Organisation of public procurements in companies, foundations and non-profit associations founded by cities or rural municipalities or with their participation

If and how rural municipality and city companies adhere to the Public Procurement Act.

NAO's report to the Parliament, Tallinn, 21 April, 2010

The NAO audited the organization of public procurements in the companies, foundations and non-profit associations founded by cities and rural municipalities or with their participation (hereinafter referred to as "companies"). After analyzing the purchases of 30 companies, 19 were selected for auditing. The assessment was given based on the acquisition of assets and contracting of services and construction work by companies in 2008.

In 2008, the purchases of the companies of Estonian rural municipalities and cities amounted to more than EEK 4.8 billion. As rural municipalities and cities can found companies, foundations and non-profit associations only based on taxpayers' interests, it is understandable that the activities of said companies are an object of public interest.

Taxpayers need to know for certain that when constructing objects of public interest, purchasing goods and ordering services, funds will be used in a transparent, purposeful and economic manner, persons will be treated equally and existing competition will be used. Both for smaller and larger purchases it is necessary to adhere to the general principles of public procurement and in the case of larger purchases, adhere to the limits for the cost of public procurement laid down in the Public Procurement Act; if said limits are exceeded, procurement must be organized to find the best tenderer.

As a result of the audit the NAO found that a large number of public purchases is still being conducted without the organization of public procurements. Many companies and their owners, local governments, often fail to realize that transparent activities that promote competition help reduce squandering and risk of corruption within companies. However, the state has failed to ensure, in the field of public procurements, clear and unambiguous legal framework and supervision, and state supervision arising from the company's substantial activity.

Current Public Procurement Act has been in force for nearly three years but the Ministry of Finance and Public Procurement Office have yet to explain the ambiguous sections of the Act that may cause confusion. This has provided a large number of local government companies with an opportunity to think that this Act does not apply to them. Thus, only 15 companies engaged in public interest have informed the Public Procurement Office of themselves as suppliers. All in all, as at 01.01.2009, there were 335 companies controlled by the state and by rural municipalities and cities, 247 of them owned by rural municipalities and cities.

In addition to not defining themselves as suppliers, the companies have mostly also failed to implement other principles promoting transparent procurement and competition upon making investments and purchases. However, the Public Procurement Office, due to ambiguous interpretation of the law, has limited the scope of its surveillance to those local government companies who have defined themselves as suppliers, formalized a decision on it and informed the Public Procurement Office of this decision. Although the Public Procurement Office carried out surveillance of 55 suppliers in 2008, these included only one company founded by a local government.

The Ministry of Finance, responsible for developing public procurement policy, has not provided any solutions to this problem, despite Public Procurement Office's repeated proposals to clarify the process of defining companies engaged in public interest as suppliers. Instead of solving substantial problems the Ministry of Finance has prepared an amendment of the Act to reorganize supervision in the field of public procurement, thus ending the activity of the Public Procurement Office. The NAO is of the opinion that along with this amendment, the substantial problems related to the implementation of the Act must be solved clearly and unambiguously.

Main observations of the NAO:

- **Of 19 audited companies, at least 9 had failed to organize procurements for larger purchases that exceeded the limit laid down in the Public Procurement Act. A total of 16 companies had failed to adhere to the more general requirements of the Public Procurement Act.**

- Local government foundations and non-profit associations are automatically defined as suppliers but the Public Procurement Act does not clearly determine which companies must organize public procurement and thus companies engaged in public interest have to define themselves as suppliers. **30 entities were analysed in the course of the audit and of those 20 companies (public limited companies and private limited companies) 17 had ignored the Public Procurement Act and had not defined themselves as suppliers. Upon making purchases, these companies adhere to the Public Procurement Act selectively (or not at all) and state supervision is not carried out for these purchases.**

- **Public Procurement Act is complicated and even in mid-size companies who try to adhere to the Act the need for organizing procurements is so rare that it is hard for the supplier to acquire consistent competence in organizing public procurements.** Only a small number of audited entities could coordinate the entire procurement process from planning the budget to monitoring the performance of the procurement contract.

- **The number of suppliers who failed to comply with the simplest requirements of the Public Procurement Act was disturbingly large.** 14 audited entities did not comply with the obligation to inform the public of smaller purchases via a website or newspaper, and 13 audited entities did not comply with the obligation to submit a report to the Public Procurement Register. Regarding smaller purchases, 18 of 19 audited entities violated the general principles of ensuring competition of the Public Procurement Act.

- 5 companies violated the ban on amending the terms and conditions of the procurement contract concluded as a result of procurement. **The number of changes was the largest after concluding procurement contracts for construction procurement and insufficient construction projects were given as a main reason for that.**

- **Rural municipalities and cities as the members, founders and owners of non-profit associations, foundations and companies could not make them carry out public procurements.** For instance, the City of Tallinn would like for all companies owned by the city to define themselves as suppliers but the East Tallinn Central Hospital did not consider it necessary and acted at its own discretion, finding the organization of public procurements to be an expensive and time-consuming procedure. The purchases made ignoring the Public Procurement Act amounted to nearly EEK 450 million in 2008.

