Executive Summary of the Public Audit Report

IS THE LITHUANIAN BUSINESS MONITORING SYSTEM EFFECTIVE?

20 March 2018, No. VA-2018-P-20-2-3

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

SUMMARY

The Importance of the Audit

In order to protect the public interest and regulate economic activity such that it contributes to public well-being, the Government makes use of an appropriate measure – the monitoring of economic entities (business monitoring). Business monitoring is necessary for the following:

- the protection of the rights of citizens and the assurance of a safe environment;
- to aid businessmen in meeting set requirements and providing the conditions necessary for fair competition.

It is important for business monitoring to contribute to the creation of value for the public and to maintain monitoring costs for business and the public sector which are proportionate to set goals.

In Lithuania, business monitoring is conducted by 56 institutions responsible for making decisions regarding the reduction of the number of bureaucratic hurdles, excessive requirements, and administrative and other regulatory loads on business. Business representatives understand the necessity of monitoring but think that institutions tasked with conducting related functions lack effective interoperability. They hold some state authorities, such as agencies responsible for administering EU funds, to be engaged in the monitoring of business, even though their functions are actually related to the inspection of the soundness of the use of funds in cases where businessmen seek to obtain and use EU funds for the purposes of developing their businesses.

Regardless of the specific area, business is continuously monitored not only by appropriate monitoring institutions, such as those engaged in the monitoring of the environment, the construction of infrastructure, transportation, non-food products, or food safety, but also by institutions concerned with the rights of consumers, health and safety, and state revenue. Some of them emphasise prevention, e.g., by providing more consultations or applying other methods to encourage businessmen to comply with legislation, while others focus more on inspections.

The reform of the business monitoring system was commenced in 2009. The year 2010 saw the adoption of the provisions for the regulation of the activities of economic entities, specified in the Law on Public Administration, and the development of guidelines for the optimisation of the monitoring functions implemented by institutions. In 2012, however, the focus shifted to the consolidation of monitoring institutions which led to a lack of attention for the encouragement of institutions to improve their operation, i.e., increase the effectiveness of relevant monitoring functions by making use of advanced monitoring measures, cooperating with one another, and conducting assessments of the costs and benefits of monitoring. For these reasons, in order to foster more rapid implementation of changes, the National Audit Office decided to conduct a systemic audit on the performance of business monitoring institutions.

The Goals and Scope of the Audit

The goal of the audit was to assess the effectiveness of the business monitoring system.

During the audit, we have considered business to be the activities of economic entities, with the latter being a natural or legal person or another organisation or branch, engaged in legally regulated economic activities in Lithuania[1]., which may be related to manufacturing, commerce, finance, or professional activities related to the purchase or sale of goods, except in cases where goods are purchased by natural persons to meet their personal or household needs[2].

The audited period was 2016-2017, although, in order to conduct a comprehensive and valid assessment, we have also collected data on previous periods. Data on 2018 was analysed to the extent of its connection to the changes which took place with regards to the business monitoring system.

The key questions of the audit were as follows:

- does the business monitoring policy and the coordination of its implementation contribute to the implementation of effective business monitoring?;
- does the institutional framework and monitoring functions provide the conditions necessary for the effective functioning of the business monitoring system?;
- how does the business monitoring conducted by the monitoring institutions ensure the protection of regulated rights and interests?

Audited subjects:

- the Ministry of Economy;
- business monitoring institutions. The Government had approved[3]. 57 institutions responsible for the monitoring of economic entities, one of which was comprised of 8 RAADs, and one of 10 territorial labour exchanges (73 legal entities in total). 56 institutions were operational by the end of 2017.

Data was collected from ministries which said institutions function under, and municipalities because they are responsible for monitoring business in some areas.

We have also communicated with representatives of the Lithuanian Confederation of Industrialists, the Lithuanian Business Confederation, the Lithuanian Confederation of Employers, and the Investors' Forum. We have conducted an informal discussion with representatives of 11 institutions (4 ministries, 2 confederations, 2 associations, and 3 business monitoring institutions) to whom the public auditors are grateful for their willingness to share their insights.

It should be noted that since business monitoring institutions are responsible for implementing more than just business monitoring functions, the insights of the present audit could also be useful to said institutions in monitoring the activities of public sector entities. Furthermore, institutions monitor objects regardless of who manages them – a private person, a public-sector entity, or a business company, e.g., immovable cultural heritage, construction, fire safety and official language. The National Audit Office will provide a more detailed opinion on state monitoring of certain areas after competing the performance audits specified in its programme for 2018.

