NATIONAL AUDIT OFFICE
OF THE REPUBLIC OF LITHUANIA

PUBLIC AUDIT REPORT
PERFORMANCE OF THE LITHUANIAN RADIO AND TELEVISION CENTRE

2 May 2013, No. P-20-12-6

Vilnius

SUMMARY

Audit started	26 November 2012
Audit completed	30 April 2013

Full public audit report is not provided to the public.
Summary of the report is available on the website
of the National Audit Office: www.vkontrole.lt

The Lithuanian electronic communications sector is one of the fastest growing sectors of economy, when it comes to technological development. Further expansion of the services offered by this sector requires investment in the electronic communications infrastructure for the implementation of new innovative technological solutions.

Pursuant to the Law on Electronic Communications[1], the regulation of electronic communications activities is based on the principles of effective management and use of limited resources, technological neutrality, functional equivalence, proportionality, minimal necessary regulation, legal certainty in a dynamic market, economic development, ensuring effective

[1] Law of the Republic of Lithuania on Electronic Communications, 15 April 2004, No. IX-2135 (version of Law No. XI-1552 of 28 June 2011).

competition, consumer rights protection, objectivity of regulatory criteria, conditions and procedures, transparency and non-discrimination.

One of the participants of the Lithuanian electronic communications market is a joint stock company Lithuanian Radio and Television Centre, whose mission is to transmit radio and TV programmes to all residents of Lithuania and which also provides fixed-line telephony, data transmission, *Erdvės* wireless Internet services, services of MEZON 4G mobile Internet, and other services.

On 2 October 2012, transmitters and broadcasters operating in Lithuania applied to the Seimas of the Republic of Lithuania and other state institutions regarding the performance of the Centre. In their view, when managing the basic infrastructure necessary for the provision of services in the TV and radio programmes transmission market, the company limits other participants' access to this market, its has been unduly raising prices for the services provided, has failed to prepare for the transition to digital television in a due manner, has not been separating costs according to activity areas and in this way has been compensating for loss-making activities, etc. By its resolution of 8 November 2012, the Seimas of the Republic of Lithuania assigned the National Audit Office to conduct a public audit of the Centre for the years 2007, 2008, 2009, 2010, and 2011.

Having read the publicly available financial statements for 2007-2011 of the Centre and independent audit conclusions and carried out an analysis of variation in the company's financial and economic indicators and taking into account the problems related to the performance of the Centre which were pointed out by transmitters and broadcasters, the following issues were examined during our audit:

- is the services pricing procedure clear, regulated and public;
- does the investment policy of the company corresponds to the goals set for the Centre;
- how is the Centre meeting its obligation to separate the costs of regulated activities;
- does the Centre have a potential to manage its assets more effectively.

The auditors did not assess technical aspects of the investment projects carried out by the Centre the assessment of which requires specialized technical knowledge in this field. The audit scope and methods are provided in Annex 1.

The audit used confidential information of the audited entity. Confidential data was also used in the audit report. With a view to protecting the information obtained during the public audit which is a commercial (industrial) secret, as well as confidential information, in the procedure established by law and in accordance with Art. 18 (1) of the Law on Provision of Information to the Public, Art. 1.116 of the Civil Code, Art 38 (2) of the Law on National Audit Office, the public audit report “Performance of the Lithuanian Radio and Television Centre” and the confidential information provided therein may neither be provided to the public nor publicly disseminated.

The audit conclusions and recommendations below are provided upon assessment of the audit findings.

Audit conclusions

1. When acting in the telecommunications market, the Lithuanian Radio and Television Centre (LRTC) encounters economically strong competitors whose activity purpose is the same as that of the Centre, namely, to increase revenues and profits in the provision of telecommunications services. The main competitor in the area of transmission of digital terrestrial television programmes at the national level is a joint stock company TEO LT.

The digital terrestrial television connection mode, which accounts for 10.7 per cent of all connection modes (digital content delivered via cable makes up 58.2%, over IP – 14.4%, via satellite – 14.2%, and microwave multichannel system accounts for 2.5%) in Lithuania is not the only and the most common way. When selecting a programme transmission mode, broadcasters take into account the end-user coverage, corresponding income from advertising, and transmission costs.

2. The Ministry of Transport and Communications, which manages state-owned shares of the LRTC, has appointed two members to the Board of the company who are involved in the formation of the information society development policy, therefore the functions of the representation of the state are not separated from the policy-making and implementation functions.

The Ministry of Transport and Communications and Communications Regulatory Authority have been carrying the functions assigned thereto in the electronic communications area within the limits of their competence. The Ministry does not affect the operation and management of the Communications Regulatory Authority, thus independence of the state regulator's independence is ensured.

3. In 2007, the LRTC introduced an activity costs accounting system based on the ABC (Activity Based Costing) method (an activity-oriented cost calculation method the need for which is created by products and services). The system was developed in accordance with the Rules for the Accounting of Costs Following a Fully Distributed Cost Method and Accounting Separation Rules, which were approved by the Communications Regulatory Authority, and observing the requirements related to the separation of accounting.

