on the indicators set, so that conclusions can be drawn and a reliable assessment can be made.

Assessment of the situation of a municipal company, from the point of view of the financial result, requires focusing primarily on indicators characterizing the profitability of operations. They inform about the effectiveness of the municipal enterprise, and affect on the ability of management to generate profits from the resources involved.

Profitability ratios are considered one of the most important in assessing all types of activities undertaken in municipal companies, both of an operational and investment nature. They can also be used to evaluate restructuring projects undertaken by municipal entities. These indicators were constructed through the relationship of various categories of financial results to the relevant volumes that contributed to its development. The classical measurement and analysis of profitability is made using three groups of indicators:

- return on equity - ROE,
- return on assets (or total equity) - ROA,
- return on sales profitability - ROS.

The in-depth analysis of profitability specifies the effectiveness of managing fixed assets and current assets using the return on net assets (RAT) and return on current assets (RAO) ratios. Both ratios determine the rate of return from individual groups of assets, i.e. how much of the net profit is generated from specific assets.

The financial results of each companies have been downloaded from the Ministry of Justice website, which enables the search for financial data of each entity entered in the Register of Entrepreneurs of the National Court Register. This website was also a source of data for the calculation of profitability ratios of the surveyed companies.

In the context of changes in municipal enterprises, a positive assessment of profitability by owners, lenders enables raising capital that will facilitate further development and, as a result, increase the company's ability to generate profits. The amount of equity is related with financial policy, including on the share of foreign sources of financing.

It seems that the analysis of the financial result from the point of view of its profitability can be made only if the entities are compared with each other with similar size and specialization. It is difficult to compare municipal companies with other capital

- 3) operating and management system,
- 4) the culture of the organization, and in it - employees,
- 5) the company's attitude to environmental protection.

After completing the preparatory stage, which involves determining the cause of the restructuring, carrying out the due diligence analysis, indicating the elements of the tax strategy, the enterprise should go to the stage of appropriate restructuring.

Effective restructuring requires solving a number of problems: technological, financial and psychological problems mainly related to employed personnel as well as social problems. Often it is not possible to solve each of them during restructuring. Setting the priorities of activities is therefore an indispensable element that affects the effects of transformations in the unit. Without the development of a plan of action and delegation of tasks, the process of its implementation may end in failure, and the municipal enterprise, as a result of disorganization, may in effect go bankrupt and be liquidated.

The efficiency of the restructuring of municipal companies is also expressed in eliminating irregularities in its functioning through the activities of local government units as part of the applied ownership policy, such as:

- 1) taking effective actions regarding the submission by management boards of companies in due time applications for their bankruptcy or effective actions aimed at improving their economic and financial situation,
- 2) conclusion by local self-government entities agreements on provision of public services by municipal companies concluding financial obligations for compensation granted to the company,
- 3) application of uniform rules for remunerating members of supervisory boards - by making the amount of remuneration paid to members of supervisory boards depending on the participation in the meetings of this body,
- 4) undertaking initiatives aimed at privatizing companies operating outside the public sphere,
- 5) development and implementation of standards and procedures for monitoring the economic and financial activities of municipal companies.

Sometimes in the organizations presented in this paper, remuneration for a service offered does not result from market mechanisms, but comes directly from the arrangements between related parties. An example is the Krakow Municipal Holding, which, thanks to its status of a tax capital group, calculates prices differently from their competitors. In this part of the dissertation, the emphasis was put on examining the areas and possibilities of using the economic transfer pricing instrument in building the company's financial results.

The tools used by municipal authorities in city-owned enterprises to control their financial results are: non-cash contributions from local government units, leases, free provision of services, etc.

Transactions involving non-cash contributions (for example real estate in exchange for shares in a municipal company) allow to obtain assets necessary to carry out public utility tasks by municipal enterprises and to avoid additional costs for the users of those utilities. Thanks to such transactions, there are no consequences in the form of public expenses, including public law liabilities resulting from this transaction. Therefore, certain dilemmas appeared:

- How was the transferred property evaluated by the local government unit?
- Was the appraisal report prepared?
- Was the value of the transferred assets significantly different from its market value?

Such questions come from the specific character of municipal entities and their differences in relation to other capital companies. A similar situation occurred in the case of property lease or free access to properties controlled by local self-governments.

The transactions were not of a market nature but were still justified by the profile of services offered by municipal companies towards the implementation of public utility tasks. The priority is always the same: to satisfy the needs of local community. Therefore, municipal companies assume further use of price preferences in relations with their owners (local governments) in order to implement their statutory objectives.

Taking into account the impact of transfer pricing on the basic scope of activity of municipal companies, it can be concluded that these companies use a number of tax preferences in relation to other capital companies. By using privileged forms of tax advantage in transactions with a local government unit, it is easier for them to provide services within their business operations and still maintain a significant position in the industry.