The audit was carried out in accordance with the Public Audit Requirements and the international standards of supreme audit institutions. A more detailed description of the scope and methodology of the audit is provided in Annex No. 2, "The Scope and Methodology of the Audit" (p. 48).

[1] Article 2, Part 22 of the Law on Public Administration of the Republic of Lithuania No. VIII-1234 of 17/06/1999 (edition No. XI-934 of 22/06/2010).

[2] Article 3, Part 23 of the Law on Competition of the Republic of Lithuania No. VIII-1099 of 23/03/1999 (edition No. XIII-193 of 12/01/2017).

[3] Order of the Government of the Republic of Lithuania No. 511 of 04/05/2010, "Regarding the Optimisation of the Supervisory Functions Performed by Institutions" (edition No. 932 of 18/07/2012).

The audit had determined the following:

Considering the level of public risk, there is a lack of prioritisation of areas to be monitored at the national level, which results in the failure to assess possibilities for (and the expediency of) transferring certain areas or functions of business monitoring to associated business structures or the private sector, delegating them to municipalities, or allowing them to self-regulate. This indicates that the possibility of improving the business monitoring system is limited.

- An analysis of the goals and activities of institutions, designed to determine which significant interests they are responsible for protecting, has shown that some institutions which have not been authorised to conduct business monitoring as per the Law on public Administration, have been considered to be business monitoring institutions. These include, e.g., the Lithuanian Labour Exchange under the Ministry of Social Security and Labour, the Public Procurement Office, and the Office of the Inspector of Journalist Ethics. The Ministry of Education and Science has been assigned with the supervision of the activities of providers of education, which does not encompass higher education, while the Centre for Quality Assessment in Higher Education actually implements said function, but has not been assigned to it. Institutions responsible for supervising objects, rather than economic activities, have also been uncertain as to their functions, e.g., the Fire and Rescue Department supervises the control of fire safety in buildings and territories, the Department of Cultural Heritage supervises the objects of cultural heritage, and the State Language Inspection supervises language.
- Some activities in the areas of non-food product safety, consumer protection, public health, healthcare (such as the use of chemical substances, sales conducted by travel agents, activities of institutions which provide ambulatory social services, activities of pawnshops, meteorological supervision in banks, etc.) are not supervised.
- There have been no assessments, which take into account the costs and benefits, and the potential public risk, of which supervisory functions could be performed by the private sector or associated business structures, either in full or in part. The areas of the protection of the environment, the construction of infrastructure, transportation, non-food products, and consumer protection, as well as banks and insurance and financial services comprise functions which should be transferred to the private sector, non-governmental organisations, and associations (integrity certification; the examination of bankruptcy and restructuring administrators, insurance brokers, and financial brokers; the coordination of land use planning projects and plot formation and readjustment; the inspection of construction projects, etc.).
- Municipalities conduct their activities in the same areas as public supervisory bodies (the protection of language, transportation, the construction of infrastructure, public health, ad social security). Institutions and municipalities lack in cooperation because they usually only coordinate changes to legislation.

The implementation of the business supervision policy lacks effective coordination.

- The consolidation which took place in 2012-2016 was oriented towards the reduction in the number of supervisory institutions. While the plan was to eliminate 38 institutions, only six were actually eliminated. In 2015, the OECD had noted the consolidation plan's failure to raise the key question of which supervisory functions are required by the state (which general values are to be protected and what goals should supervisory institutions be tasked with) and who will implement them. Since no cost-benefit analysis was conducted during the planning stage, the assessment of consolidation carried out by the Ministry of Economy in 2017 contains no such data. In order to continue with consolidation, the unimplemented proposals must be assessed in terms of soundness (e.g., in the areas of food and veterinary safety, health, construction and infrastructure, education, and the supervision of culture). The Government had assigned the Ministry of Economy and the Ministry of Justice to be coordinators. The latter only took part at the beginning of the reform and is of the opinion that the Ministry of the Interior is the body with competence in this area. Half of the heads of supervisory institutions had failed to appoint persons who would be responsible for the reform. 18 per cent of the supervisory institutions had their functions optimised by transferring (or overtaking) them to (from) other institutions, or by consolidating them, although only 36 per cent of the institutions had performed relevant analyses and calculations. Moreover, in 2017 a working group of the Seimas received a number of proposals from the Government regarding the optimisation of institutions accountable to the Seimas, encouraging it to establish a multisectoral regulator by consolidating the National Commission for Energy Control and Prices, the State Energy Inspectorate, the Communications Regulatory Authority, and to form an institution for the supervision of public information by consolidating the Office of the Inspector of Journalist Ethics and the State Language Inspection.

