Executive summary of the public audit report

EXECUTION OF CONCESSION CONTRACTS

30 September 2013 No. VA-P-20-10-13

Full audit report in Lithuanian is available on the website of the National Audit Office: www.vkontrole.lt

ABBREVIATIONS AND DEFINITIONS

Concession means the authorisation granted under the Law on Concessions by the awarding authority to the concessionaire in compliance with the concession contract under the terms and conditions set forth therein to engage in the economic and commercial activity connected with the design, construction, development, renovation, transformation, repairs, management, use and/or maintenance of infrastructure objects, to provide public services, manage and/or use state-owned, municipal property (including the exploitation of mineral resources) where the concessionaire assumes under the concession contract all or part of the operating risk and undertakes the relevant rights and duties, while the remuneration of the concessionaire for the activity consists solely of the granting of the right to engage in the relevant activity and income from the activity or the granting of the right and income from the activity together with a remuneration paid to the concessionaire by the awarding authority in light of the risk assumed by the latter[1].

Concession remuneration means any payment to the concessionaire by the awarding authority for the services provided under the concession contract. Fees or charges collected by the concessionaire from end-users are not part of the concession remuneration.

Concessionaire means any entity of the Republic of Lithuania or a foreign state awarded a concession by the appropriate awarding authority in compliance with the Law on Concession. The following shall be considered as entities: an enterprise of any type, a consortium, an association, an agency, an organisation or an entity of another legal form or type established and operating under the applicable laws of the Republic of Lithuania or a foreign state. A natural person shall not be considered as an entity[2].

Awarding authority means the authority which, within the remit of its competence and powers established by the legal acts of the Republic of Lithuania, is responsible for the appropriate functions or fields of activities that may be exercised and ensured by awarding concessions: the Government of the Republic of Lithuania or an institution authorised by it where the concession is awarded on behalf of the state, or the municipal executive authority where the concession is awarded on behalf of the respective municipality[3].

PPP means a partnership of the public and private sectors.

VSAFAS – means the Public Sector Accounting and Financial Reporting Standard.

General government and private entities' partnership (GGPEP) means a form of public-private partnerships whereby a private entity, under the terms and conditions specified in a general government and private entities' partnership agreement, invests in the areas of activities assigned to the functions of a general government entity and the state or municipal assets required for carrying out the activities and pursues in those areas a certain activity for which the private entity is paid remuneration by the general government entity[4].

[1] Law of the Republic of Lithuania on Concessions No. I-1510 of 10 September 1996, No. IX-1647 of 24 June 20013, No. X-749 of 11 July 2006, Art. 2(1).
[2] Ibid, Art. 2(4).
[3] Ibid, Art. 2(7).
[4] Law of the Republic of Lithuania on Investments, No. VIII-1312 of 7 July 1999, Art. 2, No. XI-299 of 16 June 2009.

EXECUTIVE SUMMARY

Traditionally, the public sector develops infrastructure and provides public services on its own; sometimes, however, government institutions transfer the right to carry out these functions to the private sector. This is known as a public-private partnership (PPP). Such projects make it possible for the public sector almost not to use its own funds for investment at the beginning of project implementation and to cover the costs required to build and operate an object in more or less equal amounts throughout the implementation period of the contract, as well as to attract the know-how and skills of the private sector.

Lithuanian legislation provides for two types of public-private partnerships: contractual and institutional. Contractual partnerships are further subdivided into concessions and GGPEPs. The audit looked at one way of contractual partnerships, namely, the concession. The results of the audit of GGPEP conducted by the National Audit Office are provided in the 2013 public audit report “General government and private entities’ partnership”.

The concept of concession, the procedure for selecting the concessionaire and awarding the concession, the subject-matter and content of the contract, the powers, rights and duties of the awarding authority and the concessionaire, and other related matters are regulated in the Law on Concessions[5]. The development, evaluation, implementation, control, and risk distribution of concession projects has been laid down in the Rules for developing and implementing public-private partnership projects approved by a Government resolution[6].

The objective of the audit was to assess whether the preparation for concession projects, their implementation and control help to achieve better results in the public sector.

According to the data of the Ministry of Finance[7], as on 1 January 2013, there were 36 concession contracts under implementation in Lithuania. Of these, 9 contracts were examined in detail and assessed during the audit, taking into account the investment sizes and the commitments of the awarding authorities to pay the concession remuneration.

The following audit conclusions and recommendations were drawn upon the assessment of the audit findings.

[5] Law of the Republic of Lithuania on Concessions
[6] Resolution No. 1480 of the Government of the Republic of Lithuania of 11 November 2009 on the approval of the Rules for developing and implementing public-private partnership projects,
[7] Letter No. (27.4-02)-6K-1304280 of the Ministry of Finance on the public-private partnership agreements and provision of the annual report on the implementation of these agreements

CONCLUSIONS

On the legal regulation of concessions

1. The public-private partnership forms, concession and GGPEP, have not been clearly separated, so in some cases it is not clear what specific laws should be applied when preparing for and executing such cooperation.
2. The definition of the concession remuneration, the principles of its calculation and application, and the possibility of the awarding authority to pay the remuneration to the concessionaire have not been sufficiently regulated. As a result, remunerations are set unreasonably, without having proved the economic return on the public service, a possibility to change the remuneration on the basis of the performance of the concessionaire has not been provided for, the amount of the remuneration is not linked to the risk undertaken by the concessionaire. This does not encourage concessionaires to operate efficiently and create greater value for money.

