Public-private partnerships in local authorities

Are the cooperation projects of local authorities and their private partners transparent?

Report of the National Audit Office to the Riigikogu, Tallinn, 3 April 2012

The National Audit Office analysed the cooperation of local authorities with private partners in the provision of public services. 15 public private partnership or PPP projects, where one of the parties was a local authority or its company and the other party was a private company, were inspected. The activities of the local authority or its company in the implementation of the project were evaluated in the course of the audit: was the private partner selected pursuant to the Public Procurement Act; have the long-term financial obligations assumed in order to carry out the project been correctly recognised; and have the projects been evaluated according to the principle that public services must be provided under the most favourable conditions. The National Audit Office did not evaluate whether the implementation of PPPs is reasonable, sustainable and in the interests of the taxpayer, because the National Audit Office has not been authorised by the legislature to evaluate the activities of local authorities from the viewpoint of performance.

Municipalities, towns or cities usually initiate PPP projects when they need to rapidly carry out a development plan, but lack the money, knowledge and will to do so, which can however be found in the private sector.

One of the fundamental principles of the activities of local authorities is to provide public services under the most favourable conditions, which is why they should consider whether transferring their duties to a private partner is the best and most effective solution for the taxpayer. Placing more risks on the shoulders of the private partner generally makes the project more expensive for the taxpayer. As far as the taxpayer is concerned, the responsibility for carrying out a PPP project properly rests mainly with the local authority, who does not only have to guarantee that an object is completed or a service is provided as quickly as possible, but also that the Public Procurement Act, the General Rules of State Accountancy and the debt restrictions stipulated by law are adhered to in a PPP.

The National Audit Office found that local authorities are often unaware of the requirements set for public-private partnerships and do not analyse whether the implementation of a project with a private partner is the most expedient solution. Selection of private partners for cooperation is not transparent.

In the case of more than a half of the audited projects, the local authorities did not understand that the projects are PPP projects the implementation of which is regulated with several legal acts. The reasons for this are that the legal acts which regulate PPPs are ambiguous, the theoretical interpretation of a PPP is unclear and the guidelines necessary for such cooperation have not been established.

In the case of projects that have brought about financial obligations, the lack of regulation has made it possible for local authorities to enter into contracts where future financial obligations are specified so vaguely that they cannot even be accurately calculated. This means that it is often impossible to present the public with an analysis of how much the PPP project costs in comparison with possible alternatives (e.g. using a bank loan to finance the project) before the project has ended.
The National Audit Office believes that the Ministry of Finance should analyse the PPP projects carried out by local authorities, take the initiative in developing the guidelines that regulate such projects and counsel those who carry out these projects.

As a result of the audit, the National Audit Office found that ten of the 15 audited PPP projects had the features of a construction concession (i.e. a long-term permit to establish and use a building in which public services are provided had been granted). Six of these ten contracts brought about long-term financial obligations for the local authority. Three of the 15 projects were concessions for services (i.e. the long-term permit to provide a public service had been granted) and the local authority and the private company had created a joint company in order to carry out one project . One PPP project was discontinued during the audit and the National Audit Office therefore did not give its opinion of the project.

On the basis of the actual nature of the projects the National Audit Office found that:
■ In nine of 14 projects, the local authority had not proceeded from the Public Procurement Act when selecting their private partner. A public procurement had been organised in only one of ten construction concessions (Vändra). The Public Procurement Act had been adhered to in all three cases where cooperation with a private partner entailed the provision of services.

■ Four of the six projects that brought about long-term financial obligations for the local authority were not recognised by the local authority as an obligation in their annual reports (Kuusalu Municipality had corrected this error in their financial statements before the start of the audit). Local authorities had mainly decided to carry out the projects that had brought about long-term financial obligations in cooperation with the private sector in order avoid the borrowing restrictions established for them by law. The decision to opt for a PPP is usually made when the local authority fails to obtain aid or take a loan for the project. The main criterion in the selection of a private partner for the local authorities was their financial capability with less attention paid to the partner’s competency in the field of the project. Although local authorities are well aware that a PPP is more expensive than a bank loan, they still decide in favour of PPPs because they want to start building as soon as possible.

■ None of the local authorities who had decided to opt for a PPP had analysed whether preferring the PPP to other forms of cooperation was justified. There was also no thorough risk assessment or attempts to analyse whether binding the local authority to long-term financial obligations on the account of future generations is reasonable. However, the construction and economic parts of the project had been thoroughly analysed in some cases (Loopealse residential buildings in Tallinn, Vändra Health Centre, car park of the Koidula border inspection point in Värska).

Responses of the auditees
As a result of the audit, the National Audit Office advised the Minister of Finance to develop an implementing model for public-private partnership and the national associations of local authorities to actively participate in this process.

The **Minister of Finance** promised to analyse this when reflecting on the public procurement draft directives and national **local government associations** expressed their readiness with cooperation with the Minister of Finance.

The National Audit Office also advised the Minister of Finance to develop criteria that would make it possible to accurately determine when the application of the Public Procurement Act to a public-private partnership is mandatory.

The **Minister of Finance** does not want to develop more detailed criteria and will continue interpreting the law and giving consultations about public procurements on a case-by-case basis. The necessary amendments will be made when the new Public Procurement Act is developed on the basis of the three directives that regulate public procurements. This will not happen before 30 June

2014.

The Minister of Finance promised to conduct an additional analysis of public-private partnerships and decide whether or not the long-term financial obligations assumed with projects should be considered a part of the local authority’s debt burden.

The National Audit Office advised the local authorities involved in the audited projects to assess before they enter into such transactions whether they are the kind of partnerships to which the Public Procurement Act must be applied, and to analyse the cost-effectiveness of the PPP project in comparison with other alternatives. Most local authorities agreed with the recommendations and a few of them noted that they do not want to enter into public-private partnerships that bring about long-term financial obligations in the future.

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