NATIONAL AUDIT
OFFICE OF LITHUANIA
• BRINGING BENEFITS •

LEGALITY OF THE IMPLEMENTATION OF THE MEASURES UNDER THE OBJECTIVE “HELPING BUSINESSES TO SAFEGUARD LIQUIDITY” OF THE ECONOMIC STIMULUS AND CORONAVIRUS (COVID-19) CONSEQUENCES MITIGATION PLAN

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SUMMARY

Relevance of the Audit

Lithuania, like the rest of the world, is facing new challenges and threats in the wake of the COVID-19 pandemic. The euro area economy contracted by 6.8% in 2020[1], as everyday life restriction measures had a negative impact on the services sector, pushing up raw materials prices and disrupting their supply, reducing output and exposing businesses to challenges of continuity.

In March 2020, the Government prepared a short-term plan of measures to stimulate the economy and mitigate the impact of the spread of the coronavirus, taking into account the uncertainties created by the pandemic[2]. It was designed to help solve the problems of business financial liquidity and personal income preservation. The Economic Stimulus Plan has been developed in the light of the negative socio-economic consequences of the pandemic that have already been observed, and the potential for even greater negative consequences in the short term. The plan aimed to provide the necessary

[1] Internet access: https://sdw.ecb.europa.eu/ (accessed on 13/05/2021).

[2] 16/03/2020 Decision of the Government Meeting, Minutes No 14

resources for the efficient operation of the health and public security systems, to help preserve jobs and maintain people's incomes, to help businesses safeguard liquidity, to stimulate the economy, and to ensure the liquidity of the State Treasury[3].

Recognising that successful business development leads to higher employment, higher tax revenues, social welfare and security, and faster growth of the gross domestic product, we carried out an audit on the legality of the implementation of the measures under Objective 3 "Helping Businesses to Safeguard Liquidity" of the Economic Stimulus and Coronavirus (COVID-19) Consequences Mitigation Plan. In assessing the legal compliance of the processes and funds to help businesses safeguard liquidity, we also looked at the adequacy of the legal environment to achieve the objectives and measures adopted.

Objective and Scope of the Audit

The objective of the audit is to assess the legal compliance of the implementation of Objective 3 "Helping businesses safeguard liquidity" of the 2020 Economic Stimulus and Coronavirus (COVID-19) Mitigation Plan. During the audit, we assessed the measures that received direct funding from the State budget, i.e., 9th[4]–12th measure groups of Objective 3, as well as 5th measure, which increased the guarantee limit.

Audited entities:

- Ministry of Economy and Innovation has administered the implementation of 9th (increasing the liquidity of business entities) and 12th (ensuring the liquidity of the tourism sector) groups of measures;
- Ministry of Agriculture has administered the implementation of the 10th group of measures (safeguarding the liquidity of the agricultural sector and increasing the availability of financial services for operators active in agriculture, forestry, food, rural development and fisheries, and reducing the cost of borrowing, as well as providing for the reimbursement of interest and guarantees to those economic entities that are no longer eligible for reimbursement); as well as the implementation of the 11th group of measures (enabling the preservation of the production potential of the agricultural sector and the sustainability of the food supply chain (providing temporary State aid to dairy producers, cattle farmers, pig keepers, and vegetable producers; ensuring the payment of support to enterprises active in the processing of agri-food products in the dairy, beef and veal, poultrymeat, and eggs sectors, and which have suffered losses as a result of the COVID-19 epidemic situation));
- 'Investicijų ir verslo garantijos' UAB has implemented 10 (of 13) measures of 9th group of measures and one (of 2) and 5th measure of 12th group of measures[5];

[3] Internet access: Financial and economic decisions on COVID-19 | Ministry of Finance of the Republic of Lithuania (lrv.lt) (accessed on 13/05/2021).

[4] We did not assess 9.5th measure (Business Assistance Fund) at the time of the audit as the audit period is 2020 and the Fund only became operational at the end of October 2020, with only one project committed as at 31/12/2020.

[5] To increase the guarantee limit of the Agricultural Credit Guarantee Fund and Invega to EUR 500 million and extend the conditions for granting guarantees.