On the preparation for concession

3. A number of the concession projects were launched without having analysed their appropriateness, social and economic benefits, no comparative analysis of the public-private partnership projects has been carried out. Therefore, there is no sufficient evidence that the public investment and the assets transferred to the concessionaire for management will ensure greater value for money.
4. Municipal Control and Audit Services do not provide conclusions on the appropriateness of the concession, because this is not provided by law. Conclusions on the concession tender and contract terms and the final draft of the contract are limited only to the assessment from the legal point of view, without making sure whether the project will reach the social and economic goals.
5. More than half of the concession contracts examined during the audit were awarded in tenders with only one tenderer. Lack of competition reduces the possibility of the awarding authority to negotiate better terms of concession contracts and determines that concession contracts are signed under less favourable conditions.

On the contractual conditions of concession

6. A number of the concession contracts were signed under conditions less beneficial for the granting authority than it had been indicated in the original tender conditions or in the binding offer of the concessionaire.
7. In a number of the contracts, the concessionaires do not assume most of the risk, as required by the Law on Concessions. There are also cases where the risk is borne by a partner other than the one that is best able to manage it.
8. The concession contracts do not always properly provide for the assurance of the implementation of the concessionaire’s obligations, and the penalties provided are not always sufficient in size to deter the concessionaire from non-compliance, which may prevent the achievement of the concession objectives.
9. Since the state or municipal assets are transferred to the concessionaire for managing, using and earning income therefrom during the concession period, there is no significant basis for awarding authorities to organise and finance any kind of repairs of the assets. This

does not encourage the concessionaire to operate the assets in an optimal manner; moreover, it is recognised that the risk of construction (repairs) is better managed by the private partner.

10. In a number of the concession contracts it is complicated to separate the essential contractual conditions from inessential ones, which makes it difficult to construe the penalties, termination and other provisions of the concession contracts, since the main condition frequently indicated therein is “failure to fulfil an essential term of the contract”.

11. When entering into concession contracts, the public sector fails to make full use of the possibilities of the private sector to offer innovative and more effective solutions for the provision of public services.

On the execution and supervision of concession contracts

12. In some cases, amendments of the concession contracts modify the essential tender and/or contract conditions thus violating the principles of the equality, non-discrimination and transparency in respect of other tenderers.

13. Awarding authorities have sufficient powers to control the execution of the concession contracts, however, they fail to sufficiently exercise their rights and are unable to provide evidence that the analysis carried out thereby allows making sure that the concession contract is executed in a proper manner.

14. Because of the inaccurate data provided by municipalities on the concession contracts, the Ministry of Finance does not have reliable information about the concession contracts awarded by the public sector authorities, and the data of the concession contracts and their implementation is are inaccurate.

15. Although the concession contracts are supposed to be public, the awarding authorities do not enable electronic access to the information, which limits the possibilities for interested persons and institutions to receive information on concession contracts as early as possible and in an easy and prompt manner.

16. Concession remunerations which have to be paid by the awarding authorities during the validity period of the concession contracts are not reflected in the financial statements of these authorities. Thus there is a risk that the awarding authorities will lose control of the ratio of their income to debt, which can have a negative impact on the stability of public finances.

RECOMMENDATIONS

To the Government of the Republic of Lithuania:

1. In order to improve the assessment of the appropriateness and the potential benefits of concession for public needs, the Government should improve the quality of project preparation and implementation and initiate amending relevant legislation laying down the following:

   1.1. the duty for the Public Procurement Office to publish the information not only about the organisation of tenders for public works concessions but also about the award of other concessions as well in the Official Journal of the European Union;

   1.2. the definition of the concession remuneration, aspects and ways of fixing the remuneration linked with the performance of the concessionaire and the risks assumed and explicitly allowing the awarding authority to pay the remuneration to the concessionaire;

1.3. the restriction that the concession contract may not be signed under conditions less beneficial than the ones indicated in the binding offer of the concessionaire;

1.4. the duty to the Municipal Control and Audit Services to provide conclusions on the appropriateness of concession;

1.5. the conditions to be specified as the essential ones in the concession tender documentation and the duty to explicitly indicate these conditions;

1.6. the duty to the Municipal Control and Audit Services to prepare all conclusions on concessions not only with regard to regularity, but also in terms of the economic and social benefits and other aspects;

1.7. instruction to the authorised public legal person to prepare and approve methodologies for determining the economic and social benefits to the public (feasibility study) as well as for developing and implementing projects and a duty to awarding authorities to follow these methodologies;

1.8. the duty to awarding authorities, within a reasonable specific time from the signing (approval) of the documents relating to the concession contract, to publish these documents on their website, laying down the specific information and/or documents to be published.

2. In order to improve the control of the execution and supervision of concession contracts, the Government should provide for and implement additional measures that would ensure effective supervision of contract execution.

To the Ministry of Finance:

3. In order to have reliable information about the concession projects implemented in Lithuania, the Ministry should take measures to obtain accurate data on the contracts entered into and currently being implemented the content of which conforms to the content of the concession contract.

4. In order to have reliable data on long-term financial commitments of the public sector entities, the Ministry should assess whether the legislation properly regulates the duty of awarding authorities to account for the concession remuneration in their annual financial statements and to take action to improve the regulation in case of deficiencies.