4. Analogue terrestrial television and radio broadcasting (transmission) services and digital terrestrial television and radio broadcasting (transmission) services have been regulated by the state

as from 2008 and 2010 respectively (the prices may not exceed the costs of these services and a reasonable return on investment), so the LRTC uses a cost accounting separation system for the accounting of these costs, separating the income, expenses, assets and liabilities by the company's business units (television services – TV and radio services – R, data transmission services – DT, other activities and services not subject to distribution – OTHER).

5. A detailed annual set of accounting separation reports prepared by the LRTC is evaluated by the Communications Regulatory Authority. When performing a function delegated thereto to ensure fair distribution of income, expenses, assets and liabilities by business units, the Authority initiates examination of the reports (examinations for the period 2007-2010 were conducted by an audit firm and for 2011 – by the Authority officials). Examination and audit conclusions are public and published on the website.

6. The provision of the distribution of assets by the company's business units in the cost accounting separations system of the LRTC was insufficiently accurate because cases were found when:

- assets were actually not used in the company's activities, but they were not recognized as unnecessary, inappropriate (impossible) to use;
- a property unit was registered in the company's accounting but was owned by another company;
- part of assets located in the technical buildings, where the equipment used for the provisions of services of the Centre is kept, were used for activities other than telecommunication activities.

Depreciation costs of such assets fall within regulated activities and increase the tariffs of regulated services. Although the established amount (LTL 1.2 million) does not have any significant impact on the tariffs of regulated services, there is a risk of a larger amount of such assets.

7. The LRTC handles its financial accounting in accordance with the Business Accounting Standards and generally accepted accounting principles, however, during the period 2007-2011 it did not observe the provisions of Art. 9 of the Accounting Law according to which the head of the economic entity was supposed to choose and implement an accounting policy. The Director General approved the accounting policy by his order of 2 April 2013.

8. The Administration and the Board of the LRTC failed to use all possibilities to effectively manage the company's assets during the period 2007–2011. The company's return on assets ratio, which shows the effectiveness of the use of the company's total assets, was 1.4 per cent

in 2011 and 3.3 per cent in 2007. Such ratio variation tendency indicates decline in the company's economic production efficiency.

9. The services to be provided by the LRTC and their prices are determined by the Pricing Committee and Business Solutions Council of the company. Not all decisions on services and prices which are not regulated by the state are sufficiently documented. Decisions on the prices of state-regulated services are approved by the Communications Regulatory Authority, these prices are made available to the public.

10. The investment policy of the LRTC corresponds to the goals defined in the strategic documents. During the period 2007-2011, the Centre invested a total of LTL 112.8 million for the upgrading and expansion of the telecommunication networks: 51.6 per cent of the used funds or LTL 54 million, were borrowed funds, 48 per cent or LTL 48 million were the company's equity funds, and 0.4 per cent or LTL 0.5 million were budgetary appropriations.

During the period from 2007 to 2011, 49.3 per cent of all investments from borrowed and equity funds were invested into the project of WiMAX mobile broadband internet services. The costs of the WiMAX project were not included in the tariffs of regulated activities.

11. Over the period 2007-2011, the debt of the public establishment Lithuanian National Radio and Television for the services provided by the LRTC was steadily growing: in 2007 it totalled LTL 1.0 million or 15 per cent of all company's trade receivables meanwhile in 2011 it increased to LTL 10.5 million or 65 per cent of all trade receivables. The increasing debt reduces possibilities to invest in the development of activities and to pay dividends in the amount of LTL 2.64 million due to the state from its own funds, which means that the company will have to take a loan and to pay interest to credit companies.

When approving the scope (the number of broadcast programmes and transmission time) and the structure of radio and TV programmes, in 2011 the Council of the Lithuanian National Radio and Television did not take into account lower budget funding of the programme "Transmission of radio and TV programmes via communications networks of the LRTC" which was implemented at that time, so this was one of the factors increasing the debt (LTL 11.0 million in 2012).

Changes which took place during the audit:

1. The Communications Regulatory Authority performs a market research of broadcast transmission services intended for the provision of content services to end users. The research aims to evaluate effectiveness of competition in the broadcast transmission services market and in case of

its ineffectiveness – to identify the economic operators which have a significant influence and, if necessary, to take measures to promote effective competition.

2. After having switched off analogue terrestrial TV transmissions on 29 October 2012, a commission was set up which drew up a list of assets used for analogue terrestrial television and determined which equipment is appropriate to be sold and which can be used for further activities of the LRTC. Currently, redundant analogue equipment has been offered for sale.

3. The accounting policy of the Lithuanian Radio and Television Centre was prepared and approved by the head in 2013.

4. On a decision of the Board of the LRTC, independent audit of the Centre is performed by an audit firm.

Recommendations concerning the improvement of the performance of the Lithuanian Radio and Television Centre

The recommendations were provided taking into account that the National Audit Office conducted an audit in 2010 “Performance of the public establishment Lithuanian National Radio and Television”. It was stated that the government failed to implement the recommendation issued in 2006 “to establish a procedure for the planning of funds allocated from the State budget to the LRTC defining the public services and their scope to be provided by the national broadcaster to the public for the State budget funds.” The recommendation has not been implemented and remains relevant.

Recommendations to the Lithuanian Radio and Television Centre

1. To provide for and implement measures to ensure more effective management of assets.

2. With a view to ensuring correct separation of regulated activities, assets which are not used for telecommunications operations should be transferred to the business unit “Other activities and services not subject to distribution”.