- State Tax Inspectorate under the Ministry of Finance (VMI), Lithuanian Business Support Agency and National Shared Functions Centre have implemented 2 (of 13) measures of 9th group of measures;
- 'Keliauk Lietuvoje' VšĮ has implemented one (of 2) measure of 12th group of measures;
- National Paying Agency under the Ministry of Agriculture has implemented 3 (of 12) measures of 10th group of measures and all 10 measures of 11th group of measures;
- State Enterprise Agricultural Information and Rural Business Centre has implemented 6 (of 10) measures of 11th group of measures;
- 'Agricultural Credit Guarantee Fund' UAB has implemented 9 (of 12) measures of 10th group of measures and 5th measure;
- 34 municipalities selected have implemented 3 (of 12) measures of 10th group of measures and 7 (of 10) measures of 11th group of measures.

The audit period – 2020 (from the adoption of the measures in 2020 to 31/12/2020).

The audit has been performed in accordance with the Public Auditing Requirements and International Standards of Supreme Audit Institutions. The scope and methods of the audit are described in greater detail in Annex 2 Audit Scope and Methods (p. 33).

Key Results of the Audit

1. Lack of coherence and information when planning expenditure to mitigate the effects of COVID-19

- We consider the practice when the State budget indicators approved by the Seimas are amended not by the Seimas itself but by the Government to be amended, as it reflects weaknesses in planning, does not provide sufficient information for fiscal risk management and increases the risk of breaching fiscal discipline requirements when they are applied. Therefore, we made a recommendation back in 2016[6]: to ensure compliance with the provisions of the Constitution, to initiate amendments to the legal acts after deciding what financial indicators and how many of them the Seimas must approve and the extent of rights to be granted to the Government to implement the budget. The unimplemented recommendation became particularly relevant in the pandemic year 2020, when a very large amount of borrowed funds (EUR 3,294.3 million, representing 25.7% of the appropriations approved by the law[7]) to mitigate the economic impact of COVID-19 was not included in the appropriations approved by the State budget.
- The Economic Stimulus Plan itself was approved only by decisions in the Government meeting minutes, despite the fact that the Constitution stipulates that all affairs of state governance falling within the competence of the Government must be decided

[6] Public Audit Report "Regularity of 2015 Set of Consolidated Statements of the State and Assessment of State Budget Execution" of 03/10/2016 No. FA-P-60-6-10-1.

[7] For 2020, an appropriation of EUR 12,778.5 million has been approved for expenditure and acquisition of assets.

by adopting resolutions. Given the uncertainty of the circumstances and the urgency of spring 2020, the method of adopting the Plan is understandable, however, the continued adoption of amendments to the Plan by means of decisions in the minutes has not ensured the requirements of openness, transparency, and concentration of legislation [8]. In the course of 2020, the Plan has been revised 13 times, with amendments to its measures and reallocation of funds. The Government adopted 41 resolutions on the allocation of funds on the basis of the Plan, indicating that the plan has been followed as a legal act without being registered in the Register of Legal Acts, which would have allowed access to the new version and amendments.

- There were no criteria set for including or excluding Objective 3 measures in the plan. One of these measures, the market-based incentive financial instrument "Alternative" (Lith. Alternatyva)[9] was not specifically adapted for the COVID-19 period, nonetheless, it was included in the Plan. Other measures to be implemented, such as individual guarantees[10] and "Rasberry" (Lith. "Avietė")[11] concentrated loans, which were adapted to the COVID-19 period, were not included in the Economic Stimulus Plan. In this way, the plan did not show all the measures to stimulate business.
- In addition, not all groups of measures under Objective 3 of the plan have been specified into concrete measures to be performed. The groups of measures for agriculture (10th and 11th) are not specified, only general and abstract information is provided (e.g. facilitating the safeguarding of the liquidity of the agricultural sector and increasing access to financial services); it is therefore unclear by which particular actions (loans, subsidies, etc.) the Government intended to to support or encourage this sector (Section 1, p. 12).