- The annual reports of the Government and half of the ministries contain no information on the supervision of business performed in their sectors. The rest of the ministries provide only statistical information on some of the supervisory institutions. Ministries fail to assess the effectiveness of the supervision conducted by institutions operating in the field of management. 36 per cent of institutions have not adopted effectiveness indicators and 37 per cent fail to account for their supervisory functions as required. 71 per cent of institutions have not assessed the public impact of business supervision. 52 per cent of institutions plan their funds for their overall functioning without taking into account business supervision (consultations, inspections, etc.). The Ministry of Economy lacks data to assess the state of the system. Given that no calculations are being performed on the costs of business supervision borne by the state, the auditors have performed a calculation based on the data submitted by institutions in 2016 and 2017 (data was submitted by 42 and 40 institutions, respectively), and found that 229 million Eur were used in 2016, and 233 million Eur in 2017.
- Even though one of the goals of the Ministry of Economy is to develop state policy to increase competitiveness, which encompasses business supervision, the Ministry has specified 37 different types of activity which do not include the coordination of business supervision policy, the provision of methodological or other information, and the assurance of cooperation between ministries, institutions, and municipalities. It should be noted that recommendations submitted to Lithuania by the OECD in 2015, which include the consolidation of the reform coordination system, the collection of data on business control and impact, etc., have not been implemented.

Parties to the business supervision system lack a common approach to ensuring the protection of regulated rights and interests

- A third of institutions have not adopted risk determination systems, while those who have lacked clear criteria for assigning economic entities to specific risk groups. Risk assessment results are only used for planning inspections, but not for the provision of business consultations, the assessment of related information, the provision of methodological aid, and the application of other preventive measures. Good practices regarding risk assessment have been specified at the State Food and Veterinary Service, and regarding consultation – at the State Tax Inspectorate. Approximately 80 per cent of institutions fail to implement prior commitments regarding the compliance with legal provisions and draw up declarations of conformity. When updating their questionnaires, almost half of institutions fail to consult with other institutions, business, or associations which represent business. It is the opinion of a third of institutions that current sanctions are insufficiently severe for the purposes of preventing repeated violations.

- Although as many as 89 per cent of institutions have claimed to cooperate with other institutions and coordinate their actions accordingly, only a few have provided actual data on the most frequent issues which necessitate such cooperation (e.g., the Lithuanian Meteorology Inspectorate, the Lithuanian Geological Survey, the Gaming Control Authority, and the Competition Council). Good practices have been set in the area of consumer protection. Even though 61 per cent of institutions claimed to have shared good practices with other institutions, there was a lack of sharing of experience in applying advanced methods. Good practices have been noted at the Competition Council, the Fisheries Service, and the State Consumer Rights Protection Authority.
- A third of institutions have failed to analyse the effectiveness and proportionality of legal regulations and submit proposals regarding their adjustment, while 11 per cent of institutions which did submit such proposals have failed to describe the changes that have taken place after addressing the gaps in legal regulation. 29 per cent of institutions usually review legislation once a year, 69 per cent review it as needed or when new conditions have been adduced, and 3 per cent perform no such reviews at all. Better regulatory practices have been identified at the Bank of Lithuania, the State Data Protection Inspectorate, and the Fisheries Service, while the Customs Department and the State Nuclear Power Safety Inspectorate have been found to have adopted the practice of treating violations as minor infringements.
- A fourth of institutions have only partly defined the skill and competency requirements for employees, and their effectiveness assessment criteria aren't always formulated such that it would be possible to assess their supervisory activities. Good practice – at the State Food and Veterinary Service. 44 per cent of institutions either lack or fail to offer training for their expert employees and training or seminars designed to introduce the latest supervision requirements, their implementation and examples of good practice. Most institutions have not specified ethical, impartiality, and independence requirements, choosing instead to rely on the general requirements for public servants or employees working in accordance with employment contracts. Good practices regarding the ethical code have been identified at 7 institutions, and good practices regarding declarations of confidentiality – at another 7.

Conclusions

Better coordination of the implementation of the business supervision policy, clear assignment of institutions, and a unified approach of the system parties to the protection of regulated rights and interests would provide the conditions necessary for more effective supervision of business:

1. There is currently a lack of prioritisation of activities for supervision which takes into account risks related to economic activities, the ineffective supervision of which could lead to the greatest damage to society (e.g., human life and health), and orients itself towards the services received by consumers. The following are currently not being assessed: the relevance of performed supervisory functions; the existence of activities which, having assessed the risks, costs, and benefits should be reviewed; which functions could be performed more expediently by the private sector and non-governmental or other

organisations; which functions could be allowed to self-regulate; and which functions could be only performed by municipalities, and which – by state authorities. There are currently no grounds for consolidating public resources for the effective prevention of risks, the prevention of damages, and efforts to reduce the supervisory load (Subsection 1.1).