- For undertakings providing services related to water, energy, passenger transport or other network services, procurement limit is higher for network-related procurements than for regular procurements. However, if such an undertaking corresponds to the general characteristics of a supplier, it should adhere to the provisions of the Public Procurement Act when making purchases not directly related to network areas and carry out such purchases as regular procurements. Unfortunately, network undertakings tend to adhere to the limit related to network procurements and fail to organize procurements for regular purchases. **In 2008, the total amount of the purchases of three network-related suppliers was more than EEK 268 million whereas only one company carried out procurement during the entire year.**

General comments on the audit report of audited entities and Tallinn, Pärnu and Kuressaare City Councils.

The Ministry of Finance stated that it does not approve of limiting the scope of supervision carried out by the Public Procurement Office. The Minister said that the Ministry of Finance has submitted its opinion on the authorization of performing state supervision over persons who are not suppliers but organize public procurements due to the obligation arising from the Public Procurement Act. The Ministry of Finance explained that respective provisions addressing supervision and opposition procedure should extend to everyone who is obliged to adhere to provisions related to suppliers pursuant to the Public Procurement Act. The same opinion on the scope of supervision also applies to companies founded by local governments and other suppliers who have not defined themselves as suppliers but who, according to the Public Procurement Act, have all the characteristics of a supplier.

The Ministry of Finance also stated that a draft Act to amend the Public Procurement Act is in the legislative proceeding of the Parliament and it shall try to solve the biggest problems related to the organization of public procurements.

The NAO compliments the bodies conducting draft Act proceedings who added a proposal of amendment during the proceeding, according to which in the future the state of being a supplier shall be a fact, not something defined by the founder or the company itself.

Tallinn and Pärnu City Councils, East Tallinn Central Hospital and Estonia SPA did not concur with the conclusions of the NAO that said public limited companies are suppliers for the purposes of the Public Procurement Act and should have conducted public procurements in the audited period. They were of the opinion that in its report the NAO has not given sufficient and convincing reasons for the obligation of being a supplier.

The NAO draws attention to the opinions of the Minister of Finance as the coordinator of the area of public procurement, appended to the report (See Annex C), where you will find argumentation, with references to decisions of the European Court of Justice, on why said companies are suppliers for the purposes of the Act and why they should have defined themselves as such.

Tallinn City Council agreed that several practical problems have occurred regarding the implementation of the Public Procurement Act since its entry into force on 1 May, 2007, incl. the ambiguity of the Act on defining legal persons in private law as suppliers. In its response the City Council also mentioned that during the preparation of the draft Act the representatives of Tallinn City Council drew attention to the unfortunate selection of the Act and upon its entry into force, Tallinn City Office submitted an inquiry to the Ministry of Finance regarding the implementation of the Act but failed to receive necessary instructions.

Estonia SPA replied that both its Management Board and Supervisory Board are of the opinion that public limited company is a commercial enterprise whose purpose and duty is to earn profit and that in its economic activities a company does not perform any duties for public interest.

Saaremaa Golf stated that it did not organize public procurements for the purchase of goods and services due to the opinion of an advocate's law office, according to which the undertaking did not correspond to the definition of supplier for the purposes of the Public Procurement Act.

Uikala Prügila found that as the regulator has not provided an opportunity for companies to decide whether or not to define themselves as suppliers, Uikala Prügila has not defined itself as a supplier. Public procurements have been organized only when funds are received from outside the company, e.g. from Environmental Investment Centre, Enterprise Estonia, Cohesion Fund. Uikala Prügila replaced public procurement with adjudication from companies. Upon purchasing goods and making larger investments, final decisions were adopted on the basis of adjudications presented by the Management Board at the meeting of the Supervisory Board. To prevent further mistakes in organizing public procurements, Uikala Prügila shall define itself as supplier. By the decision of the Supervisory Board, the company shall adopt the procedure for organizing public procurements and Management Board's activity in organizing public procurements shall be monitored by the internal control of the Supervisory Board.

South Estonian Hospital complimented the NAO on reaching a desired audit result: to draw the attention of audited entities to the potential shortcomings in the implementation of the rather complicated Public Procurement Act.

Tallinn Diagnostic Centre was of the opinion that the company had adhered to the Act in the best possible manner. It claims that their efforts to adhere to the Public Procurement Act were not adequately assessed in the audit, as the Diagnostic Centre has fulfilled the purpose of the Act.

Tallinn Tram and Trolleybus Company found that as their company is a supplier engaged in network-related areas whose main activity is the provision of tram and trolleybus services to the public, the law does not require the company to organize procurement if the estimated cost of the procurement contract is less than the international (i.e. in the area of transport) limit.

As a result of the audit the NAO is of the opinion that the need to organize procurements under said limit depends on whether the purchase is related to the area of network or not. According to the statutes of the public limited company, it is also active in areas not related to networks.

Põltsamaa Vallavara is of the opinion that the audit report shows that the problems addressed by the audit can mostly be blamed on the Ministry of Finance who has failed to find order in the mess it has created. In such case, it cannot be asked from undertakings either. Companies related to local governments should long ago have been given a clear sign of their rights and obligations. Conflicting Acts do not show the relationship between the state and undertakings in the best light.

Saku Maja, Pärnu Koolide Sihtasutus, SA Ida-Virumaa Kiirabi and Põlva County Local Governments Association stated that they shall start implementing the recommendations given in the audit.

As Tallinn and Pärnu City Councils did not use the opportunity to shape City Council's opinion at the session of the City Council, the NAO cannot be certain that all members of said city councils could read the draft audit report.

The full texts of the replies of the Minister of Finance, Public Procurement Office and audited entities are available at the NAO website www.riigikontroll.ee in the “Audit Reports” section.

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