2. The majority (31 out of 37) of the Plan's Objective 3 measures were also aimed at supporting large enterprises

- The Temporary State Aid Communication [12] stated that Member States should pay particular attention to supporting micro, small and medium-sized enterprises, as they make an important contribution to jobs and economic growth in the EU. In order to preserve the liquidity of micro-enterprises [13], the Government included a micro-enterprise subsidy measure in the Economic Stimulus Plan, however, the vagueness of the concept has prevented the achievement of this objective to the maximum extent. The concept of small and medium-sized enterprises is defined by the Law on Small and Medium-sized Business Development (SMBD), which includes the concept of micro-enterprise. The concept of micro-enterprise is not discussed in this law, its definition was established in the Government' Resolution, which, by defining a micro-enterprise only in terms of the number of employees, created preconditions for the allocation of the State budget funds to entities whose financial indicators are larger than those of micro-small enterprises, as defined in the Law on the Small and Medium-sized Business Development. As a result, very different market participants (non-

[8] 18/09/2012 Law on Legislative Framework, No. XI-2220, Article 5(1), Article 17, and Article 19.

[9] The Description of the Measure approved by the 17/04/2020 Order No. B-49 of 'Invega' UAB Director General.

[10] 21/10/2019 Order of the Minister of Economy and Innovation No 4-595 "On the Approval of the Provisions on the Provisions on Granting Loan Guarantees for Small and Medium-sized Enterprises".

[11] The Description of the Measure approved by the 04/04/2018 Order No. B-50 of 'Invega' UAB Director General.

[12] 19/03/2020 Communication from the Commission "Temporary Framework for State Aid Measures to Support the Economy in the Current COVID-19 Outbreak"

[13] 06/05/2020 Minutes of the Government Meeting No 23

comparable enterprises) were qualified for support; in 2020, 10 large enterprises were among the recipients of microenterprise subsidies (with annual revenue of more than EUR 50 million or a balance sheet asset value of more EUR 43 million), 113 medium-sized enterprises (with annual revenue of less than EUR 50 million and a balance sheet asset value of less than EUR 43 million), and 938 small enterprises (with annual revenue of less than EUR 10 million and a balance sheet asset of less than EUR 10 million).

- Large enterprises were eligible for 31 (of 37) of the Plan's Objective 3 measures. Of these, 22 measures meant for the agricultural sector were based on the Law on Agriculture and Rural Development [14], which does not differentiate between agricultural entities by size. All other measures for business and tourism were based on the Law on SMBD[15] regulating support for small and medium-sized enterprises, however, the Law does not regulate support for large enterprises. Thus, the support measures for business and tourism supported large enterprises on the basis of schemes approved by ministerial orders and descriptions of the conditions for the implementation of the measures, in addition to the law regulating State aid to large enterprises (Section 2, p. 15).

3. The conditions for different business sectors to receive state budget funds are not based on the same principles

- In the 2019 report[16], we provided insights into the project (selection)-based funding method, as it is widely used when the State supports relevant activities and initiatives (small businesses, agriculture, sports, culture, etc.). However, project funding is initiated by the managers of appropriations in accordance with their own procedures for a project (selection)-based funding, and this practice of applying for project funding in the absence of common funding principles creates the conditions for a potentially biased and non-transparent use of State budget funds. At the time, we recommended that the Government should regulate common principles and rules for the application of the project (selection)-based funding method.
- In implementing this recommendation, it is also appropriate to take into account the experience and practice during the pandemic period, when the conditions for access to State aid for the business and agricultural sectors were not based on the same principles: on the fall in revenues by 2020, on the size of enterprises, on the maturity of loans, on the terms and conditions of the repayment of loans, on the level of the interest rate to be compensated, etc. In 9 of the 13 measures for other businesses, the agricultural sector was also subject to support. The COVID-19 situation has thus highlighted the need to develop financing models that work not only in good times but also in emergencies (Section 3, p. 19).

4. Insufficient assessment criteria and loan conditions that do not encourage business sustainability

[14] 25/06/2002 Law on Agriculture and Rural Development No IX-987, Article 8(4)

[15] 24/11/1998 Law on Small and Medium-sized Business Development No VIII-935.