Differences between the companies set up by local governments and other capital companies can be seen in differing growth dynamics of their financial result. In communal companies the financial result will never grow as high as other companies. Regardless of the differences between the companies, the basic factor affecting the financial result is the price applied in the transactions carried out between these entities. Accounting policy as a mandatory document that each company should possess, describes the principles of valuation of individual assets, and determines the rules for building the financial result.

Having modern infrastructure and many years of experience, city companies are now becoming equal partners for other companies in the fight for the client. As part

of the company's business strategy, its accounting policy must also take into account external and internal conditions of the company's operations, including:

- dominant sources of financing (owner's capital or debt),
- characteristics of the market on which it operates,
- adopted strategy of operation,
- applied management methods and tools.

In their accounting policy, municipal companies – just like any other companies - must include some principles for the classification of economic events, taking into account the possible differentiation of prices used in operations with other entities.

Therefore, to shape prices in restructuring processes municipal enterprises should be treated with extreme caution, transparency and they should require special financial monitoring. Information flowing from the accounting system should be used in all stages of the process. A special role is played by a continuous economic analysis which supports the decision making process.

In order to meet the expectations of local communities, the companies established by local governments are managed in such a way so that the financial result confirms their financial stability year by year.

Comparative analysis (benchmarking) has become one of the basic tools that can be used in the area of transfer pricing. Both taxpayers and tax authorities use this analysis. When a municipal company as a taxpayer concludes transactions of a certain type with both its affiliated entities and independent entities, it is possible to compare them on the basis of internal data. The comparative analysis carried out in this way allows to compare the transactions with a related entity to identical transactions with entities independent of the taxpayer.

Municipal companies are interested in shaping transfer prices on the basis of carried out benchmarking in both smaller and bigger competitive environments. Among the tools which are used in this process we can indicate: sales profitability, liability turnover, receivables turnover, static liquidity ratios and level of indebtedness.

Transfer prices in municipal companies can be considered in three aspects:

- financial - transfer prices affect the company's financial situation and its results and flows presented in financial statements, which in turn has a significant impact on decisions taken by users of financial statements; Transfer prices from the perspective of financial statements should ensure reliable and a true view of the financial and property situation of the municipal company;

- management - transfer prices affect different liability centers in municipal companies and their related entities through costs or revenues, they are important in making management decisions;
- taxation - transfer prices affect the income of a municipal company. According to legal regulations, municipal companies are obliged to create special documentation verifying compliance of transaction prices with established market prices, so-called transfer pricing documentation.

The issue of transfer pricing is not just about using prices close to the prices used by entities unrelated to the industry in similar situations, but it also applies to:

- 1) determining the costs that should affect the formation of prices,
- 2) carrying out an analysis aimed at applying the appropriate level of margin,
- 3) determining the benefits of cooperation,
- 4) transferring of intangible assets,
- 5) establishing and verifying goals and business conditions,
- 6) preparation of documentation constituting evidence in the event of an inspection.

The theoretical basis for the transfer pricing study, widely accepted in the legal system of many countries, is the principle referred to in English as the arm's length principle, which can be translated literally as the "rule of arm length". Its content is an order that, despite the existing links between entities, these entities act in mutual relations, "keeping the contractor at the length of the arm", that is the appropriate distance.

Municipal enterprises, in order to apply the described principle in mutual relations with local government units must specify the conditions that unrelated entities will determine with each other. As examples, it may be appropriate to:

- 1) valuation made in the form of a contribution in kind of assets to a municipal company by local government units;
- 2) shaping the price of services provided, such as lease and rental based on market prices offered per meter of space available;
- 3) determining the amount of interest on loans granted in accordance with the interest rate applied by financial institutions operating on the market.

The consequences of the links between entities are in particular, consider from the point of view of tax law and fiscal penal code. The first consequence may be that entities, despite the existence of connections, should use market prices. The main reason for the creation of related entities is the possibility of transferring revenues between entities,

which sometimes results in showing revenues lower than those that would be expected if the links did not exist.

The application of transfer prices between enterprises is also dictated by the desire to reduce unit costs of products manufactured or services provided. As a result of price formation in related entities at the non-market level, it is possible to adjust the income by tax authorities. Tax officers are obliged to prove that related entities in mutual transactions use prices that differ from market prices. To this end, tax methods for estimating income in related party transactions have been defined, with all three methods being adequate.

Another area discussed in the dissertation was the analysis of the surveyed enterprises in relation to the type of their restructuring and its effects. Most of municipal companies were created as a result of transforming municipal budgetary establishments, and some of them were founded by dividing or separating from existing structures.

On the basis of the processes carried out, each of the enterprises became formally an independent entity with the persistent, dominating role of local government units in their management. However, examples of entities presented in this paper show that ownership supervision does not always guarantee development and good financial results of such companies. An example: deteriorating profitability ratios of municipal companies from the Podkarpackie region, as compared to previous years.