2. Since 2012, the reform of the supervision of business was oriented towards the consolidation of institutions, and the reduction of human and financial resources, rather than costs, and not towards the improvement of operation, which had led to the failure to achieve the goal of reducing supervisory costs without sacrificing quality. There is currently a lack of assessments of the state of business supervision at the national level and in specific areas of business, as well as reports for such assessments, which leads to a lack of data on the value created by business supervision to the public, business, and the state, as well as the use of state resources, which areas of supervision should be improved, etc. (Subsections 1.2 and 1.3).
3. The Ministry of Economy, responsible for the development of business supervision policy, lacks authorisations to coordinate the implementation of said policy, which encompasses all parties to the system, the provision of methodological or other information, and the cooperation between ministries, institutions, and municipalities. This could lead to the possibility of including all parties to the system into the process of improving business supervision (Subsection 1.4).
4. There is currently a number of institutions specified (designated) as supervisory institutions in legislation, which do not actually perform supervision, as well as a number of institutions not specified as supervisory institutions, which do perform such functions. Institutions designated in such a manner (without performing any actual supervision) are incapable of ensuring the mandatory supervision requirements, while institutions which do perform such functions (but have not been designated as supervisory institutions) are not obligated to comply with said requirements in organising and planning their supervisory activities (Subsection 1.2).
5. Deficiencies in business supervision activities in ensuring the protection of regulated rights and interests are as follows:

   5.1 only some of the supervisory institutions base their operations on risk assessments which help in selecting legal norms for inspection in order to ensure their implementation, and determining which norms require less intervention to eliminate the most significant risks (Subsection 2.1);
   5.2 institutions should cooperate more in exchanging information on the risk profile of activities performed by economic entities under inspection, and inspection results, as well as in exchanging good practices and experience in using advanced methods of supervision. There is also a lack of efforts to reduce administrative and supervisory load borne by economic entities, and saving state resources (Subsection 2.2);
   5.3 some institutions fail to assess information on legislation regulating the operations of supervised economic entities and submit such information to ministries in order to eliminate redundant and invalid requirements. There is also a lack in efforts to improve regulation (Subsection 2.2).
6. There is currently no system encompassing the professionalism, impartiality, and independence of supervisory employees, results-driven assessments of operation, and the improvement of skills and competencies. This leads to the failure to encourage inspected subjects to trust their supervision (Subsection 2.3).

Recommendations

To the Government of the Republic of Lithuania:

In order to ensure the development and implementation of business supervision policies, coordinate all parties to the supervisory system, set priority and high-risk areas of supervision, improve the supervisory functions performed by institutions, and consolidate the assessment of (and accounting for) the assessment of the effectiveness of supervision:

1. Designate a responsible institution or provide the Ministry of Economy with all the appropriate authorisations necessary to ensure the coordination of the implementation of the business supervision policy, the provision of methodological and other aid, and the cooperation between ministries, supervisory institutions, and municipalities (Conclusion 5).
2. Assign the designated institution or the Ministry of Economy with the following:

2.1 the assessment or coordination of assessments based on the identification and cost-benefit analysis of economic activities with the greatest potential for causing public damage; supervisory functions (either in full or in part) which could be performed by the private sector, other organisations or municipalities, or be left to self-regulate; and the operation of unsupervised economic entities (Conclusion 1);

2.2 the assessment or coordination of assessments of institutional functions, and the designation of institutions as supervisory authorities in accordance with the scope specified in Part 2, Article 36 of the Law on Public Administration1 (Conclusion 4).

2.3 the assessment or coordination of assessments of the state of business supervision at the national level, and the submission of data regarding the accounting for such to the Seimas (Conclusion No. 2);

2.4 the assessment of submitted, but unimplemented proposals regarding the consolidation of supervisory authorities, the making of decisions regarding further actions, and the performance of said actions (Conclusion 2);

2.5 the planning and implementation of actions intended for the improvement of the performance of supervisory authorities (risk-assessment-based activities; cooperation; the assessment of legislation regulating the operations of economic entities; and the ethical, impartiality, and independence requirement for employees) (Conclusions 5.1-5.3 and 6).

Measures and terms for the implementation of recommendations are provided on page 43 in “The Plan for the Implementation of Recommendations”.