[16] 01/10/2019 Public Audit Report No. FA-8 "Assessment of Regularity of 2018 Sets of State Consolidated Financial and Budget Execution Reports and Legality of Management, Use and Disposal of State Budget Funds and Property".

Insufficient assessment criteria for granting loans to companies most affected by COVID-19

- In mid-April 2020, a measure was started to provide urgent and unrestricted financing in the form of loans to small and medium-sized enterprises facing difficulties as a result of the COVID-19 outbreak in order to allow businesses to pay for their necessary expenses. The aid was open to companies that were not experiencing difficulties as of 31/12/2019. The ratio of equity to share capital was assessed in the case of experienced difficulties. We found that 8 (of 29) of the loan recipients examined were distressed by a debt-equity ratio that was not assessed at the time of the support[17], and 4 of them were in bankruptcy or restructuring in six months. We believe that the failure to select sufficient criteria for assessing the applicants' financial situation could have led to aiding companies that were already in difficulties before the pandemic (Subsection 4.1, p. 24).

Conditions of the incentive financial instrument "Alternative" do not stimulate business sustainability

- Another market-based incentive financial instrument "Alternative" was not directly linked to the COVID-19 period yet allowed businesses to borrow from the alternative market. More than half of the loans (58%) had annual interest rates between 16% and 29%, 2% had annual interest rates between 30% and 36% and one loan had an annual interest rate of 60%. In two cases (of the 13 audited), financial intermediaries charged administration and contract fees of 15–17% of the loan amount. We believe that such loan conditions may have a negative impact on the borrowers (Subsection 4.2, p. 26).

5. "Formal" assessment of applicants for granting of support to the agricultural sector entities

Municipalities and the National Paying Agency carried out a "formal" assessment of experienced difficulties

- In 6 measures for agriculture, municipalities have been entrusted to carry out an assessment to ensure that the enterprises applying for support are not considered to be in difficulty on 31/12/2019, while in 1 measure – National Paying Agency. A third of the municipalities audited (11 of 34) and the National Paying Agency indicated that they did not assess the financial statements and that they relied on the information provided by the applicants that they were not experiencing difficulties. This indicates a lack of guidance or recommendations on the assessment of the experience of difficulties (Subsection 5.1, p. 28).

9% of farmers who have received support failed to declare their income to VMI

- The Plan's Objective 3 measures for agricultural entities did not require farmers to have declared their income or paid any taxes due. Also, in order to reduce the administrative burden in assessing the impact of COVID-19, in some measures, the fall in income for the sector as a whole, rather than for an individual applicant, was assessed. We found that 9% of the beneficiaries (8 of 89) did not declare their income to the VMI in 2019, and that the same proportion of farmers declared a different income

[17] The debt-equity ratio was not assessed as the applicants had submitted an SME declaration stating that they were classified as SMEs. In accordance with Article 2(18) of EU Regulation No 651/2014 of 17 June 2014, the experience of difficulties for SMEs can only be determined by looking at the ratio of equity to share capital.

in 2019 than in their financial statements. In our 2013 Public Audit Report "Agricultural Tax Reliefs", we made observations on inconsistencies in the declaration of farmers' income to different institutions (Subsection 5.2, p. 30).

Recommendations

Our audit does not make any recommendations, yet, taking into account the experience of the pandemic and the practice of ensuring that decisions in emergencies are taken without delay and in accordance with the law, and that transparent funding models are in place during periods of economic boom and emergencies, particular attention needs to be paid to the implementation of the recommendations previously made to the Government:

1) in order to ensure compliance with the provisions of the Constitution, to initiate amendments to the legal acts after deciding what financial indicators and how many of them the Seimas must approve and the extent of rights to be granted to the Government to implement the budget (Audit result 1);
2) in order to ensure a transparent and targeted use of public budget funds, to regulate common principles and rules for the use of project (selection)-based funding (Audit Result 3).

We forwarded information on farmers who did not declare their income or whose income differed from their financial statements to VMI and other institutions for control actions.