Investment planning and management in ministries, major state companies, hospitals and universities

How are investments decided, managed and analyzed?

Summary

What did we look at?

The National Audit Office prepared a review of how large investments are selected and implemented in ministries, their subdivisions, state-owned companies, hospitals and public universities. During the preparation of the review, the National Audit Office examined how investments to be made in the following years were selected and decided on, and collected information on the most expensive investments as well as analyzed any changes in their schedule, budget and content. The National Audit Office reviewed the investments made by the aforementioned institutions in buildings and facilities; for example, IT investments and acquisitions were left out of the focus of the review.

The National Audit Office collected information on five most expensive investments made by each ministry, larger companies under the administration of the Ministry of Economic Affairs and Communications and state owned hospitals and universities, which had been completed and commenced during the last five years and which they had reported about to the National Audit Office. Their total cost was approximately 4.8 billion euros. The five most expensive investments by various institutions remained between 75,000 euros and 1.1 billion euros.

Why is this important to taxpayers?

Ministries, their subdivisions, state-owned companies, foundations and public bodies make large investments for taxpayers' money. Of the 11 billion euros in the state budget, around 1 billion is invested every year. For the people of Estonia to benefit the most from these investments, the investments need to be planned based on the long-term development needs of the country and implemented in a transparent and efficient manner.

There is always less money than needed, as it seems, so investment projects must be chosen wisely and by weighing all aspects. Changes in the implementation budget, time schedule and content may affect the state budget, implementation of other investments and the quality of public services.

What did we notice as a result of the review?

- **In investment management, there is no country-wide view that would be longer than 4 years.** Right now, it has been prescribed that the country’s budget strategy, including investments, are planned over a four year period. Government sectors make long-term plans in their development plans or other strategic documents, but there is no long-term cross-sector plan for financing and implementing investments. A multi-year cross-sectoral investment plan covering a longer period would help ministries prepare projects in the longer term and provide greater confidence that funds could be found to execute the investment.

  For certain projects, project planning only may take more than four years. But if an investment project lasts for more than four years, the Ministry of Finance or the government do not have an overview of the total expenses or duration of the project. In a survey by the International Monetary Fund, it has been recommended that Estonia prepare a 15-year investment plan covering all sectors, together with a financial plan.

- **It is not clear how national priorities for project funding are formed.** The potential investment projects of ministries are not compared or ranked. There are no cross-sector evaluation criteria established for this purpose.

  The Ministry of Finance organizes and coordinates the state budgeting process, in the course of which government sectors submit additional applications to the Ministry of Finance for covering all kinds of expenses, including investments. The conformity of these applications with the requirements, and their justification, are assessed by the Ministry of Finance.

  The ministries use different methods for ranking and selecting investments. The Ministry of Finance has prepared general guidelines for this purpose, but the procedures for selecting potential investment projects have been up to the government sectors to decide. The final decision on funding will be made by the Government of the Republic, including on the projects which come directly from the Action Program of the Government of the Republic. The state budget is approved by the Riigikogu.

- **Larger state companies, universities and hospitals have usually better thought-out investment planning and execution of investments than ministries.** Ministries generally do not interfere in the decision-making and management of investments made by state-owned companies, universities and hospitals, unless the investments include national funds (including foreign funds). Unlike ministries that had rather ambiguous project selection process, major state hospitals, universities and companies generally had well-established rules for the selection, deciding on and implementation of investments, including special arrangements for managing more expensive investment projects and assigning specific managers.

  For example, Eesti Energia AS has established different rules for the selection and preparation of projects based on how significant and expensive the investment is. Also, Riigi Kinnisvara AS, which assembles the know-how on state property management, has developed guidelines for analyzing and managing investments in built-up property.

- **The Ministry of Finance and several other ministries lack comprehensive overview of completed and pending investments.** The Ministry of Finance does not collect information on the progress of investments. The information about project cost overruns is communicated to the Ministry of Finance when the ministries submit applications for additional funds to cover the increased cost of projects. There is an overview of the projects financed by the European Union, as the data of these projects are collected in the Structural Funds Information System. Generally, government sectors do not have detailed information on the investments made by companies, foundations and public universities.

  Having a central overview of the implementation of projects would allow monitoring long-term projects, identifying issues in early stages and seeing whether the changes in the time schedule and budget are systematic. This would also allow better planning of the projects and easier reorganization of resources between projects if necessary.

  A survey conducted by the National Audit Office showed that over the last five years, the most expensive investments worth more than 100 million euros have been made in energy and health care sectors. The most expensive investments in progress are the construction of the Rail Baltic railway and the eastern border of Estonia, and the development of wind energy. The International Monetary Fund (IMF) has suggested that a database be set up to provide an overview of the investments.

- **The project executors themselves say that poor planning of the project is the main reason for cost overruns and exceeded time schedule of the project .** This means that actual needs are not clearly identified in the planning stage, and the estimated cost of project implementation is not projected correctly. Also, the increase in construction prices in the market and the prolongation of the procurement process are reasons for project cost overruns. Approximately[1] 40% of all completed projects submitted to the National Audit Office exceeded their initial budget during implementation, while 40% of the projects became cheaper.

The fall in the price may also occur due to implementation of the project in a format different from the original plan or in a lesser extent. In this case, the project may not always really become cheaper. As project costs increase, some of the planned activities/projects that are put on hold will be postponed or cancelled, but projects that have already commenced are usually completed. Normally, the authorities do not assess the impact of delays and budget overruns, but they admitted that this leads to additional costs, inconvenience, poorer quality of service, etc.

- **The wider benefits and socioeconomic impacts of the projects are not being assessed.** The ministries assess the impact their investments have on their budget and whether they complied with the plan in terms of construction. As a rule, the ministries do not assess the cost-effectiveness and wider socioeconomic impacts of the investments completed, which is why they generally have no information on whether and how the investments impact the society as a whole.

What should be agreed on?

As a result of the overview, the National Audit Office found that there are opportunities for improvement in deciding on and managing investments. For example, state companies have good practices for selecting and managing the projects, where the projects are prepared differently according to their priority, cost and nature.

Estonian investment practice was assessed by the International Monetary Fund (IMF) delegation in early 2019, and they found that overall, Estonia’s investment practice was at a good level, but they also pointed out issues to be developed. For example, Estonia was advised to improve the process of planning and selecting major investment projects, including preparing a list of nationally important investments covering all sectors and a longer than four-year period, assessing the impact of investments and involving external experts in project evaluation and selection.

Based on the above, the National Audit Office points out that for the better preparation and management of projects, the following questions should be agreed on:

- How to rank significant investments in all sectors with a longer than four-year perspective?
- Who is responsible for the planning and managing of investments in the Ministry of Finance and other ministries?
- In what form and to which extent should the Ministry of Finance have an overview of the investments by ministries and the institutions and companies in their area of governing, and the deadlines and total costs of the investments?
- What kind of an overview should ministries have of the investments made by the companies, foundations and public law institutions in their area of governing?
- What should be the level of preparation of a project applying for funding, and the method for assessing and selecting based on the priority, cost or time schedule of the project, etc.?
- How to identify the wider impacts and value Estonia will receive and has received as a result of the implementation of an investment project?

The National Audit Office will continue monitoring the development trends in investment planning and management, primarily in preparing the next state budget strategies.

[1] Out of the 89 projects submitted to the National Audit Office over the last five years, 58 were implemented by companies, universities and hospitals and 31 by ministries.