Next issue presented in this thesis was the impact of prices applied in the process of change in municipal enterprises. Often, transactions between local government units and their companies resulted from the necessity to improve the financial result.

Due to the significant volatility prevailing in the business environment and increasing competition in particular industries, restructuring in municipal companies will be undertaken more frequently. Keep in mind that effective change is a critical factor for all organizations that want to survive and be successful. The restructuring plan prepared, supported by its proper implementation, may contribute to the improvement of the financial situation and the company's image. It can be an opportunity to protect an enterprise against deteriorating financial results that may even lead to bankruptcy.

In the restructuring process, it is also important to define the rights and obligations of the municipal company before the restructuring process and to determine the impact that restructuring may have on these rights and responsibilities after its completion, especially in relations with the owner – local government.

In considerations on the nature of restructuring processes as the basic measures of their effectiveness, communal enterprises should take into account the following economic figures:

- 1) employment (indicating changes in the size of the human potential of the organization, informing about the effects of the organizational restructuring process),
- 2) property components (presenting the organization's ability to create added value, the changes of which illustrate the effects of restructuring operations),
- 3) sales revenues (expressing the effects of activities achieved by the company),
- 4) profit (being a surplus of revenues over costs, allowing to measure the effectiveness of financial restructuring).

In some of surveyed enterprises restructuring activities had a predetermined purpose and the prices between the parties were set at a level different from the market prices. Therefore, a dilemma appeared: how will the assessment of meeting market conditions proceed? It should be remembered that during tax inspections in municipal enterprises, tax authorities demand submitting transfer pricing documentation if the transactions carry out with related entities.

Within the last five years, the effectiveness of the control proceedings has significantly increased. The auditors aptly identify entities and issues which are the subject of control and they examine the methods of estimating prices case by case. When examining the market nature of restructuring, tax and fiscal authorities are required to take into account the economic reasons of the restructuring, expected benefits and realistic options which can be used by related entities involved in the transformation.

It should be remembered that during controls in the field of transfer pricing, control bodies are interested in:

- the reasons for the restructuring,
- getting to know the structure before the restructuring (in particular, what were the settlements between related entities),
- any structural changes connected with the restructuring,
- verifying whether the entity taking over certain functions has adequate resources to perform this function.

Restructuring is not a way to avoid transfer pricing obligations. It should be borne in mind that not every transfer of functions, assets or risks will be related to the restructuring which is based on transfer pricing in municipal enterprises. Auditors focus particularly on the assessment of the significance of the transferred functions, assets and risks. Research

conducted in this paper is based on the Transfer Pricing for Multinational Enterprises and Tax Administrations issued by the OECD. This document confirms that the transfer of related side functions (and related risks) between affiliated entities should not always be treated as a restructuring in the context of transfer pricing. They define restructuring as a change/reorganization of the division of functions performed, assets involved and the risk incurred in executed transactions.

Restructuring of operations in municipal enterprises is usually carried out in strong correlation with a significant impact of obliged prices. This is due to the fact that these activities are undertaken through transactions with local government units and not independently, as in the case of other capital companies. The application of the adopted methods, techniques and research tools was the basis for determining whether the adopted assumptions were confirmed in the collected research material. Verification of the data collected from municipal entities shows that the effectiveness of the companies, including the correct evaluation of transactions in restructuring processes, is noticeable in municipal companies which use innovative organizational solutions.

The dynamics of change must take into account the specificity of the operation of municipal companies and the principles of setting transfer pricing and the objectives of their founders, i.e. local government units. This confirms the first of the hypotheses of this paper. Further analysis of the research results confirmed the second hypothesis which concerns the need to strengthen the internal supervisory mechanisms of municipal enterprises in the restructuring process, using management and financial accounting instruments. The company has a chance to survive on the market of growing consumer expectations only if this company manages to effectively implement and strengthen such mechanisms.

It can be said that the main problem of the dissertation has been fully discussed. The main achievement of this paper work is the confirmation of the existence of a transfer pricing mechanism in local self-government companies and its important role in the changes carried out by municipal enterprises. The theoretical aspect of pricing strategies, as well as their tax and financial consequences have been indicated. This dissertation has also carried out a cognitive objective related to the strategy of individual companies concerning the changes and innovations implemented. Practical aspects of this paper create a possibility to use its conclusions in the future by other municipal entities.

The dissertation does not exhaust the problem of the impact of transfer pricing on restructuring processes in municipal enterprises in Poland. An area that requires further recognition is the strategy adopted by local government units in the next years in

the management of municipal companies and building their position in comparison to other enterprises in the public utilities sectors.

An interesting issue related to the assessment of financial results and profitability of municipal companies using transfer prices could be to examine the correlation between transfer prices and financial results and profitability ratios for sales, assets and equity.

In the area of further exploration, it is also required to conduct transactions between municipal companies indirectly linked by capital through a local government unit from the point of view of their marketability and tax security.

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Neigószó

Készlet